

November 14, 2013

To,
The Revenue Secretary,
Ministry of Finance,
North Block,
New Delhi

Dear Sir,

Sub: Representation regarding issues under Negative List based Service Tax regime in relation to Redevelopment and Slum Rehabilitation Projects

1. Introduction

We, Maharashtra Chamber of Housing Industry ('MCHI'), are a prominent and recognized body of real estate developers in the Mumbai and Mumbai Metropolitan Region ('MMR'). We are recognized by Government of Maharashtra and the Central Government and our members account for 80% (approx) of the organized development of new residential and commercial properties in Mumbai and MMR.

We, on behalf of our members who are real estate developers, seek to highlight certain difficulties being faced by our members due to ambiguity in interpretation of statutory provisions, especially in light of the recent Circular No F.No.V/ST-I/Tech-II/463/11 dated 31 August 2012 issued by the Commissioner of Service Tax, Mumbai, as regards applicability of Service tax on Redevelopment and Slum Rehabilitation Projects.

In this regard, we make the following submissions.

2. Redevelopment and slum rehabilitation projects in Mumbai - An overview

2.1 Slum Rehabilitation

2.1.1 It is estimated that more than 55% of Mumbai's population stays in slums. To ameliorate the problems of slums dwellers, the Government of Maharashtra appointed the Afzalpurkar Committee in 1995 to devise a scheme to rehabilitate slum dwellers in slums existent as of 01/01/1995, using the underlying land as a resource for the Slum Rehabilitation Scheme ('SRS').

- 2.1.2 The Slum Rehabilitation Authority (SRA) was established on December 15th, 1995, to serve as the planning authority for all slum areas in Greater Mumbai and to facilitate the rehabilitation schemes.
- 2.1.3 The objective of SRS is to not only redevelop, but also rehabilitate the slum and its inhabitants.
- 2.1.4 Though the social responsibility of rehabilitating the slum dwellers is with the Government, significant funds that are required for the construction of rehabilitation buildings are not readily available with the Government, and hence, in order to facilitate and incentivize involvement of private developers to cross-subsidize these SRS projects, it was decided to allow the private developers some free sale area, which may be sold by the developers to independent customers against valuable consideration, to recover their costs and profits.
- 2.1.5 Through the scheme, rehabilitation flats are built free of cost to the slum dweller by cross-subsidization provided by free-sale flats. In other words, the developers are allowed to construct flats on slum land which they can sell to private independent customers, provided they construct flats of prescribed criteria for the slum dwellers, on free of cost basis.

2.2 Redevelopment of old buildings

- 2.2.1 Most buildings were built in Mumbai and its suburbs in about 1950s with a basic floor space index (FSI) of one. Generally, the life cycle of a building with some repairs in between can be assumed to be around 40 to 50 years, depending upon the construction quality and hence, buildings built in 1950s started becoming weak by 1990s. The repairs up to a mid-stage of buildings life were viable but as it started reaching to a dilapidated stage the need for redevelopment was seen. Further, such buildings did not have the basic modern facilities or utilities such as lifts, covered parking space, children play area etc.
- 2.2.2 However, for redevelopment of any building, huge capital contribution is required which was not available with existing societies or their members.
- 2.2.3 In order to facilitate and promote redevelopment activity within Mumbai and MMR, the concept of allowing additional FSI by way of transfer of development rights was introduced for the first time in 1991, as an incentive to the developers for getting into redevelopment projects for old buildings.
- 2.2.4 The additional FSI allowed the developers, additional area, through sale of which the developers can recover their capital investment, cost

of construction, profits etc after providing some extra benefits such as additional area, rent, corpus etc to the society members.

2.2.5 Thus, simply put, 'redevelopment' is the process of demolishing existing old society building under an agreement between the developer and the society/ its members, and reconstruction of the same by the developer who constructs and handover new flats to the society members 'free of cost' with some additional benefits (increased area of flat, additional common amenities and utilities etc) and makes profit by utilizing the balance plot potential/ additional FSI by constructing additional flats and/ or shops on the free sale area as per approval from M.C.G.M.

3. Legislative background

Till 30 June 2012, Service tax was levied only on specific categories of services that were notified / defined for this purpose under the Finance Act, 1994 ('the Act').

The taxable services of 'construction of residential complex services' were defined under the erstwhile Section 65 (105) (zzzh). Further, the term 'residential complex' was specifically defined under the erstwhile Section 65 (90a) of the Act which excluded complexes constructed by a person for 'personal use' as a residence.

By virtue of aforesaid exclusion, the activity of redevelopment of an existing residential property and construction of residential buildings for redevelopment of slum dwellers under a SRS were not liable to Service tax, as the redevelopment / rehabilitation buildings are constructed for 'personal use' by existing flat owners/ slum dwellers.

3.1 Introduction of 'Negative list of services' based taxation regime

The negative list based regime for taxation of services was introduced with effect from 1 July 2012, under which all services are taxable, unless covered under the Negative list or exempted by way of specific notification.

Under the new regime, no specific exemption or exclusion has been provided for construction services relating to premises intended for personal use.

3.2 Circular no. F No.V/ST-I/Tech-II/463/11 dated 31 August 2012

We vide our letter No. MCHI/GEN/12-13/051 dated 26th July 2012 sought for clarification on applicability of Service tax on Redevelopment and SRS projects.

Pursuant to the said letter, the Commissioner of Service Tax, Mumbai vide Circular no F No.V/ST-I/Tech-II/463/11 dated 31 August 2012 replied that w.e.f 1 July 2012, Service tax would be applicable even on construction service provided by a developer to existing flat owners or slum dwellers under Redevelopment and SRA projects. In addition, it was clarified that valuation of such services would be required to be done as per the Service tax Valuation Rules.

4. The issue

We wish to respectfully submit that the interpretation adopted by the Learned Commissioner of Service Tax, Mumbai in the aforesaid Circular is adopted, the same would lead to burden of double taxation of the developers, which is against principles of natural justice.

In this regard, the following is important to be noted –

- ▶ There is no monetary consideration received by the developer from the existing society residents or slum dwellers under the Redevelopment or SRS projects. Hence, levy of service tax on construction of redevelopment/ rehabilitation buildings would result in additional tax cost to the developers, since the same cannot be recovered from the existing society owners or slum dwellers.
- ▶ As described earlier, the developers primarily recoup the entire cost of construction and their profit from sale of flats constructed from the additional Floor Space Index ('FSI')/ Free sale area ('FSA'). In other words, the total consideration being received by the developers for construction of flats under the Redevelopment/ SRS as well as the Free Sale Area are the amounts received from sale of the FSA flats only. No other consideration is received by the developers.

It is not disputed that developers are paying Service tax on the construction of FSA portion, when sold prior to completion of construction activity.

- ▶ Accordingly, in fact, indirectly, the developers are already paying Service tax on the construction of the redevelopment/ SRS buildings and any separate levy/ demand would result in double tax burden for the developers.

5. Our representation

From the above, you would appreciate that levy of Service tax on flats granted to existing society residents (under Redevelopment projects) or slum dwellers (under SRS projects) would result in double incidence of Service tax on developers, which in our humble opinion, cannot be the intention of law.

Given this, we would respectfully wish to put before Your Honor, the following alternatives, any of which can be implemented to prevent any double incidence of Service tax on developers engaged in Redevelopment/ SRS projects:

Alternate 1

Issue appropriate exemption notification or amend provisions of the Finance Act, 1994 (i.e. amending the negative list) so as to grant relief to developers in respect of redevelopment or SRS projects to the extent of construction intended for 'personal use' as a residence by the existing society members/ slum dwellers respectively. This would effectively restore the status quo as under the erstwhile Service tax legislation.

Alternate 2

CBEC may issue a clarification stating that developers would not be liable to pay Service tax separately on construction of rehabilitation buildings or redevelopment of building for existing society residents, since the cost of construction of the same along with a profit element is included in the sale price of the flats or shops constructed on the additional FSI/ FSA , on which Service tax is already being discharged by the developers, when sold prior to completion of construction.

Alternate 3

The provisions of the Act and/ or CENVAT Credit Rules, 2004 may be appropriately amended so as to allow the developers to claim Cenvat credit of the Service tax paid on construction of the rehabilitation/ redevelopment portion, and to utilize such credit to offset the Service tax liability arising on sale of FSI/ FSA flats or shops etc, since construction of rehabilitation or redevelopment buildings/ flats is a requisite input activity for construction of the FSI / FSA flats or shops etc.

6. Other industry issues

We would like to take this opportunity to also put before Your Honor, a few other significant issues that the real estate sector is grappling with, and request your kind intervention on the same by way of issuance of appropriate clarification/ amendment in statutory provisions.

Issue 1

As per the section 66E (b) of the Act, construction of complex wherein entire consideration is received after issuance of Completion certificate ('CC') by the competent authority would be outside the purview of levy of service tax.

In this regard it may be noted that especially in Mumbai and the MMR, there are administrative difficulties in obtaining the said CC within a reasonable

time. In most cases, the CC is not granted even till 3-4 years after occupation of the fully constructed building by the residents.

On the other hand, possession of flats is granted to customers immediately after obtaining Occupancy certificate ('OC'). The OC is a document certifying a building's compliance with applicable building codes and other laws, and indicating it to be in a condition suitable for occupancy. Thus, OC is generally granted upon completion of construction.

On plain reading of Section 66E(b), it appears that the intention of the government was to exclude all transactions wherein immovable property is transferred post completion of construction of property. This requirement would be satisfied even if the condition of CC is changed to OC.

Our recommendation: A clarification may be issued or the statutory provisions may be amended to provide that any flats sold after issuance of OC by competent authority should not be charged to Service tax.

Issue 2

In the aforementioned Circular issued by Commissioner of Service Tax, Mumbai, it has been clarified that "floor rise charges" recovered from customers are in relation to additional construction cost and therefore should be treated as part of the consideration for sale of flat in terms of provisions of section 66F (naturally bundled service) and accordingly, the same would be eligible for the abatement of 75% in terms of Notification No. 26/2012-ST dated 20 June 2012.

In this regard we humbly submit that in view of the concept of bundled services, preferential location charges eg – corner plot, garden view, sea view, vastu compliant property etc that are collected from buyers of the under-construction property are also in relation to the construction activity and are included in the final sale consideration in the Agreement for Sale.

Our recommendation: A suitable clarification may be issued granting benefit of abatement to such other charges also since the same are clearly related to the construction of the property and thus, are a part of consideration for taxable services of construction.

Issue 3

Pursuant to the interim order of Bombay High Court dated 18 February 2011 in respect of our Writ Petition challenging the constitution validity of levy of Service tax on construction activity, and instructions of the Court thereunder, our members are directly depositing the Service tax payable with the Bombay High Court.

However, the Mumbai Service tax authorities are demanding interest and penalty for alleged delayed of Service tax, on the ground that the monies have been deposited with the Court and have not been received by the Service tax department.

In this regard, it is relevant to note that our members are merely complying with the direction of the Hon'ble Bombay High Court by depositing the Service tax amount with the Court and thus, they should not be penalized with interest or penalty demands for following directions of the Hon'ble High Court.

Our recommendation: An appropriate clarification should be issued to granting protection and relief to our members from unnecessary interest and/ or penalty demands.

7. Prayer

We request you to kindly take the above submissions into consideration and issue appropriate clarifications/ exemption notification/ amendment, as the case may be, granting relief to real estate developers, especially from the likely double incidence of Service tax in case of Redevelopment and Slum Rehabilitation Projects.

We hope that our representation would be considered favorably.

Further, we also request if we may be granted an opportunity of meeting with your good-self in person to explain the above submissions in detail.

We would be pleased to furnish any other information or detail as may be required.

Thanking you.

Yours faithfully,
For MCHI-CREDAI

S.S. Hussain, IAS (Retd.)
CEO