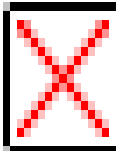


Realty Sector - Is it compulsory to claim 1/3 rd deduction towards land?

SEPTEMBER 10, 2020

By S Sivakumar, B.Sc., LL.B., FCA, FCS, ACSI, Advocate



AS

TIOL readers are well aware, the Government, for reasons best known to it, completely rewrote the GST law related to the realty sector, by issuing Notification No. [3/2019-CT\(Rate\)](#) dated 29-3-2019, amending the rate Notification No. [11/2017-CTR](#) dated 28-6-2017. Taking the Notification route to completely rewrite the GST law for an industry, is perhaps, unprecedented in the taxation history of the country. As we know, in terms of this Notification [3/2019-CTR](#), realty players have not been given any alternative but to compulsorily claim deduction towards land calculated at the rate of one-third of the total value (inclusive of land).

The question that naturally rises is whether, it is mandatory for realty developers and builders to adopt the deemed valuation, irrespective of the actual value of land? In other words, can the value of land be deemed to be one-third of the total value, irrespective of whether the flat is located in Malabar Hills where the land value could be as high as 80 to 90% or in, let's say, in the outskirts of a town in South India where the land value could be as low as 10%.? Well.. the Government does seem to think that the fact that while the cost of materials that go into the construction of a flat is more or less the same across the country, it is the land value that determines the overall cost of the flat, is immaterial.

The legal question as to whether the all important Notification No. [3/2019-CTR](#) is to be mandatorily applied by the Builders and Developers, in so far as the deduction towards land is concerned, perhaps deserves a detailed analysis.

Briefly looking back into the history of levy of service tax on the realty sector, TIOL readers would recollect that, while service tax was levied on the construction of commercial complexes and on residential complexes from 10-9-2004 and 16-6-2005, respectively, works contract services was introduced as a new head of service with effect from 1-7-2007, with a composition scheme being announced with a service tax rate of 2% (which, expectedly, was increased to 4% with effect from 1-4-2008).

With a view to bring pure Developers who took the view that they were not liable to service tax levy on the basis that they were not engaged in carrying out the actual construction activity, into the service tax net, the Government inserted an explanation to the construction services head, to the effect that, so long as any instalment is received prior to the date of the Completion Certificate, service tax was would be leviable, even on pure developers. Thus, we see that, the two heads for levy of service tax, viz. construction services and works contract services have run on a parallel basis till June 30, 2017. Of course, the Apex Court had in 2015, held that, works contract services being a new head, could be applied only from July 1, 2007 and that, civil works contractors could not be subjected to the service tax levy before July 1, 2007 under the construction services head.

Under the erstwhile service tax law, the valuation of works contract services was governed by Rule 2A of the Service Tax(Determination of Value) Rules, 2006, while the valuation of construction services was governed by Notification No. [26/2012](#) dated June 20, 2012. While under Rule 2A, service tax was levied on 40% of the construction value, under Notification No. [26/2012](#), service tax was levied on 25% of the total value including land, which was subsequently increased to 30% of the total value. The deemed valuation of land was perhaps introduced for the first time, by way of this Notification. In the meanwhile, the Delhi High Court, in Suresh Kumar Bansal's case [2016-TIOL -1077-HC-DEL-ST](#)

had held that the said Notification No. 26/2012 providing abatement to the extent of 75% was not legal as a notification or circular cannot substitute the lack of statutory machinery provisions and had also held that, such a move would tantamount to levying tax on land itself and hence would be unconstitutional. Not to be caught on the wrong side, the Government, apart from filing an SLP in the Apex Court also,

amended Rule 2A on a retrospective basis effective from 1-7-2012, to bring in the abatement provisions contained in Notification No. [26/2012](#), into Rule 2A itself.

Under the amended Rule 2A then, Developers and Builders were allowed to choose either of the two methods for valuation, viz. follow the method linked to the levy of service tax on the value of construction under which the value of land as determined by the Developer or Builder was exempt or, follow the method linked to the deemed valuation of land as contained in Notification No. [26/2012](#) which was incorporated into the Rule.

Be that as it may!

In terms of the GST law that prevailed for the period July 1, 2017 to March 31, 2019, under the rate Notification No. [11/2017-CTR](#) dated 28-6-2017, we had two service accounting codes, viz. SAC 9954(i) for construction services and SAC 9954(ii) for works contract services. The deemed valuation for land, being fixed at one-third of the total value was, interestingly, made applicable only to construction services classified under SAC 9954(i). Thus, works contractors, could legitimately claim deduction /exemption towards the actual value of the land, till March 31, 2019.

Come April 1, 2019!...the Government has (conspicuously) deleted the entry under the erstwhile SAC 9954(ii) related to works contracts and thus, under Notification No. [3/2019-CTR](#) which has amended the rate Notification No. [11/2017-CTR](#), there is virtually no distinction between realty players who render construction services and those who render works contract services and the one-third deemed valuation towards land is applicable across the realty sector.

We know that the valuation principles related to supplies between non-related parties are governed by Section 15(1) of the CGST Act. Interestingly, this all powerful Notification No. [3/2019-CTR](#) has been issued under Section 15(5) along with Sections 11(1), 16(1) and 148 of the CGST Act. Thus, Notification No. [3/2019-CTR](#) is one which covers exemption, valuation, credit availment and denial as well as the special procedure prescribed under Section 148, in one go. As a student of indirect tax laws, I cannot recall a similar notification under the erstwhile laws that covered so many aspects of taxation.

The next question that would arise is whether, a deeming provision such as Notification No. [3/2019-CTR](#) be challenged as being arbitrary or unreasonable and thus being violative of Article 14? In the past, it would seem that the Courts have not been very enthusiastic about challenges to deeming provisions. In *Union of India v Century Manufacturing Company Limited* 1992 (60) ELT 3 (SC), the Apex Court held that, the Courts will not go into a deeming provision unless it is proved that the deeming provision is extraneous to the scope and purpose of the statute. In *Bimal Kumar Modi v Union of India* 2014(306) ELT 97(Cal), the Calcutta High Court expressed a similar view. The 5 member Bench of the Apex Court, in *CCE, Indore v Grasim Industries Ltd* - [2018-TIOL-181-SC-CX-CB](#) had held that the measure of levy will not be controlled by the nature of the levy and that, they would operate in their respective fields, so long as there is a reasonable nexus between the two. Hence, it would seem that, it would be difficult to challenge Notification No. [3/2019-CTR](#), on this basis. Of course, the Supreme Court had, in *Wipro Ltd v Asst Commissioner of Customs* - [2015-TIOL-79-SC-CUS](#), struck down the adhoc values adopted by the Customs Department for determining the value of freight, insurance, etc. that go into the valuation of the imported goods, under the Customs Valuation (Determination of Price of Imported Goods) Rules, 1988, on the basis that when the actual values were available, recourse could not be had to deemed values. But, we must remember that this judgment was rendered in the context of Section 14(1) of the Customs Act dealing with transaction value and not under Section 14(2) dealing with deemed valuation. Hence, the Wipro judgment of the Apex Court may not apply to the issue under discussion in this article.

Where does this then leave the Realty sector?

As we know, Notification No. [3/2019-CTR](#) has been issued under Section 15(5) of the CGST Act, which has an overriding effect on the other sub-sections of Section 15. In fact, Sub-Section (5) starts like this

"Notwithstanding anything contained in sub-section (1) or sub-section (4), the value of such supplies as may be notified by the Government on the recommendations of the Council shall be determined as may be prescribed".

In terms of Section 2(87), the term 'prescribed' would mean prescribed by rules made under the CGST Act on the recommendations of the Council. It is clear here that the Government has violated Section 15(5) by going in for a notification rather than using the Rule route. It is settled law that, when the law provides that something is to be prescribed in the Rules, then that thing must be prescribed in the Rules to make the provisions workable and constitutionally valid, as held by the Supreme Court in *State of Jharkhand v Voltas Ltd* - [2007-TIOL-86-SC-CT](#), as well as in, *L & T v State of Bihar* 134 STC 354. Given our experience of what the Government did in the aftermath of **Suresh Bansal** will then be a rule introduced with retrospective effect incorporating the provisions contained in Notification No. [3/2019-CTR](#)?

Can Notification No. 3/2019-CTR be challenged on the basis that this is only a conditional notification and hence, is not binding on the realty players? Very much so, in my humble view. Given the restrictions on availment of ITC, utilization of already availed ITC, etc., there can be little doubt that this Notification issued under Section 11(1) is a conditional notification. The explanation to Section 11(1), reproduced below, makes it clear that only an absolute notification would be binding on the registered persons.

Explanation.--For the purposes of this section, where an exemption in respect of any goods or services or both from the whole or part of the tax leviable thereon has been granted absolutely, the registered person supplying such goods or services or both shall not collect the tax, in excess of the effective rate, on such supply of goods or services or both.

It is then clear that, Notification No. 3/2019-CTR being a conditional notification, cannot be thrust on the Developers and Builders. From a practical perspective, it is clear that, once the Developer or Builder violates Notification No. [3/2019-CTR](#) by, let's say, availing of consequently, he effectively goes out of the new scheme introduced with effect from 1-4-2019.

The next interesting question that would arise is whether it is open for the Developer and Builder to selectively apply Notification No. 3/2019-CTR, by taking the advantage of the lesser GST rate of 7.5% and while, at the same time, going for the actual value of land? I am afraid, this would not work, as an exemption notification has to be construed strictly, as repeatedly held by the Apex Court and it is not open to the registered person to selectively apply the various conditions contained in the exemption notification.

Thus, notwithstanding Notification No. 3/2019-CTR, it is open for the Developer and Builder to charge output GST @ 18% on the construction value under the residual entry SAC 9954(xii) and claim ITC as allowed under the GST law and utilize the same for payment of the output GST. In cases where the land value is high, following this method could result in a significantly lower overall quantum of GST.

Before concluding,

In my view, by restricting the deduction towards land, on a deeming basis, the Government is actually subjecting a portion of the land, to the levy of GST, albeit, in an indirect manner, which is impermissible. It is settled law that, what cannot be done directly, cannot be done indirectly as well.

A study of Articles 246A and 366(29A)(12A) makes it clear that the Parliament and the State Legislature can impose taxes only on goods and services. This is further made clear by a reading of the charging Section 9(1) of the CGST Act, in terms of which, tax can be levied only on supplies of goods or services or both. It does seem that Notification No. [3/2019-CTR](#), by seeking to restrict the deduction towards land, is actually levying tax on land which is clearly violative of the above referred Articles.

Under the garb of simplification, the Government has further complicated issues for the Real Estate Sector, with effect from 1-4-2019.

[The views expressed are strictly personal. The author wishes to thank CA Madhukar Hiregange and other members of the Artha Study Group, Bangalore for their valuable inputs.]

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