

# Articles



*This article endeavours to throw light on the various issues that affect the real estate sector as well as the legal issues to be kept in mind by the investors / end users before entering into a contract for purchase of land, residential apartment or any commercial property.*

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## Legal Issues in Real Estate Sector - A Bird's Eye View

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### INTRODUCTION

Real estate is considered to be one of the best avenues for investment since the risk involved is much less as compared to the investment in stock market, mutual funds, debentures/bonds etc. In the case of other investments, one has to act with great caution looking into various parameters affecting the return as well as the safety of capital invested. Investment in real estate gives decent return, if the basic principles on which it works are observed.

Till last year, real estate was one of the fastest growing sectors in India. It was growing at an average annual rate of 12% as a result of tremendous upsurge in the demand for commercial real estate due to BPO boom. The foreign investments in India have increased the employment opportunities and consequently the disposable income in the hands of middle class, which has fuelled the growth of the housing sector.

### LEASEHOLD *versus* FREEHOLD PROPERTY

The first step in understanding a property is to distinguish a leasehold from a freehold property. Leasehold properties (plot/built up) are those in respect of which perpetual lease has been granted by the title paramount in favour of the Lessee. In this case, the title paramount i.e. President of India acts through the Land & Development Authority to grant the perpetual lease. Annual lease charges are required to be paid to the Land & Development Authority (Lessor). Leasehold properties are not freely transferable. Depending upon the covenants of the Lease Deed, prior permission of the lessor i.e. Land & Development Authority is required to transfer the property.

Freehold properties are those where the title paramount has conveyed the property in favour of the purchaser by execution of conveyance/sale deed with no restrictions on the right of the holder to further transfer the property. But every time, the property is transferred, stamp duty is payable on the registration of the sale deed. The record of ownership of the freehold property can be ascertained from the Office of the Sub-Registrar of Assurances. A freehold property has better marketability as it can be sold, mortgaged or can be kept as security, which is difficult in the case of leasehold property.

### IMPORTANCE OF TITLE DUE DILIGENCE IN REAL ESTATE TRANSACTIONS

The basic problem which frightens the investors while entering into real estate transactions is the veracity of title. The term "title" is regarded as the right of ownership in a property. The terms "good title" and "marketable title" are quite often used interchangeably but both are different and convey different meaning. A "good title" is one which is free from all sorts of defects and litigations and, hence, can be transferred to another. A "marketable title" is one which is free from reasonable doubts and will not expose the buyer to the hazards of litigation. Thus, the marketable title is not perfect but so far as its antecedents are



concerned it is reasonably free from defects in law and is one that a court of law would ordinarily order the buyer to accept. In simple words, it can be said that a good title is a marketable title but a marketable title may not be a good title. A title confers legal ownership, right of possession and interest in the property.

Title due diligence means verifying the title to the property, ensuring that the same is unencumbered and is not fraught with litigations or fake/improper documentation. It is prudent to purchase the property only after proper title due diligence since the legal proceedings in India are usually slow and the disputes over title could even deprive the buyer from using the property and the right to further sell the property. In some cases, it is possible that the original documents are pledged with any bank or financial institution as collateral security. Similarly, when a reverse mortgage is created with any bank by a senior citizen, he has to hand over the title deeds of his property to the bank. In such cases, the purchaser should inspect the original title deed at the place of creditor. It is always advisable to approach a lawyer and get the title due diligence carried out, which is done after considering numerous enactments such as the succession laws, Land Ceiling Act, Land Acquisition Act and Acts concerning environment apart from examining the relevant Rules and Regulations, procedure for transfer of property, mutation etc.

## **Broad Check-list for carrying out the due diligence with respect to title**

- To check the classification of property from the Govt. records along with copy of site plan, survey no., layout, sanctioned plan etc. identifying the property against the adjoining land. The documents should be certified by the officer of the Land Records.
- To check whether the land is to be used for agricultural purposes or can be used for industrial, commercial or residential purposes. In case of change of land use, the permission given by the competent Govt. authority and the fee paid for conversion should be checked.
- To ensure that the land is not subject to land acquisition proceedings by verifying the records in the Office of Tahsildar and by seeing the notifications issued by the land acquisition authorities.
- To check chain of title deeds, with stamped receipts/lease deed/gift deed through which the property has been transferred/acquired by the present owner.
- To ensure that the provisions contained in the title deed do not restrict the right of the owner to transfer the property.
- If the property is in joint names, then NOC should be obtained from the co-owner(s).

- In case the property is held by HUF or is an ancestral property, to check the family tree and to verify death certificate of original owner, copy of will, succession certificate, probate obtained from Court, legal heirship certificate in original, registered copy of the partition deed/gift deed/settlement deed, as the case may be.
- In case the property belongs to partnership firm, society or trust, to check the copy of the partnership deed/trust deed.
- In case the property belongs to a company, then check the Memorandum & Articles of Association, Resolution passed by the Board of Directors/Shareholders ( as applicable) under section 293(1) (a) of the Companies Act, 1956 authorising the sale of the property. Inspection should also be done at the office of the Registrar of Companies (where the registered office of the Company is situated ) to ensure that the property has not been mortgaged/charge created under the Companies Act, 1956 in favour of any Financial Institution/Bank/Debenture Trustee through filing of Form No. 8/10.
- In case the property is being sold by the Official Liquidator, the Court order authorising the Official Liquidator to sell the land/property should be verified.
- To check the occupation certificate and also the environmental clearance issued by the competent authority.
- In some cases, the seller may not be physically present to sell the property and might appoint an agent with the power to sell. In such cases it is necessary to check the Power of Attorney to see if the principal who has executed the power is the owner of the property. The Power of Attorney must bear the photograph of the principal and it should be registered in the office of the Sub-Registrar.
- In case the the owner is a NRI and the Power of Attorney (POA) has been executed in a foreign country, the POA should be notarised before the Indian Consulate for the purpose of authentication and thereafter it is to be attested by the Sub-Registrar of the area concerned

In order to safeguard against the subsequent third party claims, it is advisable to give a public notice by way of advertisement inviting objections, if any, before the purchase of property. The above check list is only illustrative and not exhaustive since some more areas may need to be looked into depending upon the nature of the transaction.

## **SCRUTINY OF LEGAL DOCUMENTS WHILE BUYING A PROPERTY**

Buying a property may perhaps be the largest investment in any one's life. Therefore, one needs to be extra cautious in buying a property lest one's precious savings go down the drain. After zeroing in on the desired property, one still has to go through a



formidable maze of tedious legalities and paperwork to ensure proper registration of property in his name.

## **Documents to be checked while buying a flat from a Builder : -**

- Approved plan of the building.
- Whether the land is a freehold land and free from encumbrances.
- To check the building bye-laws as applicable in that area and ensure that the builder is constructing without any violation of such bye-laws etc.
- To check that the urban land ceiling NOC (if applicable) has been obtained.
- NOC from water, electricity and lift authorities has been obtained.

Besides the aforesaid documents the buyer should also carefully go through the flat buyers' agreement/construction agreement with the builder, to ensure that all the necessary terms and conditions viz., the size of flat (carpet area & super area), floor plan, car parking space, details of various amenities, date of completion and delivering of possession of the flat and other standard specifications have been incorporated in the said agreement. The agreement should also contain the payment schedule. It is preferable to opt for a construction linked payment plan as compared to a time bound payment plan since in a construction linked plan the buyer is assured of the progress of the project.

The buyer should also check that the agreement contains a penalty clause for delay in giving possession of the flat by the builder. In case, the builder is unable to give the possession of the flat on time and also avoids the payment of penalty, by justifying the delay on flimsy grounds, then it tantamounts to breach of contract and is also construed as deficiency in service within the meaning of Consumer Protection Act, 1986 for which the buyer has got recourse to the Consumer Forum.

## **Documents to be checked for purchasing a flat in a Registered Housing Cooperative Society**

- To check the Letter of Registration of Society issued by the Registrar of Cooperative Societies.
- To obtain a copy of the bye-laws of the Society.
- To check the Share Certificate issued by the Society in favour of the seller.
- To check the previous chain of conveyance/sale deeds and also Sub-Registrar's receipts in this respect.
- To receive No Objection Certificate from the Society for transfer and sale of flat.
- To check latest payment receipts with respect to electricity, water, maintenance charges and property tax.

- To fill up set of transfer forms prescribed by the Society for transfer of ownership.
- Execution of Deed of Assignment after paying the stamp duty in the Office of Sub-Registrar of Assurances.
- To ensure that the name of the buyer is recorded in the records of the Society.

## **REGISTRATION OF PROPERTY**

In case of freehold property, the sale deed should be stamped and registered at the Office of the Registrar of Sub-Assurances as per the provisions of the Indian Registration Act, 1908, within a period of four months from the date of execution of the Sale Deed. Both, the developer/seller and the purchaser need to be present at the Sub-registrars office for registering the sale deed. The stamp duty is levied by the State Government and is usually a percentage of the circle rate fixed for that area. Most of the States charge concessional stamp duty in case one of the transferees is a woman.

In case of leasehold property, the sale of property takes place through execution of Power of Attorney and other documents like agreement to sell and execution of the Will in favour of the buyer. Since no sale deed is executed, the transfer of property is not subject to levy of stamp duty. However, the buyer has to get the Power of Attorney and the Will registered with the Sub-Registrar's Office. Although the buyer gets the possession of the property but the title deeds continue in the name of the original allottee until, the buyer opts for conversion of the leasehold property into freehold property by paying the required stamp duty to the concerned Development Authority, which had originally given the property on lease.

## **LEVY OF SERVICE TAX ON REAL ESTATE DEVELOPERS**

The issue of levy of service tax on Real Estate Developers first came to lime light when the Director General of Service Tax (DGST) issued a circular after the decision by the Supreme Court of India in the case of *K. Raheja Developers*. In this case, the Apex Court had held that where a developer sells flats under construction for a consideration that is to be received in instalments such a transaction would be deemed to be works contract and, hence VAT must be paid. Although the Supreme Court in this case had not dealt with the issue of levy of service tax but the DGST relying on the ratio of the aforesaid case, issued a Circular that since the sale of residential units amounted to works contract and as the works contracts are chargeable to service tax under the heading of "residential complex construction services", service tax must be paid on such transactions.

In the matter of *Harekrishna Developers*, the Authority for Advance Ruling, Central Excise, Customs and Service Tax has held that activity of booking residential apartments is a taxable service



and is liable to service tax under the heading "construction of complex" under Section 65 (105) (zzzh).

However, in a recently decided case of *Magus Construction Pvt. Ltd. v. Union of India*, the Gauhati High Court has held that where the petitioner company was engaged in the business of development of real estate i.e. construction of flats/buildings which are later on sold to the buyers, the activities of the company do not fall within the ambit of taxable service and hence the service tax is not applicable in such cases.

In the instant case, the petitioner company had entered into flat purchase agreements with various flat buyers and the consideration was payable in instalments. The Revenue Department sought to levy the service tax. The Court has in its landmark ruling held that, "*Service is an act of helpful activity; an act of doing something useful, rendering assistance or help. Service does not involve supply of goods. It rather connotes transformation of use/user of goods as a result of voluntary intervention of 'service provider' and is an intangible commodity in the form of human effort.*"

The Court has observed that the petitioner company had not undertaken any construction work for and on behalf of the prospective customers/allottees and the title in the flats/apartments so constructed passed to the customers only on execution of the Sale Deed and registration thereof. Until the time, the sale Deed was executed, the title and interest including the ownership and possession in the constructions made remained with the petitioner company. The payments made by the prospective purchasers in instalments were just to facilitate the purchase of flats by the allottees since they may not be in a position to pay the lump sum amount towards the consideration of the flat. Thus, no service was being rendered by the petitioner company to the prospective allottees.

## LAND CEILINGS

The Central Government had enacted Urban Land (Ceiling and Regulation) Act, (ULCRA) with the objective of preventing the holding of urban land by a select few. The excess land made available after applying ceilings was to be utilised for the housing sector. However, instead of achieving this objective, the ULCRA resulted in increase in the real estate prices in the urban areas. In order to remedy the situation, an Ordinance was passed and through the Urban Land (Ceiling and Regulation) Repeal Act, 1999, an option was given to the various States to adopt the same through their own State Legislatures.

Recently, the Maharashtra State Legislature has also repealed the Urban Land (Ceiling and Regulation) Act, 1976. Now, only very few States namely Andhra Pradesh, Assam, Bihar and West Bengal are continuing with the provisions of ULCRA. The repeal of ULCRA has helped in freeing vast tracts of land, thus bridging the gap between the demand and supply of land in the urban areas. Moreover, it has also brought transparency and efficiency

in the land acquisitions and encouraged foreign investments in the real estate sector. It may be noted here that Government of India vide Press Note No. 2 of 2005 series has allowed 100% FDI for the construction and development of integrated townships, subject to fulfilment of certain conditions. The administrative fees payable under ULCRA which is some times as high as Rs.100 per sq. ft. is also no longer payable, which will also help a bit in the reduction of real estate prices.

## LIMITATION PERIOD

Where a person is wrongly deprived of possessions of his property, the Limitation Act, 1963 provides that in case a person wants to obtain possession of an immovable property or any interest therein based on the title to the said property, then he has to take legal action within a period of 12 years from the date of wrongful possession by the defendant so as to get back the possession and also to claim damages, if any.

## LAW OF ADVERSE POSSESSION

Adverse possession means that someone acquires title to another person's land after occupying that land continuously for more than the specified period of time without any challenge or permission from the true owner who has the title to that land. The theory of adverse land possession operates on the basis of doctrine of estoppel.

In some judgements, it has been held that adverse land possession is complete when the following criteria is fulfilled :

- (a) Actual possession : The adverse possessor must physically use the land and alter its current state.
- (b) Open and notorious occupation : The use of the land must be visible and apparent to all the people, including the true owner.
- (c) Exclusive and hostile : The adverse possessor occupies the land to the exclusion of everyone else, including the true owner.
- (d) Continuous : The adverse possessor should be able to prove that he has occupied the land continuously for a specific period of time.

This old law, which was based on common law and the then statutory provisions, was subject matter of criticism as it did not give any chance to the true owner in Court of Law. After the enactment of the Land Registration Act, 2002, the adverse possessor needs to apply to become the registered owner of the property after ten years of continuous occupation. On receipt of an application from the adverse possessor, the Land Registry would give notice to the true owner who has 65 days time to object. If the objection is granted, the true owner has two years time to evict the adverse possessor and regain his property. Thus, under the present system the transfer of land title is no longer automatic.



Recently the Supreme Court has given its verdict on an appeal filed by Ms. Hemaji Waghaji Jat wherein, the Court has observed that the law ought not to benefit a person who in a clandestine manner takes possession of the property of the true owner in contravention of law. The Court has stated that, *"We fail to comprehend why the law should place premium on dishonest by legitimising possession of a rank trespasser and compelling the owner to lose its possession only because of his inaction in taking back the possession within limitation. In our considered view, there is an urgent need to have a fresh look on the law of adverse possession. We recommend the Union of India should seriously consider and make suitable changes in the law of adverse possession. A copy of this Judgement be sent to the Secretary, Ministry of Law and Justice, Department of Legal Affairs, Government of India for taking appropriate steps in accordance with law."*

Thus the existing law on the one hand is too harsh on the actual owners as they are deprived of their right on the basis of adverse possession of such property and on the other hand it is a windfall for the dishonest person. We do hope that the necessary changes should be made in the Act in order to protect the interest of the true owners of land.

## REAL ESTATE MUTUAL FUNDS

A Real Estate Mutual Fund (REMF) puts together the investments of individuals/entities by issuing units to these investors and deploys the funds so collected in the income generating real estate assets. Investment in real estate involves lot of money but with the help of a REMF, even a small investor can fulfil his aspiration of investing his money in real estate and enjoy the benefit of appreciation in real estate prices. Moreover, the investor is spared of the hassles of title search, due diligence and taking care of the other rules & regulations before investing. REMF employs qualified & experienced professionals to take care of these matters. The investment is completely transparent and can be easily liquidated through sale of units at the Stock Exchanges.

REMF are very popular around the world. In India, SEBI has vide notification dated 16<sup>th</sup> April 2008 amended SEBI (Mutual Fund) Regulations, 1996 permitting mutual funds to launch Real Estate Mutual Fund schemes ( REMFs). The salient features of REMFs, as per the SEBI Regulations, are as follows :-

- (a) Existing MFs are eligible to launch REMFs if they have adequate number of experienced key personnel/directors.
- (b) Sponsors seeking to set up new MFs for launching REMFs shall be carrying on business in real estate for a period of not less than five years, in addition to fulfilling the other terms & conditions for sponsoring a MF.
- (c) REMFs shall be close ended. However, the units shall be listed on the stock exchanges.

- (d) Net Asset Value shall be declared daily. At least 35% of the net assets shall be invested directly in real estate assets. The balance amount can be invested in mortgage backed securities; securities of the companies engaged in dealing in real estate or involved in development of real estate projects and other securities. The investments in real estate assets and real estate related securities shall not be less than 75% of the net assets of the Scheme.
- (e) "Real Estate Asset" means an identifiable immovable property-
  - (i) which is located within India in such city as may be specified by the Board from time to time or in a Special Economic Zone (SEZ);
  - (ii) on which construction is complete and which is usable;
  - (iii) which is evidenced by valid title documents;
  - (iv) which is legally transferable;
  - (v) which is free from all encumbrances;
  - (vi) which is not subject matter of any litigation;  
*but does not include* - a project under construction; vacant land; deserted property; land specified for agricultural use; a property which is reserved or attached by any Government or other authority pursuant to orders of a court of law or the acquisition of which is otherwise prohibited under any law for the time being in force;
- (f) REMF shall not undertake lending or housing finance activities.

At present, some of the leading Mutual Funds as well as the Real Estate players are planning to launch REMFs, which may be beneficial to the small investors.

## CONCLUSION

In a country like India, with a population of more than one billion and that too consisting of a large middle class, the demand for real estate would continue to grow. Since the land available for real estate development is limited, the prices would continue to increase in the long run. Therefore, investment in real estate is likely to fetch good returns in the long term. However, the rising interest rates in India, the problems in US economy due to sub-prime mortgage crisis and the consequent global turmoil are creating pressure on the Indian Real Estate sector.

Every individual in his life time dreams of owning a house but some times, they are reluctant due to complexity of various laws, rules and regulations. A person can make his dream come true if he carefully observes the various legal issues involved in real estate transactions and, if necessary, takes the help of an Advocate for carrying out due diligence etc., to ensure that his dream doesn't end up into a nightmare in the form of protracted litigation in a Court of Law. □