

Private and Confidential and strictly for members of MCHI- CREDAI
Guidance Note and Advisory issued by MCHI-CREDAI on VAT issues

In continuation of our earlier communications in the VAT matter, we advise our members to be guided by the following to arrive at their VAT liability in respect of transactions of sale of under construction Flats / Units and adopt the most suitable method under the advice for your tax expert. These guidelines are being issued to our members without prejudice to the rights and contentions of the MCHI and its members in the SLP bearing No. 21052 of 2012.

Please note that under the judgment of the Bombay High Court, it is held that the Agreement of the sale of flat by the developers, till the building is completed, has character of Works contract embedded in it, and Developers shall be liable to pay the VAT for the amount of Works Contract embedded in the Agreement of Sale of flat and collect the same from the Customers. Hence under the judgment, the Developers have been construed and equated as the contractors for that portion of the Agreement of Sale, which can be construed as Works Contract and therefore, the methods available to a contractor to discharge their tax liability on the value of the goods transferred during execution of the works contract are also now applicable and available to a Developer. Accordingly, we discuss hereunder the methods in the context of the Developers treated as Contractors.

1. **Rule 58(1):** Rule 58(1) provides for the determination of the Sale Price by claiming deductions from the Agreement Value in the following manner (Contract wise).

Particulars	Amount
Agreement value	
Less:	
(i) Notional value of land cost as per rule 58(1A)	
(ii) Amount paid to sub-contractor (material + labour) –where form Forms 407 & 408 are obtained	
(iii) Labour and service charges for execution of the works	
(iv) Charges for planning and designing and architect fees	
(v) Charges for obtaining on hire or otherwise machinery, and tools	
(vi) Cost of consumables such water, electricity, fuel used	
(vii) Cost of establishment including the fees/ charges paid to municipality, interest on borrowings, marketing costs, brokerage costs etc, depreciation on equipment used in the execution of works contract etc.	
(viii) Other similar expenses relating to the said supply of labour and services.	
(ix) Profit earned by the contractor (developer) to the extent it is relating to the supply of said labour and services.	
Taxable amount	

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Please note that the deductions suggested above in respect of amounts paid for the fees/ charges paid to municipality, interest on borrowings, marketing costs, brokerage costs etc and also depreciation on equipment used in the execution of works contract etc although not mentioned categorically under the Rule 58(1), the same may be claimed in view of the constitutional powers of the state to levy & collect tax only on the “Goods” either in the form of Goods or any other form included in the ‘works contract’ as also legal precedents on the subject.

2. **Rule 58(1) – proviso:** In the event the developers has not maintained books of accounts or where books of accounts are maintained in a manner that costs as described above can not be arrived at or at the option of the developer, proviso to Rule 58(1) allows the developer to claim adhoc deduction @30% in lieu of deductions against item nos (iii) to (ix) above. The Sale Price is arrived at by claiming deductions from the Agreement Value in the following manner (Contract wise)..

Particulars	Amount
Agreement value	
Less:	
(i) Notional value of land cost as per rule 58(1A)	
(ii) Amount paid to sub-contractor (material + labour) –where form Forms 407 & 408 are obtained	
Balance amount	
30% of the balance amount as adhoc deduction as a civil contract	
Balance = to taxable turnover	

In case of the above two methods the taxable turnover so arrived at is to be taxed at the rate applicable to the material at the time of incorporation of the material. Thus, the rate applicable on the total taxable turnover would be mix of 4%, 5% or 12.5%.

State Government thought it fit to bring out composition scheme u/s 42(3) and later on u/s 42(3A) to make it feasible for the Developers to opt for an easy to implement scheme popularly known as Composition Scheme.

3. **Section 42(3) – Composition Scheme:** This composition method can be considered for the period from 20th June 2006 till 31st March 2010. It may be noted that the scheme is still in force and can be opted for later period also although it may lead to higher VAT liability in majority of the cases. The vat liability as per Section 42(3) is equal to 5% of the Contract Value. Land cost deduction as per rule 58(1A) is not available in this case. However, deduction on account of amount paid together with VAT to sub-contractor (material plus labour) is available.

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4. **Section 42(3A) – Composition Scheme effective from 1st April 2010:** Under this Composition Scheme, the Agreements which are registered on or after 1.4.2010 in respect of sale of flat shops etc will be eligible to pay composition amount equal to 1% of the agreement value . In this method also, Land cost deduction as per Rule 58(1A) is not available. The conditions prescribed by the Department in the Notification dated 9th July 2010 are to be strictly complied with.
5. **Cost plus Gross Profit Method:** The objective of Rule 58(1) is to arrive at the ‘value of goods’ transferred during execution of ‘the works contract’. The constitutional powers of the State to levy tax on transaction of works contract is defined in sections 6, definitions of sale [section 2(24)], sale price [section 2(25)] and turnover of sales [section 2(33)]. Therefore, Rule 58(1) contemplates to arrive at the value of the goods transferred during the execution of works contract. Instead of, claiming various deductions from Agreement value, one may simply find out the value of the material consumed and transferred in the construction and add a suitable margin of gross profit (which according to general consensus of the committee is that should not exceed 15%, as no contractor can have a margin of more than 15% in any works contract) to arrive at the taxable value.

Although this method is not specifically prescribed under the MVAT Rules, since the VAT is payable only in respect of Goods involved in works contract, under the MVAT Act, Dealer will be entitled to adopt this method and the same have been followed and accepted by the Department in case of contractors. The Developer, as per the judgment of the Bombay High Court, is contractor, to the extent of the Works Contract embedded in the Agreement of Sale and hence cannot be treated separately under the MVAT Act

Even in case of this method, the taxable turnover so arrived at is to be taxed at the rate applicable to the material at the time of incorporation of the material. Thus, the rate applicable on the total taxable turnover would be mixe of 4%, 5% or 12.5%.

Input Tax Credit (ITC):

The MVAT Rules provide for claim of the Input tax Credit by the Developers. The different methods as discussed above would enable the developer to work out the ‘tax payable’ by him. However, the ITC is nothing but at par with the tax paid by the Developer on his purchase/ inputs and hence, to the extent permitted by Rules, the Tax paid on Inputs is deductible from the Gross amount of tax liability payable by the Developers. However, in the Composition scheme u/s 42(3), the there is reduction of 4% from the Input Tax Credit

It is important to note that different methods can be adopted by the Dealer for each of the project being executed by the Developer.

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We also bring to your kind attention the following for compliance:-

1. The members who are not registered under the Maharashtra Value Added Tax Act must now get themselves registered on or before 15th October 2012
2. The members must pay the tax and file their VAT returns for the period from 20th June 2006 till date on or before 31st October 2012
3. The Members must also apply for Administrative Relief on or before 31st October 2012.

Members are advised to take note of the above & arrange their affairs accordingly.

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