

# GST and the litmus test of land

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After the steps taken to reduce black money and streamline election finance, the natural follow-up is to clean one of the biggest sources of black money — land and real estate. And the natural way to do that is to bring the supply of land and real estate (hereafter LARE) into the GST. At the moment, the GST law does not include LARE, but there is still a window to fix that in the GST Council meetings in the months ahead.

Before we spell out the details, a few clarifications are in order to clear misconceptions and misinformation, some of which appear to be perpetrated deliberately by vested interests with a stake in preserving the murky status quo.

The first misconception is that stamp duties will be brought into the GST. Many states have refused to entertain bringing LARE into the GST, fearing that their right to levy stamp duties on the sale of land — a big source of state revenues — will be taken away from them. This fear is unfounded. There is no such intention; stamp duties will remain untouched.

The second misconception is that agricultural land will be taxed. There is no intention to bring transactions relating to land for agriculture into the GST. The fear that there is a slippery slope leading to taxes on agricultural land and income is also unfounded.

The third misconception is that low-cost housing will be taxed and made unaffordable. There is no intention to bring transactions relating to low-cost housing into the GST. The fear that the price of housing for the poorer sections will go up because of new taxes is also unfounded. Housing below a certain cost (or below a carpet area of 60 square metres) will unambiguously not be subject to GST.

The fourth misconception is that the tax burden will increase and hence, the prices of LARE will go up — there is no intention to increase current taxation on LARE. As will be elaborated below, bringing LARE into the GST will keep current effective rates of taxation broadly unaffected; what will happen is an increase in taxes at the final stage, but because credits will be available on input taxes, the real burden of taxation will not increase.

So, what will come into the GST? Answering that requires understanding the current system. Currently, an annual property tax is levied on land as a source of wealth by urban local bodies. When land or property is sold, there is a stamp duty levied by state governments to register the sale. Neither of these will be brought into the GST.

In principle, the GST can be levied as a service tax on the supply of land and real estate. What exactly is the service? The service in question relates to that provided by those who develop and construct commercial and residential property (the LARE service provider). This service can be provided either as a works contract when the buyer gets the LARE to build and develop the property; or the service can be provided as the supply of an already constructed property (call it readymade property).

Today, the law makes an arbitrary distinction between works contracts and ready-made property. There is a service tax on works contracts both for commercial and residential properties. This tax is about 4.5 per cent, levied on the total value of the property, but no credits are available for taxes paid on inputs such as iron and steel, cement and other fittings and fixtures (many of which are transacted informally) that go into the construction of a property. The lack of input tax credits means that the effective rate of tax is not the headline 4.5 per cent, but that rate plus the cascaded sum of all the input taxes: A rough estimate is that the effective tax rate even today is over 12 per cent.

In contrast, there is no tax on ready-made properties, commercial or residential. Because there is no tax, there is also no provision of input tax credits — this means that here too, the effective rate of taxation is not the headline zero per cent, but the sum of all the cascaded taxes on inputs. One technical reason that ready-made properties are not taxed currently is that some argue immovable property is excluded in the Constitution from the definition of a “good.” But going forward, ready-made properties — or rather, the service provided in building them — can easily be taxed as a service because the definition of what can be taxed under the GST is quite broad; supply of goods or services or both (excluding alcoholic liquor for human consumption).

So, today, the playing field is not level. The service underlying works contracts is taxed more heavily than the same service embodied in a readymade property. The way forward is to recognise that this distinction between works contract and readymade property is artificial and to tax the service that went into the development and construction of both; hence, level the playing field.

The key idea would be tax them at a standard rate and allow full input tax credits. It is the flow of credit that will strike at black money because the self-policing nature of the GST will kick in — all input transactions, notably the sale of cement, iron and steel, and fixtures and fittings that go into the construction of property will have to be accounted for. So, even as the tax on the consumer can be kept the same as today, the sales and purchases of inputs can be brought into the tax net. This would be a real transformational step in the fight against black money in real estate.

But even these very important changes will not strike at another key problem — the exclusion of transactions relating to the sale of land per se from the GST net. For that to happen, the sale of land (for non-agricultural purposes) must itself be taxable as a supply of good or service. Only if the sale of land is taxed can there be input tax credit for this down the chain; and only if there is input tax credit will the self-policing GST mechanism for disclosing the sale of land transaction kick in when that land is further developed. It is this disclosure that will strike at black money in land sale transactions.

Another advantage of imposing a GST on the first sale of land is that it will deter hoarding and encourage land development because when the latter happens, the GST can be claimed as a credit. In contrast, the land hoarder will bear the full burden of the GST.

There are several international precedents for taxing the sale of land under the GST, including in the VAT

systems of Australia, Singapore, Malaysia, Indonesia and South Africa. However, Indian constitutional provisions are less clear. The exclusion of immovable property from the definition of “goods” is one impediment. But it is also quite defensible and intuitive to consider the sale of land, or the sale of the right to land, as a service which will then be covered by the definition under the GST (Singapore, for example, considers the sale of the right to land as a good).

Imposing a GST on the sale of land will be the big advance in striking at black money, complementing the other action described above to treat works contracts and ready-made properties similarly. These two actions will, respectively, bring land and real estate into the GST — which could then become a truly transformational GST. In the GST Council, the Centre and some of the pro-governance states have expressed their support for bringing LARE into the GST. But many of the largest states have expressed opposition. At a time when there is a drive to root out black money creation, it is imperative to attack the source of the problem — the flow problem — and not just the symptom, which is the stock problem.

Bringing LARE into the GST is thus a litmus test for whether state governments are serious in their efforts to address the problem, and hence, supportive of the prime minister’s drive in relation to reducing black money. Those who are for the murky status quo are hiding behind the four misconceptions stated above.

But we must be clear: If you are against bringing LARE into the GST, you are for the continuous generation of black money. If so, please stand up and be identified. It is as simple as that.

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