

## GST on 'Annuity' paid for road-construction - A long and winding path of controversy!

Aug 03, 2022



**Shivam Mehta**

Executive Partner, Lakshmikumaran & Sridharan Attorneys



**Sahana Rajkumar**

Principal Associate, Lakshmikumaran and Sridharan Attorneys

The implications of GST on 'annuity' received for construction of roads has been mired in controversy ever since the introduction of the new tax regime. This particular issue has attracted the limelight yet again by virtue of the recent decision of the Hon'ble Karnataka High Court in the matter of [DPJ Bidar - Chincholi \(Annuity\) Road Project Private Limited.\[1\]](#)

The Hon'ble High Court observed that 'annuity' received for construction of roads is exempt from GST by operation of a specific entry[2] in the Exemption Notification and that [Circular No. 150/6/2021 dated 17.06.2021](#) ('Circular No. 150') issued by the Government clarifying that annuity is not exempt from tax is in direct contradiction with the prescribed exemption. Accordingly, the Hon'ble High Court deemed it fit to strike down Circular No. 150 and set aside any actions taken pursuant to the same.

The decision is certainly being welcomed with open arms for having clarified on the intention that has always permeated down from the GST Council, i.e., to exempt 'annuity' received for construction of roads. However, this judgement also raises several open-ended questions.

The purpose of this article is to highlight some of these grey areas which require immediate attention both from the Government and Trade so as to mitigate avoidable litigations in the future.

### Background

At the Union level, National Highways Authority of India (NHAI) is the nodal authority which regularly awards road construction projects. Additionally, Public Works Departments of various State Governments also undertake such projects. These projects are generally executed by adopting specific procedures which broadly entail the following: -

- Participation in a bidding process and issuance of a Letter of Award by the relevant Authority to the winning contractor,
- The contractor is then mandated to incorporate an SPV solely for the purpose of executing the project,
- The SPV (also referred to as 'Concessionaire') executes a 'Concession Agreement' with the relevant Authority and,

- Lastly, the SPV executes an EPC agreement with the contractor or another company for actual execution of the project.

There are also various commercial models which are generally adopted by Authorities for executing road construction projects viz., Build Operate Transfer (BOT) Toll Model, BOT (Annuities) Model, Engineering Procurement Construction ("EPC") Model and Hybrid Annuity Model (HAM).

The focus of this article is primarily on HAM. In this model, the Authority would provide 40% of the project cost during the construction period as a lumpsum payment whereas the remaining 60% of the project cost would have to be borne by the Concessionaire. The Authority would then collect tolls and make periodical annuity payments to the Concessionaire which would cover the 60% of the project cost initially borne.

## Legal Framework

Toll charges collected for granting access to road has always been exempt from GST<sup>[3]</sup>. There is no dispute in this regard. The only issue concerns taxability of 'annuities' paid by the Authority under HAM. The taxability of annuity provided in lieu of Toll charges was considered by the GST Council during its 22nd Meeting and after due deliberations, it was annuity should also be exempted from GST as it was on par with toll.

The recommendations of the Council were brought into force through introduction of an exemption entry<sup>[4]</sup> in October 2017 to provide for a nil rate of tax to '*services by way of access to a road or a bridge on payment of annuity*'.

On a cursory reading of the entry, it appears that it only exempts services by way of access to a road or bridge in exchange for annuity. However, in the HAM Model, annuity is paid by Authorities to the SPV only for 'construction of the road'. Annuity is not paid for granting a right to access any road.

Recognising such ambiguities, Trade made several representations to the Government seeking clarity. Consequently, the Government issued 'Circular No. 150' adding another layer to the conundrum by distinguishing between annuities paid 'for access to road' and 'for construction of roads', without entirely considering the objective behind introducing the exemption and the purpose for which annuity is paid in the first place.

In this background, the Hon'ble Karnataka High Court rightly struck down the Circular for being contrary to the Exemption Notification issued by the Government.

## Open Questions

### Taxability

As on date, the Exemption Entry continues to only encompass 'services by way of access to a road or a bridge on payment of annuity'. Unless a specific amendment is introduced to clearly exempt 'annuity payments made towards construction of roads', clarity may not be achieved in respect of HAM Projects. Trade may make suitable representations to the effect especially now, considering the recent decision of the Hon'ble Karnataka High Court.

### Eligibility to avail Input Tax Credit (ITC)

Another allied area of concern relates to ITC. Once it is that annuity paid towards construction of road is exempt, the obvious question which arises is whether the Concessionaire is eligible to avail full ITC of the GST paid on procurements made for executing the HAM project.

As noted above, in case of a HAM Project, 40% of the consideration is paid upfront by the Authority and the remaining 60% is paid in a deferred manner in the form of annuity. On the upfront payment made, there is no exemption, while annuity is exempt from tax. The service rendered is only one, i.e., construction of roads.

In this regard, reference is made to the ruling of the Rajasthan Appellate Authority for Advance Ruling in the case of [M/s Nagaur Mukundgarh Highways Pvt. Ltd.](#)<sup>[5]</sup>. In the said case (involving the HAM model), the Appellate Authority was of the view that while exemption was available on the annuity payments received, GST was payable on payments received during the construction period.

Having concluded so, the Authority observed that since part of the value received was taxable and part was exempt, proportionate reversal was required to be made to the extent of the value of supply that was exempt. The said Ruling has been challenged before a High Court and is currently pending disposal.

It will be interesting to note how the High Court decides on the eligibility to credit considering proportionate reversal is required under the law only when procurements are commonly used for providing taxable and exempt supplies and not when part of the value of a single supply is exempt.<sup>[6]</sup>

However, proceeding on an assumption that ITC is eligible in full, another issue also deserves attention.

### Accumulation of ITC

Since output GST is payable only to the extent of the amount received from Authorities during the construction stage of the project (i.e., on 40% of the total consideration) and the annuity portion of the consideration is exempt, SPVs are faced with accumulation of unutilised credit. The provisions of GST law do not envisage grant of refund of credit in such circumstances.

Furthermore, since SPVs are formed for the specific purpose of executing the project and generally, dissolve at the end of the project, the accumulated credit would only lapse.

This significantly increases costs for the SPV to an extent that it may effectively offset the benefit of exemption available on annuity. Trade may make suitable representations to the Government seeking to address this issue.

### **Conclusion**

Taxability of annuity is just a small piece in a more complex puzzle. While the judgement of the Hon'ble Karnataka High Court is a step in the right direction, there are various other pieces such as eligibility to credit, accumulation of credit and transition of contracts from Service Tax to GST regime which are to be analysed and resolved. All the stakeholders must approach this issue in a holistic manner so that a suitable position can be adopted keeping in mind all aspects.

---

<sup>[1]</sup> Writ Petition No. 22250 of 2021.

<sup>[2]</sup> S.No. 23A of Notification No. 12/2017 dated 28.06.2017.

<sup>[3]</sup> Sl.No. 23 of Notification No. 12/2017 dated 28.06.2017.

<sup>[4]</sup> Sl.No. 23A of Notification No. 12/2017 dated 28.06.2017.

[\[5\]](#) 2019 (23) G.S.T.L. 214 (App. A.A.R. - GST).

[\[6\]](#) Section 17(2) of the CGST Act, 2017.