M B Abhyankar & Co.

Email: - mbabhyankar@gmail.com Contact no.020-24224721 / 9822475611

Service Tax or GST for Development Agreements entered during pre GST period

Introduction

In the case of construction projects, it is common to enter into development agreements where the developer undertakes to develop property (residential / commercial) in exchange for the development rights given by landlord. Consideration for such development rights is determined based on some agreed ratio of constructed area or in terms of specific number of flats and /or shops in the constructed building to be given to landlord.

As for taxability of transactions involving booking of under **construction property**, taxability of the same under service tax was fixed through an explanation inserted under definition of construction service, w.e.f. 1.07.2010 which sought to tax the sums received by builder prior to grant of completion certificate in respect of the booking made for the building under construction. Accordingly till that date such bookings made for under construction properties were not considered to be taxable under service tax.

However even after insertion of this explanation, in respect of free flats and/or shops given to landlord under development agreements, aspects whether service tax liability arises and if so what is the taxable value and what is the time when such liability arose had remained topics of debate due to absence of monetary consideration in such transactions.

Introduction of GST w.e.f. 1.7.17 which replaced service tax along with other indirect taxes, further compounded these difficulties about taxation of properties given to landlord by developer, where development agreements were made during service tax regime, but construction of these properties got extended in GST period.

At present lot of confusion persists among landlords and developers about taxation of flats to be given to landlords during GST period, Development Agreements for which were executed during Service Tax regime.

Accordingly following queries are posed to Consultants from their clients who are either landlords or developers, who have entered into development agreements before July 17, and where landlords have handed over possession of land to developers before July 17

a. Whether Service Tax or GST will be levied on such overlapping transactions between landlord and developer ?

b. If Service Tax is levied, then the rate of tax applicable.

c. If GST is levied, then the rate of tax applicable.

d. On what value the Tax will be applicable ?

An attempt has been made in this Article to analyze aspects of liability under both the tax laws and arrive at opinion in respect of above queries

A) Part- B Legal Position :

1. Basic Taxability:

With a view to form an opinion about taxability of such transitional development agreements, one has to first consider relevant legal provisions under both Service Tax Law (Finance Act 1994) and GST Law (CGST Act being relevant to earlier Service Tax Law)

2. Service Tax Law :

As a first step, Sections relevant for ascertainment of taxability Section 66B , Section 67 and Section 67A of the Act which are reproduced below

a. Section 66B– Charge of service tax on and after Finance Act, 2012

There shall be levied a tax (hereinafter referred to as the service tax) at the rate of fourteen percent. on the value of all services, other than those services specified in the negative list, provided or agreed to be provided in the taxable territory by one person to another and collected in such manner as may be prescribed.

b. Section 67. Valuation of taxable services for charging service tax. —

(1) Subject to the provisions of this Chapter, where service tax is chargeable on any taxable service with reference to its value, then such value shall, —

(i) in a case where the provision of service is for a consideration in money, be the gross amount charged by the service provider for such service provided or to be provided by him;

(ii) in a case where the provision of service is for a consideration not wholly or partly consisting of money, be such amount in money as, with the addition of service tax charged, is equivalent to the consideration;

(iii) in a case where the provision of service is for a consideration which is not ascertainable, be the amount as may be determined in the prescribed manner.

(2) Where the gross amount charged by a service provider, for the service provided or to be provided is inclusive of service tax payable, the value of such taxable service shall be such amount as, with the addition of tax payable, is equal to the gross amount charged.

(3) The gross amount charged for the taxable service shall include any amount received towards the taxable service before, during or after provision of such service.

(4) Subject to the provisions of sub-sections (1), (2) and (3), the value shall be determined in such manner as may be prescribed.

Explanation. — For the purposes of this section, —

(a)“consideration” includes —

(i) any amount that is payable for the taxable services provided or to be provided;

(ii) any reimbursable expenditure or cost incurred by the service provider and charged, in the course of providing or agreeing to provide a taxable service, except in such circumstances, and subject to such conditions, as may be prescribed;

(iii) any amount retained by the lottery distributor or selling agent from gross sale amount of lottery ticket in addition to the fee or commission, if any, or, as the case may be, the discount received, that is to say, the difference in the face value of lottery ticket and the price at which the distributor or selling agent gets such ticket.

c. Section 67A– Date of determination of rate of tax, value of taxable service and rate of exchange

(1) The rate of service tax, value of a taxable service and rate of exchange, if any, shall be the rate of service tax or value of a taxable service or rate of exchange, as the case may be, in force or as applicable at the time when the taxable service has been provided or agreed to be provided.

(2) The time or the point in time with respect to the rate of service tax shall be such as may be prescribed.

Explanation. — For the purposes of this section, “rate of exchange” means the rate of exchange determined in accordance with such rules as may be prescribed.

From provisions of these Sections , it is clear that the levy of service tax is on services provided or agreed to be provided. Since services are intangible, determination of point of time when any services are provided takes us to relevant Sections and Rules of Service Tax Law. Subsection 2 of Section 67A describes that such point of time shall be "as may be prescribed". The phrase "as may be prescribed" appearing in Section 67A (2) is notified through Point of Taxation Rules, 2011 ("POTR").

d. According to Rule 2(e) of POTR, "point of taxation" means the point in time when a service shall be deemed to have been provided;

e. According to Rule 2A, "date of payment"shall be the earlier of the dates on which the payment is entered in the books of accounts or is credited to the bank account of the person liable to pay tax:

f. Rule 3.which is for determination of point of taxation, provides that

For the purposes of these rules, unless otherwise provided, 'point of taxation' shall be,-

(a) the time when the invoice for the service provided or agreed to be provided is issued:

Provided that where the invoice is not issued within the time period specified in rule 4A of the Service Tax Rules,1994, the point of taxation shall be the date of completion of provision of the service.

(b) in a case, where the person providing the service, receives a payment before the time specified in clause (a), the time, when he receives such payment, to the extent of such payment.

Provided that for the purposes of clauses (a) and (b),-

(i) in case of continuous supply of service where the provision of the whole or part of the service is determined periodically on the completion of an event in terms of a contract, which requires the receiver of service to make any payment to service provider, the date of completion of each such event as specified in the contract shall be deemed to be the date of completion of provision of service;

(ii) wherever the provider of taxable service receives a payment up to rupees one thousand in excess of the amount indicated in the invoice, the point of taxation to the extent of such excess amount, at the option of the provider of

taxable service, shall be determined in accordance with the provisions of clause (a).

Explanation .- For the purpose of this rule, wherever any advance by whatever name known, is received by the service provider towards the provision of taxable service, the point of taxation shall be the date of receipt of each such advance.

g. Interpretation of Above Provisions:

POTR are thus crucial in the scheme of Levy and charge of Service Tax under Section 66B, in that through Section 67A, it is these Rules which determine the time at which the service tax would become liable. Unless the point of taxation is determined using POTR, the services under consideration would not become taxable, since Section 66B alone cannot conclude on taxability.

In this context, analysis of Rule 3 of POTR defines the point of taxation generally as the earlier of the following events:

a. Date of invoice, if the same is issued within 30 days of completion of service, if not, the date of completion of the service;

b. Receipt of advance to the extent of such advance or receipt of payment

So based on above analysis of various sections and POTR, we can infer that even though the service is completed on a particular date, the levy is either advanced or deferred to the date as determined based on POTR. Levy need not coincide with the completion of service. This is because as per charging Section 66 B, as any service which is “provided” is taxable, likewise any service “agreed to be provided” is also taxable.

h. Circular No. 151/2/2012-ST dated 10.2.12, issued by CBEC, about taxability of flats given to landlord, under its Para 2 (B) expressed a view that Service tax is liable to be paid at the time when the possession or right in the property of the flats are transferred to the land owner by entering into a conveyance deed or similar instrument (eg. allotment letter).

Relevant extract of the Circular No. 151 is reproduced hereunder:

“Value 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 (eg. allotment letter).."

i. However views contradictory to the above position were expressed in the Para 6.2.1 of the Education Guide on the Service Tax dated June 20, 2012 released by the Central Board of Excise and Customs. Above said Para 6.2.1, expressed a view that value of construction services provided to such land owner will be the value of the land when the same is transferred and the point of taxation will also be determined accordingly.

Clear contradiction between the views expressed by Board through **Circular No. 151** and the Education Guide, made the issue of fixation of service liability on flats given to landlords more open for interpretation.

j. With a view to provide clarity, Board issued TRU Instruction F.No. 354/311/2015-TRU dated January 20, 2016, based on the recommendation of High Level Committee set up by Ministry of Finance. Above said Instruction clarified that in valuing the services of construction provided by a builder/developer to a landowner, who transfers his land/development rights to builder, for getting, in return, constructed flats/dwellings from builder/developer, the Service tax assessing authorities should be guided by the Board Circular No. 151 and not the Education Guide. In that instruction Board expressed a view that Circular has more legal backing than Education Guide and hence **Circular No. 151** would prevail over the Education Guide.

3. Legal position after introduction of GST (CGST Act)

a. "Levy – Section 9 (1)

there shall be levied a tax called the central goods and services tax on all intra-State supplies of goods or services or both, except on the supply of

alcoholic liquor for human consumption, on the value determined under section 15 and at such rates, not exceeding twenty per cent., as may be notified by the Government on the recommendations of the Council and collected in such manner as may be prescribed and shall be paid by the taxable person.

b. Time of Supply 13

(1)The liability to pay tax on services shall arise at the time of supply, as determined in accordance with the provisions of this section.

(2) The time of supply of services shall be the earliest of the following dates, namely:

a. the date of issue of invoice by the supplier, if the invoice is issued within the period prescribed under sub-section (2) of section 31 or the date of receipt of payment, whichever is earlier; or

b. the date of provision of service, if the invoice is not issued within the period prescribed under sub-section (2) of section 31 or the date of receipt of payment, whichever is earlier; or

c. the date on which the recipient shows the receipt of services in his books of account, in a case where the provisions of clause (a) or clause (b) do not apply"

c. Transitional Provisions

Section 142(10) provides that

Save as otherwise provided in this Chapter, the goods or services or both supplied on or after the appointed day in pursuance of a contract entered into prior to the appointed day shall be liable to tax under the provisions of this Act.

Section 142(11)(b) provides that notwithstanding anything contained in section 13, no tax shall be payable on services under this Act to the extent the tax was leviable on the said services under Chapter V of the Finance Act, 1994 i.e. Service Tax.

d The CBEC on 14.12.17 has clarified about liability under GST in respect of overlapping transactions pertaining to under construction properties as on 1.7.17. In that clarification, it is mentioned that where entire consideration is paid to the builder before introduction of GST (1st July, 2017), there is no GST payable on such property even if the construction is completed after 1st July,

2017. This transaction will attract Service Tax at the rate of 4.5% because as for the Point of Taxation Rules, 2011 applicable to Service Tax, where the invoice was raised or payment made prior to the appointed date under GST, the point of taxation arose before the appointed day and thus such transaction attracts Service Tax and not GST.

e. Central Board of Excise & Customs has issued the **Circular No. 207/5/2017- Service Tax dated 28/09/2017** and has clarified certain transitional issues arising with respect to payment of service tax after 30th June 2017. Accordingly under Para 3 of the clarification, taxpayers have been advised to contact the office of the Additional Director General, Directorate of systems and Data Management, Chennai, regarding any difficulty in making payment of service tax

B) Conclusion:

1. Having gone through service tax liability on flats given to landlord and relevant GST provisions that may become applicable to overlapping transactions, following conclusions may be drawn in respect of tax liability on such flats where development agreements have been effected before Jul17 i.e. during pre GST or Service Tax period.

2. Provisions for Levy of tax and Point of Taxation under Service Tax and GST are on similar lines, so that in respect of both the taxes, supply alone does not trigger levy. Supply coupled with the Point of Taxation for the supply, effectively concludes the taxable event under both the tax laws.

3. In view of this position, for contracts which were made during service tax period, if both the aspects namely that of supply and that of the time of supply (invoice, provision of service, receipt of payment) are under GST period, then GST alone could be charged on such service.

4. In case of remaining overlapping transactions, one has to take recourse to transitional provisions under CGST to determine the respective tax liabilities under Service Tax and GST. GST Law has tried to make the tax incidence mutually exclusive, so that same transaction is not sought to be taxed twice under both service tax and under CGST.

5. Broadly for any given supply, one has to determine when was the service supplied according to point of taxation provisions. If that time is pre GST then Service Tax is payable and if the same is post GST then GST becomes payable.

6. Applying the tests for determination of point of taxation, which are similar in both the tax laws, it is observed that in the case of transactions between landlords and developer, the system of issue of invoices is normally not there. Accordingly out of the three events listed date of receipt of consideration or date of completion of service are relevant.

7. Between the two tax laws of Service Tax and GST, since overlapping transactions pertain to contracts entered during Service Tax regime, it must be first tested whether point of taxation for either whole or part of supply has occurred during service tax period. To that extent, as per provisions of Section 142 (11) (b), that part of supply would become taxable under Service tax alone and no GST shall be payable for the same. This is so because transitional provisions of CGST Act have tried to ensure that in case of overlapping transactions, both these levies should remain mutually exclusive and there is no double taxation.

8. Therefore considering point of taxation as per POTR under Service Tax, in respect of date of receipt of consideration, it has been rightly clarified in the Education Guide (Para 6.2.1) that it should be the date on which development rights are transferred to the builder, in exchange of which builder agrees to give certain flats to landowner. Date on which development rights are transferred is the point of tax because it is date when consideration is received by the developer for flats agreed to be given to landlord. Applying provisions given in the Explanation to Rule 3 of POTR, wherever any advance by whatever name known, is received by the service provider towards the provision of taxable service, the point of taxation shall be the date of receipt of each such advance. Transfer of development rights is the consideration given by landlord to the developer is advance hence the date of such transfer is the point of taxation.

9. Since entire consideration for flats given to the landlord is received by developer, when development rights are transferred, it may be concluded that such a transaction pertaining to development agreement entered before GST period is leviable under Service tax and not under GST.

10. One can take recourse here to clarification issued by CBEC on 14.12.17, according to which when entire consideration is received before 1.7.2017 no GST is payable on such property even if the construction is completed after 1st July, 2017. This transaction will attract Service Tax at the rate of 4.5% because as for the Point of Taxation Rules, 2011 applicable to Service Tax,

where the invoice was raised or payment made prior to the appointed date under GST, the point of taxation arose before the appointed day and thus such transaction attracts Service Tax and not GST.

11. Only point that still remains to be sorted out is about the valuation. In this respect it may be noted that in most of the cases market value of the land (Ready reckoner value for stamp duty purposes) is mentioned in the Development Agreements and should be considered to be the monetary value of consideration received.

12. However this view may not be accepted by the Authorities because it contradicts with the view taken in the Circular 151 and Board has clarified through Instruction F.No. 354/311/2015-TRU dated January 20, 2016, that Circular will prevail over the Education Guide. Here is worth noting that a circular cannot lay down the law. If not in line with the law it is not legally valid. Circular is guided by the aspect that monetary value of consideration in the form of land is not readily ascertainable when development agreement is signed and hence value of similar flats sold for monetary consideration should be adopted for valuation. This however is not the case in most of the development agreements where stamp duty is paid on the ready reckoner value of land given to builder. Accordingly clarification in Education guide is more likely to stand the test of law. Intention of the revenue in its preference for Circular seems to be to collect as much service tax on landowners share as possible, because in most of the cases selling price of flats would be much higher than the stamp duty value of land at the time when development rights are transferred.

13. Despite this legal position, with a view to avoid disputes with Authorities one may decide to go by the contents of Circular no.151/2/2012-ST. According to it the value of these flats would be equal to the value of similar flats sold by the builder/developer to outside buyers . Further 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 (eg. allotment letter).

14. Here it appears that Circular defers the valuation of tax for such flats for want of knowledge of open market price and waits for independent sale price of flats becoming available when first flat is sold to an independent buyer. Since both receipt of consideration and its valuation become available when first flat is so sold, it should be conclude the amount of tax liability even if one has to follow contents of Circular. Mention in the Circular about time when service tax on such tax is liable to be paid, may be taken to mean that it is only about the time when tax is to be paid to the Government though its amount is already fixed upon happening of earlier event of first sale of flat. Accordingly it may be interpreted that time for making payment should be when possession of flats is given to landlord.

15. As for payment of service tax in GST period one may refer to **Circular No. 207/5/2017- Service Tax dated 28/09/2017** where payment of service tax in respect of certain transitional issues has been clarified. Accordingly one may pay service tax at the time of handing over of possession of flats to landlord.

16. As for the issue of interest it may be argued that payment of service tax was allowed to be deferred till the date of possession and hence no interest is payable if service tax is paid at the time of giving possession. On safer side however it may be prudent to pay interest on service tax from the time when first flat was sold till the date of actual payment of tax, because amount of liability is fixed at that point of time.

c) Opinion:

Based on what is stated under Legal Position and Conclusions Part given above, following opinions may be expressed in respect of the queries listed at the beginning of this Article.

1. Whether Service Tax or GST will be levied on the above transaction

Service tax will be applicable on the above transaction (Refer **Para (10) of the Part (C) above, along with other Parts)**

2. If Service Tax is levied, then the rate of tax applicable.

This transaction will attract Service Tax at the rate of 4.5% **(Refer Para (10) of the Part (C) above, along with other Parts)**

3. If GST is levied, then the rate of tax applicable.

Not applicable

M B Abhyankar & Co.

Email: - mbabhyankar@gmail.com Contact no.020-24224721 / 9822475611

4. On what value the Tax will be applicable ?

Valuation may be done at the sale price for sale to an independent buyer at a date nearer to the date of development agreement. **(Refer Para (13) of the Part (C) above, along with other Parts)**

(Author can be reached at mbabhyankar@gmail.com)