Input tax credit of GST paid on goods or services received for construction of shopping mall, warehouse or commercial office building, which in turn are used to render renting services[1]

Background

Safari Retreats Pvt. Ltd. ('the Respondents') is carrying on business activity of constructing shopping malls for the purpose of letting out of the same to tenants and lessees. Letting out of units in the shopping mall attracts goods and services tax ('GST'). Materials and other inputs in the form of cement, sand, steel, aluminium, wires, paint, lifts, escalators, special façade, etc. and also services in the form of architectural service, engineering service including services of special team of international designers in every sphere of construction of shopping mall are required for the aforesaid construction purpose. The Respondents had accumulated input tax credit ('ITC') of GST paid on the purchase of goods and services consumed and used in the construction of the shopping mall.

Before the Apex Court, it is contended that GST is being recovered on the supply of goods and services used in the construction of commercial office buildings, and GST is also being recovered on rentals collected, but due to the restrictions imposed by Section 17(5)(c) and Section 17(5)(d) of the Central Goods and Services Tax Act, 2017 ('CGST Act'), the taxpayers are unable to avail the ITC of GST paid on goods and services used in the construction of such commercial office building or shopping malls.

Earlier, the High Court of Orissa had held that section 17(5)(d) of CGST Act was required to be read down as the very purpose of ITC is to benefit the taxpayer. The High Court held that if the taxpayer is required to pay GST on the rental income from the mall, it is entitled to ITC on the GST paid on the construction of the mall. The High Court held that the narrow interpretation given by the GST authorities to Section 17(5)(d) would frustrate the very object of the CGST Act.

Relevant Provisions in CGST Act – Section 17(5)

(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.

Explanation - For the purposes of clauses (c) and (d), the expression "construction" includes re-construction, renovation, additions or alterations or repairs, to the extent of capitalisation, to the said immovable property;

Explanation - For the purposes of this Chapter and Chapter VI, 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.

[1] **Apex Court in case of *Chief Commissioner of Central Goods and Service Tax & Ors. vs. Safari Retreats Pvt. Ltd. & Ors.* [Civil Appeal No. 2948 of 2023]**

Submissions by the Respondents (taxpayer)

1. Section 17(5)(d) is violative of Article 14 since it classifies taxpayers engaged in the business of constructing immovable properties and then renting/leasing/letting out etc. premises within the said immovable properties on the same footing as taxpayers engaged in the business of constructing immovable properties and then selling the immovable properties or premises within the said immovable properties, by denying them ITC for their business expenditure, i.e., the expenditure incurred in constructing the immovable properties. Therefore, the provision treats unequals as equals and contravenes the principle of GST law, i.e., to allow ITC for business expenditure.

2. Denying ITC essentially perpetuates and continues the cascading effect of tax, contrary to the very object of the CGST Act of eliminating the cascading effect of tax and achieving tax neutrality.

3. Section 17(5)(d) remain vague due to the absence of definitions of the expressions "on its own account" and "plant or machinery". The distinction between the expression "plant and machinery" used in Section 17(5)(c) and the expression "plant or machinery" used in Section 17(5)(d) has not been clarified by the Government.

4. Clauses (c) and (d) of Section 17(5) must be read down to the extent that ITC is blocked. Articles 246A and 279A were introduced to simplify the indirect tax regime to prevent the cascading effect of multiplicity of taxes. If the entire scheme of the CGST Act is perused, except for clauses (c) and (d) of Section 17(5), the ITC is not denied when the transaction is from business to business.

5. The phrase "on its own account" should be read down and given a purposive construction instead of a myopic one. The phrase should be deemed to mean when construction is done for personal use and not for services, i.e., ITC should be denied only when goods and services are utilised for the construction of immovable property for his own purposes, like an office building or factory building.

6. Section 17(5)(d) of the CGST Act can be interpreted in a manner that ITC is available to them for the construction of immovable property used for the purpose of further output supply, without reading down Section 17(5)(d).

7. Clause (d) exempts "plant or machinery" from blocked credit, which is distinct from the expression "plant and machinery" used in clause (c). Therefore, the Explanation which defines "plant and machinery" is not applicable to the Clause (d). The expression "plant or machinery" has not been defined under the CGST Act. Malls, hotels, warehouses, etc., are 'plants' and, therefore, are exempted from the provision. The word "plant" is not defined under the CGST Act or the General Clauses Act, 1897. Functionality or essentiality tests must be applied to decide what a plant is.

8. The legislature intentionally used the expression "plant or machinery" in only one place, and the legislative intention has to be adhered to. In its wisdom, the legislature has allowed ITC on immovable property provided it meets the criteria of functionality or essentiality of a plant. The disallowance of ITC on goods and services used in the construction of buildings could be a logical corollary only if the buildings were intended to be sold as stock by the developer instead of being further used for providing taxable goods or services.

Submissions by the Revenue Authorities

1. Denial of ITC was justified on the ground that it is not a fundamental or constitutional right; ITC is a statutory right, and in the absence of the right under the statute, the Court cannot issue a mandamus to grant ITC.

2. The test of vice of discrimination in a taxing statute is less rigorous. The Parliament is entitled to make policy choices and adopt appropriate classifications given the latitude that our Constitutional jurisprudence allows in the matters involving tax legislation. The principle of equality does not preclude the classification of property, credit, profession and events for taxation. Even assuming that clauses (c) and (d) are discriminatory, they are not manifestly discriminatory.

3. English decisions will not apply, as in India, there is a constitutional and statutory distinction between goods that are movables and immovables. This distinction is not available in England.

4. The expression "plant or machinery" must be read as "plant and machinery". It is not uncommon to read "and" as "or" or "or" as "and". If "or" is not read as "and", it would be discriminatory since ITC would be available on a mall or warehouse, but under clause (c), it would not be available on works contracts relating to the construction of a mall or warehouse. Clauses (c) and (d) of Section 17(5) deal with the same subject matter, i.e., immovable property and therefore they cannot be treated unequally. Revenue submitted that 'or' in clause (d) must be read as 'and'; stating it to be the mistake of the legislature.

5. For identifying what would constitute plant and machinery / plant or machinery, it is not necessary to refer to decisions under the Income Tax Act as the same have no relevance. If the taxpayer's submission that a shopping mall or warehouse is treated as a plant is accepted, it would amount to hostile discrimination.

6. If a shopping mall is sold as an immovable property immediately after the completion certificate is issued, no GST is payable at the time of sale of the immovable property. Therefore, ITC credit cannot be used. If the mall is used to render renting service for five years and then is sold after five years, no GST will be payable on the sale. However, if ITC is allowed as contended during these five years, ITC will be exhausted against GST payable on rental income. Thereafter, the mall would be sold without paying any tax, which would cause a substantial monetary loss.

Judgement of the Apex Court

1. There is hardly a similarity between clauses (c) and (d) of Section 17(5) except for the fact that both apply to the construction of an immovable property. It is pertinent to note that clauses (c) and (d) do not altogether exclude every class of immovable property from the applicability of ITC. In the case of clause (c), if the construction is of "plant and machinery" as defined, the benefit of ITC will accrue. Similarly, under clause (d), if the construction is of a "plant or machinery", ITC will be available.

2. There is no scope to give any meaning to clause (c) of Section 17(5) other than its plain and natural meaning. The expression "plant and machinery" has been specifically defined in the Explanation of Section 17. Works contract service has been defined under the CGST Act. We cannot add anything to clause (c) or subtract anything from clause (c). ITC is a creation of legislature. Therefore, it can exclude specific categories of goods or services from ITC. Exclusion of the category of works contracts by clause (c) will not, per se, defeat the object of the CGST Act.

Judgement of the Apex Court

3. While enacting the CGST Act, the legislature has consciously chosen to use the expression "plant or machinery" only in clause (d). If it was a drafting mistake, the legislature could have stepped in to correct it. However, that was not done. In such circumstances, it must be inferred that the legislature has intentionally used the expression "plant or machinery" in clause (d) as distinguished from the expression "plant and machinery", which has been used in several places. As the expression "plant or machinery" appears to be intentionally incorporated, it is not possible to accept the contention that the word "or" in clause (d) should be read as "and". The expression "plant and machinery" and "plant or machinery" cannot be given the same meaning.

4. The expression "plant or machinery" has a different connotation. It can be either a plant or machinery. The very fact that the expression "immovable property other than "plants or machinery" is used shows that there could be a plant that is an immovable property. 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.

5. The decision of the Apex Court, which held that building which was used as a hotel or a cinema theatre could not be given depreciation on the basis that it was plant, cannot be applied while considering the question of whether a mall or warehouse or a building other than a hotel or a cinema theatre can be said to be a "plant".

6. The word 'plant' used in a bracketed portion of Section 17(5)(d) cannot be given the restricted meaning provided in the definition of "plant and machinery", which excludes land, buildings or any other civil structures. Therefore, in a given case, a building can also be treated as a plant, which is excluded from the purview of the exception carved out by Section 17(5)(d) as it will be covered by the expression "plant or machinery". To give a plain interpretation to clause (d), the word "plant" will have to be interpreted by taking recourse to the functionality test.

7. If a building qualifies to be a plant, ITC can be availed against the supply of services in the form of renting or leasing the building or premises. However, if the construction of a building by the recipient of service is for his own use, ITC would not be available. If the building in which the premises are situated qualifies for the definition of plant, ITC can be allowed on goods and services used in setting up the immovable property, which is a plant.

8. Each mall is different. In each case, fact-finding enquiry is contemplated. Each case will have to be tested on merits as the question whether an immovable property or a building is a plant is a factual question to be decided. Thus, in the facts of the case, we will have to send the case back to the High Court to decide whether, on facts, the mall in question satisfies the functionality test so that it can be termed as a plant within the meaning of bracketed portion in Section 17(5)(d). The same applies to warehouses or other buildings except hotels and cinema theatres.

9. The cases covered by clauses (c) and (d) of Section 17(5) are entirely distinct from the other cases. This appears to be done to ensure the object of not encroaching upon the State's legislative powers under Entry 49 of List II. Therefore, it is not possible to accept the submission that the difference is not intelligible and has no nexus to the object sought to be achieved. In this case, equals are not being treated as unequals. The test of vice of discrimination in taxing law is less rigorous. Ultimately, the legislature was dealing with a complex economic problem. By no stretch of the imagination, clauses (c) and (d) of Section 17(5) can be said to be discriminatory.

CBV Comments

The Apex Court –

- has upheld the constitutional validity of clauses (c) and (d) of Section 17(5);
- has held that the expression "plant or machinery" used in Section 17(5)(d) cannot be given the same meaning as the expression "plant and machinery" defined by the Explanation to Section 17.

The question whether a mall, warehouse or any building other than a hotel or a cinema theatre can be classified as a 'plant' within the meaning of the expression "plant or machinery" used in Section 17(5)(d), the Apex Court has stated that it is a factual question which has to be determined keeping in mind the business of the registered person and the role that building plays in the said business. The Apex Court has remanded the writ petitions to the High Court of Orissa for limited purposes of deciding whether, in the facts of the case, the shopping mall is a "plant" in terms of Section 17(5)(d).

The Apex Court remarked that if the construction of a building was essential for carrying out the activity of supplying services, such as renting or giving on lease or other transactions in respect of the building or a part thereof, the building could be held to be a plant.

The issue is far from over. The legislature correcting its mistake of replacing the word 'or' with the word 'and' in clause (d) cannot be ruled out.

CBV
& ASSOCIATES LLP

Committed to Solve, Excel and Add Value

info@cbva.in

412-415, Tulsiani Chambers | Free Press Marg |

Nariman Point | Mumbai - 21