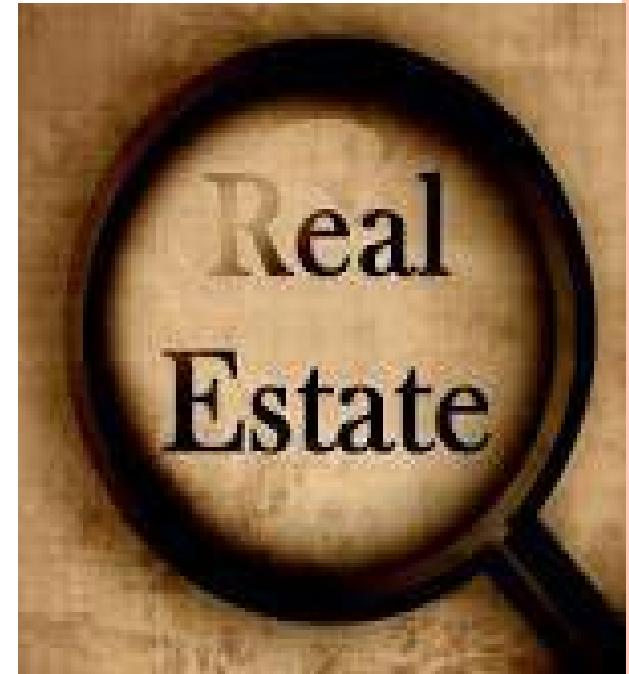


Issues and Challenges faced by Real Estate



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MVAT Applicability on Real Estate



Introduction



- It all began with verdict of Hon'

Karnataka High Court in the matter of

K Raheja Corporation wherein the facts were as follows:-

- Builder entered into two separate agreements with the customers, one for construction and the other for sale of undivided share of land.
- This was probably done with a view to save stamp duty on the value of construction



AN OVERVIEW

- Amended definition of “Sale” under the MVAT Act, 2002 includes
- *“ 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 immovable property.”.*
- Earlier to this Builders and developers were not liable for VAT.
- There are Several Controversies on VAT applicability on sale of Flats.



Sale and Works Contract

SALE

- Main object - to transfer property in a chattel to the buyer as a chattel
- End product is in a deliverable state, has individual existence as sole property of seller



WORKS CONTRACT

- Main object - use of skill and labour and incidental use of materials in work.
- End product has no commercial value and can't be sold as such to anyone or everyone in the market.



Theory of Accretion



- Brick by brick transfer of property
- Property in goods transferred to the contractee on completion of particular stage and not at the end.
- Inherent characteristics of materials used in the particular stage are lost on completion and materials cannot be taken back by the contractor as individual items.



Accounting for Running Bills



- Based on the Theory of Accretion, Running Bills issued by Contractor as and when the work is completed.
- However, Works contract TDS provisions will apply on the Value of that particular work certified by Architect.
- Recognition of profit in the books of contractor as per AS 7 on the basis of Percentage of completion method.

Provisions of Works Contract for main and sub-contractor

- Deductions will be given to either of them only on producing prescribed certificates / declarations i.e. for main contractor Form 406 and 409 to be issued and for sub-contractor Form 407 and 408 to be issued.



Illustration



A contractor has given sub-contract for doing electrical installations where sub-contractor opts for composition scheme but main contractor wants to adopt VAT method. Then determination of sale price will be as under:

Illustration (Cont.)

Particulars	Main Contractor (Amt. in Rs.)	Particulars	Sub-contractor (Amt. in Rs.)
Contract	1,00,000	Contract	80,000
Sub-contract	86,400	Sub-contract	NIL
Net Taxable Value	13,600	Net Taxable Value	80,000
Add: Tax @ 12.5%	1,700	Add: Tax @ 8%	6,400
Sale Price	15,300	Sale Price	86,400

Inherent Property in Goods

- Test to constitute sale under Works Contract Act - whether the property in goods used in the execution of works contract passes to the contractee in its original form or in some other form? – Decision of Bombay High Court in the case of Matushree Textiles Ltd.



Inherent Property in Goods (Cont.)

- Deemed sale of the materials in the execution of works contract when property in materials passes without specific agreement between the parties for sale of such materials.
- Tax on the property in goods, which passes, and not on the remnants or the effluent.



Case Study- Supply of Ready Mix

- **Issue:** Whether such supply is sale or works contract?
- **Our view:**
 1. Ready mix already in a deliverable state
 2. The contractee not under obligation to carry out any work after delivery of goods.



Thus, it is a sale and not a works contract.



Case Study – BOT Projects

- **Facts:** Public – private participation in infrastructural development in form of projects on Build Operate and Transfer (BOT) basis.
- **Issue:** Whether such BOT projects are liable Works Contract Tax?
- **Our View:**
 1. Business Venture, where one time investment is recovered with profit over a period of time
 2. No fixed sale consideration
 3. Study of clauses of agreement

Case Study – Our View BOT Projects

4. Government's property is used for a definite tenure during which no transfer of property takes place.
5. Possession and ownership with Private Companies
6. No privity of contract
7. On completion of tenure transfer of property of immovable nature which is beyond goods taxation.



Hence, BOT transactions are outside the scope of goods taxation laws

Case Study- Sale, erection and commissioning of a lift

- Contract for manufacture, supply, installation and commissioning of lift – works contract – decision of Bombay High Court in the case of M/s Otis Elevators
- However, same is declared as sale by Supreme court in case of Kone Elevators (India) Ltd.
- Contract for sale, erection and commissioning of lift – sale w.e.f. 1 April 2006 and work contract before the said date.



Case Study

FACTS:

- Contract document specifies the value of goods and the value of services separately.
- As per contractor, VAT is leviable on value of goods shown in contract.
- As per Sales Tax Department, value of goods for levy of VAT shall be arrived at by applying principles laid down in case of Gannon Dunkerly & Co. or by abatement method.

Case Study (Cont.)



ISSUE:

Whether STD is justified in adopting above course, ignoring the valuation done in contract documents?

OPINION:

- The contracting parties can specify the element of services separately and the value of goods separately.
- Taxes will be payable on such respective values

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Case Study (Cont.)

OPINION (CONT.):

- The Sales Tax Authorities will not be entitled to club the said amounts so as to arrive at the value by adopting the methods mentioned in the query.
- Thus the valuation done by the contracting party has to be accepted by the Sales Tax Department.
- In case of M/s Imagic Creative Pvt. Ltd., Supreme Court held that if the elements of material and services are determined separately by the contracting parties then the authorities cannot



Issues

Treatment of following purchases while calculating VAT liability.

- OMS purchases
- Imports
- Materials not used in the same form
- Purchases from URD
- Work done by URD contractors
- Exempted Purchases



Issues

- Depending upon the method adopted by the Developer, the VAT liability in respect of each of the aforesaid items is to be applied.
- When following cost of all purchases plus profit thereon, the deductions for the aforesaid items shall be available as per the normal VAT rules.
- In the event of the work done by the URD contractors, the liability to pay the VAT is on the principle Developer.



Issues

Whether work done/stage completed before the Agreement will be taxable to VAT ???



Issues

- The liability of the payment of the VAT is on the “Goods” being incorporated in the works contract. If on the date of Agreement, part of the building is completed, then Goods already incorporated in the immovable property cannot be subjected to VAT with respect to the contract entered with that customer. However, though this should be the legal interpretation and in view that the liability of VAT is collectible from the customer, it is better that VAT is collected and paid till building is completed from the customer.



Issues

Is VAT applicable in case of
Redevelopment and SRA project For
the rehab customers For free sale area
Customers ???



Issues

Any area given free of cost to slum dwellers or tenants, there is no value of goods transferred to the occupiers of the new premises. The premises being given free of cost is under a statute and not as an arrangement between two parties and hence no fair market value can also be affixed to such flats for arriving at VAT. Also amount spent on the Rehab of Tenant area, are in form of FSI cost (land cost) for the Developer. Hence no VAT is payable.



Issues

Flat booked in 2007, OC received in 2008, agreement executed and registered in 2009, is there any VAT Liability ???



Issues

The liability of the VAT will arise, since booking of the flat will be termed as an agreement for sale of flat.



Issues

What will be VAT implications where mere advances are received from customers and agreement for sale is not executed with the customer ???



Issues

Trade Circular 06/08/2012 is not clear however as per FAQ issued by MCHI There is no Tax Liability.



Issues



Flat sold prior to 1st April 2010, afterwards the sale is cancelled and the Flat re-sold after 1st April 2010 Will the liability of VAT be 1% for the second sale? How can refund be claimed / adjusted for the cancelled flat ???



Issues

There are two parts to this. In case of period upto 30.09.2012, all cancellations should be eliminated and VAT should be paid on the actual sale happened. Post 30.09.2012, if VAT is paid on cancelled transaction, then the same should be claimed as refund. Because on the date of agreement, Dealer will not be knowing about the cancellations, and hence VAT would be paid on that agreement. The same shall be claimed as refund on cancellation.



Issues

VAT is liability of the Builder ???



Issues

Section 6 of the MVAT Act provides for the levy of sales tax (VAT). Accordingly, the sale is subjected to tax on the turnover of the sales. The scheme of indirect taxation requires the chain of seller to charge the tax on their sales and ultimately burden of such sales tax / vat is on the buyers / consumers. The Act does not prohibit the seller from collecting the tax from the buyers. Thus the seller, in the present context builder, is allowed to collect the same from buyers. In fact, Section 60(2) prohibits collection of tax in excess of payable on the sale transaction from any buyer. Thus, the scheme allows the seller to collect and pass on the burden of tax to the



Issues

Under rule 58 (1A), how the land rebate per sq feet should be calculated ???



Issues

- The land value shall be deducted as per actual cost or as per the rate available in SDR.
- The method for calculating the land cost can be any of the following alternatives
- The Land value to be calculated as per the SDR or actual cost whichever is higher, divided by the total FSI of the land as certified by architect shall determine the per sq ft land value. The Land value shall be frozen as on the date of the agreement of sale. The FSI consumed in respect of each of the flat is also to be certified as per the plans, The land cost thus is to be deducted by multiplying FSI of the flat with the rate determined as above



Service Tax Applicability on Real Estate



Service Tax Law



- OLD SYSTEM:

The Negative list regime has brought a paradigm shift from the earlier system where only services of specified descriptions were subjected to tax.

- NEW SYSTEM

In the new system, all services (except those specified in the negative list and other services) are subject to taxation. This amalgamation of 118 services under one umbrella has had its share of rewards and pitfalls for the real estate sector.



Taxability

Services provided by Real Estate developers were covered under the gamut of the following 3 categories of services :

- Commercial or Industrial Construction Services
- Construction of Complex Service
- Works Contract Service

