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CREDAI-MCHI UNITS

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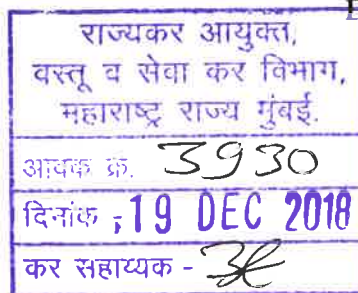
Prakash Baviskar

Ref. No. MCHI/PRES/18-19/086

o/c

December 18, 2018

To,
Hon'ble Shri Arun Jaitley
Minister for Finance
Government of India
North Block
New Delhi - 110 001



Sub: Request for carrying out certain changes with respect to in levy of GST for the real estate sector

Respected Sir,

Confederation of Real Estate Developer's Associations of India (CREDAI) is the apex organization representing 12,000 developers across 23 states and 189 cities. CREDAI members are active partners of Government in the mission of Housing for All by 2022. Over one million affordable housing units have been launched by CREDAI members since April 2017.

Further, Maharashtra Chamber of Housing Industry (MCHI), a founder member of Confederation of Real Estate Developers' Association of India (CREDAI), is a society registered under the Societies Registration Act, 1860 and under the Bombay Public Trust Act, 1950. MCHI is a recognized association having as its members, various firms and/or companies engaged in the business of development and redevelopment of immovable properties, who provide the majority of the housing (exceeding 90%) in and around the city of Mumbai. MCHI is well known for initiating and successfully espousing the cause of its members at various forums, Government, Urban Local bodies, etc.

This representation concerns the problems being faced by the real estate industry and its customers considering the applicability of GST on following transactions:

1. Land Deduction:
Relevant provision

GST Regime	Service tax Regime
The tax rate is stipulated at 18% in case of sale of under construction flats vide notification no 11/2017- Central Tax (Rate) dated 28.06.2017. After allowing presumptive deduction for land cost at 1/3 rd of sale value of the flat, the effective tax rate comes to 12% of flat value [except few notified specified Housing Schemes where the effective tax rate is 8%]	Abatement of 70% on gross amount charged towards the unit without input tax credit in respect of inputs used towards construction service i.e. the Developer was permitted to avail the credit on input service and Capital goods as defined under Cenvat Credit Rules, 2004 [Notification No. 26/2012 Service tax dated 20.06.2012]

Concerns and issues:

- a. One of the most critical issues faced by the Real Estate Industry is the 1/3rd presumptive deduction towards land to the Developer who is selling the unit along with share in undivided land.

Under Service tax regime, the overall tax burden was around 6-8% (taking into account the various indirect tax costs). However, under the GST Regime, at one hand the Government has relaxed the credit eligibility to the Developer but increased the rate of tax to 18% which, even after taking into account the presumptive deduction of 1/3rd from value of unit turns out to be on higher side. It is important to note that 6% deduction towards land in most cases is not nearly commensurate to the cost of land. The Hon'ble Council will also be aware that actual cost of land differs from city to city and within the city, from area to area. This increase in tax rate with only 1/3rd abatement towards land does not reflect the true value of the land in a metro where the land cost is the highest component, ranging from 55% to 72%, in the overall cost of the Project. This has eventually hurt the market sentiment thereby affecting the overall industry. **This indirectly results into levy of GST on land value which is not in consonance with GST legislation which specifically excludes land from scope of supply and/or levy of GST.**

- b. What distinguishes Real Estate Industry from others is that there is no fix input /output ratio / mechanism unlike other industries which can be easily understood with the help of following example and therefore needs to be treated differently:

		Premium Location	Medium Location	Remote Location
		Rs per sq. feet		
Sale price	A	70,000	40,000	5,000
Land cost	B	50,000	27,500	1,000
Presumptive Deduction for land cost (1/3 rd of A)	C	23,333	13,333	1,667
Value of land on which GST is paid (B - C)	D	26,667	14,167	(667)
Tax @ 18% on short deduction against land cost (D x 18%)	E	4,800	2,550	-
Excess tax on sale price (E / A)	F	6.86%	6.38%	

- c. To have a single presumptive deduction rate towards cost of land across the country is not the appropriate basis in as much as the ratio of land cost to construction cost can never be fixed in all cases regardless of the

location of the land. For example, in a metro city like Delhi or Mumbai, the cost of land (on a per square feet basis) is much more than the cost of construction (on a per square feet basis) and in fact in some cases the land cost is more than 10 times that of the construction cost. Such standardized ratio being applied across the board for the deduction in land cost does not provide the true deduction towards land value.

- d. Further, the transaction cost for acquiring a house under construction for the citizen has risen substantially and become unaffordable as illustrated below:

	Pre-GST	Post-GST (with land cost deduction)	Post-GST (without land cost deduction)
Stamp Duty	5.00%	6.00%	6.00%
VAT	1.00%	-	-
Service Tax	4.50%	-	-
GST	-	12.00%	18.00%
Total Tax Cost	10.50%	18.00%	24.00%

- e. Incidental cost of Stamp Duty and GST being 18% / 24% of value of a flat is a huge burden for a citizen buying a house in metro cities especially when they put their life time savings in buying a house, in addition to taking a new home loan. This will consequently result into slowing down the demand in already sluggish real estate market in most of the big cities.
- f. What is important to understand from input tax credit perspective is that not all the costs that are incurred by the Developer suffer GST. For e.g. land cost, approval cost, finance cost and employees cost does not attract GST. Therefore, contrary to the fliers/advertisements regarding the impact of GST on real estate, especially in metro cities like Mumbai, the proportionate increase in the eligible input tax credit under GST is not commensurate with the rate increase on sale of unit by the Developer. The impact of additional input tax credit available on materials and contracts in GST regime is very nominal as compared to hike in effective tax rate particularly in cases where the actual land cost is in multiples of the construction cost. The cost of construction (material and services) is usually in the range of Rs.4,500/- per square feet. Average input tax on such construction cost comes in the range of Rs.900/- per square feet. Assuming that the selling rate of flat is Rs.40,000/- per square feet, additional output tax is 6.50% (effective rate of 12% GST minus the Service tax and VAT of 4.5% and 1% respectively) of Rs.40,000/- i.e. Rs.2,600/-. The net tax incidence on customer would be Rs. 1,700/- per square feet even when developer passes on input tax credit of Rs.900/- to the customer. The additional tax incidence is 4.25% of flat value which is exorbitant from any standard.

- g. This incidence (with minimal set off against the input depending on the location of the property) would ultimately be passed on the actual consumers and is thus bound to increase the cost of housing; and the same will not be socio-economically desirable.

Representation and suggestion:

- i. We suggest that the applicable tax rate of GST be reduced generally to 12%, whilst allowing deduction of input tax credit and continuing the 1/3rd deduction towards land.
 - ii. In the alternative to the aforesaid suggestion, higher land deduction of approx. 60% should be allowed in metro cities which is likely to represent closer to the true value of the land and hence may possibly not result in levy of GST on the land, hence fulfilling the intention of the Constitution.
2. Tax implications on purchase of development rights, transferrable development rights (TDR), floor space index (FSI) and tenancy rights:

<u>GST Regime</u>	<u>Service tax Regime</u>
<p>Section 9 of Central Goods and Services tax Act, 2017 (CGST Act) stipulates GST levy on supply of Goods and/or Services.</p> <p>Section 2(52) of CGST Act defines 'goods' to mean every kind of movable property other than money and securities. Thus, immovable property is not 'goods' and cannot under circumstances be qualified as such.</p> <p>'Service' is defined u/s 2(102) of CGST Act to mean 'anything other than goods, money and securities'.</p> <p>Immovable property, not being goods, will be a 'service' as defined u/s 2(102) of CGST Act, unless excluded.</p> <p>Clause 5 of Schedule III to CGST Act excludes only the following from scope of supply:</p> <ul style="list-style-type: none"> • Sale of land • Sale of building (other than under construction sale of flats/unit) 	<p>The definition of 'Service' as per Section 65B(44) of the Finance Act, 1994 excludes from its scope an activity that merely constitutes '<i>a transfer of title in goods or immovable property, by way of sale, gift or in any other manner</i>'.</p>

Concerns and issues:

The development rights in case of joint development agreements, slum rehabilitation scheme or redevelopment projects with societies, TDR, FSI or even grant or transfer of tenancy rights or long-term leases are rights arising out of land / building, but it may not be regarded to be land / building per se. Under General Clauses Act, the term 'immovable property' is defined to include

any benefits arising out of land. Therefore, development rights, FSI, TDR, etc. are 'immovable property' under general law. Various courts in a plethora of judgments have held that the development rights and TDR are "*immovable property*".^{1&2}

An apprehension, therefore, is that acquisition of development rights, TDR, FSI, tenancy rights, etc. is liable to GST and it will be taxed at 18%. The Government has clarified the time of supply for a transaction involving consideration against TDR in the form of construction service [Area Share Arrangement] till the date conveyance deed or any other similar instrument is being entered [vide Notification No 01/2018 Central Tax (Rate) dated 25.01.2018]. However, the said notification is silent on the applicability of GST on TDR per se.

Levy of CGST on such rights under GST tantamount to effectively taxing immovable property which is not in consonance with GST legislation and also the constitution.

We are sure that it cannot be the intention of the Government to levy GST on such transactions, which in essence are nothing but 'transfers' of immovable property. However, due to the language used in the existing legislation, the position today is quite obfuscating, and it is of extreme importance that this position be clarified. The language presently used, could have an interpretation or it could be implied therefrom that GST could be levied on such transactions, which are actually in the nature of a simpliciter sale or other mode of transfer of immovable properties which do not technically qualify as a "sale of land" or "sale of building" but in essence are transactions of transfer of immovable property without there being any value addition to such immovable property or actual provision of any service.

It may also be mentioned at this juncture that the levy of such a tax on transactions of sale/transfer of immovable property falls within the purview of a State Government and not the Central Government under the Constitution of India and such a levy may thus be amenable to challenge on such ground.

Further, State Government already levies stamp duty on transfer of such rights and hence levy of SGST on the same will lead to double taxation.

Representation and suggestion:

- i. **The scope of 'supply' should be amended to exclude all types of transfers in respect of all rights arising out of immovable property such as development right, TDR, FSI, tenancy rights, etc.**

¹ Chheda Housing Development Corporation vs. Bibijan Shaikh Farid [2007 (3) MhLJ 402]

² Sadoday Builders Private Limited vs. Joint Charity Commissioner [WP No 4543/2010, delivered on 23 June 2011]

3. Credit in respect of Slum Rehabilitation Scheme (SRS) under the SRA Authority (SRA) / rehabilitation buildings for existing members in a scheme of redevelopment of Society (Rehab Scheme)

Concerns and issues:

The model prescribed by the SRA Authority or generally followed in a Rehab Scheme is that in lieu of TDR, the Developer is required to undertake various activities which *inter-alia* includes construction of rehab building so as to be able to construct the sale building which is ultimately the only revenue source for the Developer.

The modus operandi adopted in SRS is as follows -

- a) The Project (to be undertaken by the developer with consent of co-operative society of slum dwellers) is submitted by the developer to the SRA;
- b) The proposal is scrutinized by SRA and accepted, if found in order;
- c) The developer provides alternative accommodation to slum dwellers as per guidelines of the SRA
- d) The construction of rehabilitation building is commenced post receipt of Letter of Intent ('LOI') from the SRA;
- e) Post construction, the SRA issues identity cards to slum dwellers eligible for allotment of unit;
- f) The units constructed by the developer are allotted to slum dwellers by the SRA;
- g) The SRA permits construction on 'Sale Component' as per provisions of the Scheme.

Similarly, a Developer undertakes redevelopment of the property owned by Society under Rehab Scheme by demolition of the existing building and construction of a new building in place thereof for which the Society / members of the Society grant the development rights in favor of the Developer which is ultimately used for the construction of the sale building.

It can be observed from the above that practically, a Developer undertaking an SRA Project / Rehab Scheme has only one revenue source which arises from the sale of units in the sale building and all other expenses are the cost incurred by the Developer to earn the said revenue. This is further substantiated from the fact that even the books of account maintained by the Developer record the cost of construction of rehab building as expense in the P&L. Therefore, it is evident that undertaking the construction of a rehab building under both SRS and Rehab Scheme is with the sole intention to construct the sale building. One may also squarely correlate the said activity with the transaction of purchase of FSI / TDR from market with the difference that in case of purchase from market the developer would be required to pay consideration in monetary terms whereas in the instant case, the consideration is non-monetary in the form of rehab building.

Consequently, the construction of a rehab building for SRA and Society, is nothing but an input service without which Developer will not be able to construct the sale building. It is also important to note that GST, if needed to be paid on such construction service is not reimbursed by the SRA or Society and

paid by the Developer from its own pocket. This would result in double taxation and hence cost in the transaction.

Representations and suggestions:

- i. Tax cost borne by the Developer on the construction service provided to SRA / Society under the SRS and Rehab Scheme respectively, should be allowed as credit as the said cost is incurred by the Developer for the purpose of earning the revenue from the sale building.

4. High GST on commercial, Office / IT Premises on rental basis @ 18%:

Relevant provision:

Section 17(5)(c) of CGST Act provides that input tax credit shall not be available in respect of works contract services when supplied for construction of an immovable property except where it is an input service for further supply of works contract service.

Section 17(5)(d) provides that input tax credit shall not be available in respect of the goods or services received by a taxable person for construction of an immovable property on his own account.

Concerns and Issues:

Applying the aforementioned provisions, it can be construed that a Developer engaged in the construction of immovable property for onward sale shall be eligible to avail ITC of the works contract services procured by it. However, in the case of the Developer who is engaged in the construction of immovable property for onward renting, the ITC of the similar services will not be available. At this juncture we would also like to draw the attention of Your good self that even though there is credit restriction to Developers opting for the lease model, the applicable rate of GST for commercial renting services is still 18%.

It is pertinent to note that both lease and sale models involve construction of premises by procuring similar goods and services, with the only difference being in the manner of revenue generation using such constructed property. This is also evident from the following table:

Particulars	Sale Model	Lease Model
Procurements	Construction related goods / services including works contract services	Construction related goods / services including works contract services
Activity performed	Construction of immovable property for onward sale	Construction of immovable property for onward renting
Mode of revenue generation	One-time sale proceeds	Periodic lease rentals

Particulars	Sale Model	Lease Model
Applicability of GST on revenue	Yes (to the extent sale is before completion of construction)	Yes
Eligibility of construction related credits	Yes	No

Thus, the GST law differentiates between the Developer adopting a sale model and the Developer which adopts a lease model although the only difference between the two models is in respect of the timing of generation of revenue chargeable to GST. Hence, denial of credit on account of difference in the revenue models is unjustified and detrimental to the Developers adopting the lease model. Therefore, there is a dire need that the differential treatment of lease model is rectified and brought at par with sale model.

It may also be important to note that the current position in law leads to double taxation considering that the Developer is liable to pay GST @ 18% on the renting services and at the same time is not allowed to avail the credit of the goods and services used for constructing the commercial building. This is against the basic canons of GST regime to have seamless flow of credit of taxes paid at the input stage across the supply chain, so as to avoid cascading effect of taxes

Representation and Suggestions:

- i. Reduce the GST rate on renting of commercial building to 5% in case the credit restrictions continue to apply to the Developer who opts for the lease model. Alternatively, the Developer should be permitted to avail credit of goods and services (including works contract services used for the construction of the building to be leased out. The Council, if desires, may permit such credit in installments spread over a reasonable period of time say 10 years (similar to credit entitlement on Capital Goods under Rule 43 (1) (c)) on the rationale that the revenue model for leasing also results into accrued income over a period of time.

CREDAI-MCHI's Collective Prayer

- i. We suggest that the applicable tax rate of GST be reduced generally to 12%, whilst allowing deduction of input tax credit and continuing the 1/3rd deduction towards land.
 - a. In the alternative to the aforesaid suggestion, higher land deduction of approx. 60% should be allowed in metro cities which is likely to represent closer to the true value of the land and hence may possibly not result in levy of GST on the land, hence fulfilling the intention of the Constitution.
- ii. The scope of 'supply' should be amended to exclude all types of transfers in respect of all rights arising out of immovable property such as development right, TDR, FSI, tenancy rights, etc.

- iii. Tax cost borne by the Developer on the construction service provided to SRA / Society under the SRS and Rehab Scheme respectively, should be allowed as credit as the said cost is incurred by the Developer for the purpose of earning the revenue from the sale building.
- iv. Reduce the GST rate on renting of commercial building to 5% in case the credit restrictions continue to apply to the Developer who opts for the lease model. Alternatively, the Developer should be permitted to avail credit of goods and services (including works contract services used for the construction of the building to be leased out. The Council, if desires, may permit such credit in installments spread over a reasonable period of time say 10 years (similar to credit entitlement on Capital Goods under Rule 43 (1) (c)) on the rationale that the revenue model for leasing also results into accrued income over a period of time.

The real estate industry has been severely affected on account of such increase in rate of tax under GST. It is accordingly submitted that the above points may be considered and implemented so as to provide the much-needed impetus to the industry.

Should your good self require any further information / clarification on the issues set out in the Representation, we shall be glad to provide the same. We shall be happy to explain the same in person if desired.

Thanking you,


Yours sincerely,
For CREDAI-MCHI



Nayan A. Shah
President



Bandish Ajmera
Hon. Secretary



Sanjiv S. Chaudhary MRICS
CREDAI-MCHI Secretariat

CC:

1. **Shri Sushil Kumar Modi**, Dy. Chief Minister, Govt. of Bihar & Chairman for All State Finance Minister, GST Council Secretariat
2. **Shri A. B. P. Pandey (I.A.S.)**, Secretary, Department of Revenue, Govt. of India
3. **Shri S. Ramesh**, Chairman, Central Board of Indirect Taxes & Customs, New Delhi
4. **Shri Yogendra Garg**, Additional Director General GST at Ministry of Finance/CBEC
5. **Shri Rajiv Jalota (I.A.S.)**, Commissioner State Tax (GST), Maharashtra, Mumbai