Anti-Profiteering in real estate sector – Challenges and Predicaments

Anti-Profiteering is a not a new concept to global indirect taxes. In India, the provision has been introduced considering its success and looking at its importance in curbing inflation and price raise in other preceding GST implementing nations. The demands raised against many suppliers under the Anti Profiteering provisions are of great magnitude and have far reaching implications. The provision is still evolving with issuance of more and more orders under this provision. The article examines the implications of Anti Profiteering provisions in real estate sector and some of the unique elements of this sector.

What is Anti profiteering?

Section 171 of Central Goods and Services Tax Act, 2017 ("CGST Act") empowers government to create provisions for Anti Profiteering. The relevant Section reads as under:

> *"171. (1) 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.*
>
> *(2) The Central Government may on recommendations of the Council, by notification, constitute an Authority, or empower an existing Authority constituted under any law for the time being in force, to examine whether input tax credits availed by any registered person or the reduction in the tax rate have actually resulted in a commensurate reduction in the price of the goods or services or both supplied by him.*
>
> *(3) The Authority referred to in sub-section (2) shall exercise such powers and discharge such functions as may be prescribed."*

The intent of the law was to stop the inflationary tendency post advent of GST and to pass the benefit of cost reduction to the buyer. As per Black's Law Dictionary – 'Profiteering' is "taking advantage of unusual or exceptional circumstances to make excessive profits…" and thus, anti-profiteering shall mean a measure to curb this tendency of making excessive profits, and in present case when such profits arise on count of taxes. The term has been explained in the Frequently Asked Questions as under:

Q 1. What is profiteering?

Ans. In terms of Section 171 of the CGST Act, 2017, the suppliers of goods and services should pass on the benefit of any reduction in the rate of tax or the benefit of input tax credit to the recipients by way of commensurate reduction in prices. The wilful action of not passing on the above benefits to the recipients in the manner prescribed is known as "profiteering".

Source: http://www.cbic.gov.in/resources//htdocs-cbec/gst/Anti-prof-FAQs-FINAL-FAQs.pdf;jsessionid=65C5E3ED435EC71DB9884153FE2EE3D8

Thus, the intent of the legislature is not to curb the profits of a supplier which he was making in his normal course of business prior to GST but to curb his tendency to pocket any net profit which arise post GST on count of taxes (i.e.net of any cost increase so that he can retain his normal profits). The purpose of the Section 171 of the CGST Act, 2017 was to enable the Government to determine prices of goods or charges for services with the object of curbing excessive profiteering of essential goods and services by unscrupulous traders.

The section provides that any output tax ***reduction*** benefit or benefit because of ***increase*** in available Input Tax Credit ("ITC") which is related to a supply, the same should be passed onto the buyer. Thus, the whole idea is to pass the benefit of a reduction or increase to the buyer.

<u>Reduction in Output Rate of Tax</u>

On part of output tax, if there is a drop in output rate, the same is to be passed onto buyer, thus, in other words, the following general example is the differential benefit in case of drop in out put tax to be passed to the buyer:

Particular	Before Change	Post Change
Sale Value	100	100
Rate of Tax	18%	12%
Tax thereon	18	12
Effective Price to Customer	118	112
Effective benefit to Customer		6

Generally, there is no drop in case of real estate sector in rate of tax when compared to pre-GST period, but yes, there has been drop-in rates within GST periods.

<u>**Increase in benefit of input tax credit**</u>

In case of benefit of ITC, it is to be worked out as to how much of the ITC which was inbuilt in costs of the supplier prior to GST was made available to such Supplier post GST and thus, such benefit should be passed to the buyer as the cost of the supplier for manufacture or provision of such supply has gone down. Such benefit should be passed onto the buyer. The same can be understood with the following example:

Particular	Before Change	Post Change
Purchase price	118	118
Rate of Tax	12%	18%
Tax credit as available to Supplies	12.64	18
Effective Cost to Supplier	105.35	100
Benefit to be passed by reducing sale price to Customer	5.35	

Thus, if the credit which formed earlier part of the cost and has been increased **<u>leading to reduction in cost</u>** to the Supplier, **<u>such benefit of reduced cost</u>** should not be pocketed with the supplier and should be passed onto the buyer.

In above case, it is possible that total cost to the supplier is increased by his vendor and thus, even though the ITC is increased, the effective fall is not there in price. We understand this by way of an example:

Particular	Before Change	Post Change
Purchase price	112	118
Rate of Tax	12%	18%
Tax credit as available to Supplies	12	18
Effective Cost to Supplier	100	100
Benefit to be passed by reducing sale price to Customer	0	

In above case, the effective cost to the supplier has not increased and thus, if only by merely considering the increased ITC of Rs 18, the supplier is asked to pass on the benefit of Rs 6 to the consumer, we are then asking the supplier to reduce his profit forcibly without him gaining anything from ITC.

We take the third scenario whereby there is increase in cost and ITC both increase, as under:

Particular	Before Change	Post Change
Purchase price	112	122
Rate of Tax	12%	18%
Tax credit as available to Supplies	12	18.61
Effective Cost to Supplier	100	103.39
Increase in Cost		3.39
Increase in Credit		6.61
Net Benefit to be passed by reducing sale price to Customer		3.22

Thus, such computations are very complex and in absence of a standard methodology, there is a high possibility of a bias and non uniform results in such determination.

The results are subjective and rarely are correct in real estate sector

Rule 126 of CGST Rules, 2017 provides that the Authority may determine the methodology and procedure for determination as to whether the reduction in the rate of tax on the supply of goods or services or the benefit of input tax credit has been passed on by the registered person to the recipient by way of commensurate reduction in prices. The methodology and procedure has been notified vide National Anti-Profiteering Authority under the Goods & Services Tax (here-in-after referred to as the Authority) Methodology and Procedure, 2018 ("Methodology and Procedure"). The Methodology and Procedure so notified provides for the mechanism of proceedings for undertaking such enquiry, however, the methodology and procedure for computing such reduction / increase is not provided in such notified Methodology and Procedure. In absence of such standard Methodology and Procedure, the results are subjective. One must consider that there must be two comparable periods whereof one can derive the increase or decrease. Interestingly, the comparison is mostly made between the period prior to 01.07.2017 (prior to GST) and on and from 1.7.2017 (post GST). While one can understand that the two periods are to be compared, but to what limits – till which year prior and post 1.7.2017. Every change of compared periods would derieve different results. Also, the kind of work done in such period can also produce unreliable results. Lets see the results in the following data of amounts expended on the two activities:

Rs. In crore

Particular	Year 1	Year 2	Year 3	Year 4	Year 5
Construction	50	50	50	30	20
Finishing	0	10	20	50	50

Let us presume a constant ITC average rate of 7% on construction and 12% on finishing activities (it is presumed that there was no increase or decrease in ITC in two periods on both activities as tax charged as percentage in two periods is same). Now, with this data, lets construct a simple scenario in two periods (also presuming GST was introduced from 1.4.2017 for ease of reference):

Case 1

Particular	**2014**	**2015**	**2016**	**2017**	**2018**
Construction	1,000	700	200	300	200
Finishing	-	100	300	500	800
Total Expense	500	600	700	800	700
Total ITC	70	61	50	81	110
Average ITC	**10.06**			**12.73**	

Case 2

Particular	**2015**	**2016**	**2017**	**2018**	**2019**
Construction	1,000	700	200	300	200
Finishing	-	100	300	500	800
Total Expense	500	600	700	800	700
Total ITC	70	61	50	81	110
Average ITC	**11.91**			**10.95**	

One can see that in above case, there is no change of rate of tax, however, in Case 1, the results show an increase in ITC, while in case 2, it shows a fall in ITC. Thus, this clearly establishes that the choice of period, kind of expenditure in such period and constituent of such expense can produce varies results without providing any assurance of their correctness. The complexity multifolds when there are multiple projects (even residential / commercial towers) in a single company would vary the results.

The profit margin though can also change attributing to other economic factors like change in demand of the product, change in technology, change in competition pattern, change in quality and many other factors. Even if one ignores the other factors for price variation being subjective, factoring the cost increase while determining anti profiteering would be just and reasonable to any Supplier. This is moreso in case of supplies which are underway while such tax costs either side have changed.

International Practises

Internationally also, the Net profit margin formulae is being followed to determine Anti profiteering. The net profit margin implied by prices and costs incurred in the supply of a particular good or service should not increase as a result of the New Tax System changes alone. The price and net profit margin o f a particular good or service applying immediately before the date of introduction of the GST will generally be taken as the pre-GST price and margin for the purpose of assessing the price on the introduction of the GST. The determination of net profiteering is usually based on the concept that the **net profit margin** will remain same as a percentage of costs or of sales exclusive of indirect taxes, unless a supplier is able to demonstrate that exceptional circumstances justify a different approach to net profit assessment.

In case of Australia, the anti-profiteering measures were based on the 'Net Dollar Margin Rule' on which profiteering was calculated. More specifically, the prices charged by the businesses can increase (decrease) by no more than the dollar rise (fall) in their costs as a result tax change (ACCC 2000a). Businesses were allowed to factor overhead costs in their profiteering working.

In case of Malaysia, the determination of "unreasonably high profits" is made by examining the mark-up percentage mechanism or the margin percentage mechanism using the prescribed formulas. A comparison is done by comparing the percentages of any (i) goods sold or offered for sale or (ii) services supplied or offered for supply on the first day of a particular financial year (FY) or calendar year (CY), against the percentages of any (i) goods sold or offered for sale or (ii) services supplied or offered for supply in that particular FY or CY. This method ascertains a Normal Profit Margin for each product on a base day (i.e. January 1, 2015) and any profit charged by the trade above this base margin is considered Unreasonably High Profit. In a nutshell, the net profit margin of goods/services supplied between 02 January 2015 to 31st December 2016 are not allowed to be increased for all businesses. The methodologies were made available to taxpayers vide Price Control and Anti-Profiteering (Mechanism to Determine Unreasonably High Profit) Regulations 2018.

However, despite the Rules providing power to determine the methodology and procedure for determination as to whether the reduction in the rate of tax on the supply of goods or services or the benefit of input tax credit has been passed on by the registered person to the recipient by way of commensurate reduction in prices, no such methodology was determined and provided to the taxpayers by the authority. While, vide National Antiprofiteering Authority under the Goods & Services Tax Methodology and Procedure, 2018, only procedure was provided, however, no methodology for computation of profiteering was provided. Accordingly, the taxpayer has been left to determination of such methodology at a future date while he was expected to pass the benefit as computed using such methodology at the advent of GST. **A mechanism which was never provided to a supplier cannot be determined later to the detriment of the taxpayer.**

Different benefits should accrue to different customers

The Anti profiteering working also inherits another basic risk – ignoring difference in benefits attributable to different customers who have entered into buyer's agreement with builders at different periods of time. Input tax credit of property not sold on the transition date viz., 1.7.2017 is to be taken out and not to be attributable to flats already sold. Thus, the attribution of Input tax credit if given equally as a percentage to the buyer whose building is almost complete and whose only last instalment is receivable shall be a gross misreading of the provisions of the statute and shall lead to unnecessary cost of such benefit on value of other flats which are still under construction or whose value of output is yet to be received. Let us examine this by way of an example:

- Mr A is a buyer of a flat whose construction is complete before 30.06.2017, but his last instalment was due after 1.7.2017, and thus, it must be appreciated that no benefit was any input tax credit as received post 1.7.2017 shall be attributed to his flat. If we give such benefit to Mr. A, then such benefit is being taken from the pocket of the builder as he has not availed by such credit on the construction of such flat.
- Similarly, in another case where Mr. B's flat was constructed to the extent of 90%, and his output tax liability was pending on 40% amount, Mr B is eligible for input tax credit as attributable to his construction and not in equivalence of construction of other flats.

Further, there are costs which are not attributable towards the old flats which have been sold and thus, Input tax credit on such costs should be attributable to only those flats to which they relate to for eg., brokerage charges commission paid on flats sold after 1.7.2017, advertisement expenses incurred should relate to flats which are unsold as on 1.7.2017 etc. Thus, giving such benefit of Input Tax Credit to all flats shall channelize benefits of one set of buyers to all buyers at the cost of the supplier, which shall be a gross burden on the supplier.

Conclusion:

There is substantial precedence of anti-profiteering laws in other countries where it has been implemented. Though we adopted the concept, but we fail to adopt the entire concept completely, nor we did anything which can show our adoption was more mature than our predecessors. The determination of profiteered amount has opened a long phase of court battles in Real estate sector. There are both legal as well as factual assertions before Hon'ble Courts and this battle would take a long time considering the complexity of computation and involvement of so many elements in this phase. The law still needs further debate as it completely ignores the escalation of costs in periods being compared. It would also be equitable if a uniform approach for computation of such profiteered amount can be devised for all taxpayers.