

Service Tax Implications on Arrangement under Construction Projects

Relevant Definitions:-

Service: Service means any activity carried out by a person for another person for consideration and includes a declared service.

Residential Complex: "residential complex" means any complex comprising of a building or buildings, having more than one single residential unit;

Single Residential Unit: "single residential unit" means a self-contained residential unit which is designed for use, wholly or principally, for residential purposes for one family.

Works Contract: "Works Contract means a contract wherein transfer of property in goods involved in the execution of such contract is leviable to tax as sale of goods and such contract is for the purpose of carrying out construction, erection, commissioning, installation, completion, fitting out, repair, maintenance, renovation, alteration of **any movable or immovable property** or for carrying out any other similar activity or a part thereof in relation to such property."

Original Works: "original works" means all new constructions; additions and alterations to abandoned or damaged structures on land that are required to make them workable; erection, commissioning or installation of plant, machinery or equipment or structures, whether pre-fabricated or otherwise.

Valuation of Service Tax Liability in Case of

Construction Contracts

✓ As Per Notification 26/2012

Description of Taxable Service	Abatement %	Taxable Value %	CENVAT on Capital Goods	CENVAT On Inputs	CENVAT On Input Service

Construction of Complex, building except where entire consideration is received after issuance of completion certificate					
(a) residential unit having carpet area of 2000 Sq. ft. and where the amount charged in respect of such unit is less than rupees one crore	75	25	Yes	No	Yes
(b) Other than (a)					
	70	30			

As per Rule 2A of Service Tax Rules, 2006

- ✓ In case of **original work**, service tax is payable on **40%** value,
- ✓ In case of maintenance or repair or reconditioning or restoration or servicing of any **goods**, service tax is payable on **70%** value,
- ✓ In case of all other works contract, service tax is payable on **60% value**.

Service provider is also eligible to avail CENVAT Credit of input services and capital goods.

Exemptions Available in Construction Activity

- ✓ A single residential unit otherwise than as a part of a residential complex.
- ✓ Low-cost houses upto a carpet area of 60 square meters per house in a housing project approved by competent authority.

Construction Activity

Construction activity finds its place in deemed service under the proposed section 66 E. As per section 66 E(b) the following service shall be held as deemed service and service tax shall be applicable on the same.

Erstwhile construction activity was broadly covered under three heads:

- a) Section 65(105)(zzq)- Commercial or industrial Construction

- b) Section 65(105)(zzzh)- Residential Complex
- c) Section 65(105)(zzzza)- Works Contract

The above classification though removed but still prevails and is being followed by the industry.

- Construction includes additions, alterations, replacements or remodeling of any existing civil structure.

The department through the circular no. 151/2/2012-ST dated 10 February, 2012 had clarified service tax positions on some of the arrangement between the builder/developer, landlord, investors, contractors and end buyers in Residential, Commercial or Industrial projects.

Many issues have been raised in past seeking clarification regarding levy of service tax on construction services in light of various business models. Across the country, divergent business model and practices are being followed in the construction sectors which are as follows:

Tripartite Business Model

In this model, there are **three parties** involved: (i) landowner; (ii) builder or developer; and (iii) Contractor who undertakes construction. In such cases **two important transactions** are identifiable: (a) sale of land by 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 the buyers: normally in cash.

Service Tax Implication:

- No service tax is imposed on sale of land by the landowner as it is mere sale of Property.
- No service tax was imposed on construction service provided by the builder/developer before 01.07.2010.
- Construction service became taxable w.e.f. from 01.07.2010 in case any part of **payment/development rights** of the land was received by the builder/developer **before the issuance** of completion certificate.
- In case land is received from the landowner in consideration of some flats, service tax is payable on the value of flats offered to the landlord.
- Service Tax to be paid on advance received on bookings of flats when flats are under construction.

For Example: M/s A Ltd. entered into collaboration agreement dated 01.02.2014 with M/s B Ltd for developing and constructing a residential project. In consideration of B contributing land and A carrying out the development & construction on said land, total developed super-built area shall be shared between them as under:

- A Ltd. – 65%
- B Ltd. – 35%

S.no.	Nature of Transaction	Taxability
1	Granting of development rights to A by B	No service tax liability arises as the same would amount to sale of immovable property.
2	35% share of B as consideration towards development rights	The same is eligible to service tax @4.944% or 12.36% on labour portion
3	Sale of residential units pertaining to 65% share by A where amount is received before obtaining completion certificate.	Taxable @3.09/3.708% to be deposited on registration no. of A
4	Sale of residential units pertaining to 35% share of B where amount is received before obtaining completion certificate.	Taxable @3.09/3.708% to be deposited on registration no. of B
5	Services provided by A to B by way of assisting in sale of units pertaining to the share of B	Taxable @12.36%
6	Recovery of Market, advertising and other expenses from B, in case B share of units sold by A	Taxable @12.36%
7	Availability of CENVAT credit to A	CENVAT credit of service tax paid on Input Services and duty paid on capital goods shall be available and CENVAT on "Input" shall not be available to A
8	Availability of CENVAT Credit to B	Same as above Further, CENVAT Credit of service tax charged by A (in respect of 35%) share shall also be available.

Joint Development Agreement Model

Under this model, landowner and builder/developer join hands and may either create a new entity or otherwise operate as an incorporated 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.

Service Tax Implication:

- As per explanation to Sec 65 of the Finance Act, 1994 the taxable service provided or to be provided by any unincorporated association or body of persons to a member thereof, and such an entity would acquire the character of a "person".
- The transaction between it and the other independent entities will be taxable service based on the nature of transaction.
- Whereas, in case the character of a "person" is not acquired in the business transaction and transaction is as on principal-to-principal basis, the tax is leviable on either of the constituent members based on the nature of transaction and as per the rules of classification of service as embodied under Sec 65A of Finance Act, 1994.

Example1: If A Ltd. and B Ltd. Join hands and create a partnership entity to construct and develop the land of A Ltd. It is decided that the out of 150 flats to be constructed, 100 flats would be allotted to A Ltd. and 50 flats will be allotted to B Ltd. Discuss service tax liability of the same.

Reply1: The flats allotted to both A Ltd. as well as B Ltd. would subject to service tax as they would be treated as independent entities receiving construction service from the partnership entity.

Example2: In the above case, what would be service tax liability in case partnership entity is not formed?

Reply2: In case a separate entity is not formed, the services provided by B Ltd. on the land subject to the flats allotted to A Ltd. would subject to service tax and the flats allotted to B Ltd. would not attract service tax as it would be considered as self service.

Build Operate Transfer Projects

In this case, 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, for upfront lease amount or payment of annual charges.

Service Tax Implications:

- The government is providing '**Renting of Immovable Service**' (renting of vacant land to be used for business or commerce) and hence becomes service receiver.

- In case independent contractor is engaged by the concessionaire for undertaking construction, service tax would be payable on the construction service provided by the contractor to the concessionaire.
- The concessionaire will not be treated as service provider in case he is undertaking construction by himself since such construction has been undertaken by him on his **own account** and he remains the **owner of the building** during concession period.
- Where concessionaire enters into agreement with several users for commercially exploiting the building developed/constructed by him, during the lease period, he would be providing taxable services such as 'Renting of Immovable Property Service', 'Business Support Service', 'Management, maintenance or repair service', 'sale of space for advertisement', etc to the users depending upon the agreement and hence, service tax would be liable on the taxable services provided by the concessionaire to the users.

Example1: Government by an agreement transfers the right to develop a land to M/s. ABC Ltd. for a period of 25 years in return for a lease amount of Rs. 20,00,000 annually. M/s. ABC Ltd. undertakes the construction by itself. Discuss tax liability of government and M/s. ABC Ltd. in this case.

Reply1: Government would be liable to pay service tax @12.36% under 'renting of immovable property' service and M/s. ABC Ltd. (Concessionaire) is not considered as a service receiver in the above case as construction is undertaken by him on his own account and hence not liable to pay service tax.

Example2: In example 1, if M/s. ABC Ltd. instead of undertaking construction by itself engage M/s. Raksha Ltd. (contractor) , what would be service tax liability in this case.

Reply 2: Service tax will be payable on the construction service provided by M/s. Raksha Ltd. to M/s. ABC Ltd. @3.09/3.708%.

Investment Model

In this case, specified area of construction is earmarked, or a flat of a specified area is allotted to the investors, who invest in the project before commencement. Additionally in some cases the investor may also be promised fixed rate of interest. After a certain period of time, investor has the option to exit from the project on receipt of amount invested along with interest or resell the said allotment to some other buyer.

Service Tax Implication:

- Investment amount is to be treated as advance to the builders for the construction services and hence subject to service tax.

- Builder/Developer can take credit under rule 6(3) of the Service Tax Rules, 1994 to the extent of amount refunded in case investor decides to exit from the project later on.
- In case, builder again resells the flat before the issuance of completion certificate, service tax would again be payable.

For example: Modi Builders allots 300 flats under construction to the M/s. A Ltd. , who invests in the project before commencement and gets 10% return on the amount invested on 01.04.2013 and withdraws the respective amount on 01.02.2014 . Modi builders resell the flats to Hussain Ltd. before obtaining completion certificate. Discuss service tax liability in this case. Also discuss if A Ltd. instead of withdrawing the respective amount resells the flats to XY Ltd.

S.no.	Nature of Transaction	Taxability
1	Amount Invested by A Ltd. in 300 flats	Taxable @3.09/3.708% to be deposited on the registration no. of Modi Builders
2	In case, A Ltd. again sells the flats to XY Ltd.	No Service Tax would be chargeable
3	Reversal of service tax paid on the advances received by Modi Builders	Modi builders would be entitled to take credit under Rule 6(3) of the Service Tax Rules, 1994 to the extent of amount refunded to A Ltd.
4	Reselling of 300 flats to Hussain Ltd. before obtaining completion certificate	Taxable @3.09/3.708% to be deposited on the registration no. of Modi Builders
5	Availability of CENVAT to Modi Builders	CENVAT credit of service tax paid on Input Services and duty paid on capital goods shall be available and CENVAT on "Input" shall not be available to Modi Builders

Re-development Including Slum Rehabilitation Projects

In this model, society or its flat owners engage builder/developer for undertaking reconstruction for the land owned by them and builder constructs new flats with same or different carper area for original owners of the flats. Builder/Developer gets consideration through transfer of development rights over land. The builder/developer may additionally be involved in one or more of the following:

- ✓ Construct some additional flats for sale to others.
- ✓ Arrange for rental accommodation or rent payments for society members/original owners for stay during the period of reconstruction.
- ✓ Pay an additional amount to the original owners of the flats in the society.

Service Tax Implication:

- Re-construction undertaken by the building society by directly engaging builder/developer will not be chargeable to service tax as it is meant for the personal use of the society and its members.
- Construction of additional flats undertaken for sale to end customers/buyers became taxable w.e.f. 01.07.2010 in case any part payment is received from them before the issuance of completion certificate.

For Example: Flat owners of Apoorva Housing Society engage builder i.e. M/s Sun Buildprop (P) Ltd.(herein after referred to as 'Sun') for reconstruction of 105 flats where all construction related costs would be borne by the Sun. The Sun constructs some additional flats say 15 flats for sale to others and arrange rental accommodation for the members of the society.

S.No.	Nature of Transactions	Taxability
1	Reconstruction undertaken by Sun for the members of Apoorva Housing Society	Service Tax is chargeable as works contract service@4.944%or 12.36% on labour portion.
2	Sale of 45 additional flats constructed, in case payment is made to Sun before the issuance of completion certificate	Taxable @3.09/3.708% to be deposited on registration no. of Sun
3	Services provided by Sun in arranging rental accommodation for society owners for stay during the period of re construction	No Service Tax Payable
4	Availability of CENVAT credit to the Sun	CENVAT credit of service tax paid on Input Services and duty paid on capital goods shall be available and CENVAT on "Input" shall not be available to Sun