

INPUT TAX CREDIT AVAILABLE FOR CONSTRUCTION OF IMMOVABLE PROPERTY INTENDED FOR SUPPLY OF RENTAL SERVICES: SUPREME COURT

The Hon'ble Supreme Court, in *Chief Commissioner of Central Goods and Service Tax & Ors. vs. M/s Safari Retreats Private Ltd. & Ors. [C.A. 2948 of 2023]*, upheld the constitutional validity of Section 16(4) and clauses (c) and (d) of sub-section (5) of Section 17 of the Central Goods and Services Tax Act, 2017 ("CGST Act"). Furthermore, the Court, while remanding the matter back to the respective High Courts, held that Input Tax Credit (ITC) shall be available on construction costs when the construction of any building, other than a hotel or a cinema theatre, qualifies as a 'plant' as understood under section 17(5)(d) of the CGST Act.

Background:

Section 17(5) of the CGST Act, 2017, outlines the activities and transactions for which ITC has been specifically blocked. Clauses (c) and (d) of Section 17(5) have been reproduced below for reference:

"Section 17(5) - Notwithstanding anything contained in sub-section (1) of section 16 and sub-section (1) of section 18, input tax credit shall not be available in respect of the following, namely:-

(a).....

*(c) works contract services **when supplied for construction of an immovable property (other than plant and machinery)** except where it is an input service for further supply of works contract service;*

*(d) goods or services or both received by a taxable person for **construction of an immovable property (other than plant or machinery)** on his own account including when such goods or services or both are used in the course or furtherance of business."*

As per the Explanation to Section 17 of CGST Act, 2017, the expression "**plant and machinery**" means apparatus, equipment, and machinery fixed to earth by foundation or structural support that are used for making outward supply of goods or services or both and includes such foundation and structural supports but excludes-

- (i) land, building or any other civil structures;
- (ii) telecommunication towers; and

- (iii) pipelines laid outside the factory premises.

Brief facts of the case:

The issue at hand emanates from a group of SLPs concerning the interpretation and application of clauses (c) and (d) of sub-section (5) of Section 17 of the CGST Act, 2017. The Respondent, M/s Safari Retreats Private Ltd., engaged in the business of construction of shopping malls, claimed ITC on the goods and services used in construction, on the basis that such credit shall be available since the rental income derived from leasing units in the mall was taxable under the CGST Act. The Respondent also challenged the constitutional validity of Section 16(4) and Section 17(5)(d) of the CGST Act, which disallows ITC relating to goods and services received towards the construction of immovable property, except for (1) plant or machinery; and (2) construction on their own account. The matter travelled to the Hon'ble Supreme Court by way of appeal following a favourable ruling by the Hon'ble Orissa High Court, which interpreted Section 17(5)(d) to allow ITC for assesseees who paid output GST on rentals of such immovable properties.

Observations of the Hon'ble Supreme Court:

On eligibility of ITC on construction of immovable property:

- The Hon'ble Supreme Court observed that whether a building, other than a hotel or a cinema theatre, could be classified as a plant within the meaning of the expression "plant or machinery" used in Section 17(5)(d) is a factual question which had to be determined keeping in mind the business of the registered person and the purpose for which the said building was constructed.
- The Hon'ble Court held that such functionality test would have to be applied to decide whether a building is a plant for each case. Thus, ITC on construction services could be allowed if the relevant building qualifies as a 'plant' under the functionality test. The Hon'ble Court observed that as the word 'plant' has not been defined under the CGST Act or the rules framed thereunder, its ordinary meaning in commercial terms will have to be attached to it.

On constitutional validity of Section 16(4) and clause (c) and (d) of Section 17(5) of the CGST Act:

- The Court upheld the constitutional validity of clauses (c) and (d) of Section 17(5) of the CGST Act, rejecting challenge based on Article 14. The Hon'ble Court observed that the provisions involved an intelligible differentia forming the basis of the classification, and the differentia should have a rational nexus with the object of legislation, and that there was no discrimination in the treatment of ITC claims related to immovable property. The Court also observed that there was no violation of Articles 19(1)(g) and 300A of the Constitution.
- The Apex Court upheld the constitutional validity of Section 16(4) of the CGST Act and held that the time limit for availment of ITC, as provided under Section 16(4), was not arbitrary or discriminatory.

VA Comments

The Supreme Court has introduced a functionality test to determine whether a building can be considered a plant on a case-by-case basis. While the judgment has left the door slightly open regarding the claim of ITC on taxes paid for construction services, this is contingent upon the building being classified as a 'plant.' Each case will require its own independent assessment, which could lead to future disputes.

The Court emphasized that such determinations should be based on trade understanding, commercial and technical practices, and usage, rather than importing definitions from non-cognate statutes.

Given this, a legislative amendment to the GST statutes—excluding land and buildings from the definition of 'plants,' similar to the Explanation in Section 17 of the CGST Act—would not come as a surprise.

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