

Service tax Implications on Construction Sector



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Topics Covered

works contracts services

Exemptions for construction services.

Place of Provision of Services with respect to construction services

Cenvat credit vs. Construction services

Treatment of free issue of materials in case of composition scheme

Construction of Residential Complex Services – Delhi High Court Judgment and its implications

Topics Covered

Tripartite Agreements for development of Flats and service tax on land owner share

BOOT Projects and Service Tax

Redevelopment Model of Construction

Construction of Residential Complex Services – Delhi High Court Judgment and its implications

Development of layouts

What is Service?



“Service”
means

Any Activity

Carried out by a
person

For another person

For consideration

includes a declared
service

Service Excludes

A transfer of title in goods or immovable property, by way of sale, gift or in any other manner; or

Such transfer , delivery or supply of goods which is deemed to be a sale within the meaning of clause (29A) of article 366 of the Constitution; or

A transaction in money or actionable claim

A provision of service by an employee to the employer in the course of or in relation to his employment

Fees taken in any court or tribunal established under any law for the time being in force.

DECLARED SERVICES [SECTION 66E]

Sec 66E (b) – Construction Service

Construction of a complex , building, civil structure or a part thereof, including a complex or building intended for sale to a buyer, wholly or partly, except where the entire consideration is received after issuance of completion – certificate by the competent authority.

Section 66E (h)- Works Contract services

“works contract” means a contract wherein transfer of property in goods involved in the execution of such contract is leviable to tax as sale of goods and such contract is for the purpose of carrying out construction, erection, commissioning, installation, completion, fitting out, repair, maintenance, renovation, alteration of any movable or immovable property or for carrying out any other similar activity or a part thereof in relation to such property.

FAQs ON WCS

- ❑ Whether Annual Maintenance Contracts are Works Contract Services?
 - **Yes**, if materials are involved.
 - Since the definition covers both movable and immovable property.

- ❑ Whether labour contracts for building or structures are Works Contract Services?
 - **No.**
 - No transfer of property in goods.
 - Pure Labour contracts are not Works Contract Services.

- ❑ Whether repairs and Maintenance of motor vehicle is Works Contract Service?
 - **Yes**, if materials are involved.

- ❑ Whether completion & finishing services w.r.t new construction shall be construed as original works?
 - **Yes.**
 - It is eligible as original works as without it new construction cannot be said to be completed.

- ❑ Is Composition Scheme always beneficial?
 - **No.**
 - In case of Erection & Commissioning projects where the value of goods is huge
 - Its better to go with Specific Value Method.

- ❑ Can I adopt different valuation methods for different contracts?
 - **Yes.**
 - No restriction under valuation rules.

- ❑ Can I opt composition scheme in VAT & non-composition scheme in Service Tax or non-composition scheme in VAT & composition scheme in Service Tax?
 - **Yes**
 - Rule 2A nowhere states that service providers who pays VAT on actual value of materials is oblige to follow Specific Value Method.

VALUATION

Method-1

Pay ST on service portion - Rule 2A(i) of Service Tax (Determination of Value) Rules, 2006

Gross amount charged	XXX
Value of transfer of property in goods (Excluding VAT)	<u>XXX</u>
Value on which service tax payable	XXX

Method-2

Composition
/
Abatement
scheme

Original Works

AV= 40% of
total amount
charged

Other works
(Repair,
maintainance,etc)

AV= 70% OF
total amount
charged is
assessable
value

Cenvat Credit vs. WCS

As per Explanation 2 of Rule 2A of Service Tax Valuation Rules cenvat credit of inputs cannot be taken as mentioned below:

Explanation 2 --For the removal of doubts, it is clarified that the provider of taxable service shall not take CENVAT credit of duties or cess paid on any inputs, used in or in relation to the said works contract, under the provisions of CENVAT Credit Rules, 2004.

Therefore if service tax is paid on abated value of 40% or 70% as the case may be CC cannot be taken on inputs used for the said contract.

If the assessee is other than a contractor then he is not eligible for cenvat credit of any inputs or input services used in relation to construction of civil structures or building or part thereof – Rule 2 (k) read with 2(l) of CCR.

Exemptions available for Construction Sector:

The following exemptions are provided under the Mega Exemption Notification no. 25/2012:

1. Construction services to Government/LA/GA – S.No. 12 of MEN;
2. Construction of Roads, Bridges etc. –S.No. 13 of MEN;
3. Construction related services relating to railways, housing projects, agriculture.

Construction Services to Government

Services by any person to the Government, local authority, Governmental Authority by way of Construction, Erection, Commissioning, Installation, Fitting out, Repair, Maintenance, Renovation, Alteration of the following are **Exempt**:

Civil Structure/ other original works predominantly used other than for:
1) Commerce
2) Industry
3) Business/Profession;
Up to 01.3.2015



Cont...

Historical
Monuments etc.



A structure for educational,
clinical, art or cultural
establishment; Up to
01.3.2015



Canal & any irrigation
works, pipeline conduit
for Water Supply, Water
Treatment, Sewage
Treatment



Residential complex
for self-use or by their
employees;
Up to 01.3.2015

Construction Services to Government

- The 3 exemptions highlighted above are withdrawn with effect from 1.3.2015 by the Finance Bill 2015 hence became taxable from the said date.
- However, the Budget 2016 with effect from 1.3.2016 restored the above 3 exemptions retrospectively from 1.3.2015 subject to the following conditions:
 - The work order for the said works had been granted on or before 01.3.2015; and
 - This exemption is not applicable for the works executed after 31.3.2020

Construction of Roads, Bridges, etc

Services provided by way of construction, erection, commissioning, installation, completion, fitting out, repair, maintenance, renovation, or alteration of-

1) Roads, bridges, tunnels or terminals used by general public

2) Building owned by Section 12AA entity for religious use by general public/PMAY.

3) Pollution control or effluent treatment plant except as a part of factory

4) Structure meant for funeral, burial or cremation of deceased

Construction of Railways etc.

Airport, Ports,
Railways,
Monorail,
Metro.



Single residential
unit except as a
part of
residential
complex



Post harvest
storage infra.
For agri produce
& Cold Storages;



Mono rail or Metro rail would be exempt if contract is entered prior to 1.3.2016. Air ports and Ports were exempt if the contract is entered into on or before 1.3.2015 and exemption is up to 31.3.2020.

Construction of Railways etc.

Low cost houses
up to 60 sq.m. in
a approved
housing project.



Mechanized food
grain handling
system for Agri
Produce



Exemptions withdrawn - Port, Air Port, Monorail and Metro

Construction services within Port, Airport were exempt up to 1.3.2015.

However Exemption withdrawn w.e.f. 1.3.15 by Budget 2015.

Budget 2016 restored the above exemption retrospectively if the contract is entered prior to 1.3.2015 but however this benefit will be up to 31.3.2020.

Service tax paid during the period 1.3.15 to 29.2.2016 is liable to be refunded.

Exemption relating to Construction of Mono rail and Metro will continue to be exempted if the contract is entered prior to 1.3.2016. Therefore contracts entered on or after 1.3.2016 shall be subject to service tax. (under S. No 14 of the notification No. 25/12-ST) is being withdrawn, in respect of contracts entered into on or after 1st March 2016.

Taxability on Sub-Contractors

❑ Is the sub contractor liable to pay service tax if the main contractor is exempt in respect of a works contract ?

❑ Whether sub-contractor who is providing services to such main contractor also exempt?

- Sl. No. 29(h) of Notification No. 25/2012 – ST (MEN) states that “*sub-contractor providing services **by way of works contract** to another contractor providing works contract services which are exempt”*

Section 66F – Interpretive Rules

(1) Unless otherwise specified, reference to a service (herein referred to as main service) shall not include reference to a service which is used for providing main service.

Place of Provision of Construction Services

Place of provision of service for construction service shall be the place where the immovable property is situated – Rule 5 of POP Rules, 2012

Treatment of goods or material supplied by customer to service provider:

Where the goods are supplied by the contractee at free of cost the same shall be included in the gross amount charged and the tax shall be levied thereon – In case the assessee opts for the composition scheme – Explanation 1 (b) of Rule 2A of ST Valuation Rules.

However the larger bench of CESTAT Delhi in the Bhayana Builders Pvt Ltd held that the value of the free supply of materials shall not be included as mentioned above.

Construction of Residential Complex – Delhi HC

- **Declared Service** - These are specifically declared as service under Section 66E (b) of the Finance Act, 1994.
- **Abatement** - is specified @ 75%/70% from the gross amount charged if the value of the land is included.
- **Cenvat credit** - is not available on inputs used for construction – Notification no 26/2012 S.No 12 of the Table.
- **Judiciary** - Recently the Delhi High Court in the case of **Suresh Kumar Bansal vs. Union of India and others** – held that –
 - legislative competence of Parliament to tax the element of service cannot be disputed.
 - BUT the levy itself would fail, if it does not provide for a mechanism to ascertain the value of services component which is the subject of the levy.

Construction of Residential Complex – Basis of Judgment

Service tax valuation rules do not have provisions to deal with composite contracts which includes land value

Rule 2A of the Rules provide for ascertaining the value of services in a composite contract involving services and goods.

The said rule does not cater to determine the value of services in a composite contract which involves sale of land also.

Abatement notification cannot substitute Act or Rules.

Therefore service tax cannot be levied on construction of residential complex where the gross amount charged includes value of the land.

Construction of Residential Complex – Delhi HC

Key Take aways of the Judgment:

- This ratio is not applicable for land owner portion as there is no transfer of immovable property to the land owner;
- This ratio is not applicable where there are two agreements one is for sale of UDS of Land and the other is for construction of flat.
- This ratio is applicable for both prior and on and after 1.7.2012;
- The assessee may avoid payment of tax based on the judgment but subject to the risk of reversal of this judgment by the SC.

Tripartite Model of Development

Joint Development model of undertaking housing and commercial projects are widely popular because of the reason that no up front huge investments are required for acquiring lands

No cash outflows are involved in this model as a portion of the built up area is exchanged in consideration for the transfer of development rights in land.

Tripartite Model of Development

❑ **Applicability of service tax on JDAs:**

- ❑ Under the negative list regime, Section 66E (b) – declared services, specifically covers services provided by way of construction of complex.

- ❑ construction of a complex, building, civil structure or a part thereof, including a complex or building intended for sale to a buyer, wholly or partly, except where the entire consideration is received after issuance of completion certificate by the competent authority.

Tripartite Model of Development

□ Valuation of Construction Services in lieu of Development rights:

- The builder receives development rights over the land from the land lord.
- In consideration of which a portion of the built up area is transferred to the land lord.
- The value of the land received from land owner is the consideration for allotment of flats to the land owner hence there is a service.
- As far as Builder is concerned there are two categories of service receivers, one the land owners and the outside buyers of flats.

Tripartite Model of Development

What is the value on which the builder should charge service tax from the land owner?

The builder has 2 options as below:

1) Follow circular dated 10.02.2012 (prior to negative list regime)

2) Follow Service Tax Education Guide dated 20.06.2012 (on introduction of negative list regime)

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CBEC circular issued no.151/2/2012 dated Feb 10,2012 states that- the value of these flats would be equal to the value of similar flats charged by the builders/developers from the second category of service receiver i.e., outside buyers.

The Education Guide issued by the CBEC on 20.06.2012 states- the value of flats given to first category of service receiver (land owner) will be the value of land when the same is transferred and the point of taxation also be determined accordingly

NOTE: There is a ambiguity whether it is the value of the flats or value of the land that is to be adopted, for discharging service tax on flats given to land owners. As both the above documents are in conflict.

Tripartite Model of Development

Board Clarification – F.No 354/311/2015 TRU

- In the above background the department has come out with a clarification Vide no F.No. 354/311/2015-TRU where it was held that –
 - The Circular dated 10.2.2012 is in accordance with the provisions relating to valuation as laid down in the Finance Act, 1994 and the Service Tax (Determination of Value) Rules, 2006;
 - Education guide is neither a circular nor a manual of instructions issued by board, therefore it does not have a legal backing.

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Tripartite Model of Development

Board Clarification – F.No 354/311/2015 TRU

Conclusion:

- Therefore the valuation of flats given to land owner shall be made based on the 2012 Circular and hence the value shall be the value of the similar flats sold to outside buyers at around the time at which the land is being made available to the builder for construction.

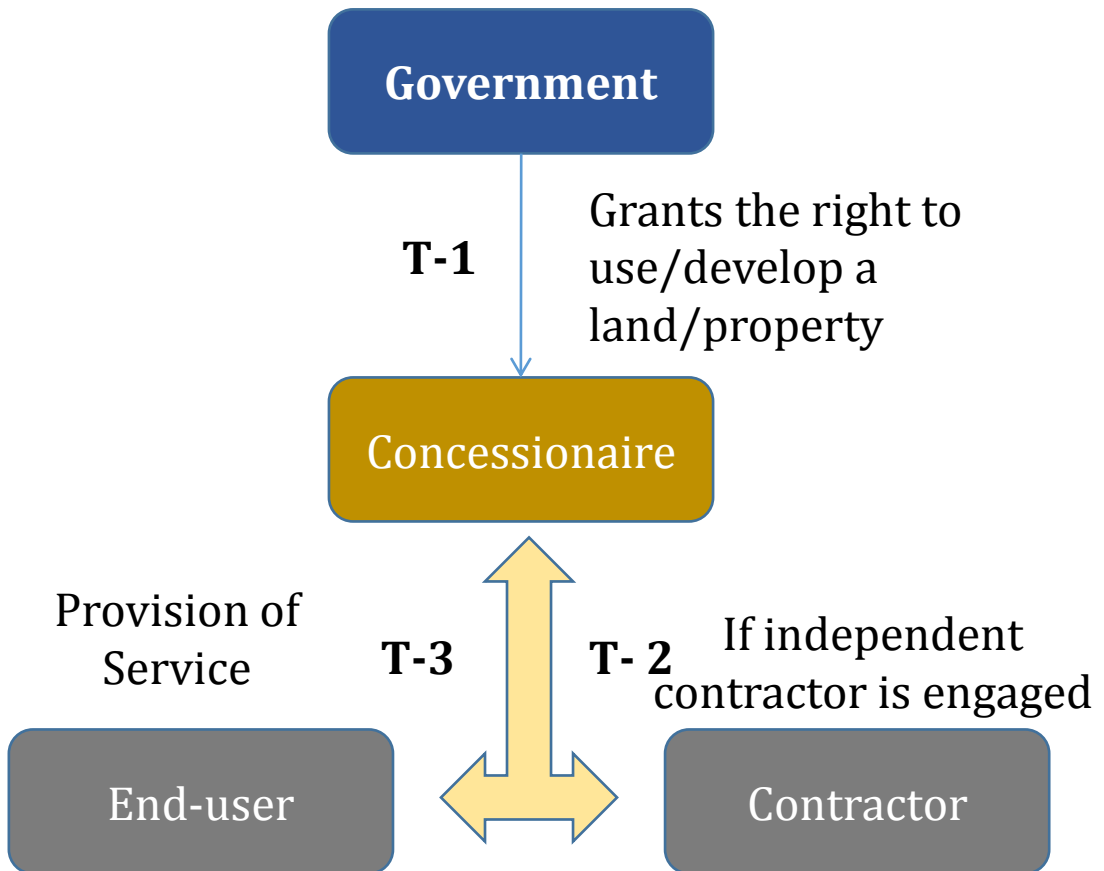
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Tripartite Model of Development

Taxation of Flats being sold by Land Owner:

- Under the negative list regime even the land owner is required to pay service tax with respect to his share of residential units when he ultimately transfers the same to customers except in cases where entire sale proceeds are received after obtaining completion certificate.
- The service tax paid by him to builder is eligible as cenvat credit.

Built own operate and Transfer



Built own operate and Transfer

❑ **T-1 : Transaction between Government and Concessionaire**

- If granting the right to use/ develop a land/property to the concessionaire involves a service, then government is the service provider and is liable to pay service tax.

❑ **T-2 : Transaction between Concessionaire and Contractor**

- If an independent contractor is engaged for construction, then the contractor is the service provider and is liable to pay the service tax. On the other hand if construction is undertaken by concessionaire himself it amounts to self service and not taxable.

Built own operate and Transfer

- **T3 : Transaction between Concessionaire and End-user**
 - If the concessionaire allowing the end-user to use the developed property on rental basis, amounts to service then the concessionaire is the service provider and is liable to pay service tax.

RE-DEVELOPMENT MODEL

Reconstruction Model

- Where the land is owned by a society with each member entitled to his share by way of an apartment.
- Society or individual flat owners give no objection certificate to the builder for construction.
- The builder makes new flat with same or different carpet areas for original owners of flats.
- Construct additional flats for sale to others.
- And or pay additional amount to the owners of original flats.

RE-DEVELOPMENT MODEL

Taxation

- Under this model, there are two categories of service receivers
 - First category being, Original flat owners
 - Second Category consists of buyers of flats other than society members – outside buyers.
- As far the second category of service receivers are concerned, the builder is liable to pay service tax in the usual manner.
- However, with respect to the first category of service receivers, the **CBEC Circular of 2012** categorically states the builder is not liable to pay service tax .

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RE-DEVELOPMENT MODEL

❑ This is because under the old regime construction of complex for **personal use is specifically excluded** from levy

• However, in the Negative List Regime, exemption is provided only with respect to residential complex services in the case of a single residential unit other than as part of a complex or building

• Exemption is provided only if it is a single residential unit, personal use not covered here, hence taxable.

❑ Consequently, the service tax education guide states that in all cases of re construction models service tax would be levied as works contract.

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DEVELOPMENT OF LAYOUTS

Kerala High Court Judgment – whether a road is public or private - 2016 (30) KHC 118

The petitioner and six others had bought 71 cent land divided into plots. A pathway was constructed connecting the plots on sides to the main road. Later, when Athirampuzha gram Panchayat began laying interlocking bricks on the road, the petitioner approached the high court, contending that it was a private path.

The petitioner's counsel argued that the panchayat had been making efforts to appropriate the pathway without informing the owners of the plots.

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DEVELOPMENT OF LAYOUTS

- The Court held that as per section 2 of the Kerala Panchayat Raj Act, 1994 "Any street, road, square, court, alley, passage, cart-track, footpath or riding path, over which the public have a right of way, even if it is not a thoroughfare, is a public road."

- However, the court said a pathway would be private in character if it connects only to a single house. "Once it is meant to connect somebody else's, thus becoming part of a network of roads or paths, however short or insignificant its extent and reach may be, it is to subserve the public purpose of providing access to and fro," the court said.

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Thank You!