

# EY Tax Alert

HC upholds validity of provisions restricting ITC where supplies are taxed under RCM

EY Alerts cover significant tax news, developments and changes in legislation that affect Indian businesses. They act as technical summaries to keep you on top of the latest tax issues. For more information, please contact your EY advisor.

## Executive summary

This Tax Alert summarizes a recent judgement of the Delhi High Court (HC)<sup>1</sup> dealing with the issue of denial of input tax credit (ITC) where supplies are taxed on reverse charge basis under both Service tax and Goods and Services Tax (GST).

Assessee is providing services of recovery agent to non-banking financial company (NBFC) and the said service is covered under RCM. Hence, ITC in the hands of the assessee is denied.

HC observed that:

- ▶ Section 9(3) of the CGST Act and Section 5(3) of the IGST Act empowers the Central Government to specify categories of supply of goods or services on which tax shall be paid on reverse charge basis. Similar provisions were there under Finance Act, 1994. Hence, RCM notifications were issued with authority of law.
- ▶ The right to avail ITC is a statutory right. The same is available only if the statute provides for it and same will be available to the extent the statute permits.
- ▶ All persons rendering services of a particular nature have been treated uniformly. It is not the case of petitioner that persons rendering services of a recovery agent to NBFC have been treated differently.
- ▶ It is well settled that Article 14 of the Constitution of India does not prohibit reasonable classification, which has the rational nexus to its object.
- ▶ Denying ITC to service providers, who are not liable to pay tax on output services, is founded on a rational basis which has a clear nexus with the classification.

Accordingly, HC held that there is no merit in the challenge laid by the petitioner to the impugned RCM Notifications or the provisions of Section 17(3) of the CGST Act.

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<sup>1</sup> TS-180-HCDEL-2024

## Background

- ▶ Petitioner is engaged in providing services of a recovery agent to a non-banking financial company (NBFC).
- ▶ It had entered into contracts with various service providers (sub-contractors) for availing their services as recovery agents.
- ▶ These sub-contractors charged tax on their services.
- ▶ However, service tax/ goods and services tax (GST) on services of a recovery agent to a NBFC is chargeable on reverse charge basis and thereby, liability to pay tax rests on the recipient of services i.e., NBFC.
- ▶ Further, where services tax/ GST is payable on reverse charge basis by the recipient of the services, the service provider cannot claim any benefit of the taxes paid on input services in absence of output liability.
- ▶ In view of above, petitioner challenged the RCM Notifications<sup>2</sup> under Service tax and GST.
- ▶ It also challenged validity of Section 17(3) of the CGST Act to the extent it provides that value of exempt supply for the purpose of ITC reversal shall include RCM supplies.

## Petitioner's contentions

- ▶ Denial of input tax credit (ITC) is discriminatory and plainly arbitrary.
- ▶ It is contrary to the scheme of the CGST Act and the fundamental structure on which the GST law is premised.
- ▶ Classification between services where tax is payable on reverse charge basis and those where tax is payable on forward charge basis, is not founded on intelligible differentia and has no nexus with any object to be served.
- ▶ The scheme of selecting certain services to be taxed under RCM violates Article 14 of the Constitution of India.
- ▶ Reliance was placed on various case laws<sup>3</sup> to submit that provision of charge on RCM basis in respect of certain services suffers from manifest arbitrariness and therefore, liable to be set aside.

- ▶ Denial of input tax credit in respect of certain services amounts to double taxation, which is impermissible.
- ▶ The same service is taxed twice, first in respect of input services and second in the hands of service recipient.
- ▶ A reference was placed on Statement of Objects and Reasons of GST to state that the entire object was to avoid a cascading effect of tax and therefore, seamless transfer of ITC from one stage to other is the fundamental rationale in the scheme of GST.

## Revenue's contentions

- ▶ Reliance is placed on SC decision in case of Cosmo Films<sup>4</sup> to contend that any inconvenience or hardship caused would not be relevant in pronouncing on the constitutional validity of a fiscal statute or economic law.
- ▶ By various provisions of the Finance Act 1994, Integrated Goods and Services Tax Act, 2017 (IGST Act) and CGST Act, the Parliament has the necessary legislative competence to enact a scheme of taxation involving levy and collection of tax on RCM basis.
- ▶ There is no statutory right to claim ITC and same is a matter of concession granted by the statute and not a vested right.<sup>5</sup>
- ▶ Merely shifting of collection of tax from provider of service to the recipient of service does not violate any constitutional right.<sup>6</sup>

## HC ruling

- ▶ Section 9(3) of the CGST Act and Section 5(3) of the IGST Act provide that Central Government may on recommendations of GST Council, *vide* notification specify categories of supply of goods or services on which tax shall be paid on reverse charge basis.
- ▶ Similarly, section 68(2) of Finance Act 1994 empowered the Central Government to notify services on which tax is payable by the recipient.
- ▶ In view of the above, there is no merit in suggesting that RCM notifications were issued without authority of law.
- ▶ There is no vested or inherent right of an assessee to claim ITC on the services availed.

<sup>2</sup> Notification No. 30/2012-ST dated 20 June 2012-ST and 10/2017-IT (Rate) dated 28 June 2017

<sup>3</sup> UOI v. N.S. Rathnam and Sons (2015) 10 SCC 681, Ayurveda Pharmacy v. State of Tamil Nadu (1989) 2 SCC 285 and Shayara Bano v. UOI (2017) 9 SCC 1

<sup>4</sup> (2023) 9 SCC 244

<sup>5</sup> TVS Motor Company Ltd. v. State of Tamil Nadu (2019) 13 SCC 403; ALD Automotive Pvt. Ltd. v. Commercial Tax Officer (2019) 13 SCC 225 and UOI v. VKC Footsteps India Pvt. Ltd. (2022) 2 SCC 603

<sup>6</sup> R.C. Jall Parsi v. UOI AIR 1962 SC 1281, Rai Ramkrishna v. State of Bihar: AIR 1963 SC 1667 and Gujarat Ambuja Cements Ltd. v. UOI (2005) 4 SCC 214

- ▶ The matter relating to whether any credit is available and to which extent it is available, is a matter of statutory prescription.
  - ▶ The right to avail ITC is a statutory right. The same is available only if the statute provides for it and same will be available to the extent the statute permits.
  - ▶ Central Government in its wisdom selected certain services on which GST is payable on a reverse charge basis.
  - ▶ The contention that same amounts to hostile discrimination is plainly unmerited.
  - ▶ All persons rendering services of a particular nature have been treated uniformly. It is not the case of petitioner that persons rendering services of a recovery agent to banking company, NBFC or financial institution have been treated differently.
  - ▶ The legislature or the Parliament has wide discretion in choosing the persons to be taxed or the objects for taxation.
  - ▶ The question whether any levy on person violates Article 14 of the Constitution of India must necessarily be viewed bearing in mind the wide amplitude of power to tax.
  - ▶ It is certainly not open for a class of assessee to seek parity with another class of persons.
  - ▶ It is not open to question as to why the Parliament has selected certain set of services for levy of tax while exempting certain other services.
  - ▶ Similarly, it is not open to question as to why certain services are selected for being subjected to payment of tax under reverse charge basis while leaving out other services.
  - ▶ If one accepts that it is not necessary for Parliament to have taxed all services in order to tax some services, then it becomes clear that selecting a different mechanism to collect tax in respect of some services is also not amenable to challenge on the ground of Article 14 of the Constitution of India.
  - ▶ A service provider providing services which are subject to payment of tax on a reverse charge basis, is not liable for payment of GST. Thus, the rationale to deny ITC in such cases is obvious.
  - ▶ Hence, denial of ITC in respect of services where GST is payable on reverse charge basis cannot held to be irrational and arbitrary.
  - ▶ It is well settled that Article 14 of the Constitution of India does not prohibit reasonable classification, which has the rational nexus to its object.
  - ▶ Denying ITC to service providers, who are not liable to pay tax on output services, is founded on a rational basis which has a clear nexus with the classification.
- ▶ Accordingly, HC held that there is no merit in the challenge laid by the petitioner to the impugned RCM Notification or the provisions of Section 17(3) of the CGST Act.

## Comments

- a. Reverse charge mechanism was brought to tackle the issue of non-payment of tax by small taxpayers and unorganized sector.
- b. While RCM notifications are held legally valid, the businesses whose services are covered under RCM may represent before the GST Council to move the levy to forward charge in case where the supplier is registered or a corporate entity,
- c. Alternatively, the Government may incorporate provisions to grant refund of ITC to the suppliers as was available in certain cases under Service tax.
- d. In 52<sup>nd</sup> GST Council meeting held on 7 October 2023, it had been suggested to move the supplies by Indian Railways from reverse charge to forward charge since ITC was becoming cost to Indian Railways.

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