

Reclaim of ITC on Use of Inputs and Capital Goods Written Off - Amendment Needed in Law

Jan 23, 2023



Kartik Solanki

Partner, Indirect Tax, BDO India LLP

In the course of business, there can be instances where the inputs or finished goods forming part of the book inventory, are not being physically traceable/present and are written off in the books of accounts. This situation is more prevalent with companies typically holding huge inventory with multiple SKUs. There are also situations where the value of such inputs/finished goods are written-off in order to comply with the accounting standards e.g. due to obsolescence despite the goods being available for actual use.

Section 17(5)(h) of the Central Goods & Services Tax Act, 2017 ('CGST Act') provides that ITC in respect of goods lost, stolen, destroyed, written off or disposed of by way of gift or free samples would not be available.

Effectively, section 17(5)(h) seeks to restrict ITC on the goods, not used to make further taxable supply and the situations mentioned above, the ITC claimed on goods written off needs to be reversed. However, in the situations mentioned above, the statutory provision leaves some issues unaddressed, as discussed below:

- It is possible that the inputs which were not traceable earlier due to the sheer volume of inventory, are traced-out subsequently. This is possible due to multitude of reasons including an inadvertent manual error in physical stock verification exercise, error in weighment etc. Such goods, once traced back, can always be used for making taxable outward supply. However, the ITC claimed on such goods would already have been reversed under section 17(5)(h) of the CGST Act by treating it as goods lost.
- Similarly, value of the inputs which had been written off by treating them as slow moving or obsolete to comply with the accounting standards may actually get used in effecting a taxable supply. However, since the value of such inputs has been written off, the ITC on such inputs would also have been reversed at the time of write off.

In both the cases above, the ITC claimed on the inputs had been reversed, by considering the goods as lost or written off. However, subsequently it may be discovered that there was no requirement to reverse the ITC.

Once it is determined that the ITC was incorrectly reversed under section 17(5)(h), ideally, the taxpayer should be allowed to reclaim such ITC. However, presently there is no specific provision to claim recredit of the ITC incorrectly reversed under section 17(5)(h). Though CBIC circular no:170/02/2022-GST dated 6 July 2022 refers to the reclaim of ITC, it only refers to reclaim of ITC under specific situations, where the reversal/ineligibility is on a temporary basis and ITC can be claimed on fulfilment of a condition, e.g. non-payment of supplier beyond 180 days, delayed receipt of goods, etc. The circular treats the ITC ineligible under section 17(5) as absolutely ineligible and non-reclaimable.

In this regard, it is worth referring to Rule 3(5B) of the predecessor CENVAT Credit Rules, 2004, providing for reversal of CENVAT Credit in case of write-off of the inputs, which read as under:

(5B) If the value of any,

(i) *input, or*

(ii) capital goods before being put to use, on which CENVAT credit has been taken is written off fully or partially or where any provision to write off fully or partially has been made in the books of account then the manufacturer or service provider, as the case may be, shall pay an amount equivalent to the CENVAT credit taken in respect of the said input or capital goods:

Provided *that if the said input or capital goods is subsequently used in the manufacture of final products or the provision of output services, the manufacturer or output service provider, as the case may be, shall be entitled to take the credit of the amount equivalent to the CENVAT credit paid earlier subject to the other provisions of these rules.*

The above rule which had envisaged this practical situation, clearly permitted claiming recredit of CENVAT Credit reversed earlier, if the inputs/capital goods written-off were actually used for manufacture of goods/provision of services. However, absence of similar provision allowing recredit of incorrectly written-off input/finished goods, leaves the taxpayer to fend-for themselves and evaluate alternate options.

It thus would become interesting to evaluate whether the following options can be explored:

1. Reclaim the ITC despite the absence of any specific provision. If the authorities object the recredit, defend themselves on the argument that goods are used for making output supplies and the reversal under section 17(5)(h) should be considered as temporary measure; or
2. Claim refund of the amount of ITC reversed by treating it as excess payment of tax, subject to fulfilment of the applicable conditions such as claiming refund within time limit, substantiating the compliance with unjust enrichment etc., which is an uncertain and cumbersome process.

Considering the lack of clarity in dealing with such practical scenario, the GST Council may consider introduction of a proviso to section 17(5)(h), similar to proviso to rule 3(5B) of the CENVAT Credit Rules, 2004, in order to permit recredit if the subject goods are used for making taxable supplies.