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IMPLICATIONS OF



**Income Tax on Joint
Development /
Re-development
of Property**



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Redevelopment of Co-operative Housing Societies - GST Implications

After the two years slow down due to COVID-19 pandemic, there is again growth in the real estate sector in India. Redevelopment projects are highly prevalent especially in metros and other large cities during this growth phase.

Post the introduction of Goods and Services Tax (“GST”) in 2017, the implications for the real estate sector have been dynamic and have continuously undergone change with the evolution of understanding of the nature of transactions including sub-transactions of certain large real estate projects. The tax authorities have been proactive in coming out with clarifications, notifications and amendments where required in a prompt and effective manner. The taxation of real estate sector has undergone significant change from a GST perspective effective from 1 April 2019. As GST is not applicable on transactions relating to sale of immovable property and input tax credit is also restricted in case of real estate development projects, the need to effectively analyse the impact of GST on transactions of redevelopment of co-operative housing societies (“**Redevelopment Project**”) gains further significance as optimisation of GST facilitates the overall cost of the Redevelopment Project. This article attempts to evaluate GST implications on execution of Redevelopment Project for a co-operative housing society.

It is important at the first instance to understand the key stakeholders in case of a Redevelopment Project:

- a. Society members (“Existing Members”): These are the existing members of the co-operative housing societies who own the flats in the existing building premises.
- b. Housing society: This is the statutorily formed co-operative housing society of which the Existing Members are shareholders. Such societies are formed under the laws applicable in the respective State in which the premises/building is located. In certain states, the society is replaced by a condominium in which ownership of individual units is considered as owning of proportionate share in the overall premises including land thereof.
- c. Promoter Developer (“Promoter”): The real estate developer with whom the society or members contractually agree to redevelop the existing premises/building.
- d. New Buyers: These are the persons who would be purchasing “additional saleable flats/units” that become

available in the hands of the developer upon redevelopment of the premises.

A. Redevelopment of Housing Society - Transaction Structure

As we proceed to analyse the GST implications of transaction relating to Redevelopment Project it is important to understand the transaction structure and the role of each stakeholder in this structure.

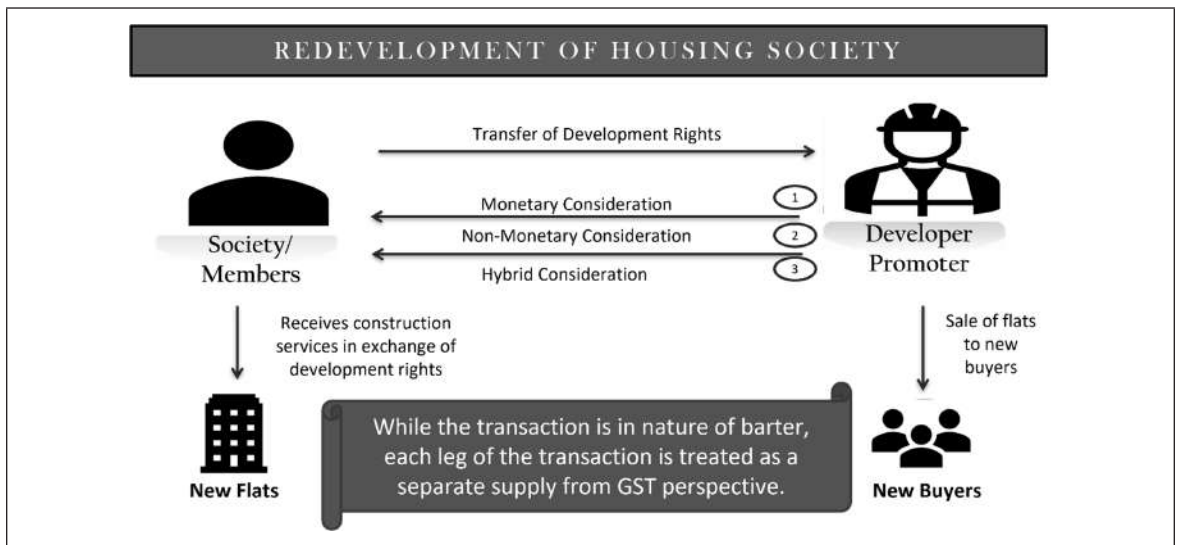
From the society’s perspective the redevelopment results in coming into existence of a new premise for the existing members and in certain cases some additional area for the members. From the Promoter’s perspective, the redevelopment would result in additional space becoming available for outright sale to new flat buyers.

Nature of Sub-Transactions in a Redevelopment Project

i. The initiation of the entire transaction is through the execution of a redevelopment agreement which results in the transfer of development rights by the society (on behalf of its members) to the Promoter. Alternatively, in case of a

- ii. The other aspect of the development agreement is the supply by the Promoter to the existing members with one or more of the following:
 - a. Newly constructed flats of the same area or higher area.
 - b. Car parking space in the building.
 - c. Rental charges/Hardship allowance for the period of displacement when the old premises is demolished till the new premises is handed over to the society/its members.
 - d. Corpus of funds to the society/ members.
- iii. The third aspect of the redevelopment agreement is the sale of additional space available with the developer on out-right basis to New Buyers.

The above transaction is depicted in the form of a diagram hereunder:



B. Legal Framework

As we proceed to analyse the GST implications on a Redevelopment Project, it is important that we understand the legislative framework applicable to such transactions.

1. Co-operative Societies Act/Law relating to Condominiums

States which have a legislative framework regulating housing societies, generally contain provisions dealing with redevelopment of such societies. For instance, Section 79A of The Maharashtra Co-operative Societies Act, 1960 (“MCSA”) empowers the authority to come out with regulations for determining the manner in which the Redevelopment Project should be carried out. In this regard the Government Resolution dated 4th July 2019 has been issued by the relevant authority in Maharashtra.

2. GST Law

Various provisions under the GST Legislations relating (i) to supply, (ii) time of supply, (iii) value thereof, etc. get triggered in case of a Redevelopment Project. Considering that a contract for redevelopment to a certain extent is in the nature of a barter transaction, the determination of these aspects for the purpose of levying GST become even further complicated. Keeping in mind these complications and to avoid ambiguity in determination of GST liability, the CBIC has issued a series of notifications dealing with transactions that entail transfer of development rights to the Promoter and provision of built-up area to the transferor of such development rights. A list of these notifications is set out as under:

Notification No.	Description
03/2019-Central Tax (Rate) [Amends the rate notification 11/2017-Central Tax (Rate)]	The notification prescribes the rate of GST in respect of construction of residential/commercial apartments and also provides for mechanism to value construction service, when provided against transfer of development rights.
04/2019-Central Tax (Rate) [Amends the exemption notification 12/2017-Central Tax (Rate)]	This notification exempts supply of service provided by way of transfer of development rights for construction of residential apartments in respect of which entire consideration has been received before the issuance of completion certificate or first occupancy. The notification also provides for the mechanism to value development rights in certain situations.
05/2019-Central Tax (Rate) [Amends the Reverse Charge Notification 13/2017-Central Tax (Rate)].	This notification provides for taxability in respect of service provided by way of transfer of development rights on reverse charge basis, in terms of which liability to pay tax has been cast upon the Promoter.
06/2019-Central Tax (Rate)	This Notification inter alia provides for: <ol style="list-style-type: none"> i) The Promoter to be the registered person to pay tax on supply of development rights and on the construction services against such development rights, ii) time when tax is to be paid in respect of services mentioned in i) above.

Each of the above notifications and other relevant provisions as applicable to the transaction of redevelopment have been referred to and dealt with in the analysis carried out hereunder for ease of reference.

Legal controversies surrounding deemed valuation

Divergent from the normal process of valuation as set out under Section 15 of CGST Act, the valuation in relation to various aspects in case of Redevelopment Project is governed by specific valuation methodology provided by notifications issued in this regard viz. 11/2017-Central Tax (Rate) and 12/2017-Central Tax (Rate).

One may argue the GST Council's free handedness in prescribing different valuation methodology that are quite divergent from the legislative mandate contained in Section 15. This in turn brings into question the GST Council's powers to recommend and the Central Government's power to legislate such valuation methodologies under the GST law.

Section 15(5) of CGST Act, however, provides that notwithstanding the general valuation provisions, value of certain notified supplies shall have to be determined in the manner prescribed by the Government on the recommendation of GST Council. The above Notifications have inter alia been issued under the said Section 15(5) to provide for deemed valuation provisions for the transactions of the nature as described above.

It is however pertinent to note that the word 'prescribed' is defined under Section

2(87) of CGST Act to mean "prescribed by rules". Accordingly, it may be argued that the Notifications insofar as they prescribed deemed values for certain supplies are ultra vires the CGST Act. This aspect has been dealt with in a recent decision of the Hon'ble Gujarat High Court¹.

Implications under GST

Having understood the nature of transaction and the legal framework applicable to such transactions, we now proceed to evaluate the implications under GST law on the various sub-transactions (as discussed in Para A above) of a Redevelopment Project.

C. Implications on Transfer of Development Rights

The subject of "development rights" has been a matter of controversy over last few years and therefore for a better understanding of the concept of development rights it is important that we track the evolution of the understanding of this concept through the Service Tax regime before proceeding to analyse its implication under GST.

Transfer of Development Rights Pre-GST

The term 'development rights' had not been defined under the Finance Act, 1994 ("Finance Act"). The development rights are nothing but rights arising out of land which is per se an immovable property.

In a plethora of decision², a view has been upheld that right associated with an immovable property partakes the nature of an immovable property.

1. *Munjaal Manishbhai Bhatt vs. UOI* [2022 (5) TMI 397 – Gujarat High Court]

2. *Chheda Housing Development Corporation vs. Bibijan Shaikh Farid* [MANU/MH/0070/2007]; *State of Orissa vs. Titagur Paper Mills Co. Ltd* [MANU/SC/0325/1985]; *Sadoday Builders Private Limited vs. Joint Charity Commissioner* [WP No 4543/2010]

In light of the judicial precedents (relating to the service tax regime), it could be said that the development rights being rights arising out of land, are akin to an immovable property and hence were outside the scope of the definition of ‘Service’ under Service Tax.

Transfer of Development Rights - Impact under GST

The definition of ‘services’ as given in the Central Goods and Services Tax Act (“**CGST Act**”) is very wide and covers all things which do not classify as ‘goods’, unless specifically excluded. ‘Goods’ have been defined to mean every kind of movable property. Therefore, development rights being rights associated with land would not qualify as ‘goods’ and would qualify instead as a ‘service’. Further, in terms of Schedule III of the CGST Act, sale of land is neither treated as goods nor services. However, since the development rights are rights arising out of land and not per se land, the transfer of the same is not within the ambit of Schedule III under ‘sale of land’ and therefore liable to GST, unless specifically exempt. Consequently, transfer of development rights by society would qualify as a supply of service which would be liable to GST unless specifically exempt.

Levy of GST

Having concluded that transfer of development rights is liable to GST, let us now analyze how this levy operates. Notification No. 04/2019 Central Tax (Rate) dated 29.03.2019 (**‘Notification No. 04/2019’**) notified that the services by way of transfer of development rights on or after 1 April 2019 will be exempt from levy of GST, subject to fulfilment of all the following conditions –

- i Development rights should have been transferred on or after 1 April 2019
- ii Such development rights should be used for the construction of residential units by a Promoter

- iii Units in the project should be intended for sale to a buyer whether wholly or partly and
- iv Such units should be sold prior to receipt of completion certificate/first occupation in the project.

Let us examine the GST implications in the following scenarios.

Scenario I – Residential Project

Where development rights are being transferred by the society after 1 April 2019 and where the project is a residential real estate project wherein all the units (including additional units) are residential units which, apart from being provided to existing members of the society, will also be marketed and sold to independent buyer, the transfer of development rights will be exempt from levy of GST in terms of Notification 04/2019, subject to the said residential units being sold prior to receipt of completion certificate/first occupation.

Scenario II – Mix Development (Residential + Commercial Units)

The exemption from levy of GST on transfer of development rights does not mandatorily require a project to be a 100% residential project. The exemption will not be available to the extent development rights are used for construction of commercial units. Therefore, in a mixed development project, proportionate exemption will be available to the extent the development rights are used for construction of residential units.

The manner of determination of the amount which would be exempt from the levy of GST on transfer of development rights prescribed under Notification No. 04/2019 is set out below.

The amount of GST exemption available for the construction of residential apartments in the project shall be calculated as under:

$$\frac{\text{GST payable on TDR used for Construction of project*}}{\text{Total carpet area of the residential and commercial apartment in project}} \times \text{carpet area of residential apartment in project}$$

Payment of GST under reverse charge [Notification No. 05/2019 Central Tax (Rate) dated 29.03.2019 ('Notification No.05/2019')]

The exemption from levy of GST on transfer of development rights is not absolute but conditional upon the fulfilment of the conditions prescribed under Notification No.04/2019. The scenario in which development rights will be liable to GST are set out below –

- i Development rights used for construction of commercial units in a project;
- ii Development rights attributable towards residential units that remain unsold on the date of receipt of completion certificate/first occupation.

The Government also amended the Notification No. 13/2017 – Central Tax (Rate) dated 28.06.2017 (“**Reverse Charge Notification**”) to include the transfer of development rights under reverse charge mechanism. Therefore, in a scenario where the transaction becomes liable to GST, the recipient (i.e. the Promoter) will be liable to pay GST.

Applicable Rate of GST

Notification No. 11/2017-Central Tax (Rate) dated 28.06.2017 (as amended) [**‘Rate Notification’**] specifies the SAC Code for different services and the applicable rate qua each SAC Code. The Government has issued a compilation of FAQs on Real Estate Sector (**FAQs**) vide F.No.354/32/2019- TRU dated 07.05.2019 wherein in the reply to Q 7 it is clarified that GST on transfer of development rights gets covered under HSN Code 9972 for Real Estate services [Sr. No. 16(iii) of the Rate Notification] on which the applicable rate of GST is 18%. Even if it is considered that transfer of development rights does not get covered under the said entry of the Rate Notification, since the transaction is not specifically covered under any other entries, it will fall under the residuary category liable to 18% GST. Hence, the applicable GST rate on supply of service of transfer of development rights will be 18%. It is however important to note that while the rate of GST is 18%, in terms of Notification no. 04/2019, the liability in case development rights used for construction of residential units has been capped at 5% of the value of a similar flat at the time of receipt of completion certificate/first occupation. GST is capped at the applicable rate of 1% (instead of 5%) of the value in case of affordable residential units.

Time of Supply [Notification No 06/2019 - Central Tax (Rate) dated 29.03.2019] ('Notification No. 06/2019')

Since the service of granting of development rights may be held liable to GST and therefore it becomes imperative to evaluate the time of supply for payment of tax by the Promoter under reverse charge.

1. For transfer in lieu of constructed area

The time of supply where the development rights have been transferred in lieu of constructed area to Existing Members, is required to be determined independently for the following –

i. Development rights used for construction of residential units which remain unsold at the time of receipt of completion certificate/first occupation:

Notification No. 06/2019 prescribes that the liability to pay tax in respect of the amount attributable towards the development rights used for construction of residential units remaining unsold, shall be in a tax period not later than the tax period in which the completion certificate is issued or the date first occupation falls, whichever is earlier.

ii. Development rights used for commercial units

Similar to the residential unit, the liability to pay tax on the development rights used for construction of commercial units, has been prescribed to be in a tax period not later than the tax period in which the completion certificate is issued or the date first occupation falls, whichever is earlier.

2. For transfer in lieu of monetary consideration

In case of monetary consideration paid for transfer of development rights, following is the

time of supply applicable in both scenarios:

i. Residential units which remain unsold at the time of receipt of completion certificate/first occupation

In terms of Notification No. 06/2019 wherein the liability to pay tax arises in respect of the amount attributable towards the development rights used for construction of units remaining unsold, has been prescribed to be in a tax period not later than the tax period in which the completion certificate is issued or the date first occupation falls, whichever is earlier.

ii. Commercial Units

Where the development rights have been transferred in lieu of revenue share or monetary consideration where tax invoice has not been issued, the liability to pay tax in respect of the amount attributable towards the development rights used for construction of commercial units, shall be the date of provision of services i.e. date of transfer of the development rights. This is substantiated by Question 14 of FAQ [F.No. 354/32/2019-TRU], dated 07.05.2019.

In case of supplies in respect of which tax is paid or liable to be paid on reverse charge basis, the time of supply is provided under Section 13(3) of the CGST Act. In terms of Section 13(3) of the CGST Act, where the development rights have been transferred in lieu of monetary consideration and invoice is issued, the time of supply of service shall be the date immediately following sixty days from the date of issue of invoice or the date of payment, whichever is earlier.

Valuation

Another important aspect while determining GST levy in case of a Redevelopment Project is the determination of value

1. For transfer of development rights in lieu of constructed area

Section 15 of the CGST Act provides that the value of the service will be the transaction value i.e. the price paid or payable for the said supply. In order to determine the value of supplies where the consideration is not solely in money terms, the value will be arrived based on the method prescribed under Chapter IV of CGST Rules titled “Determination of Value of Supply” (“**Valuation Rules**”). Rule 27 of CGST Rules provides for the methodologies to arrive at the value of the service in case the consideration is not wholly in money.

However, in terms of power given under Section 15(5) of the CGST Act, the Government has, vide Notification No. 04/2019, notified the methodology to be adopted for determining the value of development rights, more particularly described in the scenarios set out hereinafter:

- i. *Residential units which remain unsold at the time of receipt of completion certificate/first occupation*

Where the transfer of development rights is for consideration in the

form of constructed area, the value of development rights has been deemed to be equal to the value of similar units in the Project charged by the Promoter to the independent buyers nearest to the date on which the development rights is transferred to the Promoter.

It may be pertinent to note that the above-mentioned methodology will compute the value of the entire development rights transferred to the Promoter and used in the Project. However, the GST liability shall be restricted to the extent of development rights attributable towards residential units remaining unsold at the time of receipt of completion certificate/first occupation.

The Entry 41A of the Exemption Notification prescribes the method for computation of GST liability to be paid by the Promoter under reverse charge mechanism on development rights attributable towards residential units remaining unsold on the date of receipt of completion certificate/first occupation shall be calculated in the following manner:

The amount of GST which the promoter would be liable to pay under reverse charge mechanism

Amount of GST payable on TDR for construction of the residential apartments in project



carpet area of residential apartment in project which remain un-booked on the date of issuance of completion certificate

Total carpet area of residential apartments In the Project

As mentioned earlier, the Government has capped the maximum liability to be discharged by the Promoter in respect of residential units remaining unsold in the Project on the date of receipt of completion certificate/first occupation. In terms of the second proviso of Entry 41A of the Exemption Notification, the amount of tax payable shall not exceed 5%/1%³ of the value in case of residential units remaining un-booked on the date of issuance of the completion certificate.

ii. *Commercial units in the Project*

The exemption benefit is not available for development rights used in the construction of the commercial units in a project. Accordingly, the entire value of development rights attributable towards commercial area shall be the value on which GST is payable.

iii. *Mix Development*

The total value on which GST will be payable will be the combined value as computed in (i) and (ii) above. However, it may be pertinent to note that the capping on GST liability will be applicable only for residential units remaining unsold in the mixed development project and not for commercial project.

2. For transfer in lieu of monetary consideration

In terms of Section 15(1) of the CGST Act, the value of supply of development rights shall

be the transaction value, which is the price actually paid or payable for the said supply.

Other monetary consideration such as hardship allowance, corpus fund, rent etc.

Other consideration such as Hardship allowance, Corpus Fund, Rent etc. may be paid by the Promoter to the Society/Landowner as part of consideration towards the development rights transferred in favour of the Promoter.

Where the transfer of development rights is considered as a supply, then, other monetary consideration should also be added to the valuation for the purpose of computing the GST liability. The reason to add other monetary consideration for calculation as part of overall consideration is that notwithstanding the terminology used to explain such payments, the nature of transaction is akin to a mix consideration which involves consideration in the form of constructed units as well as other monetary consideration.

Thus, against the transfer of development rights, the consideration is paid by the Promoter in two-fold i.e. constructed units and other monetary consideration. This being the case, the value of both these elements must be considered for determining the value of development rights.

It may however be pertinent to note that the valuation mechanism specified in Notification 04/2019 provides that value of service by way of transfer of development rights against consideration in the form of residential or commercial units shall be deemed to be equal to the value of similar units sold to independent buyers. Therefore, one may argue

3. The concessional rate of 1.5% GST [Effective tax rate of 1%] has been extended in respect of residential units in a RREP as well as REP other than RREP, subject to fulfillment of the following conditions:

- (i) Carpet area of the affordable residential unit should be upto 60 sq. m. in metropolitan cities or 90 sq. m. otherwise; and
- (ii) The gross amount charged for the unit should not be more than Rs. 45 lakhs.

that the GST Law has already prescribed a deemed value for development rights and therefore other monetary consideration are not required to be added to such deemed value.

D. Construction Services in Relation to Units Handed Over to Existing Members

Since the transaction of Redevelopment Project is a barter transaction it is also important to decipher the GST implications in relation to the construction services provided by the Promoter. Typically, GST payable on such construction services is factored by the Promoter in the total cost of executing the Redevelopment Project and discharged, whether such GST is separately collected or not from the existing members.

Applicable Rate of GST

As per Notification No.03/2019- Central Tax (Rate), Dated 29.03.2019 ('Notification 3/2019'), the effective applicable rate of GST in respect of constructed units handed over post 1 April 2019, will be as follows –

- a) Residential Real Estate Project ('RREP') – A project wherein the commercial area is not more than 15 per cent of the total carpet area is being defined as RREP. In such project the applicable GST Rate for the units handed over to Society/Landowner will be 5%/1% for residential units and 5% for commercial units.
- b) Real Estate Project ('REP') other than RREP - A project in which the commercial area is more than 15% of the total carpet area is a REP other than

RREP. The applicable rate of GST will be 5%/1%⁴ for residential unit and 12% for commercial unit.

Time of Supply

In this regard, it may be pertinent to refer to Notification No. 06/2019 wherein the liability to pay tax in respect of the construction service provided to the Society has been prescribed to be any time upto the date of issuance of the completion certificate for the project, or the date of its first occupation, whichever is earlier.

Valuation

Vide Notification No.03/2019, paragraph 2A has been inserted in the Rate Notification which provides the valuation mechanism of the construction services being provided to the registered person transferring the development rights to the Promoter. In terms of Paragraph 2A, the value of construction service in respect of the units to be handed over to the Society shall be deemed to be equal to the value of the similar units in the project sold nearest to the date of transfer of development rights after deducting 1/3rd of the total amount charged for the unit towards land.

Input Tax Credit

In terms of Notification 03/2019, the Promoter will not be eligible to avail the input tax credit of GST paid in respect of goods and services procured for the construction of a RREP Project. However, it may be pertinent to note that in case the project qualifies as a REP other than RREP then the Promoter shall be allowed to avail proportionate credit to the extent of commercial area in such project.

4. Refer Foot Note 3 above.

E. Constructed Units Sold to New Buyers

1. *Where consideration is received by Promoter prior to receipt of completion certificate or first occupation whichever is earlier*

In terms of entry 5(b) of Schedule II to CGST Act, construction of building intended for sale to a buyer except where the entire consideration has been received after issuance of completion certificate or after its first occupation whichever is earlier is treated as supply of services under the GST. Therefore, sale of unit to New Buyer before receipt of completion certificate or first occupation shall be chargeable to GST.

Applicable Rate of GST

As stated in Para E above

Time of Supply

As per provision of Section 13 of CGST Act i.e at the time receipt of consideration or issuance of invoice whichever is earlier

Valuation

Section 15 of the CGST Act provides that the value of service will be the transaction value i.e. the price paid or payable for the said supply. Further, as per Notification 11/2017, the value of transfer of land or undivided share of land, in such construction services shall be deemed to be one third of the total amount charged for such supply. Therefore, GST shall be applicable on 1/3rd value of total consideration charged for sale of units to New Buyers.

Input Tax Credit

As stated in Para E above

2. *Where consideration is received by Promoter after the receipt of completion certificate or first occupation whichever is earlier*

In terms of Schedule III entry 5 sale of building is neither supply of goods nor supply of services (subject to entry 5(b) of Schedule II). Therefore, sale of units/flats post completion certificate or first occupation shall not be subjected to GST.

Conclusion

Each real estate project would have its own nuances and therefore requires in depth analysis of the facts on hand to derive the applicability of GST provisions. The taxation of real estate under GST is a complex issue, however the authorities have tried to iron out the complexities by issuing clarification and amendment from time to time. The trick in determining the GST liability in case of Redevelopment Project lies in properly analysing the various aspects thereof and thereafter one also needs to be diligent while applying the rate of tax, payment of tax, valuation, availment of ITC in order to be in compliance with the law. This also gives avenue to the taxpayers to structure and optimise the input tax credit wherever applicable.

