Impact of GST on Real-Estate Sector

One of the most complex areas of the tax levied by the Centre and the States is works contract and sale of property. Currently, such transactions are broken into three parts – the value of goods and materials, value of services and value of land. The States apply VAT to the goods portion and the Centre taxes the services portion, with no explicit tax on the transaction value of land. The State also collects stamp duty and registration charges for the registration of property. Each authority taxes on aspects and valuation independent of the others. More than 200% of the value is being taxed in some States which is no fair. Real estate transactions unfortunately are subject to manipulation and undervaluation in most parts of India.

This area has seen extensive litigation and many borderline, illogical reasoning has bene accepted by the tax authorities on the logic that some tax is being collected. Construction and Real Estate sector constitutes approximately 9% of the country's total GDP. Growth of this sector has a direct nexus with the nations growth.

GST could be a blessing in disguise for this sector which has been surviving the adversities of the current indirect tax complexities for a substantially long period of time the last big hit being demonetization. The immovable property part is expected to be excluded from the GST in terms of the decision of the Supreme Court in case of L&T (2014(303) ELT (003) in para 115. Herein the value of land and completed construction as on the date buyer comes to developer and gets into an agreement would be out of the purview of GST. Hopefully, the basis of deduction of the land value from the transaction liable to GST must be unambiguous and clear. Any ambiguity would only open the Pandora box of disputes.

In GST regime, there will not be any concept of manufacture, sale or service etc. There will be only one concept i.e. 'Supply'. All the supplies will be categorized as Supply of goods or Supply of Services or composite supplies (multiple supplies). Construction activities will be 'works contract' which is being categorized as 'Services'.

All builders and developers in India will be collecting and paying CGST and SGST (i.e. Central GST and State GST. The place of supply of the service is the location of the immovable property.

Recently, CBEC has issued a revised updated Model GST Law – Nov 2016 wherein the older version of the draft issued in June 2016 has been partially revised. This article discusses the nuances of revised GST from the point of view of the Real-Estate sector also bringing out the impact that will be caused in this sector. Presently builders/developers are paying following indirect taxes:

- Service tax (ST) on services either to provider or on reverse/ joint charge (sub contractors, manpower supply etc);
- Value added tax (VAT)/Central sales tax (CST) on steel, cement, RMC, electrical sanitary, lifts, DG sets etc;
- Excise duty on all items paid earlier to those on which VAT paid ;

However, in GST all the above taxes would no more be applicable and there will be only one tax i.e. GST.

However, Stamp duty would continue to be in force even after advent of GST.

Seamless flow of credits: In GST regime all the above duties/taxes (except stamp duty) will get subsumed, therefore a builders should be able to avail the input tax credit of all its procurement of goods/ services except for few restrictions placed in the Model law. Therefore, it would reduce the tax costs substantially in the construction industry. Under GST, it is expected that seamless credit of all taxes paid on procurement of goods/ services will be allowed so that net outflow of GST liability would be minimized.

Broadened Tax base: Many construction contracts which are exempted in the current regime (especially the government contracts) could be brought under the tax net in the GST regime. Therefore, if any long term contract is entered in the current tax regime now but if GST is implemented, then the same would be taxable under the strictures of the GST law therefore, It is important to factor the GST impact while arriving at the price of the contract and the burden of the taxes must be clearly reflected in the contract to avoid any complications at a later date.

Expected Rate of Tax: Recently, the GST council has agreed upon the 5 rate structure for levying tax on various goods and services i.e. 1%, 5%, 12%, 18% and 28%. It is expected that the rate of GST that may be applicable on this sector would be mostly 12%. There may not be any further abatement/ composition on this rate. Although this rate will be little on the higher side as compared to current tax rates which is between 6% to 10%. Although such high rate could have an adverse impact on this sector, however this impact could largely get reduced due to ease in credits availability.

GST on Joint Development Agreements: GST will also be levied on the Joint development agreements as Barter also amounts to 'Supply'. Comparative flat value may have to be taken for calculating GST on such transactions. There clear mechanism as to time of supply and valuation has not been explicitly provided. However, if it is not clarified then the current disputes surrounding this area would continue in the GST regime. The need for treating JDA differently from construction contracts may not be there.

Treatment of the Land Component: Since stamp duty is being paid, it is expected that the land component would be allowed as deduction in the valuation of real-estate transactions in the GST. However, the issues w.r.t the valuation of land to be adopted and claimed as deduction could continue to be a cause of dispute. Currently, even in the revised model law, no clarity has been brought in as to the valuation of the land. However, it is expected that the same must be clarified by way of issuing a notification during the GST regime. Unclear provisions in this context could lead to large scale disputes.

Requirement of completion certificate: Similar to provisions in service tax, GST is said to be levied if amount is received prior to completion certificate and there would be no GST if the entire amount is received after the completion certificate. Further, it is also stated that even if completion certificate is not received, GST may not be levied after the first occupancy of the premises. This would provide relief to builders who for various reasons were unable to obtain the completion certificate from the authorities and as a consequence were denied the exemption from service tax.

Treatment in case of SEZ/ EOU's: There is no clarity in the model GST law as to continuity of the exemptions in respect of EOU's. However, as far as units operating in the Special Economic Zone are concerned, it is explicitly stated that same will be on par with the exports and therefore such supplies will be treated as a 'Zero Rated Supplies' therefore no GST needs to be charged for supply of goods or services to the Special Economic Zones.

GST on Stock Transfers: Since, transfer of inputs/ capital equipments from one site to another is quite common in this sector. Therefore, builders operating from multiple locations in different states, then it would require to pay GST on stock/ Assets transfers from its premises in one state to its premises in another state. Further, in case builders are having multiple business verticals within the state and if a builder opts to take separate registration for each such business vertical, then GST needs to be paid for stock transfers even when made within the same state.

Multiple Registrations: Concept of centralized registration for all the projects will end and builders having a site in multiple States would require to obtain registration in each State from were the construction activity/ supplies are being undertaken even though the project is for a very small period or for a small value. Although, this scenario is in existent in the current law for the state taxes but the same will now be done even for the central taxes.

High Compliance burden: Compliance burden will be very high in the GST regime as one has to file 37 Returns in one financial year for each registration. Further, returns filed will be matched online with the support of the IT infrastructure with the returns of the vendors/ customers. In case taxes are not paid by the vendors or if the returns are not filed by the vendors, then the credit of such taxes is denied to the customers. Therefore, timely payment of taxes, filing of returns needs to be ensured in the GST regime.

Transitional Credits: To transfer the existing credits in the GST regime, condition has been kept that such credit must have been admissible in the GST regime. Therefore, builders should be able to transfer the following credits to the GST regime:

- Credit of Service Tax: The same must be properly reflected in the last service tax returns and documentation must be in place to establish the same. Further, service tax credit pertaining to inputs in stock can also be availed.
- Excise Duty/ CVD: Since, currently builders are not availing the credit of excise duty & CVD. Therefore, builders need to ascertain the value of stock as on the appointed day and based on the availability of the invoice, credit can be availed.
- VAT/ SAD: Similarly, if a builder is not availing the credit of VAT/SAD currently due to restriction in the state VAT law or due to being in the composition scheme, then the credit can be availed based on the ascertainment of stock as on appointed day.

However, if the credit of VAT is being currently availed then the same needs to be properly reflected in the last VAT return to transfer such credits to the GST regime.

Note: Section 169 relating to transitional credit on stocks also provides for deemed credit at rates to be prescribed in the absence of duty/ tax paying documents

- Credit of CST: The same cannot be availed based on the stock availability as on the appointed day.
- Entry Tax: Credit of same can be availed subject to possession of appropriate documents for the same in states where such set off is permissible.

Anti-Profiteering Measures: Since a builder will be able to take the credit of goods lying in stock, the tax cost would decrease. This additional benefit accruing to the builders is expected to be passed on to the end consumer by way of reduction in prices etc. A separate authority will be formed in the GST regime to monitor the non-compliance of the anti-profiteering matters which could have an adverse impact on the entire construction industry whose pricing is more market dependent than other factors. Therefore, it is imperative for the builders to establish passing of the GST benefit to its consumers. In these times of falling prices this may not be challenge though.

Time of Supply in GST: Currently, many builders pay taxes on receipt basis (without complying with the point of taxation) in case of service tax i.e. tax is paid only once the monies are received from the customers. However, in the GST regime, tax needs to be paid immediately on earliest of completion of service, raising of invoice or receipt of monies from customers. This could have an impact and could cause blockage of working capital.

Classification issues: It seems that certain disputes in classification may arise in the GST regime if a separate rate of tax is maintained for the construction and other additional services provided by the builders such as floor rise premium, car parking etc. Based on the terms of the contract and the nature of the supply, it needs to be determined whether it is a ‘composite supply’ or a ‘mixed supply’ and accordingly rate of tax for the additional services needs to be determined. Therefore, if the construction agreements is not in line with the naturally bundled understanding then any differential rate if applicable could be a cause of concern.

Valuation complexities: Valuation of the services would be at the transaction value. However, valuation with the related parties/ between the group companies needs to be properly dealt with and must be kept at the arms length price to avoid unnecessary departmental intrusion.

Good IT Infrastructure: In GST regime, businesses have to move from the manual environment to computerized environment. Only an efficient IT infrastructure and its best usage can help businesses meet the high compliance needs of the GST. If IT infrastructure is not optimally utilized, then it would be challenging for any business including real-estate sector to function efficiently in the GST regime. Further, in the computerized environment, physical interaction with the department officials would reduce substantially. ERP must be customized to make it capable to meet needs of the business as well as comply with GST.

Conclusion:

The implementation of GST is possible from April 2017 or little later. Migrating to the new tax regime could have substantial impact on the business houses. There would be a positive impact for those who are vigilant. The negative impact of the GST can largely be averted if counter measures/ preparedness is in place. Businesses need to re-look and action must be taken on the following areas to reduce the adverse impact of GST:

- Contracts/ Agreements re-alignment to suit the needs of GST of breaking up into the immovable part which is complete and construction to be completed;
- Business re-structuring/ Transaction re-structuring;
- Understanding the impact on various business departments including procurement, sales & Marketing, finance & Accounts, IT, Admin & HR etc. and re-structuring the same to suit the needs of the GST;
- Optimizing the transitional credits, future credits.
- Ensure original entries are verified, keep evidences of tax payments etc;
- Representing through various bodies/ associations on various adverse provisions of the GST law;
- Conducting in-house training programs for learning & development of staff to ensure smooth implementation into the new regime.

- ***CA Madhukar N Hiregange***
- ***CA Ravi Kumar Somani***

(Article written on 3rd December 2016. For any feedback or queries please write to madhukar@hiregange.com or ravikumar@hiregange.com)