



# Input Tax Credit in an Area Sharing Development Agreement



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## Introduction

Ever since the advent of GST, there have been widespread disputes over the taxability of GST and input tax credit in respect of the development agreement entered between the landowner and the builder in case of an area sharing agreement.

## Taxability of Construction services

Construction services are considered as a 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 item 5 stated above. Hence, the said activities will not be covered within the definition of supply. So, any flat sold to any buyer after the earlier of these events will not be a supply and thereby not leviable to GST.

## Taxability of land development rights

The inclusive definition of supply ensures that such activity also gets covered within the ambit of supply. 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. Upon reading 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. So, the transfer of development right will be considered as a supply under Section 7(1) (a) of the CGST Act 2017.

## Input tax credit on the construction services and land development rights

In the area sharing model, the services are received by both the landowners and the developers to each other in the form of construction services and land development rights respectively. The question to be answered here is whether both of them will be allowed to take the input tax credit of the services received by them. The eligibility of input tax credit has been depicted under Section 16(1) of the CGST Act 2017. As per the said section, every registered person is entitled to take credit of input tax charged on any supply which are used or intended to be used in the course or furtherance of business.

#### Builder's perspective

From the perspective of the builder, he intends to build and provide construction services to a buyer for pecuniary benefits. In order to provide such services, he needs to receive the land development rights. This development right is necessary and instrumental in the provision of construction service provided by the builder. Thereby, such services are used by the builder in the course or furtherance of business. There is no specific section under which such input services have been blocked under the law either. Thereby, the builder should be allowed to avail input tax credit on the land development rights availed by him. This will be applicable in case of both area sharing and revenue sharing agreements.

#### Landowner's perspective

Considering the perspective of the landowner, he intends to receive certain flats against the transfer of land development rights. The landowner may have the objective of either retaining such flats for his personal use or sell them in the open market. However, there is a benefit derived from the activity of construction services received by him. The landowner is directly receiving the construction services against the transfer of development rights. If the land development rights are considered to have been provided in the course or furtherance of business, the construction service received against it will have the same allegiance. Also considering the wide definition of business given under the GST law, both of these will be deemed to have been in

the course or furtherance of business. So, the eligibility condition given under Section 16(1) of the CGST Act 2017 will be considered to have been satisfied.

### **Blocked credit u/s 17(5)**

Upon closely studying the portion of blocked credit u/s 17(5)(c) and 17(5)(d) of the CGST Act 2017, one can see that there is a restriction on the free availment of credits in certain situations. These two sub-sections have been depicted below:

*“Section 17(5)(c). works contract services when supplied for construction of an immovable property (other than plant and machinery) except where it is an input service for further supply of works contract service*

*Section 17(5)(d). goods or services or both received by a taxable person for construction of an immovable property (other than plant or machinery) on his own account including when such goods or services or both are used in the course or furtherance of business.”*

From the above, it can be interpreted that the input tax credit is only available against receipt of construction services/works contract services of a building wherein it is used for further supply of works contract services. This means that a person receiving any works contract services in respect of any building will not be allowed to take the input tax credit if such services are used by him on his own account. The only exception which has been cast out under the said definition is the construction of plant and machinery for which the credit is freely available even if received on own account. The meaning of plant and machinery has been elaborated by means of an explanation under Section 17(5):

*“Explanation— For the purposes of this Chapter and Chapter VI, the expression "plant and machinery" means apparatus, equipment, and machinery fixed to earth by foundation or structural support that are used for making outward supply of goods or services or both and includes such foundation and structural supports but excludes—*

- (i) land, building or any other civil structures;*
- (ii) telecommunication towers; and*
- (iii) pipelines laid outside the factory premises.”*

Land and building have been specifically excluded from the ambit of plant and machinery. So, the construction services received for the building will not be excepted from the coverage of Section 17(5) of the CGST Act. Thereby, any construction services received by the landowner will be blocked under Section 17(5) of the CGST Act 2017 if the said services will not be used for further provision of construction services to an independent buyer. However, for the flats to be sold by the landowner, he may avail the complete input tax credit of the construction services received. For the services received by the landowner and the builder, input tax credit is not blocked under Section 17(5) of the CGST Act 2017 if the said services are used for providing further construction or works contract services.

### **Reversal of credit**

For the flats sold after the completion certificate or the first occupancy whichever is earlier, the eligibility of input tax credit in the hands of both the landowner and the developer needs to be determined. As per the extract of Section 17(2) and (3) of the CGST Act 2017:

*“17(2). Where the goods or services or both are used by the registered person partly for effecting taxable supplies including zero-rated supplies under this Act or under the Integrated Goods and Services Tax Act and partly for effecting exempt supplies under the said Acts, the amount of credit shall be restricted to so much of the input tax as is attributable to the said taxable supplies including zero-rated supplies.*

*17(3). The value of exempt supply under sub-section (2) shall be such as may be prescribed and shall include supplies on which the recipient is liable to pay tax on reverse charge basis, transactions in securities, sale of land and, subject to clause (b) of paragraph 5 of Schedule II, sale of building.”*

From the above, it can be inferred that the inputs or input services received used for effecting exempt supplies will not be allowable. Only to the extent the input tax credit is attributable to taxable supplies, the credit will be allowable. For determination of exempt supplies, one needs to include the sale of land and building within it. This is for the limited purpose of reversal of input tax credit that the sale and building has

been deemed to be an exempt supply. So, it can be concluded that any input credit attributable against the selling of land and completed building will not be allowable under the GST law. If any input tax credit had been availed earlier due to the expectation that the flat may be sold before completion certificate but the same is sold only after the completion certificate, then the input tax credit taken earlier will have to be reversed.

### **Conclusion**

So, input tax credit is allowable to both the landowner and the builders against the services received by them. In respect of the flats to be retained by any of them for their own account, the input tax credit will be blocked. For the flats to be sold after the completion certificate or first occupation whichever is earlier, input tax credit will not be allowed to be taken.

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