

Service Tax Liability on Land owners share

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The prohibitive cost of land in major cities means a high investment of monies for developing any property. Finance constraints add to the challenge. Therefore, in the case of construction projects, it is common to enter into joint developments agreements where the developer undertakes to develop property (residential / commercial) in exchange for the development rights. The constructed property would be shared between the land owner and the developer at agreed ratio. Service tax implication on such share of property handed over to landowners has been subject matter of debate from 2012. In this article, we examine the service tax implication.

Service tax law went through a substantial change after the introduction of negative list tax regime from 01.07.2012 as against earlier positive list taxation. Therefore, it would be important to discuss the service tax impact before and after 01.07.2012 with more emphasis on impact after negative list introduction.

SERVICE TAX IMPACT BEFORE 01.07.2012

There are various reasons to contend that the service tax is not applicable on land owners share till 01.07.2012. The CESTAT in case of *Purvankara Projects Ltd Vs CST Bangalore (2010-TIOL-28-CESTAT-Bang-Stay)* held that construction of flats and transferring them to land owners who are co-builders in exchange for land received from them cannot be held to be any service.

The joint development agreements entered assume the character of a joint venture as the land owner brings in the land and the developer brings experience for construction and sale of properties with motive of profit. Service tax would get attracted only when there is a service provider and the service receiver. In a joint venture, the concept of mutuality prevails in as much as there are no two parties involved. It can also be argued that this is a transaction of barter where one gives land to get constructed property.

Further, there was a circular no.108/2009-ST wherein it was clarified that the residential complex constructed would be not be liable for service tax when the constructed property was meant for personal use / renting by the land owners.

However, vide Circular no.151/2/2012-ST, it was clarified that service tax is payable on the construction services of land owners share post 1.7.2010 in case any part of the payment / development rights of the land was received by the builder/ developer before the issuance of completion certificate and the service tax would be required to be paid by builder/developers even for the flats given to the land owner. This particular view of liability was not supported in any of the charging sections in the Finance Act 1994.

This clarification was issued after an explanation was inserted to construction service definition from 01.07.2010 which sought to tax the **sums** received by builder prior to grant of completion certificate. The intention of introducing this explanation seems to tax the amounts received by developers from customers and not land / development rights received from landowners.

The tribunal in case of *LCS City Makers Pvt. Ltd. Vs. CST [2013 (30) STR 33]* held that construction of residential complex where land owner transferring part of his rights in land to builder is a service liable for tax. The department could also argue that non-monetary consideration is also liable for service tax in terms of service tax valuation provisions. However, as the decision is of the Tribunal, it is still possible to argue that there is no liability on land owners share for reasons discussed in earlier paragraphs.

SERVICE TAX IMPACT AFTER 01.07.2012

After introduction of negative list of taxation from 01.07.2012, also developers may argue that this is an exchange of immovable property and excluded from the definition of “service”. However, in the decision of SC in case of *L&T Vs. State of Karnataka 2013-TIOL-46-SC-CT-LB* para no.111 it was held that works contract is involved even in case of development agreements with the land lord. Next issue is in respect of valuation or point of taxation covering the transaction in question. There is a discussion on valuation in Education guide issued by CBEC in June 2012 and in circular 151/2/2012-ST which are contradictory. These clarifications have created confusion with respect to valuation which would discuss in subsequent paragraphs.

Valuation of flats given to land owners

In the Education guide, it had been clarified that the value of flats given to landowners would be **land value** when transferred. (Date of JD agreement) However, in circular 151/2/2012-ST, it was held that in case of flats given to land owners the value is determinable in terms of Section 67(1)(iii) read with Rule 3(a) of Service Tax (Determination of Value) Rules, 2006, as value of land / development rights in the land may not be ascertainable ordinarily.

Section 67(1) (iii) provides that in case provision of service is for an unascertainable consideration, then such consideration is to be determined in the prescribed manner. Rule 3(a) of the Service tax (Determination of Value) Rules 2006 prescribes that value of such taxable service shall be equivalent to gross amount charged to provide similar service to any other person in the ordinary course of trade. Accordingly, the value of these flats would be equal to the **value of similar flats** charged by the builder/developer from other normal customers.

It was also clarified that in case the prices of flats undergo a change over the period of sale (from the first sale of flat in residential complex to last sale of the flat), the value of similar flats as are sold nearer to date on which land is being made available for construction should be used for arriving at the value for the purpose of tax.

The assessee was not clear whether to consider land value or similar flat value for the purpose of payment of service tax. From nowhere, Ministry of Finance- TRU issued an instruction F.No.354/311/2015 on 20.01.2016 to clarify that the Education guide should not be relied as it is not correct and the circular 152/2/2012 would hold good for payment of service tax on land owners share.

It appears that the clarification was issued to generate more revenue as cost of land would be much lesser than the flats constructed. Even otherwise, the circular was issued much prior to 01.07.2012 and the valuation provisions got amended from this date with respect to abatement. It could be contended that the circular is not valid after 01.07.2012. The revenue has tried to give rebirth to circular 151/2/2012 after realising the difference after almost 4 years.

The advisable option for the assessee which could be accepted by the department is to discharge service tax on value of the first flat agreed to be sold. This value would be on all the flats handed over to landowners at any point of time to the extent relating to the construction portion.

Point of Taxation for payment of service tax

With respect to point of taxation, circular 152/2/2012 indicates that the valuation is based on date of transfer / conveyance of the finished flats to landowner. However Para 6.2.1 of the Education guide expressed a view that such valuation is to be based on the value of land transferred by landowners to developers as on date of transfer of land.

The date of transfer of land would be usually the date of joint development agreement. Therefore, education guide suggested for payment of service tax considering date of transfer of land whereas circular suggested that the point of taxation is date on which the flats are transferred / conveyed to the landowners by the developers.

For the purpose of service tax, the point of taxation shall be determined as per Rule 3 of Point of taxation Rules. According to this, point of taxation shall be earlier of following:

- Date of issue of invoice for service provided;
- If invoice is not issued within 30 days of completion of provision of service, then it is the date of completion of provision of service;
- If payment is received before date of issue of invoice or completion of service, then it is the date of receipt of payment.

In case of transactions between landlords and developer, the system of issue of invoices would not be there. Therefore, out of the three events listed date of receipt of consideration or date of completion of service would be relevant. Based on this it could be argued that point of taxation is the date on which development rights are received by him as developer gets land. A view could be taken that service tax is payable on guidance or market value of the land which is the consideration received. This view may not be accepted by the revenue due to their reliance on the circulars. It maybe noted that a circular cannot lay down the law. If not in line with the law it is not legally valid.

Circular no.151/2/2012-ST clarifies that point of tax is at the time when the possession or right in the property of the flats are transferred to land owner by entering into a conveyance deed or similar instrument (Ex: Allotment letter). Therefore, it is ideal to pay the service tax at the time of transfer of development rights in flats. In case any flats are sold in between by the landowner, then the service tax can be paid proportionately considering such agreement to sell as point of taxation. For flats handed over after construction the first sale value could be considered in line with the circulars.

Conclusion: The intention of the revenue seems to be to collect as much service tax on landowners share as possible. It would be prudent to discharge the service tax at least for agreements entered into after 01.07.2012 onwards. The developers are advised to bring this aspect (issue) to the owners to be able collect the service tax on their share and pay to exchequer. The land owners selling before completion of construction can also recover the tax

from the buyers of their share. They can adjust the service tax collected against the service tax as set out in the developers bill while making the payment to the exchequer. The tax could be paid under protest intimating the department with a hope that some relief would be granted in future due to court rulings.

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