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Dear Professional Colleague,

Service tax chargeable on constructed area provided by developers to land owners in lieu of development rights

We are sharing with you an important judgment of the Hon'ble Supreme Court of India, in the case of ***N. Bala Baskar Vs. Union of India and Ors. [TS-524-SC-2016-ST]***, wherein the Hon'ble Supreme Court has dismissed the review petition filed by N. Bala Baskar ("**the Petitioner**"), against ruling of the Hon'ble High Court of Madras in the case of ***N. Bala Baskar Vs. Union of India & Others [TS-176-HC-2016(MAD)-ST]***.

The Hon'ble Supreme Court held as under:

"Delay condoned.

We are not inclined to interfere with the order passed by the High Court.

The special leave petition is dismissed.

However, the petitioner may apply for refund, if permissible in law."

It is worthwhile here to note that the Hon'ble High Court of Madras in the mentioned judgment dismissed the writ petition against levy of Service tax on construction service under an agreement for development of land.

We are sharing with you gist of the judgement of the Hon'ble High Court of Madras for easy digest.

Issue:

Whether the transaction where the Petitioner and his siblings agreed to exchange certain part of undivided share of land with the Developer in lieu of constructed area under an Agreement for development, is exigible to Service tax?

Facts & Background:

The Petitioner along with his brothers and two sisters entered into an agreement namely "Agreement for development" ("**the Agreement**") with M/s. LCS City Makers Pvt. Ltd. ("**LCS**" or "**the Developer**") for developing the land owned by the Petitioner and his siblings into a complex of residential houses. In terms of the Agreement, LCS was under an obligation to construct a super built up area and hand over 65% of constructed area to the Petitioner and his siblings. The Developer was entitled to remaining 35% of the undivided share of land.

In terms of the provisions of the Finance Act, relevant circulars and in terms of the Agreement, the Developer demanded Service tax together with VAT from the Petitioner. However, the

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Petitioner contended that the Agreement did not envisage rendition of any services so as to attract payment of Service tax and also contended that for mere exchange of a property, there could not be a Service tax. Accordingly, the Petitioner filed a writ petition before the Hon'ble High Court of Madras, challenging the provisions of Section 66B read with Section 66E(b) of the Finance Act, but later got his prayer modified and challenged Circular No. 151/2/2012-ST dated February 10, 2012 ("**Circular No. 151**") and Instruction F. No. 354/311/2015-TRU dated January 20, 2016 ("**TRU Instruction No. 354**") [collectively referred to as "**the Circulars**"] as unconstitutional and ultra vires the powers of Parliament under Article 246(3) read with Entry 49 of List II of the Seventh Schedule and the Finance Act (as amended from time to time).

Further, as an alternative submission, the Petitioner also contended that the transaction could be a sale if not an exchange as the Petitioner and his siblings agreed to sell 35% of the undivided shares in the land to the nominees of the Developer and the later agreed to pay a consideration in kind in the form of a constructed area.

Held:

The Hon'ble High Court of Madras, on following grounds, held that the writ petition is not maintainable:

- The Law makes the service provider i.e. the Developer liable to pay Service tax and it is always open to the service providers either to pass on the burden to the recipient of the services or not to pass it on. However, under the Agreement entered by the parties for development, the Petitioner and his siblings, who are the service recipients, agreed to take the burden to the extent they are liable. Therefore, the Circulars cannot be challenged by the Petitioner.
- The case laws relied by the Petitioner for contending that he has locus standi to maintain the writ petition are distinguishable in nature. It was also held that the contention that the person, to whom the burden of tax is finally passed on, is entitled to challenge a levy, if accepted, would lead to disastrous consequences. Therefore, the Petitioner had no locus standi to challenge the Circulars.
- It may be true that after construction, the parties may exchange the constructed area for the undivided share of land. But, in whatever manner it was worded, the agreement was for construction of complex. It was possible for Revenue to contend that a person, who is the owner of land, had engaged a contractor to put up a construction for themselves upto a particular limit. Since the cost of construction could not be paid by the owner in the form of cash, they agreed to exchange the undivided share of the land with the contractor. If viewed from that angle, what the Developer had done is actually the service of construction. Therefore, it was not an easy proposition that it was a transfer of immovable property by way of sale or exchange.

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- Apart from this, the challenge of the Petitioner to the Circulars did not merit any approval to the Court since the Agreement gave rise to multiple rights for the Developer, of which one of them was to construct an area, a part of which could be sold to third parties, which could be sold not only as such but also along with the undivided share of land. The Petitioner did not stand on any distinct platform compared to the third parties who would have availed the services of the Developer as a service provider.

Consequently, the writ petition was dismissed by the Hon'ble High Court of Madras.

Point to note:

The issue pertaining to levy of Service tax on the builders/developers constructing residential complex under an agreement to sell, was a much debated issue for a long time. Thereafter, the Government settled the issue of taxability on the builders/developers vide **Circular No. 108/02/2009-ST dated January 29, 2009**, clarifying that any service provided by the seller i.e. the builders/developers in connection with the construction of residential complex till the execution of relevant sale deed would be in the nature of 'self – service' and consequently would not attract Service tax.

However, vide the Finance Act, 2010, effective from July 1, 2010, another gateway was created to charge Service tax from the builders/developers on constructions services towards the sale of property before the completion certificate. The Finance Act, 2010 created a legal fiction by adding an explanation to the definition of 'Construction of complex services' under Section 65(105)(zzzh) of the Finance Act, thereby stating that the *construction of a complex which is intended for sale, wholly or partly, by a builder or any person authorised by the builder before, during or after construction (except in cases for which no sum is received from or on behalf of the prospective buyer by the builder or a person authorised by the builder before the grant of completion certificate by the authority competent to issue such certificate under any law for the time being in force) shall be deemed to be service provided by the builder to the buyer.*

Later on, the CBEC vide **Circular No. 151** issued clarification on levy and collection of Service tax on construction services under varying business models such as tripartite business model, joint development agreements and BOT projects. The Circular, *inter alia*, provides manner of determination of value of construction service provided to land owner in terms of Section 67(1)(iii) of the Finance Act read with Rule 3(a) of Service Tax (Determination of Value) Rules, 2006, i.e. equal to value of similar flats charged to other buyers.

Furthermore, based on the recommendation of High Level Committee set up by Ministry of Finance, the **TRU Instruction No. 354**, has clarified that in valuing the services of construction provided by a builder/developer to a landowner, who transfers his land/development rights to builder, for getting, in return, constructed flats/dwellings from builder/developer, the

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Service tax assessing authorities should be guided by the Board Circular No. 151 and not by the Education Guide.

The above dismissal of SLP by the Hon'ble Supreme Court confirms levy of Service tax on flats given by the builders/developers to the land owners in lieu of development rights.

Hope the information will assist you in your Professional endeavours. In case of any query/information, please do not hesitate to write back to us.

Thanks & Best Regards

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