

**GST on Construction service - Forced 1/3rd land deduction is *ultra vires* –
Analysis of Guj HC decision and its impact:**

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Introduction:

The Real estate industry is prone to many taxation disputes. The common reason for these disputes lies in the fact that real estate transaction is very complex involving 3 components viz., Goods, Services and Land which are amenable to different indirect taxes by different authorities. The attempt of every authority is to collect more revenue & attempt of the taxpayer is to minimize the tax impact, created a long drawn battle for different facets of Indirect taxation. The very basis of levying VAT/sales tax and service tax was held to be wrong which compelled the Government to make frequent amendments (+ in the Constitution of India) to overcome such infirmities. When the GST was introduced to subsume Service tax & VAT into a single tax, many felt that disputes would disappear at least in the areas of taxation, valuation. However, the 3rd component i.e. Land not being subjected to GST & the way lawmakers made the GST law with many infirmities & ambiguities has given sufficient scope for the continuation of such past disputes. In this article, the Authors discuss one of such disputes in valuation for levy of GST on the Real estate transactions. As a precursor, the readers may read the old article published in June 2019 on the same subject at <https://hiregange.com/a/gst-valuation-construction-service-actual-land-deduction>.

Legal Background:

Before GST, the VAT is used to be levied on the sale of goods in Construction activity while service tax is levied on the service component (Labour). The 3rd element is liable for Stamp duty. Both Service tax & VAT laws have made provisions to identify their respective components and if not ascertainable, an option was given to the taxpayer for paying tax at a composite rate. For example, Service tax provisions say that identify the labour component of the transaction and pay service tax at full rate. If not ascertainable, opt for fixed abatement/deduction of 70% and pay service tax on 30% of the total amount. Similar provisions were there under VAT laws also. Thus, pre-GST laws have always given chance for ascertaining the actual value of the taxable event and if not ascertainable then only asked for payment at deemed value after prescribed deductions.

After GST, the first 2 components are subsumed into a single tax (GST) and the 3rd component (Land) continues to be liable to stamp duty & kept out of GST. This required the lawmakers to provide a mechanism to tax only 2 out of 3 components.

For this, the Government vide Notification No.11/2017-CT(R) dated 28.06.2017 as amended provided that the non-taxing component (land) is 1/3rd of the total amount charged thereby fixing that land value in real estate transaction is 1/3rd irrespective of actual value available or identifiable.

It is a known fact that the land value may not be the same across the country as the same depends on various factors viz., location, socio & economic components. There would be a huge variation in the land cost between Metro cities, Towns and Rural areas while the construction cost may not vary much in any of the places.

Deeming 1/3rd of the total amount charged as the land value would lead to a levy of GST on the land value in many cases though the sale of land is neither supply of goods nor supply of services as per SI No.05 of Schedule III. Whereas, in the non-metros, the construction service would not get completely taxed. The following illustration gives a bird's eye picture of the issue involved in claiming the deemed deduction toward land

Sl. No.	City	Guesstimate Cost of Construction per SFT (A)	Guesstimate unit sale price per SFT including land value (B)	Average value of land (C=B-A)	% of land value (C/B*100)
1	Ooty	1,500	2,000	500	25
2	Hyderabad	2,375	5,000	2,625	52.50
3	Bangalore	2,500	7,500	5,000	66.67
4	New Delhi	2,750	12,000	9,250	77.08
5	Mumbai	3,125	20,000	16,875	84.38

Challenging this anomaly, Writs Petition was filed before various High Courts. Recently, the Hon'ble High Court of Gujarat has examined the issue in the case of **Munjaal Manishbhai Bhatt Vs UOI 2022-TIOL-663-HC-AHM-GST** and held as follows

Decision:

- The GST has to be paid on the actual price paid or payable for the services rendered. When the actual price is available, then tax has to be imposed on such actual value only. In the instant case, when the actual value of land is ascertainable, the deeming fiction of 1/3rd of total agreement value towards land is clearly contrary to the provisions and scheme of the CGST Act and therefore *ultra-vires* the statutory provisions.
- Deeming fiction can be applied only where the actual value is not ascertainable which is not the present case. While holding so, the High Court has relied on

Gannon Dunkerley and Co. v/s State of Rajasthan (1993) 1 SCC 364, Wipro Limited Vs UOI 2015 (319) ELT 177 (SC);

- The deeming fiction has not made any distinction between a flat and a bungalow. While a flat would have a number of floors and the transfer would only be an undivided share in the land, the same deduction which is available on the supply of flats is made available on the supply of bungalows without any regard to the vast differences in factual aspects. **Such deeming fiction which leads to arbitrary and discriminatory consequences is violative of Article 14 of the Constitution of India which guarantees equality to all and also frowns upon arbitrariness in law.**
- Due to arbitrary deeming fiction by way of delegated legislation (by way of Notification), the measure of tax imposed has no nexus with the charge of tax which is on the supply of construction services. **It is well established that the measure of tax should have nexus with the charge of tax.**
- The prescription under Section 15(5) of the CGST Act has to be by rules and not by notification. While holding so, the High Court has relied on the Delhi High Court decision in the case of Suresh Kumar Bansal Vs UOI – 2016 (43) S.T.R – Del HC.
- Be that as it may, wherever a delegated legislation is challenged as being ultra vires the provisions of the CGST Act as well as violating Article 14 of the Constitution of India, the same cannot be defended merely on the ground that the Government had the competence to issue such delegated piece of legislation. Even if it is presumed that the Government had the competence to fix a deemed value for supplies, **the same can be definitely held to be ultra-vires when it is found to be arbitrary and contrary to the scheme of the statute.**
- Thereby, paragraph 2 of Notification No. 11/2017- Central Tax (Rate) dated 28th June 2017 and the parallel State tax Notification is read down to the effect that the deeming fiction of 1/3rd will not be mandatory in nature. It will only be available at the option of the taxable person in cases where the actual value of land or undivided share in land is not ascertainable.
- The specific price agreed for land sale in the agreements between the parties is sufficient to avail the deduction of actual land value in place of deemed 1/3rd.
- Wherever the revenue department doubts the correctness of the land value or Construction activity value, the valuation rules *inter alia* Rule 30 & 31 of CGST Rules, 2017 can be resorted to curb tax avoidances if any on account of artificial inflation of land value in the agreements.

Implications of the judgement:

- a. As per the above decision, the actual value of land can be claimed as a deduction where ever it is available
- b. If the land value is not ascertainable, the value of construction with the aid of valuation rules can be adopted for payment of GST. Rule 30 of CGST Rules, 2017 provides for cost +10% valuation.
- c. There cannot be a sale in respect of construction undertaken prior to agreement with the buyer and the factum of supply would be initiated only once the agreement is entered into between the supplier and recipient for consideration.

Possible course of action:

The Revenue department may appeal before Hon'ble SC & the chance for retrospective amendment is not ruled out. In this background, the following are suggested:

- a. File, a refund application for the excess taxes paid in the previous years. If it was passed onto the customer, the customer can directly file for a refund or else return the excess tax to the Builder who would claim a refund.
- b. Discharge GST payments under protest on deemed 1/3rd deduction instead of actuals, going forward, and claim a refund of the same when the issue is finally settled by Supreme Court or time limit to make demand is over.
- c. It is advised to have a specific clause specifying the value of land in the agreements entered with the customers for justifying the deduction while such value shall marry with the combination of construction cost, profit margins & final sale price.
- d. Submit a representation to the GST council for implementation of this decision
- e. File a Writ Petition before the Jurisdictional High Court wherever feasible.

The Government *qua* GST council shall act in True spirit of GST law (avoidance of cascading effect) and allow the deduction of the actual value of land more so when the State Government prescribes the minimum land prices of every area & collect stamp duty thereon. The very same State governments shall not escape stating that actual value deduction may lead to disputes or tax avoidance etc.,

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