

GST rate increase for Government projects (works contracts) – impact & way forward:

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Introduction & Background:

Construction industry plays an important role in the development of any country. It is a large sector of Economy of about Rs. 37 lakh crores (as per national accounts statistics, 2019-20). The construction industry in India consists of the Real estate as well as the infrastructure development segment. The Real estate segment consists of construction of residential & office etc. And the infrastructure development segment consists of government contracts such as irrigation contract, water supply, sanitation, and roads etc. Government of India been consistently allocating substantial portion of budget towards the infrastructure development.

Owing to the inherent style of awarding the contracts by the Government, such contracts are termed as 'works contract' under tax laws generally. In pre-GST regime, most of them are exempted from service tax and taxed under VAT with composition rates (around 5% without ITC). After GST, the exemptions were discontinued and common rate of 18% with full ITC was brought out. Due to sudden transition to GST, there was requests for rate reduction since most of the contracts were awarded before GST factoring tax component of 5% only and 18% rate is causing extra cash outflow even after ITC adjustment. Accordingly, the rates were slashed down to 12% for most of the Government works with full ITC.

W.e.f. 01.01.2022¹, the GST rates were increased from 12% to 18% wherever the works are awarded by Government entity or Government authority. The rates were unchanged if the same works are awarded by Government department or local authority directly².

The change:

Recently, GST council in its 47th Council meeting has recommended for rate increase to 18% for all Government works³ which was followed by issuance of Notification No. 03/2022-C.T (R) dated 13.07.2022.

Works contract involving construction, erection, commissioning, installation, completion, fitting out, repair, maintenance, renovation, or alteration of following⁴ rendered to Government or Local authority are earlier taxed at 12% and now increased to 18%

- Historical monuments, archaeological site or remains of national importance, archaeological excavation, or antiquity
- Canals, dams or other irrigation works
- Pipelines, conduit or plants for water supply, water treatment or sewerage treatment or disposal
- Civil structure or any other original works meant predominantly for use other than for commerce, industry, or any other business or profession;

¹ Notification No. 22/2021-C.T (R) dated 31.12.2021

² If works related to railways, Roads, Bridge etc., no change was there in January 2022 and 12% rate was continued at that time

³ Works involving pre-dominantly earthworks are increased from 5% to 12%

⁴ Do not represent the exact words of notification and presented for brevity. Readers may note that there were slight differences in nature of work or recipient to claim the concessional rates before this change.

- a structure meant predominantly for use as (i) an educational, (ii) a clinical, or (iii) an art or cultural establishment; or
- a residential complex meant predominantly for self-use or the use of their employees or other persons (MP's, MLA's etc.,)

The following works contracts were taxed at 12% (now increased to 18%) irrespective of the recipient status (whether Government or private parties)

- Road, bridge, tunnel, or terminal for road transportation for use by general public
- Various structures constructed under Housing schemes of Government
- Pollution control or effluent treatment plant, except located as a part of a factory
- Structure meant for funeral, burial or cremation of deceased
- Building owned by an entity registered u/s. 12AA or 12AB of the Income Tax Act, 1961 & used for carrying out the providing, centralised cooking or distribution, for mid-day meals under the mid-day meal scheme sponsored by the Government/local authorities
- Railways, including monorail and metro
- Single residential unit (other than part of complex)
- Low-cost houses approved under housing schemes
- Post-harvest storage infrastructure for agricultural produce including a cold storage for such purposes; or
- Mechanised food grain handling system, machinery or equipment for units processing agricultural produce as food stuff excluding alcoholic beverages.

The aforesaid concessional rate of 12% was made available to immediate sub-contractor and the successive sub-contractor's fate is in disputes as of now.

The works involving predominantly earthwork and sub-contract thereof is taxed at 5% hitherto and now increased to 12%.

Reasons for rate increase (as per Government)

One may wonder that the rate increase is ultimately must be reimbursed by the Government only, then what is the logic in increase the tax rates & reimbursing it which do not give any extra revenue to the Government. Despite this revenue neutral situation, following are the reasons stated for rate increase:

- ✓ Concessional rates leading to inversion which in turn causing the ITC accumulation which is non-refundable & would become cost.
- ✓ The ITC accumulation encouraging fake invoicing (which will be used to pass on such ITC to someone else)
- ✓ Cropping up the disputes over the eligibility of concessional rates
- ✓ The initial idea is only to have common rate of 18% and only to accommodate for temporary period, the rates were slashed to 12%/5%
- ✓ Rate increase & facility of ITC full knock off encourages tax paid procurements

Old rate v. New rates for Ongoing works:

The new rate is effective from 18.07.2022 thereby it is essential to arrive when the new rate would apply to the ongoing works. For this, the Section 14 of CGST Act, 2017 shall be resorted. The brief impact of the sec. 14 is tabulated below:

Scenarios	Supply completion date	Invoice raised on	Payment received on	Tax rate
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A	05.07.2022	20.07.2022	25.07.2022	18%
B	05.07.2022	12.07.2022	20.07.2022	12%
C	05.07.2022	20.07.2022	12.07.2022	12%
D	20.07.2022	15.07.2022	22.07.2022	18%
E	20.07.2022	15.07.2022	16.07.2022	12%
F	20.07.2022	22.07.2022	16.07.2022	18%

The basic logic of the above section is that occurrence of 2 out of 3 events would decide the application of old or new rates.

Impact of the above changes on the existing contracts

The immediate impact would be on the ongoing works since no relaxation from rate increase was given for the same. To claim increased portion of 6% GST, the clauses of the agreement play a vital role. It is to be noted that *albeit* GST is indirect tax which ideally must be paid by the Supplier after collecting from the customer, but it is settled that the parties can agree for bearing or shifting the incidence to one another i.e. the parties by contract can fix the liability on any one between them as held by the Hon'ble SC in case of **Rashtriya Ispat Nigam Ltd. vs. Dewan Chand Ram Saran 2012 (26) STR 289 (S.C.)** *"The provisions concerning service tax are relevant only as between the appellant as an assessee under the statute and the tax authorities. This statutory provision can be of no relevance to determine the rights and liabilities between the appellant and the respondent as agreed in the contract between two of them. There was nothing in law to prevent the appellant from entering into an agreement with the respondent handling contractor that the burden of any tax arising out of obligations of the respondent under the contract would be borne by the respondent."*

Thus, the terms of contract will have final word on the reimbursement or collection of GST from the Contractee and.

Accordingly, the possible scenarios and the course of action to be taken is tabulated below:

Sl.No	Price agreed	Course of action
1	Exclusive of GST	The additional claim of 6% GST can be claimed with pre-intimation
2	Exclusive of GST @12%	Since the parties intended to make GST liability over & above the base price, claim can be made for additional GST 6% subject to the language of other clauses of the agreement
3	Inclusive of GST	Plainly the contractor may have to bear the burden since price was agreed to inclusive of GST. However, the rate increase may not be the legitimate expectation or the <i>consensus ad idem</i> of parties to the contract is only for inclusion of GST @ 12%, one may attempt to ask for 6% claim additionally.
4	Inclusive of GST 12%	Since the 12% liability was only intended to be included, one can claim additional GST 6%
5	Inclusive of GST but with clause for price revision	Since the price is inclusive of GST but facility to price revision is permitted, the other clauses of the agreement play vital role in asking for upward revision considering the GST rate increase

It may be noted that in case any portion of ITC becoming cost prior to 18.07.2022 would change the dynamics & financial impact of the rate change would vary from absolute of 6% claim.

It is also important to note that section 64A of Sale of goods Act, 1930 specifies that any rate increase or decrease shall be added thereby can be collected additionally from the customers. However, this is subject to the terms of contract agreed and moreover the section application was limited to the sale/purchase of goods. Therefore, wherever the claim for reimbursement of increased portion of GST is being made, conjoint reading of the clauses of the agreement and also the effect of Section 64A, *ibid* shall be seen.

Further course of action for ongoing works:

The construction contracts are generally long term contracts, where the prices are locked and sudden change in rate of tax will contribute to delay in execution of majority works.

The further course of action for existing contracts can be as follows –

- Making application for incremental claim of GST with the concerned authorities – Existing contractors may look at the option of making representation with the concerned authorities such as PWD, NHAI or local authorities, explaining them the adverse impact of the change in rate of tax and amount of claim which will be needed to cop-up with the change in tax rate.
- Requesting concerned authorities to insert the change in law clause in the agreement if same is not present – It is advisable to request the concerned authorities who have awarded the contract to insert the change in law clause in the agreement so as to hedge against the unseen changes in law. Though there may be a reluctance on the part of authorities to modify the agreement but same is necessary.
- Sub-contractors to get the agreements modified accordingly with main contractors – Many a times, it can be seen that, a contractor who has been allotted a contract, will sub-contract the same to another contractor. In such cases, the principal contractor may be enjoying the benefit of the ‘change in rate of tax clause’ but his agreement with the sub-contractor may not be that accommodating. The agreement of main contractor with the sub-contractor, many a times contain a clause that any burden due to change in rate of tax will not be provided by the main contractor to the sub-contractor. Proper arrangements should be made by the sub-contractor with the principal contractors to ensure that change in rate of tax benefit will flow to the sub-contractor.

Course of action for prospective contracts

Though it's been five years since the inception of GST but still it cannot be said that the GST law has achieved stability from the point of view of taxability or collection. Therefore, it is important for contractors to be always ready with dynamic changes which may come in future. To cop-up with the ‘Trial & Error phase of GST’ following safeguards can be exercised –

- Entering into Government contracts with Ex-Tax prices i.e. contract should be priced in such a way that the applicable rate of taxes would be applied as a % on the contract value to arrive at final amount.
- Insertion of clause of change in rate of tax – If the agreement does not authorize for Ex-Tax price, then at least a clause should be inserted to accommodate the changes in the rates of tax so that the increase in GST rate will not pinch the pockets of the contractors.

- Many a times, it can also be seen that local authorities or PSU Banks who has assigned the contract are willing to extend the contract price so as to accommodate the change in rate of tax but same is not supported due to shortage or restrictions of funds from the government. Necessary steps such as written communications with the concerned department is needed so as to mitigate such kinds of incidents.

Above all, it is also worth making recommendation to the GST council for extending the earlier concessional rates to the existing/ongoing works as on 18.07.2022 to avoid various practical difficulties in claiming the additional GST besides the woes of the contractors where the price is inclusive of GST without scope for increase.

There were various practical difficulties in getting additional claims owing to GST introduction and resulted in taxpayers either in delaying the GST remittance or defaulting it which has unnecessarily raised the troubles to the Genuine taxpayers. Hence, the Government shall work out the concrete solution to the ongoing projects at least extending the old rate to the ongoing works/existing contracts. Otherwise, the contractors & Government drawn into long litigation or unfruitful consequences.

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