REAL ISSUES OF REAL ESTATE

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1.0 Introduction:

Indirect taxes applicable in the real estate sector has always been a bone of contention, in spite of several attempts of Government to resolve the same. In fact, the issues mainly started with the Government's zeal to collect taxes on several aspects of real estate, many a times, illegally

2.0 Legal Issues:

Article 265 of Constitution of India provides that – *"No tax shall be levied or collected except by authority of law"*

2.1 The question is what is the authority of law?

Typically, as a layman, one may have a tendency to presume that any law which is laid by the Government is the authority of law and the same needs to be followed religiously. Sometimes, even tax professionals also end up taking up such a stand and thereby advising clients to pay taxes even if they have serious doubts about validity of any law. One of the important aspects of any real estate transaction is – size. Most of the time, the amount involved in real estate transactions is huge. Therefore, even tax on such transaction can be a big chunk. In the zest of being safe on a taxation front, people end up taking a stand which can make the whole transaction an unviable one on a business front

2.2 Government is not an authority:

It may be appreciated that the role of any Government is confined to implement or administer any law but not to impose any law. Depending upon the subject, the law-making powers are vested with the Parliament or State Legislature and not with the Government

This can be understood by looking in the case of The Lord Krishna Sugar Mills vs The Union of India and others[1]. It was held by the Supreme Court that unless the law is administered by Rules placed before the Parliament, any amount collected for non-fulfilment of targets of sugar exports, is without authority of law

2.3 Even State Legislature travelling beyond Constitution is not an authority:

Similarly, in the case of indirect taxes, an attempt of State Government of Madras to impose sales tax on the goods portion involved in a works contract was held to be without authority of law by the Supreme Court, as the same was not as per the extant provisions of Constitution of India, even if such tax was imposed with an approval by the State Legislature. Please, refer State of Madras vs. Gannon Dunkerly & Co. (Madras)[2]

[1] 1959 AIR 1124 (Supreme Court of India)
[2] 1958 AIR 560 (Supreme Court of India)

2.4 Misuse/improper use of authority not permissible

In the past central/state government have carried out various attempts to levy tax on several aspects of real estate and failed multiple times on various specific grounds as the same was without authority of law. A look at history provides us with multiple instances where, challenge by a taxpayer on a proper footing has saved him from an arbitrary levy of taxes. This can be understood by looking at following cases:

In case of Magus Construction (P.) Ltd and V. Union of India and others[3]

In an attempt of the Service tax authorities to compel a builder to get themselves registered with Service tax authorities and pay taxes on the construction activities; the Builder challenged the same. Gauhati High Court held that an estate builder is constructing apartments for the purpose of sale and therefore services of construction are rendered to self, therefore, not taxable

In case of Suresh Kumar Bansal vs Union of India & Others[4]

In this case it was held that if the Act is unworkable in the absence of necessary Rules, any assessment under the said Act cannot be enforced even if such an assessment order is made by an authority under the Act purportedly in accordance with the provisions of the Act.

3.0 Other indirect tax issues:

3.1 Value of land:

The sale of land is not exigible to GST. Consequently, the GST law provides for a standard abatement of 33% of the total contract/agreement value towards value of land for taxable real estate transactions, irrespective of the actual value of land. At times, the actual value of land could be much more than just 33% of the total value charged. Recently, Gujarat high court in the case of Munjaal Manshi Bhat[5] held such deeming value mechanism to be ultra-vires.

3.2 Tax on rights emerging out of land:

Similarly, treating FSI or TDR as a taxable service by way of a backdoor of exemption notification or providing a deeming value of such FSI/TDR equivalent to value of unsold flats is also an arbitrary and a game stopper for the real estate industry.

3.3 Taxing in a taxing manner:

Creating a rate entry in the rate notification along with plethora of conditions, is another such example of step-motherly tax treatment to the real estate industry. The computation of tax becomes so difficult with concepts like 80% compulsory procurement from the registered persons, 100% compulsory procurement of cement from the registered persons, project wise accounting etc.

[3] 2008 (11) S.T.R. 225 (Gau.) (Gauhati High Court)
[4] 2016 (43) S.T.R. 3 (Del.)(Delhi High Court)
2017 (4) G.S.T.L. J128 (S.C.) (Pending)
[5] 2022 (62) G.S.T.L. 262 (Guj.) (Gujarat High Court)

4.0 Practical Issues:

4.1 Changes in law and the long-term nature of the contracts:

Normally, the Contracts of real estate are long term in nature. They take a substantial period of time to complete. Commitments made in the contract are binding on the parties as per the Contract Act, 1872 even though some terms of the contract have been heavily impacted by subsequent changes in the law. Most of the times, amendments in the indirect tax laws do not provide any immunity to the contracts made in the past.

For example, at the time of contact made in 2009, there was no levy of service tax on sale of under-construction flats, then in the year 2010 service tax was introduced, subsequently, the rates of service tax underwent changes three times. In 2017, Service tax was replaced by GST law. The taxation system of GST underwent a sea change in 2019. Imagine the scene where such contract runs till 2020. Both parties to the contact may end up either litigating between both of them for the taxes, or one of the parties may suffer heavily due to such abrupt changes in the laws without providing sufficient safeguards or clarity on the ongoing contracts.

4.2 Changes in Partners and the long-drawn tax litigations

Many a times developers jointly develop project for various reasons such as sharing of cost, requirement of expertise, etc. as the real estate project are long term it is very much possible that there can be change in partners or Joint Venture parties. In such a case, if some unfair tax demand has been raised and the same is being litigated, real estate partners undergo a tough time while parting their ways. Continuing partners run more risks in such a situation due to unreasonably long time taken by the Judiciary to give its final verdict.

4.3 Changes in the cost due to taxes and long-term contracts

Abrupt and frequent changes in the tax laws can lead to a huge impact over the final cost of the real estate product. Imposition of new taxes, changes in rates of taxes, sudden withdrawal of exemptions or changes in set of mechanism (ITC), can lead to a huge impact on the price of the end product. Many a time, such unforeseen changes in the tax laws can lead to closure of even the most pragmatic business organizations.

4.4 Anti-logic provisions like anti-profiteering

Copying the concept of anti-profiteering provisions from the foreign countries' GST laws was a good idea if the same would have been copied fully and sensibly. The way it has been implemented is beyond any horizons of sanity. Not even the members of the authority have any documented policy or procedure to determine if there is any element of anti-profiteering in any transaction. If at all there is any element of anti-profiteering, there is no set mechanism to arrive at the quantum thereof. There is no mechanism even to rectify any act of anti-profiteering. In a long -term contract, where there are number of changes in the law, it becomes very difficult to prove himself innocent.

5.0 Other legal issues:

Changes in the land usage regulations, FSI and TDR provisions, local authority charges, height restrictions, multiple permissions, are few more to name out of many other issues.

6.0 Solutions:

6.1 Drafting:

Drafting agreements keeping in mind the possibility of various future amendments could be a key to avoid multiple issues. It may not be possible to predict all such amendments, however, with an experience of the past, one can provide suitable clauses to take care of future changes.

6.2 Structuring

Structuring can help avoiding avoidable tax losses in an optimal manner. It can also help reducing tax burden or maximizing set-off or minimize compliance burden.

6.3 Keeping an eye on amendments

Amendments in taxation law come frequently. Many a times many procedural changes or addition or removal of conditions are introduced through the amendments. Keeping updated about such amendments can help one remain complaint and avoid undue penalties and surprises.

6.4 Litigation

Normally, any prudent businessman avoid litigation as far as possible. However, at times when the one is saddled with undue and unfair demands, litigation could be a good solution. Litigation with a proper planning and management, can help reduce possibilities of huge losses and probably even resultant shut downs.

6.5 Taking multiple views

It is important to consider multiple views to take a pragmatic and balanced call. At times, taking input from different experts can help identify the best possible solution as against remaining dependent on just one advice.

6.6 Updating self with the updates:

A good decision taken once upon a time, though based upon some good advice, may prove to be the worst if the basis of such decision has undergone a big change. In the light of multiple and mega changes in the laws, it could be a good idea to validate the old stands taken- at least once a year.

7.0 Conclusion:

Real estate industry may have multiple challenges to survive and grow, however, many of such challenges can be well managed with the help of proper information, planning, implementation and review. Chartered Accountant or a tax advisor plays a very important role by assisting real estate clients in successfully managing their challenges.