

**ITC Reversal in HAM Projects?**

Initially public road works were executed under the traditional EPC (Engineering Procurement and Construction) model whereby governments used to give contracts and 100% payments were released during the construction period itself. Due to increase in demand for infrastructure and paucity of funds, Government turned towards BOT (Build, Operation Transfer) model where the contractor used to construct the roads and he was given a right to collect toll for 15 to 30 years period and recover his cost. Some projects were issued under BOT Annuity system as well. Due to many reasons, these longterm projects didn't prove to be financially sound and banks started showing disinterest in funding them and contractors also found it financially unviable. In 2016 government came up with the new HAM mode (Hybrid Annuity Model)

**1. Brief understanding of HAM projects:**

In Hybrid Annuity Model, private player construct the roads in which certain portion say 40% of the project costs is paid by National Highway Authority of India (NHAI)/State Government during construction period and remaining 60% of the cost is paid as Annuity during the concession period which runs in 15 or more years along with the agreed interest. This model is a combination of both EPC and BOT annuity. In terms of an example, in a contract worth Rs. 1000 crores, NHAI releases 400 crores during the construction phase in 5 milestones of 8% each. After construction is over and after due process of verification, NHAI issues COD (Commercial Operations Date) which means that the construction phase is over and the contractor becomes eligible to receive Annuity payments (60%) as per terms of the Concession Agreement.

**2. New Special Purpose Vehicle (Company) Creation:**

Flow of the entire agreement process is as under:

- HAM Tender is issued by NHAI / Govt organisation
- Bid to this Tender is submitted by a Holding Company
- NHAI announces the winning bid

- Bidder who wins the bid must form a New SPV company to be formed as it is a Pre-condition in such contracts
- NHAI awards work to New SPV and enters into a concession agreement with this SPV
- SPV awards turnkey EPC contract for construction of road to its sister concern / holding Company

### 3. Consideration and Payment thereof under HAM:

Consideration under HAM projects is agreed upon through a well laid out tendering process and is chartered by a Concession Agreement.

- Payment Under HAM project by NHAI to SPV
  - i. On achieving predefined milestone, NHAI releases 8% payment on each such milestone. As per standard agreement, there are in total 5 milestones till the completion of the construction, which means 40% payment is released during construction period
  - ii. After Construction Period: 60% payment will be paid in form of annual/bi-annual equated annuity along with interest
- **Payment by SPV to Holding Company for EPC contract:** SPV will make 100% payment of EPC work to Holding Company during the construction phase itself

### 4. Sample Facts of one HAM contract:

- A. **Tender filed** by the ABC Projects Limited.
- B. **Letter of Award (LOA)** Received on 01.04.2016 in Name of ABC
- C. **New SPV** incorporated: ABC Highway Ltd, a 100% subsidiary of the ABC Projects
- D. **Concession agreement** between ABCHL and NHAI dt 1.05.2016.
  - i. BID Project Cost: 1000 Crore
  - ii. Payment of Bid Project Cost: Article 23.3 of the Concession agreement Vol I
    - a) 40% of the Bid Project Cost, adjusted for the price Index Multiple, shall be due and payable to the concessionaire in 5 equal instalments of 8% each during the Construction Period in accordance with the provision of Clause 23.4.

- b) The Remaining Bid Project Cost, adjusted for the Price index Multiple, shall be due and payable in 30 biannual instalments commencing from the 180<sup>th</sup> day of COD in accordance with the provision of clause 23.6.

E. **EPC agreement** between ABCHL and ABCPL

- i. Contract Price is 850 Crore
- ii. As per Clauses of the EPC agreement, the Contract Price shall be paid to the contractor in accordance with the agreement

### 5. **Some Important Clauses from the Concession agreement with NHAI**

Following text from the Concession Agreement are standard clauses found in almost all HAM project agreements tendered by NHAI

A. Scope of work in the Project as defined in Article 2 of the agreement is as under:

*(a) construction of the Project on the Site set forth in Schedule-A and as specified in Schedule-B together with provision of Project Facilities as specified in Schedule C, and in conformity with the Specifications and Standards set forth in Schedule D*

*(b) operation and maintenance of-the Project in accordance with the provisions of this Agreement; and*

*(c) performance and fulfilment of all other obligations of the Concessionaire in accordance with the provisions of this Agreement and matters incidental thereto or necessary for the performance of any or all of the obligations of the Concessionaire under this Agreement*

As can be seen, Concessionaire has to construct the road but also have to operate and maintain the same for the entire concession period.

B. As per Article 15

*Commercial Operation Date (COD)*

*15.1.1 The Project shall be deemed to be complete when the Completion Certificate or the Provisional Certificate, as the case may be, is issued under the provisions of Article 14, and accordingly the commercial operation date of the Project shall be the date on which such Completion Certificate or the Provisional Certificate is issued (the "COD"). **The Project shall***

***enter into commercial service on COD whereupon the Concessionaire shall be entitled to demand and collect Annuity Payments in accordance with the provisions of this Agreement.***

As per the above clause, Concessionaire is entitled to demand and collect payments towards annuity part only after COD is achieved.

C. Further as per Article 23 of the agreement, payment milestones are defined as under:

#### ***23.4 Payment during Construction Period***

*Upon receiving a report from the Independent Engineer certifying the achievement of the below mentioned Payment Milestones, the Authority shall disburse, within 15 (fifteen) days of the receipt of each such report, an installment equal to 8% (eight per cent) of the Bid Project Cost, adjusted for the Price Index Multiple as applicable on the Reference Index Date preceding the date of that report.*

*For the purpose of this Clause 23.4, the Payment Milestone for release of payment during Construction Period shall be as under:*

- a) I (first) Payment Milestone - On achievement of 20% Physical Progress*
- b) II (second) Payment Milestone - On achievement of 40% % Physical Progress*
- c) III (third) Payment Milestone - On achievement of 60% Physical Progress*
- d) IV (fourth) Payment Milestone - On achievement of 75% Physical Progress*
- e) V (fifth) Payment Milestone- On achievement of 90% Physical Progress*

*Provided that in case of Change of Scope, the Physical Progress shall be recalculated to account for the changed scope.*

#### ***23.6 Annuity Payments during Operation Period***

*23 .6.1 The (the "Completion Cost" shall be the summation of A, B, C, D, E, and F below:*

*A. 20% of the Bid Project Cost adjusted for the Price Index Multiple as applicable on the Reference Index Date preceding the date of report confirming 20% Physical Progress.*

*B. Another 20% of the Bid Project Cost adjusted for the Price Index Multiple as applicable on*

*the Reference Index Date preceding the date of report confirming 40% Physical Progress.*

*C. Another 20% of the Bid Project Cost adjusted for the Price Index Multiple as applicable on the Reference Index Date preceding the date of report confirming 60% Physical Progress.*

*D. Another 15% of the Bid Project Cost adjusted for the Price Index Multiple as applicable on the Reference Index Date preceding the date of report confirming 75% Physical Progress.*

*E. Another 15% of the Bid Project Cost adjusted for the Price Index Multiple as applicable on the Reference*

*F. Another 10% of the Bid Project Cost adjusted for the Price Index Multiple as applicable on the Reference Index Date preceding the COD.*

***The Parties acknowledge and agree that the Authority has paid a portion of the Completion Cost as payments during Construction Period pursuant to Clause 23.4 of this Agreement. The balance Completion Cost remaining shall be due and payable during the Operation Period in accordance with the provisions of Clause 23 .6.2.***

*23.6.2 The Completion Cost remaining to be paid in pursuance of the provisions of Clause 23.6.1 shall be due and payable in biannual installments over a period of 15 (fifteen) years commencing from COD, (the "Annuity Payments"). The 1st (first) installment of Annuity Payments shall be due and payable within 15 (fifteen) days of the 180<sup>th</sup> (one hundred and eightieth) day of COD and the remaining installments shall be due and payable within 15 (fifteen) days of completion of each of the successive six months ("the Annuity Payment Date"). For the avoidance of doubt, the last Annuity Payment Date would be adjusted to in such a way that it falls at the end of the Operations Period.*

### ***O&M Payments***

*23.7.1 The Parties acknowledge and agree that all O&M Expenses shall be borne by the Concessionaire and in lieu thereof; a lump sum financial support in the form of biannual payments shall be due and payable by the Authority, which shall be computed on the amount quoted by the selected bidder under its O&M Bid, in accordance with the*

F. Key takeaways from above clauses from the agreement are as under:

- i. Scope of work is not just for construction of road, it also involves maintaining and operating the road for a predefined period of 10 to 20 years and also performance and fulfilment of all other obligations as mandated by NHAI in the contract
- ii. Contract defines an important event known as the “Commercial operation date” (COD). Receipt of COD means that construction of the road project is complete in all respects and that it can be opened for public. **As per this clause, the SPV becomes eligible to charge and collect annuity payments only AFTER the project receives COD.**
- iii. As per the contract Payment milestones are bifurcated in 2 broad brackets, first is the Construction Phase and the other is the Annuity Phase. Phase wise milestones are as under:

### **Construction Phase**

SPV will be eligible to receive 8% of the project cost on achievement of each milestone which are based on construction, these being 20%, 40%, 60%, 75%, 90% and 100%. Accordingly, in these 5 parts SPV will receive payments worth 40% (8% x 5) of the project cost within the construction phase. Once the project receives COD, SPV becomes eligible to start claiming annuity payments

### **Annuity Phase**

As per the contract remaining 60% of the project cost is due and payable in a graded manner within 15 years starting from the COD date. SPV is slated to receive annuity payments on biannual basis which means that SPV will receive 30 payments (15 years x 2 payments every year). These 15 years are known as operation period and the SPV is required to provide Operation and Maintenance Services in these 15 years for the entire road project constructed by it. Consideration towards maintenance is paid alongwith the Annuity payments.

## **6. Legal issues involved under GST**

### **A. Exemption for Annuity payments:**

22<sup>nd</sup> GST Council meeting deliberated on the issue of granting exemption to Annuity being given to contractors in place of Toll charges. This issue was put in the agenda for the meeting at point no. 13 (iv) as under:

*iv. Issue of Annuity being given in Place of Toll Charges to Developers of Public Infrastructure-exemption thereon*

After due deliberations in the meeting, following was noted in the Minutes released:

***Agenda item 13(iv): Issue of Annuity being given in Place of Toll Charges to Developers of Public Infrastructure - exemption thereon***

*61. Introducing this Agenda item, the Joint Secretary (TRU-II), CBEC stated that while toll is a payment made by the users of road to concessionaires for usage of roads, annuity is an amount paid by the National Highways Authority of India (NHAI) to concessionaires for construction of roads in order that the concessionaire did not charge toll for access to a road or a bridge. In other words, annuity is a consideration for the service provided by*

*concessionaires to NHAI. He stated that construction of roads was now subject to tax at the rate of 12% and due to this, there was free flow of input tax credit from EPC (Engineering, Procurement and Construction) contractor to the concessionaires and thereafter to NHAI. He stated that as a result, tax at the rate of 12% leviable on the service of road construction provided by concessionaire to NHA1 would be paid partly from the input tax credit available with them. He stated that the Council may take a view for grant of exemption to annuity paid by NHAI/State Highways Construction Authority to concessionaires during construction of roads. He added that access to a road or bridge on payment of toll was already exempt from tax. The Hon'ble Minister from Haryana suggested to also cover under this provision annuity paid by State-owned Corporations. **After discussion, the Council decided to treat annuity at par with toll and to exempt from tax, service by way of access to a road or bridge on payment of annuity.***

Based on above decision of the Council, entry 23A was introduced in notification 12/2017-CTR dated 28.06.2017. **Effective from 13.10.2017 annuity portion of HAM projects was exempted from levy of GST.** Albeit from 1.07.2017 to 12.10.2017 such projects were taxable @ 12%. As this exemption entry is part of a notification, council reserves the right to remove this exemption at any time of their choosing.

**B. Time of Supply provisions – When is Invoice to be issued?**

We need to look at Time of supply provisions to see whether the SPV has supplied any exempted service during the construction phase. For this we need to look at the provisions of section 13 (2) read with section 31 of the CGST Act.

Section 13 (2) prescribes that the time of supply of services shall be the earliest of the following dates:

- Date of Invoice (if the invoice is issued within time prescribed in section 31)
- Date of payment
- Date of provision of service if the invoice is not issued within time prescribed in section 31

*13 (2) The time of supply of services shall be the earliest of the following dates, namely:—*

***(a) the date of issue of invoice by the supplier, if the invoice is issued within the period prescribed under section 31 or the date of receipt of payment, whichever is earlier; or***

***(b) the date of provision of service, if the invoice is not issued within the period prescribed under section 31 or the date of receipt of payment, whichever is earlier; or***

Further, explanation to section 13 (2) provides that Supply covered by an invoice raised will be deemed to have been provided. In view of this explanation we can deduce that supply equivalent to the value reflected in Invoice raised by SPV to NHAI during construction phase is deemed rendered and not more.

*Explanation.—For the purposes of clauses (a) and (b)—*

***(i) the supply shall be deemed to have been made to the extent it is covered by the invoice or, as the case may be, the payment;***

Section 31 (5) prescribes timeline as to when to issue an invoice in case of continuous supply of services, as per section 31(5)(a) invoice must be issued on or before the due date of payment as is ascertainable from the contract. In case due date of payment is not ascertainable then the invoice is to be issued as and when the supplier receives the payment. Further, as per section 31(5)(c), in a case where the payment is linked to the completion of an event, the invoice shall be issued on or before the date of completion of that event.

In case of HAM projects due dates of Annuity payments are clearly ascertainable from the concession agreement, which as explained above is on biannual basis for 15-20 years starting from COD date, hence invoices to principal are to be issued on or before these due dates.

*31 (5) Subject to the provisions of clause (d) of sub-section (3), in case of continuous supply of services,—*

***(a) where the due date of payment is ascertainable from the contract, the invoice shall be issued on or before the due date of payment;***



*(b) where the due date of payment is not ascertainable from the contract, the invoice shall be issued before or at the time when the supplier of service receives the payment;*

*(c) where the payment is linked to the completion of an event, the invoice shall be issued on or before the date of completion of that event.*

Term Continuous Supply of Services is defined in section 2 (33) of the Act as under:

*(33) "continuous supply of services" means a supply of services which is provided, or agreed to be provided, continuously or on recurrent basis, under a contract, for a period exceeding three months with periodic payment obligations and includes supply of such services as the Government may, subject to such conditions, as it may, by notification, specify;*

It is evident that the HAM project qualifies to be a continuous supply of services as per the definition reproduced above.

**On conjoined reading of the provisions of section 2(33), 13 and 31 of the CGST Act it is clear that the SPV is legally bound to issue invoices for 8% of the price index adjusted bid cost at every construction milestone irrespective of the fact that physical construction level are much higher. Further, in case of annuity payments invoices are required to be issued only when the payment thereof is due as per the agreement which is after the construction phase ends, hence it can be safely deduced that during the construction phase entire income is taxable because no annuity payments were due or payable during that time and accordingly SPV has not rendered any supply of exempted services during the construction phase.**

### **C. Whether the SPV is eligible to avail 100% Input Tax Credit (ITC) during the construction phase**

In order to understand whether ITC is rightly claimed we need to analyze Section 16 and 17 of the CGST Act and Rule 42 of the CGST Rules.

- i. Section 16 prescribes following conditions, if all are fulfilled the taxpayer is eligible to claim credit.
  - Services must be used or intended to be used in the course of furtherance of business
  - Must be in possession of Invoice
  - Received the goods or services
  - Tax charged is paid

- Returns are furnished
- Payment is made within 180 days

All the above conditions are fulfilled by SPV during the construction phase, hence it eligible to avail ITC.

ii. Section 17 provides for mechanism to reverse credit in certain situations as under:

- If services are used partly for business and partly for other purposes
- If services are used partly for supplying taxable supplies and partly for exempt supplies
- If ITC in respect of services prescribed under section 17 (5) is received

None of the above situation are applicable to HAM project, because as discussed above, SPV is not rendering any exempt supply during the construction phase. Entire expense incurred for construction of road is for business purposes only and none of the blocked credit mentioned in section 17 (5) are there.

### iii. Rule 42 of the CGST Rules

Said rule is for reversal of credits as per the mandate of section 17 (1) or 17 (2), as discussed above, situations covered in both these sub-sections are not present in the business being executed by the SPVs. In order for an ITC to be subjected to rule 42 it is essential to establish that the taxpayer is either rendering taxable and exempt supply in a tax period (month) or is using the services (on which it has claimed ITC) for purposes other than Business.

## 7. Notional Income and its impact under GST

Ind AS (Accounting Standard) are applicable to some SPVs due to which they account for certain income in their balance sheet as 'Notional Income'. It may be said, that because the company is accounting for an income which is not suffering any tax it could be treated as Exempt Supply and therefore questions of ITC reversal will arise. As per Appendix C of the Ind AS 115, Service Concession Agreement are governed by Ind AS 115 and therefore accounting norms prescribed in this Ind AS are to be followed. As per this Ind AS a company is required to recognize notional revenue in its books and create a Financial Asset in terms of Receivable from the Principal during the construction phase because the entire expenditure for construction is expended in this period itself, in other

words the company has to recognize expense matching revenue in its books. This is purely an accounting treatment and has no bearing whatsoever on the liability to either pay GST or claiming of exemption or reversal of ITC. Mere accounting entry cannot be deemed to become a supply, One has to satisfy requirements of Section 7, 13 and 31 of the CGST Act to establish the fact that a Supply took place whose time of supply has occurred and Invoice is due to be issued. If any one of the above 3 limbs is missing, the said transaction even if accounted for cannot be considered as taxable or exempted under GST.

### **8. Discussion on Advance Ruling given by Appellate Authority of Rajasthan in case of Nagaur Mukundgarh Highways Pvt. Ltd**

Rulings given by Advance Ruling Authority (AAR) are binding only on the Applicant and it cannot be used for or against any other taxpayer. Having said so would like to discuss this particular AAAR because the transactional facts of this case are similar to issue being deliberated in this paper.

AAAR has ruled on 3 points as under:

- Annuity payments are exempted by virtue of Entry No. 23A of the notification No. 12/2017-Central Tax (Rate) dated 28.06.2017.
- ITC of the GST paid on the Input and Input service used in the construction phase is available to the Appellant subject to the provisions of Section 17(5) of the Central GST Act, 2017.
- Full ITC of the GST paid on the inputs and input services used in the O&M phase is available to the Appellant subject to the provisions of Section 17(5) of the Central GST Act, 2017.

We are concerned with the ruling given under Second point, accordingly the ruling is analysed here for the same:

Appellate Authority has invested most of its time on the issue of taxability of Annuity Payments and very little on issue of ITC reversal. Further it has given no legal reasoning whatsoever on exactly why reversal is mandatory under GST law. Following is an extract from the ruling:

*After visiting the agenda and minutes of the 22nd GST Council meeting we concur to find that while toll is a payment made by the users of road to concessionaires for usage of roads, annuity is an amount paid by the National and State Highways Construction Authorities to concessionaires for construction of roads in order that the concessionaire did not charge toll for access to a road or a bridge. A view was taken in the meeting of the Council for grant of exemption to annuity paid by NHAI/State Highways Construction Authority to concessionaires for construction of roads. This amounts to not taxing the value addition of the concessionaire. The argument for*

exempting annuity from GST was that the road construction service was exempt from service tax. However, GST would continue to be levied on the road construction service provided by the EPC contractor to the concessionaire. After discussion, the Council decided to treat annuity at par with toll and to exempt from tax, service by way of access to a road or bridge on payment of annuity. And hence the abovementioned Entry No. 23A was introduced. Entry No. 23A ibid squarely covers the annuity paid to the Concessionaire (i.e. Appellant) by the PWD, Govt, of Rajasthan. The AAR erred in denying the benefit of Entry No. 23A ibid to the Appellant on the ground that the Entry No. 23A belongs to SAC 9967 which is meant for support services of transportation while the activity of the appellant is liable to be taxed under SAC 9954. After going through the Scheme of Classification of Services, Explanatory notes to classification of services, Agenda of the GST Council meeting, Minutes of the GST Council meeting and Entry No. 23A ibid, we are of the firm view that whole project can be divided into two parts- one is construction phase and second is O&M phase. The activity of the Appellant (i.e. Concessionaire) having nexus with annuity is classifiable under SAC 9967 and activity of the Appellant having nexus with the Construction payments during construction phase is Works Contract which is taxable under Notification No. 11/2017-Central Tax (Rate) dated 28.06.2017 under SAC 9954. Hence we have no hitch in providing the benefit of the Entry No. 23A ibid to the annuity payments i.e. road construction payments received after COD (during O&M phase). **But this benefit does not come free. It comes with a rider that only 50% ITC of the GST paid on the Input and Input service used in the construction phase is available to the Appellant because annuity (50% of the construction payments) is not taxable and the appellant is not having any other non-business and/or exempted supply.**

27. Coming to the second issue, we find that the Appellant is receiving two types of payments during O&M phase: (1) O&M related payments, and (2) Construction related Annuity payments. GST is payable on the O&M payments and the appellant has also not disputed this. While annuity payments are exempted from GST, as per discussion hereinabove, our mandate is to pronounce upon the eligibility of the ITC of GST paid on the inputs and input services used in the O&M phase. Contention of the Appellant is that since they are having both taxable supply (O&M payments) and exempted supply (annuity payments), the ITC is admissible as per Section 17(2) of the Act, read with Rule 42 of the Central GST Rules, 2017. **Contention of the Appellant is not tenable because annuity payments (exempted supply) are to be taken into consideration for taking proportionate ITC during Construction leg of the project and not during O&M leg of the project.** When such is the case, full ITC of the tax paid on the inputs and input services used in the O&M phase is available to the Appellant if they are having no other outward supply during this phase.

It is evident from the above extract that the ruling is devoid of any legal reasoning on this crucial aspect, it just goes on to rule that ITC will have to be reversed.

In my view this ruling does not carry any legal weight and therefore cannot be relied upon to conclude either way. In the Central Excise & Service Tax regime, there are innumerable judgements

of the Supreme Court which established the jurisprudence that credit once claimed legitimately cannot be questioned later on if the product or service became exempt.

## 9. Conclusion

As can be witnessed from above discussion on facts of HAM projects it is clear that these are peculiar projects in terms of execution, structuring, payment schedules and exemption granted. Between July 2017 to October 2017 these projects were fully taxable is testament that these projects can be taxed again if the Council of the day so wish.

ITC is a factum of the time it is received, it is a well settled principle that law and facts on the day of the ITC availment are to be seen and not of 2-3 or more years down the line when a purported exemption may be received. It may so happen that the exempted income may become taxable as and when they become receivable. In view of the above discussion on facts and law, it is clear that ITC reversal applies only if there is exempted income in the month/year when ITC is availed and not otherwise, accordingly ITC availed by the SPV during the construction phase is legally allowed and cannot be subjected to reversal. It would be pertinent to note that in case of real estate companies similar issues arose, to overcome them Rule 42 of the CGST rules was amended effective from 1.04.2019. Unless similar change is made in the law, ITC availed by HAM executing SPVs cannot be sought to be reversed.

**Formulated by:**

**N J Jain & Associates**

**Chartered Accountants**

**CA Nitesh Jain**

**Managing Partner**

### **DISCLAIMER**

*This GST Alert is only for the purpose of information and does not constitute or purport to be an advise or opinion in any manner. The information provided is not intended to create advisor-client relationship and is not for advertising or soliciting. N J Jain & Associates do not intend in any manner to solicit work through this Tax Alert. The Tax Alert is only to share information based on recent developments and regulatory changes. N J Jain & Associates is not responsible for any error or mistake or omission in this Tax Alert or for any action taken or not taken based on the contents of this Tax Alert. Business decisions are best taken in close consultation with the advisors.*