GST ARTICLE

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Reversal of service tax credit on receipt of completion certificate by a developer in GST Regime – A Controversy

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This article is an attempt to discuss the legal provisions relating to reversal of credit taken under service tax as well as GST regime on receipt of occupancy certificate.

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Background

Once a booming industry, the current phase through which the real estate industry is passing through can be at least said be a slow-down phase if not exactly recession phase.

The lack of clarity in the tax treatment of various transactions also add to the distress of the industry going through a slow-down phase. One of such transaction is reversal of service tax credit (availed till inception of project till completion) on unsold inventory on receipt of completion certificate by a developer. The department has been sending Notices to reverse the Cenvat Credit pertaining to unsold units at the time of receipt of completion certificate which was availed in the pre-GST regime.

The controversy arises in the backdrop of intention of Government to not allow any tax credit in respect of unsold units on which no tax is payable and the way in which the law has been drafted.

Provision related to reversal of credit in GST

Before dwelling into this issue, it is also imperative to note the provisions related to reversal of GST credit. The provisions under the CGST Act, 2017 and the CGST Rules, 2017 have made it abundantly clear that the credit which pertain to non-taxable supplies has to be reversed.

Rules 42 and 43 provides detailed, extensive and unambiguous rules for reversal of input tax credit and they should be strictly followed. Further, vide amendments[1] in Rule 42 and 43, the provisions for reversal of ITC pertaining to unsold inventory have been specifically introduced.

The specific rules under the GST regime has not left much scope of any arguments regarding non-reversal of credit pertaining to unsold inventory.

Whether service tax credit is required to be reversed?

Unlike the specific provisions related to real estate under rule 42 and 43 of the CGST Rules, 2017, the erstwhile Cenvat Credit Rules, 2004 had not any specific provision requiring reversal of credit which pertains to unsold inventories.

In Authors view, the entitlement to Cenvat credit is determined at the time of receipt of service and not on the basis of what transpires subsequently. The developer was lawfully entitled to take the credit at the time the same was availed. The immediate consequence of such lawful availment of credit is that the same becomes an indefeasible right at the hands of the developer. Hence, the same cannot be denied later on the ground of subsequent developments (albeit with retrospective effect) in the absence of a specific provision which authorizes such an action. In support of the above proposition that Cenvat credit rightly availed is an indefeasible right in the hands of the assessee, the author places reliance on the following case laws:

A. CCE, Pune v. Dai-Ichi Karkaria Ltd. 1999 (112) E.L.T. 353(S.C.)
B. H.M.T. V. CCE, Panchkula 2008 (232) ELT 217 (Tri-LB) affirmed by the P&H HC in CCE, Panchkula v. HMT Ltd 2010 TIOL 316 HC P&H.
C. Hindustan Zinc Ltd. V. UOI 2008 (223) ELT 149 (Raj)
D. CCE & Cus, Cochini v. Premier Tyres Ltd 2008 (223) ELT 149 (Raj)

Further, in ***M/s Alembic Ltd 2018-VIL-708-CESTATAT-AHM-ST and M/s Shreno Limited Vs C.C.E & ST***, the issue involved was whether the appellant was required to reverse proportionate credit out of the valid input service credits availed by them during the period till obtaining completion certificate, i.e. availing during the time when whole of output service of construction of residential complex was taxable. The Hon'ble tribunal held that the appellant were not required to reverse the proportionate credit for the past period when at the time of availment of such credit, output services of the developer were taxable. Relevant extract of the judgment is as under:

"13. We agree with such plea raised by the Appellant. While the law does not intend to allow any undue benefit to a service provider in terms of Cenvat Credit of Service Tax paid on input services used in providing non-taxable output activity, however, as held by the Hon'ble Apex Court in the case of Dai IchiKarkaria 1999(112) ELT 516(SC) - 1999-VIL-02-SC-CE, *Modvat / Cenvat Credit is a vested right. Once it is legally and validly availed, the same cannot be denied and/or recovered unless specific provisions exist for the same. The Appellants have also correctly relied upon the decisions / judgments in the case of HMT Ltd., TAFE, Ashok Iron & Steel Fabricators (supra) wherein an identical situation qua "inputs" used in production of dutiable finished goods was involved, where on a particular date, the said Finished goods became exempt and the issue involved was as regards credits availed at a time when such Finished goods was otherwise dutiable.*

14. It has been a consistent judicial view, including that of the Hon'ble Apex Court in such cases, that credit entitlement is on the date of receipt of inputs when the output activity was wholly dutiable. Merely because the finished goods eventually became exempt later on, the credit availed on inputs which were contained in semi-finished / finished goods state was held as not deniable. The present case is squarely covered vide such ratio laid down by higher courts.

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16. This being the case, a harmonious reading of Rule 3 of the CCR, 04 read with Rule 6 and Rule 11 of the said Rules will suggest that eligibility / entitlement to credit has to be examined only at the time of receipt of input service and once it is found to be availed at a time when output service is wholly taxable, and the said credit is availed legitimately, the same cannot be denied and/or recovered unless specific machinery provisions are made in this regard. As per above TRU clarification dt.28.2.07, even if one assumed sale of immovable property after Completion Certificate to be "exempt service" even going by the findings in the impugned order, even then there is no legal requirement to reverse any credit availed on "input services" in the past (prior to obtaining Completion Certificate) at all."

On appeal by the department, the Hon'ble Gujarat High Court upheld the decision of the tribunal in ***Principal Commissioner Vs. M/s Alembic Ltd 2019-TIOL-1495-Ahm-ST***.

In ***Prajapati Developers vs CCT 2019-TIOL-806-CESTAT-Hyd***, the assesse was issued SCN for reversal of Cenvat credit under rule 6 holding that the input services were used both for provision of taxable services and also for activities which do not amount to service.

It was held that since there was no provision during the relevant period for reversal of credit where common inputs or input services were used for provision of taxable services and also activities which do not amount to services at all, the assesse is entitled to credit of service tax paid or duty paid in view of rule 2(l) and rule 3 of the Cenvat Credit Rules, 2004. Accordingly, as during the relevant period rule 6(1) did not provided for reversal of Cenvat credit in respect of input services used both in provision of taxable services and for activities which do not amount to service, the judgment was pronounced in favour of the assesse.

The Hon'ble Gujrat High Court in the ***Principal Commissioner Vs M/s Shreno Ltd 2019-TIOL-1546HC-Ahm-ST*** relying on its earlier decision in Alembic (supra) held that the question of law as proposed by revenue i.e. reversal of Cenvat credit availed on account of unsold units in view of provision of rule 6 of the Credit Rules is no more res-integra. It was held that in view of the ratio of M/s Alembic the assesse is not required to reverse any credit availed on valid input services availed during 2010 till obtaining of completion certificate. The appeal of the revenue was accordingly dismissed.

In authors view, the above presents very good grounds to argue that once credit was lawfully availed it becomes a vested right and cannot be made to reverse on account of a subsequent development.

Further in respect of cenvat credit availed and utilised in pre-GST regime and the transitional unutilised credit being brought forward, in authors view, there is no requirement of reversal under Section 17(2) of CGST Act as it deals with the reversal of input tax credit.

The term "input tax credit" has been defined under section 2(63) as credit of input tax. Input tax in relation to a registered person, means the central tax, State tax, integrated tax or Union territory tax charged on any supply of goods or services or both made to him.

Since the cenvat credit and transitional credit relates to taxes paid under pre-GST regime such as excise duty service tax etc, which does not satisfy the above definition of input tax, the reversal of same cannot be governed by Section 17 of the CGST Act.

Illustration

The implications on reversal of Cenvat credit and ITC can be understood with the help of the following illustration.

S. No.	Description	Amount in crores
1.	Total Cost of construction of the Project	100
2	Service tax cenvat credit availed in pre GST regime	10
3	ITC (GST) availed from 1.07.2017 to 31.03.2019	3
4	Date of OC	31.3.20190
5	Are unsold on date of OC	33%
Reversals		
6	Cenvat Credit to be reversed	0 (In Authors View)
7	ITC (GST) to be reversed on receipt of OC	(3) x 33% = 1

Conclusion

In the light of the specific provisions related to reversals of unsold inventory, ITC availed in the GST regime which pertain to unsold inventory has to be compulsorily reversed. However, in the absence of specific provisions in respect of Cenvat credit availed in the pre-GST regime and supporting judgments in favour of the assessee, the developer has a very good case to defend where the department seek to enforce them to make reversals.