

Service tax on residential complexes: Board proposes ... Department disposes! – Nov 13, 2009

WE have heard of the very popular English adage ... 'Man proposes....God disposes'. In terms of the highly controversial subject involving levy of service tax on construction of residential complexes, it would seem that the adage, 'Board proposes...Department disposes' would be more appropriate.

As we all know, the Board had come out with Circular No.108/02/2009-ST dated January 29, 2009 to clarify, interalia, that service tax is not applicable on agreements of sale entered into by the Developer/Builder with the purchaser of the flats/residential units. The Board had taken the view in Para 3 of this Circular that, under an 'agreement to sell', since the property remains under the ownership of the seller till the ownership gets transferred to the ultimate owner on the completion of the construction and the full payment of the agreed sum, any service would be in the nature of self-service and consequently, such an 'agreement to sell' would not attract service tax. Further, the Circular went on to state that, if the ultimate owner enters into a 'contract for construction' of a residential complex with a promoter/builder/developer, who himself provides service of design, planning and construction; and after such construction the ultimate owner receives such property for his personal use, then such activity would not be subjected to service tax, because this case would fall under the exclusion provided in the definition of 'residential complex'. However, in both these situations, if services of any person like contractor, designer or a similar service provider are received, then such a person would be liable to pay service tax.

Despite the honorable intentions of the Board in issuing the Circular, it is very sad to see that the Service Tax Department has been issuing notices and expressing contradictory views, completely whittling down the Board views.

Firstly ... the Department has been taken a clear stand that, the said Circular, having been issued in terms of 'Construction of Complex' services, is not applicable to 'works contract' services. In other words, as per the Department, the Developer/Builder who has classified the contract entered into with his customer as a 'works contract', cannot take advantage of the Circular and has to continue to collect and pay service tax. The Audit Parties have already started issuing Audit Paras on this point and I've come across such cases in Bangalore. This view of the Department would considerably water down the impact of the Circular, as in most cases, the Developers and Builders have classified new contracts entered into on or after June 1, 2007 under 'Works Contract' services.

Secondly ... the Service Tax Department in Chennai has started issuing notices to the Developers and Builders stating, interalia, that the benefit of the Circular is available only in cases where the stamp duty is paid on the full portion of the flat and not for the land portion alone. This view, again, will further water down the practical applicability of the Circular, as in most States, stamp duty is paid only on the land portion adjusted for the built up area and on the basis of the rates specified by the Sub-Registrars.

Thirdly ... the Department has also taken the view that the benefit of the Circular is not applicable in cases wherein the transaction involves a composite agreement for a sale of undivided share of land and for construction of flats /apartments. The communication issued

By the Chennai Commissionerate states that 'since there is no outright sale of flat and service tax has to be paid by the builder /Promoter /Developer under Construction of Residential Complex of Service'. The attempt to deny the benefit of the Circular even for a composite agreement which includes construction of the flats/apartments is rather baffling. I wonder how even an agreement of sale could be entered into, without bringing in clauses related to the construction of the flats, etc. This is a master stroke which would virtually kill any little impact the Circular can have, as joint developments involving agreements of construction, would be outside its purview.

Fourthly ... the Department has also been issuing notices taking the view that the exemption covered by the Circular is available only if a residential complex of more than 12 flats is constructed for a single customer for his personal use. The Department has also taken the view that the exemption is not available for construction

of residential use .i.e. a single flat, even if it is for the customer's personal use. This is the most hilarious of all. I cannot even imagine a situation wherein a customer would ask a Developer/Builder to build more than 12 flats for him and that too, for his personal use, which alone would entitle him to take advantage of the Circular.

These views of the Service Tax Department, expressed in notices issued to the Developers/Builders would seem to be aimed at significantly restricting the impact of the infamous Circular No. 108/2/2009-ST dated January 29, 2009.

I have repeatedly written in the national tax press on the impact that the infamous Board Circular has created, in terms of creating a wrong impression that service tax has been abolished on construction of residential complexes. With the Department taking a stand contrary to the views of the Board, it would seem that the Circular would need to find its rightful place in history.

Before parting ...

++ The notices issued by the Chennai Commissionerate state " that the taxability of a service is decided by the provisions of the Finance Act and not by a Circular". It is good to come across this great clarity of thought from the Department, notwithstanding the unfortunate fact that, the Board does not seem to have this clarity.

++ Given the fact that the Board Circular completely lacks clarity, it is but natural that the respective Commissionerates are taking views which are best suited to them. This is very unfortunate as the levy of service tax on construction of residential complexes could be left to the whims and fancies of the local Commissioners, post this Circular.

++ I've seen in public forums, the senior officers of the Department not talking highly of this Circular. In one public meeting, one Chief Commissioner made a comment that the person who issued the Circular did not understand service tax. Does it augur well for the Board, the Department and the tax payers at large, that the circulars issued by the Board have become an object of ridicule, even amongst the Departmental officers?

++ The Circular would seem to have achieved nothing, except to put Developers and Builders completely on the defensive, with flat buyers citing this circular and refusing to pay service tax.

++ With even the Department not agreeing to its views, will the Board kindly withdraw