Judgment Analysis – Service Tax on Real Estate

Suresh Kumar Bansal -Vs- Union of India and Others, Delhi High Court

Brief facts:

1. The Petitioners had entered into a composite contract with M/s SethiBuildwellPvt. Ltd. (for short "**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.

2. 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.

3. Being aggrieved, two Writ Petitions i.e. W.P. (C) 2235 of 2011 titled as "*Suresh Kumar Bansal vs. Union of India and Ors*." and W.P. (C) 2971 of 2011 titled as "*Anuj Goyal and Ors. vs. Union of India and Ors."*were filed before the Hon'ble Delhi High Court in the year 2011 by the individual flat buyers i.e. the Petitioners. These petitions challenged:

    a. The levy of Service tax on construction services provided by a builder to flat buyers, as introduced vide the Finance Act, 2010 by insertion of Explanation to Section 65(105)(zzzh) of the Finance Act, 1994 (for short **"the Act"**); and

    b. The levy of Service tax on preferential location charges charged by builders, under Section 65(105)(zzzzu) of the Act.

Issues:

    a. Whether the consideration paid by flat buyers to a builder/promoter/developer for acquiring a flat in a complex, which is under construction/development, could be subjected to levy of service tax?

    b. Whether the Explanation appended to Section 65 (105) (zzzh) by the Act was constitutionally valid?

    c. Whether Section 65 (105) (zzzzu) of the Act was constitutionally valid?

    d. Whether in absence of any machinery in the Act and Rules providing for computation of value of services, if any, involved in construction of a complex the tax on such services could have been imposed?

Findings of Court on Facts:

    a. 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.

Findings of Court on Law:

    a. 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 installments 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 sensustricto no services, as commonly understood, are rendered in a contract to sell immovable property.

b. Legislative Competence of the Parliament:

- 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.

c. Absence of Machinery Provision:

- 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.

d. 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.

e. 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.

f. Service element in 'preferential location charges':

- 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.

Held:

- 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……..*

  .....These petitions were admitted by an order dated 21.07.2011 and the applications for stay of recovery filed along with the petitions were disposed of by directing that if any amount is collected on the basis of the impugned explanation, the same shall be refunded with the interest in case the Petitioners succeed. Accordingly, the concerned officer of Respondent No. 1 shall 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 Act and has deposited the same with the respondent authorities. Any such amount deposited shall be refunded to the Petitioners

Ratio:

Where neither the Act nor the Rules made there under provide for a mechanism to ascertain the value of the services component which is the subject of the levy, the levy of service tax must fail.

Analysis:

The above decision unless challenged in Supreme Court would protect the interests of home buyers in Delhi from burden of unnecessary taxation.As far as other states are concerned, it would be upto the respective States whether or

not to follow the ruling. However, if the judgement is challenged and the same is upheld, it would benefit buyers across India. Nevertheless, there could be a situation, where the project cost is escalated to include the service tax component without it being under a separate charge. The decision is based on the fact that under the current law, value of service cannot be totally segregated as far as composite contracts are concerned. That being so, it would lead to a situation where the Central tax on service would be charged on value of land also, which is subject to levy by the State. Considering that the concurrent list does not contain tax entries, it is clear that tax is a mutually exclusive subject. In the absence of any machinery provision as above, such exclusivity cannot be maintained and hence there cannot be said to be a tax in law in such a situation. The final outcome would depend on what happens if/when the aforesaid decision is challenged in Supreme Court. Until then the judgment is applicable to Delhi. Though the order of the Court to refund the service tax paid by the Petitioners does provide relief to them, escalation of price in future as mentioned above cannot be ruled out.