

# Sale of flats taxable as a service?

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The moot point is whether levy of service tax on the construction of an apartment that is sold by a builder is legally tenable.

"Generally, the initial agreement between the promoters/ builders / developers and the ultimate owner is in the nature of 'agreement to sell'. ... Therefore, any service provided by such seller in connection with the construction of residential complex till the execution of such sale deed would be in the nature of 'selfservice' and consequently would not attract service tax." (Union government's clarification vide Circular No. 108/02/2009 – ST dated January 29, 2009)

This is an unambiguous statement of the union government that no taxable service is provided by a builder/developer of an immovable property to a buyer thereof as the intention of the parties is that of sale of the property.

However, effective July 1, 2010, the government seems to have taken a diametrically opposite view to impose service tax on the sale of immovable property.

The scope of construction services relating to 'residential complex' and 'commercial or industrial building' was amended through the Finance Act 2010. The construction of a new building/complex which is intended for sale by a builder has been deemed to be a service.

The only exclusion from the service tax is provided if the builder does not receive any money from or on behalf of the prospective buyer prior to the grant of the completion certificate of such complex/building. This is the only condition for exclusion from service tax. But is there any 'supply of service' that can be subjected to service tax in the first place?

The construction of a new building/complex that is intended for sale has been deemed as a taxable service. As the union government is otherwise constitutionally precluded to levy tax on the sale of immovable property, it has resorted to 'deeming' the construction thereof to be a service.

Small mercies have been extended — advance payment received before July 1, 2010 has been exempted from the service tax. Similarly, 75% of the amount received by a builder has also been exempted subject to certain conditions. But the

moot point is whether levy of service tax on the construction of an apartment that is sold by a builder legally tenable?

Concept of service: The Centre has power to levy tax on 'services'. However, there is no constitutionally defined benchmark as to what constitute a 'service'.

By virtue of the amendment, a legal fiction has been created to deem the construction of the building/complex as a service. A legal fiction is generally created in tax laws if the underlying transaction does not fulfil the qualifying criteria for levying tax.

The real estate industry needs to ask the government to clarify the qualifying criteria for a transaction to be a 'service' as the recent amendment is a clear acknowledgement that the construction of a building/complex intended for sale, but for this legal fiction, is by no means a service.

Such a clarification on the concept of 'service' by government could help resolve the ongoing dispute of service tax on renting of immovable property. This levy notwithstanding the amendment made in the recent budget to re-classify it as a taxable service has yet again been stayed by different high courts.

Whether a sale transaction can be taxed as a service: Service tax is a tax on the supply of service. The intention of the parties should be to supply/receive a service as distinct from that for sale/purchase of goods.

A builder can enter into an agreement to sell even before an immovable property comes into existence. The time at which the agreement to sell is entered into will have no bearing on the intention of the parties. The recent amendment also makes it clear that the tax is proposed on the new building/complex 'which is intended for sale'.

Once the intention of the parties is to sell/ purchase the immovable property then how can a different intention, i.e. to supply a service, be imposed by way of a legal fiction?

Particularly so, if the construction has been completed before entering into the agreement to sell because the buyer was not even present during construction and as such could not have partaken such 'service'. Point is, there can only be a buyer and not a service recipient for an apartment.

Further, the intention to supply a service is not presumed for those units of a building/complex for which the money is received after the receipt of the

completion certificate, even though the agreement may have been entered much before.

It will be an interesting dichotomy if the government is to contend that the intention of the parties as to the nature of the transaction for different units of a same building/complex can vary depending on the time of receipt of the completion certificate.

Thus, it is questionable if the Centre can presume an intention between the parties, which are otherwise not present in the agreement, merely for the purpose of taxation.

Tax on a circumstance: The recent amendment imposes service tax on the sale of immovable property when money is received by the builder prior to the grant of the completion certificate. The taxable transaction — the construction of new building/complex — is merely presumed by way of a legal fiction.

No builder can construct the entire complex/building without selling at least parts of the building before receiving the completion certificate. Mobilisation of money in the form of advances for sale of goods, whether movable or immovable, is an established commercial practice.

Conclusion: With the introduction of a legal fiction to expand the scope of service tax, the government seems to have exceeded its taxing powers under the Constitution.

To expand the scope of service tax, the mandarins in North Block would perhaps do well to introduce a negative list which are not taxable rather than enlarging the scope by attempting to tax a fiction.