RELAVANT ISSUES FOR BUILDERS, DEVELOPERS AND CONTRACTORS.

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DEFINITIONS
WORKS CONTRACTS

Transfer of property in goods (whether as goods or in some other form) involved in the execution of works contract [Constitution of India : Article 366(29A)(b)]

Works Contract' defined inclusively

- Generally understood as a contract for work involving use of materials by the contractor Work done on the
- Property belonging to another
- The property in the goods passes by the theory of 'accretion' or 'accession'
- Exceptions – where work not on property belonging to another
- Merger of Maharashtra Works Contract Tax (Reenacted) Act, 1989 into the MVAT Act, 2002
- Covered under clause (ii) of Explanation to Definition of 'Sale' [S. 2(24)]

SALE PRICE

will mean / include [S. 2(25)] –

- Value of the materials used
- Customs duty, Excise duty, etc.
- Deposits (?)
- the definition includes an agreement for work involving Building, Construction, Manufacture, Processing, Fabrication, Erection, or Installation, FittingOut, Improvement Modification, Repair or Commissioning of any Immovable Property w.e.f. 20.06.2006

TURNOVER …

- Where accounts not maintained or are insufficient, total contract value less lump sum deduction for labour and services at prescribed percentages
- Percentage deduction to be made after deducting sub-contractor payments

- Alternatively –
- Value of the materials used as specified in the contract; or
- Cost of materials used plus gross profit thereon

SUB-CONTRACTED WORK

- Joint & Several Liability [S. 45(4); R. 50] –
- Main Contractor not liable on corresponding 'turnover of sales' if sub-contractor has paid taxes
- Forms 407 & 408
- Sub-contractor not liable if Main Contractor has paid taxes – Forms 406 & 409

TAX, COMPOSITION & TAX INVOICE

- Rate of Tax – At Schedule Rate
- Composition – Lump sum tax @5% for construction contracts and @8% in case of other than construction contracts, on total contract value after deducting amounts payable to subcontractors [S. 42(3)].

TAX OR COMPOSITION

- Amount can be collected separately
- Contractor can issue 'Tax Invoice' whether paying full tax or opting for composition
- where tax is not collected separately, whether reduction u/r. 57(1) permissible??

INPUT TAX CREDIT

- Input Tax Credit (ITC):
- Contractor entitled to ITC on purchases [R. 52]
- Contractor opting for composition entitled to ITC in the proportion of 16/25 only where the composition tax is paid @8% and shall be entitled to ITC after retention of 4% who have opted to pay tax 5 %(construction) [R. 53(4)]
- Contractee - No ITC where purchases effected by way of works contract results in immovable property [R. 54(g)]
- No ITC on purchases of any goods the property in which is not transferred but are used in erection of Immovable property other than Plant and Machinery [R. 54(h)]

SUPREME COURT IN K. RAHEJA'S CASE….

- Decision of SC
- Definition of "works contract" under KGST Act is very wide
- K. Raheja undertakes to build as developers for purchaser
- Therefore, the transaction is a works contract
- If agreement is entered into after the construction is completed; it would not be a works contract

TRADE CIRCULAR 12T/2007 DT. 7.2.07 AND CONSEQUENCE THEREOF

- SC decision will be applicable from 20.6.06
- All transfers after 20.6.06 will be taxable whether the agreement was prior or after
- tripartite agreement (under development agreement) will also be covered
- Earlier DDQs will have not applicability now
- Whether the agreement is entered into prior to or after completion will depend upon the terms of the agreement
- Writ before the BHC admitted. Department directed not to take coercive action

K. RAHEJA CASE DISTINGUISHED

- The Allahabad High Court in case of ASSOTECH realty distinguished the case of K Raheja and held that the facts in that case were different and peculiar and hence not applicable to the case of Assotech Realty

SITUATION IN MAHARASHTRA

- In our state the agreement are governed by Maharashtra Ownership flat act (MOFA)
- The act regulates promotion, construction, sales, management and transfer of ownership of flat.
- The act reads promoter under the development agreement as agent of owner.
- The promoter is to convey title in land and building to society/company.
- No separate agreement of land and construction are done in Maharashtra.
- The K.Raheja case is not applicable here as agreement is for sales of flat which is immovable goods.
- However if separate agreement of sale of land and vide a separately contract for construction work is given to same person then

Works Contract provisions are applicable (Sukh-karta Apartments Maharashtra Sales Tax tribunal 6-7-2002)

- The Supreme Court in Assotech's case held that the High Court erred and wrongly entertaining writ petition even though an alternative method is given.
- The arguments and finding of High Court still holds good and the lower authorities have to take cognizance of the same

SALE PRICE IN CASE OF DEVELOPERS AFTER THE INSERTION OF RULE 58(1A) WITH RETROSPECTIVE EFFECT i.e. FROM 20-06-2006.

- There is erroneous drafting as far as rule 58 (1A) is concerned.
- The rule applies to construction contractors
- The construction contractor does not transfer immovable property and therefore there is no question of land being transferred along with immovable property.

- Does not envisage situation where owners of land and developers are two distinct people.
- Also does not envisage situations where co- operative society goes in for redevelopment.

CURRENT STATUS

The controversy was recently before Hon'ble Bombay High Court in case of Maharashtra Chamber of Housing Industry & Ors. (Writ Petition No. 2022 of 2007 dated 10.04.2012)

DECISION OF BOMBAY HIGH COURT:

Hon'ble Bombay High Court has dismissed the writ petition and held as under:

"We find ourselves unable to accept the submission which has been urged on behalf of the petitioners that the Legislature, in the provisions of Section 2(24) as amended, has transgressed the limitations on its legislative power by bringing what were not in their substance works contracts within the field of the amended definition. The submission which has been urged on behalf of the petitioners proceeds on the foundation that a works contract is a contract for the purpose of work which involves only two elements viz. a supply of goods and material and a supply of labour and services. Works contracts have numerous variations and it is not possible to accept the contention either as a matter of first principle or as a matter of interpretation that a contract for work in the course of which title is transferred to the flat purchaser would cease to be a works contract. As the Supreme Court noted in its judgment in Builders' Association, the doctrine of accretion is itself subject to a contract to the contrary. The provisions of the MOFA, enacted in the State of Maharashtra, evince a legislative intent to protect the interest of flat purchasers by creating an interest in the property which is agreed to be acquired, in terms of the statutory provisions

"The effect of the amendment to Section 2(24) is to clarify the legislative intent that a transfer of property in goods involved in the execution of works contract including an agreement for building and construction of immovable property would fall within the description of a sale of goods within the meaning of the provision. Under Article 366(29A), the Constitution provides the constitutional content of the expression "tax on the sale or purchase of goods" in terms of an inclusive definition. The expanded content of that expression now provides the constitutional ambit of the legislative entry, Entry 54 of List II, which deals with taxes on the sale or purchase of goods, other than newspapers. All the instances of taxes which fall within clauses a to f of Article 366(29A) fall within the ambit of Entry 54. State legislation which meets the description of Article 366(29A) is hence legislation which would fall within Entry 54 of List II. In order to meet the description contained in clause b, State legislation must provide for a tax on the transfer of property in goods (whether as goods or in some other form) involved in the execution of a works contract. Such a transfer shall be deemed to be a sale by a person making the transfer and a purchase of those goods by the person to whom the transfer is made. The

amendment made by the State Legislature does not transgress the limitations which have been imposed by Article 366(29A)(b) of the Constitution."

The challenge to Rule 58(1A) was upheld in light of the Supreme Court Judgment in case of Gannon Dunkerley (88 STC 204) specified such deduction which can be made from the entire value of the works contracts. The Legislature was acting within the field of its legislative powers in devising a measure for the tax by excluding the cost of the land.

_ The matter has been referred to Supreme Court and interim relief has been granted

FURTHER DEVELOPMENT ON K. RAHEJA

_ In the case of M/s. Larsen & Toubro Limited vs. State of Karnataka and Another, delivered in Special Leave Petition (Civil) No.17741 of 2007, the Court has doubted the correctness of the ratio of its own judgment in K. Raheja Development Corporation reported in 141 STC page 298 and has observed that the said judgment requires re-consideration In this case of M/s. Larsen & Toubro Limited, L&T was the developer which had entered into the contract of development of plot. In this case, there were two agreements, one was the development agreement and the other was the tripartite agreement. The tripartite agreement was amongst the owner, the developer i.e. M/s. Larsen & Toubro Limited and the prospective buyer. The question which arose for determination was, whether the developer who entered into tripartite agreement to construct the flats was constructing the same on its own behalf? Or, on behalf of the owner? Or, on behalf of the prospective flat purchaser

The Court found it difficult to accept the ratio of the judgment in K.Raheja Corporation. The Court observed that if the development agreement was not a Works Contract, could the department rely upon the second contract, which was the tripartite agreement and interpret the same to be a Works Contract as defined under the Karnataka Sales Tax Act, 1957. The Court further observed that if the ratio of K. Raheja case was to be accepted then there would be no difference between works contract and a contract for sale of chattel as chattel. The Court also raised the question whether it could be said that the petitioner company was the contractor for prospective flat purchaser. The Court stated that the contention of the State that development agreement was not works contract but the tripartite agreement was works contract appeared to be fallacious

In fact, neither the judgment of the apex court in K. Raheja nor its judgment in Larsen & Toubro is applicable to the development contracts in the State of Maharashtra.

_ In our State, not a single developer enters into two agreements. There is only one agreement, which is the development agreement. There are no two separate agreements for land and construction. Unlike in Karnataka, in our State the price offered per square foot for sale of flat also includes cost of land. Further, here the development agreements are effected as per the Maharashtra Ownership Flats Act, 1963(MOFA Act) and no such agreement says that the construction would be done on behalf of the prospective

customer. Time and again this was brought to the notice of the Commissioner of Sales Tax, Maharastra State. But, despite this, he continued to enforce liability against the developers.

COMPOSITION SCHEME - BUILDERS

- Sec 42 (3A) introduced from 01/04/2010
- Power granted under the section to notify scheme for dealers undertaking construction of flats, dwelling or buildings or premises and transferring them vide an agreement along with land or interest in underlying land.
- Prescribed rate of tax by composition in lieu of amount of tax payable on the transfer of goods (whether as goods or in some other form), in the execution of such contracts by the above dealers.
- Notification dated 09/07/2010 put in public domain only on 14/07/2010.

CLASS OF DEALERS COVERED

A registered dealer who undertakes the construction of flats, dwelling or buildings or premises and transferring them vide an agreement along with land or interest in underlying land.

COMPOSITION AMOUNT

One percent of the agreement amount specified in the agreement or value specified for the purpose of stamp duty in respect of said agreement under Bombay Stamp Act,1958, whichever is higher. [Marathi version of notification erroneous with respect to composition

CONDITIONS

1. All the agreements, which are registered on or after 1st April, 2010 shall be covered under this composition scheme.
2. The claimant dealer shall make e-payment of the amount of composition for the return period in which the agreement is registered and include such agreement value as turnover of sales in the said return.
3. The claimant dealer opting to pay composition under this scheme shall not be eligible to claim set off of taxes paid in respect of the purchases.
4. The claimant dealer shall not transfer the property in goods, procured from outside the State, using the declarations in Form C under the Central Sales Tax Act, 1956 in the contract for which the composition for tax payment is opted.
5. The claimant dealer shall not issue declaration in Form 409 to his sub-contractor in respect of the works contract for which composition is opted.
6. The claimant dealer shall not be entitled to change the method of computation of tax liability in respect of contract for which he has opted for this composition scheme.
7. The claimant dealer shall not issue Tax Invoice

ISSUES & CONSEQUENCE

1) Whether the composition scheme is qua dealer or qua agreement
2) How will the tax payable to be ascertained if dealer contravenes a condition.
3) Exit Option available??
4) Whether tax can be collected from the customers in an invoice/bill (i.e. in other than Tax Invoice)
5) What would be the consequence if the Supreme Court in a writ petition of MCHI holds those builders are not liable to pay tax
6) Which are the methods by which builders can pay the vat on flats?
7) Can the different methods of calculation applied for payment of Vat on different flats/ projects?
8) When the deduction of 30% to be taken – after deduction of land & subcontract or after deduction of subcontracts only?
9) Whether the developers will be eligible to claim set-off of VAT paid on purchases?
10) What will be the VAT implications where mere advances are received from buyers and agreement for sell is not executed with the buyer?
10) Out of the three different methods of tax working, the builders/developers are given option to choose a method of their choice with a restriction that method should be applied to whole of the project concerned and no deviation is permitted. It may happen that in a project having execution period of more than 2 years, there may be possibility that some flats may have been sold before 31.03.2010 and some may be sold after 31.03.2010. In that scenario, whether the flat purchasers who have entered into an agreement after 31.03.2010 will be liable to pay VAT to the developers @ 1% of Agreement Value?

OPTION-1:

As per rule 58 of the Maharashtra Value Added Tax Rules, 2005 the sales price may be determined after deducting from the agreement value; the value of land, labour, chargers for planning, designing, architects fees, hire charges of machinery etc. The tax is computed on the value arrived as above. The tax computed as above is reduced after considering the tax paid on the purchases of building material (i.e. input tax credit). The tax so determined is required to be finally paid.

OPTION-2:

The rule 58 also provides for the standard deduction at 30% as given in the Table. The deduction towards the land value is taken from the total agreement value, the sales price is computed by further taking standard deductions (@ 30%) as provided in the Table. The tax is computed after applying the schedule rate of tax on sales price so arrived. The tax computed as above is reduced after considering the tax paid on the purchases

of building material (i.e. input tax credit). The tax so determined is required to be finally paid.

OPTION-3:

The section 42(3) of the Maharashtra Value Added Tax Act provides for tax at the rate of 5% on the entire contract value. The developer may opt for this and calculate the tax liability at the rate of 5%. This tax liability is reduced by the amount of taxes paid on purchases i.e. Input Tax Credit. The balance tax liability so computed is to be discharged.

Further, during the intervening period of litigation, various developers associations had made representations before the State Government to bring in a more simplified method of taxation in this respect.

Accordingly, the State Government, on examination, announced a scheme and issued a notification. As a result in respect of the agreements made on or after 1st April 2010 the applicable tax rate is fixed at 1% of the agreement value.

It is now learnt by the Sales Tax Department on the scrutiny of the books of accounts of certain developers after the passing of the judgment of the Bombay High Court, that many developers have collected taxes from their customers but have failed to discharge their tax liability by depositing the collected tax into the Government Treasury.

Now considering the three options as discussed above, it becomes apparent that the tax liability of developer for the period 20.06.2006 to 31.03.2010 may come to much less than 5% of the agreement value after adjustment of the available set-off as may be available to him. The law being clear on the point of leviability of tax upon such developers, it is advised that they discharge their tax liability as may be applicable to them immediately without any further delay.