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EY Tax Alert

GST Council approves transition modalities for implementing lower tax rates on residential properties

Tax Alerts cover significant tax news, developments and changes in legislation that affect Indian businesses. They act as technical summaries to keep you on top of the latest tax issues. For more information, please contact your EY advisor.

Executive summary

The Goods and Services Tax (GST) Council in its 34th meeting, held on 19 March 2019, approved transition modalities for implementing the GST rate reduction on construction of residential properties[1].

The key decisions of the Council are as follows:

- For new projects commencing on or after 1 April 2019, GST rates of 1% (for affordable housing properties) and 5% (for other housing properties), without the benefit of Input Tax Credit (ITC), shall be mandatory
- For on-going projects, builders / developers (builders) shall have an option to continue to pay tax at old rates. In case the option has not been exercised within prescribed time, new rates shall apply
- In case of on-going projects for which option of new GST rates have been exercised, ITC shall be allowed to be transitioned on pro-rata basis in proportion to the flats booked and invoices raised prior to 1 April 2019
- Under the new tax scheme, builder shall be required to procure 80% of inputs and input services from registered persons. If the procurement from unregistered persons exceed 20%, builder shall be liable to pay GST on such excess amount under reverse charge at the specified rates.
- Transfer of development rights (TDR), floor space index (FSI) and long-term lease (premium) by land owner to the builder shall be exempt. Such exemption will be withdrawn in case of flats sold after the issue of completion certificate

[1]Source: Press Release by Ministry of Finance dated 19 March 2019

Building a better working world

Background

- The GST Council in its 33rd meeting had recommended reduction in the GST rates for real estate sector (i.e. effective tax rate of 1% in case of affordable housing property and 5% for other residential property). A committee had been formed to work on the details for implementation of the same.

- In its 34th meeting, held on 19 March 2019, the GST Council approved transition modalities for implementing lower tax rates for residential properties.

- The recommendations mainly deal with granting option on applicability of reduced GST rates, transition of ITC, reversal of ITC and tax treatment for transfer of development rights.

Key Recommendations

Ongoing projects

- Projects where the construction of building and actual booking have both started before 1 April 2019, but have not been completed by 31 March 2019, are referred as 'ongoing projects'.

- The promoters of ongoing projects will be given an option to either continue to pay GST at old rates or pay tax at the new rates, effective 1 April 2019. The option shall be exercised once within the prescribed time. If the option is not exercised, new GST rates shall apply.

- If the option to pay tax at new rate is exercised in case of ongoing projects, following modalities shall be applicable:

  Lower GST rate without ITC, shall be applicable on installments payable on or after 1 April 2019.

- ITC shall be transitioned as per the following method:

  - ITC for entire project shall be arrived at by extrapolating the ITC availed (based on percentage completion as on 1 April 2019).

  - Further, the amount of ITC to be transitioned shall be calculated based on proportion of flats booked and invoicing done for such flats (prior to 1 April 2019), subject to a few safeguards.

  - In case of mixed projects (residential and commercial), ITC in proportion of carpet area of the commercial portion to total carpet area of the project, shall also be allowed to be transitioned.

  - Ongoing Affordable housing projects shall include:

    - Projects under the existing Central and State housing schemes, presently eligible for effective concessional tax rate of 8%.

    - 'Affordable houses' as defined by GST Council. The definition covers a residential house having value up to INR 45 lakh and carpet area as follows:

Type of cities	Cities covered	Carpet Area
Metropolitan cities	Bengaluru, Chennai, Delhi National Capital Region (limited to Delhi, Noida, Greater Noida, Ghaziabad, Gurgaon, Faridabad), Hyderabad, Kolkata and Mumbai	Up to 60 sqm
Non-Metropolitan cities	Other than above	Up to 90 sqm

New projects

- Effective GST rate in case of affordable housing property, which meet the criteria decided by GST Council, shall be 1% without the benefit of ITC.

- Effective tax rate in case of other residential property shall be 5% without the benefit of ITC.

Guidelines for properties attracting new GST rate

- Lower tax rate without ITC shall also be applicable to commercial apartments such as shops, offices etc. in a residential real estate project, provided that the carpet area for such commercial apartments is not more than 15% of the total area.

- Following conditions shall be applicable for paying tax at new rates:

  - The benefit of ITC shall not available.

  - 80% of inputs and input services [other than capital goods, transfer of development rights (TDR), floor space index (FSI), long term lease (premiums)] shall be procured from registered persons.

    If such procurement from unregistered person exceeds 20%, builder shall be liable to pay GST under reverse charge, on such excess amount at the following rates:
    - In case of cement - 28%;
    - Other procurements - 18%.

  - In respect of capital goods procured from unregistered persons, tax will be required to be discharged under reverse charge at applicable rates.

Treatment of TDR, FSI and long term lease for projects commencing on or after 1 April 2019

- Supply of TDR, FSI, long term lease (premium) by a landowner to builder shall be exempt from the levy of GST, provided the constructed flats are sold before the issuance of completion certificate and GST is paid on the same.

- The exemption shall be withdrawn in case the flats are sold after the issuance of completion certificate. However, such withdrawal shall be limited to 1% of value in case of affordable houses and 5% of value in case of other residential properties.

- On such withdrawal, the liability to pay tax on TDR, FSI, long term lease (premium) will be on builder and the same shall be paid under reverse charge. The point of taxation will be shifted to the date of issuance of completion certificate.

- The liability of builder to pay GST on construction of houses given to land owner, in a Joint Development Agreement will also be shifted to the date of completion.

Comments

The new tax scheme of imposing a lower tax rate without input tax credit at the outset appears to be a departure from the policy of taxation based on value-add. However, it needs to be appreciated that a lower rate like 1% or 5% is much larger incentive towards tax compliance vis-à-vis the levy of tax in the double digits. It is also a smart move to incentivize procurement from registered dealers.

One of the key asks of the industry is to be granted a one-time option to continue with the old tax scheme for ongoing projects, at a conceptual level has been accepted. Further, there is some consensus to grant input tax credit on a proportionate basis which should be welcome by the industry. While the time frame will be prescribed for deciding the option to be exercised, it is imperative for every developer to do granular assessment of the following:

- Ambit of the option
- Quantum of the loss of tax credit
- Impact on pricing
- Rate applicability for future supplies

Rationalization proposed in respect of tax on the TDR, FSI and long-term lease premium, taking into consideration the cash flow impact as also cascading of taxes, is a welcome move.

While the government is in the process of notifying regulations giving effect to the new tax scheme, it will be important to go through the fine print and engage with the government further for seeking clarity as also mitigating any unintended negative consequences.

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