

SERVICE TAX ON CONSTRUCTION OF RESIDENTIAL COMPLEXES

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In the case of *Suresh Kumar Bansal v. Union of India and others*, the Delhi High Court recently held that service tax couldn't be imposed on composite contracts for the construction of residential complexes. Composite contracts are contracts that involve both the provision of services (in the present case, the development of residential complexes) and sale of goods / property (in the present case, the sale of residential units). The court ordered a refund of the service tax levied, along with interest.



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Although this may sound like music to the ears of both home buyers and builders, the actual position of the law is not so simple - such projects may still be subject to service tax or may easily be made subject to service tax in future. The *Bansal* judgment only considered the specific provision under which service tax was levied in that case. Accordingly, where service tax has been collected under any other provision, the judgment will not apply. Further, the section under which service tax was collected in the *Bansal* case has been replaced by a new section in July 2012. Accordingly, the *Bansal* judgment is not directly applicable to contracts entered into post June 2012.

Facts and decision

The dispute in the *Bansal* case arose when the builder of a multi-storey group housing project collected service tax from purchasers for payment to the tax authorities. The tax was collected under the Finance Act, 1994 (the "**Finance Act**"), as amended at the time, on services provided "in relation to construction of complexes" under Section 65(105)(zzzh) and on services provided "for providing preferential location or development" of a residential complex under Section 65(105)(zzzzu). Several of the purchasers approached the High Court challenging the provisions levying service tax on services under these sections. In relation to Section 65(105)(zzzh), the purchasers also challenged an explanation inserted into the section that allowed the levy of service tax on composite contracts for construction and sale of residential complexes.

The court held that:

- Service tax could not be imposed on construction services under Section 65(105)(zzzh) of the Finance Act, where such services were provided as part of composite contracts for construction of residential complexes and sale of units. The court set aside the explanation to this section, to the extent that it allowed service tax to be imposed on composite contracts.

- However, service tax could be imposed on preferential location services provided under Section 65(105)(zzzzu) of the Finance Act. Service tax could be levied on preferential location payments made by buyers over and above the basic sale price – the court stated that the provision of a preferential location by the builder is a value-adding service.
- The government was required to refund the service tax collected for services under Section 65(105)(zzzh) of the Finance Act to the purchasers, with 6% interest.

It has been suggested that the decision in the *Bansal* case means that no service tax will be payable for the construction of residential complexes under composite contracts (i.e., contracts involving sale of land / goods in addition to provision of construction services). However, such blanket statements are incorrect and misleading for the following reasons:

Service tax on composite construction contracts is within Parliament's power

In the judgment, the court stated clearly that the Parliament is empowered by the Constitution to enact law imposing service tax on services provided under composite construction contracts.

The court even upheld the competence of the Parliament to enact the explanation to Section 65(105)(zzzh), which stated that a builder was deemed to be providing construction services to a buyer even before the conclusion of a formal sale agreement between the builder and the buyer.

Service tax could not be levied due to lack of valuation mechanism

The only reason that the court concluded that service tax could not be levied under Section 65(105)(zzzh) at the material time, and set aside the explanation to Section 65(105)(zzzh), was that the service tax statute and rules did not contain a mechanism to determine the value of construction services rendered as part of composite construction contracts.

The court stated that service tax could only be charged on the service element of a composite transaction. Therefore, in a composite construction contract, the value of construction services had to be separated from value of the land and goods used in construction, in order to tax the services. Since the law at the material time did not specify any mechanism for this separation or the resulting valuation of the construction services under Section 65(105)(zzzh), the court held that service tax could not be levied on composite construction contracts.

As a result, according to the *Bansal* judgment, if the Parliament does provide such a mechanism in the law, it can levy service tax on composite contracts for the construction of complexes.

Service tax could be levied on construction contracts as "works contracts"

The *Bansal* judgment only dealt with the question of whether service tax could be levied on composite construction contracts for construction services under Section 65(105)(zzzh). However, at the material time, service tax could also be levied for services provided "in relation to the execution of a works contract" under a separate provision of the Finance Act.

In fact, the court specifically stated in the *Bansal* judgment that composite construction contracts would amount to works contracts, following the Supreme Court decision in the case of *Larsen and Toubro and another v. State of Karnataka and another*. However, the court declined to consider whether such composite contracts would be subject to service tax as works contracts, as the issue was not raised before the court.

As a result, despite the *Bansal* judgment, service tax could be levied on composite construction contracts entered into at the material time by considering such contracts as works contracts.



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Judgment only considered the law pre-2012

The judgment considered the position of the law before July 2012, when service tax was imposed only on types of services specifically mentioned in the Finance Act. The service tax regime was fundamentally altered with effect from 01 July 2012. The Finance Act was amended so that rather than a list of services subject to service tax, the statute now imposes service tax on all services *except* for those contained in a "negative list".

The petitioners did argue before the court that composite construction contracts would not be subject to service tax even under the new regime. However, the court did not address this argument.

Like the pre-2012 law, the amended law also contains no mechanism for valuing construction services provided under composite contracts, so the court's findings should be equally applicable to the new legal provisions.

But, the court did not expressly rule on whether service tax could be levied on composite construction contracts under the new service tax regime. So, it is not completely clear whether service tax can be levied on such contracts entered into from 01 July 2012 onwards.

High Court judgment, subject to appeal

Finally, the judgment in the *Bansal* case is a judgment of the Delhi High Court. It is not binding on all courts in India (although it will have persuasive value). The Central Government is also very likely to challenge the High Court judgment before the Supreme Court and the final decision will be in its hands.

In conclusion

Accordingly, although the *Bansal* decision seems at first glance to be a boon to property purchasers and builders, it will not necessarily affect their liability to pay service tax on composite construction contracts. Contracts for construction of residential complexes entered into post June 2012 will need to be evaluated based on the new legal regime for service tax. Further, even where such contracts were entered into until June 2012, if service tax was imposed on such contracts as "works contracts", builders and home buyers may still remain liable to pay this tax and may not be entitled to a refund.

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