IMPACT OF GST ON ENGINEERING CONTRACTS AND REAL ESTATE SECTOR- PART-I

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Pre-GST Scenario

1. One of the most complex areas of the tax levied by the Centre and the States was Works Contract and Sale of Property. Prior to 01.7.2017, such transactions could have been broken into three parts:

– Value of goods and materials,

– Value of services; and

– Value of land.

1.1: Prior 1.7.2017, builders/developers were paying following indirect taxes:

– Service tax (ST) on services either to provider or on reverse/ joint charge (sub contractors, manpower supply etc);

– Value added tax (VAT)/Central sales tax (CST) on steel, cement, RMC, electrical sanitary, lifts, DG sets etc;

– Excise duty on all items paid earlier to those on which VAT paid;

2. The Real Estate Sector was subject to multiple taxation scheme by the government. The Central Government has levied Service Tax on under construction projects with no explicit tax on the transaction value of land, the State Government were charging VAT and Composite Tax on various materials used in the construction, without benefit of Input Tax Credit. The State also collected stamp duty and registration charges for the registration of property.

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3. There were various duties which were levied on this sector and there was no provision for claiming set off, which makes taxation in this sector onerous and costly. There was tax evasion due to this condition. Now the real estate now being subject to GST, the revenue loss to the government will stop and set off facility will provide transparency and good taxation environment.

Post-GST Scenario

4: Pursuant to the introduction of GST regime, there will be levy of both CGST as well as SGST (in case of intra-state works contract) and an IGST (in case of inter-state works contract), both the Centre and the States will get their respective shares of taxes on one single transaction and on one amount charged for works contract. Therefore, the problem of valuation will be resolved.

5: Under the GST law, we find the following two entries:

Clause 5 of Schedule-II "Supply of Service

(a)……

(b): Construction of a complex, building, civil structure or a part thereof, including a complex or building intended for a sale to a buyer, wholly or partly, except where the entire consideration has been received after issuance of completion certificate, where required, by the competent authority or after its first occupation, whichever is earlier.

Explanation: For the purposes of this Clause:-

(1)…….

(2): the expression "construction" includes additions, alterations, replacements or remodeling of any existing civil structure;

6: As per Section 2(119) of the CGST Act,

> "Works Contract" means a contract of building, construction, fabrication, completion, erection, installation, fitting out, improvement, modification, repair, maintenance, renovation, alteration or commissioning of any immovable property wherein the transfer of property in goods (whether as goods or in some other form) is involved in the execution of such contract."

7: Works Contract is essentially and inherently a contract of service, irrespective of legal fiction created by Article 366(29A) of Constitution of India as has been held by the Supreme Court in the case of Larsen and Toubro Ltd Vs. CST 2015(318) ELT 633.

8: Basically, works contract is a contract of "work", where supply of material is incidental to the contract of work. When a person acquires a flat for his own use, person declare that he has purchased a flat but he never says that he purchased (a) steel (b) cement (c) sand (d) bricks (e) bathroom fittings (f) electrical fittings (g) sanitary fittings – though the person is owner of all the above - yet he says that he acquired a flat.

9: As is evident from the definition of "Works Contract" as appearing in Section 2(119) of CGST Act, it would mean either (i) there is a emergence of the "immoveable property" or (ii) work or process has been done to "immoveable property". In the erstwhile Service Tax Law, "Works Contract" definition included both movable and immovable property. However, in the CGST Act, the above definition shall be restricted to "immovable property" only.

10: Another interesting question arises as to whether the "immoveable property" would also include those cases where the "plant and machinery" or "structure" assembled and erected at site is a "Works Contract".

11: In the case of Triveni Engineering Ltd Vs. Union of India, 2000 (120) ELT 273 SC,= MANU/SC/0488/2000, it was held by the Supreme Court as follows:-

> From a perusal of the above Explanatory Notes, it is clear that when generating sets consisting of the generator and its prime base mover are mounted together as one unit on a common base and, therefore, it follows that installation or erection of turbo alternator on the platform constructed

on the land would be immovable property, as such it cannot be 'excisable goods'.

12: The Supreme Court in the case of T.T.G. Industries Ltd., Madras vs. Collector of Central Excise, MANU/SC/0459/2004, has observed as follows:-

> Keeping in view the principles laid down in the judgments noticed above, and having regard to the facts of this case, we have no doubt in our mind that the mud-guns and the drilling machines erected at site by the appellant on a specially made concrete platform at a level of 25 feet above the ground on a base plate secured to the concrete platform, brought into existence not excisable goods but immovable property which could not be shifted without first dismantling.

13: As per Clause 5(b) of Schedule II of CGST Act, construction of a complex, building, civil structure or a part thereof, including a complex or building intended for sale to a buyer, wholly or partly, except where the entire consideration has been received after issuance of completion certificate, where required, by the competent authority or after its first occupation, whichever is earlier. The expression "construction" includes additions, alterations, replacements or remodeling of any existing civil structure. At the same time, "Residential Complex" mean any complex comprising of a building or building, having more than one single residential unit – para 2 of Notification No.12/2017-CT (Rate) dated 28.6.2017 effective from 1.7.2017. Single residential unit" means a self-contained residential unit which is designed for use, wholly or principally, for residential purposes for one family – para 2 of Notification No.12/2017-CT (Rate) dated 28.6.2017 effective from 1.7.2017.

13.1: The immovable property part is expected to be excluded from the GST in terms of the decision of the Supreme Court in case of L&T 2014(303) ELT (003) in para 115 of said judgment. Herein the value of land and completed construction as on the date buyer comes to developer and gets into an agreement would be out of the purview of GST. Hopefully, the basis of deduction of the land value from the transaction liable to GST must be

unambiguous and clear. Any ambiguity would only open the Pandora box of disputes.

Non-availability of Input Tax Credit (Section 17(5)©).

14. In GST regime, all the above duties/taxes (except stamp duty and registration charges) will get subsumed, therefore a builder should be able to avail the input tax credit of all its procurement of goods/ services except for few restrictions placed in Section 17 (5) of CGST. Therefore, it would reduce the tax costs substantially in the construction industry. Under GST, it is expected that seamless credit of all taxes paid on procurement of goods, services & Capital goods will be allowed so that net outflow of GST liability would be minimized and would thus reduce the cost of property.

15: The Input Tax Credit shall not be available in respect of works contract services when supplied for construction of an immoveable property (other than plant and machinery) except where it is an input service for further supply of works contract.

16: The question that arises is whether the Developers or Builders would have the choice of opting for classifying their output supplies under either of the above two entries, under the GST regime. The term 'Developer' is used to refer to realty players who have outsourced the actual construction activity to contractors and consequently and cannot be treated as being engaged in transferring property in goods in the execution of works contract. Builders are indeed engaged in execution of works contract, though a part of activity could be outsourced to contractors.

17: Under the current law i.e. pre-GST regime, it was more or less settled that irrespective of the type of the agreement that they enter into, Developers and Builders can opt to pay service tax on 30% of the total value under Notification No.26/2012-ST dated 20-06-2012 or under Rule 2A of the Service Tax (Determination of Value) Rules, 2006 in terms of which service tax is payable on 40% of the construction value.

18: The CGST Act provides for restriction of input tax credit on-

- Works contract services when supplied for construction of immovable property, other than plant and machinery, except where it is an input service for further supply of works contract service.
- Goods or services received by a taxable person for construction of an immovable property on his own account, other than plant and machinery, even when used in course or furtherance of business.

19: Very often, a question arises in the minds of assessee and readers about the true meaning, scope and intent of "plant and machinery" – because of the obvious reason that the Input Tax Credit (as per Section 16 of CGST Act) shall be allowable in case there emergence of a plant and machinery - though immoveable one. Hence, every one would like that his "immoveable property" be termed as "plant and machinery" so that the party is entitled to Input Tax Credit.

20: The Hon'ble Supreme Court in the case of Scientific Engineering House Pvt. Ltd. Vs. Commissioner of Income Tax, 1986(157) ITR 0086 SC relied upon foreign decisions while dealing with the explanation 'Plant' and gave it a wide meaning under the provisions of Income Tax law in the following manner:

> "The classic definition of 'plant' was given by Lindley, L.J. in Yarmouth v. France, [1887] 19 Q.B.D. 647, a case in which it was decided that a cart-horse was plant within the meaning of section 1(1) of Employers' Liability Act, 1880. The relevant passage occurring at page 658 of the Report runs thus:-
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> > "There is no definition of plant in the Act: but, in its ordinary sense, it includes whatever apparatus is used by a business man for carrying on his business, -not his stock-in-trade which he buys or makes for sale; but all goods and chattels, fixed or movable, live or dead, which he keeps for permanent employment in his business."

20.1: In other words, plant would include any article or object fixed or movable, live or dead, used by businessman for carrying on his business and it is not necessarily confined to an apparatus which is used for mechanical operations or processes or is employed in mechanical or industrial business. In order to qualify as plant the article must have some degree of durability.

20.2: In C.I.T. Andhra Pradesh v. Taj Mahal Hotel, MANU/SC/0239/1971 : 82 I.T.R. 44, the respondent, which ran a hotel, installed sanitary and pipeline fittings in one of its branches in respect whereof it claimed development rebate and the question was whether the sanitary and pipe-line fittings installed fell within the definition of "Plant" given in Sec. 10(5) of the 1922 Act which was similar to the definition given in Sec. 43(3) of the 1961 Act and the Supreme Court held that sanitary and pipe-line fittings fell within the definition of plant.

20.3: The Hon'ble Bombay High Court in the case of CIT v. Mazagaon Dock Ltd. MANU/MH/0278/1991 : (1991) 191 ITR 460 (Bom) has held that dry dock and wet dock created for ships are to be treated as plant and not building.

20.4: The Hon'ble Apex Court in the case of CIT v. Dr. B. Venkata Rao MANU/SC/1284/1999 : (2000) 243 ITR 81(SC) has held that in the case of an "Operation Theatre" in the hospital, it has been held to be a part of plant and not a part of building. The Court further held that the operation theatre in an hospital building is not simply a concrete structure but necessarily a part for running of the hospital and the assessee is entitled to claim depreciation as applicable to plant and machinery.

20.5: In another decision reported in CIT v. Karnataka Power Corporation MANU/SC/0585/2000 : [2001] 247 ITR 268 (SC), the Supreme Court held as follows (head-note):

> The question whether a building can be treated as plant, basically, is a question of fact and where it is found as a fact 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. Held accordingly, that there was a finding by the fact-finding authority that the assessee's generating station building was so constructed as to be an integral part of its generating system. It was "plant" entitled to investment allowance.'

20.6: The ITAT, in an appeal ITA No.7111/Mum/2011, vide order dated 14.3.2014, made very interesting observations.

If we apply the above decisions to the facts of the case before us, we are of the considered view that taxiways and aprons, parking bays cannot be said to be merely concrete structures but are necessary tools for operating/using the Airport. Hence, the same are to be considered as part of plant and machinery. Therefore, we hold that assessee is entitled for depreciation at the rate as applicable on plant and machinery in respect of taxiways, aprons, parking bays etc.

13: The assessee claimed depreciation @ 25% on **cold storage** building by considering the same as plant which was allowed by the Learned Assessing Officer @ 10% by treating the same as building relying on the decision of Supreme Court in the case of Anand Theaters MANU/SC/0409/2000 : 244 ITR 192. In appeal, the Learned Commissioner of Income Tax (Appeals) allowed the claim of the Assessed following the decision of the Hon'ble Calcutta High Court in the case of CIT v. Shree Gopikishan Industries (Cal) MANU/WB/0061/2003 : 262 ITR 568 and the decision of the Allahabad High Court in the case of CIT v. Kanodia **cold Storage** MANU/UP/0175/1974 : 100 ITR 155 by observing as under:

14: The Appellant, during the course of appellate proceedings, has submitted that the **cold storage** is required to be constructed and maintained as to be damp proof, heat proof and protected against entry of or damage to the stored agriculture and other produce by pests, noxious insects, rats and other rodents. The same is to be provided with insulation of the floors, roofs and doors and insulation and water proofing treatment is to be done in a proper manner in accordance with cold temperature to he maintained below or above freezing point. The Appellant has. therefore submitted that the storage or chamber itself is an apparatus and tool of the trade through which the business is carried on and the insulation without the building cannot produce the result and the building without the insulation also equally disastrous for the purpose. Therefore, it was contended that the **cold storage** plant is different from the other normal building because without the **cold storage** plant it is not possible to carry on the business of **cold storage**. In support of its contentions, the Appellant placed

several court decisions, such as 100 1TR 155-C1T v. Kanodia **Cold Storage** (All); MANU/WB/0061/2003 : 262ITR 568-CIT v. Shree Gopikishan Industries (Cal.) etc.

21: The Punjab and Haryana High Court in the case of CIT v. Yamuna **Cold Storage** MANU/PH/0244/1981 : [1981] 129 ITR 728 (P&H), has held that the **cold storage** is a factory building entitled to 10 per cent depreciation. In other words, the plant and machinery would be entitled to depreciation as is allowable to a plant and machinery.

22: The Supreme Court in CIT Vs. Dr. B. Venkata Rao MANU/SC/1284/1999 : 243 ITR 81, dealing with a question as to whether a building of "Nursing Home" is plant and machinery. In that case, the ITAT has held that the nursing home to be a plant and the same was affirmed by the High Court. In the appeal, the Supreme Court held that since the nursing home is equipped to enable the sterilization of surgical instruments and bandages to be carried on and it was reasonable to assume that nursing home was equipped with operation theater and, therefore, held to be plant and machinery.

23: After dealing with the above very important issue, now let us deal with other issues:

23:1 Transitional Credits: To transfer the existing credits in the GST regime, condition has been kept that such credit must have been admissible in the GST regime. Therefore, builders should be able to transfer the following credits to the GST regime:

24: Credit of Service Tax: The same must be properly reflected in the last service tax returns and documentation must be in place to establish the same. Further, service tax credit pertaining to inputs in stock can also be availed.

25: Excise Duty/ CVD: Prior to promulgation of GST, builders were not availing the credit of excise duty &, therefore, builders need to ascertain the value of stock as on the appointed day and based on the availability of the invoices or other duty paying documents or any other documents establishing purchase of materials, credit can be availed.

26: **VAT/ SAD:** Similarly, if a builder was not availing the credit of VAT/SAD hitherto due to restriction in the state VAT law or due to being in the composition scheme, then the credit can be availed based on the ascertainment of stock as on appointed day. However, if the credit of VAT was being availed, then the same needs to be properly reflected in the last VAT return to transfer such credits to the GST regime. The Section 169 relating to transitional credit on stocks also provides for deemed credit at rates to be prescribed in the absence of duty/ tax paying documents.

27: **Credit of CST:** The same cannot be availed based on the stock availability as on the appointed day.

28: **Entry Tax**: Credit of same can be availed subject to possession of appropriate documents for the same in states where such set off is permissible.

29: From the careful examination of the catena judgments cited in the preceding paras, it could be said that the "building", "premises", "structure" "roads within the airport or factory", would squarely within the meaning of "plant and machinery" and hence, shall be entitled to "Input Tax Credit notwithstanding the bar laid down in Clause (c) and (d) of Sub-Section (5) of Section 17 CGST Act –, of course, in various situations explained in various judgments cited above.

To be continued ……...