

Tax alert: ITC not allowed on lease rental paid during pre-operative period to the extent of capitalisation: WB AAAR

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Summary

The West Bengal Appellate Authority for Advance Ruling (AAAR) upheld the order of West Bengal Authority for Advance Ruling (AAR) in a recent case¹ and held that Input Tax Credit (ITC) of GST paid on lease rent during the pre-operative period on leasehold land used for construction of resort, on own account, shall not be allowed if the same is being capitalised in the books of accounts.

Facts of the case

- The Applicant² is engaged in the hospitality and real estate business. The Applicant started the construction of a resort on a land taken on lease from the West Bengal Housing Infrastructure Development Corporation Limited (WBHIDCL) for a period of 32 years.
- The project is proposed to be completed in 2 years. Lease rental paid during the aforesaid pre-operative period shall be capitalised in the books of accounts of the Applicant.
- The Applicant sought an advance ruling in respect of whether ITC is available on GST paid on lease rent during the pre-operative period when the same is capitalised. The AAR, vide its order³, held that ITC shall not be available to the Applicant as it falls under 'blocked credit'⁴ under the GST law.

- The Applicant has challenged the aforesaid order of AAR before the AAAR.

Applicant's contentions

- The Applicant contended that every registered person is entitled to take credit on any supply of goods or services or both used in the course of furtherance of business. Thus, it was argued that GST paid on input supplies during the pre-operative period should be available even though the appellant is not providing taxable output supply.
- The Applicant argued that land and building are treated separately for the purpose of Accounting Standard 10. Thus, the Applicant submitted that the concept of blocked credit under the GST law applies to 'construction of immovable property' and hence the same

¹WBAAAR No. 01/WBAAAR/APPEAL/2019 dated 06 February 2019

²GGL Hotel and Resort Company Ltd.

³30/WBAAAR/2018-19 dated 8 January 2019

⁴Section 17(5)(d) of GST Act

should not be applied to lease rent paid to acquire 'rights in the land'.

- Thus, the Applicant argued that lease rent paid in not used for construction of immovable property but to acquire rights in land so that hotel can be operated.

AAAR's observations and order

- **Construction on own account:** The AAAR observed that since WBHIDCL holds only ownership title of the land and no proprietary interest in the immovable property constructed, it can be stated that the Applicant is constructing the resort on its own account.
- **Nexus between lease rental and construction:** The AAAR observed that the lease agreement clearly stipulates that the lessee shall use the demised land exclusively for the purpose of constructing building at the cost of the lessee and the Applicant was entitled to collect inter alia all revenue from the project. Therefore, the AAAR held that the lease rent paid during

the preoperative period on the leasehold land had a direct nexus between the lease rent and construction of resort.

- **Construction for furtherance of business:** The AAAR observed that as the asset will be capitalised in the books of accounts of the Applicant, it is clear that the Applicant is building the resort on its own account for furtherance of business of providing hospitality service for which one of the input services availed is lease rentals.
- **Blocked credit:** The AAAR held that the ambit of the blocked credit⁵ under the GST law is broad and includes such goods or services or both when used in the course of furtherance of business. So, as per the said provision, the Applicant is restricted from availing ITC on lease rental paid. Accordingly, the AAAR upheld the order of the AAR and held that the ITC of GST paid on lease rent during the pre-operative period is not available to the Applicant.

⁵ as per clause (d) of sub-section (5) of section 17 of CGST Act, 2017

Our comments

The ruling reiterates that ITC in respect of supply used towards the construction of an immovable property to the extent capitalised shall not be available. It may be noted here that recently, the Orissa High Court had held that the ITC of GST paid on inputs/input services used for the construction of immovable property to be used for letting out is not blocked since under the GST law, ITC on inward supplies is available when they are used for providing taxable output supplies.

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