Tax on Transfer of Development Rights: An Indirect Tax Perspective

1. **Meaning of Transfer of Development Rights ('TDRs')**

To understand the meaning of TDRs, first of all one needs to understand the working style under the real estate sector. Under this sector various kinds of Joint Development Agreements have been entered between various parties.

One such type is TDRs, where landowner offers rights in his land to the developer and developer undertakes construction activity on the land owned by the landowner. They both share certain portion of the area under-construction in an agreed manner. Both the parties have liberty to sale the under-construction area from their own share to the prospective buyers as well.

2. **GST on TDRs:**

- For levy of GST on TDRs, first we need to understand whether TDRs are goods or services under GST. Section 2 of the Central Goods and Services Tax Act, 2017 ('the CGST Act') provides definition of goods and services, the same as been reproduced hereunder:

(52) "goods" means every kind of ***movable property*** *other than money and securities but includes actionable claim, growing crops, grass and things attached to or forming part of the land which are agreed to be severed before supply or under a contract of supply;*

(102) "services" means ***anything other than goods****, money and securities but includes activities relating to the use of money or its conversion by cash or by any other mode, from one form, currency or denomination, to another form, currency or denomination for which a separate consideration is charged;*

- TDR refers to transfer of right in land by the landowner. The right is not a movable property. Hence, TDRs cannot be said as goods under the CGST Act.

- Further, the term immovable property has not been defined under the CGST Act and Finance Act, 1994. Therefore, to understand the meaning we need to borrow the definition from the General Clauses Act, 1897 which is reproduced as under:

Section 3 (26) states "immovable property" shall include land, benefits to arise out of land, and things attached to the earth, or permanently fastened to anything attached to the earth.

- TDRs are benefits which arises out of land and therefore, as per the above stated definition of immoveable property, TDRs can be considered as immovable property. The same view has been pronounced by judiciary, which are mentioned hereunder:

- ✓ In the case of **Chheda Housing Development Corporation Vs Bibijan Shaikh Farid - 2007 (2) TMI 664 – Bombay High Court**, the Hon'ble Court has observed that the benefit arising from land is an immovable property and FSI/TDR being benefit arising out of land must be held to be immovable property. Relevant Para of the Judgment is extracted below:

  > *15…… From these judgments what appears is that a benefit arising from the land is immovable property. FSI/TDR being a benefit arising from the land, consequently must be held to be immovable property and an Agreement for use of TDR consequently can be specifically enforced, unless it is established that compensation in money would be an adequate relief.*

- ✓ Further, the **Hon'ble Bombay High Court in the matter of Sadoday Builders Pvt. Ltd.** (2011)6 Bom CR 42 has relied on the Judgement given in Chheda Housing Development Corporation and held that transfer of development rights are benefits arising out of land and therefore must be considered as immovable property.

- ✓ In the case of **DLF Commercial Projects Corporations Vs. Commissioner of Service Tax, Gurugram 2019 (5) TMI 1299 – CESTAT (Chandigarh)** the Hon'ble CESTAT (Chandigarh) has held that transfer of development rights is an immovable property and no service tax is payable on the same. Relevant para of the Judgment is extracted herein:

  > *16. …. As the Hon'ble High Court observed in the case of Sadoday Builders Private Ltd. and Ors. (supra) that transferrable development right is immovable property, therefore, the transfer of development rights in the case in hand is termed as immovable property in terms of Section 3 (26) of General Clauses Act, 1897 and no service tax is payable as per the exclusion in terms of Section 65B (44) of the Finance Act, 1994.*

From the above judicial pronouncements, we can conclude, TDRs are immovable property. Therefore, the same are covered under the definition of services, which means anything other than goods, under the CGST Act.

Hence, transfer of development right is 'Supply' under Section 7 of the CGST Act. Therefore, GST will be leviable.

3. <u>Tax Rate, SAC and person liable to pay tax:</u>

- ➢ TDRs are taxable at the rate of 18% under the SAC – 9972 i.e., Real Estate Services.

<u>Person liable to pay GST on TDRs:</u>

- ➢ Till March 31, 2019, tax was payable by transferor of development rights i.e. land-owner who transfers his right in land to the promoter (i.e. builder).

- This provision was changed w.e.f April 1, 2019, vide Notification No. 05/ 2019 – CT (Rate) dated March 29, 2019. Accordingly, S.No. 5B of Notification No. 13/2017 – CT (Rate) dated June 28, 2017 has been inserted w.e.f April 1, 2019, which has been explained as under:

- W.e.f April 1, 2019, the promoter is liable to pay tax under reverse charge on development rights received on or after April 1, 2019 for construction of project. It may either be residential or commercial.

4. **Exemption on TDRs:**

- W.e.f April 1, 2019, vide Notification No. 4/2019- CT (Rate) dated March 29, 2019, the government has inserted a new entry no. 41A for granting exemption on TDR for construction of **Residential Apartments**. The same has been reproduced here under:

  - ✓ *"Service by way of transfer of development rights (herein refer TDR) on or after 1st April, 2019 for construction of **residential apartments** by a promoter in a project, intended for sale to a buyer, wholly or partly, except where the entire consideration has been received after issuance of completion certificate, where required, by the competent authority or after its first occupation, whichever is earlier.*

    *The amount of GST exemption available for construction of **residential apartments** in the project under this notification shall be calculated as under:*

    *[GST payable on TDR for construction of the project]x (carpet area of the **residential apartments** in the project ÷ Total carpet area of the **residential and commercial apartments** in the project)"*

- In simple words, the exemption is not available: –

  (a) Where the entire consideration of residential apartment is received after the completion certificate or first occupation i.e. when ready residential apartments are sold without GST; (i.e. exemption is available to the extent of residential apartments sold before completion);

  (b) Development Rights transferred prior to April 1, 2019;

  (c) Transfer of development rights for commercial apartments.

- At last, it is pertinent to note that as per formula provided in exemption notification, the amount of exemption is restricted to the proportionate area of the residential apartments without any distinction of project in real estate project ('REP') / residential real estate project ('RREP'). Therefore, TDRs proportionate to commercial area in RREP are not subjected to exemption.

- Conditions related to exemption:

Two conditions have been provided under the said exemption.

(i) First one, is related to liability to pay Tax on exempted TDRs on un-booked apartment on the date of issuance of completion certificate. The relevant extract has been reproduced as under:

- ✓ *"Provided that the promoter shall be liable to pay tax at the applicable rate, on reverse charge basis, on such proportion of value of development rights, as is attributable to the **residential apartments,** which remain un-booked on the date of issuance of completion certificate, or first occupation of the project, as the case may be, in the following manner:*

  *[**GST payable** on TDR for construction of the **residential apartments** in the project but for the exemption contained herein] x (carpet area of the residential apartments in the project which remain **un-booked** on the date of issuance of completion certificate or first occupation ÷ **Total** carpet area of the residential apartments in the project)".*

  Time of supply in such cases shall be earlier of, date of completion or first occupation of the project.

(ii) Second one, is providing an upper limit of tax liability of development rights on un-booked residential apartments. The relevant extract is reproduced as under:

- ✓ *"Provided further that tax payable in terms of the first proviso herein above shall not exceed 0.5 percent of the value in case of affordable residential apartments* and 2.5 percent of the value in case of residential apartments other than affordable residential apartments remaining un-booked on the date of issuance of completion certificate or first occupation".*

  In simple words, tax payable under RCM shall not exceed:

- 1% of the value, in case of affordable residential apartments; and
- 5% of the value, in case of residential apartments other than affordable residential apartments

remaining un-booked on the date of issuance of completion certificate or first occupation.

***Note**: *Affordable residential apartment means a residential apartment in a project commences on or after April 1, 2019, or in an ongoing project where the promoter has not exercised the option, having carpet area ≤ 60 sq. meters in metropolitan cities or 90 sq. meters in other than metropolitan cities and for which gross amount charged ≤ 45 lakhs rupees.*

5. Time of Supply ('TOS'):

- The liability to pay tax on the goods and services shall arise at the time of supply of goods and services, as determined in accordance with the provisions of Section 12 and 13 of the CGST Act for the goods and services respectively.

- Let's discuss the TOS of the TDRs:

  - Until January 24, 2018 there are no specific provisions which provides that landowner and developers were liable to pay tax under a joint development agreement.

  - On January 25, 2018, the government has issued a notification number 4/2018 – CT (Rate), which provides as under:

    - Registered persons who supply development rights to a developer, builder, construction company, wholly or partly, ***in the form of construction service*** of complex, building or civil structure – liability to pay tax on said services shall arise when the said developer transfers the possession or rights in constructed complex to the person supplying the development rights by entering into a conveyance deed or similar instrument (Ex: allotment letter).

    - Further, in case the consideration is received in ***monetary form*** then, Section 13 of the CGST Act – continues to apply.

  - This position has been amended by Notification No. 6/ 2019 – CT (Rate) dated March 29, 2019, applicable w.e.f April 1, 2019 provides as under:

    As discussed above, w.e.f April 1, 2019, the promoter (builder) is liable to pay tax under the RCM. Therefore, below provisions shall be read accordingly.

    - Consideration is given by the promoter ***in the form of construction service*** (i.e. construction of commercial or residential apartments) – TOS is the date of completion certificate of project or its first occupation whichever is earlier [S.No. (a) of N.No. 6/2019 – CT(Rate)]

    - Consideration is paid by the promoter in ***cash (i.e. monetary consideration)***, in this scenario, the notification provides separate TOS in respect of residential and commercial apartment. The same is discussed as under:

      - ***For residential apartment*** – TOS is date of completion certificate of project or its first occupation, whichever is earlier [S.No. (b) of N.No. 6/2019 – CT(Rate)].

- ***For commercial apartment*** – TOS shall be the date when payment is made by the promoter for transfer of rights to supplier of service (i.e. landowner) or within 60 days from contract, whichever is earlier [S.No. 13(3) of the CGST Act]

- Recently, this position has been further amended by notification no. 03/ 2021 – CT (Rate) dated June 2, 2021. Let's discuss the scenario in detail. For the purpose of analysis, the author(s) start the conceptual discussion from the initial stage:

- Under a joint development agreement, the transferor of development rights ('landowner – promoter') may sale his share of apartments (received from developer promoter in lieu of TDRs) to others. If he sales after obtaining completion certificate, the issue of GST does not arise. However, if he sales before completion certificate or first occupation, whichever is earlier, liability of GST will arise.

- In such case, the promoter developer shall charge GST to landowner – promoter by raising tax invoice. The landowner – promoter can take its input tax credit and in turn, raise tax invoice on the buyer. The statutory provision, as contained in fourth proviso to S.No. 3(i) of Notification No. 11/2017 – CT (Rate) dated June 28, 2017, as amended time to time, which is reproduced as under:

  - *"Where a registered person (landowner- promoter) who transfers development right to a promoter (developer- promoter) against consideration, wholly or partly, in the form of construction of apartments, -*

  (i) the developer- promoter shall pay tax on supply of construction of apartments to the landowner- promoter, and

  (ii) such landowner – promoter shall be eligible for credit of taxes charged from him by the developer promoter towards the supply of construction of apartments by developer- promoter to him, provided the landowner- promoter further supplies such apartments to his buyers before issuance of completion certificate or first occupation, whichever is earlier, and pays tax on the same which is not less than the amount of tax charged from him on construction of such apartments by the developer- promoter".

➢ **Time of Supply of service of developer – promoter:**

- As per clause (d) of Notification No. 6/ 2019- CT (Rate) dated March 29, 2019, in case of *supply of construction service by promoter against consideration* in the form of development rights shall arise on date of completion certificate of project by competent authority or first occupation, whichever is earlier.
- Thus, liability of developer promoter to pay GST arises only when completion certificate **is obtained**. However, the landowner - promoter is required to issue tax invoice when he makes supply to his buyer **before** issuance of completion certificate by competent authority.

- Thus, there is a time mismatch. The landowner – promoter is required to pay tax first while he can take input tax credit of tax charged to him by promoter developer only on obtaining completion certificate. In many cases, the land owner promoter may not be able to utilise the input tax credit which may go waste, or we can say it leads to accumulation of input tax credit in the hands of landowner, if the landowner promoter does not have any project in hand.

- This issue came in knowledge of GST Council and recently in their 43rd Council meeting they have recommended to make suitable changes in this regard. The relevant extract of press release is reproduced hereunder:

    - *"To make appropriate changes in the relevant notification for an explicit provision to make it clear that land owner promoters could utilize credit of GST charged to them by developer promoters in respect of such apartments that are subsequently sold by the land promotor and on which GST is paid. The* ***developer promotor shall be allowed to pay GST relating to such apartments any time before or at the time of issuance of completion certificate".***

    - Accordingly, notification no. 3/2021 – CT (Rate) dated June 2, 2021 has been issued by the government and therefore TOS shall be *in a tax period not later than the tax period in which the date of issuance of the completion certificate for the project, where required, by the competent authority, or the date of its first occupation, whichever is earlier, falls.*

    - Now, after the amendment, there will be no time mismatch, since the land owner promoter and developer promoter may pay the tax at any time before or at the time of completion certificate.

6. <u>Valuation provisions:</u>

➢ After the above discussion, now it's turn to analyse at what value the tax needs to paid by the developer promoter under RCM. The applicable legal provisions are reproduced as under:

- Paragraph 2 of Notification 11/2017 – CT (Rate) dated June 28, 2017, as amended vide notification no. 3/2019 – dated March 29, 2019, inserted w.e.f April 1, 2019:

    "In case of supply of service specified in column (3), in item (i), (ia), (ib), (ic), (id), (ie) and (if) against serial number 3 of the Table above, involving transfer of land or undivided share of land, as the case may be, the value of such supply shall be equivalent to the total amount charged for such supply less the value of transfer of land or undivided share of land, as the case may be, and the value of such transfer of land or undivided share of land, as the case may be, in such supply ***shall be deemed to be one third of the total amount charged for such supply****".*

- Paragraph 2A of Notification 11/2017 – CT (Rate) dated June 28, 2017, as amended vide notification no. 3/2019 – dated March 29, 2019, inserted w.e.f April 1, 2019:

  "2A. Where a registered person transfers development right to a promoter against consideration, wholly or partly, in the form of construction of apartments, the value of construction service in respect of such apartments shall be deemed to be equal to the Total Amount charged ***for similar apartments*** *in the project from the independent buyers, other than the person transferring the development right,* ***nearest to the date on which such development right*** *is transferred to the promoter, less the value of transfer of land, if any, as prescribed in paragraph 2 above."*

  Explanation. –For the purposes of this paragraph and paragraph 2A below, "total amount" means the sum total of, -

  (a) consideration charged for aforesaid service; and

  (b) amount charged for transfer of land or undivided share of land, as the case may be including by way of lease or sub-lease.

➢ In simple words, the analysis is as under:

- If the transferor of development rights transfers development rights and receives consideration in form of cash, the value of such supply will be the amount of money received in cash.

- If the transferor of development rights transfers development rights and receives consideration in form of construction of apartments, the value will be equal to total amount charged by developer – promoter from other buyers of similar apartments less the value of land, which will be taken as one third of total amount charged.

- If he receives partly in cash and partly in form of construction of apartments, the value will be sum of both the two.

7. <u>Understanding with the help of example:</u>

The provision discussed above is defined in very inexpert manner. Hence, we have to understand the provision considering the principles behind the provisions.

Ex: A promoter (Mr. P) entered into agreement with landowner (Mr. L) for transfer of development rights on May 15, 2019. As per the agreement, promoter was allowed to develop a real estate project on the land. The promoter had agreed to give apartments consisting of 40% of the carpet area to land owner as consideration for granting development rights to promoter. The real estate project was of 100 apartments of same size. Out of these 100 apartments, 40 apartments were to be given by promoter to land owner. It was agreed that promoter

will make all the bookings and sales, even of apartments given to land owner. The project was registered under RERA and construction commenced in August 2019.

The promoter has started booking of apartments in September 2019. The rate offered was 75 lakhs per apartment and first two apartments were booked at that rate.

The construction was completed on November 20, 2020. Five apartments were sold in October 2020 for Rs. 102 lakhs each.

Calculate value of transfer of development rights on which the promoter is liable to pay GST under reverse charge (without considering the exemption available in respect of residential apartments booked prior November 20, 2020) and the GST payable.

Also, calculate the value of apartments remaining un-booked on November 20, 2020.

Answer:

The development rights were transferred in May 2019. The booking rate at that time was Rs. 75 lakhs. Hence, the value of supply of service is {Rs. 75 lakhs - (1/3*75 lakhs)} = 50 lakhs. *[1/3rd has been deducted as standard value of land as provided in notification]*.

Since 40 apartments were to be given to landowner, the total value of transfer of development rights – 40 *50 lakhs = Rs. 2,000 lakhs.

GST payable on transfer of development rights = Rs. 2,000 lakhs * 18% = Rs. 360 lakhs.

The value of un-booked apartments is to be considered on the basis of similar apartments booked nearest to the date of completion. The apartments were booked by the promoter for Rs. 102 lakhs in October 2020. Hence, value of the apartment nearest to the date of completion is {Rs. 102 lakhs - (1/3*102 lakhs)} = 68 lakhs.

Since, 30 residential apartments remained un-booked on the date of completion certificate, the value of un-booked apartments = Rs. 68 lakhs * 30 = Rs. 2,040 lakhs.

Ex: In the aforesaid example, out of 100 apartments, 30 were commercial apartments and 70 were residential apartments. Carpet area of each is 100 sq. meters. Out of these, 20 commercial apartments and 40 residential apartments were booked prior to date of completion certificate. Value and carpet area of commercial and residential apartments are same. Calculate the exemption available to promoter in respect of GST on development rights and GST payable by promoter under reverse charge on transfer of development rights.

Answer: The calculation are as follows:

GST payable on transfer of development rights is Rs. 360 lakhs (as calculated above).

Carpet area of residential apartments of project = 70 * 100 = 7,000 sq. meters.

Total carpet area of residential and commercial apartments = 100 * 100 = 10,000 sq. meters.

Carpet area of residential apartments which remain un-booked on the date of completion = 30 *100 = 3,000 sq. meters.

Step 1: *GST on transfer of development rights attributable residential apartments =*

GST payable on TDR for construction of project * (carpet area of the residential apartments in the project) / (Total carpet area of the residential and commercial apartments in the project).

Hence, GST on transfer of development rights attributable residential apartments = Rs. 360 lakhs * 7,000 sq. meters. /10,000 sq. meters. = Rs. 252 lakhs.

Step 2: *GST payable on residential apartments remain un-booked on date of completion =*

GST payable on development rights * (carpet area of the residential apartments in the project which remain un-booked on date of issuance of completion certificate or first occupation) / (Total carpet area of residential apartments in the project).

Hence, GST payable on residential apartments remain un-booked on date of completion = Rs. 252 lakhs * 3000 sq. meters / 7000 sq. meters = Rs. 108 lakhs.

Step 3: Upper limit:

The tax payable shall not exceed 1% of value of affordable residential apartments remaining un-booked and 5% of value of residential apartments (other than affordable residential apartments) remaining un-booked on date of completion.

The value nearest to date of completion is Rs. 2,040 lakhs (as in above example). Since area of each residential apartment is 100 sq. meters, these are residential apartments (other than affordable residential apartments). Hence, 5 % of Rs. 2,040 lakhs = Rs. 102 lakhs.

Thus, GST payable on un-booked residential apartments is Rs. 102 lakhs due to the ceiling.

Conclusion:

Exemption available on development rights pertaining to residential apartments which were booked prior to the date of completion = Step 1 – Step 2 = Rs. 252 lakhs – Rs. 102 lakhs = Rs. 150 lakhs.

GST payable by promoter on transfer of development rights under reverse charge = Total GST Rs. 360 lakhs – Exemption available on transfer of development rights pertaining to residential apartments transferred prior to completion certificate/ occupancy certificate i.e. Rs. 150 lakhs = Rs. 210 lakhs.

Thus, the developer is liable to pay Rs. 210 lakhs under reverse charge as GST on transfer of development rights.

Further, the above calculations can be checked by making same calculations in a different manner:

(i) GST on transfer of development rights attributable on commercial apartments:

[GST payable on TDR * (carpet area of the commercial apartments in the project) / (Total carpet area of the residential and commercial apartments in the project)] = Rs. 360 lakhs * 3,000 lakhs / 10,000 lakhs = Rs. 108 lakhs.

(ii) GST payable on un-booked residential apartments = Rs. 102 lakhs (due to ceiling limit).

Total GST payable by promoter on reverse charge basis = (i) + (ii) = Rs. 108 lakhs + Rs. 102 lakhs = Rs. 210 lakhs.

Disclaimer:

The views expressed herein are the views of the author and cannot be used in framing of opinions or for the purpose of compliance without an independent evaluation. Author can be reached at: cayugalgoyal@gmail.com.

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