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INPUT TAX CREDIT AND ITS NUANCES UNDER THE GST LAW

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Preamble

Goods and Service Tax is considered as reform in the history of indirect taxes in the country as it aimed at subsuming a range of Indirect taxes at both central and state level. The GST Act was implemented in July 2017 with an aim to not just subsume the tax but to allow a seamless flow of credit to reduce the cascading effect of tax.

With almost four years into its regime, we are still faced with challenges and ambiguity in relation to the input tax credit and its ecosystem. This note seeks to understand the legal provisions governing the same and its interpretations and implications.

Legislative Provisions

Sec 16 of the CGST Act, 2017

The legislative provisions for eligibility and conditions for availment of input tax credit has been provided in Sec 16 of the CGST Act, 2017. Sec 16(2) of the CGST Act provides for the conditions for the availment of such credit. An extract of the same has been provided below-

“no registered person shall be entitled to the credit of any input tax in respect of any supply of goods or services or both to him unless,—

(a) he is in possession of a tax invoice or debit note issued by a supplier registered under this Act, or such other tax paying documents as may be prescribed;

(aa) the details of the invoice or debit note referred to in clause (a) has been furnished by the supplier in the statement of outward supplies and such details have been communicated to the recipient of such invoice or debit note in the manner specified under section 37;

(b) he has received the goods or services or both;

(c) subject to the provisions of section 41, 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; and

(d) he has furnished the return under section 39”

Analysis of Sec 16

Once the registered person satisfies the primary condition which is that the said goods or services or both are used or intended to be used in the course or furtherance of business. Sec 16(2) comes into foreplay. We need to ascertain whether such registered person satisfies the conditions for availment of ITC. From the reading of the above we can construe that a registered person must satisfy the following conditions-

- 1) he must be in physical custody of the valid tax invoice- Rule 36 of the CGST Rules, 2017 prescribes set of documents that is considered for availment of credit as per 16(a)-
 - a) Invoice issued by supplier of goods or services or both in accordance with the Sec 31
 - b) Invoice issued on Reverse charge mechanism
 - c) A debit note issued by the supplier in terms of Sec 34
 - d) A Bill of Entry (BOE) or any other document as prescribed under the Customs Act
 - e) An ISD Invoice or ISD credit note or any such documents that is issued by an ISD

- 2) it has been communicated to the recipient of such invoice- Sec 16(2)(aa) was recently included vide the Finance Act 2021, with effect from 28 March 2021. This essentially puts a restriction on availment of such input tax credit to the extent that the registered person shall claim such credit if such details have been furnished by the supplier in GSTR 1 and the same has been communicated via Form GSTR 2A/2B.

Sec 41 of the CGST Act, 2017 allows for provisional availment on self-assessment basis subject to the conditions prescribed. Further, we would like to bring light to Rule 36(4) of the CGST Rules, 2017 which offers these conditions and reads-

“input tax credit to be availed by a registered person in respect of invoices or debit notes, the details of which have not been uploaded by the suppliers under sub-section (1) of section 37, shall not exceed 20 per cent of the eligible credit available in respect of invoices or debit notes the details of which have been uploaded by the suppliers under sub-section (1) of section 37”

This 20 percent was changed to 10 percent from 1 Jan 2020 vide Notification No. 75/2019 dated 26th December, 2019. Further, this percentage for availment of credit was reduced to 5% with effect from 1 January 2021 vide Notification No. 94/2020 dated 22nd December, 2020

This imposes a critical question on the enforceability of Rule 36(4) of the CGST Rules, 2017, as the relevant clause is added to the enactment thereby constraining the availment of such credit.

- 3) the goods or services or both must have been received- such goods or services has been received by the registered person. An explanation is inserted to clarify what construes as received the goods or services. It is deemed that the goods and services have been received when-
- a) where the goods are delivered by the supplier to a recipient or any other person on the direction of a registered person, whether acting as an agent or otherwise, before or during the movement of goods, either by way of transfer of documents of title of goods or otherwise.
 - b) Where services are provided by the supplier to any person on the direction of or on account of such registered person.

Therefore, we understand that receipt of goods is not limited to physical possession. This is especially relevant in the bill to ship to transactions.

- 4) the supplier has discharged his tax liability- from the reading of the provision we understand that ITC shall be made available to recipient only if the tax charged on such supply has been appropriately discharged to the government.

However, from a reading of Section 41 of the said act, provides for availment of ITC by a registered person on a self-assessment basis. Furtherance to this Rule 86A was introduced vide Notification no. 75/2019 with effect from 26 December 2019, which essentially empowers the revenue authorities (not below the rank of Assistant Commissioner) to restrict the credit so availed by the registered taxpayer if they have the reason to believe that ITC has been availed on the basis of incorrect document, without receipt of goods or services, non-payment to the supplier, not in possession of tax invoice.

- 5) furnishing of return by the registered person- To avail such credit the registered person must have filed his return under Sec 39 (GSTR-3B) of the said act either monthly or quarterly.

In furtherance to the above the following must be noted.

- 1) Where the registered person receives the goods in lots or instalments, the registered person must take the credit.
- 2) Where the registered person does not pay the supplier of goods/services within a period of 180 days from the date of invoice, an amount equal to the ITC shall be added to the taxpayer's liability along with interest. Please note that such interest will be computed only after 180 days and not from the date of invoice.
- 3) If depreciation is claimed on the tax component of the cost of capital goods and plant and machinery, ITC shall not be availed on such goods.

Timelines for availment of credit

Sec 16(4) of the CGST Act gives a clarity on the timelines for availing such credit that is available to a registered person. Sec 16(4) states that-

“A registered person shall not be entitled to take input tax credit in respect of any invoice or debit note for supply of goods or services or both after the due date of furnishing of the return under section 39 for the month of September following the end of financial year to which such

invoice or invoice relating to such debit note pertains or furnishing of the relevant annual return, whichever is earlier”

From the above paragraphs we understand that Sec 16(2) deals with the eligibility and conditions whereas 16(4) deals in conformity to the same by establishing a time period for availment of credit that is available to registered person. The person shall not be entitled to avail ITC on any invoice/debit note for the relevant financial year after the due date of furnishing return under Sec 39 for the month of September or the annual return whichever is earlier.

Restriction in terms of utilisation of credit

In addition to the above pointers, Rule 86B was introduced vide notification no. 94/2020 dated 22 December 2020, thereby imposing a further restriction on the **utilisation of ITC** with effect from 1 January 2021. The extract of Rule 86 is provided below-

“Notwithstanding anything contained in these rules, the registered person shall not use the amount available in electronic credit ledger to discharge his liability towards output tax in excess of ninety-nine percent of such tax liability, in cases where the value of taxable supply other than exempt supply and zero-rated supply, in a month exceeds fifty lakh rupees”

Thus, with the insertion of Rule 86B of the CGST Rules, 2017, the usage of ITC has been restricted to 99 percent of the outward liability for the said month for the applicable registered persons where the value of taxable supply other than exempted and zero rated supplies exceeds 50 lakhs rupees in the said month.

Along with the conditional restrictions on ITC prescribed in Sec 16 of the CGST Act, we must equally place importance on Sec 17 of the CSGT Act which provides for apportionment of credit and blocked credits.

Sec 17 of the CGST Act, 2017

The relevant Section aims to restrict the credit at its root level thereby preventing it from entering the credit ledger. Let us look at the provisions of Sec 17(1) to 17(4)-

“(1) Where the goods or services or both are used by the registered person partly for the purpose of any business and partly for other purposes, the amount of credit shall be restricted to so much of the input tax as is attributable to the purposes of his business.

(2) Where the goods or services or both are used by the registered person partly for effecting taxable supplies including zero-rated supplies under this Act or under the Integrated Goods and Services Tax Act and partly for effecting exempt supplies under the said Acts, the amount of credit shall be restricted to so much of the input tax as is attributable to the said taxable supplies including zero-rated supplies.

(3) The value of exempt supply under sub-section (2) shall be such as may be prescribed and shall include supplies on which the recipient is liable to pay tax on reverse charge basis, transactions in securities, sale of land and, subject to clause (b) of paragraph 5 of Schedule II, sale of building.

*[Explanation.— For the purposes of this sub-section, the expression value of exempt supply“ shall not include the value of activities or transactions specified in Schedule III, except those specified in paragraph 5 of the said Schedule;]*³⁷

(4) A banking company or a financial institution including a non-banking financial company, engaged in supplying services by way of accepting deposits, extending loans or advances shall have the option to either comply with the provisions of subsection (2), or avail of, every month, an amount equal to fifty per cent. of the eligible input tax credit on inputs, capital goods and input services in that month and the rest shall lapse”

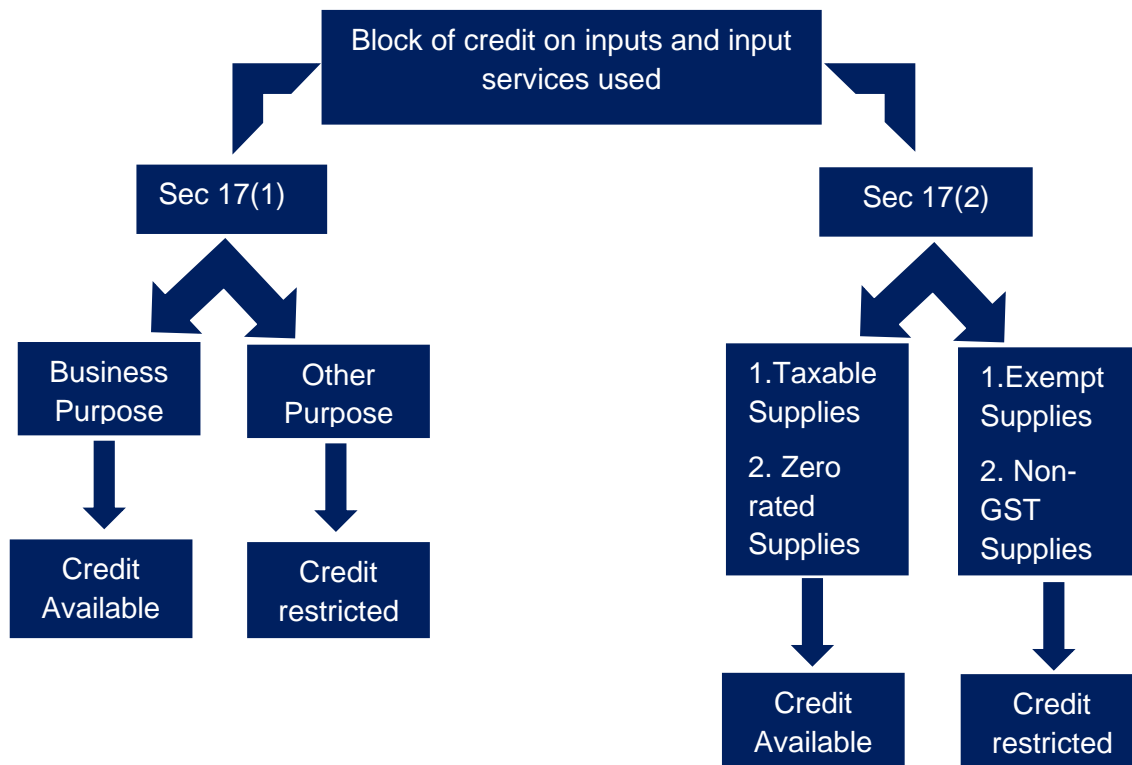
Analysis of Sec 17(1) to (4)

Let us understand each of these provisions and its impact on the credit. This section predominantly seeks to reverse the credit that available but not eligible to the registered person in terms of the said section. Sec 17(1) states that the credit shall be availed only if the same is used or is attributable to business which means that any input that is consumed but is not in relation to the business shall not be available as credit to the registered person. To understand what is used in business, it would be pertinent to understand what business means. Business is defined under Sec 2(17) of the C GST Act, 2017 and needs to be read with Sec 17(1) to appropriately bifurcate the credits that is used for business and other purposes.

Sec 17(2), restricts the availment of ITC to the extent of taxable supplies (including zero rated) but excludes exempt supply and non-GST supplies.

Both these sections need to be read with Rule 42 of the CGST Act, 2017 which offers the manner of determination of ITC in respect of inputs or input services and reversal of credit.

Let us understand this with the following flow chart-



Thus, rule 42 and 43 have to be conjointly read with Sec 17(1) and Sec 17(2), wherein the registered taxpayer is expected to reverse the ITC that is attributable to non-business purpose, exempt supplies and non-GST supplies. Sec 17(3) states that value of exempt supply shall include supplies on which the recipient is liable to pay tax on RCM, transaction in securities, sale of land and building (except for when supplied prior to completion certificate) is neither supply of goods nor services as per Schedule III.

For banking Companies or a financial institution including an NBFC, Sec 17(4) of the Act, provides an option to either comply with Sec 17(2) or avail 50% of the eligible input tax credit on inputs, capital goods and input services for every month and the rest shall lapse.

Blocked Credit

Sec 17(5) specifies certain category of goods and services on which the credit is blocked on the outset and therefore will not be available to the registered person.

JUDICIAL INTERPRETATION

As stated, the ideation for the advent of GST was to allow a seamless flow of credit. However, even after almost 4 years since its introduction there continues to be ambiguity and challenges that is faced by the taxpayers in terms of Sec 16 and Sec 17 of the Act. As aforementioned, the two Sections in the law have restricted this seamless flow and have brought in various unclarified questions in the minds of the taxpayer. The following paragraphs aims to clarify certain challenges faced by the India Inc along with judicial interpretation.

1) Sec 16(2)(c) – Conditional Availment

As understood from the provisions and the analysis in the above paragraphs, one of the conditions for the availment of ITC is that the supplier of the goods or service or both must have paid the tax so collected to the exchequers.

Let us look at the following WRIT petition of M/s LGW Industries Limited Vs Union of India [HC Calcutta].

The matter relates to denial of credit on account of default in payment of tax by the supplier. It was submitted that the credit was availed based on legally valid tax invoices and that the same were reflected in GSTR 2A which is based on the supplier's GSTR 1 return and the payment to such suppliers have been made by the registered person. Further, they submit that this condition essentially shifts the incidence of tax from supplier to buyer which is unconstitutional.

The registered person does not have access to the return filed by the suppliers and therefore, the denial of credit on the ground that the supplier has not discharged the tax so collected is unfair and beats the idea of seamless flow of credit.

2) Denial of credit on account of non-payment of tax by supplier

One of the conditions of Sec 16 is that the tax so charged has been paid to the Government. However, it is unfair to pass the onus of proof from supplier to buyer and restricting the credit.

Hon'ble High Court of Madras has held in the case of Sri Ranganathar Valves Pvt Ltd V/s Assistant Commissioner (CT), that ITC claimed by an assessee cannot be denied solely because the dealers from assessee purchases has not paid the taxes. One of the conditions of Sec 16 is that the tax so charged has been paid to the Government.

This judgement can be used against the notice that disallow the credit due to a mismatch between GSTR 2A/2B and GSTR 3B.

3) Wrongful availment or utilization of ITC

We understand that one of the conditions for availment of credit is possession of a valid tax invoice and that the supply of goods or services or both ought to have been made.

It was held by the Hon'ble Calcutta High court in case of Pavan Kumar Bansal v/s Union of India that the registered had supplied goods or services or both without issuance of invoices and had issued invoices and bills without supply of goods or services or both, leading to wrongful availment and utilization of credit. This would amount to a punishment under Sec 132(1) of the CGST Act.

(Pronounced on April 12, 2021)

4) Invocation of Rule 86A

Similarly, in case of SS Industries V/s Union of India, proceeding was initiated on account of availment of credit based on tax invoices but non-supply of goods. The Hon'ble Gujarat High court held that invocation of Rule 86A should not be based on subjective approach and shall not be used to harass the assessee, as it may have a detrimental impact on the business. Further, it was stated that availment of credit and utilization are two different stages, utilization is a vested right which does not accrue prior to availing credit.

5) Validity of Rule 36(4) of the CGST Rules, 2017

Rule 36(4) restricts the availment of credit in respect of invoices or debit notes, that have not been uploaded by the supplier in GSTR-1.

In the case of Surat Mercantile Association Vs Union of India, Hon'ble High Court of Gujarat held that the said rule puts an onerous and impossible burden on the buyer of the goods and service to ensure that the supplier of goods or services does in fact upload the details of the outward supplier on the common portal and if the supplier fails to do so, it has to face the risk of the benefit of the ITC big cap being blocked or is kept in suspension.

NOVELLO COMMENTS

From the reading of the legislative provisions of the law, its analysis and judicial interpretations, we understand that there is still ambiguity regards the world of GST and especially input tax credit, its availment and utilization.

Sec 16, provides for the conditional availment of input tax credit and with the introduction of 16(2)(aa) vide the Finance Act of 2021, it has imposed a larger question in terms of enforceability of Rule 36(4) of the CGST Rules, 2017 and Sec 41 of the CGST Act, 2017.

Further, in relation to Sec 16(2)(c) wherein it states that the tax charged so has been appropriately paid to the government, as a condition for availment of credit, it seems unfair to the registered person to take the onus of this merely to avail credit. Thus, the lawmakers have to introduce the initially recommended GSTR 2 and GSTR 3, in order to have a clear linking between the three forms in order for the Registered persons to avail and utilize credit and thereby reduce the litigations arising ambiguity on account of such confusion and uncertainty.

CONCLUSION

With the introduction of GST, the businesses we please with the concept of seamless flow of credit which was absent in the erstwhile laws. However, even after 4 years since its introduction, the business's and industry seems to be struggling to avail the credit that is available to them due to the conditions and restrictions thrust upon them.

Therefore, the lawmakers will have to simplify the rules and the conditions to set the seamless flow of credit in action and boost the Indian business. Especially given the crisis that the nation and the world is going through, clarity in relation to availment and utilization of input tax credit is the need of the hour and shall bring respite in these difficult times.