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ITC: SEAMLESS FLOW ENDLESS RESTRICTIONS

The Task Force on Implementation of the Fiscal Responsibility and Budget Management Act, 2003 observed that “high import tariffs, excises and turnover tax on domestic goods and services have enormous cascading effects, leading to a distorted structure of production, consumption and exports. **This problem can be effectively addressed by shifting the tax burden from production and trade to final consumption, and from savings to consumption. Accordingly, the Task Force recommended that “a well-designed destination-based value added tax on all goods and services is the most elegant method of eliminating distortions and taxing consumption.**

Report of The Empowered Committee of State Finance Ministers: The first ever discussion paper on GST in India saw light of the day through the report of the Empowered Committee of State Finance Ministers which was submitted to the Government of India on 10th of November 2009. This report talked about GST and its benefits to trade, industry, agriculture and consumer. Some of the extracts of the report are as under:

If the Value Added Tax (VAT) is considered to be a major improvement over the pre-existing Central excise duty at the national level and the sales tax system at the State level, then the Goods and Services Tax (GST) will be a further significant breakthrough - the next logical step towards a comprehensive indirect tax reform in the country.

Keeping this objective in view, an announcement was made by the then Union Finance Minister in the Central Budget (2007-08) to the effect that GST would be introduced with effect from April 1, 2010.

In the GST, both the cascading effects of CENVAT and service tax are removed with set-off, and a continuous chain of set-off from the original producer's point and service provider's point up to the retailer's level is established which reduces the burden of all cascading effects. This is the essence of GST, and this is why GST is not simply VAT plus service tax but an improvement over the previous system of VAT and disjointed service tax.

The GST at the Central and at the State level will thus give more relief to industry, trade, agriculture and consumers through a more comprehensive and wider coverage of input tax set-off and service tax setoff, subsuming of several taxes in the GST and phasing out of CST. With the GST being properly formulated by appropriate calibration of rates and adequate compensation where necessary, there may also be revenue/ resource gain for both the Centre and the States, primarily through widening of tax base and possibility of a significant improvement in tax-compliance. In other words, the GST may usher in the possibility of a collective gain for industry, trade, agriculture and common consumers as well as for the Central Government

and the State Governments. The GST may, indeed, lead to the possibility of collectively positive-sum game

The Empowered Committee of State Finance Ministers report was followed by **13th Finance Commission Report** submitted on 15th December 2009 and the said report mentioned how GST will be regulated in India:

The computation of the CGST and SGST liability should be based on the invoice credit method i.e., allow credit for tax paid on all intermediate goods or services on the basis of invoices issued by the supplier. As a result, all different stages of production and distribution can be interpreted as a mere tax pass-through, and the tax will effectively 'stick' on final consumption within the taxing jurisdiction. **This will facilitate elimination of the cascading effect at various stages of production and distribution.** (Para-2.16).

Full and immediate input credit should be allowed for tax paid (both CGST and SGST) on all purchases of capital goods (including GST on capital goods) in the year in which the capital goods are acquired. (Para-2.18)

Under the present Indirect Tax regime at the State level, the lower rate is generally 4 per cent. However, **in the absence of a seamless flow of the input credit mechanism resulting in cascading of taxes and the CENVAT-inclusive tax base, the incidence on products liable to the lower rate of 4 per cent is substantially higher.** Since, we recommend in para 5.79 a single rate, which is extremely low in comparison to the existing standard rate of 12.5 per cent, there is little scope for providing a further lower rate. In addition, the proposed GST design structure envisages a comprehensive base with a seamless flow of the input credit mechanism. Consequently, the cascading effect would be negligible (Para 5.11).

All the above three documents emphasis improvement over the pre-GST tax structure if GST is introduced in the country. Goods and Service Tax was introduced in the country wef 01.07.2017 after having numerous rounds of debates among all political parties across India. Late Sh. Atal Bihari Vajpai, the then Prime Minister first talk about GST in FY 2001-2002 and we took seventeen years to introduced it finally. We discussed GST politically but not technically hence we have numerous amendments since it was introduced. Today, perhaps there is no section in GST

which has not been amended since it introduced.

Before GST and /or after GST, governments have been continuously claimed that it is industry and user friendly and is good and simple tax. No doubt, it has increase the revenue of exchequer but at the same time has enhance the confusion, litigation and compliances. It has also increased the unemployment. MSMEs are worst effected as has increased their input cost and has blocked their working capital at various stages. Provisions are such that one can't compliance within their frame work. Due to frequent amendments on one side, GSTN who is responsible for the smooth operations of GST Portal is unable to update the GST portal so frequently and on the other side professionals have wasted many working hours to study the provisions again and again.

All the above three reports on pre-GST tax structure talked about seamless flow of taxes and elimination of cascading effects of taxes in GST regime. Keeping major items i.e Petrol, Diesel, CNG, ATF and Liquor for human consumption out of GST purview has adversely effected the economy and the benefits of GST has not been derived fully. Apart, keeping Electricity, Education and Health in exemption list without setoff of taxes has further jeopardies the economy. So in over all, by keeping more than 40% of the total economy out of the GST purview, has not derived much, rather put the stake holders in doldrum.

Further, if we go by the provisions of existing GST laws, we found that more and more restrictions have been imposed to claim Input Tax Credit (ITC). Provisions are so stringent and confusing that sometimes it seems that how one can compliance it under the law and under given frame work. In GST laws, many restrictions have been imposed on taxable persons to avail ITC and the basic purpose and spirit of law have been defeated.

Under CGST Act, 2017 many sections and rules have been framed to avail and not to avail ITC. Let us talk about these sections and rules one by one:

Section 16: This section narrates the eligibility and conditions to avail the ITC and reproduced as under:

- (1) *Every registered person shall, subject to such conditions and restrictions as may be prescribed and in the manner specified in section 49, be 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 and the said amount shall be credited to the electronic credit ledger of such person.

2) Notwithstanding anything contained in this section, 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;(wef 01.01.2022)

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

Explanation.—For the purposes of this clause, it shall be deemed that the registered person has received the goods or, as the case may be, services—

(i) where the goods are delivered by the supplier to a recipient or any other person on the direction of such registered person, whether acting as an agent or otherwise, before or during movement of goods, either by way of transfer of documents of title to goods or otherwise;

(ii) where the services are provided by the supplier to any person on the direction of and on account of such registered person.]

(c) subject to the provisions of section 41 or section 43A*, 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:

Provided that where the goods against an invoice are received in lots or instalments, the registered person shall be entitled to take credit upon receipt of the last lot or instalment:

Provided further that where a recipient fails to pay to the supplier of goods or services or both, other than the supplies on which tax is payable on reverse charge basis, the amount towards the value of supply along with tax payable thereon within a period of one hundred and eighty days from the date of issue of invoice by the supplier, an amount equal to the input tax credit availed by the recipient shall be added to his output tax liability, along with interest thereon, in such manner as may be prescribed: Provided also that the recipient shall be entitled to avail of the credit of input tax on payment made by him of the amount towards the value of supply of goods or services or both along with tax payable thereon.

(3) Where the registered person has claimed depreciation on the tax component of the cost of capital goods and plant and machinery under the provisions of the Income-tax Act, 1961, the input tax credit on the said tax component shall not be allowed.

(4) 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 debit note pertains or furnishing of the relevant annual return, whichever is earlier.

Provided that the registered person shall be entitled to take input tax credit after the due date of furnishing of the return under section 39 for the month of September, 2018 till the due date of furnishing of the return under the said section for the month of March, 2019 in respect of any invoice or invoice relating to such debit note for supply of goods or services or both made during the financial year 2017-18, the details of which have been uploaded by the supplier under subsection (1) of section 37 till the due date for furnishing the details under sub-section (1) of said section for the month of March, 2019.

**Section 43A omitted through Budget-2022*

Our views on Section 16:

This section made taxable person eligible for ITC.



But it has imposed endless restrictions to avail the ITC. The basic and foremost condition to avail ITC is that Outward supplies must be taxable. Clause- 2, of the section put practically five conditions which must be fulfilled in- Toto to avail ITC. If any condition out of five is not met, ITC will be rejected. Having Invoices or Debit Notes in custody along with goods and or services is natural phenomena of any business. Filing of periodical returns also a regular exercise for any business entity. But clause (2)(c) seems to be impractical and illogical. **How a buyer can force a supplier to file his return and pay taxes to government account if not paid. If government laws can't force supplier to compliance under the law, how an innocent buyer can get it done who has no power under the law or otherwise.**

Case Laws challenging the legality of Section 16:

In a case of **Arise India Ltd v/s Commissioner Of Trade & Taxes, ... on 26 October, 2017 Appeal Number : W.P.(C) 2106/2015 Date of Judgement/Order : 26.10.2017** before the Hon'ble Delhi high court, court held that:

This is violation of Article 14 of the Constitution in as much as it treats both the innocent **purchasers and the guilty purchasers alike**. In other words, it is submitted that by treating unequal's equally the legislative measure is violation of Article 14 of the Constitution. **There are other statutory avenues available to the State to collect tax from the defaulting dealer.**

Similarly, in another case before Kolkatta High Court, notice was issued to Centre and State Governments regarding Clause 2(4). **It was argued that ITC is not taken through return but instead it is taken through the books of accounts immediately on receipt of goods or services in terms of 1st proviso to Section 16(2) of the Act.** It was also argued that the provision of section 16(4) of the CGST Act, 2017/WBGST Act, 2017 is arbitrary and unreasonable and it was pleaded that they are also violative of Article 19(1)(g) and Article 300A of the Constitution. The denial of ITC would defeat the object of the 122 and Constitutional Amendment Bill, 2017.

As purchaser has paid and compliance was made on his part under the law how he can be denied for a fault of supplier not paying tax to government. Hence, grounds have not distinguished **guilty buyer and innocent buyer**

and kept them at par which is unconstitutional. Shifting the incidence of tax from the supplier to the buyer, over whom buyer has no control whatsoever, is arbitrary and irrational & therefore violative of the Article 14, Article 19(1)(g) and Article 300A of the Constitution of India

In another case of **Bharti Telemedia Ltd. Vs. Union Of India & Ors.** (Delhi High Court) W.P.(C) no 6293/2019. The Petitioner i.e. Bharti Telemedia Ltd. is engaged in providing Direct-To-Home satellite television broadcast services. Delhi HC issues notice in writ petition challenging Section 16(2)(c), second proviso to Section 16(2)(d) and proviso to Section 16(4) of Central Goods and Service Tax Act, 2017 (CGST Act). **In the case Petitioner's contention is that the Department has been vested with all the powers to recover any revenue lost owing to non-payment of taxes by erring suppliers and credit cannot be denied to recipient for default on part of the supplier;**

Litigation to the facts is still going on which is just a wastage of time, money and energy of each stake holder. Better if policy makers can draft the user-friendly and practical provisions.

Section 17: Banned ITC on some of the transactions/businesses.

Section 17 of CGST Act, 2017 banned some of the transactions where ITC can't be claimed. Such transactions are narrated under sub-clause (5) of Section 17. In other words, there is list of blocked credits. The same is reproduced as under:

Section 17(5):

“(a) motor vehicles for transportation of persons having approved seating capacity of not more than thirteen persons (including the driver), except when they are used for making the following taxable supplies, namely:—

- (A) further supply of such motor vehicles; or*
- (B) transportation of passengers; or*
- (C) imparting training on driving such motor vehicles;*

(aa) vessels and aircraft except when they are used

- (i) for making the following taxable supplies, namely: —*
 - (A) further supply of such vessels or aircraft; or*



- (B) transportation of passengers; or
- (C) imparting training on navigating such vessels; or
- (D) imparting training on flying such aircraft;

(ii) for transportation of goods;

(ab) services of general insurance, servicing, repair and maintenance in so far as they relate to motor vehicles, vessels or aircraft referred to in clause (a) or clause (aa)

Provided that the input tax credit in respect of such services shall be available—

(i) where the motor vehicles, vessels or aircraft referred to in clause (a) or clause (aa) are used for the purposes specified therein;

(ii) where received by a taxable person engaged—

(i) in the manufacture of such motor vehicles, vessels or aircraft; or

(ii) in the supply of general insurance services in respect of such motor vehicles, vessels or aircraft insured by him

(b) the following supply of goods or services or both—

(i) food and beverages, outdoor catering, beauty treatment, health services, cosmetic and plastic surgery, leasing, renting or hiring of motor vehicles, vessels or aircraft referred to in clause (a) or clause (aa) except when used for the purposes specified therein, life insurance and health insurance:

Provided that the input tax credit in respect of such goods or services or both shall be available where an inward supply of such goods or services or both is used by a registered person for making an outward taxable supply of the same category of goods or services or both or as an element of a taxable composite or mixed supply

(i) membership of a club, health and fitness centre; and

(ii) travel benefits extended to employees on vacation such as leave or home travel concession:

Provided that the input tax credit in respect of such goods or services or both shall

be available, where it is obligatory for an employer to provide the same to its employees under any law for the time being in force.

(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.

Explanation.—For the purposes of clauses (c) and (d), the expression “construction” includes re-construction, renovation, additions or alterations or repairs, to the extent of capitalisation, to the said immovable property;

(e) goods or services or both on which tax has been paid under section 10;

(f) goods or services or both received by a non-resident taxable person except on goods imported by him;

(g) goods or services or both used for personal consumption;

(h) goods lost, stolen, destroyed, written off or disposed of by way of gift or free samples; and

(i) any tax paid in accordance with the provisions of sections 74, 129 and 130.

Explanation.— For the purposes of this Chapter and Chapter VI, the expression “plant and machinery” means apparatus, equipment, and machinery fixed to earth by foundation or structural support that are used for making outward supply of goods or services or both and includes such foundation and structural supports but excludes— (i) land, building or any other civil structures; (ii) telecommunication towers; and (iii) pipelines laid outside the factory premises.

Our Views on Section 17:

As per section 17 clause (5)(a), (aa), (ab) and (b) ITC



on purchase/rent or lease of motor vehicles, vessels and aircraft if purchased for business purposes not available. However, if said vehicles purchased for following businesses/purposes ITC is allowed:

- (i) for trading of motor vehicles, vessels and aircraft
- (ii) for transportation of passengers by motor vehicle, vessels and aircraft;

- (ii) for driving schools of such motor vehicles, vessels and aircraft
- (vi) for transportation of goods;
- (v) In case of Motor vehicles having seating capacity more than thirteen persons**, including driver, ITC is available even if it is purchased for business other than above mentioned business.

As per section 2(28) of Motor Vehicles Act, 1988, Motor vehicles exclude:

- ❖ **vehicle running upon fixed rails**
- ❖ **special purpose vehicles for being used in a factory or any enclosed premises like fork lifts, pay loaders, work lifts**
- ❖ **vehicle with less than 4 wheels fitted with engine capacity of up to 25cc**
- ❖ **tippers and dumpers**

Also GST taxes paid on insurance premium, repair and maintenance etc for above said vehicles, ITC not available. However, ITC is available if these vehicles are purchased for above mentioned businesses and or purposes.

So, if bus or any motor vehicle having seating capacity more than 13 persons, is purchased for official use, ITC is available. But if car or vehicle having seating capacity less than 13 persons is purchased for official purposes, ITC is not allowed.

In any business, without the use of motor vehicles, especially in administration, marketing and after sale services functions, business is not possible. So, we are of the view that some percentage of the taxes paid on such services, ITC must be allowed.

Also, in clause (b), ITC is available if made mandatory under any law for the time being in force. It creates confusion among stake holders as laws have their own interpretations. So, it's better if things can be made clear and specify the activities allowed for ITC.

In clause (c) and (d), ITC on taxes paid for the services of construction immovable property is not allowed. No business can be run in open space. Business need buildings for inventory, proper space for man power, and

equipment etc. Accordingly, GST paid on Construction material, fittings, Lifts, electrical etc ITC not allowed.

Explanation at the end of the section 17, does not include Land and building, pipelines laid down outside the factory premises, telecommunications towers as plant and machinery which is illogical view as in all such industries, operations are not possible.

We are of the view that based upon some technical estimates, certain percentage of taxes paid for such construction activities must be allowed to hotels and manufacturing sector.

Cases challenging legality of Section 17: Block Credits

In a case of **M/S Safari Retreats v/s Revenue Authorities** before Hon'ble Orissa HC, where in petitioner has constructed a big mall and has invested huge money. Out of that investment petitioner has an accumulated ITC of Rs. 35.00 Cr in his account. Hon'ble court held that:

- the court has accepted the submission of the petitioners that very object of enacting GST law is to obviate the cascading effect of various indirect taxes and reduce multiplicity of indirect taxes.

- If the benefit of input tax credit is denied by invoking Section 17(5)(d) of the CGST Act the said object will be frustrated, especially in view of the fact that the petitioner shall be required to pay GST on its rental income.
- The Hon'ble Court held that letting out the property cannot be said to be using the property "on his own account".
- The Hon'ble High Court has rejected the narrow interpretation of the section 17(5)(d) of the CGST Act done by the department and held that the benefit of credit would be available to assessee on goods or services used in construction of immovable property if the assessee is required to pay GST on the rental income arising out of the investment on which he paid the GST.
- The court duly noted the submission of the Petitioner that in case where immovable property is sold before issuance of completion certificate or first occupation (i.e. on payment of GST), the input tax credit is not denied u/s 17(5)(d). Whereas, in the current case when the petitioner has to pay GST on its rental income, the input tax credit is denied by invoking Section 17(5)(d).
- In such case the petitioner's prayer was that on this ground Section 17(5)(d) of the CGST Act and OGST Act has to be struck down as violative of Article 14 of the Constitution and if the said section is not read down by the court.
- The Hon'ble Court chose to read down Section 17(5)(d) of the CGST Act and OGST.

Section 38: Newly drafted section in Budget-2022 imposed further restrictions on ITC:

Section 38 has been redrafted through Budget-2022. Though it is not notified yet, but has put more restrictions and conditions to avail ITC. Newly drafted section 38 is reproduced as under:

"38. (1) The details of outward supplies furnished by the registered persons under sub-section (1) of section 37 and of such other supplies as may be prescribed, and an auto-generated statement containing the details of input tax credit shall be made available electronically to the recipients of such supplies in such

form and manner, within such time, and subject to such conditions and restrictions as may be prescribed.

(2) The auto-generated statement under sub-section (1) shall consist of—

- (a) details of inward supplies in respect of which credit of input tax may be available to the recipient; and
- (b) details of supplies in respect of which such credit cannot be availed, whether wholly or partly, by the recipient, on account of the details of the said supplies being furnished under sub-section (1) of section 37,—
 - (i) by any registered person within such period of taking registration as may be prescribed; or
 - (ii) by any registered person, who has defaulted in payment of tax and where such default has continued for such period as may be prescribed; or
 - (iii) by any registered person, the output tax payable by whom in accordance with the statement of outward supplies furnished by him under the said sub-section during such period, as may be prescribed, exceeds the output tax paid by him during the said period by such limit as may be prescribed; or
 - (iv) by any registered person who, during such period as may be prescribed, has availed credit of input tax of an amount that exceeds the credit that can be availed by him in accordance with clause (a), by such limit as may be prescribed; or
 - (v) by any registered person, who has defaulted in discharging his tax liability in accordance with the provisions of sub-section (12) of section 49 subject to such conditions and restrictions as may be prescribed; or
 - (vi) by such other class of persons as may be prescribed."

Our views for newly drafted Section:

Section 38 has been newly drafted and our understanding is that:

- GSTR-2B will be consisting of two parts i.e ITC available and ITC not available.
- The following may be the additional reasons for ITC

'Not available' as per GSTR-2B in the hands of the recipient:

- a. Inward supply is received from a supplier having new registration –conditions applied
- b. Supplier has defaulted in payment of tax and the default has continued for the prescribed time period – may be less than six/three months
- c. Tax paid in GSTR-3B is lower than the output tax shown in GSTR-1
- d. Inward supply is received from a supplier who has taken more ITC in GSTR-2B than in GSTR-3B by the prescribed limit
- e. Supplier has paid higher proportion of taxes from his electronic credit ledger than what is allowed as per law.
- f. Other Notified persons.

Section 49, 49A: These sections stop to utilise ITC lying in Credit ledgers

Section 49 read with rule 86A, empowered the officers to block ITC ledgers of taxable person if they have reason to believe that ITC if availed based on invalid documents/invoices, supplier is not existing and so on.

Case LAW:

In case filed by MRS Realty Private Ltd in Kolkatta High Court, challenging the constitutional validity of rule 86A, Hon'ble court issued notices both to Centre and State governments.

In another case, where in Kalpsutra Gujarat v. Union of India (2020) 120 (Gujarat), the applicant, which is a partnership firm, through one of its partners, had asked the High Court to issue a writ of mandamus or any other appropriate writ, direction or order, striking down rule 86A in so far as it gives power to block ITC through no fault of the registered bona fide recipient, as ultra vires of section 16 of the CGST Act. The applicant further also asked for a direction allowing it to utilize the ITC till the time it is proved that the supplier did not honor his tax liability. The question that the Court put before the respondents in this case, is whether omission on part of the supplier will be sufficient to block the ITC of the applicant. The Court noted

the possible misuse of the Rule by the revenue authorities to harass the taxpayer and directed proper guidelines to be issued prescribing the procedure to be followed in order to invoke the said rule 86A.

Section 49 read with Rule 86B 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 per cent. 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. So, here taxable person is forced to pay cash even if has ITC in its credit ledgers.

Case LAW:

The constitutionality of Rule 86B, which was introduced w.e.f. 1st January 2021 vide Notification No. 94/2020, was challenged in Hon'ble Gujarat High Court where in Court issued notice to the government. Though government clarified that this provisions will impact only 0.5 percent taxable persons.

Further, **Section 49A, read with rule 88A** emphasis to use and exhaust IGST first and only than CGST/SGST can be used against outward tax liability. Section 49A is reproduced as under:

Notwithstanding anything contained in section 49, the input tax credit on account of central tax, State tax or Union territory tax shall be utilised towards payment of integrated tax, central tax State tax or Union territory tax, as the case may be, only after the input tax credit available on account of integrated tax has first been utilized fully towards such payment.

In net shell section 49A forced taxable person to pay outward tax liability in cash though he has ITC in his ledgers.

Section 49(5) describe the order of adjustment of ITC available, but Section 49A forced to exhaust IGST -ITC first without using other ITC available. So by following the order described in section 45(5), one has to meet the liabilities. There are instances where ITC in CGST/SGST got accumulated and taxable person is forced to pay Taxes in cash. This can be understand with following example:



Taxes	Tax Lia	ITC Avl	ADJ/Setoff	ADJ2	BAL	CASH
IGST	500	700	500	200*		0
CGST	300	500	200*(IGST)	100 (CGST)	400	0
SGST	400	250	250	-150	-150	150*

*To exhaust IGST first, CGST liability paid from IGST. Otherwise CGST liability could have been met from CGST-ITC and IGST-ITC could have been utilised for SGST where taxable person forced to pay cash. It has on one side blocked his money in ITC and on other side increased his working capital requirement.

Our views on Section 49 and rule drafted there in:

So much restrictions and overlapping of provisions

causes unnecessary litigation, corruption, wastage of national resources and make the business unviable. On one side we talk about “Make in India” and on the other side making India tough to business. **Because of very few evaders of the taxes, other honest and genuine tax payers should not be penalised rather systems should be in place to curb the evasion.**

