



JMVD LEGAL UPDATES

ON "*TREATMENT OF INPUT TAX CREDIT ON
WORKS CONTRACT UNDER GST*"

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The contract concerning an Immovable property where services are provided together with the transfer of goods is known as a "Works Contract". While reading together clause 5(b) of schedule II and clause 5 of schedule III under CGST Act, 2017, the transaction of constructed property cannot be taxable under GST but under-construction property can be. Hence, GST on works contract & construction services is completely for the Immovable properties which is under-construction and whose completion certificate is not issued by competent authorities or chartered engineer.

ITC Restriction on Works Contract:

GST been brought out of the inspiration of a liberal credit regime i.e. to permit the credit in respect of all goods and services with minimal restrictions. But there is incredible misperception regarding this provision, specially, in businesses whether the works contract provider can avail credit of inputs and input services. They are mingling the provisions of credit restrictions under section 17(5) with outward supply but one thing is indisputable that blocked credit provisions are for works contract service recipients and not for works contractors. Composite supply of Works Contract as defined in clause 119 of section 2 of the CGST Act is liable for GST at a prescribed rate with FULL Input Tax Credit (ITC) of Inputs and Input services. Service provider of Works



Contract Service (i.e. works contractor) can avail credit on Input tax paid on Inputs and Input services.

The relevant provision for works contract and construction is prescribed in Section 17 (5) –

"(5) Notwithstanding anything contained in sub-section (1) of section 16 and subsection (1) of section 18, the 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."

From the above provision, it is clear that:

- 1) Service provider of Works Contract Service (i.e. works contractor) can avail credit on Input tax paid on Inputs and Input services.
- 2) Works contract to a sub-contractor, the main contractor can claim the credit on tax paid on Sub-Contract i.e. input service for further supply of Works Contract Services.



3) Works contract of plant and machinery, service receiver can claim the credit on tax on that works contract of plant and machinery.

4) As per Section 17(5)(c) of the CGST Act, the Input tax credit shall not be available for service receiver i.e. tax paid on works contract cannot be claimed by service receiver.

5) As per Section 17(5)(d) of the CGST Act, the Input tax credit shall not be available for a service provider of construction, which is employed for one's own account (as it will be capitalized in the accounts of works contractor).

Thus, ITC for works contracts is often availed only by one who is within the same line of business and is using such services received for further supply of works contract service. It is often clearer from this example - a building developer may engage the services of a sub-contractor for a particular portion of the full work. The sub-contractor will charge GST within the tax invoice raised on the main contractor. The main contractor is allowed to get ITC on the tax invoice raised by his subcontractor as his output shall be a works contract service. However, if the main contractor provides works contract service (other than for plant and machinery) to an organization say within the IT business, the ITC of GST paid on the invoice raised by the works contractor won't be available to the IT Company.

Plant and Machinery in certain cases when affixed permanently to the land would constitute immovable property. When a works contract is for the



construction, Repair & maintenance of plant and machinery, the ITC of the tax paid to the works contractor would be available to the recipient, whatever is that the business of the recipient. This is often because works contract in respect of plant and machinery comes within the exclusion clause of the exemption list of the Act and ITC would be available when employed in the course or furtherance of business.

Also, it's well provided within the AAR Andhra Pradesh Ruling¹ that, *“The Applicant is eligible for Input Tax Credit (ITC) in respect of the GST paid on goods and services used as inputs in the execution of 'Works Contracts'. Input Tax Credit restriction under section 17(5)(c) and 17(5)(d) will not apply to the applicant as his output is works contracts service.”*

Input tax credit restrictions / reversals:

The GST law provides for disallowance of credit because of non-payment (of value and tax) to the vendors within 180 days. This could lead to the disallowance of ITC on the retentions on account of performance clauses made by the project owners for the payments to be made to the sub-contractors. This may lead to a working capital blockage either within the hands of the project owners or the sub-contractors.

¹ Order of AAR Andhra Pradesh GST - M/s KSR & Company (AAR No. 07/AP/GST/2019) Dated: 14.02.2019.



GST is applicable to advance procured services (while the provision regarding the applicability of GST on the advance of goods has currently been deferred by the CGST Notification NO. 66/2017)². Hence, the project owner would be required to pay GST on advance payments to contractors. However, credit is allowed only after receipt of invoice and goods/services. This may result in working capital blockage. One may analyse whether the running bill would be treated as an invoice. If the identical is treated as an invoice, GST liability would be triggered at the time of issuance of the running bill itself. This might however pose commercial challenges because the running bill is often modified/ amended.

² *Impact of GST on Infrastructure sector – PwC, January 2019.*



In view of the above, it can be concluded that, under the GST law, the rate prescribed for taxing most of the works contracts is 12% and such rate difference vis a vis the applicable rate under pre-GST regime is more prominent for construction activities falling under the service tax exemption category. However, availability of higher pool of input tax credit in the hands of the contractors could help neutralizing such higher output GST.

Thus, GST law provisions let the ITC of GST paid on inputs, input services, and capital goods in contrast to the works contract/ development services provided by civil contractors. However, the GST law restricts ITC of GST paid on goods and services procured for construction of an immovable property (other than plant and machinery) which is utilized for one's own account. Despite of interpretation by many professionals there is still ambiguity amongst the industry for Blocked Input Tax Credit, which can be resolved only by multiple decisions by High Courts of each states, or a decision by the Supreme Court or a clarification/amendment by the Parliament or the GST Council.



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