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Blocking of ITC without Investigation – Unlawful



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Abstract:

The introduction of the Goods and Services Tax (hereinafter referred as "**GST**") regime, implemented in India in 2017, marked a significant reform in the country's taxation system. One of the key components of this reform is the Input Tax Credit (ITC)¹ mechanism, which allows businesses to offset the tax paid on inputs against the tax liability on outputs, thereby reducing the overall tax burden. However, recent instances of blocking ITC without proper investigation have raised concerns about the legality and fairness of such actions. This article aims to analyse the meaning of Input Tax, eligibility and condition of taking ITC along with legal implications of blocking ITC without investigation.

Understanding Input Tax Credit (ITC)

Before delving into the legal aspects, it is essential to grasp the concept of ITC under The Central Goods & Services Tax Act, 2017 (hereinafter referred as "**CGST**") which defines Input Tax under Section [2\(62\)](#)² which states that "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 receipt him and includes

- (a) The integrated goods and services tax charged on import of goods³;
- (b) The tax payable under the provisions of sub-sections (3) and (4) of section [94](#);
- (c) The tax payable under the provisions of sub-sections (3) and (4) of section [5](#) of the Integrated Goods and Services Tax Act (hereinafter referred as "**IGST**")⁵;
- (d) The tax payable under the provisions of sub-sections (3) and (4) of section 9 of the respective State Goods and Services Tax Act; or⁶
- (e) 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 levy⁷.

According to Section [16](#) of the CGST Act, 2017⁸, which deals with the-

Eligibility for ITC: A registered person is eligible to claim ITC on the goods or services received by them, which are used or intended to be used for business purposes.⁹

Conditions for claiming ITC: The following conditions must be met to claim ITC:

- (a) Possession of tax invoice or debit note: The registered person must possess a valid tax invoice or debit note issued by the supplier.
- (b) Receipt of goods or services: The registered person must have received the goods or services.
- (c) Payment of tax: The tax due on such goods or services must have been paid to the government by the supplier.
- (d) Furnishing of return: The registered person must have furnished the required GST returns.¹⁰

Time limit for claiming ITC: The ITC can be claimed by the recipient in their electronic credit ledger within the due date of furnishing the return for the month of September following the end of the financial year to which the invoice pertains or the date of filing the annual return, whichever is earlier.¹¹

As per Rule [37](#) of CGST Rules, 2017¹² which states the provision regarding Reversal of ITC, if the recipient fails to pay the supplier within 180 days from the date of issue of the invoice, the ITC claimed earlier will be added to their output tax liability along with interest.

The Legal Implications of Blocking ITC without Investigation:

As per Section [17](#) of CGST Act,¹³ encompass provisions that grant the adjudicating authority¹⁴ the power to block or restrict ITC under certain prescribed conditions-

- (1) ITC cannot be claimed for goods or services used for personal purposes, exempt supplies, or supplies that are not part of the business activities.¹⁵
- (2) ITC is not allowed for certain goods or services, such as motor vehicles and other conveyances, unless they are used for specific purposes as prescribed.¹⁶
- (3) ITC is restricted for works contracts when they relate to the construction of immovable property (other than plant and machinery) unless it is used for further supply of works contract service.¹⁷
- (4) If a registered person opts for the composition scheme, they are not eligible to claim ITC.¹⁸

As per **Circular No. CBEC-20/16/05/2021-GST / 1552 Dated 2nd November, 2021**, Rule 86A provides that in certain circumstances, Commissioner or an officer authorised by him, on the basis of reasonable belief that credit of input tax available in the electronic credit ledger has been fraudulently availed or is ineligible, may not allow debit of an amount equivalent to such credit in electronic credit ledger¹⁹.

While the CGST Act allows for the denial or blocking of ITC under specific circumstances, it is crucial to note that such denial must be based on the "Reason to believe", such "Reasons to believe" shall be duly recorded by the concerned officer in writing on file, before he proceeds to disallow debit of amount from electronic credit ledger of the said person. In the absence of proper reasons to believe, the invocation of Rule 86A²⁰ would be malafide as it is essential to ensure that taxpayers are given an opportunity to present their case and provide necessary evidence before their ITC is blocked.²¹ The restriction imposed as per sub-rule (1) of rule 86A shall cease to have effect after the expiry of a period of one year from the date of imposing such restriction.

The Hon'ble Delhi High Court in "**Parity Infotech Solutions (P.) Ltd. v. Government of National Capital Territory of Delhi**" [\[2023\] 151 taxmann.com 349/75 GSTL 329/98 GST 840](#) held that "the ITC in the Electronic Credit Ledger cannot be blocked unless the competent officer has reasons to believe that the conditions in the said clauses are satisfied or the ITC was fraudulently availed. The directive to issue a show cause notice proposing to create a demand by disallowing the ITC and thereafter, creating a demand cannot be read in isolation and in disregard of the provisions of the Act and the Rules." ²²

The practice of blocking ITC without conducting a thorough investigation raises several legal and ethical implications-

- (1) **Violation of Natural Justice:** Blocking ITC without investigation infringes upon the principles of natural justice, which include the right to be heard and the right to a fair and impartial decision-making process. Natural justice requires that any decision affecting the rights of individuals must be made after giving them a reasonable opportunity to present their case. As per Section [126\(3\)](#) of the CGST Act, 2017, "No penalty shall be imposed on any person without giving him an opportunity of being heard"²³, Therefore Blocking ITC without investigation denies taxpayers this fundamental right and undermines the fairness and integrity of the tax administration.
- (2) **Arbitrary Exercise of Power :** Blocking ITC without investigation can be seen as an arbitrary exercise of power by the tax authorities. The power to block ITC should be exercised judiciously and in accordance with the law. Arbitrary actions not only violate the rights of taxpayers but also erode public trust in the tax administration. It is essential for tax authorities to act within the confines of the law and provide valid reasons for blocking ITC, supported by evidence. Various judicial decisions have emphasized the importance of fair and reasonable exercise of power by tax authorities. In the case of **Commissioner of Customs (Import) v. Dilip Kumar & Co.**²⁴, the Hon'ble Supreme Court of India held that arbitrary exercise of power by authorities is not permissible and violates the principles of natural justice.
- (3) **Adverse Impact on Businesses:** Blocking ITC without investigation can have severe consequences for businesses. It disrupts cash flow, increases the cost of compliance, and hampers the ability of businesses to compete in the market. Small and medium-sized enterprises (SMEs) are particularly vulnerable to such actions, as they heavily rely on ITC to manage their working capital and remain competitive. Unjust blocking of ITC can lead to financial distress and hinder the growth of businesses. It is crucial to strike a balance between tax administration and the smooth functioning of businesses. In the case of **Megha Engg. & Infrastructures Ltd. v. Commissioner of Central Tax**²⁵, the Telangana High Court held that blocking ITC without conducting a thorough investigation is not justified and can have serious repercussions for businesses

Recommendations:

To address the issue of unlawful blocking of ITC without investigation, the following recommendations are proposed:

Clarity in Rules & Regulations: The CGST Act, 2017 empowers the government to prescribe rules and procedures for various aspects of GST, including the blocking of ITC. Section [164](#)²⁶ of the GST Act allows the government to make rules to carry out the provisions of the Act. By providing clear guidelines and procedures, the government ensures that the blocking of ITC is done in a transparent and consistent manner, promoting fairness and accountability. In the case of **Union of India v. R. Gandhi**²⁷, the Supreme Court of India held that administrative actions must be guided by clear rules and procedures to avoid arbitrariness and ensure fairness

Timely Investigations: Tax authorities should carry out investigations in a prompt and efficient manner to avoid unwarranted delays and disruptions to businesses.

Provision for Appeal: Taxpayers should have the right to appeal against the blocking of ITC, and an effective dispute resolution mechanism should be established. The Hon'ble Madras High Court in the case of ***Tvl. Transtonnelstroy Afcons Joint Venture v. Union of India***²⁸ held that the blocking of ITC without providing reasons and without giving an opportunity of being heard is arbitrary and violative of Article 14 of the Constitution of India²⁹. The court emphasized the need for a fair and effective dispute resolution mechanism to protect the rights of taxpayers.

Conclusion:

The practice of blocking Input Tax Credit without conducting a proper investigation raises genuine legal and ethical concerns. While it is essential to prevent tax evasion and misuse of the ITC mechanism, it is equally crucial to ensure that businesses are treated fairly and justly.. To ensure a fair and transparent tax administration, it is imperative that blocking of ITC is carried out only after a thorough investigation. Tax authorities should provide clear guidelines and reasons for blocking ITC, allowing taxpayers an opportunity to present their case and provide necessary evidence. Transparency and accountability in the process will help build trust between taxpayers and tax authorities, fostering a conducive business environment. It is essential for tax authorities to communicate effectively with taxpayers and provide them with a fair chance to rectify any discrepancies.

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1. Section [2\(63\)](#) of the CGST Act, 2017 define the definition of "Input Tax Credit".
 2. Section [2\(62\)](#) of the CGST Act, 2017, which define the definition of "Input Tax"
 3. Section [2\(62\)\(a\)](#) of the CGST Act, 2017.
 4. Section [9](#) of the CGST Act, 2017 which state the provision regarding "Levy and Collection", Section 2 (62) (b) of the CGST Act, 2017.
 5. Section [5](#) of the IGST Act, 2017 which state the provision regarding "Levy and Collection", Section 2 (62) (c) of the CGST Act, 2017.
 6. Section [2\(62\)\(d\)](#) of the CGST Act, 2017.
 7. Section [2\(62\)\(e\)](#) of the CGST Act, 2017.
 8. Section [16](#) of CGST Act, 2017.
 9. Section [16\(1\)](#) of CGST Act, 2017.
 10. Section [16\(2\)](#) of CGST Act, 2017.
 11. Section [16\(4\)](#) of the CGST Act, 2017, Ins. by Order No. 02/2018-Central Tax dated 31-12-2018.
 12. Rule [37\(1\)](#) of the CGST Rules. 2017.
 13. Section [17](#) of the CGST Act, 2017 which state the provision regarding "Apportionment of Credit and Blocked Credits"
 14. Section [2\(4\)](#) of the CGST Act, 2017.
 15. Section [17\(2\)](#) of the CGST Act, 2017.
 16. Section [17\(5\)\(a\)](#) of the CGST Act, 2017.

- [17.](#) Section [17\(5\)\(c\)](#) of the CGST Act, 2017.
- [18.](#) Section [17\(5\)\(e\)](#) of the CGST Act, 2017.
- [19.](#) Circular No. CBEC-20/16/05/2021-GST / 1552 Dated 2nd November, 2021.
- [20.](#) Rule [86A](#) of the CGST Rules, 2017 states the rule regarding "Conditions of use of amount available in electronic credit ledger".
- [21.](#) Circular No. CBEC-20/16/05/2021-GST / 1552 Dated 2nd November, 2021. "3.3 Procedure for disallowing debit of electronic credit ledger/blocking credit under Rule 86(A)".
- [22.](#) *Parity Infotech Solutions (P.) Ltd's. case (supra)*.
- [23.](#) Section [126\(3\)](#) of the CGST Act, 2017.
- [24.](#) [\[2018\] 95 taxmann.com 327/69 GST 239/361 ELT 577/ AIR 2018 SC 3606](#).
- [25.](#) [\[2019\] 104 taxmann.com 393/73 GST 787/26 GSTL 183 \(Telangana\)](#).
- [26.](#) Section [164](#) of CGST Act, 2017.
- [27.](#) [\[2010\] 5 taxmann.com 28/100 SCL 142/156 COMP. CAS. 392 \(SC\)](#).
- [28.](#) [\[2020\] 119 taxmann.com 324/43 GSTL 433/SCC ONLINE MAD 2570](#).
- [29.](#) Article 14 of the Indian Constitution, 1950