GST Valuation – Construction Service - Actual land deduction?

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Valuation is the measurement of value on which any tax has to be paid. The typical construction contract is the composition of three components namely

- Land or an undivided portion of land in case of apartments
- Materials/goods like cement, steel etc.,
- Services like labour in construction, designing etc.

Before GST was introduced, different indirect taxes were levied on the above mentioned three components. State government levied Stamp Duty on transfer of immovable property and Local VAT on value of material transferred by way of accretion to the IP. The Central government levied service tax on service portion.

There were practical difficulties in arriving at the exact value of each component and taxing such component at full rate by the respective Governments was not proper. Therefore every State VAT law used to provide the optional composition rates. Similarly, service tax law also used to prescribe the deemed valuation by way of abatements.

After the introduction of GST w.e.f. 01.07.2017, the bifurcation of materials and service components was not warranted as such composite contracts are now deemed as services. However, with the presence of the third component i.e. sale of land which was kept outside the GST, the need arises to prescribe the mechanism to identify the land value from the total amount received and taxing only the net of land value. For this reason, GST law (vide Notification No. 11/2017- Central tax (Rate) dated 28.06.2017 as amended provides that GST rate applicable is 18% on 2/3rd of the total amount received which was formulated as (total amount received – 1/3rd of such total amount which was deemed as land value). This is as per sec.15 (5). Thus, making the effective rate as 12% of the total amount received from the customer. The GST rates are referred as 18% while explaining the implications of actual deduction of land v. 1/3rd deemed deduction of land, readers may note that w.e.f. 01.04.2019, the rate is revised to 7.5% (effective

rate of 5%) in case of non-affordable residential apartments and 1.5% (effective rate of 1%) in case of affordable residential apartments subject prescribed conditions. The analysis would be relevant even after 01.04.2019 as there are no changes in the provisions for land deduction.

For example, the amount received from the customer is 4,500/- per sq. ft then the GST shall be paid at 18% of 3,000 (4,500-1,500) which indirectly means 12% on 4,500. The 1,500 arrived as 1/3rd of 4,500 and same was deemed as value collected from customer towards the sale of land or an undivided portion of land.

While providing the rate, the law, in fact, a delegated notification deemed that 1/3rd of the total amount is the amount collected towards the sale of land or an undivided portion of land. Now the question arises whether such deemed value of land is to be mandatorily followed? On a plain reading of the notification, the answer is yes, as the law provides for deemed value and has not given any scope to deduct the actual land thereby making the actual land value irrelevant while applying the above referred rate of 12%.

Mandatory deduction towards land @1/3rd might be sufficient or even be on the higher side if the project is located in the suburban or rural areas. However, in the metros, premium or semi-premium localities where land value is almost 60-90% of the unit value, this deduction is not sufficient. The law should have provided the mechanism to reduce the value of land in the prescribed manner and it should have been left to the option of the builder to pay tax at the reduced rate of 12% if he is unable to value the land. Notional deduction of 1/3rd value towards land value for all tax payers is clearly unreasonable, arbitrary, violates principles of equity laid down under Article 14 as it treats 'unequal treated as equal'. The restriction to carry on business guaranteed under Article 19(1)(g) whether reasonable or not could also be examined.

In many southern States, traditionally builders execute two agreements

- One is sale deed conveying the title of land (undivided portion in case of apartments).

- Other is 'construction agreement' popularly known as work order which is entered to undertake the construction work on the land which was already conveyed to such customer through the above referred agreement

There is a clear identification of consideration towards land but the GST law does not recognise these values to deduct from the total amount and uniformly fixes that land value as 1/3rd.

The readers may note that there are advance rulings stating that though there exists separate agreement for sale of land/undivided share land, the GST shall be paid on the total value including the amount charged towards land thereby implying that deemed deduction of 1/3rd is mandatory in all cases and actual value of land is to be ignored. **In Re: Kara Property Ventures LLP 2019-TIOL-86-AAR-GST; In Re: Sanjeev Sharma 2018 (13) G.S.T.L. 395 (A.A.R. - GST)**

Whether such deeming value of land amounts to taxing the land component?

Undoubtedly, the GST is not applicable on the sale of land. That being a case, the question is whether land can be subjected to GST indirectly through an artificial valuation of construction. The Supreme Court in Acer India Ltd -2004(172 ELT 289(SC) observed that excise duty could nto be collected indirectly. More so considering the settled jurisprudence that one cannot achieve by indirect means what one is not permitted to do directly. Jagir Singh vs Ranbir Singh 1979 AIR 381; Gian Singh vs State Of Punjab & Anr on 24 September, 2012; Delhi Administration vs Gurdip Singh Uban And Ors. Etc on 18 August, 2000 etc.,

Here it appears that the value of land is sought to be taxed through GST which is a tax on goods or/and services.

Judicially, the Courts have permitted the Governments to prescribe a larger value not exclusively limited to the particular nature of the tax. In this regard, the decision of Hon'ble Apex court (larger bench) in case of Commissioner v. Grasim Industries Ltd 2018

(360) E.L.T. 769 (S.C.) held that measure of the levy will not be controlled by the nature of the levy. So long as a reasonable nexus is discernible between the measure and the nature of the levy and measure/valuation would operate in their respective fields.

When there is availability of actual value is 1/3rd mandatory or can it be challenged?

Paper writers are of the view that the 1/3rd deemed deduction of land can be challenged on the ground that Government can devise the formula for capturing the taxable portion of composite contract consists of both taxable (labour & materials) & non-taxable components (land) only when **there is no bifurcation is available**. It should not be made universal or apply in all cases of composite contracts. That is to say Government cannot override or ignore the identified components while providing for deemed valuation or so called formula. This is more specifically when the agreements/records of assessee clearly capture the taxable component. In this regard, ratio of Hon'ble Supreme court decision in case of **Wipro Ltd v. Assistant Collector Of Customs 2015 (319) E.L.T. 177 (S.C.)** can be referred wherein it was held that

"*We are also of the opinion that when the actual charges paid are available and ascertainable, introducing a fiction for arriving at the purported cost of loading, unloading and handling charges is clearly arbitrary with no nexus with the objectives sought to be achieved. On the contrary, it goes against the objective behind Section 14 namely to accept the actual cost paid or payable and even in the absence thereof to arrive at the cost which is most proximate to the actual cost. Addition of 1% of free on board value is thus, in the circumstance, clearly arbitrary and irrational and would be violative of Article 14 of the Constitution.* (Para 31)

No doubt, rulemaking authority has the power to make Rules but such power has to be exercised by making the rules which are consistent with the scheme of the Act and not repugnant to the main provisions of the statute itself. Such a provision would be valid and 1% F.O.B. value in determining handling charges, etc., could be justified only in those cases where actual cost is not ascertainable. (Para 32)

34. *In the present case before us, the only justification for stipulating 1% of the F.O.B. value as the cost of loading, unloading and handling charges is that it would help Customs authorities to apply the aforesaid rate uniformly. This can be a justification only if the loading, unloading and handling charges are* ***not ascertainable****. Where such charges are known and determinable, there is no reason to have such a yardstick. We, therefore, are not impressed with the reason given by the authorities to have such a provision and are of the opinion that the authorities have not been able to satisfy as to how such a provision helps in achieving the object of Section 14 of the Act. It cannot be ignored that this provision as well as Valuation Rules are enacted on the lines of GATT guidelines and the golden thread which runs through is the actual cost principle. Further, the loading, unloading and handling charges are fixed by International Airport Authority."*

It is interesting to note that under GATT (which is followed after carve out in India) the emphasis is on actual cost.

Further decision in case of **Federation of Hotels & Restaurants Association of India *v*. UOI 2016 (44) S.T.R. 3 (Del.)** wherein while dealing with the Rule 2C of service tax (determination of value) Rules, 2006 it was clearly held that *"It also requires to be kept in mind that the ready reckoner formula is useful* ***where an assessee does not maintain accounts in*** *a manner that will enable the assessing authority to clearly discern the value of the service portion of the composite contract. It hardly needs emphasis that when during the course of assessment proceedings an assessee is able to demonstrate, on the basis of the accounts and records maintained by it for that purpose, that the value of the service component is different from that obtained by applying Rule 2C the assessing authority would be obliged to consider such submission and give a decision thereon."*

The paper writers view therefore is that the actual deduction of land should be permissible when it is supported by the sufficient evidence and the 1/3rd deduction is not always mandatory and can be challenged.

Besides the above, there are some serious legal infirmities in prescribing the valuation for 'construction services' involving the transfer of land. Few of them are given below:

- Out of 3 components in composite transaction of flat construction & sale, only 2 components (Goods & services) are leviable to GST and third component (land) is not leviable to GST. in this background, Neither the GST Acts nor the Rules framed therein provide for a machinery provision for excluding the non-leviable component ('land'). in absence of proper measurement provisions, levy itself fails. The notional deduction of 1/3rd by a notification or a circular cannot substitute the lack of statutory machinery provisions to ascertain the value of goods & services involved in a composite contract. Judgments in case of Commissioner v. Larsen & Toubro Ltd. — 2015 (39) S.T.R. 913 (S.C.); CIT v. B.C. Srinivasa Shetty : (1981) 2 SCC 460; Suresh Kumar Bansal v. Union of India — 2016 (43) S.T.R. 3 (Del); and many other.
- It appears the deemed 1/3rd deduction was given taking the powers from Section 15(5) of CGST Act, 2017 which can be challenged on the grounds of excessive delegation and arbitrariness.
- Be that as it may, the valuation u/s. 15(5), ibid shall come through the rules as the 'prescribed' definition given under section 2(87) of CGST Act, 2017 covers only the 'rules' not the notification.
- Even the rules made taking powers from section 15(5), ibid applies in specific cases of consideration not being ascertainable or conditions of transaction value' fails or composite rates at the option of tax payer. Here again, no imposition of the notional valuation.
- The levy of stamp duty is on the aspect involving 'transfer of land' which is precisely GST notification allows as the 1/3rd notional deduction. Thus, there are no two different aspects here thereby the aspect theory does not justify the notional deduction.

In light of the above, it is recommended to make representation to the GST Council to

clarify in line with the Apex courts earlier judgment. This may also lead to a just correction. Alternatively, the filing of writ petition before jurisdictional High court can be explored if the notional deduction is adversely impacting the business/cost.

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