NAREDCO

Pre-budget Memorandum 2019-20

1. Rationalisation of GST on real estate.

The basic intent of GST was to be tax neutral and create One Nation One Tax. Before GST was implemented, under construction properties were taxed at 4.5% Service Tax and 1-1.5% VAT, total 5.5-6%. After GST implementation, GST on under construction properties has been fixed at 18%, with one third abatement for land, which works out 12% on the sale value.

Abatement for land in Service Tax regime, before GST, was 70-75 percent of the property value, including land cost, and service tax was imposed only on 30-35 percent of the property value. As land cost varies from cities to cities and in some cities it goes up to 80 percent of the total property value, it is unfair to restrict land abatement to 33%. It should either be the actual market value of land or at least 50% of the total property cost.

Keeping extra burden on poor in view, GST on low cost houses upto 60 sqmtr carpet area, in an affordable housing project, which has been given infrastructure status, vide Ministry of Finance, Department of Economic Affairs, notification no. 13/06/2009-INF, dated 30th March 2017, has already been brought down to 12% with one third abatement for land, which works out to 8% net.

As the tax burden is ultimately passed on to the end consumers, they are feeling the real pinch of GST and are avoiding investment in under construction properties, to save 12% GST, as there is no GST on completed housing properties.

Suggestion

To make affordable housing available to all class of people, it is suggested that the GST on under construction housing properties be brought down to 12% slab and land abatement increased to 50%. This will bring down the effective GST rate to 6%, which, after ITC will become tax neutral for the end consumers.

2. Treatment of Joint Development Agreements (JDA) under GST

JDAs are widely prevalent in the real estate sector due to scarcity of land and their prohibitive cost. Under the JDA, the land owner receives compensation for land in the form of built up property, which saves capital cost for developer and makes property more affordable to buyer. There is no transfer of land from land owner to developer at any stage and services performed by developer occurs only at the time when completed flats are transferred to the ultimate purchaser. In other words, prior to the transfer of property to the buyer, developer is not performing any service for the buyer from whom he is supposed to recover GST.

However, Section 13 of GST Act, defines time of supply of service to state among other things the date of issue of invoice or the date of receipt of payment, whichever is earlier. The result is that developer becomes liable to pay GST for the total receipts of the project regardless of whether the built-up area falls in his share or the share of the landowner. Developer cannot recover GST from the landowner for his share because landowner is not in a position to pay, as no service has been performed for him. As a result, GST liability continues to fall on the developer for his as well as the landowner's share of property. Even in service tax regime, the service tax liability in JDA remained a vexed issue.

Suggestion

It is suggested that a notification may be issued under section 13(5) to defer the time of supply of service in Joint Development Agreements to three years from the date of receipt of payment or the transfer of the units to the buyers, whichever is later. This will provide relief, reduce litigation and, above all, enhance affordability of built up units.

3. Tax Implications on purchase of development rights, transferrable development rights (TDR), floor space index (FSI) and tenancy rights

The development rights in case of joint development agreements 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 which may not be regarded 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 plethora of judgments have held that the development rights and TDR are "immovable property". An apprehension, therefore, is that acquisition of development rights, TDR, FSI, tenancy rights, long term lease, etc. is liable to attract GST at 18%. The Government has clarified the time of supply for a transaction involving consideration against development rights in the form of construction service {Area Share Arrangement} till the date conveyance deed or any other similar instrument is 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 development rights per se. Levy of GST on such rights (development rights, TDR, FSI, tenancy right, long term lease, etc) tantamount to effectively taxing immovable property which is not in consonance with GST legislation.

Suggestion

It cannot be the intention of the Government to levy GST on development rights, TDR, FSI, Tenancy right, long term leases etc, which in essence are nothing but 'transfers' of immovable property. Therefore, the scope of supply should be amended to exclude all types of transfers in respect of rights arising out of immovable property such as development right, TDR, FSI, tenancy right, long term lease etc.

4. Input Credit of Construction against output of Renting

Under commercial construction, property (building) is constructed by the developer/ builder as business asset. The building or units in the building are then given on rent to lessee or tenants who could be service providers, retailers, hoteliers, theatres or hospitals, to name a few, all of which are businesses which generate employment and contribute to the growth of economy and GDP.

Under GST, goods and services acquired by the developer for property construction will be subject to GST. Under the GST Law, any lease or letting out of immovable property will be deemed to be service. Section 15(1) of the GST Act provides that the value of a supply of goods and/or services shall be the transaction value i.e. the price actually paid or payable for the supply of goods and/or services. GST, thus, will be applicable on the rentals collected from tenants at the rate of 18%. However, under Section 17(5)(d), Input Credit for construction of an immovable property is not allowed. It is pertinent to note that without the construction of immovable property there can be no renting of it. As far as the point that there is no GST in respect of a completed building is concerned, renting of commercial immovable property is made liable to GST and such renting is possible only of a completed commercial immovable property. In other words, on one hand, GST is sought to be levied on a completed commercial immovable property renting but Input Credit on such construction is disallowed possibly on the presumption that after completion of construction there is no GST applicable.

Suggested Amendment

Since renting is sought to be made liable to GST, all Input Credit should be permissible without it being disallowed. In any case, due to anti-profiteering provisions, there cannot be a case of unjust enrichment. The fundamental objective of bringing in a reform like GST is to eliminate the current anomalies in taxation that lead to cascading of taxes and distortions in the system. The enhanced cost burden due to restriction on input tax credit will have a ripple effect on the total cost of construction of the property and will escalate the project costs. Moreover, high rate of GST on inputs/input services will have an adverse impact on the working capital of the company especially at the time when the industry is struggling and has been witnessing a deceleration in growth.

One of the primary objectives behind the introduction of GST is to enable seamless flow of input tax credit across the value chain. The property, as stated above, is constructed for the business purposes and given on lease also for business purposes. Thus, these transactions are B2B transactions where there must be seamless flow of credit across supply chain. The additional costs on account of blocked credit will be crippling for the industry.

5. Bring Stamp Duty within the purview of GST

Since GST in-compasses all taxes, Central and State, keeping Stamp Duty out of its purview increases total tax burden on consumers.

Suggestion

It is suggested that Stamp Duty be brought under the purview of GST.

6. Section 23 (5) - notional income for house property held as stock-in-trade.

Section 23 (5) provides that in respect of unsold property, held as stock-in-trade and not let out, the annual value of the property for the period upto one year from the end of the financial year in which completion certificate is received from competent authority, will be taken as Nil. Thereafter, it will be assessable as income from have property on the basis of its notional rent. This is an extremely "subjective" criteria, which will obviously be open for misuse.

This provision is very harsh and is creating genuine hardship to real estate developers, who are already under pressure in the ongoing sluggish market. Real estate industry is already struggling with large unsold inventories. Taxing notional rent, after one year from the end of the financial year in which completion certificate is received from competent authority, will lead to severe financial implications for the developer/industry.

It may also lead to no new projects being launched, if sales remain low, which in turn will defeat the mission of the Government to provide "Housing for All" by 2022.

The industry is clearly nervous. This is more so, because the sector is not going through the best of times. Buyer interest has been erratic at best. Sales have plummeted to historic lows. Without any fresh stimulus, the housing sector has had to deal with a series of disruptions.

Suggestion:

Entities engaged in real estate business should be exempted from the burden of tax on notional rental income because they are in any case subjected to levies at the time of Sale.

(OR)

the period of 1 year should be extended to 5 years before such a provision begins to operate.

7. Section 80-IBA (Deductions in respect of profits and gains from housing projects)

New section 80-IBA, inserted by Finance Act 2016, wef 01.04.2017, specifies that the profits and gains derived from the business of developing and building housing projects comprising housing units of 30 sqmtr carpet area in cities of Chennai, Delhi, Kolkata or Mumbai and 60 sqmtr carpet area at any other place, shall be allowed a deduction of an amount equal to hundred percent of the profits and gains derived from such business, subject to fulfilling certain other conditions of the section.

Other conditions interalia include “the project is approved after 01st June 2016 and not less than 90% of FAR in case of project located within cities of Chennai, Delhi, Kolkata or Mumbai and not less than 80% of FAR in case of project located at any place other than the places mentioned above are used for constructing residential units not exceeding 30 sqmtr carpet area in cities of Chennai, Delhi, Kolkata or Mumbai and not exceeding 60 sqmtr carpet area at other places."

As the land cost has gone up at all places after the implementation of LARR Act 2013, higher FAR and density, to make best use of land and to keep property prices within affordable limit, have become a necessary in most urban settlements. Constructing 30 to 60 sqmtr residential units, using 80-90 percent FAR, over shoots density criteria in most tier I cities, as a result many projects fail to utilise the available FAR. Raising density to match FAR, leads to other problems such as inadequacy of infrastructure and congestion. The solution, therefore, lies in reducing the FAR prescribed in section 80IBA to 50% from 80 and 90 percent. It is pertinent to mention here that Ministry of Finance (Department of Revenue), vide their notification F. No. 13/6/2009-INF, dated 30 March 2017, have already defined affordable housing project as that project which uses 50% of FAR/FSI for dwelling units with carpet area not more than 60 sqmtr and the same has been given infrastructure status. This is more realistic and accordingly utilisation of FAR in affordable housing project, under section 80IBA, should also be amended to read 50% in place of 80% and 90% (both).

80IBA primarily covers affordable housing upto 30 sqmtr and 60 sqmtr carpet area for EWS and LIG respectively, under Pradhan Mantri Awas Yojana. Extension of the provisions of this section for housing units of 160 and 200 sq mtr carpet area for MIG I & MIG II, included in PMAY under interest subvention scheme, will provide great relief to MIG segment and incentive to developers.

Suggestions

80IBA should include projects approved after the 1st day of June 2015, as many projects were approved between June 2015 and June 2016, after the PMAY was launched in June 2015.

FAR utilisation of 90 percent and 80 percent should be lowered to 50 percent for both, in line with the Ministry of Finance (Department of Revenue) notification F.No.13/6/2009-INF, dated 30th March 2017, which is more realistic.

Applicability of 80IBA should be extended to affordable housing projects from 30 to 200 sqmtr carpet area to cover all classes of people (EWS, LIG, MIG-I & MIG-II) for their first house. This will indeed help in Housing for All Mission in a big way.

8. Section 54 (Capital Gain from sale of house property)

At present, capital gain arising from transfer of any capital asset, being buildings or lands appurtenant thereto, and being a residential house, is exempt from tax in cases where the sale proceeds are invested in acquiring/constructing of one residential house anywhere in India. Such a restriction is deterrent to the objective of boosting the housing stock, and hence needs to be repealed.

Suggestion

To overcome the huge housing shortage in the country, the restriction imposed on investment of sale proceed on acquiring one residential house should be removed and scope broadened to exempt capital gain tax if the sale proceed is invested in creating one or more housing stock.

9. Incentivise for Rental Housing to meet Housing for All commitment by 2022.

In view of the housing shortage in the country and the objective 'Housing for All by 2022' as also in view of the fact that all cannot afford ownership housing, we need to give a big boost to 'Rental Housing'.

Suggestion

The following incentives are suggested (for companies / partnership / HUF / Individuals):-

a) **Income from renting of housing properties be taxed at a flat rate of 10%.**

b) **Remove cap on adjustment of interest deduction on computation of house property loss to promote new housing stock.**

c) **Provision of rental housing on a large scale will require the services of Property Management Firms. In order to make property management a viable activity, income of firms which are wholly engaged in maintenance / repair and other specified management services for rental housing blocks may be brought within the ambit of Section 80 IBA.**

d) **High cost of houses and high property taxes lead to a low rate of return (ROR) from rental housing making renting out an un-remunerative proposition. To improve the effective ROR from renting, it is suggested that the deduction from rental income under Section 24(a) be increased from 30% to 50%. This will promote rental housing. For Handicapped, Women and Senior Citizen, the deduction could be 100%, keeping social requirements and empowerment of women in view.**

10. Increasing limit of interest deduction, paid on home loan, from 2 lakh to 3 lakh.

Under Sec. 24(b), deduction on account of interest payment on housing loans is permissible to owners of rented dwelling units to the fullest extent. In case of owner occupied houses the limit is set at Rs. 2 lakh. Also, the deduction is available after acquisition or construction is completed within five years from the end of the financial year in which capital was borrowed.

Suggestion

It is suggested that the deduction on account of interest payment available under section 24 should be made applicable from the year in which capital was borrowed as for principal u/s 80C and should be to the extent of full interest paid, at least in respect of one house. In case this is not agreed, at least the limit of Rs. 2 lakh should be raised to Rs. 3 lakh for owner occupied houses. Also, five years period for acquisition / completion from the year of borrowing should be dispensed with. This will provide much needed impetus to housing sector which is reeling under huge housing shortage and relief to consumers, in view of delayed projects due to cash flow.

11. Deemed Tax on difference in transaction and RR/Circle rate value u/s 43CA of IT Act 1961.

Section 43CA, inserted by Finance Act 2013, provides for considering valuation assessed or assessable by any authority of State Govt., for the purpose of payment of Stamp Duty, as the value of consideration received or accruing as a result of transfer of an asset being land or building or both.

Stamp duty is generally calculated on valuation of asset based on circle rate fixed by State Govts., which are in many cases higher than the market value or the value negotiated between seller and buyer. This makes seller and buyer both liable to pay tax on notional gain / profit under the provisions of sections 43CA, 50C and 56(2)(vii)(b), making the case of double taxation.

Finance Act 2018 has proposed some relief through an amendment stating "Provided that where the value adopted or assessed or assessable by the authority for the purpose of payment of stamp duty does not exceed one hundred and five per cent of the consideration received or accruing as a result of the transfer, the consideration so received or accruing as a result of the transfer shall, for the purposes of computing profits and gains from transfer of such asset, be deemed to be the full value of the consideration."

Section 43CA does not take into consideration the normal practice of land assembly adopted by developers in India, in view of Land Ceiling Act, which prevents land assembly by one entity beyond certain limit.

In all fairness the actual sale value should only be the basis for computing tax on profit and gain from land and building assets and not the notional income. In real terms, the provision u/s 43CA will create lot of harassment to the real estate developers and may become big deterrent.

Suggestion

In view of the above, it is suggested that the section 43CA be dropped all together. In case it is not possible to agree to the above, primary market transactions should at least be kept out of its purview.

12. Section 194-IA (Payment on transfer of certain immovable property other than agricultural land)

Section 194-IA inserted by Finance Act 2013 makes transferee liable to deduct TDS at the rate of one percent of the value of consideration paid to transferor and deposit in Govt. treasury, where value of consideration exceeds Rs. fifty lakh. No TAN is required to be obtained and TDS certificate is required to be issued manually in form 16B.

Suggestion

This is big deterrent in promoting housing for all and will impact middle income segment hard. Housing cost varies from cities to cities and Rs. fifty lakh is not sufficient to meet the cost of average residential unit in Metros and tier I cities. Looking at huge shortages in housing stock for all categories, it is suggested that the provision under section 194I-A be done away with, at least for primary market.

13. Stressed Assets of the Real Estate Sector

It is well-known that there was a global economic breakdown and an Indian economic slowdown since 2008-09. In reference to the Indian Real Estate context, this was in sharp contrast to a boom period of 2004-08 and a period of good growth from 2000-2004. A sustained upward cycle had led to a proliferation of commercial office space and retail mall space till 2008, when companies and investors were lapping up every announcement/launch. Real Estate companies, faced with a long time-gap cycle between purchase of land and delivery of product had entered in a frenzied purchase of land parcels till 2008, in order to cope up with the expected and continued rush of projects.

Unfortunately, all these expectations came crashing with the economic slow-down. Soon, Malls began closing and commercial office space came into an excessive "over-supply" situation. Sales came to a halt and lease rentals went down drastically. In order to continue business, Real Estate companies made a whole-sale shift to Residential Projects, hoping that the shortage of homes in India would fuel adequate demand to keep their increased level of activity alive. However, expectations were belied and today even the completed residential projects have suffered from delays, fall in prices and unsold inventories. One can, therefore, imagine that with the glut in supplies, depleted financial resources and a weak market, most companies are facing stressful conditions leading to increased judicial and buyer activism, burgeoning complaints by buyers and investors as well as a surfeit of STRESSED ASSETS with real estate companies.

The FIRST set of “Stressed Assets” can be classified as LAND PARCELS, where Government and Urban Development Authorities/Public Sector Corporations can still salvage value. These are land parcels, which were auctioned/ leased and where projects have not been able to come up. Nor can these be expected to be launched in the near future, since existing excess supplies have still to be absorbed. The best recourse would be to take back the land and return the money/funds paid by the Developers. This would lead to a win-win situation for both, the Government as well as the Developers. The Government Authorities would gain from the value of land having gone up in the intervening years, whereas the Developer would get ready-made cash to pump into viable projects to complete the commitments made to buyers.

The SECOND set of "Stressed Assets" can be classified as DELAYED PROJECTS WHERE CASH-OUTFLOW IS LESSER THAN EXPECTED INFLOWS. These are those projects, where a substantial part of the structure is ready, but they need "top-up" funds to complete and deliver to customers. The top-up funds can come from various sources. One source can be from funds received by surrender of leased/ auctioned land parcels by the Government / Public Sector Corporations. Another source can be through a construction-linked commitment from Buyers, with a marginal funding from financial institutions to kick-start the largely-completed structure. The Developer would gain by virtue of a stalled project coming to life and the buyers would gain from an asset purchased at old, historical prices.

The THIRD set of "Stressed Assets" are those Projects, which have neither begun construction, but have also hugely over-leveraged, either through excess collections from Buyers or due to huge debts to financial institutions. These are projects and companies in distress. First option would be to look for internal funds from the companies itself. It could be funds returned by Government/Authorities for land parcels returned to the agency concerned, but to be kept in Escrow Accounts to be used for completing distressed projects primary. The second option could be to permit Rules of Escrow accounts for existing projects to allow funded projects to pay for over-leveraged projects and projects which can be completed.

An important task, to begin with, would be to ask Banks and State Authorities to prepare lists and find out the magnitude of the problem, besides taking up the above-listed solutions. These are essential and would come in use even for the new Real Estate Regulatory Authorities set up in each State. The Authorities could act as a bridge, to begin with, between companies in distress and banking institutions to give finance at reasonable rates and for short-term duration in order to complete such distressed projects. The quantum of funds required could be worked out by the figures collected by Banks and State Authorities.

As an industry, we do realise that there can be good developers and bad developers. The idea is not to protect any one of them, although they may be in trouble for various reasons of their own making or purely due to economic realities not controlled by them. But the critical factor is to restore the faith of the Buyers, who are the most affected and whose savings are being threatened by high EMIs and lack of deliveries. Therefore, it call upon the Government, Banking institutions as well as the industry to work for innovative solutions. One example of these initiatives are the steps taken by the Minister for Surface Transport, Shri Nitin Gadkari, Some of these steps are:

(i) To give 10% of the project cost as advance to private developers, which could be deducted along with interest from the pre-scheduled payments due to the Real Estate companies;

(ii) Raw materials can be collectively bargained at discounted rates, due to large requirements of the sector; and

(iii) Government and Public Sector Undertakings could plan to buy housing in bulk in "sweet-heart deals", which would fulfil the requirements of housing in Government/PSU employees and at the same time get the same in prized locations, get them on an immediate availability basis and also at prices which will be lower than the Government/PSU costs, specially if interest costs are to be added to the cost of money being deployed if the same were to be constructed by the Government/PSUs.

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