Recovery of Transitional Credit Wrongly Availed and Validity of Rule 121of CGST Rules

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Off late, many show-cause notices under section 73(1) of the Central Goods and Services Tax Act, 2017 (CGST Act) read with Rule 121 of the Central Goods and Services Tax Rules, 2017 ("CGST Rules") are being issued by the GST Officers for recovery of transitional credit which are alleged to have been wrongly claimed by the taxpayers in Form TRAN-1 when the GST regime was introduced. Though there may be numerous reasons for issue of such notice viz., wrong entry in the columns in Form TRAN-1, excess claims not supported by invoices etc., however, the primary issue which arises is whether the proceedings under section 73(1) of the CGST Act r.w. Rule 121 of the CGST Rules can at all be initiated to determine and recover such excess transitional credit. Same question would also arise when proceedings are initiated under section 74 of the CGST Act or under the respective State GST Acts / UT GST Acts. However, the larger question is, if reliance is being placed upon Rule 121 of the CGST Rules by the GST Officers to trace their power to determine and recover such transitional credits wrongly availed / utilised, it begs the question whether the Rule is framed without any authority from the parent statute and therefore, valid at all.

Whether proceedings under section 73 can at all be initiated?

As stated above, the discussion will also be relevant for proceedings initiated / sought to be initiated by the GST officers under the provisions of section 74 of CGST Act or under the respective State GST Acts / UT GST Acts. However, for the purpose of this article, reference is restricted to the provisions of section 73 of the CGST Act only.

Section 73(1) reads as under:

*"**Sec. 73(1)** - Where it appears to the proper officer that any tax has not been paid or short paid or erroneously refunded, or **where input tax credit has been wrongly availed or utilised for any reason,** other than the reason of fraud or any wilful-misstatement or suppression of facts to evade tax, he shall serve notice on the person chargeable with tax which has not been so paid or which has been so short paid or to whom the refund has erroneously been made, or who has wrongly availed or utilised input tax credit, requiring him to show cause as to why he should not pay the amount specified in the notice along with interest payable thereon under section 50 and a penalty leviable under the provisions of this Act or the rules made thereunder." [Emphasis supplied]*

Section 73(1) applies in a scenario where, inter-alia, input tax credit has been wrongly availed or utilised. It need not be stated that the other instances viz., tax not paid or tax short paid or erroneous refund do not apply in the case of transitional credit availed / utilised. It is to be only considered if alleged excess transitional credit availed and utilised falls within "*input tax credit has been wrongly availed or utilised...".*

Section 2(63) of CGST Act defines "input tax credit" to mean "credit of **input tax**". The term "input tax" is defined in section 2(62) of the CGST Act as under:

"Sec.2 – Definitions

In this Act, unless the context otherwise requires,-

.....
.....

*(62) "**input tax" in relation to a registered person, means the central tax, State tax, integrated tax or Union territory tax** charged on any supply of goods or services or both made to him and includes –*

- *the integrated goods and services tax charged on import of goods;*
- *the tax payable under the provisions of sub-sections (3) and (4) of section 9;*
- *the tax payable under the provisions of sub-sections (3) and (4) of section 5 of the Integrated Goods and Services Tax Act;*
- *the tax payable under the provisions of sub-sections (3) and (4) of section 9 of the respective State Goods and Services Tax Act; or*
- *the tax payable under the provisions of sub-sections (3) and (4) of section 7 of the Union Territory Goods and Services Tax Act;*

*but does not include the tax paid under the composition levy;" **[Emphasis supplied]***

The terms "Central tax", "state tax", "integrated tax" and "Union territory tax" have been defined in section 2(21), 2(104), 2(58) and 2(115) respectively to mean the taxes levied under CGST Act, State GST Act, Integrated GST Act and Union Territory GST Act. As per section 2(62) of the CGST Act reproduced above, input tax is a Central Tax or a State Tax or an integrated tax or an Union Territory tax **charged on the supply of goods or services or both made to him** and the definition further includes other specific items. It may be noted that the 2nd part of the definition which provides for inclusion of taxes referred in clauses (a) to (e) above does not include "transitional credit under section 140".

Though each of the aforesaid enactments provides for taxation in respect of supplies under different circumstances in the respective enactments, for the purpose of this article, reliance is placed upon section 7 of the CGST Act. Section 7(1) of the CGST Act defines "supply" to include –

- all forms of supply of goods or services or both such as sale, transfer, barter, exchange, licence, rental, lease or disposal made or agreed to be made for a consideration by a person in the course or furtherance of business;
- import of services for a consideration whether or not in the course or furtherance of business; and
- the activities specified in Schedule I, made or agreed to be made without a consideration.

Thus, for an item to be considered as an "input tax", twin conditions are to be satisfied: (1) it has to be either (a) Central tax – tax levied under CGST Act; or (b) State tax - tax levied under a State GST Act; or (c) Integrated tax – tax levied under Integrated GST Act or (d) Union Territory Tax – Tax levied under Union Territory GST Act; and (2) such tax should be **charged on the supply of goods or services or both made to the person in accordance with section 7 of CGST Act or the applicable statute for the transaction**. Unless the twin conditions are satisfied, a tax cannot be said to be an "input tax". Further, the entire scheme of availing and utilising the input tax credits is governed by Chapter V of the CGST Act r.w. Chapter V of the CGST Rules. Therefore, the expression *"input tax credit availed or utilised"* used in section 73(1) refers to only input tax credit availed and utilised in accordance with the provisions of Chapter V of the CGST Act r.w Chapter V of CGST Rules and not the transitional credit claimed under section 140 of the CGST Act.

In the case of claim of transitional credit under section 140 of the CGST Act, the aforesaid conditions are not satisfied as basically, they are CENVAT credits of erstwhile indirect taxes i.e. Excise duty, service tax etc which are to be transitioned to the new GST regime, albeit satisfaction of certain conditions. Section 140 provides for transition of "eligible duties" paid / eligible for credit under the erstwhile laws. Explanation 1 and 2 define the terms "eligible duties" and "eligible duties and taxes". These are two different expressions used in section 140, however, there is no difference between the two expressions except the inclusion of "service tax leviable under section 66B of the Finance Act, 1994" under "eligible

duties and taxes". Whereas the expression "*input tax credit availed or utilised....*" used in section 73 covers only tax on the supplies made under the CGST Act and claimed in accordance with the provisions of Chapter V of the CGST Act and CGST Rules, transitional credits under section 140 are in respect of taxes paid under the erstwhile "existing laws" [defined in section 2(48) of the CGST Act]. Therefore, the claim for transition of CENVAT credit cannot be considered as "input tax credit" availed and utilised in respect of taxable supplies under this Act and therefore, determination and recovery of such transitional credit is completely out of the ambit of section 73 of CGST Act.

A question may, however, arise as to if the transitional credits cannot be treated as "input tax credit", whether the taxpayers will be justified in utilising the same in settling their liabilities arising under the GST Acts in respect of output supplies made by them. Without getting into the specifics of the provisions of section 140, it is only suffice to say at this juncture that the provisions of section 140 entitles a registered person to take credit in his electronic credit ledger the amount of CENVAT credit under the erstwhile indirect tax laws albeit satisfaction of certain conditions. Further reference in this regard can also be made to Rule 117(3) of the CGST Rules which states as under:

*"**Rule 117 - Tax or duty credit carried forward under any existing law or on goods held in stock on the appointed day***

.....

(3) The amount of credit specified in the application in FORM GST TRAN-1 shall be credited to the electronic credit ledger of the applicant maintained in FORM GST PMT-2 on the common portal."

Once such amount is credited in the electronic credit ledger in accordance with Section 140 of the CGST Act read with Rule 117 of the CGST Rules, the same can be used for making payments of output taxes in accordance with the provisions of section 49 of the CGST Act without any reference to Chapter V of the CGST Act which governs the provisions relating to input tax credits. Therefore, it is certainly arguable that the nature of "transitional credits" are different from the "input tax credits", and therefore, falls out of the ambit of section 73 of the CGST Act.

Validity of Rule 121 of CGST Rules:

After discussing that the scope of section 73 does not cover the determination of excess transitional credit availed / utilised, it now has to be seen whether Rule 121 of the CGST Rules, which provides for verification and initiation of proceedings under section 73 in respect of any excess credit availed is within the vires of the parent legislation i.e CGST Act or is made without an express statutory authority, in which case, it is ultra vires. Rule 121 of the CGST Rules states as under:

"Rule 121 – Recovery of credit wrongly availed:

The amount of credited under sub-rule (3) of rule 117 may be verified and proceedings under section 73 or, as the case may be, section 74 shall be initiated in respect of any credit wrongly availed, whether wholly or partly."

It is a settled law that if the power to legislate a particular Rule can be traced to any provision of the Parent Act, then such Rule is a valid Rule. From the discussion in the preceding paragraphs, one can be convinced that the provisions of section 73 nowhere contemplates initiation of proceedings for recovery of transitional credit. Section 164 of the CGST Act gives power to the Government to frame the Rules, pursuant to which the CGST Rules, including Rule 121, were framed and notified by the Government. Section 164 of the CGST Act reads as under:

"Sec.164 – Power of Government to make rules.

- *The Government may, on the recommendations of the Council, by notification, make rules for carrying out the provisions of this Act.*
- *Without prejudice to the generality of the provisions of sub-section (1), the Government may make rules for all or any of the matters which by this Act are required to be, or may be,*

prescribed or in respect of which provisions are to be or may be made by rules.

- *The power to make rules conferred by this section shall include the power to give retrospective effect to the rules or any of them from a date not earlier than the date on which the provisions of this Act come into force.*
- *Any rules made under sub-section (1) or sub-section (2) may provide that a contravention thereof shall be liable to a penalty not exceeding ten thousand rupees."*

Thus, under Section 164(1), the Government may frame the rules for carrying out the provisions of the CGST Act and under section 164(2), the Government may make the rules for all or any of the matters for which rules are to be or required to be prescribed by CGST Act or in respect of which provisions are to be made or may be made by the Rules. In other words, both the sub-sections do not empower the Government to expand the scope of the Act especially Section 73. The Government is conferred with the powers to frame the rules only for the purpose of carrying out the provisions of the CGST Act. In light thereof, for the purpose of carrying out the determination of taxes short paid or short levied or not paid or input tax credit wrongly availed or utilised under section 73 of the CGST Act, Rule 142 was framed which lays down the procedure to determine such taxes. However, Rule 121, on the other hand, expands the scope of section 73 as it empowers the GST Officers to initiate the proceeding under section 73 which otherwise they are not entitled to in the absence of such rule, and therefore, in my view, Rule 121, being a delegated legislation, is framed without any authority from the Parent Act and therefore, the not valid at all.

In one of the classic decisions of the Supreme Court in the case of***Assam Co ltd vs State of Assam: 248 ITR 567 (SC),*** Rule 5 of the Assam Agricultural Income-tax Rules, which empowered the State Agricultural income-tax officers to recompute the agricultural income for state tax purposes, was challenged on the ground that the Assam Agricultural Income-tax Act merely provided for assessment based on the agricultural income determined under the Income-tax Act, 1961 and did not empower the State officers to recompute the income determined under Central Act. In these circumstances, it was held as under:

*"Even under Section 50, we do not see any provision which specifically authorises the State Government to make any such Rules in the nature of the proviso to Rule 5 of the State Rules.**It is an established principle that the power to make rules under an Act is derived from the enabling provision found in such Act. Therefore, it is fundamental that a delegate on whom such power is conferred has to act within the limits of the authority conferred by the Act and it cannot enlarge the scope of the Act. A delegate cannot override the Act either by exceeding the authority or by making provision which is inconsistent with the Act. Any Rule made in exercise of such delegated power has to be in consonance with the provisions of the Act, and if the Rule goes beyond what the Act contemplates, the Rule becomes in excess of the power delegated under the Act, and if it does any of the above, the Rule becomes ultra vires of the Act. We have already noticed that none of the provisions of the Act has contemplated any power to be vested in the State officers to recompute the agricultural income from tea while proviso to Rule 5 of the Rules in specific terms empowers the State Officers to recompute the agricultural income from tea while proviso to Rule 5 of the Rules in specific terms empowers the State Officers to recompute the agricultural income from tea different from that which is computed by the Central officers under the Central Act. Thus, it is seen that this Rule is not only made beyond the rule making power of the State under S.50 of the Act but also runs counter to the object of the Act itself and enlarges the scope of the Act. The same also suffers from the other vices pointed out by us hereinabove, hence such a Rule, in our opinion, is ultra vires of the Act**. Therefore, proviso to Rule 5 of the State Rules to the extent it empowers the State Officers to recompute the agricultural income already computed by the Central Officers is ultra vires of the State Act." **[Emphasis supplied]***

In another decision of the Apex Court in the case of **Bimal Chandra Banerjee: 81 ITR 105 (SC)**, it was held as under*:*

*"**18.** No tax can be imposed by any bye-law or rule or regulation unless the statute under which the subordinate legislation is made specially authorises the imposition even if it is assumed that the power to tax can be delegated to the executive 1 he basis of the statutory power conferred by the statute cannot be transgressed by the rule-making authority. A rule-making authority has no plenary power. It has to act*

within the limits of the power granted to it.

19. ***19**. We are of the opinion that the impugned rule as well as the demands are not authorised by law."*

It was similarly held so in the following cases:

- **Mahavir Enterprises: 82 GSTR 228 (Guj HC)** – "*A rule under delegated legislation can be held to be ultra vires the statutory provisions of the Act if it is shown that (i) it is beyond the scope of or in excess of the rule-making power of the delegate conferred under the Act, or (ii) it is in conflict with or repugnant to any enactment in the Act.*"

- **All India Lakshmi Bank Officer's Union vs UoI: 150 ITR 1 (Del HC)** – "*Rules under the statute may be treated for all purposes of construction or obligation exactly as if they were in the Act and are to be of the same effect. But the rules cannot travel beyond the Act and have to be read subject to its provisions. ..... Recourse also cannot be had to the rules made under the authority of the Act for the purpose of construing the provisions of the statute except where the construction of a statute may be ambiguous or doubtful and a particular construction has been put upon the Act by the Rules."*

As held by the Apex Court in the case of**ITW Signode India Ltd vs. Collector of Central Excise: 158 ELT 303 (SC)**, "*It is a well-settled principle of law that in case of a conflict between a substantive act and delegated legislation, the former shall prevail inasmuch as delegated legislation must be read in the context of the primary/legislative act and not the vice-versa."* Therefore, Rule 121 cannot empower an officer to initiate the proceedings under section 73, rather, power has to vested under section 73, pursuant to which the Rules are to be framed and read.

It may also be pertinent to refer to the decision of the Patna High Court in the case of**Commercial Steel Engineering Corporation vs State of Bihar: 28 GSTL 579 (Pat HC),** wherein, **t**he question arose whether the proceedings under section 73 of the Bihar GST Act (pari materia to Section 73 of the CGST Act) can be initiated when the transitional credit is claimed and credited to the electronic credit ledger and not availed or utilised by the taxpayer. It was held by the High Court that the proceedings cannot be initiated unless there is a positive act of availment of credit in the monthly returns filed by the taxpayer and that mere credit in the electronic credit ledger on submission of Form TRAN-1 does not entitle the Department to initiate the proceedings. While holding so, it was observed by the High Court that *"The legislative intent reflected from a purposeful reading of the provisions underlying section 140 alongside the provisions of section 73 and Rules 117 and 121 is that even a wrongly reflected transitional credit in an electronic ledger on its own is not sufficient to draw penal proceedings until the same or any portion thereof, is put to use so as to become recoverable."* This observation by the High Court should not be construed to mean that the High Court has rendered a decision on the validity of Rule 121 per se. The question whether Rule 121 of BGST Rules (pari materia to Rule 121 of CGST Rules) was ultra vires the provisions of section 73 of BGST Act or not was neither raised nor considered by the High Court.

Conclusion:

While this is not the first time that the Government has framed a delegated legislation without an express authority, yet, unless and until the validity of the same is decided by a Competent Court of law, the GST officers will enforce Rule 121 and thereby, issue notices and take every step possible to recover any excess transitional credit availed or utilised by the taxpayers. Of course, availing excess transitional credit beyond what the taxpayers are entitled to is certainly not right and ought to be recovered by the Revenue, however, such recovery process can be put in motion only if a power is conferred on such officers by a valid law as otherwise, it would be in violation of Article 265 of Constitution of India which states, "*No tax shall be levied or collected except by authority of law*".