NUS National University of Singapore
ISAS Institute of South Asian Studies

ISAS Brief
No. 641 – 8 March 2019

Boost for India's Realty Sector before the Elections

Vinod Rai

Summary

The real estate sector is the largest employer of labour in India and provides downstream support to industries such as steel, cement, iron, bricks, and wood. It also helps boost consumption around construction sites. As a consequence of a slowdown of construction activity in the housing and commercial sectors, there was financial stress among developers with a fairly large number of dwelling units lying unsold. The budget for 2019-20 has introduced much-needed relief for buyers and developers. In addition, the government has announced a very substantial reduction in the rates of the Goods and Services Tax that this sector will attract. These moves are bound to provide acceleration in the construction activity across the country.

The interim budget presented by the Indian government on 1 February 2019 has provided some unexpected but much-needed relief for property owners and developers. There is a dual benefit to property owners and developers, who can off-load some of the inventory they hold, which has been estimated to be in the range of 625,000 to 700,000 units. The budget has indeed addressed some long-standing issues which were creating distress in the real estate sector.

Until now, taxpayers who own and self- occupy more than one house are required to pay notional tax which one property may fetch. This was a source of undue pressure on some taxpayers who would be owners of property in their native places, or in which their parents could be residing and for which no rental was being realised. On the rationale that a person can reside in only one house, they had to pay tax on notional rent on the second property. The relief now provided is that taxpayers will be able to claim up to two self-occupied houses without paying any tax being assessed on the notional rent of the second property, provided it is not let out. This move will create more demand and make the realty market attractive.

The other relief is in terms of exemption on long-term capital gains when the same is invested in two houses. Presently, tax benefit on long-term capital gains is permissible on the sale of a residential house, if the indexed long-term capital gain is invested in the buying or construction of another residential house within the period specified. The benefit accruing to house owners henceforth is that the benefit will accrue to buying or constructing two residential houses, provided the amount of capital gain does not exceed ₹2 crore (S$400,000). The only restriction is that once the tax benefit is claimed over two houses, it cannot be claimed over the same year or in subsequent years.

In addition to these two benefits, another benefit provided is the increased limit for which tax can be deducted at source by the lessee while paying rent to the land lord. The limit has been raised from the present ₹180,000 to ₹ 240,000 (S$3600 to S$4800).

Unsold properties have created a serious liquidity crunch for developers, leading to defaults to financing institutions. In addition, builders are required to pay taxes on the notional rent of this inventory if it is held for more than a year. The current budget has extended this period to two years, which is another major relief to developers.

A panel of ministers headed by the Gujarat Deputy Chief Minister, Nitin Patel, had favoured a reduction in the rate of the Goods and Services Tax (GST) applicable to under construction homes. Accepting the recommendation, the GST Council has approved substantial reduction in the levy of homes under construction and raised the threshold for affordable housing. Hence, the GST rates applicable for homes under construction from 1 April 2019, will be 5 per cent against 12 per cent earlier. Affordable homes will be taxed at only one per cent from the earlier 8 per cent. The latter segment comprises homes priced at ₹45 lakhs (S$90,000) and with a carpet area of 60 square metres in metro cities and 90 square metres in non-metro cities. This is against the earlier uniform limit of 80 square metres in both segments. There will be no input tax credit for GST paid on materials such as cement and steel for this sector. This reduction will make more purchases eligible for concessional tax. However, the flip side of this concession could be that builders do not bother to bring on record purchases of such raw material, thus enabling cash transactions. To address this fear, the law review committee and fitment commitment will suggest measures.

These measures will provide much-desired relief as this sector generates the maximum amount of employment opportunity within the country. It also utilises raw materials such as steel, bricks, cement, wood, and paint, thereby giving a boost to those industries also. Besides there being a slowdown in the sector and low take-up of houses under construction, these measures will help reduce the cost of houses as unutilised input tax credit, which used to add to the cost at the end of the project, will now be removed leading to more attractive pricing of housing units. The move will also make tax compliance easier for the builders with simplification of the tax structure.

The sector has long been suffering from a build-up of inventory and subdued prices, which have been causing distress to the realty sector. It had led to a vicious circle since builders were unable to sell units leading to a liquidity crunch. They also faced a double jeopardy as they were required to pay notional rent on unsold units. With the reduction in GST rates and a relaxation of the long-term capital gains cycle, purchases have become far more attractive. A very wide cross-section of people believe that these measures should have been introduced at least two years earlier as, besides reviving economic activity in the construction sector, it would have released the pressure on bank balance sheets.

. . . . .

Mr Vinod Rai is a Distinguished Visiting Research Fellow at the Institute of South Asian Studies (ISAS), an autonomous research institute at the National University of Singapore (NUS). He is a former Comptroller and Auditor General of India. He can be contacted at isasvr@nus.edu.sg. The author bears full responsibility for the facts cited and opinions expressed in this paper.