

ITC on Construction: Legal Clarity or More Litigation Post Amendment?

Introduction

While Section 17(5)(c) blocks input tax credit (ITC) in respect of works contract service received for construction of an immovable property other than **plant and machinery**, 17(5)(d) blocks ITC in respect of goods or services received for construction of immovable property other than **plant or machinery**. Orissa High Court while examining eligibility of ITC in respect of construction services for construction of mall relied on purposive interpretation and allowed the ITC which is overturned by the Supreme Court. However, the Apex court preferred to distinguish between “plant or machinery” as appearing in 17(5)(d) vis a vis “plant and machinery” as appearing in 17(5)(c) and recommended to apply functionality test to see whether the construction / structure may qualify as a “plant”.

Supreme Court’s Landmark Ruling in Safari Retreat’s Case

The **Supreme Court**, in its interpretation of "**plant or machinery**" under **Section 17(5)(d)** of the **CGST Act**, emphasized that the legislature's choice of the term "**plant or machinery**" rather than "**plant and machinery**" in the explanation to **Section 17** was **deliberate**. The Court clarified that if a building satisfies the **functionality test**—meaning it functions as an **essential tool** in **business operations** rather than merely serving as a **passive setting**—**Input Tax Credit (ITC)** may be allowed. This interpretation leaves scope for structures like **malls** or **warehouses** to be considered "**plant**" if they are **integral** to the business. The ruling overturned the Orissa High Court’s decision, and the case was remanded for factual examination to determine if the mall in question met the Functionality Test.

Finance Bill 2025 Introduces Retrospective Amendment – Reshaping ITC Eligibility on Construction

In a significant move, the **Union Finance Bill 2025** introduced a **retrospective amendment to Section 17(5)(d) of the CGST Act**, replacing the phrase "**plant or machinery**" with "**plant and machinery**". This amendment **narrows the scope of ITC eligibility**, ensuring that **goods classified strictly as both "plant and machinery" qualify for ITC**. As a result, buildings that could have previously qualified as a "Plant" under the Functionality Test now face an explicit restriction. The amendment, being retrospective, **effectively overrides the Supreme Court’s ruling in Safari Retreats**, eliminating any room for litigation-based ITC claims based on “plant” classification.

Validity of the Retrospective Amendment – Can It Be Challenged?

The Apex Court had numerous occasions to examine the issue. **Retrospective amendments** to tax laws are **permissible** to **safeguard the exchequer** from **large refunds** arising from **judicial decisions**, but they must **address the defect or lacuna** identified by the court. The **legislature** cannot use such amendments **solely** to **nullify** the effect of a **binding judgment**, nor can they **raise fresh demands** through retrospective changes. **Retrospective taxation** must be **reasonable**, and any amendment that appears **arbitrary, unfair**, or enacted **solely** to **override a judicial decision** can be **challenged as unconstitutional**.

Way Forward for Taxpayers

- **No demand u/s 74** can be raised for ITC reversal due to this amendment, as it was a matter of **interpretation, neither a wilful suppression nor a fraud**.
- If the **functionality test is satisfied**, then even a **demand u/s 73 may not sustain**, as past ITC availment being **questioned solely based on the retrospective amendment would be subject to judicial review**.
- If the **functionality test is not satisfied** and the **time limit u/s 73 has not expired**, the **taxpayers may choose to reverse the ITC with applicable interest, if required**.
- For **future transactions, ITC on buildings qualifying as plant is now explicitly barred**, making it necessary for businesses to **restructure investment strategies and explore tax-efficient alternatives**.

Ars Alert

Businesses engaged in construction-related activities should **immediately reassess their ITC claims, review ongoing transactions, and evaluate potential legal recourse** to safeguard their tax position.