Articles

ADJUDICATION/VERIFICATION OF TRANSITIONAL CREDIT : ANOTHER FERTILE GROUND FOR LITIGATION

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The Goods and Services Tax (GST) regime has completed three years since its implementation. Despite the efforts made by the Government in these years, a lot more is still to be done. The major litigation under GST, seen repetitively before the various Courts has been pertaining to the carry forward of transitional credit. The said dispute stands unresolved even as the fourth year of the GST implementation has begun.

Verification of the transitional credit carried forward by the taxpayers into the GST regime, has already been initiated by the GST Authorities. An important issue that needs to be addressed is that whether the GST Authorities have the power to adjudicate/verify and recover the transitional credit wrongly availed by the taxpayers in Form TRAN-1/TRAN-2 *(Form for carry forward of transitional credit).*

Chapter XX *(Section 139 - Section 142)* of the Central Goods and Services Tax Act, 2017 (CGST Act), deals with Transitional Provisions. Section 140 of the CGST Act provides for *"Transitional Arrangements for Input Tax Credit"*. On perusal of the same, it appears that such provision, does not empower the GST Authorities to adjudicate/verify and recover the transitional credit wrongly availed by the taxpayers.

Furthermore, Chapter XIV of the Central Goods and Services Tax Rules, 2017 (CGST Rules), contains rules with respect to transitional provisions. In this regard, it is pertinent to note that, Rule 121 of CGST Rules deals with *"Recovery of Credit Wrongly Availed"*, which reads as under :

> **"Rule 121. Recovery of credit wrongly availed. -** The amount 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."*

On perusal of the above, it may be worthwhile to note that such rule empowers the GST Authorities to adjudicate/verify the transitional credit availed by the taxpayers. The said rule also provides for initiation of proceedings under Section 73 or

Section 74 of the CGST Act. Such proceedings can be initiated in respect of any transitional credit wrongly availed, whether wholly or partly.

However, as discussed supra, Section 140 of the CGST Act, does not empower the GST Authorities to adjudicate/verify and recover the transitional credit wrongly availed by the taxpayers.

Section 73 of the CGST Act provides for *"determination of tax not paid or short paid or erroneously refunded or input tax credit wrongly availed or utilised for any reason other than fraud or any wilful misstatement or suppression of facts"*. The relevant extract of the same are us under :

> (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.

Similar provisions are also contained under Section 74, which provides for *"determination of tax not paid or short paid or erroneously refunded or input tax credit wrongly availed or utilised by reason of fraud or any wilful misstatement or suppression of facts"*.

Basis above, it is pertinent to note that adjudication proceedings under Section 73 or Section 74, may be initiated in the following circumstances :

(i) Tax has not been paid or short paid;

(ii) Tax has been erroneously refunded; or

(iii) Input tax credit has been wrongly availed or utilised.

Therefore, it is important to ascertain that whether the transitional credit wrongly availed, falls within the purview of the aforesaid circumstances or not.

In this regard, the adjudication of transitional credit wrongly availed is clearly not the case of determination of *tax not paid or short paid,* as the same relates to *output tax.* Further, there is no provision of refund of transitional credit under the GST Legislation, and thus, adjudication of transitional credit wrongly availed, cannot be held to be within the ambit of tax erroneously refund.

Hence, the only question that remains to be answered is that, whether adjudication of transitional credit wrongly availed can be equated with *"input tax credit wrongly availed or utilised"*.

The term "input tax" and "input tax credit" has been defined under Section 2(62) and Section 2(63) of the CGST Act, respectively. The said definitions have been reproduced below for ready reference :

> *Section 2(62)*
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> "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 -
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> (a) the integrated goods and services tax charged on import of goods;
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> (b) the tax payable under the provisions of sub-sections (3) and (4) of section 9;

(c) the tax payable under the provisions of sub-section (3) and (4) of section 5 of the Integrated Goods and Services Tax Act;

(d) the tax payable under the provisions of sub-section (3) and sub-section (4) of section 9 of the respective State Goods and Services Tax Act; or

(e) the tax payable under the provisions of sub-section (3) and sub-section (4) of section 7 of the Union Territory Goods and Services Tax Act,

but does not include the tax paid under the composition levy;

Section 2(63)

"input tax credit" means the credit of input tax;

On perusal of the above definitions, it appears that definition of "input tax" read with "input tax credit", only includes the tax which has been charged on the supply of goods or services or both. However, the transitional credit is not the tax charged on any supply of goods or services or both and thus, it does not fall within the definition of input tax" read with "input tax credit".

Therefore, the transitional credit wrongly availed is not covered within the ambit of the ingredients required to initiate the proceedings under Section 73 or Section 74 of the CGST Act.

Hence, it may be contested that adjudication/verification of transitional credit wrongly availed, cannot be undertaken by initiating proceedings under Section 73 or Section 74 of the CGST Act,

Furthermore, it is worthwhile to note that Rule 121 has been formulated by exercising the power conferred by Section 164 *(Power of Government to Make Rules)* of the CGST Act, which reads as under :

"164. Power of Government to make rules. - (1) The Government may, on the recommendations of the Council, by notification, *make rules for carrying out the provisions of this Act.*

(2) 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.*

(3) 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.*

(4) 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."*

On perusal of the above provisions, it appears that Section 164(1), provides for the power of Government to make rules for carrying out the provisions of CGST Act. Section 164(2) empowers the Government to make rules for any matters which are required to be done under the CGST Act.

Therefore, for formulating the rules with regard to adjudication/verification of transitional credit, there must be some provision which has been incorporated in the substantive legislation. However, there is no such provision in the CGST Act, which empowers the GST Authorities to adjudicate/verify and recover the transitional credit wrongly availed by taxpayers.

Furthermore, Section 164(3) and Section 164(4) of the CGST Act, deals with the power of Government to give a retrospective effect to the rules or to impose a penalty on contravention. Albeit, the said provisions are not relevant with regard to adjudication/verification of transitional credit wrongly availed by the taxpayers.

Hence, it can be contested that Rule 121 of CGST Rules does not derive its validity from Section 164 of the CGST Act and the same has not been formulated to give effect to any provisions of the CGST Act.

It is a settled principle of law that *"rules or procedural law cannot override the substantive law"*. In this regard, the Hon'ble Supreme Court in the judgment of *Babaji Kondaji Garad* v. *Nasik Merchants Co-Operative Bank Ltd.* [(1984) 2 SCC 50], has observed that rules cannot go beyond the statute :

> "Now if there is any conflict between a statute and the subordinate legislation, it does not require elaborate reasoning to firmly state that the *statute prevails over subordinate legislation* and the bye-law if not in conformity with the statute in order to give effect to the statutory provision the rule or bye-law has to be ignored. *The statutory provision has precedence and must be complied with."*

Furthermore, it was held by the Hon'ble Supreme Court in the judgment of *General Officer Commanding-in-Chief* v. *Dr. Subhash Chandra Yadav* [(1988) 2 SCC 351], that a rule must conform to the provisions of the statute under which it is framed :

> "…….It is well settled *that rules framed under the provisions of a statute form part of the statute.* In other words, rules have statutory force. But before a rule can have the effect of a statutory provision, two conditions must be fulfilled, namely, (1) it *must conform to the provisions of the statute under which it is framed;* and (2) it *must also come within the scope and purview of the rule making power of the authority framing the rule.* If either of these two conditions is not fulfilled, the rule so framed would be void……"

Also, in *Union of India* v. *S. Srinivasan* [2012 (281) E.L.T. 3 (S.C.)], the Hon'ble Apex Court in Para 16 and Para 21 has held that :

> "16. …….. if a *rule goes beyond the rule-making power conferred by the statute, the same has to be declared ultra vires…….*".
>
> "21…..a regulation is a rule or order prescribed by a superior for the management of some business and implies a rule for general course of action. Rules and Regulations are all comprised in delegated legislation. *The power to make subordinate legislation is derived from the enabling Act and it is fundamental that the delegate on whom such a power is conferred has to act within the limit of authority conferred by the Act. Rules cannot be made to supplant the provisions of the enabling Act but to supplement it.* What is permitted is the delegation of ancillary or subordinate legislative functions, or, what is fictionally called, a power to fill up details."

Accordingly, it can be very well contested that Rule 121 does not derive its power from the substantive legislation. The same has not been formulated to give effect to any provisions of the CGST Act, as there is no provision which provides for adjudication or verification of transitional credit wrongly availed by the taxpayers.

Conclusion

On the above analysis, there appears to be a gap between Rule 121 and Section 73/Section 74. Further, Rule 121 does not derive its power from any of the provisions of the CGST Act.

Therefore, in the ensuing times, it is likely that the validity of Rule 121 may be challenged before the Courts and the same may be declared as *ultra vires* to the provisions of the CGST Act, unless an amendment is made in the provisions of the enabling Act itself.