



**ITC reversal on
goods written off
or destroyed –
A new pandora
box under GST!**



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Input tax credit ('ITC') under Indirect Tax Laws has always been one of the subject matters which invites close attention by taxpayers, revenue and professionals. There are numerous matters relating to ITC under erstwhile Indirect Tax Laws which are pending for decision. One of the objectives to bring Goods and Services Tax ('GST') in India was to ensure seamless flow of ITC in the supply chain. The GST fairly brings this flavor on plate as it allows ITC on all goods and services which are used or intended to be used in the course or furtherance of one's business. However, the law specifically prohibits ITC on few goods and services even if they are used in one's business.

The Central Goods and Services Tax Act, 2017 ('CGST Act') provides for specific situations wherein a registered person cannot avail ITC on various goods and services. One of the situations is that a registered person needs to reverse ITC availed on goods 'destroyed' or 'written off'. This article aims to enlighten the scope of Section 17(5)(h) of the CGST Act which deals with reversal of ITC in this situation.

Section 17(5)(h) of the CGST Act reads as under:

'(5) Notwithstanding anything contained in sub-section (1) of section 16 and sub-section (1) of section 18, input tax credit shall not be available ***in respect of the following***, namely:

(h) goods lost, stolen, ***destroyed, written off*** or disposed of by way of gift or free samples; and...'

A plain reading of above section reveals that the reversal requirement arises only on goods on which ITC is claimed and these goods are now 'destroyed' or 'written off'. For instance, (i) a trader purchases goods for trading and claimed ITC on them, or (ii) a manufacturer purchases raw material and claimed ITC on them. Later-on, these goods are destroyed or written off by trader / manufacturer. ITC reversal needs to be done in this case. The issue will arise when GST paid raw material is used in the manufacturing of finished goods and such finished goods are destroyed or written off by the manufacturer. The question arises whether or not there is a requirement to reverse ITC in this case. The answer to this question would come from the interpretation of expression 'in respect of'

Meaning of expression 'in respect of'

The expression 'in respect of the following' used in Section 17(5) of the CGST Act restricts the scope of this section. This expression was examined by the Supreme Court in the case of ***State of Madras v. M/s.***

Swastik Tobacco Factory [AIR-1966-SC-1000]. In this case, the assessee purchased raw tobacco and converted the same into chewing tobacco. Excise duty was paid on purchase of raw tobacco. As per the applicable provisions, the assessee could claim deduction of excise duty if it was paid 'in respect of' the good sold by him (which in this was chewing tobacco). The SC held that Indian tax laws have used the expression 'in respect of' as synonymous with the expression 'on'. If excise duty was paid on raw tobacco it can be attributable only to the raw tobacco and not to chewing tobacco. It was held that no deduction of excise duty is permitted to the assessee.

The above interpretation would mean that no ITC is required to be reversed in cases where ITC has been claimed on raw materials used in the manufacturing of finished goods which ultimately got destroyed or written off. This seems to be a fair interpretation of legislation. The legislation could have chosen to cover reversal of ITC on input contained in finished goods if that would have been the intention of law. For instance, under the erstwhile CENVAT Credit Rules, 2004 ('Credit Rules') there was a specific provision allowing CENVAT Credit availed on input contained in finished goods in stock when exempted goods become excisable. Such explicit provision is missing under GST.

Similar view has been echoed in advance ruling in case of ***M/s. General Manager Ordnance Factory Bhandara [2019-VIL-171-AAR]*** where input was used in the manufacturing of finished goods. These finished goods were sent out for testing. Few finished goods got destroyed during the testing process. By applying the above interpretation of law, the authority held that no ITC is required to be reversed on finished goods that are destroyed during testing.



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Interestingly, it appears that the tax authorities are in 'no mood' to adopt the above interpretation of law. The Government vide ***Circular No. 72/46/2018***-

GST dated October 26, 2018 has clarified its intention that in case of expired finished goods, ITC attributable to manufacturing of such finished goods needs to be reversed. In a ***FAQ on Drugs & Pharmaceuticals***, the government clarified that a manufacturer is required to reverse ITC on destruction of expired medicines

The above contrary views are going to create more problems for the taxpayers in a time to come.

ITC reversal is not required on 'services'

Section 17(5)(h) required reversal of ITC on 'goods' only. Here goods would mean input and capital goods. This provision doesn't require reversal of ITC on input services which are relatable to goods destroyed or written off.

Scope of word 'written off'

ITC needs to be reversed on goods which are 'written off' by the taxpayer. Similar provision existed in the erstwhile Rule 3(5B) of the Credit Rules. Under this rule, if the value of any input is written off fully or partially or where the provision to write off fully or partially is made in the books of account then the manufacturer / service provider was required to pay an amount equal to the CENVAT credit taken in respect of such input. Historically, there has been dispute on scope of 'write off' and hence the scope of this rule was expanded to cover situations of partial write off and creating provision to write off.

Under GST, the requirement to reverse ITC arises only in case of actual write off. No ITC reversal is required where goods have been partially written off and provision to write off is made.

Conclusion

In our view, a registered person is not required to reverse ITC availed on raw materials used in manufacturing of finished goods which are written off or destroyed. Further, there is no need to reverse ITC on provision for writing off the inputs. A registered person shall reverse ITC only on actual written off the inputs.