

'Credit Allowed on Construction of Immovable Property' - Orissa High Court

Section 17(5) of CGST Act, 2017 clearly restricts the credit on goods and services when used in construction of immovable property. The language of this section seemed clear and unambiguous until Hon'ble Orissa High Court gave it's consideration to this question in the case of Safari Retreats Private Limited Vs Chief Commissioner of Central Goods and Service tax [(2019) (Orissa)]. This article is an insight into verdicts given by Hon'ble High Court by analysing the provisions of section 17(5) of CGST Act, 2017. To know more, read on...



CA. Preeti Parihar

The author is a member of the Institute. She can be reached at preeti.parihar@gmail.com and eboard@icai.in



Input tax credit (ITC) is the key area of any Indirect tax regime and utmost care is taken while drafting provisions relating to it. However, it is also true that despite all efforts of law makers, it still remains the key area of litigation. This fact is once again proved by the judgement of Hon'ble Orissa High Court in the case of *Safari Retreats Private Limited Vs Chief Commissioner of Central Goods and Service tax [(2019) 105 taxmann.com 324 (Orissa)]*. This piece articulates an analysis of this judgement along with author's respectful views on the consequences that arise from this judgement.

Legal Provisions Related to Construction of

Immovable Property

Schedule II to CGST Act, 2017

As per schedule II to CGST Act, 2017, construction of complex, building or civil structure or its part including where it is intended for sale to buyer wholly or partly is deemed as supply of service except where entire consideration is received after issuance of completion certificate by competent authority or after its first occupation whichever is earlier. In other words, where the immovable property is sold after issue of completion certificate or first occupancy whichever is earlier; it is treated as sale of immovable property.

Schedule III to CGST Act, 2017

Schedule III to CGST Act, 2017 provides the list of certain transactions which are neither treated as supply of goods nor supply of services, i.e. the transactions which are outside the purview of GST law. It covers sale of land and building, subject to clause 5(b) of Schedule II. In other words, no GST is leviable on sale of land. Various provisions have been drafted in CGST Act laying down the policy of the Legislature to deny ITC on construction of immovable properties.

Blocked Input Tax Credit

Section 17(5) of the CGST Act, 2017 contains list of blocked credits covering the list of certain goods or services on which ITC shall not be allowed despite fact that all the conditions specified in section 16(1) of CGST Act, 2017 are satisfied. Clause (c) and (d) of section 17(5) restricts ITC on construction of immovable property. Clause (c) reads as follows :

“(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;”

This provision states that where a person has received inward supplies by way of composite supply of “works contract services”, he shall not be allowed its ITC unless his outward supply is also “works contract service”.

Example

X Ltd. is in business of manufacture and sale of plastic bottles. It engages AB Buildcon Ltd. for construction of factory building against consideration of ₹ 1 crore. AB Buildcon Ltd. outsources this contract to Y & Co. against a consideration of ₹ 80 lacs. In the given case, Y & Co. will raise tax invoice under the head of works contract service on AB Buildcon Ltd. for ₹ 80 lacs. AB Buildcon will further raise tax invoice under the head of works contract service on X Ltd. As per the said clause (c), ITC shall be allowed to AB Buildcon on the basis of invoice issued by Y & Co. as its outward supply is also works contract. However, ITC shall not be allowed to X Ltd.

Further, clause (d) of section 17(5) reads as follows :

“(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.”

This clause restricts the admissibility of ITC on goods or services received and used by the taxable person on his own account including when such goods or services are used in course or furtherance of business.

Example

In the example given above, if X Ltd. does not engage a contractor and get the factory constructed on his own account (i.e. he buys cement, steel, tiles, etc. in its own name) then also,

ITC shall not be allowed on the same even if the said goods and services are used in furtherance of business.

In view of said clause (d), ITC is not allowed on goods and services used for construction of immovable property, whether constructed by a person on its own account or through contractor. However, where the immovable property is in form of supporting structure or for laying foundation of plant and machinery, related ITC will be allowed.

Meaning of term “construction”

The term construction has been defined by inserting an explanation after clause (d) which reads as follows:-

“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;”

Thus, the term construction has been used as a wide term covering re-construction, renovation, additions or alterations or repairs to an immovable property provided the same is capitalised.

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other words, if the goods and services are used for minor repairs which are expensed off in Profit and Loss Account; this restriction is not applicable and ITC can be claimed on such invoices.

Meaning of term “Plant and Machinery”

The restrictions contained in clause (c) and (d) of Section 17(5) are not applicable if the immovable property results into plant and machinery. The term “Plant and machinery” has been defined in explanation given at the end of Section 17 of CGST Act, 2017. This explanation reads as follows :

“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.”

The analysis of this definition makes it clear that :

- Plant and machinery is any apparatus, equipment and machinery fixed to earth by foundation or structural support that is used for making outward supply and includes foundation and structural supports. Thus, ITC will be allowed on

goods and services used for laying foundation and for construction of structural supports to plant and machinery.

- The definition of plant and machinery excludes land, building and other civil structures, telecommunication towers and pipelines laid outside factory premise. Therefore, no ITC would be allowed on goods and services used in their construction.

Judgement in Case of Safari Retreats Private Limited Vs. Chief Commissioner of Central Goods and Service Tax

Recently, Hon’ble Orissa High Court analysed the above referred clause (c) and (d) of Section 17(5) of CGST Act, 2017 and allowed ITC on construction of immovable property. Care must be taken to identify the *ratio decidendi* which will operate as law in the whole of the State of Orissa and in every State that does not have a contrary decision from its own High Court.

Issue

M/s Safari Retreats Private Limited, the petitioner, was engaged in construction of shopping malls. The shops constructed were let out on which GST (on such rental charged) was duly paid. For the purpose of construction of malls, various inputs like cement, sand, steel, tiles, etc. and input services like consultancy, architectural, legal services, etc. were availed. GST paid on these inward supplies were noted to be substantial

amount. ITC on such goods and services which was denied by tax authorities in view of Section 17(5).

Petitioner’s contention

Matter was carried before the Hon’ble Orissa High Court in a writ petition contesting that the ITC on such goods and services used for construction of shopping malls should be allowed to them based on the following contentions :

- the restriction imposed in clause (c) and (d) of section 17(5) of CGST Act, 2017 was not applicable on them;
- these clauses restrict the ITC if the immovable property was for sale or on their own account;
- in the instant case, the immovable property was neither intended for sale nor on his own account but was intended for letting out.

For these reasons, ITC ought to be allowed and the action by the tax authorities is liable to be quashed. is admissible on the same. It was also pleaded that the denial of ITC in this case will break the credit chain and thus will defeat the ultimate purpose of GST law.

Decision

Hon’ble High Court of Orissa observed that clause (c) and (d) of section 17(5) of CGST Act provides that input tax credit is not available when the immovable property is constructed ‘on his own account’. And that this condition cannot be applied in cases where construction of immovable property is



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intended for letting out. It was further held that the shopping mall was neither intended for sale nor on his own account but was 'intended for letting out'. For these reasons, it was held that set off ITC on the goods/services used in the construction of mall is admissible against the GST payable on the renting of immovable property service.

Analysis of Decision - Author's Views

Interpretation of phrase "on his own account"

The Hon'ble High Court has concluded that the restriction contained in clause (d) is not applicable on the immovable property constructed for the purpose of renting out as the phrase "on his own account" cannot be construed as "intended for letting out". For better understanding, clause (d) is once again produced as follows :

"(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."

The analysis of this clause makes it clear that the ITC is not available if the immovable property is constructed "on his own account". In this regard, it is worthwhile to mention here that the phrase "on his own account" is not defined anywhere in GST law. However, the dictionary meaning of this term is as follows :

"Without requiring or having been given instruction, prompting, or guidance from others; by one's own effort or energy."

Thus, the phrase "on his own account" means carrying out any activity *suo moto* or with own effort or energy and not at instruction of any other person.

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In construction sector, two types of practices are prevalent – one where the sale is made before issue of completion certificate or first occupancy whichever is earlier and other one is when flat is booked after any of these two events have occurred. The former case is covered in GST law and it is assumed that the builder is constructing the immovable property for prospective buyers, i.e. some other person. In latter case, it is assumed that "builder is constructing the immovable property on his own account" and this case has been kept outside the purview of GST law by virtue of schedule III to CGST Act. And ITC has been denied under section 17(5) of CGST Act.

When the builder constructs a commercial property for the purpose of letting out, it is simply the case of "constructing the building on his own account" as he is not constructing the same at the direction of some other

person as it happens in the case where the flat is booked before issuance of completion certificate or first occupancy whichever is earlier. Therefore, construction for the purpose of letting out cannot be equated with para (5)(b) of Schedule II to CGST Act where it is certain that the construction is being carried on account of some other person.

The present case (despite fact that the ultimate aim is renting) clearly indicates that the immovable property is first constructed on his own account and then let-out. These two activities are not one unbroken transaction but necessary interrupted on the date of completion of construction. At this point, there is an option, both to the owner and tenant, to proceed with the rental arrangement. Merely because these two are occurring in succession does not render them unbroken and contiguous events. At this point where the break occurs, the mall stands constructed on 'own account'. Of course, construction of mall would have kept the 'let-ability' in mind but it is important to recognise that the mall stands in the name of Safari as the sole and exclusive owner. And the construction so carried out that brings the mall into existence will on 'own account' and not on 'account of tenants' as the ultimate rights to rent it out or dispose it off rests with the builder only.

On the other hand, in case of clause 5(b) of Schedule II, the ultimate right vests with the person, i.e. prospective buyer, under a prior contract

to construct 'for and on account of' such buyer subject to all attendant contractual obligations being duly met by the buyer. This point appears to have eluded the Hon'ble High Court at the time of comparing the given case with clause 5(b) of Schedule II. Had it been brought to the attention, perhaps the Hon'ble High Court could have laid down a wonderful decision and the conclusion would have been more explicit.

Interpretation leading to redundancy of phrase "even if it is used in course or furtherance of business"

Clause (d) of Section 17(5) states that the ITC is not allowed if the immovable property is constructed by a taxable person on his own account "EVEN IF IT IS USED IN COURSE OR FURTHERANCE OF BUSINESS". This phrase used in language of clause (d) makes it crystal clear that the law makers were certain that ITC should not be allowed even if the immovable property were, in fact, used for business purpose such as renting or as factory or as warehouse, etc.

However, one argument that found favour with the Hon'ble High Court was that the property is used for business purpose and tax is payable on outward supply namely "renting of immovable property". If such interpretation is made then, the phrase "even if it is used in course or furtherance of

business" is rendered otiose.

It has been held by Hon'ble Supreme Court in the case of *Union of India vs. Hansoli Devi* [2002 7 SCC 273] that legislature never wastes its words or says anything in vain and where an interpretation attributes in redundancy of any phrase or provision, it should be avoided. While this principle of construction of statutes is well known, the issue may not have been presented along these lines for the Court to appreciate the facts and the express policy of the Legislation in the form of this 'credit embargo' would have shone through.

Intention of law makers

The decision has been mainly given on the basis of fact that ultimate aim of GST is removal of cascading effect. It is true that ultimate aim of GST is to avoid double taxation, however, at the same time provisions have been framed to restrict the facility of ITC to genuine cases only. As to what was the lawmaker's intention cannot be supplied by a Court but gleaned from the words of the lawmaker himself. This is the reason provisions of Section 17(5) have been framed and overriding effect has been given.

It is worthwhile to mention here that there are cases covered in Section 17(5) of CGST Act, 2017 wherein outward supply is leviable to tax and still no ITC is allowed like in case of goods or services received by Non Resident

taxable person (NRTP) other than goods imported by him. In this case NRTP is duly paying the tax on his outward supply and still ITC is not allowed to him, resulting into double taxation. Yet another instance would be the case of composition taxpayer, where tax charged on inward supplies become part of cost and results into double taxation. Other cases mentioned in section 17(5) are also duly covered in section 16 and ITC is otherwise admissible, however, section 17(5) restricts the same; thereby resulting into cascading effect.

No extent of rationalising trumps the express words in the law. At best, Government could have been directed to examine this apathy when tax is anyway being paid (on rental) credit could well be allowed. But, it is most respectfully submitted, that the interpretation taken by Hon'ble High Court would erode the policy statement embedded in the entire Section 17(5) leaving it wholly redundant and this does not seem to be intention of lawmakers.

Reason behind blocking credit in relation to construction of immovable property

Now, attempting to submit a rationale to support the policy statement lying in clause (c) and (d) of Section 17(5) of CGST Act, appears to block credits in order to curb misuse of large amounts of credit involved

in construction activities. Sale of land and subject to clause (b) of paragraph 5 of Schedule II, sale of building is included in Schedule III of CGST Act which means its sale is neither supply of goods nor supply of service. In other words, sale of any of these does not attract GST. To align with this provision, clause (c) and (d) have been kept in section 17(5) of CGST Act to block the credit pertaining to goods and services used in relation to such activities. It seems that intention of lawmakers is to ensure that malpractices related to huge amount of credit involved in such activities does not pop up. Let us assume a situation – A person constructs a building for using it as his office, avails large amount of credit involved in it and subsequently sells the same; thereby earning dual benefits - once in form of credit and second time on its sale on which no GST is payable. Perhaps these provisions have been kept simply for the reason that when sale of land and subject to clause (b) of paragraph 5 of Schedule II, sale of building is not subject to GST, why

credit should be allowed on its construction. This intention is strengthened by the fact that the clause (d) of section 17(5) specifically covers the phrase “even if it is used in course or furtherance of business”.

Beginning of new era of litigation

The decision given by Hon’ble Orissa High Court has opened up following issues :

- The interpretation taken by hon’ble High Court that since outward supply is leviable to tax, credit should be allowed in order to maintain the credit chain may lead to different interpretations. It has straightforwardly questioned the rationale of section 17(5) of CGST Act, 2017.
- Some people may contend when credit has been allowed on immovable property used for renting out, why is it not allowed when same property is used as factory or shop? Even factory and shop are used in course or furtherance of business and have direct contribution in making taxable supply.



• It is worthwhile to mention here that the telecom towers have been excluded from the definition of plant and machinery and have been covered in clause (d) of

Caution is advised that there is no estoppel that operates against the Government here and anyone who relies on this decision would do so at the risk of interest on the amount of such credit claimed by him

Section 17(5) of CGST Act, 2017. Thus, as of now, no credit is allowed on construction of telecom towers despite fact that the telecom companies are paying tax on its outward supply.

Before Parting

The judgement of Hon’ble Orissa High Court has stirred the entire construction sector and it is all set to make all the adjustments for the financial year 2018-19 and avail the credit before the deadline mentioned in Section 16(4) of CGST Act, i.e., 20th October 2019. Since this judgement appears to have considered limited aspects and travelled into policy review, it would not be unusual for the Government to appeal to Supreme Court and until that appeal is decided, the issue will not be free from doubt and could heat up construction sector due to the temptation to claim credit on construction of immovable property.

Caution is advised that there is no estoppel that operates against the Government here and anyone who relies on this decision would do so at the risk of interest on the amount of such credit claimed by him. ■