

Service tax relating to Construction Industry

Service tax was imposed on construction industry way back in 2004. But the same was not implemented fully because of various litigations. A deeming provision was introduced in definitions of commercial or industrial construction and construction of residential complex. The effect of the provision was that if a builder / developer received any payment towards sale of flat or shop or commercial / industrial gala before obtaining completion certificate from concerned authorities, it will be treated as taxable service. Section 66E of Finance Act, 1994 defined "Declared service" which covers construction activity.

Builders / Developers enter into various agreements with various people in respect of construction activities. Taxation under construction service depends upon various business models and contracts that are entered into by Builders / Developers with landowners, contractors, investors etc. Some of the business models are discussed here:

I. Supply of some flats / shop etc to landowners

Builder / Developer may a times give some flats / shops etc to landowner, who has given the land for construction. In such cases, service tax is payable by builder / developer on flats / shops etc. given to landowners on the value of such flats. Value of service will have to be found out on the basis of value of service of identical or similar flat / shop or on the basis of cost of construction plus reasonable profit.

Point of taxation of such flats / shops given to Builder / Developer by landowner who gives land / development rights have been point of dispute. The dispute was between views expressed in Para 6.2.1 of the Education Guide 2012 and the CBEC Circular No.151/2/2012 dated 10/02/2012 on how flats handed over to the landowners in case of redevelopment are to be valued for the purpose of levy of service tax. Tax Research Unit from Ministry of Finance has issued report of the High Level Committee (HLC) dated 20th January 2016. HLC has opined that the guidelines communicated by the said Circular are more appropriate. According to the CBEC Education Guide on Taxation of Services, 2012 value of construction service 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. However, Circular No.151/2/2012 dated 10/02/2012 states that the value of land/ development rights in the land may not be ascertained ordinarily and therefore, value, in the case of flats given to the landowners is determined in terms of section 67(1) (iii) read with rule 3(a) of Service Tax (Determination of Value) Rules, 2006. Accordingly, the value of these flats would be equal to the value of similar flats charged by the builder/ developer from the other buyers. 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 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 (e.g. allotment letter).

II. Joint Development by land owner and builder / developer

In some cases, the land owner and builder/ developer may have a joint venture for the construction project. Such a joint venture may be in the form of separate legal entity or unincorporated Joint Venture. Service tax will be payable in both the cases. If separate legal entity is constituted, then service tax would be payable by such legal entity. Even in case of unincorporated joint venture, it will come under the definition of 'person' under association of persons or body of individuals. In such cases, such AOP / BOI should obtain PAN and have separate registration under service tax. Some time joint venture agreement provides that some flats will be sold directly by the land owners and some by the builder/ developer. In such cases, land owner will pay service tax on flats sold by him and builder/ developer on flats sold by him directly to customers.

III. Investor investing in construction project on sharing basis

In some cases, an investor invests in a project where he is allotted some flats / shops which he can sale later. In such cases, the builder/ developer will be liable to pay service tax on amount invested as it will be treated as advance received towards construction of flats / shops. If the investor exists later and the amount is refunded, service tax to the extent of refunded amount can be adjusted against future service tax liability.

Service tax will not apply only when a builder sale a ready possession flat or shop or industrial gala after building completion certificate is obtained from competent authority and entire consideration is obtained only after building completion certificate is obtained. In all other cases, the builder will be liable to pay the service tax.

"Competent authority" means the Government or any authority authorized to issue completion certificate under any law for the time being in force. In case of non-requirement of such certificate from such authority, certificate of registered architect, chartered engineer, licensed surveyor is acceptable.

Cenvat credit taken on such construction activity will have to be reversed proportionately to unsold flats. Such reversal shall be made immediately after obtaining completion certificate from competent authority.

Under service tax law, construction service and works contract service are two different services. But really, both are contracts of work of construction. If such work is pure labour work, it is construction service. If during execution of construction work, property in goods gets transferred from contractor to customer, it is works contract. Even then it remains a contract for work of construction.

Works Contract

The term 'Works Contract' has been defined in Sec.65B(54) of Finance Act, 1994. The definition covers wide range of activities relating to movable and immovable property. Following get covered under this definition:

- a) Erection, Commissioning or Installation of plant, machinery, equipment or structures
- b) Construction of buildings and civil structures
- c) Turnkey projects
- d) Maintenance services relating to goods where goods and services both are involved as composite contract (e.g. Annual Maintenance Contracts)
- e) Job work where job worker uses some of his own material (which does not amount to manufacture)

Exemptions to activities relating to construction

- I. Serial No.12 of Notification No.25/2012 - Construction service provided to Government, Local Authority and Governmental Authority
- II. Serial No.13 of Notification No.25/2012 - Exemption to various projects of general use
- III. Serial no.14 of Notification No.25/2012 - Exemption to some infrastructure projects
- IV. Serial no.14A of Notification No.25/2012 - Exemption to construction related services for airport or port
- V. Serial no.29(b) of Notification No.25/2012 – Exemption to sub-contractors

I. Serial No.12 of Notification No.25/2012 - Services must be provided to Government, a Local Authority or a Governmental Authority by way of construction, erection, commissioning, installation, completion, fitting out, repair, maintenance, renovation or alteration of –

- a. Civil structure predominantly for use other than for commerce, industry or any other business or profession [omitted w.e.f.01/04/2015]
- b. Any other original work meant predominantly for use other than for commerce, industry or any other business or profession
- c. Historical monument, archaeological site or remains of national importance, archaeological excavation, or antiquity
- d. Structure meant predominantly for use as (i) an educational; (ii) a clinical; or (iii) an art or cultural establishment [omitted w.e.f.01/04/2015]
- e. Canal, dam or other irrigation works
- f. Pipeline, conduit or plant for (i) water supply, (ii) water treatment, or (iii) sewerage treatment or disposal
- g. Residential complex predominantly meant for self-use or the use of their employees or other persons specified in the Explanation 1 to Sec.65B(44). [omitted w.e.f.01/04/2015]

The above clause no. a, d and g which were omitted w.e.f.01/04/2015 are proposed to be restored in Serial No.12A in the said notification with additional condition. The additional condition is that the contract must be entered prior to 01/03/2015 and on which appropriate stamp duty where applicable have been paid prior to 01/03/2015. This exemption is provided for services provided upto 01/04/2020

- II. Serial No.13 of Notification No.25/2012 - Services must be provided by way of construction, erection, commissioning, installation completion, fitting out, repair, maintenance, renovation or alteration of –
 - a. Road, bridge, tunnel or terminal for road transportation for use by general public
 - b. Civil structure or any other original works pertaining to a scheme under JNNURM or Rajiv Awaas Yojana.
 - c. Building owned by an entity registered under Sec.12AA of the Income Tax Act, 1961 and meant predominantly for religious use by general public
 - d. Pollution control or effluent treatment plant except as part of factory
 - e. Structure meant for funeral, burial or cremation of deceased
 - f. In-situ rehabilitation of existing slum dwellers using land as a resource through private participation under the Housing for All (Urban) Mission / Pradhan Mantri Uwas Yojana, only for existing slum dwellers [w.e.f.01/03/2016]
 - g. Beneficiary-led individual house construction / enhancement under the Housing for All (Urban) Mission/ Pradhan Mantri Awas Yojana [w.e.f.01/03/2016]

- III. Serial no.14 of Notification No.25/2012 - Services must be provided by way of construction, erection, commissioning or installation of original works and pertaining to –
- a. Railways, excluding monorail and metro [w.e.f.01/03/2016]
 - b. Single residential unit otherwise than as part of a residential complex
 - c. Low cost houses upto a carpet area of 60 square meters per house as per scheme approved by Ministry of Housing and Urban Poverty Alleviation, Government of India
 - ca. Low cost houses upto a carpet area of 60 square meters per house in a housing project approved by the competent authority; [w.e.f.01/03/2016]
 - (ii) the “Affordable Housing in Partnership” component of the Housing for All (Urban) Mission / Pradhan Mantri Awas Yojana;
 - (iii) any housing scheme of a State Government
 - d. Post-harvest storage infrastructure for agriculture produce including a cold storage
 - e. Mechanized food grain handling system, machinery or equipment for units processing agricultural produce as food stuff excluding alcoholic beverages
- IV. Serial no.14A of Notification No.25/2012 - Exemption to construction related services relating to airport, port, metro and monorail is withdrawn from serial no.14 and proposed to be inserted in serial no.14A with certain additional conditions. The additional conditions provide that contract for providing service shall be entered prior to 01/03/2015 and appropriate stamp duty should have been paid prior to 01/03/2015. Also a certificate from Ministry of Civil Aviation or Ministry of Shipping is required stating the same. The exemption is valid upto 31/03/2020.
- V. Serial no.29(b) of Notification No.25/2012 - Sub-contract providing services by way of works contract is exempt from payment of service tax, provided such services are provided to main contractor who is also providing services of works contract which is exempt from payment of service tax.

Place of Provision of Services

As per Rule 5 of Place of Provision of Services Rules, 2012, if any services are provided directly in relation to immovable property including some of the specified services, the place of provision of service shall be place where the immovable property is located or intended to be located. Rule 8 of POPS Rules states that place of provision of service where provider and receiver are located in a taxable territory shall be the location of service receiver. As per Rule 14 of POPS Rules, Rule 8 prevails over Rule 5. Therefore, if the service provider and service receiver, both are located in taxable territory, the service would be taxable even if the construction relates to immovable property located outside India.

Point of Taxation

Point of Taxation Rules states that any service which is provided under a contract for a period exceeding 3 months and service specified by Central Government shall be considered as continuous supply of service. Works Contract service therefore qualifies under continuous supply of service as per Point of Taxation Rules. Rule 3 of Point of Taxation provides that in case of continuous supply of service, where the provision of whole or part of 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 shall be deemed to be date of completion of provision of service.

Payment of Service tax under Reverse Charge

The service tax in respect of Works Contract services provided –

→ By Individual, HUF, Proprietary firm or Partnership firm (including AOP) located in the taxable territory

→ To a business entity registered as a body corporate, located in the taxable territory

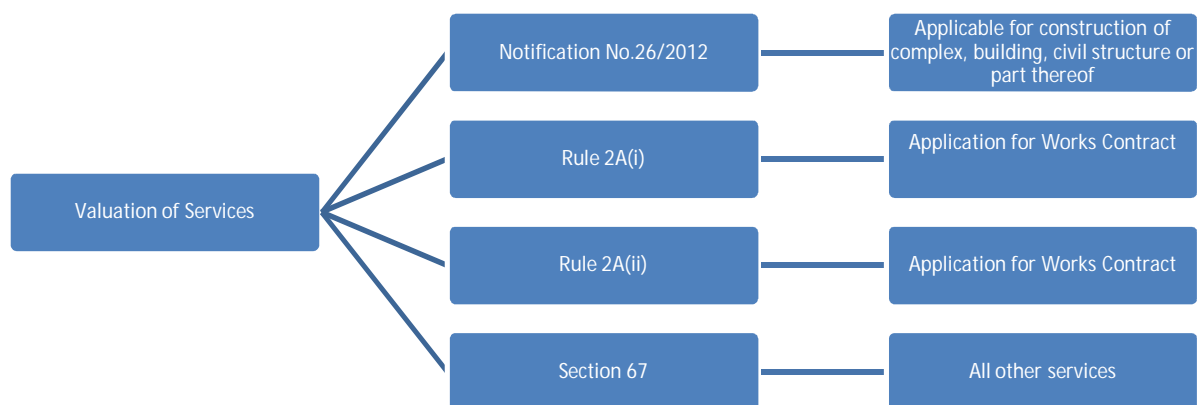
is partially payable by recipient of service and partially by provider of service

As per Notification No.30/2012, 50% of service tax is to be paid by service recipient and balance 50% of service tax is to be paid by service provider.

The service tax in respect of any taxable services provided or agreed to be provided by any person who is located in a non-taxable territory and received by any person located in taxable territory, shall be payable by recipient of service. As per Notification No.30/2012, 100% service tax is to be paid by service receiver.

Valuation of Services

There are four ways to determine the taxable value of service provided in respect of construction industry



Under Notification No.26/2012, there are two scenarios for determining value of taxable service

- 1) For residential units having carpet area upto 2000 sq.feet or where the amount charged is less than Rs.1 crore, then exemption is 75%
- 2) For all cases other than covered in (1) above, exemption is 70%

W.e.f.01.04.2016, exemption of 70% is available, and service tax will have to be paid in all cases on 30% of the gross amount charged.

Rule 2A(i) provides that the service portion shall be equivalent to gross amount charged less the value of property in goods transferred in the execution of works contract. Gross Amount charged will not include VAT paid / payable on the said works contract, but will include –

- i) Labour charged for execution of the works
- ii) Amount paid to a sub-contractor for labour and services
- iii) Charges for planning, designing and architect's fees
- iv) Charges for obtaining on hire or otherwise, machinery and tools used for the execution for the works contract

- v) Cost of consumables such as water, electricity, fuel used in the execution of the works contract
- vi) Cost of establishment of the contractor relating to supply of labour and services
- vii) Other similar expenses relating to supply of labour and services; and
- viii) Profit earned by the service provider relating to supply of labour and services

Where VAT has been paid on the actual value of transfer of property in goods involved under the State Law, the said value shall be taken as value of transfer of property in goods for calculating service tax liability.

Rule 2A(ii) provides that where the value has not been determined under Rule 2A(i), value shall be determined in the following manner :

- (A) In case of works contract entered into for execution of original works, service tax shall be payable on 40% of total amount charged for the works contract;
- (B) In case of works contract, not covered in (A) above, including works contract entered into for, -
 - (i) Maintenance or repair or reconditioning or restoration or servicing of any goods; or
 - (ii) Maintenance or repairs or completion and finishing services such as glazing or plastering or floor and wall tiling or installation of electrical fittings of immovable property;service tax shall be payable on 70% of the total amount charged for the works contract.

Section 67 provides for chargeability of service tax on value of taxable service where –

- (i) In a case where the provision of service is for a consideration in money, value shall be gross amount charged by the service provider for such service.
- (ii) In a case where the provision of service is for a consideration not wholly or partly consisting of money, value shall 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, value shall be the amount as may be determined in the prescribed manner.
- (iv) Where the gross amount charged by a service provider 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.
- (v) The gross amount charged shall include any amount received towards the taxable service before, during or after provision of such service.