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Dear Professional Colleague,

No Service tax on sale of under construction flats if contract price includes value of land

We are sharing with you an important judgement of the Hon'ble High Court of Delhi in the case of ***Suresh Kumar Bansal Vs. Union of India & Ors; Anuj Goyal & Ors Vs. Union of India & Ors [2016-TIOL-1077-HC-DEL-ST]*** on the following issue:

Issue:

Whether Service tax is exigible on the consideration paid by flat buyers to a builder/ developer, for purchasing a flat in a complex, which was under construction/ development?

Facts & Background:

Suresh Kumar Bansal & Ors (**"the Petitioners"**) has entered into a composite contract with M/s Sethi Buildwell Pvt. Ltd. (**"the Builder"**) for purchase of flats in a multi-storey group housing project named 'Sethi Group-Max Royal' situated in Sector 76, Noida, Uttar Pradesh. The Builder has in addition to the consideration for the flats also recovered Service tax from the Petitioners, on account of services in relation to construction of complex and on preferential location charges.

Being aggrieved, the Petitioners filed Petitions before the Hon'ble High Court of Delhi challenging the levy of Service tax collected by the Builder on the services 'in relation to construction of complex' as defined under Section 65(105)(zzzh) of the Finance Act, 1994 (**"the Finance Act"**) read with the explanation introduced by virtue of the Finance Act 2010, as being ultra vires of the Constitution of India. The Petitioners also challenged Section 65(105)(zzzzu) of the Finance Act, which seeks to subject preferential location charges charged by a builder to Service tax.

Petitioners' contentions:

- The Agreement entered with the Builder are for purchase of immovable property and the Parliament does not have the legislative competence to levy Service tax on such transaction;

- The entries relating to taxation in List I and List II of the Seventh Schedule to the Constitution of India were mutually exclusive and the Parliament did not have the power to levy tax on immovable property; thus, the levy of Service tax on agreements for purchase of flats was beyond the legislative competence of the Parliament;

- Their Agreement with the Builder is a composite contract for purchase of immovable property and in absence of specific provisions for ascertaining the service component of

the said Agreement, the levy would be beyond the legislative competence of the Parliament;

- There was no service element in preferential location charges which were levied by the Builder and the same related only to the location of the immovable property and, therefore, such charges were not exigible to Service tax.

Revenue's contention: The Revenue submitted that development of a project results in the substantial value addition on bare land and includes various services such as consulting services, engineering services, management services, architectural services etc. These services are subsumed in the taxable service as contemplated under Section 65(105)(zzzh) of the Finance Act. The Revenue also submitted that as the gross charges include value of land and construction material, only 25% of the Base Selling Price (BSP) charged by a Builder from the ultimate consumer is subjected to levy of Service tax.

However, in case of preferential location charges, the entire amount charged by a developer is for value addition and therefore, the gross amount charged for such services is chargeable to Service tax under Section 66 read with Section 65(105)(zzzzu) of the Finance Act.

Held:

The Hon'ble High Court of Delhi after detailed deliberation held as under:

No services are rendered in a contract to sell immovable property

- Service tax is essentially a tax on the value created by services as distinct from a tax on the value added by manufacturing goods. Construction of a complex essentially has three broad components, namely, (i) land on which the complex is constructed; (ii) goods which are used in construction; and (iii) various activities which are undertaken by the Builder directly or through other contractors. The object of taxing services in relation to construction of complex is essentially to tax the various activities that are involved in the construction of a complex and the resultant value created by such activities;

- It is a usual practice for Builders/ Developers to sell their project at its launch. Builders accept bookings from prospective buyers and in many cases provide multiple options for making payment for the purchase of the constructed unit. In some cases, prospective buyers make the payment upfront while in other cases, the buyers may opt for construction linked payment plans, where the agreed consideration is paid in instalments linked to the Builder achieving certain specified milestones;

- Whilst it may be correct to state that the title to the unit (the immovable property) does not pass to the prospective buyer at the stage of booking, it can hardly be

disputed that the buyer acquires an economic stake in the project and in one sense, the services subsumed in construction services in relation to a construction the complex are rendered for the benefit of the buyer. However, but for the legal fiction introduced by the impugned explanation to Section 65(105)(zzzh) of the Finance Act, such value add would be outside the scope of services because sensu stricto no services, as commonly understood, are rendered in a contract to sell immovable property.

Imposition of Service tax in relation to a transaction between a developer of a complex and a prospective buyer does not impinges on the legislative field reserved for the States

- The use of a legal fiction is a well-known legislative device to assume a state of facts (or a position in law) for the limited purpose for which the legal fiction enacted, that does not exist. The Parliament is fully competent to enact such legal fiction. In the present case the Parliament has done precisely that; it has enacted a legal fiction, where a set of activities carried on by a builder for himself are deemed to be that on behalf of the buyer;

- The imposition of Service tax by virtue of the impugned explanation is not a levy on immovable property as contended on behalf of the Petitioner. The clear object of imposing the levy of Service tax in relation to a construction of a complex is essentially to tax the aspect of services involved in construction of a complex, the benefit of which is available to a prospective buyer who enters into an arrangement for acquiring a unit in a project prior to its completion/development;

- There is no merit in the contention that the imposition of Service tax in relation to a transaction between a developer of a complex and a prospective buyer impinges on the legislative field reserved for the States under Entry-49 of List-II of the Seventh Schedule to the Constitution of India.

No statutory machinery provision for determining the service element in Composite Contract

- Undisputedly, the contract between a buyer and a builder/ promoter/ developer in development and sale of a complex is a composite one. The arrangement between the buyer and the developer is not for procurement of services simplicitor;

- While the legislative competence of the Parliament to tax the element of service involved cannot be disputed but the levy itself would fail, if it does not provide for a mechanism to ascertain the value of the services component which is the subject of the levy;

- In the present case, there is no machinery provision for ascertaining the service element involved in the composite contract. In order to sustain the levy of Service tax

on services, it is essential that the machinery provisions should provide for a mechanism for ascertaining the measure of tax, that is, the value of services which are charged to Service tax.

None of the Rules under the Service Tax (Determination of Value) Rules, 2006 ("the Service Tax Valuation Rules"), cater to determination of value of services in case of a composite contract which involves sale of land

- For the purposes of ascertaining the value of services, the Central Government has made the Service Tax Valuation Rules, but none of the Rules provides for any machinery for ascertaining the value of services involved in relation to construction of a complex;

- Rule 2A of the Service Tax Valuation Rules provides for determination of the value of service in execution of a composite Works contract but the said Rule does not ascertain determination of value of services in case of composite contract which also involves sale of land;

- The gross consideration charged by a builder/promoter of a project from a buyer would not only include an element of goods and services but also the value of undivided share of land which would be acquired by the buyer.

The abatement to the extent of 75% by a notification or a circular cannot substitute the lack of statutory machinery provisions to ascertain the value of services involved in a composite contract

- In the present case, neither the Act nor the Rules framed therein provide for a machinery provision for excluding all components other than service components for ascertaining the measure of Service tax;

- The abatement to the extent of 75% by a notification or a circular cannot substitute the lack of statutory machinery provisions to ascertain the value of services involved in a composite contract.

Challenge to levy of Service tax on preferential location charges under Section 65(105)(zzzzu) negated

- Preferential location charges are charged by the builder based on the preferences of its customers. They are in one sense a measure of additional value that a customer derives from acquiring a particular unit. However, such charges cannot be traced directly to the value of any goods or value of land but are as a result of the development of the complex as a whole and the position of a particular unit in the context of the complex;

- Though the challenge to insertion of clause (zzzzu) in Section 65(105) of the Finance Act is negated, however, the Petitioners' contention that no Service tax under Section 66 of

the Finance Act read with Section 65(105)(zzzh) thereof could be charged in respect of composite contracts such as the ones entered into by the Petitioners with the Builder, is accepted. The impugned explanation to the extent that it seeks to include composite contracts for purchase of units in a complex within the scope of taxable service is set aside.

Therefore, the Hon'ble High Court of Delhi held that no Service tax under Section 65(105)(zzzh) of the Finance Act to be levied on composite contract as there is no machinery provision for ascertaining the service element involved in the composite contract. Accordingly, the concerned officer was directed to examine whether the Builder has collected any amount as Service tax from the Petitioners for taxable service as defined in Section 65(105)(zzzh) of the Finance Act and has deposited the same with the Respondent Authorities. It was further directed that any such amount deposited shall be refunded to the Petitioners with interest at the rate of 6% from the date of deposit till the date of refund.

Our Comments:

This is indeed a game changer judgment for the real estate sector, wherein Service tax is levied on any part of the consideration received prior to completion certificate, as the same is treated as rendering of services.

Though the Hon'ble Delhi High Court while upholding constitutional validity of the levy, has set aside levy of Service tax in absence of any statutory measure to ascertain the value of services involved in the composite contract, involving sale of undivided share of land, the same will surely have wide ramifications. Undoubtedly, the Revenue would take up the matter to the Hon'ble Supreme Court and it would be interesting to see how the matter dwells & get decided by the Hon'ble Apex Court.

Further, it may not be out of place here to mention that though the Petitioners, inter alia, submitted before the Hon'ble High Court, that *"the challenge laid by the Petitioners to the provisions of Section 65(105)(zzzh) and 65(105)(zzzzu) of the Act would also be equally valid for the taxing provisions introduced with effect from 1st July, 2012…"*, the Hon'ble High Court in the present petition has dealt with the clauses (zzzh) and (zzzzu) of Section 65(105) of the Finance Act as were applicable at the material time period involved. In such a scenario it would also be interesting to see how the inference of the judgment is applied for the period w.e.f. July 1, 2012, when the services covered under Section 65(105)(zzzh) and 65(105)(zzzzu) of the Finance Act are taxed by virtue of Section 66E(b) read with Section 65B(22) and Section 65B(44) of the Finance Act.

Hope the information will assist you in your Professional endeavours. In case of any query/ information, please do not hesitate to write back to us.

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Thanks & Best Regards,

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