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IMPACT OF GST ON INDIAN REAL ESTATE SECTOR

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Abstract
This paper focuses on the impact of GST on the real estate sector in India. Goods & Service Tax (GST) is a comprehensive tax system expected to subsume all indirect taxes of states and central government and simplify the present indirect tax regime. It is expected to iron out wrinkles of existing indirect tax system and play a vital role in growth of various industrial sectors including real estate. The real estate sector is one of the most globally recognized sectors. In India, real estate is the second largest employer after agriculture and is slated to grow at 30 per cent over the next decade (IBEF Dec 2016). This paper presents an overview of GST, current types of tax and tax rates in real estate sector, issues and challenges in the implementation of GST and its impact on the real estate sector.

Keywords: GST, Real Estate Sector, Indirect Tax.

1. Introduction

The proposed GST is likely to change the whole scenario of current indirect tax system in India. It is considered as biggest ever tax reform since 1947. Currently, in India complicated indirect tax system is followed with different types and rates of taxes imposed by union and states separately. GST will unify all the indirect taxes under an umbrella and will create a smooth national market. Experts say that GST will help the economy to grow in more efficient manner by improving the tax collection as it will disrupt all the tax barriers between states and integrate country via single tax rate. GST was first introduced by France in 1954 and now it is followed by 140 countries. Most of the countries followed unified GST while some countries like Brazil, Canada follow a dual GST system where tax is imposed by central and state both. In India also dual system of GST is proposed including CGST and SGST. (Sehrawat et. al., Dec, 2015).

2. Literature Review

Panda and Ratel (2015) analyzed about what the impact of GST (Goods and Services Tax) will be on Indian Tax Scenario. The authors have stated with a brief description of the historical scenario of Indian taxation and its tax structure. Then the need arose for the change in tax structure from traditional to GST model. GST has been discussed in detail in this paper by the authors as the background, silent features and the impact of GST in the present tax scenario in India.

Ehtisham Ahmed and Satya Poddar (2009) studied, “Goods and Service Tax Reforms and Intergovernmental Consideration in India” and found that GST introduction will provide simpler and transparent tax system with increase in output and productivity of economy in India. But the benefits of GST are critically dependent on rational design of GST.
Monica Sheratwat and Upasana Dhanda (2015) presents an overview of GST concept, explains its features along with its timeline of implementation in India. The paper is more focused on advantages of GST and challenges faced by India in execution.

Agogo Mawuli (May 2014) studied and found that GST is not good for low-income countries and does not provide broad based growth to poor countries. If still these countries want to implement GST then the rate of GST should be less than 10% for growth.

Dr. R. Vasanthagopal (2011) studied and concluded that switching to seamless GST from current complicated indirect tax system in India will be a positive step in booming Indian economy. Success of GST will lead to its acceptance by more than 130 countries in world and a new preferred form of indirect tax system in Asia also.

Nitin Kumar (2014) studied and concluded that implementation of GST in India help in removing economic distortion by current indirect tax system and expected to encourage unbiased tax structure which is indifferent to geographical locations.
Pinki, Supriya Kamma and Richa Verma (July 2014)7 studied and concluded that the new NDA government in India is positive towards implementation of GST and it is beneficial for central government , state government and as well as for consumers in long run if its implementation is backed by strong IT infrastructure.

3. Objectives of the study

The study has the following objectives:

a) To understand the concept of GST
b) To understand the current scenario of real estate sector
c) To analyze the possible impact of GST on the Indian real estate sector.

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4. Research Methodology

This paper is a descriptive study based on secondary data of journals, articles, newspapers and magazines. Considering the objectives of study descriptive type research design is adopted to have more accuracy and rigorous analysis of research study. The accessible secondary data is intensively used for research study.

5. Concept of GST

Tax policies play an important role on the economy through their impact on both efficiency and equity. A good tax system should keep in view issues of income distribution and, at the same time, also endeavor to generate tax revenues to support government expenditure on public services and infrastructure development. Cascading tax revenues have differential impacts on firms in the economy with relatively high burden on those not getting full offsets. Analysis of the tax levy can be extended to international competitiveness of the adversely affected sectors of production in the economy. Such domestic and international factors lead to inefficient allocation of productive resources in the economy. This results in loss of income and welfare of the affected economy.

Even though the country has moved on the path of tax reforms since mid 1980s yet there are various issues which need to be restructured so as to boost productivity and international competitiveness of the Indian exporters.

- Sales of services to consumers are not appropriately taxed with many types of services escaping the tax net.
- Intermediate purchases of inputs by the business firms do not get full offset and part of non-offset taxes may get added up in prices quoted for exports thus making exporters less competitive in world markets (Poddar and Ahmad, 2009)

The proposed reform on moving to a 'goods and services tax' would impact the national economy, international trade, firms and consumers.

- GST is a tax on both goods and services across the supply chain/Value Chain.
- It is levied at every stage of supply/Value Addition.
- The GST on Inputs (known as ITC - Input Tax Credit) is generally available as credit for set-off against the GST on the output supply.

Goods and Services Tax (GST) in India is proposed to be the maiden reform (and not an amendment) in the existing indirect taxation structure. The proposed GST is a long pending and much awaited tax reform in India which is hoped to iron out the wrinkles in the existing indirect taxation system. This comprehensive tax policy is expected to be one of the most important contributors to the India growth story (An insight of GST in India, Tax Research Department, The Institute of Cost Accountants of India, Oct 2015).

Implementation of GST will have a far reaching impact on all the industrial sectors including real estate. The real estate sector is one of the most globally recognised sectors. In India, real estate is the second largest employer after agriculture and is slated to grow at 30 per cent over the next decade.

6. Indian Real estate sector

The real estate sector comprises four sub sectors - housing, retail, hospitality, and commercial. The growth of this sector is well complemented by the growth of the corporate environment and the demand for office space as well as urban and semi-urban accommodations. The construction industry ranks third among the 14 major sectors in terms of direct, indirect and induced effects in all sectors of the economy. It is also expected that this sector will incur more non-resident Indian (NRI) investments in both the short term and the long term. Bengaluru is expected to be the most favoured property investment destination for NRIs, followed by Ahmedabad, Pune, Chennai, Goa, Delhi and Dehradun.

The Indian real estate market is expected to touch US$ 180 billion by 2020. The real estate sector contributes 9 per cent to the country's Gross Domestic Product (GDP).(Live Mint, Mar 2016).

In the period FY2008-2020, the market size of this sector is expected to increase at a Compound Annual Growth Rate (CAGR) of 11.2 per cent. Retail, hospitality and commercial real estate are also growing significantly, providing the much-needed infrastructure for India's growing needs.

Private Equity (PE) investments by domestic and international investors in the Indian realty market declined 30 per cent year-on-year to US$ 2.5 billion across 48 deals during January-September 2016.

Mumbai is the best city in India for commercial real estate investment, with returns of 12-19 per cent likely in the next five years, followed by Bengaluru and Delhi-National Capital Region (NCR). Sectors such as IT and ITeS, retail, consulting and e-commerce have registered high demand for office space in recent times.(IBEF, Dec 2016)

7. Impact of GST on Real estate sector

GST, which has been one of the longest awaited tax reforms, got unanimous approval of both houses of parliament this monsoon session. Union government of India has set a deadline of April 2017 for its roll out how it might impact taxes in residential real estate transactions has got varied views of industry experts. Let's first understand the various taxes applicable in a residential real estate transaction.

1. Service Tax – If you are purchasing an under-construction property, developer will have to charge you service tax and deposit it with central government. This tax was not applicable till 1st July 2010. The key reason for the same was contract between builder and buyer for construction of residential unit was disputed as works contract as it also includes value of land. Hence rules regarding taxes on work contract were not applicable on residential complex construction. In finance act 2010, government added an explanation to definition of construction of residential complex and made it deemed service. For the simplicity sake government has given abatement of 3/4th of cost of unit as land and goods for construction and only 1/4th of the cost of unit is treated as service. Hence presently most homebuyers are paying 3.75% of cost of unit as service tax (1/4th of 15%). Recently service tax on under construction property has again been put under question as Delhi High Court ruled against this and matter is sub-judice at Supreme Court of India.

2. VAT (Value Added Tax) – If you are purchasing an under-construction property, you will have to pay additional VAT in some states such as Karnataka, Haryana and Maharashtra. Developers charge this value added tax and deposit it with state government. VAT has also been under dispute for long time and still there are many states such as UP who do not charge VAT. Also unlike service tax there is no uniform way of computing VAT across states. E.g. in Maharashtra under composition scheme VAT is charged as 1% of agreement value whereas in Haryana the same proposal was passed but not yet agreed by developers. In Karnataka VAT is charged at 5% of agreement value of unit. To calculate accurate value of VAT and not use composition scheme, developers will have to maintain proper accounts of goods purchased for construction and VAT paid by them for the same to get input credits which is cumbersome and makes it tough for buyers to understand.

3. Stamp Duty – Stamp duty is charged by state government, again at varying rates, for registration of sale agreement for real estate transactions.

Incidentally if you are buying a ready to move-in property directly from developer after he has obtained completion certificate from authority, you don't need to pay service tax and VAT hence saving 3.75% to 9% of property cost depending on state where you are buying property.

Now lets understand how GST will impact these three taxes. Service Tax and VAT will be replaced by Central GST and State GST whereas stamp duty stay unchanged as it is out of purview of GST.

There are two open items because of which at present it is difficult to predict accurately the impact of GST on real estate transactions. One is the GST rate and second is abatement for land value in total agreement value of under construction residential unit. Let me take assumptions on these two items to estimate impact of GST. These assumptions might be off but has a high probability of being true as well. GST rate might be set at 18% as many experts back this rate and abatement of land might be only 25% of agreement value as 50% is assumed to be cost of goods and remaining 25% as cost of service. Based on these assumptions the effective GST on under construction property transaction will be 13.5% (3/4th of 18%). Now this rate is significantly high compared to 3.75% - 9% currently being paid. Hence we can assume cost of buying under-construction property will significantly increase after GST becomes applicable from1stApril2017.

But this might not be true. Currently developers pay service tax and VAT on services and goods they procure for construction of residential complex but are not allowed to take input credits of this tax because of which end customer pays tax on tax. As per estimates given by developer community this tax on tax adds up to 20 – 25% of the cost of residential unit. Hence if GST is implemented and developers are allowed to take free credits of input tax paid, the cost of unit should reduce by 20% at least. To understand this better lets take an example, a residential apartment which is sold at Rs 100 today finally cost end customer 103.75 in Uttar Pradesh excluding stamp and registration duty. If post GST price of unit is reduced by 20% i.e., it becomes Rs 80 then final cost to end customer will be 80 + (13.5% of 80) i.e., Rs 90.8 which is much less than Rs 103.75. So in fact if developers pass the benefit, which they will get from GST, cost to end customer actually will reduce.

But it is easier said than done. First of all current under construction projects are at different stages of construction and developers would have already paid service tax and VAT for procurement of goods and services for which they will not get input credit. Hence cost reduction will be lesser than 20% for current under construction project. Second model GST law clearly mentions input credit will not be available for goods and services purchased for execution of work contracts. Presently we have seen two different interpretations by courts of whether construction of residential complex is a work contract or not. If it is treated as a work contract cost of developer will not reduce at all after GST implementation. Another issue which needs to be kept in mind is, presently government does not allow input credit if the composition scheme (i.e., abatements for cost of land and goods) is used by developers for calculating service tax and VAT.

8.Conclusion

Therefore at present, it can be concluded that cost of under construction residential unit will increase post GST implementation. This will be a hefty blow to industry, which is already suffering from slow sales. Industry bodies need to urgently engage with government to minimize this impact by clarifying position on works contract, composition scheme and already paid service tax and VAT by developers on under construction property. As per the latest news, the goods and services tax (GST) is set to be rolled out from 1 July 2017(Live mint, 17th Jan 2017).

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