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EY Tax Alert

SC holds ITC should be eligible on goods and services used for construction of building, if qualifies as a 'plant'

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Executive summary

This Tax Alert summarizes a recent ruling of the Supreme Court (SC)[1] on the eligibility of input tax credit pertaining to goods and services used in construction. The Court has held that the functionality test would need to be applied to determine whether the construction is of a "plant or machinery" to determine credit eligibility.

The key observations of the SC are:

- The expression "plant or machinery" used in Section 17(5)(d) cannot be given the same meaning as the expression "plant and machinery" defined in 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" is a factual question which has to be determined keeping in mind the business of the person and the role that building plays in the said business.
- If the construction of a building was essential for carrying out the activity of supplying services, such as renting or giving on lease, the building could be held to be a plant.
- Therefore, by using the functionality test, in each case, it will have to be decided whether the construction of an immovable property is a "plant" for the purposes of clause (d) of Section 17(5).
- The challenge to the constitutional validity of clauses (c) and (d) of Section 17(5) and Section 16(4) of the CGST Act is not established.

The writ petitions are remanded to HC for limited purposes of deciding whether, in the facts of the case, the shopping mall is a "plant" in terms of clause (d) of Section 17(5).

[1] 2024-TIOL-101-SC-GST

Building a better working world

Background

- The taxpayer is engaged in the construction of shopping mall for the purpose of letting out premises in the mall to different tenants. It used various taxable goods and services for construction of the mall.
- Department denied the input tax credit (ITC) basis section 17(5)(d) of Central Goods and Services Tax Act, 2017 (CGST Act).
- Aggrieved, the taxpayer filed a writ before Orrisa High Court (HC). HC held that if the assessee 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.
- Against the HC order, the Department filed an appeal before the Supreme Court (SC).

Taxpayer's Contentions

- Clauses (c) and (d) of Section 17(5) are violative of Articles 14, 19(1)(g) and 300A of the Constitution of India.
- Denial of ITC on construction expenditure results in cascading effect of taxes, and denial of credit for business expenditure is in direct contradiction of the objects of the GST law.
- ITC should be available on the construction of immovable property which are used for further output supply.
- 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 to Section 17, which defines "plant and machinery" is not applicable to clause (d).
- Malls, hotels, warehouses, etc., are 'plants' and, therefore, are exempted from the provision. Reliance is placed on various rulings in this regard[2].
- If one reads Section 17 objectively, the benefit of ITC is restricted when the services are used for personal purposes or for providing exempted services, or if the supply is outside the ambit of levying GST. However, where the taxing chain continues, ITC is not restricted.

Revenue's Contentions

- Denial of ITC was justified on the ground that it is not a fundamental or constitutional right[3].
- 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"[4].
- The entire purpose of ITC is to extend the benefit of credit paid at the anterior stage to remove the cascading burden of taxation at a subsequent stage. As there is no GST payable on shopping malls, there is no need to grant ITC.
- The principle of equality does not preclude the classification of property, credit, profession and events for taxation.

Supreme Court's Ruling

- The Court has framed the following questions for consideration:
  - Whether the definition of "plant and machinery" in the explanation appended to Section 17 applies to the expression "plant or machinery" used in section 17(5)(d)?
  - If it is held that the explanation does not apply to "plant or machinery", what is the meaning of the word "plant"?
  - Whether clauses (c) and (d) of Section 17(5) and Section 16(4) of the CGST Act are unconstitutional?
- The Court reiterated the rules regarding interpretation of taxing statutes, which *inter alia* includes:
  - While dealing with a taxing provision, the principle of strict interpretation should be applied.
  - A taxing statute has to be interpreted in the light of what is clearly expressed. The Court cannot imply anything which is not expressed.
  - Equity and taxation are strangers. But if construction results in equity rather than injustice, such construction should be preferred.
  - When a word used in a taxing statute is to be construed and has not been specifically defined, it should not be interpreted in accordance with its definition in another statute that does not deal with a cognate subject.

Analysis of clause (c) and (d) of section 17(5)

- Clause (c) applies when works contract services are supplied for constructing immovable property with the exception when services are received by a

[2] (2006) 4 SCC 786, (1971) 3 SCC 550, 2000) 5 SCC 393, (2002) 9 SCC 571, (2016) 16 SCC 553

[3] (2019) 13 SCC 225

[4] (2020) 8 SCC 129, (1957) SCC OnLine SC 12

taxable person for the construction of "plant and machinery", as defined in explanation to Section 17.

- Clause (d) of Section 17(5) is different from clause (c).
- Clause (d) seeks to deny ITC on goods or services received by a taxable person to construct an immovable property on his own account, with the exception where goods or services are received to construct an immovable property consisting of a "plant or machinery".
- Clause (c) uses the expression "plant and machinery", which is specifically defined in the explanation. However, clause (d) uses an expression "plant or machinery", which is not specifically defined.
- The expression "plant and machinery" has been specifically defined in the explanation of Section 17. We cannot add anything to clause (c) or subtract anything from clause (c). Exclusion of the category of works contracts by clause (c) will not, per se, defeat the object of the CGST Act.

Meaning of the expression "plant or machinery" in clause (d) of section 17(5)

- Revenue accepted that the expression "plant and machinery" appears at ten different places in CGST Act. The expression "plant or machinery" appears only in clause (d) of Section 17(5). The use of the word "or" in clause (d) is a mistake of the legislature.
- If it was a drafting mistake, as suggested by Revenue, 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 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.
- In case of Anand Theatres[5], it was held that building used for running of a hotel or carrying on cinema business cannot be treated to be a plant.
- The later decision of a three-judge bench of SC in case of Karnataka Power Corporation[6] limits the applicability of the decision in case of Anand Theatres to hotels or cinema theatres.
- Therefore, the decision in the case of Anand Theatres 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".
- In the case of Karnataka Power Corporation, SC has laid down the functionality test. It held that if it is found on facts that a building has been so planned and constructed so as to serve an assessee's special technical requirements, it will qualify to be treated as a plant for the purposes of investment allowance.
- To give a plain interpretation to clause (d) of Section 17(5), the word "plant" will have to be interpreted by taking recourse to the functionality test.
- 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. Therefore, the argument regarding breaking the chain cannot be accepted in its entirety.
- As clauses (c) and (d) operate in substantially different areas, the argument of discrimination cannot be accepted.

Constitutional validity challenge

- The laws relating to economic activities should be viewed with greater latitude than laws touching civil rights such as freedom of speech, religion, etc.[7]
- The right of ITC is conferred only by the Statute. Therefore, unless there is a statutory provision, ITC cannot be enforced. It is a creation of a statute, and thus, no one can claim ITC as a matter of right unless it is expressly provided in the statute.
- 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.
- Hence, clauses (c) and (d) of Section 17(5) cannot be said to be unconstitutional.
- It is not shown how the provision of section 16(4) prescribing the time limit to claim ITC is arbitrary and discriminatory.

Conclusion

- The challenge to the constitutional validity of clauses (c) and (d) of Section 17(5) and Section 16(4) of the CGST Act is not established.
- 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.

[5] (2000) 5 SCC 393
[6] (2002) 9 SCC 571
[7]

- 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) 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.

  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, which are covered by clauses (2) and (5) of Schedule II of the CGST Act, the building could be held to be a plant.

  Therefore, by using the functionality test, in each case, on facts, it will have to be decided whether the construction of an immovable property is a "plant" for the purposes of clause (d) of Section 17(5).

- The writ petitions are remanded to the High Court for the limited purposes of deciding whether, in the facts of the case, shopping mall is a "plant" in terms of clause (d) of Section 17(5).

Comments

The Supreme Court has laid down principles to be applied in determining eligibility to input tax credit in matters involving construction of a facility that could qualify as a plant.

The real estate sector engaged in commercial leasing may need to apply these principles to determine whether input tax credit can be claimed on grounds of the construction being of a plant.

A lot of emphasis has been placed by the Supreme Court on the difference in language used by the legislature ("and" vs "or") in arriving at its conclusion. It also needs to be seen whether the Government would be inclined to amend section 17(5)(d) to align the same with the expression used in the Explanation thereby restricting the impact of this ruling.

While this ruling has been rendered in the context of a fact pattern involving the construction and commercial lease of a shopping mall, its applicability to various fact patterns and use cases, upon applying the functionality test, assumes significance for business across sectors. A determination would need to be made basis whether the constructed facility can be treated as a plant that is crucial for providing services.

Ability to claim credit would also be a factor of the same having been availed within specified timelines with necessary Income tax adjustments that may need to be undertaken where such credits have been capitalised and with depreciation having been claimed.

Further clarity on this aspect is likely to arise when the High Court makes its detailed ruling on facts in the context of construction of a mall which is the fact pattern in the Safari Retreats case.

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