

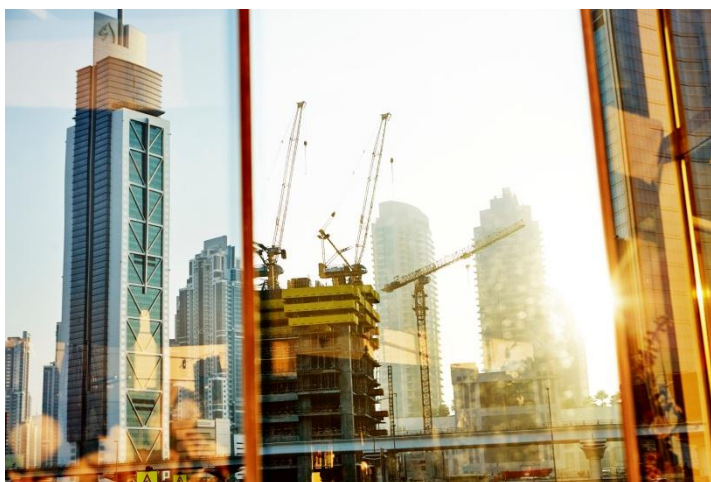
White Paper

Analysis of GST Implications on Real Estate Sector in India

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1.0 Introduction

The real estate sector is a critical sector of Indian economy. Real estate sector in India is expected to reach US\$ 1 trillion by 2030. It has a huge multiplier effect on the economy and therefore, is a big driver of economic growth. It is the second-largest employment-generating sector after agriculture. The real estate sector is growing at a rate of about 20% per annum and has been contributing about 5-6% to India's GDP. Not only does it generate a high level of direct employment, but it also stimulates the demand in over 250 ancillary industries such as cement, steel, paint, brick, building materials, consumer durables and so on¹.



Taxability of Construction activity under indirect taxes has always been challenging and prone to litigation. In the pre- Goods and Services tax ('**GST**') regime, the developer and the buyer, both the parties had to deal with issues emerging from multitude of erstwhile taxes such as VAT, Central Excise, Entry Tax, Local Body Taxes, Octroi, Service Tax, etc. Further, state specific rates, concept of deemed sales, different valuation for the purpose of VAT and Service tax, different schemes for payment of tax etc. made contributions to the challenges faced by real estate sector.

Before the introduction of GST, Central Government used to levy excise duty at the rate of 12.5% on most of the items required for construction activities. At the same time, State Governments used to charge value-added tax ('VAT') in the range of 12.5% to 14.5% on the same items. The real issue was the taxes paid in the form of Excise and VAT on the construction items was not freely available as input tax credit against service tax (4.5%) and State Specific VAT (1% - 2%) levied on the under-construction flat sold to the buyers.

Post implementation of GST from 1 July 2017, there has been a radical change on applicability of Indirect Taxes on the Real Estate Sector. From 1 July 2017 to 31 March 2019, major relief provided to the developers by not only allowing Input tax credit but also by providing single levy i.e. GST at the effective rate of 12% for Residential and commercial projects and 8% for affordable housing projects.

One of the key objectives of introduction of GST is the seamless flow of input credit across the entire supply chain and across the country for supply of Goods or Services. However, with effect of April 1, 2019, Real estate sector separated from Input Tax Credit ('ITC') chain

¹ Reports from ficci.in and ibef.org

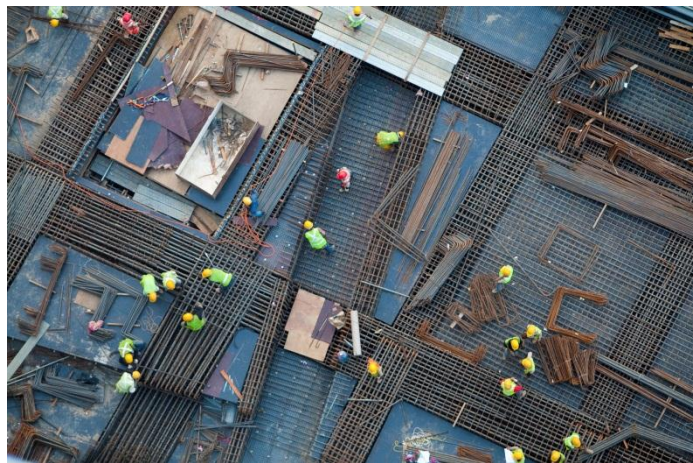
and builders and developers have been given the option to either continue in 12 percent GST slab with ITC (8 per cent for affordable housing), or opt for 5 per cent GST rate (1 per cent for affordable housing) without ITC for the ongoing residential projects. Further, such option was not available for new residential projects i.e. new residential projects must follow 5 percent GST rate (1 per cent for affordable housing) without ITC.

2.0 Impact of GST on Real Estate Sector

In the present note, we have focused on Impact of New Scheme of Taxation on the Real Estate Sector along with some of the current issues.

2.1 On-going projects – options available with developer and not with the buyer

As per the new scheme of taxation for real estate projects, the developers of under construction projects / ongoing projects as on 31 March 2019 had an option either to continue with the old rates at 12%/8% with ITC or to shift to the new 5% / 1% rates without ITC. The developer opted to continue with the old rate was required to communicate the same to GST Authority by 20 May 2019.



As a layman, every home buyer would be willing to avail the benefit of reduced rate on purchase of flat without considering impact of increase in cost of developer due to restriction of ITC.

The buyer does not have eligibility to exercise option to pay tax at the new or old rates. It is the developer, who has to exercise the option to pay tax on construction of residential apartments at the old rate of 12% with ITC. If the builder does not exercises his option to continue to pay tax at the old rate by specified date, then the effective GST rate applicable on all future instalments payable to the developer on or after 01.04.2019 as per the contract shall be either 1% or 5% (without ITC benefits), depending on whether the apartment is an affordable or other than affordable residential apartment.

2.2 Input tax Credit

As discussed above, developer of on going residential project had an option to either to continue with the old scheme with ITC or to opt for the new scheme of taxation without ITC. It is to be noted that by exercising the option to pay tax under new scheme, Developer was required to reverse certain portion of total ITC which has been claimed for the Project as specified under GST legislation. The ITC is to be reversed from Electronic Credit Ledger and from Electronic Cash Ledger, in case of short balance.

Under the new scheme of taxation for real estate sector, developer is eligible to claim ITC for commercial projects commencing after 1 April 2019 falling under Real Estate Project category. Further, in case of mixed project where commercial carpet area is more than 15% of total carpet area, the developer is eligible to claim ITC with regard to Commercial

premises only. However, it is to be noted such projects also involves amenities like Elevators, Corridors, etc. which will be used commonly by Residential premises as well as Commercial premises. No clarity has been provided for claim of ITC pertaining to such common amenities. A clarification from Government will help avoid litigations in future.

Additional liability under RCM:

Under the new scheme of taxation, during a financial year, Developer should procure at least 80% of inputs and input services (other than FSI, TDR/ JDA, Capital goods, long term lease) only from Registered Supplier. In case of non-compliance, developer is liable to pay tax under the Reverse Charge Mechanism (RCM) at following rates:

- Cement and Capital Goods – At applicable rate of tax
- Input and Input Services – At the rate of 18%

It can be argued that intention of government to keep a check on tax avoidance is genuine but at the same time this provision creates additional challenges for developers. It will not only create additional liability on developer under RCM but also it will add to cost of the project as ITC of the same will not be available except for Commercial projects.

In order to comply with the above requirements, following is the key additional burden on the developers:

- Developer is required to maintain project wise record of purchase from registered and unregistered person. This will have a significant impact on compliance cost.
- Developer will be liable to pay tax @ 18% even in case of Purchase of goods or services from Unregistered Person (URP) which may be otherwise taxable at lower rate of tax. E.g. – Sand, Bricks, Wood, etc.
- Provision is silent on implications on purchase of exempted supply from URP. However, in FAQ (Part II), it was clarified by CBIC that the same is to be included in calculation threshold limit. This will further increase cost of project, as ITC of the same is not available.
- Further, provision is also silent on offset of purchase from registered person exceeding required threshold in a given Financial Year against shortfall in subsequent Financial Year(s).

2.3 Mixed Project – Limitation of 15%

In case of mixed project, where carpet area of commercial premises is less than 15% of total carpet area, developer can discharge GST at 5% without ITC even for commercial premises. However, in case, the carpet area of commercial premises exceeds 15% of total carpet area, the developer has to discharge GST at 12% with ITC. Hence, in a mixed project, the scheme of taxation for commercial premises depends on the ratio of carpet area of commercial premises to total carpet area of the project. Due to any unexpected circumstances, eventually, if such ratio change and result in to carpet area of commercial premises to be more than 15% of total carpet area, the entire calculation of cost and the

profitability will go haywire. Further, benefit of ITC will also be limited due to time limit to claim ITC by return for the month of September of succeeding F.Y.

2.4 Deemed valuation of land:

The reduced rate of 1% without input credit on construction of the affordable houses and 5% on construction of other than affordable houses is the effective rate after considering 33% deemed deduction for the value of the land. This one third deemed deduction on account of transfer of Land or Undivided Share of land is irrespective of the actual value of the land transferred. However, the said deemed deduction is not available when there is no transfer of land or undivided share of land.

The issue here is that in metro cities, at times, value of the land exceeds the value of the construction. In such a scenario, only 1/3 deemed deduction is not justifiable.

2.5 Credit note within 6 months from end of financial year

Under GST legislation, a taxpayer can adjust his tax liability if he declares the details of credit note in the return latest by September' return following the end of the Financial Year in which such supply was made, or the date of furnishing of the relevant annual return, whichever is earlier.

However, in Real Estate sector, construction service is a 'continuous supply of service' requiring 3 to 5 years for completion. However, due to this time limit of September's return, Developers could get only six months after end of the year to issue credit note. The aforesaid provision leads to practical challenge for builder /developers to take benefit of reduction of tax liability on account of credit note issued after 6 months from the end of financial year.

In view of the above, the cost of GST paid on flat cancelled is either required to be borne by developer or the buyer. This GST cost could be an area of dispute between developers and property buyers.

2.6 Joint Development Agreement

A Joint Development Agreement ('JDA') is one wherein, Landowner gives development rights of the land owned by him to a Developer and in return Developer undertakes the responsibility for development of property.

In a JDA, Developer may pay consideration to Landowner in following forms:



- Consideration in kind i.e. in form of Percentage of Developed Area
- Monetary Consideration either as Lump sum amount or Percentage of Sales Revenue
- Part Consideration in kind and part consideration in money

There have been many pressing issues on Indirect tax front on Real Estate Sector and more so in case of JDA. In pre-GST regime, there was no tax to be levied on transfer / sale of Transferable Development Rights ('TDR') and Floor Space Index ('FSI') as it was considered as akin to sale of Immovable Property. However, as per FAQ issued by GST authorities, the activity of transfer of development rights by a Landowner (whether an individual or promoter) is a supply of service subject to GST.

2.6.1 GST Implications on Consideration paid by Developer to Landowner against transfer of development rights:

a. Consideration in kind:

In the given case, Developer transfers certain percentage of developed area to Landowner as a consideration against transfer of Development Rights. Developer is required to discharge tax at applicable rate i.e. either at effective rate of 1% (affordable house), 5% (residential) or 12% (commercial), depending on the nature of premises so transferred. However, tax is required to be discharged on total amount charged to Independent buyers for similar premises which is nearest to the date of transfer of TDR / FSI, after deduction of value of land i.e. 1/3rd of total consideration.

It may be argued that the value of construction service provided by developer to the land owner should be either equal to value of land or the construction cost incurred. Also, the value for individual flats to the buyer may not be compared with value of flats given in bulk to land owner.

In case of JDA, the developer's role is like a works contractor for the land owner and hence, GST, if any shall be leviable on cost of construction and not on the total amount charged to Independent buyers for similar premises which is nearest to the date of transfer. This may lead to litigations in future.

Further, Landowner is eligible to claim ITC of such GST charged by Developer only if output tax liability on sale of such premises is higher than ITC so availed.

b. Consideration in Money

In case where consideration is wholly or partly paid in money, there is no supply of any goods or services or both by Developer to Landowner and hence, there will not be any GST Implications on it from developer perspective.

2.6.2 GST Implications on transfer of Development rights by the Landowner to the Developer:

GST implications on transfer of TDR and FSI has been discussed in the table below:

Particulars	Complete Commercial Project	Mixed Project with Commercial > 15% of total carpet area	Mixed Project with Commercial < 15% of total carpet area
Commercial Premises	Tax @ 18% under RCM payable by Developer. ITC of the same eligible	Tax @ 18% under RCM payable by Developer. ITC of the same eligible	Tax @ 18% under RCM payable by Developer. ITC of the same ineligible
Residential Premises	N.A.	Exempt in case of all the Flats sold before cut-off date ²	Exempt in case of Flats sold before cut-off date ²
Common Areas	N.A.	No Clarifications have been provided	No Clarifications have been provided

2.6.3 Impact of GST on TDR and FSI

In case of Residential premises, due to liability on unsold premises after cut-off date, it will lead to additional costs for the Developer, which may be difficult to foresee at the time of commencement of construction. Further, no clarity has been provided whether developer is required to consider all unsold flats in a project, including those which has been transferred to Landowner or only those unsold flats which belongs to him. Though, logically Developer should be liable to pay tax only on those unsold flats which remained unsold with him. However, a clarification from Government will help avoid litigation in future.

2.7 Anti-Profiteering

Anti-profiteering provisions under GST mandate passing on the tax benefits arising from GST to the customers by way of commensurate price reductions. However, no methodology has been prescribed for the same. Recently, penalty of 10% of the profiteered amount was also notified by Government if there is delay in payment of profiteered amount for more than 30 days.

Unlike other sectors, the Real Estate Sector will be required to carry out Anti-profiteering studies twice to ensure benefits have been commensurately passed on. First study as on 1 July 2017 ie at the time of transition from erstwhile Indirect Tax Laws to GST and second study as on 1 April 2019 ie on conversion from Old Scheme of Taxation to New Scheme of Taxation. Further, the Industry will have to keep track on frequent changes that may have impact on Cost of the project.

² In case of unsold flats, tax is payable @ 18% under RCM with upper limit of 1% of value of flat in case of Affordable Housing and 5% in other Residential flats.

3.0 Conclusion

Implementation of GST has a major impact on the Real Estate Sector. While removal of cascading effect under GST as compared to pre-GST regime is beneficial to all the real estate companies, however, restriction on claim of ITC especially in case of residential projects in the New Scheme of Taxation has defeated the primary purpose of GST i.e. to allow unrestricted flow of credit.

Due to New Scheme of Taxation, the companies having ongoing residential projects are required to revisit their cost sheets and identify the benefits of Old Scheme vs. New Scheme. While prima facie, reduction in rate of tax is a welcomed move however, the same has come with the cost of ITC. Thus, whereas consumers expect reductions in prices, in reality, such reduction may be very minimal or may even lead to increase in costs due to restriction in claiming ITC. The industry has to find out a balance between consumers' expectations of lower prices and developers expectations to maintain profitability of the project.



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This white paper has summarized and highlighted the implications of GST on Real estate sector in India. It may be noted that nothing contained in this newsflash should be regarded as our opinion and facts of each case will need to be analyzed to ascertain applicability or otherwise of the said notification and appropriate professional advice should be sought for applicability of legal provisions based on specific facts. We are not responsible for any liability arising from any statements or errors contained in this newsflash.

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