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## Indirect Tax

Perspective  $\Rightarrow$  everything

No service tax on composite contracts for purchase of Flats without machinery provisions to ascertain value of Services

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# Summary

The Hon'ble Delhi High Court held that no service tax could be charged in respect of composite contracts, in the absence of specific machinery provisions for ascertaining the service component of an agreement. The Hon'ble court upheld the constitutional validity Section 65(105)(zzzzu) of the Finance Act, 1994 ('the Act') by holding that preferential location charges charged by the builder are based on the preferences of its customers. The explanation to Section 65(105)(zzzh) ('impugned explanation') is set aside only to the extent that it seeks to include composite contracts for purchase of units in a complex within the scope of taxable service. This order is in the context of erstwhile sections of the Finance Act, 1994.

# Background

The petitioners have entered into agreements with a builder to buy flats in a multi-storey group housing project. Such agreements are for purchase of immovable property. The builder in addition to the consideration for the flats, also recovered service tax from the Petitioners, payable for services in relation to construction of complex and on preferential location charges.

# Issues

- Whether the explanation to Section 65(105)(zzzh) of the Act is ultra vires of the Constitution of India.
- Whether Section 65(105)(zzzzu) of the Act seeking to subject preferential location charges charged by a builder to service is ultra vires of the Constitution of India.

- Whether the consideration paid by flat buyers to a builder/promoter/developer for acquiring a flat in a complex, which is under construction/development, could be subjected to levy of service tax.

## Decision of the Hon'ble Delhi High Court

- Prior to the introduction of explanation to Section 65(105)(zzzh) and clause (zzzzu), no service tax was chargeable on builders/developers engaged in construction of real estate residential projects and selling residential units in those projects to prospective buyers. Hence, unless the builder was rendering the service of construction of a complex simplicitor, no service tax was chargeable for service covered under clause (zzzh) of Section 65(105) of the Act.
- Explanation to Section 65(105)(zzzh) expands the scope of the taxable service under the said Section. By a legal fiction, construction of a complex which is intended for sale by a builder, before, during or after construction is deemed to be a service. The sole exception envisaged is where no sum is received from the prospective buyer prior to grant of the completion certificate, implying that the project is complete. At that stage all services and goods used for construction are subsumed in the immovable property; thus, sale of a complex or a part thereof to a buyer constitutes an outright sale of immovable property, which admittedly is not chargeable to service tax.
- The object and purpose for enactment of the impugned explanation was to obliterate - for the purposes of levy of service tax - the distinction between a person who engages a builder to construct a unit for him and a person who enters into an arrangement to purchase a unit in a complex, which is under development, from a builder.
- While the legislative competence of the Parliament to tax the element of service involved cannot be disputed but the levy itself would fail, if it does not provide for a mechanism to ascertain the value of the services component which is the subject of the levy.

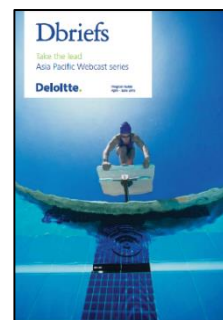
- Even Rule 2A of the Service Tax (Determination of Value) Rules 2006 does not cater to determination of value of services in case of a composite contract which also involves sale of land. Thus, the impugned explanation expands the scope of Section 65(105)(zzzh) of the Act and does not provide any machinery for excluding the non-service components from the taxable services covered therein. Neither do the Rules contain any provision relating to determination of the value of services involved in the service covered under Section 65(105)(zzzh). Thus the said clause cannot cover composite contracts i.e. agreement for construction of residential flats contracts that would include proportionate share of undivided portion of land.
- The abatement to the extent of 75% by a notification or a circular cannot substitute the lack of statutory machinery provisions to ascertain the value of services involved in a composite contract. It was held that no service tax under Section 66 of the Act read with Section 65(105)(zzzh) of the Act could be charged in respect of composite contracts.
- The challenge to insertion of clause (zzzzu) in Sub-section 105 of Section 65 of the Act was negated as there is an element of service involved in the preferential location charges levied by a builder. Preferential location charges are charged by the builder based on the preferences of its customers.
- The impugned explanation to the extent that it seeks to include composite contracts for purchase of units in a complex within the scope of taxable service is set aside.

***Suresh Kumar Bansal v. Union of India & Ors. and Anuj Goyal & Ors. v. Union of India & Ors. reported in 2016-VIL-284-DEL-ST dated 3 June 2016***

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