

## Impact of notification No. 46/2017 Central Tax (Rate) for restaurant services

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**Introduction:** Initially, restaurant services were liable to 18% GST. Subsequently, at the 23<sup>rd</sup> GST Council meeting on 10.11.2017 held at Guwahati, it was recommended that all standalone restaurants, irrespective of whether air conditioned or not, will attract 5% GST without ITC. To give effect to such decision, a notification No. 46/2017- Central Tax (Rate) dated 15.11.2017 was issued, as per which the GST rate applicable to services provided by restaurants, eating joint including mess, canteens etc. was reduced to 5% subject to a condition that input tax charged on goods and services used in supplying the service has not been taken (hereinafter referred as 'ITC condition').

Thereby, with respect to inputs which are used for making restaurant, etc. supplies @5%, reversal is required to be done in terms of rule 42 of the CGST Rules, 2017 (hereinafter referred to as the 'Rules'). However, credit with respect to capital goods which are used for affecting such supplies, whether any reversal of credit is required? In this article, we have attempted to answer this question.

### Discussion on relevant provisions of CGST Act:

Section 18(4) of CGST Act, 2017 (hereinafter referred to as the 'Act') provides that

*“Where any registered person who has availed of input tax credit opts to pay tax under section 10 or, where the goods or services or both supplied by him become wholly exempt, he shall pay an amount, by way of debit in the electronic credit ledger or electronic cash ledger,*

*equivalent to the credit of input tax in respect of inputs held in stock and inputs contained in semi-finished or finished goods held in stock and on capital goods, reduced by such percentage points as may be prescribed, on the day immediately preceding the date of exercising of such option or, as the case may be, the date of such exemption:  
Provided that after payment of such amount, the balance of input tax credit, if any, lying in his electronic credit ledger shall lapse.”*

In this case, the tax rate for restaurant service has been reduced from 18% to 5%. Let us analyse whether such reduction in rate (with ITC restriction) would be considered as exempt or not.

#### **Analysis of the Notification**

In terms of explanation (iv)(b) in para 4 to notification No. 11/2017 *ibid*, where a rate has been prescribed in the notification subject to the condition that ITC on goods or services used for supplying such services has not been taken, it shall mean that

- i. ITC on goods or services used exclusively in providing such service has not been taken.
- ii. ITC on goods or services used partly for providing such services and other services eligible for credit shall be reversed as if supply of such service is an **exempt supply** and attracts the provision of section 17(2) of the Act.

Section 17(2) of the Act, requires reversal of ITC in terms of rule 42/43 of the Rules in case when goods/services are used commonly for effecting both taxable and exempt supplies. Thereby, it can be said that the change in rate of tax w.r.t. restaurant service falls under the purview of section 18(4) and reversal of ITC is required which shall be done in terms of section 17(2) of CGST Act read with rule 43 of the Rules.

From the above explanation in the notification read with section 17(2) of the Act, it can be said that in case of restaurant service being taxed @ 5% from 15.11.2017 (which is considered as an exempt supply), ITC of inputs held in stock, WIP and finished goods, needs to be reversed/paid as per rule 42 of the Rules. Further, ITC on capital goods also needs to be reversed/paid as per rule 43 of the Rules. The ITC to be considered for such reversal would be ITC (of capital good) as reduced by 5% points per quarter or part thereof, from the date of issue of invoice for such goods till the date the supplies become exempt.

#### **ITC reversal w.r.t. capital goods**

Therefore, for the month of **Nov '17** (as notification is w.e.f 15.11.2017) compute the reversal as follows (**for capital goods purchased prior to 15.11.2017**):

- i. **ITC to be reversed** =  $(\text{ITC on capital goods}/60) * (\text{Turnover of Nov '17 on which ITC is eligible}) / (\text{Total Turnover of Nov '17})$

Where:

- a. **ITC on capital goods/60** - This indicates the monthly ITC with respect to the capital goods in question. The useful life of the asset is taken as 5 years as per the said rule.
- b. **Turnover on which ITC is not eligible** - Restaurant sales on which GST is paid @ 5% in the month of Nov '17.
- c. **Turnover on which ITC is eligible** – Restaurant sales on which GST is paid @ 18% in the month of Nov '17

Further, from Dec '17 onwards, ITC pertaining to the remaining useful life of the above referred assets shall be reversed if used only for providing 5% restaurant services. If used commonly for taxable and exempt supplies then reversal to be done as per rule 43 of the Rules.

**Eg:** If the asset was purchased on Aug '17. As per law, the useful life of the asset is taken as 60 months. So, in Dec '17 the remaining useful life of the asset would be 56 months. Therefore,

**ITC to be reversed = ITC on capital goods/60 \*56**

- ii. Further, from 15.11.2017, with respect to the capital goods purchased and used completely for 5% restaurant service, ITC pertaining to the remaining useful life of the asset shall not be availed as used exclusively for exempt supplies.

There could be three possible cases which are as follows:

**Case-I:** XYZ Ltd engaged in the restaurant business has purchased capital goods being furniture, kitchen equipment, air conditioners, etc. to be used in the restaurant, in the month of Aug '17 and claimed ITC of Rs.50 Lakhs and utilized Rs.10 lakhs up to Nov '17 w.r.t such capital goods. In this case, whether any reversal of ITC availed on capital goods is required, as XYZ Ltd opted to pay GST @5%. If yes, what is the amount of ITC that needs to be reversed?

**Answer:** ITC in respect of such goods i.e. goods that are used for supplying restaurant services liable to GST @5% shall be reversed, as if they are used for providing both exempt and taxable supplies and reversal of credit shall be done in terms of section 17(2) of CGST Act read with rule 43 of the CGST Rules, 2017 (as discussed in previous section of article).

**Case-II:** XYZ Ltd purchased a capital asset prior to July, 2017 (pre-GST) which is used in restaurant charging 5% GST, and credit on such asset has not been carried forward in Tran-1. In this case, whether any reversal of credit is required?

**Answer:** Input tax credit as defined in section 2(62) the Act means credit of CGST, SGST, IGST or UTGST charged on any supply of goods or services made.

In this case, as no credit has been carried forward in Tran-1, no ITC has been availed under GST. Therefore, reversal of credit is not required.

**Case-III:** XYZ Ltd purchased a capital asset prior to July, 2017 (pre-GST), and credit availed on such asset has been carried forward in Tran-1. In this case, whether any reversal of credit is required?

**Answer:** As discussed in above case, ITC includes only CGST, SGST, IGST or UTGST charged and it doesn't include CENVAT credit. Therefore, no reversal of ITC is required. However, this view could be disputed by the department as unutilized CENVAT credit has been carry forwarded as CGST/SGST. Therefore, reversal of credit would be required

- ❖ Further, in later months i.e. from Dec '17 with respect to the capital goods used completely for 5% restaurant service, XYZ Ltd shall reverse the ITC pertaining to the remaining useful life of the asset. Here, a doubt arises as to how to calculate to the remaining useful life. Whether it should be calculated from July, 2017 as if such asset was purchased in July or the original date of purchase of asset which could be in pre-GST regime?
- ❖ Clause (c) of Rule 43 of Rules, states that the useful life of the asset shall be taken as five years from the **date of invoice** of such asset. Therefore, the useful life shall be calculated from the original date of purchase of asset.

### **Conclusion**

From the above we can conclude that ITC on capital goods which are used for providing restaurant services liable @ 5%, even if purchased prior to 15.11.2017, needs to be reversed as per rule 43 of the Rules by considering such service as exempt in terms of section 17(2) of the Act. Therefore, it is advisable to reverse the credit pertaining to period from 15.11.2017 along with interest, if applicable, if not reversed earlier.

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