

GST IMPACT ON SOLAR POWER GENERATION PROJECTS – NOT SO SUNNY!

The year gone by witnessed a paradigm shift in Indian indirect taxation system as the nation migrated to the goods and services tax ('GST') regime effective July 1, 2017. This new scheme of taxation is undoubtedly a mammoth improvisation over the erstwhile indirect landscape in India on several counts. First and foremost, GST has led to standardization of indirect tax laws across the country thus making the indirect tax laws more intelligible and business friendly especially for foreign investors. GST has also led to removal of multiplicity of taxes and thereby their cascading impact in product / service pricing. Furthermore, it is with the advent of GST that uniformity in tax rates on goods could finally be achieved throughout the country. Standardization of tax compliances on pan India basis have also significantly led to ease of doing business in India. GST laws have also effectively put to rest the characterization and taxability related disputes of several historically debated commercial transactions such as hiring / leasing of goods, job-work / works contract transactions etc.

The foregoing narration of the benefits that GST has offered, is however, not to suggest that India Inc did not face any transition challenges in the roll-over to the GST era. Besides several interpretational as well as process related challenges, GST has also reignited classification debates for several industries. This has led to ambiguity in applicable GST rates on several product / transaction types. This write-up is an endeavor to highlight the adversarial impact of GST on turnkey projects for setting up of solar power generation systems, in view of the way the Indian GST laws are currently structured.

Before we deep dive into the challenges for the solar power sector under GST, a sneak peek into the erstwhile tax benefits available to solar power generation projects. In order to boost the solar energy sector, various tax incentives had been provided by both central as well as state governments for setting up, operation and maintenance of solar power plants. This included exemptions / tax rate concessions under several erstwhile indirect tax laws including the Central Excise Act ("Excise Act"), state value added tax ('VAT') legislations as well as under the Indian customs laws, specifically for capital goods and inputs used for setting up of solar power generation systems. Considering the tax rates structures and the cost break-up in a typical turnkey project for setting up of a solar power plant, the indirect tax costs thereon worked out to approximately 6-7 percent of the project cost.

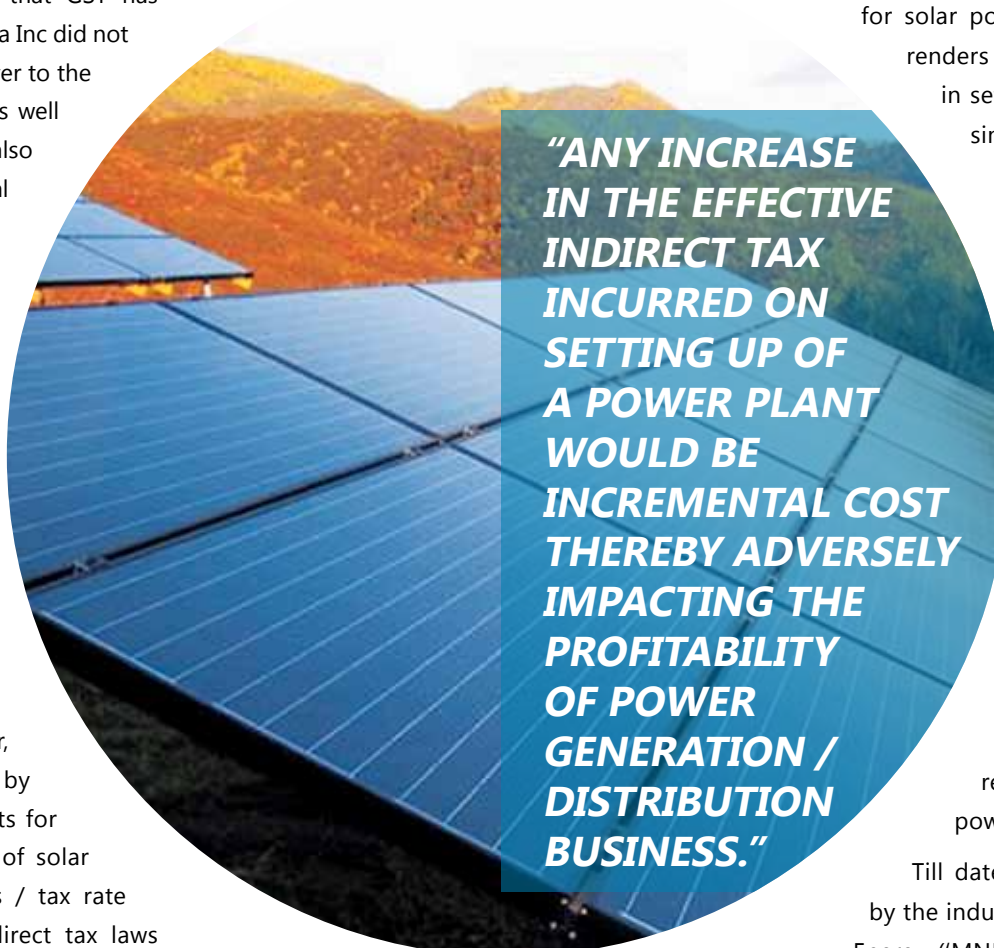
Post implementation of GST, as things stand, States would continue to tax electricity vide entry 53 of List II of Seventh Schedule of the Constitution of India ('Constitution'), as this entry has not been subsumed under GST. Further, even though the entry 54 of List II of Seventh Schedule of the Constitution which empowered the states to levy tax on 'sale of goods' has been subsumed as part of GST, the GST rate on electrical energy is Nil. This is in line with the stated intent of the government to keep electricity outside the purview of GST. Also, taxes on transmission or distribution of electricity have been exempted under GST.

On the other hand, taxes on various inputs, capital goods and input services used for generation of renewable energy would be subject to GST. With the supply side of a power plant, namely electricity, being not subject to GST, taxes paid on procurements would continue to be non-creditable for the project owner. Thus, any

increase in the effective indirect tax incurred on setting up of a power plant would be incremental cost thereby adversely impacting the profitability of power generation / distribution business.

PRINCIPAL MOTIVE OF THE NATIONAL SOLAR MISSION

The Government has always strived to boost the renewable energy sector. This is also evident from the current government policies and initiatives. The Jawaharalal Nehru National Solar Mission launched in January 2010 by the then Prime Minister of India, Dr. Manmohan Singh aimed at reducing the cost of solar power generation in the country. Notable that the policy itself incorporated specific clauses to provide fiscal / taxation incentives including custom duties and excise duties concessions/exemptions on specific capital equipment, critical materials, components and project imports.



GST IMPACT

Under the erstwhile system, the solar power generating systems were exempt from the whole of excise duty and most state VAT laws provided merit rate of tax of 4 – 5 percent thereon. It is perhaps considering this rate structure that renewable energy devices and parts thereof including solar power based devices, solar power generating systems, solar lantern/solar lamp have been made subject to GST at the rate of 5 percent. In specifying a 5 percent GST rate, however, the policy makers seem to have missed several important aspects.

Firstly, the concessional GST rates of 5 percent applies only on specified devices and equipment used in setting up a solar power plant such as solar photo voltaic ('PV') modules and solar heaters and other solar power based devices such as solar cells, solar panels that contribute to only 55-60 percent of the overall project cost. Rest of the components such as module mounting structures, cables, inverter, battery, transformers etc are chargeable to higher GST at the rate of 12 / 18 / 28 percent. Similarly, unlike the erstwhile service tax rate of 15 percent or approx. 6 percent on services like erection, installation, operation and maintenance and works contract services respectively, the GST rate on all such

services is 18 percent. On the face of it, one could argue that the turnkey project of setting up a solar power plant is indeed to be considered a composite contract for supplies of goods and services. Hence the tax rate of 5 percent should apply on the total contract value, in view of the principle of taxation of composite supplies under the GST laws. While such a position legally not tenable (for the reasons explained later), even if it was assumed to be correct, it would lead to an inverted duty structure (i.e taxes on input leg being higher than the taxes on output side) and thus lead to huge working capital blockage issues and consequently, long-drawn refunds dependencies at the end of the department.

Secondly, and more importantly, turnkey contract for setting up solar power plant as a whole will qualify as works contract as defined under the GST laws since the same lead to construction of an immovable property. Work contract transactions have been specifically deemed to be services under GST attracting GST at the rate of 18 percent with no exception being carved out for solar power generation projects. This effectively renders the lower GST rate notified on devices used in setting up of a solar power plant, redundant since the overall GST rate of 18 percent needs to be applied on the contractor's billing which becomes cost for the project owner.

Recently the All India Solar Industries Association ('AISIA') made a statement that GST has led to 10-12 per cent rise in overall cost of solar projects. Such a material increase in indirect tax incidence on solar power projects would effectively make the such projects commercially unviable, especially the tax inclusive contracts continuing from pre-GST regime. This also defies the policy level intent of the government to encourage and promote renewable energy sector, particularly solar power based generation of electricity in India.

Till date, several representations have been filed by the industry to the Ministry of New and Renewable Energy ('MNRE') as well as to the GST Council seeking specification of lower GST rate in respect of supply and installation of solar power plants.

Despite rigorous representations, no relaxation has yet been announced to alleviate the serious industry wide concerns including lack of clarity on GST rate structure to be followed on contractor's billings; blockage of working capital due to high GST rate on procurements etc. Continuity of these grey areas even after close to 6 months journey of GST, will only lead to dire situations like halted execution of the projects and billing by contractors; and thereby significant lag in completion of strict time sensitive projects involving serious operational and financial implications.

In view of above consequences, it is imperative that the MNRE as well as the GST Council urgently intervene into the matter to review the applicable GST rate structure for setting up a solar power projects and set right the anomalies highlighted herein.

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Disclaimer: The views expressed herein are personal.