

## Concept of Blocked Input Tax Credit in Specified Context under GST: An Analysis



*The subject of input tax credit is central to tax on goods and services. The rule in the goods and services tax is that there should be seamless credit of input tax to avoid cascading effect and it is only by way of exceptions that such seamless inflow of tax credit can be interrupted. Sub sections 5 of section 17 of The Central Goods and Services Tax Act 2017 through its various clauses carve out situations in which the legislation intends to interrupt such seamless flow. Sub clause (i) of clause (b) of sub section 5 of section 17 puts such embargo on food and beverages, outdoor catering, beauty treatment, health services, cosmetic and plastic surgery barring some exceptions specified therein. The article deals with the help of case studies and illustrations some of the most vexed issues that may arise in respect of specified supplies in the sub clause. Read on to know more...*

Section 17 of the Central Goods and Service Tax Act deals with apportionment of credits and blocked credits. Obviously, the section is an exception to the general rule of tax on goods and services tax which is destination based consumption tax. As a general rule, taxes paid on goods and services should be passed

through till the time the goods or services are finally consumed by the consumers. Accordingly, subject of seamless input tax credit is central to the goods and services tax regime and anything that blocks it should only be aberration and taken on board with a pinch. It should be in fitness of things, therefore, that artificial creations enunciated in the section to cut short input tax credit's life, at the interim stage, much before the stage of destination and consumption should receive stricter of interpretations and application. This premature termination of input tax credit also violates the avowed objective of the whole eco system around goods and services tax which is that there should be no cascading effect of taxes or in



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other words that there should be no tax on tax. It will not be surprising that these principles enunciated to stop the premature flow of tax credit will be a breeding ground for lot of doubts for the users and also result in lot of eventual litigation. Last words on several of the intricacies in the section will take years to be pronounced by the highest judiciary. But it is always good that enlightened minds keep engaged in constant deliberations to solve the puzzles involved on the subject for the guidance and benefit of the stakeholders at large. This article is a humble attempt to undertake an explorative trip to scratch the surface of sub clause (i) of clause (b) sub section 5 of section 17.

### Overarching Scheme of Sub Section 5 of Section 17

#### Non obstante sub section

The sub section 5 starts with *non obstante* provision stipulating that sub section 5 will apply notwithstanding anything contained in section 16(1) and section 18(1). Section 16(1) which deals with input tax credit generally and section 18(1) which deals with input tax credit in special circumstances allow input tax credit in respect of the goods or services or both used or intended to be used in the course or furtherance of business. The sub section 5 of section 17, however, restricts input tax credit in the cases specified even if the goods or services or both are used or intended to be used in course or furtherance of the business. Thus is the need for *non obstante* nature of the sub section.

#### Scope of the phrase in respect of followings, namely

The section provides that input tax would not be available in respect of the followings, namely and then gives the list of what contains the followings. Lest one may miss the significance of the way the sub section is worded, it is important to underline that it does not state that input tax credit will not be available in respect of the following supplies or in respect of the following goods or services or both or anything else. Each clause provided in the sub section 5 is distinct and differently worded and each contains restriction that is unique in nature and, therefore, no universal rule would get applied to while interpreting different clauses of sub section 5 of section 17.

One more fact that needs to be kept in mind is that it uses the phrase “in respect of” before the

word following which in turn is followed by the word namely and colon thereafter. The phrase “in respect of” does not carry the same meaning as the phrase “in relation to” or other similar phrases which are used. Therefore, few lines on what exactly is meant by this phrase in English language or in legal terms may help. In common English, meaning of this phrase is “in connection with something” or “with reference to” or “as regard”. No special meaning is found for this in legal diction.

### Drafting Cauldron of Sub Clause (i) of Clause b of Sub Section 5

There is no doubt that the way the sub section 5 and clauses thereof read with their sub clauses are drafted, it is going to be a major hassle to comprehend the same by the users. It would entail cross views of different shades and hues and may see protracted litigation before final view is reached. To illustrate the problem in hand in the case of sub clause (i) of clause b of sub section 5, let us recapitulate the way sub section, clause and sub clause are worded. Sub section 5 which is the fountain head states that input tax credit will not be available in respect of the followings; namely what is specified in the given clauses. Clause (b) of the said sub section, in turn, stipulates the following supply of goods or services or both in the main limb and then follows this with three sub clauses which specify the supplies. Sub clause (i) of the said clause lists food and beverages, outdoor catering, beauty treatment, health services and plastic and cosmetic surgery except where the inward supply of goods or services or both of a particular category is used for making an outward supply of the same category of goods or services or both or as an element of taxable composite or mixed supply.

If we cut out the umbilical cord of the drafting of the sub section, clause (b) of the sub section and sub clause (i) of the clause, the final reading, that would emerge, would be something like, either of the two options. One, the input tax credit would not be available in respect of supply of foods and beverages, outdoor catering, beauty treatment, health services, plastic and cosmetic surgery. In this version, use of goods or service or both after the words “following supply of” may go *otiose*. Another version could be that mention of food and beverages, outdoor catering, beauty treatment, health services, plastic and cosmetic surgery are the supply of goods or services or both talked about in the sub clause

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and therefore, these supplies consisting of goods or services or both should be replaced in the sub clause and as a result of which, it would read as the input tax credit shall not be available in respect of goods or services or both of food and beverages, outdoor catering, beauty treatment, health services and plastic and cosmetic surgery. A third and stretched version could be that the input tax credit shall not be available in respect of the goods or services or both used or intended to be used in foods and beverages, outdoor catering, beauty treatment, health services and cosmetic or plastic surgery. The real challenge of interpretation lies in the fact that the clause talks of following supply of goods or services or both, but what follows in the sub clause are not goods or services or both *per se* but certain categories of activities specified in which may be submerged the supply of goods or services or both. In the myriad of possibilities, the search for right interpretation can lie in understanding the whole scheme of input tax credit. Input tax credit in sub section 2(63) of the act means the credit of input tax. Input tax in sub section 2(62) in relation to a registered person means the central tax, state tax, integrated goods and service tax, union tax charged on any supply of goods or services or both **made to him and includes the specified taxes**. Therefore, essentially input tax is tax paid on supply of goods or services or both made to a registered person. As such, the question of non-availability of input tax credit is to be reckoned with in the hands of recipient of inward supply of goods or services or both. Accordingly, when sub section 5 speaks of that input tax credit shall not be available in respect of specified supplies, it is in essence talking of the inward supplies specified in the hands of recipient. In final analysis, anything in the form of goods or services or both when received as part and parcel of the specified supplies only gets barred from availability of input tax credit under this sub clause and not otherwise. Taking into account the whole conspectus of the subject of input tax credit, I am of the opinion that the restriction is not attached to the goods or services or both used or intended to be used in the specified supply, but it is attached to the specified supplies. By way of passing remark, one cannot but highlight that in the specified supplies, it is of not much relevance as to what goods or services or both are being supplied but what is of penultimate relevance is the supplies specified. Goods or services or both comprising of the specified supplies are at best secondary.

### Case Studies

- I. Suppose a trader X, registered under the act, supplies taxable grocery items to another registered taxable person Y who is engaged in business of outdoor catering. Will clause (b) of sub section 5 of section 17 apply to this supply without considering the exception clause? Thus the supply is not hit by the clause (b) of the sub section 5 without considering the exception for the reason that the supply from X to Y is not that of food and beverages but of food products. The counter view, which may be argued, is that grocery item being food product would be hit by clause b of sub section and input tax credit would be available only if it falls in the exception.
- II. Assuming that supply of food and beverages products is hit by the clause (b) of sub section 5, suppose a sugar mill S supplies sugar to a candy manufacturer C and both being registered taxable persons under the act and presuming that clause b of sub section 5 of section 17 also covers food and beverages products in its ambit, the candy manufacturer will not be entitled to input tax credit in respect of inward supply of sugar under the main sub clause (i) of clause (b) of section 5. It will also not be eligible for input tax credit under the two situations mentioned in the exception clause as well. It will not be eligible under the first limb of the exception because sugar which falls in the particular category will not be the same as that of the category of candy and therefore, it cannot be said that inward supply of goods or services or both of a particular category has been used for making an outward supply of the same category. It will also not be eligible for input tax credit in the second limb also because the sugar, being an inward supply of a particular category used as element of taxable composite or mixed supply as sugar would not be one of the elements of either the mixed or composite supply. This case study would fortify the view that it is the specified supplies which are covered in the clause (b) and not goods or services or both of which the supply is made of.

### Definitional Challenges of Excepted Categories

The sub clause either speaks of supply of a specified character or supply of goods or services or both having usage in supply of the specified character. Which one of the two is being spoken of in the

sub clause remains a grey area and dealt with hereinbefore. But whatever view may prevail, there are going to be interpretational issues because none of the specified categories is defined in the act or the rules.

First of such challenges is to decide whether the supply specified forms a genus of some kind or these are purely heterogeneous in nature, having no interlinkages? The possible genus that can be thought of is that all the specified supplies go, to result into personal consumption. The other possible genus that comes to mind is that all are activities/performances and therefore all categories being talked of are in verb form.

Second challenge can be with regard to the fact whether the term category used in the second limb of the clause dealing with exception, refers to each of the specified supplies because to ascribe meaning to the category in the second limb is very important to claim exemption, which is not otherwise defined in the clause or elsewhere. On careful reading of the first limb and second limb of the clause, there is strong probability to infer that category mentioned in the second limb does refer to the specified supply in the first limb, each one of which constitutes individual supply. Any other meaning ascribed to the word category in the second limb of the clause would make the clause unworkable more particularly the second limb which creates exception to the rule.

Another issue that may come up for discussion is whether the restriction on availability of input tax credit is to the supplier of specified categories of supplies or to the goods or service or both in relation to specified categories. This is the most critical question in the clause and to my mind in all probability the restriction would apply on the supplier supplying goods or services or both in the

course of specified categories and not otherwise. But the possibility of cases being argued from the other point of view cannot be fully ruled out.

It would be interesting to know about each category of supply and what implications it has on availability of input tax credit.

Foods and beverages is the first category. Like other specified categories, foods and beverages is also not defined in the clause or elsewhere. At the outset, it is worth mentioning that there is “and” between the two words namely; food, beverages. The usage of “and” between the two words is understood in the sense of conjunction/togetherness. Does that mean the supplier who is engaged in supply of food sans beverages or in supply of beverages sans food is not hit by this clause? Another similar question that would arise is whether the term covers supply of food and beverage services or supply of food and beverages as the two have absolutely different connotations.

**Food and beverage services (as a verb/activity)** can be broadly defined as the **process of preparing, presenting and serving** of food and beverages to the customers. Food and Beverages service can be of the following two types. **On premises**-food is delivered where it is prepared. The customers visit the premises to avail the food service. **Off Premises – outdoor catering**-this kind of service includes partial cooking, preparations and service at customers’ premises. It is provided away from F&B service provider’s base on the occasion of major event which call for large number of customers.

As against the meaning of food and beverage service, **food as a noun**, as per Merriam Webster dictionary, is defined (a) as a material consisting essentially of protein, carbohydrates, and fat used in the body of an organism to sustain growth, repair, and vital processes and to furnish energy also (b) inorganic substances absorbed by plants in gaseous form or in water solution (c) nutrient in solid form (d) something that nourishes, sustains and supplies.

Beverages, **as noun** and defined in Cambridge English dictionary, means **a drink of any type** and as defined in Merriam dictionary means **a drinkable liquid**.

As per another definition, a beverage can be generally described **as any liquid specifically consumed by drinking whether as food or solely for the purpose of hydration**. It is said that beverage is always a food though food is not necessarily a beverage.



In the light of above discussion, let us examine how the restriction on availability of input tax credit would or should work. Would the restriction apply on supply of food or **supply of beverages or on supply of food and beverages' services? Supply of food and beverages service as we noted above in the definition section, includes preparation, presentation and service either on the premises or off the premises.** In supply of food or beverages all the three necessary elements namely; preparing, presenting and serving would never be present together. To take an example for the understanding, let us take the case of cake. If it is made in a factory and supplied to a shop who supplies it to customers, it is supply of cake. But one goes to a restaurant and order the cake for eating there, the preparation, presentation and serving is done in the restaurant only. The latter is covered and hit by the clause and the former may not be.

### Exceptions Explained

Sub clause (i) of clause (b) also creates exceptions. As a result of these exceptions, the input tax credit shall be available on the supply of goods or services or both as specified, namely, food and beverages, beauty treatment, health services and plastic and cosmetic surgery in the situations carved out by way of exceptions. The language used in the clause is "except where an inward supply of goods or services or both of a particular category is used by a registered person for making an outward taxable supply of the same category of goods or services or both or as an element of a taxable composite or mixed supply."

Before one embarks on examining the issue related to exceptions, it is worthwhile for the purpose of this article to recapitulate the definition of input tax, input tax credit, inward supply and outward supply.

Section 2(62) of the act states that "input tax" in relation to a registered person, means the central tax, State tax, integrated tax or Union territory tax charged on any supply of goods or services or both made to him and includes—

- (a) The integrated goods and services tax charged on import of goods;
- (b) The tax payable under the provisions of sub-sections (3) and (4) of section 9;
- (c) The tax payable under the provisions of sub-section (3) and (4) of section 5 of the Integrated Goods and Services Tax Act;

- (d) The tax payable under the provisions of sub-section (3) and sub-section (4) of section 9 of the respective State Goods and Services Tax Act; or
- (e) The tax payable under the provisions of sub-section (3) and sub-section (4) of section 7 of the Union Territory Goods and Services Tax Act, but does not include the tax paid under the composition levy;

Section 2(63) provides that "input tax credit" means the credit of input tax.

Section 2(67) provides that the inward supply in relation to a person, shall mean receipt of goods or services or both whether by purchase, acquisition or any other means with or without consideration.

Section 2 (83) provides that "outward supply" in relation to a taxable person, means supply of goods or services or both, whether by sale, transfer, barter, exchange, license, rental, lease or disposal or any other mode, made or agreed to be made by such person in the course or furtherance of business.

### Meaning of phrase "supply of goods or services or both of particular category" in the exception clause

The exception starts with the words "except where the inward supply of goods or services or both of a particular category." Though not explicitly mentioned but the term "particular category" in all likelihood refers to the supplies spoken of in the clause before, namely; food and beverages, outdoor catering, beauty treatment, health services or cosmetic and plastic surgery. But the problem does not end there. As per the sub clause, exception would apply to inward supply of goods or services or both of a particular category. Viewed from that perspective, what does supply of goods or services or both of a particular category imply? Each of the particular categories of supply may comprise of several sub supplies of goods or services or both, but each one of such sub supplies is also known by the same name of particular category. For example, in a supply of outdoor catering, there may be several sub supplies of drinks, snacks, main course, crockery, linen and so on and each such supply is also known by the name of outdoor catering. Therefore, the phrase "supply of goods or services or both" used in the exception refers to the supply of these sub supplies of goods or services or both as well.

### Meaning of the term "is used" in the exception

There are two implicit conditions in this phrase to

attract exception; one that the inward supply of a particular category **is used** by the registered person and two that it is used **for making** an outward supply of the same category of goods or services or both. The English dictionary meaning of the word **used** is “employed in accomplishing something” and that of word **making** is “the activity or process of producing something” and the meaning of the word **for** is “the purpose of”. Read together, the input tax credit would be permissible where the inward supply of a particular category is employed in accomplishing the purpose of the process of making or producing an outward supply of the same category of goods or services or both.

**Whether or not the condition of “for making an outward supply of the same category of goods or services or both” also apply when inward supply of particular category is used by the registered person as an element of a taxable composite or mixed supply**

Before one deals with this issue, it is significant to draw the attention of the readers to the manner in which the two sub limbs of the exception limb may be read. The correct way to read the two limbs may be as under:

- (a) Where an inward supply of goods or services or both of a particular category is used by a registered person for making an outward supply of the same category of goods or services or both and
- (b) Where an inward supply of goods or services or both of a particular category is used by a registered person as an element of a taxable composite or mixed supply.

**Holistic Perspective**

It is important to highlight at the outset that the term “supply of the same category of goods or services or both” in the exception clause in second limb of the exception is in absolute contrast to the language used in the first limb of the exception where the phrase used is “supply of goods or services or both of a particular category”. In the latter, it is supply of the same category of goods or services or both while in the former it is supply of goods or services or both of a particular category”. In other words, in the latter it is the category of the goods or services or both which is of reckoning, while in the former it is the supply of particular category which is of reckoning. This drafting issue requires an urgent correction.



Having said so, now we can interpret the exception clause in holistic perspective. The intention of the exception clause is to allow input tax credit in following situations, subject to compliance with the conditions stated in the clause:

- A. Where the inward supply of goods or services or both of particular category is used by a registered person for making an outward taxable supply of the same category of goods or services or both. Suppose a hospital engages the services of a doctor to conduct a specialised surgery in its hospital on the patient who is admitted in that hospital for that operation/surgery, both the services of doctor to hospital and service of hospital to patient falling under the particular category of health services, the hospital would be entitled to input tax credit on the tax paid on services supplied to hospital.
- B. Where the inward supply of goods or services or both of a particular category is used by the registered person as an element of taxable supply or mixed supply. Example of this kind of situation would be the case of an event management company, a registered taxable person, which procures taxable outdoor catering services, beauty treatment services (specified services in the sub clause) and other taxable services and these inward supply of services are used in providing outward taxable service of management of a function (which not necessarily is one of the specified supplies in the sub clause but is either a composite or mixed supply in the hands of such registered taxable person), such registered person would be eligible to claim input tax credit on specified supplies. ■