Impact of GST

Infrastructure

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GST implementation – Current state of play
GST is India’s biggest tax reform in the post-independence era. Prior to the introduction of GST, a heterogeneous indirect tax structure existed in India which included levy of taxes by the centre and states under different tax laws. The earlier indirect tax framework had challenges of multiplicity and cascading of taxes, apart from other issues and complexities, both technical as well as from the perspective of ground-level practices.

The GST regime implemented on 1 July 2017 has transformed the Indian economy with its ‘One Nation, One Market, One Tax’ principle by subsuming a host of indirect taxes charged at varied rates by the centre and states, therefore bringing uniformity in taxation across the country. The GST law ushered in numerous positive aspects such as uniformity in tax rates across India, widening of tax base on account of transparent digital processes, subsuming of as many as 17 taxes and multiple cesses, elimination of check posts at state borders etc. However, a year into the goods and services tax (GST) regime, initial apprehensions have given way to general acceptance that the tax structure is a work-in-progress as there are several concerns that remain to be addressed.

One of the biggest challenges in implementation of GST was the functionality of the technology infrastructure and experience of compliance process; as since inception, the portal had a slow response rate, performance issues and bugs. The Government has constituted a committee to address these issues and it is continuously working on improving the tax payer’s experience and various steps at simplification of process has been continually introduced.

The implementation of the E-way bill also brought with it operational and technology challenges due to which the Government took additional time to get the framework up and running. The portal was revamped and was introduced in February 2018 and is completely functional since April 2018 on a pan-India basis. The automation of E-waybill system is a welcome relief from the previous practice of manual checking of way bill information at check posts in different States which led to different legal interpretations and required maintenance of different types of documentation/ records based on State VAT law provisions.

An important aspect of the implementation of a new law is to have a quick and robust dispute prevention and resolution mechanism. Acknowledging the need for suitable clarifications, the Authority for Advance Ruling (AAR) has been set up in multiple jurisdictions across India. The AAR has been fairly proactive in disposing off advance ruling applications, especially in Karnataka, Maharashtra, Kerala and Gujarat. However, given that the AAR is constituted at a State level, there have been contrary rulings by two different AARs. This indicates a need for a central management system. In this regard, the Union Cabinet has recently approved the creation of National Bench of the Goods and Services Tax Appellate Tribunal (GSTAT) which is the forum of second appeal in GST laws and the first common forum of dispute resolution between Centre and States.

Refunds under the GST regime could arise due to many factors such as refund of tax on account of inverted duty structure. Because of technical glitches, problems were faced by several tax payers in filing refund applications on the online portals resulting in blockages of funds. To address this concern, the Government organized special refund drives in March, June 2018 and July 2018. While this initiative of the Government is commendable, most of these refund claims appear to pertain to exports. The refund claims related to unutilized credit on closure of business, inverted duty structure remains unattended.

In a recent amendment to the GST Acts, the Government has removed the option available to the taxpayer for registration of a ‘business vertical’ by allowing separate registrations for multiple places of business in a state. The omission of registration for separate business vertical could lead to a situation where a taxpayer may not be able to take separate registration if there is no separate place for its different businesses.

One of the focus areas under GST law is the “matching concept”, wherein a buyer is required to reconcile its tax payments on invoices with the tax collections, deposited and reported by the supplier on the Government portal. Any incorrect or unmatched transaction would lead to denial of credit to the buyer. However, due to IT glitches, this concept did not take off since GST implementation and the requirement was deferred till necessary technological framework was put in place by the Government. The Government has now approved formats of simplified single monthly / quarterly GST return to reduce the compliance burden on the taxpayers for replacing the multiple returns that were required to be filed in a tax period. Further, the Government has also introduced provisions to allow taxpayers to amend their tax returns in order to rectify errors which would widen the scope for availing input tax credit.

Even after one year of GST go-live, there had been a deferment of implementation of provisions relating to advances and purchases from unregistered vendors, Tax Collection at Source (TCS) for e-commerce players and
Tax Deducted at Source (TDS) for works contractors which led to an atmosphere of ambiguity for existing businesses as well as those looking to set up new ventures.

While the above seeks to provide an overview of challenges being faced by all assesses, there are also sector specific concerns and focus areas in the infrastructure space. This paper attempts to cover such key sector specific concerns.
Impact of GST on Infrastructure sector

The introduction of GST appears to be a mixed bag for the infrastructure sector—predictability and efficiency being the key advantages, while non-continuity of exemptions, higher rate credit restrictions and credit reversals are negatives.

This note attempts to shed light on the impact of GST thus far on the infrastructure sector and highlighting the key issues.

1. **Removal of dichotomy on taxability of works contract services**

Generally, contracts entered into between project owners/employers and contractors are segregated into the following separate contracts. Details of such contracts are as follows:

- Contract 1: Offshore supply contract
- Contract 2: Offshore services contract
- Contract 3: Onshore supply contract
- Contract 4: Onshore services contract (which includes pure services and civil work)

In the pre-GST era, treatment of infrastructure contracts as ‘supply of goods’ or ‘provision of service’ contracts, or as a composite works contract involving the supply of both goods and services has been a litigious issue.

While central laws provided exemptions and concessions under service tax for infrastructure projects, state VAT (value-added tax) and entry tax laws were applicable to goods procured. In addition, the cascading effect of central and state indirect taxes was a concern, due to a high base for levy of respective taxes and a restrictive credit mechanism. There have been several disputes at the Central and state levels concerning classification of contracts, valuation and jurisdiction of state on inter-state works contracts. Further, certain conceptual debates on taxability of Build-Operate-Transfer (BOT) contracts were existing with different interpretations adopted for VAT and service tax.

The GST law specifically provides that ‘works contract’ as well as ‘construction of a complex or a building, civil structure or a part thereof’ shall be treated as supply of services. Even though such provision will provide clarity to a great extent, it may not be able to eliminate ambiguity completely. Contracts in the infrastructure sector can be complex, and determining the nature of these contracts would be difficult, particularly in the context of the peculiar and varied nature of arrangements involving multiple scope of work and multiple participants (consortium) for either full project or for parts of a single project.

However, the question involving how a particular contract involving both supply of goods and services should be taxed, which had typically sparked differences between central and state indirect tax authorities, would be put to rest with the GST legislation laying down unambiguously that works contracts would be regarded as supply of services.
2. **Effective tax rate**

In the pre-GST era, a majority of construction contracts, being work contracts, were subject to a combination of both service tax and VAT. A service tax of around 4.5% (assuming taxable component of the service contract is 30%) and VAT ranging from 1-15%, depending upon the state, was applicable to construction contracts. Moreover, there were several construction activities, such as the construction of roads, dams, irrigation, that were exempt from service tax. However, such activities were subjected to VAT.

Under the GST law, the rate prescribed for taxing works contracts is 18% and such rate difference vis-a-vis the applicable rate under pre-GST regime is more prominent for construction activities falling under the service tax exemption category. However, availability of higher pool of input tax credit in the hands of the contractors could help neutralising such higher output GST.

On the other hand, a higher GST rate could also result in higher costs, if there is limited scope for renegotiating construction contracts, and contracts that do not account for contingency factors. Multiple GST rates (5%, 12%, 18% and 28%) on procurement of inputs and input services is another aspect which adds complexity and leads to unwarranted classification disputes. This has partially been recently addressed with rate reduction from 28% to 18% coming into effect on 27 July 2018.

3. **Increased costs for power generation projects**

The government has exempted electrical energy as well as services of transmission and distribution of electricity by an electricity transmission and distribution utility respectively under the GST law. As a result, power producing companies (both renewable and conventional) would be required to pay GST for their inputs such as fuel and machinery, but will not be able to get these taxes refunded, given that their output ie electricity is exempt.

Power is the most important component of infrastructure. Services of transmission or distribution of electricity being exempt under the GST law, power generation companies would continue to have indirect taxes as a significant cost factor. Such companies may ultimately pass on such burden to consumers under the “change of law” clause in power purchase agreements (PPA). Developers selling electricity in the spot market or on a non-PPA basis would have to factor in the higher cost.

Under the pre-GST regime, a project owner engaged in setting up of a power plant or engaged in power transmission/distribution could procure goods (under an inter-state sale transaction) at a concessional CST rate of 2% (against Form C) and structure some of the procurements as in-transit sales to reduce tax incidence on the project. However, there is no such concession GST law. In the absence of such exemptions/concessions, there is a significant increase in project cost. Further, there are ongoing disputes on the entitlement to issue Form C on petroleum based fuels after GST law became operational.

An increase in rate of services and withdrawal of exemptions and concessions for power projects has significantly impacted the power companies including solar power projects where the entitlement to a concessional rate has been questioned.

4. **Classification of contracts - Works contract vs composite supply**

As per the GST law, definition of works contract is restricted to contracts related to immovable property. However, various engineering, procurement and construction (‘EPC’) / erection and commissioning (‘E&C’) contracts involve various activities in relation to movable as well as immovable property.

As works contracts are limited to only immovable properties, turnkey or other contracts which do not result in creation of immovable property would plausibly be treated as “composite supplies” and depending on the principal supply, tax liability would arise either as a supply of goods or services since only works contracts relating to immovable property is treated as a service.
There are also disputes regarding whether the aspects of high sea sales of goods / equipment by a contractor to the project owner as well as free issue of goods / equipment to the contractor under an infrastructure project would constitute as a “composite supply”.

There is presently a lot of ambiguity revolving around taxability of activities in relation to movable properties in such contracts under the GST law. The Advance Ruling Authorities (AARs) in the states of Karnataka\(^1\) and Maharashtra\(^2\) have treated separate contracts executed for supply of goods and services for the supply of the turnkey contract for construction of a solar power plant as an indivisible works contract leading to ambiguity in the interpretation of the term “works contract”. To resolve the disputes and grant relief to the taxpayers, the GST Council has recommended\(^3\) the mechanism for the valuing a fixed component that would attract the lower tax rate of 5%.

Therefore, determining the nature of a particular agreement, or a set of agreements, for a project (i.e. whether it qualifies as works contract or not) would still be critical from the perspective of the place of supply, the taxable value, the applicable rate of tax and the compliances to be undertaken.

5. **Possible requirement of contract restructuring**

Under the GST law, the place of supply of services in relation to immovable property is location of the immovable property.

There may be possible issues where a single contract is entered into for provision of services related to immovable properties across two or more States. For example, in case of highway construction services, railway track laying project, typically a single contract may be entered into with the vendor, for which consolidated invoices may be raised at one location. Such a contract may involve execution of work across multiple states.

Since immovable property may be located in more than one State, the place of supply would be each such State where the immovable property is located and hence, there may be a requirement for the vendor to raise separate invoices for the same project.

In the pre-GST tax regime, contractors were required to segregate contract values (for sale of goods) for the purpose of determining VAT/ CST liability in different states. Under the GST regime, the contractor would continue to segregate the contract values in different states and comply with the GST registration and compliances requirements in each of the states.

6. **Annuity payments in case of specified infrastructure projects**

There are several road highway projects wherein the National Highway Authority of India pays a portion of the project cost as payment during construction period and completion cost remaining to be paid in installments on annual basis. These contracting models are referred to as “hybrid models” and the installments paid are called as annuity payments.

As regards the taxability of annuity, the Government has exempted\(^5\) services by way of access to a road or a bridge on payment of annuity. Accordingly, any payment made towards annuity and (interest on annuity, if any) shall not be subject to GST and the same shall form part of the ‘exempt turnover’ in the books of the contractor. However, there remains an ambiguity on whether the above exemption may be questioned on account of the fact that overall the contract will be viewed as a composite supply of works contract / composite supply which shall be liable to GST. If the annuity payments are considered as exempt services, would there be...

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\(^1\) M/S Skilltech Engineers and Contractors Pvt Ltd - 2018-vil-39-AAR

\(^2\) Giriraj Renewables Private Limited 2018-TIOL-12-AAR-GST (No.GST-ARA-01/2017/B-01)

\(^3\) Fermi Solar Farms Private Ltd 2018-TIOL-17-AAR-GST (No.GST-ARA-03/2017/B-03)

\(^4\) 31\(^{st}\) GST Council meeting dated 22 December 2018

\(^5\) Notification no. 32/2017 – Central Tax (Rate) dated 13 October, 2017 and no. 12/2017-Central Tax (Rate) dated 28 June, 2017
a requirement of credit reversal. Such reversal would increase the cost of providing the services and thus poses a question for the need of such an exemption.

7. **Input tax credit restrictions / reversals**

GST is built on the foundation of a liberal credit regime i.e. to allow credit of all goods and services with minimal restrictions. GST law allows ITC of GST paid on inputs, input services and capital goods against the construction / works contract services provided by works contractors. However, the GST law restricts ITC of GST paid on goods and services procured for construction of an immovable property (other than plant and machinery) which is used for one’s own account. The interpretation of the term “used for own account” is unclear as it ideally should mean an immovable property which does not constitute “plant and machinery” and which is used for own business. This is against the fundamental principle of free flow of credits. Under the erstwhile service tax regime, restriction to avail ITC was only on works contract services and not all goods and services.

The GST law provides for disallowance of credit due to non-payment (of value and tax) to the vendors within 180 days. This may result in disallowance of ITC on the retentions on account of performance clauses made by the project owners for the payments to be made to the sub-contractors. This would result in working capital blockage either in the hands of the project owners or the sub-contractors.

GST is applicable on advance paid for services (while the provision regarding applicability of GST on advance of goods has currently been deferred). Hence, the project owner would be required to pay GST on advance payments to contractors. However, credit is allowed only after receipt of invoice and goods/services. This would result in working capital blockage. One may have to analyze whether running bill would be treated as invoice. If the same is treated as invoice, GST liability would be triggered at time of issuance of running bill itself. This may however pose commercial challenges as running bill is typically modified/amended.

Most infrastructure projects cater to public utilities where project owners do not have the ability of taking credits, and thus the increase in tax cost would only lead to a cascading effect that defeats the efficiency that GST proposes to bring about.

8. **Decentralised GST registration**

Due to the concept of decentralized registration under GST, every project owner will be required to obtain registration in every state where construction projects have been undertaken. It will be an arduous and a tedious task for the companies to execute with the compliance requirements such as returns, maintenance of separate records, etc. for each state. It should be noted that a proposed amendment to section 25(2) could potentially allow registration at the project level within a state. This will need to be analysed to generate any potential benefits.

Further, owing to the complications and ambiguities in relation to tax credits, etc. the project owners may intend to explore the option of project wise registration under GST. An analysis is nonetheless required to ensure that credit accumulated on closure of one project does not lapse where multiple projects are under the same GSTIN, as compared to separate GST registrations obtained for each project.

Further, as each registration and the head office will be considered as a distinct person, the services provided by them to each other shall be considered as supply under the provisions of the GST law. Thus, there has to be charge for these internally provided support services. This poses a question for the valuation of these services, as these services are provided to the related parties and there may be cases where full credit of the services is not received by the services recipient. Further, in cases of common services received by the head office, there is an ambiguity as to where the credit of these services should be cross charged or distributed as input services distribution credit.

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6. **Section 17 (2) of the Central Goods and Services Act, 2017 read with Rule 42, 43 of the Central Goods and Services Tax Rules, 2017.**

7. **Section 25 (4) read with entry 2 of Schedule 1 to the Central Goods and Services Tax Act, 2017.**
9. **Taxability of stock transfers**

Transfer of consumables, inputs, capital equipment, etc. from one site to another is quite common in this sector. Under the previous regime, such ‘branch transfers’ could be done without the payment of taxes. Owing to the removal of state barriers, there is a considerable relief in terms of transportation of material, machinery etc. from one state to another.

In case goods are transferred by a works contractor between two locations having separate registrations, the same shall be treated as ‘supply’ and GST shall be payable. This leads to an increased effort in terms of valuation, invoicing, compliance, etc. Not to mention, this will mean blocking of working capital for the contractor company. In this regard, a recent circular8 issued by the government clarifies that inter-state movement of rigs, tools and spares, and all goods on wheels (like cranes) between distinct persons for repairs and maintenance shall be treated neither as supply of goods or supply of service, except in cases where movement of such goods is for further supply of the same goods.

10. **Transition issues and eligibility of credit on transition stock**

In the pre-GST regime, works contractors were neither entitled to ITC of central excise duty in respect of inputs used for provision of works contract services because of conditions attached to availing abated rate under the service tax regime, nor to ITC of VAT on inputs under composition scheme. Thus, these taxes formed part of the cost of procurement.

The GST law provides that credit of goods held in stock by the works contractors as on GST transition date should be available subject to satisfaction of certain conditions:

- The works contractor needs to be in possession of the invoice evidencing payment of duty and such invoice should not be issued more than twelve months prior to the GST transition date.
- Credit of central excise and VAT paid on goods held in stock as on transition date is not availed as credit in returns.
- The goods were required to be stored in a manner easily identifiable.

Input tax credits on inputs procured for construction not meant for further sale / supply is restricted. Thus, transition credit may be available only with respect to such goods lying in stock in the same manner as procured and not in relation to goods used in the construction activity. Further, the goods need to be easily identifiable. While this criteria is satisfied for items in stock as is, however, the identity is lost for all materials which is WIP (in the constructed property). The Government has also issued a clarification9 stating that transition credit on inputs already consumed in the construction project as WIP is ineligible. Accordingly, the benefit of tax credits on under-construction projects is likely to be low.

Transition from one regime to another is always a difficult process and it was no different in the present case. The Government did allow for transition of all input tax credits in the books of accounts to the new regime, subject to fulfillment of prescribed conditions. This step taken by the Government was appreciated by the industry. However, the nuances for interpreting the conditions of availing such credit were not appropriately addressed. For eg. while the Krishi Kalyan Cess (‘KKC’) was available as input credit under the previous regime, there was no clarity on transitioning it to GST. Further, it was clarified in an Advance Ruling10 that KKCs was ineligible for transition. The GST law11 has now been amended in order to clarify with retrospective effect from 1

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8 Circular No. 21/21/2017-GST dated 22 November 2017 read with Circular No. 1/1/2017-IGST dated 7 July 2017 issued by the CBIC
9 F. No. 296/07/2017-CX.9 dated 15 June 2017
10 Kansai Nerolac Paints Limited 2018-TIOL-09-AAR-GST (No GST-ARA-18/2017-18/B-25)
11 Section 140 of the Central Goods and Services Tax Act, 2017
July 2017 that the cesses levied under the pre-GST laws shall not be a part of the transitional input tax credit under GST.

Due to revenue collection challenges in the initial months, the Government also issued numerous notices disputing eligibility of transitional credit, thereby imposing more rigorous documentation / compliance requirements on players already reeling under transition challenges. In some cases, due to technical glitches, the eligible transitional credit did not reflect on the GST portal or dealers were unable to electronically submit the prescribed forms. The Government has addressed these concerns by extending the due dates for filing transitional return (Form GST TRAN-1) for some taxpayers who have huge amounts that are blocked due to procedural challenges faced.

11. Taxability of bonuses, liquidated damages, cancellation charges, late fees etc.

In case of certain projects (such as construction of highways, dams etc.), the project owner typically pays to the contractor a bonus equal to a specified percentage of the project cost in the event the work is completed as per the scheduled due date / prior to the scheduled due dated of completion. Such bonus payment although being a reward is includible in the value of the services provided by the contractor and is considered as a part of consideration for supply of works contract services.

On cancellation / delay in performance / dispute related to the project, the project owner / contractor may recover liquidated damages for delay in performance, quality issues, etc. Such damages may also get adjusted from the invoice, thus resulting in net billing/payment. The taxability of liquidated damages/ cancellation charges have been matter of litigation even under the erstwhile indirect tax regime. It was clarified in an Advance Ruling\(^\text{12}\) that levy of GST on liquidated damages would be covered under Schedule II entry no. 5(2)(e). The liability to pay GST on liquidated will be established once the delay in successful completion of trial operation is established on the part of the contractor or if the contractor fails to complete the work within a specified time period.

Given the wide coverage of the definition of services, the ambiguity on their taxability continues even under the GST regime.

12. Anti-profiteering

Anti-profiteering provisions mandate passing on the tax benefit due to GST to the customers by way of price reductions. Implementation of the anti-profiteering provisions is one of the key areas of conversation amidst the industry players. While the regulations seek to prevent entities from making excessive profits on account of GST implementation, an overarching anti-profiteering provision under the GST law without clear guidance or explicit rules has led to considerable ambiguity, primarily on account of the following:

a) The level of granularity of anti-profiteering analyses i.e. at aggregate company level, project level.

b) Whether the Indian tax payers can rely on mechanisms followed in other jurisdictions which introduced GST and had similar anti-profiteering provisions.

c) Whether transition costs incurred by the Company on account of GST implementation may be absorbed while computing the anti-profiteering obligations.

d) On which date such price reductions were/ are to be made effective.

\(^{12}\) Maharashtra State Power Generation Company -2018-VIL-33-AAR (No.GST-ARA-15/2017-18/B-30)
Recently, the National Anti-Profitereing Authority (NAPA) has issued few orders for eg. one for a company dealing in automobiles\textsuperscript{13}, one for one engaged in rice business\textsuperscript{14} and another for an e-commerce company\textsuperscript{15}. In all these cases, the authority ruled in the favour of the companies. However, it is not clear as to exactly how the revised price computations were carried out by the companies and how this computation may differ basis the nature of the product and business.

The contractors will have to rework their costing from scratch in order to ensure that the benefit of reduced costs is passed on to the customers to avoid defaulting under the anti-profitereing rules. This could prove to be a hassle for many developers especially in case of on-going projects on the appointed day of GST roll-out.

**Conclusion**

Implementation of GST has brought in predictability and efficiency in the administration of indirect taxes for this sector. The cascading effect of indirect taxes has been reduced for contractors and suppliers. However, for project owners, there is an increase in cost with input tax credit restrictions coupled with the withdrawal of tax exemptions.

Electricity being outside the ambit of GST, increase in the rate of tax on services and withdrawal of exemptions for power projects has had an adverse impact. The infrastructure sector should now expect to enter into a compliant tax regime, though clarity is still required on certain conceptual points.

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\textsuperscript{13} Dinesh Mohan Bhardwaj Vs Vrundavaneshurree Automotive Pvt Ltd - 2018-TIOL-01-NAPA-GST  
\textsuperscript{14} Kumar Gandharv v. KRBL Limited - TS-173-NAA-2018-NT  
\textsuperscript{15} Rishi Gupta v. Flipkart Internet (P.) Ltd.[(2018) 95 taxmann.com 221 (NAA)]
**Disclaimer:** The above-mentioned updates are intended for informational purposes only. They constitute some select important points in the GST law. There could be other additional features that too may be important.
Thank you