

Actual value of land not liable to GST holds Gujarat High Court

*Munjaal Manishbhai Bhatt v. Union of India*¹

Paragraph no. 2 of Notification No. 11/2017-Central Tax (Rate) dated 28th June 2017 (the 'Notification') provides an ad-hoc deduction of 1/3rd of the total amount charged towards sale of land in case of supply of construction services irrespective of whether the value of land is ascertainable or not. The Gujarat High Court examined this deeming fiction to cases where the cost of land is available, given that cost of land is specially excluded from the ambit of GST vide entry 5 of schedule III to the central Goods and Services Tax Act, 2017 ('CGST Act).

Facts of the cases:

Case 1:

- The Petitioner entered into an agreement with a developer, dated 29th September 2020, for the purchase of a plot of land and construction of bungalow on the said plot of land.
- Separate and distinct consideration was agreed upon between the parties to the agreement for the sale of land and construction of a bungalow on the land.
- The Petitioner was liable to pay GST as per the agreement and believed that he would be liable to pay GST on the consideration payable for the

construction of the bungalow in as much as it would constitute supply of construction service under the CGST Act and Gujarat Goods and Services Tax Act, 2017 (collectively "the GST Acts"). However, the Developer, relying upon entry no. 3(if) of the Notification pertaining to construction service read with paragraph 2 of said notification informed the Petitioner that he would be liable to pay GST at the rate of 18% (CGST + SGST) under the GST Acts on the entire consideration payable for the land as well as the construction of the bungalow after deducting 1/3rd of the total value that is attributable towards cost of land.

- Entry 5 of schedule III to the GST Acts specifies that supply of land is neither supply of goods nor supply of services. Hence, a contradiction is created by entry no. 3(if) of the Notification read with paragraph 2 of the notification which allows a deduction only of 1/3 of the total cost considering it to be value for sale of land.
- The Petitioner contested the levy of GST on the arbitrarily determined value of land and the applicability of the deeming fiction created by the Notification (delegated legislation) which exceeds the tax liability as computed in accordance with the provisions of the statute. It was the petitioner's

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stance that the Notification leads to a consequence whereby GST is imposed on land, which is not sought to be taxed by the statute. Therefore, it was contended that the notification is *ultra-vires* the provisions of the GST Acts.

- The question before the Gujarat High Court was whether the 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 of Article 14 of the Constitution of India.

Case 2:

- In a related matter decided by the Advance Ruling Authority concerning the developer held that the deduction for sale of land (developed plots) was admissible only to the extent of 1/3rd of the total consideration based on the Notification. These rulings have been affirmed by the Appellate Authority for Advance Ruling.
- Hence, the developer also a petitioner to the writ approached the High Court challenging the validity of the Notification as well as the ruling of the appellate advance ruling authority.

Since the issues raised in the above two cases were the same, these were taken up for hearing together and disposed of by a common judgement.

Judgement of the Gujarat High Court:

Reading down the mandatory deeming fiction of 1/3rd of the total amount charged, for value of land in constructions contracts as *ultra vires*, the High Court held that the entry in the notification is *ultra-vires* the provisions as well as the scheme of the GST Acts.

It was held that the application of such mandatory uniform rate of deduction is discriminatory, arbitrary and violative of Article 14 of the Constitution of India.

In the judgment the Hon'ble Gujarat High Court observed as follows:

- The Service Tax Valuation Rules were retrospectively amended to provide for deduction of

land, and deduction at a fixed percentage was made applicable only where the actual value was not ascertainable. Thus, when a workable mechanism for deduction of land was already in force under the erstwhile service tax regime, the same ought to have been continued

- Mandatory application of deeming fiction of 1/3rd of the total agreement value towards land even though the actual value of land is ascertainable, is clearly contrary to the provisions and scheme of the CGST Act and therefore *ultra-vires* the statutory provisions.
- Apart from being contrary to the statutory provisions contained in the CGST Act, one of the most glaring features of the deeming fiction is its arbitrariness, in as much as the same is uniformly applied irrespective of the size of the plot of land and construction therein.
- The prescription under section 15(5) of the CGST Act has to be by rules and not by notification and even if it is presumed that the Government has the competence to fix a deemed value for supplies, if the deeming fiction is found to be arbitrary and contrary to the scheme of the statute, then it can definitely be held to be *ultra vires*.
- The Court held that the deduction of 1/3rd for value of land cannot be made mandatory in cases where the value of land is clearly ascertainable or where the value of construction service can be derived with the aid of valuation rules, and that such deduction can be permitted at the option of a taxable person particularly in cases where the value of land or undivided share of land is not ascertainable.

Dhruva Comments:

This is a welcome judgement since it aligns the intent of the GST legislation and its administration, clarifying that in the scenarios where the cost of land is available the actual value should be excluded from the taxable value. The verdict impacts the real estate sector in a significant way and the tax incident on agreements will reduce *ab-initio* where cost of land is ascertainable and included in



the transfer and development agreement. However, it should be noted that documentation will be key, and any stand will have to be supported with the agreements and other documents involved in the supply.

Prior to the GST regime, developers in different parts of India were following different practices. In some cases, there was one agreement for construction and the agreement value included the cost of land/undivided share of land. Meanwhile, in others, developers would enter into independent agreements for sale of land and for construction service. However, with the advent of GST and the Notification prescribing the deemed value for the land, developers could no longer reduce the actual value of land while determining the tax payable. Now, developers, with the help of this judgment, have the discretion to adopt the method suitable to them.

Impacted persons coming forth to apply for a refund based on this judgment should keep in mind the timeline to apply for refunds of GST for the past period. The agreement should transparently denote the land value to substantiate the land value.

Going forward, taxpayers (developers) may opt to tread cautiously in view of the documentary aspects and that GST authorities across the States will not readily accept the verdict pronounced by the High Court.

Interestingly, the High Court in this case addressed the challenge of vires with a reading down instead of striking down the deeming portion of the Notification.





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