Reversal of credit as per rule 42 for ongoing real estate projects

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The real estate sector has seen a mass change in the provisions under GST from 1st Apr '19, be it relating to the taxability or the input tax credit. In this article we would be discussing the provisions relating to input tax credit. From 1st Jul '17 to 31st Mar '19, the provisions relating to credit for this sector (including for any other sector) were something similar to the provisions contained under the CENVAT Credit Rules, 2004 wherein the common credit was required to be proportioned to the extent of the taxable revenue, which only would be an eligible credit.

Provisions prior to 1st Apr '19

All the units in respect of which amounts are received from customers before the **project completion** (i.e. receipt of completion certificate or first occupation, whichever is earlier) would be considered as **taxable units** i.e. amounts received towards their sale would be liable to GST. Amounts received in respect of the other units are considered as those that are not liable to tax and thereby requiring reversal of credit in terms of section 17(3) of the CGST Act, 2017 (referred to as Act).

The flaw with this credit reversal mechanism was that

a. During the initial phases of the project before completion, huge amount of expenses are incurred commonly for the entire structure which consists of the taxable and the exempt units. At this time, there is no exempt revenue whereby entire credit becomes eligible.
b. After the project is completed also there are taxable receipts, which only diminish as the expenses in the project diminish thereby leading to a sizable amount of credit being availed at such point of time also.
c. The units that were never sold, never get considered towards the credit reversal as there is no revenue recognised in the books in this regard to take part in the credit reversal calculation.

All the above cumulatively led to availing more credit than what would be eligible.

Credit reversal provisions from 1st Apr '19

Due to the above, the Government was losing a lot of revenue in terms of the huge credits being availed by this sector which was not in proportion to the exempt revenue or area in the project, when considered as a whole. Thereby, while attempting to rationalise the rate of tax for this sector, amendments were also made to the credit provisions contained in rule 42 and 43 of the CGST Rules, 2017 (referred to as Rules).

As per the amended provisions of rule 42, which are effective from 1st Apr '19, all credits relating to the project are to be considered as common credit and the monthly reversal is to be computed which would be in proportion to the carpet area (and not revenue) of the units that are exempt or identified to be sold after completion (say for example the mortgaged units). Then, finally on project completion the said reversal is to be re-calculated which would be in proportion to the carpet area of the units that actually remain unsold. This provision would ensure that the credit availed by this sector is more representative of the credit attributable to the units sold in respect of which tax is being paid by the assessee.

Issues in the above provision

Past credits of projects that have not attained completion

The said provision states that the credit reversal in respect of a project is to be done before the month of September following the end of the financial year in which the project completion is attained. Further, the project credit **from 1st Jul '17** till the project completion has to be taken to compute this reversal.

The first question arising from the above is, whether a provision which is effective from 1st Apr '19 can require re-computation of any credit that has already been availed by the assessee? That is, whether the credit availed during say FY 2017-18 and 2018-19 (assuming the project completion is attained during FY 19-20), is actually required to be considered for reversal as per the new provisions effective from 1st Apr '19?

No, in light of the decision of the Supreme Court in the case of Collector Of Central Excise, Pune Versus Dai Ichi Karkaria Ltd. 1999 (112) E.L.T. 353 (S.C.) where it held that the credit once availed is indefeasible more so when there is no provision in the law for reversal unless credit has been taken illegally or irregularly. Thereby, in the present scenario as well, before 1st Apr '19, the credit which was availed by the promoter in respect of a project that has not attained completion, the intention being to use the goods/services for taxable supplies, is an eligible credit in terms of section 16(1) (assuming all the other conditions u/s 16(2) are fulfilled) and does not fall under the ambit of section 17(2) and rule 42. Similar was held by the Gujarat High Court in the case of Principal *Commissioner* v. *Alembic Limited*, 2019-TIOL-1495-HC-AHM-ST, though in the context of the earlier laws.

A subsequent change in the provisions cannot defeat such credit that has been validly availed earlier. Further, the provision under rule 42(3) requires re-calculation of the final amount that is to be reversed in the project which has attained completion, by considering the credit ascertained under rule 42(1). In this regard, as discussed in the above paragraph, the credit availed for the project in the FY 2017-18 and 2018-19 were not in terms of rule 42, whereby the newly inserted provision rule 42(3) will not be applicable for such credits availed earlier.

Hence it can be said that only the credit that is being availed from 1st Apr '19 is required to be considered for the reversal as per rule 42(3) *ibid* for the projects that have not attained completion before 1st Apr '19.

Say for example
The credit availed during FY 2017-18 and FY 2018-19 is Rs. 1.5 crores in total.
Completion certification (CC) received during Jul '19.
Proportion of carpet area of units unsold as on the date of CC = 30%
Credit availed from Apr '19 to Jul '19 = Rs. 10 lakhs
No reversal of credit required w.r.t. Rs. 1.5 crores availed prior to 1st Apr '19.
Credit availed from Apr '19 to Jul '19 of Rs. 10 lakhs to the extent of 30% i.e. Rs. 3 lakhs, is to be reversed.

Credit reversal to be as per revenue or carpet area, for period prior to 1st Apr '19
Say, in respect of a project which has attained completion in the FY 2018-19, the assessee does the final credit reversal in terms of rule 42(2), which is to be done before the due date of Sep '19 return, whether such reversal is to be done on the basis of the revenue during the FY 2018-19 or on the basis of the carpet area of the exempt units in the project?

Since this reversal is to be done as per the provisions contained in the law before 1st Apr '19 (the date on which the provisions of rule 42(2) were amended and rule 42(3) was inserted requiring final reversal to be done on carpet area basis) such reversal is to be done on the basis of the exempt revenue booked during FY 2018-19 and not on the basis of the carpet area of the exempt units.

Thereby, if an assessee, being conservative opts to reverse credit availed right from 1st Jul '17, for the project which has attained completion during FY 2018-19, such reversal will have to be done on the basis of the **exempt revenue** in the project and not on the basis of the carpet area of the exempt units.

Say for example

The credit availed during FY 2018-19 is Rs. 1 crores in total.
Completion certification (CC) received during Dec ’18.
Proportion of exempt revenue as per returns during 18-19 is 20%, whereas carpet area of unsold units as on completion is 40%.
Credit to be reversed for FY 2018-19 = Rs. 20 lakhs (on the basis of revenue and not on carpet area).

Thereby, even though the provisions have changed from 1st Apr ’19, the credit reversal for the transitioning projects would still be majorly as per the provisions contained prior to such date. This could be disputed by the department and thereby a suitable intimation can be made to the department regarding the credit reversal methodology.

For any further queries/comments please write to shilpijain@hiregnage.com.

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