

Recent developments on imposition of VAT on agreements for The Building And Construction of Immovable Property

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■ **SUPREME COURT BACKS THE RIGHT TO EDUCATION ACT**

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Introduction

The levy and collection of tax on sale and purchase of certain goods in the State of Maharashtra is governed by the Maharashtra Value Added Tax Act, 2002 ("**MVAT Act**") which came into force on 1 April 2005. Section 2(24) of the MVAT Act defines the expression "Sale" for the purpose of levy of Value Added Tax ("**VAT**").

In 2005 when the MVAT Act came into force, by virtue of Clause b(ii) of the Explanation to Section 2(24) any transfer of property in goods (whether as goods or in some other form) involved in the execution of a works contract was included within the ambit of the expression "Sale" for the purposes of levy of VAT. Pursuant to the Hon'ble Supreme Court's decision in **K. Raheja Development Corporation vs. State of Karnataka (2005) 5 SCC 162**, the Clause b (ii) of the Explanation to Section 2(24) of the MVAT Act was amended with effect from 20 June 2006 to include an agreement for the building and construction of immovable property within the ambit and purview of the expression "Sale". [\[1\]](#) Section 42(3) of the MVAT Act provides for a composition scheme for levy of VAT in respect of a works contract. With effect from 20 June 2006, Section 42(3) of the MVAT Act was also amended to the effect that VAT shall be levied at the rate of 5% of the total contract value in case of a construction contract. It has been clarified that VAT is payable only if the Developers have entered into agreements with purchasers of flats, units, buildings, bungalows or premises before the same are constructed. However, if the agreements for the purchase of the flats, units, buildings, bungalows or premises are entered into after the construction is completed, then it would not be considered to be a works contract.

Levy of VAT challenged:

As a result of the amendment to Section 2(24) of the MVAT Act as mentioned above, with effect from 20 June 2006, VAT was imposed on the sale and purchase of flats, units, bungalows, buildings or premises under construction.

The validity of the amendment to Section 2(24) of the MVAT Act was challenged before the Hon'ble Bombay High Court by filing various Writ Petitions. On 10 April 2012, the Division Bench of Justice D.Y. Chandrachud and Justice R.D. Dhanuka of the Hon'ble Bombay High Court dismissed the various Writ Petitions and upheld the validity of the amendment to Section 2(24) of the MVAT Act.

New composition scheme for levy of VAT:

On 9 July 2010, the Government of Maharashtra provided for a composition scheme under Section 42(3) of the MVAT Act applicable to registered dealers who undertake the construction of flats, dwellings, buildings or premises and transfer them in pursuance of an agreement along with land or interest underlying the land. The composition scheme introduced on 9 July 2010 prescribes that VAT shall be levied at 1% of the agreement amount specified in the agreement or the value specified for the purpose of stamp duty under the Bombay Stamp Act, 1958, whichever ever is higher. The composition scheme introduced on 9 July 2010 is subject to certain conditions.

Special Leave Petition before the Hon'ble Supreme Court:

Special Leave Petitions bearing Nos. 17709/ 2012, 17738/ 2012 and 21052/ 2012 are filed before the Hon'ble Supreme Court challenging the Order dated 10 April 2012 passed by the Hon'ble Bombay High Court by which the validity of the amendment to Section 2(24) of the MVAT Act was upheld. The aforementioned Special Leave Petitions are pending before the Hon'ble Supreme Court.

Circular by Sales Tax Department, Maharashtra:

Pending the disposal of the aforementioned Special Leave Petitions, a Circular dated 6 August 2012 was issued by the Joint Commissioner of Sales Tax, State of Maharashtra stating that as no stay has been granted by the Hon'ble Supreme Court on the Order dated 10 April 2012 passed by the Hon'ble Bombay High Court, the Developers are liable to pay VAT with effect from 20 June 2006. The Circular dated 6 August 2006 states that under the composition scheme provided under Section 42(3) of the MVAT Act, the Developers are liable to pay VAT at the rate of 5% from 20 June 2006 to 31 March 2010 and at the rate of 1% from 1 March 2010 onwards according to the new composition scheme introduced on 9 July 2010. The Circular dated 6 August 2012 also clarifies that interest along with penal interest will be charged in the event the Developers fail to make payment on or before 31 August 2012.

Extension of deadline of 31 August 2012:

On 28 August 2012, an Interim Order was passed by the Hon'ble Supreme Court in Special Leave Petitions bearing Nos. 17709/ 2012, 17738/ 2012 and 21052/ 2012 whereby the cut off date of 31 August 2012 to pay the arrears of VAT by the Developers is extended to 31 October 2012. The Hon'ble Supreme Court has directed the Developers to register themselves with the Sales Tax Department by 15 October 2012. The Hon'ble Supreme Court has directed that in case the Developers pay VAT under the MVAT Act with effect from 20 June 2006, on or before 31 October 2012, the coercive process for recovery of VAT, interest or penalty shall remain stayed. This shall however not preclude the assessing officer to complete the assessment. The Hon'ble Supreme Court also ruled that

in the event the Developers succeed in their Special Leave Petitions that are filed to challenge the Order dated 10 April 2012 of the Hon'ble Bombay High Court, the amount deposited with the Sales Tax Department would be refunded to them along with interest. The rate of such interest payable would be decided by the Hon'ble Supreme Court at a later stage.

Conclusion:

The Circular dated 6 August 2012 issued by the Sales Tax Department came as a rude shock to the Developers and flat purchasers in Maharashtra. The Interim Order dated 28 August 2012 passed by the Hon'ble Supreme Court has come as a relief to the Developers and flat purchasers. However, the moot question regarding levy of VAT on agreements for the building and construction of immovable property is still pending before the Hon'ble Supreme Court. It has been clarified by the Sales Tax Department that the obligation and liability to pay VAT is that of the Developers and not the flat purchasers in which event irrespective of the flat purchasers having committed to the Developers under the agreements for sale of flats that they shall bear and pay the VAT liability, the primary responsibility will be of the Developers to pay VAT to the Sales Tax Department. This may also lead to disputes and litigation between the flat purchasers and the Developers. The result of imposition of VAT on Developers for sale of under construction property will in turn increase the costs of flat in the hands of the end user and this will have an impact on the volume of sales in the real estate market.

- By Heena Chheda (Partner) & Mirat Patel (Associate)

Download Link : [Click here to Download Interim Order dated 28 August 2012 passed by the Supreme Court](#)

[1] : Pursuant to the amendment of Section 2(24) of the MVAT Act with effect from 20 June 2006, the Clause b(ii) of the Explanation to Section 2(24) reads as follows: *of property in goods (whether as goods or in some other form) involved in the execution of a works contract namely, an agreement for carrying out for cash, deferred payment, or other valuable consideration, the building, construction, manufacture, processing, fabrication, reception, installation, fitting out, improvement, modification, repair or commissioning of any movable or immovable property.* (emphasis supplied)

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