

“Rule 86A of CGST Rules 2017- An Analysis”

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ABSTRACT

Rule 86A in Central Goods and Services Tax Rules was introduced in reference to the notification no. 75/2019 with effect from 26.12.2019, which empowers the revenue to impose additional restriction on use of amount of Input Tax Credit which is available in the electronic credit ledger. Rule 86A has given extremely serious powers to the department so as to restrict the credit of any person in certain cases where it can be believed that Input Tax Credit was availed fraudulently and is ineligible. Recently, we have seen lots of cases where practice of blocking the credit of a person merely by way of computer entry on the common GST portal, on one or any other reasons without any justification for such action. Whereas, Gujarat High Court in the case of *Valeurius Industries Vs. Union of India*¹, had laid down that blocking of credit by way of mere computer entry is absolutely illegal.

KEY WORDS

CGST Rules, Input Tax Credit, Credit ledger, Blocking, Justificationa

INTRODUCTION

One of the objectives of the Goods and Services Tax regime was the seamless flow of credit from one state to another in the chain of the value addition and to avoid the gush effect of tax. Thus, after two and a half years of the introduction of GST Act, the objectives and the motive of the Act, seems to be very far away from the grim reality. In the recent times, the government has excavated lots of cases of fake Input Tax Credit, due to issuance of fake invoices, issuance of invoices without supply and some other fraudulent activities, which has led to deduction in revenues of the exchequer. Thus, to build such gaps, it introduced the concept of blocking of Input Tax Credit by the way of rule 86A of the CGST Rules, 2017. Though the above mentioned rule was introduced the motive of estopping such fraud activities, it is very important to understand and analyse whether said Rule would truly live up to the expectations of the Government or presents itself with issues which would ultimately be raised by taxpayers before various Judicial forums of the Nation.

RULE 86A- Conditions of use of amount available in electronic credit ledger-

(1) *“Commissioner or an officer authorised 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:*

¹ Decided on August 28, 2019.

a) the credit of input tax has been availed on the strength of tax invoices or debit notes or any other document prescribed under rule 36-

i. issued by a registered person who has been found non-existent or not to be conducting any business from any place for which registration has been obtained; or

ii. without receipt of goods or services or both; or

b) the credit of input tax has been availed on the strength of tax invoices or debit notes or any other document prescribed under rule 36 in respect of any supply, the tax charged in respect of which has not been paid to the Government; or

c) the registered person availing the credit of input tax has been found non-existent or not to be conducting any business from any place for which registration has been obtained; or

d) the registered person availing any credit of input tax is not in possession of a tax invoice or debit note or any other document prescribed under rule 36,

may, for reasons to be recorded in writing, not allow debit of an amount equivalent to such credit in electronic credit ledger for discharge of any liability under section 49 or for claim of any refund of any unutilised amount.”

(2) The Commissioner, or the officer authorised by him under sub-rule (1) may, upon being satisfied that conditions for disallowing debit of electronic credit ledger as above, no longer exist, allow such debit.

(3) Such restriction shall cease to have effect after the expiry of a period of one year from the date of imposing such restriction.

Whereas, as mentioned above, in the recent Judgment before the Hon'ble High Court of Gujarat in *Valerius Case*², the issue was regarding blocking of Input Tax Credit that whether it can be blocked or not without issuing a proper show cause notice and opportunity of hearing where it was held that it would be illegal if the same was done, But the decision was given prior to the introduction of Rule 86A, of CGST Rules.

ANALYSIS OF THE RULE

- Supplier found non-existent or not conducting business on its registered place- It has been availed on the basis of documents prescribed under Rule 36 i.e. tax invoice, debit note etc issued by a registered supplier who has been found non-existent or not to be conducting any business from any place for which registration has been obtained.
- Non receipt of goods or services or both: It has been availed on the basis of documents prescribed under Rule 36 i.e. tax invoice, debit note etc without receipt of goods or services or both.

² Supra Note 1.

- Tax not paid into the Government treasury: It has been availed on the basis of documents prescribed against which no tax has been paid into the Government treasury.
- Recipient found non-existent or not conducting business on its registered place: It has been availed on the basis of documents prescribed under Rule 36 i.e. tax invoice, debit note etc issued by a registered person availing the credit (i.e. recipient) who has been found non-existent or not to be conducting any business from any place for which registration has been obtained.
- Availing of credit without documents: The registered person availing any credit of input tax is not in possession of a tax invoice or debit note or any other document prescribed under rule 36.

ASSISTANT COMMISSIONER- POWERS

Though the Assistant Commissioner is entitled to block the ITC, he has no jurisdiction to inspect the statements of accounts as because Rule 86 A of the Act, clearly states that the commissioner has to give in writing and state the reasons for his cause of action. If the Assistant Commissioner did not show any letter of authorisation and the taxpayer was not given the show cause notice for the inspection. Having failed so, to provide with the reasons for his action, the Assistant Commissioner has no authority to proceed further with the inspection and blocking the Input Tax Credit of the client.

In the case of *Savan Retailers Private Limited v. Union of India*³ reported in, Delhi, the appellants filed a Writ Petition to unblock the input tax credit of the petitioner with a prayer to issue direction to the Department to unblock Input Tax Credit (ITC) of the petitioner which has been blocked by it without any reasons and without issuing any show cause notice or granting any opportunity of hearing to them. In this case notice was issued.

Similarly, in the case of *Alfa Industries v. State of Gujarat*⁴, in a proceeding under Section 83, among others, where the authorities blocked the input tax credit available in the ECL of the applicant. It was held that the authorities cannot block the input tax credit by making a computer entry not justified in the absence of any statutory provision to that effect. However, before exercising this power reasons must be recorded in writing.

CONSTITUTIONAL VALIDITY OF THE RULE 86A

Stating for the stance that the Rule 86A is unconstitutional, the author would like to mention few reasons to support the stance. The reasons are as follows:

- **Principles of Natural Justice:** Whenever any right of a taxpayer is curtailed or a demand is to be raised against such taxpayer, an opportunity of being heard must be afforded to the taxpayer before raising the demand or taking away the right. As per the Rule 86A, the empowered officer is not required to give the assessee an

³ 2020 (32) G.S.T.L. J41

⁴ 2019 (31) G.S.T.L 592

opportunity of being heard before blocking of the ITC, which is a right of the assessee under the CGST Act. It has been held in a catena of judgements that an opportunity of personal hearing or representation is required to be given to the assessee in circumstances wherein their legal or vested rights have been curtailed or taken away, even in the cases where the express provision contained in the statute does not require it to do so.

The Hon'ble Supreme Court in the case of *Kesar Enterprises Ltd*⁵, relying on an earlier judgement in the case of *Swadeshi Cotton Mills v/s Union of India*⁶, Supreme Court has held that the Principles of Natural Justice require that an opportunity of being heard is afforded to the assessee before passing an order irrespective of whether the requirement of hearing has been mandated in the law or not. Therefore, the operation of Rule 86A in itself tantamount to violation of Principles of Natural Justice insofar as it does not mandate that an opportunity be given to the assessee to be heard before the ITC is blocked and therefore, any action taken by the Department arbitrarily under said Rule is in violation of Principle of Natural Justice.

- **Provisions of Section 164 and 49(4) of the CGST Act, 2017:** Section 164 of CGST Act gives the Government the power to make Rules for carrying out the provisions of the CGST Act as prescribed therein. Notification 75/2019 – C.T. which notifies Rule 86A has been issued by the Government under the powers conferred under Section 164 of the CGST Act.

As stated hereinabove, there is no provision under the CGST Act which specifically allows the Government to restrict the right to ITC of the assessee by resorting to blocking of the same on the common portal. Therefore, introduction of Rule 86A by using the powers under Section 164 is clearly ultra vires the powers conferred under Section 164. Section 49 of the CGST Act, as evident from its heading itself, specifically deals with manner of payment of tax, interest, penalty and other amounts. Thus, it is imperative to note that this section only deals with the manner in which the GST and other associated liabilities of the assessee are to be discharged.

Thus, the power to prescribe conditions for blocking of ITC by introduction of Rule 86A does not flow from Section 49 (4) or for that matter, Section 49A or any other section of the CGST Act as well. Thus, Rule 86A of the CGST Rules appears to be running ultra vires to the provisions of the CGST Act and accordingly, is required to be struck down.

- **The flow of various returns and modifying details by counter-party, as envisaged under GST law, have not been implemented.** In such a scenario, restricting tax credit for deficiencies in auto-populated details in purchase returns (GSTR-2A) of buyer based on outward supply return of seller appears to be on a weak wicket. This has come as an additional burden as many taxpayers are being issued letter-cum-notices to reverse credit taken for mismatch between purchase returns and monthly

⁵ 2012 (12) TMI 828

⁶ 1981 (1) TMI 250

summary returns. Even when goods and services have been received and tax invoices are available with the buyer, for absence of details in auto-populated return, reversal of credit is insisted. This has no legal sanction and businesses suffer immensely due to such action.

CONCLUSION

Rule 86A has been brought to check fake invoicing and fraudulent availment of credit. This rule provides liberty to the officer to block input tax credit in some circumstances. Thus, the following rule puts fake practices adopted by supplier and lack of due diligence by buyer in the same perspective. Credit can be blocked by the department if buyers fail to ensure that their suppliers have paid tax as shown in the invoices.

GST law provides for compliance rating, and it has not been implemented. The buyer has not been provided with any facility by which he can scrutinize the compliance behaviour of the seller. In this backdrop, neither can the buyer be asked to share burden of the department to verify compliances of assesses nor is the buyer equipped with resources to undertake such verification with all her suppliers. Issuing tax invoice without supply of goods to facilitate fraudulent availment of credit cannot be put on par with inability of the buyer to check compliance of seller. Such rough edges in the new provisions need to be ironed out so that the compliant taxpayers are allowed to do business using rightfully earned tax credits without hassle.

As Rule 86A is concerned, in addition to the fact that there is no procedure prescribed for the authorities or for the registered person, the legality of the said provision itself is questionable, since, there is no Section under the CGST Act, which enables the enactment of the said Rule in the first place. In fact, Rule 86A comes into operation only in cases involving fraudulent availment of credit and seeks to bypass the process of adjudication contemplated under Section 73 of the CGST Act. In terms of the long-standing jurisprudence under the erstwhile laws, it is held that the credit lying in assesses account creates infallible and indefeasible right. Hence, the registered person cannot be divested of this right. Therefore, it is open to challenge the constitutional validity of Rule 86A of the CGST Rules.

With this rule a tax payer have to be very cautious about the selection of supplier. It has to make proper due diligence of the supplier before executing any transaction otherwise he will be in trouble. In my opinion in every case it would not be possible for the tax payer to carry out such due diligence due to various factors like cost, time etc. The government should come with a provision so that innocent tax payer would not suffer at the cost of defaulting supplier otherwise whole idea of creating atmosphere of ease of doing business with the introduction of GST would fail.