

### **SALES TAX FOR APARTMENTS**

In a recent decision having a significant impact on both the developer and the purchaser of flats, a three judge bench of the Supreme Court of India in the case of **Larsen and Toubro Limited and Another Vs. State of Karnataka and Another (Civil Appeal No. 8672/2013 and other connected appeals)** (on 26.09.2013), has held that the agreements entered into between the developer and the prospective purchaser of flats to construct flats amounts to a "works contract" and is chargeable to sales tax. The Court upheld the view taken by it in **K. Raheja Development Corporation Vs. State of Karnataka [(2005) 5 SCC 162]** which had been taken up for reconsideration. Further, the Court upheld the validity of Explanation (b)(ii) to Section 2(24) of the Maharashtra Value Added Tax Act and Rule 58(1A) of the Maharashtra Value Added Tax Rules. By this judgment the Court has shut the doors on the arguments against this levy.

The correctness of the view taken in Raheja Development Corporation case was doubted for the following reasons:

- (a) The developer had undertaken the contract to develop the property of the owner. It is not alleged by the department that there is monetary consideration involved in the development agreement. If the development agreement is not a works contract, could the department rely upon the second contract which is the tripartite agreement and interpret it to be a works contract;
- (b) If the ratio in Raheja Development is to be accepted then there would be no difference between works contract and a contract for sale of chattel as a chattel; and
- (c) From the definition of works contract, the contractor must have undertaken the work of construction for and on behalf of the flat purchaser for cash, deferred or any other valuable consideration but could it be said that developer was contractor for the prospective flat purchaser.

The factual matrix of all the appeals heard by the Supreme Court was similar. The developer had entered into an agreement with the prospective purchaser of flat to construct a flat and sell undivided share in the land. The sales tax authorities issued demand notices seeking to tax the sale of materials used in the construction of flats. The challenge to the demand notices in the High Court was rejected based on the law laid down in K. Raheja Development case. On appeal to the Supreme Court, a division bench of the Supreme Court expressed doubts on the law laid down in K. Raheja's case and the question was referred to a larger bench.

After a detailed consideration of various judgments and legislative changes, the Supreme Court held that the traditional distinction between contract for sale of goods and contract for work (or service) has lost significance. By a legal fiction under Article 366 (29A)(b), it is now possible even in a composite contract to separate consideration received for transfer of property in goods from that for work and labour and assess the former component for sales tax. Clause 29(A)(b) of Article 366 includes sale of goods involved in the execution of a works contract within the scope of "tax on sale of goods". The Court held that the transaction between the parties may be sale of flat but the transaction also has the characteristics of works contract. The Court has, however, clarified that the activity of construction undertaken by the developer would be a "works contract" only from the stage the developer enters into a contract with the flat purchaser and the value of the goods transferred should be determined at the time of their incorporation onto the immovable property.

### **IndusLaw Quick View:**

*An Important point is that the value in the contract cannot be taken as such but the value at the time of incorporation into the property has to be considered for tax. Thus it can be invoice value of the material rather than the agreement value.*

*It does not convincingly counter the point that the developer is not a contractor for the purchaser as the purchaser does not even own the land. The agreement to construct had already been entered into with the owner and this agreement with the purchaser is a nomination of the right to UDS and sale of developer's share of built up area which is crystallised by a sharing agreement with the owner. Thus there is no works contract with the purchaser but only an agreement of sale of immovable property and no sales tax is leviable*

*This may result in a move to have separate agreements for sale of UDS and construction again to have certainty on sales tax liability, reversing the trend to have composite ones which are more prevalent now.*



**BANGALORE**  
101, I Floor, "Embassy  
Classic" # 11, Vittal  
Mallya Road,  
Bangalore -560001,  
India  
Tel: +91 80 4072 6600  
Fax: +91 80 4072 6666  
[bangalore@induslaw.com](mailto:bangalore@induslaw.com)

**DELHI**  
A-4, Sector 26  
Noida -201301  
NCR of Delhi, India  
Tel: +91 120 472 8100  
Fax: +91 120 472 8114  
[delhi@induslaw.com](mailto:delhi@induslaw.com)

**MUMBAI**  
1002A, 10<sup>th</sup> Floor,  
Tower 2  
Indiabulls Finance Centre  
Senapati Bapat Marg,  
Elphinstone Road,  
Mumbai 400 013  
[mumbai@induslaw.com](mailto:mumbai@induslaw.com)

**HYDERABAD**  
204, Ashoka Capitol,  
Road No. 2, Banjara Hills,  
Hyderabad 500 034,  
India  
Tel : +91 40 4026 4624  
Fax: +91 40 4004 0979  
[hyderabad@induslaw.com](mailto:hyderabad@induslaw.com)