

PART-I

RULE 86B OF CGST RULES

The Central Goods and Service Tax (CGST) Act introduced Rule 86B vide GST *Notification number 94/2020 dated 22nd December, 2020* with effect from 1.1.2021/ The intention behind this rule is to curb fake transactions. This rule restricts the utilisation of electronic credit ledger for payment of tax.

Rule 86B :- Restrictions on use of amount available in electronic credit ledger

Notwithstanding anything contained in these rules,

- o the registered person shall not use the amount available in electronic credit ledger
- o to discharge his liability towards output tax
- ♦ in excess of 99% of such tax liability, in cases where the value of taxable supply in a month exceeds 50 Lakhs other than
- o exempt supply and zero-rated supply.

Commentary:

Taxpayers can use the balance available in credit ledger upto 99% of tax liability and 1% tax liability to be paid through cash ledger only..

This rule is applicable to taxpayers whose turnover in excess of Rs.50 lakhs in a particular month. Turnover of exempt supply and zero rate supply not to be included.

Example :-

- ♦ Taxable turnover during April, 2024 = Rs. 1,80,00,000
- ♦ Applicable tax rate = 18%

♦ Thus amount of tax = Rs. 1,80,00,000 * 18% = Rs. 32,40,000

99% using ITC Rs.3207600

The balance liability of Rs.32400 to be discharged through e-cash ledger

The provision specified in this rule will prevail over provisions specified in other rules in view of non-obstante clause

Applicability of restriction:-

o It applies in the month where VALUE OF TAXABLE SUPPLY exceeds Rs. 50 Lakhs in the month. In the next month such value of taxable supply does not exceeds Rs.50 lakhs this rule lapse the restriction.

Objectives of Rule 86B

The objective behind this rule is to curb the creation of fake invoices for claiming fraudulent ITC. This can be done by mandating a minimum cash payment for output tax liability, to discourage the generation of fictitious invoices and evade taxes

Exceptions to the Rule

While Rule 86B applies to most businesses exceeding the Rs. 50 lakh turnover threshold, certain exceptions exist. These exceptions include:

o If a registered person or the proprietor/karta/managing director/partners have paid income tax exceeding Rs. 1 lakh in each of the preceding two financial years, they are exempt from the rule.

If the registered person under concern has received a refund of amount greater than Rs.1 lakh in the preceding financial year on account of export under LUT or due to inverted tax structure

- o If the registered person under concern has discharged his liability towards output tax by electronic cash ledger for an amount in excess of 1% consecutively of the total output tax liability up to the said month in the current financial year.
- o Government bodies, Public sector undertaking, Local authority and Statutory Authority are not subject to Rule 86B.
- o The Commissioner or authorized officials can, at their discretion and after due verification, remove the restriction on a case-by-case basis.

Non Compliance of Rule 86B

- According to Rule 21 of the CGST Rules 2017 which provides for cancellation of registration for violation of Rule 86B of the CGST Rules 2017.
- Scrutiny of returns can be carried out by the proper officer to verify the correctness of the return u/s Section 61 of the CGST Act 2017. Non-payment of mandatory of 1% cash element can attract the Department's attention through this section. Tax payer who is violating the above rule will be liable to pay minimum penalty Rs, 10,000/- and maximum penalty equal to the tax evaded, whichever is higher. It is one time penalty for one offence

Recently the Himachal Pradesh High Court recently in the case of A.M. Enterprises vs State of Himachal Pradesh &Ors. (CWP No.1517 of 2024)observed that Rule 86B of the Central Goods and Services Tax (CGST/HPGST) Rules, 2017, which restricts use of Input Tax Credit (ITC) in the Electronic Credit Ledger for releasing Output tax, appears to be ultra vires the HP Goods and Services Tax Act 2017.

The Court pointed that there are no conditions or restrictions other than these and that respondent-authority failed to reply to Petitioner's contention that Rule 86B itself is not backed by any statutory provision. It further added that though Section 164 of the Act enables the Rule making authority to frame Rule 86B or other Rules, However, such Rules must have "backing in the main body of the statute".

The Court also pointed out that the amount available in the Electronic Credit Ledger is taxpayer's own money. The High Court found that since the tax liability of the petitioner towards output tax is discharged, no prejudice was caused to the authority.

The court allowed the appeal in favour of the petitioner and instructs the respondent instead of cancelling the GST registration any other penalty under the act can be levied for violation of the act.

To Sum up

- Rule 86B mandates cash payment of 1% of the output tax liability on a monthly basis for the registered persons who are covered by this rule. This payment of liability in cash would be required irrespective of the fact that there is an existing balance in the electronic credit ledger.
- The limit of 1% is on the output tax liability only. RCM liability cannot be considered as payment of output taxes.
- Only registered persons who have taxable supplies of more than Rs. 50 lakhs in a particular month (subject to certain exceptions) must comply with this provision.
- Zero-rated supplies including exports and supplies to SEZ will be excluded for calculating the limit of Rs. 50 lakhs. To the exempted supplies will also not be counted for this Rs. 50 lakhs turnover restriction.
- To calculate the threshold limit, the value of taxable supplies excluding the zero-rated supplies needs to be considered. However, for the purpose of payment of tax liability, 1% of the total output tax needs to be disbursed in cash.

PART-II

FREQUENTLY ASKED QUESTIONS

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

It restricts the use of electronic credit ledger to 99% of output tax liability for monthly taxable supplies exceeding ₹50 lakhs turnover.

2. Who is exempt from Rule 86B?

Entities with turnover below ₹50 lakhs, high-income taxpayers, government bodies, and exporters receiving refunds.

3. What happens if Rule 86B is violated?

Penalties may include ₹10,000 or tax evaded, whichever is higher, and scrutiny of returns under Section 61.

4. Can RCM payments count toward Rule 86B compliance?

No, RCM payments cannot be considered output tax liability.

5. Is Rule 86B legally challenged?

Yes, some courts, like Himachal Pradesh High Court, have questioned its statutory backing.

6. How is the ₹50 lakh threshold calculated?

It is based on taxable turnover excluding zero-rated and exempt supplies.

7. Can ITC be used to pay penalties under Rule 86B?

No, penalties must be paid via cash ledger.

8. What records are scrutinized for compliance?

Monthly returns and turnover records exceeding the threshold.

9. Are there exceptions for newly registered taxpayers?

No, Rule 86B applies once turnover exceeds ₹50 lakhs.

10. What is the role of the Commissioner in Rule 86B?

The Commissioner can waive restrictions on a case-by-case basis.

11. How is compliance verified under Rule 86B?

Through automated checks and scrutiny of GST returns.

12. Does Rule 86B impact the overall ITC balance?

No, it only restricts its utilization for output tax payment until 99% of it.

13. What actions are taken for non-compliance?

Cancellation of GST registration and penalties under Rule 21.

14. Can multiple businesses under the same PAN claim exemption?

No, Rule 86B applies individually to each GSTIN.

15. Are input services included in the calculation?

No, the restriction is only on goods turnover.

16. Can refund claims be adjusted under Rule 86B?

Refund claims are unaffected but must comply with ITC rules.

17. Is RCM included in taxable turnover?

No, RCM is not considered as a part of taxable turnover for this rule.

18. What penalties apply for repeated violations?

Continuous violations may result in additional scrutiny or legal action.

VA-GST UPDATES

19. Are there specific formats for reporting under Rule 86B?

No additional formats; compliance is monitored through regular returns.

20. What are common issues flagged under Rule 86B?

Discrepancies between turnover and ITC utilization.

21. Does Rule 86B apply to SEZ units?

No, SEZ supplies are excluded.

22. Can past compliance records affect Rule 86B applicability?

Yes, consistent compliance may lead to exemptions upon request.

23. What is the appeal process for disputes under Rule 86B?

Appeals can be filed with the appropriate GST appellate authority.

24. Does Rule 86B encourage cash payments?

Yes, it ensures at least 1% of tax liability is paid in cash.

25. What safeguards exist against misuse of Rule 86B?

Exceptions for legitimate businesses and review mechanisms by authorities.

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PART-III

RELATED CIRCULAR/NOTIFICATIONS/CASE LAWS

Notification No. 94/2020-Central Tax [G.S.R. 786(E)/[F. No. Cbec-20/06/04/2020-Gst], Dated 22-12-2020

Rule 86B : Restrictions on use of amount available in electronic credit ledger.-

- o This rule prevails over all the other rules in the CGST Rule
- o This rule will be effective from 01/01/2021
- o It says that the registered person shall not use the amount available in electronic credit ledger to discharge his liability towards output tax in excess of 99% of such tax liability,
- o This rule is not applicable
- o When the value of taxable supply during a month is up to 50 lakhs (Value of taxable supply will not include exempt supply & zero rate supply)
- o To the proprietor or Karta or the managing director or any of its two partners, whole-time Directors, Members of Managing Committee of Associations or Board of Trustees who,
- o have paid more than one lakh rupees as income tax in each of the last two financial years for which the time limit to file return of income under subsection (1) of section 139 of the said Act has expired;
- o Where the registered person has received a refund amount of more than one lakh rupees in the preceding financial year on account of unutilised input tax credit under zero rated supplies made without payment of tax
- o Where the registered person has received a refund amount of more than one lakh rupees in the preceding financial year on account of unutilised input tax credit under inverted duty structure;

- o the registered person has discharged his liability towards output tax through the electronic cash ledger for an amount which is in excess of 1% of the total output tax liability, applied cumulatively, up to the said month in the current financial year;
- o the registered person is –
- o Government Department;
- o a Public Sector Undertaking;
- o a local authority
- o a statutory body:

S.S. Marketing Vs. Union Of India

The Rajasthan High Court in the case of *S.S. Marketing Vs. Union of India* has recently admitted a petition challenging Rule 86B of Central GST Rules, 2017 wherein the Court has issued a notice to the Centre.

Rule 86B limits the use of input tax credit (ITC) available in the electronic credit ledger for discharging the output tax liability. This rule has an overriding impact on all the other CGST Rules.

The petitioner S.S. Marketing contended before the High Court that the registered person is entitled to take credit of eligible input tax as self-assessed in his return.

It was also submitted that the original return filing design involved the linkages with invoices having back and forth movement between sellers and buyers and there was a flow of return amongst GSTR1, GSTR-2 and ending with GSTR-3. But it could not be implemented. It was noticed that the system of GSTR -1, 2 & 3 was complicated and hence, it was decided to limit the implementation of GST with GSTR-1 and GSTR-3B.

It was also submitted that in view of the lacuna in the system of matching, reversal and reclaim of input tax, the notification no. 94/2020 Central Taxes, dated 22.12.2020 amended CGST Rules 2017 and inserted rule 86B to be effective from 01.01.2021 is arbitrary, unreasonable and violative of Article 14, 19(1)(g) and 300A of the Constitution of India and ultra vires the parent Act. As per Rule 86B the petitioner has been restrained from utilizing the amount available in its electronic credit ledger to discharge his liability towards output tax in excess of ninety-nine percent, in case where the value of outward taxable supply other than exempt supply and zero-rated supply in a month exceeds fifty lakh rupees.

A.M. Enterprises Vs State Of Himachal Pradesh &Ors.

The Himachal Pradesh High Court recently observed that Rule 86B of the Central Goods and Services Tax (CGST/HPGST) Rules, 2017, which restricts use of Input Tax Credit (ITC) in the Electronic Credit Ledger for releasing Output tax, appears to be ultra vires the HP Goods and Services Tax Act 2017.

The court said that the petitioner's contention that Rule 86B of the Act has no statutory backing and appears to be ultra vires the provisions of the HPGST Act, 2017.

Thanks and Regards

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