

Service Tax on Plotted Development

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In this article we would examine what would be the effect of some services activity conducted in the course of a sale of immovable property in general and development of plots in particular. Consequently the impact of service tax. We also examine the service tax implications along with few possible issues arising out of the recent decision of the Apex Court in L&T case.

Background

It would be relevant to understand the scheme of taxing powers set out in Constitution of India, as per which, the power to tax is distributed between Union and State (some of which are covered by both as well). These are set out in three lists in the Seventh Schedule to the Constitution of India. Accordingly, if the subject matter is covered under List I to the said Seventh Schedule, then the Union Legislature has powers to legislate it. On the other hand if the matters are covered under List II of the said Schedule, then the State Legislature has powers to legislate and if it is covered by List III, both State and Union has powers to legislate.

As far as Immovable property [lands and buildings] related transactions are concerned, only the State has the powers to legislate. The Central Government cannot infringe on the power of the State. Taxes on property are the jurisdiction of the State. However the different aspects of the transactions could be taxed by the Centre like Income from Immovable property under Income Tax and Service portion of the sale of immovable property as well as goods involved in a composite contract which involve land, goods and services.

The Larger Bench of SC in [L&T Limited v. State of Karnataka 2013 \(9\) TMI 853 - SUPREME COURT](#) had recently upheld levy of sales tax / VAT on construction and sale of flats, holding building contracts to be species of "works contract". Larger Bench has, thereby, approved the ratio laid down by 2-Judge Bench of SC in K. Raheja Development a couple of years back. However, it has clarified that construction activity undertaken by the developer would be "works contract" only from the stage when developer enters into a contract with the flat purchaser. We examine implications of this decision on the plotted developments as well.

Models of plotted development

The common modes in which the plotted developments are undertaken in Karnataka could be as follows:

1. **Joint Development Projects:** In respect of Joint Development projects, the developer would take possession of land from the owner, through Joint Development Agreement, for

purposes of plan sanction and infrastructural development. After possession of land converts the same into sites.

2. **Partnerships / SPV:** Where there is more trust between the landlords and developers they may form a partnership/ SPV for each project to avoid cross charges of Stamp duty, VAT or Service tax.
3. **Own projects:** Developer procures the land and develops the same and then sell the land owned by developer.

The JD route presently has been found to be favoured as neither the landlord nor the develop needs to invest substantial amount of monies in the project. As and when the plot is getting developed as per the terms of plotted development in the Municipality, Local Boards or Panchayats etc, these Government / Authorities release parts or whole of the land and consequently those plots are saleable and loans against the same are possible. In Bangalore now using loan to procure a plot has become quite common. Using this monies development is completed in stages. After the amendments to both the direct tax and indirect tax laws seeking to collect tax at the earlier point of time without considering the realities of business, the partnership/ SPV route may gain favour.

In normal course the sale of the individual plots [developed/ in progress] could be under the following options:

- a. **Direct Registration of plot:** This can be done only for completed plots. [practically only left over unsold plots or plots retained for land value appreciation].
- b. **Agreement of Sale of Completed Plots:** Only one agreement to sell the plots normally providing for enough time for the buyer to arrange his finances. [normally through bank/ NBFC] Then go for the registration of the plot. [Possibly where there is no/ minor difference between the guidance value fixed and the market value. At times the value in sale deed and agreement value there could be a difference which could be a cause of concern].
- c. **Agreement of sale of Completed Plots while development of sites under progress:** Where the site is not complete a single agreement for sale plot in future with specified facilities such as roads, park, club house, trees.... Once complete go for registration of the plot. [At times as in b) above there could be a difference in value].
- d. **Two Separate Agreements for sale + development:** One agreement to sell land and another to recover development costs. [These are cases where there is a difference between the guidance value and market value + developers offers/ buyer invariably wishes to register at a lower value but need to raise the money from the bank].

In the opinion of the paper writers, the liability under Stamp Act would continue in case of difference and with increased transparency which is the order of the day, this window of saving of

stamp duty may close in some time.

Position Under Service Tax upto 01.07.2012

Prior to the negative list, in order to attract service tax levy, the service involved must be taxable i.e. finding a mention under any of the sub-clauses of [Section 65\(105\)](#) of [Chapter V of Finance Act 1994](#) as amended from time to time. The classification would be on the basis of the substance of the contract/agreement rather than form as such substance, which would indicate the intention of the contracting parties. The said service should also be provided by a defined service provider to a defined service receiver. The service should also be for a consideration as the question of paying service tax to the Government is only on receipt of consideration or payment. We examine whether there could be a possible coverage.

Site Formation And Clearance, Excavation And Earthmoving And Demolition Service:

As per [Section 65\(97a\)](#) "Site formation and clearance, excavation and earth moving and demolition" *includes*,-

- i. *Drilling, boring and core extraction services for construction, geophysical, geological or similar purposes; or*
- ii. *Soil stabilization; or*
- iii. *Horizontal drilling for the passage of cables or drain pipes; or*
- iv. *Land reclamation work; or*
- v. *Contaminated top soil stripping work; or*
- vi. *Demolition and wrecking of building, structure or road,*

but does not include such services provided in relation to agriculture, irrigation, watershed development and drilling, digging, repairing, renovating or restoring of water sources or water bodies."

While considering the fact that the scope of the words "site formation" is defined in inclusive manner the revenue could take a view that said taxable services category covers the activity of development of residential sites though within development a small part [5-10 percent] could be site formation. The reality is that large amount of the infrastructural development activity would be on the Governments property like roads, parks, water lines/ tank all of which is put up in the part of the property is ceded/ gifted to the Government.

In decision of [Narne constructions 2013 \(2\) TMI 298 - SUPREME COURT](#) the appellant was engaged in offering of plots for sale with assurance of lay-out approvals, development of infrastructure / amenities etc. as part of package of fully developed plot. The Supreme Court held that it was not a case of mere sale of property. Where the essential nature of works executed by

the developer is that of works related to roads, drains, water lines which could be considered as a part of road, it is exempted under earlier service tax law from site formation service. Not liable to service tax in the opinion of the paper writers.

Further the service tax is leviable on the value of taxable services. The land costs recoveries are not liable to service tax. This was also clarified in TRU letter No.1/06/2005-TRU.

Though there is no clarity on applicability of service tax on development activity erring on side of caution, developer could decide to pay service tax only on the part of the development costs of the site recovered towards drilling, boring, stripping under the category of site formation services. This would not include the cost of infrastructure ceded to authorities or the value of land per se.

The accounting (costing) records + the certificate of chartered engineer could be used to arrive at the values of the development works of nature of exempted works of road, its drains and allied works which are exempted from service tax. On the balance the developers could chose to pay service tax.

Discussion under negative list based taxation

Under negative list based taxation all services, other than those mentioned in negative list or a subject matter of exemption is liable to service tax. The term "Service" is defined to mean **any activity carried on by any person to any other person for consideration and includes declared services** but shall not include an activity which constitutes *merely transfer of 'TITLE' in goods or immovable property* by way of sale, gift or in any other manner.

Discussion on transfer of title:

The 'service' definition contains certain exclusions as stated earlier in the opinion. The exclusions cover at clause (a). i.e. ***Transfer of title in goods or immovable property, by way of sale, gift or in any other manner***.

The word/phrase 'merely' assumes significance. The meaning of the word merely as per Oxford English Dictionary is 'just' 'only'. P Ramanatha Aiyer Concise Law Dictionary refers 'merely' is a term which is to be given a reasonable construction according to the subject matter.

From this it is clear that the transaction shall be out of service tax net only if the activity is exclusively dealing with transfer of title in goods or immoveable property or actionable claim. If the transaction is coupled with another activity then this exclusion cannot be applied and consequently the transaction shall be subject matter of service tax. The above clause specifically excludes a transfer of 'TITLE' in immovable property.

Whether the development works done by developers post 1.7.2012 is classifiable in [Section 66E \(b\)](#)? In our view, the sub-clause is applicable only in respect of the consideration received towards the **construction of a complex or building intended for sale** to a buyer, **before the issuance of completion certificate** by the competent authority. The development works which is not activity of construction and sale of complex is not covered in this category.

Further where the essential activity is a sale of immovable property of plot and incidental service is taxable, it may not be possible to vivisect and tax the same. At the same time, in light of recent L&T decision, amounts received after entering into contract by developer would be treated as works contract in VAT. Whether development charge would be more specifically covered in works contract services category wef 1.7.2012? In our view if VAT is not being paid on said activity, it cannot be treated as works contract under service tax either.

As discussed earlier, the road works were exempted from service tax under earlier service tax law. Same exemption is continued in negative list based taxation as well in Sl.no.13 the exemption [notification no.25/2012-ST](#) provides exemption for the Services provided **by way of construction**, erection, commissioning, installation, completion, fitting out, repair, maintenance, renovation, or alteration of,-

- a. **a road**, bridge, tunnel, or terminal for road transportation **for use by general public**;.....

Though there is no clarity at present on taxing on transactions involving immovable property + recovery of service costs, the revenue could demand service tax on the charges collected vide agreement towards development works. As major portion of layout development involves the road and related works, it could claim exemption on the payments received towards such activity. In which case, the service tax could be paid on the charges towards the leveling and marking alone determined as discussed earlier under heading for period earlier to 1.7.2012.

Implications for each model:

Joint Development Projects:

It was not taxable earlier to 1.7.2012 for following reasons:

- a. JDA for development of layout arrangement was nowhere set out in any of the taxable services category of [section 65\(105\)](#).
- b. Though post 1.7.2010 service tax is levied on the construction and sale of **building** by builder where any **sums are received prior to completion certificate** as the developer would not be receiving any sums towards construction and sale of buildings from land

owner earlier to completion certificate. Not liable to service tax.

As post 1.7.2012 service tax is leviable on consideration received towards construction of complex intended for sale to buyer before completion certificate. As consideration is wider term than sums [could include non-monetary as well], the revenue could treat land as a consideration towards civil structures of development works, and demand service tax on the same.

In which case, applying the decision of L&T mentioned at supra, developer could segregate the amounts received towards completed layout (immoveable property). Pay service tax only on the balance.

Own projects:

As this is a transaction in immoveable property, it is not liable for period earlier to and post 1.7.2012.

At same time, if developer receives any payments earlier to completion the revenue could demand service tax. He could opt to pay service tax excluding value of land + roads and other immoveable property. Pay only on balance.

Service tax implications of Sale of Plots under various options

Direct Registration of plot:

It may not be liable for period earlier to and post 1.7.2012 as it is sale of immoveable property. It is not liable to service tax.

Agreement of Sale of Completed Plots:

It may not be liable for period earlier to and post 1.7.2012 as it is sale of immoveable property. It is not liable to service tax.

Agreement of sale of Completed Plots while development of sites under progress:

The agreement to sell land which is for sale of immovable property of land is clearly excluded from service tax levy as it is a mere transfer of immoveable property.

At same time, when development is in progress citing decision in L&T mentioned at supra, the service tax could be demanded on sums received after entering agreement. The developer could segregate the amounts received towards completed layout (immoveable property). Pay service tax only on the balance to extent of works done for other than government and registered value of

land.

Two Separate Agreements for sale + development:

The agreement to sell land which is for sale of immovable property of land is clearly excluded from service tax levy as it is a mere transfer of immoveable property.

The service tax could be demanded on the development agreement to extent not ceded to government. Based on documentary evidence to prove what was transferred was immoveable property of developed land. It would not be liable to service tax for period earlier to and post 1.7.2012.

In this article paper writers have examined the service tax implications of plotted development. The matter has started being examined by the revenue and early resolution would help those in this sector.