

Anti-Profiteering vis -a-vis Real Estate Sector – Practical Insights

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Section 171 of the CT Act¹ provides for anti-profiteering measures owing to the introduction of GST laws in India. The said section was a last-minute inclusion as it was missing in the model GST laws that were released for stakeholders' consultation. Moreover, section 171 is not exhaustive and is only an enabling section which provides for the meaning and scope of profiteering and conferred powers on Central Government for constitution of Anti-Profiteering Authority for implementation of the said section. However, there were no general or industry-specific guidelines laid down on manner in which profiteering amounts are required to be determined for pass on to customers.

In the absence of such guidelines, taking measures to avoid profiteering became very difficult and complex especially in sectors like real estate. In this article, an effort is made to bring certain practical insights of compliance with anti-profiteering measures to be undertaken by builders in real estate sector and position laid down several rulings pronounced by National Anti-Profiteering Authority.

Brief of Profiteering:

In terms of section 171(1) of the CT Act, *any reduction in rate of tax on any supply of goods or services or the benefit of input tax credit shall be passed on to the recipient by way of commensurate reduction in prices*. Thus, a person is said to have resorted to profiteering when the price of goods or services are not reduced for the following reasons:

- Reduction in the rate of tax on supply of goods or services
- Benefit of input tax credit

Under the explanation provided to section 171, the expression "profiteered" shall mean the amount determined on account of not passing the benefit of reduction in rate of tax on supply of goods or services or both or the benefit of input tax credit to the recipient by way of commensurate reduction in the price of the goods or services or both. Thus, in short, the benefit arising out of rate reduction and input tax credit due to the introduction of GST law shall be required to be passed on to the customers.

Coming to real estate projects, under the erstwhile regime, they are subject to both service tax and VAT². The applicable rate of service tax was after abatement is 4.5% (15%*30%). The benefit of CENVAT Credit was available on capital goods and input services but not on inputs. Coming to VAT, there were two options available. One with the benefit of input tax credit where the value of goods involved shall be arrived at the actual basis and subject to VAT at applicable rate (colloquially known as regular method). The other option is composition scheme where benefit of input tax credit was not available but the value of flat is subject to a concessional rate (colloquially known as composition method).

¹ Central Goods & Services Tax Act, 2017

² Valued Added Tax

The composition rates under VAT vary from one state to another. Coming to the state of Telangana, the applicable rate is 1.25% of the value of the flat including the value of the land. Therefore, the total rate of tax under the erstwhile regime is 5.75% (4.5% + 1.25%). The effective rate of tax under GST is 12% (after considering 1/3rd deduction towards land value). Thus, there is no benefit of rate reduction under GST law as compared to the previous regime.

As stated earlier, the other benefit that may arise is out of input tax credit. As mentioned above, under the erstwhile regime, CENVAT credit of excise duty paid on materials used in the construction of residential complex was not available while CENVAT Credit of excise duty paid on capital goods and service tax paid on input services were available. Coming to VAT, input credit availability depends upon the type of options choose (composition vs regular) for payment of VAT. In case composition scheme was opted for, then the VAT paid on material used in construction was not available as input tax credit. Assuming that VAT was paid under composition scheme, the additional benefit of credit that would flow under the GST regime is the tax paid on material used in construction. With respect to expenditure incurred in the pre-GST regime, this benefit would flow in the form of transition credit.

Thus, in case of real estate projects, profiteering is limited to input tax credit which is required to be analyzed separately for each of the following scenarios:

- Scenario – I: Project completed prior to 01.07.17
- Scenario – II: Project commenced after 01.07.17
- Scenario – III: On-going Project as on 01.07.17

Scenario – I: Project completed prior to 01.07.17:

In this scenario, it is assumed that project has commenced and completed prior to 01.07.17. Section 142(10) and Section 142(11)(c) states that in terms of long term contracts and specifically in the nature of works contract, the tax is required to be paid only if there is a supply happening post 01.07.17. Since, in the case of projects which have completed prior to 01.07.17, there would not be any tax liability under GST regime, since there are no fresh supplies happening post 01.07.17. Ideally, the applicable tax would be in such case the service tax which the builder should have paid in accordance with the mile stones and by the time project gets completed and accordingly there will be no liability under GST regime. As far as VAT is concerned, the state government of Telangana has issued a GO MS No 124³, which omitted the rule prescribing the payment of VAT on receipt basis to align with the position under GST laws.

Since there would not be any liability under GST laws, the transition credit which would be otherwise eligible under Section 140(3) and Section 140(6) cannot be availed since the said transition credit comes with a condition that such goods should be used for taxable purposes under GST laws. Since there were no taxable supplies under GST law, the transitional credit is not available and accordingly there would not be any benefit accruing to the developer to further pass it on to the customer.

This proposition was also confirmed by National Anti-Profitteering Authority vide their ruling in the case of Shri Ramesh Kumar Yadav & Others vs. Vatika Limited⁴ wherein it was held vide para 16 as under:

³ Revenue (CT-II) dated 30.06.2017

⁴ 2019 (7) TMI 138 - National Anti-Profitteering Authority

Further, it has been revealed from the records that Respondent had completed the project “Independent Floor Phase-II” prior to implementation of the GST and he had neither availed ITC on any of the inputs procured in the GST Regime, nor had he availed/carried forward the pre-GST credit pertaining to the stock held in hand as on 30.06.2017. Therefore, he is not liable to pass on the benefit of ITC to the above Applicants. Therefore, the provisions of Section 171 (1) of the CGST Act, 2017 which state that “a reduction in rate of tax on any supply of goods or services or the benefit of input tax credit shall be passed on to the recipient by way of commensurate reduction in prices”, have not been contravened in the present case, as the same are not even applicable.

Hence, in scenario where the developer has completed the project prior to 01.07.17 and part of receipts were received post 01.07.17, there would not be any case of profiteering which would arise to the developer to pass it on to the customer.

Scenario – II: Project commenced after 01.07.17

In this scenario, it is assumed that the entire project has commenced after 01.07.17. Since the project was commenced after 01.07.17, the procurements would take place after 01.07.17 which would be subject to tax under GST laws and the availment of transition benefit under section 140(3) & (6) would not arise. Question of profiteering in these cases would not arise which was also confirmed by the National Anti-Profitteering Authority vide their ruling in Shri Arjun Kumar Parwani & Others vs. Signature Builders Private Limited⁵ wherein it was held vide para 16 as under:

*The agreement between the above Applicant and the Respondent was executed on 13.12.2017. Therefore, it is apparent that the Applicant No. 1 had applied for allotment and was allotted the above flat after coming in to force of the GST w.e.f. 01.07.2017. Since the above project was not under execution in the pre-GST period i.e. before 01.07.2017 therefore, no comparison can be made between the ITC which was available to the Respondent before 01.07.2017 and after 01.07.2017 to determine whether the Respondent had benefitted from additional availability of ITC or not. The Respondent through his sworn affidavit has also claimed that he had not availed benefit of ITC during the pre-GST period and he had availed the same on 28.07.2017 after coming in to force of the GST. From the above facts it is established that there has been no additional benefit of ITC to the Respondent and hence he was not required to pass on its benefit to the above Applicant by reducing the price of the flat. **The Applicant No. 1 could have availed the above benefit only if the above project was under execution before coming in to force of the GST as the Respondent would have been eligible to avail ITC on the purchase of goods and services after 01.07.2017 on which he was not entitled to do so before the above date. Since there was no basis for comparison of ITC available before and after 01.07.2017, the Respondent was not required to recalibrate the price of the flat due to the additional benefit of ITC. Hence, the allegations of the Applicant made in this behalf are incorrect and therefore, the same cannot be accepted.***

Further, since the project has commenced post 01.07.17 in a regime, where the input tax credit is made available to the developer, the question of profiteering does not arise, since the credit which was available cannot be taken into cost of the flat that would be recoverable from customers, due to market competition and accordingly the developer is forced to pass on the benefit of input tax credit that was available to him to the customer by way of commensurate reduction in prices.

Scenario – III: On-going Project as on 01.07.17:

⁵ 2019 (7) TMI 237 - National Anti-Profitteering Authority

In this scenario, it is assumed that the projects were commenced prior to 01.07.17 and extended after 01.07.17, the additional benefits that would arise owing to the introduction of GST laws are as under:

- a) The transitional credit of eligible duties with respect to closing stock of inventory viz. inputs in stock and used in construction, which were erstwhile not available as stated in opening paras of this article.
- b) As the construction got commenced prior to 01.07.17, the estimated amount of taxes viz. excise duty and VAT⁶ that would be payable upon procurement of material would be factored as cost while determining the price as they were ineligible for credit. However, to the extent of procurements made for construction on or after 01.07.2017, the notional tax cost that was factored in determining prices would amount to profiteering.

The Director-General of Anti-Profiteering (DGAP) who has investigated the cases related to real estate projects undertaken by builders has resorted to determine the notional gain related to credit available for builders by comparing the input credit to turnover ratio between pre-GST and post-GST regime. The excess ratio in post-GST regime was considered as profiteered amount for price reduction to customers. In case of Shri Sukhbir Rohila & Others vs. Pyramid Infratech Private Limited⁷, DGAP has determined the additional benefit of credit as 6.1 percent of the gross consideration received on or after 01.07.17.

Period	ITC available Pre-GST			ITC Available Post-GST		
	FY 2016-17	FY 2017- 18 (April to June, 2017)	Total	July, 2017 to January, 2018	February, 2018	July, 2017 to February, 2018
VAT	21557942	11476408	33034350	-	-	-
CGST	-	-	-	3109559 5	5478788	36574383
SGST	-	-	-	3109559 5	5478788	36574383
IGST	-	-	-	1197256 8	1829277	13801845
Total	21557942	11476408	33034350	7416375 8	12786853	86950611
Taxable Turnover	29249554 29	76935214	30018906 43	7256205 66	482186312	12078068 78
ITC ratio to Taxable Value (%)	0.74	14.92	1.1	10.22	2.65	7.2
Additional ITC availed (%)						6.1
Tax Rate	5.25% (VAT)	5.25%(VA T)		12%(GS T)	8%(GST)	

The said methodology of arriving at the benefit of additional input tax credit was upheld by the National Anti-Profiteering Authority in the said ruling and the same was consistently followed in other rulings as well. However, in the humble opinion of paper writers, the said methodology fails to take into consideration the extent of completion of project and the value of bookings that took place as on 30.06.17 which would have a bearing on the extent of profiteering involved.

⁶ On the assumption that the builder has opted for composition scheme.

⁷ 2018-TIOL-06-NAPA-GST

The implications of failure to consider these aspects would be understood based on the following example:

Particulars	Units
Total built-up area to be constructed for the project	2,00,000 sft
Total estimated cost of the Project	Rs. 200 crores
Total estimated Revenue of the Project	Rs. 250 crores
Extent of Project completed as on 30.06.2017	30%
Amounts received upto 30.06.2017 and are subject to VAT and service tax	Rs. 80 crores
Cost of construction incurred upto 30.06.2017	Rs. 60 crores
Amount of credit claimed under the existing regime	Rs. 3 crores
Balance revenue received on or after 01.07.2017	Rs 170 crores
Amount of transition credit claimed on closing stock of inventory under section 140(3) & (6)	Rs. 1 crore
Credit claimed in GST regime	Rs. 17 crores
Total Credit claimed under GST regime	Rs. 18 crores

Based on the above proposition of credit ratio to turnover as accepted National Anti-Profiteering Authority, the extent of additional input tax credit benefit available due to GST would be determined as under:

Particulars	Pre-GST Regime	Post-GST Regime
VAT Credit/GST Credit claimed	3,00,00,000	18,00,00,000
Turnover	80,00,00,000	170,00,00,000
Ratio of credit to turnover	3.75%	10.60%
Excess of credit which would be considered as a profiteered percentage based on the proposition accepted by National Anti-Profiteering Authority		6.85%
Profiteered amount (17,00,00,000*6.85%)		11,64,50,000

In the above example, let us take into consideration that the revenue received in the pre-GST regime as Rs. 60 crores instead of 80 crores and the revenue received in post-GST regime as Rs. 190 crores. Ideally speaking, the extent of construction undertaken in pre and post-GST regime in both the scenarios is unchanged. Therefore, the amount of profiteering should not undergo a change. However, going by the above proposition, the extent of the benefit of credit would be determined as under:

Particulars	Pre-GST Regime	Post-GST Regime
VAT Credit/GST Credit claimed	3,00,00,000	18,00,00,000
Turnover	60,00,00,000	190,00,00,000
Ratio of credit to turnover	5%	9.47%
Excess of credit which would be considered as profiteered percentage based on the proposition accepted by National Anti-Profiteering Authority		4.47%
Profiteered amount (17,00,00,000*6.85%)		8,50,00,000

Thus, the proposition accepted by National Ant-Profiteering Authority is not foolproof and in identical circumstances, the amount of profiteering would vary based on revenue collected in Pre-GST and Post-GST regime. In fact, the extent of revenue collected in pre-GST and post-GST regime has no bearing on amount of profiteering made.

As mentioned above, the amount of profiteering in case of real estate projects is nothing but the amount of transition credit of eligible duties with respect to closing stock of inventory as on 30.06.17 viz. inputs in stock and used in construction and the amount of notional savings in the tax cost that would have been factored in determining the price of the flat. The benefit out of transition credit can be considered on an actual basis. While the notional tax cost factored in determining the price of flat sold in the pre-GST regime should be determined based on cost records/estimates maintained by the builder.

As discussed above, the notional tax cost involved is based on the estimate of the amount of VAT and excise duty payable on the material procured in the post-GST regime. In the absence of adequate cost records, as an alternative basis, this can be determined based on the extent of excise duty and VAT paid on the material procured in the pre-GST regime. Let us consider the following example:

Particulars	Amounts
Material cost incurred upto 30.06.17 (including excise duty and VAT paid on materials)	Rs. 40 crores
Amount of excise duty and VAT paid on the material cost	Rs. 5 crores
Percentage of tax cost involved in the material used for construction in pre-GST regime	14% (5/35)
Material cost incurred from 01.07.17 till project completion date (excluding GST)	Rs. 160 crores
Amount of credit availed on these materials (estimated at 18%)	Rs. 28.8 crores
Notional tax cost that would have been factored as cost in determining the price of flats	Rs. 22.4 crores (160*14%)

Thus, the notional tax cost of Rs. 22.4 lakhs that was factored as the cost would be considered as the profiteered amount for the project undertaken by the builder. The extent of profiteering for each of the flats booked prior to 01.07.17 shall be arrived at and accordingly the same should be reduced from the price charged to the customers.

With respect to the flats booked on or after 01.07.17, the question of anti-profiteering would not arise if the developer maintains an objective cost data and was able to prove that the savings in credit have been considered to determine the price at which flats are sold after 01.07.17. In the absence of such objective data and price reduction after 01.07.17, as a matter of conservative approach, it would be advisable to reduce the corresponding profiteered amount of each flat from the price charged from the customers who have booked the flats after 01.07.17.

Conclusion:

In view of the above discussion, the question of profiteering does not arise in case of projects which were completed prior to GST since no transition benefit under section 140 (3) & (6) was claimed. Similarly, question of profiteering does not arise with respect to projects which are commenced in GST regime.

As discussed above, the proposition laid down by DGAP and National Anti-Profiteering Authority to determine the profiteered amount in case of real estate projects whose construction was commenced prior to 01.07.17 and extended after the said date is not a fool proof methodology and is required to be revisited. The notional tax cost factored in determining the price and the extent of transition benefit claimed under section 140(3) and (6) shall be considered to

determine the profiteered amount. Absence of proper guidelines from Government about the manner in which the profiteered amount is to be determined has led many sectors including real estate clueless about the manner in which anti-profiteering compliance is required to be undertaken. Let us hope for clarity when these issues land up in courts.