

# GST on managed workspace services

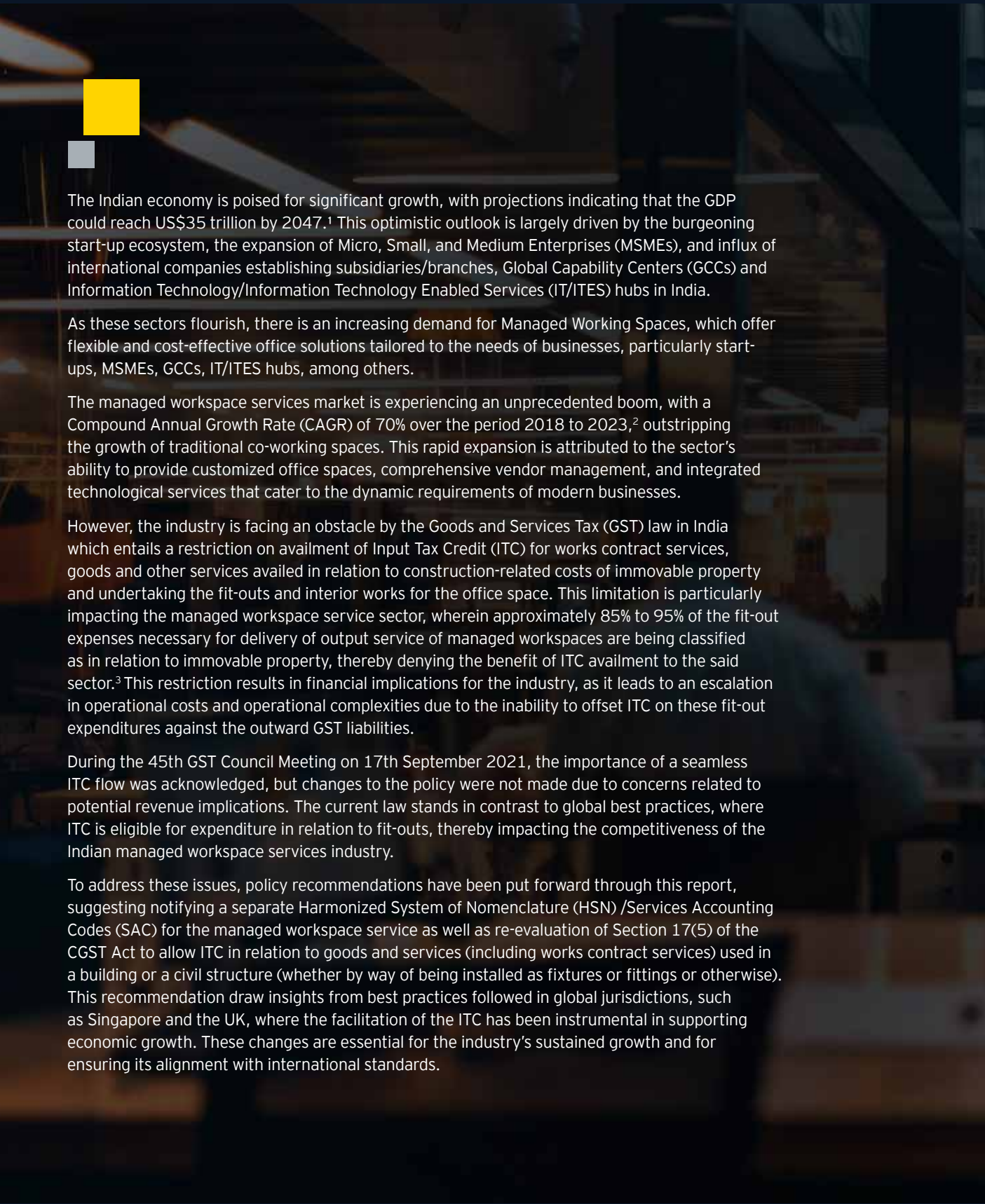
November 2024



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The Indian economy is poised for significant growth, with projections indicating that the GDP could reach US\$35 trillion by 2047.<sup>1</sup> This optimistic outlook is largely driven by the burgeoning start-up ecosystem, the expansion of Micro, Small, and Medium Enterprises (MSMEs), and influx of international companies establishing subsidiaries/branches, Global Capability Centers (GCCs) and Information Technology/Information Technology Enabled Services (IT/ITES) hubs in India.

As these sectors flourish, there is an increasing demand for Managed Working Spaces, which offer flexible and cost-effective office solutions tailored to the needs of businesses, particularly start-ups, MSMEs, GCCs, IT/ITES hubs, among others.

The managed workspace services market is experiencing an unprecedented boom, with a Compound Annual Growth Rate (CAGR) of 70% over the period 2018 to 2023,<sup>2</sup> outstripping the growth of traditional co-working spaces. This rapid expansion is attributed to the sector's ability to provide customized office spaces, comprehensive vendor management, and integrated technological services that cater to the dynamic requirements of modern businesses.

However, the industry is facing an obstacle by the Goods and Services Tax (GST) law in India which entails a restriction on availment of Input Tax Credit (ITC) for works contract services, goods and other services availed in relation to construction-related costs of immovable property and undertaking the fit-outs and interior works for the office space. This limitation is particularly impacting the managed workspace service sector, wherein approximately 85% to 95% of the fit-out expenses necessary for delivery of output service of managed workspaces are being classified as in relation to immovable property, thereby denying the benefit of ITC availment to the said sector.<sup>3</sup> This restriction results in financial implications for the industry, as it leads to an escalation in operational costs and operational complexities due to the inability to offset ITC on these fit-out expenditures against the outward GST liabilities.

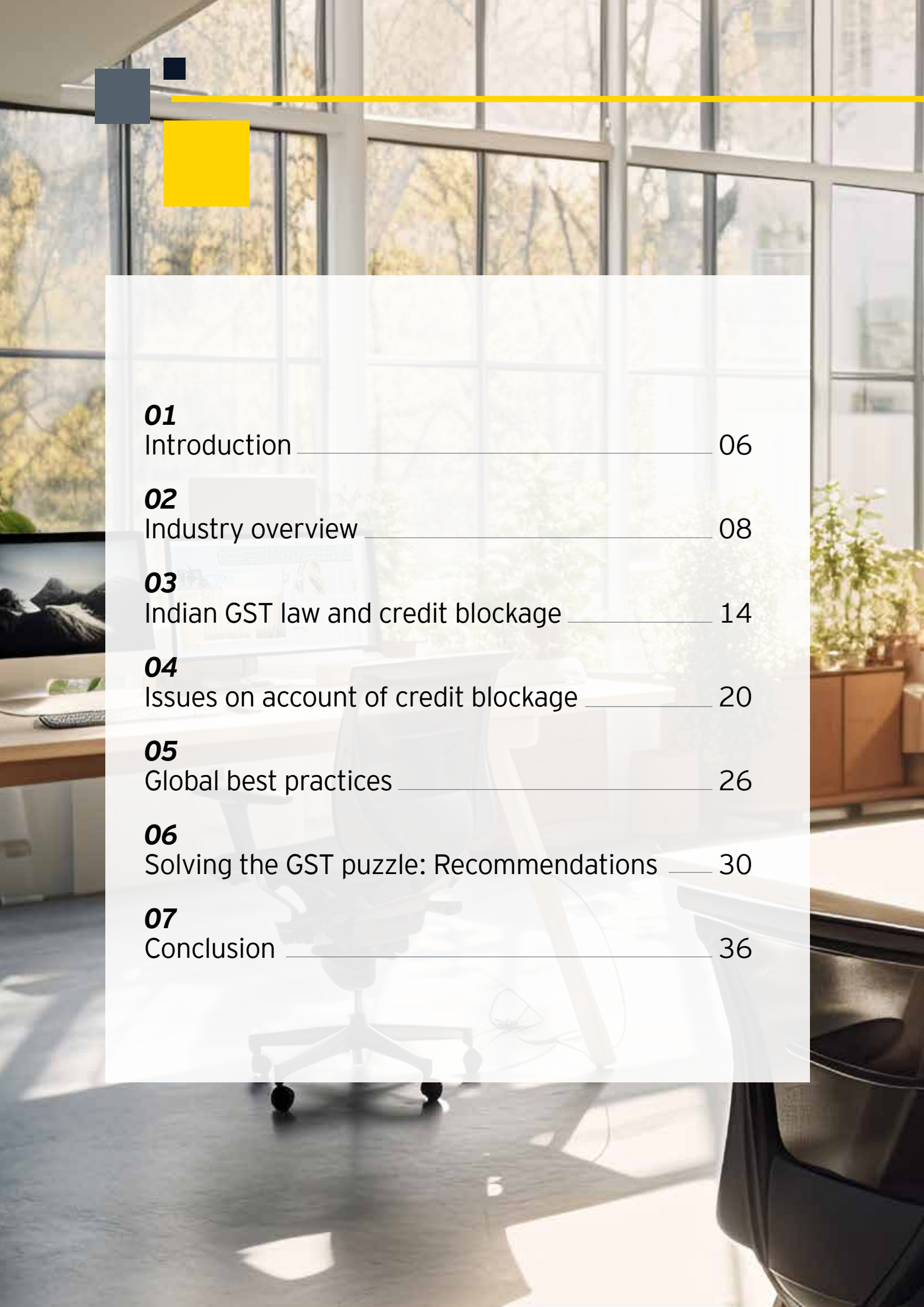
During the 45th GST Council Meeting on 17th September 2021, the importance of a seamless ITC flow was acknowledged, but changes to the policy were not made due to concerns related to potential revenue implications. The current law stands in contrast to global best practices, where ITC is eligible for expenditure in relation to fit-outs, thereby impacting the competitiveness of the Indian managed workspace services industry.

To address these issues, policy recommendations have been put forward through this report, suggesting notifying a separate Harmonized System of Nomenclature (HSN) /Services Accounting Codes (SAC) for the managed workspace service as well as re-evaluation of Section 17(5) of the CGST Act to allow ITC in relation to goods and services (including works contract services) used in a building or a civil structure (whether by way of being installed as fixtures or fittings or otherwise). This recommendation draw insights from best practices followed in global jurisdictions, such as Singapore and the UK, where the facilitation of the ITC has been instrumental in supporting economic growth. These changes are essential for the industry's sustained growth and for ensuring its alignment with international standards.

# Executive summary







A modern office interior with large windows overlooking a cityscape. A desk with a computer monitor and a white office chair is visible in the foreground. The background shows a bright, airy space with more windows and some indoor plants.

<b>01</b>	Introduction	06
<b>02</b>	Industry overview	08
<b>03</b>	Indian GST law and credit blockage	14
<b>04</b>	Issues on account of credit blockage	20
<b>05</b>	Global best practices	26
<b>06</b>	Solving the GST puzzle: Recommendations	30
<b>07</b>	Conclusion	36

# Contents







# 1

India is one of the fastest growing economies of the world and is on the right track to become a US\$35 trillion fully developed economy by 2047.<sup>4</sup>

The said growth can be attributed to an influx of start-ups, focus on MSME development, the right ecosystem for driving the creation of Global Capability Centers (GCCs) in India, and the right set of Government policy and initiatives. An increase in the economic activities also creates a high demand for office spaces to accommodate the businesses with the flexibility to upscale/downscale the space depending on the requirement of the business at a different point in time.

Traditionally, businesses used to invest high costs in setting up their office. However, with the growth and evolution of new ways of working, the way businesses setup their offices is also changing. Not every business (especially MSMEs and start-ups) can afford the high costs and long process of setting up their own traditional office.<sup>5</sup> This has given rise to managed workspace services, which adapt to providing an ideal balance between agility

# Introduction

and flexibility for businesses to run and operate, along with giving enterprises an opportunity to reimagine their space needs, pursuing more cost-effective alternatives<sup>6</sup>. These managed workspace services operators are a part of a larger industry, often termed as the 'flexible workspace industry'. Opting for a third-party managed workspace services provider allows businesses to focus on their core work by eliminating the stress of setting up an office, managing day-to-day operations such as housekeeping, food and beverages, repairs, maintenance, and dealing with multiple vendors.

The managed workspace services industry operates on a model where companies lease buildings (bare shell) from landowners or commercial real estate (which can range from the entire building to the floors to designated spaces within one floor), customize them as per client's needs, and then provides managed workspace services which includes building, modular fit-outs and managing/operating the built-out office spaces to the clients for a specified tenure. On completion of the contract, the workspaces are fully dismantled and recreated as per the new client requirement. This model offers clients flexible and ready-to-use office environments for businesses.

The **focus** of this report is to explore the **managed workspace service sector**, which is a subset of flexible workspace industry, examining the uniqueness of this sector, market dynamics, and growth trends that are influencing the evolution of tailored and fully managed office spaces for Indian businesses. Further, despite the promising growth developments, **the industry faces an**

## **obstacle on account of the ITC blockage under GST, which becomes an additional cost for the industry.**

These obstacles limit these services' capacity to claim credits for expenses incurred by them for setting up the managed workspaces. Thus, presenting financial obstacles thereby affecting the sector's growth and expansion. Further, the managed workspace services sector is taxed at 18% GST without the benefit of substantial ITC, unlike the real estate industry which enjoys lower rates or ITC options, i.e., tax @ 7.5% (with no ITC being available) and 18% (with substantial ITC available) on construction services. This discrepancy, due to restrictions under Section 17(5)(c) and (d) of the CGST Act, places a heavier tax burden on managed workspace service providers. Besides, the clientele using the workspaces are primarily exporter of services outside India, as well as GCCs and IT/ITES companies, and therefore the embedded tax cost on account of the denial of credits on such inputs are being indirectly exported outside India, which is against the Government's stated fundamental principle of not exporting any taxes in relation to goods and services exported outside India.







# 2

## Defining the industry

In today's dynamic office space segment, flexible workspaces have emerged as a groundbreaking alternative to traditional real estate leases. The flexible workspace industry provides the customers with fully functional and operational offices spaces without the hassles of dealing with different vendors for different operational requirements. This holistic approach positions flexible workspace services not merely as static properties but as dynamic service platforms tailored to meet diverse operational needs.<sup>7</sup>

The flexible workspace model operates under different models, namely:

### **Co-working model**

Fully operational offices with shared workspaces (hot desks, dedicated desks, and private meeting rooms) where individuals from same or different organizations or professions work collaboratively in the same environment<sup>8</sup>.

### **Enterprise leasing**

Fully operational offices where companies get innovative offices designed resulting in efficient usage of office space to enhance employee collaboration and productivity.

### **Managed workspaces**

Workspaces are customized, operated, and managed as per the needs of the clients/ organizations. The industry offers a suite of end-to-end customized service offerings based on clients' requirements which includes a search for the right location and project, mapping of exact space requirement, complete office design and fit-outs, facility management and operations, vendor management, clients' branding, etc. Additional facilities related to technology integration, including touchless technologies, app-based meeting room booking, tech-based monitoring of space usage, internet of things (IOT) and sustainability-oriented features are also made available.



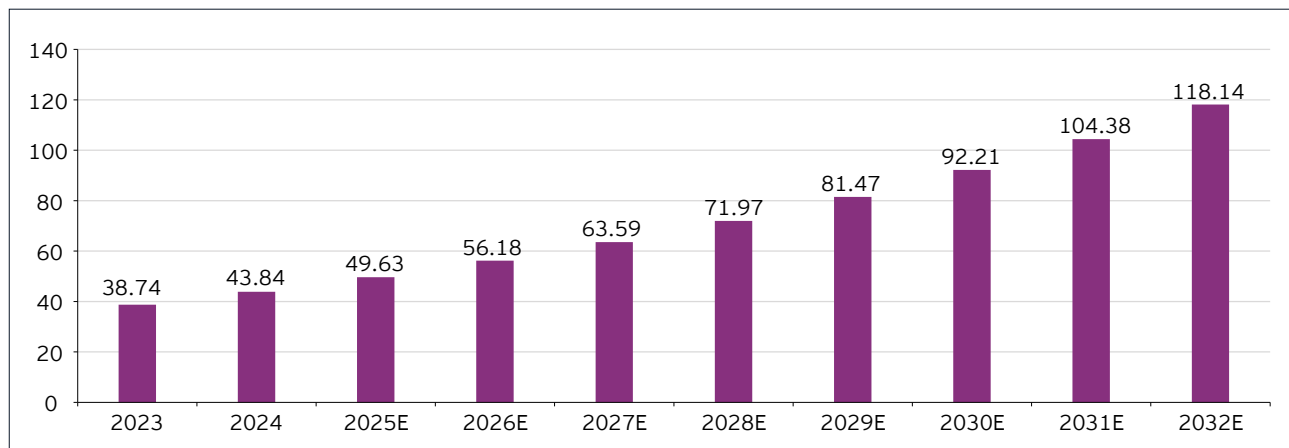
# Industry overview



## Market size

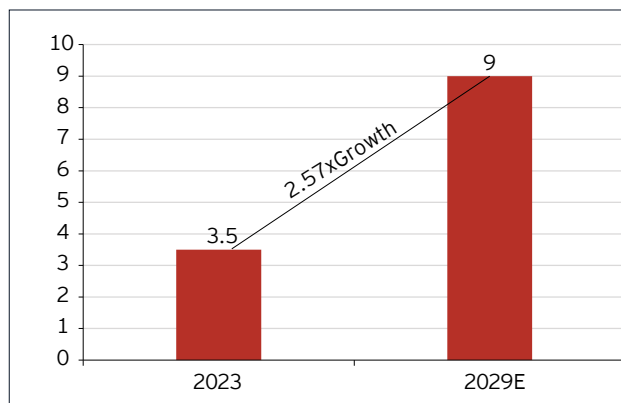
**Global flexible workspace** market size in terms of revenue was valued at around **US\$ 38.74 billion** and is expected to reach a value of **US\$118.12 billion** by 2032, showing a CAGR of 13.19%.<sup>9</sup>

**Exhibit 1: Global Revenue (US\$ billion)**

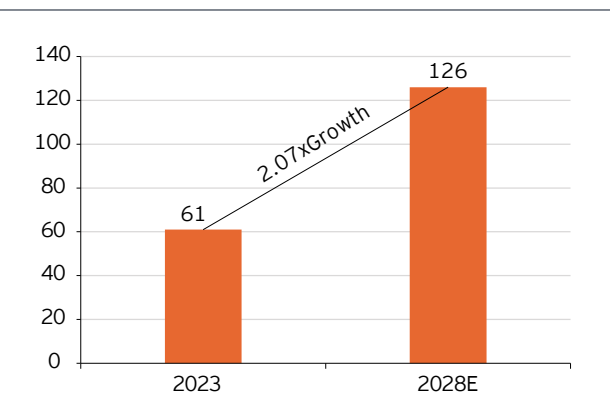


On the other hand, the **market size of flexible workspaces in India**, as of 2023, stands at approximately US\$3.5 billion which encompasses roughly 61 million square feet (**msf**) of space, accommodating over 680,000 operational seats. The said sector has the potential to reach a market size of US\$9 billion by 2028, which is expected to lead to a sectoral growth of approximately 126 msf at a CAGR of 15% by 2028. The growth parameters of the flexible workspace sector are measured in terms of 'flex stock' which is determined in terms of the msf of operational area available with flexible workspace industry.<sup>10</sup>

**Exhibit 2: Growth in market size (billion USD)**



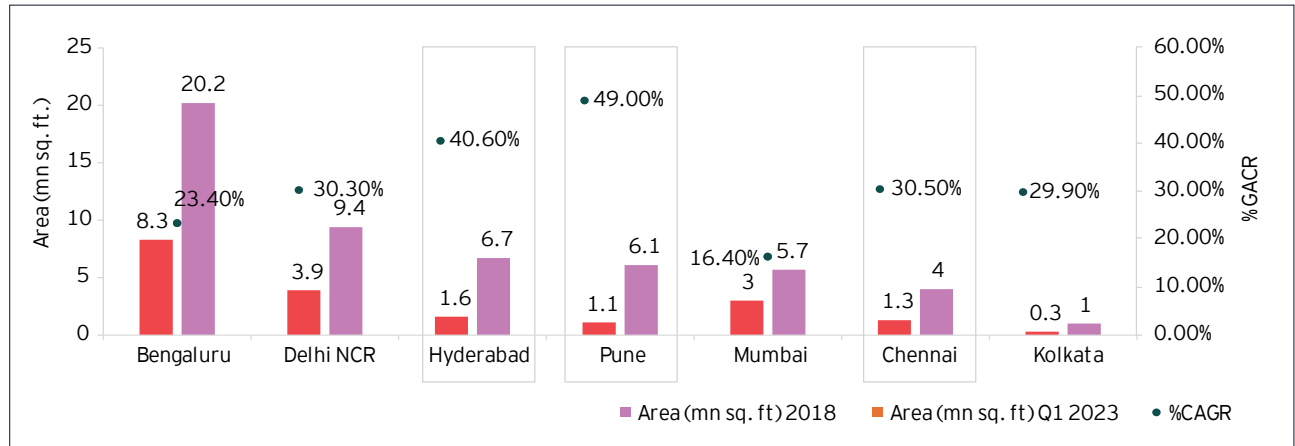
**Exhibit 3: Growth in space (million sq. ft.)**



## Geographical spread

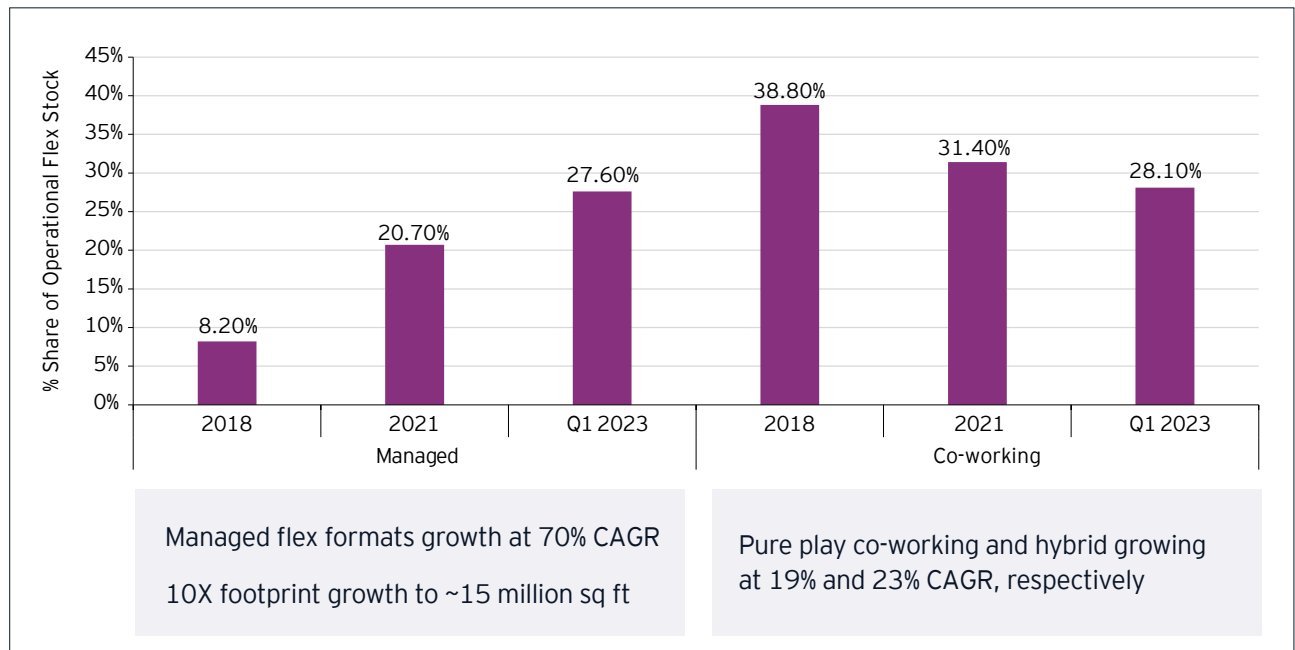
Further, the **growth of flex stock in India** is evident in most major cities and the below graph outlines the growth of total flex stock in each of the major cities in India between 2018 and 2023.<sup>11</sup>

**Exhibit 4: City wise Flex Stock Growth**



Within the flexible workspace industry, the businesses are increasingly moving towards managed workspace services model, which is growing at a CAGR of 70% as compared to co-working spaces growing at 19%. Enterprise suited customized workplaces are gaining momentum due to its distinct characteristics, which have been discussed in detail in the upcoming sections.

**Exhibit 5: Operational Flex Stock - Split by Type**





## Value proposition: managed workspaces vs. traditional offices

A managed workspace service is a unique service wherein the operators offer a bouquet of services ensuring that the client can enjoy a fully functional office environment without the burden of managing it. The management and operation may include security, attendance, technology enablement in terms of printers, etc., pantry control, accessibility, single point of contact for managing the entire office operations. This is ideal for clients who cannot spend time and money on the process of setting up a traditional office space, and therefore can use managed workspace services like plug and play models for

all their office requirements. Operators also allow office customization/office design/office operations' services through the online apps and through websites which are accessible through the internet and clients abroad can design/customize/operate their office using such technology, making it ideal for overseas clients and people working from remote areas.

Certain unique characteristics of managed workspace services which distinguishes it from the traditional lease services are as follows:

### Exhibit 6

S. No.	Features	Managed workspace	Traditional lease
1	Nature of service	Provides a fully functional and operational office	Provides an office space/building on lease for the client to manage and operate
2	Space flexibility	Custom solutions: option to occupy a floor or full building at any time on demand/need basis	No such option available
3	Single touch point	Single point of contact for all space and business-related support services	Multiple vendors involved
4	Cost advantage	Cost-efficient: cheaper than owning and leasing office and incurring capex for fit-outs. It is a shift from Capex to opex model	Expensive and requires capex investment
5	Geographical flexibility	Single operator for multiple locations	Different contracts for multiple locations
6	Scaling flexibility	Flexibility to scale up/down on a completely modular basis	Scaling up/down will involve an element of investment/cost and time

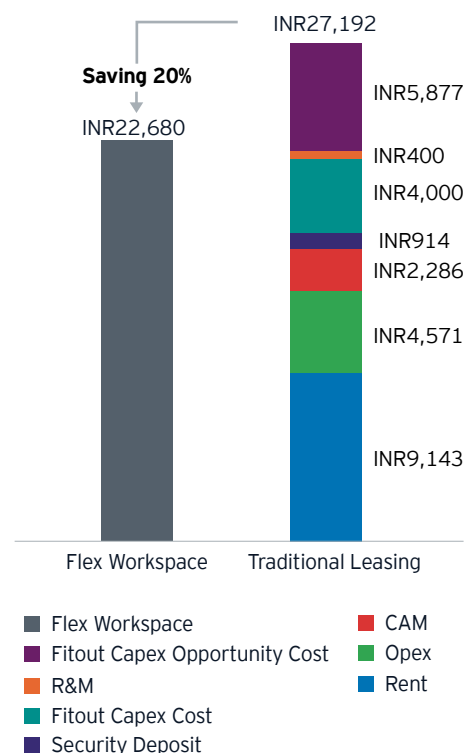
Thus, managed workspace services represent a paradigm shift in how businesses perceive and utilize office environments. By integrating services, prioritizing flexibility, and enhancing workspace experience, managed workspace services not only meet the evolving needs of modern enterprises but also contribute to reshaping the future of work.

## Cost benefit analysis

A report launched by Aventus on Flexible workspaces<sup>12</sup> in May 2024 illustrates how flexible workspaces make economic sense when compared to a traditional lease, which leads to a cost saving of 15% to 20%.

### Exhibit 7: Analysis of how Flex Workspace makes economic sense Vs Traditional Leasing

Particulars	Unit	Flex Workspace	Traditional Leasing
Desks	#	100	100
Efficiency	%	70%	70%
Density	Sqft	60	80
Leased Area	Sqft	8571	11429
Rent	INR/sqft	150	80
Fitout Cost (on Leased Area)	INR/sqft	0	2100
Opex (on Leased Area)	INR/sqft p.m.	0	40
CAM (on Leased Area)	INR/sqft p.m.	0	20
Revenue to Rent Ratio	X	2.4	NA
Price per Desk	INR p.m.	21600	NA
Lease Tenor	Months	60	60
Lock-In Period	Months	36	36
Security Deposit	Months	3	6
R&M Cost	% of Initial Capex	0%	2%
Opportunity Cost on Fitout Capex	%	NA	8%



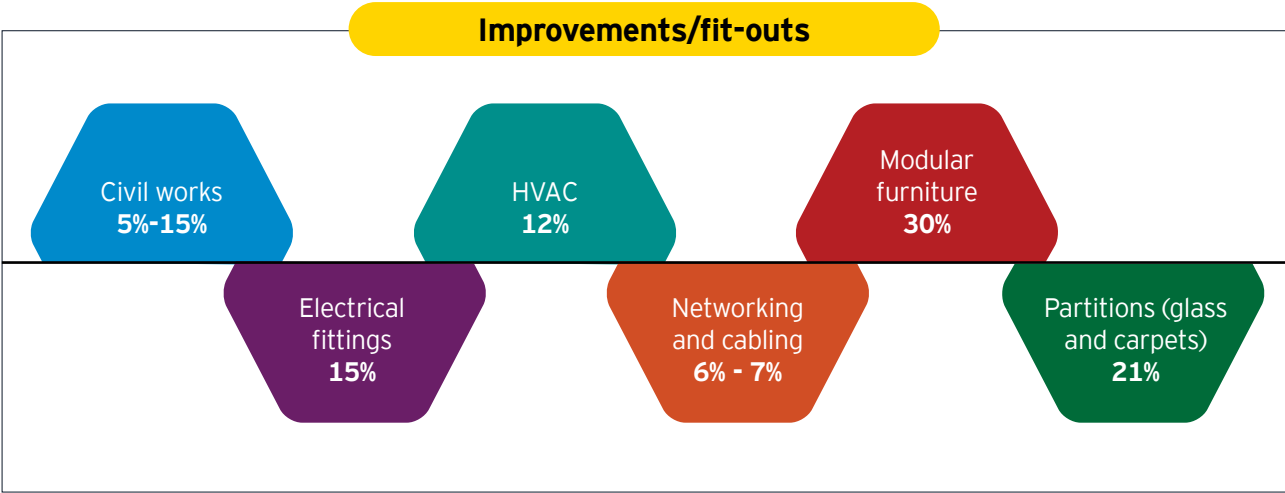
Herein, it is important to highlight that managed workspace service providers are solely concerned with the post-construction phase, focusing on the operational excellence and management of the workspace environment. In other words, for a managed workspace service provider, the operations commence after the construction of the building, i.e., they do





not partake in the construction phase itself. Uniqueness of the services offered by a managed workspace service model is already providing a cost advantage to the occupier. However, the industry itself suffers from the restriction on availment of ITC under GST on the expenditure incurred by them, especially on the fit-outs, and thus, the same becomes a cost. As per industry analysis, out of the total improvements/fit-outs (100%), the usual division of the different fit-outs used is as follows:

**Exhibit 8**



As evident from the above breakup, expenditure incurred on improvements/fit-out constitutes ~85% to 95% of the cost incurred by the said sector, which is movable in nature and on which ITC is allowed independently. The moment these costs are classified in relation to the expenditure for immovable property and capitalized in the books, the ITC on such expenses is being restricted as per the provisions of GST law.

The industry is experiencing growth, yet it encounters obstacles due to the non-availability of ITC on the said expenditure incurred by the companies. The said restriction of ITC eligibility on improvements/fit-outs' adversely affects the industry and is a cost deterrent. This difficulty in claiming ITC is leading to financial pressures and impeding the sector's expansion. To understand the full impact of these issues, we have provided the legislative background of GST provisions in the next chapter to understand the impact on the industry in greater detail.





# 3

ITC concept has significantly influenced how businesses manage taxes, offering a strategic tool to utilize tax credits from input expenses, thereby reducing overall tax burdens. This mechanism plays a key role in protecting businesses from financial strain related to tax liabilities, optimizing tax management, and improving financial efficiency.

Implementation of the GST w.e.f. 1 July 2017 unified various state and central taxes, allowing for seamless credit across state lines. This reform allowed for the interconnection of various levies and positioned GST as the most sophisticated form of indirect tax in India's history. The overarching aim of GST is to enhance operational efficiency for businesses, reduce the burden of cumulative taxation on the end consumer and promote economic integration. Consequently, GST has significantly reduced the detrimental impact of tax cascading, facilitating the creation of a unified market and actualized the ideology of 'One Nation, One Tax.'<sup>13</sup>

ITC is a fundamental component of the GST regime. It plays an indispensable role in the tax optimization for manufacturers, service providers, etc. It allows for the recovery of taxes paid on the acquisition of inputs, which is instrumental in preventing the cascading effect of taxes and promoting the seamless flow of tax credits throughout the supply chain. This mechanism is heart to the operational framework of the GST system in India, underscoring its core principles and effectiveness.



# Indian GST law and credit blockage

## Classifying managed workspace services

Managed workspace services are a unique and comprehensive suite of solutions, stepping in after the completion of construction work related to any building. Managed workspace service providers are not engaged in the construction activities; rather, their focus is on equipping such workspaces/building with vital infrastructure, advanced technology, and comprehensive amenities and provide fully functional and operational offices with a single point of contact for all the customer requirements.

Managed workspace service covers every aspect of the management of workspace, starting from the initial concept and design, through the fit-out stages, to the successful completion as well as complete management and operations of the workspace on a day-to-day basis. The goal is to ensure that every managerial and supervisory task aligns seamlessly with the client's specific objectives and requirements.

As per the current Harmonized System of Nomenclature ('HSN') code/Services Accounting Codes ('SAC')/Scheme of Classification of services prescribed by Central Board

of Indirect Taxes and Customs (CBIC), the companies are classifying managed workspace services under HSN/SAC code of 9972, which is described as 'Rental or leasing services involving own or leased non-residential property.' The same is on account of non-availability of a HSN/SAC code which matches the type of services provided by such companies.

The absence of a separate code that captures the unique nature of services offered by managed workspace service providers leads to unnecessary litigation and disallowances of ITC for the operators which are not warranted and envisaged. Without a specific classification, managed workspace services are often mis-categorized as real estate services, resulting in disputes over the eligibility of ITC claims on various expenditures, such as improvements/fit-outs. Also, the denial of ITC claims is attributed to the fact that in the absence of designated HSN codes, the input goods or services, which are utilized for the provision of outward services, are not acknowledged as corresponding to the same line of business. The relevant HSN codes considered by the managed workspace services are mentioned below:

**Exhibit 9**

Entry No.	Chapter Section	Service Code Tariff	Service Description	Explanatory notes
220	Heading 9972		Real estate services	
221	Group 99721		Real estate services involving owned or leased property	
		997212	Rental or leasing services involving own or leased non-residential property	<p>This service code includes:</p> <ul style="list-style-type: none"><li>rental or <b>leasing services concerning industrial, commercial or other non-residential buildings</b> or property by owners or leaseholders, such as factories, <b>office buildings</b>, warehouses, theatres, convention centres, exhibition halls and multiple-use buildings that are primarily non-residential; agricultural, forestry and similar properties.</li><li>rental or leasing of caravan sites, lock-up garages or other places for parking vehicles, by the month or year</li></ul>

Entry No.	Chapter Section	Service Code Tariff	Service Description	Explanatory notes
223		997221	Property management services on a fee or commission basis or on contract basis	<p>This service code includes:</p> <ul style="list-style-type: none"> <li>■ <b>management services concerning residential, industrial and commercial properties, on a fee or contract basis</b></li> <li>■ management services concerning residential mobile home sites</li> <li>■ management services concerning dwellings in joint ownership</li> <li>■ management services concerning agricultural, forestry and similar properties</li> <li>■ <b>management services concerning buildings or properties used on a time-share basis</b></li> </ul> <p>This service code does not include:</p> <ul style="list-style-type: none"> <li>■ sports and recreational sports facility operation services, cf.99652</li> <li>■ operation of other recreation and amusement service facilities n.e.c., cf.999699</li> </ul>

As mentioned above, the managed workspace services industry is not limited to providing workspaces for lease, but the major value-addition provided by them is on account of fully customized workspaces suiting the needs of the organizations with a single contact for vendor management.

The existing codes currently do not encapsulate the specific nature of the managed workspace services industry's offerings, which provide an end-to-end solution to clients. These solutions include, but are not limited to, **facilitating streamlined vendor interactions through a single point of contact** and offering a range of support services, such as **IT technology solutions, security measures, parking facilities, manpower supply, food**

**and beverages supply and other services in relation to day-to-day operations.** This unique blend of services offered by the managed workspace services industry cannot be effectively categorized under any of the existing HSN/SAC codes as mentioned above. Thus, it is evident that the comprehensive service model provided by the managed workspace services industry merits a unique HSN/SAC classification that truly represents the breadth and depth of these innovative services.

**Considering that there is no single HSN/SAC code which covers both the services along with the other services being offered by an operator of the managed workspace services industry, a new HSN/SAC code should be introduced to recognize the same.**





## ITC restrictions under GST for the industry

Section 16 of the CGST Act 2017 provides a detailed framework for the availability of ITC under the GST regime, specifically addressing the issue pertinent to the current report. This pivotal provision outlines the eligibility criteria, conditions, etc., for a registered taxpayer to claim credit on the taxes paid on inputs, which can be utilized to offset the GST liability on their outward supplies. The section is instrumental in ensuring seamless flow of credit in the supply chain and preventing cascading of taxes, thereby enhancing the efficiency of the GST system.

In addition to the above, Section 17(5) of the CGST Act enumerates a list of activities wherein ITC is blocked, i.e., the taxes paid on procurement of such inward supplies will not be available as input tax credit. Herein, section 17(5) of the CGST Act bars input tax credit if the inputs or input services are for the construction of an immovable property. These restrictions are contained in clauses (c) and (d) of section 17(5) of the CGST Act.

17(5) Notwithstanding anything contained in sub-section (1) of section 16 and sub-section (1) of section 18, input tax credit shall not be available in respect of the following, namely:-

(a).....

(b).....

(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 capitalization, to the said immovable property;

It emerges that any goods or services supplied for the construction of an immovable property (on own account) including works contract service will be ineligible for availment of the credit. Law defines "Works contract" service 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"

Both clauses (c) and (d) of Section 17(5) of the CGST Act pertain specifically to ITC on construction of immovable property. These entries cover scenarios where input tax credit is not permitted for any goods or services used in the construction of immovable property by a taxable person even when these inward supplies are eventually used or to be used for providing taxable output supplies of goods or services like for managed workspace services. The limitation outlined in Sections 17(5)(c) and Section 17(5)(d) of the CGST Act contradicts with Section 16(1) of the same Act which allows registered persons to claim credit for input tax charged on any supply of goods or services used or intended for use in the course or furtherance of their business.

Also, plant and machinery has been specifically defined under Section 17(5) of the Act to mean:

For the purposes of this Chapter and Chapter VI, the expression "plant and machinery" means apparatus, equipment, and machinery fixed to earth by foundation or 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.

Further, the term “immovable property” is not defined in the CGST Act. However, section 3(26) of the General Clauses Act defines immovable property as land, benefits to arise out of land, and things attached to the earth, or permanently fastened to anything attached to the earth. For clarity on the meaning of “attached to the earth” we need to refer to section 3 of the Transfer of Property Act, in terms of which:

**“attached to the earth” means -**

**(a) Rooted in the earth, as in the case of trees and shrubs;**

**(b) Imbedded in the earth, as in the case of walls and building;**

**(c) Attached to what is so imbedded for the permanent beneficial enjoyment of that to which it is attached.**

## Landmark judgement of Hon'ble Supreme Court:

*M/s Safari Retreats Pvt Ltd and Ors*

CIVIL APPEAL NO. 2948 OF 2023

Recently, the Hon'ble Supreme Court has delivered its judgment in *M/s Safari Retreats Private Limited and Ors*<sup>14</sup> which primarily deals with the eligibility of ITC (in terms of Section 17(5)(d) of the CGST Act) in case of construction of an immovable property, specifically for shopping malls intended for leasing/renting purposes.

In this case, for the purpose of construction of malls (immovable property), the taxpayer procured various taxable goods and services for construction of the mall. Taxpayer accumulated ITC from the good and services procured for building the mall, which the taxpayer was intending to utilize against GST on rental income received from letting out the mall premises. The said ITC was denied by the tax authorities under section 17(5)(d) of the CGST Act. Aggrieved by the said denial, taxpayer filed a writ

petition before Orrisa High Court (HC) which 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.<sup>15</sup> The said decision of Hon'ble HC was challenged by the tax department before the Hon'ble Supreme Court.

## Key takeaways from the ruling:

- The Hon'ble Supreme Court has upheld the constitutional validity of Section 17(5)(c) and (d) of the CGST Act.
- Clause (c) of section 17(5) of the CGST Act uses the term 'plant and machinery', which is specifically defined under the CGST Act. Conversely, clause (d) uses the term 'plant or machinery', which is not specifically defined. 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 of Section 17.
- 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.
- The question of whether a building can be classified as a “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. The court has laid down the importance of functionality test to determine the same if the construction of a building is essential for carrying out the activity of supplying services, such as renting or giving on lease or other transactions in respect of the building or a part thereof, the building could be held to be a plant.
- For clause (d) of section 17(5) of the CGST Act, 'construction' is said to be on a taxable person's 'own account' if it is for personal use or for use as a business setting, but not if it is intended for sale, lease or license.
- The decision on whether a building qualifies as 'plant' for ITC purposes requires a factual analysis on a case-to-case basis and must be made by examining the unique business needs and the function of the building within the taxpayer's business activities.

## Verdict

Verdict pronounced by the Hon'ble Supreme Court in this (supra) case has undoubtedly brought a ray of hope amongst industries and resulted in a positive outcome by allowing ITC on the construction of immovable property/building when such property/buildings are integral to the provision of services such as rental or leasing activities. This decision provides substantial relief to the taxpayer by addressing the ITC on construction related challenges faced by the industry.

With the above background on the ITC related provisions under GST, in the subsequent chapters we move towards highlighting the challenges or issues faced by the industry on account of credit blockages and how the same is impacting its growth and competition.





# 4

## On account of blocked ITC

Given the unique nature of the managed workspace services industry, the credit restrictions under GST under section 17(5)(c) and (d) on inward supplies related to improvements/fit-outs expenditure adversely impacts the working capital requirement. These improvements/fit-outs expenditure is a significant component of the business model followed by the managed workspace services industry. These expenses, along with ITC thereon, directly influence the cost structure of the managed workspace services offered to the customer. Breakup of expenditure incurred on improvements/fit-outs are as follows:

**Exhibit 10**

Particulars	Cost bifurcation
Civil work	5%-15%
Electrical and fittings	15%
HVAC	12%
Networking and cabling	6%-7%
Modular furniture	30%
Partitions made of glass or any other material, carpets and miscellaneous items	21%-22%
Total expenses incurred on fit-out/improvements	100%

Source: Industry data

# Issues on account of credit blockages

The above break up provides the significance of fit-out expenditures for supply of uniquely managed workspace services. Out of the total of the improvements/fit-outs, ~85% to 95%<sup>16</sup> of the cost pertains to the items are movable in nature and on which ITC is allowed independently. The moment these fit-outs expenditures are classified and capitalized under fixed assets head in the books of accounts, the ITC on such expenses is being restricted by virtue of Section 17(5)(c) and (d) of the CGST Act. This restriction hampers the smooth credit flow, which is contrary to the foundational goal of GST.

Given the obstacles imposed by Section 17(5)(c) and (d) of the CGST Act, which prevent the managed workspace services industry from claiming ITC for goods and services utilized in interior fit-outs and renovations, the ramifications of such restrictions are substantial. These limitations not only impose significant financial burdens but also impede the growth potential of the managed workspace services industry.

As explained earlier, improvements/fit-outs are a pivotal component in delivering managed workspace services, with the inputs and input services procured for these improvements/fit-outs being integral to the provision of outward supply services. However, the restrictions imposed by Section 17(5)(c) and Section 17(5)(d) of the CGST Act may present potential challenges, impacting the financial and operational aspects of the industry and impeding the seamless delivery of these essential services:

## Disruption in ITC Flow

The fundamental crux with which GST in India was implemented was the free flow of ITC across the supply chain to ensure uninterrupted and seamless flow of ITC. However, on account of blocked ITC provisions, the industry is facing issues with the fundamental objective of the free flow of ITC. This ineligibility has created distortions in GST, which deviate from the basic structure of the GST taxation system. Also, these distortions lead to a cascading effect of multi-stage taxation, i.e., tax on tax.

## Additional tax burden

The restrictions imposed by Section 17(5)(c) and (d) of the CGST Act results in double taxation. The first incidence occurs when the input tax credit restrictions are applied on inputs and input services used for fit-out expenditures incurred to provide managed workspace service and the second instance arises on the supply of managed workspace services with GST at 18% using the ITC restricted inward supplies. This double taxation imposes an unreasonable financial burden on the industry, making services uncompetitive and hampering growth.

## Export of tax

The provisions of Section 17(5)(c) and (d) of the CGST Act may lead to scenarios that seem to be at odds with the Government's foundational stance that 'Export of goods and services should not include any taxes, whether directly or indirectly'. The managed workspaces are primarily used by an exporter of services and GCCs who are engaged in export of services outside India. The blocked credit on account of the above restriction under GST becomes part of the cost of managed workspace services operations, which in turn becomes the cost of export of services. This cost on account of blocked credit of GST imposes an unreasonable financial burden on the export of services, making these export services uncompetitive and hampering growth.

## No ease of doing business

Taxation significantly impacts the 'Ease of Doing Business,' particularly in the managed workspace services industry where ITC limitations on improvements/fit-outs and hinder growth and efficiency. These ITC restrictions can inflate operational costs, escalating prices for end-users and potentially impeding the industry's growth and operational efficiency.

This financial impediment, stemming from the ITC restrictions on fit-out expenses, poses a significant challenge for the managed workspace services industry. These restrictions prevent the offsetting of GST paid on fit-out expenses against output tax liabilities of managed workspace services, leading to higher service rates for customers and inflated operational costs for providers.

## 45th GST Council Meeting discussions

(17 September 2021)

### Proposal-

**To allow ITC on works contract services (WCS), goods and services on construction of immovable property.**

**Comments-** Opening up ITC of Works Contract Service supplied for construction of immovable property, would **promote procurement by businesses/manufacturers of tax paid WCS. This would in turn encourage suppliers of WCS to procure tax paid inputs, capital goods and services. This will make manufacturing and export of goods and services more competitive.**

The proposal for opening up of ITC of WCS for suppliers of all taxable goods and services is in keeping with the cardinal principle of GST of allowing seamless flow of ITC. However, revenue implication of this proposal is expected to be of the order of magnitude of **INR 6300 crore** at the same level of economic activity as in 2016-17.

**Conclusion- May not be accepted.**

Considering the challenges faced by the industry on account of the said ITC restriction, the 45th GST Council meeting also acknowledged the importance of enabling restricted ITC recognizing that it aligns with GST's principles by ensuring a seamless tax credit flow and could enhance manufacturing and exports through better cost competitiveness. However, due to the potential revenue impact estimated at around ~INR6,300 crores, the proposal was not adopted, acknowledging the industry's difficulties with ITC on construction but citing revenue constraints as the reason for maintaining the status quo.

The managed workspace services industry is clearly separate from the real estate industry, as they commence operations only after the construction is over. Hence, any GST discharged by a managed workspace service provider is only for goods and services procured for primarily moveable improvements/fit-outs, which are used for providing managed workspace services (and not real estate services) leviable to GST at 18%. Given that the cascading effect of GST is a critical bottleneck for the industry, and that the Government has been actively seeking to remove such difficulties for various industries, the ask of the managed workspace services industry for removal of cascading effect (as enunciated in the succeeding paragraphs) should be considered.

### On account of high rate of output tax

The managed workspace service providers are discharging GST liability at the standard rate of 18%. As mentioned earlier, given the unique nature of the business and absence of a specific classification, the companies are classifying managed workspace services under HSN/ SAC code of 9972- 'Rental or leasing services involving own or leased non-residential property' which also results in disputes over the eligibility of ITC claims on various expenditures, such as improvements/fit-outs. The restriction on account of disallowance of ITC on account of Section 17(5) (c) and (d) of the CGST Act precludes the managed workspace services industry from claiming ITC for goods and services utilized in interior fit-outs and renovations.

Despite of the fact that managed workspace services commence their operations only after completion of construction activity of a building, the said industry is at a double disadvantage from a GST perspective i.e., one on account of the blockage of ITC and the second in terms of the output tax being paid by them which is higher than the rates that are applicable in case of construction services in real estate industry. The below-mentioned table clearly provides an overview on the disparity of rates between the real estate industry and managed workspace services:



## Exhibit 11<sup>17</sup>

Services	GST Rate	ITC Eligibility
Real estate services		
Construction services for non-affordable residential apartment by a promoter in a RREP which commences on or after 1 April 2019	7.5%	No ITC available
Construction of commercial apartments (shops, offices, godowns etc.) by a promoter in a RREP which commences on or after 1 April 2019	7.5%	No ITC available
Construction of non-affordable residential apartments by a promoter in a REP other than a RREP which commences on or after 1st April, 2019	7.5%	No ITC available
Construction services for commercial apartments (shops, offices, godowns etc.)	18%	ITC is available subject to restrictions under Section 17(5) of the CGST Act - <u>Limited/No restrictions under Section 17(5) (c ) and 17 (5) (d) since output services are works contract and construction is undertaken for third party in typical instances</u>
Composite supply of works contract as defined in clause (119) of section 2 of the Central Goods and Services Tax Act, 2017	18%	ITC is available subject to restrictions under Section 17(5) of the CGST Act - <u>Limited/No restrictions under Section 17(5) (c) and 17 (5) (d) since output services are works contract and is undertaken for third party in typical instances</u>
Managed workspace services		
Managed workspace services to the customers generally to a business entity	18%	ITC available subject to restrictions under Section 17(5) of the CGST Act - <b><u>Substantial restrictions under Section 17(5) (c) and 17 (5) (d)</u></b>

The table provides that the law prescribes a rate of 7.5% (with no ITC being available) and 18% (with substantial ITC available) for construction-related activities in the real estate industry. It is thus clear that in order to make up for the lost ITC, a lower rate of GST is prescribed for various services under the GST legislation. This is in line with the principles of equity and GST principle of reduction of cascading effect. However, in the case of managed workspace services, the output GST is leviable at the full rate of 18% with substantial ITC being restricted under Section 17(5) (c) and (d) of the CGST Act. This essentially leads to an effective tax rate of 22% to 25%<sup>18</sup> on such service providers. This cost burden aggravates the financial pressure and makes managed workspace services expensive, which hampers the industry at large in terms of their growth and cost efficiency.

Further, with the recent ruling of the Hon'ble Supreme Court in the case of M/s Safari Retreats Private Limited & Ors, there are multiple scenarios which are now open to interpretation i.e. whether a particular building would qualify as a plant or not depending on the facts of each case by applying the functionality test. Further, the ruling is also silent on the eligibility of ITC in terms of

Section 17(5)(c) of the CGST Act, i.e., ITC in relation to works contract services for construction of immovable property. These scenarios still affect the ability to claim the ITC of GST paid on crucial investments incurred in improvements/fit-outs.

It is therefore crucial for policymakers to recognize the existing issues in the managed workspace services industry currently, which could be minimized by permitting ITC claims under section 17(5)(c) and (d) for managed workspace services industry. The key advantages that would arise in bringing such parity would be:

### Free flow of ITC

Considering the managed workspace services industry, where the end product is not the sale of immovable property, but the delivery of a fully functional office space, inclusive of necessary improvements/fit-outs, the eligibility of ITC is crucial to allow free flow of ITC. Expenditure incurred by the operators on improvements/fit-outs is essential for furtherance of business and is used

for further supply of taxable output services at the full rate of GST at 18%. The procurements of improvements/fit-outs made by the industry are generally movable in nature and being used by them for supply of output services and form the basic need for requirement of provision of managed workspace services.

## Cost reduction

Permitting ITC claims under Section 17(5)(c) and (d) would benefit the managed workspace services industry by way of reduction in the overall cost, leading to more cost-effective service provision. The reduced cost would result in more affordable offerings to the customers, increasing demand and subsequently enhancing GST revenue over the medium to long term.

## Increased investment

ITC admissibility to the managed workspace services industry would improve cash flows, allowing companies to reinvest in their businesses or allocate funds to other growth or expansion opportunities such as opening new locations or enhancing existing ones, thereby increasing market reach and client base and ultimately resulting in an increase in revenue of exchequer in the medium to long run.

## Competitive pricing

ITC admissibility on improvements/fit-outs would lead to lower operational costs, which could enable managed workspace services providers to offer more competitive pricing to their clients, making their services more appealing to businesses looking for cost-effective office solutions. This will, in turn, make export more competitive and India a more competitive destination for the world to outsource and engage for providing services to their global operations.

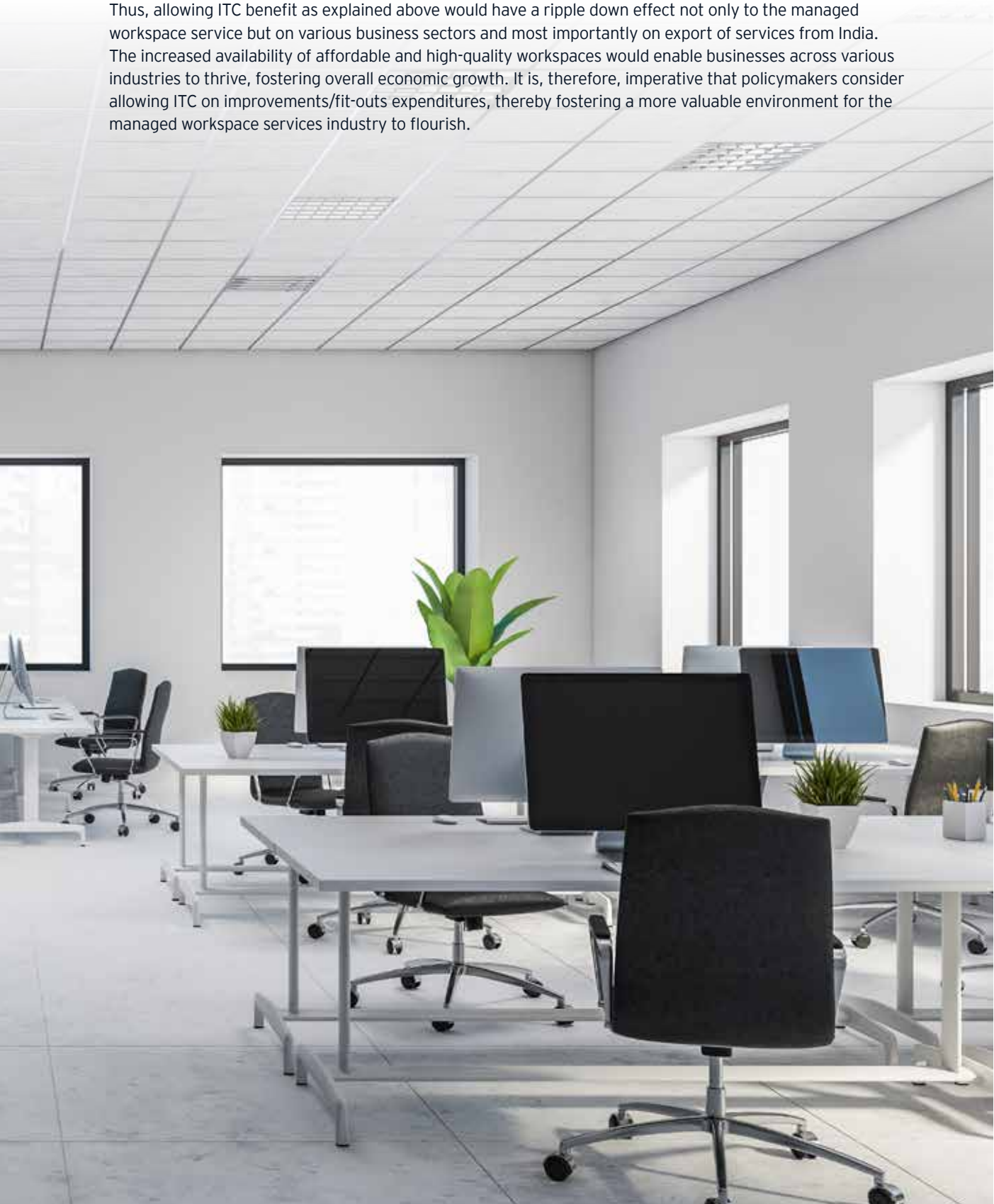
## Positive economic impact

Increased investment and expansion in the managed workspace services industry would lead to job creation and stimulate related industries, such as construction, interior design, and technology providers. The demand for extensive facility management services is expected to provide employment opportunities for the lower-income demographic, thereby contributing to inclusive economic growth. Furthermore, the enhanced attractiveness of the managed workspace services industry serves as a catalyst for foreign investment, as international companies



evaluate India as a strategic location for setting up offices, businesses, and GCCs in comparison to other South Asian nations. This, in turn, would stimulate the Indian economy to grow as a whole, by promoting holistic development and positioning India as a leading economic hub in the region.

Thus, allowing ITC benefit as explained above would have a ripple down effect not only to the managed workspace service but on various business sectors and most importantly on export of services from India. The increased availability of affordable and high-quality workspaces would enable businesses across various industries to thrive, fostering overall economic growth. It is, therefore, imperative that policymakers consider allowing ITC on improvements/fit-outs expenditures, thereby fostering a more valuable environment for the managed workspace services industry to flourish.





A modern, industrial-style interior. In the foreground, a bright orange tufted sofa sits on a patterned rug. In front of the sofa is a low, rustic wooden coffee table. Behind the sofa, a dark wooden shelving unit holds several potted plants and decorative items. The background features a large window or glass partition, revealing another part of the space. The ceiling is exposed, showing pipes and a long, thin light fixture. The overall aesthetic is contemporary and functional.

# 5

At this juncture, it is appropriate to conduct a comparative analysis of the availability of input tax credit for businesses operating within the same sector, particularly focusing on the eligibility of ITC on expenditures incurred on fit-outs and improvements. This also encompasses services where ITC has been allowed on the same line of operating business, as well as construction. This global perspective may provide valuable insights for policymakers as they devise strategies to support the industry. To facilitate this, a concise analysis of the practices in the countries such as Singapore, New York (US), United Kingdom, and Japan are being presented in the succeeding paragraphs:

# Global best practices



## Global analysis on eligibility of ITC on improvements/fit-outs



### Singapore

#### ITC on expenditures incurred on improvements/fit-outs

Singapore Goods and Service Tax Act permits input tax credit on expenditure incurred on fit-outs and improvements. Section 38 of the said Act includes goods or services comprising or relating to land or any interest in or right over land as a prescribed supply. The said supply is being treated as a taxable supply under GST. This scenario also covers goods consisting of furniture, furnishings, fittings, appliances, or effects that are supplied together with any goods or services in relation to the prescribed supply of land or interest in or right over land. Thus, outward supply of goods, such as furnishings, fittings etc., is taxable supply under GST.

Further, Section 26 and 27 of Singapore GST Act (Regulations) provides the list for ineligible ITC, which includes the following:

1. club subscription fee
2. medical and accident insurance premium
3. medical expenses
4. family benefits
5. any transaction involving betting, sweepstakes, lotteries, fruit machines or games of chance, shall be excluded from any credit under sections 19 and 20 of the Act
6. Motor vehicles

The above stated ineligible list of supplies excludes ITC w.r.t. expenditure incurred on fit-outs, improvements. Hence, ITC on fit-outs and improvements is allowed under the Singapore GST Act. To support the view, the **IRAS e-Tax** Guide administered by Singapore GST authorities also holds the following in the guidelines for Property Owners and Property Holding Companies, which states that<sup>19</sup>:

- Businesses registered for GST may claim GST incurred on the purchase and rental of non-residential property, provided the property is utilized for business activities or is leased out for business purposes.
- The business must engage in activities that generate GST-taxable sales and must report and remit GST on those sales.
- Claimable GST includes that incurred on the purchase price, rental fees, maintenance, service charges, furniture, fittings, renovations, repairs, and legal fees

Hence, ITC is allowed for the supplies on expenditure incurred on fit-outs, improvements by way of renovations, repairs, etc. This ITC is pertinent to the managed workspace service industry, as the Act provides costing relief to the operators of this specific industry.



## New York, US

### ITC on expenditure incurred on improvements/ fit-outs

New York State sales tax law provides that businesses can claim sales tax credit on their tax returns under the following conditions<sup>20</sup>:

If **sales tax was paid on building materials** purchased from a supplier,

If those **materials were then used in a taxable repair, maintenance, or installation service provided to a customer, and**

If sales tax was collected from the customer for that service.

Typically, a sales tax credit is applicable when the service provided is considered taxable repair, maintenance, or installation work. However, it is not applicable when the service is deemed a capital improvement. Generally, any additions or changes made to a property by or for a tenant, especially in leased spaces, **are assumed to be temporary**. Therefore, they are not usually classified as capital improvements. But if there is clear intent to make these changes permanent and all other criteria for capital improvements are met, then they may be considered as such<sup>21</sup>.



## United Kingdom

### ITC on expenditure incurred on improvements/fit-outs

The VAT law of the United Kingdom provides that VAT may only be claimed as input tax if it is incurred for business purposes by a person who is registered for VAT or is required to be registered.

Under the United Kingdom's VAT legislation, landlords are entitled to claim VAT on expenses related to the acquisition, upkeep, and renovation of office buildings as input tax credits. Similarly, tenants who conduct business operations where a minimum of 90% of their activities are subject to VAT can also claim input tax deductions on their lease expenses. This provision offers an opportunity for businesses to reduce their net rental costs, potentially leading to significant financial savings for the company.

Section 24 of the UK Vat Act provides that input tax can be claimed for the relevant assets to be regarded as used or to be used for the purposes of the business. The relevant assets includes: (a) any interest in land, (b) **any building or part of a building, (c) any civil engineering work or part of such a work, (d) any goods incorporated or to be incorporated in a building or civil engineering work (whether by being installed as fixtures or fittings or otherwise)**, (e) any ship, boat or other vessel, or (f) any aircraft.<sup>22</sup>

Thus, it is evident from the above legislation of the UK VAT Act that a person can claim ITC on expenditure incurred on fit-outs, improvements made in the said buildings.

### ITC on construction materials

The UK's Value Added Tax Act of 1994, particularly Section 26, sets out the criteria for VAT credits, ensuring a fair and efficient tax system in compliance with the UK legislation.<sup>23</sup> As per the UK VAT guidelines:

- The amount of input tax for which a taxable person is entitled to credit at the end of any period shall be so much of the input tax for the period
- The credit shall be entitled wherein supplies made or to be made by the taxable person in the course or furtherance of his business of:
  - taxable supplies
  - supplies outside the UK which would be taxable supplies if made in the UK
  - such other supplies outside the UK and such exempt supplies as the Treasury may by order specify for the purposes of this sub-section.



In the United Kingdom, **the VAT framework permits the reclaiming of ITC for construction materials and related services when utilized for taxable outputs.** This provision markedly differs from the Indian context, where Input Tax Credits for construction-related expenditures are categorically disallowed, irrespective of their application in generating taxable supplies.

In summary, the UK VAT legislation facilitates the recovery of input tax credits for expenditure incurred on fit-outs/improvements, any enhancements made to these properties, along with ITC allowance, on construction materials. This approach not only supports businesses in offsetting costs associated with improvements, fit-outs expenses but also encourages the reclaiming of VAT for the construction material and services within the framework of the UK tax law.

## Japan

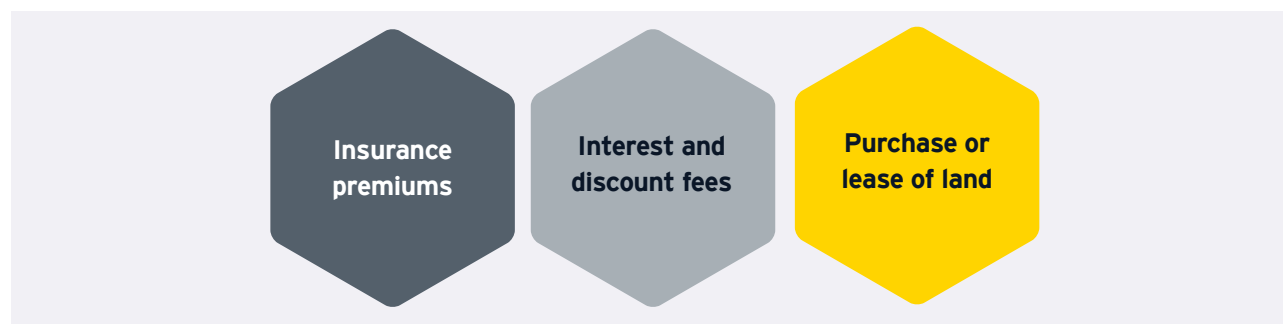
The concept of “Taxable Purchases eligible for tax credit” in Japan pertains to specific transactions in which businesses receive assets or services. These transactions encompass a wide range of activities within the country.

### ITC on construction materials

Taxable Purchases include not only the acquisition of products and goods for inventory but also substantial investments like buildings and machinery used for business operations. Additionally, they encompass everyday business expenses such as repair costs and fuel expenses for delivery vehicles.<sup>24</sup>

However, it’s important to note that certain financial transactions fall outside the scope of Taxable Purchases and do not qualify for tax credits. These non-taxable transactions encompass activities like:

#### Exhibit 12



In Japan, transactions involving construction materials used in immovable property and works contract services are exempt from taxation, rendering them ineligible for input tax credits. This exemption provides transparency in the tax code, delineating which transactions qualify for credits. Contrasting with India, **Japan does not restrict the claim of input tax credits for construction-related expenses, highlighting a significant divergence in tax policy between the two nations.**

Thus, as evident from the above discussion on global best practises, the allowance of ITC on expenditures incurred on improvements has emerged as a strategic approach to foster economic growth and bolster businesses. Such a mechanism not only ensures equity and efficiency but also stimulates investments within the industry. The concept of ITC on the same line of business has been recognized at the global level. Recognizing the potential benefits of combination of ITC on same line of business with eligibility of ITC on improvements/fit-outs on a global scale, India could draw valuable insights from these models.

Addition to the above, countries such as Japan and the UK are promoting ITC even on construction activities which inter alia include improvements/fit-outs expenditure. Thus, inference can be drawn from these countries to allow ITC on improvements/fit-outs that have been qualified in India as construction of immovable property by the field formations.

A thoughtful integration of ITC for managed workspace services industry endeavors that India has the potential to create a more business-friendly environment, attract investments, and propel the nation towards robust economic development and infrastructure advancement. Learning from global practices, India can fine-tune its tax policies to align with international success stories, fostering a more sustainable and progressive economic landscape.



# 6

## Deciphering classification for managed workspace services

As previously outlined, managed workspace services offer a unique and comprehensive range of solutions that address every facet of workspace management. From initial design to final execution and daily operations, these services go beyond mere workspace leasing to deliver fully tailored environments that align with organizational needs.

In an attempt to deciphering the classification of managed workspace services, inference can be taken from the classification prescribed for co-location services. Co-location is a data center facility in which a business/company can rent space for its own servers and other computing hardware, along with various other bundled services related to hosting and information technology (IT) infrastructure. Here, the co-location facilities provide not only server space rental within a data center but also encompass a comprehensive array of ancillary IT infrastructure and hosting services—including network support, data backup, security measures, and operational monitoring—which are integral to the client's use and management of the hosted servers. Consequently, the provision of co-location services surpasses the mere leasing of immovable property.

Vide circular number 203/15/2023-GST dated 27 October 2023, CBIC has clarified that Co-location services are in the nature of "Hosting and Information Technology (IT) Infrastructure Provisioning Services" (as per Serial No. 3 of the Explanatory Notes to Service Accounting Code 998315). The arrangement of co-location services extends beyond the passive activity of rendering immovable property accessible to a client, as it

# Solving the GST puzzle: Recommendations

also supplies various services integral to hosting and IT infrastructure such as network connectivity, backup facility, firewall services, upkeep, security, monitoring and surveillance service, etc. However, only in cases where the agreement between the provider and client is confined to the leasing of physical space without any ancillary services, as mentioned above, then only such services are deemed as the service of renting of immovable property.

By applying the same rationale for classification of managed workspace services, it can be said that the service rendered by the managed workspace services industry is not merely limited to the leasing of workspaces but extends to the comprehensive services associated with procurement, creation, design, management, and operation of the workspaces. The aim is to furnish a fully operational office with vital infrastructure, advanced technology, extensive amenities, parking facilities, a single point of contact for vendor management, and the execution of day-to-day operational tasks.

Thus, in cases wherein co-location services are provided by the companies (includes services such as upkeep, security and maintenance etc.) a separate classification has been accorded under HSN 998315 - Hosting and Information Technology (IT) Infrastructure Provisioning Services.

Similarly, the managed workspace services industry also merits a separate classification given that the service is to provide a fully functional workspace, and the service is not merely limited to renting of immovable property.

## Resolving ITC hurdles for seamless credit

It is worthwhile mentioning that despite the explicit restrictions outlined in Section 17(5) of the CGST Act 2017 on the eligibility of ITC for certain supplies, the legislation also embodies a progressive perspective where ITC is admissible in businesses that are intrinsically linked to the supplies on which restrictions are imposed.

### In case of motor vehicles

17 (5) (a) **motor vehicles for transportation** of persons having approved seating capacity of not more than thirteen persons (including the driver), **except when they are used for making the following taxable supplies, namely:-**

- (A) further supply of such motor vehicles; or
- (B) transportation of passengers; or
- (C) imparting training on driving such motor vehicles
- (aa) .....

**(ab) services of general insurance, servicing, repair, and maintenance in so far as they relate to motor vehicles, vessels or aircraft referred to in clause (a) or clause (aa):**

### In case of food and beverages and health services

17 (5) (b) the following supply of goods or services or both-

- (i) food and beverages, outdoor catering, beauty treatment, health services, cosmetic and plastic surgery, leasing, renting or hiring of motor vehicles, vessels or aircraft referred to in clause (a) or clause (aa) except when used for the purposes specified therein, life insurance and health insurance:

**Provided that the input tax credit in respect of such goods or services or both shall be available where an inward supply of such goods or services or both is used by a registered person for making an outward taxable supply of the same category of goods or services or both or as an element of a taxable composite or mixed supply;**



## In case of works contract services

17 (5) (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;**

To summarize, entities engaged in the business of motor vehicles, restaurant, catering, health services or works contract services etc., are allowed to claim ITC when such ITC are used for the purpose of making an outward supply of the same category of goods or services, or both.

The Fitment Committee has extensively discussed the availability of ITC under the abovementioned exceptions during 22nd and 25th GST Council meetings. The rationale behind allowing ITC in the said exceptions is driven by the fact that the absence of allowing credit in the abovementioned scenarios would result in the cascading of taxes.

The same analogy can be applied in the case of managed workspace services industry to claim ITC on inward supplies of fit-outs/improvements. As explained above, disallowing ITC on improvements/fit-outs expenditures, which are essential for the industry, could lead to the cascading of taxes. Thereby, the end-service, i.e., managed workspace services, becomes more expensive due to accumulated taxes. This situation mirrors the GST issue with motor cab services, tour operator, health services etc., wherein disallowance of ITC has led to cascading effect of taxes, thus stifling industry growth. However, conditional ITC claim was subsequently allowed for cab and health services. In the context of managed workspace services, applying the same analogy can prevent the cascading effect, i.e., tax-on-tax, thereby reducing overall costs and enhancing the industry's competitiveness, which benefits both providers and clients.

The legislative provision, council discussions, along with notification, reflect a balanced approach, aiming to facilitate the free flow of ITC and avoid any cascading effect of taxes. Thus, it is imperative to recognize that the underlying principle of the GST regime is to ensure the seamless flow of ITC across the supply chain, which is vital for the growth of industries.

Building upon this foundation, this chapter aims to present targeted solutions that address the identified challenges and pave the way for the industry's sustained growth, avoid ambiguity in relation to ITC on improvements/fit-outs expenses and contribution to the managed workspace services industry and Indian economy.

# 1

## Defining a new classification: A separate HSN/SAC code for managed workspace service

Given the managed workspace services industry's unique business model and its distinct role in India's evolving economic landscape, notifying a separate HSN/SAC specifically for managed workspace services offers a resolution. The below mentioned definition provides a solution for defining the new HSN/SAC:

### Managed workspace services

"This service code is for provision of managed workspace services that encompasses a comprehensive suite of solutions provided by a service provider for use of non-residential buildings (like office spaces, workspaces etc.) by a customer, wherein the entire services in relation to procurement, creation, designing, management, and operation of the said non-residential buildings (like office spaces, workspaces etc.) is provided by the service provider. This comprehensive service includes customization, designing (custom designed or otherwise), renovations (including civil construction, fit-outs) and operation, administration, maintenance and supervision of the non-residential building on a day to day basis. It may include integrated value-added goods and services like network equipment, IT solutions, additional manpower supply and food and beverages supply etc within the scope of managed workspace services for non-residential building."

The proposed HSN/SAC code covers the full process of the managed workspace service, from procurement, designing, management and operations of a workspace. The above HSN/SAC can be added as part of either of the below mentioned:

**HSN/SAC 99721 - Real estate services involving owned or leased property**

Or

**HSN/SAC 99839 - Other professional, technical and business services**

A separate HSN/SAC may not only ensure a clear demarcation from conventional real estate services but also streamline tax filing, compliance processes, facilitate better governance and enable policymakers to track the industry's growth, thereby providing targeted support and recognition within the taxation system.

## 2

### Removing credit restrictions

The managed workspace services industry is currently facing a significant challenge due to the restrictions on ITC under section 17(5)(c) and (d) of the CGST Act on expenditures incurred for improvements/fit-outs. This restriction may not fully align with the core objective of GST to enable a seamless flow of ITC. The denial of ITC due to restrictions under section 17(5)(c) and (d) of the CGST Act on fit-outs/improvements, renovation expenses leads to a cascading effect of taxation, resulting in higher service costs that are ultimately passed on to customers. This not only undermines the competitiveness of the managed workspace services industry but also affects the affordability of businesses.

To align with the foundational goals of GST and to support the growth of the industry, it is recommended that the managed workspace services industry be allowed to claim ITC on inward supplies related to improvements/fit-outs. In this regard, insights from the 22nd and 25th GST council meetings, as mentioned earlier in Chapter 2, demonstrate the positive shift towards permitting ITC in sectors where it was previously barred due to its cascading tax impact.

To mitigate ambiguity and ensure a more consistent and equitable approach, a strategic re-assessment of Section 17(5) of the CGST Act may be warranted to enable the seamless flow of ITC for the industry. To facilitate this shift, we recommend the following options, which are aimed at addressing these gaps and providing greater certainty for businesses:

### Option 1: Omission of Section 17(5)(c) and (d) from the CGST Act

We propose the complete removal of Section 17(5)(c) and (d). The provisions of the said sections restrict availability of ITC for goods and services (including works contract) used in the construction of immovable property, improvements/fit-outs etc, even if used in the course of furtherance of business. This has led to significant challenges across industries in addition to steering away of basic tenet of ITC, which propagates removal of cascading effect. Removal of section 17(5)(c) and (d) of the CGST Act would benefit in multiple ways as enumerated below:

#### Enhance business efficiency

The current provisions restrict ITC on construction of immovable property, improvements/fit-outs, etc., even when such construction is for the furtherance of business that leads to increased costs. Eliminating such restrictions on ITC for construction activities promotes cost savings and operational efficiency.

#### Aligned with GST objectives

The restrictions under section 17(5)(c) and (d) are contrary to the core GST objective of a seamless flow of ITC, as they create a blockage of ITC, leading to a cascading effect. Removing these sections aligns with the GST's aim to prevent tax cascading and ensure a smooth credit flow.

#### Promoting uniformity and equity across sectors

The removal of Section 17(5)(c) and (d) will promote fairness by allowing all businesses, regardless of the industry type, to avail ITC on all key business expenditure including on construction, improvements/fit-outs, etc. This will also align the law with the principle of equity, ensuring that no industry is disadvantaged due to the nature of its operations - be it works contract services or a managed workspace service, treatment of ITC would be same for all.

## International best Practices

Many countries with GST or VAT regimes do not have restrictive provisions in relation to ITC on expenses incurred on construction, improvements /fit-outs, etc., which allows for a broader ITC availment mechanism. This has also been explained in the preceding chapters. Adapting such practices in India may align its policies with international best practices to encourage investment and economic growth.

In light of the above reasons, it is recommended that Section 17(5)(c) and (d) of the CGST Act be removed completely to ensure clarity, reduce litigation, and foster a business-friendly environment. This strategic move will eliminate existing ambiguities, provide equitable treatment across industries, and promote the seamless flow of input tax credit, in line with the overall intent of the GST regime.

### Option 2: Through insertion of exception under section 17(5)(c) and (d) of the CGST Act

This option will permit availing ITC on improvements/fit-outs (goods or services or both) made in the bare shell building, as per the customer's needs, for further supply of managed workspace services. This would be consistent with the treatment of ITC within the same line of business model, as evidenced by the allowances made for motor car, restaurant services, health sectors, etc., despite being listed under the blocked ITC list of section 17(5) of the CGST Act.

Additionally, it aligns with the global best practices where ITC is more liberally granted for same line of business, particularly in jurisdictions like Singapore and the UK, which have successfully integrated ITC allowances into their tax structures in case of improvements/fit-outs.

This section will be read as –

Section 17 (5)- Notwithstanding anything contained in sub-section (1) of section 16 and sub-section (1) of section 18, input tax credit shall not be available in respect of the following, namely: –

(a).....

(b).....

(c) works contract services when supplied for construction of an immovable property (other than plant and machinery) except:

(i) where it is an input service for further supply of works contract service

**(ii) where it is an input service for further supply of managed workspace services**

(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 except **where goods or services or both are used in a building or any other civil structure (whether by being installed as fixtures or fittings or otherwise) for further supply of managed workspace services**

### Option 3: Amending the definition of "construction" under explanation under section 17(5) of the CGST Act

An alternative measure to resolve the ITC issue for the managed workspace service industry is by amending explanation defining the term "construction" under Section 17(5) of the CGST Act. This amendment would categorically exclude expenses incurred on improvements/fit-outs that are installed in the building or civil structure and can be subsequently reused for providing managed workspace services. This approach would allow the managed workspace service industry to claim ITC on such improvements/fit-outs, which are essential for delivering outward services.



The proposed amendment to the explanation under Section 17(5) of the CGST Act for the expression 'construction' may be considered in the following manner:

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, **but excludes any improvements or fit-outs made by way of any goods or services, or both, even though capitalised, to an immoveable property wherein such immoveable property is used for further supply of managed workspace services**

The abovementioned amendment aims to provide clarity and facilitate the managed workspace service industry in claiming ITC for expenses on improvements/fit-outs that are essential for delivering their services, thereby promoting a more favorable business environment within this industry.

Exhibit 13



Thus, permitting ITC to the industry would enable substantial enhancement of working capital and funds which can provide multifaceted benefits to the industry.

Giving workspace service operators more flexibility would make the tax system more adaptable and fairer, while also recognizing the specific needs of these providers. This strategic move has the potential to amplify job creation, boost revenue generation, nurture entrepreneurship, and bolster the growth of ancillary industries, thereby contributing to the nation's economic prosperity.

The recommendations allowing ITC on the expenses paid on improvements/fit-outs will be in line with the spirit of GST law and as per the global best practices followed by various other developed major world economies. Aligning with these international standards would address the current challenges faced by the industry in India, enabling it to claim ITC on improvements/fit-outs, thus fostering a favorable environment for growth and innovation.

Given the growth prospects of the managed workspace services industry and the increasing preference of customers to opt for such models, the cost disadvantage associated with the ITC restriction on goods and services used by the said industry, results in a high cost and we believe that Section 17(5)(c) and (d) of the CGST Act may inadvertently impact customers and constrain industry expansion.

The following key recommendations may be implemented in line with the solutions as proposed in the previous chapter:

## 1.

**Defining a new classification:** Notify a new HSN/SAC code to suit the requirements of a managed workspace industry i.e., Managed Workspace Services .

The term 'managed workspace services' can be referred from the description of recommended HSN/SAC.

# Conclusion

## 2.

### Removing credit restrictions

**(a) Omission of section 17(5)(c) and (d) from the CGST Act:** Section 17(5)(c) and (d) of the CGST Act to be omitted entirely, as these sections limit ITC for construction and related improvements/fit-out expenses. This change would enhance business efficiency, align with GST objectives, promote equity across sectors, and match international best practices.

Or

**(b) Through insertion of exception under Section 17(5)(c) and (d) of the CGST Act:** Create exceptions by allowing ITC on goods and services used in building or any other civil structure (whether being installed as fixtures or fittings) for further supply of managed workspace services.

Or

**(c) Amending the definition of “construction” under explanation under section 17(5) of the CGST Act:** To address the ITC issues faced by the managed workspace service industry, it is proposed to refine the definition of “construction” in Section 17(5) of the CGST Act to specifically exclude improvements/fit-outs from the definition of construction.

In case of options (b) and (c), to remove any ambiguity in terms of eligibility to **avail ITC by the managed workspace service providers, the term ‘managed workspace services’ can be referred from the description of recommended HSN/SAC.**

Allowing ITC on fixtures, fitting, improvements/fit-outs used in provision of managed workspace services would not only rectify the tax inefficiencies but also promote a more equitable tax structure, thereby enabling the industry to offer premium services without the additional tax burden. It is crucial for policymakers to consider this amendment to foster a favorable environment for the managed workspace service industry to thrive.



# ! Acknowledgments

## The Associated Chambers of Commerce and Industry ('ASSOCHAM')

**Mohd Nahid Alam**

Additional Director

## EY

**Bipin Sapra**

Partner

EY India

**Vivek Pachisia**

Partner

EY India

**Swati Saraf**

Director

Indirect Tax

**Shradha Sancheti**

Director

Indirect Tax

**Sherry Nigam**

Indirect Tax

**Contact Us**

**Swati Saraf**

swati.saraf@in.ey.com

**Jayant Chaudhry**

Indirect Tax

**Ashita Kumar**

Indirect Tax

## Editorial

**Shweta Sharma**

## Design

**Jasmeet Joshi**

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## Notes

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# Our offices



**Ahmedabad**

22nd Floor, B Wing, Privilon  
Ambli BRT Road, Behind  
Iskcon Temple  
Off SG Highway  
Ahmedabad - 380 059  
Tel: + 91 79 6608 3800

8th Floor, Building No. 14A  
Block 14, Zone 1  
Brigade International  
Financial Centre  
GIFT City SEZ Gandhinagar  
- 382355, Gujarat  
Tel +91 79 6608 3800

**Bengaluru**

12th & 13th Floor  
"UB City", Canberra Block  
No.24 Vittal Mallya Road  
Bengaluru - 560 001  
Tel: + 91 80 6727 5000

Ground & 1st Floor  
# 11, 'A' wing  
Divyasree Chambers  
Langford Town  
Bengaluru - 560 025  
Tel: + 91 80 6727 5000

3rd & 4th Floor  
MARKSQUARE  
#61, St. Mark's Road  
Shantala Nagar  
Bengaluru - 560 001  
Tel: + 91 80 6727 5000

1st & 8th Floor, Tower A  
Prestige Shantiniketan  
Mahadevapura Post  
Whitefield, Bengaluru - 560 048  
Tel: + 91 80 6727 5000

**Bhubaneswar**

8th Floor, O-Hub, Tower A  
Chandaka SEZ, Bhubaneswar  
Odisha - 751024  
Tel: + 91 674 274 4490

**Chandigarh**

Elante offices, Unit No. B-613 & 614  
6th Floor, Plot No- 178-178A  
Industrial & Business Park, Phase-I  
Chandigarh - 160 002  
Tel: + 91 172 6717800

**Chennai**

6th & 7th Floor, A Block,  
Tidel Park, No.4, Rajiv Gandhi Salai  
Taramani, Chennai - 600 113  
Tel: + 91 44 6654 8100

**Delhi NCR**

Aikyam  
Ground Floor  
67, Institutional Area  
Sector 44, Gurugram - 122 003  
Haryana  
Tel: + 91 124 443 4000

3rd & 6th Floor, Worldmark-1  
IGI Airport Hospitality District  
Aerocity, New Delhi - 110 037  
Tel: + 91 11 4731 8000

4th & 5th Floor, Plot No 2B  
Tower 2, Sector 126  
Gautam Budh Nagar, U.P.  
Noida - 201 304  
Tel: + 91 120 671 7000

**Hyderabad**

THE SKYVIEW 10  
18th Floor, "SOUTH LOBBY"  
Survey No 83/1, Raidurgam  
Hyderabad - 500 032  
Tel: + 91 40 6736 2000

**Jaipur**

9th floor, Jewel of India  
Horizon Tower, JLN Marg  
Opp Jaipur Stock Exchange  
Jaipur, Rajasthan - 302018

**Kochi**

9th Floor, ABAD Nucleus  
NH-49, Maradu PO  
Kochi - 682 304  
Tel: + 91 484 433 4000

**Kolkata**

22 Camac Street  
3rd Floor, Block 'C'  
Kolkata - 700 016  
Tel: +91 33 6615 3400

6th floor, Sector V, Building  
Omega, Bengal Intelligent Park,  
Salt Lake Electronics Complex,  
Bidhan Nagar Kolkata - 700 091  
Tel: +91 33 6615 3400

**Mumbai**

14th Floor, The Ruby  
29 Senapati Bapat Marg  
Dadar (W), Mumbai - 400 028  
Tel: + 91 22 6192 0000

5th Floor, Block B-2  
Nirlon Knowledge Park  
Off. Western Express Highway  
Goregaon (E)  
Mumbai - 400 063  
Tel: + 91 22 6192 0000

3rd Floor, Unit No 301  
Building No. 1  
MindSpace Airoli West (Gigaplex)  
Located at Plot No. IT-5  
MIDC Knowledge Corridor  
Airoli (West)  
Navi Mumbai - 400708  
Tel: + 91 22 6192 0003

Altimus, 18th Floor Pandurang  
Budhkar Marg Worli,  
Mumbai - 400 018  
Tel: +91 22 6192 0503

**Pune**

C-401, 4th Floor  
Panchshil Tech Park, Yerwada  
(Near Don Bosco School)  
Pune - 411 006  
Tel: + 91 20 4912 6000

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