RERA to IBC – A Real Estate Story

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The Supreme Court **recently upheld the constitutional validity of the amendments** introduced to the Insolvency and Bankruptcy Code in the context of home-buyers. This article seeks to examine the interplay of RERA and IBC; the reason for the amendment; the reason for the challenge; the rationale of the decision and the outcome and impact of the decision in other laws including GST.

Background

The Real Estate (Regulation and Development) Act, 2016 was enacted with many objectives and one of the key objectives was to protect the interest of the consumers in the real estate sector. RERA was implemented across the country barring a few States and State RERA Authority was created and is fully functional. A sample verification of various State RERA websites would show the status of application, disposals, relief granted, directions given, etc. The law was slowly and steadily taking shape as one of the key legislations which was beneficial for both developers and home buyers.

The Insolvency and Bankruptcy Code 2016 was enacted to consolidate the laws relating to reorganization and insolvency resolution of corporate persons, partnership firms and individuals in a time bound manner for maximization of value of assets of such persons, to promote entrepreneurship, availability of credit and balance the interests of all stake holders.

Forum Shopping

Imagine a scenario where a home-buyer has taken significant loans in order to purchase an apartment in a residential complex and discovers a delinquent developer who does not show any interest in completing the project or returning the money. The buyer could have filed a consumer complaint before the Consumer Disputes Redressal Forum which unfortunately would have taken years given the non-availability of members and pendency. The buyer could have filed a complaint before the RERA which would have probably been effective. Thanks to the popularity of IBC and regular news about NCLT action in the print and social media, a home buyer decided to approach the NCLT under IBC. The question that had to be addressed by the NCLT was whether the home buyer would qualify as an 'operational creditor' or 'financial creditor'.

Multiple judgments of the NCLT's had categorized Home Buyers as neither fitting within the definition of 'financial' nor 'operational' creditors[1]. On appeal, the NCLAT[2] held that home buyers were to be classified as 'financial creditors' due to the assured return scheme in the contract, in which there was an arrangement wherein it was agreed that the seller of the apartments would pay 'assured returns' to the home buyers till possession of property was given. It held that such a transaction was in the nature of a loan and constituted a 'financial debt' within the Code.

The situation was such that the home buyers who had an assured returns clause in their agreement could file an insolvency petition and others could not. However, after initiation of insolvency process the other home buyers could submit their claim to the resolution professional.

IBC Amendment

When one of the home buyers approached the Supreme Court with a plea that there was no relief under IBC, the media coverage of the proceedings built the momentum for a change in law. If there is any law that can be considered as responsive and reactive to the needs of time, it is only IBC. The **2018 amendment** inserted an explanation to the definition of 'financial debt' under Section 5(8) of the IBC to provide that *any amount raised from an allottee under a real estate project shall be deemed to be an amount having the commercial effect of a borrowing.* The term 'allottee' and 'real estate project' had their meaning assigned through the Real Estate (Regulations and Development) Act, 2016.

Opening of flood gates

The amendment opened the flood gates and a number of petitions were filed across the country by home buyers. One interesting aspect of the IBC law is that there must be a 'default'. Section 3(12) of the IBC defined 'default' to mean *non-payment of debt when whole or any part or installment of the amount of debt has become due and payable and is not paid by the debtor or the corporate debtor as the case may be.* Where a home-buyer has paid money under an agreement to purchase an apartment and when there is a delay in completion or delivery, can it be said that there is a default?

In some of the more publicized cases[3], the Principal Bench of the NCLT did not agree with the argument that a delay in handing over a residential unit will not amount to default as defined under the Code. The NCLT in the *Emmar MGF Land* case observed that the amount paid by the home buyer becomes payable by the developer on the expiry of stipulated time for completion of the project.

Constitutional challenge

The constitutional validity of the amendment was challenged before the Supreme Court by many developers and the batch of writ petitions were disposed of by the Supreme Court[4].

The Writ Petitioners before the Supreme Court assailed the amendment on the ground that it affected the fundamental right under Article 19(1)(g) and the deeming fiction introduced through the explanation was inconsistent with the object of the IBC.

Further, it was also argued that when there was a specific legislation viz. RERA which would address all these issues and was a sector specific legislation, the enactment of 'a sledgehammer to kill a gnat' would render the impugned amendment excessive, disproportionate and violative of Article 14 and 19(1)(g). It was also contended that there was no 'debt' or 'borrowing'.

The Additional Solicitor General relied upon the decision of the Supreme Court[5] and contended that Amendment Act would cover by the ratio laid down therein. It was also contended that even without the explanation real estate development agreements would get covered under the definition of 'financial debt'. The counsel for various allottees contended that the remedies under other legislations were not meaningful and the loopholes in the State Rules ensured the continuance of one-sided agreements favouring the developer.

Decision of the Supreme Court in Pioneer Urban Land case

The Supreme Court upheld the constitutional validity of the amendments introduced to IBC with reference to home buyers and held that -

(i) The Insolvency Law Committee has found as a matter of fact that delay in completion of flats / apartments has become a common phenomenon and the amounts raised from home buyers contribute significantly to the construction of such flats / apartments. It was important therefore to clarify that home-buyers are treated as 'financial creditors' so that they can trigger the Code and have their rightful place in the committee of creditors.

(ii) It is difficult to accept the argument that RERA is a special enactment which deals with real estate development project and must therefore be given precedence over the Code which is only a general enactment. At the time of introduction of the explanation to Section 5(8)(f) of the IBC, Parliament was aware of RERA and applied some of the definition provisions to the Code.

(iii) The fact that RERA is in addition to and not in derogation of other laws (Section 88) makes it clear that remedies under RERA to allottees were intended to be additional and not exclusive remedies.

(iv) The Supreme Court in *KSL Industries Ltd. Vs. Arihant Threads Ltd. (2015) 1 SCC 166* has held that Sick Industries (Special Provisions) Act, 1985 would prevail over the Recovery of Debts Due to Banks and Financial Institutions Act, 1993.

(v) By the process of harmonious construction, RERA and Code must be held to co-exist and in the event of a clash, RERA must give way to the Code. RERA therefore cannot be held to be a special statute which in the case of a conflict, would override the general statute viz. the Code.

(vi) The Code is meant to a proceeding in *rem* which after being triggered goes completely outside the control of the allottee who triggers it. Thus, any allottee / home buyer who prefers and application under Section 7 of the Code takes the risks of his apartment not being completed in the near future in the event of there being a breach on the part of the developer.

(vii) If the Petition is admitted under the Code the allottee may never get refund of the entire principle let alone the interest on account of an elaborate insolvency resolution process. On the other hand, if such allottee were to approach under RERA it is more than likely that the project would be completed early and / or full amount of refund and interest with compensation and penalty would be awarded.

(viii) Only an allottee who has completely lost faith in the management of the real estate developer would come before the NCLT under the Code.

(ix) When a person supplies goods and services such a person is a creditor and the person who has to pay for the goods and services is the debtor. In the case of real estate developer, the developer who is the supplier of the apartment is the debtor inasmuch as the homebuyer / allottee funds his own apartment by paying amounts in advance.

(x) In a real estate project, money raised from the allottee is being raised as consideration for the time value of money. The fact that the allottee makes such payment in installments which are co-terminus with phases of completion of the real estate project does not any the less make such payments as payments involving 'exchange', i.e. advances paid only in order to obtain a flat / apartment.

(xi) Based on the fundamental differences between the real estate developer and the supplier of goods and services, the legislature has focused upon and included real estate developers as financial creditors.

(xii) Home buyers/ allottees can be assimilated with other individual creditors like debenture holders and fixed deposit holders who have advanced certain amounts to the corporate debtor.

(xiii) Given the fact that the allottee may be entitled to claim of compensation in the event of a breach of agreements with the developer, the allottee gets a right to have seat on the committee of the creditors.

(xiv) The information published in the website under RERA can be the basis for 'a default' relating to the amount due from the developer.

(xv) It is also open to a developer to point out that the allottee is a speculative investor and not a person who is genuinely interested in purchasing the apartment. The contention that a wholly one sided and futile hearing would take place before the NCLT and would ignite the process of removal of management and lead to the death of the corporate debtor cannot be accepted.

(xvi) The expression 'disburse' would refer to the payment of instalment by the allottee to the real estate developer for the

particular purpose of funding the real estate project. The allottee 'disburses' money in form of advance payments made towards construction of the real estate project. Section 5(8)(f) would subsume amounts raised under transactions which are necessarily loan transactions so long as they have the commercial effect of borrowing.

(xvii) The allottees and homebuyers were included in the main provision i.e. Section 5(8)(f) with effect from the inception of the Code and the 2018 explanation merely clarifies doubts that had arisen.

New issues

The home-buyer is now in a quandary. There could be a set of allottees who may want the apartment where there could be others who may trigger the IBC which would bring in all other creditors into the scene and from a claim perspective there could be much serious and bigger debts compared to what is due to the allottee. The developer is also in trouble since the IBC window may have the effect of affecting a business which is otherwise healthy but in trouble due to market conditions.

The three-member Bench decision of the Supreme Court upholding the constitutional validity of the 2018 amendment and holding that the allottee/ home-buyer is a 'financial creditor' from inception of IBC is likely to open up completely new issues of significance.

(i) The Supreme Court has recognised the principle that the Parliament is very much aware of the existence of RERA and had still chosen to clarify that *any amount raised from an allottee under a real estate project shall be deemed to be an amount having the commercial effect of a borrowing*. If that be the case, the Parliament is equally aware of the existence of the Central Goods and Services Tax Act, 2017 which seeks to treat construction of complex as a service. Now that the allottee is to be considered as a financial creditor, can it be said that a real estate developer is engaged in providing construction services to a consumer?

(ii) The Supreme Court in Para 40 has held that in operational debts when a person supplies goods and services, such person is the creditor and the person who has to pay is the debtor but in the case of real estate developers, the developer is the debtor since the allottee is funding his own apartment by paying amounts in advance. By classifying the allottee as a creditor and as a financial creditor, can it now be said that the transaction is akin to borrowing and hence there is no service rendered by the developer for levy of GST?

(iii) If real estate developers are considered as only financial debtors and not operational debtors, what would be the character of monies in the hands of the developers?

(iv) The Supreme Court in Para 61 observes that the allottee 'disburses' the money in the form of advance payments towards construction of the real estate project and therefore it is a debt. If the Court had held that an allottee is an operational creditor, the nature of the construction as a service could have survived but declaration as a financial creditor would open up new vistas of debate as to whether there is a supplier or recipient or service equation in real estate development.

(v) None of the decisions in the context of tax laws relevant to construction seem to have been cited. The developer had undertaken to build for the flat purchaser and so long as there was no termination of the contract the construction is for and on behalf of the purchaser and it remains a works contract.[6] Interesting questions are inevitable in the future when the IBC precedent and tax precedents are juxtaposed against each other.

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[1] Col. Vinod Awasthy v. AMR Infrastructure Ltd., NCLT, Principal Bench, Delhi, CP No. (IB)-10(PB)/2017 and Nikhil Mehta v. AMR infrastructures Ltd, NCLT, Principal Bench, Delhi, CP No.(IB) – 03(PB)/2017 **[LSI-376-NCLT-2018(PB)]**.

[2] Nikhil Mehta v. AMR Infrastructure, NCLAT, New Delhi, Company Appeal (AT) (Insolvency) No. 07/2017, Date of decision – 21 July, 2017.

[3] Alka Agarwal Vs. Parsvanath landmark Developers Pvt. Ltd. (IB)-1229(PB)/2018 and Neeraj Gupta Vs. Emmar MGF Land Ltd. (IB) – 1403(PB)/2018

[4] Pioneer Urban Land and Infrastructure Ltd. & Another Vs. Union of India & Ors. – WP No.43/2019 – Date of decision – 9 August, 2019 **[LSI-424-SC-2019(NDEL)]**.

[5] Swiss Ribbons Pvt. Ltd. & Anr. Vs. Union of India & Ors.– (2019) SCC OnLine SC 73**[LSI-18-SC-2019(NDEL)]**

[6] Larsen and Toubro Vs. State of Karnataka, (2014) 303 ELT 3 (SC)