

## **Service Tax – Real Estate**

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This article gives a brief knowledge about the service tax impact on the Construction Industry. We shall discuss the legal provision of the services that affect the industry and later take up some issues involved in each type of service. The whole gamut of service tax for the construction Industry was started with Consulting Engineer in the year 1997, which was extended to include Interior Decorator, Architect so on till the latest service Works Contract.

### **Consulting Engineer Service**

This service was introduced with effective form the 07<sup>th</sup> July 1997, initially only advisory service was covered under this entry, but later a part of execution in the nature of technical assistance was also made covered. This entry seems to be the source for all the services introduced there after in relation to Construction Industry.

The taxable service with respect to consulting engineer service is defined under clause (g) of sub-section (105) of section 65 of chapter V of the Finance Act (herein after referred as Act) as any service provided or to be provided “ *to a client, by a consulting engineer in relation to advice, consultancy or technical assistance in any manner in one or more disciplines of engineering including the disciplines of engineering, including the discipline of computer hardware engineering but excluding the discipline of computer software engineering.*”

The definition of Consulting Engineer is given under clause (31) of Section 65 of the Act as “*consulting engineer*” means any professionally qualified engineer or any body corporate or any other firm who, either directly or indirectly, renders any advice, consultancy or technical assistance in any manner to a client in one or more disciplines of engineering.

The definition quoted supra was amended on 01.05.2006 to include the words “*any body corporate or any other firm*”. The scope of the service was restricted to only if a

professionally qualified engineer or an engineer firm was rendering the service till the date of such amendment.

The following services rendered in relation to any field of engineering are covered under this entry

- Advisory service
- Consultancy service
- Technical Assistance

The important issue to be noted in this entry is the service provided should fall under any field of engineering.

On transfer of technology by the consulting engineer, the exemption has been granted vide 18/2002 dated 16.12.2002 to the extent of the Research & Development Cess paid to the Central Government on import of technology.

Under Export of Service Rules 2005, this service is covered under the recipient clause and hence the service is said to be exported if the recipient of the service is located outside India and all other common conditions are satisfied.

**Possible Issues:**

1. Whether a firm or a body corporate having no engineers will be covered under this entry?

**Comment:** The definition of the consulting engineer requires the service provider to be a professionally qualified engineer or a firm or a body corporate. Here the words firm and body corporate has to be read in conjunction with professionally qualified engineer. Hence the firm and body corporate here refers to the firm or a body corporate having professionally qualified engineer as employee or as partners or directors. The firm or a body corporate having no professionally qualified engineers is not covered under this entry.

2. Whether consulting engineer acting as Insurance Surveyor or loss assessor is covered under this entry?

**Comment:** The Definition requires the services to be provided in relation one or more fields of engineering, the insurance loss assessment is not a field of

engineering, but is a science of actuary, so the consulting engineer here will not be covered under this entry. This is also supported by the CBEC Circular no. 34/2/2001 dated 31.04.2001.

3. Whether the consulting engineer executing the work is covered?

**Comment:** As discussed above, the services taxable are advisory, consultancy and technical assistance. If the Consulting Engineer undertakes to perform the actual work in whole, here there is execution of the work and no any assistance is provided. The assistance is said to be provided where the execution work is performed by the client and the consulting engineer extends his support based on his expertise.

### **Architect Service**

This service was introduced with effective from 16<sup>th</sup> October 1998, this service covers the services provided by an architect in relation to architecture. This service is extended to commercial concerns also not restricting to just Architect.

The taxable service in relation to architect service is defined under clause (p) of the sub-section (105) of section 65 of the Act as *“any service provided or to be provided to a client, by an architect in his professional capacity, in any manner”*

The definition of the architect is given under clause (6) of section 65 of the act as *“architect” means any person whose name is, for the time being, entered in the register of architects maintained under section 23 of the Architects Act, 1972 (20 of 1972) and also includes any commercial concern engaged in any manner, whether directly or indirectly, in rendering services in the field of architecture*

Unlike in the Consulting engineer service, here the architect service provided by any commercial concern is covered either they have a qualified architect or not.

Let us analysis the dictionary meaning of Architect and Architecture. The meaning of Architect is a person who designs and supervises their construction. The meaning of the Architecture is the art or practice of designing and constructing buildings as given in Concise Oxford English Dictionary.

The scope of the Architect is explained in the Trade Notice given by the Mumbai Commissionerate no. 7/98 dated 13.10.1998 “Broadly, the work of an architect starts from providing appropriate advice keeping in view the requirements of the client at the preliminary stage of initial sketches, specifications and drawings of plans and consist of providing a detailed drawings, approval of drawings from the concerned authorities, supervision at each stage of construction, and till the point when the completion certificate is obtain from the authorities”.

From the discussion above, it gives a clear picture that any service provided by a professionally qualified architect or any commercial concern in relation to designing of the building is covered under this entry.

Under Export of Service Rules 2005, this service is covered under the immovable property situated out side India clause and hence the service is said to be exported if the immovable property to which the property provided is situated out side India and all other common conditions are satisfied.

**Possible Issues:**

1. Whether the Architect performing the service of survey and valuation of immovable property is covered?

**Comments:** The definition under this clause is wide enough to cover all the service provided by an architect in any manner. Hence the services such as survey and valuation of immovable property are covered under this entry.

2. Whether the Architect involved in civil construction is taxable under this entry?

**Comments:** The Service of the Civil Construction is covered under a specific entry Construction of complex service or Industrial or commercial construction. The architect providing construction service will not be covered under this entry but may be covered under the specific entry if the definition is satisfied.

3. Art Directors who designs and setup the temporary construction for films are covered under this entry?

**Comments:** The service of architecture is related to the designing and construction of buildings that are immovable and permanent in nature. The

designing and construction service provided by an art director for the films and other purpose is said to be in temporary in nature and not permanent hence this is not covered under the meaning of Architecture. Therefore the said service is not taxable. The department has also issued a circular no. 7/98 dated 13.10.1998 clarifying the same is not taxable.

4. Whether the director of the company being and professionally qualified architect provides service to company is taxable?

**Comments:** If the Director is professionally qualified architect and is providing service with his own capacity, then the said service so provided will be taxable.

### **Interior Decorator Service**

This service was introduced with effective from 16<sup>th</sup> October 1998, this service aims to cover the services provided by an Interior decorator in relation to interior designing. Although the name suggests interior the scope is not restricted to only interior designing but is wide to cover the designing of space either interior or exterior of the premises. The landscape designing is specifically covered under this entry.

The taxable service in relation to Interior service is given under clause (q) of sub-section (105) of Section 65 of the Act as any service provided or to be provided *to a client, by an interior decorator in relation to planning, design or beautification of spaces, whether man-made or otherwise, in any manner*

The definition of the Interior Decorator is given under clause (59) of Section 65 of the Act as *“interior decorator” means any person engaged, whether directly or indirectly, in the business of providing by way of advice, consultancy, technical assistance or in any other manner, services related to planning, design or beautification of spaces, whether man-made or otherwise and includes a landscape designer*

Any person, firm or a body corporate providing the service in relation to following services is covered

- Planning of spaces
- Designing of space
- Beautification of space

- Landscape designing

This clause covers the services like

- Advisory Services
- Consultancy Services
- Technical Assistance

The services provided by Vaasthu or Feng Shui Consultants are also covered under this entry

Under Export of Service Rules 2005, this service is covered under the immovable property situated outside India clause and hence the service is said to be exported if the immovable property to which the service provided is situated outside India and all other common conditions are satisfied.

### **Possible Issues**

1. Whether an interior decorator, who involves in civil construction as a part of beautification of space is covered?

**Comments:** Usually the interior decorators enter into composite contract of designing and beautification of the space, that involves some portion of civil work to be performed. In such case the liability may not arise under this entry in view of Dailem Industry Case where it was held composite indivisible contracts is not taxable. If there is two contract, one for designing and other for civil work involved, then the first contract is only covered under this entry.

2. Whether Space Management Service is covered?

**Comment:** The space management service is where the office or residential space is designed to meet the requirements by optimum utilization of the space. This service is involved in the designing of space and hence is covered under this entry.

3. Whether supply of beautification material is covered?

**Comments:** If a person supplies only the beautification material such as pots, frames or furniture etc. Here there is no service in relation to planning or

designing or beautification of Space. Therefore on mere supply of such material the same will not be covered under this entry

### **Real Estate Agent/ Consultant**

This service was introduced with effect from 16<sup>th</sup> October 1998, this service aims at covering the services provided in relation to sale, purchase, leasing or renting of real estate. This service covers the service provided by both real estate agent and a real estate consultant.

The taxable service in relation to real estate service is given under clause (v) of the Act as any services provided or to be provided *to a client, by a real estate agent in relation to real estate.*

The definition of the Real Estate is defined under clause (88) of Section 65 of the Act as *“real estate agent” means a person who is engaged in rendering any service in relation to sale, purchase, leasing or renting, of real estate and includes a real estate consultant.*

The definition of the real estate agent includes real estate consultant, the definition of the real estate is defined under clause (89) of the section 65 of the Act as *“real estate consultant” means a person who renders in any manner, either directly or indirectly, advice, consultancy or technical assistance, in relation to evaluation, conception, design, development, construction, implementation, supervision, maintenance, marketing, acquisition or management, of real estate.*

The definition of the real estate is not defined under the act, the meaning of the real estate is not defined under Finance Act, the dictionary meaning of real estate as given under Black Law is “Land and anything permanently affixed to the land, such as buildings, fences, and those things attached to the buildings such as light fixtures, plumbing and heating fixtures, or other such item items which would be personal property if not attached. The term is generally synonymous with real property.

From the definition of the real estate consultant and real estate agent, it is very clear that the definition is very wide to cover every service related to real estate.

The following types of service is taxable under this entry

- Advisory Service
- Consultancy Service
- Technical Assistance

Under Export of Service Rules 2005, this service is covered under the immovable property situated out side India clause and hence the service is said to be exported if the immovable property to which the property provided is situated out side India and all other common conditions are satisfied.

**Possible Issues:**

1. Whether the builder providing assistance to sell the flats of the landlord portion is covered?

**Comment:** The usual practice in the industry is that the builder transfers some portion of the flats to the landlord as a consideration for the land provided. Builder also provided some assistance in make the sale of the said flats. In such case the builder receives some commission, this commission is taxable under this entry as the definition is wider enough to cover this transaction.

2. Whether the survey of title etc provided is covered?

**Comments:** The definition covers any service in relation to sale and purchase of the real estate. Usually at the time of purchase of the real estate, an opinion is generally taken on the genuineness of the Title of the real estate. This service is a service provided in relation to buying of the real estate and hence is cover under this entry.

**Erection, Commissioning & Installing**

The Service was introduced with effective from 1<sup>st</sup> July 2003 covering commissioning or installation of plant and equipment, this was amended on 10<sup>th</sup> September 2004 to include erection of plant, machinery or equipment, this was further amended on 16<sup>th</sup> June 05 to include installation of specific item, further amended on 1<sup>st</sup> May 2006 to include Erection, commissioning and installing of structures.

The taxable service in relation to erection, commissioning and installing is given under clause (zzd) of sub-section (105) of Section 65 of the Act as any service provided or to be provided *to a customer by a erection commissioning and installing agency in relation to commissioning or installation*

The Definition of erection, commissioning and installing is defined under clause (39b) of section 65 of the Act as “*erection, commissioning or installation*” means any service provided by a commissioning and installation agency, in relation to, —

- (i) *erection, commissioning or installation of plant, machinery, equipment or structures, whether pre-fabricated or otherwise; or*
- (ii) *installation of —*
  - (a) *electrical and electronic devices, including wirings or fittings therefor; or*
  - (b) *plumbing, drain laying or other installations for transport of fluids; or*
  - (c) *heating, ventilation or air-conditioning including related pipe work, duct work and sheet metal work; or*
  - (d) *thermal insulation, sound insulation, fire proofing or water proofing; or*
  - (e) *lift and escalator, fire escape staircases or travelators; or*
  - (f) *such other similar services*

Under Export of Service Rules 2005, this service is covered under the performance out side India clause and hence the service is said to be exported if the Service is performed either wholly or party out side India and all other common conditions are satisfied.

### **Management, Maintenance or Repair Service**

This Service is covered with effective from 1<sup>st</sup> July 2003, initially this covered only maintenance or repairs of any good or equipments, later this was extended on 16.06.2005 to cover reconditioning or restoring of goods or equipment and maintenance and management of immovable property, this was further extended on 1<sup>st</sup> May 2006 to include Management maintenance or repair of property whether movable or not.

The taxable service in relation to Management, Maintenance or repair service is defined under clause (zzg) of the (105) of section 65 of the Act as any service provided or to be provided *to a customer, by any person in relation to management, maintenance or repair*

The definition of the management, maintenance or repairs is defined under clause (64) of the section 65 of the Act as “*management, maintenance or repair*” means any service provided by —

- (i) *any person under a contract or an agreement; or*
- (ii) *a manufacturer or any person authorised by him, in relation to, —*
  - (a) *management of properties, whether immovable or not;*
  - (b) *maintenance or repair of properties, whether immovable or not; or*
  - (c) *maintenance or repair including reconditioning or restoration, or servicing of any goods, excluding a motor vehicle;*

**Explanation.** — *For the removal of doubts, it is hereby declared that for the purposes of this clause, “goods” includes computer software*

This entry covers the entire ambit of maintenance and repair of the property movable or immovable and also goods.

The service provided by manufacturer or his authorized person is cover without any contractual obligation. But for the others there is a prerequisite of an agreement or a contract. However this agreement may be either in oral or written. In trade parlance it is generally found that the contracts are written.

Under Export of Service Rules 2005, this service is covered under the performance out side India clause and hence the service is said to be exported if the Service is performed either wholly or party out side India and all other common conditions are satisfied.

#### **Possible Issues:**

1. Whether the builder collecting maintenance charges is liable?

**Comments:** Usually the builder takes the responsibility of the maintenance of the building in the absence of any society or an association, in such case the maintenance charges so collected is for the maintenance of the immovable property and hence the builder is liable under this entry.

2. Whether the common charges for electricity collected is also chargeable?

**Comments:** along with the maintenance charges of the flat, the specific electricity charges, gas charges pertaining to the customers are collected and will be paid to the concerned authorities. In such case the concept of the pure agent is considered and all such expenses will not form part of the value.

### **Commercial or Industrial Construction Service**

This service was introduced with effective from 10<sup>th</sup> September 2004 to cover the construction of new building and also repairs and alteration of the new building. The definition was amended on 16<sup>th</sup> June 2005 to include construction of pipeline or conduit and completion or finishing service.

The definition of the taxable service in relation to construction of complex service is given under the clause (zcp) of sub-section (105) of Section 65 of the Act as *any service provided or to be provided to any person, by any other person, in relation to commercial or industrial construction service*

Commercial or industrial Construction is given under the clause (25b) of Section 65 of the act as “*commercial or industrial construction service*” means —

- (a) *construction of a new building or a civil structure or a part thereof; or*
- (b) *construction of pipeline or conduit; or*
- (c) *completion and finishing services such as glazing, plastering, painting, floor and wall tiling, wall covering and wall papering, wood and metal joinery and carpentry, fencing and railing, construction of swimming pools, acoustic applications or fittings and other similar services, in relation to building or civil structure; or*
- (d) *repair, alteration, renovation or restoration of, or similar services in relation to, building or civil structure, pipeline or conduit,*

*which is —*

- (i) *used, or to be used, primarily for; or*
- (ii) *occupied, or to be occupied, primarily with; or*
- (iii) *engaged, or to be engaged, primarily in,*

*commerce or industry, or work intended for commerce or industry, but does not include such services provided in respect of roads, airports, railways, transport terminals, bridges, tunnels and dams*

This service covers only the construction or building or civil structure that will be having a commercial motive/ profit motive.

This service covers construction of new building and also repairs of the said buildings and also the completion or finishing service such as painting, plastering, wall covering etc

Under Export of Service Rules 2005, this service is covered under the immovable property situated out side India clause and hence the service is said to be exported if the immovable property to which the property provided is situated out side India and all other common conditions are satisfied.

**Possible Issues:**

1. Whether the builder constructing with his own materials is covered?

**Comment:** If the builder uses the material of his own in an indivisible contract, then there is a combination of material and labour and hence will result in Works Contract. The works contract service has a specific entry and hence it is not covered here.

2. If the developer enters into a contract with the sub-contractor for the construction, whether there is a liability on the builder?

**Comment:** The developers will not be involved in the construction, all the construction activity will be performed by the various contractor, in such case the contracts are providing the construction service and not the developer and hence the sub-contractors are liable. The department has also clarified this issue vide Circular F. No. 332/35/2006-TRU, dated 1-8-2006.

3. If only labour charges then would it be liable?

**Comment:** Yes as long as it is in relation to construction. There would be no abatements or deduction available and ST has to be paid on the gross value.

### Site formation service

This service was introduced with effective from 16<sup>th</sup> June 2005, this service aims at covering the service in relation to site formation clearance, excavation and other similar service.

The taxable service in relation to site formation is given under clause (zzza) of Sub-section (105) of Section 65 of the act as any service provided or to be provided to any person, by any other person, *in relation to site formation and clearance, excavation and earthmoving and demolition and such other similar activities*

The definition of the site formation and clearance service is defined under clause (97a) as site formation and clearance, excavation and earthmoving and demolition” includes,

—

- (i) *drilling, boring and core extraction services for construction, geophysical, geological or similar purposes; or*
- (ii) *soil stabilization; or*
- (iii) *horizontal drilling for the passage of cables or drain pipes; or*
- (iv) *land reclamation work; or*
- (v) *contaminated top soil stripping work; or*
- (vi) *demolition and wrecking of building, structure or road,*  
*but does not include such services provided in relation to agriculture, irrigation, watershed development and drilling, digging, repairing, renovating or restoring of water sources or water bodies*

Exemption is provided for the site formation service in relation to construction of roads, airports, railways, transport terminals, bridges, tunnel, dams, ports or other ports.

Under Export of Service Rules 2005, this service is covered under the immovable property situated out side India clause and hence the service is said to be exported if the immovable property to which the property provided is situated out side India and all other common conditions are satisfied.

**Possible Issues:**

1. During the Construction, if the builder under takes the activity of site formation whether it is taxable?

**Comments:** During the construction, the site formation activity is carried on and then the construction activity is started. If the site formation is part of the entire contract and no separate amount is allocable to the same then the taxability as construction activity would apply.

However if the site formation activity is taken separately and it does not involve transfer of materials then the ST is payable on the gross amount and no abatements are available.

2. Whether the site formation activity prior to sale of sites is liable?

**Comment:** Unless there is an agreement for site formation with the buyer, the charge for site formation would merge with the sale of land and there would be no service tax. Further if the development agreement includes the construction of club house etc the same would be covered under the construction activity and would be charged accordingly.

**Residential Complex Service**

This service was introduced with effective from 16<sup>th</sup> June 2005 and aims at including the services of construction of the residential complex.

The definition of the taxable service in relation to construction of complex service is defined under clause (zzzh) of the sub-section (105) of section 65 of the act as *any service provided or to be provided to any person, by any other person, in relation to construction of complex*

The construction of complex is defined under clause (30a) of the Act as “*construction of complex*” means —

- (a) *construction of a new residential complex or a part thereof; or*
- (b) *completion and finishing services in relation to residential complex such as glazing, plastering, painting, floor and wall tiling, wall covering and wall papering, wood and metal joinery and carpentry, fencing and railing, construction of swimming pools, acoustic applications or fittings and other similar services; or*

*(c) repair, alteration, renovation or restoration of, or similar services in relation to, residential complex*

Residential Complex service is defined under clause (91a) of the Act as “*residential complex*” means any complex comprising of —

- (i) a building or buildings, having more than twelve residential units;*
- (ii) a common area; and*
- (iii) any one or more of facilities or services such as park, lift, parking space, community hall, common water supply or effluent treatment system, located within a premises and the layout of such premises is approved by an authority under any law for the time being in force, but does not include a complex which is constructed by a person directly engaging any other person for designing or planning of the layout, and the construction of such complex is intended for personal use as residence by such person.*

**Explanation.** — *For the removal of doubts, it is hereby declared that for the purposes of this clause, —*

- (a) “personal use” includes permitting the complex for use as residence by another person on rent or without consideration;*
- (b) “residential unit” means a single house or a single apartment intended for use as a place of residence*

This service covers the service in relation to construction or new building, repairs of the building, and also finishing service such as glazing, painting, wall covering etc.

The construction of residential complex is covered, the residential complex should satisfy the following conditions

- the building should have 13 or more residential unit
- there should be a common are shared
- there should be one or more common facilities such as parking, lift etc.
- the complex should not be used for personal use.

Under Export of Service Rules 2005, this service is covered under the immovable property situated out side India clause and hence the service is said to be exported if the

immovable property to which the property provided is situated out side India and all other common conditions are satisfied.

**Possible issues:**

1. Whether the builder constructing with his own materials is covered?

**Comment:** If the builder uses the material of his own, then there is a combination of material and labour and hence will result in Works Contract. The works contract service has a specific entry and hence it is not covered here.

2. If there are more than 13 residential units under the same compound but with separate plan sanction, is such construction of units are liable?

**Comment:** If there is a separate plan sanction for each such unit, then each such unit is considered as a building and such building having less that 12 residential units are not covered under the residential complex definition. And further there is no common area and common facilities shared within such unit. There it is not liability under this entry.

3. If the construction of residential quarters is undertaken for the employees of the factory, is there a liability under this entry?

**Comments:** The definition of the residential complex excludes the buildings that are constructed for the personal use. Further the personal use covers letting it out or allow others use. Hence in such case the construction is said to be for the personal used and therefore not covered under service tax net.

**Works Contract Service**

The service tax on “works contract” would be w.e.f. 1.06.2007. This category seeks to tax those services wherein transfer of property in goods is involved during the execution of works contract. The tax would be on services involved in the execution of a works contract. This category however deals with only certain type of activities wherein the transfer of property in goods is involved and not all type of services wherein the goods are also transferred like Management, Maintenance and repair Services, Business auxiliary etc.

**Definition**

“Works contract” means a contract wherein transfer of property in goods involved in the execution of such contract is leviable to tax as sale of goods and such contract is for the purpose of carrying out –

1. Erection, commissioning or installation of plant, machinery, equipment or structures (whether pre-fabricated or otherwise), installation of electrical and electronic devices, plumbing, drain laying or other installations for transport of fluids, heating, ventilation or air-conditioning (including relating pipe work, duct work and sheet metal work), thermal insulation, sound insulation, fire proofing or water proofing, lift and escalator, fire-escape staircases or elevators or
2. Construction of a new building or a civil structure or a part thereof, or of a pipeline or conduit, primarily for the purposes of commerce or industry or
3. Construction of a new residential complex or a part thereof or
4. Completion and finishing services, repair, alteration, renovation or restoration of, or similar services, in relation to (2) or (3) above or
5. Turnkey projects including engineering, procurement and construction or commissioning (EPC) projects.

The services provided by any person, to any other person in relation to execution of a works contract excluding works contract in respect of roads, airports, railways, transport terminals, bridges, tunnels and dams would be taxable under this head as per section 65(105)(zzzza).

The term “turnkey projects” has not been defined and one would have to be understood in common parlance until clarified.

#### **Who is liable? To whom applicable?**

This entry would be applicable to the following existing service providers:

1. Industrial and Commercial Construction
2. Construction of Complex
3. Erection, installation and Commissioning

If there are works contracts which cover activities not coming under the ones specified above, they would have to be taxed under other existing heads and consequently, the composition benefit in such cases would not be available. In such a scenario, the

existing notifications such as 12/2003 ST and 1/2006 ST would have to be relied upon to get the any deductions.

For pure labour services where there is no material involved the service would continue to be covered under the above categories as the definition of works contract makes it clear as to the requirement of transfer of property in goods for a contract to be liable under this category.

### **Composition Scheme**

Works contract (Composition Scheme for Payment of Service Tax) Rules 2007 has been notified vide notification 32/2007 ST dated 22.05.2007 by the Central Government for the purpose of specifying the scheme for composition. The person executing works contract has the option to pay tax under the composition scheme at the rate of two percent on the gross amount charged for the works contract. Gross amount shall not include the VAT or sales tax paid on the goods transferred during the execution of such works contract. The option is to be exercised prior to payment of service tax in respect of the said works contract and once exercised, shall be in force till the completion of the works contract.

### **Exemption**

Services in relation to execution of works contract provided by any person to any other person in relation to construction of ports or other ports has been exempted from service tax. This exemption shall not extend to services of completion, finishing, repair, alteration, renovation, restoration, maintenance or repair. This maybe an unintended omission.

### **Valuation**

A new Rule 2A has been inserted by notification 29/2007 ST dated 22.05.2007, which prescribes the valuation method in case of works contract service. The value of works contract service shall be equivalent to the gross amount charged for works contract less the value of goods transferred during the course of execution of works contract. The gross amount shall not include the VAT and sales tax paid on the goods transferred. The service provider shall ensure that the value of works contract service as aforesaid shall include the following –

- Labour charges for execution of the works

- Amount paid to a sub-contractor for labour and services
- Charges for planning, designing and architect's fees
- Charges for obtaining on hire or otherwise, machinery and tools used for execution of the works contract
- Cost of consumables such as water, electricity, fuel used in the execution of the works contract
- Cost of establishment of the contractor relating to supply of labour and services
- Other similar expenses relating to supply of labour and services and
- Profit earned by the service provider relating to supply of labour and services

The above has been cut pasted from the landmark decision of Gannon Dunkerly under sales tax law but may not be legally valid, as some of the components above do not appear to have the characteristics of a service at all.

It remains to be seen whether the deduction for CST paid on transfer of property would be allowed. At present, it appears to be deductible.

It is to be noted that the rules specifically allow for deduction of the amount on which Sales Tax/VAT is paid if it is on actuals. On the other hand if it is on a notional basis or tax is paid under a composition scheme the rules are silent as to how the value of the goods has to be determined.

In view of the paper writers, the value of the goods added with the normal Gross Profit ratio would be proper methodology to arrive at the value of the goods transferred. The said value can be claimed as a deduction while arriving at the value of service in the works contract as per the valuation rules.

### **Cenvat credit**

Where the service provider opts for the composition scheme for the purpose of payment of service tax, he shall not take cenvat credit of duty and cess paid on inputs used in relation to such works contract. However, the credit on capital goods used for providing the service as well as the input service credit (sub-contractors, insurance, telephone, manpower supply, architect etc) would be available.

Where the service provider does not opt for a composition scheme, he should be entitled to cenvat credit on inputs, input services and capital goods used in execution of such works contract.

### **Possible Issues**

1. Whether the works contractor can continue under the existing entries for ongoing contracts?

**Comments:** Since there is a new entry it is presumed that service providers may have to choose considering the principles of Section 65A on classification. However if they do not transfer any materials they would continue under construction or erection categories. Herein it is important to note that the department letter F.No. B1/16/2007 TRU dated 22.05.2007 goes on to say that contracts which are treated as works contract for levying VAT/sales tax shall also be treated as works contract for levying service tax. However, this letter would have to be seen in the light of the explanation to section 65(105)(zzzza), which deals with the contracts, which can be regarded as works contract under this category. This has already been discussed under the head definition given earlier. This leads us to the conclusion that under the specified categories of activities, if the definition of works contract were satisfied, the assessee would be liable under this head.

2. Whether the works contracts involving materials in progress can also opt for the new entry though earlier they were registered under the old entries?

**Comments:** The intention of the legislature in bringing about this entry and the definition itself allows ongoing construction and erection contracts to be reclassified under the WC entry. Therefore such contractors can opt for the entry by intimating the department for inclusion of new category in the registration certificate.

3. What is a turnkey contract?

**Comments:** The expression has not been defined and the common understanding may have to be adopted. It may indicate contracts of bigger size having a number of sub contracts or differing nature such as erection of a plant or a town itself. These contracts earlier were covered under erection head.

4. Whether the option of availing the credit on all the inputs (cement, steel, glazing, tiles etc) and paying the service tax on the gross amount is still available?

**Comments:** The composition scheme is optional and the works contractor can even pay service tax on a value arrived at as aforesaid at the normal rate. The

law as it stands today is silent regarding the cenvat credit on inputs in such a scenario as the credit has been expressly barred only in case of an assessee opting for composition scheme. Where the amount subject to VAT/sales tax has been deducted from the gross value to arrive at the taxable value, it is hard to imagine that credit would be available on inputs when the material value is not considered for paying service tax. This aspect might have to be clarified in future. Service providers who claim this may face litigation and possible retrospective amendment.

5. Whether the option chosen under VAT law has any bearing for the classification or valuation under this new entry?

**Comments:** The WC option provides for the option of deducting the value of goods transferred. The Rules provides that the value which is adopted for Sales Tax/VAT would be accepted if it is actuals. However for the purpose of sales tax /VAT ad hoc method of value of materials is adopted or composition payment of tax is opted under Sales Tax/VAT, then the deduction of value would be dependent upon the actual value of goods transferred. This may have to be arrived based on the supporting evidence/document.

6. Whether the service providers under the specified categories were not liable for works contracts earlier to this entry?

**Comments:** The entry read with the department circular indicates that works contracts were not earlier covered. The purpose for which this entry was bought in also is favorable to this interpretation. Therefore it can be construed that there was no liability earlier. This view is also confirmed in the case of Dr. Lath Path Labs P Ltd. { 2006 (3) STR (711(T- Bom). This could lead to a situation where the service provider who has paid the service tax from their pockets ( not recovered from the customers) could go for a refund especially if the same was done in pursuance of an investigation.

7. Whether the sub contractors would be exempt as the main contractor is paying the service tax?

**Comments:** The sub contractors would also have to discharge the ST under works contract or other categories and would be liable for the tax unless they are

below Rs. 8 Lakhs. In case of litigation there are a couple of trade notices and circulars which till date have not been withdrawn.

8. Whether the option of 2% allows for cenvat credit on capital goods and inputs?

**Comments:** The cenvat credit on inputs is barred. However there is no bar on the credit on capital goods and input services though the budget clarifications had included such a restriction.

### **Renting of Immovable Property**

Renting of immovable property is to be taxed with effect from 01.06.2007 under this new category of service to be taxed is rental income when let out for business or commercial purposes.

### **What does immovable property includes?**

First Explanation to section 65 (105) (zzzz) defines what immovable property means for this sub-clause. It includes

- any land incidental to use of such building or
- part of a building,
- the common or shared areas and facilities relating thereto and
- in case of a building located in a complex or an industrial estate, all common areas and facilities relating thereto, within such complex or estate.

### **What does immovable property excludes?**

First Explanation to section 65 (105) (zzzz) defines what immovable property means for this sub-clause. It excludes

- vacant land solely used for agriculture, aquaculture, farming, forestry, animal husbandry, mining purposes,
- vacant land, whether or not having facilities clearly incidental to the use of such vacant land,
- land used for educational, sports, circus, entertainment and parking purposes; and

- building used solely for residential purposes and buildings used for the purposes of accommodation, including hotels, hostels, boarding houses, holiday accommodation, tents, camping facilities.

It is clear from the above definition that the rental of the building used for residential purpose is not included in the definition of immovable property and hence stands exempted. But in cases where the property is partly used for residential and partly for the commerce or business then in such case the property is deemed to be immovable property for use in the course or furtherance of business or commerce and the entire receipts from that property is taxable. The Finance Ministry has used the back door entry to tax the residential properties with the use of this clause.

### **What does rental of immovable property includes?**

Section 65 (90a) defines “renting of immovable property”, it includes renting, letting, leasing, licensing or other similar arrangements of immovable property for use in the course or furtherance of business or commerce

Renting means an arrangement to rent something, or the amount of money that you pay to rent something.

Letting means to allow to do something or to allow something to happen

Leasing to use a building or a piece or a piece of land, or to allow someone to use a building or a piece of land in exchange of money

Licensing is to give some one an official permission to do or have something.

There is a common practice of letting the premises on mortgage basis, which is termed as ‘Lease’. In this transaction the lessee pays a lumpsum amount to the lessor for the agreed period say 3 years and after the expiry of the said period on vacation the lessor refunds the amount without interest. Here there is no payment of rent does the levy fails as there is no gross amount charged remains as a question.

### **What does rental of Immovable property excludes?**

Section 65 (90a) of the Finance Act defines “renting of Immovable Property”, it excludes

- renting of immovable property by a religious body or to a religious body,

- renting of immovable property to an educational body, imparting skill or knowledge, lessons on any subject or field, other than a commercial training or coaching center;

The education institute is exempt only as tenant where as the religious body is exempt both as landlord and tenant.

The exclusion does not exclude the government that means government has to collect and pay to itself.

### **What does use in the course of furtherance of business or commerce includes**

*The Explanation to section 65 (90a) of the Finance Act defines “for use in the course or furtherance of business or commerce” to include use of immovable property as factories, office buildings, warehouses, theatres, exhibition halls and multiple-use buildings.*

### **Who is liable? What is liable?**

This category applies to all service providers whether he is an individual or company or partnership firm. The service provider shall first of all satisfy that the property in question falls within the definition of “immovable property” given under section 65(105)(zzzz) and explained above. This would be critical as there would be no liability under this head if the property happens to fall under categories excluded by the definition of “immovable property”. Even where the property is partly let out for use in course of furtherance of business or commerce, the liability would exist.

### **Valuation**

The service tax shall be levied on the gross amount charged as rent for the property. Where any property taxes paid to the local authorities, such tax paid is exempted by way of exemption notification thereby deducted from the gross value and the service tax is charged on the net value (gross value – property tax paid and eligible for deduction). It is important to note that the deduction of the property tax is allowed only on payment basis. Further it is important to note that the deduction for property tax is not given in one lump sum and would have to be calculated on a proportionate basis where the period for which service tax is paid differs from the period for which property tax has been paid. This type of narrow view and nit picking was not necessary.

**Example –**

If property tax for the year is Rs. 12000 and service tax is to be paid for the month of April, and the rent for April is Rs. 100000, then the service tax is to be paid on Rs. 99000 ( $100000 - (12000/12)$ ) at the applicable rate of 12% plus education and SHE cess.

The exemption has not been given on interest and penalty payments to local authorities for delay in property tax payment, by notification 24/2007 ST dated 22.05.2007

Where the assessee is not able to claim deduction for property tax at the time of payment of service tax, he can adjust the service tax paid in excess within one year from the date of actual payment of property tax as per Rule 6(4C) of Service tax Rules 1994 and submit the relevant details of such adjustment to the SCE handling service tax within 15 days of such adjustment.

Where the property is let out partly and the consideration cannot be segregated, the entire amount would have to be taxed.

If the property tax is paid at a later date after receipt of the rent and paying service tax to the Government, the service tax attributable to the property tax so paid can be adjusted in the subsequent payments.

**Exemption**

The assessee can however examine the benefit of general exemption of up to 8 lakhs where he does not have liability on any other service in such a way that the value exceeds the aforesaid limit. Further for the year 2007-08 in such cases the value of taxable services will have to be taken only from June 2007 to March 2008 and if the same is less than 8 Lakhs the assessee can also avail the benefit of exemption in the year 2008-09 also.

**Cenvat credit**

The service provider would be eligible to avail cenvat credit on inputs, capital goods and input services used to provide such service. The credits could be on telephone bills, security agency's bills, maintenance bills, equipments like computers etc. If the construction is completing after 01.07.2007 even the service tax paid on the said construction services is also available as credit.

**Possible Issues**

1. Where the property is a composite one and property tax is paid, whether the entire amount is eligible for deduction remains to be seen?

Comments: Where the entire amount of rental is taxed (because of lack of segregation,) the entire property tax can be considered. But where the rental can be segregated in terms of property liable and property not liable, even the property tax might have to be split on some reasonable basis.

2. What is the treatment in case of co-ownership?

Comments: Where there is a case of co-ownership, the property can be assessed separately and the basis adopted for Income Tax Assessment along with other authorities like municipal authority may be used as a basis to ascertain the shareholdings of the concerned owners (any other basis not in conformity with basis adopted under IT assessment and other authorities could lead to unnecessary litigation).

3. Whether vacant land let out for parking purposes be liable under this head?

Comments: Letting out of vacant land alone for parking of vehicles would not be liable as the definition of immovable property under this head excludes such vacant land.

4. Whether precincts of building let out to members of a residential block for parking of their vehicles be exempt?

Comments: It is important to note that letting out of immovable property solely for residential purposes is exempt under this category. But where the parking space is allowed to members of a residential block and they in turn pay an amount towards the same to an association which maintains the same, the taxability will have to be seen in light of the category club or association's membership service wherein up to Rs. 3000 per month per member would be exempted by notification 8/2007. Letting out space to third parties who are not members, would be exempt under renting category.

5. Whether renting of residential flat to tenant with parking space liable?

Comments: Where letting out is for residential purposes, the same would not be liable.

6. Whether residential flat let out by a member for the association's office be liable?

Comments: Where the flat is let out to the association itself for rental, the rental may not be taxable as the association cannot be said to be indulging in business or commerce.

7. Whether letting out a building for hotel would be liable?

Comments: The definition of immovable property itself excludes boarding houses, hotels, hostels etc. Hotels would in common parlance also include restaurants. However only letting out to restaurants may require clarification. In India especially hotels mean eating places also..

8. Whether a building having commercial use in the ground floor and having residential use in the first floor can be deemed to be commercial?

Comments: This deeming provision is applicable only in case of a property having dual use under single contract and hence in case where there is a separate contract for a single premises would not attract such deeming provision.

### **Exemptions/deduction Notification**

1. Deduction of the material value in the contract?

In a contract the material involving both material and service, the deduction is given for the value of the material involved subject to condition that the no CENVAT Credit can be take on the inputs. However the CENVAT on the input services and Capital Goods are available. (Refer Notification 12/2003)

2. Abatement

The abatement of 67% for the material value involved has been granted to the Construction Service Industry, where the service tax is paid only on the balance 33% of the consideration. While Claiming this abatement, the CENVAT credit on inputs, input services and capital goods is not allowed. No Credit is available under this notification (Refer Notification 1/2006)

3. Small service provider exemption

The exemption from the payment of service tax is provided to small service provider upto 8 lacks, whose value of service is less than 8 lacks in the previous financial year. The small petty contractors can make use of this exemption.

(For queries mail to [vssudhir@gmail.com](mailto:vssudhir@gmail.com) or post to [www.pdicai.org](http://www.pdicai.org))