

GST ASPECTS FOR THE REAL ESTATE INDUSTRY



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For decades, we have been hearing that “*Roti, Kapda, and Makaan*” – Food, clothing, and shelter, are the 3 essential needs of our compatriots. While food and clothing are fairly taken care of for most classes of the populace, “*Makaan*” – housing remains an aspiration for most, especially the youth of our country.

The government is also actively pursuing policies to ensure housing for all with various housing schemes like PM Awaas Yojana (PMAY) and schemes launched by State Governments. In doing so, GST remains an important cost consideration for the developers, as well as the buyers.

While prima facie it might look like a fairly simple task to determine the GST rate on construction services – 1% for affordable and 5% for non-affordable houses, the reality is far from simple. Let us understand some of the finer nuances under GST for real estate developers.

Applicability of GST on Real Estate:

GST is an indirect tax i.e.; it is levied on the consumption of goods and services. However, immovable properties have been kept outside the scope of indirect taxes and GST is no exception to that. Sale of land and building has been kept outside the purview of GST law by way of Schedule III of CGST Act. While “immovable property” has not been defined in GST law, however, General Clauses Act, 1897 defines “immovable property” as land, benefits arising out of the land, and things permanently attached to the earth.

In the context of the above definition, it is only logical that GST does not apply to the sale of land and has been placed in Schedule III of the CGST Act which covers activities that are not to be considered as supply of goods or services. Hence, the sale of land is outside the purview of GST.

Similarly, any property for which an occupation certificate/completion certificate from the relevant authority has been received has been considered to be immovable property, and when such a property is sold, it will also be treated at par with the sale of land and shall be outside the purview of GST.

In contrast, when a property is sold while it is under construction, it is not considered to be land. It is deemed to be a composite supply of construction services that involves the supply of material and labour i.e., goods and services. Schedule II of the CGST Act classifies this composite supply as a “service” since it is in the nature of a “works contract service” and it is eligible to GST.

New Regime:

W.e.f. 1st April 2019, new tax rates for the real estate sector were ushered in by the Government. These changes brought in some radical changes not only in the taxability of the services provided by the real estate sector but also on various inward supplies like TDR.

Some of these major changes include the following:

- Introduction of the concept of Residential Real Estate Project (RREP) and Real Estate Project (REP);
- Effective rate of GST for construction services was reduced to 1% for affordable housing projects and 5% for non-affordable housing projects;
- Commercial shops in RREP to be treated at par with residential houses;
- No ITC for residential projects opting under the new regime;
- Tax payable on Transferable Development Rights (TDR) by the developer under reverse charge, in proportion to the unsold area as on the date of occupation certificate;
- If URD purchases are more than 20% of the total cost (with certain exceptions) then tax payable under reverse charge on such excess purchases
- Reversal under Rule 42 shall be done at the end of the project instead of at the end of each financial year.

Further, after the 47th meeting of the GST Council, various GST rates on various goods and services have been changed. Amongst the said changes, the most notable changes pertain increase in the rate of GST of all works contract services from 12% to 18%.

Earlier, works contract services provided by contractors to promoter-developers who are selling affordable residential flats under the new regime were taxable at 12%. Similarly, works contract services provided in relation to various projects of the PMAY, Affordable housing scheme, projects meant for low-income groups, etc shall also be taxable at 18%.

The impact of this is that, while the contractor will charge a higher rate of GST to the developers, the developers will not be able to take the input tax credit for these services and therefore, they will have to ultimately pass on the burden of this additional cost to the home buyers which will, in turn, increase the cost of purchasing a house.

The Valuation conundrum

As mentioned earlier, the sale of immovable property has been kept out of the purview of GST. However, any price for purchasing a real estate property invariably involves two components – the cost of land and cost of development and it is nearly impossible to separate one from the other.

To ensure that GST is not levied on the value of the land of any such agreement, the Government allowed for 1/3rd abatement in the total contract value as being towards the cost of land and GST was payable on the balance of 2/3rd of the contract value.

For example, the developer entered into a contract for the sale of a flat for Rs. 1.50 crores. In that case, 1/3rd of the contract value i.e., Rs. 50 Lakhs will be deemed towards the value of land and a balance of Rs. 1 crore will be deemed to be towards construction service and GST will be payable on the same at the applicable rate.

Hon'ble Gujarat High Court in the case of **M/s Munjal Manishbhai Bhatt - 2022-TIOL-663** has held the deeming fiction of 1/3rd value towards land as ultra-vires the GST law and allowed the option to the assessee to consider the value of land as per the information available and if the value of land is not ascertainable, only then it will be deemed to be 1/3rd of the contract value.

It is very much likely that the Government will approach the Supreme Court and challenge this judgement. However, what are the developers supposed to do in the meantime? While the judgement of the Hon'ble Gujarat High Court is applicable to the entire country until there is any contradictory judgement from any other High Court, it is highly possible that GST Departments of other States may not be as willing to follow the judgement in the right spirit and the developers valuing land at more than 1/3rd of the contract value will face an uphill challenge till the final verdict from Supreme Court is received.

Any developer wishing to take such a route must ensure that the rate of land considered must be derived using proper mechanisms and with ample evidence. This bifurcation must be specified in the agreement as well. Further, if this route is followed and the same is challenged by Department, it may be possible that any other High Court may take a contrasting view. Therefore, any developer opting to take such a route of valuing the land portion at more than 1/3rd value shall do so only after weighing in all the risks and shall bear in mind that this fight will have to be fought till the very end, as the stakes are very high in such cases.

Taxability of Development Rights

Developing a building by purchasing Transferable Development Rights (TDR) is one of the popular mechanisms followed by a majority of builders. The basic tenet here is that the builder purchases rights for developing a particular plot from the owner and in exchange give a portion of the developed land to the owner. Such an arrangement may include some cash portion or % of revenue as well. Whatever may be the nuances of the agreement, these types of agreements by and large fall under the category of barter transactions.

The idea here is that in exchange for the construction activities, the developer is receiving development rights as consideration whereas the owner of the plot is giving away the rights and receiving construction service as consideration therefore, GST shall be payable as it is a supply by way of a barter transaction.

It can very well be argued that TDR is a benefit arising out of land and therefore it is an "Immovable Property" (ref. definition of Immovable Property as per General Clauses Act) and therefore outside the purview of GST law.

In the case of M/s Vasantha Green Projects - 2018-TIOL-1611, the Division Bench of Hon'ble CESTAT has held that cost incurred by the developers towards the TDR (construction of area allotted to land owner) is already included in the price charged to the customer and service tax is paid on such price. Therefore, since service tax is already paid on the rights received from the land owner, asking the developer to pay the tax again on the same service would lead to double taxation.

Department has already filed an appeal with the Hon'ble Supreme Court in the said matter and the final verdict of the Supreme Court is awaited, which will have an impact not only on service tax but also on the GST regime.

Under the GST regime, the Government has continued to maintain its stand that GST shall be payable on the TDR received from the land owner. However, w.e.f. 1st April 2019, in the case of residential apartments, GST applies on TDR only to the extent of the area remaining unsold on the date of OC / CC. Whereas GST will be payable on the entire TDR value in the case of commercial shops.

GST on TDR is payable by the developer (recipient of TDR) under the reverse charge mechanism at the time of receipt of OC / CC. The mechanism for calculation of GST liability for TDR pertaining to residential apartments has been prescribed as follows:

*Tax payable under RCM = GST Payable on TDR * Residential area unsold on date of OC ÷ Total residential area in the entire project.*

Tax payable under RCM should not exceed the actual tax which would have been payable on the unsold area, if the area was sold before OC (at the price closest to OC)

*GST Payable on TDR = Value of the area allotted to land owner * 18%*

Value of area allotted to land owner = Price at which apartment sold to a third person nearest to the date of transfer of development rights.

Let us understand the above by way of an illustration:

Mr. Akash (land owner) has entered into an agreement with GRC Developers to transfer his TDR to them and in exchange, GRC will give him 40% of the area they develop on the said land. GST liability calculation is to be done as per the following table:

Total Area to be developed	1,00,000 sq. ft.
Area to be allotted to land owner Mr. Akash	40,000 sq. ft.
Area to be sold by Developer directly	60,000 sq. ft.
TDR Transferred on	15 th May 2022
Flat booking was done on 17 th May 2022 (nearest from date of transfer)	Rs. 10,000 per sq. ft.
Area booked up to the date of OC / CC	75,000 sq. ft.
Area not booked up to the date of OC / CC	25,000 sq. ft.
Flat booking done just before OC	Rs. 45,000 per sq. ft.
Value of TDR = Area allotted to Mr. Akash at the nearest price value	40,000 sq. ft. * 10,000 per sq. ft. = Rs. 40 Crores
GST Payable on TDR = Value of TDR * 18%	Rs. 40 Crores * 18% = Rs. 7.2 crores
GST payable under RCM on residential apartments = GST Payable on TDR * Area unsold ÷ total area in the project	Rs. 7.2 Crores * 25,000 ÷ 1,00,000 = Rs. 1.8 Crores
GST Payable on unsold area (at the rate closes to OC) (assuming it is an affordable property)	25,000 sq. ft * Rs. 45,000 per sq. ft. * 1% = 1.12 crores

Accordingly, the developer shall pay GST of Rs. 1.12 crores under RCM when the OC / CC is received. It must be noted that for ease of understanding, the example is only for a 100% residential project. In the case of a project with residential apartments and commercial shops, the calculation will be modified to the extent of GST payable on the TDR of the commercial area for which no exemption is available and GST will be payable on the entire value.

Taxability of Preferential location charges, floor rise, etc.

It is a common practice for builders to charge additional value for allotting a flat on a higher floor or facing a particular direction under various nomenclatures like "Preferential Location Charges", "Floor Rise", etc.

These concepts are not new to the construction industry and are commonly followed by all developers across the country. Hence, these charges are incidental to the main supply of service and therefore, the entire package should be treated as a composite supply under Section 2(30) of CGST Act and GST as applicable to construction services shall apply to these types of charges as well.

However, in a lot of cases, Department has been taking the stand that PLC, Floor rise, and such charges have no nexus with the construction services provided by the Developers and therefore, they must be treated separately from the construction service and GST shall be payable at the rate of 18%.

In the press release issued after the 47th GST Council meeting, the council has clarified that PLC collected in case of a long-term lease are a part of the consideration of long-term lease and therefore shall get the same treatment in GST. Applying the same logic for construction services, PLC, Floor rise charges, etc. shall also be considered to be a part of the consideration for the construction charges as well.

Due to a lack of clarification from the Council and Department in this aspect, there could probably be some difficulty in obtaining relief in such cases at the preliminary stages, but in the long term, it is expected that this matter will mostly be ruled in the favour of the developers only.

Conclusion

From the above discussion, it can be safely assumed that a lot of grey areas have cropped up under the GST law as far as the real estate sector is concerned. The more Government has tried to simplify the entire tax regime for construction activities, it has somehow become more complicated.

Taxability for construction is vastly different from how the law operates for all other sectors and that has made uncertainty the only constant in this sector.

