

Service Tax: Non-taxability in case of Residential Complex

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In the Finance Act of 2004 commercial construction was introduced followed by site formation and residential complex construction in 2005. Due to disputes on service tax not applicable on composite contract under this entry a new entry of “works contract” was introduced w.e.f 1.6.2007. The department in the meantime issued several circulars/ trade notices were also issued by various Commissionerates. This led to more confusion. Recently the High Court also held that when there is a transfer of property at the end of a contract for immovable property sale then ST was not applicable.

To give a breathing space to this industry which is reeling under lack of demand presently Board Circular No. 108/02/2009 – ST dated 29.01.2009 was issued. This article aims at giving a brief of the applicability of the said circular for the Industry and addressing the possible questions in this regard.

Generally in case of the construction industry, there is a person named “Developer”/ ”Builder” / Promoter who enters into a Joint Development Agreement with the other person named “Landlord” for the development/construction of land held by the said land-lord. The Developer may himself engage the direct labour and undertake the construction of the building and in some cases he may outsource such construction activity to other person named “contractor”. Developers generally have the following arrangements with the prospective buyer/customers

- I. Developers may enter into an “agreement to sell” sell the house/flat and execute the sale deed on full completion of the construction. However Developer collects consideration in periodical installments during such period.
- II. Developers execute the sale deed for undivided portion of land with/without semi-constructed flat for the part of the consideration; subsequently for the balance consideration a construction/ finishing agreement is entered.

The transaction in the scenario I is in the nature of sale of immovable property, therefore the same is not liable under service tax. However this did not stop the departmental office for raising

the Demand Note or Show Cause Notice on the builders across India. These notices took the shelter of the Supreme Court Judgment in case of K. Raheja Development Corporation Vs. State of Karnataka [2006 (3) S.T.R. 337 (S.C.)] held that “Agreement made before completion of construction is works contract”. However department failed to appreciate the facts of the case, this was the case of agreement of construction and not the case of agreement to sell. This differentiation was bought by Allahabad High Court in case of Assotech Realty Pvt Ltd., Vs State of UP [2007 (7) S.T.R. 129 (All.)] stating “Payment by installment by prospective purchaser not transferring any right, title or interest in impugned construction - Construction not undertaken for and on behalf of purchasers - Action imposing tax on impugned activity treating it as works contract wholly without jurisdiction”

These decisions did not solve the confusion of the trade and also with the department. However department was again gifted with the tool of an Advance Ruling in case of Harekrishna Developers [2008 (10) S.T.R. 341 (A.A.R.)] held that service tax is applicable once advance is collected form the prospective buyer. However this ruling was immediately followed with the Gauhati High Court decision in case of Magus Construction (P) Ltd., and others Vs. UOI [(2008) 15 VST 17 (Gauhati)] held that- Payments made by prospective buyers in instalments is against consideration of sale—Construction not on behalf of prospective buyers—No taxable service rendered.

However the same has been now resolved with the issue of the circular.

Gist of the Circular

The circular issued addresses the applicability of the service tax in both the scenarios discussed supra. In case of scenario I the circular clarifies that since the sale is happening only after the completion of the construction, the construction service provided by the developer is in the nature of “self-service” hence the same is not liable for service tax. Similarly in case of scenario II, it is clarified that there is service a construction service provided, but the same is not taxable for the reason that the personal use of the property by the buyer is excluded in the definition of residential Complex defined under Section 65(91a) of the Finance Act. It is also interesting to observe that the circular has also taken care to override the Advance Ruling in case of Hare Krishna Developers. The circular states that the service provided by the developer is to himself and only on completion does the property pass to the buyer and till then whatever is done is for self.

FAQ's on Circular

1. What is meant by the personal use referred in this circular?

The definition of Residential Complex given under section 65(91a) of the Finance Act excludes 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. The explanation to the said section gives the meaning of personal use to include permitting the complex for use as residence by another person on rent or without consideration. In case the buyer gets the construction for the purpose of sale, then the same is liable for service tax. It is important to observe that the action of the buyer is not important but the intention. In case a Developer has a project having 500 residential units/flats, it may be difficult to find or ascertain the intention of each such buyer and decide the taxability. Further in some case the intention of the buyer would for personal use but due to some reason, may sell the same during or after the completion of the construction, but how to establishing the proof of intention remains as a question.

2. What is the legal status of this circular?

Generally circulars are not considered as law and cannot override the provision of the act or a rule. Circular is only clarificatory in nature. One more interesting fact about the circular is that circulars are not binding on the assessee but is binding on the department, even in case the circular is contrary to the provision of the Act it is binding on the department. However this well settled law is presently before the larger bench of the Supreme Court and therefore cannot be fully relied on. In our opinion the given circular is in line with the legal provision and also beneficial to the assessee, therefore the same may be made use of. Intimation to the department of the same may also be preferable to guard against future litigation.

3. Whether this circular is applicable only for disposing the pending cases?

The closing paragraph of the circular ends with directing to dispose all pending cases accordingly. This is only direction given to the departmental authority and not the subject matter of clarification. Therefore in our view the circular is applicable to all assessee for the past, present and future projects also.

4. Whether this circular is having retrospective or prospective effect?

This circular does not specify the applicability of the circular, however since the reference is made to the definition as on 16.06.2005 and also direction is give to dispose the pending cases, the same would have retrospective effect.

5. Is this circular restricted to Construction of Residential Complex Service only?

The circular has reference to only Construction of Residential Complex Service, However since the definition of the residential complex is common for the Works Contract Service also, this circular would equally apply to both the service. The clarification of having the agreement to sell is applicable for commercial or Industrial construction also. However the personal user cannot be applied to commercial or industrial construction as the definition does not have such exclusion of personal use.

6. Whether refund can be claimed for the Service Tax paid for the earlier period by the builder?

Yes refund is possible under the provision of Section 11B of the Central Excise Act made applicable to Service Tax u/s 83 of the Finance Act. However is important to note that under the principles of “unjust enrichment” the service tax should not have been collected from the buyer/customer. In other words the incidence of tax should be on the builder and not collected from the buyers. In case the incidence is passed on to the customer, then the refund claim can ONLY be made by such buyer/customer. Alternatively the builder can return the monies separately to each buyer (keep evidence of the same) and then claim the refund. If builder has used credits and paid only the balance in cash, the refund would be net of credit. Refunds generally take a little time and also face show cause notice and appeals when the department attempts to deny the same. This would take a year or two to resolve. Therefore it is advisable to make refund claims when substantial stakes are involved.

It maybe noted that the contractors who provide construction services for such projects would still be liable as they do not transfer immovable property.

7. What is the procedure for claiming the refund?

The assessee claiming refund can follow the below procedure:

- a. The Application in Form R may be made to Jurisdictional ACCE or DCCE before the expiry of one year from the relevant date. (Date of Circular- 29th January 2009)

- b. It should be signed and pre-receipted with revenue stamp.
 - c. The application in Form R shall have valid grounds for refund.
 - d. The applicant should seek a personal hearing.
 - e. Proof should be submitted that refund would not result in unjust enrichment. Invitation for authorities to verify the accounts maybe attached. A CA certificate that the ST has not been passed on may also be obtained and submitted where the CA clearly specifies the books, records, payments received verified.
- 8. What is implication for the ongoing contracts, in case the Developer is paying service tax?**

In case the builder is not collecting the service tax from the customer/buyer then he may immediate stop the payment of service tax by indicating the reason to the department. However in case the service tax is collected form the customer, then payment to such extent shall be made under section 73A to the department or shall be paid back to the customer.

9. Whether this circular exempts contractor?

No. Contractors/sub-contractors is liable for service tax either under Construction of Complex Service or under Works Contract as the case may be. This is for the reason that they are providing the construction service to the builder, who is not using the same for the personal use.

This article has been put together considering the huge amount of interest the circular has elicited. Deeper issues may evolve due to the part compliance non compliance in the industry.

(For any further queries or clarification please feel free to mail yssudhir@gmail.com)