SUPREME COURT UPHOLDS CONSTITUTIONAL VALIDITY OF SECTIONS 17(5)(C), 17(5)(D) AND 16(4) OF CGST ACT

Legal Provisions

- Section 16(4) of the Central Goods and Services Tax Act, 2017 (CGST Act) provides the time limit within which a registered person can avail ITC in respect of an invoice or a debit note.
- Section 17(5) of CGST Act *inter alia* provides that notwithstanding anything contained in Section 16(1) of CGST Act, ITC in respect of the following would not be available to a registered person:
  - Works contract services for construction of an immovable property (except plant **and** machinery) except where it is an input service for further supply of works contract service (Clause (c));
  - Goods or services or both for construction of immovable property (except plant **or** machinery) **on his own account** (Clause (d)).
- The term 'plant and machinery' is defined in Explanation to Section 17 to *inter alia* mean apparatus, equipment and machinery fixed to earth by foundation or structural support but excludes land, buildings or any other civil structures.

Historical Background

- The Orissa High Court in ***Safari Retreats Pvt. Ltd. Vs. Chief Commissioner of GST [TS-350-HC(ORI)-2019-NT]*** had read down the restriction provided under Section 17(5)(d) of CGST Act and held that if the Taxpayer is required to pay output GST on the rental income from the mall, it is entitled to claim ITC of GST paid on construction of mall.
- Aggrieved by the above, the Tax Authorities filed an appeal before the Supreme Court. In addition, various parties filed Petitions on the same issue with different nature of buildings, which were heard together.

Issues considered by the Supreme Court

- Whether Sections 17(5)(c), 17(5)(d) and 16(4) of CGST Act are unconstitutional?
- 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) of CGST Act?
- If the answer to the above is in the negative, what is the meaning of the word 'plant'?

Observations and Ruling by the Supreme Court

- **Constitutional validity:**
  - **Test of reasonable classification (Article 14 of Constitution of India (Constitution)):**
    - To satisfy this test, there must be an *intelligible differentia* forming the basis of classification and such differentia should have rational nexus with the object of legislation.
    - The right to claim ITC is a creation of statute and hence, no one can claim ITC as a matter of right unless it is expressly provided in the statute.
    - The cases covered by Section 17(5)(c) and (d) of the CGST Act are entirely distinct from other cases and this is done to ensure the object of not encroaching upon the State's legislative powers under Entry 49 of List II of the Seventh Schedule of Constitution.
    - Thus, 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. Consequently, Sections 17(5)(c) and (d) cannot be said to be discriminatory.
  - The violation of Articles 19(1)(g) and 300A of the Constitution, though contended by the Taxpayers, has not been elaborated as to how such violation is made out.
  - Accordingly, constitutional validity of sections 16(4), 17(5)(c) and 27(5)(d) was upheld.

- **Interpretation of 'plant or machinery' under Section 17(5)(d) of CGST Act:**
  - There are two exceptions to the restriction provided under Section 17(5)(d) of CGST Act viz., (1) where goods or services or both are procured for construction of immovable property consisting of 'plant or machinery' and (2) where goods or services or both are received for construction of immovable property that is not made on his own account.
  - Construction can be said to be made on a taxable person's 'own account' when –
    - It is made for his personal use and not for service; or
    - It is to be used by the person constructing a setting in which business is conducted.

    However, a construction cannot be said to be on a taxable person's 'own account' if it is intended to be sold or given on lease or license.
  - While the term 'plant and machinery' is defined in Explanation to Section 17 of CGST Act, the term 'plant or machinery' (referred to in Section 17(5)(d)) is not specifically defined.
  - It was contended by the tax authorities that the expression 'plant and machinery' appears at ten different places in Chapters V (ITC) and VI (Tax Invoice, Credit and Debit Notes) of CGST Act (including in section 17(5)(c)). However, the expression 'plant or machinery' only appears in Section 17(5)(d) of CGST Act and the use of the word 'or' in clause (d) is a mistake of the legislature. However, this contention was not accepted on basis of the following:
    - The Model GST Law had used the words 'Plant and Machinery' in section 17(5)(d).
    - If it was an error, the tax authorities could have stepped in to correct the mistake, which was not done. Thus, it must be inferred that the legislature has intentionally used the phrase 'plant **or** machinery' (in Section 17(5)(d)) as distinguished from the expression 'plant **and** machinery' (used in other places).
  - Since the legislature had made this distinction consciously, the expressions 'plant **and** machinery' and 'plant **or** machinery' cannot be given same meaning. Giving same meaning to these terms would be violative of the words used in the statute.
  - When the legislature uses the expression 'plant and machinery', only a plant will not be covered by the definition unless there is an element of machinery or *vice versa*. The expression 'plant or machinery' has a different connotation – it can either be a plant or machinery. As the word 'plant' is not defined under the GST law, its ordinary meaning in commercial terms will have to be attached to it.
  - The adoption of different interpretations to the terms 'plant **or** machinery' (used in section 17(5)(d)) and 'plant **and** machinery' (used in section 17(5)(c)) would not result in discriminatory treatment since clauses (c) and (d) operate in different areas.
  - **Interpretation of the term 'plant':**
    - As per the functionality test laid down by the Supreme Court, it was observed that whether a building is a plant is a question of fact. If it is found on facts that a building has been so planned and constructed so as to serve a taxpayer's special technical requirements, it will qualify to be treated as a 'plant'. Thus, the term 'plant' will have to be interpreted by taking recourse to the functionality test.
    - Applying this test, the Supreme Court in ***Anand Theatres***[1] held that a building used as a hotel or a cinema theatre cannot be termed as 'plant'. However, the Larger Bench of the Supreme Court, in ***Karnataka Power Corporation***[2] restricted the applicability of ruling in ***Anand Theatres*** only to hotels or cinema theatres.
    - Accordingly, 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, subject to other conditions and restrictions provided under the GST law.
  - Applying the aforesaid principles, 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, subject to other conditions and restrictions provided under the GST law.
  - In view of the above, since the Orissa High Court had not decided whether the mall in question will satisfy the functionality test of being a plant, the matter is remanded to the High Court to decide whether, on facts, the mall in question satisfies the functionality test so that it can be termed as 'plant'. The same position would apply to warehouses or other buildings except hotels and cinema theatres.
- **Conclusion:**
  - The constitutional validity of Sections 17(5)(c), 17(5)(d) and 16(4) is upheld.
  - The expression 'plant or machinery' used in Section 17(5)(d) cannot be given the same meaning as the term 'plant and machinery' defined in Explanation to Section 17 of the CGST Act.
  - Whether a mall, warehouse or any other building (other than a hotel or a cinema theatre) can be classified as a plant is a factual question which has to be determined by applying the functionality test on a case-to-case basis. If the construction of the building was essential in supplying services, such as renting or giving on lease or other transactions which are covered by clauses (2) and (5) of Schedule II of the CGST Act, the building can be held to be a plant.

BDO in India Comments

The Supreme Court has confirmed the applicability of the functionality test to determine the eligibility of input tax credit under section 17(5)(d). This would help the taxpayers, where the business model is to earn revenue from leasing or renting buildings of a specialised nature and are able to meet the functionality test. The Taxpayers in all cases should now evaluate whether they meet the functionality test as per the existing jurisprudence and accordingly assess their entitlement for input tax credit.

[Chief Commissioner of CGST and Ors. Vs. M/s. Safari Retreats Pvt. Ltd. and Ors. [TS-622-SC-2024-GST]]

[1] CIT, Trivandrum Vs. Anand Theatres [2000 (5) SCC 393]
[2] Commissioner of Income Tax, Karnataka Vs. Karnataka Power Corporation [2002 (9) SCC 571]

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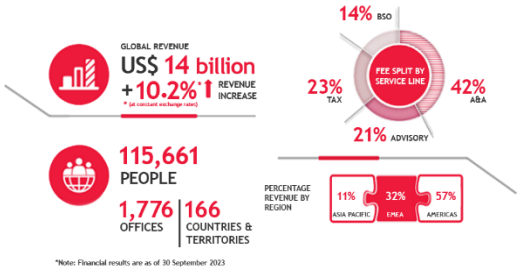

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