

Joint Development Agreement - Taxability and other aspects

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GST शास्त्र : Joint Development Agreement - Taxability & other aspects

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◆ Introduction :-

In the real estate industry, tri-partite business model known as Joint Development Agreements are often observed model. Due to sky high reaching prices of the land, option to enter into such agreements has become a normal practice in the industry.

After 1st April, 2019, real estate sector has undergone massive changes as far as GST implications are concerned. Hence, it is important to revisit law, understand taxability impacts and other aspects in respect of joint development agreement. Joint development agreements are normally entered into either on revenue sharing basis or area sharing basis. In this article, we will have a walk through provisions relating to area sharing agreement.



◆ The model :-

In such business model, 3 parties are involved

- 1) The land owner
- 2) The builder / developer
- 3) Contractor who undertakes construction

In area sharing agreement, landowners enter into an agreement with the developer, whereby, the landowner gives development rights to construct or develop a complex to the developer. In return, developer agrees to assign a portion of the constructed area in the form of flats.

In this case, flow of consideration from both ends is as follows –

Landowner to Developer – Rights to construct or develop a complex

Developer to Landowner – A portion of the constructed area in the form of flats

◆ Tax implications :-

Tax implications for 1st limb of transaction i.e transfer of development rights is as follows -

In pre-GST regime, it was a settled principal that land includes benefits arise out of land. Various judicial pronouncements have also upheld the same view. However, in GST regime the legislative intention is to make it taxable. To understand the issue, kindly refer our previous article “**GST का: Mystery of applicability of GST on Transferable Development Rights (TDR)”**.”

Hence, the legislative principal that any benefit arising out of land will form part and parcel of land i.e immovable property is no more applicable in GST and transfer of development rights will be treated as supply of service.

It is needless to mention that 2nd limb of transaction i.e assignment of a portion of the constructed area in the form of flats is taxable under pre-GST regime as well as in **GST regime** also.

Let's understand various aspects of both the limbs in detail.

Part I: Service by way of transfer of development rights - Rate of tax, Exemption, Valuation, Reverse charge mechanism, Time of supply

a) Rate of Tax –

In the absence of any specific entry of concessional rate, such activity is taxable @18%.

b) Exemption –

As per notification no. 4/2019 - Central Tax (Rate) dt. 29th March, 2019, exemption has been provided to service by way of development rights **on or after 1st April, 2019** for construction of **residential apartments** by landowner. However, such exemption is subject to sale of flats before date of issuance of completion certificate or first occupation of project whichever is earlier.

It implies that GST is payable in proportion to area of flats remained unbooked as on date of issuance of completion certificate or first occupation of project whichever is earlier. **Also, exemption is granted to above mentioned service for construction of residential apartments and not for the construction of commercial apartments.**

c) Valuation –

Valuation mechanism has been provided in notification no. 4/2019 – Central Tax (Rate) dt. 29th March, 2019 as follows –

Value shall be calculated according to paragraph 1A as mentioned below. However, such value shall not exceed 1% of the value in case of affordable residential apartments and 5% of the value of non-affordable residential apartments. Value of apartments remained unbooked is to be calculated according to paragraph 1B.

As per paragraph 1A, value of supply of service by way of transfer of development rights by a person to the promoter against consideration in the form of residential or commercial apartments shall be deemed to be equal to the **value of similar apartments** charged by the promoter **from the independent buyers nearest to the date on which such development rights is transferred** to the promoter.

As per paragraph 1B, value of portion of residential apartments remaining un-booked on the date of issuance of completion certificate or first occupation, as the case may be, shall be deemed to be equal to the **value of similar apartments** charged by the promoter **nearest to the date of issuance of completion certificate or first occupation**, as the case may be.

Thus, valuation mechanism of service by way of transfer of development rights has two fold effects.

1) Calculate value **on the date of transfer of development rights** for entire area of project considering value charged for similar apartment from independent buyer **nearest to the date on which such development rights are transferred.**

The value calculated as per above mechanism pertains to complete area of the project including area of flats remain unsold. Hence, **in case of residential apartments**, proportionate tax payable on value of flats remained unbooked is to be calculated as follows

–

Value as calculated above (x) area of flats remain unsold (÷) complete area of project.

As there is no exemption to service provided by way transfer of development rights for construction of commercial apartments, there is no need to calculate proportionate value for unbooked apartments.

2) In case of residential apartments, tax payable calculated @ 18% on value calculated as above shall not exceed 1% of value of similar affordable and 5% of value of similar non-affordable apartments charged by the promoter **nearest to the date of issuance of completion certificate or first occupation, whichever is earlier.**

Thus, tax payable on value of flats remained unbooked is to be calculated as follows –
Value of unbooked affordable flats (x) 1% (+) value of unbooked non affordable flat (x) 5%

Value is to be considered nearest to the date of issuance of completion certificate or first occupation, whichever is earlier.

Final tax liability on service by way of transfer of development rights for construction of residential apartments shall be lower of tax calculated as per step 1 and step 2. In case of commercial apartments, final tax liability will be calculated @18% on value as prescribed in paragraph 1A.

d) Reverse charge mechanism –

As specified in **notification no. 5/2019 – Central Tax (Rate) dated 29th March, 2019**, where service is supplied by way of transfer of development rights for construction of residential as well as commercial apartments, tax is to be paid by recipient as specified in section 9(3) of **CGST Act, 2017**. Hence, developer, who is recipient, shall pay tax on service specified above.

e) Time of supply –

As per entry (i) read with entry (a) of **notification no. 6/2019 – Central Tax (Rate) dated 29th March, 2019**, time of supply shall arise on the date of issuance of completion certificate for the project or on its first occupation whichever is earlier.

Hence, liability payable is deferred as prescribed above.

Part II: Supply of construction service - Rate of tax, Exemption, Valuation, Time of supply, additional points

a) Rate of Tax –

As per **notification no. 3/2019 – Central Tax (Rate) dt. 29th March, 2019**, new rates have been specified along with option to opt for old rates.

Applicability of new tax rates are as follows :-

New rates / Old rates	Category of apartments	Definition	Gross tax rate	Effective tax rate
New rate	Affordable residential apartment	Apartments having carpet area of upto 90 sq. mtr (968.75 sq. ft) and having gross amount charged upto Rs. 45 lakhs	1.5% (Without ITC)	1% (Without ITC)
New rate	Non-affordable residential apartment	Other than affordable apartments	7.5% (without ITC)	5% (without ITC)
Old rate	Affordable residential apartment	As per various schemes	12% (with ITC)	8% (with ITC)
Old rate	Non-affordable residential apartment	Other than affordable apartments	18 % (with ITC)	12 % (with ITC)
	Commercial apartments	-	18% (with ITC)	12% (with ITC)

b) Exemption – No exemption to construction service provided by developer to landowner

c) Valuation –

Valuation mechanism has been provided in **notification no. 3/2019 – Central Tax (Rate) dt. 29th March, 2019** as follows –

As per paragraph 2A of the said notification, where a **registered*** person transfers development right or FSI (including additional FSI) to a promoter against consideration, wholly or partly, in the form of construction of apartments, the **value of construction service** in respect of such apartments shall be deemed to be equal to the **Total Amount charged for similar apartments** in the project **from the independent buyers**, other than the person transferring the development right or FSI (including additional FSI), **nearest to the date on which such development right or FSI (including additional FSI) is transferred** to the promoter, **less the value of transfer of land**, if any as per paragraph 2.

*(*The word registered has been omitted vide **notification no. 20/2019 – Central Tax (Rate) dt. 30th September, 2019**. It implies that the said valuation mechanism is applicable to any such kind of transaction irrespective of status of registration of landowners. However, in the absence of clarity, whether the word omitted has retrospective effect or prospective effect is another open debate.)*

As per paragraph 2, value of land is deemed to be 1/3rd of the gross amount charged.

Thus, such value shall be calculated considering **value of similar apartments** charged by the promoter developer **nearest to the date on which such development rights are transferred** where development rights have been transferred against consideration in the form of residential as well as commercial apartments.

d) Time of supply -

As per entry (i) read with entry (d) of **notification no. 6/2019 – Central Tax (Rate) dated 29th March, 2019**, time of supply shall arise on the date of issuance of completion certificate for the project or on its first occupation whichever is earlier.

Hence, liability payable is deferred as prescribed above.

e) Additional points –

(i) As prescribed in **notification no. 3/2019 – Central Tax (Rate) dt. 29th March, 2019**, landowner will be eligible to claim **input tax credit** of tax charged on such construction service.

(ii) However, to claim such ITC-

(a) Land owners must be registered under GST.

(b) Land owners shall sale flats buyers before completion certificate or first occupation whichever is earlier.

(c) Land owner shall charge tax which is not less than amount of tax charged by developer.

(Above article was written on 5th December, 2019 & jointly authored by CA. Yogesh Ingale, CA. Tushar Ajmera and CMA. Anuj Chordiya. Views expressed are strictly personal. For any queries & feedback, reach us at yogesh.ingale@talentax.in)

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