

Renting of commercial property - A crazy puzzle under GST!!

(From the perspective of 54th GST Council Meeting)



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Introduction:

In an effort to stop revenue leakage, the 54th GST Council meeting recommended on September 9, 2024 to apply the Reverse Charge Mechanism (RCM) to the renting of commercial property given by an unregistered person to a registered person. Such recommendation produces several questions such as what does the word 'property' include, what is included under 'commercial property', the implications on past cases as presently no GST is being charged on renting of commercial property by an unregistered person to a registered person. This article attempts to evaluate this matter.

Note - This article is based on the press release released from the 54th GST Council Meeting. On this issue, the CBIC has not yet released a Notification.

1. Excerpts of 54th GST Council Meeting:

As per the recommendations made during 54th meeting of GST Council, it has been clarified as per below:

“To bring renting of COMMERCIAL PROPERTY by unregistered person to a registered person under Reverse Charge Mechanism (RCM) to prevent revenue leakage.”

2. Issues at hand

Issue No. 1: Can GST be levied on ‘Rent’ in light of the provisions of the Constitution of India?

Issue No. 2: If only renting of commercial property is being brought under Reverse Charge Mechanism, what exactly is the scope of coverage under ‘commercial property’?

- A. Whether the meaning of commercial property is confined to only **commercial land and building**?
- B. What shall be the implication for renting the **industrial land and building**, how can a distinction be made between commercial and industrial properties?
- C. Whether **warehouses** are to be considered as commercial or industrial property? Could warehouses be considered commercial property due to their potential for revenue generation and their use in business?
- D. Whether **machinery** is also to be considered as commercial property since it is used for commercial purpose aiding in the furtherance of business activities?

Issue No. 3: What shall be the implication of this recommendation on **claiming of ITC**?

Issue No.4- If a **director (unregistered person)** rents out a commercial property in **his personal capacity to registered person** whether GST under RCM is applicable or not?

Issue No. 5: If **hostel accommodations** are rented out to a registered person by an unregistered person who further rents it to students, in such cases, do we consider hostel accommodations given to students to be **residential or commercial property**?

Issue No. 6: What if a **residential property is given out on rent for commercial use** (like PG, Hostel etc.), should such transaction also be taxable under Reverse Charge Mechanism solely on the grounds that the use of such property is commercial in nature? What if a commercial property is used for residential purpose?

Issue No.7 – Would GST on **hotel accommodations** also be charged on RCM basis?

Issue No.8- In case of commercial shops located within precincts of a religious place being given out on rent by the trust owning it, who is an unregistered body, to a registered person, shall GST on such rent be applicable on RCM basis?

Issue No. 9: When a leave and license agreement is entered for letting out of a commercial property, shall the same also be chargeable to GST under RCM? Such question arises since **Section 7 (1) (a) of the CGST Act, 2017** (the scope of supply), states that supply also includes license, rental, lease, differentiating the three as separate forms of supply.

3. Issue No. 1 - Can GST be levied on 'Rent' in light of the provisions of the Constitution of India? What is the present position under GST Law for this issue?

Note: Constitutional aspect is discussed in Para 3 and statutory aspect is discussed in Para 4.

The constitutional validity of GST on rent is a pivotal issue that delves into the core of India's taxation framework. At the heart of this debate is the interpretation of Article 246A of the Constitution, which grants the power to levy GST on the supply of 'goods and services'. The contention arises from whether leasing or renting property constitutes a "service" and thus falls under the purview of GST. Critics argue that such transactions should be governed exclusively by state legislatures under Entry 49 of List II of the Seventh Schedule, which pertains to taxes on immovable property. This issue has significant implications for application of GST laws in India.

3.1 In case of *Myrayash Hotels Pvt. Ltd. vs. Union of India & Ors.*, **The Bombay High Court** received a Writ Petition filed by Myrayash Hotels Pvt. Ltd. (Petitioner) that challenged the Constitutional Validity of Para 2 and Para 5(a) of the Schedule II of CGST Act, 2017 and the Goa GST Act, 2017.

3.2 The petitioner stated that as per Article 246A of the Constitution of India, only 'goods and services' are leviable under GST.

3.3 Petitioner states that

- In case of a lease/rent agreement, the landlord/lessor does not provide any 'service' to the tenant/lessee. Hence, GST cannot be applied to the same.
- According to Entry 49 List II of the Seventh Schedule of the Constitution of India, only State Governments have the power to impose taxes on transactions involving immovable property. Therefore, lease/rent transactions are not subject to GST as per Article 246A of the Constitution of India.
- The petitioner claimed that when a landlord leases/rents out a property to a tenant, the landlord relinquishes all rights and enjoyment of that specific property to the tenant for the duration specified in the agreement.

3.4 As per the Bombay High Court's decision,

The Parliament possesses broad powers under the residuary power of legislation. The Court recognized that the Parliament operated under the assumption that there is a service component in the leasing of land. Therefore, since the Service Tax was enacted under the residual power of the government, it was not permissible to challenge the Parliament's assumption as long as the tax did not fall under List II of the Seventh Schedule.

3.5 Petitioner challenges the order issued by Bombay HC along with constitutional validity of GST on lease/rent

The petitioner challenged the order passed by the Bombay HC along with the constitutional validity of GST on lease/rent. The petitioner filed a **Special Leave Petition (SLP) with the Supreme Court of India**, and the court granted leave to hear the petitioner's appeal and decided to admit the appeal as well. The Appeal was instructed to be listed before the 9 Judges' **Constitution Bench of the Supreme Court of India** and to be connected with **Civil Appeal No. 4487 of 2010**.

In the aforementioned Civil Appeal, the Supreme Court, through its order dated April 5, 2018, directed that since the interpretation of Entry 49 of List II of the Seventh Schedule of the Constitution of India is pending before the Bench, matters related to service tax should also be listed before the same Bench.

The Supreme Court, while hearing the SLP and Civil Appeal No. 4487 of 2010, directed that the matters should await the decision of the nine-judge bench in the case of *Mineral Area Development Authority and Others vs. Steel Authority of India and Others*. The Court noted that the scope of Entry 49 of List II of the Seventh Schedule of the Constitution of India is under consideration by the larger bench. Consequently, the hearing of these matters will resume once the larger bench delivers its judgment, allowing the parties to present additional relevant points. The SLP was deferred until the resolution of the issues pending before the bench in the case of *Mineral Area Development Authority and Others*.

Observation-

In view of the above case, it is interesting to note that the question of whether or not tax should be charged on rent, itself is being reviewed currently before the Hon'ble Supreme Court of India.

Presently, GST is being levied on supply of renting services of commercial property (by a taxable person to a registered/unregistered person) under Forward Charge Mechanism and now in latest development GST (Post issuance of notification to bring the recommendation of 54th GST Council Meeting in reality) shall also be imposed on renting of commercial property by an unregistered person to a registered person under Reverse Charge Mechanism as recommended by the GST Council.

Subject to the above contemplation pending in the forum of Apex Court, the discussion on various aspects of GST on the rent under GST Law is being discussed here below.

4 Before delving deeper into this topic, let us first take a look at the existing provisions to understand whether the renting of property is leviable under GST Act.

To be chargeable under GST, such renting activity should first amount to as supply.

Whether renting activity constitutes as supply and further is it to be treated as supply of goods or supply of services can be understood by reading of the following relevant provisions-

4.1 Section 7 of CGST Act, 2017 - Scope of supply

Section 7 (1) (a):

*“7. Scope of supply. – (1) for the purposes of this Act, the expression —supply includes—
(a) all forms of supply of goods or services or both such as sale, transfer, barter, exchange, licence, rental, lease or disposal made or agreed to be made for a consideration by a person in the course or furtherance of business;”*

Section 7(1A):

“(1A) where certain activities or transactions constitute a supply in accordance with the provisions of sub-section (1), they shall be treated either as supply of goods or supply of services as referred to in Schedule II.”

4.2 Para 2 of Schedule II of the CGST Act- Activities or transactions to be treated as supply of goods or supply of services

*“(a) any lease, tenancy, easement, licence to occupy land is a supply of services;
(b) any lease or letting out of the building including a commercial, industrial or residential complex for business or commerce, either wholly or partly, is a supply of services.”*

Observation:

- Words ‘Lease’, ‘license’, ‘letting out’, ‘tenancy’, ‘easement’ are used separately (nevertheless all these are treated as supply of services).
- It may be noted that Press Release of 54th GST Council Meeting refers to the word ‘Rent’ only.

5. Issue No. 2 –If only renting of commercial property is being brought under Reverse Charge Mechanism, what exactly is the scope of coverage under ‘commercial property’?

- Para 2 of Schedule II of the CGST Act specifies that lease or letting out of building including a **commercial, industrial or residential complex** for business or commerce shall be treated as supply of services.
- It can be observed that a clear distinction has been made in the nature of property being commercial or industrial. While as per the Act, there has been made a distinction in nature of property being ‘commercial’, ‘industrial’ or ‘residential’, the press release only specifies commercial nature property. Hence a question arises as to what constitutes as commercial property since the same has not been defined under the CGST Act/SGST Acts.

- It may be observed that the term 'commercial property' has not been defined under GST Act. This notion is formed of 2 words i.e. 'Commercial' and 'property'. As per Merriam-Webster Dictionary, the word 'commercial' means occupied with or engaged in commerce or work intended for commerce and the word 'property' means an object or objects that belong to someone/something owned or possessed. **The notion of commercial property signifies the concept of 'commercial asset' which infers that any commercial asset (be it movable or immovable!!) could be the subject matter of this amendment!! Crazy!!**
- This raises the question of whether industrial property/complex/building etc. used for business purpose comes under the definition of commercial property also making it chargeable to GST under Reverse Charge Mechanism.
- Further, in case of renting of machinery by an unregistered person to registered person, can machinery also be viewed as commercial property since it is used for commercial purpose in furtherance of business activity? It shall be imperative to note on the issue of circular based on this recommendation, whether the use of word 'commercial property' can be construed to mean only **real estate** used for business activities or shall it also include **business assets** such as machinery. Accordingly, shall renting of machinery come under the purview of this recommendation?

6. Issue No.3 - What shall be the implication of this recommendation on claiming of ITC?

When recipient of such services is not eligible to claim ITC, this change will bring an additional cost.

Say for example,

Shri Sanjay Tiwari, an unregistered person from Rajasthan rents out his owned commercial premises to a registered restaurant 'The Raju Baman' in Mumbai. The premises has been rented out at a monthly rent of INR 95,000 and GST rate is 18%. Hence, 'The Raju Baman' is liable for paying GST liability of ₹17,100 (18% of 95,000) directly to the government under the RCM.

GST rate on restaurant services is 5% without the claim of ITC. Since 'The Raju Baman' charges 5% GST on its services, it cannot claim any ITC and subsequently it also cannot offset the GST of INR 17,100 it has paid on rent against its GST liability on restaurant services.

Similarly, any registered recipient whose further outward supply is ineligible for claiming of ITC, or is an exempt supply, would have to pay tax on the rent expense under Reverse Charge Mechanism without being able to claim any ITC. This brings an additional liability on the shoulders of such registered recipients.

7. Applicability of GST on Renting of Commercial Property- what has been the story so far? Let us take a look at the timeline-

On the question of applicability of GST on RCM basis for supply of such services by an unregistered person, is discussed below in reverse chronological order starting with the current situation leading back to the past situation.

7.1 Proposed Position-GST applicability before and after the said recommendation on Renting of Commercial Property-

Sr. No	Registration status of Supplier	Registration status of Recipient	Existing position	New Position (Once the change is notified)
1.	Registered Person	Registered Person	FCM	FCM
2.	Registered Person	Unregistered Person	FCM	FCM
3.	Unregistered Person	Registered Person	No Tax	RCM
4.	Unregistered Person	Unregistered Person	Not Applicable	Not Applicable

- Understanding with the help of illustration-

Mr. Krishna is an unregistered person residing in Delhi and owns a commercial apartment in Mumbai. He rents out such property to Mr. Ankit Raipuria at a monthly rent of INR 90,000. Mr. Ankit Raipuria is a registered person having his registration in state of Maharashtra.

The place of supply shall be the location of the commercial apartment, i.e. Maharashtra and since the owner and the commercial apartment are located in different states, this shall be an inter-state supply with GST rate of 18% (IGST) being applicable.

As per the proposed change, The GST on such transaction shall be levied on Reverse Charge Mechanism. Accordingly, Mr. Krishna being the unregistered owner, shall receive only the rent amount of INR 90,000 while the tenant Mr. Ankit Raipuria, being registered recipient is liable for paying the GST of ₹16,200 (18% of 90,000) directly to the government. Mr. Ankit Raipuria can claim the ₹16,200 GST paid as ITC.

7.2 Present Position (For period 1st February 2019 till date):

In case of renting of commercial property by unregistered person (Owner) to registered person (tenant), such services although taxable in nature, had not been notified till date under Reverse Charge Mechanism but is being brought so (Notification is yet to be issued), based on the recommendation of the GST Council.

7.3 Earlier Position

7.3.1 From 1st July 2017 till 12th October 2017:

As per **Notification No-08/2017, Central tax (Rate) dated 28th June, 2017** the Central Government, under section 11(1) of the Central Goods and Services Tax Act, 2017, exempts intra-State supplies of goods or services received by a registered person from unregistered suppliers from central tax under section 9(4). However, the exemption does not apply if the aggregate value of such supplies exceeds ₹5,000 in a day. This notification took effect from July 1, 2017.

In our case of renting of commercial property, rent is usually charged on a monthly basis by the landlord. Hence, the limit of ₹5,000 in a day could be interpreted as ₹ 1, 50,000 in a month (an example for the simplicity) meaning that intra-state supply of renting service by unregistered person to a registered person had been exempt unless the monthly rent exceeded ₹ 1, 50,000 in a month (Considering that it is an only supply from unregistered person in a month).

7.3.2 From 13th October, 2017 to 31st January, 2019

The blanket exemption from RCM for purchases from unregistered persons was given (with no limit of Rs. 5000) which can be understood by the combined reading of the following notifications-Notification No.38/2017-Central Tax (Rate) dated 13.10.2017, Notification No.10/2018-Central Tax (Rate) dated 23.03.2018, Notification No.12/2018-Central Tax (Rate) dated 29.06.2018, Notification No.22/2018-Central Tax (Rate) dated 06.08.2018.

8. Issue No.4- If a director rents out a commercial property to registered person in his personal capacity whether GST under RCM is applicable or not?

According to Entry No. 6 of notification No. 13/2017-CTR, dated 28.06.2017, tax on services supplied by a director to the company or body corporate must be paid by the company or body corporate under RCM.

Reading of **CIRCULAR NO. 201/13/2023-GST [F. NO. 190354/133/2023-TRU]**

The circular addresses whether services supplied by a director in their personal capacity, such as renting immovable property to the company, are subject to the Reverse Charge Mechanism (RCM).

Circular clarifies that this provision applies only to services provided by the director in their official capacity as a director and not in personal capacity.

Therefore, services supplied by a director in their personal or private capacity, such as renting commercial property to the company, are not taxable under RCM. Only those services that are provided by the director in their capacity as a director of the company or body corporate are subject to RCM.

But in view of the recommendation of 54th GST Council Meeting, if a director (unregistered person) rents out a commercial property to the company or body corporate (registered person) of which he is a director in his personal capacity, it shall be subject to GST under Reverse Charge Mechanism. (We reiterate that the Notification is yet to be issued and this will be a separate entry and not to be covered by Entry No. 6 of notification No. 13/2017-CTR, dated 28.06.2017.)

9. Issue No.5 - If hostel accommodations are rented out to registered person by an unregistered person who further rents it to students, in such cases, do we consider hostel accommodations given to students to be residential or commercial property?

Note: It may be noted that the press release has not put any stress on what should be the usage of the property, whether it should be used for residential or commercial purpose. Actually, this point is mix of the matter of fact and matter of law.

So far, we have dealt with applicability of GST on commercial property. Looking from a different perspective, do we consider **hostel accommodations** given out on rent to students to be residential or commercial property?

This is with emphasis on the initial supply of renting services by unregistered owner to a registered person (first tenant), where the first tenant is further providing it to the students (second tenant, who are unregistered).

Say, Mr Bhavesh Singhvi (Unregistered person) has given a commercial property on rent to Mr Ashok Nahta (Registered person) on rent of INR 200000 per month. Mr Ashok Nahta gives this property on rent for hostel purpose to students. Mr Ashok Nahta is liable to pay GST on RCM basis on INR 200000 as per the amendment. Property used for hostel purpose cannot be treated as residential dwelling blindly and eventually it is the character of the property which is to be seen. Therefore, if hostel is run on a residential property, this amendment will not bring the GST liability on RCM basis as per this amendment. See the clarification below for the latter case.

Issue No.6 - What if a residential property is given out on rent for commercial use (like PG, Hostel etc.), should such transaction also be taxable under RCM solely on the grounds that the use of such property is commercial in nature? What if a commercial property is used for residential purpose?

Also, there are numerous cases where residential properties are used to provide accommodation services such as hostels and paying guest (PG) facilities. Is it permissible to operate hostel and PG services on residential properties? Even if it is, the given clarification still would not apply to such transactions, as merely using the property for commercial purposes does not change its residential status.

It is pertinent to consider whether usage of property defines the nature of the property. The classification of a property as 'residential' or 'commercial' is determined by the inherent characteristics of the property, a decision within the purview of the respective land regulator, generally which is the State Government. Authors are of the view that the usage of a property does not determine the nature of the property rather it is the inherent characteristics of the property. So, see the property papers!!

For example, if you build a house on a farm land, the status of the land does not change to residential simply because it is used for residential purpose. It shall still be considered an agricultural land only.

10. Issue No.7 - Would GST on hotel accommodations also be charged on RCM basis?

If a hotel is viewed as a commercial establishment and is unregistered under GST, will GST have to be paid on a reverse charge mechanism basis?

As per **Notification No. 11/2017-Central Tax (Rate), dated 28-6-2017** explanation for the purpose of this notification, point no (xxxiv), "*'Hotel accommodation' means supply, by way of accommodation in hotels, inns, guest houses, clubs, campsites or OTHER commercial places meant for residential or lodging purposes including the supply of time share usage rights by way of accommodation.*"

As per **Notification No. 20/2019- Central Tax (Rate) dated September 30th, 2019** GST rate applicable on hotel accommodation services depends on the room tariff per day which is summarized below-

Sr.no	Value of Supply per day per unit	Applicable GST rate
1.	Less than or equal to INR 7,500	12%
2.	More than INR 7,500	18%

Hotels are used for residential or lodging purpose but they are run as commercial businesses.

So, should they be considered residential or commercial property? Generally, CA, Advocates, Doctors are allowed to provide their services from the residential property and the land regulators do not allow to run the hotel etc. on residential property.

Further, even if hotels are viewed as commercial, can hotel accommodation services be differentiated from other renting services on the grounds of permanence of stay? Hotels are generally booked for temporary stay and hence the word 'tariff' is more commonly associated than 'rent' for charging accommodation services. Hence, in this light, will it be brought under the purview of the 54th recommendation?

Therefore, the academic issue is that if a hotel is viewed as a 'renting activity' on 'the commercial property' and if the hotel is unregistered under GST, will not the GST have to be paid on a reverse charge mechanism (RCM) basis?

11. Issue No.8- In case of commercial shops located within precincts of a religious place being given out on rent by the trust owning it, who is an unregistered body, to a registered person, shall GST on such rent be applicable on RCM basis?

According to Notification No. 12/2017-Central Tax (Rate) dated June 28, 2017, entry 13(b), renting out precincts of a religious place is exempt from GST if the following conditions are met:

- The place is intended for use by the general public.
- It is owned or managed by an entity registered as a charitable or religious trust under section 12AA or 12AB of the Income-tax Act, 1961 or a trust or an institution registered u/s 10(23C)(v) of the Income-tax Act or a body or an authority covered u/s 10(23BBA) of the said Income-tax Act
- The consideration charged for renting does not exceed the prescribed ceiling limits.

This exemption is based on the amount of consideration charged for such renting. If shops intended to be used for business/commerce purpose are rented out at a charge of ₹ 10,000 or more per month such exemption will not be available.

As the new amendment, for such shops located within the precincts of the said religious place wherein monthly rent is ₹ 10,000 or more and is given on rent by the trust which is an unregistered body, to a registered person GST on the same will be applicable on RCM basis.

Finally, it is puzzling!! Isn't it?

Disclaimer:

It is stated that the Press Release contains the gist of certain matters for clarification. Of course, these matters will be crystallized with the publication of the circular. This article is authored based on the reading of the Press Release only. Authors and publishers shall not be responsible for the decisions taken based on this document.