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# INPUT TAX CREDIT- EMERGING ISSUES

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## **Agenda**

- Scheme of ITC
- Reading between the lines
- Interpretation by Courts
- Input Service Distributor
- Key Takeaways

# SCHEME OF INPUT TAX CREDIT

# OVERVIEW



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- GST is a **VALUE-ADDED TAX**
- ITC is a concession or entitlement **NOT AN ABSOLUTE RIGHT** (refer **Bom HC-Mahalaxmi Mills**)
- Sections 16-19 of the CGST Act are the key provisions that deal with the availment of ITC
- Sections 20 and 21 deal with the provisions and mechanism applicable to Input Service Distributor
- Input and input service are given equal treatment in the scheme of law, whereas, ITC on capital goods is governed by special provisions, specially in the case of the assessee having taxable and exempt operations.

# Section 16 - CGST Act



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## Eligibility for taking ITC

- Who can avail ITC?
  - *Registered person* – Section 2 (94)
  - *On supply* of goods and/or services to him
  - Intended to be used in the '*course or furtherance of business*'

## Conditions for taking ITC:

- The registered person must be in possession of tax invoice/debit note issued by supplier
- The supplier should have furnished the details of such supply in his GSTR-1
- The registered person has 'received' the goods and/or services
- The tax charged has been paid to the Govt.
- The registered person has furnished details in GSTR 3B

# Section 16 - CGST Act



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## **Time limit**

- Assessee can take input tax credit in respect of any invoice/debit note up to 30<sup>th</sup> November of the following financial year/ furnishing of the relevant annual return, whichever is earlier- Section 16(4)
- For FYs 2017- 2021, ITC can be taken in any return u/s.39 filed up to 30<sup>th</sup> November 2021- Section 16(5)

## **Depreciation**

- No ITC where assessee has claimed depreciation on the tax component of the cost of capital goods and plant and machinery under Income-Tax - Section 16(3)

# Section 17- CGST Act



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## Apportionment of credit and Blocked credit

- Credit of goods/services not used for business purposes – Section 17(1)
- Credit of goods/services used for effectuating exempt supplies – Section 17(2)
- Mechanism to calculate the exempted turnover- Section 17(3)
- Deeming provisions (optional) for reversal of credit @ 50% in case of Banks, Financial Institutions, NBFCs engaged in accepting deposits, extending loans or advances – Section 17(4)
- Blocked credit - Section 17(5)

# Section 18- CGST Act



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## Availability of credit in special circumstances

- ITC in respect of inputs/semi-finished/finished/capital goods held in stock can be taken, subject to conditions in Section 18(1)
- No ITC after the expiry of one year from the date of issuance of tax invoice relating to supply.
- Where dealer opts for composition levy or his supply becomes wholly exempt, he must make payment of ITC taken on inputs/semi-finished/finished/capital goods held in stock, through ECL, and any remaining ITC in the ledger will lapse subsequently.
- Transfer of unutilized ITC allowed upon change in the constitution of a registered person (sale/merger/demerger/amalgamation/transfer of business with transfer of liabilities/lease)
- Liability to pay GST in case of sale of capital goods on which ITC has been taken



# Section 19- CGST Act



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## **Taking ITC in respect of inputs and capital goods sent for job work.-**

- Principal (*as defined in Section 143*) can take ITC of inputs/capital goods sent for job work directly
- Need not bring such inputs/capital goods to his place of business first
- Where conditions under Section 143 are not satisfied, it is deemed as a supply of the inputs/capital goods
- Not applicable for moulds and dies, jigs and fixtures, or tools

# READING BETWEEN THE LINES

# Reading Between the Lines



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## Connection with *business* is important

- To avail ITC- *in the course or furtherance of business*
- What is business? [Section 2(17)] Existing or New?
- Whether expenses incurred for new acquisition of the business or listing of the business are also covered in the ambit of ITC?
- Principles laid down by the Courts in interpreting Section 37 of Income Tax Act would be relevant.

# Reading Between the Lines



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## Receiving the supply, in actual

- Mere issuance of debit note or receipt of goods (not under a contract of supply) is not enough
- Law requires that the party receives the supplies contractually
- Whether ITC is admissible where goods are not physically received by the party?
  - Yes, if party receives the goods as per contract
  - **Circular No. 241/35/2024 GST** – ITC can be availed when goods are in transit, provided ownership passes to dealer (Ex-works contract)

# Reading Between the Lines



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## Is mere tax/duty paying challan enough to take ITC?

- *Essar Propack* (Bombay HC) is still relevant?
- Whether credit can be availed basis the challan covering the payment of differential duty and IGST and not amending the BoE?
- Whether payment of tax through DRC-03 challan is a valid document to avail ITC ?
- Debit note to recover the differential amount for the past period is a valid document to take ITC.

# Reading Between the Lines



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## **Time limit to take ITC under Section 16(4)**

- Not applicable in case of BoE
- ITC should be available even if BoE is amended after the prescribed time-limit available under Section 16(4)
- In case of RCM transactions, the time limit will be determined basis the date of issuance of self-invoice u/s. 31

# Reading Between the Lines



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## Reversal of proportionate ITC on interest earned on fixed deposits

- Interest income earned by Assessee by way of extending bank deposits – exempt supply under Entry 27 of Notification 12/2017
- Bar of Explanation 1(b) of Rule 43 – CGST Rules

*“Explanation 1:-For the purposes of rule 42 and this rule, it is hereby clarified that the aggregate value of exempt supplies shall exclude: - (b) the value of services by way of accepting deposits, extending loans or advances in so far as the consideration is represented by way of interest or discount, except in case of 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; and”*
- Reading down ‘accepting deposits’ as ‘extending deposits’
- Enzene Writ Petition in Bombay HC - interim stay granted

# Reading Between the Lines



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## **Taking ITC for employer's obligations**

- Credit of canteen services, for the factory workers, if no amount is being recovered from the employees?
- Credit of canteen services for the factory workers in case of partial recovery from the employees? GST is to be paid on which amount?
- Credit of the canteen services for other offices?
- Credit of canteen services for third-party workers operating in factory premises? In case of recovery, then the GST would be paid on which amount?
- Credit of bus transportation with or without recovery of any concessional amount from the employees?
- What about the ITC on car transportation?



# Reading Between the Lines



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

- *Safari Retreat – SC*
  - Overturned Orissa HC judgement: Hotel and theatre building not ‘plant or machinery’ – no ITC
  - Expounded *functionality test* - matter remanded to determine whether ‘mall building’ is a plant and machinery
  - Difference between ‘plant and machinery’ & ‘plant or machinery’
- *Whether retrospective amendment to 17(5)(d) has nullified the effect of the SC judgement?*
  - Revenue SLP pending; interpretation of ‘on his own account’

# Reading Between the Lines



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

What will happen in case of construction-related expenses are not capitalized by the developer?

- *Mindrill Systems and Solutions* (AAAR-West Bengal) held that the condition of capitalization would be applicable in case of reconstruction, renovation, etc., it is not applicable in case of original construction.

# Reading Between the Lines



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

- Whether ITC can be taken for Lift, HVAC units, etc.?
  - *Wago (P) Ltd. & Varachha Co-op Bank Ltd. (GUJ AAAR) decided against in the case of HVAC*
  - *Nikhil Comforts – MH AAAR – conflicting opinion (W.P filed in Bom HC)*
- Whether ITC can be taken for Rotary Parking System?
  - *Arthanarisamy Senthil Maharaj-AAAR- Tamilnadu- held against the assessee*

# Reading Between the Lines



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

- Whether ITC can be taken for interior related activities/supply?
- Test of immovability laid down by the court is critical to decide the admissibility of ITC
  - *Solid & Correct Engg Works - SC*
  - *Bharti Airtel, Vodafone Idea- SC* (Cenvat Credit)
  - *Bharti Airtel – Delhi HC* (GST)
- Structuring of the contract is very important to maximize the credit

# Reading Between the Lines



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## **Interpretation of Section 17(5)(f)**

What is the interpretation of clause (f) i.e. goods or services or both received by a non-resident taxable person except on goods imported by him?

# Reading Between the Lines



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## Interpretation of Section 17(5)(h)

- ITC blocked on goods lost, stolen, destroyed, written off or disposed of by way of gift or free samples
  - Whether ITC can be denied for handling loss or manufacture loss?
  - Inevitable in the course or furtherance of business
  - What if the assessee has written down the value of the inventory to a nominal amount by applying Accounting Standard-2?

# Reading Between the Lines



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## Implications of Section 17(5)(i)

- Whether ITC can be taken in case the demand notice has been received by the vendor under Section 74?
- What will happen if the Assessee himself has received demand notice (either under Section 74 or Section 73) in respect of RCM transaction?
- Whether the ITC would be available in case of Section 73 payment made via DRC-03?
- *Whether DRC-03 is a valid document to avail ITC?*

# Reading Between the Lines



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## Credit on promotional material distributed to the customers or dealers

- Supply of flyer, display board and returnable material like refrigerator, dispenser, demo products ?
- *ARS Steel and Alloys International Private Limited* (Mad HC) - credit of T-shirts and Gold Coins would not be admissible.
- *Rodec Pharmaceuticals (P.) Ltd. (UP AAR)* – no ITC on items procured for distribution to retailers as sales promotion rewards; held, goods are used as gifts or for personal consumption.
- *GRB Dairy Foods (P.) Ltd (TN AAAR)* - ITC not available on inputs/input services procured for promotional scheme if supplied free of cost.



# Reading Between the Lines



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## Credit on demo vehicle

- *BMW- P&H HC* (decided against)
- *Sai Service (P) Ltd.* - AAAR-Goa (decided against)
- *Landmark Cars East Pvt. Ltd.* - AAR-West Bengal (decided in favour)
- ***Circular No. 231/25/2024-GST***
  - Credit allowed as it is used for making '*further supply of such motor vehicles*'
  - Not affected by way of capitalisation in books
  - Blocked: dealer has claimed depreciation under income-tax; dealer has subsequently sold the demo vehicle.

# Reading Between the Lines



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## **Interpretation of Section 17(5): Questions to ponder:**

- Whether ITC can be taken for social expenses which are not forming part of CSR ?
- What is personal consumption for a corporate or any firm?
- Fate of transitioning related issues in case of merger, demerger, slump sale, etc.

# INTERPRETATIONS BY COURT

# Interpretations by Court



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## **Demand on Pan India Creditors**

- ***TMF Business Service Limited (Mad HC)***- Sundry Creditors – in case of non-payment by the petitioner for supplies received, imposition of tax liability on total value of trade receivables incorrect. Assuming dues to sundry creditors were not discharged, even then only trade payables and not receivables should be taken into account.
- ***Ingram Micro India Private Limited (Mad HC)***- under the Companies Act, every company has to file financial statements in respect of its entire operations, there is no provision for filing State-specific financial statements.

# Interpretations by Court



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## **No swapping of entries between credit ledger & cash ledger- *UOI v. Bharti Airtel Ltd. – 2021 SC***

- Assessee was aggrieved by the non-operability of Form GSTR 2A (Jul-Sept 2017) and claimed that it was denied information about the credit ledger, due to which outward tax liability was discharged by paying cash instead of utilizing the ITC lying in its credit ledger. Therefore, prayed for rectification of GSTR 3B to avail ITC for the relevant period and get a refund of the cash deposited in the cash ledger.
- Held, there is no provision for swapping of entries, so as to show the corresponding outward tax liability amount in the cash ledger from where refund can be taken. Once assessee exercises an option to discharge liability either through credit or cash ledger, same cannot be reversed.
- Assessee had the option to rectify the GSTR 3B u/s. 39(9) upon noticing the error/omission which he failed to exercise.

# Interpretations by Court



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## **Mis-Match between GSTR-2A vs. GSTR-3B (till 01.01.2022)**

- ***Suncraft Energy Private Limited (Cal HC)***- Recovery from recipient taxpayer where payment was made via valid tax invoice invoices not reflected in the GSTR-2A is bad in law and the recovery should have been made from the supplier.
- ***Henna Medicals (Ker HC)***- ITC cannot be denied merely based on discrepancies between GSTR-2A and 3B.
- ***Diya Agencies (Ker HC)***- Where supplier had not remitted GST amount, assessee could not be held responsible; ITC claim cannot be denied merely on ground that said tax was not reflected in Form GSTR-2A.

# INPUT SERVICE DISTRIBUTOR

# Input Service Distributor



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- In principle, the scheme of ISD under GST is aligned with the erstwhile regime despite the fact that GST is implemented state wise.
- It is applicable only in case of distribution of the credit availed on services and not on goods.
- From 2024, the registration of ISD has become mandatory
- Cross-charge v. ISD will always create controversy and complexity for the taxpayers to comply with both the provisions and draw a balance in both of them, given their overlap
- What type of expenses will go under ISD and what needs to be cross-charged would be a long-lasting controversy
- Separate recording and distribution of admissible and non-admissible ITC and that so month wise.



# Input Service Distributor



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- The provisions under S.20 providing mechanism of distribution of credit appear to be simple and logical, however, Rule 39 which elaborates the mechanism is a complex and would always be prone to litigation. It will be heaven for the tax professional and all for the Departmental authorities.
- Under the scheme of law, the Revenue can demand tax, along with interest & penalty, from the recipient unit to whom excess credit has been distributed.
- The Revenue can also impose penalty on the ISD in case of wrongful distribution equivalent to the tax demand.
- The amendment proposed in the present budget is clarificatory and to fill the gaps in the erstwhile wordings in the provision.

# KEY TAKEAWAYS

# Key Takeaways



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- ITC related disputes would continue to exist
- Whether the substantive issues decided by the Courts in previous regime would continue to be relevant for GST?
- Equal grip on the substantive law, Forms, procedure and the understanding of the GST Portal is important
- ISD vs. Cross Charge would pose complex challenges for the larger groups having PAN India operations and hence, it will provide a lot of professional opportunities.



**THANK YOU!**