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Analysing developments impacting business

GUJARAT HIGH COURT HOLDS MANDATORY DEEMING FICTION OF 1/3RD DEDUCTION FOR VALUE OF LAND IN UNDER-CONSTRUCTION REAL ESTATE TRANSACTIONS UNDER GST AS ULTRA VIRES AND UNCONSTITUTIONAL, 'READS DOWN' HOLDING IT TO BE OPTIONAL

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Facts of the case

Petitioner (Munjaal Manishbhai Bhatt), an advocate entered into an agreement with a landowner/developer for purchase of an already developed plot of land (1021 sq mt) and construction of bungalow (160 sq mt) on the said plot by the developer. Separate consideration was agreed for both between the parties.

Issue under consideration

For purchase of under-construction real estate, GST is leviable on the entire contract value minus the value of land. However, there is a mandatory deeming fiction presuming 1/3rd of the total amount charged as attributable towards sale of land, irrespective of the actual value of land.

The foregoing is in terms of paragraph 2 of Notification No. 11/2017-CT (Rate) (*impugned notification*) as per which, the value of land or undivided share of land is to be deducted for arriving at the value of supply of construction services. The value of land or undivided share of land is deemed to be 1/3 of the total amount charged for the supply of construction services, including the value of land or undivided share of land, irrespective of the actual value thereof.

The constitutional validity of this mandatory deeming fiction was challenged in multiple High Courts. The Hon'ble Gujarat High Court (HC) has come out with the first judgment in this regard. Passing an order in favor of the taxpayers the Hon'ble Gujarat HC has directed refund to be granted of excess GST to the affected taxpayer.

The issue before the Hon'ble Gujarat HC was whether such mandatory deeming fiction fixing the value of land (for exclusion from the taxable base under GST) is *ultra-vires* the provisions of the GST Acts and/or violative Article 14 of the Constitution of India.

Observations

The Hon'ble Gujarat HC observed the following:

- Statutory provisions under GST requires valuation in accordance with actual price (where available) and hence, "*tax has to be imposed on such actual value*". Consequently, "*Deeming fiction can be applied only where actual value is not ascertainable*"
- "*Sale of land*" is excluded from levy of GST. The tax authorities contended that the "*exclusion of sale of land will not be available since the land is a developed piece of land*" - the Hon'ble Gujarat HC rejected this argument since GST cannot be imposed on developed land when development is done before entering into

agreement with buyer, as such development activity was not undertaken for the prospective buyer.

- Notification cannot provide for a fixed deeming deduction towards value of land in a case where agreement clearly stipulates specific consideration for sale of land and for construction of bungalow. The statutory provision requires valuation in accordance with the actual price paid and payable for the service and where such actual price is available, then tax has to be imposed on such actual value. Deeming fiction can be applied only where actual value is not ascertainable. Reliance in this regard was placed on the Supreme Court judgement in the case of Gannon Dunkerley¹.
- Reference was made to Supreme Court judgement in the case of Wipro Ltd.² wherein, rule providing flat rate of 1% addition to value towards loading, unloading charges even in cases where actual value is ascertainable was held *ultra-vires* the Customs Act, 1961.
- The deeming fiction provided in the notification is arbitrary, as it is applied irrespective of the size of the plot of land and construction therein. Further, no distinction is made between a flat and a bungalow in the impugned notification.
- The minutes of the 14th GST Council Meeting clearly contemplates that the deduction was inserted only in the context of flats wherein value of undivided share of land was unascertainable.
- The arbitrary deeming fiction by way of delegated legislation has led to a situation whereby the measure of tax imposed has no nexus with the charge of tax which is on supply of construction service.
- Validity of a delegated legislation cannot be defended merely on the ground that the Government had competence to issue such delegated piece of legislation.
- Notification cannot be justified on the basis that it curbs avoidance of tax, as parties may inflate consideration of land in the agreement. Detailed statutory mechanism for determination of value is available in case Revenue wishes to challenge valuation.
- Entry 5(b) of Schedule II cannot be relied upon to justify the Notification, as the sole purpose of Schedule II is to clarify whether a supply will be a supply of goods or supply of services.

Ruling

The Hon'ble Gujarat HC held that the impugned paragraph 2 of Notification No. 11/2017-CT (Rate) and identical state notification in cases where land value is ascertainable is ultra-vires the provisions as well as the scheme of the GST statutes. It further held that application of such deduction is discriminatory, arbitrary and violative of Article 14 of the Constitution of India, and subsequently, ordered the GST authorities to refund the excess amount of GST directly to the petitioner along with interest @ 6%.

The impugned deduction can be permitted only in cases where value of land is not ascertainable and hence, it cannot be mandatory in nature.

Comments

¹ [Gannon Dunkerley and Co. Vs. State of Rajasthan - (1993) 1 SCC 364]

² [Wipro Ltd. Vs. Assistant Collector of Customs and Others - (2015) 14 SCC 161]

This ruling is a welcome judgment for the real estate sector players as well as the buyers.

The said judgment would bring down the cost of purchases in the hands of the buyer and would aid in increasing the demand for real estate.

The Way Forward

This judgment gives rise to the following points of review and analysis not only for players/ stakeholders/ investors in the real estate space but also entities/persons who have recently purchased/about to purchase under-construction real estate:

- Reviewing past/existing/future agreements to identify necessary amendments/additional documentation to take benefit of this judgment to enable a lesser purchasing cost for buyers on account of lower GST impact.
- Examining the possibility of claiming refund of excess GST that buyers may have borne on account of not factoring abatement of land value on actuals.

- Sudipta Bhattacharjee (Partner) and Rahul Dhanuka (Partner)

[Munjaal Manishbhai Bhatt Vs. Union Of India - R/Special Civil Application No. 1350 Of 2021]

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