

# New Taxability and Valuation clarifications for Construction Services -New Circular

CA Amarpal M- 0971.710.5008

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## Preface

Service Tax Laws have divided the Construction Services under two categories: -

- (i) **Construction Services – Commercial or Industrial** [u/s 65(105)(zzq)] which was brought to service tax w.e.f. 10/09/2004.
- (ii) **Construction of Residential Complex** [u/s 65(105)(zzh)] which was brought to service tax w.e.f. 16/06/2005.

After this, Doubts have arisen regarding the applicability of service tax in a case where developer/builder/promoter enters into an agreement, with the ultimate owner for selling a dwelling unit in a residential complex at any stage of construction (or even prior to that) and who makes construction linked payment.

On 29/01/2009, CBEC (Central Board of Excise and Custom) vide its **Circular No. 108/02/2009 dated 29/01/2009** clarified that service tax shall not be applicable on such transactions. It was clarified that the transaction of sale is completed only after complete construction of the residential unit. Till the completion of the construction activity, the property belongs to the builder or promoter and any service provided by him towards construction is in the nature of 'self service' and consequently would not attract service tax.

Further, **Finance Act, 2010** inserted an explanation in the above definitions which was given effect from 01/07/2010, that in case any sum is received from the prospective buyers before grant of completion certificate by competent authority, construction services shall be deemed to be provided by the builder to the buyer. Hence, after this explanation, the

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construction services were taxed to service tax.

Even after the above explanation, many questions/issues were left unanswered in the light of varying business models. E.g. valuation and taxability of services (i) in case flats are allotted to landowners in lieu of their land, (ii) any re-construction services are taken by any old society etc.

Now CBEC, vide its New Circular No. 151/2/2012- ST dated 10/02/2012 have clarified various model along with the taxability and their valuation. It would be help to a good extent to determine the proper tax liability in construction sector.

## Analysis of New Circular No. 151151/2/2012- ST dated 10/02/2012

Under the new circular, 7 various models which are adopted in the construction sector have been analysed in detail and accordingly, service tax liability have been established. Along with tax liability, valuation for construction services provided or to be provided by builders have been ascertained. Following is the brief of the circular:-

**A. Tripartite Business Model:** - Under this model, landowner transfer their land/developments right to builders and builders transfers flats/houses to landowner.

- (i) Where flats/houses are agreed to be given by builder/developer to the land owner towards the land /development rights.

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**Ans:** The builder shall be liable to Service Tax on 'construction services' involved in the flats at the time when possession or right in the property of the said flats are transferred to the landowners, on the value equal to value of similar flats charged from other buyers.

(ii) Where flats/houses are transferred to other ultimate buyers.

**Ans:** In this case, the service tax shall be paid by builders and value shall be determined as per section 67 of Finance Act, 1994.

**B. Redevelopment including slum rehabilitation projects**:- In case societies, when it becomes necessary after the lapse of a certain period, society or its flat owners may engage a builder for undertaking re-construction. Society /individual flat owners give permission to the builder, for re-construction. The builder/developer makes new flats with same or different carpet area for original owners of flats and some additional work may also be carried on.

**Taxability:**

(i) Re-construction undertaken by a building society by directly engaging a builder will not be chargeable to service tax as it is meant for the personal use of the society/its members.

(ii) Construction of additional flats undertaken as part of the reconstruction, for sale to the other buyers, will also not be a taxable service, during the period prior to 01/07/2010;

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- (iii) For the period after 01/07/2010, construction service provided by the builder to other buyers is taxable in case any payment is made to the builder/ developer before the issuance of completion certificate.
- (iv) Value shall be determined in view of section 67 of Finance Act, 1994.

**C. Investment Model**:- In this model, before the commencement of the project, the same is on offer to investors. Either a specified area of construction is earmarked or a flat of a specified area is allotted to the investors and as it happens in some places, additionally the investor may also be promised a fixed rate of interest. After a certain specified period an investor has the option either to exit from the project on receipt of the amount invested along with interest or he can resell the said allotment to another buyer or retain the flat for his own use.

### Taxability

- (i) In this model, after 01/07/2010, investment amount shall be treated as consideration paid in advance for the construction service to be provided by the builder to the investor and the said amount would be subject to service tax.
- (ii) If the investor decides to exit from the project at a later date, either before or after the issuance of completion certificate, the builder/developer would be entitled to take credit under rule 6(3) of the Service Tax Rules, 1994( to the extent he has refunded the original amount).

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(iii) If the builder/developer resells the flat before the issuance of completion certificate, again tax liability would arise.

**D. Conversion Model:** - Conversion of any hitherto untaxed construction /complex or part thereof into a building or civil structure to be used for commerce or industry, after lapse of a period of time.

**Taxability:** Mere change in use of the building does not involve any taxable service, unless conversion falls within the meaning of commercial or industrial construction service.

**E. Non-requirement of completion certificate / where completion certificate is waived or not prescribed:**

In certain states, completion certificates have been waived or are considered as not required for certain specified types of buildings. Doubts have been raised, regarding levy of service tax on the construction service provided, in such situations.

**Taxability -** Where completion certificate is waived or is not prescribed for a specified type of building, the equivalent of completion certificate by whatever name called should be used as the dividing line between service and sale. In terms of the Service Tax (Removal of Difficulty) Order, 2010, dated 22/06/2010, authority competent to issue completion certificate includes an architect or chartered engineer or licensed surveyor.

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- F. **Build- Operate - Transfer (BOT) Projects:-** Generally under BOT model, Government or its agency, concessionaire (who may be a developer/builder himself or may be independent) and the users are the parties. Risk taking and sharing ability of the parties concerned is the essence of a BOT project. Government or its agency by an agreement transfers the 'right to use' and/or 'right to develop' for a period specified, usually thirty years or near about, to the concessionaire.

### **Taxability**

- (i) At the first level, where Government or its agency transfers the right to use and/or develop the land, to the concessionaire, for a specific period, for construction of a building for furtherance of business or commerce (partly or wholly). Here, Government or its agency is providing '**renting of immovable property service**' (renting of vacant land to be used for furtherance of business or commerce) and in such cases the concessionaire becomes the service receiver.
- (ii) At the second level, for the 'construction services' undertaken by concessionaire for construction of building to be used wholly or partly for furtherance of business or commerce, on the land provided by the government or its agency, he will not be treated as a service provider since such construction has been undertaken by him on his own account and he remains the owner of the building during the concession period.

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- (iii) At the second level, where an independent contractor is engaged by a concessionaire for undertaking construction for him, then service tax is payable on the construction service provided by the contractor to the concessionaire.
- (iv) At the third level, the concessionaire enters into agreement with several users for commercially exploiting the building developed/constructed by him, during the lease period. Here, the concessionaire is the service provider and user of the building is the service receiver. The concessionaire may provide to the users, taxable services such as 'renting of immovable property service', 'business support service', 'management, maintenance or repair service', 'sale of space for advertisement', etc. and accordingly services tax shall be paid.

**G. Joint Development Agreement Model:-** Under this model, land owner and builder/developer join hands and may either create a new entity or otherwise operate as an unincorporated association, on partnership /joint / collaboration basis, with mutuality of interest and to share common risk/profit together. The new entity undertakes construction on behalf of landowner and builder/developer. Such new entity shall be deemed to be a person in view of circular no. **148/17/2011-ST dated 13/12/2011, particularly paragraphs 7, 8, 9.**

*Note: - This note/analysis has been drafted based on the personal interpretation of the facts/laws/notification in this regard. We shall not be responsible for any loss caused based on this interpretation.*