GST 2019 - Real Estate Industry

The one industry that occupied the Government's feverish attention was the Real Estate development segment to save the hapless home-buyers from the onslaught of the Developer to usher in a new rate-regime from 1 April, 2019. RERA does its bit in saving the very same home-buyer. Now, its GSTs turn to arm home-buyers with new rates of tax. Without bothering about the policy-thinking behind the amendments approved in the 34th meeting of the GST Council and the slew of changes notified on 29 March, 2019 set to roll out from 1 April 2019 makes for some very interesting learning about the muscles in this law, that can be flexed to bring in order and transparency in an industry that was barrelling at break-neck growth and prices. Homes-for-all is a promise that the Government is resolved to deliver; and no GST is going to come in the way. After letting the dust settle down, it's time to understand the contours of these changes and analyse the 'hits' and 'misses'!

RERA applies only if a project is 'intended for sale' and the present set of GST changes will apply even if there haven't been any sales as long as that intent exists. RERA does not require registration where the 'real estate developed' is 'intended' to be let-out. GST seems to rely on averments made in the RERA application. 'Project' isn't project-in-title but a phase or towers that are so 'admitted' before the RERA-Authority. And 'apartment' isn't just a residential dwelling unit, but it includes shops, offices, showrooms, chambers, unit or godown, etc. that are intended-for sale as well as 'plots for sale'. So, it's apparent that the slew of changes in the GST Laws, that has come into effect from 1 Apr 2019, affects the real estate industry, but within a narrow compass. Let's look into these changes and understand 'why it is, and what we think it is!'

Overview

GST rates are set to move down from 12% (in case of affordable housing) [(or 18% in case of non-affordable housing)] with the benefit of input tax credit, to 1.5% (or 7.5%) without this benefit and these rates shall apply on a 'deemed value'. This is made possible by 'upgrading' the rate notifications to be the one issued under Section 15(5) of the CGST Act.

While all new projects commencing from 1 April, 2019 **'must' follow** this new rate-regime, there's a choice, however, **in respect of ongoing projects to continue under the previous rate-regime**. This is somewhat of a 'put' option, where the Developer is to make his decision known to stay put, on or before the 10th of May, 2019. If not, the new rate-regime will be thrust upon the Developer even in respect of on-going projects.

So, not everyone can simply switchover to 1.5% (in case of affordable housing), [(or 7.5% in case of non-affordable housing)] and give up all available credits. Careful evaluation of 'pros and cons' are required to be carried out in respect of on-going projects. Don't they say, "fools rush in"?

But, what about instalments to be billed to the buyers from 1 April, 2019? Well, it needs to be understood and billed 'as if' the decision (yet) to be made, was already known. Invoice for upcoming instalments, need to be issued making it clear on the invoice, the option that is exercised from 1 April to 10 May, 2019.

Firstly, all changes apply only in respect of real estate development 'intended for sale' on owned-land or under joint-development arrangement with the Landowner. So, development that is 'not for sale' stays out of the new rate-regime (as discussed later).

Secondly, all changes are to affect 'ongoing' development unless 'opted out' by filing project-wise intimation to the jurisdictional Commissioner in Annexure IV by 10 May, 2019. This evaluation of '12% (or 18%) with credit' or '1.5% (or 7.5%) without credit' must be undertaken on project-by-project basis. Each Phase in a single Project could be a 'project' for GST (explanation to section 3, RERA). Look for 'project' as stated in RERA application. So, the option to opt-in or not, is to be decided project-wise.

Thirdly, commercial effects of the new rate-regime are that 'prices' cannot be readily revised since agreements have already been entered into with the Buyers, housing loans approved, and may therefore, be commercially unthinkable to revisit the price. Further, 'tax clause' in the signed agreements state 'GST extra' or 'GST as applicable'. Such a clause only helps to replace 'output tax' on the invoice and as such, one cannot go back and revisit the contracted price with the intending buyer. *Contract Cost* will increase if, input tax credit that was available till now is no longer available. If Contract Price cannot be increased to recoup increase in Cost, it will result in additional cost being absorbed by Developer.

Lastly, one must recognize that the new rate-regime is riddled with pre/post conditions. Embracing these new rates will not be without examining compliance requirements on Developer-Landowner (immediate and continuing).

Also, development of 'plots for sale' is included in this new rate-regime as 'taxable project' based on the external development works carried out on immovable property.

New Rate-Regime

Although a new rate-regime has been introduced, the previous rate-regime has not been abolished, whereas it continues to occupy the field that's not affected by these changes. New rate-regime comprises:

- affordable residential apartment 1.5%**;
- residential apartment 7.5%**; and
- commercial apartment (in RREP) 7.5%**.

** RREP which is a creation of the GST laws, is a Residential Real Estate Project where the carpet area of commercial apartments is not more than 15% of total carpet area.*

**When these rates of 1.5% or 7.5% are applied after 1/3rd abatement on total value, it reaches an 'effective rate' of 1% or 5%.

Now, these rates are to be applied on 'deemed value' which is "2/3rds of Unit Price" (2/3P) prevalent contemporaneously. Para 2 (relates to 1/3 abatement towards land cost) of the notification 11/2017 dated 28.06.2017 is made applicable to all new rates. Authors are of the view that it may not be permissible to vivisect the total value of apartment into 'construction price' and 'price of undivided interest in land', to apply tax only on construction price.

Since, 1/3rd abatement is allowed, this abatement is an 'exemption' so as to comply with the input tax restriction under Section 17(2) of CGST Act (#16(ii) to 12/2017 as updated by 03/2019 dated 29th March, 2019 vide (ii)(c) for all entries under new rate-regime). Experts are divided whether this abatement will attract reversal of common credits at all as abatement is only for purposes of discharging GST although activity remains well within section 2(119) as a works contract.

'Affordable residential apartment' is defined to mean a unit that is less than 60 sq. mtrs. (non-metros*) or 90 sq. mtrs (metros) AND price is less than Rs.45 lacs. Each apartment needs to pass these tests 'cumulatively' at the time of sale, to avail the concessional rate.

** (xvi) in 03/2019 dated 29th March, 2019*

So, a given project may involve units that are taxable at 1.5% or at 7.5%, depending on the conditions met at unit-level.

Sub-contractors are allowed to charge 12% where affordance residential apartments are < 50% of total carpet area. And if this fails, the differential 6% is payable by Developer on RCM basis. Authors point out an anomaly that clause (va) of the notification 03/2019 dated 29th March, 2019 contains the words *"Rs.45 lakhs or less"* to attract this RCM-tax whereas it should be read as *"Rs.45 lakhs or more"* to attract this liability.

Development Rights

The Government seems unmoved by the outpouring of objections to the levy of 'tax on immovable property'. And reference to 'land' in schedule III of the CGST Act is clearly not meant to cover 'immovable property', as widely opined by experts to be either too obvious or drafting oversight. The issue remains to be debated whether term 'land' will include 'immovable property' in its ambit, whether transfer of development right, is not included in the phrase 'sale of land' as definition of land includes benefits arising out of land also.

So construed, development rights (DRs) are taxable under #16(iii) in 11/2017 at 18%, but interesting changes made are:

- supply of DRs in respect of all projects that are 'intended for sale' is brought to tax under reverse charge, whether Landowner is registered or unregistered (05/2019); **and**
- supply of DRs in respect of residential projects that are 'intended for sale' is fully exempted from this tax (RCM) where units are sold by date of OC/CC (04/2019).

This means, supply of DRs is not taxable in the hands of a Landowner at all instead, the tax burden is on Developer. But, in relation to residential apartments, even Developer is excused from payment of tax (RCM) except to the extent tax applies on unsold units (capped at 1% or 5% of deemed value of unsold residential units). So, development rights will go completely tax-free if all units in a residential apartment project are sold before date of OC/CC.

Where tax is to be paid by a Developer, the time-of-supply will be the 'date of completion / occupancy certificate' but value-of-supply will be 'deemed value'. Yes, deemed value being derived from the valuation method in explanation 1A of 04/2019 on the date when development rights were transferred, that is, date of joint-development agreement. Care must be taken to ensure that 'nearest' is not 'last'. 'Last' has mathematical precision but 'nearest' has an equitable application of price that's before or after the actual supply.

Now, when 'all projects' are listed for payment of tax on RCM basis in 05/2019, it is interesting that only 'residential apartments' are allowed exemption from tax under 04/2019. Unless this is inadvertent, development rights with respect to all units of **commercial apartments** are liable to tax in hands of Developer on RCM basis. At the same time, without benefit of input tax credit, supply of construction service with respect to the same commercial apartments, are also taxable. Time of supply would be earlier of (a) percentage of completion or (b) date of OC/CC for project. Rate of tax and value of supply (of development rights) would be 18% on deemed value on RCM basis. In case, omission of 'commercial apartments' in 04/2019 is inadvertent, these too would be liable to tax (RCM) to the extent they remain unsold. As the law stands today, as per revenue, development rights with respect to **commercial apartments** are liable to tax in hands of Developer on RCM basis. Time, Place and Value of supply would remain the same. Authors are of the view that since, tax paid (RCM) on development rights is non-creditable on (all residential units and commercial units which are part of RREP) would anyway suffer tax on 'date of OC/CC', levying tax on DRs (on reverse charge) once and again on construction service (on forward charge) would result in double tax in respect of commercial apartments which are part of RREP.

Since, tax is applied on 'deemed value', there is no requirement to include 'non-refundable deposit' paid by Developer as it would amount to double-counting of consideration (to this extent) in taxable value.

So, Landowner is NOT required to register under GST, if and only if:

- JDA is on 'area sharing' basis;
- Project is 'intended for sale', even if not fully sold; and
- All units are sold after the date of OC/CC.

Since, satisfying all these conditions is rare, the Landowner can hardly escape the requirement to register under GST even if they manage to keep out of definition of 'promoter' in RERA.

Exchange

A Developer is required to pay tax on construction services as a continuous supply of services. Although supply of construction service is not the same as supply of construction pursuant to sale of apartment, following rate-options are provided:

- where tax on apartment sales is payable at 1.5% or 7.5% of 2/3P, construction service *inter se* between a Developer and Landowner, is to be taxed at 1.5% or 7.5% of 2/3P from contemporaneous sales (*fourth proviso* in conditions to 03/2019 dated 29th March, 2019); and
- where tax on apartment sales is at 12% or 18% is opted for, construction service *inter se* between a Developer and Landowner, is to be taxed at 18% of 2/3P (03/2019 dated 29th March, 2019 omits #3(ii) and updates #3(xii) in 11/2017).

And on resale of units (before OC/CC), a Landowner is required to pay tax at 1.5% or 7.5% of 2/3P of 'actual resale price' charged from buyers. Here, tax already paid on sale (by Developer) is allowed to be set-off against tax payable on resale (by Landowner) under a special internal credit scheme. Tax on sale (by Developer) will be paid based on 'percentage completion' and tax on resale (by Landowner) will be paid on 'actual billing or collection' from Buyer, as both (sale and resale) are considered to be continuous supplies of services.

Authors are of the view that this 'credit scheme' does not attract all conditions applicable under Section 16 as it is specially allowed under this notification. Authors are also of the view that the ban on claiming input tax credit under this notification and condition that output tax be paid 'in cash only' does not annul set-off allowed under this 'credit scheme'.

Where some apartment units remain unsold and OC/CC is granted, construction services *inter se* between a Developer and the Landowner, is to be taxed at the same rates (stated earlier) with the date of OC/CC as their time of supply (06/2019 dated 29th March, 2019).

Ban on Input Tax Credit but……

The new rate-regime places a total ban on 'input tax credit' in the hands of the Developer as well as a Landowner (registered). Authors are of the view that this ban will not affect set-off allowed on supply inter se between Developer and a Landowner (discussed earlier).

Now, where tax at 1.5% is applicable on affordable residential apartment sales, sub-contractors are allowed to charge a special rate of 12% instead of default rate of 18%. On date of OC/CC, if it's discovered that 12% was wrongly applied as project did not qualify (due to shortfall in 50% carpet area or the value being more than 45 lacs), the Developer would be liable to pay the differential 6% on RCM basis (#3(va) included by 03/2019 dated 29th March, 2019).

So, a Developer would be liable to RCM (without credit) in following cases:

- Where the Development rights to the extent of Landowner's share of unsold (residential) units on date of OC/CC (discussed earlier);
- In situations where a sub-contractor is allowed concessional rate of 12% but a project that fails to qualify (carpet area of affordable units < 50% of total carpet area); and
- Liability towards new shortfall-tax (discussed later).

So, it is important to note that the new rate-regime imposes a total ban on input tax credit where the output tax rate at 1.5% or 7.5% is applicable. And where output tax is applicable at 12% or 18%, credit is available.

One very significant qualifying condition to avail output tax at 1.5% or 7.5%, is to find out if there's any overdrawn credit as at 31 Mar 2019. That is, credit that accrues at a certain rate linked to 'percentage-of-completion' that is 'billed-and-taxed'. Now, if credit is actually availed up to 31 March 2019, is more than credit so accrued, it's a case of credit being 'overdrawn'. Annexure I and II to the notification 03/2019 dated 29th March, 2019 provides the formula for calculating overdrawn position of credit as on 31 March, 2019 which is to be treated as follows:

- If credit accrued is less than that availed, then reverse credit to the extent it is overdrawn. If this overdrawn credit has been utilized, it is to be paid back 'in cash' (file GST ITC 03). And facility to pay in instalments is permitted if approved by Commissioner (Section 80 of the CGST Act, 2017); or
- If credit availed is less than that accrued, then the credit that is 'underdrawn' and is permitted to be availed well into 2019-20, even though credit is generally banned under this new rate-regime.

Look into the illustrations in Annexure I and II of the notification 29th March, 2019 to determine the ineligible extent of credit 'Tx'. Credit overdrawn / underdrawn is to be worked out if a Developer does not opt to continue the previous rate-regime.

New 'Shortfall-Tax' on RCM-basis

Shortfall-Tax is just a moniker for RCM-tax liability that arises under 07/2019 in the following situation:

- Output tax at 1.5% or 7.5% is applicable to a project (new or ongoing);
- Inward supplies are from 'unregistered suppliers'; and
- Such inward supplies exceed 20% of total inward supplies (excluding development rights, electricity and 3 petro-products);

In such a situation, a Developer is required to pay this shortfall-tax (*fifth to seventh proviso* in the conditions to notification 03/2019 dated 29th March, 2019) on RCM-basis:

- At the respective rates applicable, if shortfall is due to cement or capital goods; and
- At a flat rate of 18%, if shortfall is due to any other taxable inward supply of goods or services.

Special HSN is introduced with rate of 18% for payment of this shortfall-tax. Goods are listed in #452Q in schedule III of 01/2017 and services in #39 in 11/2017. This unique 'shortfall-HSN' will not apply to cement and capital goods which will fall under their respective HSN for rate of tax. Shortfall-tax on cement is to be paid monthly, while tax on all others to be paid by June 20XX.

Please note that 'place of supply' is to be carefully identified as this shortfall-tax is prescribed both under CGST Act and IGST Act. Since it is known which category of inward supply is from unregistered persons, a Developer is free to pick the ones to pay tax on that helps reach the threshold of 80%. Since, input tax credit is not available, it merits to hit 80% and not exceed it.

Apartments 'intended' for Sale

All notifications refer to the word 'apartment' which is defined in RERA (section 2(e)). Units that are 'not for sale' do not come within scope of apartment under RERA. Real Estate Project (REP) is defined to mean development 'for the purpose of selling all or some' (section 2(zn) of RERA). So, application for RERA registration must state whether project is 'for sale' or not so as to come within requirement of RERA compliance.

If the development is 'not for sale', then it is out of scope of RERA and out of scope of this new rate-regime too. It is possible that some (or several) units may not be sold, that does not mean the project was not 'intended for sale'.

Where investors are identified who do not take up equity in SPV but present themselves as bulk-customers, then project qualifies as 'intended for sale' and tax consequences discussed above will equally apply.

Conspicuous by their absence

In all the notifications under this new rate-regime, there's no mention of TDR-Certificates. View held so far, that TDR-Certificates are actionable claim appear to continue and can be argued to be non-taxable.

Previously, revenue-sharing JDA attracted tax on development rights on forward charge basis, without the benefit of deferment of time of supply (as 4/2018 dated 25th January 2018 was never applicable). Now, revenue-sharing JDA is rescued from this incidence, but only in case of development that's 'for sale'. Development that's 'not for sale' (for rental returns) will attract previous rate-regime on supply of development rights i.e. 04/2018 dated 25th January, 2018.

Though REP is defined in RERA, RREP is not defined. 03/2019 defines RREP as 'REP with commercial carpet area (CCA) not greater than 15% of total carpet area (TCA)' which works out to be 17.64% of developed residential area. So, based on this definition, commercial apartments are allowed concessional rate of 7.5% under the new rate-regime. Further, if RREP has CCA > 15% of TCA, then the project does not qualify for the new rate-regime.

Special dispensation is made available to pay GST on construction service by a Developer to Landowner on the date of OC/CC under 06/2019 dated 29th March, 2019. But, where the units are offered for sale before OC/CC, out of Landowner's share of units, this special dispensation is forfeited. And Developer is required to pay tax on intermittent supply to the extent of these units offered for sale by Landowner. GST applicable is at 1.5% or 7.5% on 2/3P on 'percentage of completion' basis, and Landowner to charge GST at 1.5% or 7.5% to Buyer but with special benefit of off-set with tax paid earlier by Developer.

Deemed Value

Concept of 'deemed value' brought into rate notification because of 'upgrade' of notification 11/2017 dated 28th June, 2017 from being a notification issued under section 11(1) to be the one issued under section 15(5). So, where specified, tax applies on deemed value, which is price of similar units sold to independent buyers. And where such deemed value does not apply, fall back to rules is inevitable.

Actual 'cost of construction' will not have any bearing on the valuation for payment of tax when the project is 'intended for sale' as 'deemed value' is made applicable to such projects.

Deemed value is 'all in' price and no separate tax is applicable on utility deposits, legal and registration charges, PLC, club membership, car parking, etc. But then there are transactions between the parties that occur outside their relationship of 'Promoter-Buyer'. For example, claim for liquidated damages, modification-enhancement works (by altering scope of original works or in addition to scope of original works), complements (white goods, car, holiday package). Please take care that these may fall outside the 'scope of 9954' and hence will be treated as a supply on stand-alone basis. GST will apply accordingly and will be unaffected by credit-ban under 3/2019. And to determine the 'scope of 9954', look into RERA application and find out what was the 'offering' and everything outside that offering will be subject to GST independently.

Then there's marketing fee (charged by Developer for sale of Landowner' units) which also is an independent supply taxed separately with benefit of credit, where available. And if the marketing fee were to be remodelled as 'amendment to area sharing' where Developer retains a few units out of Landowner share as compensation for marketing efforts, GST requires unbundling such arrangements for it to be taxed appropriately.

Status Quo Ante

As stated earlier, the new rate-regime affects the real estate development sector within a very narrow compass. There lies beyond in this sector, a far greater space that continues to bear the GST treatment under the previous rate-regime. But the current changes bring much needed clarity (though some experts continue to express reservations) as to the Government's view of 'taxable supplies' in this sector, namely:

- Development rights supplied by Landowner to Developer is taxable;
- Supplies *inter se* between Developer and Landowner is a taxable-exchange;
- Development 'not for sale' continues to be taxable to the extent of units involved in 'exchange';
- 'Value of exchange' will be based on 'cost of construction' (as deemed value not applicable outside of 03/2019); and
- Input tax credit will be available to the extent of taxable outward supplies.

With this background, some key pointers regarding the continuance of *status quo ante* in this sector in respect of all developments that are ‘not meant for sale’:

- Notification 4/2018 continues to exist and extends time of supply to ‘date of OC/CC’;
- Development rights supplied is taxable on forward charge basis in hands of Landowner;
- To avail the benefit under 4/2018 (deferment of time of supply to date of OC/CC), Landowner must be a registered person;
- On the date of OC/CC, Landowner is to pay tax (in cash) on supply of development rights, which is available as input tax credit to Developer;
- Immediately thereafter, a Developer is to pay tax, by utilizing the input tax credit cited supra, on his supply of construction service to the Landowner vide 3(xii) of 11/2017 and this tax paid by the Developer is not available as input tax credit in the hands of the Landowner (as no further sale is intended);
- Valuation of exchange to be ‘cost of construction’ as the concept of deemed value (in para 2 and 2A of 11/2017 as amended by 03/2019) is not applicable in case of development that is ‘not for sale’; and
- Developer to carry out construction on his inward supplies from registered suppliers without any RCM liability on development rights (05/2019 applicable only to ‘for sale’ development) and without any shortfall-tax liability on inward supplies from unregistered persons (again 07/2019 applies only to ‘for sale’ development).

So, new rate-regime does NOT apply to:

- All commercial projects in REP; and
- All ‘not for sale’ projects.

Ongoing projects are those that:

- Commencement certificate is issued;
- Certificate of actual commencement is issued by Architect, Engineer or Surveyor;
- Completion certificate is not issued; and
- Apartments partly booked.

All these events to have occurred before 31 March, 2019.

And where Developer opts-in to continue under current rate-regime, Landowner too may be compelled to follow this option so as to maintain harmony in tax payments.

Please note that projects that have received OC/CC but some finishing-work is underway, tax treatment applicable would not be affected by the present changes.

Conclusion

New rate-regime applies to all new ‘for sale’ projects and to all ongoing projects where continuance of previous rate-regime has been opted for (by 10 May 2019). From detailed discussion of the ‘pros and cons’, following are rate-options available:

- opt-in to pay 12% or 18% with credit; and
- opt-out to pay 1.5% or 7.5% without credit.

Description	New Rate Regime	Old Rate Regime
Development rights	05/2019	11/2017 at #16(iii)-
Exchange	06/2019	04/2018

Unit sales	11/2017 r/w 03/2019 at #3(i) to (if)	11/2017 at #3(xii)

Development rights and construction service are both taxable, both in Developer's hands. New rate-regime is not an omnibus scheme that is 'in lieu' of tax under this Act. It is just a rate notification that applies over a very small space within the vast expanse of development undertaken in real estate industry.

And though not prohibited, authors see it's not for faint-hearted to 'collect 5% but pay 12%'.

Numerous notifications to accommodate the changes that can bring the house down on Developers if they don't evaluate quickly and make up their mind, if it's affordable or not!

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- Indirect Taxes Committee