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TAXABILITY OF TRANSFER OF DEVELOPMENT RIGHTS – THE CONUNDRUM CONTINUES



‘Your house is not an asset; it is a liability.’

--- Russell Sage

Ever since the concept of taxation evolved, the real estate sector has been 'a goose that lays the golden eggs' for the tax collecting authorities. The situation in India is no indifferent. The monarchies gave way to the present day central and state governments, whose endeavour is to tax all aspects of this sector.

The nature of real estate distinguishes it from all forms of movable assets (goods) as well as services. The ever-evolving multifaceted arrangements and transactions in this sector has

resulted in framing of numerous laws seeking to tax various aspects and transactions - all contributing in making it the most litigation prone sector. Amongst the several litigious issues that have emerged over time, this article focuses on the controversies surrounding the taxability of Transfer of Development Rights ('TDR') of land.

Prior to delving into the same, it is imperative to briefly chart out the background and the development of taxability of TDR.

Background

TDR as a concept evolved in 1913 in the USA and has since been followed across the globe for development of large crowded metro cities. The idea is to promote planned development of the city by decongesting the highly congested areas. For this purpose, the development rights in respect of privately owned land is acquired by the authorities for creating public amenities, building roads, etc. In lieu of the same, the owner of land who surrendered rights over his land is issued a TDR certificate, which certificate could be sold / transferred for value to any other person.. This concept evolved over the years and took different forms and shapes to suit the development requirements.

This concept has been adopted over time for development of large real estate projects in the private sector as well where the typical modus operandi is through execution of a development agreement between a developer and a landowner for transfer of development

rights to the developer which enables the developer to either trade in such development rights or itself undertake development of the land for commercial exploitation. Under this arrangement, the Developer may rent out or sell the developed area without any transfer of title in land. Landowner is compensated either in pure monetary terms or by way of ownership rights over certain percentage of the developed area.

For development of residential complexes, simplistically, such arrangements involve area sharing or revenue sharing models between the landowner and developer. Under the revenue sharing model, the Developer sells proportionate undivided share in the land to prospective buyers and compensates the landowner in cash. Whereas, in area sharing model, landowner receives a portion of the developed area in lieu of his portion of land, which the developer sells to prospective buyers along with his (developer's) share of the apartments.



Taxability of TDR in the Service Tax regime

Prior to July 2012, Finance Act, 1994 adopted a selective approach, whereby it identified the services eligible to service tax. The scope of these services was clearly delineated in the definition of 'taxable services' under Section 65(105). With each succeeding year, the Parliament extended the tax net by providing for more and more services. Activities such as 'construction', 'works contract' and renting were made taxable, but out of the several services listed, none of the entries found kinship to TDR.

Effective July 1, 2012, the positive list approach to tax specified services was substituted by a negative list regime which sought to tax all services except those excluded from the definition of service or were part of the negative list or were specifically exempted. 'Service' was defined under Section 65B(44) to mean "any activity carried out by a person for another for consideration....but shall not include an activity which constituted merely a transfer of title in goods or immovable property, by way of sale, gift or in any other manner; or..."

Transfer of title in immovable property

For the purposes of exclusion, the term 'immovable property' was not defined under the Finance Act, 1994, but has been defined in the General Clauses Act, 1897, the Registration Act, 1908 and the Transfer of Property Act, 1882. From a combined reading of the definitions, it emerged that 'immovable property' includes land and any benefit arising out of land.

In the case of **Chheda Housing Development Corporation v. Bibijan Shaikh Farid, 2007 (3) MhLJ 402**, the Bombay High Court held that development rights being a benefit arising from the land must be held to be immovable property. Following this decision, Bombay High Court in the case of **Sadoday Builders Pvt Ltd v. Joint Charity Commissioner, Order dated 23.06.2011 in WP No. 4543/2010** observed that development rights being a benefit arising from the land, must be held to be immovable property.

Further, the term 'title', as employed in the phrase 'transfer of title', refers to a claim to the ownership of a property. Thus, the expression 'transfer of title' implies change in ownership owing to transfer of freehold interest from one person to another. In the case of **Rajendra Kumar v. Poosamal, AIR 1975 Mad. 379**, the Madras High Court held that 'title' means a present right or interest in an immovable property capable of contracting to convey/transfer. Further, the Apex Court in the case of **Canbank Financial Services v. Custodian, 2004 (8) SCC 355** held that the word 'title' generally used in the context of immovable property means a right in the immovable property, which is capable of being transferred.



Tax on land and buildings outside the purview of Parliament

Article 246(1) of the Constitution provides for 3 lists in the Seventh Schedule. List I (Union List) enlists subjects for which the Parliament alone enjoys legislative powers. Likewise, List II (State List) enlists such subjects for which the State Legislature enjoys legislative powers. List III (Concurrent List) allows concurrent legislative powers to both Parliament and State Legislatures on the subjects enlisted therein.

Other laws

The above view is further endorsed by the treatment of TDR under the provisions as contained under the Income Tax Act, 1961 ('Income Tax Act') and The Indian Stamp Act, 1899 ('Stamp Act'). Under the Income Tax Act, the transaction is considered as transfer of land and eligible to long term capital gains tax. Further, as per the Stamp Act, in cases involving transfer of immovable property, registration is mandatory and a stamp duty at a higher

Taxes on land and buildings, house tax, etc. are legislated by the State legislatures basis the powers drawn from the State list, thereby giving no power to Parliament to legislate on the same. Thus, levy of service tax on TDR (being an immovable property) is constitutionally invalid.

rate is applicable whereas in other cases (like developer agreements, etc.), registration is optional, and the stamp duty rate of around 1 or 2 per cent is payable. The Schedule to Stamp Act has a separate entry for TDR and prescribes for mandatory registration and stamp duty rate equal to that applicable to transfer of immovable property. Thus, even Stamp Act recognizes TDR as a transaction in immovable property and charges stamp duties accordingly.

Jurisprudence under service tax on taxability of TDR

Notwithstanding the provision of specific exclusion in the definition of 'service' to transfer of title in immovable property, the legislative powers of Parliament and the jurisprudence relating to TDR, in the negative list regime, the service tax authorities in their anxiety to collect more tax, started alleging as if there is a barter transaction between the landowner and developer under the area sharing arrangement.

As per the authorities, under the development agreement, the landowner permanently and irrevocably transferred development rights in the land to the developer and received developed area as consideration. Likewise, the developer provided construction service to the landowner and received consideration in the form of TDR. For both these transactions, the authorities computed value of the constructed area given to

the landowner based on the value of apartment sold to prospective buyer nearer to the date of execution of the development agreement. For the transaction of provision of construction service by the developer to landowner, abatement prescribed for construction services was factored, whereas for the transaction of giving of TDR by the landowner to developer, no abatement was factored. Per the authorities, giving of TDR is a taxable activity undertaken by landowner against receipt of consideration in the form of constructed area for which no exclusion or exemption or abatement is available.

The Central Board of Excise and Customs ('CBEC') (now enshrined as Central Board of Indirect Taxes and Customs or CBIC) issued Circular No. 151/2/2012-ST dated February 10, 2012 ('the Circular') inter alia discussing various

models for undertaking construction. Under the model 'Tri-partite Agreement', the Circular provided that in the area sharing model, the developer is providing construction services to prospective buyers as well as to the landowner. The Circular further provided that since the landowner pays consideration to the developer in the form of land, the value of which is not easily available, the Circular held that the value at which the developer sells apartment to prospective buyer nearer to the date of execution of the development agreement, should be adopted as the value of provision of construction services by the developer to the landowner. For valuing the TDR, the authorities relied upon this Circular.

The Circular did not consider that land was sold by the developer to the prospective buyers but not to the landowner and therefore, the two values are not comparable. Moreover, the Circular prescribed machinery provisions to value services which were not prescribed by the Finance Act or the valuation rules framed thereunder. Therefore, the Circular was not applicable. Moreover, the Circular did not provide for the valuation of TDR per se, but for the construction services provided by the developer to landowner. The Delhi High Court decision in the case of **Suresh Kumar Bansal, 2016-TIOL-1077-HC-DEL-ST** directly applies on this aspect of inability of the tax authorities to collect service tax for lack of enabling legal provisions.

The above view was echoed in the case of **Vasantha Green Projects, 2018-TIOL-1611-**

Taxability of TDR in the GST regime

Effective July 1, 2017, the indirect tax regime witnessed a tectonic shift whereby Finance Act, 1994 along with various central and state tax legislations got subsumed in a new law, Goods and Service Tax ('GST'). The laws relating to land and building continued to remain outside the purview of GST and continue to be in the domain of State legislatures. Therefore, jurisprudence relating to immovable property and TDR which evolved over the years, continue to remain relevant.

Though the ambit of 'goods' and 'services' as defined under the GST law is very wide, yet, as

CESTAT-HYD, wherein whilst negating the applicability of the Circular and distinguishing the case of **LCS City Makers Private Limited, 2012-TIOL-618-CESTAT-MAD**, the Tribunal observed that the developer receives consideration from landowner in the form of land, which is sold to prospective buyers and the service tax paid on the consideration received from the prospective buyers also includes the value of land received from the landowner. Thus, service tax on construction services for landowner portion also stands duly discharged.

On May 21, 2019, the Chandigarh Bench of the Tribunal in the case of **DLF Commercial Projects Corporations, 2019-TIOL-1514-CESTAT-CHD** ('DLF') whilst explaining the intricacies of the TDR transactions, emphasised on the aspect that TDR constitutes immovable property, and is therefore not eligible to service tax. The Tribunal further took cognizance of the fact that the developer sold undivided share in land received from the landowner to prospective buyers and therefore, if land was transferred by the landowner to the developer or to the prospective buyers, there cannot be a case of TDR from landowner to the developer. Thus, there was no element of service provided by the landowner to the developer under the development agreement which could be eligible to service tax. The Tribunal relied on the case laws which held TDR to be immovable property.

immovable property does not qualify as goods or service, the GST law also provided for an exclusion to 'sale of land' and 'sale of completed building' (i.e. post completion of construction). Since land includes benefits arising out of land, TDR is akin to sale of land. Therefore, the legislature in its wisdom rightly did not declare TDR to be a deemed supply of good or service under the GST law.

Thus, the GST law provided for specific exclusion for sale of land and completed building, and further does not contain specific taxability provisions for TDR. However, in utter disregard

of the nature of TDR and jurisprudence relating to TDR discussed above, the CBIC issued Notification No. 4/2018-Central Tax (Rate) dated January 25, 2018 notifying applicability of GST on transfer of possession or development rights by executing a conveyance deed or a similar instrument. The notification assumed taxability of TDR which is beyond the ambit of GST law.

A writ petition, **Nirman Estate Developers Private Limited, 2018-TIOL-2935-HC-MUM-GST**, challenging the notification no. 4/2018 to be ultra vires the GST laws on the ground that TDR does not qualify as a supply of service, was withdrawn and consequently, no judicial scrutiny of the issue could take place under GST. Without discussing the jurisprudence relating to taxability of TDR and other related aspects, by simply relying on the notification, an advance ruling in the case of **Patrick Bernardinz D'sa**,

2018-TIOL-292-AAR-GST was pronounced, holding TDR to be a taxable supply of service and therefore eligible to GST.

Based on the numerous representations received from the trade and industry and to address the issues being faced by the real estate sector which was going through acute slow down and turmoil, the GST Council formed a subgroup to examine all such issues. This resulted in introduction of various changes in the GST laws relating to real estate sector effective from April 1, 2019 (in GST Council's 33rd and 34th meetings). From the perspective of taxability of TDR, without examining the aspect of nature and taxability, amending rate notifications and FAQs by way of TRU Circulars effective from April 1, 2019 were issued inter alia deeming TDR to be a taxable supply of service for which GST was payable under reverse charge by the developer and exemption was also provided for residential

projects proportionate to the apartments sold prior to receipt of completion certificate.

The above amending rate notifications and FAQs relating to TDR under the GST laws were a jolt to the real estate sector. However, soon thereafter, the real estate sector saw a ray of hope in the

DLF decision rendered by the Chandigarh Bench of CESTAT. Amidst the flux created, this ruling has come as a sigh of relief. This decision being the first one on the subject, discussing in detail the taxability of TDR under service tax, should be equally applicable in the GST regime.

Conclusion

The moot question which looms at large is whether TDR, being immovable property and therefore akin to sale of land, can be deemed as a supply of service under the GST laws? Further, would the decision of DLF hold good under the GST regime? It is expected that the tax authorities are likely to challenge the decision of DLF before the Supreme Court. It would be interesting to witness how the issue unfolds or

continues to be vexed as these issues will finally be set to rest only after proper judicial scrutiny and till such time, the conundrum continues and the Revenue authorities would continue to view real estate sector as a goose laying the golden eggs while the poor market sentiments and uncertainties of high GST have become a liability for the bleeding real estate sector.

