

## Rule 86A - Judicial Fetters on Administrative Arbitrariness

Sep 23, 2024



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Input Tax Credit (“ITC”) has been and continues to remain the contentious issue under GST regime and rightfully so, as the denial or restriction of credit would vitiate the foundational blocks of GST framework. The latest development that has further exacerbated this controversy to the detriment of the taxpayer is arbitrary application of the Rule 86A of CGST rules. This provision empowers the commissioner or an authorized officer to restrict the usage of the Input tax credit available in the electronic credit ledger (“ECL”) in cases where he has “reasons to believe” that ITC has been fraudulently availed or is ineligible.

Following the insertion of this provision the CBIC noting the far-reaching implications this provision could entail, issued a circular<sup>[1]</sup> cautioning the authorities to exercise this power sparingly, judiciously only when circumstances warrant. However, ostensibly the efforts of CBIC fell short, which has impelled the taxpayers to seek judicial recourse. This recourse was necessitated by the absence of an appellate mechanism within the GST framework to contest the decisions taken under rule 86A.

In some of the early judicial pronouncements on this issue<sup>[2]</sup>, the taxpayers struggled to present persuasive arguments, resulting in adversarial rulings. However, to the joy of taxpayer an interesting and a notable development has occurred in recent past. The division bench of Honorable Karnataka High court has rendered a decision providing a much-needed sigh of relief to the taxpayer<sup>[3]</sup>.

This writeup aims to dissect this judgement which has explained the operability of Rule 86A in vivid detail.

### **Facts of the case:**

In the current case, the ITC of the petitioner lying in the ECL was blocked by the proper officer basis the field report of Asst. State Tax Officer, Vasco-D-Gama, (Goa)(Co-officer). Aggrieved by this decision, the taxpayer has filed a writ petition before single judge bench of Karnataka High Court Dharwad bench.<sup>3</sup> This court has endorsed the action of the proper officer by stipulating the grant of a post decisional hearing. For being unsuccessful before single bench, the taxpayer has appealed to the division bench seeking a relief<sup>[4]</sup>. The Hon’ble court with the assistance of an amicus curiae has delineated the following issues for consideration.

1. Whether the action of the proper officer in blocking the usage of credit without granting a pre decisional hearing is justified?

Whether the proper officers had his own “reason to believe” under Rule 86A?

### **Pre conditional hearing:**

In the simplest terms, pre-conditional hearing in the context of this provision means that the proper officer must notify the concerned taxpayer and provide them an opportunity to be heard before proceeding to block the credit. Prior to advertent to the observations of Hon’ble court it is pertinent to ascertain whether rule 86A in itself stipulates the requirement of according a pre conditional hearing?

The relevant excerpt of the provision reads as under:

*“(1) The Commissioner or an officer authorized by him in this behalf, not below the rank of an Assistant Commissioner, having reasons to believe that credit of input tax available in the electronic credit ledger has been fraudulently availed or is ineligible in as much as-----”*

A bare perusal of the excerpt would distinctly reveal that the provision per se does not stipulate for such a requirement. Nonetheless, the Hon’ble court in the current case while acknowledging the absence of an express requirement in the statute has held that, since the blocking of credit would entail severe civil consequences on the taxpayers, the principles of natural justice have to be read into rule 86A.

In effect, the Hon’ble court has essentially held that the proper officer is bound to abide with the principles of natural justice before exercising the powers conferred in this rule. Put differently, *audi alteram partem* being a cornerstone of natural justice the proper officer is obligated to grant a pre decisional hearing before blocking the ITC for ensuring that a party has an opportunity to be heard.

Further, the hon’ble court in its decision has also emphasized on the distinction between pre decisional and post decisional hearing and held that the latter cannot be a substitute for former.

### **Reasons to believe:**

The second issue for consideration before the court whether the decision by the proper officer to block credit based on a communication from another officer was valid? Before, adverting to the judgement of the Hon’ble court on this aspect, it is apposite to invite the attention of readers to the circular<sup>1</sup> issued by CBIC in this regard.

Para 3.1.3 of this circular in no uncertain terms has categorically stated that the proper officer should after considering all the facts of the case and after proper application of mind should proceed for blocking the credit. Further, as an additional safeguard, para 3.3 of the circular has reiterated the requirement of rule 86A by mandating the proper officer to duly record the reasons in writing before disallowing the debit of amount from ECL.

In the instant case, as stated hereinabove the proper officer has solely relied upon the communication of the co officer in framing his opinion. Therefore, Hon’ble court has held that exercise of power under Rule 86A was irregular because the proper officer was not independently satisfied about the need for blocking the ECL rather he felt compelled to obey the command of another officer. Accordingly,, the court has annulled the decision of the proper officer in blocking the credit.

Notably, the court in its concluding paragraphs has also taken the note of the genuine hardships that would have to be met by the taxpayer for disabling the availment of credit vide this provision.

In summation, this decision of the Hon’ble court represents a watershed moment, as it has read into the necessity of abiding by the principles of natural justice in administrative decisions despite the absence of such requirement in the letter of the law. The decision to grant a Pre conditional hearing would provide a much-needed respite to bona fide taxpayers. Equally critical is the second part of the decision wherein a credence was accorded to an own opinion instead of a borrowed opinion

### **Conclusion:**

Prior to offering our concluding remarks it is prudent to take note of the rationale behind the Governments decision in inserting this provision. A reflection onto the minutes of the council meeting<sup>[5]</sup> that preceded the enactment of this rule would reveal that, the objective in inserting this provision was to curb the menace of fake invoices and the associated credit. While the intent of the Government in restricting the credit is laudable as combating the claims of illegitimate ITC is vital for seamless functioning of GST ecosystem, at the same time the interest of bona fide taxpayer is also equally significant.

In the wake of this judgement the author sincerely hopes the revenue authorities will exercise the jurisdiction conferred in this provision judiciously by granting a pre decisional hearing and desist from

mechanical application of this provision.

In any case, the Government should find a right balance between curbing fraudulent claims and protecting legitimate taxpayers for preserving the synchrony of the existing system.

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[1] [CBEC-20/16/05/2021-GST / 1552 Dated 2nd November 2021.](#)

[2] [\[TS-43-HC\(BOM\)-2022-GST\]](#)

[3] WP No. 104242 of 2023 (Karnataka High Court Dharwad Bench)

[4] K 9 Enterprises vs The State of Karnataka [\[TS-573-HC\(KAR\)-2024-GST\]](#)

[5] [Para 35.2 of minutes of 38th council meeting.](#)