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UPDATE

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A. Introduction

On 3rd October 2024, the Hon'ble Supreme Court in Civil Appeal No. 2948 of 2023, in the case of Safari Retreats Pvt. Ltd., has given its verdict on the Constitutional Validity of Section 17(5)(c) and (d) of the Central Goods and Services Tax Act, 2017 (CGST Act, 2017), and availability of Input Tax Credit (ITC) on construction services construed to be 'Plant and Machinery'.

B. Key Issue

The case focuses on the constitutional validity of **Section 17(5)(d)** of the **CGST Act, 2017**, which **restricts ITC** on goods and services used for constructing immovable property, such as malls, even if the property generates taxable income through leasing or renting.

C. Safari Retreats' Argument

Safari Retreats Pvt. Ltd. argued that they should be allowed to claim **ITC** on the construction costs of a shopping mall, as the property is used to generate **taxable rental income**. They challenged **Section 17(5)(d)** of the CGST Act, 2017, contending that it leads to a **cascading effect** of taxes, which contradicts the fundamental principles of GST.

D. Government's Argument

The **GST Department** maintained that **Section 17(5)(d)** of the CGST Act, 2017 explicitly **disallows ITC** for the construction of immovable properties, except for **plant or machinery**, to prevent potential tax leakage. They argued that **ITC is a statutory right**, not a fundamental right, and the restriction is valid under the CGST Act, 2017.

E. Debate on "Plant and Machinery" vs. "Plant or Machinery"

- While dealing with the above issues, the Hon'ble Supreme Court observed that the expression **"Plant or Machinery"** has not been defined under the CGST Act, 2017. It is pertinent to note that Clauses (c) and (d) of Section 17(5) of the CGST Act, 2017 do not altogether exclude every class of immovable property from the eligibility of ITC. In the case of Clause (c) of Section 17(5) of the CGST Act, 2017, if the construction is of "Plant and Machinery" as defined, the benefit of ITC will accrue. Similarly, under Clause (d) of Section 17(5) of the CGST Act, 2017, if the construction is of a "Plant or Machinery", ITC will be available. The Court further observed that when the legislature uses the expression "Plant and Machinery," only a plant will not be covered by the definition unless there is an element of machinery or vice versa.

- Hon'ble Court further observed that the expression "Plant or Machinery" has a different connotation. It can be either a Plant or a Machinery. Section 17 (5) (d) of the CGST Act, 2017 deals with the Construction of an Immovable Property. **The very fact that the expression "Immovable Property" other than "Plants or Machinery" is used, shows that there could be a Plant that is an Immovable Property.** As the word 'Plant' has not be en defined under the CGST Act, 2017 or the rules framed

thereunder, its ordinary meaning in commercial terms will have to be attached to it.

- The Hon'ble Court held that if it is found on facts that a building has been so planned and constructed as to serve an Assessee's special technical requirements, it will qualify to be treated as a plant for the purposes of investment allowance. The word 'Plant' used in a bracketed portion of Section 17 (5) (d) of the CGST Act, 2017 cannot be given the restricted meaning provided in the definition of "Plant and Machinery", which excludes Land, Buildings or any other Civil Structures. **Therefore, in a given case, a building can also be treated as a plant, which is excluded from the purview of the exception carved out by Section 17 (5) (d) of the CGST Act, 2017 as it will be covered by the expression "Plant or Machinery".**

F. Supreme Court's Observations

- The **Supreme Court** acknowledged the difference between **"plant and machinery"** (used in **Section 17(5)(c) of the CGST Act, 2017**) and **"plant or machinery"** (used in **Section 17(5)(d) of the CGST Act, 2017**). It emphasized that **Section 17(5)(d) of the CGST Act, 2017** should be read **strictly**, as it is an exception to the general rule of ITC availability.

- In **CIT v. Anand Theatres (2000)** [[2000] 110 Taxman 338/244 ITR 192 (SC)] the **Supreme Court** ruled that **hotels and cinema buildings** cannot be classified as **"plants"** for the purpose of depreciation under tax law. The Court made a clear distinction between **buildings** and **plant**.

- The Court further observed that **each case** will have to be tested **on merits** as the question whether an **immovable property** or a building is a plant is a factual question to be decided.

- The challenge to the constitutional validity of clauses (c) and (d) of Section 17(5) and Section 16(4) of the CGST Act, 2017 is not established.

- The question of whether a **mall, warehouse or any building** other than a **hotel or a cinema theatre** can be classified as a **plant** within the meaning of the expression "plant or machinery" used in Section 17 (5) (d) of the CGST Act, 2017 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. If the construction of a building was 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, which are covered by Clauses (2) and (5) of Schedule II of the CGST Act, 2017, the building could be held to be a plant. Then, it is taken out of the exception carved out by clause (d) of Section 17(5) to sub-section (1) of Section 16 of the CGST Act, 2017.

- **Functionality test** will have to be applied to decide whether a **building is a plant**. Therefore, by using the functionality test, in each case, on facts, it will have to be decided whether the construction of an immovable property **is a "Plant" for the purposes of clause (d) of Section 17(5) of the CGST Act, 2017**.

- The Court did **not make a final ruling** on whether the mall qualifies as a plant, instead **remanded the case back to the Orissa High Court** to apply a **functional test**: determining whether the mall functions as an essential business tool (like a plant) or is merely a passive asset.

G. Points to be Considered

- The **functionality test** set by the Court means that if an immovable property (e.g., a mall) is **actively used** for providing taxable services (such as leasing), it could be considered a **"plant"** under **Section 17(5)(d) of the CGST Act, 2017**, potentially making ITC allowable.

- ITC on goods or services used for repairs, construction, works contract, etc to such buildings, which **have not been capitalized** in the books, **is as it is available** and not blocked under Section 17(5) of the CGST

Act, 2017.

- This ruling opens the door for further cases where other **commercial buildings** may be treated as **"plants"** if they are essential to business operations, setting a broader interpretation for **Section 17(5)(d) of the CGST Act, 2017** in the future. Business, needs to review their ITC positions, based on the interpretation and judgement, particularly those involving **construction related expenses.**

- **Other ITC** under the purview of Section 17(5)(c) and Section 17(5)(d) of CGST Act, 2017 would stand blocked.

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