

PART-I

RULE 86A - AN ANALYSIS

Rule 86A has inserted by the Central Government vide *Notification No. 75/2019-Central Tax dated 26.12.2019 w.e.f. 26.12.2019* . The rule has been introduced by the Government to safeguard the interest of the revenue. In other words to curb availment of ITC on the basis of bogus purchases without payment of tax or in some cases without an invoice.

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:

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.

Our understanding:

Rule 86A has two parts. The first part of the Rule 86A (1) provides conditions to invoke the rule and the second part provides consequences of invocation of the rule.

The first part of Rule 86A GST Rules has following mandatory conditions to invoke Rule 86A (1) GST Rules

If any supplier found non-existent or not conducting any business in their registered place- ITC 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.

- ITC 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.
- ITC has been availed on the basis of documents prescribed against which no tax has been paid to the Government.
- ITC 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

VA-GST UPDATES

- The registered person availing input tax credit is not in possession of a tax invoice or debit note or any other document prescribed under rule 36.

The Second part has following consequences of invocation of Rule 86A (1) GST Rules

- Disallowing debit of credit available in ECL;
- Disallowance of ITC after recording reasons in writing.

The Commissioner, or any other officer authorized by him, not below the rank of Assistant Commissioner, must have reasons to believe that ITC availed is ineligible or availed fraudulently and have material evidence for disallowing debit of an amount from ECL, only after proper consideration of all the grounds mentioned above.

The Commissioner must be very careful to the fact that such rule is not intended to authorise him to make pre-emptive strikes on the credit of ITC available in ECL, merely because same is available for disallowance. There must be valid reasons to believe that credit of ITC lying in ECL is fraudulently availed or ineligible because of reasons discussed in Rule 86A (1) GST Rules.

Rule 86A does not require the Commissioner to afford the assessee an 'opportunity to be heard' before blocking such ITC and only requires that such reasons be recorded in writing by the Commissioner.

The said rule does not prescribe for a prior issue of notice to the assessee regarding the blocking of ITC.

The Apex Court in the case of Kesar Enterprises Ltd. – 2012 (12) TMI 828 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

VA-GST UPDATES

In view of the above judgment in my opinion 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.

We further argued that 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. Rule 86A has been issued by the Government under the powers conferred under Section 164 of the CGST Act.

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. Rule 86A by using the powers under Section 164 is clearly ultra vires the powers conferred under Section 164.

According to Section 49(4) of CGST Act, ITC available in ECL may be utilised towards discharging outward tax liability in such manner and subject to such conditions as may be prescribed.

Section 49A of the CGST Act has been introduced w.e.f 1.2.2019, which provides for 'Utilisation of input tax credit subject to certain conditions'. This section does not provide the conditions subject to which the ITC lying in the ECL shall not be available for utilisation i.e. will be blocked.

Neither Section 49 (4) nor the newly introduced Section 49A of the CGST Act provide for prescription of conditions for blocking the ITC, as is provided in Rule 86A of CGST Rules.

In our opinion the Commissioner after thorough investigation can exercise Rule 86A GST Rules is blocking the electronic credit ledger in the following to two instances:

- i) input tax credit available in the electronic credit ledger (called as Positive blocking); and

ii) anticipated input tax credit which has to be availed in the electronic credit ledger (called as Negative blocking). In our opinion the commissioner has no authority to negatively block the Electronic Credit Ledger

(Note: This proviso applicable for section 73 case dealers only)

The Gujarat High Court in the case of **Samay Alloys India P. Ltd. versus State of Gujarat, 2022-TIOL-246-HC-AHM-GST** held that the negative blocking under Rules 86A GST Rules is not permissible.

The blocking of input tax credit shall cease to have effect after expiry of a period of one year from the date of imposing the restriction.

The Karnataka High Court in the case of ***Padmavathi Electrometals (P) Limited Vs Assistant Commissioner of Commercial Taxes (Karnataka High Court)*** has set-aside the order on the ground due to lapse of one year period by cited Rule 89A(3)

Before concluding in our opinion that the implementation of Rule 86A is without the authority of the law and is ultra vires the CGST Act and also in violation of the Principles of Natural Justice. This Rule may be to curb the practice of Bogus Purchases and to safeguard the revenue, there is every chance that an honest taxpayer may be put to disadvantage due to operation of this provision.

In our opinion 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.

PART-II

FREQUENTLY ASKED QUESTIONS

1. What is Rule 86A under the CGST Rules?

Rule 86A empowers the Commissioner or an authorized officer to block the Input Tax Credit (ITC) available in the electronic credit ledger if they have reasons to believe that the ITC has been fraudulently availed or is ineligible.

2. When was Rule 86A introduced?

Rule 86A was introduced vide Notification No. 75/2019-Central Tax dated 26.12.2019 and became effective from the same date.

3. What are the key conditions to invoke Rule 86A?

Rule 86A can be invoked under the following conditions:

Supplier issuing the tax invoice is non-existent or not conducting business from the registered place.

ITC is availed without actual receipt of goods or services.

Tax charged in the invoice has not been paid to the government.

The recipient availing ITC is non-existent or not conducting business from the registered place.

The recipient does not possess the prescribed tax invoice or debit note.

4. Does Rule 86A allow for blocking ITC without issuing prior notice to the assessee?

Yes, Rule 86A does not mandate issuing a prior notice to the taxpayer before blocking the ITC. The reasons for blocking must only be recorded in writing.

5. What is the maximum period for which ITC can be blocked under Rule 86A?

The restriction on ITC utilization ceases to have effect after one year from the date the restriction was imposed.

6. Who is authorized to block ITC under Rule 86A?

The Commissioner or an officer authorized by him, not below the rank of an Assistant Commissioner, can block ITC under Rule 86A.

7. Can the taxpayer appeal against the blocking of ITC under Rule 86A?

Yes, taxpayers can challenge the blocking of ITC through appropriate legal channels, including filing a writ petition in the High Court.

8. Is an opportunity of being heard provided before ITC is blocked?

No, Rule 86A does not explicitly provide for an opportunity to be heard before blocking ITC. However, courts may consider this a violation of the principles of natural justice.

9. Is blocking of anticipated ITC (negative blocking) allowed under Rule 86A?

No, negative blocking (blocking ITC not yet availed) is not permissible. The Gujarat High Court in *Samay Alloys India P. Ltd. v. State of Gujarat* held that such actions are beyond the scope of Rule 86A.

10. Does Rule 86A violate the principles of natural justice?

Yes, Rule 86A may violate the principles of natural justice as it does not mandate providing an opportunity to the taxpayer to be heard before blocking ITC.

11. Is Rule 86A ultra vires the CGST Act?

Some legal experts argue that Rule 86A exceeds the powers conferred under the CGST Act and is thus ultra vires, as there is no explicit provision in the CGST Act allowing such restrictions on ITC.

12. What is meant by positive blocking of ITC?

Positive blocking refers to restricting ITC that is already available in the electronic credit ledger of the taxpayer.

13. What happens if the reasons for blocking ITC no longer exist?

If the conditions for blocking ITC no longer exist, the Commissioner or authorized officer may allow the utilization of the ITC by lifting the restriction.

14. Can blocked ITC be utilized for discharging tax liability?

No, once ITC is blocked under Rule 86A, it cannot be utilized for discharging tax liability or claiming a refund.

15. Can Rule 86A be invoked based on mere suspicion?

No, there must be valid reasons to believe and material evidence to support the claim that ITC was fraudulently availed or is ineligible.

16. Does Rule 86A have retrospective application?

No, Rule 86A applies prospectively from 26.12.2019.

17. What safeguards exist to prevent misuse of Rule 86A?

The rule mandates that reasons for blocking ITC must be recorded in writing, and courts have emphasized that the rule must not be used for arbitrary or preemptive actions.

18. Can ITC blocked under Rule 86A be refunded?

No, ITC blocked under Rule 86A cannot be claimed as a refund unless the restriction is lifted by the authorized officer.

19. Does Section 49A of the CGST Act authorize blocking ITC?

No, Section 49A deals with the utilization of ITC and does not specifically provide for blocking ITC.

20. What is the role of Rule 36 in Rule 86A?

Rule 36 prescribes the documents (e.g., tax invoices, debit notes) based on which ITC can be availed. Rule 86A can be invoked if ITC is availed in violation of Rule 36.

21. How does the Karnataka High Court view Rule 86A?

In Padmavathi Electrometals (P) Ltd. v. Assistant Commissioner, the Karnataka High Court held that ITC blocking lapses after one year, as prescribed under Rule 86A(3).

22. Can Rule 86A be used to block ITC due to technical errors?

No, Rule 86A is intended to curb fraudulent ITC claims and does not cover technical errors or procedural lapses.

23. What is the impact of Rule 86A on honest taxpayers?

Honest taxpayers may face undue hardship due to ITC blocking, which can disrupt cash flow and operations.

24. Can Rule 86A override statutory provisions of the CGST Act?

No, Rule 86A cannot override the CGST Act. It must operate within the framework and powers granted under the Act.

25. What remedies are available to taxpayers against Rule 86A?

Taxpayers can seek legal recourse through High Courts and argue on grounds such as violation of natural justice, lack of authority under the CGST Act, and absence of evidence.

PART-III

RELATED CIRCULARS/NOTIFICATIONS/CASAE LAWS

Key Highlights of Rule 86A from Notification No. 94/2020

Scope of Rule 86A: Rule 86A was introduced to prevent the misuse of Input Tax Credit (ITC) in cases of fraudulent activities or where the ITC is found ineligible. The notification further clarifies the authority and conditions under which ITC in the electronic credit ledger can be restricted.

Conditions for Blocking ITC: Rule 86A provides that an officer, not below the rank of an Assistant Commissioner, can restrict the use of ITC available in the electronic credit ledger if there are reasons to believe that:

The credit is availed based on fake or ineligible invoices.

The supplier has been found non-existent or not conducting business from the registered address.

Goods or services have not been received by the recipient.

The tax charged in the invoice has not been deposited with the government.

The recipient does not have proper documentation such as tax invoices or debit notes.

Reasons to Believe: The notification emphasizes that the officer must have material evidence or reasons to suspect fraud or ineligibility before exercising powers under Rule 86A. These reasons must be recorded in writing.

Validity Period of ITC Blocking: The restriction imposed under Rule 86A shall remain in effect for a maximum period of one year from the date of the restriction. After the lapse of one year, the restriction ceases to apply automatically unless otherwise revoked earlier by the officer.

Discretion to Lift Restrictions: The officer who imposed the restriction (or another officer with equivalent authority) can lift the restriction if satisfied that the conditions for blocking ITC no longer exist.

Implications of Notification No. 94/2020 on Rule 86A

Strengthened Safeguards for Revenue Protection: The notification reinforces Rule 86A to prevent the misuse of ITC, particularly in cases of fake invoices and non-compliance by suppliers.

Compliance Burden on Taxpayers: While the rule aims to curb fraud, it places an additional compliance burden on taxpayers to ensure that their suppliers are compliant with GST laws to avoid ITC restrictions.

Potential Legal Challenges: The lack of a mandatory provision for giving taxpayers an opportunity to be heard before blocking ITC may invite legal challenges, as seen in several High Court judgments.

Legal and Procedural Aspects Highlighted in the Notification

The officer's authority to block ITC must be exercised judiciously and based on documented evidence.

The rule provides administrative discretion but also requires a balance to avoid arbitrary actions.

The automatic lapse of restrictions after one year ensures that businesses are not indefinitely penalized without due process.

Conclusion: *Notification No. 94/2020* clarifies and strengthens the application of Rule 86A under the CGST Rules to safeguard revenue interests. It emphasizes the importance of material evidence and procedural safeguards in blocking ITC while highlighting the one-year limitation period for such restrictions. This ensures a balance between preventing tax evasion and protecting taxpayer rights

Thanks and Regards

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