Service Tax Implications of Plotted Development

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In this article we would examine what would be the effect of some services activity conducted in the course of a sale of immovable property in general and development of plots in particular. Consequently the impact of service tax. We also examine the service tax implications along with few possible issues arising out of thelegal developments.

Background

The scheme of taxing powers set out in Constitution of India specifies that the power to tax is distributed between Union and State (some of which are covered by both as well). These are set out in three lists in the Seventh Schedule to the Constitution of India. Accordingly, if the subject matter is covered under List I to the said Seventh Schedule, then the Union Legislature has powers to legislate it. On the other hand if the matters are covered under List II of the Schedule, then the State Legislature has powers to legislate and if it is covered by List III, both State and Union has powers to legislate.

In so far as Immovable property[lands and buildings] related transactions are concerned, only the State has the powers to legislate. The Central Government cannot infringe on the power of the State. Taxes on property are the jurisdiction of the State. However the different aspects of the transactions could be taxed by the Centre like Income from Immovable property under Income Tax and Service portion of the sale of immovable property as well as goods involved in a composite contract which involve land, goods and services.

The L & T decision 2013-TIOL-46-SC-CT-LB, affirming K Raheja decision 2006 (3) STR 337 (SC), has held even an agreement to sell an immovable property would be treated as a ‘works contract' as long as, amounts are received from the prospective buyer prior to the completion of the construction, as this transaction would also be a ‘works contract' coupled with a transaction involving sale of immovable property.In light of L&T decision, amounts received after entering into the contract with buyersbefore completion of construction would be treated as works contract in VATand consequently service tax.

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Models of plotted development

The common modes in which the plotted developmentsareundertaken in Karnataka could be as follows:

1. **Joint Development Projects:** In respect of Joint Development projects, the developer would take limited possession of land from the owner, through Joint Development Agreement, for purposes of plan sanction and infrastructural development. After sanction form the local authority land is convertedinto sites.
2. **Partnerships / SPV:** Where there is more trust between the landlords and developers they may form a partnership/ SPV for each project to avoid cross charges of Stamp duty, VAT or Service tax.
3. **Own projects:** Developer procures the land and develops the same and then sell the land owned by developer.
4. **Mixture of all above with different parties is also possible.**

The JD route presently has been found to be favoured as neither the landlord nor the developer needs to invest substantial amount of monies in the project. As and when the plot is getting developed as per the terms of plotted development in the Municipality, Local Boards or Panchayatsetc, these Government / Authorities release parts or whole of the land and consequently those plots are saleable and loans against the same are possible. In Bangalore now using loan to procure a plot has become quite common. Using this monies development is completed in stages.After the amendments to both the direct tax and indirect tax laws seeking to collect tax at the earlier point of time without considering the realities of business, the partnership/ SPV route may gain favour. Judicial ruling for directions do not exist.

In normal course the sale of the individual plots [developed/ in progress] could be under the following options:

a) **Direct Registration of plot:** This can be done only for completed plots.[practicallyin majority of cases only left over unsold plots or plots retained for land value appreciation].

b) **Agreement of Sale of Completed Plots:** Only one agreement to sell the plots normally providing for enough time for the buyer to arrange his finances. [normally through bank/ NBFC] Then go for the registration of the

plot.[Possibly where there is no/ minor difference between the guidance value fixed and the market value.At times the value in sale deed and agreement value there could be a difference which could be a cause of concern].

c) **Agreement of sale of Completed Plots while development of sites under progress:** Where the site is not complete a single agreement for sale plot in future with specified facilities such as roads, park, club house, trees…. Once complete go for registration of the plot. [At times as in b) above there could be a difference in value].

d) **Two Separate Agreements for sale + development:**One agreement to sell land and another to recover development costs.[These are cases where there is a difference between the guidance value and market value + developers offers/ buyer invariably wishes to register at a lower value but need to raise the money from the bank].

In the view of the paperwriters, when certain portion of amount is not accounted as sale of land, instead it is called as development charges, there could be demand of service tax alleging why and how the same can be considered as sale of land when it is not forming part of the value of sale deed as registered with registering authorities.

The liability under Stamp Act would continue in case of difference and with increased transparency which is the order of the day, this window of saving of stamp duty may close in some time.

Service tax and development works position upto 01.07.2012

Prior to the negative list, in order to attract service tax levy, the service involved must be taxable i.e. finding a mention under any of the sub-clauses of Section 65(105) of Chapter V of Finance Act 1994 as amended from time to time. There was no taxable service category covering specifically plotted development.

However Section 65(97a) covered at that time"Site formation and clearance, excavation and earth moving and demolition" *includes,-*

(i) Drilling, boring and core extraction services for construction, geophysical, geological or similar purposes; or

(ii) Soil stabilization; or

(iii) Horizontal drilling for the passage of cables or drain pipes; or

(iv) Land reclamation work; or

(v) Contaminated top soil stripping work; or

(vi) Demolition and wrecking of building, structure or road,

but does not include such services provided in relation to agriculture, irrigation, watershed development and drilling, digging, repairing, renovating or restoring of water sources or water bodies."

While considering the fact that the scope of the words "site formation" is defined in inclusive manner the revenue could take a view that said taxable services category covers the activity of development of residential sites though within development a small part [5-10%] could be site formation.

The reality is that large amount of the infrastructural development activity would be on the Governments property like roads, parks, water lines/ tank all of which is put up in the part of the property is ceded/ gifted to the Government.

Further the service tax is leviable on the value of taxable services. The land costs recoveries are not liable to service tax. This was also clarified in TRU letter No.1/06/2005-TRU. It was also clarified in Circular no. 151/2/2012-ST that land is not liable to service tax.

Though there is no clarity on applicability of service tax on development activityerring on side of caution, developer could decide to pay service tax.

The accounting (costing) records + the certificate of chartered engineer could be used to arrive at the values of the development works of nature of exempted works of road, its drains and allied works which are exempted from service tax. On the balance the developers could chose to pay service tax.

Position post 1.7.2012

Under negative list based taxation all services, other than those mentioned in negative list or a subject matter of exemption is liable to service tax. The term "Service" is defined to mean **any activity carried on by any person to any other person for consideration** and **includes declared services** but shall not include an activity which constitutes *merely transfer of 'TITLE' in goods or immovable property* by way of sale, gift or in any other manner.

Concept of transfer of title:

The 'service' definition contains certain exclusions. The exclusions cover at clause (a). i.e. *'Transfer of **title in goods or immovable property**, by way of **sale, gift** or in any **other manner**'.*

The word/phrase 'merely' assumes significance. The meaning of the word merely as per Oxford English Dictionary is 'just' 'only'. P RamanathaAiyer Concise Law Dictionary refers 'merely' is a term which is to be given a reasonable construction according to the subject matter.

From this it is clear that the transaction shall be out of service tax net only if the activity is exclusively dealing with transfer of title in goods or immoveable property or actionable claim. If the transaction is coupled with another activity then this exclusion cannot be applied and consequently the transaction shall be subject matter of service tax. The above clause specifically excludes a transfer of 'TITLE' in immovable property.

Service Tax and development works post 1.7.2012

Whether the development works done by developers post 1.7.2012 is liable to service tax?When the amount towards infrastructure/development costs is being received in stages prior to completion of construction from the buyers, it could be treated as a works contract liable to service tax. This is supported by view expressed in L&T given supra.

As discussed earlier, the road works were exempted from service tax under earlier service tax law. Same exemption is continued in negative list based taxation as well in Sl.no.13 the exemption notification no.25/2012-ST provides exemption for the Services provided **by way ofconstruction,** erection, commissioning, installation, completion, fitting out, repair, maintenance, renovation, or alteration of,-

a) **a road**, bridge, tunnel, or terminal for road transportation **for use by general public;…….**

In this regard reference is made to the concept of bundled service explained under Section 66F which gives guidelines for interpretation of the service tax provisions. Under the said provision if in ordinary course of business, one service is naturally provided in combination with another service or services; it is treated as the providing of a service which gives the bundle its essential character. Here **the essential character of the arrangement is to develop the property and not the construction of road**. If this view were taken the exemption cannot be availed on that count. This could be the revenue view.

Further an argument is there that exemption could be claimed at sl no. 12(a) in respect of development works such as parks transferred to Govt/local authority. Same exemption continues post 1.4.2015, when stamp duty has been paid on such contract

entered earlier to 1.3.2015. **The revenue could dispute citing contract is not entered by developer with Government/local authority. This exemption could be claimed under intimation to dept.**

In paper writers view, erring on caution service tax could be paid on 40% of development works after deducting road and allied works. The value of road works to be arrived at based on chartered engineer certificate.

Implications for each model:

Joint Development Projects:

Till 1.7.2012

It may not be taxable earlier to 1.7.2012 for following reasons:

a. JDA for development of layout arrangement was nowhere set out in any of the taxable services category of section 65(105).
b. Though post 1.7.2010 service tax is levied on the construction and sale of **building** by builder where any **sums are received prior to completion certificate** as the developer would not be receiving any sums towards construction and sale of buildings from land owner earlier to completion certificate. Not liable to service tax.

In paper writers view, for reasons given earlier, there maybe be no service tax liability on JDA entered till 1.7.12 at all. In the light of the recent decision of BalaBaskarVs. CST(2016-TIOL-824-HC-MAD-ST) where in it was held that exchange of undivided land with builder for developed area amounts to service. The decision of BalaBaskar being a High Court decision, this hasonly persuasive value in other States including JD entered in Karnataka. However citing this decisionthe revenue could demand service tax from builder. The period of limitation may also be invoked as matter was not clear earlier.

Post 1.7.2012:

Post 1.7.2012 service tax is leviable on consideration received towards construction of complex intended for sale to buyer before completion certificate. Consideration is a wider term than sums[could include non-monetary as well], the revenue could treat land as a consideration towards civil structures of development works, and demand service tax on the same.

When developer takes call to pay ST, in respect of JD agreement, the invoice is not issued nor any amount received by the developer from LL. Therefore the ST liability could arise on developer on proportionate sites of LL's share, at the point at which LL sells his portion (or part) to end customer before completion. In respect of the unsold plots, ST liability could arise, when the development is completed and possession handed over to the LL.

The valuation could be done on one of following basis:

a. **Guideline value of the land**: The date of JD is the first point of time when development service is agreed to be provided by the builder to LL. The guidance value of undeveloped land as on date of entering JD could be adopted. However Revenue may dispute that. [GVxSft ceded to Builder.] The defense is that you have adopted the Government value which should be accepted.

b. **Alternatively the** market value of undeveloped land [in that area] as on date of entering JD could be a defensible option. A certificate from a qualified valuer referring to the standards adopted may be taken. [MVxsft ceded to Builder]. These first 2 options could lead to least outflow of tax for developer. Further defense that higher amount offered to tax.

c. **Construction cost**: This is set out as alternate option in Rule 3 (b) of Valuation Rules to arrive at the equivalent money value of such consideration. [Cost of Development x sft allocated to LL]. In our view the words used is cost therefore margin may not be required to be added. The defense is that it is as per the rule.

d. **First sale price of the similar services**: This would be under Rule 3 of ST Valuation Rules. Value of similar plots booked [say bhoomipoojaor any day] nearer to the date on which land is being made available for development could be used for arriving at the value for the purpose of tax. Circular 151/2/2012-ST has also clarified similarly. **This option is ideal and may avoid disputes**

e. ST could be paid on 40% of value arrived at above under one of earlier options after deducting value of road works.

Own projects:

This is a transaction in immoveable property, it is not liable for period earlier to and post 1.7.2012.

However if developer receives any payments towards development earlier to completion the revenue could demand service tax. He could opt to pay service tax excluding value of land+roads and other immoveable property. Pay only on balance. This should be clear in the agreement/ subsequent documentation is any.

Service tax implications of Sale of Plots under various options

Direct Registration of plot:

It may not be liable for period earlier to and post 1.7.2012 as it is sale of immoveable property. It is not liable to service tax.

Agreement of Sale of Completed Plots:

It may not be liable for period earlier to and post 1.7.2012 as it is sale of immoveable property. It may not be liable to service tax.

Agreement of sale of Completed Plots while development of sites under progress:

The agreement to sell land which is for sale of immovable property of land is clearly excluded from service tax levy as it is a mere transfer of immoveable property.

At same time, when development is in progress citing decision in L&T mentioned at supra, the service tax could be demanded on sums received after entering agreement.Based on documentary evidence to prove what was transferred was immoveable property of developed land. It would not be liable to service tax

Two Separate Agreements for sale + development:

The agreement to sell land which is for sale of immovable property of land is clearly excluded from service tax levy as it is a mere transfer of immoveable property.

The service tax could be demanded on the development agreement. Pay service tax only on the balance after deducting registered value of land and road works.

In this article paper writers have examined the service tax implications of plotted development. For further queries may host on pdicai.org or contact at madhukar@hiregange.com or roopa@hiregange.com.