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Safari Fallout

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SINCE much has been written about the judgement [*2024-TIOL-101-SC-GST*], let me directly delve into the core issues arising out of this judgement.

The following clauses of sub-section (5) of Section 17 of the CGST Act were under challenge before the Hon'ble Supreme Court. The said sub-section lays down the *"blocked credit"* i.e. cases where input tax credit (ITC) would not be admissible and clauses (c) and (d) thereof are reproduced below.

> *(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.*

The term *"plant and machinery"* used in clause (c) is also explained by way of an Explanation as below.

> *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 of 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.*

It may be noted that while clause (c) deals with *"Works contract services",* clause (d) deals with *"goods or services or both"*

The term *"works contract"* is defined in clause (119) of Section 2 of the CGST Act, as

> *"works contract" means a contract for building, construction, fabrication, completion, erection, installation, fitting out, improvement, modification, repair, maintenance, renovation, alteration or commissioning of any immovable property wherein transfer of property in goods (whether as goods or in some other form) is involved in the execution of such contract*

As per sub-section (1A) of Section 7, where certain activities or transactions constitute supply in accordance with the provisions of sub-section (1), they shall be treated either as supply of goods or as supply of services as referred to in Schedule II. As per Sl. No. 6 (a) of Schedule II, *"Works contracts as defined in clause (119) of Section 2"* are declared as a supply of service.

Thus, being declared as a service, *"works contracts"* are covered under both clauses (c) and (d) and going by the legal maxim, lex specialis derogat legi generali, clause (c), being specific to works contract, would prevail over the general description *"services",* used in clause (d).

So, while the eligibility to ITC in respect of works contract services received by a taxpayer would be governed by clause (c) ibid, the eligibility to ITC in respect of all other goods and services would be governed by clause (d).

A reading of clause (c) would reveal the following -

> (i) Input services in the nature of works contract services is not eligible for availing ITC, if such works contract service is for construction of an immovable property.
>
> (ii) But, if the immovable property satisfies the definition of "plant and machinery", ITC would still be eligible.
>
> (iii) The restriction mentioned in (i) above, would not apply and ITC would be eligible for works contract services used for construction of immovable property, if the output supply of the taxpayer is also Works contract service.

A reading of clause (d) would reveal the following.

> (i) ITC in respect of goods or services or both is not eligible, if such goods or services or both are used for construction of an immovable property.
>
> (ii) But, if the immovable property is in the nature of plant or machinery, ITC of taxes paid on such goods or services or both, used for construction of such immovable property, i.e. plant or machinery, would still be eligible.
>
> (iii) The restriction mentioned in (i) above would apply only when the immovable property in question is "used on the taxpayer's own account"
>
> (iv) In other words, if the immovable property is not used on the taxpayer's own account, ITC in respect of the goods or services or both used for construction of such immovable property, would be eligible.

In para 32 of the judgement, the Hon'ble Supreme Court has held as below.

> *Construction is said to be on a taxable person's "own account" when (i) it is made for his personal use and not for service or (ii) it is to be used by the person constructing as a setting in which business is carried out. However, construction cannot said to be on a taxable person's "own account" if it is intended to be sold or given on lease or license.*

So, when a building is constructed for the purpose of renting or leasing, the same is a supply of service and attracts GST. Since such renting or leasing is held to be not considered as being used for one's own account, ITC of GST paid on all goods, services or both (excluding input services in the nature works contract services) would be eligible without being hit by clause (d).

If a taxpayer uses the building constructed by him for carrying out his own business (other than by way of renting or leasing of such building), then ITC would be eligible, only if the immovable property in question, qualifies as a *"plant"* by applying the functionality test.

Thus, the *"functionality test"* laid down by the Hon'ble Supreme Court would be relevant only in the following situations.

> (i) A taxpayer, <u>whose output service is not Works contract service</u>, intends to avail ITC for the GST paid on input services in the nature of works contracts.
>
> (ii) A taxpayer, intends to avail ITC of GST paid on goods and services, which are used for construction of an immovable property <u>for using the same on his own account.</u>

It may be noted that if works contract services are received by a taxpayer, he would be eligible to avail ITC of GST paid on such works contract service, only in the following situations.

> (I) If his output service is also Works contract service; or
>
> (II) The immovable property in question satisfies the definition of *"plant and machinery"* (even if the output service is not Works contract service).

It may be noted that normally construction contracts are awarded on works contract basis, where the contractor would be responsible for both goods and services and undertake composite construction activity. It may be noted that the eligibility to avail ITC on works contract services is very narrow as per clause (c), i.e. only when the output service is also works contract service or the immovable property is *"plant and machinery".*

But, if the goods required for the construction of an immovable property are procured separately and the construction activity is awarded separately to a contractor, such goods and services would be dealt with under clause (d) and if the resultant immovable property is not used on the own account of the taxpayer, ITC would be eligible.

To elaborate further, if an office building is constructed for leasing out, the goods and services separately procured for such construction would be eligible for ITC, as renting is not "on his own account". If the very same building is constructed, by awarding a composite works contract to a single contractor, ITC of GST paid on such works contract would not be eligible as the output service is not works contract service but renting of immovable property service.

So, the Hon'ble Supreme Court's judgement would force splitting up of contracts into separate contracts for goods and service, in order to avail ITC.

The moot question, therefore, is can the ITC entitlement thus be dependent upon the mere mode of procuring inputs and input services?

It only exhibits the poor drafting of clauses (c) and (d) of sub-section (5) of section 17 of the Act, which requires a complete overhaul. In the opinion of the author, clause (c) may completely be omitted and clause (d) alone, as interpreted by the Hon'ble Supreme Court would serve the purpose.

[The views expressed are strictly personal.]

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