

GST Implications on Redevelopment Projects- A Thorny Issue

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Jay Jhaveri

Partner, Bhuta Shah and Co LLP

Re-development of existing constructions is significant in the Indian landscape on account of the following three factors:

- a. The vast majority of India's population belongs to the aspirational low- and middle-income group whose entire savings are spent in buying an apartment. Generally, these apartments are a part of bigger townships or co-operative housing societies. When these structures deteriorate, it is exceedingly difficult for people in these income groups to arrange additional funds to maintain their property or get it equipped with modern amenities.
- b. Real estate developers, especially boutique developers, on the other hand, find it difficult to find land located at attractive locations or to arrange for funding to acquire land where such apartments can be constructed. Building an entire apartment complex can help entice the target group to liquidate the constructed stock with ease.
- c. In certain cases, vacant plots of land, inherited by owners as ancestral property, can come under years of title dispute, preventing any construction activity. Even after the dispute is settled, these landowners neither have the financial muscle nor the technical ability to carry out construction activity on their own. They, therefore, intend to give development rights to real estate developers in lieu of receiving the entire consideration upfront in cash or in exchange for certain flats/apartments out of the construction projects.

In view of the above considerations, re-development is an equally attractive proposition and a win-win situation for both the real estate developers and apartment owners (societies or townships) / landowners.

Under, the erstwhile indirect tax regime wherein such construction activity was squarely covered both under respective state's ambit to tax the same (VAT) and under center's ambit to tax the same through a levy of service tax with effect from 1st July 2010. Under the new regime, such activity is squarely covered and taxable under GST laws (CGST, SGST and IGST).

To understand the veracities of indirect tax implications on re-development projects, we shall bifurcate the discussion into two broad parts - redevelopment of societies / townships including slum rehabilitation and redevelopment by tie-in up with a landowner.

I. Redevelopment of Societies / Townships including Slum Rehabilitation

Every such re-development project poses complex questions for Indirect Tax Authorities as there are generally two elements involved:

1. Barter element wherein the existing flat/apartment/slum owners are given bigger flats / better amenities in lieu of their temporary transferring the right for development in favour of the real estate developers who will construct new structures on the existing plot after dismantling all existing and old structures. The compensation for the real estate developer is in terms of the additional flats/apartments that get constructed which he/she is rightfully entitled to sell as his/her stock.

2. Actual sales consideration received by the real estate developer from the sale of additional flats/apartments.

II. Redevelopment of Plot of Land by Real Estate Developer in Agreement with the Landowner

Such redevelopment projects have similar elements as explained in case I above with slight modifications as under:

1. Barter element wherein the existing landowner either temporarily transfers the right for development in favour of the real estate developers or enters into a joint development agreement with the real estate developer who will construct new structures on the existing plot after dismantling all existing and old structures if any. The compensation for the real estate developer is in terms of the additional flats/apartments that get constructed which he/she is rightfully entitled to sell as his/her stock. The compensation for the landowner is that he/she gets certain flats as his/her share on which he/she has a right to sell free of cost from the real estate developer.
2. Actual sales consideration received by the real estate developer from the sale of additional flats/apartments.

GST Implications on Re-Development Projects

Both the erstwhile and existing laws are noticeably clear with respect to the tax implication of the second part as described in both cases above (Case I and Case II) above wherein actual sales consideration is received by the real estate developer. A summary of tax rates applicable under GST laws on the same is shown below:

Property type	GST rate till March 2019	GST rate from April 2019
Affordable housing	8% with ITC	1% without ITC
Other than affordable housing	12% with ITC	5% without ITC

The new tax rate without ITC will apply to all new projects. But for ongoing projects as of 01st Apr 2019, the developers were given a one-time option to pick between the old rate and the new rate by 10th May 2019. Moreover, the above rates are subject to a plethora of conditions that have never been investigated practically by the real estate developers and could lead to subsequent litigations. Some key conditions are highlighted below:

- a. At least **80% of the total value of Input and Input Services should be purchased from registered suppliers**. If the value of supplies from registered suppliers is lower than 80% of the total value of supplies for the project, then the real estate developer must pay tax on a reverse charge basis @ 18% on the shortfall in value. This reverse charge rate is further increased to 28% in case of cement if purchased from unregistered persons.
- b. GST is not applicable only if the **entire consideration** is paid after the issue of certificate of completion by the competent authority or after its first occupation, whichever is earlier. In such a case, ITC must be reversed proportionately to extend flat sold after OC/CC whichever is earlier.

Also, the above revised rates, from April 2019, are applicable only in the case of residential real estate flats/apartments. In the case of commercial premises, the rates applicable are as follows:

SR No	Premises Type	Project	Effective Rate
1	Commercial	If commercial apartments are less than 15% of the total project, then the entire project is considered as residential real estate project (RREP)	5%
2	Commercial	If commercial apartments are greater than	12%

	15% of the total project, then the entire project is not considered as a residential real estate project (Others)	
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Coming back to the crux of the matter, the barter transactions between the existing owners of the flats/apartments/slums and the real estate developer as explained in 1 above.

- a. Majority of the state VAT laws had clarity and a simplified structure to tax such transactions wherein every registered flat/ apartment/ slum whether given to existing owners or new buyers was leviable to VAT.
- b. However, there were complications under the erstwhile Service tax laws as to whether the barter transactions of the flat / apartment / slum owners transferring the rights to the real estate developer in lieu of getting flats / excess area / better amenities in return will be liable to service tax or not. There was no clear consensus among the authorities and real estate developers. However, the authorities tried to bring some clarity by way of Circular 151/2/2012-ST dated 10.02.2012 wherein the following scenarios were explained:

Sr. No.	Model / Projects	Situations	Clarifications
1.	Tripartite Business Model / Joint Development Agreement with Landowner Parties: a. Landowner b. Builder or Developer c. Contractor who undertakes construction	(a) Liability to pay service tax on flats/houses agreed to be given by builder/developer to the landowner towards the land /development rights and to other buyers. (b) Valuation	(a) For the period prior to 01/07/2010 Service will not be taxable in terms of Board's Circular No. 108/02/2009-ST dated 29.01.2009. (b) For the period after 01/07/2010 Construction service provided by the builder/developer is taxable in case any part of the payment/development rights of the land was received by the builder/ developer before the issuance of the completion certificate and the service tax would be required to be paid by the builder/developers even for the flats given to the landowner. Value of a flat given to a landowner shall be equal to the value of similar flats charged by the builder/developer from the other buyers. In case of change in price, the new value shall be based on the value of similar flats as are sold nearer to the date on which land is being made available for construction.
2.	Redevelopment including slum rehabilitation projects	The land is owned/leased by a society, comprising members of the society with each member entitled to his share by way of an apartment.	Re-construction undertaken by a building society by directly engaging a builder/developer will not be chargeable to service tax as it is meant for the personal use of the society/its members. In respect of additional flats <u>For the period prior to 01/07/2010</u>

	<p>Society or its flat owners engage builder/developer for undertaking construction. The builder/ developer makes new flats with same or different carpet area for original owners of flats and additionally may also be involved in one or more of the following:</p> <p>(i) construct some additional flats for sale to others;</p> <p>(ii) arrange for rental accommodation or rent payments for society members/ original owners to stay during the period of reconstruction;</p> <p>(iii) pay an additional amount to the original owners of flats in the society.</p>	<p>Construction of additional flats undertaken as part of the reconstruction, for sale to other buyers will not be re-taxable</p> <p><u>For the period after 01/07/2010</u></p> <p>Construction service provided by the builder/developer to other buyers is taxable in case any payment is made to the builder/ developer before the issuance of the completion certificate.</p> <p>Valuation</p> <p>The value shall be determined in terms of section 67(1)(i) of the Finance Act, 1994.</p>
<p>3. Investment Model</p>	<p>In this model, before the commencement of the project, the same is on offer to investors. After a certain period, an investor has the option either to exit from the project on receipt of the amount invested along with interest or he can re-sell the said allotment to another buyer or retain the flat for his use.</p>	<p>In this model, after 01/07/2010, investment amount shall be treated as consideration paid in advance for the construction service to be provided by the builder/developer to the investor and the said amount would be subject to service tax.</p> <p>If the investor decides to exit from the project at a later date, either before or after the issuance of completion certificate, the builder/developer would be entitled to take credit under rule 6(3) of the Service Tax Rules, 1994 (to the extent he has refunded the original amount).</p> <p>If the builder/developer resells the flat before the issuance of the completion certificate, again tax liability would arise.</p>
<p>4. Conversion Model</p>	<p>Conversion of any hitherto untaxed construction /complex or part thereof into a</p>	<p>A mere change in the use of the building does not involve any taxable service unless conversion falls within the meaning of commercial or industrial</p>

		building or civil structure to be used for commerce or industry, after the lapse of a period of time.	construction service.
5.	Non-requirement of completion certificate / where completion certificate is waived or not prescribed	Levy of service tax on the construction service provided in cases completion certificate are not required or waived.	Where a completion certificate is waived or is not prescribed for a specific type of building, the equivalent of completion certificate by whatever name should be used as the dividing line between service and sale. In terms of the Service Tax (Removal of Difficulty) Order, 2010, dated 22/06/2010, the authority competent to issue a completion certificate includes an architect or chartered engineer or licensed surveyor.
6.	Build, Operate and Transfer (BOT) Projects (Risk-taking and sharing ability of the parties concerned is the essence of a BOT project.)	Generally under the BOT model, there are 3 parties - Government or its agency, concessionaire (who may be a developer/builder himself or maybe independent), and the users. Government or its agency by an agreement transfers the 'right to use' and/or 'right to develop' for a period specified, usually thirty years or near about, to the concessionaire.	The service provided by the Government or its agency to the concessionaire is liable to service tax; the construction services provided by the contractor to the concessionaire would be examined from the point of taxability as to whether the activity is not otherwise excluded; the services provided by the concessionaire to the user of the facility are liable to service tax

Despite the above circular which was binding on the departmental officers, differing views regarding classification of Case B as Scenario 1 or Scenario 2 were being adopted by the departmental officers as in the majority of cases, the land was being leased to the society / township / slum by the landowners rather than being owned by them despite in substance both being the same and hence there should have been no service tax on flats / extra area / additional amenities given to existing flat / apartment owners or slum dwellers.

Under GST in trying to simplify the taxability of such barter transactions as explained in points 1 of both Case A and Case B above, the government has increased the complexity manifold making it impossible for real estate developers to practically visualize the cost implications on themselves at the inception of the project. To better understand the tax implications on these barter transactions it is important to break it down as follows:

I. Taxability of TDR / FSI (Transferrable Development Rights / Floor Space Index)

The first leg of the barter transaction involves transfer of development rights or FSI available with the landowner / society / members / slum dwellers in favour of the real estate developer either through a joint development agreement or a development agreement or a mere tenancy rights transfer agreement. The consideration for such transfer can be discharged in either of the following two ways:

- a. **Upfront monetary consideration paid in cash equivalent:** In this scenario, GST on consideration

attributable to TDR's / FSI relating to commercial apartments to be constructed in the project shall be payable immediately by the real estate developer on a reverse charge basis (RCM) on the date of execution of the agreement. However, in the case of residential apartments to be constructed in the project, the liability to pay GST shall arise on the date of issuance of completion certificate or date of first occupation whichever is earlier. Moreover, this liability shall arise only in respect of consideration attributable to TDR's / FSI relating to residential apartments which remain un-booked / unsold on the date of issue of completion certificate or first occupation whichever is earlier.

- b. **Consideration is paid in form of commercial / residential apartments:** In this scenario, the liability to pay GST on development rights shall arise on the date of completion or first occupation of the project, whichever is earlier both in respect of commercial as well as residential apartments. The same shall still be payable on RCM by the real estate developer. The valuation of TDR / FSI shall be based on the consideration paid by independent buyers (after deducting 1/3rd abatement for the value of land) for similar apartments as are given by the real estate developer to the landowners / society / members / slum dwellers closest to the date on which such development rights or FSI are transferred in favour of the real estate developer.
- c. **Tax Rate:** The applicable tax rate in respect of TDR/FSI attributable to commercial apartments to be constructed in the project shall be 18%. However, in case of residential apartments, only that value of supply of TDR or FSI which is proportionate to the construction of the residential property that remains un-booked on the date of issue of completion certificate or first occupation whichever is earlier would attract GST at the rate of 18% but the amount of tax shall be restricted to a maximum of 1% or 5% of the value of apartments basis their categorization as affordable or other than affordable residential apartments.

II. Taxability of Construction Service in respect of Units provided by the Developer

The second leg of the barter transaction involves taxability in respect of construction service provided by the real estate developer to the landowner/society/members/slum dwellers in respect of the apartments provided against the transfer of development rights or FSI. The tax implications of this have changed in the GST era itself and the taxability is different for the transactions pertaining to the period before 1st April 2019 and Post 1st April 2019. The same is explained below:

SR No	Date of Joint Development / Development / Tenancy Transfer Agreement	Type of Apartments given to Landowner / Society / Members / Slum Dwellers	Effective Rate
1	On or Before 31 st March 2019	Any	18% with 1/3 rd abatement for value of land in case consideration includes land
2	On or After 1 st April 2019	Affordable Residential Housing	1.50% with 1/3 rd abatement for value of land in case consideration includes land
3		Other than Affordable Residential Housing or Commercial Apartments / Units in case of RREP	7.50% with 1/3 rd abatement for value of land in case consideration includes land
4		Commercial Apartments / Units in cases other than RREP	18% with 1/3 rd abatement for value of land in case consideration includes land

Conclusion

The current manner of calculations and exemptions as stated in GST laws require granular calculations at each instance to ensure correct computation and taxability. The law also fails to take into consideration certain practicalities. Most real estate projects receive initial permissions for only part of the project with subsequently constructions needing additional permits. What happens if a Joint Development Agreement entered before 31st March 2019 gets modified substantially post 31st March 2019 or what happens to the concept of mutuality under GST wherein development rights are transferred by society only for the benefit of its members, etc? Moreover, the current provisions do not cover the plethora of structures or agreements by which redevelopment projects are undertaken by real estate developers, such as title defects, litigations, disputes etc that could arise in each project.

Like the erstwhile service tax regime, more clarity is required under the GST regime on lines of Circular 151/2/2012-ST dated 10.02.2012. Therefore, in my honest opinion, the same guidelines as prescribed in this circular should be followed for taxability of construction service/units awarded by the developer to the landowner/society/slum dwellers whereas for taxability of TDR's and FSI the current taxation prescribed above under GST should be adhered to. However, in case of a sizeable re-development project wherein the number of existing owners is substantial it is advisable to go for an Advance Ruling depending on the exact model of re-development and get clarity on all aspects under GST laws.

I also believe that from a substance-over-form perspective, the taxability of TDR's or FSI should be done away with as the government has already abolished availment of ITC in case of new real estate projects and imposing taxability on an RCM based on the real estate developer (when the real estate developers are already paying stamp duty to get development agreements registered or premiums to avail additional FSI to municipal corporations) only increases the cascading effect of taxes, resulting in increased real estate prices for the end consumer. Moreover, these are rights attached to the land and as a sale of land or building (barring construction service covered in Schedule II) is covered by Schedule III, the rationale behind taxing TDR's or FSI is not clearly understood. I hope this aspect is addressed by the GST Council sooner rather than later.