TRILEGAL

Indirect Tax Updates

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This update covers:

1 Goods and Services Tax

This update covers key judicial decisions relating to GST, sales tax, service tax and customs.

Jharkhand High Court quashes Show Cause Notice due to insufficiency of details of contravention; holds summary of Show Cause Notice in Form DRC-01 cannot substitute requirement of a proper Show Cause Notice

The Jharkhand High Court in *NKAS Services Pvt. Ltd. v State of Jharkhand* has quashed the Show Cause Notice issued under Section 73 of Jharkhand Goods and Services Tax Act, 2017 (**JGST Act**) and summary of Show Cause Notice issued to the assessee in Form DRC-01 under Rule 142(1)(a) of the Jharkhand Goods and Services Tax Rules, 2017 (**JGST Rules**) on the ground that they did not fulfil the ingredients of a proper Show Cause Notice and thus, amounted to violation of principles of natural justice.

The High Court observed that the Show Cause Notice was issued without stating any contravention committed by the assessee. Even Form DRC-01 did not disclose the complete material basis for the tax demand. Further, the High Court noted that while Form DRC-01 did not mention or indicate the contravention by the Petitioner, even otherwise a summary of Show Cause Notice in Form DRC-01 could not have substituted the requirement of a proper Show Cause Notice which needs to specify the grounds for proceeding against a person for imposition of tax, interest or penalty.

This decision is important as under the GST regime, the tax department has been proposing to raise tax demand without mentioning the details of violation committed by the taxpayers in the Show Cause Notice. The tax department has been briefly indicating the grounds for proposing to raise tax demands in summary Form DRC-01. However, as per the judgment, this is not sufficient as it does not provide a material basis to the assessee to defend itself.

Input tax credit can be blocked only when there is balance in Electronic Credit Ledger; blocking future credit that is yet to be availed through a negative balance is not possible

The Gujarat High Court in *Samay Alloy v State of Gujarat* has held that under Rule 86A of the Central Goods and Services Tax Rules, 2017 (**CGST Rules**), the input tax credit (**ITC**) can be blocked only when credit is available in Electronic Credit Ledger (**ECL**) and that under this rule, there is no power with the authorities to negatively block credit to be availed in future.

The High Court noted that the power to freeze the debit in ECL under Rule 86A can be exercised when (i) credit of input tax is available in ECL, (ii) there are reasons to believe that such credit has been fraudulently availed or is ineligible and (iii) such reasons are recorded in writing. The Court thus held that where the credit of input tax is not available in the ECL, the powers under Rule 86A cannot be invoked to disallow registered person to debit ECL as this would tantamount to permanent recovery of input tax credit. The High Court held that Rule 86A has not been framed to recover ITC which may have been fraudulently availed. In case of fraudulent availment or utilisation of ITC, the appropriate recourse was initiation of appropriate proceedings under Section 73 or Section 74 (pertaining to determination of tax for reasons other than fraud or for reasons of fraud respectively).

The High Court observed that once ITC is claimed in the ECL, it becomes part of one fungible pool and such ITC cannot be separately identified and therefore, Rule 86A provides restriction on an equivalent amount and not on the credit itself. The High Court held that the said rule presupposes existence of credit in the ECL and therefore, only if credit balance is available in the ECL, then for the reasons to be recorded in writing, the debit of amount equal to the ineligible/ fraudulently availed credit may not be allowed.

Given that the power to block ITC under Rule 86A is very severe, this decision will help the businesses against negative blocking of credit by the tax department, which can amount to summary recovery by the tax department without following the due process provided under the statute.

2 Sales Tax

Supreme Court denies tax exemption on raw materials not used directly for conducting manufacturing activities

The Supreme Court in *State of Gujarat v Arcelor Mittal Nippon Steel India Pvt. Ltd*. denied the exemption of purchase tax to a dealer who had not used the raw materials directly in its manufacturing activities as the relevant entry of the exemption notification prescribed actual use of the goods purchased.

An exemption was granted by government of Gujarat from payment of purchase tax on raw materials such as (i) Naptha and (ii) Natural Gas. Such exemption was made available to steel manufacturing units only but not to units engaged in generation of electricity. However, the dealer-respondent, upon purchasing Naptha and Natural Gas, sold the same to another dealer for generation of electricity. The electricity was thereafter purchased by the dealer-respondent and used for carrying out manufacturing of steel products.

The Supreme Court noted that the state government had granted exemption from payment of purchase tax for eligible units to use the raw materials for manufacturing of goods. The Court observed that the relevant entry of the exemption notification did not provide that eligible unit, after purchase of raw materials, instead of using the same itself, could transfer the raw materials to another unit and such other unit could use the raw materials.

Noting that the exemption notifications have to be construed strictly, the Supreme Court held that the intention of the state government was to provide exemption under the incentive policy only to eligible units. Accordingly, the Court rejected the contention of the dealer-respondent that Naptha and Natural Gas were ultimately used by it for carrying out its manufacturing activity. The Court held that by not using the raw materials itself, the dealer-respondent had violated the requirement of the exemption notification.

This serves as a reminder to businesses that they should factor in the conditions prescribed under exemption notifications, such as the actual user condition, as the courts are inclined towards interpreting such notifications strictly.

3 Service Tax

Supreme Court denies tax exemption upon wholesome reading of underlying agreement

The Supreme Court in *Adiraj Manpower Services Pvt. Ltd. v Commissioner of Central Excise, Pune -II* has upheld the decision of the Central Excise, Customs and Service Tax Tribunal thereby denying the service tax exemption to the assessee who had availed benefit under the category of job work services.

The Court held that while the exemption notification provided exemption from service tax on 'carrying out intermediate process as job work', the assessee was not a job worker as the underlying agreement pertained to supply of manpower. It stated that agreements have to be read as composite whole and that upon such wholesome reading, it was apparent that the contract was a pure and simple contract for provision of contract labour, which was not eligible for exemption from service tax.

This decision is important as many a times businesses, with a view to reduce tax costs, adopt positions based on narrow reading of the contracts. However, the courts may examine the entire agreement to determine the true nature of the transaction and the taxability thereof.

4 Customs

Provisions of limitation and unjust enrichment applicable to refund of security deposited during provisional assessment of duty

The Central Excise, Customs and Service Tax Tribunal (CESTAT), Ahmedabad in *Nirma Limited v Commissioner of Customs, Jamnagar* has held that an amount deposited as security at the time of provisional assessment of duty is not a deposit but duty and therefore, the refund thereof will be governed by Section 27 of the Customs Act, 1962 (Customs Act) which deals with claim for refund of duty.

In the present case, the importer had paid security under protest for provisional assessment of its bills of entry. Subsequently, the bills of entry were assessed and the entire duty paid during provisional assessment was adjusted and appropriated as finally assessed duty. Thereafter, the importer sought refund of security amount which was deposited at the time of provisional assessment. The refund claim was rejected by the Customs authorities on the ground of limitation as well as unjust enrichment.

The CESTAT, upon examination of the bond executed by the importer at the time of provisional assessment of the goods as well as the payment challan, noted that the security amount had been paid by the importer as differential customs duty and therefore, the refund sought by the importer was of a duty and not a deposit. Accordingly, the CESTAT held that the refund was governed by Section 27 of the Customs Act and provisions pertaining to limitation and unjust enrichment were applicable thereto.

In light of this decision, importers need to be mindful of the limitation period at the time of filing of refund for any security amount paid at the time of provisional assessment of duty. Importers will also need to establish that incidence of tax has not been transferred to a third party and has been borne by them only.