

## Sore Point

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*Service tax on construction would mean paying higher price for property which is under construction. In an industry where agreement of contract between lessor and lessee providing for construction on vacant lands are a common phenomenon, an imposition like this is not likely to go down too well with the real estate sector.*

For the real estate sector the Union Budget 2010-11 offered more sore points than one, the most important being the proposed levy of service tax. As of now, the confusion over service tax is possibly a greater irritant than its possible fall out.

As per budget proposals, pre-sales of property will be brought under the service tax ambit. And even before figuring out how this is going to affect the business of someone engaged in real estate sector, a large section of the country's realty sector is unsure if service tax is to be charged on sale of property, which is under construction.

Ask any developer about the impact of the Union budget and the proposed imposition of the service tax would certainly be the most common issue that they would raise.

Deepak Jodhani and Ruchir Sinha of Nishith Desai Associates have come up with some likely fallouts of this. "Service tax on the activity of construction would primarily mean, buyers paying a higher price for property, which is under construction. In an industry where agreement of contract between lessor and lessee providing for construction of building/structure on vacant lands are a common phenomenon, imposition of service tax on such transactions is not likely to go down well with the real estate sector," they said in a report on March 4.

The Delhi High Court in the case of Home Retail Solution and Others Vs Union of India had clarified that renting of commercial property would not be subject to the levy of service tax. The budget has amended the scope of 'Renting of Immovable Property Service,' so as to directly overrule the high court judgment and to explicitly cover the activity of mere renting as well, and this has been done with retrospective effect from June 1, 2007.

Moreover, renting of vacant land where the agreement of contract between lessor and lessee provided for undertaking construction of building/structure on such land for furtherance of business or commerce during the lease period, will also be subjected to service tax, the Nishith Desai Associates' report pointed out.

Pursuant to the Delhi High Court judgment, most industry players refrain from paying service tax for such transactions. This amendment would also have a significant impact on both the real estate sector, as also sectors which rely on lease of immovable property for running their business. Further, retrospective nature of the amendment will now result in an adverse impact on the sector and may lead rise to a large amount of litigation.

Let us take a look at what the Union Finance Minister Pranab Mukherjee said in his budget speech. He

had said that development of real estate complexes will attract service tax, unless the entire consideration for the property is paid after completion of construction. "In the construction of complex services', it is being provided that unless the entire consideration for the property is paid after the completion of construction (that is, after receipt of completion certificate from the competent authority), the activity of construction would be deemed to be a taxable service," say the budget papers. And a 'complex' has been defined as consisting of more than 12 residential units in that budget paper.

Realty players made it clear that such a service tax would make housing costlier for buyers. However, even in the wake of the mounting pressures from the industry, the finance minister has refused to budge down. At a CII-organised seminar in Delhi, the finance ministry ruled out rolling back of service tax on real estate developers at the time of construction.

"Construction is a service. As a service, there is no reason why it should not be taxed. It is only 3 or 3.5 per cent that gets added up for the buyer," revenue secretary Sunil Mitra said at the CII-sponsored seminar. Harsh Neotia, chairman, Ambuja Realty Ltd, told FC Estate, "Although this is a growth-oriented budget on many counts, on the negative side, there is a proposal to bring real estate sector into the service tax net and rental income also comes under service tax net with retrospective effect from 2007. This will be like a dampener as rentals are bound to go up." He however hoped that overall economic development would make up for the negative impacts.

Santosh Rungta, president, CREDAI is not as optimistic as Neotia. "The issue of applicability of the service tax levied on renting of commercial property and for under construction units is a major area of concern for the developers. The service tax will be an additional burden and project costs will shoot up by 4-5 per cent. End consumers, thus will be most affected as they have to pay the service tax coupled with the existing stamp duty charges. Moreover, indirect taxes on raw materials for the industry like steel, cement, etc will further escalate project costs," Rungta said.

Rajiv Talwar, group executive director, DLF echoed the same sentiment. "It is a retrograde step. Without any warning, this 10 per cent levy has been dropped into our laps. It is going to escalate costs because there is no logic in taxing every activity related to construction," he said.

After speaking to a cross section of realty players across the country, FC Estate gathered that construction of real estate complexes will now attract service tax, unless the entire consideration for the property is paid after the completion of construction, that is, on obtaining the occupation certificate from the concerned authorities. Service tax will now also be levied on additional services provided by a builder to buyers for extra charge like preferential location, internal and external development of complexes.

According to CREDAI, the service tax levied on renting of commercial property and on sale of under construction housing units would prove critical as project costs will escalate by 4-5 per cent and this additional burden would ultimately be passed on to the home buyers, making the houses costlier for them.

Further, indirect taxes on raw materials like steel, cement, etc. will add to the project costs, increasing the prices for the home buyers. The applicability of service tax to all under construction flats and homes being booked prior to completion will increase the end cost and this will significantly impact affordability of the home buyer.

Rohtas Goel, chairman Omaxe and president, National Real Estate Development Council (NAREDCO) said, "We will call a meeting of the association to discuss the budget proposals, particularly the levying of service tax on housing which will have a negative impact on the realty sector."

Knight Frank in its post budget analysis also pointed out that the inclusion of renting immovable property under the service tax net will have a negative impact on the real estate sector. The levy of service tax will

impact rented commercial property with a retrospective effect since June 1, 2007. Secondly, in cases where an under construction property is bought and the consumer makes the payment over a period of time then it will attract service tax. In cases where the developer takes land on lease and pays lease rent, the lease rent will attract service tax. A hobsons choice by any reckoning.

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