

Real Estate Update

March 04, 2010

IMPACT OF BUDGET 2010 ON REAL ESTATE SECTOR IN INDIA

This is further to our recent hotline *India Budget Insights (2010 – 11)* analyzing the implications of the Budget 2010. This Hotline seeks to bring to the fore the provisions of Budget 2010 and attendant implications concerning the Indian Real Estate Sector.

INTRODUCTION

With the recession fading out gradually and fund raising showing gradual and steady increase once again, the Indian real estate sector was clearly looking at 2010 as a year to build on its 2008 run. While concerns over liquidity and demand constraints have eased, developers were looking to execute the planned projects to maintain cash flows rather than raise more debt. The industry was therefore looking at Budget 2010 for “boosters” like tax breaks for townships / affordable housing sector, allaying the ambiguities on the real estate mutual funds to heal the bruises that the sector suffered in 2009. While the “infrastructure” status still alludes the real estate sector, a clear lean towards low-cost real estate especially housing was seen. It would be interesting to look at both sides of the coin flipped up by the Budget 2010.

THE POSITIVES

§ The pending housing projects have been granted a one year extension for completion, from the existing four years to five years, for claiming a 100% deduction on their profits under section 80-IB of the Income Tax Act, 1961 (“Act”). This extension is available for housing projects approved by a local authority on or after April 1, 2005.

§ In addition, under section 80-IB of the Act the built-up area of shops and other commercial establishments in housing projects has been relaxed to 3% of the aggregate built-up area of the housing project or 5000 square feet, whichever is higher, from the existing 5% of the aggregate built-up area or 2000 square feet, whichever was less.

§ A 4 month extension has been provided for setting up and commencing operations of hotels and convention centers in National Capital Territory of Delhi and specified surrounding regions. Such hotels and convention centers would now be eligible to claim specified deductions, where such facilities are set up and commence business by July 31, 2010.

§ Investment linked incentives have been proposed for the business of building and operating new hotels of two-star or above category, anywhere in India, which start functioning after April 1, 2010. The incentives are in the nature of 100% deduction with respect to capital expenditure, incurred wholly and exclusively, for the purposes of such business, provided such expenditure is incurred prior to commencement of operations and the amount is capitalized in the books of such undertaking.

§ One per cent interest subvention on housing loans up to Rs.10 lakh (where the cost of the house does not exceed Rs.20 lakh) has been extended till March 31, 2011.

§ There has been higher allocation under *Indira Awas Yojana* and other rural development/infrastructure schemes.

What it means: The extension of time period for completion of existing projects will give the industry players the comfort of time and help developers whose projects were held up during the slowdown of last year. The relaxations regarding commercial establishments in the housing projects would enable basic facilities for the residents and help developers and real estate companies to make their projects more viable. Whilst the demand for “infrastructure” status to hotels has not been acceded to, inclusion of hotels for eligible deduction, through an investment linked incentive and not a profit linked one (as demanded by the industry players) does sweeten the deal and is likely to stimulate investments in this sector. The interest subvention along with increase in the tax slab rates for individuals should provide the necessary demand boost for low-cost housing. It may also encourage the developers to build more houses in this segment to benefit from this demand pick-up.

AND THE NEGATIVES

Budget 2010 in spite of positives like incentives to hotel business, housing projects, higher allocation under Indira Awas Yojana and other rural development/infrastructure schemes, is unlikely to meet the expectations of the industry primarily due to some of the service tax proposals such as.

§ Service tax on commercial rentals: The High Court of Delhi in the case of *Home Retail Solution and Ors. v. Union of India* had clarified that renting of commercial property would not be subject to the levy of service tax. The Budget has amended the scope of ‘Renting of Immovable Property Service’ to directly overrule the High Court judgment and to explicitly cover the activity of mere renting as well and this has been done with retrospective effect from 1st June 2007. Moreover, renting of vacant land where the agreement of contract between lessor and lessee provided for undertaking construction of building/structure on such land for furtherance of business or commerce during the lease

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period will also be subjected to service tax.

§ Construction of real estate complexes will now attract service tax, unless the entire consideration for the property is paid after the completion of construction, that is, on obtaining the occupation certificate from the concerned authorities.

§ Service tax will now also be levied on additional services provided by a builder to buyers for extra charge like preferential location, internal and external development of complexes.

§ Increase in the standard rate of excise duties to 10% and also on cement, which is a major input for real estate construction.

What it means: Service tax on the activity of construction would primarily mean, buyers paying higher price for property which is under construction.

The expansion of scope of 'Renting of Immovable Property Service' is likely to be one of the most controversial proposals. Pursuant to the Delhi High Court judgment, most industry players refrained from paying service tax pursuant to such transactions. This amendment would have a significant impact on both the real estate sector as also sectors which rely on lease of immovable property for running their business. Further, retrospective nature of the amendment will now result in an adverse impact on the sector and may lead rise to a large amount of litigation.

In an industry where agreement of contract between lessor and lessee providing for construction of building/structure on vacant lands are a common phenomenon, an imposition of service tax on such transactions is not likely to go down too well with the real estate sector.

The increase in the standard rate of excise duty and increase in duty of cement and petroleum products will increase the cost of construction and it is expected that per unit cost for prospective buyers will also increase. But, the industry may also have to bear the pinch of such increase in excise duties, as at present, when the demand is on a slow recovery path, it may not be able to pass on the entire increase in the cost of construction to the buyers.

CONCLUSION

From demand boosters and other reliefs, to far-ranging service taxes and higher excise duties, the Budget 2010 presents a mixed bag for real estate sector in India. However, it has failed to address some of the key demands of the real estate developers, including infrastructure status to the real estate sector, relaxation of external commercial borrowings to fund projects, provision of separate deduction of Rs. 1 lakh for housing loan repayment or increasing the overall 80C deduction to Rs. 2 lakhs et al. Though the positives mentioned above will indeed ease the burden imposed by widening the service tax net and rise in excise duties, it is difficult to be clairvoyant on the impact of the policy announcements at this time. However, it seems the service tax implications, especially from renting of property that are now required to be reckoned from 2007 are likely to be the dampeners in the growth driven and growth stimulated Budget 2010.

- Deepak Jodhani & Ruchir Sinha

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