THE JOURNEY OF GST SINCE ITS IMPLEMENTATION & ITS IMPACT ON THE REAL ESTATE SECTOR

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The past three years have seen numerous policy changes that have significantly impacted the real estate sector including demonetization, RERA and GST. These reforms have changed the dynamics of how the sector conducts its business. Chief amongst these changes was the implementation of GST in July 2017. GST was introduced to replace a complex and multi-layered taxation system with a clear unified tax. It was expected to simplify the tax system, as well as improve compliance in the real estate sector.

In the previous tax regime, homebuyers had to pay VAT, Service Tax, Registration Fees and Stamp Duty on purchase of properties that were under construction. Since VAT, Registration and Stamp Duty were state levies, property prices varied from state to state. Developers had to pay various duties including sales tax, custom duty and OCTROI for which credit was not available. This would impact the property prices and subsequently the burden was transferred to the buyer.

With the advent of GST, there was a paradigm shift in the tax structure of real estate. Under the GST regime, construction cost complexities have significantly reduced as multiple taxes are combined into a single tax structure. The original GST on under-construction properties, after deducting land value, was fixed at 12 percent. Full input tax credit for procurements was made available to developers, thereby eliminating cascading taxes embedded into the property cost. Projects with OC received status were exempt from GST.

However, this had an unintended consequence where buyers preferred buying completed projects with OC received status as there was no GST involved as opposed to under-construction projects where 12 percent GST was in effect. This was the case even though completed projects were more expensive than under construction projects net of taxes. This was purely a psychological barrier in customers mind. Furthermore, the GST of 12 percent on under-construction properties was seen as a hindrance to the revitalisation of the sector. Considering that the modest turnaround witnessed in 2018 was primarily driven by sales of completed projects, which do not levy GST, a reduction in GST for under-construction properties would invariably spur demand for new projects. This was one of the real estate sector's foremost requests since the policy was introduced.

GST also impacts the accessibility of affordable housing projects. The majority of projects under the 'Housing For All By 2022' programme are to be constructed for low income groups. As this is a highly cost-sensitive segment with low property values, the slightest tax burden can be counter-productive. Lowering GST for only affordable housing projects will bring it within reach of a wider audience.

In January 2019, the GST Council announced the formation of a seven-member Group of Ministers to look into various demands of the real estate sector. In subsequent GST Council meetings, the proposal to reduce the GST rate on under-construction properties to five percent and affordable housing to one percent, both without input tax credits, was announced with new rates applicable from April 1st, 2019. Reduction in the GST rate on under-construction properties is expected to have positive implications for the sector and is projected to increase the demand conversion by removing the psychological barrier that customers had for under construction projects.

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Previously, input tax credits helped in slightly reducing construction costs, thereby preventing delays. The removal of input tax credits may affect short-term profitability on the supply side including steel and cement inputs. However, the resulting demand generation from the reduction in GST will far outweigh the negative aspects. To ensure that the real estate sector does not

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revert to being cash-driven, builders will have to purchase their inputs predominantly from GST-registered dealers.

A transition plan is available for the implementation of the new tax structure. Developers have the option to continue paying the previous GST rates with input tax credits for ongoing projects which are not completed by March 31st, 2019. This option is required to be exercised by May 10, 2019; else the new GST rates will apply.

The real estate sector is a significant contributor to India's growth and is its second largest employing sector. The contribution of the sector is set to grow at a rate of 30 percent CAGR in the next ten years and is expected to have revenues worth $180 billion by 2020. It is clear that the growth of the real estate sector has a multiplier effect on the growth of the entire economy. The rationalisation of GST is a strong impetus for growth of the real estate sector that will bolster momentum moving forward.