

ANALYSIS OF THE SUPREME COURT JUDGEMENT IN THE SAFARI RETREATS PRIVATE LIMITED CASE¹

Authored by
Srinivas Kotni, Managing Partner and Tanmay Singh, Junior Associate, Lexport

In the evolving landscape of the Goods and Services Tax (GST) regime, Input Tax Credit (ITC) plays a pivotal role in ensuring the seamless flow of credit across the supply chain. The seamless flow of ITC is also essential to avoid any cascading tax consequences. However, quite against the principles of avoidance of cascading effect, certain inputs and services are artificially excluded / restricted from eligibility to ITC, known as "**Blocked Credits**," which has sparked widespread debate and litigation, particularly in the context of construction of immovable properties.

Section 17(5) of the CGST Act, 2017, outlines provisions for "Blocked Credits," which refer to certain input tax credits (ITC) that cannot be claimed. These blocked credits cover inputs such as for food and catering, vehicles for personal use, and construction of immovable property etc. The rationale behind these restrictions is that these goods and services are primarily consumed by the end-user rather than being used to generate taxable outputs, thus breaking the taxable supply chain. To prevent potential tax leakage from such final consumption, the government has restricted ITC on these items.

However, significant litigation has arisen regarding ITC on the construction of immovable property. In several cases, immovable properties were not used for personal purposes but were rented out, with GST payable on the output renting services. Additionally, buildings like hotels, factories, and other commercial structures often play a crucial role in furtherance of business operations. Businesses argue that denying ITC in such instances unfairly increases costs since these properties are essential for generating taxable output.

In the case *Chief Commissioner of Central Goods and Service Tax v. Safari Retreats Private Ltd²*, the Supreme Court delivered a significant judgment that has substantial implications for businesses involved in constructing and renting out immovable properties. The case revolved around the issue,

¹ CHIEF COMMISSIONER OF CENTRAL GOODS AND SERVICE TAX V. SAFARI RETREATS PRIVATE LTD - 2024 SCC ONLINE SC 2691

² 2024 SCC Online SC 2691

whether ITC on goods and services used in the construction of immovable property, such as malls, should be allowed when the property is further used for letting out on rent, which is a taxable supply under Goods and Service Tax.

The decision by the Hon'ble Supreme Court is a pivotal judgment for businesses constructing and renting out immovable properties. The Court upheld the validity of Section 17(5)(c) and (d) of the CGST Act, 2017, while introducing the '**Functionality Test**' which is a crucial criterion to determine whether a building or structure can be classified as '**plant**' under the GST law, allowing businesses to claim ITC on the goods and services used in its construction.

Factual Background

The petitioner, Safari Retreats Private Ltd. is a company engaged in constructing shopping malls and thereafter renting out such constructed units to tenants. The company accumulated ITC on goods and services used in the construction of these malls, including cement, steel, and professional services. However, when the company sought to offset the ITC against GST payable on rent, the authorities denied the claim, citing the embargo under Section 17(5)(d) of the CGST Act, 2017. This provision blocks ITC on goods and services used in the construction of immovable property unless it relates to plant and machinery.

Petitioner challenged the aforesaid embargo under Section 17(5)(d), arguing that ITC should not be blocked when immovable property is used for further taxable supplies, such as renting or leasing.

Key Legal Issues

The main issues before the Supreme Court were:

1. **Interpretation of Section 17(5)(d):** Whether the phrase "on his own account" used in the Section 17(5)(d) of the CGST Act, 2017 applies to immovable property constructed for letting out rather than for personal use.
2. **Constitutional Validity:** Whether the restriction on ITC violates Articles 14 and 19(1)(g) of the Constitution by discriminating against businesses that construct immovable property for taxable purposes.

3. **Cascading Effect of Taxes:** Whether denying ITC leads to double taxation, as GST is paid both on inputs used in construction and on rent collected from tenants.

Submissions by the Petitioner

The Petitioner argued that Section 17(5)(d) should be read down to allow ITC for construction undertaken for the purpose of renting, as the rental income is subject to GST. Blocking ITC, leads to a cascading effect, where taxes are paid on both inputs and outputs, contrary to the GST law's aim of providing seamless credit and avoiding cascading effect of double taxation.

Petitioner further argued that the restriction violates the principle of equality under Article 14, as it treats businesses constructing properties for renting on the same footing as those constructing for further sale, where no ITC is available, which they contended is arbitrary and unreasonable.

Submissions by the Department

The Department, represented by the Additional Solicitor General, defended the denial of ITC, arguing that the creation of immovable property breaks the tax credit chain. They maintained that ITC is a statutory benefit, not a fundamental right, and can be restricted as per legislative intent to prevent abuse.

Moreover, they justified the classification under Section 17(5)(d) based on intelligible differentia which is the distinction between immovable property construction for sale versus rental, which has a rational nexus with the objectives of the GST Act.

The Functionality Test

One of the landmark aspects of the *Safari Retreats* judgment is the introduction of the 'functionality test' to determine whether a building or structure qualifies as 'plant' under the CGST Act for the purpose of claiming ITC. The test revolves around the role the building plays in the business of the Petitioner.

If the structure is more than just a 'setting' for conducting business and serves an essential function such as a warehouse designed for specific business needs or a cold storage facility, then it can be treated as 'plant' under Section 17(5)(d). This, in turn, allows businesses to claim ITC on the goods and services used in constructing such structures.

The Court distinguished the term 'plant or machinery' in Section 17(5)(d) from 'plant and machinery' as defined in the explanation to Section 17. While the term 'plant' is not explicitly defined in the GST law, its interpretation must be derived from commercial parlance and trade practices. For example, structures like dry docks, insulated walls in freezing chambers, or specialized warehouses could qualify as 'plant' if they play a critical role in business operations.

Judicial Precedents on the Definition of 'Plant'

The Court drew upon various judicial precedents from income tax law to support its interpretation. For instance, in earlier cases, sanitary fittings or pipelines installed in hotels were considered 'plant' because they were essential for the hotel's operations. Similarly, insulated walls for freezing chambers and dry docks used in ship manufacturing have been deemed 'plant' based on their functionality in the respective businesses.

However, the Court clarified that not every building can be classified as 'plant.' For instance, a hotel building with specialized fittings may not qualify unless the entire structure serves a distinct operational role beyond being a mere setting for business.

Applicability of the Functionality Test

The Supreme Court emphasized that whether a building qualifies as 'plant' is a question of fact that must be determined based on the specific business needs in each case. For example, if a building is planned and constructed to meet the unique technical requirements of a business, it could be classified as 'plant.' This allows for ITC on the GST paid for the goods and services used in constructing such a building.

This principle presents opportunities for businesses that construct specialized structures—such as warehouses, prefabricated buildings, cold storage facilities, or silos—to analyze whether their buildings could be classified as 'plant' under the functionality test, thereby allowing them to claim ITC.

Interpretation of phrase, 'On His Own Account'

Another critical aspect of the judgment is the interpretation of the phrase 'on his own account' under Section 17(5)(d). The Court clarified that this expression refers to cases where the property is

constructed for personal use rather than for providing services, renting, or leasing. Therefore, if the property is intended for sale, lease, or rental purposes, it does not fall under the 'on his own account' exception, and ITC may be available if the structure qualifies as 'plant.'

However, the Court noted some ambiguity regarding whether the exceptions related to 'plant or machinery' and 'on his own account' in Section 17(5)(d) function independently or in conjunction, particularly in the context of leased properties.

Judgment

The Supreme Court upheld the Revenue's stance that Section 17(5)(d) blocks ITC for goods and services used in constructing immovable property, even when the property is let out. The Court ruled that this restriction is in line with the legislative intent to prevent the misuse of ITC and does not violate constitutional provisions.

However, the Court also provided a nuanced interpretation, suggesting that ITC may be available if the immovable property qualifies as 'plant or machinery' under the CGST Act. Still, commercial properties like shopping malls typically do not fall into this category unless they meet the functionality test.

Conclusion

The *Safari Retreats* judgment provides a new avenue for businesses to claim ITC on buildings used in business operations, provided they meet the functionality test. However, the decision also introduces challenges for businesses in determining how the exceptions under Section 17(5)(d) interact, particularly concerning the phrases 'plant or machinery' and 'on his own account.'

Businesses must carefully analyze their operations to determine whether their buildings play an essential functional role and can qualify as 'plant' for the purpose of claiming ITC under GST law. The judgment highlights the fine balance between preventing tax avoidance and maintaining the seamless credit system central to the GST regime.
