

Topic of today's article examines another novel issue which is equally relevant for Indian GST landscape.

The ECJ in **Vos Aannemingen BVBA V. Belgische Staat (C-405/19)** (decided on 01.10.2020) <http://curia.europa.eu/juris/liste.jsf?language=en&td=ALL&num=C-405/19>, had occasion to examine - When an expenditure incurred by a taxable person, benefits him as well as a third party, whether the taxable person is entitled to deduct VAT incurred in respect of such expenditure in its entirety.

The parties in the background of the dispute are a builder and a land owner. The arrangement was a typical Joint Venture scenario where the builder undertook construction of land belonging to the land owner. When the building was sold by the builder to the ultimate buyers, the undivided Share of land ( UDS) was transferred by the land owner to the buyers. The builder had claimed complete set off of input tax incurred on expenses as real estate agency, advertising and administrative services.

The availment of Input Tax Credit in full by the builder was objected to by the Revenue on ground that the items on which expenditure had been incurred had benefitted a third party, ie, the land owner and hence the builder can claim only proportionate ITC and not full ITC.

ECJ, held that, the expenditure incurred by the property developer, in respect of advertising costs, administrative costs and estate agents' commission, in connection with the sale of apartments, also benefits a third party, does not preclude that taxable person from deducting in full the input VAT paid on that expenditure where, firstly, there is a direct and immediate link between that expenditure and the taxable person's economic activity and, secondly, the benefit to the third party is ancillary to the taxable person's business purposes.

The following principles settled by precedents had weighed with ECJ in holding so:

- The relevant legal provision, reads that the goods or services supplied or to be supplied to them by another taxable person, in so far as those goods or those services are used for the purposes of their taxable transactions are eligible for deduction. Such right to deduct therefore constitutes the fundamental principle of common system of VAT;
- Through system of deductions, the VAT system ensures complete neutrality of taxation of all economic activities, whatever be their purpose or results, provided those activities are subject o VAT;

- Right to deduct input VAT presupposes a direct and immediate link between the input transaction and one or more output transactions and that the expenditure is forming part of component of cost of output transaction gives rise to right to deduct.
- Even the expenditure is not having a direct link , eligibility to deduct still exists if such costs are part of general overheads and are as such components of price of goods or services which are supplied.
- It would be contrary to principle of neutrality, to make a person bear VAT on expenditure incurred for his taxable transactions for the sole reason that a third party derives an ancillary benefit.

In present case, the expenditure corresponding to advertising, real estate agent commission etc are incurred in taxable persons's interest though there is an incidental benefit to third party. Such incidental benefit is therefore ancillary, provided above parameters are met.

The second question and third question posed to ECJ pertains to the scope and extent of deduction as permitted under the relevant statutory provision (Article 17 (2) (a) of Sixth Directive). It has been held in this regard that the fact that the expenditure incurred by the taxable person also benefits a third party does not preclude that taxable person deducting in full the input VAT paid in relation to that expenditure, in the case where that expenditure does not relate to the taxable person's general overheads but constitutes costs attributable to particular output transactions, in so far as those costs maintain a direct and immediate link with the taxable person's taxable transactions. The ECJ has left it to the referring court to assess whether there is a direct and immediate link with regard to all of the circumstances in which those transactions occurred.

Next issue considered by ECJ in this regard was the possibility of recovery of such VAT from the third party. It has been held that in the case where a third party benefits from expenditure incurred by the taxable person, the fact that it is possible for the taxable person to pass on to the third party a part of the expenditure so incurred **constitutes one of the elements**, along with all of the other circumstances in which the transactions concerned occurred, **which the referring court must consider for the purposes of determining the scope of the taxable person's right to deduct VAT.**

## **Indian Scenario**

Let us examine, the applicability of above principle to the Indian scenario.

Joint Ventures are unavoidable in Construction sector. The ambiguities in taxation aspects of such joint ventures have resulted in much litigation especially in domain of service tax. Towards the end of service tax regime, though the builders started discharging service tax in respect of constructions done for the land owner, the issue regarding valuation of such service has still not attained finality. GST has further added the new segment of development rights and hence no limb of a joint venture transaction is left untaxed. The regime is however simplified under GST, with effect from 01.04.2019, when concessional rates of 1% (for affordable housing) and 5% for other than affordable were introduced. Relief has also been granted to commercial apartments (shops, offices etc) in any residential project for lower GST rate of 5% where carpet area of such commercial space is not more than 15% of the total carpet area of all apartments. The new schemes simplified the tax scenario, since the concessional rates were granted at the cost of sacrifice of Input tax credit and hence the taxpayer need not follow the laborious task ITC availment, reversal etc. Clarity was also provided in respect of joint venture arrangements, when the liability to pay GST on transfer of land development rights by land owner to builder was exempted in respect of residential units sold till date of completion.

However, the simplification is restricted only to residential projects and such commercial projects forming part of residential projects as mentioned in Notification No. 03/2019-Central tax (Rate) dated 29.03.2019. Therefore, the construction of commercial projects which are not falling within the scope of Notification No. 03/2019-GST, still have to face the complexities of ITC reversal and maintenance of records. Therefore, the above Judgment of ECJ, would be relevant in a typical Indian scenario, where the builder is availing full input tax credit in respect of Joint Venture construction of projects which are outside the scope of Notification 03/2019 – Central Tax (Rate). The expenses in nature of real estate agent commission, advertisement expense, and administrative expenses as discussed in the ECJ Judgment are part of parcel of each such project.

Coming to eligibility of for credit, as per Section 16 of CGST Act, 2017, a registered person is entitled to take credit of input tax charged on any supply of goods or services or both to him which are used or intended to be used in the course or furtherance of his business. Therefore when the services procured by the builder is benefitting the supplies of land owner also, **whether** , to that extent , credit is said to be used by landowner and hence the builder is not entitled to take credit to the extent it has benefited the landowner. Applying the ratio of ECJ Judgment, it can be said that if there is a DIRECT AND IMMEDIATE LINK between such services availed by builder, then an incidental or ancillary benefit of such expenses to landowner need not result in blocking the credit of builder to the extent it has benefitted the land owner.

The scenario of some expenses benefitting a third party , is however, not unique to JV models or construction sector. The most common third party beneficiaries are prevalent in the form of distributors of consumer products. Say, when a manufacturer is incurring advertising or marketing expenses, same is incidentally benefitting the sales of all distributors and dealers down the line. A Vehicle manufacturer incurring marketing expenditure is benefitting the authorized dealers in boosting their sales. Therefore, an incidental benefit to a third party should not be a factor to deny credit to the registered person who has incurred the expense as long as he is the primary beneficiary of such expense.

Coming back to the Joint Venture arrangements, the most common of which is the arrangement where constructed area is shared between the builder and land owner, the builder is anyway liable to discharge GST in respect of service of construction provided to the land owner. In cases where the units belonging to the land owner are sold during the stage of construction , such GST would be collected from respective buyers instead of land owner. Therefore, an incidental benefit of promotion being accrued to land owner in way of promoting his

Applying the ratio to the JV Models, the builder would, under any circumstance, be discharging GST in respect of constructions done for the land owner. In a scenario in which there is a constructed area sharing arrangement between the builder and landowner, the builder would be discharging GST on value of construction whether such construction service is provided to buyer or to land owner. Therefore, the incidental benefit of promotional expenses being a factor which has facilitated sale of units belonging to land owner, the link is not prominent so as to deny entire credit to builder. Since, section 16 uses the expression 'used' or 'intended to be used' in course or furtherance of business or commerce, as long as the intention of use and fact of actual use of such services by the builder are in course or furtherance of his business, an incidental benefit to a third party cannot restrict ITC to the builder.

However, to safeguard themselves, a cautious builder can always choose either to cross charge the land owners for such expenses or can include such cost components while arriving at area sharing arrangement with the land owner.