

Transfer of Tenancy rights – GST impact on ‘Pagadi System’

Background:

There is a system prevalent in some states where the transfer of tenancy rights against tenancy premium which is also known as “Pagadi system”. This is similar to any other renting system that is prevalent across the world i.e. landlord and a tenant. However, the only deviating factor is that the tenant also becomes a part owner of the house but not of the land.

In the Pagadi system, the tenant acquires the tenancy rights in the property against payment of tenancy premium (Pagadi). The landlord would be owner of the property (land and building) but the possession of the same lies with the tenant. The tenant pays periodic rent to the landlord as long as he occupies the property. The tenant also has the option to sell the tenancy right of the said property and in such a case has to share a percentage of the proceed with owner of land, as laid down in their tenancy agreement. This percentage varies from anywhere between 30-50%. Alternatively, the landlord pays to tenant the prevailing tenancy premium to get the property vacated. Such properties in Maharashtra are governed by Maharashtra Rent Control Act, 1999.

Following are the nature of incomes generated in the above said arrangement:

- a) Tenancy premium received by landlord from incoming tenant against transfer of tenancy rights in the property.
- b) Tenancy Premium received by outgoing tenant from the incoming tenant/landlord on vacating the premises.

Discussion on Relevant GST Provisions

GST shall be leviable on inter/intra state supply of goods or service or both on the value determined under section 15 at the notified rate. The term ‘Supply’ is defined to include 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 and also includes the activities specified in Schedule II.

Further, Schedule II provides that any lease, tenancy, easement, licence to occupy land is a supply of services and similarly any lease or letting out of the building including a commercial, industrial or residential complex for business or commerce, either wholly or partly, is also to be considered as a supply of services.

Hence, the tenancy premium earned on transfer of tenancy rights attracts GST subject to the exemption given vide Sl. No. 12 of notification No. 12/2017-Central Tax(Rate) dated 28.06.2017 on ‘services by way of renting of residential dwelling for use as residence’.

Discussion on possible contentions:

Para 5 of the Schedule III of the CGST Act provides that, 'Sale of land and, subject to clause (b) of paragraph 5 of Schedule II, sale of building' shall be treated neither as a supply of goods nor a supply of services and hence out of GST levy.

The tenancy premium collected by landlord is subject to stamp duty and registration charges which are levied on transfer of rights in immovable property and hence same shall not be subjected to GST as per para 5, Schedule III of the CGST Act.

Department clarification:

Recently Government has issued a circular (Circular No.44/18/2018-CGST dated 02.05.2018) where the department has opined that "the contention that stamp duty and registration charges is levied on such transfers of tenancy rights, and such transaction thus should not be subjected to GST, is not relevant. Merely because a transaction or a supply involves execution of documents which may require registration and payment of registration fee and stamp duty, would not preclude them from the scope of supply of goods and services and from payment of GST. The transfer of tenancy rights cannot be treated as sale of land or building declared as neither a supply of goods nor of services in para 5 of Schedule III to CGST Act, 2017. Thus, a consideration for the said activity shall attract levy of GST".

Short Summary:

Particulars	Levy under GST	Exemption from payment of GST
Tenancy Premium earned on residential units by landlord	Leviable to GST	Exempted vide exemption entry 12 of Notification 12/2017-CT(Rate)
Tenancy Premium earned on residential units by outgoing tenant	Leviable to GST	Exempted vide exemption entry 12 of Notification 12/2017-CT(Rate)
Tenancy Premium earned on other than residential units by land lord/ outgoing tenant	Leviable to GST	Not exempted and hence liable at 18%
Share of tenancy premium received from outgoing tenant by the landlord on sale of tenancy rights by such outgoing tenant	Leviable to GST	Exempted if rights pertain to residential units. Otherwise liable to GST at 18%.

Assessee having earned tenancy premium from both residential as well as commercial properties, ITC to be reversed proportionately to the extent of income towards residential units (Exempted supplies).

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