White Paper:

An Analysis of GST Implications on Infrastructure Sector in India

21 April 2020

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White Paper

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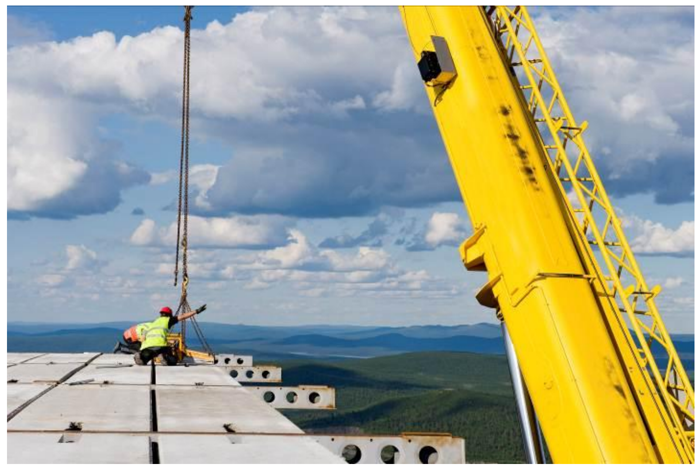
1.0 Introduction:



The infrastructure sector is considered as one of the most focused area of the government. It is considered as the backbone of the Indian economy. The government of India has projected an investment of Rs. 100 Lakh Crores in the infrastructure sector over next 5 years which is also expected to revive growth and employment. The increasing impetus in the infrastructure sector not only paves the way for the development of the said sector but for the growth and development of the entire nation. Moreover, it also enables in contributing to the global economy by way of attracting foreign investment. Increasing incentive and schemes to the infrastructure in the county are attracting both domestic and global players which in turn facilitate flow of private and foreign investments. The infrastructure sectors consist of various sub-sectors. Some of the sub-sectors are listed below:

a) Transport- Roads and Highways
b) Social & Commercial infrastructure
c) Electrical Energy / Electricity - Generation, Transmission and Distribution
d) Logistics and warehousing
e) Water sanitation and urban waste management
f) Infrastructure investment funds

In this white paper, we seek to provide an overview of the governing regulations under Goods and Services Tax (GST) Act on the following vital verticals of the infrastructure sector:

1) Transport- Roads and Highways
2) Electrical Energy / Electricity - Generation, Transmission and Distribution
3) Logistics and warehousing

Apart from above, highlights with respect to vital key issues under infrastructure sectors are also covered in this white paper.

2.0 Transport- Roads and Highways

For Public Infrastructure projects such as the construction of road, highways, etc., the Government enters Public-Private Partnership (PPP) financial models. The public partner is represented by the government at a local, state and/or national level and the private partner can be a privately-owned business, public corporation or association of businesses with a specific area of expertise.

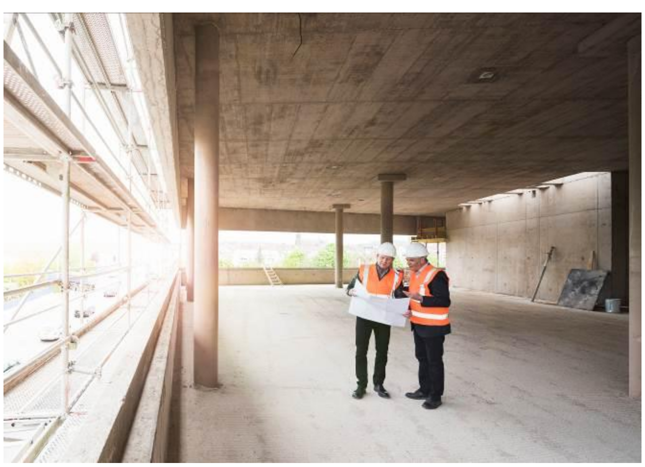
There are various PPP models in the construction Industry. However, the most popular PPP models for construction of roads and highways are as under:

- BOT-Toll Revenue Model
- Engineering Procurement & Commissioning (EPC contract)
- Hybrid Annuity Model ('HAM' which is a combination of EPC + Annuity Model)

Construction of roads, highways, etc are generally considered as works contract. Further, as per the provisions of GST Act, 2017, the Works Contracts has been defined in Section 2(119) of the CGST Act, 2017 as "works contract" means a contract for building, construction, fabrication, completion, erection, installation, fitting out, improvement, modification, repair, maintenance, renovation, alteration or commissioning of any immovable property wherein transfer of property in goods (whether as goods or in some other form) is involved in the execution of such contract.

Under GST laws, the definition of "Works Contract" has been restricted to any work undertaken for an Immovable Property only.

2.1 BOT-Toll Revenue Model



Under the toll revenue model, a concession agreement is entered between a government entity (SPV) & Concessionaire. The concessionaire has been entrusted to construct, operate & maintain the project.

In simple terms, in this model, a road developer constructs the road and he is allowed to recover his investment through **toll collection**. This toll collection will be over a long period which is nearly 30 years in most cases. There is no government payment to the developer as the developer earns his money invested from tolls.

2.1.1 Taxability under the model:

Service provided by concessionaire by way of access to a road or a bridge would be an exempt service as per exemption notification.

It is prudent to examine the fact whether above exemption may be denied by the departmental authorities as the contract may be considered as composite supply of works contract which is liable to GST and may not view the same as service provided by way of access to roads or bridge.

2.1.2 Input Tax Credit (ITC) under this model:

As per Section 17(5)(d) of the CGST Act, 2017, the input tax credit shall not be available for goods or services or both received by a taxable person for construction of an immovable property (other than plant or machinery) on his own account. Under such model, it cannot be said to be procuring goods or services on its own account for construction and therefore ITC shall be available subject to the condition that the concessionaire/contractor has provided taxable output services.

2.2 Engineering, Procurement and Construction Contract (EPC contracts)

Under EPC Contract, the EPC contractor is made responsible for all activities from design, procurement, construction, commissioning and handover of the project to SPV or the owner.

2.2.1 Taxability under the model:

As per Para 6 (a) of Schedule II to the CGST Act, 2017, works contracts as defined under CGST Act, 2017 shall be treated as a supply of services.

Rate of GST on works contract services relating to the construction of roads and bridges for use by general public shall be as under:

- 12% (6% CGST and 6% SGST)
- 5% (2.5% CGST and 2.5% SGST) depending on the earthwork (75%) when provided to governments subject to conditions specified therein.

2.2.2 Input Tax Credit (ITC) under this model:

In case of EPC contract, as the EPC contractor is not constructing road on his own account and hence, he shall be eligible to avail ITC for goods and services used for the construction of road and would not be covered section 17(5)(d) of the CGST Act, 2017.

However, it may be noted that Government entity / SPV shall not be eligible to claim ITC for GST charged by EPC Contractor.

2.3 Hybrid Annuity Model ('HAM' which is a combination of EPC + Annuity Model)

Generally, HAM is a mix of EPC Contracts and BOT Annuity Model. Under this model, the contractor agrees to deliver the project for a guaranteed price from SPV which will be received partly during the construction phase and partly during the Operation and Maintenance (O&M) phase.

2.3.1 Taxability under the model:

During **Construction phase**, the transaction between the parties would be Works contract services to the extent the consideration is received during this phase. The taxability would be similar as discussed under EPC contract mentioned above in point 2.2.

Consideration received during **O&M phase** by way of annuity payments would be treated as service provided by concessionaire by way of access to road or bridge which is exempt from GST. This is a general view which is taken by the industry which needs to be examined keeping in mind the recommendation provided by GST council in 22nd Council meeting.

2.3.2 Input Tax Credit (ITC) under this model:

As per provisions of Section 17(2) read with Rule 42 of the CGST Rules. 2017, where goods or services are used for effecting taxable as well as exempt supplies i.e. Annuity payments received, Input Tax Credit shall be restricted to Input Tax Credit attributable to taxable supplies only.

3.0 Electrical Energy / Electricity - Generation, Transmission and Distribution

3.1 Thermal Power Plant

3.1.1 Taxability:

- Supply of Electricity is exempt under GST law.
- The construction/expansion of thermal power plant would be works contract services provided by contractor to power generating companies which are taxable at 18% under GST.
- Transmission or distribution of electricity by an electricity transmission or distribution company is exempt.

3.1.2 Input Tax Credit (ITC)

- As electricity is exempt from GST, GST paid on the inputs (goods or services) procured will be cost to the power generating company.

- However, where the contracts are vivisected for setting up/installation, in such cases, the restriction on eligibility of ITC in case of plant and machinery may not be applicable especially in case of captive power plant dedicated to manufacturing facility.

3.2 Solar Power Plant

3.2.1 Taxability:

- The solar power generating system and Photo voltaic cells are taxable at 5% under GST law.

- Taxability incase of a contract for construction of solar power plant as notified by CBIC viz notification 24/2018-CT (Rate) Dt. 31-12-2018 is as under:

Nature of Service	Quantum of goods and services	Taxability
Construction of Solar power Plant	70% Goods	5%
	30% Services	18%

3.2.2 Input Tax Credit (ITC)

The ITC eligibility would be similar to ITC under thermal power plant as mentioned in point 3.2.

4.0 Warehousing

4.1 Taxability:

- The construction of warehouse is generally in the nature of Composite supply of works contract services taxable at 18%.

- Warehousing services are generally in the nature of composite supplies which consists of various other services such as pest control services, fumigation services, security services etc. taxable 18% with principal supply (defined under section 2(30) of the CGST Act, 2017) as supply of warehousing services.

- Warehousing service provided for certain products such as rice, agriculture produce, pulses, fruits are exempted from GST.

4.2 <u>Input Tax Credit (ITC)</u>

The warehouse owner would not be eligible to avail ITC towards construction of warehouse as the goods or services are procured for construction on his own account which does not result in plant and machinery.

5.0 Logistics:

5.1 Roadways:

- Transportation of goods by Goods Transport Agency (GTA) is taxable at 5% under reverse charge or 12% under forward charge.

- Transportation of goods other than by GTA or courier agency is exempt from GST.

- Transportation of passengers by non air conditioned contract carriage, metered cab, auto rickshaws etc. is exempt from GST. (Other than radio taxi).

- Renting of motor vehicles services for transportation of passengers where cost of the fuel forms part of consideration were taxable at 5% (forward charge)with restrictions in claiming input tax credit or at 12% (forward charge) with no restrictions in claiming input tax credit till 30th September 2019.

- From 01st October 2019, the services by way of renting of motor vehicles designed to carry passengers is covered under reverse charge mechanism through notification 22/2019-Central tax dated 30.09.2019. The entry in the said notification was substituted by issuing notification 29/2019 – Central tax dated 31.12.2019 retrospectively applicable from 01st October 2019. The entry reads as follows:

Category of supply of services	Supplier of Service	Recipient of service
Services provided by way of renting of any motor vehicle designed to carry passengers where the cost of fuel is included in the consideration charged from the service recipient provided to a body corporate	Any person, other than a body corporate who supplies the service to a body corporate and does not issue an invoice charging central tax at the rate of 6 per cent to the service recipient	Any body corporate located in taxable territory.

- Therefore, if the services are provided by any person to body corporate in taxable territory, who do not issue tax invoice levying GST @12%, in such cases the recipient i.e. body corporate in taxable territory is liable to pay tax under reverse charge mechanism.

5.2 Airways:

- Transportation of goods is taxed at 18% for transportation within India.

- Service by way of transportation of goods by aircraft from place outside India to custom station of clearance in India is exempt from GST. Transportation from custom station in India to place outside India is also exempt from GST till 30th September 2020.

- Transportation services for passengers embarking from or terminating to specified NE states are exempt.

- Other services relating to transportation of passengers are taxable at 5%, 12% or 18% as specified in the notification.

5.3 Railways:

- Transportation of goods by India Railways are taxable at 5%. For transportation other than by Indian Railways are taxable at 12% or 18% as specified in the notification.

- Transportation of goods within India for specified goods such as relief materials for victims of natural disaster, agriculture produce; defense materials etc. specified in the notification is exempt from tax.

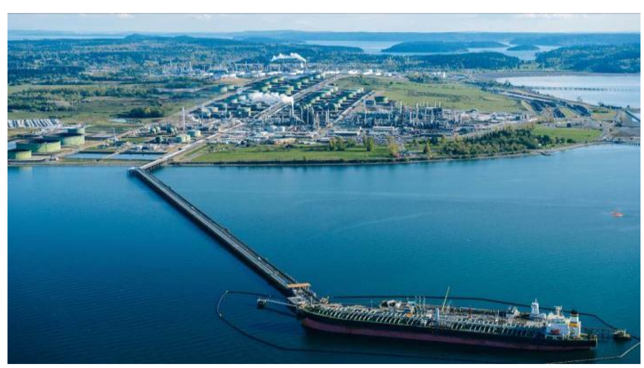
- Transportation of passengers in class other than first class or air- conditioner coach or by metro, mono rails, or tramway is exempt from GST.

5.4 Waterways:

- Movements of goods by vessel are taxable at 5% under GST laws.

- Exemption is provided for transport of goods by vessel from custom station in India to place outside India is applicable till 30th September 2020.

- Transportation of goods by vessel within India for specified goods such as relief



materials for victims of natural disaster, agriculture produce; defense materials etc. specified in the notification is exempt from GST.

5.5 Input Tax Credit (ITC)

As per provisions of Section 17(2) read with Rule 42 of the CGST Rules. 2017, where goods or services are used for effecting taxable as well as exempt supplies, Input Tax Credit shall be restricted to Input Tax Credit attributable to taxable supplies only.

6.0 Key Issues under Infrastructure Sector in recent times

6.1 Deduction of land value – Deemed value and not the actual value

- In order to determine value of supply of construction services which includes transfer of land or undivided share in the land, the law provides that the value of land shall be deemed to be one-third of the total amount charged.
- The law does not provide to deduct actual value of land thereby making actual value irrelevant.

6.2 Anti-Profiteering

- The contractors having long term contracts which are 'on going' as on 1st July 2017 will need to look in to their costing from scratch to ensure that the benefits on account of reduction in cost is passed on to the customers.

6.3 Reversal of ITC if vendor is not paid within 180 days:

- In cases of contracts where there is long gestation period and where the credit period agreed between the supplier and recipient as per the terms is more than 180 days, the restriction on account of payment towards supply to be made within 180 days for claiming Input Tax Credit is forcing businesses to make the payment within 180 days.
- If not paid within the said period, the ITC claimed to be reversed along with interest. The said ITC reversed can be claimed after making the payment resulting interest paid to be the cost to the company.

6.4 Benefit of zero rating to the sub-contractors of contractors supplying to SEZ.

- The benefit of zero rated supplies available to the main contractor supplying goods or services to SEZ unit or developer are not available to sub-contractors supplying goods or services to such contractor.

- This results in blockage of funds/working capital for the contractor.

6.5 Deferment of ITC eligibility of GST paid on advances

- As per the provisions of time of supplies, GST needs to be discharged on receipt of advances, though there will no supply of goods or services at that point of time.

- One of the vital conditions for claiming ITC is the receipt of goods or services. Hence the supplier is paying GST on advances while the recipient has to defer ITC till the receipt of goods or services. This again results in blockage of funds/working capital.

7.0 Conclusion:

Though GST has removed the multiplicity of taxes unlike erstwhile laws wherein service tax and VAT both were levied in transactions relating to works contract activities, it has resulted in waiver of certain exemptions/abatements which were available under the erstwhile laws. It has been almost 3 years since the implementation of GST but there are still some uncertainties, ambiguities which are not yet clarified by the government resulting in facing of hardships by the sector. The growth of the economy is directly proportional to the growth of the infrastructure. The government should discover the challenging areas and must come out with resolutions or relaxations on the issues faced by the sector so that there would be more opportunities rather than challenges.

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