

VAT and service tax swamp new home buyers

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Mumbai builders are slapping new home buyers with a nasty surprise in the form of value-added tax and service tax. This means that buyers have to pay 12% more on taking possession of their contracted and fully-paid apartments

Property prices in Mumbai have already zoomed past their pre-2008 peak and have become inaccessible to most people, but the nasty surprises for buyers who had already booked and paid for their flats do not seem to end.

Moneylife learns that builders are demanding extra money under value-added tax (VAT) and service tax from homebuyers who had booked properties during the recent slump. The demand apparently comes up when a person goes to complete possession formalities, leaving investors high and dry, say aggrieved buyers.

In fact, in case of service tax, there is no clear regulation passed by the government as of yet on whether the buyer has to pay the tax. This tax seems to be just another way for builders to extract more money than contracted, although some of the amount collected may be in the form of an undertaking to pay. However, for homebuyers who have borrowed heavily to pay for their properties, this additional 8%-10% cost differential is often difficult to cough up.

Importantly, developers do not mention these costs while booking the property—nor is it mentioned in the sale agreement. Consumers are asked to pay 4.5% VAT on the agreement value plus approximately 4% as service tax for buying a new property only while taking possession. Some consumers have had to give up their booked apartments because they could not arrange this additional financial demand.

"I had to cancel my deal as the developer asked me to pay 4.5% VAT on agreement value and also asked for a blank cheque with an undertaking for the service tax. It is very difficult to arrange such amounts just when you go to take the possession of the property," said a buyer, who is a senior executive with a leading IT company.

Sources say that developers try to make this additional demand appear very justified and even pretend to help the customer. Some suggest putting the money into an escrow account or creating a fixed deposit to pay the tax amount in the future, if necessary. They are told that the deposit /escrow will be tapped only if the ongoing litigation on the VAT issue goes against them.

"The Maharashtra government is yet not clear on VAT. There will be clarity in a few weeks, so we are collecting the money and keeping it separately in an escrow account as it is very difficult to collect the amount from the consumers after the Act is enacted," said Lalit Kumar Jain, chairman, Kumar Urban Development Ltd.

However, sources connected with the realty industry say that builders could just as well take an undertaking from each buyer that they (the builders) will pay VAT if the court rules against the builders. They further point out that litigation in India goes on for decades and there is no reason to collect money from customers today in anticipation of a judgement. Some point to a similar litigation in the 1990s over the stamp duty issue—at that time, builders merely collected undertakings from buyers and when the issue was decided, the state government offered an amnesty scheme permitting a reasonable stamp duty payment to ensure that buyers were not unduly harassed.

Sources also tell us that charging VAT from customers is a new development. Earlier, builders used to include VAT in the sale price. The demand for a blank cheque for service tax payment is another travesty. "As of now, developers are not supposed to charge service tax because it is still not mandated by statute. After it becomes a final Act, the government will notify the date from when it can be applicable and only then can you ask for service tax," said Vimal Punmiya, chartered accountant and proprietor, Vimal Punmiya and Company (an audit firm).

However, legal firms are not yet clear on the whole issue of VAT and service tax payment on property.

“The Supreme Court has ruled on this issue in the case of K Raheja Development Corporation versus the State of Karnataka [2005] 2 STT 178 (SC)] where the Karnataka Sales Tax Act, 1957, was held to be applicable to payments made towards construction activity taking place between the date of agreement and transfer of possession to the buyer. Subsequently the service tax authorities issued a clarificatory circular stating that service tax would be applicable to these ‘works contract’ arrangements. The validity of this circular is currently being questioned before the Bombay High Court. Meanwhile the 2010 Finance Bill has also introduced an explanation including such construction services within the definition of taxable construction services. This explanation will come into effect in a couple of months when the Bill is passed,” said Shreya Rao, lawyer, Nishith Desai Associates.

She also clarified, “Both service tax and VAT apply to ‘works contract’ arrangements such as construction contracts, which involve an inextricable element of both sale of goods and service. This is why an abatement is provided, both for VAT and service tax which are applied to works contracts at a lower rate than usual. If the purchase is of a completed property there should be no ‘works contract’ with the buyer, pursuant to the decision in Raheja. Therefore these taxes should not be applicable as VAT/service tax does not generally apply to sale of completed immovable property.”

However, an independent chartered accountant, Prem Chhatpar, argues, “In 2008, while giving the judgement for Larsen & Toubro’s case under works contract, the Supreme Court doubted the law laid down in the Raheja case. The Court has decided to reconsider the principles in the Raheja case in front of the larger bench of the Court. The Court also hinted that examination has to be made in the context of definition of sale under the Sale of Goods Act and Transfer of Property Act.”

“In the L&T judgement, the court hinted that it is perverse to consider every case where the flat is booked under construction to be deemed to be under ‘works contract’,” added Mr Chhatpar.

The issue from the customer perspective is that he/she is suddenly being asked to pay more—an additional amount which was neither disclosed nor contracted earlier. As things stand now, for a purchaser acquiring a new property, he has to pay 5% stamp duty (for value over Rs5 lakh), 1% as registration fee, 4.5% as VAT and 3.5%-4% as service tax. This works out to 14% over the property price which is extracted by the government on property prices, which are already astronomical.

The ground reality also is that a customer booking a flat is not signing a construction contract with the builder, he is only contracting to buy a completed property. The developer is not rendering any service to the consumers but only carrying out his duty.

Besides these taxes, the interest rates on home loans are also increasing gradually. A common man hunting for a roof over his head is now totally pinched with the sudden increase in property prices, taxes and interest rates.