MODIFICATION IN TAXATION AND REGULATION OF THE UNREGULATED SECTOR

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ABSTRACT

The paper provides an inter-disciplinary approach between taxation and real estate sector in the country and the impacts they have on one another. The objective of this paper is to study the fundamentals and basics of GST & RERA, to look into the present conditions of real estate in India. GST was implemented in 2017 with a view to enforce a single tax for the entire country. The concept was one nation, one market, one tax, in order to avoid tax duplication. RERA was enacted in the same year, that is, 2017, with the object to regulate the unregulated sector of real estate. The real estate sector is growing within the country and is also expected to grow further till 2020. Initially, there were many intricacies in the real estate sector due to the system of multiple taxation in the sector, and with implementation of GST, it is expected to bring in simplicity for the purpose of taxation. The government is of the view of providing houses to all by the year 2022. At present real estate sector the second largest employment provider within the country and the introduction to various laws like RERA (Real Estate Regulation and Development Act), REIT (Real Estate Investment Trust), Benami Transactions (Prohibition) Amendment Act, etc. have led to formulation of strategies to govern real estate in the country. The paper would step by step cover the concepts of GST, development in real estate sector and introduction of Real Estate (Regulation and Development) Act, impact of GST and RERA on real estate sector in the country. The paper will also discuss the narrower concept of GST and RERA on how it impacts the buyers, investors, property prices, developers, and under construction property.

INTRODUCTION

The real estate sector in the country is faced with two big events, which are the enactment of two significant acts. One being the Real Estate (Regulation and Development) Act (RERA) while the other being Goods and Service Tax (GST) Act. Both these acts are enacted with the purpose to make the real estate sector as transparent as possible and process driven. GST aims to bring uniformity and rationalization in the tax structure of the country. This will eventually benefit both home buyers and developers of project. Whereas RERA seeks to regulate the unorganised and unregulated sector, and bring discipline to keep a check and balance so that there is no delay on the projects and the promises made by the developers, and these are fulfilled by them towards the home buyers.

Introduction to GST

One of the revolutionary changes that are brought after 1947 in the taxation regime was the introduction of GST, which was made an act in 2016. Along with GST, four supplementary legislations were approved by the Lok Sabha, which were- Central GST Bill, 2017, Integrated GST Bill, 2017, The GST (Compensation to States) Bill, 2017 and The Union Territory GST Bill, 2017.[1] Initially there were approximately 33 taxes to be paid in the country in a single year. In addition to indirect taxes, there were several other taxes like VAT, property tax, sales tax, etc. there was no uniform market for payment of taxes. Thus, GST was introduced in the country with the view of one nation, one tax, and one market and is introduced with the object to boost the GDP of the nation by 2%, as estimated by the economic think tank NCAER[2] and to keep a check on tax evasions. GST is an indirect tax that is imposed on sales, manufacturing and supply of goods and services. Input tax credit is to be paid at each stage makes GST a tax on value addition. Under section 171 of the GST law, the clause clearly makes it mandatory to pass on the benefits of the credits availed in input tax to the final costumer.[3] In the supply chain, only the tax charged by last dealer will be imposed to the final consumer. GST is charged at

[1] https://economictimes.indiatimes.com/news/economy/policy/gst-bills-may-be-introduced-in-lok-sabha-on-monday/articleshow/57814836.cms?from=mdr (last visited on 25th May 2019).
[2] https://economictimes.indiatimes.com/news/economy/indicators/gst-to-boost-gdp-by-4-2-or-rs-6-5-lakh-crore-fed-paper/articleshow/58306081.cms (last visited on 25th May 2019).
[3] Section 171 of GST Act, 2017

both centre and state level for same products at similar interest rates and subsumes all indirect taxes.

There are three types of taxes under GST[4], which are as follows-

1. Central GST.
2. State GST.
3. Integrated GST.

The Central GST and State GST will be imposed if supply of goods and services in within the territory of state, while the Integrated GST will be applicable if supply is made across the state.

Benefits of GST-

- Comparatively lower tax rates.
- Compliance costs will fall, as it subsumes 17 indirect taxes.
- Efficient supply chain management.
- Decrease in price of goods and services.
- Change from unorganised to organised sector.
- Reduction in tax evasions.
- By widening tax base, there is increase in GDP and revenue.
- Bring transparency.
- Less number of tax departments, thus leading to less corruption.
- Simple tax structure.

GST TAX STRUCTURE

A GST council was formed, which recommended a four tier tax structure, that is, 5%, 12%, 18% and 28%.[5] According to the scheme, there will be imposition of a cess on luxury and demerit goods for first five years of GST implementation in order to compensate the state for loss in revenue and will be imposed on the highest slab. According to the central GST, the

[4] https://www.taxmann.com/blogpost/2000000038/types-of-gst-in-india.aspx (last visited on 25th May 2019).
[5] http://housing.com/news/how-has-the-gst-been-structured/ (last visited on 25th May 2019).

rate prescribed is 20% and similarly state GST has prescribed the rate to be 20% making overall of 40 per cent tax. This will be applicable only in financial exigencies.

APPLICATION OF GST IN REAL ESTATE SECTOR

In case there is construction of a civil project or part of project is carried out, the rate applicable is 12% along with input tax credit. If the services carried out are composite supply of Works Contract which is defined under section 2(119) of CGST Act 2017[6], then the interest rate is fixed as 18% with input tax credit, and similar rate of 18% is imposed for all other services in real estate. The builder is entirely entrusted with the liability of GST for the complete project. They get refund of their input tax credit, once they have a GST registration.

The contract will be reduced as there will be elimination of excise duty and other subsequent taxes. The total configuration of the materials used in the project will help to find the final cost along with tax.

IMPACT ON HOME BUYERS

The total tax incidence is estimated to increase from 5% to 12% after the introduction of GST. However, input tax credit can be availed by the developers for all the goods and services provided in the construction of property. Further it is difficult to estimate the prices of property as there is no clarity on the value of land; moreover major raw material prices are not covered under GST, which in turn makes it hard to calculate the tax input benefit. It is only left upon the market forces to decide the benefits than are to be transferred to the purchasers by the developers. The prices of input materials are volatile, that is, they are subject to change without warning. Thus, industries like that of sand, cement and steel may not entirely pass the tax benefits.[7] The stage of construction is another important factor that needs to be analysed. In case, construction of the project is at very advanced stage and before the application of GST, substantial costs are being incurred, thus very low amount of input tax credit and benefits are available. Eventually, more tax benefits will be provided if the construction is at initial stage.

IMPACT ON UNDER CONSTRUCTION PROPERTY- AFFORDABLE HOUSING

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[6] Central Goods and Services Tax Act, 2017

[7] http://housing.com/news/will-gst-help-home-buyers/ (last visited on 25th May 2019).

Under the GST regime, the affordable homes were to become cheaper, if GST exemption is extended to these housing projects.[8] The builders were ordered not to charge any GST from home buyers. The rate of interest is 8% on almost every housing project, which can be adjusted against the input tax credit.[9] According to government, if the builders reduce apartment prices after obtaining the input credit, then GST can be levied on the buyers of affordable housing projects.

Under the Credit-Linked Subsidy Scheme, the GST council, in the year 2018 has extended the concessional rate of 12% for construction of houses. This was done with a purpose to promote affordable housing. Later the effective GST rate was brought down to 8% after deduction of one third of the house/rent amount charged towards land costs.

IMPACT ON PROPERTY PRICES- LUXURY SEGMENT

When looked into the case of premium properties, although the construction cost may come down, but the credit on input tax is limited to 12%. The fresh tax liability cannot be brought down to nil as there are taxes paid on other expenditures.

IMPACT ON RATES OF INPUT MATERIAL

Under GST regime, it can be noted that majorly construction material lies between the slabs of 18 to 28 per cent.[10] However, the total tax incidence shall be neutralized as credit on input tax is available on products that are being utilised for construction.

IMPACT ON READY PROPERTIES

No GST will be made applicable when the occupation certificate has been received. Before introduction of GST, excise tax and VAT were to be paid on inputs like steel and cement at rate of 27.7% and 18% respectively by the developer. While after the introduction of GST, the rate of cement is 28% and steel is 18%, and other products like paints and white goods will be taxed at a rate of 28%. The housing project which is the final unit will be taxed at a rate of

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[8] http://housing.com/news/will-gst-impact-various-segments-indian-real-estate/ (last visited on 25th may 2019).

[9] http://housing.com/news/not-charge-gst-affordable-housing-buyers-government-builders/ (last visited on 26th May 2019).

[10] https://economictimes.indiatimes.com/blogs/et-editorials/rationalise-gst-on-building-material/ (last visited on 26th May 2019).

12% along with input tax credit. Thus a buyer that moves in a ready to move in property avoids tax burden.

However, calculating tax under GST for real estate is not so simple. Taking the example, in case of under construction projects, the home buyers will be charged GST on sale price but credit on input tax can be availed by the developers on the construction cost. The input tax credit is availed on construction cost, while the builder has to pay GST for complete project thus leading to a gap of approximately 30%. Thus the developer will increase price, whether one opt for under construction project or ready to move in. this is done by the developer in order to bridge the gap for his costs.

IMPACT ON RENTAL PROPERTIES

Prior to obtaining completion certificate or occupancy, if sale is executed, then set off or input tax credit on GST is available to the developer. But in case, the developer rents out the property, this input tax credit is not available.[11]

COMPUTATION ON RENTAL PROPERTIES

Not only the taxable but also exempted goods and services supplied are to be taken into consideration for the purpose of calculating the aggregate limit of 20 lakhs under the GST, whereas before GST, only the taxable services were taken into account. In case of letting out of a commercial property, the GST rate proposed is to be 18%.

One implication that can be seen is that the parliament has borrowed the concept of 'reverse charge mechanism' under the GST. This concept was borrowed from service tax regime. However, in the service tax regime, only the services and not on sale and manufacture of goods while under GST regime both goods and services are covered. Reverse charge mechanism will apply to a person who is registered under GST and taking supplies from a person who is not registered under GST, while under the service tax regime there was no such application carried out, with respect to rent paid by lessee. Thus due to increase rate and levy under reverse mechanism, the GST provisions will make it costlier to take any commercial properties on rent.

[11] http://housing.com/news/gst-impact-buying-renting-properties/ (Last visited on 26th May 2019).

IMPACT ON HOME LOANS

The interest which has to be paid on the loan amount is the main cost incurred while taking a loan. This cost is not affected as there is no GST or service tax. On similar grounds, as the GST does not subsume the stamp duty, any stamp duty is not affected by implementation of GST. Lenders levy various charges when a person signs up to take a home loan, the primarily one being the processing fee that is charged at the time of taking home loan. Before GST, the rate of interest was 15%; however after implementation of GST it has gone up to 18%.[12] Thus there was an increase of 3% in processing fee for the home loans. The cost is however insignificant on the overall home loan tenure and it is a one-time cost. The home loan also goes up as banks tend to impose charges like advocates fee, valuation charges, etc. in case where a person decides to prepay before the completion of tenure of the loan or when home loan is shifted to any other lender, pre-payment charges are imposed by the banks. This is generally payable when home loan under a fixed rate of interest. There are instances like floating rate in home loans and payment of home loans from one's own resources, the bank cannot levy prepayment loan as seen in floating rate. However, if one decides to shift the loan from himself to another lender, the housing finance companies can levy prepayment charges. In case, there is either return of cheque or ECS return, the lenders can levy charge for any EMI default.

INTRODUCTION TO RERA

RERA was introduced on 1st May 2017,[13] with the objective to protect the home buyers, enhance transparency and boost investments in these real estate sectors. Further a committee headed by the Union housing and Urban Affairs Joint Secretary Shiv Das Meena was constituted to give recommendations for the regulations (RERA) and to remove the difficulties occurred for its implementation.[14] The governing authorities in every state and union territory are bound to keep a check and monitor the real estate projects that are being carried out.

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[12] https://www.wishfin.com/gst-impact/gst-impact-on-personal-car-home-loans/ (last visited on 27th May 2019).
[13] https://economictimes.indiatimes.com/wealth/real-estate/rera-from-may-1-2017-are-on-going-projects-being-covered-in-your-state/articleshow/58161531.cms?from=mdr (last visited 27th May 2019).
[14] https://economictimes.indiatimes.com/industry/services/property-/-cstruction/govt-forms-committee-for-effective-implementation-of-real-estate-law-rera/articleshow/67326683.cms(last visited on 27th May 2019).

IMPORTANCE OF THE ACT

Real estate in our country is the largest revenue generator. Before the enactment of the real estate (Regulation and Development) Act, there were many complaints and grievances to the buyers that real estate transactions favoured the developers. Thus, there needed to be market which is fair for both the buyer and developer. Regulation like RERA was enacted in order to revive confidence among the investors, home buyers, etc. it was implemented with the object to ensure transparency in the real estate sector. For both buyer and developer, the regulation provided a fair and common ground; and also reduced the risks faced by these groups before the enactment. Registration of projects and real estate agents are few of the things which have become mandatory according to the regulations.

Benefits of RERA-

- Simplified procedure- it is to be made mandatory for every state and union territory to have the facility of online registration. In this way, the consumers will benefit as the procedure are made easy and can save time from tedious documentation process.
- RERA brings in transparency among the individuals by giving the facility to the consumers to track the developments of the project from any part of the world. The regulations also bring in more precision between buyers and developers.
- Timely possessions- delay of possession of the estate was the biggest worry to the customers while in the real estate sector. The implementation of RERA ensures to resolve this problem of delay in possessions to the customers.
- Grievance Remedy- consumers can address their grievances and complaints under an official authority established under RERA, with regard to their investments in real estate.
- To encourage more investments, a strong and trustworthy relationship is to be present between the developers and consumers, and strong and efficient implementation of RERA can help in achieving such relation.
- Buyer has the right to access or get all the documents of the project.
- Buyer’s right to know the details involved in the real estate project.

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APPLICATION OF RERA IN REAL ESTATE SECTOR

IMPACT ON BROKERS

The brokers are to be registered with the regulatory authority of real estate. It is made mandatory to obtain licence by the broker when they are in unorganised sector or they are out of the market. The provisions of the regulation provide to have a compulsory code of conduct for the agents and the transactions by these agents need to be made officially. This would help in curbing the unfair trade practices that are being carried out in the sector.

IMPACT ON REAL ESTATE INDUSTRY

Before the implementation of RERA, a lot of tedious work needed to be done to get the project registered, whether existing or new. Minute details needed to be prepared. They may the status of each project executed in last 5 years, detailed execution plan, promoter plans, etc. There were establishment of specialised forums like and Real Estate Appellate Tribunal and State Real Estate Regulation Authority, after the implementation of RERA. The purpose behind these special forums was to resolve disputes that occur between home buyers and there will be no course to other consumer forums and civil courts to the aggrieved party. As per the regulations, it sets fast track procedure for resolving disputes; however the success of the RERA will depend upon how quickly these bodies for resolving disputes will be set up and how efficiently these disputes are to be resolved. Other impact that RERA had on real estate sector was the increased launch time in project, rise in cost of capital, rise in project cost, initial backlog and consolidation.

IMPACT ON HOME BUYERS

The implementation of RERA provides for a unified legal regime for purchase of flats or apartments by the home buyers and made this practice standardised across the country. The buyers are to be subjected in knowing information and details relating to project plan, government approval, layouts, etc. Increased construction quality can be noted as the regulations provide a defect liability of 5 years.[15] Further it can be asserted that the housing

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[15] https://economictimes.indiatimes.com/wealth/real-estate/builders-will-have-to-give-5-year-warranty-against-structural-flaws-as-per-rera/articleshow/59697346.cms?from=mdr (last visited on 27th May 2019).

projects to be completed timely without undue delay and delivered to the consumer. The people allotted the housing must be informed about the minor additions or alterations.

Although RERA brings in transparency among the buyers, many of these buyers are unaware of many crucial factors before they invest in real estate. In metro cities, the transactions are mostly conducted via real estate agents, and according to the regulations, these agents must be registered with the regulatory body. The buyers, as a precautionary measure must ask the agent for his registration. In a similar manner, when a buyer tends to invest his money in the real estate business, he must check for the RERA registration number for the property he deems to invest in. many buyers are also misguided by the sellers as these sellers put up boards which read that the property is RERA certified or listed. This becomes a significant misuse of RERA and the home buyers must take these practices into considerations.

IMPACT ON DEVELOPERS

RERA imposes certain hindrances to the real estate developers and these regulations are more inclined towards the buyers. It mandates that for a particular project, the builders must deposit 70% of the collected amount from the consumers in a scheduled bank to initiate the project.[16] The land costs and cost of construction of the particular project is to be covered from this amount. In case of any delays by the developers, they will be penalised and maybe required to compensate the buyers. Although it can be easy for the large developers to arrange funds from their existing reserves for their projects, the small developers may face problems in developing and building RERA certified projects. Thus, it leads to many new developments lying unsold in mostly suburban areas.

The small developers in the real estate markets are thus faced with problems in raising funds for their projects creating an unfavourable field in these markets. Further, the regulations do not provide for any provisions when the delay for approval is caused by regulatory bodies. The objective by which the regulation was enacted has been diluted when it comes to the benefits of small developers. The regulation favours only the large developers and thus the confidence

[16] https://centrik.in/blogs/rera-provision-regarding-70-percent-deposit-in-bank-account/ (last visited on 27th May 2019).

of foreign investors usually invests in favour of large developers. In order to make the Act fair, interests of all developers must be taken into account irrespective of the size.

IMPACT ON PROMOTERS

The promoters need to make continual disclosure of information which has to be made available to the buyers. After the implementation of the Act, the buyers are given access to all information regarding the project as the promoters are required to make periodic submissions in the online websites regarding the progress of the project.[17] Further, a warranty on right title and interest on land have to be made by the promoters, so that it can be used against him by the home buyer in case any defect is discovered on the title. The promoters are required to get insurance on the titles and construction on project which are to be transferred to the person allotted when the agreement of sale is executed.

IMPACT ON SALE AGREEMENTS

The sale agreement model has been standardised after the enactment of RERA wherein, the home buyers and promoters need to enter into an agreement for sale of property. Promoters insert a punitive clause wherein they are saved from the liabilities and do not attract penalty or negligible penalty, while the home buyers are penalised for any default by them. The home buyers must be alert and enter into agreements in future which are more balanced.

CONCLUSION

With the introduction of RERA and GST, it can be optimistically taken that these regulations will bring reform to the unorganised and unregulated sector in real estate. RERA and GST provide transparency and efficiency among the sector. With GST being in force, one does not need to pay multiple taxes and thus no complications are involved. Further the construction costs for the project will be reduced. With the enactment of RERA, the project that is under the scan of RERA will surely be completed within specified period and handed over to the buyer. The regulation also helps in improving the relationship between developers and home buyers, in terms of accountability, credibility and trust. Aspect of accountability is

[17] https://www.lawyered.in/legal-disrupt/articles/rera-real-estate-regulatory-act-all-you-need-know/ (last visited on 27th May 2019).

shown not only by the developer but also by suppliers of material and contractors and they thus tend to deliver high quality work as per proper plan.

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