

EY Tax Alert

HC allows input tax credit on goods and services used in construction of shopping mall

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Executive summary

This Tax Alert summarizes a recent ruling^[1] of the Orissa High Court (HC) allowing input tax credit (ITC) on goods and services used in construction of shopping mall, intended to be rented / leased.

High Court (HC) observed that as the petitioner is required to pay Goods and Services Tax (GST) on the rental income from the property on which GST has been paid, he is entitled to avail ITC.

HC read down section 17(5)(d) of Central Goods and Services Tax (CGST) Act, 2017 by confining the provision to cases where the building is constructed for the purpose of sale post issuance of completion certificate.

Thus, HC held that where the building was constructed for the purpose of letting out and tax chain was not broken (as GST is payable on rentals), the restriction under section 17(5)(d) is not applicable.

^[1] 2019-VIL-223-ORI

Background

- The petitioner is engaged in the business of constructing shopping malls for letting out the same to various tenants.
- It wants to avail ITC on purchase of goods and services which are used / consumed in the construction of the shopping mall, in order to utilise the same to discharge tax leviable on the rental income.
- It approached Revenue in this regard. Petitioner was informed that ITC is not available in respect of goods and services procured and used for construction of shopping mall.
- Thus, the petitioner filed a writ petition before Orissa HC.

Petitioner's Contention

- On a plain reading of section 17(5)(d) of CGST Act, it is clear that what it contemplates and provides for is a situation where goods and services are consumed in construction of an immovable property which is meant or intended to be sold.
- The sale of immovable property post issuance of completion certificate does not attract GST. Consequently, in such a situation, there is a break in the tax chain and therefore, there is full justification for denial of ITC.
- But the position is totally different where the immovable property is constructed for the purpose of letting out because, in that event, the tax chain is not broken and on the contrary, the construction of the building will result in a fresh stream of GST revenues to the exchequer on the rental income from the building.
- Denial of ITC in such situation would be completely arbitrary, unjust and oppressive and would be directly opposed to the basic rationale of GST itself, which is to prevent the cascading effect of multi-stage taxation. It will result in inevitable increase in costs which would have to be borne by the consumer.
- Further, the denial of ITC in respect of a building which is meant and intended to be let out would amount to treating it as identical to a building which is meant and intended to be sold.
- The treatment of these two different types of buildings as one for credit eligibility under GST is itself contrary to the basic principles regarding classification of subject matter for the levy of tax and therefore, violative of Article 14 of the Constitution.
- The GST authorities are themselves reading down section 17(5)(d) and treating it inapplicable to a builder who sells units in the building before the issuance of completion certificate and who is required to pay tax on the amount of sale price received by him.
- Granting ITC to a builder who sells building where completion certificate has not been issued at the time of sale, while denying it to a person, like the petitioner, is patently and egregiously arbitrary and discriminatory.
- It would also be violative of the petitioner's fundamental right to carry on business under Article 19(1)(g) of the Constitution as it would impose a wholly unwarranted, unreasonable and arbitrary restriction which would render buildings constructed for letting out uncompetitive, by imposing the burden of double taxation on such buildings.
- It is a settled principle that interpretation should be adopted which avoids or obviates double taxation.
- The interpretation of section 17(5) (d) which leads to the conclusion that petitioner is not entitled to avail the ITC even if tax is payable on the rental income, clearly goes against the intention of the legislature. It also frustrates the object sought to be achieved by the legislature in enacting the GST legislation.
- It is an undisputed fact that GST was implemented to obviate the cascading effect of various indirect taxes and to reduce multiplicity of indirect taxes.
- It is a well settled law that the interpretation which defeat the very intention of the legislature should be avoided and that interpretation which advances the legislative intent will have to be accepted.
- In paragraph 5(b) of Schedule II, which provides that sale of a building before issuance of a completion certificate is a supply of service, the legislature used the phrase 'intended for sale'. Thus, the intention of the builder was made the decisive factor by the legislature. Same approach should have been adopted in the present case also.
- The shopping mall which the petitioner is constructing is neither 'intended for sale' nor 'on his own account' but it is 'intended for letting out'.
- When the said shopping mall is constructed purely for the purpose of letting out, then such construction will not come within the mischief of section 17(5)(d).
- Reliance was placed on various rulings to argue that ITC is a vested right². Further, reliance was also placed on Supreme Court (SC) ruling in case of Shayara Bano v. Union of India³, wherein the court has observed that the state's arbitrary action is violative of Articles 14 and 16 of Constitution.
- Thus, section 17(5)(d) requires to be read down, in order to save it from the vice of unconstitutionality, by confining the provision to cases where the building is constructed for the purpose of sale post issuance of completion certificate, thereby terminating the tax chain, and by not applying the provision to cases where the building is constructed for the purpose of letting out and the tax chain is not broken.

² Eicher Motors Ltd. v. Union of India [(1999) 2 SCC 361], Collector of Central Excise, Pune v. Dai Ichi Karkaria Ltd [1999-VIL-02-SC-CE]

³ (2017) 9 SCC 1

- If this interpretation of section 17(5) (d) is not accepted, then there would be no alternative except to declare the provision as unconstitutional, illegal, null and void.

Revenue's Contention

- The petitioner's contention that denial of ITC is ultra vires of Article 14 and 19(1)(g) of the Constitution is unjust and improper.
- Reliance was placed on several judgments wherein it was held that no taxpayer can claim set off as a matter of right.⁴
- Article 14 of the Constitution can be said to be breached only when there is perversity or gross disparity resulting in clear and hostile discrimination practiced by the legislature, without any rational jurisdiction for the same.
- Restrictions with respect to avilment of credit under GST, being reasonable, are equally applicable to all.
- As the suitability and requirement varies from person to person, law cannot be changed accordingly. It is mandatory for the taxpayers to adhere to the restrictions prescribed in the law.
- Such restrictions cannot be challenged by the taxpayer under the plea of being violative of the fundamental rights guaranteed under Articles 14 and 19(1)(g) of the Constitution.
- Powers to restrict credit also exist under section 16(1) of CGST Act which empowers the Government to impose conditions and restrictions on availing ITC. This shows the legislative intent that ITC may not always be allowed.
- Section 17(5)(d) prescribes denial of credit for certain class of taxpayers with certain conditions and limitations. This would mean that legislature has decided in its wisdom, the credit of taxes which would be allowed as ITC.
- Credit that has not been allowed, as policy call of the Government, given effect through legislation, cannot be obtained through judicial review.
- Further, reference was made to various rulings which laid down scenarios in which a provision can be declared as unconstitutional.⁵

High Court Ruling

- While considering the provisions of section 17(5)(d), the narrow construction of interpretation put forward by the Revenue is frustrating the very objective of the CGST Act, in as much as the petitioner has to pay huge amount without any basis.
- In the given case, petitioner is retaining the property. The property is not being used for own purpose but is let out,

on which GST is payable.

- The very purpose of the credit is to give benefit to the assessee. Thus, if the petitioner is required to pay GST on the rental income arising out of the investment on which GST has been paid, it is required to have the ITC.
- The court has read down section 17(5)(d) by confining the provision only to cases where the building is constructed for the purpose of sale post issuance of completion certificate.
- Thus, where the building was constructed for the purpose of letting out and tax chain is not broken, the restriction under section 17(5)(d) is not applicable.

Comments

The ruling may benefit the taxpayers who are engaged in the business of renting of immovable property. However, considering the significant impact that it may have, there is a likelihood of revenue approaching the Supreme Court on the issue.

Considering the fact that the provisions of section 17(5)(d) have not been struck down but only the scope has been narrowed, it will be critical for taxpayers to analyze the implication before taking any decision in respect of claiming tax credits.

The observations in the order on double taxation and the cascading of taxes may be interesting for other cases where ITC has been expressly denied.

There is a writ petition pending before Delhi HC dealing with eligibility of credit in the hands of real estate companies, malls and hotels where the construction is undertaken by the taxpayer itself.

⁴ Indian Oil Corporation Ltd v. State of Bihar [TS-347-SC-2017-VAT], Cellular Operators Association of India v. Union of India [2018-TIOL-310-HC-DEL-ST], Mohit Minerals Pvt Ltd. v. Union of India [TS-512-SC-2018-NT], JCB India Ltd v. Union of India [2018-VIL-165-BOM]

⁵ Government of Andhra Pradesh and others v. P. Laxmi Devi [(2008) 4 SCC 720], State of M.P. v. Rakesh Kohli [(2012) 6 SCC 312]

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