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JUDGEMENT OF GUJARAT HIGHCOURT ON TAXABILITY OF LAND - ANALYSIS

Issue of taxability of Land in its various forms other than land simpliciter under indirect tax laws especially GST has been subject of debate and discussion since long. Important issue in this debate was pertaining to the legality of deemed deduction of 1/3rd towards the value of land in real estate transactions as prescribed in notification 11/2017-CT Rate. This crucial issue has been addressed in the landmark judgement pronounced by Gujarat High Court in its order dated 6.05.2022 in the case of Munjaal Manishbhai Bhatt vs Union of India SCA 1350 of 2021. Following is an analysis of this judgement and its impact on the real estate sector across India.

1. Facts of the petitioners

There were three petitioners who approached the High Court, the facts were a bit different but the issue involved was identical, hence the court took the petitions together.

Facts of Munjaal Bhatt [Para 4]

Mr Munjaal entered into an agreement with the developer for the purchase of a plot of land. The said agreement also encompassed construction of bungalow on the said plot of land by the same developer. Separate and distinct consideration was agreed upon between the parties to the agreement for

(i) the sale of land and

(ii) construction of a bungalow on the land.

The developer, relying upon the prescribed law and notification informed the writ applicant that he would be liable to pay tax at the rate of 18% on the entire consideration payable for land as well as construction of bungalow after deducting 1/3rd of the value towards the land in accordance with the impugned paragraph 2 of the said notification. The developer accordingly raised an invoice on the writ applicant to collect such tax.

Facts of other 2 petitioners [Para 30]

Other 2 petitioners are **developers who have sold/intending to sell developed parcels of land**.

Their advance ruling applications were filed seeking a ruling on the question whether there was any tax liability under the GST Acts on supply of developed land. The advance ruling authority held that the deduction for sale of land was admissible only to the extent of 1/3rd of the total consideration on the basis of the impugned notification. Such ruling has been affirmed by the appellate authority for advance ruling. This AAAR ruling as well as the notification para 2 was challenged by them.

2. Legal Text which was under challenge in this petition

Entry 3 of the Notification 11/2017-Central Tax Rate and equivalent notification in SGST Act provides for mechanism and rate to tax the real estate sector. At the end of each of its sub-entries, it is mentioned that valuation of the service would be as per Paragraph 2 of this notification. Said para 2 reads as under:

> *"2. In case of supply of service specified in column (3), in item (i), (ia), (ib), (ic), (id), (ie) and (if) against serial number 3 of the Table above,* ***involving transfer of land or undivided share of land****, as the case may be, the value of such supply shall be equivalent to the total amount charged for such supply less the value of transfer of land or undivided share of land, as the case may be, and the value of such transfer of land or undivided share of land, as the case may be, in such supply* ***shall be deemed to be one third of the total amount charged for such supply****.*
>
> *Explanation. –For the purposes of this paragraph and paragraph 2A below, "total amount" means the sum total of,-*
>
> *(a) consideration charged for aforesaid service; and*
>
> *(b) amount charged for transfer of land or undivided share of land, as the case may be including by way of lease or sublease."*

It can be seen that para 2 provides for mechanism for arriving at value of land for deducting from the whole consideration towards sale of real estate unit. Paragraph 2 creates a deeming fiction

and says that in all transactions which involve either transfer of land or transfer undivided share of land, value of the land would be deemed to be 1/3rd of the total consideration.

This very paragraph is under challenge in this writ petition.

3. Question framed by the High Court for its consideration [Para 58]

High Court after going through the facts and law, framed the question for its consideration as whether the impugned notification providing for 1/3rd deduction with respect to land or undivided share of land in cases of construction contracts involving element of land is ultra-vires the provisions of the GST Acts and/or violative Article 14 of the Constitution of India?

4. Judicial precedents and legislative history on the matter under writ [Para 14 and 18]

Before arriving at the judgement, court went through important historical judicial and legislative background, same is discussed hereunder:

a. State of Madras v/s Gannon Dunkerley and Co. (Madras) Ltd. (1958) 9 STC 353

In the first Gannon Dunkerly case, the Supreme Court observed that in case of building construction contract the property in goods passes to the buyer by the theory of accretion as and when the goods are embedded into the earth. The property in goods does not pass as chattel pursuant to the agreement of sale and therefore it is not sale as per the Sale of Goods Act, 1930. **Thus it was held that the State legislatures did not have the competence to impose sales tax on the goods element of a construction contract, accordingly entire construction contract was kept outside the levy of Sales tax.**

b. 46th Constitutional Amendment

Constitution was amended to overcome the judgement of the Supreme Court in the case of Gannon Dunkerley. Article 366(29A) of the Constitution was introduced whereby the transfer of property in goods (whether as goods or in some other form) involved in the course of execution of works contract was deemed to be sales. **Thus, the State legislatures were**

conferred with the power to impose tax on the goods element in a construction / works contract.

c. Gannon Dunkerley and Co. v/s State of Rajasthan (1993) 1 SCC 364

Thereafter, a question arose as to on what amount sales tax could be imposed as a works contract would even contain some element of labour. It was held by supreme court that tax could be imposed only on the value of goods incorporated in the works contract and that the labour expenses and profit thereon was to be excluded.

It was observed that the value of goods was to be ascertained from the books of account of the assessee. **Only in the event where it was not possible to ascertain the actual value, it was held that the State could prescribe a formula on the basis of fixed percentage of value of contract.** It was however clarified that such prescribed value should not appreciably differ from the actual value.

d. States implemented the above judgements by amending respective Sales tax laws and introduced valuation mechanisms giving deductions for value of service and profit on actual basis. Some states also gave option to pay lumpsum tax on the entire value, however this formula based mechanism was optional for the dealer, its validity was upheld by the Supreme Court in the case of State of Kerala v/s Builders Association of India (1997) 2 SCC 183

e. K. Raheja Development Corporation vs State of Karnataka (2005) 5 SCC 162

The Supreme Court held that even a tripartite agreement involving construction of flats having land for prospective buyer would constitute sale in the course of the execution of works contract.

f. Larsen and Toubro Ltd. v/s State of Karnataka (2014) 1 SCC 708

Supreme Court affirmed the view taken in the case of K. Raheja Development Corporation. It was however clarified in para 110 of the judgement that the activity of construction undertaken by the developer **would be works contract only from the stage the developer**

enters into a contract with the flat purchaser and that the value addition made to the goods transferred after the agreement is entered into with the flat purchaser can only be made chargeable to tax by the government. It was further observed in para 112 of the judgement that if at the time of construction and until the construction was completed, there was no contract for construction of building with the flat purchaser, the goods used in the construction could not be deemed to have been sold by the builder since at that time there was no purchaser. It was held that the fact that the building was intended for sale ultimately after construction did not make any difference.

g. Service Tax on real estate and the case of Suresh Kumar Bansal v/s Union of India (2016) 92 VST 330 (Del.)

Service tax was first introduced on real estate transactions vide Finance Act 2010

Imposition of service tax on service by a builder was challenged before the Delhi High Court on the ground that there was no mechanism for computing service tax in case of a transaction involving transfer of land. It was held that the valuation rules did not provide any mechanism for deriving value of services in case the transaction involved sale of land. It was therefore held that no service tax could be demanded in the absence of any computation mechanism. The argument of the revenue that there was an abatement notification to take care of deduction for land was rejected on the ground that mere abatement by way of notification could not be a substitute for statutory valuation mechanism which was absent.

To overcome the above judgement, Service tax valuation rules were amended retrospectively to expressly provide for deduction of amount charged for land.

The above judicial and legislative history of the real estate sector establishes the fact that tax could be levied only on the basis of actual valuation, any measure to tax the transaction by way of deeming fiction was upheld only if it was optional.

5. Judgement of Wipro Ltd [Para 23]

In this case the Customs Rule provided that Customs duty in addition to the value of goods would also be payable at the rate of 1% of the FOB value of goods towards loading, unloading and handling charges. Wipro challenged this rule on the grounds that such adhoc valuation cannot be made mandatory if actual value of such charges was ascertainable. This rule was held to be ultra-vires the provisions of the Customs Act, 1961 as well as arbitrary, irrational and violating Article 14 of the Constitution of India by the Supreme Court.

6. Definition of Land [Para 33]

GST law provides that 'Sale of Land' would be outside the purview of GST, however it does not define the term Land. Therefore, the court relied upon the definition of the term "land" as contained in Section 3(a) of the Land Acquisition Act, 1894 wherein land is defined to include the **"benefits to arise out of land, and things attached to the earth or permanently fastened to anything attached to the earth."**

7. GST Council Deliberations [Para 84]

Provisions for taxing real estate sector whereby decision to give 1/3rd deduction towards value of land was discussed and decided in 14th Council meeting held on 18th and 19th May 2017. In this meeting ministers from atleast 2 member states, Maharashtra and Gujarat, recorded their specific comments against giving an adhoc fixed deduction for Land. Infact, Deputy Chief Minister of Gujarat expressed that courts could take adverse view regarding the proposed 1/3rd abatement for land value and that it could create problems. This shows that the Council knew the legal and judicial pitfalls at the time of making this provision but still went ahead and recommended 1/3rd deduction towards land. Relevant abstract from the Minutes of the 14th GST Council meeting is reproduced below:

> *The Hon'ble Minister from Maharashtra stated that abatement regarding value of land should be kept out of the current proposal as in his State, in 12 Corporations, the land value was about 50% of the value of the flat and abatement of 30% would*

lead to litigation. He suggested that abatement should be given as per ready reckoner of the land value or on the basis of the stamp duty value. He also referred to the Supreme Court Judgment in the case of M/s Larsen & Tourbro Limited.

The Hon'ble Deputy Chief Minister of Gujarat also expressed apprehension that if Courts gave adverse judgments regarding the proposed abatement for land value, it could create problems.

8. Developed vs Undeveloped Land [Para 88]

Schedule III uses the phrase "sale of land" and so it can be land in any form whether developed or undeveloped. GST is levied on supply of goods or services for a consideration and therefore even in a case of an agreement for sale of land and building, in line with the second L&T judgement, imposition of GST can only be on the construction activity which is undertaken by the supplier at the behest of the proposed buyer. **Thus, if an agreement is entered into after the land is already developed by the developer, then such development activity was not undertaken for the prospective buyer and therefore there is no question of imposition of GST on the developed land.**

9. Taxability of Under Development Plots of Land [Para 89 and 121]

Court has categorically mentioned in para 89 that in the petitions before it, it is not dealing with a case where development is undertaken at the behest of the customer. Having said so, the court also says that, if that is the case, then there could be imposition of GST on the goods and services used during development.

Further, in para 121 while discussing Supreme Court order in case of Narne Construction Pvt Ltd., High Court has said as under:

We have already observed that in a given case there may be tax liability if the development of land is undertaken pursuant to contract with buyer. However, if

the land is already developed and thereafter agreement is entered into with the buyer for sale of such developed land, then it would not involve any service.

Sum and substance of above abstract is that if a plot of land is sold during its development phase, it could be taxed.

10. Judgement of the Court [Para 122 to 127]

a. Is provision for deemed valuation (deduction) of 1/3rd for Land ultra vires the GST law?

Yes. Paragraph 2 of the Notification which provides for a mandatory fixed rate of deduction of 1/3rd of total consideration towards the value of land **is ultra-vires the provisions as well as the scheme of the GST Acts**. **Application of such mandatory uniform rate of deduction is discriminatory, arbitrary and violative of Article 14 of the Constitution of India.**

b. Is provision for deemed valuation (deduction) of 1/3rd for Land struck down from the notification?

No. Paragraph 2 is not struck down from the notification, Gujarat High Court has stated as under:

i. Mandatory deduction of 1/3rd for value of land will not be applicable where the value of land is clearly ascertainable or where the value of construction service can be derived with the aid of valuation rules

ii. However, 1/3rd mandatory deduction will be allowed at the option of a taxable person in cases where the value of land or undivided share of land is not ascertainable.

c. What happens to tax already paid on the excess of value of land?

Grant Refund of the tax paid by the petitioner on the value of land (which was not disputed by the department) alongwith interest @ 6% to be calculated from the date of excess payment of tax till the date of refund.

d. Who can claim refund – the developer or the customer who has bought the plot of land?

Recipient of Service (buyer of the plot of land) is eligible for refund as he has borne the burden of tax and such tax was paid under protest. Section 54 of the CGST Act also envisages claim of refund directly by the recipient if he has borne the burden of tax. It has been so held by the Supreme Court in the case of Mafatlal Industries Ltd. v/s Union of India (1997) 5 SCC 536.

e. What is the status of AAAR ruling in case of Dipesh Anilkumar Naik?

Appellate Advance ruling order in case of Dipesh Anilkumar Naik – 2022 (1) TMI 1055 issued by Gujarat Bench of AAAR which said that sale of developed plot was taxable @ 18% has been quashed and set aside as it was based on paragraph 2.

f. Is the land value proposed by the developer or the buyer sacrosanct or can the department challenge the land value?

Court in its judgement as well as in the last paragraph has stated that if it is found by the department that there is an element of supply of goods or services in the transactions undertaken, then it is always open for the authority to adjudicate such liability in accordance with law.

11. Conclusion

There are many transactions in the real estate sector which involve one form of land or the other, all transactions except sale of pure and untouched land is under dispute since the introduction of Service tax. There have been cases where taxability is under challenge in plotting schemes or TDR / FSI, in other cases valuation mechanism has been challenged (Suresh Kumar Bansal). It would have been prudent for the Government and GST Council to take a more lenient and constitutionally sound view on these challenges; however, it chose to take the "Test as you go along" route whereby each such transaction will be tested by the court of law, be it underdevelopment and developed Plotting schemes or TDR or FSI or valuation of land in an under construction real estate project. All these transactions are in various stages of litigation across

India either under service tax or now in GST. This Judgement comes as a huge relief for the sector as a whole, many new challenges shall emerge from this judgement and therefore this is one in a series of expected judgements and this judgement would prove to be a milestone in coming days and decades.

It has sanctified an important principle of taxation, that valuation must be based on actual transaction value only, in case, if actual transaction value is not ascertainable then and then only, valuation can be done on a fictional percentile. This judgement not only gives relief to the buyers, it also gives legal handle to the department to check that this judgement is not misused to arbitrarily increase the value of land to evade payment of GST. This judgement will travel to the Supreme Court as all such matters do, I personally believe the legal tenets adjudged in this case will stand the scrutiny of the apex court, so the question is not if but when.

On the whole this judgement epitomises the fact that the GST council could have bitten the bullet when the time was ripe and avoided this sheer waste of national energy.

Sincerely hope they listen to the collective voice of the nation!!!

Formulated by:

N J Jain & Associates
Chartered Accountants

CA Nitesh Jain
Managing Partner

CA Gaurav Khetan
Partner

CA Praveen Maheshwari
Partner

CA Jay Dalwadi
Partner