Government must clarify service tax levy on Joint Development Agreements – Feb 14, 2013

By S Sivakumar, Advocate

THE Government had issued a highly controversial Circular bearing No. 1 51/2/2012-ST, dated 10-2-2012 , 'clarifying' the service tax issues on Joint Development Agreements entered into by Realty Players. Though issued in the context of Commercial or Industrial Construction services, this Circular is perhaps, the first circular from the Board on the levy of service tax on Joint Development Agreements, which we know, is a very popular method used by landowners and Developers for developing commercial and residential projects.

Unfortunately this Circular seems to have created a lot of confusion on the subject matter instead of clarifying issues.

Look at what the Board has to say, in respect of tripartite agreements:

Quote:

2. *From the issues referred by the field formations, important ones have been identified model wise, examined and clarified as follows:*

2.1. *Tripartite Business Model (Parties in the mode l: (i) landowner; (ii) builder or developer; and (iii) contractor who undertakes construction): Issue involved is regarding the liability to pay service tax on flats/houses agreed to be given by builder/developer to the land owner towards the land /development rights and to other buyers.*

Clarification: Here two important transactions are identifiable: (a) sale of land by the landowner which is not a taxable service; and (b) construction service provided by the builder/developer. The builder/developer receives consideration for the construction service provided by him, from two categories of service receivers: (a) from landowner: in the form of land/development rights; and (b) from other buyers: normally in cash.

(A) Taxability of the construction service:

(i) For the period prior to 01/07/2010: construction service provided by the builder/developer will not be taxable, in terms of Board's Circular No.108/02/2009-ST, dated 29.01.2009.

(ii) For the period after 01/07/2010, construction service provided by the builder/developer is taxable in case any part of the payment/development rights of the land was received by the builder/ developer before the issuance of completion certificate and the service tax would be required to be paid by builder/developers even for the flats given to the land owner.

(B) Valuation:

(i) Value, in the case of flats given to first category of service receiver, is determinable in terms of section 67(1)(iii) read with rule 3(a) of Service Tax (Determination of Value) Rules, 2006, as the consideration for these flats i.e. , value of land / development rights in the land may not be ascertainable ordinarily. Accordingly, the value of these flats would be equal to the value of similar flats charged by the builder/developer from the second category of service receivers. In case the prices of flats/houses undergo a change over the period of sale (from the first sale of flat/house in the residential complex to the last sale of the flat/house), the value of similar flats as are sold nearer to the date on which land is being made available for construction should be used for arriving at the value for the purpose of tax. Service tax is liable to be paid by the builder/developer on the 'construction service' involved in the flats to be given to the land owner, at the time when the possession or right in the property of the said flats are transferred to the land owner by entering into a conveyance deed or similar instrument (e.g., allotment letter).

(ii) Value, in the case of flats given to the second category of service receivers, shall be determined in terms of section 67 of the Finance Act, 1994.

Unquote:

In what has become typical of recent Board Circulars, the confusion arising out of this Circular is palpable. At one place, the Board says that, " *the value of similar flats as are sold nearer to the date on which land is being made available for construction should be used for arriving at the value for the purpose of tax* " indicating clearly that that taxable event, for the Builder/Developer is the date on which the land is made available to him, by the land owner, which is normally, at the beginning of the project. Elsewhere, in the same paragraph, given above, the Board says that, service tax is to be paid by the Builder/Developer at the time when the possession or right in the property of the said flats are transferred to the land owner by the Developer. One can see an obvious contradiction here.

Neither the Department nor the Realty Players nor the Consultants have been able to make out what exactly the Board is trying to communicate, even after about a year since this Circular was issued.

Not-withstanding this… the Board seems to be oblivious of the fact that, the definition of a 'works contract' under the service tax law follows the definition of the works contract under the VAT law, inasmuch as a transaction that is not a works contract under the VAT law, cannot, *ipso facto* , be considered as a works contract under the service tax, as well. **Joint Development Agreements are not subject to the VAT levy as these are considered as 'barter' transactions** . As we know… under the VAT law, non-monetary consideration is not recognized.

This being the case….when Joint Development Agreements cannot be treated as 'works contracts' under the VAT law, how can these be treated as 'works contracts' under the service tax law and subjected to service tax levy, in as much as the service tax law related to works contracts faithfully follows the VAT law on works contracts.

Given the fact that the Education Guide issued by the TRU also refers to this Circular and clearly states that joint development agreements are taxable, it means that the Government wishes to carry forward the confusion into the new service tax law regime as well.

One hopes that this Circular is either withdrawn immediately or a new Circular is issued by the Board on the levy of service tax on Joint Development Agreements.

Before concluding…

Insofar as the levy of service tax on works contracts is concerned, our brilliant officers at the TRU would need to carefully follow the developments in the VAT law on the same subject. The levy of VAT on advances received by Builders/Developers without the actual commencement of the construction activity (i.e. without the transfer of property in goods having commenced) has been struck down by the Courts. With the service tax law following the VAT law, in so far as works contracts are concerned, I would presume that the levy of service tax on advances received by Developers/Builders without the construction activity having commenced would be equally bad in law. Similarly, the service tax law on joint development agreements would have to follow the VAT law on the same subject.