

**GST Alert**      **04/2018-19**  
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## **Input Tax Credit on expenses relating to Construction and Plant & Machinery**

Companies are required to incur many expenses for creation of new assets in terms of immovable property as well as Plant and Machinery to sustain and augment their businesses. GST law was brought in with a promise of seamless credit across all business expenses be it capital or revenue in nature. However, Section 17 of the CGST and SGST Act (Hereinafter referred to as the Act) prescribes certain restrictions on claiming of credits. There are lot of misconceptions about legalities surrounding credits on expenses relating to Immovable properties and Plant and Machinery which require clarification, this alert deals specifically with 2 questions:

1. Eligibility of Credit on expenses related to construction of Immovable properties like offices, buildings, furniture, etc.
2. Eligibility of Credit on Plant and Machinery

### **Genesis of the Confusion**

Section 17 (5) (c) and (d) of the Act restricts certain credits, these provisions read as under:

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

- (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 capitalisation, to the said immovable property;*

*Explanation.—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.*

Above provisions restrict credit of Construction related expenses in certain scenarios and not all cases. In other words, credit of GST paid on expenses relating to construction of immovable property be it works contract or otherwise is not completely restricted, only in certain cases would the credit be disallowed.

**Principles necessary to be established before deciding whether credit of expenses relating to construction is available:**

### **1. Whether the expense is in the nature of a Works Contract**

Term “Works Contract” is defined under section 2 (119) of the Act as under:

*“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;*

Any of the activities listed above like construction, maintenance, etc of any immovable property shall be classified as a works contract. In other words, if the same are done in respect of any movable property then the same shall not be a works contract for the purposes of GST. First step would be to establish the factum that the transaction concerned can be classified as a works contract or not.

It is pertinent to note that a service where property in goods is involved in the execution of such contract cannot be in relation to a Plant & Machinery which is not in the nature of Immovable Property as the definition of Works Contract restricts its applicability to Immovable Properties only.

### 2. Whether the expense is in the nature of Construction

Term “Construction” is defined vide explanation to section 17 (c) and (d) so as to include

- Construction
- re-construction,
- renovation,
- additions
- alterations or
- repairs

Traditionally the term ‘Construction’ is associated with civil works relating to a building but under GST especially for section 17 construction shall mean a lot more than mere construction. If the expense can be categorised in any of the above words, then the same would be in the nature of the word “Construction”.

Second step would be to establish whether the expense concerned can fall into the definition of Construction or not.

### 3. Nature of the expense - ‘Capital’ or ‘Revenue’.

Classification of an expense between Capital and Revenue runs on a very thin line of interpretation and final decision rests on exact facts of a transaction. GST Law does not define the terms capital expenditure and revenue expenditure; hence one will have to depend on their natural meaning as well as decided cases

#### **Capital Expenses**

Capital expenditure represents expenditure on fixed assets. Capital expenditure can be an outlay of resources on the investment of long-term income generating capability of the company. Investment in fixed assets will lead to an increase or improvement in the investing company's revenue generating capacity. Capital expenditure can also be in the form of significant acquisitions or purchases of more expensive items of equipment that will last longer than a financial year and give enduring benefit to the company.

All capital expenditures are recorded in the balance sheet. It will be depreciated or amortised annually to ensure that an expense is charged to the profit and loss account to reflect the capital expenditure's usage by the company.

### Revenue Expenses

Revenue expenditure are expenses incurred in the day to day running of a company. In most cases revenue expenditure involves the procurement of services and goods that will be used and consumed within one year. It does not improve or increase the life or quality of the underlying asset but only leads to the maintenance or continuation thereof.

Revenue expenses are recorded in the profit & loss account under various expense heads.

### Certain cases decided by Supreme Court give us tests to decide whether an expense is Capital or Revenue in nature.

A. In **Empire Jute Company Ltd** Supreme Court laid down one of the most important tests and said:

*“When an expenditure is made, not only once and for all, but with a view to bringing into existence an asset or an advantage **for the enduring benefit of a trade**, there is very good reason (in the absence of special circumstances leading to an opposite conclusion) for treating such an expenditure as properly attributable not to **revenue** but to **capital**.”*

So an expense made to create an asset to bring an enduring benefit to the trade would make that expense of capital nature.

B. In **Associated Cement Co. Ltd.** Supreme Court said that once for all payment test may be inconclusive and laid out another important test and said:

*The 'once for all' payment test is also inconclusive. **What is relevant is the purpose of the outlay and its intended object and effect, considered in a common- sense way having regard to the business realities.***

In addition to 'Once for all' payment test, keeping in mind the business realities, the purpose, intended object and effect of the underlying expense would also be the deciding factors.

In addition to the above tests laid down over the years by the Supreme Court, following principles will also help in deciding whether an expenditure is capital or revenue in nature:

- **Acquisition of Fixed Assets v. Routine Expenditure-** Capital expenditure is incurred in acquiring extending or improving a fixed asset, whereas revenue expenditure is incurred in the normal course of business as a business expenditure.
- **Several years v. One year-** Capital expenditure produces benefits for several years, whereas revenue expenditure is consumed within a year.
- **Improvement v. Maintenance-** Capital expenditure makes improvements in earning capacity of a business. Revenue expenditure, on the other hand, maintains the profit-making capacity of a business.
- **Non-recurring v. Recurring-** usually capital expenditure is non-recurring in nature, whereas revenue expenditure is recurring.

It can be deduced from above discussion that a decision between capital and revenue depends on exact facts of the transaction, but above stated principle may be used to arrive at a conclusion.

Third step would be to establish whether the expense on which credit is sought to be taken is capital or revenue in nature.

**For any expense to be classified as 'Construction' for the purposes of section 17 of the Act, it has to be of 'Capital' in nature. Any expense which even though is of construction type is booked as revenue in the books of accounts then it shall not be called 'Construction'.**

#### 4. Expenses being incurred are for an immovable property?

Again, this very important term 'Immovable Property' is not defined in the GST Law, hence we will have to rely on the definitions given in other laws.

Immovable property is defined in Section 3(26) of the General Clauses Act, 1897 as under:

*Immovable Property shall include land, benefits to arise out of land and things ATTACHED TO THE EARTH, or permanently fastened to anything attached to the earth.*

Term "Attached to earth" is defined u/s 3 of the Transfer of Property Act as meaning:

- rooted in the earth, as in the case of trees and shrubs;
- imbedded in the earth, as in the case of walls or buildings; or
- attached to what is so imbedded for the permanent beneficial enjoyment of that to which it is attached.

Under the erstwhile excise law, excise duty was payable on manufacture of goods. As per Sale of Goods Act, term "goods" was defined to mean every kind of movable property. In view of this excise duty was payable only if the goods being manufactured were movable in nature. Many disputes arose whereby the question was asked whether the goods in question were movable or immovable in nature. Following judgements of Supreme Court clarified the concept of what factors differentiates movable from immovable.

- **Commissioner of Central Excise vs Solid and Correct Engg Works (Civil Appeal No. 960-966 of 2003) (SC):**

It was held that the plants were not per se immovable and they become immovable when embedded in the earth. The attachment of the plant with nuts and bolts intended to provide stability and prevent vibration is not covered as attached to earth. The attachment can be easily detachable from the foundation and is not permanent

- **Sirpur Paper Mills Ltd v. Collector of Central Excise, Hyderabad (1998) 1 SCC 400**

Excise duty on paper making machine – Attached to earth for operational efficiency - If the appellant wanted to sell the paper-making machine it could always remove it from its base and sell it – Held as movable.

- **T.T.G. Industries Ltd. V. CCE, Raipur (2004) 167 ELT 501 (SC)**

Machinery was erected at the site on a specially made concrete platform at a level of 25 ft. height - Considering the weight and volume of the machine and the processes involved in its erection and installation – held as immovable property which could not be shifted without dismantling the same.

Following defining factors emerge from the case laws and these can be used for deciding the all important question of whether something is immovable or movable:

- Degree of permanency of the attachment to the earth
- Intent of the Use of the goods / property is essentially of Immovable nature
- Cannot be detached from earth without causing substantial damage to it
- Identity of the goods as such post removal is lost

### 5. Whether the expense is in relation to a Plant and Machinery

Section 17 (5) (c) and (d) would not apply if the expenditure is in relation to a Plant & Machinery. Term 'Plant & Machinery' is defined in explanation to section 17 as under:

*Explanation.—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.*

On dissection of the above definition we get the following:

Plant and Machinery” means

- a. apparatus, equipment, and machinery, which is
- b. fixed to earth by foundation or structural support, that are
- c. used for making outward supply of goods or services or both and

d. includes such foundation and structural supports

e. but excludes—

- land, building or any other civil structures;
- telecommunication towers; and
- pipelines laid outside the factory premises.

If a structure resulting from an expense satisfies above definition, then it shall be construed as a Plant and Machinery.

### 6. Conclusion

Once we have established clear answers to the above 5 questions, decision with regards to the eligibility of credit can be taken. In view of the above discussion and legal text following factors would emerge.

Sr No	Type of Transaction				Credit Eligibility
	Type of Inward Supply	Type of Property	Use of the property	Capital Expense OR Revenue Expense	
1	Works Contract	Immovable Property	Own Use	Capital	No
2	Works Contract	Immovable Property	Own Use	Revenue	Yes
3	Works Contract	Immovable Property	For Further Supply in course of business	Revenue	Yes
4	Goods or Service purchased	Immovable Property	Own Use	Capital	No
5	Goods or Service purchased	Immovable Property	Own Use	Revenue	Yes
6	Goods or Service purchased	Immovable Property	For Further Supply in course of business (where immovable property itself is being supplied)	Revenue	Yes
7	Goods or Service purchased	Plant & Machinery	Own Use	Capital	Yes
8	Works Contract	Plant & Machinery	Own Use	Revenue	Yes

Hope the above paper helps one to decipher the issue of eligibility of credits on this very important aspect of the business.

We believe that putting such unnatural restrictions on availing otherwise legitimate credits defeats the very purpose of introducing GST in India and will prove to be regressive in nature. We strongly urge the GST council and Governments across India to remove these restrictions and make credit truly seamless.

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