

Service Tax on Builders and Developers

- CA Ritesh Kanodia

History of taxation on construction contracts

History of taxation on construction services

- » Prior to 01.06.2007 - Construction services were taxable under the taxing entries of:
 - › Commercial or industrial construction service – Section 65(105)(zzq) w.e.f. 10.09.2004
 - › Construction of complex service – Section 65(105)(zzzh) w.e.f. 16.06.2005
- » Daelim Industrial Co. Ltd. vs. CCCE [2007] 7 STT 184 (2003)
 - › *“6 Thus a perusal of the clauses of the contract leaves no doubt that the appellant contract with IOC was a works contract on turnkey basis and not a consultancy contract. It is well-settled that a work contract cannot be vivisected and part of it subjected to tax. The impugned order proceeded to do precisely that. Therefore, they are required to be set aside”*
- » Bharat Sanchar Nigam Limited vs. UOI [Union of India [2006 (2) S.T.R. 161 (S.C.)]
 - › *“42. Of all the different kinds of composite transactions the drafters of the 46th Amendment chose three specific situations, a works contract, a hire purchase contract and a catering contract to bring within the fiction of a deemed sale. Of these three, the first and third involve a kind of service and sale at the same time. **Apart from these two cases where splitting of the service and supply has been Constitutionally permitted in Clauses (b) and (g) of Clause 29A of Art. 366, there is no other service which has been permitted to be so split.** For example the clauses of Art. 366(29A) do not cover hospital services Therefore, if during the treatment of a patient in a hospital, he or she is given a pill, can the sales tax authorities tax the transaction as a sale? ...”*

History of taxation on construction services

- » W.e.f. 01.06.2007
 - › Works Contract Service introduced as a separate taxable service w.e.f. 01.06.2007 – Section 65(105)(zzzza)
 - composite activities involving supply of goods (e.g. supply of cement, steel, bricks etc.) and services (e.g. labour involved in construction), would be recognized as works contracts services
- » Judgement in the case of K. Raheja Development Corporation vs.State of Karnataka (2006 (3) S.T.R. 337 (S.C.)
 - *“...if the agreement is entered into after the flat or unit is already constructed, then there would be no works contract. But so long as the agreement is entered into before the construction is complete it would be a works contract.”*
- » Amendment made w.e.f. 01.07.2010
 - › Explanation inserted under the taxing entries of “Commercial or industrial construction service” and “Construction of complex service” w.e.f. 01.07.2010:
 - › *“For the purposes of this sub-clause, construction of a complex which is intended for sale, wholly or partly, by a builder or any person authorised by the builder before, during or after construction (except in cases for which no sum is received from or on behalf of the prospective buyer by the builder or a person authorised by the builder before the grant of completion certificate by the authority competent to issue such certificate under any law for the time being in force) shall be deemed to be service provided by the builder to the buyer”*
 - › Judgement in Maharashtra Chamber of Housing Industry vs. UOI [012-TIOL-78-HC-Mum-ST]

History of taxation on construction services

- » W.e.f. 01.07.2012
 - › Term 'service' widely defined
 - › All activities related to construction fall within the purview of following "declared Services" under Section 66E of the Act:
 - › Section 66E(b) - Construction of a complex, building, civil structure or a part thereof, including a complex or building intended for sale to a buyer, wholly or partly, except where the entire consideration is received after issuance of completion-certificate by the competent authority.
 - › Section 66E(h) - Service portion in the execution of a works contract.

Comparison – Pre 01.07.2012 vs. Post 01.07.2012

Particulars	Prior to 01.07.2012	W.e.f 01.07.2012
Taxability	Specific taxing entry	Service & Declared service
Valuation methods	<ul style="list-style-type: none"> ▪ Section 67 read with Service Tax (Determination of Value) Rules, 2006 / Abatement ▪ Works Contract (Composition Scheme for Payment of Service Tax) Rules, 2007 	<ul style="list-style-type: none"> ▪ Section 67 read with Rule 2A of Service Tax (Determination of Value) Rules, 2006 ▪ Opt for Abatement as below.
Construction and sale of complex containing 2-12 residential units	Not Taxable (Residential complex means any complex comprising of a building having more than twelve residential units)	Taxable (Exemption available only for construction of single residential unit)
Construction directly for personal use as residence	Not liable	Liable
Construction and sale of units to charitable / non-profit organizations for educational purposes, hospitals etc.	Exempt	Taxable (Exemption available only to government, local authorities and government authorities)

New Negative list regime for taxation of services

Charging Section

Old charging provision (Section 66)	New charging provision (Section 66B)
<p><i>“There shall be levied a tax (hereinafter referred to as the service tax) at the rate of twelve per cent. of the value <u>of taxable services referred to in sub-clauses [] of clause (105) of section 65</u> and collected in such manner as may be prescribed.”</i></p> <p>Applicable up to: 30th June, 2012. Notification No. 22/2012-ST, dated 05.06.2012</p>	<p><i>“There shall be levied a tax (hereinafter referred to as the service tax) at the rate of twelve per cent. on the value <u>of all services, other than those services specified in the negative list, provided or agreed to be provided in the taxable territory by one person to another and collected in such manner as may be prescribed.”</u></i></p> <p>Applicable from: 1st July, 2012. Notification No. 19/2012-ST, dated 05.06.2012</p>

Taxability under Negative List

Is the activity a “service”?

‘Service’ Means	Includes	But shall not include
<ul style="list-style-type: none">- Any activity- Carried out by a person for another- For consideration	<ul style="list-style-type: none">- Includes a declared service- 9 Declared categories / species of services	<ul style="list-style-type: none">- Any activity that constitutes merely a transfer in title of goods or immovable property by way of sale, gift or in any other manner;- Such transfer, delivery or supply of any goods which is deemed to be a sale within the meaning of clause (29A) of Article 366 of the Constitution- A transaction in money or actionable claim;- Any service provided by an employee to an employer in the course of or in relation to his employment;- Fees taken in any Court or a tribunal established under any law for the time being in force

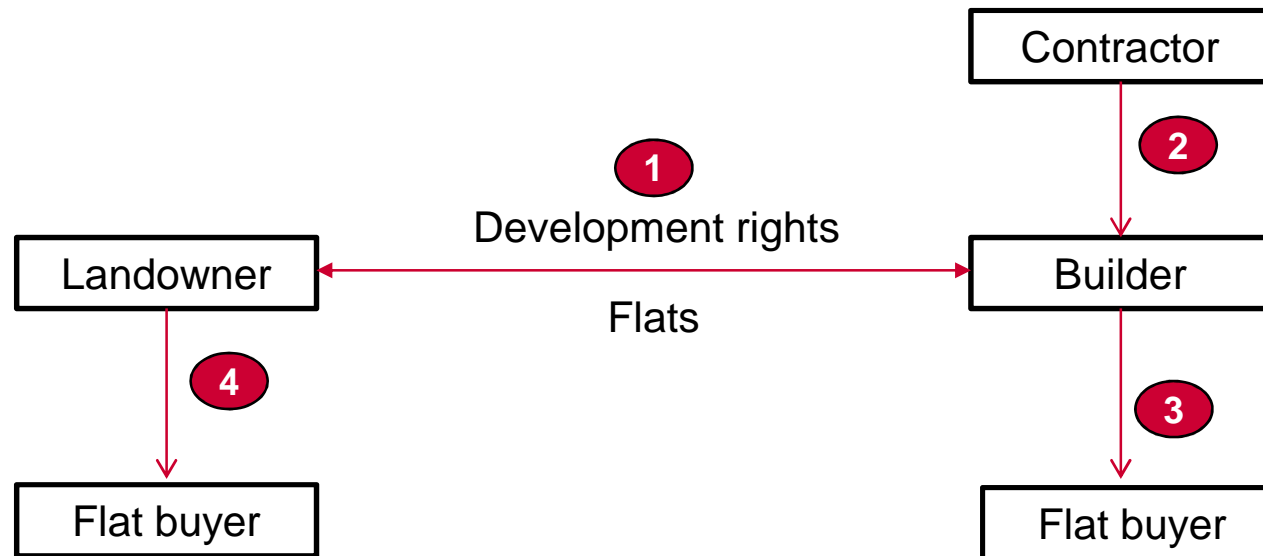
Declared Service – Section 66E

- » The following **shall constitute** declared services, namely:-
 - › (b) construction of a complex, building, civil structure or a part thereof, including a complex or building intended for sale to a buyer, wholly or partly, **except where the entire consideration is received after issuance** of completion certificate by the competent authority.
 - Explanation.- For the purposes of this clause,-
 - (I) the expression “competent authority” means the Government or any authority authorised to issue completion certificate under any law for the time being in force and in case of non-requirement of such certificate from such authority, from any of the following, namely:-
 - » (A) architect registered with the Council of Architecture constituted under the Architects Act, 1972; or (20 of 1972.)
 - » (B) chartered engineer registered with the Institution of Engineers (India); or
 - » (C) licensed surveyor of the respective local body of the city or town or village or development or planning authority;
 - (II) the expression “construction” includes additions, alterations, replacements or remodelling of any existing civil structure

Declared Service – Section 66E

- › (h) service portion in the execution of a works contract.
 - Section 65B(54) defines a works contract as under:
 - “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.”

Tripartite Business model



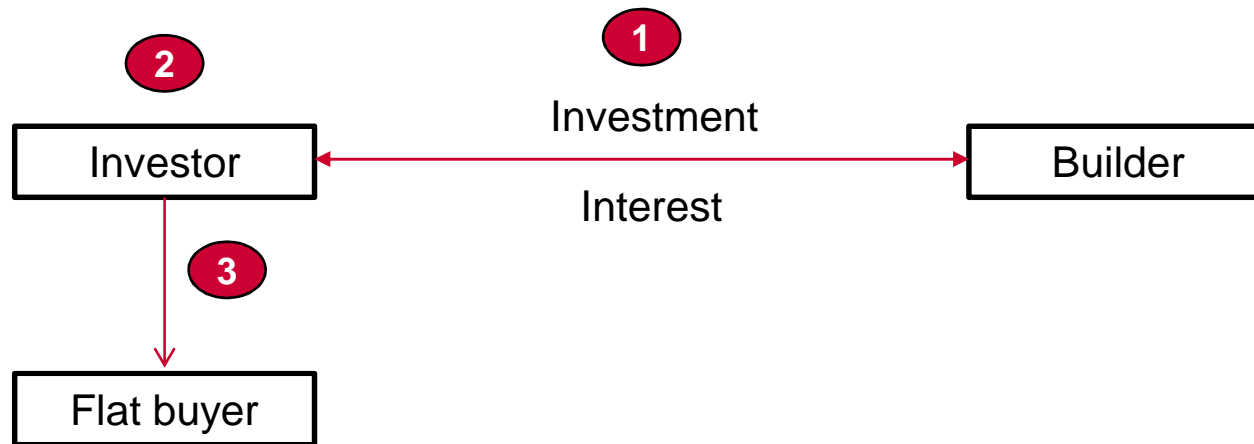
Sr. No.	Transactions	Taxability
1.	Development rights to builder and provision of construction service to land owner	Not liable – excluded under the definition of service (Sale of immovable property)
2.	Services by contractor to builder	Liable to Service tax – construction services
3.	Declared service by builder to flat buyer	Liable to Service tax if any part of consideration / development rights received prior to completion certificate
4.	Sale by Landowner to Flat buyer	Who is liable to pay Service tax?

Re-development



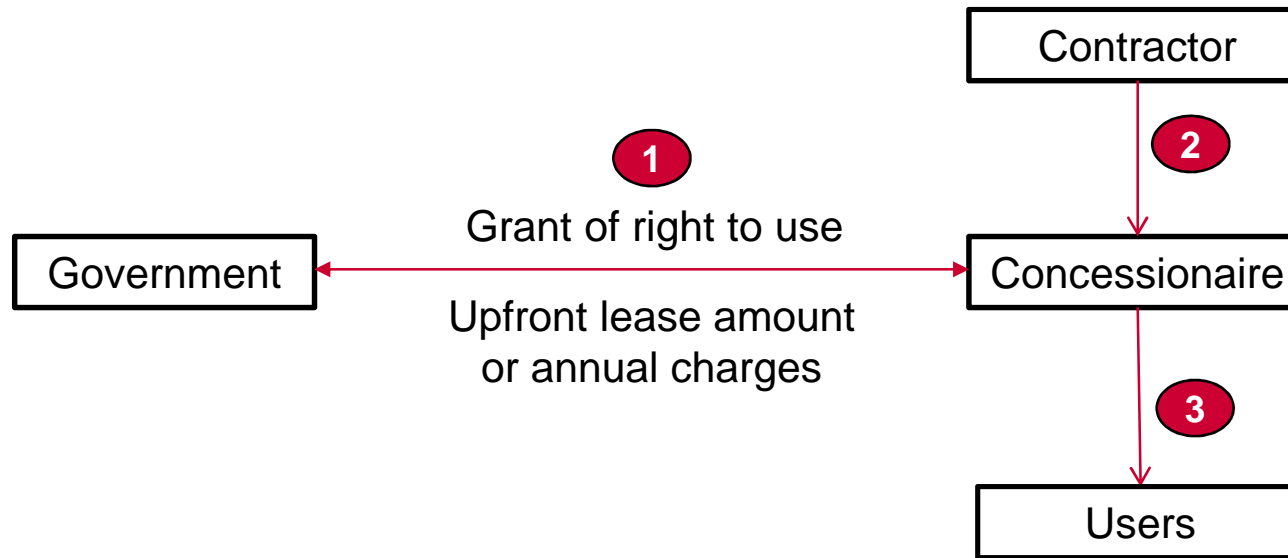
Sr. No.	Transactions	Taxability
1.	Development rights to builder	?
2.	Services by contractor to builder	Construction service
3.	Services by builder to Society (Flat buyer)	Construction service – Prior to 01.07.2012, complex constructed by a person directly engaging any other person not liable. What is the value?
4.	Sale by builder to new buyer	Not liable (assumed OC received)

Investment



Sr. No.	Transactions	Taxability
1.	Investment by investor	Earlier TRU Circular clarified that liable to Service tax. Tax base is the investment amount made [Language of the 66E] TRU circular clarified that if investor exits, builder can take benefit under Rule 6(3) – applicable only if services wholly or partly not provided or amount renegotiated
2.	Flat retained by Investor	Sale actually happens at this point. What if OC received by this time
3.	Sale to Flat buyer	Liable if consideration paid before CC

BOOT Projects



Sr. No.	Transactions	Taxability
1.	Grant of right to use	Not liable as not in the Negative list unless they qualify as support services of business or commerce
2.	Services by Contractor to Concessionaire	Liable to Service tax. No service of construction rendered by Concessionaire to Government
3.	Services by Concessionaire to Users (could be rent / lease etc.)	Liable to Service tax

Valuation Rules

- » Valuation of Service portion involved in the execution of works contract – Rule 2A of Service Tax (Determination of Value) Rules, 2006
 - Rule 2A(i) - gross amount charged for the works contract less the value of transfer of property in goods involved in the execution of the said works contract or
 - Rule 2A(ii) – Value of service portion shall be specified percentage of the total amount charged depending upon the nature of contract.
 - (A) 40% - in case of original works
 - (B) 70% - in case of maintenance or repair or reconditioning or restoration or servicing of any goods
 - (C) 60% - in case of any purpose other than (A) & (B) above, including maintenance, repair, completion and finishing Services such as glazing, plastering, floor and wall tiling, installation of electrical fittings of an immovable property

- » As per Explanation (c) to the said sub-rule (i), where value added tax or sales tax has been paid or payable on the actual value of property in goods transferred in the execution of the works contract, then such value adopted for the purposes of payment of value added tax or sales tax, shall be taken as the value of property in goods transferred in the of the works contract execution of the said works contract.

Exemptions

- » Mega Exemption Notification No. 25/2012-S.T. dated 20.06.2012 w.e.f. 01.07.2012
 - › Sr. No. 12 – Services provided to the Government, a local authority or a governmental authority by way of construction, of:
 - (a) a civil structure or any other original works meant predominantly for use other than for commerce, industry, or any other business or profession;
 - (c) a structure meant predominantly for use as (i) an educational, (ii) a clinical, or (iii) an art or cultural establishment;
 - (f) a residential complex predominantly meant for self-use or the use of their employees or other persons specified in the *Explanation 1* to clause 44 of section 65 B of the said Act;

 - › Sr. No. 14 - Services by way of construction, erection, commissioning or installation of original works pertaining to,-
 - (b) single residential unit otherwise as a part of a residential complex;
 - (c) low- cost houses up to a carpet area of 60 square metres per house in a housing project approved by competent authority empowered under the 'Scheme of Affordable Housing in Partnership' framed by the Ministry of Housing and Urban Poverty Alleviation, Government of India;

Abatement

- » Abatement Notification No. 26/2012-S.T. dated 20.06.2012 w.e.f. 01.07.2012
 - › Sr. No. 12 – Abatement of 75% in respect of Construction of a complex, building, civil structure or a part thereof, intended for a sale to a buyer, wholly or partly except where entire consideration is received after issuance of completion certificate by the competent authority.
 - Conditions:
 - (i) CENVAT credit **on inputs used** for providing the taxable service has not been taken under the provisions of the CENVAT Credit Rules, 2004.
 - » No restriction on availment of CENVAT credit for input services and capital goods.
 - (ii) The value of land is included in the **amount charged** from the service receiver.
 - › Explanation C to the above notification clarifies the meaning of amount charged –
 - The amount charged shall be the sum total of the amount charged for the service including the fair market value of all goods and services supplied by the recipient(s) in or in relation to the service, whether or not supplied under the same contract or any other contract, after deducting-
 - (i) the amount charged for such goods or services supplied to the service provider, if any; and
 - (ii) the value added tax or sales tax, if any, levied thereon:
 - Provided that the fair market value of goods and services so supplied may be determined in accordance with the generally accepted accounting principles.

Point of Taxation and Reverse Charge

» Point of Taxation Rules, 2011

- › Rule 2(c) - “continuous supply of service” means any service which is provided, or agreed to be provided continuously or on recurrent basis, under a contract, for a period exceeding three months with the obligation for payment periodically or from time to time, or where the Central Government, by a notification in the Official Gazette, prescribes provision of a particular service to be a continuous supply of service, whether or not subject to any condition.

- › First Proviso to Rule 3 - In case of continuous supply of service where the provision of the whole or part of the service is determined periodically on the completion of an event in terms of a contract, which requires the receiver of service to make any payment to service provider, the date of completion of each such event as specified in the contract shall be deemed to be the date of completion of provision of service;

Reverse charge mechanism

Reverse charge mechanism w.e.f. 01.07.2012

Nature of service provided or agreed to be provided	Share of Service Tax Liability		Effective rate of Service Tax
	Service provider	Service receiver	
Insurance Agent to any person carrying on insurance business	Nil	100%	12.36%
Transportation of goods by road by a goods transport agency (Abatement of 75% available*)	Nil	100%	3.09%
Sponsorship services to any body corporate or partnership firm	Nil	100%	12.36%
Services provided by an arbitral tribunal to any business entity	Nil	100%	12.36%
Legal services provided by individual advocate or firm of advocates to any business entity located in the taxable territory	Nil	100%	12.36%
Support service provided by Government or local authority excluding: 1. renting of immovable property; 2. Services specified in sub-clauses (i), (ii) and (iii) of Section 66D(a)	Nil	100%	12.36%
Services provided by a director of a company to the company (w.e.f 07.08.12)	Nil	100%	12.36%

* Under Sr. No. 7 of Notification No. 26/2012-S.T. dated 20.06.2012

Reverse charge mechanism w.e.f. 01.07.2012

Nature of service provided or agreed to be provided	Share of Service Tax Liability		Effective rate of Service Tax
	Service provider	Service receiver	
Taxable services received by any person located in the taxable territory provided by any person located in non-taxable territory.	Nil	100%	12.36%
<i>Following services provided by any individual, Hindu Undivided Family or partnership firm, whether registered or not, including association of persons, located in the taxable territory to a business entity registered as body corporate, located in the taxable territory:</i>			
Renting of a motor vehicle designed to carry passengers to any person who is not engaged in the similar line of business:			
<ul style="list-style-type: none"> • On abated value (abatement of 60% available**) • On non-abated value 	Nil 60%	100% 40%	4.944% 4.944%
Supply of manpower for any purpose (w.e.f 01.07.12) or security services (w.e.f. 07.08.12) provided to a business entity registered as body corporate	25%	75%	9.27%
Service portion in execution of works contract provided to a business entity registered as body corporate	50%	50%	Depending upon the works contract.

** Under Sr. No. 9 of Notification No. 26/2012-S.T. dated 20.06.2012

CENVAT Credit

Input Service definition (Rule 2(I) of CCR)

Part I: Eligibility criteria	Any service, - <ul style="list-style-type: none"> › used by a provider of output service for providing an output service; or › used by a manufacturer, whether directly or indirectly, in or in relation to the manufacture of final products and clearance of final products upto the place of removal
Part II: Specific Inclusion	Services used in relation to modernisation, renovation or repairs of a factory, premises of provider of output service or an office relating to such factory or premises , advertisement or sales promotion, market research, storage upto the place of removal, procurement of inputs, accounting, auditing, financing, recruitment and quality control, coaching and training, computer networking, credit rating, share registry, security, business exhibition, legal services, inward transportation of inputs or capital goods and outward transportation upto the place of removal;
Part III: Specific Exclusion	<ul style="list-style-type: none"> › Construction service or service portion in execution of works contract of a building or a civil structure or a part thereof; or laying of foundation or making of structures for support of capital goods › services provided by way of renting of a motor vehicle, in so far as they relate to a motor vehicle which is not a capital goods › service of general insurance, servicing, repair and maintenance, in so far as they relate to a motor vehicle which is not a capital goods › services used primarily for personal use or consumption of any employee

Input definition (Rule 2(k) of CCR)

- » The term 'Inputs' is defined under Rule 2(k) of the CCR to mean:
 - › all goods used in the factory by the manufacturer of the final product (including goods and accessories cleared with final product whose value has been included in value of final products and goods used for providing free warranty of final products); or
 - › all goods used for generation of electricity or steam for captive use; or
 - › all goods used for providing any output service;
 - › **but excludes -**
 - light diesel oil, high speed diesel oil or motor spirit, commonly known as petrol;
 - **any goods used for – construction or execution of works contract of a building or a civil structure or a part thereof; or**
 - **laying of foundation or making of structures for support of capital goods, except for the provision of service portion in the execution of a works contract or construction service as listed under clause (b) of section 66E of the Act;**
 - capital goods except when used as parts or components in the manufacture of a final product;
 - motor vehicles;
 - any goods, such as food items, goods used in a guesthouse, residential colony, club or a recreation facility and clinical establishment, when such goods are used primarily for personal use or consumption of any employee; and
 - any goods which have no relationship whatsoever with the manufacture of a final product.

Availment of CENVAT Credit and reversals

» 'Definition of "exempted services"'

- taxable service which is exempt from the whole of the service tax leviable thereon; or
- service, on which no service tax is leviable under section 66B of the Finance Act; or
- taxable service whose part of value is exempted **on the condition that no credit of inputs and input services**, used for providing such taxable service, shall be taken; but shall not include a service which is exported in terms of Rule 6A of the Service Tax Rules, 1994
 - Reversal of credit where abatement of 75% provided
 - Reversal of credit in case where building partly sold and partly rented out

» What stage do I take credit?

Questions?

Thank You