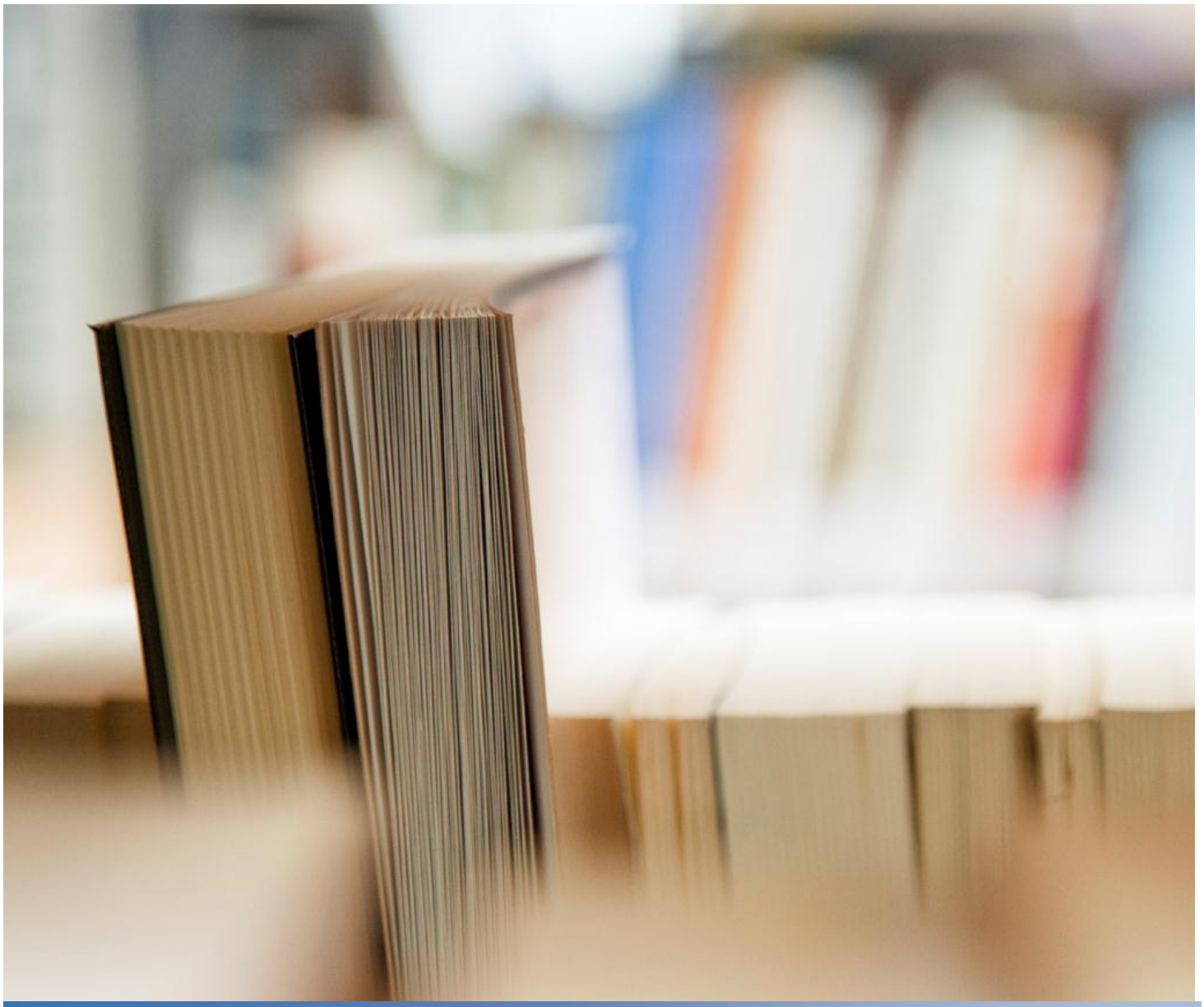

Development Agreement - A Taxability and Timing perspective

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1. Preamble

Ever since the advent of GST, there have been widespread disputes over the taxability of GST in respect of development agreement entered between the landowner and the builder. The major area of concern for the industry has been the question whether the land development rights transferred by the landowner to the developer should be considered as taxable under GST Law. Further, if such transaction is taxable then the timing of payment of taxes for the developer and the landowner has been an equally pertinent issue raised by the real estate sector as a whole. This article purports to examine these apposite issues and provide an in-depth analytical perspective upon them. It is understood that this issue is a vexed one at that, and the revenue will go to any extent and attempt to levy GST.

2. Taxability of the construction services

a. As per Section 9 of the CGST Act 2017, CGST is levied on all intra state supplies of goods or services or both except on alcoholic liquor for human consumption. To have a clear understanding of this section, it is imperative that three major definitions be examined here – goods, services and supply. The following are the definitions of goods and services as per Section 2(52) and 2(102) of the CGST Act 2017:

"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;

"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.

On a plain reading of the above two definitions , it can be inferred that only movable properties can be classified within the ambit of goods. The way the definition of services has been structured, it includes anything other than goods, money and securities. Thereby, it appears that immovable property may also get covered within the term 'services'.

b. Now, in order to be leviable to tax, the definition of 'supply' should also be closely examined. The definition of supply as per Section 7(1) of the CGST Act 2017 has been given below:

"supply" includes—

(a) all forms of supply of goods or services or both such as sale, transfer, barter, exchange, licence, rental, lease or disposal made or agreed to be made for a consideration by a person in the course or furtherance of business;

(b) import of services for a consideration whether or not in the course or furtherance of business;

(c) the activities specified in Schedule I, made or agreed to be made without a consideration; and

(d) the activities to be treated as supply of goods or supply of services as referred to in Schedule II."

Clause 5(b) of Schedule II deems the following to be supply of services:

"construction of a complex, building, civil structure or a part thereof, including a complex or building 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."

From the above, it can be inferred that any construction services provided for sale to a buyer where even a part of the consideration is received before earlier of two events, the said activity will be deemed to be supply of services. The two events are:

(i) Issuance of completion certificate by the competent authority; or

(ii) First occupation

It does not matter whether the construction services are provided to the landowner or to a buyer. In both the situations, the services provided by the developer will be considered as a supply.

c. In order to determine the taxability where the entire consideration is received after the two events given above, one needs to refer to Section 7(2) of the CGST Act read with Schedule III. Section 7(2) overrides the definition of supply given as per Section 7(1) of the CGST Act 2017. As per this sub-section, the activities or transactions specified in Schedule III are to be treated as neither supply of goods nor supply of services. Since this sub-section overrides Section 7(1), the said activities or transactions will not be construed as supplies even though they qualify as supply in terms of sub-section (1) of Section 7. Para 5 of the said Schedule III states the following:

"Sale of land and, subject to clause (b) of paragraph 5 of Schedule II, sale of building"

As mentioned above, construction services are considered as supply only if any part of the consideration is received before the earlier of the two events i.e. obtaining of completion certificate and first occupation. If the entire consideration is received after the earlier of the two events, then the said activity will fall within the ambit of Schedule III para 5 cited supraand therefore, the said activities or transactions will not be covered within the scope of the definition of supply. So, any flat or apartment sold

to any buyer after the occurrence of these two events cited supra, will not tantamount to be a supply and thereby not leviable to GST.

3. Taxability of land development rights

i. In order to properly understand and determine the taxability of the land development rights which are given (or granted) by the landowner to the developer, one should carefully analyse the definition of the word 'supply' and activities covered in Schedule II and activities or transactions stated in Schedule III. The definition of supply is an inclusive one and purports to cover within its scope and ambit even such of those activities which are not expressly mentioned, but are implied to be part of the definition. It has already been stated above that the activities specified in Schedule II will be deemed to be supplies. Further, the activities or transactions specified in Schedule III will be considered as - neither supply of goods nor supply of services.

ii. To enable one to understand the tax implications of land development rights under Schedule II, one should carefully analyse Schedule III first. Para 5 of Schedule III which reads *"Sale of land and, subject to clause (b) of paragraph 5 of Schedule II, sale of building"* excludes sale of land and completed building from the ambit of supply. Sale of land can be basically categorized as neither supply of goods and nor supply of services and thereby not leviable to tax under the GST Laws.

iii. To analyse and understand as to whether transfer of land development rights can be construed as sale of land, one should compare the said provision with the definition of service given under the Service tax law.

iv. As per the extract of the Section 65B (44) of the Finance Act, 1994:

"service" means any activity carried out by a person for another for consideration, and includes a declared service, but shall not include—

(a) an activity which constitutes merely—

(i) a transfer of title in goods or immovable property, by way of sale, gift or in any other manner

As per the definition of service under Service tax law, transfer of title in immovable property was not at all a service . The definition of immovable property was not given under the Service tax law. Thereby, one needs to borrow the definition of immovable property from other Acts.

v. As per the Registration Act 1880:

"immovable Property" includes land, buildings, hereditary allowances, rights to ways, lights, ferries, fisheries or any other benefit to arise out of land, and things attached to the earth, or permanently fastened to anything which is attached to the earth, but not standing timber, growing crops nor grass

vi. As per the General Clauses Act 1897:

"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".

On an understanding of the above definitions one could infer that benefits arising out of land can also be considered as an immovable property. Also, since it is expressly provided (as compared to the land itself), one can easily argue that land is a separate element as compared to the benefits arising out of land. What was excluded from service tax was both these elements of land and benefits arising out of land.

vii. However, under the GST laws, the exclusion as per Schedule III is only the land and not benefit arising out of land. Thus, several experts argue that "it can be inferred that benefits arising out of land was not taxable under the Service tax law but the same is leviable to tax under the GST law".The other school of thought is that since transactions relating to "sale of land" are neither a supply of goods nor a supply of services, the benefits arising out of land (being an immovable property also ought to be treated 'sale of land' and would

therefore stand excluded from the definition of the word supply and would therefore, be outside the ambit of the GST laws.

viii. In this paper, an attempt is made to analyse the tax and timing implications by assuming that such transactions are taxable transactions under the GST Laws. Therefore, on the assumption that such transactions are taxable one should examine whether development rights can be classified as 'sale land' or 'benefits that arise out of land'.

ix. The fact is that the 'Development Rights' are actually given or granted by the landowner to the developer for the limited purpose of construction, owning and reselling the building relating to the developer's share which arise out of the said development. Thus, the developer does not get complete ownership of the land. He is bound by the terms of the development agreement for the use of the land. In a complete transfer of title, there cannot be any limited rights over the use of the land. Therefore, if one were to assume that such transactions are taxable then, the transfer of development rights should not be equated with 'sale of land'. This is perhaps, the argument that the revenue would bank upon to subject such transactions to the levy under the GST laws.

x. The following judgements are relevant:

In the case of Chheda Housing Development ... vs Bibijan Shaikh Farid And Ors. on 15 Feb, 2007 (2007 SCC Online Bombay 130), it was held that TDR being a benefit arising from the land, consequently must be held to be immovable property.

In the case of Sadoday Builders Private Limited v. Joint Charity Commissioner (2011 SCC Online Bombay 760), the Hon'ble Bombay High Court was dealing with Section 36(1)(c) of the Bombay Public Trusts Act, 1950 which necessitated taking permission of the Charity Commissioner for sale of immovable property.

The Court held that transferable development rights are benefits arising out of land and must be considered as immovable property.

A plain reading of the above judgements indicate that the transfer of development right is to be considered as benefits arising of land and will be classified as immovable property. However, the revenue may contend that the same cannot be construed as sale of land and therefore, it will not be excluded from the definition of supply as per Schedule III, experts will argue that benefits arising from land would undisputable be in the nature of a 'sale of land' and would therefore remain outside the scope of the definition of the word supply. This is a vexed issue and the apex Court alone can settle this vexed issue.

xi. Even though the transfer of development rights is not explicitly or expressly mentioned in the definition of the word 'supply', the revenue would necessarily put forth the contention or argument that inclusive definition of the word 'supply' ensures that such activity also gets covered within the scope and ambit of the word 'supply' (experts would counter this argument by saying that what is not expressly or explicitly stated in law is prohibited by law meaning – the immovable property cannot be a subject matter of levy. Section 7(1)(a) of the CGST Act 2017 covers all supplies of goods and/or services for a consideration in the course or furtherance of business. The revenue will contest the matter by stating that the all-encompassing definition of business given under the GST law, even the transfer of development rights should be covered therein. As regards the consideration, the developer has to pay to the landowner in some form i.e. construction services in case of area sharing agreement or a share from the flat sold to a third party buyer in case of a revenue sharing agreement.

4. Time of supply in an area sharing agreement (assuming that there is a 'supply')

i. As discussed above in para 3 under taxability, there are two services which are supplied concurrently in the case of an area sharing agreement:

a) construction service by the builder to the landowner

b) land development rights by the landowner to the builder

ii. In order to determine the time of payment of taxes in case of services, one should interpret Section 13 which deals with time of supply of services. However, Section 148 allows the Government to notify certain classes of registered persons and the special procedures that can be followed by such persons with regard to registration, furnishing of return, payment of taxes and administration of such persons. Under this section, the Government issued Notification no. 4/2018-Central tax (rate) dated 25th January 2018. This notification provides a special procedure with regard to the timing of payment of taxes for both the landowners and the developers in case of an area sharing agreement. Following are the wordings of the said notification:

"In exercise of the powers conferred by section 148 of the Central Goods and Services Tax Act, 2017 (12 of 2017), the Central Government, on the recommendations of the Council, hereby notifies the following classes of registered persons, namely:-

(a) registered persons who supply development rights to a developer, builder, construction company or any other registered person against consideration, wholly or partly, in the form of construction service of complex, building or civil structure; and

(b) registered persons who supply construction service of complex, building or civil structure to supplier of development rights against consideration, wholly or partly, in the form of transfer of development rights,

as the registered persons in whose case the liability to pay central tax on supply of the said services, on the consideration received in the form of construction service referred to in clause (a) above and in the form of development rights referred to in clause (b)

above, shall arise at the time when the said developer, builder, construction company or any other registered person, as the case may be, transfers possession or the right in the constructed complex, building or civil structure, to the person supplying the development rights by entering into a conveyance deed or similar instrument (for example allotment letter)"

iii. On a plain reading of the above notification, it can be gathered that it recognizes the payment of taxes for both the landowner and the developer supplying development rights and construction services to each other respectively. On making a threadbare analysis, it can be seen that the liability for payment of goods and service tax arises (a) either upon transfer of possession or (b) at the time of transfer of that right in the property - to the landowner. Any one of these two events can attract the payment of goods and service tax.

iv. Possession means making available the property for usage by the other person. As regards the right in the property, the right to resell is one of the primary rights that should be considered to be accruing in the property. The right in the property can only arise if the flats have been allocated between the landowner and the builder. Once, any of the two events i.e. right or possession arises in the property, the timing of payment of taxes will be triggered. This transfer of right or possession can be by means of conveyance deed or a similar instrument which includes an allotment letter. The primary purpose of allotment letter is to allot the flats which can be handed over at a future date to the landowner. Upon allotment, the right in the property will be said have arisen and GST will be payable. When the allotment takes place, the right to sell those flats also arises for the landowner. A right in the property is passed upon the allotment whereas the possession may be transferred at a later date. Had the intention been to only cover the aspect of possession, the word 'right' would not have been mentioned in the notification. Also,

'allotment letter' as one of the instruments in the Notification affirms the fact that the right can be considered to have been transferred by means of an allotment letter. As already mentioned above, transfer of either right or possession can result in liability for payment of GST. So, the allotment will entail the requirement of paying GST in the given situation. This allotment may take place either at the time of entering into the joint development agreement or at a future date when the area sharing happens. If the joint development agreement provides for the allotment of flats, then the tax will be required to be paid at the time of entering into the agreement itself. There will be no requirement of an allotment letter separately. However, if the joint development agreement does not provide for the allotment of flats and the same takes place at a future date, then the tax liability will be attracted when the said allotment happens.

5. Time of supply in a revenue sharing agreement

i. In a revenue sharing agreement, the developer gets the land development rights from the landowner against which he contracts to provide a share in the revenue from the flats sold back to the landowner. Here, it should be first determined whether the services provided can be construed as continuous supply of services. As per Section 2(33) of the CGST Act 2017:

> *"continuous supply of services" means a supply of services which is provided, or agreed to be provided, continuously or on recurrent basis, under a contract, for a period exceeding three months with periodic payment obligations and includes supply of such services as the Government may, subject to such conditions, as it may, by notification, specify;*

ii. As per the above definition, continuous supply of services can be categorized into two kinds:

a) any service provided or agreed to be provided continuously or on recurrent basis under a contract for a period exceeding three months with the obligation for payment periodically

b) any services which is notified by the Central Government to be a continuous supply of service

iii. Till date, no services have been notified to be continuous supply of services . However, under point (a) above, all services which are provided continuously/ recurrently for a period greater than 3 months against which payment is required periodically will be covered. Provision of land development rights perfectly fits into the mould of such services. Till the landowner receives his complete share for the flats sold by the developer against the development rights provided, the developer is not discharged of the obligation. Upon failure by the developer to comply with his side of the agreement, the landowner can withdraw the land development rights that he had parted with. In lieu of receiving the development rights, the developer is under an obligation to periodically pay the revenue earned from the flats sold to the landowner. Hence, the land development rights can be inferred to be falling under the ambit of continuous supply of services.

iv. As regards the last date of issue of invoice in the case of continuous supply of services, the following has been mentioned under Section 31(5) of the CGST Act 2017:

(a) where the due date of payment is ascertainable from the contract, the invoice shall be issued on or before the due date of payment;

(b) where the due date of payment is not ascertainable from the contract, the invoice shall be issued before or at the time when the supplier of service receives the payment;

(c) where the payment is linked to the completion of an event, the invoice shall be issued on or before the date of completion of that event.

v. The development agreement may provide the date for the settlement of payment periodically by the builder in the favour of the landowner. If this date is specifically available, then invoice will be issued by the landowner by such date to the developer against his share of revenue. In case there is no specific due date for payment available and the landowner is paid upon mutual agreement at any date, then the invoice is required to be issued by the landowner to the developer before or on such date. The agreement may also provide for the sharing of the revenue immediately upon receipt of the payment by the developer. In such cases, before or on the date when the supplier receives the payment, the invoice is to be issued by the landowner.

The next step will be the correlation of the time of supply i.e the liability to make the payment of taxes with the date of issue of invoice. As per the extract of Section 13(2) of the CGST Act 2017:

"13(2) The time of supply of services shall be the earliest of the following dates, namely :—

(a) the date of issue of invoice by the supplier, if the invoice is issued within the period prescribed under sub-section (2) of section 31 or the date of receipt of payment, whichever is earlier; or

(b) the date of provision of service, if the invoice is not issued within the period prescribed under sub-section (2) of section 31 or the date of receipt of payment, whichever is earlier;"

vi. It appears that there is an inherent flaw in the time of supply provisions as it refers to issue of invoice under Section 31(2) of the CGST Act 2017. It totally discounts the fact that the invoice can be issued under Section 31(5) of the CGST Act 2017 as well. However, assuming issue of invoice under Section 31(5)

also entails the attraction of Section 13(2) of the CGST Act, 2017, the basic fact to be determined is whether the invoice has been issued in the prescribed time period or not. The due date for issue of invoice in every situation in case of continuous supply of services of land development rights by the landowner to the developer has already been depicted above. If the invoice is issued within the given time period, the time of supply will be the date of receipt of actual payment or the date of issue of invoice whichever is earlier. If the invoice is not issued within the due date specified above, the time of supply will be the date of completion of service or the date of receipt of payment whichever is earlier. Finding the date of completion of service in case of continuous supply of services by the landowner to the developer in respect of land development rights can be challenging and litigative. So, it is recommended that the invoice should be issued within the prescribed time period for ensuring the certainty of the date for payment of taxes.

Conclusion

In an area sharing agreement, the provision of land development rights by the landowner and the construction service provided by the builder to the landowner could be considered as revenue as taxable services (despite the arguments which the tax payer may put forth) under GST both of which will be taxable at the rate of 18%. In such a situation, the timing for payment of taxes in such cases will be the date of transfer of right or possession in the property by means of a conveyance deed or allotment letter or a similar instrument.

In a revenue sharing agreement the revenue would contend, that the land development rights provided by the landowner to the developer will be treated as a continuous supply of services. The due date of issue of invoice is dependent on whether the same is determinable within the terms of the agreement between the developer and the landowner. In turn, the time of supply for such services depends on whether the invoice is issued within the prescribed time period.

Disclaimer

The author has made an attempt in this article to analyse the tax implications that may arise on the vexed issue relating to transfer of development rights in land. Every attempt has been made to cite the various points of view from both the revenue angle and the tax payers view point. It can be fairly said that either side will be out with their weaponry to fight out the legal issue. It appears that this legal tussle can be resolved only by an authoritative pronouncement of Courts.

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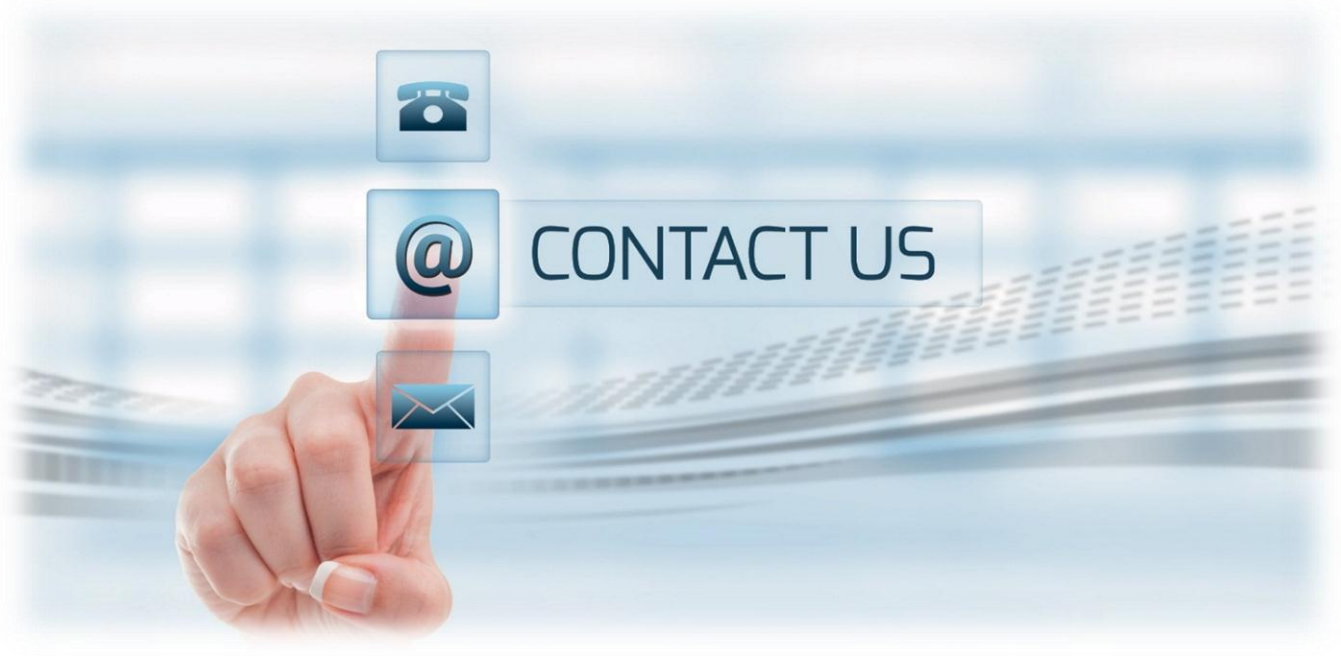

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