

EY Tax Alert

Bombay HC upholds levy of GST on advances and allows ITC in the hands of recipient basis receipt voucher

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Executive summary

This Tax Alert summarizes a recent ruling of the Bombay High Court (HC)¹ on admissibility of input tax credit (ITC) w.r.t GST on advance paid for procuring services.

The issue in the writ petition was regarding non-admissibility of ITC as per Section 16(2)(a) and (b) of the Central Goods and Services Tax Act, 2017 (CGST Act), on advances paid by consortium (petitioner) to its member entities against receipt voucher. Consequently, petitioner challenged the above provisions together with Sections 7, 9, 12 and 13 in the context of levy of tax on advances.

The key observations of the HC are:

- ▶ The phrase "*in course or furtherance of business*" in Section 7 of the CGST Act encompasses advances which are received for supplies agreed to be made as well, thereby, would attract payment of tax on advances as per Section 13(2). The same is not unconstitutional.
- ▶ Section 16(1) entitles a registered person to take ITC on any supply of goods or services which "*are used*" or "*intended to be used*" in the course or furtherance of his business. The word "*intended*" is required to be given its due meaning in applying the provisions of Section 16(2)(b), which prescribes condition for registered person to receive goods or services.
- ▶ If ITC is denied merely on interpretation that goods or services are not received but in the process of being received, the same would create a complete dichotomy, disturbance or friction in the interplay between Section 13(2) and Section 16.
- ▶ A receipt voucher is a valid tax paying document for claiming ITC under Section 16(2)(a). Merely reading Section 31(1) with Rule 36 of the Central Goods and Services Tax Rules, 2017 (CGST Rules) would not be correct in law for denying ITC. Rule 36 cannot control the operation of Section 31 being the substantive statutory provision.

Accordingly, HC upheld levy of tax on advances while allowing ITC on the same at the time of payment of advance against receipt voucher.

¹ TS-740-HC(BOM)-2024-GST



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Background

- ▶ Petitioner, an unincorporated consortium of two entities, entered into a contract with Mumbai Metropolitan Region Development Authority (MMRDA) for construction of a bridge.
- ▶ For execution of project work, the members of the petitioner would raise bills on the petitioner for the portion of the work executed by them each month. In turn, the petitioner would raise a single consolidated invoice on MMRDA.
- ▶ As per contract, MMRDA made advance payments along with Goods and Services Tax (GST) termed as an interest-free loan to the petitioner, which was to be repaid through percentage deduction from the interim payments.

Petitioner remitted the advance along with GST to its constituents against receipt vouchers, before receiving goods or services.

Being back-to-back contracts, there was no value addition by the petitioner.

- ▶ Input tax credit (ITC) on the tax charged by constituents was not immediately available to the petitioner in terms of clause (a) and (b) of Section 16(2) of the Central Goods and Services Tax Act, 2017 (CGST Act) since the supply of goods or services had not been received yet and "receipt voucher" is not a prescribed tax paying document to claim ITC as per Rule 36 of the Central Goods and Services Tax Rules, 2017 (CGST Rules).
- ▶ Aggrieved, petitioner filed a writ petition before the Bombay High Court (HC) challenging the validity of Section 16(2)(a) and (b) along with challenge to Sections 7, 9, 12 and 13 of CGST Act in the context of levy of GST on advances.

Petitioner's Contentions

- ▶ Article 246A read with Article 366(12-A) of the Constitution permits levy only on "supply of goods or service or both" and not on "supply to be made of goods or services or both". In other words, the Constitution does not permit taxation of a future event *de hors* the fact whether ITC can be taken of such GST statutorily levied and collected on a future supply.

However, levy and collection under Section 9 of CGST Act is on event of supply, which is defined under Section 7 to include supply of goods or services "agreed to be made" as well within its ambit. Therefore, such levy and collection are *ultra vires* the Constitution.

- ▶ The provisions of Section 12 and 13 of the CGST Act, which provides for time of supply of goods

and services, stands invalid and *ultra vires* on similar grounds.

- ▶ Section 12(2)(b) and Section 13(2)(b) stipulates time of supply for goods and services, respectively, as the date of upfront receipt of payment for discharging tax.

However, Notification² exempts advance receipts with respect to the goods from GST.

Thus, merely granting exemption for supply of goods with reference to Section 12(2)(b) and denying the same for services under Section 13(2)(b) is violative of Article 14 of the Constitution of India.

- ▶ Section 13(2)(b) read with the "Explanation" thereto creates a legal fiction whereby supply is deemed to have been made on the date of receipt of payment. Thus, the liability to pay the tax arises simultaneously at the time of payment. However, Section 16(2)(b) provides that ITC cannot be claimed unless supply is received.

The object of Section 16(2)(b) is to curtail fraudulent taking of ITC, in the absence of goods/services and not to deny ITC where payment has actually been made for a service and the tax thereon too has been remitted.

However, the said provision takes away and/or negates the consequences which are brought about by Section 13(2)(b). The precluding of ITC immediately upon payment of tax, results in excess payment of tax.

Hence, on account of such inconsistency, Section 16(2)(b) has to be held *ultra vires* the provisions of Section 13(2)(b) of the CGST Act.

- ▶ Even if ITC is substantively available upon payment of tax, its benefit could not be taken because of a procedural roadblock in Rule 36 as receipt voucher has not been specified as a document based on which ITC can be claimed.
- ▶ Denying ITC at relevant time leads to its accumulation. The refund of the same is precluded since the proviso to Section 54(3) stipulates refund of ITC only in two circumstances, *i.e.*, zero-rated supplies and inverted duty structure.

Accordingly, constitutionality of relevant portion of Section 54 has been challenged as well.

- ▶ Moreover, the tender documents clearly stipulate the payment to be a loan. However, it was inadvertently treated as an advance with MMRDA paying tax on the same and in these circumstances, GST amount was remitted to the Government. Payment being a loan, no GST is payable on the same.

² Notification 66/2017 dated 15 November 2017

In case the challenge to Sections 7, 13, 16(2)(b) does not succeed, no tax would be payable on the same and refund would be due.

Revenue's Contentions

- Article 246A read with Article 366(12A) of the Constitution empowers Government to levy tax on supply of goods and services, wherein, the term "supply" has not been defined.

Accordingly, there is field open to the Legislature to create a fiction of including agreement to supply within the scope of supply.

Further, the use of the words in a statute is stated to be the prerogative of the legislature on which the petitioner would not have any locus to comment upon.

For such reasons, supply agreed to be made as per Section 7 cannot be held unconstitutional. Thus, the Section 7 and 13 has to be read together to understand the net effect.

- Section 76(1) of the CGST Act begins with a non-obstante clause *inter alia* provides that "every person who has collected from any other person any amount as representing the tax under the said Act, and has not paid the said amount to the Government, shall forthwith pay the said amount to the Government, irrespective of whether the supplies in respect of which such amount was collected are taxable or not".

In the present case, MMRDA has paid advance money along GST to the petitioner. Tax element included in such advance payment amounts to collection of tax and would be required to be included in the amount of treasury as per Section 76.

- As per Section 16, ITC can be claimed only after goods or services are received. Any comparison between Section 13(2) and Section 16(2)(b) of the CGST Act is misplaced.

In this case, since the work under the contract had not started, no service has yet been provided to the petitioner, and hence, the petitioner was precluded from availing ITC.

- The writ petition is infructuous as even if the ITC is initially not available, the same is later made available to be taken upon actual receiving of service.
- Lastly, the writ petition should be held to be non-maintainable as the same has been filed without fully exhausting the alternate remedy of appeal as availed by the petitioner which is pending disposal.

High Court Ruling

Loan vs Advance

- The amounts received for mobilization and design are integral to the petitioner and its constituents in discharging their obligations under the contract.
- When MMRDA remitted the amount, the petitioner neither demanded the advance as an interest free loan nor treated the same to be an interest free loan. Rather, issued "advance receipt voucher" to MMRDA and back-to back remitted amounts to its constituent. Such advance receipt voucher indicated several details *inter alia* the total amount of advance claimed before tax and the GST amounts payable on such advance and the total invoice value.
- The petitioner has now intended to take a different position that these advances be treated purely as a loan.
- Necessarily, considering the mandatory provisions of Section 76 of the GST Acts, the petitioner could not have "not" deposited the GST amounts received by it from the MMRDA with the Government.
- Such advance payment does not simply remain to be "an interest free loan" as the advance payment is permitted to be proportionately deducted and forms part of the contract consideration payable by MMRDA.
- Further, Section 2(31) defines consideration in relation to supply of goods or services or both to include "any payment made" or "to be made". Accordingly, the payment received as advance would partake the character of a consideration.

Challenges to vires of Section 7, 9, 12 and 13 of CGST Act

- In case of R. K. Garg³, Supreme Court (SC) held that the laws relating to economic activities need to be viewed with greater latitude and that the court should feel more inclined to give judicial deference to legislature's judgment in the field of economic regulation than in other areas where fundamental human rights are involved.
- Such principles as applicable to economic legislation also would be relevant insofar as the tax legislation is concerned.
- The wisdom of the legislature, in its anticipation, working and the implications brought out by the tax provision, is also required to be of paramount consideration in testing the constitutional validity.

³ (1981) 4 SCC 675,

- ▶ Accordingly, to gather the object and intention behind the provision as intended by the legislature, every word as contained in the provision is required to be given its due meaning.
- ▶ Section 7(1)(a) of CGST Act *inter alia* includes “*all forms of supply of goods or services or both*”, of the nature as specified therein which are “*made or agreed to be made*” for a consideration by a person in the course or furtherance of business”.
- ▶ Merely for the reason that Section 7(1)(a) uses the word “*or agreed to be made for a consideration*” would not render nugatory the contents of the earlier part, which categorically includes all forms of supply of goods or services or both.
- ▶ For understanding the phrase “*in the course of*”, SC in the context of language employed in Article 286, pointed out that the expression not only implies a period of time during which the movement is in progress but also postulates a connected relation⁴.

By applying such interpretation, it cannot be denied that once an advance was received by the petitioner in the course of or in furtherance of the contract, it would necessarily amount to a supply attracting payment of GST.

- ▶ Further, Section 7(1A), which provides activities to be treated either as supply of goods or as services in Schedule II to the CGST Act, includes works contract as supply of services under composite supply.
- ▶ Further, Section 7(1)(aa) was inserted⁵, to inter alia provides that “activities or transactions, by a person other than an individual, to its members or constituents or vice versa, for cash, deferred payment or other valuable consideration” will also fall within the ambit of supply.
- ▶ Thus, the common thread running through the sub-section (1A) and (1)(aa) of Section 7 discerns that the word supply cannot be given a meaning *de hors* from what has been attributed by the Parliament, even applying the constitutional intent as contained in Article 366(12A) which defines goods and services tax.
- ▶ Once it is established that advance payment amounts to supply, liability to pay tax would stand governed by Section 13(b) on the date of receipt of payment by the petitioner from MMRDA. Same would be the case, on the leg between the petitioner and its constituent.
- ▶ The Article 246A read with Article 366(12A) of the Constitution of India empowers the Parliament as well the State Legislature to make laws in respects of goods and services tax to be imposed by the Union or a State. Such

constitutional provisions merely lay down the broad contours of the subject matter of the legislation.

- ▶ The Parliament as well State legislature, both, are within their constitutional authority, to not only enact the provisions but also to prescribe the manner and the method under which the scheme of the GST laws ought to work.
- ▶ The petitioner’s proposition is too weak that Article 246A read with Article 366(12A) would negate the validity of Sections 7, 9, 12 and 13 of the CGST Act. Accordingly, stands rejected.

Challenge to vires of Section 16 of CGST Act / Eligibility of ITC

- ▶ Section 16(1) entitles a registered person to take credit of input tax charged on any supply of goods or services or both to him, which “*are used*” or “*intended to be used*” in the course or furtherance of his business.
- ▶ The word “intended” in aforesaid provision is required to be given its due meaning in applying the provisions of Section 16(2)(b), which prescribes condition for registered person to receive goods or services or both.
- ▶ On one hand, tax has been deposited on intended supply of goods or services entitling them to ITC as per Section 16(1), however, on the other hand, merely on the interpretation that goods or services are in the process of being received, ITC is denied.
- ▶ If such denial of supply is to be accepted, a converse situation emanates by virtue of Section 12 or 13, the Government becomes recipient of the tax, despite there being no supply. This would create a complete dichotomy, disturbance or friction in the interplay between Section 13(2) and Section 16 of the CGST Act.
- ▶ The intention underlying Section 16(1) is not only required to be affected but safeguarded by a meaningful and purposive reading of the provisions of Section 13(2), so as to apply the provisions of Section 16(2)(b), as it stands and intended by the Legislature.
- ▶ Moreover, for entitlement of ITC, Section 16(2)(a) requires possession of tax invoice or debit note or other tax paying document. As per Rule 36, ITC can be availed on the basis of invoice issued by the supplier under Section 31 but does not include receipt voucher issued under Section 31(3)(d).
- ▶ Section 31 has to be holistically read so as to make the provision meaningful. When the petitioner satisfied the requirements of Section

⁴ AIR 1972 SC 23, AIR 1953 SC 333 and AIR 1975 SC 1564

⁵ Vide Finance Act No.13 of 2021, w.e.f. 1 January 2022

31(3)(d), it would not be correct in law that the petitioner is denied ITC.

Merely reading Section 31(1) with Rule 36 would not be correct in law for denying ITC. Rule 36 cannot control the operation of Section 31 being the substantive statutory provision.

- ▶ Thus, it is held that in the peculiar facts of the case, receipt voucher issued by the constituent in favor of petitioner would be a tax paying document, thereby, entitling ITC on procuring the intended supply of goods or services under Section 16.

Comments

The Ruling clarifies the eligibility of ITC on advance payments and may facilitate easing working capital requirements of businesses where payment of advance is a common practice.

Although the ruling refers to the peculiar facts in the given writ petition while deciding on ITC eligibility, the ratio of the same can be applied to all other business transactions involving advances.

HC has analyzed Section 16(2)(a) and (b) and allowed ITC on advances, however, has not commented on applicability of Section 16(2)(aa) read with rule 36(4), imposing condition regarding furnishing and communicating details /documents by the supplier.

Our offices

Ahmedabad

22nd Floor, B Wing, Privilon
Ambli BRT Road, Behind Iskcon Temple
Off SG Highway
Ahmedabad - 380 059
Tel: + 91 79 6608 3800

8th Floor, Building No. 14A
Block 14, Zone 1
Brigade International Financial Centre
GIFT City SEZ
Gandhinagar - 382355, Gujarat
Tel +91 79 6608 3800

Bengaluru

12th & 13th Floor
"UB City", Canberra Block
No.24 Vittal Mallya Road
Bengaluru - 560 001
Tel: + 91 80 6727 5000

Ground & 1st Floor
11, 'A' wing
Divyasree Chambers
Langford Town
Bengaluru - 560 025
Tel: + 91 80 6727 5000

3rd & 4th Floor
MARKSQUARE
#61, St. Mark's Road
Shantala Nagar
Bengaluru - 560 001
Tel: + 91 80 6727 5000

1st & 8th Floor, Tower A
Prestige Shantiniketan
Mahadevapura Post
Whitefield,
Bengaluru - 560 048
Tel: + 91 80 6727 5000

Bhubaneswar

8th Floor, O-Hub, Tower A
Chandaka SEZ, Bhubaneswar
Odisha - 751024
Tel: + 91 674 274 4490

Chandigarh

Elante offices, Unit No. B-613 & 614
6th Floor, Plot No- 178-178A
Industrial & Business Park, Phase-I
Chandigarh - 160 002
Tel: + 91 172 6717800

Chennai

6th & 7th Floor, A Block,
Tidel Park, No.4, Rajiv Gandhi Salai
Taramani, Chennai - 600 113
Tel: + 91 44 6654 8100

Delhi NCR

Aikyam
Ground Floor
67, Institutional Area
Sector 44, Gurugram - 122 003
Haryana
Tel: +91 124 443 4000

3rd & 6th Floor, Worldmark-1
IGI Airport Hospitality District
Aerocity, New Delhi - 110 037
Tel: + 91 11 4731 8000

4th & 5th Floor, Plot No 2B
Tower 2, Sector 126
Gautam Budh Nagar, U.P.
Noida - 201 304
Tel: + 91 120 671 7000

Hyderabad

THE SKYVIEW 10
18th Floor, "SOUTH LOBBY"
Survey No 83/1, Raidurgam
Hyderabad - 500 032
Tel: + 91 40 6736 2000

Jaipur
9th floor, Jewel of India
Horizon Tower, JLN Marg
Opp Jaipur Stock Exchange
Jaipur, Rajasthan - 302018

Kochi

9th Floor, ABAD Nucleus
NH-49, Maradu PO
Kochi - 682 304
Tel: + 91 484 433 4000

Kolkata

22 Camac Street
3rd Floor, Block 'C'
Kolkata - 700 016
Tel: + 91 33 6615 3400

Mumbai

14th Floor, The Ruby
29 Senapati Bapat Marg
Dadar (W), Mumbai - 400 028
Tel: + 91 22 6192 0000

5th Floor, Block B-2
Nirlon Knowledge Park
Off. Western Express Highway
Goregaon (E)
Mumbai - 400 063
Tel: + 91 22 6192 0000

3rd Floor, Unit No 301
Building No. 1
Mindspace Airoli West (Gigaplex)
Located at Plot No. IT-5
MIDC Knowledge Corridor
Airoli (West)
Navi Mumbai - 400708
Tel: + 91 22 6192 0003

Altimus, 18th Floor
Pandurang Budhkar Marg
Worli, Mumbai - 400 018
Tel: +91 22 6192 0503

Pune

C-401, 4th Floor
Panchshil Tech Park, Yerwada
(Near Don Bosco School)
Pune - 411 006
Tel: + 91 20 4912 6000

10th Floor, Smartworks
M-Agile, Pan Card Club Road
Baner, Taluka Haveli
Pune - 411 045
Tel: + 91 20 4912 6800

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