Three important questions answered by the Honourable SC in relation to ITC of (real estate) inputs used in immovable property.

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SC in case of Safari retreats- 3rd Oct 2024

The Supreme Court of India delivered a significant judgment concerning the constitutional validity of Sections 17(5)(c) and 17(5)(d) of the CGST Act, which govern the blocking of input tax credits (ITC) in certain cases, especially in construction activities. The Court framed three critical questions and provided a verdict that has far-reaching implications for businesses involved in construction-related services.

- **Key Questions Framed by the Court:**

1- Difference Between "Plant and Machinery" vs. "Plant or Machinery":

The first question addressed by the Court was whether the phrase "plant or machinery" in Section 17(5)(d) is to be treated the same as the phrase "plant and machinery" in Section 17(5)(c) of the CGST Act.
The Court found that these phrases are not identical. Section 17(5)(c) uses the phrase "plant and machinery," whereas Section 17(5)(d) uses "plant or machinery," creating a distinction.
The Court ruled that these phrases have different legal interpretations, which impacts the determination of which properties or equipment can be considered for input tax credit (ITC). This distinction has major implications, as it affects businesses' ability to claim substantial tax credits.

2- Definition of "Plant" and its Implications:

If a property qualifies as a "plant," it becomes eligible for significant ITC for goods or services used in its construction.

The Court emphasized that understanding the definition of "plant" is crucial. If a building or structure qualifies as a plant, ITC on goods and services used in its construction can be claimed by the business.

This is particularly important for businesses engaged in construction of malls, warehouses, or other immovable properties, where ITC on the construction is a contested issue.

3- Constitutional Validity of Sections 17(5)(c) and 17(5)(d):

The Supreme Court ruled that Sections 17(5)(c) and 17(5)(d) ***are constitutionally valid.***
However, this does not imply that every transaction falling under these provisions will automatically lead to blocked credits. Instead, the factual nature of each case will determine the tax liability.

4- Functional Test and Essentiality Test:

The functional test requires assessing whether the construction is essential for delivering taxable services. For instance, in the case of a mall, the building itself is necessary for renting out premises, which is a taxable service.

T***he essentiality test evaluates whether the construction is indispensable to the business's ability to provide output services.*** If the construction is deemed essential to the business operations, then ITC may be allowed.

The Court highlighted that the nature of the business, the role of the building, and the functionality of the structure are critical factors that must be examined in determining whether input credits can be claimed.

5- Section 17(5)(d) -“On his ow account” is important

Section 17(5)(d) deals with blocking of credits for goods or services used in the construction of immovable property, other than plant or machinery.

The key phrase here is ***"on his own account"***, which means credits are restricted when the construction is for personal use or for the business itself, rather than for generating taxable output services.

The Court emphasized that the distinction between "plant and machinery" and "plant or machinery" in these sections is essential for determining whether businesses are eligible to claim ITC.

6- Impact of the Judgment:

The Supreme Court's judgment provides much-needed clarity for businesses engaged in construction activities, especially those involved in constructing immovable properties like malls, warehouses, and office spaces.

It ***recognizes the difference in tax treatment for "plant or machinery" and "plant and machinery" and affirms the constitutional validity of Sections 17(5)(c) and 17(5)(d).***

The case will now return to the High Court for detailed examination, where credit eligibility will be determined based on the factual circumstances of each case.

This judgment is expected to set a significant precedent in future disputes related to ITC on construction activities, especially concerning large infrastructure projects.

Overall, the judgment is seen as a win for taxpayers as it opens avenues for claiming ITC on construction-related expenditures, provided the business can satisfy the functional and essentiality tests. However, ***it may also lead to further litigation, as businesses will need to demonstrate the necessity and functionality of their constructions in relation to their taxable output services.***

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