

Preferential Treatment to Services Relating to Preferential Location

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Introduction:

- 1.0 Statutory enactment is supposed to be drafted in a language which conveys the same meaning to all. This is for the reason that any term conveying varied meanings can lead to chaos as it can be interpreted in varieties of ways over a different period of time. Not only that, interpretation will differ from person to person as well. Primarily this is due to use of certain terms and phrases which cannot be defined or structured as per one's desire. It also arises due to lack of proper explanatory notes or administrative guidelines. Insertion of section zzzzu relating to levying Service Tax (ST) on Preferential Location (PL) and External or Internal Development of a Complex (EIDC) provides a classic case wherein large number of subjective terms and phrases has been used. What is more surprising is lack of guidelines by the policymakers for its interpretation. Have a look at some of them therein and the letter no. D.O.F. No.334/1/2010-TRU New Delhi dated 26th February 2010 issued by Tax Research Unit.

First of all, let us have a look at the section zzzzu as it has been inserted.

“taxable service” means any service provided or to be provided: to a buyer, by a builder of a residential complex, or a commercial complex, or any other person authorised by such builder, for providing preferential location or development of such complex but does not include services covered under sub-clauses (zzg), (zzq), (zzzh) and in relation to parking place.

Explanation. – For the purposes of this sub-clause, “preferential location” means any location having extra advantage which attracts extra payment over and above the basic sale price;

Have a look at the letter issued by Tax Research Unit (TRU) explaining salient features of provision in this regard.

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Scope and the background of the new services included in the List of Taxable Services

8. Special services provided by builder etc. to the prospective buyers such as providing preferential location or external or internal development of complexes on extra charges.

8.1 Construction of commercial or industrial structures was brought under service tax net in 2004 while construction of residential complexes became a taxable service in 2005. The scope of the existing

services includes construction, completion and finishing, repairs, alterations, renovation or restoration of complexes. It has been reported that in addition to these activities, the builders of residential or commercial complexes provide other facilities and charge separately for them and these charges do not form part of the taxable value for charging tax on construction. These facilities include,-

(a) prime/preferential location charges for allotting a flat/commercial space according to the choice of the buyer (i.e. Direction- sea facing, park facing, corner flat; Floor- first floor, top floor, Vastu - having the bed room in a particular direction; Number- lucky numbers);

(b) internal or external development charges which are collected for developing /maintaining parks, laying of sewerage and water pipelines, providing access roads and common lighting etc; (c) fire-fighting installation charges; and (d) power back up charges etc.

8.2 Since these charges are in the nature of service provided by the builder to the buyer of the property over and *above* the construction service, such charges are being brought under the new service. Charges for providing parking space have been specifically excluded from the scope of this service. Development charges, to the extent they are paid to State Government or local bodies, would be excluded from the taxable value levy. Further, any service provided by Resident Welfare Associations or Cooperative Group Housing Societies consisting of residents/owners as their members would not be taxable under this service.

Also have a look at some of the terms and phrases applied herein above which sounds subjective and can pose serious problem in administration of the said clause.

Section zzzzu:

- a) providing preferential location
- b) development of such complex

Explanation to Section zzzzu:

- a) extra advantage
- b) extra payment
- c) basic sale price

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- a) charges for allotting a flat/commercial space according to the choice of the buyer

An attempt has been made herein to explain salient features of this section, the problems which may arise for the buyers and the builders.

Basic Proposition:

2.0 *Section refers to the services to be rendered to a “buyer”. Who is to be considered as a buyer?*

This has not been defined. However, reading the clause in totality, it appears that the term “buyer” has to be given an extended meaning. It means that not only the person who has already purchased the flat / office but it also includes even the person who has entered into an agreement to buy the same. This is for the reason that the section is applicable to a person who has not purchased the property but who proposes to do so.

2.1 *In order to invoke this clause, which conditions have to be satisfied?*

Section zzzzu refers to the payment made, or to be made, by a buyer of a flat / office to the builder of a complex. In order to invoke this section, following conditions have to be satisfied.

- a) There should be person who has constructed or proposes to construct a residential / commercial complex.
- b) There is a person who has entered into an agreement with the builder for purchase of, or has purchased, office / flat etc. in such a complex.
- c) The buyer has opted for a particular location in the complex or the builder has carried out some development activities for the complex
- d) The builder has quoted an additional amount for the said particular location or the such development activities
- e) The buyer has agreed to pay additional consideration for allotment of preferred location.

It is this additional amount, which the buyer will pay to the builder, is subject to tax.

2.2 *Explanation inserted to clause 25(b) and 30(a) applies to the cases wherein completion certificate has not been issued. In the instant clause, whether tax can be levied for charges collected for complex wherein completion certificate has already been issued?*

Yes. Provisions of this clause will be applicable even if the completion certificate has been issued. Therefore, if the builder collects any amount after issue of completion certificate, which are covered under this clause, tax will have to be paid thereon. This is for the reason that there is no reference to amount collected subsequent to issue of completion certificate.

Justification for Enacting the Clause:

3.0 *What is the rational for levying tax on such services?*

As per the DO letter –

It has been reported that in addition to these activities, the builders of residential or commercial complexes provide other facilities and charge separately for them and these charges do not form part of the taxable value for charging tax on construction.

Since these charges are in the nature of service provided by the builder to the buyer of the property over and above the construction service, such charges are being brought under the new service.

3.1 *Whether it will cover payments made to any person other than the builder?*

No. It is necessary that the payer and the payee should have relationship of a builder and the buyer of a particular complex. If it does not exist, there is no question of paying the tax under this section.

3.2 *Whether the clause will be applicable to the cases wherein no PL service has been provided but the buyer has made higher payment as compared to others?*

No. If the builder has not provided any service relating to PL etc., the question of paying the tax does not arise.

3.3 *Does it mean that items provided to all the members are not covered herein?*

Yes. If certain amenities are provided to all the buyers of the office / flat without charging any additional amount, there is no question of paying the tax under this section. These amenities, even though are covered under the provisions of the section, are not provided at the preference of the buyers. The same are provided by the builder as a part of the scheme. Here, the buyer has no option of rejecting the said amenities. Even if he does not make use of it, the builder is going to charge pre-determined amount. The price fixed by the builder includes cost of these preferential amenities. This also gets support from the definition provided for the term PL under the said section itself. It provides that the buyer should get extra advantage for which he should have made extra payment. If all the members of the complex are having the same facilities, it cannot be said that a particular buyer is having any advantage of preferential nature.

Preferential Location:

4.0 *What is PL?*

As per Explanation “preferential location” means any location having extra advantage which attracts extra payment over and above the basic sale price. In order to invoke this definition, all the following conditions have to be satisfied.

- a) There should be a location;
- b) The said location should have extra advantage; and
- c) The extra advantage provided by the location should attract extra payment.

If any one of the above is missing, it cannot be considered as PL.

Role of the buyer in opting for PL

5.0 *Is it necessary that there should be a request by the buyer for a particular location?*

Letter by TRU refers to the term “according to the choice of the buyer”. Therefore, there should be a specific request by the buyer for a specific location or a particular type of location which the builder has agreed to provide. Therefore, if the buyer has not insisted upon for a particular location, the question of the tax being paid under this section does not arise.

5.1 *Whether allotment of a particular flat / office to the buyer can be implied by act of the buyer or the builder?*

Clause zzzzu is silent on this aspect. However, the letter by TRU is more specific. As explained above, the letter by TRU expects a specific request by the buyer for a particular flat or office. In view of this, there is no question of any implied preference by the buyer.

5.2 *Recently some of the builders are collecting certain charges from all the buyers which resembles to preferential location irrespective of the location of the flat / office. Whether tax will have to be paid in such cases?*

Such cases will not satisfy the condition laid down in clause zzzzu and DO letter. However, since the amount is collected by the builder as location charges, assessing authority will assessee under this clause rather than under construction of commercial or industrial construction or construction of complex.

5.3 *In the above case, if the builder has paid the tax under the category of Construction of Commercial or Industrial Complex with respect to such charges, whether tax can be levied on such amount collected?*

Since the rate of tax is much higher for the services under clause zzzzu, there will be an attempt to levy tax on such amount under the clause zzzzu. Apart from that it should be remembered that if the amount collected can be classified as falling into the category of services under zzzzu, it cannot be covered under other services. If done so, serious problem can arise for the builder with respect to short payment of tax, interest thereon, penalty for concealment etc.

Location:

6.0 *What is location?*

It has not been defined. However, it refers to flat or an office in a complex.

6.1 *Whether its meaning can be extended to the complex as a whole?*

In the absence of definition of the term “location”, one can be led to such an interpretation. It should be noted that Explanation to section zzzzu refers to extra payment made over the Basic Selling Price. It does not state explicitly so with reference to other flat or office in the same complex. One can be led to interpret it with reference to the complex as a whole.

6.2 *A builder is constructing two complexes viz. A and B. A is located at a place which is sea-facing. Complex B is in the same area and adjoining to the complex A but is not having the advantage of sea-facing view. The builder is quoting Rs. X per sq. feet for flat in complex B. For complex A, the builder is quoting Rs. X+1 per sq. feet. Quality of construction and area of the flat is same in both the cases. Whether additional amount charged for flat in complex A can be considered as PL and can be subject to tax under this clause?*

It depends on how one interprets BSP. If BSP is interpreted with reference to a particular complex, one can say that rates fixed for complex A cannot be the basis for

complex B. However, if one takes a view that BSP refers to the rates prevailing in the said area, question of levying tax may arise.

Extra Advantage

7.0 What is extra advantage?

This is a subjective term. The word “extra” is a relative term as it can have its existence only if there is a base. If the base does not exist there is no question of identifying the “extra”.

In the same manner, the term “advantage” is also subjective as it differs from person to person. What is advantage for a person may not be so for others. Certain flats in a complex may be having good wind direction in the complex due to its designing. The builder may be charging higher price for these flats as compared to others. The builder is not charging any additional amount separately for these flats. Can it be said that additional amount as computed with reference to other flats is liable to tax under this section?

7.1 Whether the Assessing Officer can value it with reference to valuation of such facilities in the surrounding area?

It should be remembered that tax implication of applying this clause are severe as the rate applicable will be @10.30%. Therefore, one should not be surprised if this line of argument is also advanced.

Extra Payment (EP):

8.0 What is EP?

Explanation to clause zzzzu defines it as amount paid in excess of BSP.

8.1 Can the Assessing Officer take the rate prescribed in property valuation reckoner (jantri) as prescribed by the State Government?

There is no clarity. There is no definition for the term BSP. The Assessing Officer can be tempted to refer to these rates and levy tax on the difference amount.

8.2 There are two complexes viz. C and D located in the same area but under different zone for valuation purposes as prescribed by the State Government. Complex C is located in the zone for which the rate for valuation prescribed is Rs. X as compared to complex D for which the rate is X+1. Whether additional amount prescribed in the property valuation reckoner (jantri) can be considered as payment for extra advantage?

In the absence of clear definition of BSP, such issues are bound to arise. Since this line of interpretation will result into higher valuation, one should not be surprised if the same is also advanced in justification.

Basic Selling Price:

9.0 What is “basic sale price” (BSP)?

The said term has not been defined. It appears that the section has been drafted with the presumption that the builder fixes the BSP while launching the project for construction of a complex. It is assumed that all the offices / flats will have the same

BSP. Therefore, any payment made by the buyer over and above the said BSP is proposed to be covered under this section.

- 9.1** *Whether the BSP will have to be with reference to the same complex as a whole or can it differ from floor to floor? For example, all flats on the first floor are priced at Rs. X per sq. feet. However, all the flats on the tenth floor are fetching Rs. X+1 sq. feet. Can it be said that additional amount of Rs. 1 per sq. feet charged for all the flats on the tenth floor will attract tax under this section?*

There is no clarity. Such issues are bound to arise. The assessing Authorities will prefer this line of interpretation as it may lead to higher valuation for tax purposes. In the absence of any clarity with respect to BSP, it is difficult to say anything.

- 9.2** *There may be difference in valuation for the same type of flat on the same floor as well. For example flat No. 101 on the first floor is fetching Rs. X. Same type of flat viz. 1002 on the tenth floor is fetching Rs. X+2 per sq. feet. Flat bearing no. 1001 on the tenth floor is fetching Rs. X+3 per sq. feet. In this case, how the valuation will be arrived at? Will it be with reference to flat No. 101 or 1002? If done with reference to value of flat no. 101 there will be substantial difference as compared to flat no. 1002.*

Yes. In the absence of well defined guidelines, this is bound to create serious problems. There will be large number of cases of inflated valuation and high demand of service tax.

- 9.3** *Whether the price quoted at the time of launching of the scheme will be considered as BSP?*

Wordings in this respect are vague. It is not necessary that the builder will always disclose BSP at the time of launching of the scheme. Even assuming that he does so, it will differ from buyer to buyer. Apart from that with the advancement of construction of the complex, BSP itself will go on increasing. Moreover, there is no statutory requirement for the builder to disclose his BSP at any time. Therefore, the yardstick laid down for computing value for PL itself is confusing.

- 9.4** *Whether the BSP can change over a period of time? During buoyancy period, a flat / office was priced at Rs. X per sq. feet. However, due to slump in the demand, it is not possible to sell at the said rate. The builder is offer the same location at Rs. X-1 per sq. feet. Whether the rate X-1 can be considered as BSP?*

As in many cases above, there cannot be any answer to such questions. It is not clear whether the concept of BSP is static one or a dynamic one. If it is dynamic, meaning thereby the value assigned as BSP can be changed, a question will arise at what interval? Who will determine the revised BSP?

- 9.5** *Whether the rate disclosed by the builder in the brochure as BSP for each flat / office will be acceptable to the ST Department for valuation purposes?*

Once again there is no clarity about this aspect as well. It is not clear whether the BSP as disclosed by the builder can be challenged by the assessing authorities.

Extra Facilities:

10.0 What is the meaning of the term “Extra Facilities” (EF)?

There is no clear definition for the term EF. It is presumed that all the flats / offices will be having the same type of facilities. However, for certain reasons, some of the locations will be having additional features as compared to others.

10.1 What is the meaning of the term “facilities”?

There is no clarity. The letter by TRU refers to certain features which have been highlighted as facilities. There can be various other facilities which have not been covered therein.

10.2 Which extra facilities are covered?

The section is silent about it. However, as per DO letter, it has been divided into two parts. The first part refers to prime/preferential location charges for allotting a flat / commercial space according to the choice of the buyer

- (a) Direction-sea facing
- (b) Park facing
- (c) Corner flat
- (d) Floor- first floor
- (e) Top floor
- (f) Vastu - having the bed room in a particular direction;
- (g) Number - lucky numbers

10.3 Can there be any additional parameters for levying tax on some other basis under this section?

Unfortunately, the section is silent about it. The above said letter does not say that additional items cannot be considered. Therefore, one should not be surprised if assessing officers issuing notices on various other grounds for charging the tax. However, the Assessing Officer is duty bound to charge tax on all the items as referred to in the DO letter.

Development of a Complex:

11.0 Other than PL, which are the other items in respect of which tax can be levied under this section?

The section provides levying tax for development of a complex. The letter from TRU is more specific in this respect and terms it as “Internal or External Development Charges”.

11.1 Which are the items covered therein?

Section zzzzu does not provide for any specific item in this respect. However, the letter by TRU refers to the following items.

- (a) internal or external development charges collected for developing / maintaining
 - i. parks,
 - ii. laying of sewerage and water pipelines
 - iii. providing access roads and common lighting etc
- (b) fire-fighting installation charges; and

(c) power back up charges etc.

11.2 *Whether the amount collected by the builder for maintenance purposes in future is covered under this section?*

To an extent, yes. The DO letter refers to “developing” and “maintaining”. If the builder has collected any amount towards development or maintenance of park, water pipeline etc. tax will have to be paid thereon. This is despite the fact that the amount so collected may be handed over to the Co-operative society or the Association carrying out maintenance work in future.

11.3 *What is Development of Complex?*

Not defined anywhere.

11.4 *Whether charges levied for changes carried out in the flat as required by the buyer will be covered herein?*

If the builder is carrying out the changes as required by the buyer, it will be not taxable under this section. This is for the reason that the section refers to “development of a complex”. Therefore, any development work carried out for a particular flat / office cannot be covered therein. On a plain reading of the section it appears that only the charges collected for the development of the complex will be taxable.

It may be noted that such services by the builder to a particular buyer may be taxable under other section, say, works contract service etc.

11.5 *Are there any items which are not covered therein?*

Yes. Following services are not covered therein.

- a) services covered (zzg) i.e. Management, Maintenance or Repair
- b) services covered (zzq) i.e. Commercial or Industrial Construction
- c) services covered (zzzh) and Construction of Complex
- d) Parking place.

As per DO letter following charges are not covered -

- a) *Development charges, to the extent they are paid to State Government or local bodies*
- b) *any service provided by Resident Welfare Associations or Cooperative Group Housing Societies consisting of residents/owners as their members would not be taxable under this service.*

11.7 *All these are confusing. Section zzzzu contains so many words which have not been defined in the Finance Act or any rules there under. It also refers to certain practices followed by the builders which may not be prevalent in many part of the countries. How should one read and comply with this provision?*

On combined reading of the section zzzzu and DO letter, it appears that the policy-makers have following picture of the process of construction and sale of residential and office complexes.

- 1) A builder selects a piece of land for developing it into residential / commercial complex.
- 2) The Builder enters into an Agreement to Sale or executes Conveyance Deed with the owner of the land
- 3) Design of the building / complex is prepared
- 4) Building plan is submitted to the local / Government authorities for its approval.
- 5) The builder lays down basic sale price for sale of flat/apartment/offices etc.
- 6) Builder also lays down additional facilities and price thereof which can be provided to the prospective buyer
- 7) On approval of the plan marketing of the scheme commences
- 8) The builder quotes the basic price to the prospective buyer. On demand from the buyer for a particular type of flat / office, he quotes additional amount to be paid
- 9) On demand from the buyer for additional facilities in the flat / office, the builder quotes extra amount to be paid by the buyer.
- 10) The builder also charges extra amount from all the buyers for additional facilities like swimming pool, gymnasium etc.
- 11) The additional amount collected by the builder, do not form part of the consideration for flat / offices. Hence, it does not find any reference in the documents to be executed. Hence, it is not subject to service tax.

It appears that there was an apprehension in the mind of policy-makers that substantial amount of tax can be avoided under this route and, hence, the provisions like section zzzzu.

11.8 *Many of the above presumptions may be true in certain cases. However, in large number of cases the reality is different. What will happen in such cases?*

Yes. It is going to be controversial issue. Number of presumptions may not be valid. Any action taken on the basis of it may lead to long drawn process of litigation. Let us examine each of the case in detail.

1) Basic Sale Price (BSP)

Explanation to section zzzzu refers to it as price to be paid by the buyer for extra advantage. A question here arises how to determine its value? The explanation itself says that any extra amount paid by the buyer over and above the BSP will invoke the provisions of section zzzzu. But the basic question is determining the BSP. Following question arises.

- a) As in cases of many commodities where Maximum Resale Price is required to be disclosed as per the statutory requirements, there are no legal requirements wherein the builder is required to disclose BSP.
- b) In real estate there is no concept of BSP. In majority of the cases, the prices differ from person to person.
- c) The prices also fluctuate from time-to-time. It never remains static.

- d) When all the buyers are offered and required to pay for all the facilities which appear to be additional one, whether section zzzzu can be invoked?
- e) What will happen if the builder does not charge for additional facilities but some other entities charges for the same?

11.9 What are the tax implications?

Let us examine from the perspective of the buyers and the builders.

From the perspective of the buyers:

This will make flat/office more costly. In the case of buying of the flat / office, due to abatement provisions additional burden is working out on 25.00% of the value. However, in this case, tax will be leviable on the entire amount as the provisions relating to abatement are not applicable here.

From the perspective of the builders:

The builders will have to face various legal issues due to subjective terms used in the section and the letter issued. Since many of the terms can be interpreted in various ways, it will be difficult to determine exact amount of tax liability. Secondly, due to non-applicability of the provisions of abatement, there will be heavy burden of tax. Although, it has to be borne by the buyers, it may not be so in all the cases. Thirdly, there will be additional burden with respect to compliances. Since this is a separate service by itself, the builder will have to get registered for the same as well. Details will have to be provided in the periodical returns i.e. ST-3 required to be filed.

An off-shoot of this provision will be that the ST Department may try to levy tax on certain value of the services relating to Construction of Commercial or Industrial Complex (CCI) and Construction of Complex (CoC) under this category. This is for the reason that rate of tax is fairly high under this clause. Disputes with respect to classification of various transactions under a particular head of service will rise substantially.

Moreover, if the builder has got himself registered under CCI or CoC, he may be issued notice for failure to get registered for the service under this clause.

Conclusion:

- 12.0 It is reported that during the current financial year, the Government is expecting tax collection of Rs. 5,000 cr. from the services relating to real estate and preferential location. Construction activities take place in small towns and cities throughout the country round the year. Therefore, there is no doubt that for the financial year 2011-12 tax collection will be substantially higher. However, an additional factor contributing to the higher collections will be assessment of high value and classification of services. And for obvious reasons, tax disputes will also rise, if not in the same proportion, at least in large numbers.