CESTAT decision on Joint Development Agreement – A (further) Analysis – June 5, 2012

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THE recent decision of the Chennai CESTAT in the *LCS Citymakers (P) Ltd* case (**2012-TIOL-618-CESTAT-MAD**), with due respects and regards to the Tribunal, has come as a big surprise and might seem to suffer from certain serious infirmities. As we know, the Tribunal, in this decision, has held interalia, that, service tax is leviable on joint development agreements. I've taken three views expressed in this decision, for the purpose of this piece.

Firstly, let's see how this decision has dealt with the principles governing 'joint development agreements', a very popular tool that is widely used by Realty players. Here is what has been stated under Paras 8 and 9 of the decision:

Quote

8. The Appellants argue that there is no relationship of service provider and service recipient between the Developer and the Land Owner. According to them it is a relationship in a joint venture for profit. Both the parties have joined together in the business of construction of complex and the land owner brings in the capital by way of his land. The Developer by way of his capital and services and they jointly construct the complex and use or sell the flats for profit. He argues that CBEC had clarified the position that no service arises in such context. This clarification dated 29-01-09 is examined later in this order.

9. On the contrary we find that the Joint Development agreement does not indicate any terms on the above lines. The parties were neither taking risks jointly or doing any common activity. There was no participation by the land Owners in organizing or carrying out the activity. The Joint Development Agreement as one in which the land owner transfers part of his rights in the land and gets the value of such rights transferred, in the form of constructed flats which consist of value of material used and services rendered by the Developer. After the Land Owner transfers a part of his rights through the agreement, his share of UDS is registered in his name and he is like any other prospective buyer for whom construction of complex is carried out under an agreement for construction of flats except that he has a guaranteed right to get his share of the number of flats constructed.

Unquote

The decision makes a sweeping statement that, the parties were neither taking risks jointly or doing any common activity. As is known, in any joint development arrangement, the Land Owner takes a huge risk, by entirely depending on the Developer/Builder to undertake and complete the project, both in terms of the time frame as well as, in terms of the quality. To say that the Landowner and the Developer are not taking joint risks or undertaking joint activity might not be correct, in as much as, in respect of projects which get struck midway, it is the Landowner who suffers. Now, the decision also states that, the parties were not taking any common activity. It seems like, the concept of a joint development has not been appreciated in the decision. Moreover, certain earlier Tribunal decisions have also not been considered. In terms of **Black's Dictionary 9th Edition, 2009 (page 915)**, "Joint Venture" is a business undertaking by two or more persons engaged in a single defined project. The necessary elements are: (1) an express or implied agreement; (2) a common purpose that the group intends to carry out; (3) shared profits and losses; and (4) each member's equal voice in controlling the project. In terms of the Apex Court's decision in New Horizons Ltd v. Union of India (1997) 89 Com Cases 849, p.867 (SC), the expression "Joint Venture" connotes a legal entity in the nature of a partnership engaged in the joint undertaking of a particular transaction for mutual profit or an association of persons or companies jointly undertaking some commercial enterprise wherein all contribute assets and share risks. In essence, in a joint venture, the concept of mutuality prevails in as much as, there are no parties involved.

Apart from not appreciating the concept of a joint venture, this decision has not considered the earlier decisions of the CESTAT benches, in which a view was taken that joint ventures are not covered under

service tax. Some of these are : Initiating Explosives Systems v. CCE, Kolkata-V, Sunshield Chemicals Ltd v. CCE, Raigad, CCE, Chennai v. Sundaram Finance Ltd and Glaxo Smithkline Pharmaceuticals Ltd. v. CCE, Mumbai. More importantly, in CST v. Puravankara Projects Ltd, the Bangalore CESTAT had taken a prima facie view that, in joint development agreements, no service is rendered by the Developer to the Land Owner.

This decision has also not considered the 'dominant intention' test enunciated by the Supreme Court in several cases and notably in the BSNL case ***(2006-TIOL-15-SC-CT-LB)***. In the case of a joint agreement, in my view, the dominant intention would be the joint development of the property and not one involving rendering of service by the Developer to the Landowner. Though the BSNL case has been discussed in this decision, in the context of the aspect theory, etc., one would have been happy if the 'dominant intention' test had been discussed in the Tribunal decision.

The decision has also not considered the Board's view expressed in Circular No. **109/03/2009** covered by F. No. 137/186/2007-CX.4 dated 23-02-2009, wherein, it has been recognized that transactions between two contracting parties, on a principal to principal basis, are not to be treated as 'services'. In this Circular which was issued with regard to the applicability of service tax on screening of films by theatre owners, the Board had clarified that under the particular type of arrangement which typically is undertaken between the theatre owners and the distributors of films, a revenue sharing model operates whereby a fixed and predetermined portion/percentage of revenues earned from the sale of cinema tickets goes to the theatre owners and the residual portion/percentage is paid over to the distributors. The Board had clarified that in such a situation, the two contracting parties act on a principal to principal basis and do not provide any services to each other and consequently no service tax would apply. In this rather benevolent Circular (which may seem so untypical of the Board), a clear has been articulated that, in any revenue sharing arrangement, the contracting parties do not provide services inter se to each other but merely come together to jointly undertake an economic activity and to share the economic gains resulting from such activity and hence, service tax cannot be levied. Though this view has been expressed in the context of the levy of service tax on movie theaters, the concept is nevertheless, applicable to the case of joint development agreements, in my opinion.

In my humble opinion… the views expressed regarding joint developments, can, at best, be treated as facts applicable to this specific case and consequently, this decision cannot have precedential value in terms of service tax levy on joint development agreements.

Secondly, this Tribunal decision also, very surprisingly, takes the view that, works contracts are taxable even before 1-6-2007, despite having considered the various decisions of the higher judicial forums including the Turbotech case. The decision, in Para 10.4 records the following observation about the Turbotech case:

Quote

10.4. The decision of the Karnataka High Court in *Turbo-Tech* (Supra) is with reference to the question whether the entry for "Consulting Engineer Service" during the period 1997 to 2001 could cover the activities of design, development in a contract for "Design, development and supply of turbo power pack and spares". In the first place the levy extended to only professionally qualified engineer or an engineering firm and not to a corporate entity as the respondent in that case. Further in that situation there was a basic question whether the contract was for supply of goods or for providing service. In the case of construction of a complex, which is the impugned service in this case, the contract is for providing service considering the aspect theory laid down by the Apex Court in the case of BSNL Ltd (Supra) and also in Tamil Nadu Kalyana Mandapam Assn. Vs. UOI – ***2004-TIOL-36-SC-ST*** . This service is different from design and service involved in supply of material where the main aspect is supply of service.

Unquote

This CESTAT decision would seem to have completely overlooked the fact that the binding precedent of law, as laid down in the Turbo Tech case **2010-TIOL-498-HC-KAR-ST**, is in respect of non-taxability of works contracts prior to 1-6-2007. I've reproduced the Paras 9 and 10 of the High Court decision, which would seem to clearly that works contracts cannot be taxed prior to 1-6-2007:

Quote

9. So far as the execution of the works contract is concerned, the works contract is defined under section 65(105)(zzzza) which reads as under:

(zzzza) to any person, by any other person in relation to the execution of a works contract, excluding works contract in respect of roads, airports, railways, transport terminals, bridges, tunnels and dams. Explanation.- For the purposes of this sub-clause, 'works contract' means a contract wherein, – (i) transfer of property in goods involved in the execution of such contract is leviable to tax as sale of goods, and (ii) such contract is for the purposes of carrying out,- (a) erection, commissioning or installation of plant, machinery, equipment or structures, whether pre-fabricated or otherwise, installation of electrical and electronic devices, plumbing, drain laying or other installations for transport of fluids, heating, ventilation or air-conditioning including related pipe work, duct work and sheet metal work, thermal insulation, sound insulation, fire proofing or water proofing, lift and escalator, fire escape staircases or elevators; or (b) construction of a new building or a civil structure or a part thereof, or of a pipline or conduit, primarily for the purposes of commerce or industry; or (c) construction of a new residential complex or a part thereof; or (d) completion and finishing services, repair, alteration, renovation or restoration of, or similar services, in relation to (b) and (c); or

(e) turnkey projects including engineering, procurement and construction or commissioning (EPC) projects.

10. This section has come into force with effect from 1-6-2007. After considering the contract entered into between the assessee and its employer, the case of the assessee falls under Section 65(105)(zzzza) Explanation (a) and (e). Even though the assessee's case falls under the definition of works contract, but the revenue has no power to call upon the assessee to pay service tax, interest and penalty therein, since the provisions of law has come into force with effect from 1-6-2007.

Unquote

I would humbly point out that, non-consideration of the binding precedent of the High Court decision, might greatly reduce the precedential value of this Tribunal decision.

And, thirdly, in Para 13.5, the decision rejects the argument, services can be taxes on the basis of non-monetary consideration prior to 18-4-2006. This is what the decision records:

Quote

13.5 So we, we do not agree with the argument that prior to 18-04-2006 the service could not be taxed for the reason that consideration was received in the form of land and not in the form of amount. Further substantial part of service is provided after Service Tax (Determination of Value) Rules, 2006 were notified on 19.4.2006.

Unquote

With Section 67 of the Finance Act, 1994 taking effect from 19-4-2006, this view contained in the Tribunal decision seems rather surprising. The best that could have been done is to bisect the transaction and confirm the tax for the period prior to 18-4-2006.

Before concluding …

This decision, with utmost respect and regards to the Hon'ble Tribunal, would seem to suffer from many serious infirmities, thereby significantly reducing its value as a binding precedent.

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