

GST Newsletter ON Real Estate

REAL ESTATE, REAL ISSUES



Preface:

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At the 33rd GST Council Meeting held on 24th February 2019, new GST rates have been introduced for residential real estate which will come into effect from the 1st of April 2019. The new GST rates on residential real estate transactions have been proposed as follows:

- GST to be charged at 5% without Input Tax Credit (ITC) on residential properties that are not part of the affordable housing segment.
- GST to be charged at 1% without ITC on residential properties that are included in the affordable housing segment.

Current Rate of GST:

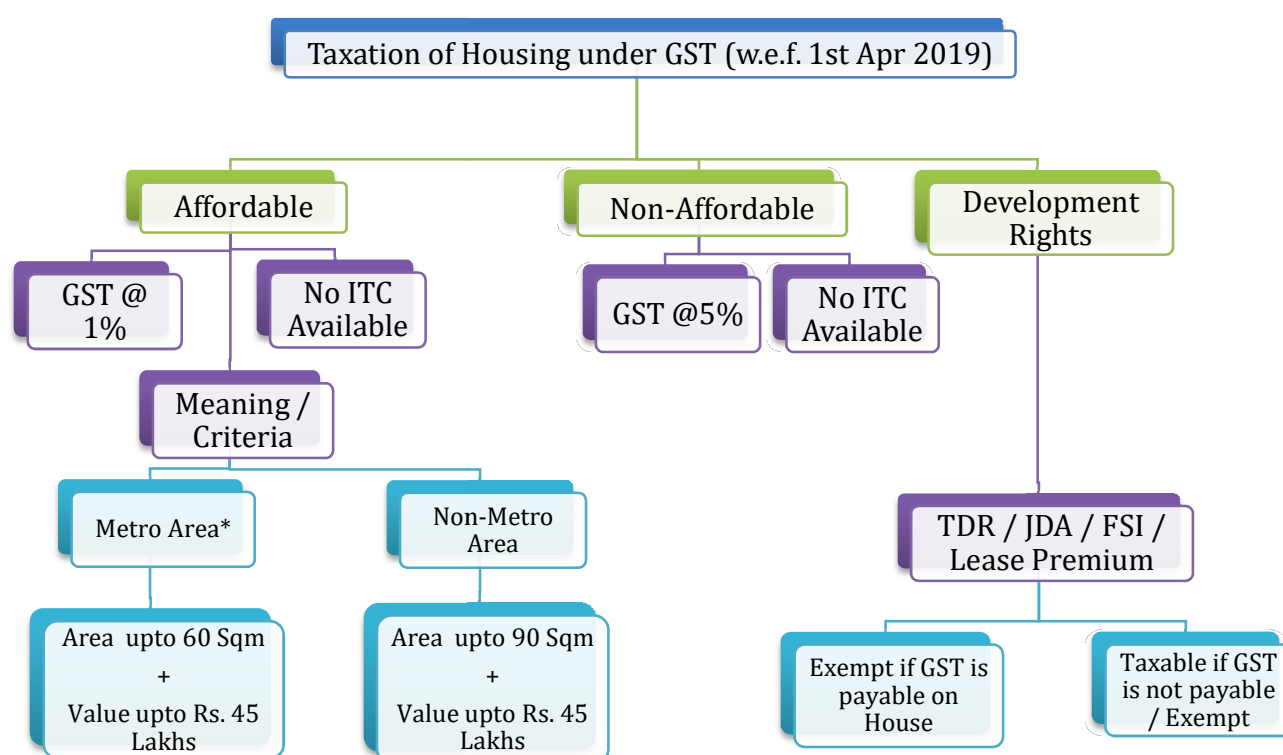
Sale of Land and ready to occupy buildings are not subject to GST as it is covered under Schedule III of the CGST Act. In case of under-construction property, the current tax GST rate structure is as under:

- On Residential Property (affordable housing segment) is 12% (with deduction of 1/3rd for land, hence effective rate is 8%).
- On other construction services (non-affordable housing segment) is 18%. (with deduction of 1/3rd for land, hence effective rate is 12%).

In both the cases the Input tax credit would be available.

Changes after 33rd GST Council Meeting - Press release dated 24.02.2019 relating to GST rate for the residential sector of the real estate sector

Diagrammatic representation of the effects of the meeting:



***Meaning of metropolitan city/ town** - Bengaluru, Chennai, Delhi NCR (limited to Delhi, Noida, Greater Noida, Ghaziabad, Gurgaon, Faridabad), Hyderabad, Kolkata and Mumbai (whole of MMR). As per the 2011 census, we have 46 metropolitan cities in India but here it covers limited cities/ towns.

Why did GST council recommend this change?

Real Estate industry was suffering from recession and stress since last couple of years. Post implementation of GST the industry was almost dormant. On, 15th January, 2019 in pursuance of the decision in 32nd GST Council meeting, a Group of Minister (GoM) consisting of 7 members was constituted to boost up the Real

Estate Sector. The panel will be headed by Gujarat Deputy Chief Minister Nitin Patel. The council, in its meeting on 10th January, 2018, had suggested setting up of a panel to boost the residential segment of the real-estate sector.

The terms of reference of the panel include:

- Studying GST rates and problems the residential segment faces under the new indirect tax regime.
- Suggesting a scheme for the sector like the composition scheme—where taxpayers can pay a flat GST rate without the option of availing credit on inputs—for traders.
- Examining GST on transfer of development rights and development rights in a joint development agreement.
- Examining legality of inclusion or exclusion of land in composition scheme and suggest valuation mechanism. Currently, purchase or sale of land doesn't attract GST.

As per the discussion the group has recommended 3% as GST rate for all those who are in Affordable Housing Projects and 5% for all others. This very Government and the Honourable Prime Minister has the target that every citizen should have a house of his own. He must be owner of a house. "Housing for All by 2022" envisions that every citizen would have a house and the urban areas would be free of slums. Considering all this the initiative was taken by the Government of India and the GST Council has formed the committee which made the recommendation that was discussed in the GST Council meeting held on 20th February 2019 which was adjourned to 24th February 2019.

In 33rd GST Council meeting finally held on 24th February 2019 the decision were taken and the recommendation were made by the GST Council. The notification about the same is expected to be in public by 10th of March 2019.

Advantages of the recommendation of the GST council meeting:

The new tax rate in principle was approved by the Council taking into consideration the following advantages:-

- The buyer of house gets a fair price and affordable housing gets very attractive with GST @ 1%.
- Interest of the buyer/consumer gets protected; ITC benefits not being passed to them shall become a non-issue.
- Cash flow problem for the sector is addressed by exemption of GST on development rights, long term lease (premium), FSI etc.
- Unutilized ITC, which used to become cost at the end of the project gets removed and should lead to better pricing.

- Tax structure and tax compliance becomes simpler for builders.

Disadvantages of the recommendation of the GST council meeting:

Now prima facie there might seem various merits to the press release reducing the rate of GST on construction of Affordable as well Non-Affordable housing, however the reality seems to be different on actual working out of the numbers due to the restriction of Input tax credit. This is analysed by us in the subsequent parts of this newsletter with illustrations.

Further, there are a few issues which are not yet been settled and which needs to be clarified by the dept. Below are such issues listed in detail.

Issues arising after the 33rd council meeting decision:

1. What would be the tax rates and ITC when the builder deals with construction of both residential as well as commercial property ?

Rates are revised w.r.t. residential properties only (1% without ITC for affordable, 5% without ITC for non affordable). ***Kindly note that there is no change in rate w.r.t. commercial properties.*** Moreover, these are effective rates, which means it will be applied to the total amount charged and not on 2/3 portion of total amount charged.

One may note that press release is not talking about the rate of inward supply of works contract to builder w.r.t. construction of residential property. It seems that such supply will be levied as per earlier position. Let's wait for the notification to have the clarity.

Further, Issue arises ***how ITC shall be availed*** in cases where the subject matter is partially residential and partially commercial project because residential properties are charged without ITC (1%/5%), whereas commercial properties are charged without restricting ITC. It will emerge new issues for builders.

It will bring another transitional phase for builders. Few instances can be as below:

- a. Where properties are under construction out of which few are sold on or before effective date (i.e. 01.04.2019 to be notified) and few are sold post such effective date. How ITC/ ITC reversal shall be dealt with in such cases?

This issue is not addressed in the press release, however it is to be noted that after 1.4.19 the ITC would be allowed to be adjusted only on those properties on which GST would be payable (commercial Properties) and not on residential properties.

- b. Where the part of the tax is levied (on account of advances/demand as per completion stage on booking of unit) before effective date and part of the tax to be levied post the effective date. How the tax liability shall be determined on the entire unit? It is also noticeable that meaning of affordable housing is different before and after the effective date.

The press release is silent as to how this scheme would apply to the ongoing projects and the notification has to be awaited. However on notification being silent, GST needs to be applied on the rate prevailing on the time of supply. For all the new bookings after 1st of April 2019 the new rate of GST @ 5% will apply. For the flats booked prior to 1st April 2019 GST rates needs to be determined as per section 14 of the CGST Act, 2017.

c. What will be the fate of ITC remaining as on 31.03.2019?

The press release is silent on this aspect, and one needs to wait for the notification to address this scenario. It could be possible that the credit as on 31st March 2019 may lapse, which needs to be confirmed on issuance of notification

If they are forced to shift to the new scheme, they will have no means to adjust the unutilized ITC balances, leading to huge losses.

We will, of course, have to wait for the relevant Notification to be issued by the Central Government in this regard and one fervently hopes that the issues discussed in this article are duly considered.

2. GST on TDR / JDA/ Lease / FSI on residential properties are exempted, however the same does not apply to commercial properties.

Press release also states that tax on development right, such as TDR, JDA, lease (premium), FSI shall be exempted only for such residential property on which GST is payable.

Though post this amendment, issues relating to development rights and one time lease payment will be limited to non residential properties but in cases where the project is partially residential and partially commercial, what would be the fate of this exemption. Clarity is expected from the notification.

Also one may note that in case of JDA, buyer of residential properties will face the double costing due to the tax implication as below:

First Transaction	Developer will charge tax from landowner. - @5%/1%
Second Transaction	Landowner will again charge tax from buyer whereas he is not eligible for ITC on such residential properties received from developer. So eventually buyer will face two times cost of tax in cases of JDA.

3. What rate shall be applicable in case the land value is not included in any residential project?

As it appears the new proposed scheme would be applicable only when the sale of land is also part of the consideration and hence charging GST @ 5% excluding land, may not be possible. However this needs to be confirmed on issue of the notification.

4. What will be the situation where the supplier collects tax from the builder/developer but does not pay the same?

Since ITC is not allowed it should not affect the builder but whether such nonpayment by supplier can in any manner affect the builder. This again will depend on the scheme framed by the council.

5. What will be the situation where the works contract services are taken by the builder from a works contractor?

Press release is silent on this issue so as on date, until the scheme is recommended by the GST Council and is approved, it could be said that such supplies of services by works contract shall be leviable as per the earlier rates only.

6. Will the Developer be allowed to raise his Sale price by 5% to 6%? Is there anything in the GST law that would prevent the Developer to cover him for the loss that he would suffer, on account of loss of ITC.

By way of a reiteration, the Developer would indeed be entitled to increase his basic price to cover himself for the loss of ITC, as anti-profiteering provisions contained in Section 171 are inapplicable here. Of course, if the Developer is indeed allowed to increase his basic price, one would wonder as to the very purpose of the proposed reduction in the GST rate.

7. Whether it would be compulsory for Developers to implement the new scheme with effect from April 1, 2019?

The Government should offer the new scheme as an alternative to the existing scheme of charging GST @ 12% after claiming ITC. Making it compulsory for Developers to implement the scheme could face constitutional challenges, for sure, as this would go against the concept of seamless credit which is at the heart of the GST regime.

8. Whether, the Developer would be free to choose the new scheme of lower GST rates without ITC for some projects and the regular scheme of higher GST rates with ITC for some other projects?

The Government should ensure that the Developer is given the freedom to choose the scheme that he finds appropriate. However, this would be clear only once the clear notification is received.

Comparison of New scheme with the current scheme and its impact to the customers

Here we have made comparison current scenarios with the future scenario and the expected effect the same is highlighted:

Residential property other than affordable housing

Scenario - 1 - (Considering 60% of the total cost of project on which ITC available @ average rate of 18%) - Residential property other than affordable housing

Before 1-4-2019		After 1-4-2019	
Particulars	Amount	Particulars	Amount
Land and Labour cost	40	Land and Labour cost	40
(+) Construction cost	60	(+) Construction cost	60
(+) GST on construction cost @18% (60*18%)	10.8	(+) GST on construction cost @18% (60*18%)	10.8
Total Cost of project	110.8	Total Cost of project	110.8
(-) Input Aailed	-10.8	(-) Input Aailed	0
Net cost to the Developer	100	Net cost to the Developer	110.8
(+) Margin	20	(+) Margin	20
Sale value of property	120	Sale value of property	130.8
Sale value of property consists of		Sale value of property consists of	
a) Taxable value (120*2/3)	80	a) Taxable value	130.8
Add : GST (80*18/100)	14.4	Add : GST (130.8*5%)	6.54
b) Land Value (120*1/3)	40		
Cost to the buyer	134.4	Cost to the buyer	137.34 2.19%

Scenario - 2 -(Considering 50% of the total cost of project on which ITC available @ average rate of 18%) - Residential property other than affordable housing

Before 1-4-2019		After 1-4-2019	
Particulars	Amount	Particulars	Amount
Land and Labour cost	50	Land and Labour cost	50
(+) Construction cost	50	(+) Construction cost	50
(+) GST on construction cost @18% (50*18%)	9	(+) GST on construction cost @18% (60*18%)	9
Total Cost of project	109	Total Cost of project	109
(-) Input Aailed	-9	(-) Input Aailed	0
Net cost to the Developer	100	Net cost to the Developer	109

(+) Margin	20
Sale value of property	120

Sale value of property consists of

a) Taxable value ($120 \times 2/3$)	80
Add : GST ($80 \times 18/100$)	14.4
b) Land Value ($120 \times 1/3$)	40
Cost to the buyer	134.4

(+) Margin	20
Sale value of property	129

Sale value of property consists of

a) Taxable value	129
Add : GST ($129 \times 5\%$)	6.45
Cost to the buyer	135.45

0.78%

Residential property under affordable housing

Scenario - 1 - (Considering 60% of the total cost of project on which ITC available @ average rate of 18%) - Residential property under affordable housing

Before 1-4-2019		After 1-4-2019	
Particulars	Amount	Particulars	Amount
Land and Labour cost	40	Land and Labour cost	40
(+)Construction cost	60	(+)Construction cost	60
(+) GST on construction cost @18% (60*18%)	10.8	(+) GST on construction cost @18% (60*18%)	10.8
Total Cost of project	110.8	Total Cost of project	110.8
(-) Input Avaailed	-10.8	(-) Input Availed	0
Net cost to the Developer	100	Net cost to the Developer	110.8
(+) Margin	20	(+) Margin	20
Sale value of property	120	Sale value of property	130.8
Sale value of property consists of		Sale value of property consists of	
a) Taxable value (120*2/3)	80	a) Taxable value	130.8
Add : GST (80*12/100)	9.6	Add : GST (130.8*1%)	1.308
b) Land Value (120*1/3)	40		
Cost to the buyer	129.6	Cost to the buyer	132.108 1.94%

Scenario - 2 -(Considering 50% of the total cost of project on which ITC available @ average rate of 18%) - Residential property under affordable housing

Before 1-4-2019		After 1-4-2019	
Particulars	Amount	Particulars	Amount
Land and Labour cost	50	Land and Labour cost	50
(+)Construction cost	50	(+)Construction cost	50
(+) GST on construction cost @18% (50*18%)	9	(+) GST on construction cost @18% (50*18%)	9
Total Cost of project	109	Total Cost of project	109
(-) Input Availed	-9	(-) Input Availed	0
Net cost to the Developer	100	Net cost to the Developer	109
(+) Margin	20	(+) Margin	20
Sale value of property	120	Sale value of property	129
Sale value of property consists of		Sale value of property consists of	
a) Taxable value (120*2/3)	80	a) Taxable value (129*2/3)	129

Add : GST (80*12/100)	9.6	Add : GST (129*1%)	1.29	
b) Land Value (120*1/3)	40			
Cost to the buyer	<u>129.6</u>	Cost to the buyer	<u>130.29</u>	0.53%

Conclusion:

It is hereby noted that, in every scenario shown above there is a negative impact to the buyers wherein there is a increase in cost ranging from **2.2% to 0.78%** in case of **Other than Affordable housing** scheme and **1.94% to 0.53%** in case of **Affordable housing scheme**.

It is understood that many Developers have already started receiving calls from their flat buyers not to bill them till March 31, 2019. While i am not sure as to whether the proposed reduced GST rate would indeed push up demand, it would certainly result in most Developers see significant reduced cash flows till March 31, 2019.

Disclaimer:

This document is prepared by A. K. Lunawath & Associates solely for clients and other chartered accountants to provide updates on important amendments in GST. The information is exclusively for educational purposes, professional advice shall be taken before taking any decision based on this document.

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