CASE STUDY - 2
INDIRECT TAX PERSPECTIVE

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Implications in the hands of Society on (i) sale of flats to new members / purchasers and (ii) construction of new flats for old members.

Normally, in the case of a Re-development / Joint development agreement, there are three parties involved, the land owner, the developer and the new purchaser. And these transactions are governed by the detailed amendments made into the taxability of construction services vide multiple notifications. However, when it comes to self-redevelopment of the society, there is a shift in the position because the society being the land owner is also taking on the roles and responsibilities of the developer.

In the present scenario, the ownership of land is transferred by the builder / previous owner in the name of the society. Though technically one may argue that the society holds this land as a "trustee" on behalf of the beneficial / real owners i.e., the members, and that the formation of a society and the subsequent transfer is a creature of convenience rather than a requirement of the law.

Be that as it may, the fact remains that the society itself is the owner of the land, and by authorization from the general body of the members, also becomes a developer of the land. And it is in the garb of this role that the society enters into a contract not only with the contractor for the development of the new property, it also enters into a contract of sale and development directly with the new buyers. So instead of 3 parties, there are only 2 parties to the contract, society and the new buyer.

Secondly, in the case of a joint development agreement, the seller undertakes to sell the free sale area at his own risk without any recourse to the Society, even though a tripartite agreement is signed for every sale. In contrast, in the case of self-redevelopment, the land owner i.e. the society itself sells the free sale area, that is to say that it carries the risk of the area remaining unsold.

With the above discussion in mind, let us analyse the situation under GST for such self-redevelopment of property:

(i) GST implications in the hands of Society on sale of flats to new members / purchasers:

In this regard, the position is by and large very clear. The society in its new found role as a developer of the land is providing the service of "construction of immovable property" and accordingly, it is a supply under the definition of Section 7 and therefore GST shall be payable upon the same. In this case, $1/3^{rd}$ abatement is also available.

Accordingly, GST shall be payable at the rate of 1% or 5% as maybe applicable.

(ii) GST implications in the hands of Society on construction of new flats for old members.

Scope of "Supply" under Section 7

The transaction of giving new unit and Rs. 20 lakhs (as corpus fund) to the existing members in lieu of their old unit is a barter transaction. As per Section 7(1) of CGST Act, the term "supply" includes goods or services supplied in the form of barter, exchange etc. Therefore, there is a prima facie view that such a transaction between the society and the existing members falls within the scope of Section 7 of CGST Act.

Transfer of right in land is akin to transfer of land?

The term "immovable property" has not been defined in the GST Law. As per Section 3(26) of General Clauses Act, 1897, the term "immovable property" includes Land, benefits arising out of land and anything that is permanently fastened or attached to the land. Definition of "immovable property" in Transfer of Property Act, 1882 is *pari materia* to the General Clauses Act. Therefore, any benefit arising out of land is also an immovable property.

As discussed earlier, the members of the society have a beneficial interest in the land and therefore, it can be definitely said that they have a right arising out of the land and that such right in land being a benefit arising out of land can be defined as an immovable property.

It is noteworthy that Entry 5 of Schedule III has kept "Land" outside the scope of supply. In such a scenario, can one argue that immovable property is akin to land and therefore would be covered under the exception carved out by Entry 5 of Schedule III?

Reference may be had to the judgement of Hon'ble Supreme Court in the case of **Commissioner of Customs (Import), Mumbai v/s Dilip Kumar & Co. – 2018 (361) ELT 577** wherein the Apex Court has laid down the ratio that wordings of any exemption have to be construed strictly and in case of any ambiguity, it must be interpreted in favour of the revenue. Though Schedule III does not provide exemption but carves out an exception to the general definition of "supply", it would be hard to find a convincing argument to say that the aforesaid judgement would not apply to transactions enlisted in Schedule III either.

Similarly, *expressio unius est exclusio alterius* is a latin phrase used in law that means "to express or include one thing implies the exclusion of the other, or of the alternative." This means that if a law explicitly mentions one thing, it is assumed that other things are not included or allowed. For e.g., if a store says that only women above age of 35 are allowed, it automatically means that not only women below the age of 35 are not allowed, but also that even men are not allowed.

As discussed above, immovable property includes land, benefits arising out of land and anything permanently attached or fastened to land. In the present case, Schedule III has explicitly kept land outside the scope of supply, and such specific inclusion of land would automatically rule out all other forms of immovable properties including right in land.

In light of the above discussion, it would be rather difficult to say that such a right in land, being an immovable property, would be out of the contours of GST.

Is GST applicable on self-service?

As discussed earlier, though the land is owned by the society there is a view that can be taken that the society holds the land as a trustee on behalf of the members of the society who are the beneficial owners of the land. These members exercise their control on the society by way of share certificates issued to them by the society and by voting in matters of the society. Therefore, a view can be taken that society (a collective body of all the members) and the members are one and the same and the service of self-redevelopment between the society and the members is in the nature of self-service and therefore, not a supply under GST.

Situation before 01.01.2022

The Hon'ble Supreme Court in the landmark judgement of **State of West Bengal vs. Calcutta Club Limited – 2019 (29) GSTL 545** has held that "doctrine of mutuality" is applicable on the relation between a club and its members and therefore, any goods or services supplied by a club to its constituents i.e., members is a self-service and therefore, beyond the purview of Sales Tax.

Similar logic can be imported into GST and reliance can be placed on the above judgement of the Hon'ble Court to state that where the society is giving service to its own members by giving them new units and therefore say that "doctrine of mutuality" would be applicable in the present case and therefore the transaction would be outside the purview of GST law.

Situation before 01.01.2022

However, Finance Act, 2021 has closed this door shut by introducing Section 7(aa) in CGST Act. Section 7(aa) has been inserted retrospectively from 1st July, 2017 which is ironically effective from 01.01.2022. Section 7(aa) states that any supply between a club and its constituents, or vice versa, shall be specifically covered under the definition of "supply".

Therefore, apart from the debate as to what is the actual date of applicability of Section 7(aa), it is very clear that "doctrine of mutuality" under GST has been watered down by the said amendment and any transaction between the society and its members, for any valuable consideration, monetary or otherwise, would be covered under the scope of supply and therefore, GST shall be applicable on such transactions.

How to quantify the GST payable on the transaction?

Having primarily determined that the service provided by the society to the members by way of re-development of the property is well within the scope of supply, the next question to solve is how much GST is to be paid.

To answer the said question, we need to first answer the following questions:

- What is the nature of the service?
- What is the time of supply of such service?
- How do we value the service?
- Whether any abatement shall be available?

What is the nature of the service?

Having determined that the transaction between the society and the existing members is within the scope of supply, a major challenge to determine is that whether the service is a service of construction of an immovable property or whether it is a service of works contract simpliciter.

The term "works contract service" has been defined in Section 2(119) of CGST Act to mean *"a contract for building, construction, fabrication, completion, erection, installation, fitting out, improvement, modification, repair, maintenance, renovation, alteration or commissioning of any immovable property wherein transfer of property in goods (whether as goods or in some other form) is involved in the execution of such contract"*

As can be seen from the above definition, any work done on an immovable property which includes goods and services is a "works contract service". In the present case, the society is developing a new premises for the existing members, it is carrying our works contract service.

The above definition includes multiple types of variations which inter alia include "construction". It means that construction is a sub-set of works contract service, that is to say every construction activity is a works contract service, but every works contract service is not construction. In the explanation to Entry 5 of Schedule II, the term "construction" has been defined (for the purpose of the said entry only) to include "additions, alterations, replacement or remodeling of any existing civil structure".

Therefore, from the above, it is evident that the service provided by the society to the existing members is a construction service and not merely a works contract simpliciter.

<u>What is the time of supply of such service?</u>

In this particular scenario, the nature of service is such that it will be provided over a long period of time and therefore, it is difficult to determine at which point is the service being provided. Further, the society will not be raising any invoices to the existing members for such service, hence, time of supply cannot be determined like a "continuous supply of services" in terms of Section 31(5) read with Section 13 of the Act.

Reference may be had to Notification No. 4/2018 – CT (Rate) dated 25.01.2024 wherein the Department has fastened the liability to pay tax on the transfer of development rights on the date when the right in the new property is transferred to the owner by way of conveyance deed, allotment letter or similar instrument.

Borrowing logic from this notification and applying it to the current situation, it would mean that the time of supply is triggered when the society transfers the right in the new property to the existing member, by way of allotment letter or some other instrument.

Practically, it is also seen that in most cases the agreement for redevelopment already mentions the floor no. and unit no. which will be given to the existing member, therefore, the right to new property is passed on to the existing member in the same agreement in which the right to old property is passed on to the society. Therefore, time of supply is the time when the agreement is signed. Where right in new property is not immediately transferred by way of identification of the new unit, the time of supply shall trigger when the new unit to be allotted to the existing member is identified.

<u>How do we value the service?</u>

The impugned service is a barter service and therefore, valuation of the underlying supply by the society to the existing member is to be done in terms of Rule 27 of CGST Rules which lays down the guidelines for valuation where the consideration is not wholly in money.

In the present case, in exchange for right in the new property and a corpus of Rs. 20 lakhs, the society is getting right in the old property. Therefore, the consideration for the society is the right in the old flat and we need to determine the value of supply in the following order of preference, i.e., if (a) is not possible then (b) and so on:

(a) Open market value of the supply i.e., the right in the new property

(b) Value of the consideration not in money i.e., right in the old property

(c) Value of supply of services of like kind and quality

(d) 110% of the cost or any other reasonable method

Clause (a) of Rule 27 states that where the consideration is not wholly in money, the value of supply shall be the open market value of the supply. In this case, the open market value of the right in new property will be easily available and ascertainable by various means such as stamp duty value, ready reckoner value, etc., and shall be treated as the value of supply of service given by the society to the existing member. However, one might argue that such right in the new property against the right in old property is limited only to the existing set of members and therefore, it cannot be said to be an "open" market value.

In such a scenario, value of supply may be determined as per Clause (b) of Rule 27 which says that the value of supply shall be equal to the consideration not in money. In the present case, the consideration for the society is the right in the old property which it is getting from the existing members and therefore, the right in new property must be valued at the market value in the old property which is also easily ascertainable.

There is a school of thought which suggests that Clause (a), (b) and (c) neither are applicable and valuation is to be done under clause (d) i.e., at either 110% of the cost of construction incurred by the society or any other reasonable means. However, in my opinion, it appears that when value can be ascertained with certainty and reasonableness under clause (a) and clause (b), the scope for venturing into subsequent clauses is very limited.

<u>Whether abatement is available?</u>

Under the traditional construction service, the GST law allows for 1/3rd value abatement in lieu of the value of land involved in the construction contract. Paragraph 2 of the Notification No. 11/2017 – CT (rate) dated 28.06.2017 states that 1/3rd value of construction contract which includes transfer of undivided share in land shall be deemed to be towards such undivided share in the land. Hence, in the present case the value determined earlier can be reduced by 1/3rd value on account of such value.

Having earlier determined that right in immovable property is not land, one can argue that this provision is not applicable and therefore, abatement is not available. However, this practice is being followed widely even in cases where new flats are being purchased and the same has been accepted by the Department, therefore, in my opinion it shall not be an issue if abatement is claimed for the construction service provided by the society to the existing member.

One might also argue that the Department has prescribed a mechanism for valuation via a rate notification, which is invalid. In this regard, reference may also be had to the judgement of the Hon'ble Gujarat High Court in the case of **Munjaal Manishbhai Bhatt v/s Union of India - 2022 (62) G.S.T.L. 262** wherein the Hon'ble Court has held that the deeming fiction imposed by the paragraph 2 of Notification No. 11/2017 – CT (Rate) is ultra vires in so far as it imposes tax on the value of land by arbitrarily valuing the land at 1/3rd of contract value.

While the logic of the judgement might be true, especially in areas like Mumbai where the value of land is substantially higher than the 1/3rd amount, practical experience shows that the industry is happy following the 1/3rd abatement diktat than to take an aggressive view propounded by the above judgement of the High Court due to the sheer value of the stakes involved.

Rate of tax

Having determined that the service is a construction service, the rate of tax applicable is a known commodity i.e., 1.5% in case of affordable housing (effectively 1% before abatement) and 7.5% in case of non-affordable housing (effectively 5% before abatement).

Alternative view

An alternative view may be taken that the services provided by the society to the existing members cannot be treated at par with the service provided by the society to new purchasers of the flats and therefore, it cannot be said to be a construction service. It shall be treated as a works contract simpliciter where the value of supply is the cost of construction incurred by the society, proportionately attributable towards the flats belonging to the existing members.

Whether tax needs to be paid on the unsold area?

Under the traditional JDA or TDR transactions, the promoter is required to pay tax under reverse charge mechanism on the value of development rights acquired them in the ratio of the area remaining unsold to the total area, on the date when the occupation certificate is received.

In the case of self redevelopment, the society itself is the owner of the land and therefore, there is no transfer of development rights from one person to another, therefore, there can be no levy of tax under reverse charge mechanism for transfer of development rights for the unsold area on the date of occupation certificate.

Alternative view

An opposite view to the entire discussion above is that there is no consideration involved in the transaction between the society and the existing member. The cost of construction is not going to be recovered from the existing member, but from the flats sold to the new customer on which society will be paying GST on the said value anyway. When GST already being paid on the flats sold to the new customer, the value of which also includes the cost of construction of flats allotted to existing members, then demanding GST on the flats allotted to existing members would amount to double taxation. Support for this view can be found in the judgement of Hon'ble CESTAT in the case of Vasantha Green Projects v/s Commissioner of CGST, Rangareddy – 2019 (20) GSTL 568.

In my opinion, while such view may have sailed through in service tax regime where the levy of tax was on “an activity for consideration” where the law has not included transactions like barter, exchange etc. under the ambit of service tax. Under GST Law, the scope of supply is very wide with a variety of contracts included within the scope of supply and the definition of service is also very wide to include “anything other than goods” within it, it would be difficult for such a view to sail through under GST.

Summary

- Flats sold to new customers to be taxable under GST at the applicable rate;
- Transaction between society and existing members is a barter transaction;
- Supply under Section 7 includes barter transaction;
- Right in land is an immovable property, however, it is not land and therefore, not covered under Schedule III;
- Doctrine of mutuality is not applicable under GST and therefore transaction between society and existing members is covered under "supply";
- Society is providing construction service to the existing member;
- Valuation of the service is to be done at (a) open market value of the right in new property, or (b) open market value of the right in old property;
- Difficult to value the services at 110% of cost or any other reasonable method;
- 1/3rd reduction in value in lieu of the value of land involved in the supply shall be available;
- Rate of tax as applicable to construction services to be applicable
- An alternative view of the service being in the nature of works contract simpliciter maybe taken, however, it seems to be litigative;
- Tax not payable under RCM for the unsold flats;
- Ratio of the judgment in Vasantha Green Projects is not applicable under GST.

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