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Taxation in the Real Estate Sector: Legal Implications of GST and Capital Gains Tax

Shreyanshi Basediya
Student, faculty of Law, Jagran Lakecity University
Jlu06224@student.jlu.edu.in

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Abstract

Real estate business in India is a very important contributor to the GDP and employment of the country. But in addition it is also prone to intricate taxation regulations particularly following the adoption of the Goods and Services Tax regime (GST). Moreover, capital gains tax still has a far-reaching effect on both the developers and the investors. The current paper examines the legal aspects of GST and capital gains tax on the real estate industry in terms of its compliance issues, tax planning, and the overall effects on stakeholders. The study will examine the impact of such tax structures on transactions, property development, and investment and discuss the possible reforms and interpretation by the court.

Key Words: *Taxation, Real Estate Sector, Legal Implications, GST, Capital Gains Tax.*

Introduction

The subject of taxation in the real estate industry has never been easy since various laws, heads of taxes, and administrative bodies were involved (Ahuja and Gupta, 2023). As compared to the other sectors, the real estate transactions are subjected to both direct and indirect tax at various levels of development, transfer, and ownership. Traditionally, these transactions were exposed to a disjointed indirect tax structure that comprised of value added tax (VAT), service tax, excise duty, and stamp duty each having different laws and administered by various bodies. This redundancy in many cases brought about duplicated taxation, a domino effect, interpretational differences and high compliance liabilities on both parts of the developers and purchasers (Rao & Chakraborty, 2022).

The introduction of the Goods and Services Tax (GST) in July 2017 was a huge transition to the previous model of indirect taxation that encompassed VAT, service tax, excise duty, and stamp duty (Rao and Chakraborty, 2022). The introduction of GST was done with the aim of establishing a national market through the combination of various indirect taxes into a single taxation framework. Within the real estate sector, GST was aimed at bringing transparency, cutting the tax cascading as well as simplifying compliance. But the real estate was not fully included in GST, since stamp duty and registration fee still remained outside the GST, and so some elements of fragmentation of taxation remained (Mukherjee, 2021).

At the same time, capital gains tax according to the Income Tax Act, 1961 remains a central figure in the transactions of property particularly in the transfer of immovable property (Ahuja and Gupta, 2023). The direct impact of capital gains tax on an individual taxpayer, investors, and businesses is that it taxes on the profit which is gained through the sale or other transfer of property. Splitting gains as short-term and long-term, exemptions and deductions availability have a

significant effect on investment decision-making and structuring of transactions in the real estate market.

The aim of the paper is to assess the way GST and capital gains tax restructured the real estate taxation in India (Mukherjee, 2021). It also examines the implications of the event on different stakeholders such as constructors, homeowners, and investors (Sharma and Kumar, 2023). Through the analysis of the statutory provisions, judicial interpretation and compliance issues, the paper will also give a detailed insight into the dynamic taxation regime concerning the real estate transactions in India.

Legal System Regulating Real Estate taxation.

Indian real estate taxation exists in a two-fold system that includes indirect taxation under the GST and direct taxation under the Income Tax Act, 1961. All these regimes have different purposes, processes and consequences to the real estate stakeholders.

Goods and Services Tax (GST)

The GST regime has joined different types of indirect taxes into a single framework (Rao & Chakraborty, 2022). Before GST, real estate transactions were taxed in many ways including service tax on construction services, VAT on sale of goods to be used in construction and excise duty on manufactured inputs like cement and steel. This disjointed government resulted in cascading taxes and overcharged projects. The GST was supposed to remove these inefficiencies as it would enable a free flow of credit through the supply chain.

The GST is mostly applicable in real estate, where houses that are not fully finished are sold or services offered by the contractors and developers (Ahuja and Gupta, 2023). The supply of services is the taxable event in GST and construction activities before the issue of a completion certificate are considered as a supply of services. This is the main difference that constitutes the applicability of GST in real estate transactions.

Key provisions include:

Sale, or rather levy is based on section 7 of the CGST Act, 2017, which defines supply (Government of India, 2017). The definition of supply is extremely wide and encompasses any type of supply of goods or services that is placed to consideration in the course or furtherance of business. Under-construction property is a property whose construction fits well within this definition.

The Act under Schedule III exempts the sale of land and completed buildings (Government of India, 2017). This exclusion means the constitutional restriction on the taxation of the immovable property under the GST and making sure that the buyer-seller transactions with complete buildings are not subject to GST.

Notified rates: It encourages different taxes rates on affordable and non-affordable housing as well as specifications applicable to an input tax credit (ITC) (GST Council, 2023). These are rate formations that are aimed at encouraging low-cost housing as revenue factors are put into consideration.

Although GST has brought about consistency in terms of tax rates and processes, its partial exemption of real estate among the other processes has created an interpretational and practical problem.

Capital Gains Tax

Capital gains tax is imposed as per the income tax act, 1961 on profit which is realized when selling a capital asset (Ahuja and Gupta, 2023). All the immovable property such as land and buildings are considered as capital asset unless otherwise indicated. The capital gains tax incidence is imposed during the transfer that involves a sale, exchange, relinquishment, or compulsory acquisition of property.

The real estate transactions usually involve:

Short-term capital gains (STCG) of properties that are owned below 24 months (Income Tax Act, 1961). These gains are charged at the rates which are charged as slabs hence payable by the tax payers at a comparatively high cost.

Long-term capital gains (LTCG) in the cases of properties that are held above 24 months (Income Tax Act, 1961). LTCG is charged at a concessional rate and it is also indexed which is used to adjust cost of acquisition due to inflation.

Section 54, 54EC and 54F exemption gives taxpayers an opportunity to escape LTCG by investing in certain assets (Ahuja and Gupta, 2023). These provisions are reflective to the policy objective of reinvestment in housing and infrastructure and reduction of the direct tax burden on tax payers.

GST in real estate sector: Legal implication

Applicability and Ambiguities.

GST is paid at the sale of unfinished property, but not in the case of ready-to-move-in property or land (Mukherjee, 2021). This is the major distinction that is core to the GST structure yet it has created a lot of gray areas in practice. Whether a property is in construction or is completed or not is determined by the issue of a completion certificate by the competent authority which may differ between states.

This has also caused some difficulties in terms of the timing of taxation and categorization of properties (Sharma & Kumar, 2023). Transaction structuring is also commonly designed to reduce the GST liability among the developers and the buyers may want to avoid GST by buying completed properties.

Key Legal Issues include:

- These controversies have the potential to be controversial in terms of classifications: is a property complete or under construction? (Rao & Chakraborty, 2022). Late issuance of completion certificates or incomplete projects are some of the common grounds that result in conflicts with the taxation bodies.
- Input Tax credit (ICT): Builders at first took ITC on construction material such as cement and steel. Nonetheless, since April 2019, ITC is not allowed on the new tax rate system (5% on residential and 1% on affordable housing) (GST Council, 2019). Though this made the tax regime easier, it made costs of construction higher and impacted developer margins.
- Joint Development Agreements (JDA): JDAs are landowner-developer agreements that have numerous taxable events, which can result in possible doubling of taxation (Mukherjee, 2021). The value and timing of tax liability of such agreements is controversial.

Judicial Interpretations

GST-related issues in the real estate have been dealt with in a number of cases. The judicial intervention has been very instrumental in removing ambiguity and providing uniformity in the administration of taxes.

Notable cases include:

- Larsen and Toubro Ltd. V. State of Karnataka (2013) 3 SCC 330, in which the Supreme Court found the construction contracts to be works contracts where both goods and services were involved. This ruling formed the basis of taxation of construction services on GST.
- NBCC (India) Ltd. v. Union of India (2021) that discussed the concern regarding the GST liability on the right to develop and the services in construction.

Such determinations highlight the necessity of more specific legislative stipulations and principles on GST application (Sharma and Kumar, 2023). This is despite judicial clarification and inconsistencies in interpreting it by tax authorities that still presents an uncertainty.

Compliance and Challenges

GST has brought about a lot of change to compliance requirement in the real estate industry.

- **Heightened Compliance Cost**: Developers have to undergo more compliance in terms of record-keeping and reporting (Rao and Chakraborty, 2022). Administrative costs have increased because of monthly returns, ITC reconciliation and audit requirements.
- **Problems with cash flow**: ITC blocking and advance payment influences liquidity (Mukherjee, 2021). Buyers usually expect developers to make the payments required to be paid in GST prior to expected full consideration.
- **Burden to the homebuyers**: GST on under-construction flats goes up, becoming higher than the cost of ready flats, thereby discouraging demand (Sharma and Kumar, 2023). This has affected the tastes of buyers and the forces in the market.

Under Legal Implications in Real estate, capital Gains Tax

Taxation Mechanics

Capital gains tax is imposed on an entity when a person sells a property and generates profit (Ahuja and Gupta, 2023). Computation includes the establishment of the entire value of consideration and the subtraction of indexed cost of acquisition and improvement and the use of the applicable tax rate. There are usually disagreements on the valuation, determination of costs as well as the date of transfer.

Exemptions and Reliefs

Income Tax Act offers a number of exemptions as a way of encouraging reinvestment and economic activity (Ahuja and Gupta, 2023). Under section 54, 54EC and 54F, taxpayers are permitted to postpone or wipe out capital gains on residential premises or a designated bond by investing the capital gains in the building. These are especially important provisions to individual taxpayers and investors.

Litigation Trends and Judicial Trends.

The cases of litigation to capital gains tax in real estate usually involve the issue of exemption eligibility, when to reinvest and adherence to procedures. The courts have broadly interpreted liberally to favor the actual taxpayers particularly when there are procedural weaknesses (Mukherjee, 2021). This is a judicial tendency to balance the interests of revenue and the interests of taxpayers.

Conclusion

Real estate is one of the pillars of the Indian economy and its taxation has extensive consequences (Rao & Chakraborty, 2022). The tax policy in this industry will have a direct influence on the affordability of housing, investment, and development of infrastructure. GST was introduced to make the indirect tax regime easy to understand, yet it has created new compliance issues and uncertainty (Sharma and Kumar, 2023). The partial exemption of real estate to GST and the frequent changes of the policy have limited the realization of its initial goals.

Capital gains tax remains a crucial factor when transacting in property and exemptions and planning have been key to capital gains tax (Ahuja and Gupta, 2023). Even though exemptions can lead to reinvestment, they also add to the problems of litigation and interpretation.

All in all, the presence of GST and capital gains tax has transformed the legal environment of taxation of real estate in India. There is a need to have a more consistent policy course, more explicit legal frameworks and more uniform judicial interpretation to minimize the ambiguity and encourage sustainable development of the real estate business.

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