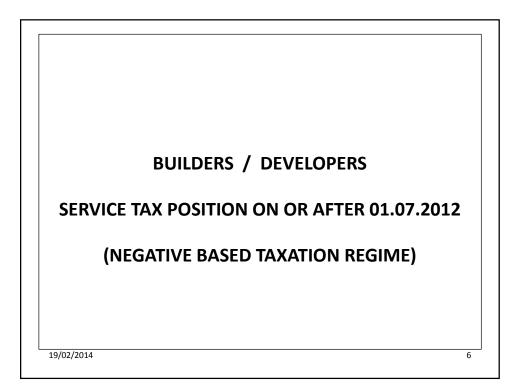
Intensive Workshop on Redevelopment of Soc	
Subject	: Service Tax – Redevelopment of property of the Society.
Date	: Friday, February, 21, 2014
Venue	: J. S. Lodha Auditorium, I.C.A.I. Bhavan, Cuffe Parade, Mumbai : 400 005
Faculty	: CA Naresh K. Sheth

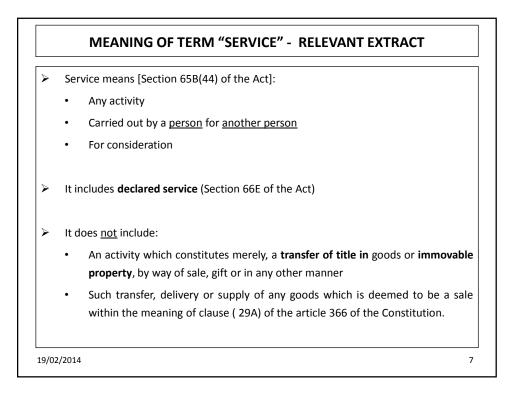
PREAMBLE		
≻	Abbreviations:	
	• The Act – Finance Act, 1994 (Service tax legislation)	
	• The Rule – Service Tax Rules, 1994	
	CCR – Cenvat Credit Rules, 2004	
	• POTR – Point of Taxation Rules, 2011	
	• Valuation Rules – Service Tax ( Determination of Value) Rules, 2006	
≻	Scope of presentation is restricted to :	
	Service tax implications of Redevelopment of Society's property for:	
	Existing Members	
	<ul> <li>Society</li> </ul>	
	<ul> <li>Builder/ Developer</li> </ul>	
	Position on or after 01.07.2012 (Post Negative list based levy of taxation)	
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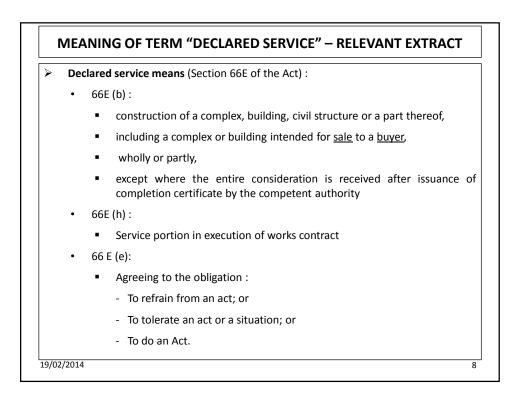


	SERVICE TAX – POSITION TILL 30.06.2012
>	Sale of completed flats / units being a immovable property transaction was not liable to Service tax
>	Sale of under construction flats / units were deemed to be Service provided by builder to buyers w.e.f. 01.07.2010
>	Abatement of 75% was available and effective tax rate:
	• Before 31.03.2012 – 2.575%
	• 01.04.2012 to 30.06.2012 - 3.09%
۶	Builder / Developer was not entitled to Cenvat credit of input, input services and capital goods
>	Service tax levy on sale of under construction flats /units is highly litigative issue and matter is pending before Honorable Supreme Court
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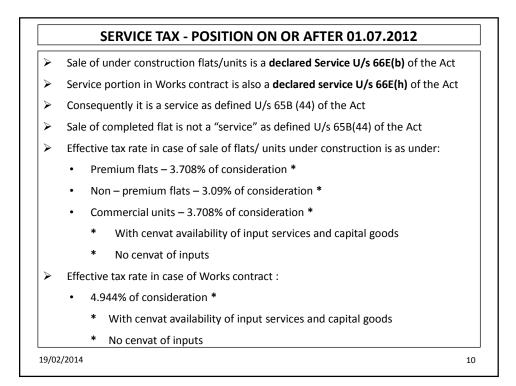
	PRESENT STATUS OF LITIGATION
~	Honorable Punjab & Haryana High Court in <b>M/s G S Promoters Vs Union of India</b> [2010-TIOL-813] upheld constitutional validity of service tax levy on builders and developers
>	Honorable Bombay High Court in <b>Maharashtra Chamber of Housing Industry's case</b> [2012-TIOL-78-HC-MUM-ST] also upheld the levy of Service tax on sale of under construction flats / units
٨	Honorable Supreme Court, on 30 <sup>th</sup> March, 2012, admitted Special Leave Petition (SLP) challenging the above referred order of Bombay High Court
>	<ul> <li>Legal issues are still open whether:</li> <li>Sale of under construction flats amount to provision of Service?</li> <li>Levy of Service tax on sale of under-construction flats is constitutionally valid?</li> </ul>
>	The Honorable Supreme Court in it's judgment in case of Larsen & Toubro Ltd/ MCHI and others [2013- TIOL-46-SC-CT-LB] upheld that sale of under construction flat is a "works contract" liable to VAT

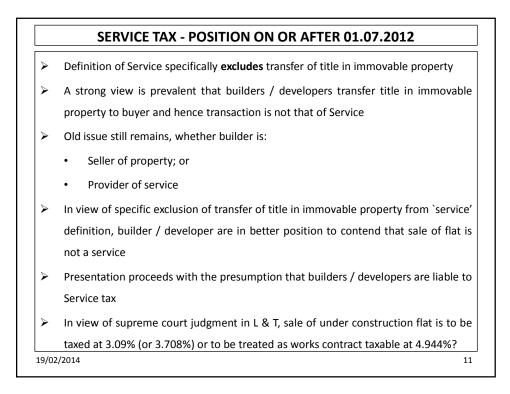


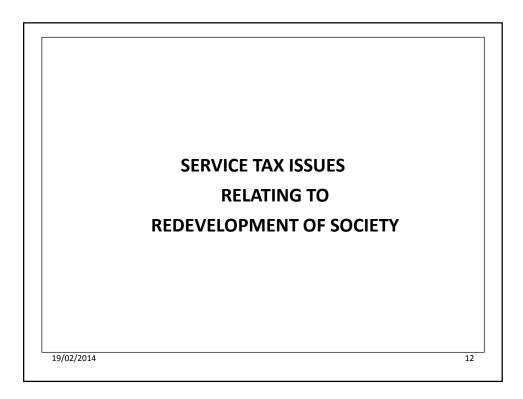


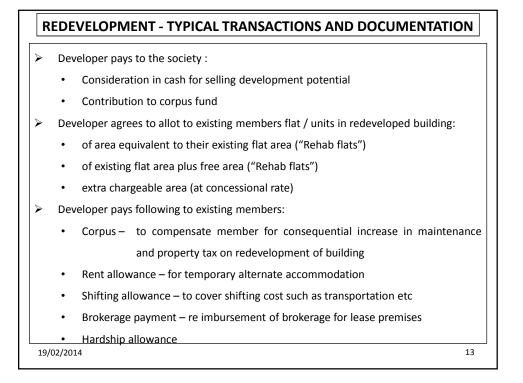


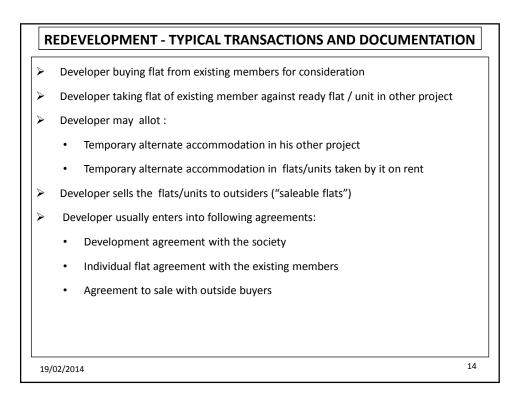
۶	Ser	vice portion in wor	ks contract is decla	ared as service u/s	66E(h) of the Act	
۶	Wo	rks contract servic	e means [ Section 6	65B (54)] :		
	•	Contract involvin	g transfer of goods	in execution of suc	ch contract	
	•	such transfer of g	goods is leviable to	tax as sale of good	s; and	
	•	such contract is f	or carrying out:			
		Construction	Erection	Commissioning	Installation	
		Completion	Fitting out	Repair	Maintenance	
		Alteration	Renovation	Other similar act	ivity	
		of / in respect of	movable or immov	able property		•
	"Or	iginal work" mean				
	•	all new construct	ions			
	•		ions and alteration to make them wo		amage structures o	n lan
	•		ssioning or installa ner pre-fabricated (		hinery or equipme	ent o

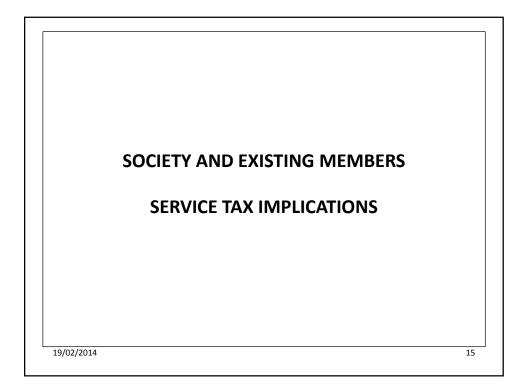






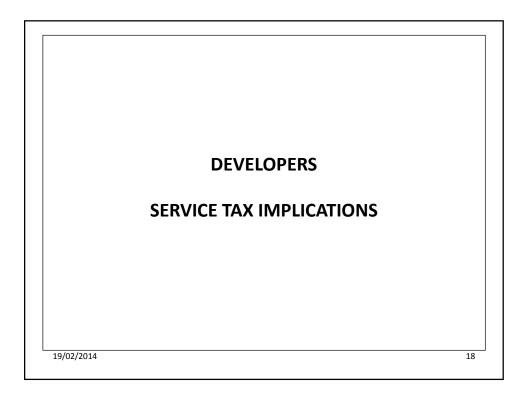


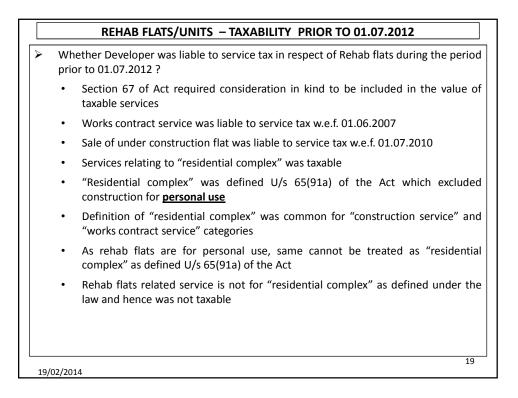




	SOCIETY AND EXISTING MEMBERS - ISSUES	
►	Whether following receipts are liable to service tax in the hands of society:	]
	Contribution to Corpus or other funds	
	Consideration for selling development potential to the developer	
≻	Whether following receipts are liable to service tax in the hands of members:	
	Hardship allowance	
	Shifting allowance	
	Rent allowance for alternative accommodation	
	• Corpus	
	Consideration for vacating the flat/unit	
	Exchange of old flat with ready flat in other project of developer	
≻	Whether members are liable to bear service tax in respect of :	
	Rehab flats allotted free of cost	
	Extra area purchased	
	10	
19	16	

	SOCIETY AND EXISTING MEMBERS - ISSUES
>	If rehab flats are liable to service tax, whether existing members are liable to discharge service tax liability under Reverse charge mechanism in following cases?
	When developer is a non corporate entity; and
	Member is corporate business entity
≻	Above referred issues to be examined with reference to :
	• Definition of "service" as defined U/s 65B(44) of the Act
	• Definition of "declared service" as defined in U/s 66 E (e) of the Act
	• Definition of "works contract" as defined U/s 65B(54) of the Act
	Notification No. 30/2012–ST dated 20.06.2012 for Reverse Charge Mechanism
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	REHAB FLATS/UNITS – SERVICE TAX IMPLICATIONS PRIOR TO 01.07.2012
≻	Circular No.151/2/2012–ST dated 10.02.2012 clarified as under:
	"reconstruction undertaken by a building society by directly engaging a builder/ developer will not be chargeable to service tax as it is meant for the personal use of the society/ its members."
>	The developers were not liable to service tax in respect of rehab flats
>	Whether commercial units in redeveloped building allotted to existing members of the society were also not taxable?
19/	20

## REHAB FLATS / UNITS - SERVICE TAX IMPLICATIONS ON OR AFTER 01.07.2012

- > Whether developer is liable to service tax in respect of rehab flats / units?
- If such service is liable to tax then :
  - What is the point of taxation of such service?
  - How to value such service?
  - In respect of redevelopment project, whether developer is :
    - A "builder" in respect of entire project (Rehab and Saleable flats)
    - A "works contractor" for entire project (Rehab and Saleable flats)
    - A "works contractor" for Rehab flats and "builder" for the saleable flats
- Difference in tax implications:

 $\geq$ 

Position	Effective tax rate	Cenvat eligibility
Works Contractor	4.944% of Consideration (whether to include land value or not?)	Input services & capital goods – available Inputs – not available
Builder	3.09% or 3.708% of consideration (including value of land)	Same as above

	REHAB FLATS/UNITS – TAXABILITY ON OR AFTER 01.07.2012
>	Whether Developer is liable to service tax in respect of Rehab flats/units on or after 01.07.2012 ?
	<ul> <li>"Works contract service" and "Construction service " categories are no longer on statue book w.e.f. 01.07.2012</li> </ul>
	• Definition of "residential complex" is not applicable on or after 01.07.2012
	<ul> <li>Circular No.151/2/2012–ST dated 10.02.2012 is no longer valid and subsisting after introduction of negative list based levy w.e.f. 01.07.2012</li> </ul>
	• Service defined U/s 65B(44) of the Act includes almost all commercial activities
	Declared service defined U/s 66E of the Act includes:
	<ul> <li>Sale of under construction flats/ units</li> </ul>
	<ul> <li>Service portion in works contract</li> </ul>
	<ul> <li>Section 67 of Act requires consideration in kind to be included in the value of taxable services</li> </ul>
	<ul> <li>Letter F.No V/ST – I /Tech – II / 463/ 11 dated 31.08.2012 from service tax commissioner, Mumbai – I to MCHI clarifies that rehab flats/units are taxable</li> </ul>
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## REHAB FLATS/UNITS – TAXABILITY ON OR AFTER 01.07.2012

Whether rehab flats are not taxable as same are not falling under definition of "Declared service" as defined U/s 66E (b) of the Act on following grounds:

- Rehab flats are not intended for sale to buyer
- Allotment of rehab flats cannot be regarded as "sale"
- Existing members are not buyers of rehab flats
- Whether one can contend that developer transfers title in the rehab flats / units and hence same is excluded from definition of "Service" ?

Redevelopment of the society (to the extent of Rehab flats) is a barter transaction:

- Developer provides services of reconstruction of society building
- Society grants balance development potential to the developer
- Whether developer is liable to service tax on value of redevelopment services under charging Section 66B of the Act:
  - There shall be levied a tax (herein after referred to as service tax)
  - At the rate of 12%
  - On the **value** of all services
- Department is of the view that rehab flats / units are liable to service tax
- Many reputed developers have taken conservative position and accepted the departmental view on taxability of rebab flats / units

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 $\triangleright$ 

	"Point of Taxation" ('POT') means the <u>point of time</u> when service shall be deemed to have been provided [Rule 2(e)of POTR]
$\triangleright$	It signifies date of occurrence of taxable event
$\succ$	POTR determines the point of taxation
$\succ$	Relevant service is a "continuous supply of service" for POTR
$\succ$	POT for services in respect of rehab flats U/R 3 would be earlier of:
	Invoice date where invoice issued within 30 days of completion of service
	• If invoice not issued within 30 days, the date of completion of service
	Date of receipt of payment
	• Where advance is received towards provision of taxable service, the POT shall be date of receipt of such advance
$\succ$	Date of completion for continuous supply of service shall be:
	Date of completion of an event
	Requiring service receiver to make payment to service provider as per contract
$\succ$	Service tax liability accrues on POT date
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	REHAB FLATS/UNITS – POINT OF TAXATION
	<ul><li>Provisions, Rules, Notifications, circulars etc. subsisting on POT shall govern:</li><li>Taxability</li></ul>
	Applicable tax rate
	Valuation
	Cenvat Applicability
	Due date for tax payment
>	POT arises when developer gets irrevocable development rights (consideration) unconditionally from society for allotment of rehab flats
>	One should examine relevant agreement carefully to decide POT from following probable dates:
	Date of execution of development agreement
	Date of developer getting vacant possession free from all encumbrances
	• Date on which developer gets necessary permissions (IOD, Commencement Certificate etc) from local authority or government to commence the construction
	• Date on which developer completes the construction of area earmarked for existing members and society
	Date of full and final payment for development rights
	Date of completion of entire project
	Any other date on which the substantial rights in land are unconditionally and irrecoverably bestowed on the developer
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	REHAB FLATS/UNITS – POINT OF TAXATION
۶	The liability to discharge service tax arises on POT even if construction is not started.
۶	Whether development agreements in respect of which POT has already arisen before
	30.06.2012 is not liable to service tax even if:
	Construction started on or after 01.07.2012
	Construction started before 30.06.2012 but completed on or after 01.07.2012
	Possession of Rehab flats given on or after 01.07.2012
	/02/2014 26

	REHAB FLATS/UNI	TS – VALUATION
>	If service in respect of Rehab flats/unit discharging service tax liability?	s is taxable, how to value such services for
≻	Redevelopment transaction can be summ	arized as under:
	Transaction	Consideration received in kind
	Developer constructs and allots rehab flats to existing members	Development Potential (to be used for Saleable flats/ units)
	Society sells development potential to the developer	Rehab flats for member
	Developer is obliged to pay service tax <b>o</b> stipulated under : • Charging Section 66B of the Act	n value of the services provided to society as
		ined U/s 67 of the Act read with Valuation
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Section	Consideration	Value
67(1)(i)	Received in money	Gross amount charged by service provider fo such service
67(1)(ii)	Fully or party in kind - Where value of consideration is ascertainable	Monetary value of such consideration
67(1)(iii)	Fully or party in kind - Where value of consideration is not ascertainable	<ul> <li>Prescribed manner i.e. as per Rule 3 of Valuations Rules</li> <li>(a) Gross amount charged by service provide for providing similar service in ordinary course of trade</li> <li>(b) Where value is not determinable as per (a) service provider to determine monetary value of consideration * <ul> <li>*(which should not be less than cost of providing such service)</li> </ul> </li> </ul>

	REHAB FLATS/UNITS - VALUATION
۶	An erroneous notion prevails that Rehab flats are to be valued U/s 67(1)(iii) read with Rule 3 of Valuation Rule
۶	Accordingly following valuation methods are followed :
	<ul> <li>Rehab flats are valued at sales rate of saleable flats sold nearer to date of agreement with existing members</li> </ul>
	Ready Reckoner value of constructed flats
	Construction cost of Rehab flats
۶	Above valuation methods appear not to be in consonance with legal position:
	<ul> <li>Section 67(1)(iii) and Valuation Rule are applicable only when value of consideration (development potential) is unascertainable.</li> </ul>
	<ul> <li>Developer gets development potential as consideration and hence same is to be valued and not the Rehab flats</li> </ul>
	<ul> <li>Development rights are liable to stamp duty on the market value as prescribed by state Government. Hence, value of consideration is ascertainable</li> </ul>
	29

	REHAB FLATS/UNITS – VALUATION
	• In case of works contract, the land already belongs to society and it is not transferred by builder to the existing members of the society
	<ul> <li>Reconstruction of society's building is a "works contract" and hence same cannot be valued at par with saleable flat which includes land value attributable to such flats</li> </ul>
>	Since value of development potential (consideration for rehab flats ) is ascertainable, Service to be valued <b>U/s 67(1)(ii)</b> of the Act and not U/s 67 (1)(iii) of the Act
•	Value of development potential adopted / assessed for stamp duty purpose should be taken as monetary consideration for Rehab flats
19	30

	Dev	eloper provides "Works Contract service	" to the society	
۶	Two Rule	o methods of valuation of works contrac es	t service prescribed U/R 2A of Va	aluatior
≻	Spe	cific valuation [Rule 2A(i)]:		
	•	Value of service portion shall be gross goods (material) transferred in execution VAT / Sales Tax to be excluded from gro	on of contract.	alue of
		Gross Contract Value	А	1
		(less) VAT / Sales tax	В	
		(less) value of goods	C	
		Taxable Value	D = (A - B - C)	
		Tax payable would be 12.36% of D		
	•	What about deduction for value of lan	d?	_

	REHAB FLATS/UNITS – VALUATION
≻	Presumptive valuation [Rule 2A(ii)]:
	• Where value of service is not determined under specific valuation method, value of the service would be specified percentage of works contract value
	<ul> <li>Construction/ works contract is an "Original works" wherein 40% is presumed to be value of service portion</li> </ul>
	• Effective tax rate under presumptive scheme is <b>4.944% of consideration for works contract</b> (i.e. 12.36% of 40%)
	• Even under presumptive scheme, the vat or sales tax to be excluded from gross contract value
	• Whether land value can be excluded from total consideration for working out the value of the works contract?
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Particulars	Rs.	Rs.
Market Value of development rights assessed for the purpose of stamp duty		20,00,00,000
Less : Paid to society/Existing members in cash:		
a) Corpus/ consideration paid to society	1,00,00,000	
b) Corpus paid to members	75,00,000	
c) Rent allowance	1,50,00,000	
d) Shifting allowance	5,00,000	
e) Hardship allowance	30,00,000	
Considera	tion paid in cash	3,60,00,000
Balance being cons	ideration in kind	16,40,00,000

	Service tax payable under specific valuation U/R 2A (i):	
	Particulars	Rs.
	Value of development right (Gross value of works contract)*	16,40,00,000
	(less) value of material consumed for rehab flats/ units	(6,50,00,000
	Service portion in execution of works contract	9,90,00,000
	Service tax payable @ 12.36% of Rs.9,90,00,000	1,22,36,400
	Developer is eligible to cenvat of input services and capital goods	
$\succ$	Service tax payable under presumption scheme U/R 2A (ii) :	
-	Particulars	Rs.
*		
-	Particulars	<b>Rs.</b> 16,40,00,000 6,56,00,000
•	Particulars           Value of development right (Gross value of works contract) *	16,40,00,000
•	Particulars           Value of development right (Gross value of works contract) *           Service Portion in "works contract" – 40% of Rs.16,40,00,000	16,40,00,000 6,56,00,000

Saleable flats/ units / extra area:       Premium flats - 3.708         a)       Sale of under construction flats to outsiders       Premium flats - 3.708         b)       Sale of extra area to existing members at concessional rates       Premium flats - 3.708         c)       Sale of flat after completion       No service tax	- 3.09% 3%
outsiders     Non- premium flats -       b)     Sale of extra area to existing members at concessional rates     Premium flats - 3.708       Non- premium flats - amount charged     Non- premium flats -	- 3.09% 3%
concessional rates Non- premium flats – amount charged	
c) Sale of flat after completion No service tax	
Rehab flats/ units:	
a) Flats to existing members 4.944% irrespective of premium or non-pre-	
b) Commercial units to existing members 4.944%	

Words of Caution		
2	Views expressed are the personal views of faculty based on his interpretation of law	
>	Application/implications of various provisions will vary on facts of the case and law prevailing on relevant time	
٨	Contents of this presentation should not be construed as legal or professional advice	
•	This is an educational meeting arranged with clear understanding that neither Faculty nor WIRC of ICAI will be responsible for any error, omission, commission and result of any action taken by participant or anyone on the basis of this presentation	
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