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Vijay Lakhani

Ref. No. MCHI/PRES/19-20/644

August 26, 2020

To,
Shri Ajit Pawar
Hon'ble Deputy Chief Minister &
Minister of Finance
Government of Maharashtra
Mantralaya, Mumbai - 32

Sub: Grant of immediate relief relating to GST effect on Redevelopment Projects.

Respected Sir,

Plea for the relief measures:

The Real Estate Sector is a significant contributor to GDP, is the 2nd largest creator of jobs after Agriculture and directly supports nearly 250 industries. The Sector was already struggling hard to grasp and adapt itself to the fundamental changes and reforms brought in by demonetization, RERA, GST, IBC and the ban on Subvention scheme. The Sector was also facing the subdued demand due to slowdown in the economy, unaffordable prices and the liquidity constraints. COVID 19 pandemic and the consequential all-round disruption of business activities has thus dealt almost a mortal blow to the Sector!

It is, therefore, imperative that the Sector is provided all the necessary supports by the Government which would enable it to tide over these critical times and revive itself as soon as possible. Considering the fact that the Sector is one of the chief contributors to the GDP, the early revival of the Sector would also significantly accelerate the revival of the economy once the normalcy returns.

Since, "Goods and Service Tax" (GST) policy has a significant impact on the overall performance of the Sector, the relief measures suggested herein are being restricted to only GST Policy.

A. Restructuring of tariff structure and the extension of Input Tax Credit (ITC):

Existing structure:

After complete revamping of the tariff structure effective from April 1, 2019, the GST rates for the main asset class prevalent as on date are summarized as under:

- | | | |
|------|------------------------------------------------------------|--------------------|
| i. | Affordable Residential Apartments | - 1% (without ITC) |
| ii. | Other Residential Apartments | - 5% (without ITC) |
| iii. | Commercial Apartments in Residential Estate Project (RREP) | - 5% (without ITC) |
| iv. | Commercial Apartments (Other than in RREP) | - 12% (with ITC) |

It is thus evident that post-April, 2019, multiple rates of GST are in vogue for the Sector with artificial creation of the asset classes. More importantly, the benefit of ITC has been withdrawn for all types of Residential projects and also for the commercial units which are part of RREP. The **withdrawal of ITC has not only created the distortions in the ITC chain** but has also severally affected the liquidity of the sector. The situation is only going to worsen in the coming days.

Justification for the Re-structuring tariff and extension of benefit of ITC:

It is, thus, essential that the existing tariff structure for the Sector be revisited on priority basis and is harmonized as well as simplified. As the 'commercial space' segment is equally bearing the brunt of the impact of COVID-19, there is a need for extending the benefit of the concessional rate to this segment as well. Last, but not the least, the benefit to ITC is also required to be restored for the Sector as a whole (including redevelopment projects) so as to ensure an uninterrupted, seamless ITC chain. This would not only be in consonance with the basic philosophy underlying GST Policy but would also ease the liquidity problem of the Sector by mitigating the cascading effect of tax.

So far as the "affordable housing" is concerned, if it is felt that the existing rate of GST of 1% (without ITC) cannot be tampered with, it is strongly suggested that a marginally higher GST rate with ITC be prescribed as an option and it may be left to the discretion of the developers engaged in such projects to avail either of the options.

Our suggestions:

We accordingly seek the revision of tariff structure in the following manner:

- | | | | |
|------|-------------------------------------------|---|------------------|
| i. | Affordable Residential Apartments | - | 1% (without ITC) |
| | Or | | |
| i. | Affordable Residential Apartments | - | 3% (with ITC) |
| ii. | Other Residential Apartments | - | 5% (with ITC) |
| iii. | Commercial Units (offices, godowns, etc.) | - | 5% (with ITC) |

B. Waiver of GST on the rehabilitation component (Free of cost allotment) in redevelopment projects

Free of cost allotment to the existing members of the society in case of the redevelopment of Housing societies, tenanted building and/or slums and the desirability of the grant of exemption from payment of GST Thereon;

In Respect of Slum Rehabilitation Scheme and Redevelopment Projects:

The redevelopment projects consist of Society redevelopment, Old & dilapidated building redevelopment, Dharavi redevelopment, Redevelopment of MHADA colonies, BDD Chawl redevelopment as well as Slum Rehabilitation Schemes. These are important socio-economic schemes that meet the aspirations of the poor and the lower middle class segment of our Society. These schemes also achieve the Government's avowed objective to provide 'Housing For All' by the year 2022, and thus deserve a special tax treatment under GST legislation.

To meet the aforesaid objective:

- An exemption should be granted for construction/ works contract services provided in respect of rehabilitation area to be given free of cost by the developers; and
- The Developers should be allowed to utilize ITC in respect of such rehabilitation area for discharge of GST payable on saleable area.

C. Change in Affordable Housing definition

A dual threshold of sale value of INR 45 lakhs and carpet area of upto 90 sqm (in non-metropolitan cities/towns) or 60 sqm (in metropolitan cities) has been prescribed for the lower GST rate of 1% to apply on affordable housing units.

It may be noted that region like Mumbai MMR, Delhi NCR etc. the value of INR 45 lakhs is very less and hence it is difficult to find units which qualify as affordable units in such cities.

Following definition of "Affordable Housing Unit" may be adopted in all GST schemes:

"Affordable housing unit means a unit with carpet area as defined under RERA that do not exceed 60 sqm in the metros and 90 sqm elsewhere."

D. Retention of ITC benefit in case of sale of constructed units' post - completion certificate:**Existing legal position:**

At present, builder/ developer is required to reverse proportionate ITC in respect of the constructed units which are sold after the issue of the completion certificate or after its first occupation, whichever is earlier. This stipulation, no doubt, presently applies in case of the residential projects which have been undertaken prior to April, 2019 where the builder/ developer has availed the benefit of ITC and in respect of pure commercial projects where also such benefit has been availed.

Justification for the removal of the stipulation:

The subject stipulation is rather unjustified as the benefit of ITC is always taken into consideration by the builder/ developer while fixing the sale price of a unit. As the burden of subsequent recovery/ reversal of proportionate ITC will have to be borne by the developers, this would be a double whammy for the developers. Moreover, the issue of the obligation for the reversal of proportionate ITC and/or the computation of such proportionate ITC in respect of the constructed units sold after issue of the completion certificate or after its first occupation, whichever is earlier, is also highly dispute prone and complex.

Our Suggestions:

We suggest that the existing stipulation relating to the reversal of the proportionate ITC in respect of the constructed units sold after issue of the completion certificate or after its first occupation, whichever is earlier be removed or suspended for at least 2 (two) years. The same relaxation would also be necessary in the event of the extension of the grant of the benefit of ITC to the Sector as a whole as suggested by us in this representation. This relief shall be made available across the Sector, irrespective of the asset class. For this purpose, an exclusion may be provided in the provisions of Section 17(3) of the CGST Act, 2017 read with Rules 42 and 43 of the CGST Rules, 2017.

E. Levy of GST proportionate to the development rights in case of the constructed units sold after issue of the completion certificate:**Existing legal position:**

At present, the grant of development rights by the owner (generally, a land owner or the owner/hold of TDR/FSI) is exempted from the payment of GST. However, this is subject to the condition that the GST shall be levied on such development rights proportionate to the constructed units which are sold after issue of the completion certificate or first occupation, whichever is earlier by the developer on reverse charge basis. The valuation of such development rights is based on the nearest equivalent sale price of the constructed units at the relevant time in the project concerned.

Justification for the removal of the stipulation:

The issue of levy of GST on the development rights itself is litigation prone. Needless to say, the issue of levy of GST on the development rights proportionate to the constructed units sold after issue of the completion certificate or after first occupation whichever is earlier is bound to be litigious.

The present stipulation would also expose the developers to an unpredictable financial burden in future. The developers will not be in position to pass on the burden of the levy of GST on the proportionate development rights to the customers buying the constructed units after issue of the completion certificate or after first occupation, whichever is earlier. Since any such levy of GST on a future date cannot be possible envisaged or figured into by the developers earlier, the entire burden will have to be shouldered by the developer. Moreover, there is an uncertainty and vagueness about the whole proposition.

Not only this, the adoption of the equivalent sale price of a constructed unit as a basis for the purpose of valuation of such proportionate development rights being subject to levy of GST besides being unreasonable, is also dispute prone. If the policy of levy of GST on the proportionate development rights in the given circumstances is intended to be continued then the valuation mechanism thereof has to be simple, reasonable and realistic.

Last but not the least, since the entire burden of such levy falls on the developers only and cannot be passed on to the customers, it is absolutely necessary that a reasonable rate of GST is prescribed.

Our Suggestions:

The existing provision relating to the levy of GST on the development rights proportionate to the constructed units sold after the issue of completion certificate or after its first occupation, whichever is earlier, payable by developer on reverse charge basis be omitted or suspended

Since the Development rights are similar to land rights which are not taxable under GST, and there is no ITC given in current regime for the construction of entire project, there should not be further incidence of any additional GST on Development rights basis or on unsold area at the time of occupation certificate.

F. Reconsideration of the levy of GST on the entire amount charged by the Contractors etc. providing the contract labour;

Existing legal position:

At present, GST is being levied on the entire amount charged by a Contractor or Manpower supply agency or a Security Service agency in respect of the Contract labour or any other manpower or security personnel provided/supplied by them. Such amount includes the wages/salary as well as other statutorily mandated benefits like PF, ESIS, etc. payable to such contract labour etc.

Justification for the levy of GST only on service charge/commission charged by the contractor etc.:

It is a well-known fact that the Sector employs huge number of contract labour as well as security personnel which are supplied by the independent contractors/agencies. The levy of GST on the entire amount charged by the contractor in respect of the Contract Labour etc. supplied by him is rather unjustified and extremely burdensome for the developers since such amount includes the wages/salary and other statutorily mandated benefits like PF, ESIS etc. payable to such contract labour etc. It shall noted here that the supply of services by an employee to the employer is outside the purview of levy of GST in terms of Schedule III to the CGST Act, 2017. There is no reason or justification for levying GST on the salary/wages component of the amount charged by the contractor merely because the contract labour are not directly engaged by the recipient tax payer though effectively, the relationship between him and such contract labour is virtually that of employment.

The existing provision also puts tremendous financial strain on the developers in these different times when the developers are struggling to honor their moral-if not statutory-obligation towards their employees/labour force including Contract labour.

Under these circumstances, restricting the levy of GST only to the service charges/commission charged by the constructor/manpower supply agency/ security service agency is not only the dire need for the Sector but is also a rational step. This will also help the developers to retain the contract labour force as far as possible even in these critical times.

We therefore earnestly suggest that the levy of GST be restricted only to the service charges/commission charged by a contractor/manpower supply agency/security service agency by suitable providing exclusion of that part of the total amount charged by him which is attributable to the salary/wages etc. payable by him to the labour/security personnel supplied by him. The concession/exemption may be made subject to suitable conditions as may be deemed fit.

We further suggest that with a view to put the matter beyond any doubt, entry at Sr. No. 1 of Schedule III to the CGST Act, 2017 be suitably amended, if required by way of insertion of an Explanation, so as to include such contract labour/work force or other personnel supplied by the independent agencies within the scope of the term 'employee'.

G. GST on Development Agreements

GST under schedule III exempts only supply of 'land' and not 'benefits arising out of land'.

This results in a possibility that Development agreements which transfer benefits in land may attract GST.

The Government has provided some relief to the developers constructing residential units from the development rights received on or after 1st April 2019. As per revised GST scheme for real estate sector which became effective from 1st April 2019, Developers have been given a partial exemption on such type of transactions.

The real estate sector works on multiple models and one such model is by way of transfer of development rights to the developer by the landlord/ society. The land-owner receives consideration in monetary or non-monetary form.

This transaction can be termed as an indirect sale of land. In these transactions the stamp duty is payable rendering it equivalent to the sale of land. Similarly, Income tax act also recognizes these transactions as sale of land and accordingly charges capital gain tax.

In case of agreement to sell land, land is transferred to transferee being the developer, whereas in case of Development Agreement, the land is transferred along with constructed building to the unit buyer. Thus, underlying intention of both agreements is to transfer land.

By taxing these transactions under the GST Act as "Service rendered", in effect land component is being subjected to GST which is against the basic principle of GST Act that GST cannot be charged on land component.

Further, such taxation leads to cash flow mismatches and imposes burden on the working capital on an existing cash starved cash flows, even if tax credit is available. Lastly, in a typical built up area sharing agreement, the allotment is made on the date of completion which renders GST paid by the landowner as ineligible for ITC since there is no output liability to be adjusted against the same. This leads to escalation in costs adversely impacting affordability.

Giving the requested benefit will help lot of developers in all parts of India to sell constructed inventory at a reasonable sale price and release themselves from the burden of interest.

Providing a one-time relief to past cases aligned with an already implemented scheme for new projects effective 1st April 2019, also reduces chances of litigation.

For Cases from 1st April 2019:

The conditional exemption granted to residential units post 1st April 2019 results into GST being loaded on completed units (indirectly). In other words, for a project under development rights arrangement all the units whether being sold before completion or post completion are being loaded with GST cost. Hence the exemption on development rights transferred for residential projects should be unconditional which will give required relief to units sold post completion.

Suggestion

For Cases from 1st July 2017 to 31st March 2019:

A one-time exemption for all such cases upto 31st March 2019. This will help Developers to free up some portion of the real estate inventory which is blocked due to increase in cost on account of GST applicability on land component of the transaction.

For Cases from 1st April 2019:

An unconditional exemption be granted on all development rights transferred based on the premise that it is nothing but an indirect sale of land.

H. Grant of benefit of ITC in case of the Construction of Commercial Property meant for lease:

At present, the benefit of ITC is being denied in case of the construction of the commercial units (offices, godowns, warehouses, etc.) meant for leasing in terms of Section 17(5) (d) of the CGST Act, 2017. This is despite the fact that GST @ 18% is being levied on the lease rentals charged for the leasing of such commercial property. This is highly unjustified and exposes this crucial and growing segment of the Sector to the ill-effects of 'cascade of tax' and consequential high lease rentals.

Moreover, the Lessees of such commercial property are already invoking the 'Force Majeure' clause in the wake of outbreak of COVID 19 pandemic so as to avoid or delay the payment of lease rentals. The high rate of GST of 18% coupled with the denial of ITC and the stoppage/delay in payment of lease rentals by the Lessees is a triple whammy for the developers of such commercial property.

The issue is also litigation-prone. The Hon'ble Orissa High Court, in the case of Safari Retreats (P) Ltd. vs. CCGST - (2019) 105 taxman.com 324 Orissa has held that if GST is payable on rental income arising out of investment made in construction of shopping mall, input tax credit of GST, which has been paid for construction, is eligible. Restriction under section 17(5)(d) on ITC, i.e. blocked credit is not applicable. In effect, it was held that the restriction is arbitrary and unreasonable and hence section 17(5) (d) of CGST Act has to be read down in line with section 16 of CGST Act.

Justification for the grant of ITC:

It is essential that the benefit of ITC is extended to the construction of commercial property meant for leasing. This will not only avoid the distortions in the ITC chain by mitigating cascade of tax but also provide much-required fillip to this beleaguered segment having otherwise a tremendous growth potential.

It is also imperative that considering the present difficult times, the rate of GST on lease rental of commercial property is brought down to a reasonable level so as to enable this segment to remain afloat.

We earnestly suggest that:

- **The benefit of ITC be extended in respect of the construction of the commercial property meant for leasing;**
- **The rate of GST on lease rentals for commercial property be reduced to 12%.**

CREDAI-MCHI Prayers

CREDAI-MCHI sincerely believes that the above immediate relief measures would enable the beleaguered and badly bruised Real Estate Sector to tide over the present crisis, remain afloat and ensure its sustenance, stability and ultimate revival. The suggested relief measures would also serve as a strong basis for the much-needed comprehensive overhauling GST structure for the Sector in future. CREDAI-MCHI strongly believed that in the long run, if not in near future, a comprehensive coverage of entire Sector including the transaction in 'land and buildings' within the scope of GST and consequential subsuming of all the State level and/or Municipal levies including stamp duty is inevitable which will only pave the way for the robust growth of this crucial Sector and also in achieving the dream of Hon'ble PM of 'Housing For All by 2025'.

CREDAI-MCHI sincerely hopes that the suggestions for the immediate relief measures outlined above will be considered positively and the suggested measures will be announced expeditiously. We shall be grateful if an opportunity is provided to discuss the suggested measures via Video Conferencing on a suitable date and time, as may be advised.

Thanking you,

Your sincerely,

For CREDAI-MCHI



Nayan A. Shah
President



Bandish Ajmera
Hon. Secretary