

## **BASIC INFORMATION ABOUT TAX ON DEVELOPERS**

The Government of Maharashtra has amended the definition of “Sale” under the Maharashtra Value Added Tax Act, 2002 with effect from 20<sup>th</sup> June 2006 thereby including in the said definition “ the transfer of property in goods involved in the execution of works contract, including an agreement for carrying out for cash or for deferred payment or other valuable consideration, the building , the construction, manufacture, the processing, fabrication, erection, installation, fitting out, improvement, modification, repair or commissioning of any moveable or immoveable property.” As a result of this amended definition, the builders and developers become liable to pay tax on the sale of their under construction flats to the prospective buyers with effect from 20<sup>th</sup> June 2006 in respect of the transfer of property in goods involved in execution of such contracts. However, it is abundantly clarified that if sales takes place after the construction is completed then the tax is not applicable on the sales of such flats or commercial complexes etc.

The constitutional validity of the said amendment was challenged by the The Maharashtra Chamber of Housing Industry and others by way of a writ petition bearing number 2022 of 2007 filed before the Hon’ble Bombay High Court whereby the hon’ble Court was pleased to grant a conditional interim stay with regards to applicability of tax on said sale. But on 10<sup>th</sup> April 2012, the hon’ble Bombay High Court after the final hearing was pleased to uphold the constitutional validity of the amendment made to definition of “Sale”.

Hence in view of this judgment, the applicability of tax upon the builders and developers in respect of the transfer of property in goods involved in execution of building/construction contracts is held valid and the same becomes effective from the date of amendment i.e. 20<sup>th</sup> June 2006.

For the sake of bringing in simplicity of calculation of this tax, The Maharashtra Value Added Tax Act provides for three options to the builders/ developers to discharge their tax liability under any one of this option as under:

**OPTION-1:**As per rule 58 of the Maharashtra Value Added Tax Rules, 2005 the sales price may be determined after deducting from the agreement value; the value of land, labour, chargers for planning, designing, architects fees, hire charges of machinery etc. The tax is computed on the value arrived as above. The tax computed as above is reduced after considering the tax paid on the purchases of building material (i.e. input tax credit). The tax so determined is required to be finally paid.

**OPTION-2:** The rule 58 also provides for the standard deduction at 30% as given in the Table. The deduction towards the land value is taken from the total agreement value, the sales price is computed by further taking standard deductions (@ 30%) as provided in the Table. The tax is computed after applying the schedule rate of tax on sales price so arrived. The tax computed as above is reduced after considering the tax paid on the purchases of building material (i.e. input tax credit). The tax so determined is required to be finally paid.

**OPTION-3:** The section 42(3) of the Maharashtra Value Added Tax Act provides for tax at the rate of 5% on the entire contract value. The developer may opt for this and calculate the tax liability at the rate of 5%. This tax liability is reduced by the amount of taxes paid on purchases i.e. Input Tax Credit. The balance tax liability so computed is to be discharged.

Further, during the intervening period of litigation, various developers associations had made representations before the State Government to bring in a more simplified method of taxation in this respect. Accordingly, the State Government, on examination, announced a scheme and issued a notification. As a result in respect of the agreements made on or after 1<sup>st</sup> April 2010 the applicable tax rate is fixed at 1% of the agreement value.

It is now learnt by the Sales Tax Department on the scrutiny of the books of accounts of certain developers after the passing of the judgment

of the Bombay High Court, that many developers have collected taxes from their customers but have failed to discharge their tax liability by depositing the collected tax into the Government Treasury.

Now considering the three options as discussed above, it becomes apparent that the tax liability of developer for the period 20.06.2006 to 31.03.2010 may come to much less than 5% of the agreement value after adjustment of the available set-off as may be available to him.

The law being clear on the point of leviability of tax upon such developers, it is advised that they discharge their tax liability as may be applicable to them immediately without any further delay.

## **FREQUENTLY ASKED QUESTIONS [FAQs] ON TAXATION**

### **OF DEVELOPERS**

**1.** What is the effective date from which the VAT will be applicable for sale of under constructed flat? -

**Ans:** The VAT is payable from the date of amendment i.e. 20 June, 2006.

**2.** On what type of contracts the VAT is payable?

**Ans:** VAT is payable in respect of sale of under construction flat.

**3.** Whether VAT is payable on the sale of completed flat?

**Ans:** VAT is not payable if a completed flat is sold by the developer.

**4.** How is VAT calculated? Is it on under construction or ready flats?

**Ans:** It is on under construction flat not on ready flats.

**5.** Who has to pay VAT; Flat buyer or Developer?

**Ans:** The liability to pay VAT is on developer.

**6.** Who has to pay VAT if a developer has not told the buyer of VAT to be paid when he purchased flat post 2006?

**Ans:** The developer has to pay the VAT.

**7.** What is the rate of tax under VAT Act applicable for agreement to sell for under construction flats?

**Ans:** Tax rates would be those which apply to the goods in which property is transferred.

**8.** The agreement to sell the flat was executed before 20.06.2006 and the building was under construction and possession is given after 20.06.2006. Whether the VAT will apply in such case because the agreements were executed prior to 20.06.2006? If yes how the sale value will be determined for calculation of VAT? Whether the amount received prior to 20.06.2006 will be exempt from VAT? .

**Ans:** Yes. VAT will apply. It will be levied on value received or receivable after 20th June, 2006.

**9.** Whether the levy of VAT on agreement for under construction flats/ shops etc. is covered with in the amended definition of Works Contract? When is it not leviable?

**Ans:** Yes. It is covered. If the sale is after completion, there is no levy of VAT.

**10.** What are the various options available to the developers for disclosing tax liability?

**Ans:** Developers can discharge their tax liability by any of the following option:-

**From 20.06.2006 to 31.03.2010**

**1. Composition Scheme U/s 42 (3)** - Under this scheme developer has to pay 5% tax on the agreement value. Land deduction is not available. Input tax credit is available subject to the reduction of 4 per cent.

**2. Actual Expense Method U/r 58-** Under rule 58, the deduction of Labour & service charges is available on actual basis. Land deduction is also available. Set-off will be calculated subject to the conditions u/r 53 and 54.

**3. Standard Deduction Method U/r 58-** Under rule 58, the deduction of land cost will be allowed. Thereafter, 30% standard deduction from remaining amount will be available as per proviso to sub-rule 1. Set-off will be calculated subject to the conditions u/r 53 and 54.

**After 01.04.2010**

The developers can opt for fourth option also, under this option u/s 42 (3A), developer has to pay 1% tax on agreement value. No land deduction and input tax credit is available.

Needless to mention that, the developers will be required to make the payment of interest according to the provisions of law.

**11.** Whether the developers will be eligible to claim set-off of VAT paid on purchases?

**Ans:** Yes. The Purchases made on or after 20th June, 2006, will be eligible for set off subject to MVAT rules. However, if the developer opts for 1% composition scheme for agreements registered from 1/4/2010 onwards, then no set off is eligible.

**12.** If composition scheme is not opted then what is the rate of tax and how the sales price will be determined? What are the deductions permissible like labour charges, profit margin etc. In such cases how the set off will be worked out?

**Ans:** Deductions are available as per rule 58. Set-off will be worked out as per rules 52, 53 and 54.

**13.**In the system, return cannot be accepted for old period prior to date of registration. What is the situation?

**Ans:** The periodicity for earlier period will be set manually. Necessary instructions have been issued to help desks. Developers are requested to contact to help desk officer.

**14.**Whether the credit of input tax paid while effecting purchases of materials like cement, iron & steel etc. required to be used in the Construction project, will be available?

**Ans:** Yes, they will get input tax credit of the taxes paid on purchases subject to the set-off rules.

**15.**If an Agreement to Sell is prepared much in advance at the time when a prospective buyer book the accommodation in a building under construction and the developer concerned undertakes to give possession of the accommodation so booked after obtaining completion certificate. At what point of time the VAT under the amended law would be payable?

**Ans:** Tax is levied as and when the installments become due and payable or are received, whichever is earlier.

**16.**Many times mere advances are received and agreement is executed much later. What will be the point of liability whether at the time of receiving the advances or at the time of execution of the agreement or thereafter on possession?

**Ans:** Tax will be levied from the date of the agreement. The amount of advance, as and when it is adjusted towards the agreement amount, will be taxed.

**17.**The builders receive non-refundable deposits and other charges under the agreement such as electricity deposit, water charges, legal

charges, development charges etc. Whether such receipts will also form part of sale price for VAT?

**Ans:** The amounts which are received as deposits will be a deduction to the extent such amounts are actually paid to other authorities.

**18.** In under construction flats, the amounts are received in installments. How the sale price will be determined? Whether the actual receipts will be taken as sales or the whole of the agreement value will be taken as sale at the time of execution of the agreement, even though the amount is yet to be received?

**Ans:** Received or receivable. Receivable means due and payable.

**19.** Can the VAT applicable in above cases be collected by raising a debit note or the same should be mentioned in the agreement itself? Whether VAT should be collected on each installment or at one go upon execution of the agreement?

**Ans:** Yes. It can be collected by raising a debit note. Specific mention in the agreement is a choice of the contracting parties. It will be payable on the installments received.

**20.** Whether any interest or penalty will be attracted for non-registration with sales tax authorities under VAT and non-submission of VAT returns for the transactions executed for sale of flats/ shops under construction between intervening period i.e. 20.06.2006 to 07.02.2007?

**Ans:** Please refer to circular 14T of 2012 Dt. 6<sup>th</sup> August, 2012.



**21.** What will be the VAT implications where mere advances are received from buyers and agreement for sell is not executed with the buyer?

**Ans:** There is no tax liability.

**22.** If a project based partnership firm is created for the project which commenced in the year 2006 and completed in the year 2008 and stands dissolved as on today and the bank account is also closed as of now, then what would be the legal implications of producing the partnership deed that is already dissolved for obtaining MVAT registration?

**Ans:** The developers have to provide evidence for the period when the firm was in existence. The necessary instructions have been issued to the registration authorities. Dealer may contact to respective registration authority in this regard.

**23.** Whether a possession letter or letter from architect can be termed as completion of building. Who is the proper authority to grant the completion letter? Sometimes application for completion is made but completion is granted much later in such case whether date of application is considered to be the date of completion?

**Ans:** Whether sale is of a completed flat is to be ascertained from books of accounts. Necessary clarification had been issued in Trade Circular 12 T of 2007 dt. 7/2/2007.

**24.** In the event where an agreement entered into is cancelled and said flat is sold to someone else and the agreement is again entered. What would be the VAT implication for the first sale and the second one?

**Ans:** If the first sale of flat is cancelled then the subsequent sale of the same flat by the developer is taxable. The tax paid on first sale can be adjusted towards subsequent sale.

**25.** If builder constructs the flat on the land which is owned by land owner and out of the constructed flats some flats are given to land owner and other flats are sold by builder to prospective buyer. Land owner sales the flat afterwards to buyers. In such instance what will be the point of taxation? Whether land owner is liable to pay the VAT on sales of flats which were handed over to him by builder?

**Ans:** Builder is liable to pay tax only in respect of sale of flats to prospective buyers. The flats which are given to land owners will not be taxable. The land owner when subsequently sales the flat will not liable to pay any tax as he is not a dealer.

**26.** Out of the three different methods of tax working, the builders/developers are given option to choose a method of their choice with a restriction that method should be applied to whole of the project concerned and no deviation is permitted. It may happen that in a project having execution period of more than 2 years, there may be possibility that some flats may have been sold before 31.03.2010 and some may be sold after 31.03.2010. In that scenario, whether the flat purchasers who have entered into an agreement after 31.03.2010 will be entitled to pay VAT to the developers @ 1% of Agreement Value?

**Ans:** The composition scheme of 1% is applicable in respect of agreement registered on or after 1<sup>st</sup> April 2010, irrespective of the method adopted for periods prior to 01/04/2010. However, set-off or deductions earlier claimed in respect of such agreements will have to be reversed.

**27.**Most of the development/redevelopment projects involve purchase of Transferable Development Rights (TDR) as these are related to land only, the cost of TDR should also be available as deduction from sale price, along with cost of land.

**Ans:** Yes, the cost of TDR will be available for deduction from sale price along with cost of land.

**28.**A scheme was launched in 2005-06. Major purchases of cement and steel were effected during the year 2005-06. The purchases effected after 20.06.2006 are much lesser as compared to those effect prior to it. Sales of flats were effected during 2007-08, 2008-09, 2009-10 etc. that is after 20.06.2006. Dealer is liable to pay tax on all these sales as there was no completion certificate. Even if he chooses to discharge liability by way of composition @ 5%, he is losing set-off of taxes paid prior to 20.06.2006. In the normal course this set-off is not admissible as per provisions of law. Whether such cases can be dealt with administratively? In addition to taxes whether there will be burden of interest for these old periods?

**Ans:** Developer will not be entitled for set-off on purchase effected prior to 20/06/2006. Interest will be payable in addition to taxes paid.

**29.**If the builders/developers commences project of 100 flats and the said project is sold for three years 2007-08, 2008-09 and 2009-10, like 30 flats in first year, 40 flats in next year and 30 flats in third year. Whether builder/developer is allowed to claim land deduction proportionately in three years or in first year only?

**Ans:** He may claim land deduction in first year or proportionately in three years.

**30.**The builder had sold and registered one flat in January 2010 and three flats in May 2010. Can builder pay VAT for one flat as per Standard Deduction Method u/r 58 and on balance three flat pay 1%? Can he pay 1% tax under Composition Scheme u/s 42(3A) for all the four flats as on today? Can he change the method of tax in same project after 01.04.2010 under Composition Scheme u/s 42 (3A)?

**Ans:** He is not allowed to take benefit of 1% Composition Scheme u/s 42(3A) for flats sold and registered in January 2010. The composition scheme u/s 42(3A) at 1% of agreement value is applicable for agreement entered on or after 01.04.2010.

**31.**In the course of construction project what will be the impact of land cost when it is incurred or paid prior to 20-06-2006 and there is no land cost there after i.e. within the period: 20/06/2006 to 31/03/2010

**Ans:** You may claim the deduction of land cost at the time sales.

**32.**Developer has started construction of a project prior to 01.04.2006 consisting of about 100 units. The work was started in the year 2005 and completed in 2008.

Whether it has to pay MVAT in respect of all the 100 units or only the units sold under construction i.e. 30 units and not on 70 units which have been sold after construction was completed, occupation certificate obtained and documents registered.

**Ans:** The taxability will arise only in respect of transfer of property after 20/06/2006. Please refer to Trade Circular 14 T of 2012 dated 06 August, 2012.

**33.** While calculating the liability for the period from 20/06/2006 to 31/03/2010, some developers have effected purchases in one year and there are no sales in that year. As a result there is a refund. In the second year, there are sales. Can we adjust the refund of first year to second year?

**Ans:** As per the provisions of MVAT Act, refunds cannot be carried forward from one year to next year. However, it has been decided administratively that in respect of developers the carried forward of refund from one year to next year will be allowed for the period from 20/06/2006 to 31/03/2010.

**34.** A buyer has purchased ready flat in April 2006 when no VAT was in place. Building society got formed in 2008/2009. Can the developer ask VAT from such buyers?

**Ans:** Since it is a sale of completed flat, no VAT is payable.

**35.** A buyer has purchased under construction flat in 2009. Following discussions with the developers, he put 5% as VAT to be paid in an escrow account. Will VAT remain at 5% or would the buyers have to shell out extra for interest for not paying VAT over the past three years?

**Ans:** Considering the various options available to developers, the liability may come much less than 5 %. However, the developers are also required to pay interest for late payment of taxes.

**36.** If the buyer refuses to pay VAT more than 5% as per Government's order, does the developer have any right to demand more VAT?

**Ans:** The liability to pay VAT is on developer. It is not contingent on collection by developer. However, whatever option the developer

chooses to discharge the tax liability, the net burden will be less than 5%.

**37.** Was the recent Bombay High Court order in reference to paying 1% VAT?

**Ans:** High Court has upheld the composition scheme of 1% w.e.f. 01/04/2010. Also, the High Court upheld the amendment to definition of "Sale" from 20/06/2006.

**38.** If the Builder, Developer has commenced the construction in 2006-07, initially for two years there was no sales, there were only purchases for first two years, i.e. 2006-07 and 2007-08, the sales agreements were effected in the year 2008-09. Whether the dealer can claim refund for the first two years or can he carry forward the set-off of first two years to next financial year.

**Ans:** He can carry forward the set-off of first two years to next financial year for the period from 20/06/2006 to 31/03/2010.

**39.** If the dealer has effected purchases in one year and part sales of flats has taken place in that year and part of the sales in next year, How the set-off to be granted, set-off to be granted proportionately or full set off in first year.

**Ans:** Set-off is based on purchases. He may claim full set off in the year in which purchase are made. However, if he discharge the liability @ 1% under composition scheme for agreement entered on or after 01/04/2010, then he is required to reverse the set-off proportionately, if it is already claimed.

**40.** In the first year of construction projects, purchases, expenses and land purchases are more in comparison to less sales or less

agreements, therefore whether the Builders, Developers can carry forward the ITC, land Deductions to periods of next year as sales in next year are substantial.

**Ans:** The Builders, Developers can carry forward the ITC; land Deductions to periods of next year for the period from 20/06/2006 to 31/03/2010.

**41.**At what point of time deduction has to be given in respect of value of undivided share in Land u/r 58(1A). Whether such value of land be deducted from first few installments till the value of land is covered and thereafter deduction for payment made (or to be made) to sub-contractors and from the final installments reduction on account of other services (as per Table), or all these deductions have to be apportioned proportionately on all the installments (as and when amount received from the purchaser/s). And the periodic taxable value should be calculated accordingly.

**Ans:** The developer may apply the initial installments towards cost of land.

**42.**During the period 2006-2010, since there are huge purchases of material during 1st year, so developer has to claim refund and after that there are dues due to sell of flats. What will be the position? Can he carry forward his refund to the next year?

**Ans:** Yes. He can carry forward it to next year for the period from 20/06/2006 to 31/03/2010.

**43.**The developers have complained that contrary to the High Court order of 2007 and 2012, sales tax department have erred in considering them as dealers and demanding high tax from them?

**Ans:** Hon' High Court had upheld the amendment to MVAT Act and levy of tax on sale of under construction flats.

**44.**What action is the government planning to take on behalf of consumers if VAT of 5% is collected post 2010?

**Ans:** The excess collection of tax if any shall be liable for forfeiture.