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# GST

A mixed bag for the real estate sector

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### **Shashwat Tulsian, Partner**

*I am a Qualified Chartered Accountant, Lawyer and Company Secretary. As a result, I have a unique ability to manage multi-disciplinary projects and to navigate complex challenges. I have helped work on more than 5000 such projects for multinationals over the last few years.*

**"Real Estate industry has been embroiled in disputes due to ambiguity in provisions as well as multiple taxation. The proposed GST regime is expected to reduce the construction cost in the hands of the developer ,however, these provisions need deeper evaluations as further details are awaited."**



### **Nisha Kulthia, Partner**

*I am a Qualified Chartered Accountant, Company Secretary. I like to think strategically and i'm driven to help businesses solving their financial and taxation needs. I also like to add value to research on economy and industry Analysis and its impact on business.*

**"The real estate sector has been a major contributor towards the revenue for the governments at both the levels . Industry would also need to effectively represent to the Government about any changes that are needed in the law to address their genuine concerns."**

## **Critical Points on which consensus is pending to be built:**

GST Rates

Exemption Threshold

Composition Scheme Threshold

Exemption / Negative List

Credit rules etc

## **Key highlights**

- The Model GST Law specifies that works contract would be taxed as a service. This is a welcome move and should provide certainty on taxability of the construction sector.
- IGST & concept of 'supply' are the game changers. It will help in developing national market and considerably reduce the cascading effect of taxes.
- It is widely expected that GST would reduce the construction cost in the hands of the developer and thereby aid in reducing or at least maintaining the current level of prices in the real estate sector.
- Ease of doing business will drastically changed with the introduction.
- GDP will improve by 1% to 2%. •

#### How did it all start ?

No VAT on Works Contract  
Deeming Provisions introduced in Constitution  
Theory of Dominant Intention  
Splittable and Non-Splittable Composite Contracts  
Builder vs Developer  
Introduction of Service tax on builders  
Developer is also a Works Contractor  
Overlapping of Goods, Service and Land while calculating taxes

### The most significant changes in the taxation of Real Estate sector were:

- 20/06/2006:** The Apex Court's decision in the case of K. Raheja Builders Corporation which declared the levy of **VAT on builders** for the first time. There was also 46th Amendment in the Constitution.
- 01/06/2007:** Levy of **Service Tax on works contract** under Finance Act, 2007.
- 09/07/2010:** Notification on **Composition Scheme** under Maharashtra VAT, applicable to Construction Contracts for all agreements registered after 1-4-2010, to be charged with 1% VAT, with no input credits available.
- 20/06/2012:** Notification No. 26/2012 providing an abatement of 75%/70% on the total contract price (including the cost of land). The real estate transactions, particularly the transactions involving the **construction** of flats, dwellings or buildings, for **selling** them along with the interest in land can broadly be categorized in three parts viz.
  - the value of goods and materials involved in construction,
  - the value of **services** involved therein ,and
  - the value of divided or undivided interest in **land**.

## Current Tax System

- The states apply VAT to the goods portion
- The centre taxes the services portion,
- **no explicit tax on the transaction value of land** (other than stamp duty).  
Though such split may sound reasonable or logical, the same is fictional in nature and hence more often leads to dual-taxation and difficulty in implementation and compliances.
- **Non-creditable costs are one of the major causes for the higher price:**  
A developer/ builder incurs various types of costs during the construction phase. Such costs have **different indirect tax components**, most of which are costs in the system as many of them are not creditable either to the Developer/ Builder or to the end-customer. All these taxes collectively have a substantial impact on the final price of the units sold by the Developer/Builder.

## GST and Real Estate Sector

- In the proposed GST regime, the restrictions on credit utilization (other than basic customs duties and additional tax @1%) would be eliminated, thus strengthening the credit chain in the system.
- If this so happens, there will be increased credits available in the procurement chain and hence better utilization of input tax costs towards output GST liability.

Currently, the real estate industry is passing through a widespread recession with months of inventory remaining unsold with builders/developers.

Even the Real Estate Bill, which recently received the President's assent, is going to impose several restrictions on Builders/Developers.

On this backdrop, the GST appears to be a benefactor for the real estate regime, primarily in the light of the expected **free flow of credit**, which should translate into an increase in margin in the hands of the developer.

It would also ensure a substantial **reduction in compliance** of tax laws. Whether these benefits will percolate into the end customers / users is to be seen because pricing in this sector is more driven by market forces than on costing principles.

More importantly, as the GST regime is expected to impart greater transparency through market mechanism, it is imperative that real estate transactions forms an integral part of the proposed GST design.

## Annexure Case:

A builder in Maharashtra constructs & sells a residential flat of area (say) 1200 sq ft. @ Rs.4000/sq ft. for the agreed consideration of Rs. 48,00,000/-. The proportionate land cost for the said flat (say @ 37.5% of the value) is Rs. 18,00,000/-. The construction cost inclusive of material and labour is assumed @ 2,000/-per sq ft. The construction cost is divided as 1400/-sq ft. as material cost and 600/-sq ft. as labour charges. The ratio of purchases of material consumed chargeable to VAT at 5% and at 12.5% is (say) 25:75 respectively.

### Tax implications for this builder under:

- Current regime: VAT regular scheme & Service Tax.
- Current regime: VAT composition scheme & Service Tax.
- Proposed regime: CGST & SGST.

Particulars	Calculation	Vat (normal) & st	Vat (composition) & st	CGST & SGST
Collection from customer	1200 Sq Ft *Rs 4000 per Sq Ft	48,00,000	48,00,000	48,00,000
Less : Land cost	37.5% of A	18,00,000	N.A	18,00,000
Construction Cost and Profit Margin	(A-B)	30,00,000	N.A	30,00,000
Less : Labour and other charges (Rule 58A standard deduction)	30 % of C	9,00,000	N.A	
Net Amount Taxable Under Vat	(C-D)	21,00,000	48,00,000	
Net Amount Chargeable to vat @ 5%	(25% of E)	5,25,000	N.A	
Net Amount Chargeable to vat @ 12.5%	(75% of E)	15,75,000	N.A	
Output vat liability @ 1%	1% of E	N.A	48,000	
Output vat liability @ 5%	5% of F	26,250	N.A	
Output vat liability @ 12.5%	12.5% of G	1,98,875	N.A	
Total Contract Value Including Land Cost	A	48,00,000	48,00,000	
Less : Abatement of 70% for Construction Services	70% of H	33,60,000	33,60,000	
Net Amount Taxable Under Service Tax	(H-I)	14,40,000	14,40,000	
Output Service Tax Liability @ 14.5%	14.5% of J	20,08,800	20,08,800	

## Relevant Definition

- (48) "goods" means every kind of movable property other than actionable claim and money but includes securities, growing crops, grass and things attached to or forming part of the land which are agreed to be severed before supply or under the contract of supply;
- (88) "services" means anything other than goods;

–Why such a wide definition of service ?

–Whether the services includes immovable properties as the same is not included in the "goods" ?

–Is classification between goods and services still relevant?

–Splitting of Contract – Whether relevant under GST??

### Interpretation:

1. Definition of "services" – very extensive (Risky). Explanation added is not a part of definition as given in proposed Article 366(29A) of Constitution.
2. The definition of service under GST includes actionable claim and supply of same with or without consideration.

## Whether Transferable Development Rights (TDR) would be taxable under GST ?

Exchange FD



Ambiguity remains regarding taxability of such TDR as to whether the same are liable to Service tax, and at what value

- It is a common practice for the landowner to transfer development rights in the land to the developer. In lieu of such rights, the developer may provide a fixed quantity of flats to the landowner or share in the revenue from sale of the flats.
- The Model GST Law defines 'supply' in very wide terms, which also includes barter/exchange of goods or services. Hence, ambiguity on taxability of TDR may continue under GST.
- If TDR is taxable, time of supply, the valuation of transfer of the development rights by the landowner to the developer, as well as credit eligibility of the developer needs to be clearly provided for in the GST law.
- If the current credit provisions remain, the developer may not be entitled to avail credit of GST paid on TDR, hence resulting in huge incremental cost.

## works contract

(107) works contract" means an agreement for carrying out

- for cash, deferred payment or other valuable consideration,
- building, construction, fabrication, erection, installation, fitting out, improvement, modification, repair, renovation or commissioning.
- of any movable or immovable property;

Interpretation:

- No condition of transfer of property in goods
- does not contain "any other similar activity" like the Finance Act 1994
- **New words added** - building, fabrication (may be because fabrication leads to manufacture so it was not there earlier), improvement;
- The expression "construction" includes **additions, alterations, replacements or remodeling of any existing civil structure;**
- The concept of original works – **Removed.**
- The earlier leaked version talked only of immovable property, but the latest one talks of both moveable and immoveable property - Surprisingly there is no reference of "maintenance" Works Contract

What about other completion services ?

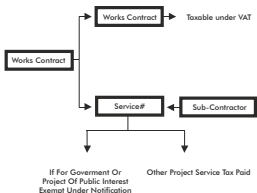
What if pure labour services are provided however the materials are issued by principal ?

What about onsite manufacturing ?

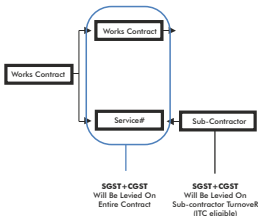
What about made to order goods ? Whether they are covered here ?



## Works Contract under present regime



## Works Contract under GST regime



## Current

Both VAT and Service tax is applicable on construction as well as sale of under-construction property (referred to as 'works contract') at abated/ concessional rate<sup>1</sup>. This has not only resulted in higher tax burden but also in numerous litigations for real estate developers.

Currently, a service provider is not eligible to avail credit of the tax paid on goods (specially VAT)

## GST

Works contract as well as sale of under-construction property **deemed as 'service'**

**Free of cost supplies** by recipient to contractor would be liable to GST. Thereafter, the contractor may need to include value of such free supplies in the value of his **services**.

Following specific restrictions are proposed under **credit rules** with regard to goods and services acquired for the purpose of **construction of immovable property** as per section 16(9):

- (c) goods and/ or services acquired by the principal in the execution of works contract when such contract results in construction of immovable property, other than plant and machinery
- (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

- What about credit reversal in case of units sold after BU / Completion certificate which are currently exempt under GST ?
- Whether input on common services or total input to be reversed ?
- Not clear why the term 'Principal' is used – Whether this would also include main contractor or the developer ?

### Key Action points

Representation to be filed to include specific provision to allow credit of stock in hand for service provider as well as for traders.

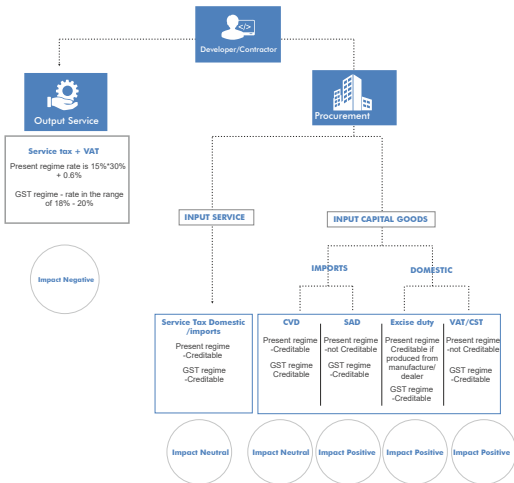
## Input Service Distributor concept ('ISD')

- ISD concept has been proposed for transfer of credit of input services between two or more locations. ISD can transfer credit of all types of GST (CSGT, SGST or IGST).
- Further, ISD can be any supplier of goods or services.
- Considering the possibility of multiple registration state-wise, ISD could be used as a tool to ensure optimal utilisation of head office related credit, and hence resulting in actual reduction in cost.

### Key Action points

- Locations to be identified where there may be accumulated credit, and there may not be sufficient output liability – ISD registration may be taken in such State to distribute credit to other locations

## GST Impact On Construction Sector



## Valuation under GST

No choices available as of now

Full value of consideration to be treated as a service

Subject to GST at Full rate

Valuation Determination of value of Supply of Goods & Services:-

↓ "transaction value"

↓ Value by Comparison.

↓ Value shall be cost of goods / services + Charges + profit - Computed value method

↓ The value shall be determined using reasonable means consistent with the principles and general provisions - Residual method

## Restrictions under Credit Rules

In case no deduction is provided under GST for value of land, or no abatement/ composition is provided, it may lead to significant increase in tax burden, especially if such services are taxed at Standard GST rate (which is expected to be 18%).

Even if such services are subjected to lower tax rate (expected to be around 12%) considering that there is additional tax incidence in the form of Stamp duty on value of land/ immovable property, it would need to be evaluated whether the tax incidence would be higher than the current regime (in absence of any deduction).

Expectations: The industry was expecting a much more liberal credit regime where it could get the credit of the construction services acquired in relation to commercial property which would be subsequently leased.

### Issue is arguable

However, the draft law could be interpreted to mean that there may not be any credit available either to a contractor or the developer involved in construction of immovable property (whether sold as under construction property or leased). This does not seem to be the intent of the lawmaker and hence would need significant revision.

## An Open Issue under GST

Taxability on agreement between contractor and sub- contractor for construction of property; whether exemption is available to sub-contractor. Multiple deemed sales were declared invalid in L&T 17 VST

*"Considering the absence of valuation rules and the restrictions under Credit Rules, the proposed law as it stands today could have a negative impact on the Real Estate Industry."*

## Key Action points

- Assess possible impact if no deduction is provided under GST – Possible impact on vendor agreements as well as prices of the property
- Representation for lower rate of tax for Real Estate sector
- Representation for specific valuation rule under GST which provides for deduction of value of land from transaction value. Such representation may include that no tax to be levied on FOC supplies in hand of contractee as the same would be revenue neutral
- Representation for simpler and liberal credit regime allowing credit of goods and services acquired either by contractor or developer and the provisions should not be subject to multiple interpretations which would result in future litigations
- Review of existing contracts with customers as well as contractors/ vendors to analyze impact of change in taxability of works contract – Tax clause and Change in law clause to be analyzed
- Future contracts to be framed in light of proposed GST provisions for tax optimization
- In case of increased eligibility of credit, IT systems would need to be revamped to record input tax credit (currently various credits may not be recorded if developer opts for composition/ abatement scheme).

## **Place of Supply (Current Regime)**

- No such concept under Central Excise / State VAT
- Concept of Place of provision of Service (POPS) in service tax to decide import / export
- The residual or general principle is that the location of recipient of service is place of provision of service
- Whereas separate rules have been prescribed for separate services wherein different places of provision of service are defined
- Under CST, the principles determining situs of sale is prescribed in Chapter II of Central Sales Tax Act, 1956
- The major principle for determining situs of sale is the location of sale that occasions the movement of goods

### **(64) "location of recipient of service"**

- (i) place of business;
- (ii) fixed establishment;
- (iii) Multiple establishment most directly concerned with the receipt
- (iv) in absence of such places, usual place of residence of the recipient

### **(65) "location of supplier of service" Where the supply is made from**

- (i) place of business ;
- (ii) fixed establishment;
- (iii) establishment most directly concerned with the provision of the supply;
- (iv) in absence of such places, the usual place of residence of the supplier;

### **Meaning of "Supply is made" ?**

In a construction project supply is always received at the construction site as per POS, but can we say that supply is also made at the construction site so as to require local registration ?

## Possible requirement of contract restructuring

### Place of Supply Rules :

- 3rd party supplies (such as bill-to/ ship-to or sale in transit): Section 5(2A) of the Model IGST Law states that where the goods are delivered on the direction of a third person, whether as an agent or otherwise, before or during movement of goods, either by way of transfer of documents of title to the goods or otherwise, it shall be deemed that the said third person has received the goods and the place of supply of such goods shall be the principal place of business of such person.
- The place of supply of services, in relation to an immovable property, would be the location at which the immovable property is located or intended to be located.
- There may be possible issues where a single contract is entered into for provision of services related to immovable properties across two or more States.  
*For example, in case of facility management services outsourced to vendors, typically, a single contract may be entered into with the vendor, for which consolidated invoices may be raised at one location. Under GST, since immovable property may be located in more than one State, the place of supply would be each such State where the immovable property is located, and hence, there may be a requirement for the vendor to raise separate invoices (for which separate contracts may also be required).*
- In case of multi state project, based on revenue collected for such place as per Contract.
- Thus Works Contract services it would be mostly the place where works contract is being executed and completed project is handed over to Customer.
- Determination of place of supply in cases of transshipment and bundling of goods before delivery undertaken – not clear and lacks clarity
- Please refer EU Regulations on this issue

### Key Action points

- Identify vendor contracts which need to be split State-wise to comply with GST requirement
- Revamp IT system to be in line with place of supply for various transactions

## Compliance requirements

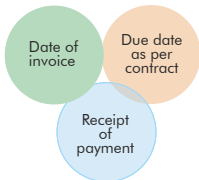
- Registration may be required in each State where there is a premises from where supplies are being made. Hence, registration may need to be obtained in each State where there is a premises (including site office) from which services are being provided.
- One aspect which may be analysed is, if place of business is located in one State and services relating to immovable property are provided in various States (where there is no place of business), would registration be required in all States, or would it suffice if registration is obtained in only one State.  
Identification of States where registration may be required
- Appropriate changes required in IT systems to be GST compliance ready

- Whether a Real Estate developer having Head office at Gujarat and Project Site at Maharashtra would be required to obtain registration under SGST for both locations or it would be ok if he pays IGST
- While paying IGST do we have to select account code of IGST or IGST – Maharashtra ? Its relevance and what if there is a mistake ?
- Whether the site at Maharashtra is a :-
  - Place of Business
  - Principal Place of Business
  - Fixed Establishment
  - Place of residence
- What if all goods are directly billed from Gujarat to the buyers at Maharashtra ?

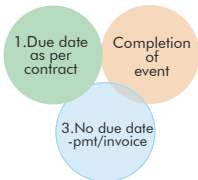


## Identifying the date on which tax is due – Time of Continuous Supply of Services

### Currently



### Under GST



### Critical Issues expected to be faced

- a. Advisable not to document due dates in the contract
- b. Completion of Event clause to be properly drafted
- c. Advisable to be based on certification of work

## Transitional Provisions

### Treatment of long term construction / works contracts (Impact on ongoing contracts)

- Specific transition provision has been stipulated vide Section 159 and 160 for works contract/ periodic supplies as under:

- '159. The goods and/or services supplied on or after the appointed day in pursuance of a contract entered into prior to the appointed day shall be liable to tax under the provisions of this Act.
- 160. Notwithstanding anything contained in section 12 and 13, no tax shall be payable on the supply of goods and/or services made on or after the appointed day if the consideration for the said supply has been received prior to the appointed day and the duty or tax payable thereon has already been paid under the earlier law'

Per the above, it appears that in case of periodic supply of goods/ services, GST Act would not apply on advances received prior to the GST law for goods/ services to be provided during the GST regime, provided tax has been paid on the same.

*This provision does not cater to the scenario where tax has not been paid, but is payable under earlier law post enactment of GST regime.*

Also, there is no provision for treatment of supplies prior to GST law where either the invoice has not been raised for the same, or payment has not been received, or tax has not been paid prior to enactment of GST law.

*This could result in dual taxation both, under the previous regime as well as under the GST regime.*

- Coverage of the transition provision to be analysed as to whether implications for all its possible transactions during the transition period are clear. Accordingly, necessary representation would need to be filed for clear transition provisions

To analyse tax liability for all ongoing projects in line with transition provision

- Transaction structuring may be undertaken depending on impact of GST. If GST has negative impact, consideration may be made earlier even for supplies to be undertaken post GST
- Transition planning for timing of supplies, advances and payment of tax
- Representation to be filed to provide more clarity on transition provision for ongoing contracts

#### Input Tax Credit

- Eligible CENVAT Credit can be carried forward – clause 143(1)
- Eligible State VAT Credit can be carried forward – clause 143(2)
- Unavailed credit on eligible capital goods not carried forward in a return can taken – clause 144(1)
- Eligible duties and taxes exempt prior to GST and taxable in GST – credit can be availed on such 'inputs and inputs contained semi-finished and finished stock on date of introduction of GST on the basis of GAAP – clause 145
- Credit can be availed if the person switches from composition to normal scheme – clause 146

#### Transitional Provisions – Missing Points

- CST paid on goods lying in stock to be used in taxable supply in GST
- Service tax/ Excise credit for VAT dealers or vice-versa The underlying principle is that- these goods 'and services would be used in the provision of output goods or services chargeable to tax under GST regime.
- There is reference of Stocks and inputs in FG and SFG, however there is no reference of Work in Progress of a developer / contractor
- Returning the FIM lying with the contractor as on the date of GST

### Reverse Charge Mechanism

- Aggregate Turnover – does not include supplies applicable under RCM
- Output tax – excludes tax payable on RCM (excluded to restrict input tax credit)
- Person required to be registered irrespective of threshold limit
- No specific provisions indicating specific reverse charge shall be applicable – may specify through Rules

### TDS

- Applicability: – Department of Central & State Government – Local Authority – Government Agencies – any other 'persons' as may be notified
- Rate of TDS – 1%
- Certificate of TDS by Deductor to Deductee
- Deductor – to file electronic return
- Credit of TDS available to deductee in electronic cash ledger

### Exemptions

- Central Government has been granted to reduce GST Rates as per requirements by issuing a general exemption notification
- Exemption optional but absolute exemption compulsory
- Composition Scheme – Turnover does not exceed – Rs. 50 Lakhs
- Scheme is Optional – all supplies should be within the state
- Scheme is useful to persons who are making direct sale to consumers
- No clarity so far as far as other exemption are concerned
- No Negative list within the act

## Reference

<http://reality.economictimes.indiatimes.com/reality-check/gst-a-mixed-bag-for-the-real-estate-sector/1707>

## About R.Tulsian and Co. LLP

R.Tulsian and Co. LLP is a full services multinational chartered accountancy and legal services firm having its head quarters in India. We have a multinational presence with clients in USA, Europe and Australia. We also have a strong PAN India presence in important strategic locations including Kolkata, New Delhi, Bangalore, Mumbai and Gujarat, North East India, among other places.

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