

2016 Big Story: How will GST be for realty?

By: Aseem Kalia, FCA

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The Real Estate development sector encompassing the housing and construction activity has a substantial potential to kick-start the economy on account of the significant backward and forward linkages with crucial and critical sectors of the economy including over 280 associated industries. Construction is the second largest employment generator in the country after agriculture and accounts for a significant proportion of the GDP.



GST: A Boon or Bane For Realty?

With the Constitution (122nd Amendment Bill) for Goods and Services Tax (GST) having been cleared by 16 states – and now due to be sent to the President for his nod – GST is set to soon become a reality that transforms India into a single common market from a nation of 29 markets. However, there is much confusion and debate about how GST will benefit the real estate and other associated sectors.

Clarity on Treatment of Land under GST and Its Valuation Mechanism for Exclusion of Land

The model act in the current form doesn't provide any explicit exclusion of immovable property from the services. Though the intent seems not to include immovable property in the ambit of GST as evident from below but explicit clarity shall be sought to avoid litigation at the initial stage as:

1. *Property tax, Stamp duty and taxes on immovable property are not getting subsumed in the proposed GST;*
2. *No ITC benefit is extended to the goods/services which result in the construction of immovable property;*

While there are many case laws suggesting that tax cannot be levied in the absence of the valuation mechanism, it is hoped that GST would entail such mechanism to exclude the value of land to avoid locking of government revenues in unnecessary litigation.

Sale of Under Construction Property

Under the current regime, the effective rate of tax on an under construction property is 4.5% service tax and 1-5% VAT depending on the scheme adopted. Input credit is available in both service tax and VAT except for the schemes like composition scheme which specifically deny such credit. VAT transactions are also eligible for self-construction benefits. This pertains to exemption from tax of work done/goods

sold before entering into agreement with the seller. So the incidence of tax on combined goods and services is around 5-7%. Stamp duty is paid @5-7% on the overall sales consideration at the time of registration of sale deed.

In the GST regime, there are two specific exclusions:

1. *“Section 16(9)(c) Goods and/or services acquired by the principal in the execution of works contract when such contract result in construction of immovable property, other than plant and machinery.*
2. *Section 16(9)(d) Goods acquired by a principal, the property in which is not transferred (whether as goods or in some other form) to any other person, which are used in the construction of immovable property, other than plant and machinery.”*

This shall mean that there is no input tax credit either on FOC given to contractors nor on work done by them. This shall increase the incidence of tax on goods and services to 19-25% and shall have consequential impact on the stamp duty as well, since stamp duty is not being subsumed in the GST.

Construction for Leasing of Commercial Properties

The activity of leasing of immovable property is likely to qualify as a service under the GST regime and would accordingly attract GST. In today's regime, leasing of immovable property for commercial purposes attracts service tax whereas leasing for residential purposes is in the negative list and does not attract service tax. The same regime should continue under GST.

For residential properties, since there is no service tax the input taxes become a cost; this situation is likely to continue in GST.

For commercial properties, although, service tax is applicable on lease rentals, the input tax credits are not available under the current regime. In the proposed regime, GST is likely to apply on lease rentals; the issue for consideration is whether credit of GST paid on procurement of goods and services would be available or not. The answer is linked to whether immovable property for commercial leasing would qualify as plant and machinery (in which case credit would be available) and if it does not (then credit would not be available).

Taxability of Development Rights

Transfer of development rights is quite common in real estate dealings. Under such an arrangement, following are prevalent:

1. Contribution of land in exchange for area share
2. Contribution of land in exchange for revenue share
3. Contribution of land in exchange for profit share
4. Joint Ventures/ Joint controls

Supply has wide meaning and includes:

- All forms of supply
- Made or agreed to be made
- For a consideration
- By a Person

- In the course or furtherance of Business
- Sale/ Transfer / Barter / Exchange / License / Rental / Lease / Disposal

Though it seems most likely that such transactions shall be liable to GST since exchange / barter are clearly included in the above definition but there exists no clarity on the valuation of such transactions.

Positive Impact - Level-Playing Field, Transparency and Economic Prosperity

Unorganized entities will be negatively impacted because they avoid paying taxes, which will not be so easy under the GST regime since tax credits cannot be availed if taxes are not paid in the first place.

Higher transparency in real estate transactions will be the biggest blessing in disguise because there are many negative perceptions about the sector, leading to a huge trust deficit between builders and buyers. Since all transactions under GST will leave a clear audit trail, each person in the value chain will have no option but to pay taxes.

Finally, GST is expected to add around 2% to the country's GDP growth. As and when this becomes a reality, it will help the Indian economy become more vibrant, engendering a sense of confidence among all individuals, industries and other entities. When this happens, the GST Bill would then have truly worked its magic. However, it is imperative to bring clarity on the above issues and this requires immediate advocacy.

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Contact Us:

Aseem Kalia

Managing Partner – Real Estate Advisory

Recherché India Advisors LLP

102, Vishwadeep Towers, District Center, Janakpuri,
New Delhi – 110 078

www.recherche-india.com

info@recherche-india.com