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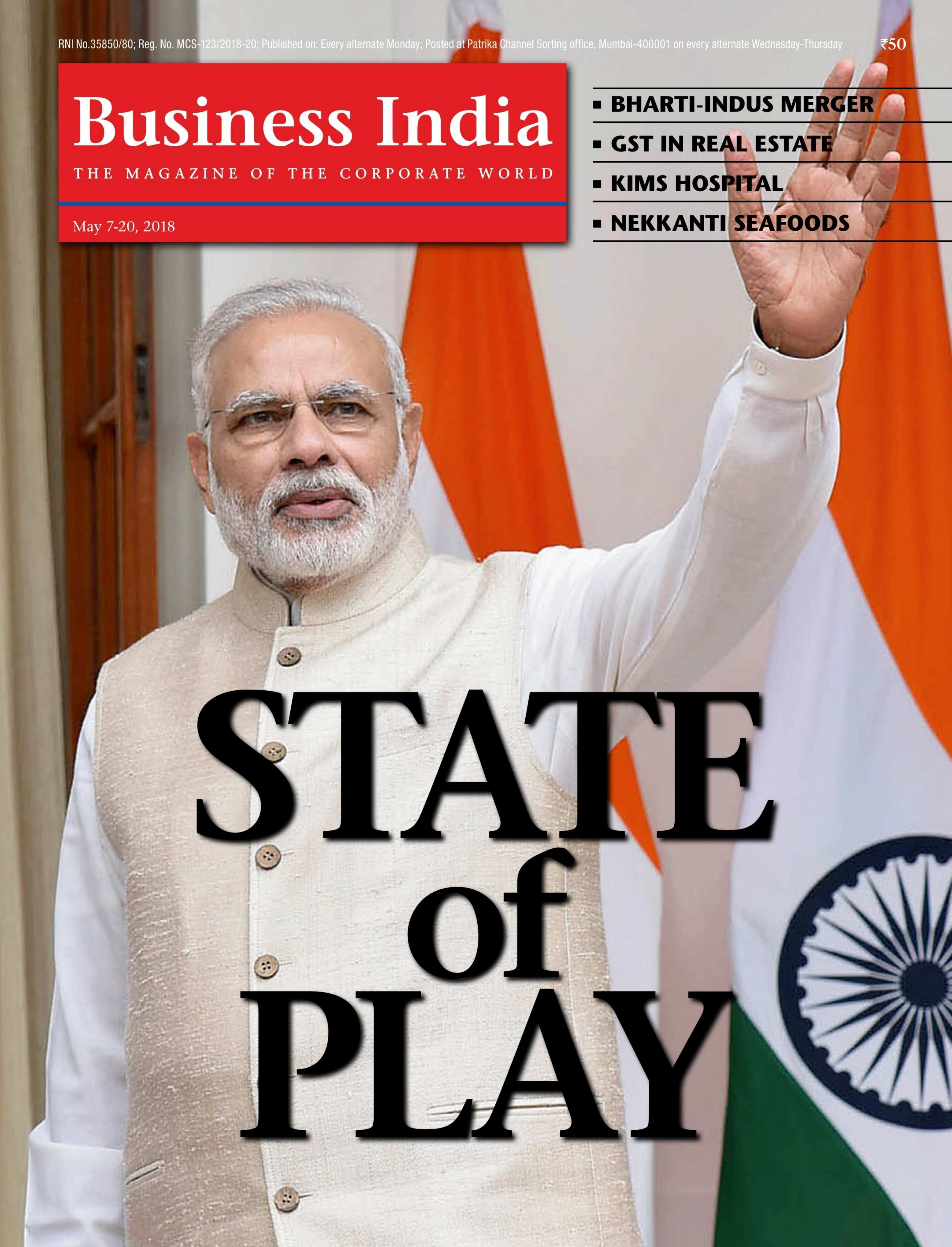
- BHARTI-INDUS MERGER
- GST IN REAL ESTATE
- KIMS HOSPITAL
- NEKKANTI SEAFOODS



STATE of PLAY

Contents

SPECIAL REPORT

SANJAY BORADE

IN THIS ISSUE

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Towards long-term impact

Nair: clarity on implementation required

GST will help the realty sector create a transparent and matured scenario

Goods & Services Tax (GST) has undoubtedly been the biggest tax reform since independence. The new tax regime, which came into being on 1 July 2017, is expected to transform the entire system, cutting through confounding taxation structures, replacing the multiple taxes levied by the Central and state governments, and local bodies. It has sought to transform the country's economy with its 'One Nation, One Market, One Tax' principle by subsuming a host of indirect taxes charged at varied rates by the Centre and states, therefore bringing near uniformity in taxation across the country. Its primary objective is to simplify the complex tax structure on the supply of goods and services. Liquor and fuel have been left as before.

The implementation of GST is expected to have a dramatic impact on the real estate sector too, which has faced multiple challenges due to a lack of transparency. The new tax regime, along with the Real Estate & Regulation Act (RERA), will not only help bring about the much needed transparency and accountability across the value chain, but also make doing business an easier proposition. The primary aim of GST is to remove the cascading effect of taxes by making credits fully fungible and ensure that businesses only pay tax on the value added at each stage only. Of course GST is then finally borne by the end consumers.

This is aimed to benefit end consumers by virtue of reduced prices, as businesses are expected to pass on the benefits of reduced tax costs to end consumers in cases where the tax costs are reduced or eliminated. "While this is the intention of the GST framework, how soon the same happens would ultimately be determined by market forces and possibly the effectiveness of the measures the government takes from an anti-profiteering perspective," says a recent report, *Impact of GST on residential markets*, co-authored by JLL and PwC.

A GST National Anti-profiteering Authority (NAA) has been established by the government to ensure that the full benefits of input tax credits (ITCs) and reduced GST rates on goods and services are passed on to end consumers.

Effective taxation on real estate, particularly land, has been inexplicably high over the years and has not augured well for the government's agenda of enhancing affordability in the housing sector. Implementation of the GST is widely expected to usher in the much-needed changes, by subsuming the myriad of charges such as Central excise duty, value added taxes (VAT), service taxes and entry taxes. But it still leaves untouched other high charges and taxes like conversion charges, where the use of land is charged, and stamp duties on conveyances. Both of these have been sources of easy money for State governments.

"Implementation of GST in the real estate sector has created a level playing field for all organised developers and builders in the country," says Ashish R. Puravankara, managing director, Puravankara Ltd, builders of repute. "A single consolidated tax system brings more clarity and transparency, while also avoiding double taxation, which is relevant in the real estate sector, where developers and users end up paying multiple taxes and duties. A simpler tax structure has encouraged homebuyers to invest in their dream homes and has also attracted interest from investors, indicating positive growth for the sector in the days to come."

"The government's achievement in the field of GST over the past one year has helped streamline the tax administration by bringing more transparency into our taxation system," affirms Surendra Hiranandani, CMD, House of Hiranandani. "As expected with any game changer of this magnitude, the initial few months were fairly disruptive to our operations, particularly for our under-construction projects. However, now that clarifications have been offered on key issues by the government, we are confident that the benefits of the new tax system will only increase in the long run. Effective implementation of the GST in the coming years will further improve transparency and help in ease of doing business. This will have a multiplier effect on all the sectors of the economy and further make India an attractive place for investments."

Good news

While the effective GST rate for the real estate sector is 12 per cent, the government has recently announced a concessional GST rate of 8 per cent for the affordable housing segment. The move has been hailed by all industry sections and is expected to give the much-needed boost to the affordable housing market. The move will also encourage developers to effectively lower the tax incidence on the buyers, as they will not be required to pay GST on the construction service of flats, but would have enough input tax credit (ITC) to pay the output GST, thereby eliminating the need to recover any GST payable by the consumers.

"Moreover, the reduction in the effective GST rate to 8 per cent from 12 per cent on affordable housing is good news for the entire economy, as it will increase employment and consumption at the national level," says Mohit Agarwal, associate director, capital markets & investment services, Colliers International, India. "However, high land prices still remain a major stumbling block in making real estate an affordable commodity in the true sense. Thus, a real revival of the low-cost housing segment can happen only when land prices witness a correction in the near future."


SANJAY BORADE

Puravankara: avoiding double taxation in real estate

"The shift to the GST regime has simplified tax treatment for the realty sector and has resolved some of the long-standing issues of double taxation," remarks Kamal Khetan, CMD, Sunteck Realty. "GST has further helped developers in the ease of doing business, reduction of the cost of production and creation of transparency in processes. This will provide additional benefit to end consumers in the long term and has acted as a sentiment booster for the industry and has revived home buyer and investor interest. The simplified and unified tax regime is expected to benefit the organised realty players and thus help organising the sector."

According to Anuj Puri, chairman, Anarock Property Consultants, the biggest game changer in GST is that the introduction of ITC paid at each stage of production or service delivery can be availed in the succeeding stages of value addition. This makes GST fundamentally a tax only on value addition at each stage. This means that the end consumer will thus only bear the GST charged by the last dealer in the supply chain, with set-off benefits at all the earlier stages. To ensure that manufacturers, developers and service providers pass on the benefit to the final customer, the government has included an anti-profiteering clause in the GST bill under section 171 of the GST law, which clearly states that it is mandatory to pass on the benefit tax reduction due to input tax credit to the final customer. But while GST takes care of cascading costs on construction, materials, etc, it is unlikely to eliminate all black money in real estate. In particular the "cash costs" associated with

Puri: GST is simple and transparent

land purchases, permissions, etc, still have to be paid. And the cost of land is the single largest element in the cost of buildings.

The Indian real estate sector has been going through significant transformation in recent times. The recently-implemented RERA Act has already started addressing the issue of non-transparency and affixes a level of accountability on real estate builders and brokers, which is unprecedented in the history of the Indian property sector. For the residential real estate sector, the implementation of GST will definitely be a positive sentiment booster among property buyers. GST may not be instrumental in bringing down the prices of residential real estate over the short term. However, it will benefit all the stakeholders of the residential real estate sector, as the perception of the sector will improve on the back of a simplified tax structure and accountability being fixed at every stage.

"A simple and transparent tax applied on the purchase price is the biggest take-away for property buyers," informs Puri. "Under the GST regime, all under-construction properties will be charged at 12 per cent except affordable housing (excluding stamp duty and registration charges). It will not apply to the completed and ready-to-move-in projects, as there are no indirect taxes applicable in the sale of such properties."

Lack of clarity

VAT (with rates differing from one state to another) and service tax together account for 7-9 per cent of the ticket price for a residential property, which is 3-4 per cent lower than the GST rate. However, due to information asymmetry, consumers were largely unaware of how VAT and service tax are calculated. Any real estate product consists of three expense components – land, material and labour or service costs. VAT is calculated on material cost, whle service tax is calculated on labour and service cost. "It is difficult for buyers to ascertain what components were included for calculation of VAT and service tax," points out the Anarock chief. "The implementation of GST makes the calculation simpler, since the buyer has to pay only a single GST. Also, the builder must pass on the benefit of the price reduction he enjoys due to input tax credit to the buyer." But again, the costs associated with land are untouched.

While most are convinced about the benefits the new regime is likely to bring about in the long term, in the short-to-medium term, there are quite a few issues that need to be addressed before the process start bearing fruits. "The impact on the real estate sector has always been part of the limelight for any major reform," reveals Kunal Wadhwa, partner, indirect tax, PwC India. "GST is no exception. While the change brings in more transparency and maturity to the sector, the requirements under the anti-profiteering law have been a contentious issue for this sector."

Abhishek Goenka, partner & tax leader, real estate, PwC India, is of the opinion that the benefit to the end customer would be seen primarily in projects executed after the implementation of GST, but the benefit may not be as significant as the government anticipates. The government should engage with stakeholders to understand and address their concerns, which would help the market gain the needed momentum, as anything related to the sector significantly impacts the sentiment of the economy.

"GST has been a matter of discussion for both the demand and supply side of the real estate community," comments Ramesh Nair, CEO & country head, JLL India. "While a transparent uniform taxation system is good, the exact nitty-gritty of 'how' to implement this needs to be addressed swiftly. The government has issued certain circulars to set clarity in this sector, however, the need of the hour is to set up discussion forums across locations and engage with tax authorities and developers at different levels. This alone can address the concerns of this sector, which plays a significant role in impacting the overall sentiment of the economy."

Currently, there is lack of clarity even among developers, with access to expensive tax advisors, regarding the exact implications of GST. Developers feel that the exact impact will be understood only after a thorough analysis of the implications on each input cost (in form of labour and raw material, namely steel, cement, bricks, etc.)

Further, with regard to such raw material inputs, the challenge lies in estimating the cost of these commodities over the entire lifecycle of the project. Since the purchase of these supplies is linked to construction progress, it is difficult for developers to estimate upfront the costs and input tax credit received for the same.

Hiranandani: confident of the benefits

Moreover, the prices of input materials can also be volatile. Cement and steel prices can soar, without warning. Similarly, sand is always in short supply and not available in the monsoons. Hence, it is likely that these industries may not pass on the entire benefit of tax credit.

"The impact of the GST on property prices will be difficult to gauge at this stage, because of the lack of clarity on abatement for land value," says Ashok Kumar, MD, Gennex Partners. "In a product, where the major raw material is not covered by the GST and the completed unit is also not covered by the GST, the tax input benefit will be hard to calculate or justify. Only the market forces, the ready reckoner rates and time, will decide whether and how much benefit will be passed on by the developers to the purchasers. I don't see any significant reduction in property prices due to GST, even as it is aimed at reducing the final prices for the consumer. A lot will depend upon market forces and the effectiveness of the established NAA."

The JLL-PwC report says that, with the market opening up beyond state boundaries, GST's immediate benefit to developers is visible in an increase in the credit flow of taxes paid on interstate procurements. Further, GST mandates the passing on of benefits arising due to increased credits to customers by way of reduced prices. "However, the timelines and manner of computations of such benefits are not clear under the law," adds the report. "Further, with maximum benefits available to projects, which are yet to commence and minimum benefits to those nearing completion, it will be an uphill task for the developers to compute the overall benefits arising due to GST and the quantum of such value transferable to customers."

Tier I cities

The cascading effect of taxes has been mitigated under GST, with construction services specially being classified as 'supply of services'. Further, the tax rate has also been pegged at 18 per cent, with an abatement of one-third being provided towards land value, thereby reducing the effective tax rate to 12 per cent of the entire agreement value. While this may be beneficial to projects where land value is closer to one-third of the total contract value, where the land cost is considerably higher (mostly in case of Tier I cities), a low deduction of one-third of the contract value towards land may not be sufficient. To a large extent the tax impact on Tier I cities is higher than that on other cities, primarily on account of the actual value of land being higher than one-third of the total contract value.

"Land cost varies considerably across locations," says Kumar. "And, a standard deduction of one third of the total contract value for levying GST is not appropriate. While the maximum benefit is for projects which are yet to commence, consumer interest remains more for projects nearing completion."

"With regards to the abatement of land costs, clarity is required on the abatement available for the land cost for calculating service tax on under-construction projects," points out Hiranandani (of the House of Hiranandani). "This will have a major implication on the final prices because if the cost of land is 10 per cent of the overall project, there is a possibility of stagnant final costs. However, in major metropolitan cities of India, the land cost is 50-60 per cent of the total costs, so apartment prices could rise here."

SANJAY BORADE

Khetan: tax simplified

Hiranandani feels that some attention to stamp duty will further strengthen GST's long-term impact. "Stamp duty continues to remain in force even after the implementation of GST and the rates vary in different states," he says. "The additional burden on the sector on account of the stamp duty averages 5-7 per cent. We hope the state governments will abolish the same or merge them with the existing GST rates, which will further help bring down the cost of apartments." And most builders prefer not to talk openly about the costs of obtaining planning permissions and building permits.

The impact of GST on property prices is also dependent on the segmental classification of projects. Customers opting for affordable housing projects are expected to reap the maximum, whereas such benefits are expected to reduce as the segment moves towards the luxury and ultra-luxury sector.

"The impact of GST lacks uniformity, as it varies across products," points out Samantak Das, chief economist

& national director, research, Knight Frank India. "The premium and mid segment housing projects have seen some escalation due to the implementation of GST because of the high proportion of land cost in the cost of a house. On the other hand, the lower mid and affordable segments have seen a favourable impact of GST. However, across markets and cities, we have observed that the buyers are not much affected by the implementation of GST as most of the developers have absorbed the negative impact of this tax."

"GST has simplified various issues," argues Abhishek Rastogi, partner, Khaitan & Co. "But, while the inclusion of transactions involving land and building within the ambit of GST is still contemplated by the government, there is an inherent complexity in it, as the power to tax land and building is a state subject. Even the constitutionality of GST on long-term leasing of land or building remains debatable, despite the recent Bombay High Court decision affirming GST on such lease. While the government has rationalised the GST rates for contractors, as well as sub-contractors on government contracts after the Delhi High court admitted a writ petition, the uncertainty on eligibility of ITC for works contract services on builders and the applicability of GST on transfer of development rights on land are still plaguing the sector."

Many benefits

While there is a reduction in the total tax component of inward supplies of materials, there is also a corresponding increase in the tax cost on services received. However, with the unrestricted flow of credits available under GST, as compared to restrictions under the earlier regime, developers should benefit with a higher credit pool and, therefore, from the government perspective, be required to pass on such benefits to customers by way of reduced prices, says the JLL-PwC report.

So far as the real estate industry is concerned, while it is struggling to determine the actual benefit on account of GST, there is also considerable lack of clarity on how the benefit, if at all any, has to be computed. "The government has been aggressive,

Das: GST lacks uniformity

especially with the real estate sector, to investigate businesses for non-compliance with the anti-profiteering provisions. Against such a backdrop, businesses should take appropriate steps to evaluate the quantum of benefits to be passed on and the methodology for passing on such benefit, if any, to customers," says the report. "There is a possibility of the market perceiving GST to be a 'by default' agent for a price drop for all projects, whereas the actual factor for such price reduction is business and market requirements," it adds.

All in all, the industry continues to be under transition, evaluating the nitty-gritties of the whole process. In addition, there is the complexity of being on the right side of the NAA by passing on the benefit of input tax credit to the customer, despite an increase in any other costs. There is no specific mechanism provided for offsetting any other increase in costs against the benefits of input tax credit.

"GST, along with RERA, has the potential to boost real estate to higher levels," says Niranjan Hiranandani, president, NAREDCO. "And yet, we find that it remains locked in a 'work in progress' situation. Works contracts have been covered under GST, but we are still awaiting the announcement about bringing the entire transaction – from land purchase to handing over possession to the end-user – under GST. Ideally, at a rate that would be in a single digit. The basic aim of introducing GST was to reduce the large number of taxes, cess and levies into a single tax, which was supposed to bring about uniformity in taxation rates across the nation. We look forward to this becoming a reality," he adds.

The general consensus is that the impact on pricing will not be much. The larger force of demand and supply will continue to determine the pricing. The effective rate of tax has not seen too much of a deviation, with the earlier rate ranging from 10–15 per cent and now moving to 12 per cent under GST. Therefore, it may appear that the GST would result in savings of at least 3-4 per cent to the end customer. However, the ground-level reality may be different. The cost of land involved in the project would significantly impact the ultimate savings the end customer may derive under the GST. For developers to continue their business confidently, they will certainly have to put in place a transparent mechanism that deliberates on various issues with clarity.

But one big advantage of GST and proper accounting and the traceability of transactions is that the books of accounts of builders will become a lot more transparent. This in turn will allow banks to rely much more on the accounts of builders. In turn they will grant credits much more easily to the industry. With the cost of finance being a major cost, over time, with institutional funding the construction business will become part of the industrial main stream. The impact on prices wil then be clearly noticeable.

All said and done, even as the industry is still trying to evaluate the actual impact of the new tax regime (particularly in terms of lowering of pricing), GST, along with RERA, will go a long way in transforming the domestic real estate sector, which has long been grappling with the challenges arising due to lack of transparency. The new regime, which represents unified and simplified taxation, will add to the country's attractiveness as an investment destination in the long run. It will further help in ease of doing business and creating transparency in processes and, thus, help build a matured and organised set-up.

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