Transitional credit – A Tale on Missing Recovery Provision

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Transitional provisions covered under Chapter XX of the Central Goods and Services Tax Act, 2017 (CGST Act) *inter-alia* provide for carry forward of credits pertaining to the erstwhile Indirect Tax laws which were subsumed under GST. Taxpayers availed such credit upon filing of transitional forms on the GST portal which got transferred to the electronic credit ledger for further utilisation. The tax authorities undertook scrutiny of this transitional credit and issued notices demanding tax reversal, interest and penalty on irregular availment and utilization of transitional credit.

The Comptroller and Auditor General of India (CAG) has also tabled its report for the year 2020-21 before the Parliament in August 2022. In this report, the CAG observed that there were significant irregularities in the transitional credit claims of taxpayers around ineligible credit of duty like credit of Cessess, PLA balance, carry forward of credit on stock without documents, carry forward of 100% credit on capital goods, ineligible credit on inputs or inputservices in transit, etc.. Therefore, it became incumbent upon the tax authorities to undertake the verification of the transitional credit.

The moot question is can department legally demand tax reversal, interest and penalty on transitional credit? It becomes imperative to analyse various provisions of the CGST Act dealing with ITC and transitional credit.

The term "input tax credit" means the credit of input tax in terms of section 2(63) of the CGST Act. “Input tax” *means central tax, state tax, integrated tax or union territory tax charged on any supply of goods or services etc*. in terms of section 2(62) of the CGST Act. Thus, input tax refers to tax charged on goods or services received in the GST regime only. There is no reference to tax charged / credits under the erstwhile regime.

It is also pertinent to discuss the view adopted by Appellate Authority for Advance Ruling (AAAR) and Authority for Advance Ruling (AAR) in relation to transitional credit in recent past. Section 97 of the CGST prescribes the issues on which advance ruling can be sought. One of the questions on which advance ruling can be sought is admissibility of ITC of tax paid on goods and services. The Tamil Nadu AAAR in the case of ***Shapoorji Pallonji and Company Private Limited*** and Madhya Pradesh AAR in the case of ***Sasan Power Limited*** have refrained from passing a ruling on the issue of eligibility of transitional credit on the ground that it is not “ITC”, hence outside the purview of the advance ruling. Even the CBIC has recognised this interpretation while dealing with refunds under GST. ***Circular No. 125/44/2019 –***

GST dated 18 November 2019 clearly provides that the transitional credit pertains to duties and taxes paid under the erstwhile laws cannot be treated as part of "Net ITC" and no refund of such unutilized transitional credit is admissible.

It is a settled legal principle that taxing statutes must be given a strict interpretation. Since the definition of ITC pertains to goods and services received in the GST regime only, it can be said that transitional credit on supplies received in the pre-GST era cannot be considered as ITC under GST law. This lacunae in legal provision will have wider implications.

Section 50 of the CGST Act deals with interest on wrongful availment and utilization of ITC. As the provision for imposition of interest only deals with ITC, it can be argued that interest on irregular availment of transitional credit cannot be recovered under section 50 of the CGST Act.

Another aspect to be examined is the procedure for recovering the transitional credit along with interest and penalty. It has been observed that authorities often issue a letter mentioning the amount to be recovered without following the procedure provided under the CGST Act. The Jharkhand High Court, in the case of ***Bluestar Malleable Pvt. Ltd. v. The State of Jharkhand [2022-VIL-579-JHR]*** has recently held that if any taxpayer disputes interest liability, procedure provided under Section 73 or 74 of the CGST Act must be followed by the authorities. Meaning thereby, a proper show cause notice should be issued and adjudication process should be followed to recover interest.

Section 73/74 of the CGST Act inter-alia provide for recovering ITC wrongly availed by a taxpayer. Since there is considerable doubt as to whether ITC covers transitional credit, the Jharkhand High Court, in the case of ***Usha Martin Limited v. Additional Commissioner, CGST and Excise*** [TS-427-HC(JHAR)-2022-GST], has stayed the recovery of CENVAT credit transitioned to the GST regime on the ground that there is a distinction between CENVAT credit carried forward from the previous regime and ITC specifically mentioned in Section 73 of the CGST Act.

The CBIC had also issued ***Circular No. 42/16/2018-GST dated 13 April 2018*** providing for the recovery mechanism of CENVAT credit of central excise duty/service tax availed which is not admissible in terms of section 140 of the CGST Act along with interest and penalty. The said circular provided that such credit shall be recovered as an arrear of tax under section 79 of the CGST Act. Further, Circular No. 58/32/2018-GST dated 4 September 2018 provided that such reversal is to be done through Form GSTR-3B.

However, it has to be kept in mind that the current provisions of the CGST Act in relation to the procedure for determination of the amount to be reversed has certain loopholes. While Rule 121 of the CGST Rules, 2017 provides that proceedings relating to transitional credit wrongly availed can be initiated under section 73/74, since the substantive law (CGST Act) does not provide for the recovery of transitional credit, Rule 121 cannot override Section 73/74. It is a proven principle that Rules and Circulars cannot override the Act.

The government may come up with retrospective amendment in the relevant provisions of the GST law to cover such credit within its ambit.

The issue of transitional credit bears more relevance now considering the Supreme Court, in the case of ***Union of India and Another v. Filco Trade Centre Pvt. Ltd. and Another*** [TS-442-SC-2022-GST] has directed the authorities to open a fresh window of 2 months from 1 October 2022 for availing transitional credit upon verification by the authorities. The upcoming guideline for verification needs to be examined in detail to ascertain the parameters on which credit will be allowed to be transitioned.

Though the authorities may continue to issue notices for recovery of transitional credit wrongly carried forward to the GST regime, the taxpayers should contest the recovery as well as levy of interest and penalty in the absence of recovery provision.