IMPLICATIONS OF VAT & SERVICE TAX ON BUILDERS COLLABORATION AGREEMENTS

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Abbreviations used: LO - Land Owner; BD - Builder/Developer; PB - Prospective Buyer.

1. Introduction

Indirect Taxation, namely State VAT and Service Tax, on building contracts has become a complex issue; not only for the stake holders, which are, land owners, builders/ developers and the actual users, but also for the tax professionals. The Revenue Departments are also not very certain and clear about the incidence and manner of taxation and also the point/time of tax. This article is an attempt to discuss various issues in this regard. **"Builders Collaboration Contracts (referred as Builder Contracts)"** for the purpose of our present discussion means the contracts where LO offers his land to BD for construction of residential/commercial complex/units and the latter offers part of the constructed flats/units to LO; and remaining flats are sold by BD to the customers, either during construction or post construction as ready units. Size of complex, which may contain 4 units or 400 units, will not have an effect on our discussion; nonetheless, in big complexes, number of LOs can certainly be more than one, and certain other issues would also crop up. Pure works contracts where LO awards construction contract to the contractor do not involve much complexity; and therefore, not discussed here. Revenue sharing contracts between LO and BD have also been excluded from our present discussion. We have also excluded the aspect of stamp duty, which, generally, is levied at two points: first, at the time when land is transferred by LO to BD as outright sale or under the agreement of power of attorney; and second, at the time of execution of conveyance deed with the actual user. **In short, our present discussion is confined to implication of VAT and Service Tax on those contracts where, apart from material and services, value of land is also taking part of the bargain, and the size of the plot is limited to few hundred yards containing, generally, four to ten units.**

Let us adapt our discussion in the form of an illustration:
LO enters into a collaboration agreement with BD, wherein -

(Rs. In lacs)

- BD constructs 4 flats/units;
- Out of which, BD gives 2 flats to LO towards consideration of land;
- Remaining 2 flats are kept by BD for further sale in market;
- BD sells 2 flat to PBs during construction for Rs.1200 (600 per flat); sale deed also executed for Rs.1200;
- Out of 2 flats, LO sells 1 flat to another PB during construction;
- Value of land is Rs.2000 and value of construction is Rs.400 (Rs.100 per floor);

- Since BD receives land worth Rs.1000 (2000*2/4) and gives Rs.200 as value of construction for 2 floors (100 per floor); it is further agreed that BD will give Rs.800 to LO towards land or as value for transfer of construction rights;
- Circle rate in Delhi, per flat, of land : Rs.500; and for construction : Rs.100;
- Agreements to sell between BD and PBs specify that value of land is Rs.500 and value of construction is Rs.100.
- Break-up of value of construction of Rs.400 is:-
  - Material with proportionate overheads & profit - Rs. 240
  - Labour & Services with proportionate overheads &profit - Rs. 120
  - Permissions and sanctions (treated as services) - Rs. 40
  - Total Expenses - Rs. 400
  - Proportion of expenses towards LO and BD portion (for sale to PB) - 50 : 50
- It is assumed that total material consists of 1/3 iron & steel taxable @5%; and 2/3 other materials taxable @12.5%: thus average VAT rate comes to 10%;
- VAT input tax credit is assumed at Rs.16 (10% of 66% of 240);
- It is also assumed that majority of the contract is executed by BD himself, and thus, Cenvat Credit is only Rs.2;
- Total Investment of BD comes to : Rs.800 paid to LO (+) Construction value of all four flats being Rs.400 (=) Rs.1200.

2. Background

Before coming to the taxability part, it is necessary to look at the history of the same. In a case before *the Division Bench of the Supreme Court in K. Raheja Development Corporation vs. State of Karnataka (2005) 141 STC 298* ***(hereinafter referred as Raheja case)***, the owners of the land were also engaged in the business of constructing apartments/complexes, and for this purpose, they entered into agreements of sale with the intended purchasers. It was held by the Supreme Court that even an owner of the property might also be said to be carrying on a works contract if the builder enters into an agreement to construct with the intended purchasers. However, if the agreement is entered into after the unit is already constructed, then there would be no works contract. But so long as the agreement is entered into before the construction is complete, it would be a works contract. *[It may, however, be noted that in this case the builder entered into two separate agreements with the intended purchasers : one for sale of land and another for sale of buildings; and, thus, in another way, the builder constructed the property on the land owned (or to be owned) by the prospective purchasers.]*

However, the *Raheja case* has been referred to the larger bench in the case of *Larsen & Toubro Limited vs. State of Karnataka (2008) 17 VST 460 (SC)*; but, without grant of any stay by the Apex Court.

Relying upon the judgment in *Raheja case*, many State VAT Departments, including Delhi, U.P. and Haryana, have initiated imposition of VAT on the material involved in the transfer of residential and commercial complexes by considering the activity as works contracts. Similarly, steps were also taken to impose service tax by way of amendment in the Finance Act, 1994.

The Bombay High Court in the case of *Maharashtra Chamber of Housing Industry vs. State of Maharashtra (Writ Petition no. 2568 of 2007 dated 10.4.2012) (2012) 51 VST 1 (Bom)* also examined this issue. The Court observed that since works contracts have numerous variations, it was not possible to accept the contention of the appellant either as a matter of first principle or as a matter of interpretation that a contract for work in the course of which, title was transferred to the flat purchaser, would cease to be a works contract. The Court further made a note from the judgment by the Supreme Court in the case of *Builders' Association vs. U.O.I. (1989) 73 STC 370 (SC)*, that the doctrine of accretion is itself subject to a contract to the contrary. Analyzing various clauses of the agreement under the Maharashtra Ownership Flats Act, 1963 (MOFA), the High Court held that it was in the nature of works contract. The High Court also held that the explanation (b)(ii) to Section 2(24) of Maharashtra VAT Act, which reads, "'works contract' includes an agreement for carrying out for cash, deferred payment or other valuable consideration the building, construction, manufacture, processing, fabrication, erection, installation, fitting out, improvement, modification, repair or commissioning of any movable or immovable property", is constitutionally valid and within the legislative competence of the State Legislature.

The Court also approved the composition scheme under the Maharashtra VAT Act which applies to the registered dealers who undertake construction of flats, dwellings, buildings or premises and transfer them in pursuance of an agreement along with land or interest underlying the land, at 1% of the agreement amount specified in the agreement or the value specified for the purpose of Stamp Duty under the Bombay Stamp Act, 1958 whichever is higher, subject to certain conditions.

3. Delhi VAT on Builders Contracts

3.1 Taxability / Incidence of tax

In accordance with *Raheja case*, builder contract, where agreement is executed with intended buyers before completion of the building, falls within the definition of works contract. Under the Delhi VAT, the term "works contract" has been defined under section 2(1)(zo) as,

"works contract" *includes any agreement for carrying out for cash or for deferred payment or for valuable consideration, the building construction, manufacture, processing, fabrication, erection, installation, fitting out, improvement, repair or commissioning of any moveable or immovable property.*

Other States also have similar definition in their respective State VAT Laws.

Analyzing the activity in detail in view of *Raheja case*, it can be fairly stated that BD executes works contract for two separate persons, that is, -

(A) Works Contract for the LO: where BD constructs the units for a consideration in the form of share in the land; and

(B) Works contract for PB, if BD receives payment (or enters into agreement of sale) from PB before completion of the construction.

So far as activity stated at (A), it is always a works contract activity (unless, it can be termed as barter transaction, discussed later); whereas activity referred to at (B) has become taxable with the decision in *Raheja case*. Supposing, the *Raheja case* is overruled by the larger bench, then no VAT will be payable *qua* this activity.

Valuable Consideration – Barter Transaction

As per the Courts, valuable consideration includes cash, money, cheques, bill of exchange, promissory notes, shares and like instruments. Whether exchange of goods (barter) constitutes a valid sale? It had been a matter of great controversy and the Courts had expressed different views in this regard. While discussing the basic elements of "sale", the Apex Court in the case of *Devi Dass Gopal Krishnan vs. State of Punjab (1967) 20 STC 430 (SC)* opined that cash or other valuable consideration is essential for completion of a sale. In the absence of cash or deferred payment, it is exchange of goods (barter), and not a sale.

In *CST vs. Ram Kumar Agarwal (1967) 19 STC 400 (All)*, gold was paid as a price of jewellery. The jeweller purchased gold from the market, prepared ornaments, and transferred to the customer against the gold. It was held that exchange of goods was "barter" and not a "sale". It was also observed that it was immaterial whether gold was given before the preparation or at the time of transfer of jewellery. In another case, the dealer collected kansa, melted it and returned to the customer after deducting certain percentage in weight and collected labour charges extra: the Court held it as a barter transaction and not as sale. *[CST vs. Kansari Udyog (1979) 43 STC 176 (MP)].* **However**, contrary views were observed in the case of *VP Vadivel Achari vs. State of Madras (1969) 23 STC 273 (Mad)*, where gold was exchanged for new jewellery; it was held to be a "sale" since gold, handed over to assessee, could easily be converted into money.

Where goods are sold partly for goods and partly for money, it is a transaction of sale. For example, fifty two bullocks, valued at $ 6 a piece, were exchanged for 100 quarters of barley at $ 2 per quarter, the difference to be made in cash: the contract was held as sale. *[Aldridge vs. John. (1887) 7 E & B 885; LJ QB 296; Sheldon vs. Cox (1824) 3 & C 420]. Similarly,* in the case *CIT vs. M. & G. Stores AIR 1968 SC 200*, an old car was returned and difference was paid in cash: while explaining the word "price", the Supreme Court held that it was a transaction of sale. Likewise, where machinery was transferred against allotment of shares, it was considered as sale since transfer of shares was a mode of payment of price and discharge of liability. *[Premier Electro Mechanical Fabricator vs. State of T.N. (1984) 55 STC 371 (Mad) followed in State of T.N. vs. T.M.T. Drill (P) Ltd. (1991) 82 STC 59 (Mad); I.B.P. Co. Ltd. vs. Asstt. CCT (2000) 118 STC 33 (WBTT)]*

In another case, the Madras High Court held that even barter or exchange of goods might be considered as sale under the Act, provided there is transfer of property in the goods. *[Vishweshwasadars Gokuldas vs. Govt. of Madras (1962) 13 STC 113 (Mad)]*

In the case of *Dhampur Sugar Mills Ltd. vs. CTT (2006) 147 STC 57 (SC)*, a company, which owned a sugar mill, executed a deed of licence in favour of the dealer. In terms of the deed and performance guarantee deed, the dealer was to pay the company a fixed sum per annum by way of licence fee for the use of the entire sugar mill complex in the shape of molasses. At the end of every licence year, the value of the molasses had to be ascertained on the basis of the rates notified by the Government and any excess or shortage towards the amount of licence fee was to be made good by either party. The question was whether sales tax under the U.P. Trade Tax Act, was exigible in relation to the transfer of molasses under the deed of licence. It was held that the mode and manner in which the licence fee was to be paid was not the subject-matter of the deed of licence. The deed of licence did not contain any provision that the dealer was required to transfer to the company the molasses produced by it, in lieu of the licence fee. Further, an adjustment of price in a case of this nature would come within the purview of the term "other valuable consideration" in as much as the dealer and the company were fully aware that they had to fulfill their respective terms and obligations,

i.e., (i) payment of licence fee on monetary terms, and (ii) payment of price of molasses supplied by the appellant to the company which was again in monetary terms. Thus, it was held that the transaction could not be termed as "barter".

Therefore, looking at the afore-stated pronouncements, it would be difficult to plead before the courts with success that exchange of land with value of construction is merely a barter transaction.

3.2 Measure of tax

Determination of VAT in case of works contract depends upon the provisions under the State VAT Act. In general, three methods have been laid for computation of State VAT:

(1) Regular Scheme – Labour & Services are determined on actual basis;

(2) Regular Scheme – Labour & Services are computed on percentage basis;

(3) Composition Scheme.

Under the regular scheme, determination of turnover and output VAT of works contract transaction is as under: -

i	Gross Turnover – Work executed during the tax period	…….
ii	Less : Cost of land and labour & services	…….
	[Either on actual basis or at percentage basis]	
iii	Taxable value of material (Taxable Turnover)	…….
iv	Computation of Output Tax on (iii)	
	Declared goods @ 5% ……. Tax ……	
	Other goods @12.5%..... Tax ……	…….

Provisions under the Delhi VAT Act:

As per section 2(1)(zd)(vii), the term "sale price", in relation to works contract means the amount of valuable consideration paid or payable to a dealer for the execution of the works contract.

As per section 5(2) of the Act, in the case of turnover arising from the execution of a works contract, the amount included in taxable turnover is the total consideration paid or payable to the dealer under the contract excluding the charges towards labour, services and other like charges, subject to such conditions as may be prescribed:

Provided that where the amount of charges towards labour, services and other like charges is not ascertainable from the books of accounts of the dealer, the amount of such charges shall be calculated at the prescribed percentages.

As per Rule 3(1) of the DVAT Rules, in case of turnover arising from the execution of the works contract, the amount representing the taxable turnover shall be the value at the time of transfer of property in goods (whether as goods or in some other form) involved in the execution of works contract and shall exclude -

(i) the charges towards labour, services and other like charges; and

(ii) the charges towards cost of land, if any, in civil works contracts,

subject to the dealer's maintaining proper records such as invoice, voucher, challan or any other document evidencing payment of referred charges to the satisfaction of the Commissioner.

As per its Explanation, the term "civil works contracts" for the purpose of this rule shall include, *inter-alia*, construction of building or complexes - residential or commercial.

As per rule 3(2), the charges towards labour, services, etc. shall include: -

i. Labour charges for execution of works;
ii. Charges for planning and architects fees;
iii. Charges for obtaining on hire or otherwise machinery and tools used for the execution of the works contract;
iv. Cost of consumables such as water, electricity, fuel, etc. used in the execution of the works contract the property in which is not transferred in the course of execution of a works contract;
v. Cost of establishment of contractor including cost of marketing, finance expenses and security deposits to the extent relatable to supply of labour & services;
vi. Other similar expenses relatable to supply of labour and services;
vii. Profits earned by contractor to the extent it is relatable to supply of labour and services subject to furnishing of a profit and loss account of the works sites.

Two methods for determination of labour, services and other charges have been specified under the Delhi VAT Rules, as under:

(A) Actual Basis (B) Percentage Basis

(A) Actual Basis

If labour and services are determined on actual basis, the contractor shall maintain the records in a manner so as to easily quantify the value of material, amount of direct labour and services and proportionate amount of indirect labour and services. Scope of "labour and services" is not confined to wages and salaries; but it extends to the other charges of the nature of expenses stated in seven clauses of Rule 3(2) discussed above.

Deduction towards cost of land in civil works contracts:

Since sales tax/VAT cannot be levied on transfer of the immovable property, rules have been framed to identify the cost of land in the total value of a flat or apartment and to allow deduction thereof.

As per Rule 3(3)(a), in the case of works contract of civil nature where the payment of charges towards the cost of land, if any, is not ascertainable from the books of accounts of the dealer, the amount of such charges shall be calculated –

- In the case of construction of commercial buildings or complexes: @ 50% of the total value of the contract.
- In other cases: @ 30% of the total value of the contract.

Further, in the case of works contract of civil nature where only a part of the total constructed area is being transferred, the charges towards the cost of land shall be calculated on a pro-rata basis by applying the following formula: -

$$\frac{\text{Proportionate Super Area}}{\text{Total Plot Area}} \times \frac{\text{Indexed Cost of Acquisition of Land}}{\text{Floor Area Ratio}}$$

"Proportionate super area" for the purpose of this clause means the covered area booked for transfer and the proportionate common constructed area attributable to it. "Indexed cost of acquisition" shall be calculated as per section 48 of the Income Tax Act, 1961.

Moreover, where only a part of total constructed area is being transferred, the deduction towards labour, services and other like charges mentioned in rule 3(1) shall be calculated on a pro-rata basis. Further, the tax shall be payable by the contractor during the tax period in which the property in goods is transferred. [Rule 3(3)(c) & (d) of Delhi VAT Rules]

Many States have not framed rules in respect of determination of value of land. This may, however, be computed as per the cost to the builder. Many a time, it also happens that land was acquired way back and there is significant appreciation in the value of land up to the date of sale deed with PB. In such cases, State like Haryana has stated that the value of land can be determined on the basis of Municipal Circle Rate.

It may be added that the Delhi (Prevention of Under Valuation of Instruments) Rules, 2007 (hereinafter referred as "circle rates") has laid twin circle rates, depending upon the location of the property, for the purpose of registration of conveyance deed : one for the land; and another for the construction.

(B) Percentage Basis

Where amount of charges towards labour, services and other like charges are not ascertainable from the books of accounts of the dealer, the amount of such charges shall be calculated on the basis of percentages specified in the rule 3(2) of DVAT rules. Builder contracts fall within the following clause: -

Sl. No.	Type of contract	Percentage of total value of the contract
6	Civil works [excluding the cost of land transferred, if any]	25%

(C) Composition Scheme

Under the Delhi VAT Act, in relation to builders contracts, following composition schemes are applicable with effect from 01.04.2013:-

S.N.	Nature of the Contract	Scheme A	Scheme B
1	Construction, of complex, building, a civil structure or a part thereof, including residential unit or complex or building, for sale whether wholly or partly, to a buyer before construction is complete, **where value of land is included in total consideration.** (Excluding contracts where entire consideration is received after issuance of completion certificate by competent authority).	1%	3%
2	Other construction/building contracts	3%	6%

Scheme A: The contractor shall (i) not purchase or procure goods from any place outside Delhi at any time during the period for which he opts to avail this Scheme; and (ii) not sell or supply goods to any place outside Delhi at any time during the period for which he opts to avail this Scheme. However, he may procure his own plant & machinery and equipments from outside Delhi, meant exclusively for use in execution of the works contract by him.

Scheme B: The contractor shall be entitled to make purchases of goods required for the execution of the contract in the course of inter-State trade or commerce on the strength of his certificate of registration against declaration in Form C or by way of inward transfer of stocks from other States against Form F or by way of imports from other countries solely for the purposes of utilizing the same in the execution of works contract in Delhi only. However, the dealer shall use the material/goods imported or procured from outside Delhi strictly for use in execution of the works contract transactions.
Apart from various other restrictions, the composition dealer is not eligible for input tax credit on purchases made within Delhi. He cannot also issue tax invoices. Further, he can purchase goods from unregistered dealers only to the extent of 2% of his total purchase turnover during the year or Rs. 25 lakhs, whichever is lower.

Composition schemes for works contracts are different from State to State. For example, in Haryana, rate of composition tax is 4% with the benefit of eligibility of input tax credit on local purchases and central purchase against Form C.

3.2.1 Booking/Sale of flat during construction

In a collaboration agreement, BD's share in the property could be sold prior to completion, but at various stages of construction. Sometimes, BD sells the flat when the project has just started, and sometimes when the flat is almost complete. The question generally arises as to at which value of construction, VAT shall be paid; that is, on the total value of flat or on the value received after the date of booking? The DVAT Department in a clarification has stated that if the unit is sold prior to the completion, the tax would be levied on the sale value of the unit minus the available deductions.

3.3 Time of turnover / Point of taxation

Works contracts are generally taxable at the time of incorporation of goods in the contract. As per 4(c) of the DVAT Rules, read with section 12(4) of the Act, the amount of turnover or turnover of purchases arising in the tax period in the case of a sale or purchase occurring by means of transfer of property in goods (whether as goods or in some other form) under a works contract executed or under execution in the tax period, is the consideration received or receivable by the dealer for such transfer of property in goods (whether as goods or in some other form) during the relevant tax period.

3.3.1 Works contract executed by BD for LO

In this case, the entire land is received by the BD in advance, before commencement of construction. Therefore, time of turnover would be the execution of agreement between LO and BD; and tax would be payable at that time itself on total construction value.

3.3.2 Works contract executed by BD for PB

Here, incidence of DVAT would arise at the time of execution of agreement with PB. Till that time, no VAT is payable by BD. After the execution of agreement with PB, DVAT would be payable at the time of receipt of consideration from PB or when the installment becomes due, depending upon method of accounting.

3.3.3 Cancellation of booking by PB

If booking of the flat is cancelled during the construction thereof, and subsequently the construction is carried by the BD for itself, the sale shall be treated cancelled in accordance with section 8(1)(a) of the DVAT Act, and the BS would be entitled to

adjust/refund the tax already paid. However, if the same flat is again sold to another PB during construction, then it would be taxable under the DVAT, as discussed earlier.

3.4 Liability of BD – Computation of Delhi VAT – Illustration given in Para 1

Met-hod	Description	Output VAT-LO	Output VAT-PB	Input Tax	Net Liabi-lity	Liability (% of Inv-estment)
(1)	(2)	(3)	(4)	(5)	(6)	(7)
I	**Percentage Method (Services 25%; Land-30%)** • LO-10% of 75% of (400)/2 • PB -10% of 75% of 70% of 1200	15	63	16	62	5.18
II	**Hybrid Method (Services-Actual; Land 30%)** • LO-10% of (240)/2 [50% material pertains to LO] • PB -10% of [(70% of 1200) – (160)/2]	12	76	16	72	6.01
III	**Hybrid Method (Services-%; Land-Actual)** • LO-10% of 75% of 200 • PB -10% of 75% of (1200-1000)	15	15	16	14	1.18
IV	**Composition Method** • LO-3% of 200 • PB -1% of 1200	6	12	0	18	4.33

The above illustration does not discuss various complex situations, such as, sale deed is executed for a higher price : In such case, the differential value, wherever necessary, can be proportionately divided amongst the value of land, material and services. To illustrate, sale deed is executed for Rs.1600 instead of Rs.1200. Then, the differential Rs.400 will be added in the ratio of:- Land-1000 : Material-120 : Services-80 [All three figures have been halved since additional consideration has been received in relation to portion sold to PB]

In case of sale by BD to PB, where deduction for land is claimed on actual basis, ascertainment of land value is a difficult task. It is also known fact that wherever projects are located in the prime localities, value of land may even account for at 80% to 90% of the total flat/unit value. As per the DVAT Rules, BD is also eligible for deduction towards the cost of land on actual basis, which *in the opinion of author*, can be determined by applying any of the following method, depending upon facts of the case,-

- Rate arrived at based upon sale agreement between LO and BD for sale of land; or
- Value of land disclosed in the sale agreement between BD and PB; or
- Amount paid by BD to LO towards the land rights (plus) value of construction transferred by BD to LO; or
- Indexed cost of land determined as per the Income Tax Act.

State like Haryana has stated that where value of land cannot be ascertained, Municipal Circle Rates may be applied for the purpose of determination of Haryana VAT.

Note: These methods are suggestive in nature, and the users/stake holders must examine them before applying to their own case.

4. Service Tax on Builder Contracts

4.1 Taxability / Incidence of tax

Up to 31.07.2012, builders contracts were taxable as part of construction of residential complex service under clause (zzzh) of section 65(105) of the Act and as part of service in relation to commercial or industrial construction under clause (zzq) of the same section 65, through an explanation inserted with effect from 01.07.2010. Presently, under the negative list scheme, this activity has been defined under clause (b) of section 66E of the Finance Act, which covers services provided by builders or developers or any other person, where building complexes, civil structure or part thereof are offered for sale but payment for such building or complex or part thereof is received before the issuance of completion certificate by a competent authority.

The term 'complex' has not been defined under the Finance Act. However, clause no. 14 of the mega exemption notification no. 25/2012-ST dated 20.06.2012 exempts, *inter-alia*, the services provided by way of construction, erection, commissioning, or installation of original works pertaining to "a single residential unit otherwise than as a part of a residential complex". The term "residential complex" has been defined under clause 2(zc) of the notification, which means any complex comprising of a building or buildings, having more than one single residential unit. As per clause 2(ze) of the notification, "single residential unit" means a self-contained residential unit which is designed for use, wholly or principally, for residential purposes for one family.

Therefore, under the erstwhile provisions up to 30.06.2012, the term residential complex meant any complex comprising of a building or buildings having more than twelve residential units; whereas effective from 01.07.2012, more than one single residential unit would be considered as residential complex. Therefore, at present, construction of all residential complexes (having more than one unit) is subject to service tax.

In accordance with Para 6.2 of the Service Tax Education Guide:-

In the activity of complex construction, two transactions are identifiable:

(a) Sale of land by the landowner which is not a taxable service; and

(b) Construction service provided by the builder/developer.

The builder/developer receives consideration for the construction service provided by him, from two categories of service receivers:

(a) From landowner: in the form of land/development rights; and

(b) From other buyers: normally in cash.

Construction service provided by the builder/developer is taxable in case any part of the payment/development rights of the land has been received by the builder/ developer before issuance of completion certificate, and thus service tax would be payable by builder/developers even for the flats given to the land owner.

Value, in the case of flats given to the LO will be the value of the land when the same is transferred and the point of taxation will also be determined accordingly.

Therefore, BD provides two services while carrying out building activity: -

(A) Construction (Works Contract) Service for the LO: where BD constructs the complex for a consideration in the form of share in the land; and

(B) Complex construction service if BD receives payment from the customer before the issuance of completion certificate by a competent authority.

In general, complex construction is also a works contract, which is also observed by the Supreme Court in *Raheja case*; and it may be stated that whereas works contract is a genesis, complex construction is its species. However, for the purpose of service tax, works contract transactions are specified in clause (h) of section 66E, whereas construction of complex, building or civil structure has been specified in clause (b) of section 66E. By declaring them as separate services, the legislature has made a remarkable distinction between these two services.

Therefore, activity of construction of a complex, building, civil structure or a part thereof, including a complex or building intended for sale to a buyer, wholly or partly (except where entire consideration is received after issuance of certificate of completion by a competent authority), would fall within the ambit of clause (b) of section 66E of the Finance Act.

It may further be noted that so far as activity stated at (A), it was always a works contract service; whereas activity stated at (B) has become taxable with the decision in *Raheja case.* Nevertheless, with the incorporation of suitable provisions under the Statue, the charge of service tax in the latter case, at present, is not dependent upon the fate of *Raheja Case.*

4.2 Measure of tax

4.2.1 Works Contract activity

In accordance with rule 2A of Service Tax (Determination of Value) Rules, 2006 value of service portion in the execution of a works contract, referred to in clause (h) of section 66E of the Act, shall be determined in the following manner, namely:-

(i) Actual Basis:

Value of service portion in the execution of a works contract shall be equivalent to: - Gross amount charged for the works contract (-) Value of property in goods transferred in the execution of the said works contract.

Where VAT or sales tax has been paid/payable on the actual value of property in goods transferred in the execution of works contract, then, such value adopted for the purposes of payment of VAT or sales tax, shall be taken as the value of property in goods transferred in the execution of the said works contract for determination of the value of service portion in the execution of works contract under this clause.

For the purposes of this clause,-

(a) gross amount charged for the works contract shall not include value added tax or sales tax, as the case may be, paid or payable, if any, on transfer of property in goods involved in the execution of the said works contract;

(b) value of works contract service shall include, -

(i) labour charges for execution of the works;

(ii) amount paid to a sub-contractor for labour and services;

(iii) charges for planning, designing and architect's fees;

(iv) charges for obtaining on hire or otherwise, machinery and tools used for the execution of the works contract;

(v) cost of consumables such as water, electricity, fuel used in the execution of the works contract;

(vi) cost of establishment of contractor relatable to supply of labour and services;

(vii) other similar expenses relatable to supply of labour and services; and

(viii) profit earned by the service provider relatable to supply of labour and services.

(ii) Percentage Basis:

Where the value has not been determined under clause (i), then the service portion involved in the execution of the works contract (relating to original works, which shall also include construction of buildings) shall be determined @ 40% of the total amount charged for the works contract.

"Total amount" means the sum total of the gross amount charged for the works contract and the fair market value of all goods and services supplied in or in relation to the execution of the works contract, whether or not supplied under the same contract or any other contract, after deducting: -

(i) the amount charged for such goods or services, if any; and

(ii) the value added tax or sales tax, if any, levied thereon:

Provided that the fair market value of goods and services so supplied may be determined in accordance with the generally accepted accounting principles.

4.2.2 Complex construction activity

In relation to complex construction service specified in clause (b) of section 66E, abatement/taxable value has been prescribed vide Notification No. 26/2012-ST dated 20.6.2012 as amended vide Notification No. 2/2013-ST dated 1.3.2013. **Taxable value** in case of complex construction service would be arrived at by applying following percentage to the amount charged by the builder -

S.N.	Description	%	Conditions
12.	Construction of a complex, building, civil structure or a part thereof, intended for a sale to a buyer, wholly or partly except where entire consideration is received after issuance of completion certificate by the competent authority,-		(i) CENVAT credit on inputs used for providing the taxable service has not been taken under the provisions of the CENVAT Credit Rules, 2004; and (ii) The value of land is included in the amount charged from the service receiver.
	(i) for residential unit having carpet area upto 2000 square feet or where amount charged is less than rupees one crore;	25%	
	(ii) for other than the (i) above.	30%	

It may be noted that claiming abatement for computation of taxable services is not mandatory, and the service provider may compute the amount of taxable services by using actual method. However, no separate rules, similar to Rule 2A in relation to works contract (discussed earlier), have been laid down for complex construction service. Therefore, in the opinion of author, the service provider may deduct the value of land and material incorporated on actual basis from the total consideration. By considering the contract as works contract, he may also deduct the land value on actual basis, and material value in terms of Rule 2A of the Determination Rules.

4.3 Point of taxation

The general rule for determination of point of taxation in service tax is: Earlier of (a) Raising of an invoice; and (b) Receipt of payment.

4.3.1 Service rendered by BD to LO

Here, the entire land is received by BD in advance, before commencement of construction. Therefore, point of taxation would be the date of execution of agreement between LO and BD; and service tax would be payable at that time itself on total construction value.

4.3.2 Service rendered by BD to PB

In this case, charge of service tax shall be execution of agreement with PB. Till that time, no tax is payable by BD. After the execution of agreement with PB, service tax would be payable at the time receipt of consideration from PB or when the installment becomes due, whichever is earlier.

4.3.3 Cancellation of booking by PB

If the booking of the flat is cancelled during the construction thereof, and subsequently the construction is carried by the BD for itself, the service shall be treated as cancelled since returned deposits are in the nature of a returned consideration; and, thus, BD would be entitled for refund of service tax already paid in accordance with the law in this regard. However, where certain amount is forfeited by BD, such forfeited amount would be taxable as provision of service.

4.4 Liability of BD – Computation of Service Tax – Illustration given in Para 1

Method	Description	Output ST-LO	Output ST-PB	Cenvat	Net Liability	Liability (% of Investment)
(1)	(2)	(3)	(4)	(5)	(6)	(7)
I	**Percentage Method** • LO-Works Contract (Rule 2A -%): 12.36% of 40% of 200 • PB-Complex: 12.36% of 30% of 1200	10	44	2	52	4.33
II	**Hybrid Method [LO (Services)-Actual; PB- 30%]** • LO-Works Contract (Rule 2A -Actual): 12.36% of (160)/2 • PB-Complex: 12.36% of 30% of 1200	10	44	2	52	4.33
III	**Hybrid Method (Services-%; Land-Actual)** • LO-Works Contract (Rule 2A -%): 12.36% of 40% of 200 • PB-Works Contract; Land on actuals *(see note)* : 12.36% of 40% of (1200-1000)	10	10	2	18	1.45

Note: In the above illustration at Method Number III, instead of following the abatement method, value of land has been reduced at its actual value since claiming of abatement is not mandatory; which certainly could be a matter of litigation. It is assumed that in the absence of abatement method, the person can determine the value of service on the actual method, unless there are specific rules in this regard. Nevertheless, for the purpose of valuation of services, total consideration shall exclude values of land and material involved therein, which are dominantly involved in the complex construction service.

In the case of *K. Damodaraswamy Naidy vs. State of Tamil Nadu (2000) 117 STC 001 (SC),* five judges bench of the apex court, in relation to the taxability of composite charges received by the hotels, opined that the composite charge that the hotel owner levied for lodging and boarding had to be split up and only the element thereof that related to the supply of meals could be subjected to the sales tax. The Court held that sales tax could not be levied on the composite charge for boarding and lodging unless the State made Rules which set down formulae for determining the supply component on the composite charge. It was further held that it was not for the assessing authority to split up the composite price into two and make the one part taxable; that is, only the State could promulgate rules to indicate how to treat the composite charges for lodging and boarding and set out formulae for splitting of the two.

The said judgment squarely applies to our case, and unless rules are framed by the Government, the tax payer *(unless challenges the levy itself based upon this judgment)* can adopt a fair and reasonable method for valuation of service. Here, the value of land can be determined on the basis of its valuation at the time of agreement with LO or agreement of sale with PB; or some other fair and reasonable basis. After deducting the value of land, the remaining consideration comes within the purview of works contract, involving material and service; and therefore, may be taxable as per Rule 2A of the Determination Rules: either on actual basis or on percentage basis.

5. Conclusion

Even after having a lengthy discussion on the subject, it is difficult to conclude the topic with certainty and authority. We have taken a fairly simpler illustration, wherein various complex situations have not been considered. The measure of tax would further be complex if the discussion on the amount of conveyance/sale deed, which varies from customer to customer even in the same building and at the same time, is also initiated. Further, the exact taxation would depend upon the terms of the collaboration agreement between the parties, which might vary from case to case.

Moreover, looking at the impact of service tax and VAT simultaneously, double taxation certainly tortures the stake holders. For example, in case of works contracts for construction of building (without land), if calculated by percentage method, service tax is payable on 40% of the total value of the contract, and DVAT on 75% : therefore, both taxes taking together comes to 115% of the total value, that is, at more than 100% of the total value. Further, in case of construction of residential complex (with land), service tax is payable on 30% (or 25%) of the total value of the contract and DVAT is paid on 52.5% (100 * 70% * 75%) : therefore, total taxes comes to 82.5% of the total value. Comparing these two types of contract, we may observe that the builder gets rebate of 32.5% (115 - 82.5) of the total value towards land, which, however, in Delhi would not be less than 50% to 80% of the total project cost. Thus, in a way, the builder is paying VAT and/or Service Tax on the value of land.

The Revenue should realize that it can tax material and services portion respectively; whereas, the value of land, particularly in the metro cities, has the maximum involvement in this activity. The variance in the total price of a flat/unit is mainly due to land rates. For example, a flat of 500 sq. yards with same amenities would price for Rs.10 crores in south Delhi and Rs.5 Crores in east Delhi. The land rate may also vary within the same colony, depending upon its location. Value of material and services would, by and large, remain the same everywhere. To arrive at the value of taxable service for complex construction services under section 66E(b) of the Act, Service Tax allows abatement of 70% toward the value of land and material. In our illustration, in east Delhi, taxable value of services would be Rs.1.5 crores, whereas, in south Delhi, it would be Rs.3 crores. Similarly, Delhi VAT allows abatement of 30% towards value of land in case of residential properties, irrespective of its location. It is certainly an attempt to levy service tax and Delhi VAT, respectively, on the value of land, which is out of their jurisdiction. This is the reason, why everyone is eagerly waiting for implementation of GST.

This activity is also facing different treatment under different statutes, even by the same Government. Both, VAT and the stamp duty, are collected by the State Government; and for the purpose of collection thereof, it has got different charging provisions: that is, for the purpose of levy of VAT, land is deemed to be sold during the construction itself; and for the purpose levy of stamp duty, land is treated to be sold along with construction, as a ready unit.

Since the levy is somewhat new, and in the absence of appropriate assistance in the form of clarifications by the Authorities or the judicial pronouncements, the builders are always in the sate of confusion while discharging their obligations and making compliances. Being an indirect tax, if VAT and Service Tax are not recovered from the customers in time, at the time of making sale or rendering of service, it becomes the cost of the dealer/service provider; and if any additional demand is raised after few years along with interest and penalty, many of the persons would have no option but to shut down their businesses; which is not the appropriate manner of taxation. Do the Governments want the stake-holders to carry on their businesses with such amount of uncertainties? Taxation on this infrastructural activity certainly needs early attention of the Governments and Revenue Authorities for the systematic growth of this sector; and thus, our economy.

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