National Journal of Multidisciplinary Research and Development
ISSN: 2455-9040
Impact Factor: RJIF 5.22
www.nationaljournals.com
Volume 2; Issue 3; September 2017; Page No. 222-224

GST: A positive development for real estate

Dr. Jayashree, R Kotnal
Assistant Professor, BLDEA's A S Patil College of Commerce (Autonomous), Vijayapur, Karnataka, India

Abstract
Real estate industry in India in the recent past has seen a phenomenal growth, not just in the Tier-1 cities, but even Tier-2 and Tier-3 cities and towns. The industry is in the cusp of increased regulations, with bills such as the Real Estate (Regulation and Development) Bill, pending for approval in the side lines. GST is another development that will have a significant impact on this sector. The real estate sector is likely to attract a GST rate of 18 per cent and though the impact of this tax on residential real estate prices will be broadly neutral, there is bound to be some variation due to diverse taxation policies and practices across states. With the announcement of the Goods and Services Tax (GST) and the implementation of GST for real estate, 2017 is bound to have a brighter horizon for the sector. Let's understand the impact of GST on real estate. Meanwhile in GST news, earlier this month, the government stated that property prices would not witness inflation once GST for real estate would be implemented. Budget 2017 saw the announcement of the affordable housing initiative under the Prime Minister Modi Government. This paper will highlight the impact of GST in real estate sector.

Keywords: Real estate industry, Goods and Services Tax (GST), residential real estate, real estate regulation and development act 2016

Introduction

Real estate industry in India in the recent past has seen a phenomenal growth, not just in the Tier-1 cities, but even Tier-2 and Tier-3 cities and towns. The industry is in the cusp of increased regulations, with bills such as the Real Estate (Regulation and Development) Bill, pending for approval in the side lines. GST is another development that will have a significant impact on this sector.

The Government could also play a part in softening its position relative to Mutual Agreement Procedure in the treaties, specifically by allowing for bilateral Advance Pricing Agreements (APAs) even in cases where Article 9(2) dealing with correlative relief for Associated Enterprises is not present in the respective treaty.

2016 wasn't a very good year for the real estate sector what with the government's attempts to regulate the real estate sector with the passing of RERA (Real Estate Regulation and Development Act 2016) and the Benami Transactions Act. The demonetization drive was the cherry on top of this not so pleasant sundae – as most real estate deals are infamous for black money transactions.

With the announcement of the Goods and Services Tax (GST) and the implementation of GST for real estate, 2017 is bound to have a brighter horizon for the sector. Let's understand the impact of GST on real estate.

The real estate sector is likely to attract a GST rate of 18 per cent and though the impact of this tax on residential real estate prices will be broadly neutral, there is bound to be some variation due to diverse taxation policies and practices across states.

Builders and tax consultants are of the opinion that the implementation of GST for real estate will help reduce the cost of ownership for property buyers, especially if the GST rate is lower than all the collated tax rates; additionally GST for real estate will definitely help bring about transparency in the buying process. Developers hope that affordable rates will most likely result in a surge in sales, which in turn will help payoff project investors.

However, the GST Law Model had stated that input tax credit would not be available with reference to goods/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. As the real estate sector falls under immovable property transactions, there would be multiple counts of taxation on prospective home buyers as builders are most likely to pass on non-creditable tax to them (even as they pay GST on the consideration charged to them for a residential property, followed by stamp duty for registration).

Mean while in GST news, earlier this month, the government stated that property prices would not witness inflation once GST for real estate would be implemented. Budget 2017 saw the announcement of the affordable housing initiative under the Modi Government, naturally, developments on GST for real estate will see efforts to strengthen the initiative for affordable housing. Minister of Urban Development, Venkaih Naidu while addressing CREDAI said that the affordable housing initiative that had already been exempted from service tax, will also be exempted from the Goods and Services Tax. The Urban Development Ministry also issued recommendations to the Ministry of Finance to tax the real estate sector at a rate which is revenue neutral and not higher.

Even though construction services has been taxable under VAT and service tax for a decade or so, the industry is still plagued with uncertainty on key basic issues that remains unsolved leading to intense litigation, especially on issues like transfer of development rights in land, taxability of joint development agreements, taxable value for goods and services, etc. While it is expected that immovable property transaction, i.e., transfer by way of sale of immovable property after completion, would continue to be outside the purview of GST and be liable only to applicable stamp duties, the proposed shift to the GST regime is expected to usher in the wings of change and wipe the slate clean in a bid for a fresh start on the indirect taxation of all other real estate transactions. However, the foremost thought in everyone’s mind is whether GST is indeed the solution to an industry riddled with complex structures and issues.

Today, this industry has two primary levies, Service tax and VAT, with overlap of tax base and constant disputes on the rate of tax, given the multiple options available for discharge of taxes across States. This has resulted in diverse practices being followed by developers, across geographies and even within each State. These issues should be put to rest under the GST regime and the practices and positions should be common across India. Hence, the taxes paid by home buyers across States should more or less be the same.

Presently, home buyers pay service tax and VAT on purchase of residential units when booked prior to their completion. There are also various elements of non-creditable tax costs, like excise duty, customs duty, CST, entry tax, etc. paid by the developer on his procurement side, which is inbuilt into the pricing of the units. All these tax costs add up to anywhere between 22%-25% of the price of the units. The proposed GST should replace these multiple taxes with a single tax and should also ensure smooth flow of credits through the chain. Hence, it is widely expected that GST should 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. The only damper could however be high GST rates (like the 27% GST rate that is doing the rounds) which will offset any possible gains on incremental credits. Stamp duty is not proposed to be subsumed under GST and hence will continue as it is today.

The Supreme Court’s decision in L & T that VAT to be applicable only on construction carried out after agreement of sale was a game changer for VAT and the industry is still grappling with the impact of the same on payment of taxes and availment of credit. This principle could continue to apply even under the GST regime, as there can be a supply of goods and services only from the date the agreements are entered into with the buyers, unless the GST legislation introduces a deeming fiction.

GST should have a significant impact for commercial property developers, who today are burdened with high costs as no credit is available on construction services used for developing a commercial property which is then rented out. It is expected that under the GST regime, there should be a smooth flow of credit and current restriction on construction related credits not being available for offset is expected to be removed. This would help reduce the project costs in the hands of the developer, which should have a positive effect on rentals. If the credit restrictions continue, due to higher GST rates, the project cost are only going to get escalated further. Additionally, all business entities, including the trading companies should be able to take credit of the GST paid on the rentals, which in turn should help the developer community in negotiating better rentals. To recap, under the current regime, service tax on rentals to traders, is not available as a credit.

SEZ projects should by and large be neutral as the present exemptions on the procurement side should transition into GST as well. It is expected that supplies of goods and services to SEZ developers and units will be zero rated.

Under the GST regime, special focus would be required on the taxability of landlord-developer transactions, especially on the taxation, valuation and timing for payment of taxes on such transactions and also on the liability of landlords for sale of their portion of constructed area before completion of construction.

Overall, GST appears to be a benefactor for the real estate regime, primarily in light of the expected free flow of credit, which should translate into an increase in margin in the hands of the developer. Whether these benefits will percolate into the end customers / users is to be seen, more so 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.

GST implications for real estate

The Goods and Services Tax (GST), is a comprehensive indirect tax on the sale, manufacture and consumption of different kinds of goods and services throughout India, with all other central and state taxes intended to be subsumed under it. This tax will have far-reaching implications, including on real estate.

Existing taxation norms

The real estate industry in India has witnessed major tax changes, in the last few years. However, these taxes are not uniform all over the country - different practices and regulations are followed in different states. It was the 46th amendment to the constitution that brought massive changes towards taxation in the real estate sector. Subsequently, special powers were given to the state governments, for implementing Value-Added Tax (VAT) on some specific kinds of transactions.

For land, property and other kinds of work contracts, different kinds of taxes are levied by the state government and the central government. The transactions are mainly categorized in three parts - value of services, value of goods and materials, and value of land. VAT is applied by the state government on the goods portion, while value of services is taxed by the central government. However, other than stamp duty, there is no clear tax on the transactions regarding value of land. This situation leads to confusion and can result in dual taxation. Compliance and implementation of such taxes are also difficult.

This has led to a situation, where for one real estate transaction; multiple taxes need to be paid. This has a negative effect on the industry. The industry’s demand to bring GST on board, is primarily to get a clear and transparent taxation rule for the real estate sector in India.

Impact of GST on Indian realty

The implementation of GST, can prove to be a significant step in reforming indirect taxation in India. Chances of double taxation would be diminished, as some of the central and state government taxes will be amalgamated into one tax. This will ease the process of taxation considerably, making it easier to enforce and administer.

In the current situation, a developer incurs various kinds of expenses during the construction phase of a project. Different kinds of taxes are involved with these expenses, such as VAT/CST, customs duties, service tax, excise duty, etc. A majority of these taxes, are expenses that are included in the system. This is because they are not creditable to the developer or to the end-customer. These non-creditable expenses lead to tax inefficiency, which is not desirable.

One positive impact of the GST, could be the doing away of restrictions on credit utilization. This will definitely help in strengthening the credit chain in the entire system. If builders can properly manage this aspect, they will see some profit.

The proposed GST structure should provide a progressive and streamlined approach. Presently, builders running projects in different states have to comply with state-specific VAT laws, as well as other kinds of service taxes. Bringing in GST will, therefore, not bring any additional compliance burden on real estate builders in the country.

Issues regarding GST which affect real estate builders

Developers, on their part, have also been seeking certain clarifications, vis-à-vis GST. For example, the definition of a real estate developer varies from one state to another. The composition scheme varies according to state, in which the VAT rates range between 1% and 5%. In some states, there are differences between the terms 'real estate contractors' and 'real estate developers'. These different meanings will have to be factored in, while evaluating the GST implications.

There might be some confusion regarding GST implementations on residential property, as well. In the present scenario, there is no service tax applicable on renting immovable property, particularly for residential purposes. However, service tax and VAT is applicable on construction work. The question that arises is if the GST will offer differential tax for residential properties.

As of now, it does not look like completed residential projects will be affected by GST, as buyers into completed projects have already paid the statutory charges, such as stamp duty and registration charges on the transaction.

The segments to watch on the GST front are under-construction flats and rental flats, which are expected to come under its ambit. GST will apply to the materials that a developer procures for building a residential project. Hence it will have a direct impact on the overall cost of construction.

Moreover, a lot also depends on the final rate of GST. If it is more than the existing cumulative taxes, then, the overall cost of buying an under-construction flat will increase, along with the added cost of stamp duty and registration. Developers will also have to keep an eye on costing, as price competitiveness is very important in the current real estate market scenario.

Conclusion

The impact of GST on real estate sector cannot be completely assessed as it largely depends on the rate to be declared under GST. Though, still there is going to be a substantial benefit from GST as it will bring a lot of required transparency and accountability. Developers/Contractors would reap the benefit of many taxes which will be subsumed by GST. "Real estate sector should be happy with GST even if the rate declared is higher than current rate"

References

1. Jayashree R, Kotnal. GST in India: An enrichment of indirect taxation system, International Journal of applied Research. 2016; 2(4):735-738.
2. http://goodsandservicetax.com/gst/showthread.php?69-CHAPTER-X-Goods-and-Services-Tax-Theway-forward.
3. http://en.wikipedia.org/wiki/Goods_and_Services_Tax_India, 2014.
4. http://www.taxmanagementindia.com/visitor/detail_rss_feed.asp?ID=1226
5. http://www.gstindia.com/
6. http://www.thehindubusinessline.com/todayspaper/tp-others/tp-taxation/article2286103.ece
7. http://finmin.nic.in/workingpaper/gst%20reforms%20and%20intergovernmental%20considerations%20in%20india.pdf.