Impact of GST – Real Estate

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1. GST implementation – Current state of play
1 **GST implementation – Current state of play**

GST is India’s biggest tax reform in the post-independence era. Prior to the introduction of GST, a heterogeneous indirect tax structure existed in India which included levy of taxes by the centre and states under different tax laws. The earlier indirect tax framework had challenges of multiplicity and cascading of taxes, apart from other issues and complexities, both technical as well as from the perspective of ground-level practices.

The GST regime implemented on 1 July 2017 has transformed the Indian economy with its ‘One Nation, One Market, One Tax’ principle by subsuming a host of indirect taxes charged at varied rates by the centre and states, therefore bringing uniformity in taxation across the country. The GST law ushered in numerous positive aspects such as uniformity in tax rates across India, widening of tax base on account of transparent digital processes, subsuming of as many as 17 taxes and multiple cesses, elimination of check posts at state borders etc. However, a year into the goods and services tax (GST) regime, initial apprehensions have given way to general acceptance that the tax structure is a work-in-progress as there are several concerns that remain to be addressed.

One of the biggest challenges in implementation of GST was the functionality of the technology infrastructure and experience of compliance processes; as since inception, the portal had a slow response rate, performance issues and bugs. The Government has constituted a committee to address these issues and it is continuously working on improving the tax payer’s experience and various steps at simplification of process have been continually introduced.

The implementation of the E-way bill also brought with it operational and technology challenges due to which the Government took additional time to get the framework up and running. The portal was revamped and was introduced in February 2018 and is completely functional since April 2018 on a pan-India basis. The automation of E-waybill system is a welcome relief from the previous practice of manual checking of way bill information are check posts in different States which led to different legal interpretations and required maintenance of different types of documentation/ records based on state VAT law provisions.

An important aspect of the implementation of a new law is to have a quick and robust dispute prevention and resolution mechanism. Acknowledging the need for suitable clarifications, the Authority for Advance Ruling (AAR) has been set up in multiple jurisdictions across India. The AAR has been fairly proactive in disposing off advance ruling applications, especially in Karnataka, Maharashtra, Kerala and Gujarat. However, given that the AAR is constituted at a state level, there is a possibility of contrary rulings by two different AARs. This indicates a need for a central management system. Further, the appellate process for challenging such advance rulings is not completely robust as yet. These factors are placing the efficacy of the advance ruling mechanism in doubt in the minds of the tax paying community.

Refunds under the GST regime could arise due to many factors such as refund of tax on account of inverted duty structure. Because of technical glitches, problems were faced by several tax payers in filing refund applications on the online portals resulting in blockages of funds. To address this concern, the Government organized special refund drives in March, June 2018 and July 2018. While this initiative of the Government is commendable, most of these refund claims appear to pertain to exports. The refund claims related to unutilized credit on closure of business, inverted duty structure remains unattended.

In a recent amendment to the GST Acts, the Government has removed the option available to the taxpayer for registration of a ‘business vertical’ by allowing separate registrations for multiple places of business in a state. The omission of registration for separate business vertical could lead to a situation where a taxpayer may not be able to take separate registration if there is no separate place for its different businesses.

One of the focus areas under GST law is the “matching concept”, wherein a buyer is required to reconcile its tax payments on invoices with the tax collections, deposited and reported by the supplier on the Government portal. Any incorrect or unmatched transaction would lead to denial of credit to the buyer. However, due to IT glitches, this concept did not take off since GST implementation and the requirement was deferred till necessary technological framework was put in place by the Government. The Government has now approved
formats of simplified single monthly / quarterly GST return to reduce the compliance burden on the taxpayers for replacing the multiple returns that were required to be filed in a tax period. Further, the Government has also introduced provisions to allow taxpayers to amend their tax returns in order to rectify errors which would widen the scope for availing input tax credit.

Even after one year of GST go-live, there has been deferment of implementation of provisions relating to advances and purchases from unregistered vendors, Tax Collection at Source (TCS) for e-commerce players and Tax Deducted at Source (TDS) for works contractors which leads to an atmosphere of ambiguity for existing businesses as well as those looking to set up new ventures.

While the above seeks to provide an overview of challenges being faced by all assesses, there are also sector specific concerns and focus areas in the real estate space. This paper attempts to cover such key sector specific concerns.
2. Impact of GST on Real Estate sector
2 Impact of GST on Real Estate sector

The highlight of the GST regime for the Real estate sector is the availability of Input Tax Credits (ITC) paid on inputs, capital goods and input services. Under the erstwhile regime, developers would be liable to pay a multitude of taxes such as VAT, Central Excise, Entry Tax, LBT, Octroi, Service Tax, etc., the credits of which were not freely available against the output tax liability. However, the GST regime provides for ITC eligibility on construction and other services procured, thereby eliminating the inefficiency ushered in by the cascading effect of taxes.

This paper attempts to shed light on the impact of GST thus far on the real estate sector and highlighting the key issues.

2.1 Effective tax rate

From a real estate developer’s standpoint, GST would apply on sale of under-construction properties i.e. prior to the receipt of Occupancy Certificate (OC). Under GST, the tax rate has been pegged at 18% (or 12% for specified affordable housing projects), with a standard 33% abatement being provided towards the value of the land. Thus, the effective GST rate for sale of under construction properties is 12%/8% of the entire agreement value as compared to around 5.5% (i.e. 4.5% Service Tax and 1% VAT under the composition scheme with limited credits) under the erstwhile indirect tax regime. Needless to say, GST levy is over and above the stamp duty (around 5%) payable on the agreement value.

This leads to an overall tax burden of around 17%-13%. Such a heavy tax burden on the transaction results in cost escalations for the final consumers. However, GST allows broader level of ITC, the agreement value should ideally reduce.

Multiple GST rates (5%, 12%, 18% and 28%) on procurement of inputs and input services is another aspect which adds complexity to the taxation system and leads to unwarranted classification disputes. The Government has indicated that it will continue to work on rationalization of rates and try to move towards a simplified tax rate structure. This has partially been recently addressed with rate reduction from 28% to 18% coming into effect on 27 July 2018.

2.2 Valuation of supply

Sale of land is not exigible to GST. Consequently, the GST law provides for a standard abatement of 33% of the total contract/agreement value towards value of land for taxable real estate transactions. While the allowance of abatement is welcome move from the Government, this is not representative of the land value; especially in metropolitan areas where land value can exceed around 50%-60% of the contract value. Thus, such provision creates a burden where the actual value of land is higher than the 33% norm; which effectively taxes the value of land.

It should be noted that the GST law is silent on whether this standard abatement would prevail even in case separate agreement is entered for land portion, or a separate value is demarcated towards land component, which is the historical practice adopted in certain states.

2.3 Input tax credit restrictions / reversals under development projects

GST is built on the foundation of a liberal credit regime i.e. to allow credit of all goods and services with minimal restrictions. GST law allows ITC of GST paid on inputs, input services and capital goods against the construction / works contract services provided by developers. However, the GST law restricts ITC of GST paid
on goods and services procured for construction of a building which is used for one’s own account. The interpretation of the term “used for own account” is unclear as it ideally should mean a building which is used for own business and not sold. However, the situation when the building is leased out is unclear. Thus, properties developed for leasing/rental purposes may not be entitled to ITC even though the rental income generated is taxable under GST. Credit restrictions would also apply to commercial constructions or immovable property (if it does not constitute “plant and machinery”) used in the course or furtherance of business, thereby increasing costs substantially. This is against the fundamental principle of free flow of credits. Under the erstwhile service tax regime, restriction to avail ITC was only on works contract services and not all goods and services.

Purchase and sale of lands/plots is a common phenomenon in the real estate industry. As such sale of land is not considered as supply of goods/services and outside GST. Contrary to this, GST law deems sale of land as an exempt supply and mandates proportionate reversal of common credits. This would result in an increase in tax cost as the credit attributed towards the sale of land shall be non-creditable.

Sale of properties after obtaining Occupancy Certificate (‘OC’) being outside the ambit of GST, developers may be required to reverse proportionate credit of GST on expenses incurred during a financial year attributable to such revenue. Considering that the construction period spreads over more than a year, the standard mechanism for credit reversal does not cater to the special attributes of this industry which has a multi-year cycle for each project. Further, common expenses such as administration charges, finance, marketing, etc. shall be required to be apportioned among projects and ITC reversal shall be triggered on such expenses on sale of properties post obtaining OC. The mechanism for bifurcation and reversal of such ITC needs to be determined on a case to case basis.

The effective GST rate for sale of real estate sector is 12%-8% while the median rate of tax on inputs/input services may be at 18-20% (cements, plywood, etc.) or 18% (subcontractor services, etc.). This may result in accumulation of credit due to an inverted duty structure (especially in affordable housing projects which attract tax at 12%). It would be imperative to determine whether refunds under inverted duty structure would be available, and if yes, would be computed at a registration level.

The GST law provides for disallowance of credit due to non-payment (of value and tax) to the vendors within 180 days. This may result in disallowance of ITC on the retentions on account of performance clauses made by the developers for the payments to be made to the subcontractors. This would result in working capital blockage either in the hands of the developer or the sub-contractors.

GST is applicable on advance paid for services (presently the provision regarding applicability of GST on advance of goods has currently been deferred). Hence, developer would be required to pay GST on advance paid to contractors. However, credit is allowed only after receipt of invoice and goods/services. This would result in working capital blockage. One may also have to analyze whether running bill would be treated as invoice. If the same is treated as invoice, the GST liability would be triggered at time of issuance of the running bill itself. This may however pose commercial challenges correct as running bill is typically modified/ amended in real estate industry.

**2.4 Taxability of development rights**

In states such as Maharashtra and Gujarat, the concept of tradable Development Right Certificates / Transferrable Development Rights (DRC / TDR) is very common in the real estate sector. Government provides DRC / TDR as a consideration against acquisition of land parcel from the owners or against construction services provided by developers in Slum Rehabilitation Projects (SRA Projects) etc. This DRC / TDR is freely transferrable and is commonly traded in the market. Similarly, many housing societies, land owners and corporates transfer development rights in land without selling the land outright which allows for development without a huge financial outlay.

There is a school of thought that DRC / TDR in spirit is at par with transactions in land i.e. land parcel and thus should not be taxable under GST. We understand that real estate developers have filed a writ petition in Bombay High Court against GST levy on development rights and is expected to be argued before the High Court on a priority basis.
Under GST law, ‘services’ is defined to be anything other than goods. Further, entry no 5 of Schedule III to the Central Goods and Services Tax Act, 2017 provides that sale of land would be treated as neither supply of goods nor services. Thus, given the wide definition of the term “services” under the GST law, the transfer of development rights may be considered as taxable service. In such a scenario, reverse charge implications in case of acquisition of development rights from the Government will also need to be analysed.

2.5 Joint Development Agreements (JDA)

It is a common practice for land owners and developers to come together and jointly develop a property. In such case, the land owner transfers development rights (TDR) in the land to the developer. In lieu of such rights, the developer may provide a share in the revenue from sale of the developed area or a fixed share in the developed area to the landowner.

The term ‘supply’ is defined in very wide terms which also includes barter/exchange of goods or services; whereas the term ‘services’ is defined to be anything other than goods. Further, entry no 5 of Schedule III provides that sale of land would be treated as neither supply of goods nor services. Ambiguity remains regarding taxability of transfer of development rights under the JDA and as to whether the same are liable to GST. However, a recent notification assumes that the transfer of development rights from the land owner to a developer is taxable.

In case of revenue sharing model, the constructed property is sold together by the land owner and developer post which the landowner is paid the agreed share. Under the erstwhile regime, there were litigations over the issue whether such collaboration between land owner and developer would constitute ‘unincorporated AOP’. The definition of “person” under the GST law includes an unincorporated AOP. Hence, ambiguity on JDA transactions may continue. It may be possible that each such AOP may be required to opt for separate registration under GST.

In case of area sharing model, the time of supply for transfer of development rights (by land owner) as well as supply of construction services (by developer) have been specified at the time of transfer of possession of /right in the constructed area by entering into conveyance deed or allotment letter. This could be beneficial for the developers as they would be in a position to utilize the ITC on development rights against their output taxes. However, restriction of ITC of the construction services in the hands of the land owner (if its share of properties is sold after issuance of OC) would result in added cost which could have an impact on the overall project cost of the developer. Given this, the timing of tax payment and related triggers for the same needs analysis.

In the absence of clarity on the valuation of development rights and constructed area for discharging GST (which is an issue that was debated in the service tax regime which still persists), it needs to be analysed whether the valuation of both the services (i.e. transfer of development rights and construction services) can be different or whether a common benchmark for valuing the services can be adopted.

2.6 Taxability of additional charges and reimbursable components

As part of sale of housing property, various charges are recovered by a developer from the customer in addition to the Basic Sale Price (such as preferential location charges for esteemed properties). These charges are inextricably linked to the sale of property as such charges would not be payable if the customer would not have bought the house. Similar charges are recovered in case of car parking charges, club house/amenities charges, etc.

The GST Act provides the concept of a composite supply which include a supply consisting of two or more goods or services or a combination of goods or services which are naturally bundled and supplied in conjunction with each other in the ordinary course of business. In case of composite supply, the supply is taxed as per rate applicable on the principal supply. The charges recovered by the developer in form of preferential location, car parking etc are part of a composite supply in which the principal supply is construction of complex.

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1 Notification No. 4/2018-Central Tax (Rate) dated 25 January 2018
Under GST, rate of 12% (18% less one third abatement) has been provided for construction of complex. There has been ambiguity whether such other charges can be clubbed with basic sale price for construction of complex and be chargeable at 12% or would be chargeable to tax at full rate of 18%.

Developers also recover statutory development charges in the form of internal development charges (EDC) and external development charges (‘EDC’) from the customers as they are mandatory to be collected and deposited to the Government. GST law provides for inclusion of taxes, duties, fees, charges levied under any law in the transaction value. Such provision explicates the Government’s intention to levy GST on any statutory levies. However, this would result in a ‘tax on tax’ situation and would result in increase in costs.

2.7 Taxability of interior construction services offered by developer to customers

The developers additionally charge certain customers towards interior construction or sale of mock-up flats or optional/built to suit features in flats. In this regard, the services provided by developer includes construction service and works contract service. Valuation and taxability of such supply shall be required to be ascertained where a single contract is entered with customer for such supplies. Further, where there is a single price, the availability of 1/3rd land deduction on entire contract value shall be required to be evaluated.

2.8 Adjustments for cancellation of bookings, rebates etc.

The construction projects in the real estate sector are spread over a span of couple of years. Consequently, the taxability of the same is also spread across the years based on billing milestones (defined in the development agreement). Cancellation of booking after 1-2 years is a common event in real estate industry where the amount paid by the customer may be refunded in whole, or in part by the developer after retention.

Further, offering rebates (like timely payment rebate, early move-in rebate, etc.) is also prevalent in the industry.

However, the time limits prescribed under the law for issuance of credit notes would lead to tax loss in many cases (as tax would have been paid but no adjustment would be available). Thus, the issuance of credit notes on account of cancellation of contracts or as a result of rebates offered pose a challenge for tax adjustments on the refundable portion and this will increase tax burden on end customer only as developer would not be in position to refund the tax amount back to customer.

2.9 Taxability of liquidated damages, cancellation charges, etc.

Developers may recover liquidated damages from their vendors i.e. subcontractors, etc. for delay in delivery, performance issues, etc. Such damages may also get adjusted from the invoice, thus resulting in net billing/payment.

Taxability of liquidated damages/cancellation charges have been matter of litigation even under the erstwhile indirect tax regime. Given the wide coverage of the definition of services, the ambiguity on their taxability continues even under the GST regime. In case of taxability of the same, it is likely that the developer may have to bear the tax cost since the compensation/charges would always be inclusive of taxes (unless recovered separately). The taxability of liquidated damages/cancellation charges have been matter of litigation even under the erstwhile indirect tax regime. It has been clarified in an Advance Ruling\(^2\) that levy of GST on liquidated damages would be covered under Schedule II entry no. 5(2)(e).

\(^2\) Maharashtra State Power Generation Company -2018-VIL-33-AAR (No.GST-ARA-15/2017-18/B-30)
2.10 Compensation received for alternate accommodation

Typically, in case of redevelopment projects, the existing landowners or society members are generally reimbursed for expenses incurred by them for alternate accommodation. Such expenses are generally in nature of rent reimbursement, displacement compensation, transportation and brokerage allowances, etc.

It would require analysis whether GST would be applicable on such charges received by the landowner considering that the Maharashtra Advance Ruling Authority in a recent matter of Zaver Shankarlal Bhanushali has upheld the levy of GST on such charges. Basis such ruling, it appears that every landowner / tenant getting compensated will be required to register under GST law and undertake compliances.

2.11 Anti-profiteering

Anti-profiteering provisions mandate passing on the tax benefits arising from GST to the customers by way of price reductions. Implementation of the anti-profiteering provisions is one of the key areas of conversation amidst the industry players. While the regulations seek to prevent entities from making excessive profits on account of GST implementation, an overarching anti-profiteering provision under the GST law without clear guidance or explicit rules has led to considerable ambiguity, primarily on account of the following:

a. The level of granularity of anti-profiteering analyses i.e. at aggregate company level, project level.

b. Whether the Indian tax payers can rely on mechanisms followed in other jurisdictions which recently introduced GST and had similar anti-profiteering provisions (such as Australia/ Malaysia).

c. Whether transition costs incurred by the Company on account of GST implementation may be absorbed while computing the anti-profiteering obligations.

d. On which date such price reductions were/ are to be made effective.

The first administrative instruction on anti-profiteering was issued by the Government for the real estate sector. Recently, the National Anti-Profiteering Authority (NAPA) has issued few orders – eg. one for a company dealing in automobiles and another for one engaged in rice business. In both these cases, the authority ruled in the favour of the companies. However, it is not clear from the rulings as to exactly how the revised price computations were carried out by the companies and how this computation may differ based on the nature of the product and business.

The sale price for the flats are dynamic and based on various factors i.e. saleable area, floor and location, payment terms, etc. In the absence of specific instructions, it would be difficult to determine the benchmark pre-GST price for passing on the benefit by reduction in prices.

The developers will have to rework their costing from scratch in order to ensure that the benefit of reduced costs is passed on to the customers to avoid defaulting under the anti-profiteering rules. This could prove to be a hassle for many developers especially in case of on-going projects on the appointed day of GST roll-out.

2.12 Decentralised GST registration

Due to the concept of decentralized registration under GST, every real estate developer will be required to obtain registration in every state where construction projects have been undertaken. It will be an arduous and a tedious task for the companies to execute with the compliance requirements such as returns, maintenance of separate records, etc. for each state. It should be noted that a proposed amendment to section 25(2) could

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3 Zaver Shankarlal Bhanushali vide order NO. GST-ARA-29/2017-18/B-37 dated 22/05/2018
4 F. No. 296/07/2017-CX.9 dated 15 June 2017
5 Dinesh Mohan Bhardwaj Vs Vrandavanshree Automotive Pvt Ltd - 2018-TIOL-01-NAPA-GST
potentially allow registration at the project level within a state. This will need to be analysed to generate any potential benefits.

Owing to the complications and ambiguities in relation to tax credits, etc. developers may intend to explore the option of project wise registrations. An analysis is required to ensure that credit accumulated on closure of one project does not lapse where multiple projects are under the same GSTIN, as compared to separate registrations obtained for each project.

### 2.13 Place of provision of supply

The place of provision for services in relation to immovable property is the location of the immovable property. There may be possible issues where a single contract is entered into for provision of services related to immovable properties across two or more States. For example, in case of works contract services, facility management services, etc. outsourced to vendors, typically a single contract may be entered into with the vendor for which consolidated invoices may be raised at one location. Under GST, since immovable property may be located in more than one State, the place of supply would be each such State where the immovable property is located and hence, there may be a requirement for the vendor to raise separate invoices (for which separate contracts or invoicing may also be required).

### 2.14 Taxability of stock transfers

Transfer of consumables, inputs, capital equipment, etc. from one site to another is quite common in this sector. Under the previous regime, such ‘branch transfers’ could be done without the payment of taxes. Owing to the removal of state barriers, there is a considerable relief in terms of transportation of material, machinery etc. from one state to another. In case goods are transferred by a developer between two locations having separate registrations, the same shall be treated as ‘supply’ and GST shall be payable. This leads to an increased effort in terms of valuation, invoicing, compliance, etc. Not to mention, this will mean blocking of working capital for the real estate company.

### 2.15 Transition issues and eligibility of credit on transition stock

In the pre-GST regime, developers were neither entitled to ITC of central excise duty in respect of inputs used for provision of works contract services because of conditions attached to availing abated rate under the service tax regime, nor ITC of VAT on inputs under composition scheme. Thus, these taxes formed cost and were embedded in the value charged from the buyers.

GST laws provides that credit of goods held in stock by the developers as on GST transition date should be available subject to satisfaction of certain conditions:

- The developer needs to be in possession of the invoice evidencing payment of duty and such invoice should not be issued more than twelve months prior to the GST transition date.
- Credit of central excise and VAT paid on goods held in stock as on transition date is not availed as credit in returns.
- The goods were required to be stored in a manner easily identifiable.

Input tax credits on inputs procured for construction of property not meant for further sale / supply is restricted. Thus, transition credit may be available only with respect to such goods lying in stock in the same manner as procured and not in relation to goods used in the construction activity. Further, the goods need to be easily identifiable. While this criteria is satisfied for items in stock as is; however, the identity is lost for all materials which is WIP (in the constructed property). The Government has also issued a clarification stating

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7 F. No. 296/07/2017-CX.9 dated 15 June 2017
that transition credit on inputs already consumed in the project as WIP is ineligible. Thus, transition credit may be available only with respect to such goods lying in stock in the form as procured and not in relation to goods used in the construction activity. Accordingly, the benefit of tax credits on under-construction projects is likely to be low.

Transition from one regime to another is always a difficult process and it was no different in the present case. The Government did allow for transition of all input tax credits in the books of accounts to the new regime, subject to fulfillment of prescribed conditions. This step taken by the Government was appreciated by the industry. However, the nuances for interpreting the conditions of availing such credit were not appropriately addressed. For eg. while the Krishi Kalyan Cess (‘KKC’) was available as input credit under the previous regime, there was no clarity on transitioning it to GST though the same is now sought to be reversed. Further, it was clarified in an Advance Ruling\(^8\) that KKC was ineligible for transition. The legality of such clarification is likely to be tested before the courts. Moreover, due to revenue collection challenges in the initial months, the Government also issued numerous notices disputing eligibility of transitional credit, thereby imposing more rigorous documentation / compliance requirements on players already reeling under transition challenges. Further, in some cases, due to technical glitches, the eligible transitional credit did not reflect on the GST portal or dealers were unable to electronically submit the prescribed forms. It is expected that the Government will address these concerns soon and give relief to taxpayers who have huge amounts that are blocked due to procedural challenges they faced or where they have failed to report credits due to inadvertent errors.

The GST law is ambiguous pertaining to availment of credit for past period payments (such as payment on account of tax demands, Additional duty of Customs and Special Additional Duty payable on account of non-fulfillment of export obligation under any of the Foreign Trade Policy schemes such as Advance Authorization, EPCG etc).

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\(^8\) Kansai Nerolac Paints Limited 2018-TIOL-09-AAR-GST (No GST-ARA-18/2017-18/B-25)
3. **In Conclusion**

Policy reforms such as the GST, registration of commercial and residential projects with Real Estate Regulatory Authority (‘RERA’), and easing of Foreign Direct Investment norms have started impacting investment scenario positively by bringing much-needed transparency, compliance and corporate governance into the system. The real estate sector is likely to flourish well in the coming years, with office and residential sectors to further strengthen and new sectors such as logistics and warehousing sector to witness increased traction.

Implementation of the GST is truly a remarkable achievement for the Government and India Inc. Although it is at its early days, GST started on a positive note and the benefits for all stakeholders are visible.

While GST has simplified the tax treatment for the real estate sector and has resolved some long standing issues of valuation, nature of supply etc., the significant benefit appears to be with regard to increased input credit on the procurement of goods and services.

However, there still persist certain grey areas which are yet to be evaluated by developers to stand the test of law; some of which include -

- taxability of land value where the same exceeds 33% of the total sale price and the developer has contracted separate agreements for the supply of land and construction property;

- adopting different tax computation methods for different projects / phases of the same projects;

- taxability of charges in respect of preferential location, car parking, electricity deposits etc and eligibility of one-third land deduction on the same;

- eligibility of developers to claim refund under the inverted duty structure
Thank you