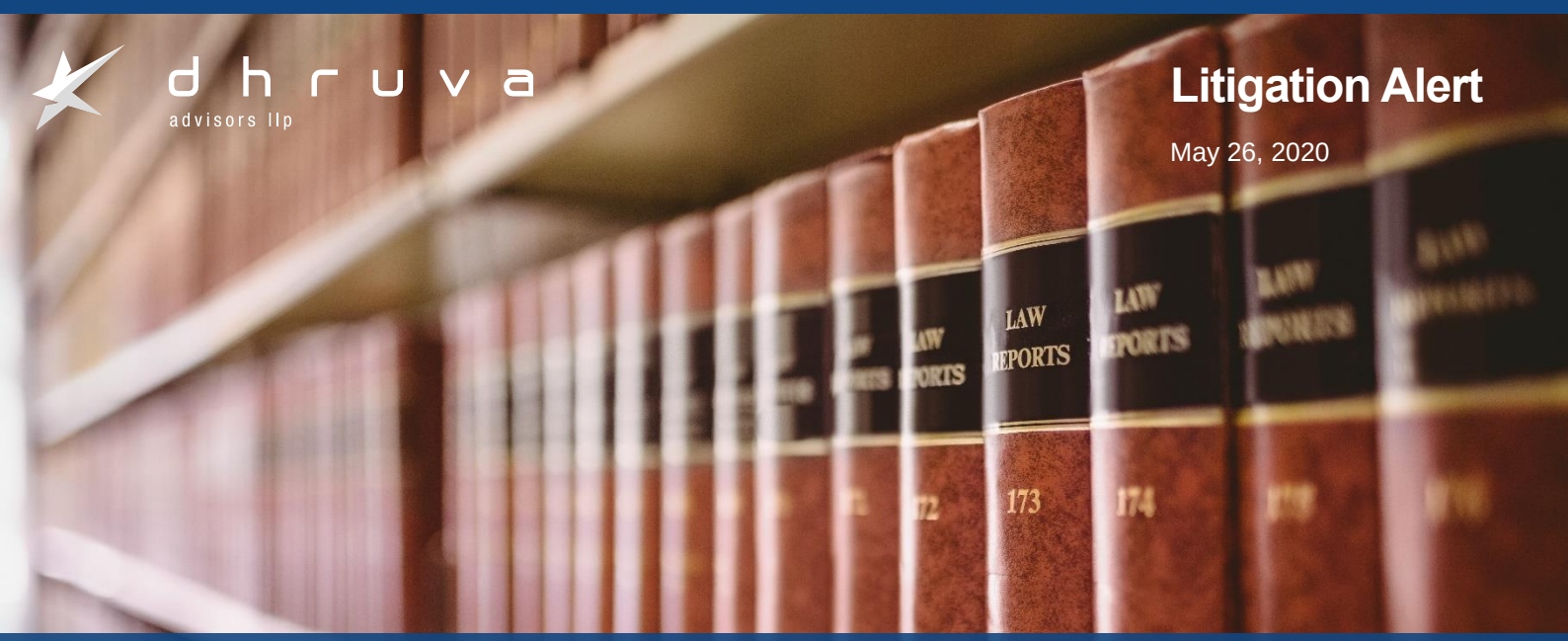

dhruva advisors llp

Litigation Alert

May 26, 2020

Services under a JDA will attract the levy of GST

M/s MAARQ Spaces Pvt. Ltd.

The Karnataka Appellate Authority for Advance Ruling ("AAAR") reviewed the ruling[1] (Ruling) pronounced by the Karnataka Authority for Advance Ruling ("AAR"), upholding the levy of Goods and Service Tax ("GST") on transfer of rights in land for development in exchange for development services provided by the Appellant under a Joint Development Agreement ("JDA").

Question for determination

- Whether the Ruling pronounced by the AAR was correct in upholding the levy of GST on transfer of rights in land for development in exchange for development services provided by the Appellant under a JDA?

Discussion

- The Appellant is engaged in the business of property development and has entered into a JDA with landowners for the development of a piece of land into residential plots along with amenities.
- The revenue sharing ratio between the Appellant and landowners is 25:75, respectively. The cost of development will be borne by the Appellant. According to the JDA, the Appellant has entered into an agreement with the customers for the sale of the residential plots.
- The Appellant challenged the AAR on the following grounds:
  - The Appellant is primarily engaged in the sale of land and the development activity is only incidental to sale of land. Because the definition of 'supply' and Entry no. 5 of Schedule III of the Central Goods and Service Tax Act, 2017 ("CGST Act") excludes sale of land from the scope of 'supply', the transaction should not attract the levy of GST.
  - The Appellant opposed the observation made by the AAR that the Appellant is not the owner of the property. The Appellant submits that as they have rights in the project to the extent of 25% of the total revenue, this implies that the Appellant has rights in the property. Reliance was placed on *Sunil v. CIT*[2] wherein it was held that when a partner brings its personal assets into the capital of a partnership firm, there may be a reduction in the exclusive right of the original owner in the totality of rights.
  - The JDA is a composite supply. The principal supply, as defined under the CGST Act, is the

[1] Order no. KAR ADRG/ 199/2019 dated September 30, 2019

[2] AIR 1986 SC 368

sale of land, and the development activity is incidental to the sale of land. As the development activity is naturally bundled with the sale of land, and the sale of developed plots is nothing but sale of land as a composite supply, which falls under Entry 5 of Schedule III of the CGST Act, the same should not attract GST.

– In terms of section 32 of the Karnataka Urban Development Authorities Act, 1987 ("KUDA Act"), the Appellant is required to transfer ownership on developmental works such as roads, drains, water supply mains, etc. to the developmental authority for which the Appellant has entered into separate agreements. Therefore, there cannot be an agreement for supply of service but only for the sale of land.

Ruling

- Although the sale of land is *per se* out of the GST ambit, the exclusion applies only if the transaction is exclusively for transfer of title or transfer of ownership of land which is an immoveable property. If the transaction of sale of land is coupled with another activity such as infrastructure works, then this exclusion will not apply. Hence, the substance of the agreement between the parties is important.
- It was held that the JDA in the present case provides for receiving consideration on a revenue share model from the sale of the plotted land between the landowners and the developer in the agreed ratio of 75:25. It therefore manifests that the transaction between the landowners and the Appellant-Developer is not a sale of land simpliciter, but is coupled with obligations for development of the land and provision of infrastructure / amenities. There is an element of service which is rendered by the Appellant in the form of plotted development of the land which is the dominant activity of the agreement. The Appellant has represented himself as a person with experience and expertise as a land developer.
- There are two supplies in the present case: development of land and sale of plots. The transaction of the sale of land is outside the purview of GST and is not an exempt supply, whereas development of land is a taxable supply under section 7 of the CGST Act. A combination of two activities, one of which is not a supply under GST, cannot be said to be a composite supply.
- Even under section 32 of the KUDA Act, the onus is on the landowners to comply and ensure that the Appellant does not have any role to play in obtaining the necessary sanctions under the KUDA Act.

Dhruva Comments:

There has been a dispute on the applicability of service tax on the granting of development rights by a landowner to the developer / builder on the basis that the grant of development rights is a transaction akin to sale of land and therefore not liable to service tax. Interestingly, the current ruling is completely opposite to the above proposition viz. whether the Appellant (builder / developer) undertakes the supply of development of land services to the landowners.

The activity of development of plots as residential property and the sale to ultimate buyers *per se* is taxable under GST as an activity of construction of complex in the hands of the builder/developer. The said services are provided to the buyer of the residential property and not to the landowners (except where landowners keep some part of the constructed property in lieu of cash / revenue share). The fact that the revenue is split between the landowners and the developer under a revenue share arrangement could at best be looked at as compensating the landowners for development rights in the land, i.e. a supply from the landowners to the applicant and not vice-versa. This is also evident from Notification no. 4/2018 dated January 25, 2018, ("Notification") which notifies that registered persons supplying development rights to a developer / builder where consideration is in the form of construction of service of complex, building etc. and registered persons who supply construction service of complex, building etc. against consideration in the form of development rights, are liable to GST. Subject to the dispute around the taxability of development rights, the Notification clearly brings out that the builder/developer

is only liable for construction services, and the landowners for the granting of development rights, and in case of barter, both would become liable for their respective services.

The Appellant also argued that the arrangement is nothing but a revenue share arrangement, which the AAAR did not agree to. While the position on revenue share is a disputable issue, the emerging view is that if the revenue share is nothing but a consideration for supply, the same shall be taxable.

It is very clear that both levels of the advance ruling authorities have failed to understand the transaction and the nature of supply viz-a-viz the landowners and the developer and the developer and ultimate buyer.

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