

# **Controversies in Input Tax Credit**

**Adv. Rohan Shah**

**rohan@shahchambers.in**

**February 19, 2022**

# Index

- Eligibility and conditions for taking Input Tax Credit
- Transitional provisions under section 140 of the CGST Act
- Restrictions under Section 17(5) of the CGST Act
- Section 54: Cash refund of unutilized Input Tax Credit

# Objective of implementing GST - Free flow of credits

- *Taxes or levies to be subsumed should be part of the transaction chain which commences with import/ manufacture/ production of goods or provision of services at one end and the consumption of goods and services at the other. [...] The subsumation should result in **free flow of tax credit** in intra and inter-State levels.*

*GST is a tax on goods and services with comprehensive and continuous chain of set-off benefits from the producer's point and service provider's point upto the retailer's level. [...] The final consumer will thus bear only the GST charged by the last dealer in the supply chain, **with set-off benefits at all the previous stages.***

*First Discussion Paper on GST (10.11.2009)*

- *The goods and services tax shall replace a number of indirect taxes being levied by the Union and the State Governments and **is intended to remove cascading effect of taxes and provide for a common national market for goods and services.***

*Statement of Objects and Reasons to the Constitution (122nd Amendment ) Bill, 2014*

- *"With the introduction of GST, the **cascading effects of CENVAT, State VAT and service tax will be more comprehensively removed with a continuous chain of set-off from the producer's point to the retailer's point** than what was possible under the prevailing CENVAT and VAT regime."*

*Goods and Service Tax (Concept and Status) – GST Council Website*

- *However, over a period of time, there have been a series of amendments by which, the taxpayer's right to claim and utilize ITC have been curtailed significantly. The key instances are summarised in the ensuing slides.*

# ELIGIBILITY AND CONDITIONS FOR TAKING INPUT TAX CREDIT

# Conditions for taking Input Tax Credit as on 01.07.2017

- Every registered person is entitled to take credit of input tax charged on any supply, which are used or intended to be used in the course or furtherance of his business. [Ref: Section 16(1) of the CGST Act]
- The conditions for taking Input Tax Credit (“ITC”) are as under :
  - ❖ The person is in possession of a tax invoice or other prescribed documents issued by the supplier,
  - ❖ The person has received the goods or services or both,
  - ❖ The tax charged in respect of such supply has been actually paid to the Government, and
  - ❖ The return (GSTR - 3) has been filed under Section 39. [Ref: Section 16(2)]
- ITC is not available on the tax component of the cost of capital goods and plant and machinery, if the same has been claimed as depreciation under the provisions of the Income-tax Act, 1961. [Ref: Section 16(3)]
- The time period for taking the ITC is the due date of furnishing of the return for the month of September following the end of FY to which such invoice or invoice relating to such debit note pertains or furnishing of annual return, whichever is earlier. [Ref: Section 16(4)]

# Beneficial amendments to Section 16

## Amendments vide the Finance Act, 2020

- W.e.f. **01.01.2021**, Section 16(4) was amended so as to delink the date of issuance of debit note from the date of issuance of the underlying invoice for the purposes of taking ITC. Accordingly, in case of debit notes, the date of issuance of debit note (not the date of underlying invoice) shall determine the time limit for taking ITC.
- *Illustration: Debit note dated 01.07.2021 issued in respect of the original invoice dated 01.03.2021. Time limit for taking credit as per Section 16(4) would be (a) September 2021, in respect of the invoice, and (b) September 2022, in respect of the debit note dated 07.07.2021.*
- Even though the amendment is curative and seeks to do away with an unintended anomaly, the Board has clarified that the amendment is applicable prospectively w.e.f. 01.01.2021. [Ref: Circular No. 160/16/2021-GST dated 20.09.2021]
- The concept of bill-to ship-to (and cross charge) in **relation to services** has been recognized by the Legislature by inserting Explanation (ii) to Section 16(2)(b), whereby it is **deemed** that the registered person has received the services “*where the services are provided by the supplier to any person on the **direction of and on account** of such registered person.*”

## Proposed amendments in the Finance Bill, 2022

- Section 16(4) is being amended so as to provide for an **extended time** for taking ITC in respect of any invoice or debit note pertaining to a Financial Year, upto **30<sup>th</sup> day of November of the following Financial Year.** [Ref: Clause 99 of the Finance Bill, 2022]

# ONEROUS CONDITIONS FOR TAKING INPUT TAX CREDIT

# Denial of credit if tax not paid to the Government

- Section 16(2)(c) [since 01.07.2017] specifies that **ITC shall be available to the recipient** if *“the tax charged in respect of such supply has been **actually paid to the Government**, either in cash or through utilisation of input tax credit admissible in respect of the said supply.”*
- The vires of the said section was challenged in a number of cases, mainly on the ground that (i) the recipient has no control over the supplier to ensure that the tax (paid by the recipient to the supplier) is deposited with the Government, (ii) it is the supplier’s obligation to deposit such tax with the Government, and (iii) denial of ITC to the recipient in respect of supplies for which tax has been paid by the recipient to the supplier would **amount to double taxation**.
- It must be noted that a similar provision, i.e., Section 9(2)(g) of Delhi VAT Act was struck down as being unconstitutional by the Delhi High Court in **Arise India Limited [2017 (10) TMI 1020 - Delhi High Court]**, in as much as it disallowed ITC to the purchaser due to the default of selling dealer in depositing tax. The Supreme Court has maintained the said decision in **Arise India [2018 (1) TMI 555]**.

- The challenge to Section 16(2)(c) of the CGST Act is pending before various High Courts, including :
  - ❖ **Unifab Engineering [2021 (11) TMI 646 - Bombay High Court]**
  - ❖ **Sahil Enterprises [2021 (9) TMI 826 - Tripura High Court]**
  - ❖ **Aniruddha Banerjee [2021 (8) TMI 1010 - Calcutta High Court]**

- Various High Courts have upheld the proposition that ITC cannot be denied to the recipients due to the defaults of the supplier:
  - ❖ **East Singhbhum [2013 (294) E.L.T. 394 (Jharkhand High Court)],**
  - ❖ **R.S. Infra-Transmission [2018 (4) TMI 1800 - Rajasthan HC]**
  - ❖ **D.Y. Beathel Enterprises [(2021) 127 Taxman. Com 80 (Madras High Court)]**



# Mismatch of ITC between GSTR – 3B and GSTR – 2A

- After the implementation of GST, taxpayers used to avail the entire ITC on their invoices. GSTR – 2A was implemented as a facilitation measure and did not impact the ability of the taxpayer to avail ITC. (Press Release dated 18.10.2018)

## **Insertion of Rule 36(4) vide Notification No. 49/2019 – Central Tax dated 09.10.2019**

- In order to restrict ITC on the basis of GSTR-2A, Rule 36(4) was introduced to provide that a registered person shall be eligible to take ITC up to a maximum of 120 % / 110% / 105% (as amended from time to time) of the ITC as reflecting in its Form GSTR-2A..
- Absent any provision enabling the rule-making body to place such substantive restrictions on the availment of ITC, the Constitutional validity of Rule 36(4) has been challenged in a number of cases, including in **Gr. Infraprojects Limited [Rajasthan High Court]**, **Society for Tax Analysis [Gujarat High Court]** and **Surat Mercantile [Gujarat High Court]**. The matters are currently pending.

## **Insertion of Section 16(2)(aa) to give statutory sanction to Rule 36(4)**

- In light of various challenges pending before the jurisdictional High Courts, **Section 16(2)(aa) was inserted w.e.f. 01.01.2022** to give **statutory sanction** to **Rule 36(4)**. The said Section provides that ITC shall be taken by the recipient subject to the condition that the supplier has furnished the details of the invoices / debit notes in GSTR – 1 and the same are reflected in GSTR – 2B / GSTR – 2A..
- Therefore, w.e.f. 01.01.2022, ITC is to be taken by the recipient only in cases where the details of the **invoices / debit notes are appearing in GSTR – 2B / GSTR – 2A.**
- It is evident that another **onerous and impossible burden** has been placed on the recipient to ensure that the supplier remains tax compliant.

# Rule 86A and blocking of Electronic Credit Ledger

## Insertion of Rule 86A in the CGST Rules vide Notification No. 75/2019 – Central Tax dated 26.12.2019:

- Rule 86A empowers the Commissioner or its authorized officers to disallow debit of Electronic Credit Ledger and block the said Credit Ledger based on a **reasonable belief** that ITC in the Electronic Credit Ledger has been fraudulently availed or is ineligible in as much as:
  - ❖ ITC has been taken on the strength of documents(i) issued by a non-existent person / business, (ii) without receipt of goods or services,
  - ❖ tax has not been paid to the Government in respect of the supply,
  - ❖ ITC has been taken by a non-existent person / business, and
  - ❖ person taking ITC is not in possession of the prescribed documents.
- The Constitutionality of Rule 86A has been challenged in a number of cases, including in **Realty Private Ltd. vs. UOI [2021 (7) TMI 315 - Calcutta High Court]** and **VIJ Engineers [2020 (7) TMI 375 - Punjab and Haryana High Court]**.

## Decision of the Bombay High Court in Dee Vee Projects

- Recently, the Bombay High Court in **Dee Vee Projects [TS-43-HC(BOM)-2022-GST]** has held that Rule 86A has been adequately framed by the rule making authority so as to take care of any possible misuse of power.
- The Hon'ble Bombay High Court also observed that the **Department can exercise power under Rule 86A**, only if:
  - (i) it has “**reasons to believe**” on the basis of **material available before it** that the credit is ineligible / fraudulent, and
  - (ii) **reasons have been recorded in writing.**
- The High Court also held that that **post decisional or remedial hearing** would have to be granted to the affected person **within 2 weeks.**

# Rule 86A and blocking of Credit Ledger (...Contd)

## Board Circular dated 02.11.2021 providing guidelines for blocking of ITC

- In light of the rising litigation, the Board has issued **Circular dated 02.11.2021** to provide guidelines for blocking of ITC under Rule 86A. The key guidelines are summarized hereinbelow:
  - ❖ The concerned officer must have “**reasons to believe**” that credit of input tax available in the Credit Ledger is either ineligible or has been fraudulently availed, before blocking the ledger.
  - ❖ The opinion for blocking the ledger must be formed **only after proper application of mind** considering all the facts of the case.
  - ❖ The power of blocking the ledger **must not be exercised in a mechanical manner**. It contemplates an objective determination based on intelligent care and evaluation as distinguished from a purely subjective consideration of suspicion.
  - ❖ The amount of fraudulently availed or ineligible ITC shall be prima facie ascertained based on **material evidence available**. The officer **should apply his mind** as to whether the remedy under Rule 86A is necessary.
  - ❖ “**Reasons to believe**” shall be duly recorded by the concerned officer **in writing**.

## Way Forward

- Even though Rule 86A was introduced with the intention of curbing tax evasion, the said rule is being used as a tool to harass genuine taxpayers. The Electronic Credit Ledger is also being blocked in cases where genuine taxpayers have taken ITC on the strength of invoices issued by suppliers, if the supplier was subsequently found to be fraudulent. Therefore, the Government must consider restricting blocking of Credit Ledger only in cases where fraud is committed by the recipient (and not in cases of defaults / fraud by supplier).

# Rule 86B and restriction in utilization of ITC

## Insertion of Rule 86B in the CGST Rules vide Notification No. 94/2020-Central Tax dated 22.12.2020 (w.e.f. 01.01.2021):

- Rule 86B was inserted in the CGST Rules to provide that in cases where the value of taxable supply (other than exempt supply and zero-rated supply), in a month exceeds INR 50 lakhs, more than 99 percent of the output tax liability cannot be discharged by using ITC.
- The intent of the said rule is to curb fake invoicing. Therefore, Rule 86B is not applicable in cases where the financial *bona fides* of the supplier is evident through payment of Income Tax, receipt of refunds, prior tax payments in cash, or where the supplier is the Government.

## Issue

- The vires of Rule 86B has been challenged before the Gujarat High Court in **AAP and Co. [[2021] 123 taxmann.com 365]** on the ground that the CGST Act does not envisage such restriction and / or empower the rule making body to notify such a restriction. (matter currently pending)
- Therefore, the GST Council and the Law Committee recommended an amendment to Section 49 to grant a statutory sanction to Rule 86B.

## Proposed amendments to Section 49 of the CGST Act

- Vide the Finance Bill, 2022, amendments are proposed in Section 49(4) and Section 49(12), which empowers the Government to prescribe the maximum proportion of output tax liability which may be discharged through the Electronic Credit Ledger.

*“(12) Notwithstanding anything contained in this Act, the Government may, on the recommendations of the Council, subject to such conditions and restrictions, specify such maximum proportion of output tax liability under this Act or under the Integrated Goods and Services Tax Act, 2017 which may be discharged through the electronic credit ledger by a registered person or a class of registered persons, as may be prescribed.”*

- Considering that the amendments to Section 49 are prospective in nature and Rule 86B may have statutory backing going forward, the vires of the said rule for the period prior to enactment of the Finance Bill, 2022 may still be tested in the Courts.
- While Rule 86B might be a significant tool to curb fake invoicing, one only hopes that genuine taxpayers are not caught in the crossfire.

# New availment framework under Section 16(2)(ba)

## Insertion of Section 16(2)(ba) vide the Finance Bill, 2022

- Section 16(2)(ba) is proposed to be inserted to the CGST Act to provide that ITC with respect to a supply would not be available if the same is restricted in the details provided in Form GSTR – 2B under Section 38 of the CGST Act.
- The ITC availment process is being moved to a one-way communication process (auto-generated statement in Form GSTR – 2B) which would consist of a list of (i) eligible, and (ii) ineligible / restricted credits, in terms of Section 38.

## Substitution of Section 38 of the CGST Act vide Finance Bill, 2022

- The proposed Section 38 prescribes that recipients cannot take ITC on invoices (ineligible credits) from suppliers who have:
  - ❖ raised invoice within such period of registration, as may be prescribed;
  - ❖ defaulted in payment of tax for a continuous period, as

prescribed;

- ❖ short paid the tax under Form GSTR – 3B as compared to the self-assessed liability under Form GSTR – 1;
  - ❖ availed ITC in excess of eligible ITC;
  - ❖ defaulted in paying the prescribed minimum output tax liability in cash; and
  - ❖ Such other cases as may be prescribed.
- Considering that GSTR – 2B would be an automated statement (consisting of eligible and ineligible credits), with the recipients having little or no room to modify the eligibility of their credits, businesses may face huge challenges and cash flow issues on account of (a) defaults of the suppliers, and (b) technical glitches in the GST system.
  - This is another instance where recipient would be punished due to the defaults of the supplier.

# Common thread: ITC denied for supplier's defaults

- The common thread that runs through most of the amendments in relation to ITC is that the Government seeks to deny ITC to the recipient on account of supplier's defaults / frauds. The key amendments, as discussed earlier, are:
  - ❖ Section 16(2)(aa) provides that ITC may be availed if the supplier has declared the details of the invoices / debit notes in its Form GSTR – 1 and the same is reflected in Form GSTR – 2B of the recipient.
  - ❖ Section 16(2)(ba) read with Section 38 restricts ITC in cases where the supplier has defaulted in tax payments, has availed excess ITC, etc.
  - ❖ Section 41 (proposed amendment vide Finance Bill, 2022) provides that in case the supplier has not paid the tax, the recipient is required to reverse ITC along with applicable interest. Such credit may be re-availed when the supplier makes the payment of such tax.
  - ❖ Rule 86(4) which provides for blocking of Electronic Credit Ledger in cases where supplier is non-existent, has not paid the tax, etc.
- The fundamental issue that arises is whether a recipient, who has duly paid tax, can be made **vicariously liable** for the acts and **omissions of the supplier**, especially in a situation where the Tax Department has the **recourse to take civil and criminal actions against such suppliers?**

# Common thread: ITC denied for supplier's defaults

- The trend of ever-growing restrictions and denial of ITC raise fundamental issues in respect of Article 14, Article 19(1)(g) and Article 265 of the Constitution of India – the vice of excessive delegation.
- In addition, these successive restrictions shake one of the **fundamental pillars of the GST structure** and the promise made to assesseees.
- It is also a well settled principle of law that the law **does not compel a man to do that which he cannot possibly do** (*“lex non cogit ad impossibilia”*). Requiring the recipient to ensure that the supplier complies with the GST law is arbitrary.
- The said amendments may therefore be challenged before the jurisdictional High Court as they are contrary to the decision of Hon'ble Supreme Court in **Arise India Limited (Supra)**.

# RESTRICTIONS UNDER SECTION 17(5) OF THE CGST ACT



# Restrictions under Section 17(5) as on 01.07.2017

- Motor vehicles and conveyances except where they are used for specified purposes
- Food and beverages, outdoor catering, beauty treatment, health services, cosmetic and plastic surgery except when they are used for specified purposes
- Membership of a club, health and fitness center
- Rent-a-cab, life insurance and health insurance except where it is obligatory for an employer to provide to its employees or when they are used for specified purposes
- **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**
- **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**
- Goods or services or both on which tax has been paid under section 10 (i.e., composition levy)
- Goods or services or both received by a non-resident taxable person except on goods imported by him
- Goods or services or both used for personal consumption
- Goods lost, stolen, destroyed, written off or disposed of by way of gift or free samples
- Tax paid under Sections 74, 129 and 130

# Expansion of the scope of the restrictions under Section 17(5)

Scope of blocked credits under Section 17(5) has been **expanded vide** the **CGST (Amendment) Act, 2018** w.e.f. **1 February 2019** as follows:

- Services of general insurance, servicing, repairs and maintenance in respect of motor vehicles (having approved seating capacity of not more than 13 persons), vehicles and aircrafts, except when the services are used for the specified purposes
- Leasing, renting or hiring of motor vehicles, vessels or aircraft , except when the services are used for the specified purposes or for making outward supply of same category of or as an element of a taxable composite or mixed supply
- Life insurance or health insurance, except when the services are used for making outward supply of same category of or as an element of a taxable composite or mixed supply

# Section 17(5)(c) and Section 17(5)(d)

- The Hon'ble Orissa High Court in the case of **Safari Retreats Pvt. Ltd. [2019 (5) TMI 1278 (Orissa High Court)]** had held that –
  - ❖ Section 17(5)(d) of the CGST Act is to be read down in as much as keeping in mind the language used in **Eicher Motors Ltd. [1999 (1) TMI 34 – Supreme Court]**, the very purpose of credit is to give benefit to the assessee.
  - ❖ Accordingly, if the assessee is required to pay GST on the rental income arising out of the investment on which he has paid GST, it is required to have the input credit on the GST, which is required to be paid under Section 17(5)(d) of the CGST Act.
- Revenue has filed SLP before the Hon'ble Supreme Court whereby notice has been issued to the Respondent. However, no stay on the operation of the aforesaid High Court order has been granted (Order dated 8 November 2019).
- In **DLF Cyber City Developers Ltd. [2019 (12) TMI 413 – Punjab and Haryana High Court]**, **Hinganghat Integrated Textile Pvt. Ltd. [2019 (10) TMI 1008 – Bombay High Court]**, whereby the Hon'ble High Courts referred to the Safari Retreats (Orissa High Court decision) and issued notice to the Respondents.
- Similarly, notice is issued in **Bharti Airtel Limited [2020 (10) TMI 371 - Delhi High Court]** whereby the assessee has **challenged the validity of the Explanation to Section 17(5)(d) as regards the exclusion of “telecommunication towers” from the term “plant and machinery”**.

# Open Issues – Section 17(5)(c) and 17(5)(d)

- Meaning of the term “**immovable property**”
  - ❖ General Clauses Act - “immovable property” shall include land, benefits to arise out of land, and things attached to the earth, or permanently fastened to anything attached to the earth.”
  - ❖ **Permanency test** [See Solid and Correct Engineering 2010 (5) SCC 122]
  - ❖ **Object of annexation test** [See Sirpur Paper Mills Limited [1998 (97) ELT 3 (SC)]
  - ❖ **Dismantling without damage test** [See Silican Metallurgic Ltd. [1999 108 ELT A58 SC]
  - ❖ **Marketability test** [See Triveni Engineering [2000 8 TMI 86 SC]
- Meaning and scope of exclusion under “**Plant & Machinery**”:
  - ❖ Whether all items falling under Chapter 84 and 85 are plant and machinery?
  - ❖ Under Income Tax Act, the term “plant and machinery” has been given a very liberal interpretation
- **Meaning of “civil structures”**: Not specifically defined, applying the principle of ejusdem generis it would include any building like structure
- Implications under separate contracts for supply of goods and construction services
- Implications of the concept of “composite supply” under GST
- Scope of “*to the extent of capitalisation to the said immovable property*” in Explanation to Section 17(5)(d) which defines the term “**construction**”.

# Input tax credit – CSR expenditure

- **In Re: M/s Polycab Wires Pvt. Ltd. [2019 (4) TMI 111 – Authority for Advance Ruling, Kerala]:** The applicant had distributed electrical items like, switches, fan, cables, etc. to flood affected people under “*CSR expenses*” on a free-of-cost basis. The AAR held that for these transactions, the applicant **would not be entitled to claim input tax credit** under Section 17(5)(h) of the CGST Act.
- **In Re: M/s Dwarikesh Sugar Industries Ltd. [2020 (1) TMI 1430 – Authority for Advance Ruling, Uttar Pradesh]:**
  - ❖ It was held that since the applicant is compulsorily required to undertake CSR activities in order to run its business, it becomes an essential part of his business process. Hence, the said CSR activities are to be treated as incurred “in the course of business”.
  - ❖ The AAR also sought to distinguish between free supplies made as CSR activities vis-à-vis gifts and held that the gifts are voluntary and occasional in nature whereas CSR activities are obligatory and regular in nature. **Consequently, credit of CSR Expenses is not restricted under Section 17(5) of the CGST Act, 2017.**
- **In Re: M/s Adama India Pvt. Ltd. [2021 (9) TMI 1061 – Authority for Advance Ruling, Gujarat]:** CSR activities, as per Companies (Corporate Social Responsibility Policy) Rules, 2014 are those activities **excluded from normal course of business of the applicant** and therefore, not eligible for ITC as per Section 16(1) of the CGST Act.

# Open Issues

- Goods disposed by way of gifts and free samples
  - ❖ Disallowance flows from the principle that no credit is eligible when there is no tax paid on outward supply
  - ❖ Meaning of Gifts – Gift is an act on voluntary basis [Sonia Bhatia Vs State of UP 1981 (2) SCC 585]
  - ❖ Various Advance Rulings have disallowed sales promotion items given to customers and dealers (See **Biostadt India Limited** [2019 (73) GST 393], **Sanofi India Limited** [Order dated 24 April 2019 (Mah AAR)]). Whether sales promotion can be considered as a gift?
  - ❖ Input tax credit eligibility on CSR expenses
- Goods lost, stolen, destroyed or written off
  - ❖ No clarity on whether restriction is *qua* inputs or semi-finished / finished goods
  - ❖ Whether actual or provisional written off?
  - ❖ Whether write-off should be partial or complete?
- Goods meant for personal consumption
  - ❖ Can it apply to corporates?
  - ❖ Unlike CENVAT Credit Rules, the term personal consumption “of employee” is absent under the GST law

# TRANSITIONAL PROVISIONS UNDER SECTION 140 OF THE CGST ACT

# Transitional provisions under Section 140 as on 01.07.2017

Provision	Transitional provisions (subject to fulfilment of certain conditions)
140(1)	Closing balance of CENVAT credit /VAT credit in the last returns filed under the erstwhile law allowed to be carried forward
140(2)	Enabled tax assesees to claim the balance instalment of un-availed credit on capital goods
140(3)	A person not registered under earlier law, was allowed to avail credit of duty paid on goods lying in stock on 01.07.2017 basis the duty/tax paying document. Traders who did not possess a duty/tax paying document could claim deemed credit as per the prescribed mechanism qua the goods held in stock on 01.07.2017
140(5)	Credit of input or input services received on or after 01 July 2017 but the duty or tax on the same has been discharged under the erstwhile laws
140(7)	<b>Notwithstanding anything to the contrary contained in this Act</b> , ISD could distribute the credit in respect of any services received prior to 01 July 2017, even if the invoices relating to such services were received on or after 01 July 2017
140(8)	Carry forward and transfer of credit by service providers having Centralised Service Tax Registration
140(9)	CENVAT credit reversed on account of non-payment of consideration within 3 months, could be reclaimed if the payment was made to the supplier of service within 3 months, from 01 July 2017



# Issue 1: Time limit for claiming transition credits in Form GST TRAN-1

- Rule 117 of CGST Rules prescribed the time limit for filing Form GST – TRAN 1 to avail transitional credit (i.e. 27 December 2017)
- The core issue before the Court was whether the time limit prescribed under Rule 117 for availment of credit was **mandatory or directory**.
- Various Petitioners had challenged the **vires of Rule 117** on the ground that it **seeks to take away vested rights to claim credits**.

<i>Gujarat HC in the case of Willowood Chemicals – Order dated 19 September 2018</i>	<i>Punjab HC in the case of Adfert Technologies - Order dated 4 November 2019</i>	<i>Bombay HC in case of NELCO - Order dated 20 March 2020</i>	<i>Delhi High Court in the case of Brand Equity – Order dated 5 May 2020</i>
First judgment on the issue	Considers <i>Willowood</i>	Considers <i>Willowood &amp; Adfert</i>	Considers <i>Willowood &amp; Adfert</i> (but not <i>NELCO</i> )
The Government has prescribed the time limit in exercise of its Rule making power under Section 164(2)	No comment on Rule making power	Rule 117 is traceable to rule making power conferred by Section 164(2)	There is nothing sacrosanct about the time limit imposed by Rules. No restriction under the Act.
Wider considerations of State Exchequer cannot be kept out of purview	Denial of credit paid under existing Acts would amount to violation of Article 14 and 300A of the Constitution of India	Credit being a ‘ <b>concession</b> ’ granted by the Government can be regulated by placing a time limit	Credit being an <b>accrued and vested right</b> cannot be taken away by delegated legislation
If there is any technical glitch, the Petitioner can approach the Commissioner	Referred to series of Delhi and Gujarat High Court judgments on technical glitches to allow the credit	Examining the system log to ascertain technical difficulties is not arbitrary	Term “technical difficulty” cannot be interpreted narrowly and would also include concerns faced by tax payers in adapting to new regime
<b>Rule 117 is not ultra vires the Act.</b>	<b>No challenge to vires of Rules.</b>	<b>Rule 117 is not ultra vires the Act.</b>	<b>Rule 117 has been read down as being <u>directory and not mandatory</u>. Three years under Limitation Act should be permitted for availing credit. Other taxpayers are also to be benefitted</b>
SLP filed by Willowood [SLP (C) Dairy No. 27099 of 2020]	<b>SLP dismissed by SC - In the facts and circumstances of the present case, we are not inclined to exercise our jurisdiction under Article 136 of the Constitution</b>	SLP filed by Nelco [SLP (C) 11095 of 2020]. Matter has been tagged with Brand Equity / Filco Trade vide order dated 15 October 2020	SLP filed by Revenue [SLP (C) 7425-7428 of 2020]. Matter has been tagged with Filco Trade vide order dated 19 June 2020. <b>High Court order has been stayed.</b>

# Issue 1: Time limit for claiming transition credits in Form GST TRAN-1

## RETROSPECTIVE AMENDMENT

- Considering the conflicting decisions of the various High Courts, an amendment was made under Section 140 of the CGST Act vide the **Finance Act, 2020** to specifically mandate the taxpayers to claim the transition credit “***within such time and in such manner as may be prescribed***”. The said amendment was retrospective with effect from 1 July 2017

## JUDICIAL PRECEDENT – POST FINANCE ACT, 2020

- Hon’ble Madras High Court, *vide* Order dated 13 July 2020 in **P. R. Mani Electronics [2020 (7) TMI 443 – Madras High Court]** inter alia held that there is ample reason to conclude that **Rule 117** of the CGST Rules is intra vires **Section 140** of the CGST Act.
- The aforesaid matter is being reconsidered by the Hon’ble Madras High Court in **Amplexor India Private Limited [2021 (2) TMI 477 – Madras High Court]**, wherein the Court has framed the following questions of law for consideration.
  - ❖ Whether input tax credit is a **vested right** and therefore, whether the imposition of time limit for transitioning or utilisation thereof, is constitutionally permissible?
  - ❖ Whether time limit imposed in Rule 117 of CGST Rules is **mandatory or directory**?
  - ❖ Whether Section 140 of the CGST Act read with Rule 117 of the CGST Rules divests the assessee of an alleged vested right or whether it **prescribes conditions** relating to enforcement of such right?
  - ❖ Whether the assessee has a **legitimate expectation** that ITC availed under the erstwhile regime should be permitted to be transitioned in the new tax regime without imposing a time limit?
  - ❖ Whether the deprivation of the benefit of transitioned ITC should amount to **double taxation** of the assessee as alleged?

# Issue 2: Time limit of 1 year under Section 140(3)

Whether the time limit of 1 year imposed by Section 140(3)(iv) governing the transition of credit into GST was unconstitutional and sought to take away the vested right by denying carry-forward of CENVAT credit?

## RELEVANT CONDITIONS FOR AVAILING CREDIT UNDER SECTION 140(3) OF THE CGST ACT

- The registered person is in possession of invoice / other documents evidencing payment of duty under the existing law in respect of such inputs
- Such invoices or other prescribed documents were issued not earlier than twelve months immediately preceding the appointed day

## KEY ASPECTS BEFORE THE HON'BLE BOMBAY HIGH COURT IN JCB INDIA

- CENVAT credit is a **mere concession** and cannot be claimed as a matter of right.
- Section 140(3) does not violate the principle of promissory estoppel and there **cannot be an estoppel against a statute**.
- If CCR stipulates and provides conditions for availment of credit, then, **such credit is not an absolute but a restricted or conditional right**. It is only subject to the fulfilment or satisfaction of certain requirements and conditions that the right to credit can be availed of.

## KEY ASPECTS BEFORE THE HON'BLE GUJARAT HIGH COURT IN FILCO

- Benefit of credit of eligible duties on purchases made by First Stage Dealer as per CCR was a vested right and cannot be denied retrospectively. **No such restriction existed in the prior regime**.
- The retrospectivity given to Section 140(3) in relation to goods which were purchased prior to one year from the appointed day has **no rationale or reasonable basis** for imposition of the condition.

JCB India and Filco Trade are pending before Supreme Court and stay is granted on the operation of Filco Trade decision [Next date – 22 March 2022]

# Issue 3: Transition and carry forward of cess

Credit of Cess was available to be utilized under earlier regime. Prior to retrospective amendment, Section 140(1) stipulated that “CENVAT Credit” balance as per last returns would be allowed to be carried forward under GST. The transition credit of cesses availed was disputed by GST authorities.

## RETROSPECTIVE AMENDMENT

- Since the assessee had claimed transitional credit of cess, the following amendments were proposed / made *vide* the CGST (Amendment) Act, 2018:
  - ❖ **Section 140(1):** The word “eligible duties” was introduced to enable transition of “eligible duties” under the GST law (effective 1 July 2017)
  - ❖ **Explanation 1 to Section 140:** The term “*eligible duties*” is proposed to be amended to provide reference to Section 140(1) (Not been notified).
  - ❖ **Explanation 3 to Section 140:** “*Eligible duties and taxes*” is defined to exclude any cess not specified in Explanation 1 and 2 to Section 140 (effective 1 July 2017).

## KEY JUDICIAL PRECEDENTS

<i>Sutherland Global Services Pvt. Ltd. [2020 (10) TMI 804 – Madras High Court]</i>	<i>BHEL [Tribunal Order in Excise Appeal No. 50081 of 2019] – Refund claim filed by Assessee</i>	<i>Grasim Industries Limited [2019 (7) TMI 678 – Gujarat High Court]</i>
Character of levy of Cess like EC, SHEC and KKC was distinct and stand alone levies. Explanation 3 cannot be applied in a restricted manner to the specified sub-sections of Section 140 mentioned in the Explanations. Assessee was not entitled to carry forward and set off of unutilised EC, SHEC and KKC against the GST Output Liability under Section 140. <b>[Pending before Supreme Court – Next date 21 February 2022]</b>	No provision in the newly enacted law that cess credits would lapse. Merely by change of legislation suddenly the appellants could not be put in a position to lose this valuable right. The Appellants were held to be entitled to a cash refund. <b>Current Status:</b> Appeal filed by Revenue (CEA-11-2020) before the Madhya Pradesh High Court is and Tribunal order is stayed [2021 (3) TMI 1318 (Madhya Pradesh High Court)]	The Hon’ble Gujarat High Court has issued notice in a Writ Petition challenging the Constitutional validity of the retrospective amendment brought about in Section 140 of the CGST Act <i>inter alia</i> on the ground that the amendments take away a vested right.

In Godrej & Boyce Mfg. Co. Ltd. [2021 (11) TMI 157 – Bombay High Court], it was held that upon introduction of Explanation 3 of Section 140 read with the partly unamended Explanations 1 and 2 thereof, the Revenue did not have the jurisdiction to issue the show-cause notice.

# Controversies – Section 140(7) and 140(9)

## ISSUE 4: DENIAL OF RIGHT OF ISD TO DISTRIBUTE CREDIT – SECTION 140(7)

- Section 140(7) provides that ISD could distribute transitional credit. However, no mechanism was provided under Form GST-TRAN 1 / GSTR-6 (monthly ISD return) to distribute the transitional credit to the respective branches.
- Section 140(7) begins with a “**non obstante clause**” which provides that to enable the ISD to claim input tax credit notwithstanding anything contrary contained in any other provisions of the CGST Act.
- Under Rule 39, distribution of credit under Form GSTR-6 must be the credit which is availed in the same tax period. Instruction No. 6 to Form GSTR-6 also suggests that ISD has to distribute credits in the same month as the receipt of the inward supplies.
- Thus, the **right of availment and distribution of credit**, which was guaranteed under Section 140(7) have been **taken away due to lack of procedural capabilities**. This restricts the ability of tax assesseees to distribute transitional credits arising under Section 140(7) of the CGST Act.
- **Various Petitioners have filed Writ Petition before the Hon’ble Bombay, Delhi and Telangana High Courts**

## ISSUE 5: DENIAL OF CREDIT ON PAYMENT BEYOND 3 MONTHS – SECTION 140(9)

- Section 140(9) imposes a condition that the CENVAT credit reversed under the erstwhile law could be reclaimed only if the payment to the supplier is made within a period of 3 months from the appointed date.
- **Such a condition has been challenged in a Writ Petition on the grounds of being unreasonable and arbitrary since both the erstwhile CENVAT Credit Rules and CGST Act recognise the reclaiming of the credit as an indefeasible right**

# SECTION 54: CASH REFUND OF UNUTILIZED INPUT TAX CREDIT

# Cash refund of unutilized ITC on account factory closure

## Cash refund of unutilized credit on closure of factory: Erstwhile regime

- The CGST Act, much like the erstwhile Central Excise Act, 1944 and the Finance Act, 1994, does not contain any express provision for cash refund of unutilized ITC in case of closure of factories.
- In the erstwhile regime, the Hon'ble High Court of Karnataka in **Slovak India [2006 (201) ELT 559 (Kar.)]**, maintained by the Hon'ble Supreme Court in **Slovak India [2008 (223) ELT A170 (SC)]**, allowed cash refund of unutilized credit on closure of factory on the grounds that there is no express restriction under law to grant such cash refund. The same was followed by the Rajasthan High Court and Bombay HC in a number of cases.
- However, the Bombay High Court in **Gauri Plastics [2018 (360) ELT 967 (Bom.)]** held that cash refund of unutilized credit is not permissible.
- In view of the contrary decisions, recently, a difference of opinion has emerged between the Technical Member and the Judicial Member of the Mumbai CESTAT in **ATV Projects India Ltd. [TS-543-CESTAT-2021-EXC]** as to whether such cash refund is permissible.

## Cash refund on account of closure of factory: Section 54 of the CGST Act

- Under the CGST Act, there is neither an express provision nor an express bar on cash refunds on account of factory closure.
- Accordingly, it is likely that the Hon'ble Supreme Court would have a final word on the issue.

# Refund of unutilized ITC on account of inverted duty structure

## Controversy

- An issue arose as to whether, in terms of Section 54(3) of the CGST Act, the refund of ITC taken on Inputs as well as Input services is to be granted in the scenario of inverted duty structure?
- Consequently, whether Rule 89(5), which confines the refund on account of inverted duty structure to Inputs only, is ultra vires Section 54(3)?
- A batch of appeals were filed before the Hon'ble Supreme Court for deciding the validity of Rule 89(5) of the CGST Rules on the grounds that it is ultra vires Section 54(3)(ii) of the CGST Act, in view of the divergent views of the Gujarat High Court in **VKC Footsteps India Pvt. Ltd. [TS-585-HC-2020(GUJ)-NT]** and the Madras High Court in **Tvl. Transtonelstroy Afcons [TS-800-HC2020(MAD)-NT]**.

## Decision of the Hon'ble Supreme Court

- The Hon'ble Supreme Court in **VKC Footsteps [2021 (9) TMI 626 – Supreme Court]** has upheld the validity of Rule 89(5) and held that refund of unutilized ITC on account of inverted tax structure is restricted to Inputs only. The key findings of the Hon'ble Supreme Court is as under:
  - ❖ refund is a matter of a statutory prescription and cannot be claimed as a constitutional right,
  - ❖ clause (ii) of the first proviso to Section 54(3) is a substantive restriction under which a refund of unutilized ITC can be claimed only when the accumulation can be related to an inverted duty structure on account of Inputs alone,
  - ❖ if 'inputs' is construed to include both input goods and input services, it would do violence to the provisions of Section 54(3), and
  - ❖ Acknowledging the inequities tied to the formula prescribed under Rule 89(5), the Supreme Court urged the GST Council to reconsider the formula.



# THANK YOU

With grateful thanks to:

Kumar Harshvardhan  
Parin Masalia  
Mohammed Anajwalla

for the contribution to this presentation

Chambers of Rohan Shah

[E: rohan@shahchambers.in](mailto:rohan@shahchambers.in) / P: 022 22873131