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Retrospective reversal of ITC for real estate sector - An 'unreal' welfare?

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"You can't build a great building on a weak foundation. You must have a solid foundation if you're going to have a strong superstructure"

- Gordon B. Hinckley



It is a universal truth that when the basics are right, everything falls in place! Without a good drawing, a beautiful painting will never emerge. The same principle applies to laws as well. Without good legislation, the law becomes ineffective. The aforesaid holds true in the light of recent amendments introduced for the real estate sector under GST.

Since the introduction of GST in India, the government has been appreciably proactive and has always endeavoured to simplify the new indirect tax regime. However, the amendments in the real estate sector effective from April 1, 2019 have been an exception and one of the most complex set of changes introduced in the GST regime till date.

While the intent of the government to reduce the rate of tax was noble, the execution has been hasty and totally unprepared. Seamless flow of credit is one of the basic tenets of the GST regime. However, Input Tax Credit ('ITC') was not allowed for supply of goods / services falling under the tax slab of 5 percent or lower such as restaurant services, canteen services etc. Recently, the real estate sector has also been added to this list. The law seems to treat such supplies as 'exempt' and accordingly warrants ITC reversal on the same. This is where the issue arises!

'Exempt': To be or not to be? - An Analysis

As per GST law, a registered person is entitled to take ITC to the extent it attributes to taxable supplies including zero-rated supplies¹. Correspondingly, ITC attributable to exempt supplies needs to be reversed in the prescribed manner². Effective April 1, 2019, ITC needs to be reversed on carpet area basis in case of construction services.

The moot question that needs to be answered is whether construction services would constitute to be an 'exempt supply' in the first place or not? As per Section 2(47) of the **Central Goods and Services Tax Act, 2017** ('CGST Act'), an exempt supply means a supply attracting nil rate of tax or wholly exempt from tax. An exempt supply also includes a non-taxable supply within its ambit i.e. a supply not leviable to tax under GST.

It is pertinent to note that the above definition only includes supply which is wholly exempt from tax. On the other hand, construction services are not wholly exempt from tax but are partly exempt. This is in contradistinction with pre-GST regime wherein the definition of 'exempted service' specifically covered service whose part of value was exempt subject to non-availment of credit. The extension in definition of 'exempted service' in pre-GST regime took place with effect from July 1, 2012; however, such services / supply does not qualify as 'exempt supply' under the GST regime.

The next relevant point for consideration is presence (or absence) of specific provision that can warrant ITC reversal validly claimed till March 31, 2019.

Section 18(4) of the CGST Act is a statutory provision that prescribes reversal of ITC where a supply becomes wholly exempt. Even this provision does not envisage a situation wherein a supply becomes partly exempt like construction services in the instant case. Thus, there is a casus omissus i.e. lack of statutory provision that can warrant reversal of ITC taken by real estate companies till March 31, 2019.

A similar controversy arose prior to GST regime as well wherein the tax authorities sought reversal of credit attributable to goods lying in stock on the day on which the taxpayer's goods became exempt. Prior to March 1, 2007, there was no statutory provision like Section 18(4) of the CGST Act mandating such reversal. The Courts consistently held that at the time when the taxpayer purchased the goods and took credit, it was valid. A subsequent exemption granted to such goods will not make such credit invalid. The Courts relied on the case of Collector of Central Excise v. Dai Ichi Karkaria Limited, - **2002-TIOL-79-SC-CX-LB** wherein the Supreme Court held that credit is indefeasible and in absence of any provision providing for reversal of credit, the authorities cannot demand reversal of credits.

Conclusion

The reversal of ITC in case of construction services can be triggered only when the statute contains a specific provision to that effect. In the instant case as well, a statutory provision dealing with reversal of ITC in respect of partly exempt supply is conspicuously missing. The above discussion holds true with regard to ITC already availed by real estate companies prior to April 1, 2019 and can be successfully challenged before the Courts.

In view of the authors, the proposed mechanism seeking reversal of ITC on procurements made by construction companies till March 31, 2019, cannot be enforced. However, prospectively, Section 11 of the CGST Act and Section 6 of the IGST Act empower the government to grant full or part exemption subject to conditions, one of which can be ITC reversal. Thus, going forward, non-availability of ITC on procurements post April 1, 2019 is valid.

The government has been quite good in making things smooth for the taxpayers in recent times. However, looking at this basic loophole, it can safely be said that too much of a good thing can be 'tax'ing!

(Article co-authored by Ashutosh Mishra, Associate, NITYA Tax Associates. The views expressed are strictly personal.)

¹Section 17(2) of the **Central Goods and Services Tax Act, 2017**.

²Rule 42 and Rule 43 of the **Central Goods and Services Tax Rules, 2017**.



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