

Entitlement of ITC under GST- Doctrine of 'Look At' vs. 'Look Through'¹

A doubt lingers as to whether a registered person should look to the immediate use of inward supply received or he needs to pursue further and examine the purpose of inward supply i.e., end use to decide upon entitlement of Input Tax Credit (ITC) on the said inward supply. Let us take an example of procurement of goods/services for installation of solar power plant, which is for captive consumption for manufacture of goods. The article attempts to aid the registered person in selection of approach to be adopted for examination of Input Tax Credit under GST law. Read on ...



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If doctrine of 'look at' is applied, then immediate use of solar power plant is for generation of electricity- an exempted supply and therefore ineligible for credit in terms of Rule 42(1) (c) /Rule 43(1)(a) of CGST Rules, 2017. If doctrine of 'look through' is applied, then purpose of generation of power is for captive consumption in manufacture of goods and entitlement to input tax credit will depend on taxability of goods manufactured using the power generated.

'Look through' – Approach:

Relevant provisions of CGST Act, 2017 dealing with Input Tax Credit are extracted below for ease of reference:

Section 16

16. (1) Every registered person shall, subject to such conditions and restrictions as may be prescribed and in the manner specified in Section 49, be entitled to take credit of input tax charged on any supply of goods or services or both to him which are used or intended to be used in the course or furtherance of his business.

Section 17 (1) & 17 (2)

17. (1) Where the goods or services or both are used by the registered person partly for the purpose of any business and partly for other purposes, the amount of credit shall be restricted to so much of the input

¹ Expressions & doctrine borrowed (inspired) from landmark decision of Hon'ble Supreme Court in case of Vodafone International Holdings B.V. in Civil Appeal no.733 of 2012

tax as is attributable to the purposes of his business.

(2) Where the goods or services or both are used by the registered person partly for effecting taxable supplies including zero-rated supplies under this Act or under the Integrated Goods and Services Tax Act and partly for effecting exempt supplies under the said Acts, the amount of credit shall be restricted to so much of the input tax as is attributable to the said taxable supplies including zero-rated supplies.

(Emphasis supplied)

As can be seen from emphasised portions, both sections look to the purpose and use of the inward supply to the business of the registered person, hence a 'look through' approach of how the inward supplies are put into use i.e. end use is more aligned and suited.

Examination of the 'use' & 'purpose' is to be done from the stand point of the 'registered person'. Useful reference can be made to decision of Hon'ble Chhattisgarh High Court² wherein the appellant was manufacturer of iron and steel products. For carrying out the manufacturing operations, they manufactured coking coal as intermediary product and as the coke comes into existence in bigger size, it was put through coke cutter, during which process - coke fines (coke dust) emerged. While deciding the issue on entitlement of cenvat credit, the Hon'ble Court gave due emphasis to the business of the manufacturer as can be seen from the extract below:-

"the Learned Commissioner had not at any point of time concluded that the coke fines themselves is a product intended by the manufacturer to be available as commodity for its commercial and trade dealings", hence the business of the registered person will be pertinent to appreciate whether the product produced by them is one of intermediate nature or in itself a finished product. Appreciation of what constitute business for each registered person will therefore be vital in examining whether the same is in the course or furtherance of business of registered person.

From the above, it looks straightforward that only 'look through' is relevant and may even cause doubt to readers as to what is the doubt said to be lingering in the commencement of the article.

'Look at' – Approach:

Let's take another set of examples

1. Outdoor catering services received at a customer meet event.
2. Beauty treatment services received by film artist.

If 'look through' is employed then the above said inward supplies are towards furtherance of business. Whereas if 'look at' is employed, then there is receipt of outdoor catering, beauty treatment which are blocked in terms of section 17(5)(b) of CGST Act, 2017.

The purpose is given a go-by and the nature of expense and immediate use is taken for consideration for examination

of input tax credit in case of blocked credits. Section 17(5) is non-obstante clause & it is driven by 'look at' approach and the purpose will be of relevance only when the clauses indicate so. Various clauses under section 17(5) relaxes the restriction of credit, when said inward supply is used for providing outward supply of same category.

In nutshell, it is 'look through' approach which is relevant with a rider that in cases of inward supplies hit by restrictions contained under section 17(5) 'look at' approach becomes relevant, except when restrictive clauses gives a carve out. Blocked credits are policy matter of the Government, hence intentionally the purpose have been given a go-by in the legislation.

Is there any doubt on the approach to be adopted?

Even the Hon'ble High Court of Orissa in the case of M/s. Safari Retreats Private Limited was not free from the doubt on the appropriate approach. With due respect, 'look through' approach employed by Hon'ble court is questionable for the following reasons:-

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² *Jayaswal neco industries ltd. Reported at 2018 (14) GSTL 20 (Chhattisgarh)*

Firstly, Hon'ble Court was dealing with an inward supply covered by Section 17(5)(d) – a blocked credit and furthermore the clause specifically restrained from looking to the purpose – input tax credit shall not be available even when such goods or services or both are used in the course or furtherance of business.³

“(d) goods or services or both received by a taxable person for construction of an immovable property (other than plant or machinery) on his own account including when such goods or services or both are used in the course or furtherance of business.”

Secondly, the expression “his own account” in the clause was equated to “own purpose” which may not be true intent of the clause. It will be more aligned if the expression is understood in contradistinction with construction of immovable property on account (of others) i.e. for sale vs construction on his own account. It is a case of construction and lease/renting, hence construction cannot be attributed to account of others.

Thirdly, Section 17(5)(c) allows credit only when it is used for further supply of works contract services, can Section 17(5)(d) – which is nothing but modified form of similar inward supply for construction of immovable property provide more relief?

‘Look at’ approach will be relevant in respect of blocked credits. Special Leave Petition (SLP) has been filed against the above said decision before Hon'ble Supreme Court.

To simply put negative list of credits - go by heads of expense in Section 17(5) and positive list of credits require test of end use of inward supply.

Sanctity of look through under GST law:

What is sanctity of ‘look through’ approach for ITC determination under GST law?

1. Para 9 of C.B.I.C. circular⁴:

Issue: A registered person uses coal for the captive generation of electricity which is further used for the manufacture of goods (say aluminium) which are exported under Bond/Letter of Undertaking without payment of duty. Refund claim is filed for accumulated Input Tax Credit of compensation cess paid on coal. Can the said refund claim be rejected on the ground that coal is used for the generation of electricity which is an intermediate product and not the final product which is exported and since electricity is exempt from GST, the ITC of the tax paid on coal for generation of electricity is not available?

Clarification: There is no distinction between intermediate goods or services and final goods or services under GST. Inputs have been clearly defined to include any goods other than capital goods used or intended to be used by a supplier in the course or furtherance of business. Since coal is an input used in the production of aluminium, albeit indirectly through the captive generation of electricity, which is directly connected with the business of the registered person, input tax credit in relation to the same cannot be denied.

2. Advance Authority Ruling of Karnataka⁵ Cited Advance

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Authority Ruling of Karnataka is one of its kind in the sense that even when applicant viewed activity of generation of electricity as separate supply (delinking it from manufacture of final product albeit captively consumed) and thereby stated they are effecting exempt supply, the authority stepped in and provided correct guidance as under:

“The second activity of production of electric energy is a supply to self as the electricity produced is captively used. In fact the production of electricity in a solar power plant geographically separated from the manufacturing site is an intermediate process in the manufacture of cement akin to the use of generator sets within the factory premises to produce electricity for consumption in the manufacturing process. The operation of generator sets within the factory would not constitute a separate supply. Similarly the operation of the solar power plant shall not constitute a separate supply warranting the application of Section 17(1) and /or 17(2). Needless to say that this shall apply only in the case where the entire electricity generated is consumed captively and no part of the energy produced is sold or discharged into the grid and not taken out at their manufacturing site.”

3. Para F(d) of Flyer no.19 dated 01.01.2018 - Goods or services received by a taxable person for construction of immovable property on his own account, other than plant & machinery, even when used in course or furtherance of business;

4. CBIC No.79/53/2018-GST dated 31.12.2018 though primary dealt with refund related issues – also brought clarity on what constitute inputs in para 9(b), 12 & 13

5. AAR Karnataka in the case of M/s. Shri Keshav Cement and Infra Limited (26/2019 dated 12.09.2019)

There are also occasions where the said approach has not been adopted, like in the case of M/s. JSW Energy Limited (JEL)⁶, wherein order of AAAR stated that applicant had not gone before AAR on issue of admissibility of input tax credit and restricted itself to issue of job-work. In the facts of the case M/s. JSW Steel Limited (JSL) (principal) sends coal to M/s. JEL (job-worker) who would manufacture electricity and return to M/s. JSL, which will be used by M/s. JSL for manufacture of steel.

Electricity generated is intermediate product, whereas authorities did not adopt 'look through' approach and stated that coal is input for M/s. JEL for production of electricity and not input for M/s. JSL for manufacture of coal. It also doubted arrangement existing for return of electricity by JEL to JSL and therefore held that arrangement does not qualify requirements of job-work under section 143 of CGST Act, 2017. Matter was carried by applicant to Hon'ble High Court of Bombay, wherein it was held that Court cannot go into merits of the case as the statute has not provided for appeal mechanism but considering the fact that decision of AAAR is based on various new grounds raised against the appellant, it remanded matter for reconsideration on merits.

Though issue is on job-work, primary thrust is on whether coal is an input for manufacture of Steel? There are various rulings of Hon'ble Apex court on fuel being cenvatable for manufacture of final product, useful reference

can be made to decision in case of Solaris Chem Tech Limited⁷

Instead of the generation of intermediate product being done by registered person – it is given on job-work basis to job-worker, who will generate power (based on inputs provided by principal) and return to principal for manufacture of steel. This reminds us of an important decision of Hon'ble Supreme court in the case of Tata Oil Mills⁸ dealing with exemption under Excise Act -granted when soap was made using rice bran oil. The assessee manufactured soap from rice bran fatty acid, which is an extract from rice bran oil processed in the assessee's factory at different place. The exemption was denied on the ground that soap was not manufactured in the factory from rice bran oil. The Court took a purposive construction and allowed the exemption. Though not on similar issue, taking cue from the decision it can be said that 'electricity' will continue to remain intermediate product and generation at different place or through job-worker should not result in different tax incidence.

Limits of 'look through'?

Next question arises as to how far, we should look through? Whilst we understand that for examination of credit one should not stop at intermediate stage, the question arises at which point the look through should cease. This brings us to the interesting decisions available in the context of input tax credit when by-product & waste emerge during process of manufacture.

A. Central Excise law:

Guiding principle on the decision

in excise law has been that one cannot use lesser quantum of the inputs to manufacture the same quantity of final product and prevent emergence of by-product /waste.

Hon'ble Supreme Court⁹ in the context of by-product firmly held that emergence of by-product is technological necessity and hence no part of input can be said to be used in production of by-product.

Hon'ble High Court of Madras¹⁰ in the context of attribution of inputs to wastes (press mud and spent wash) emerging during the manufacture of sugar, made a significant finding in para 15 of the order that *".. the commencement of journey of those cenvated inputs used either in or in relation to the manufacture of final products ends with the emergence of those final products along with inevitable wastes. Their usage cannot be traced beyond the first degree."*

What transpires from above is that said inputs are eligible in entirety for input tax credit as specific inputs and they do not become common credits.

Issues mainly arose on the fact that those products were non-excisable goods¹¹ and accordingly did not garner any Revenue to exchequer while credits were fully allowed on inputs. Hence various amendments in law in the form of legal fiction of deemed marketability of the goods, amendment to Cenvat Credit Rules, 2004¹² to include non-excisable goods cleared for consideration within ambit of 'exempted goods' for Rule 6 of CCR, 2004 were done.

⁶ The Maharashtra Appellate Authority got Advance Ruling for Goods and Service Tax in the case of M/s. JSW Energy Limited – order dated 02.07.2018.

⁷ Collector of Central Excise vs Solaris ChemTech Ltd reported at 2007 (214) ELT -481 (SC)

⁸ Tata Oil Mills Company Limited vs Collector of Central Excise dated 14.08.1989 in Civil Appeal Nos.1304 -1305 of 1987

⁹ Union of India vs Hindustan Zinc Limited reported at 2014 (303) ELT 321 (SC)

¹⁰ Commissioner of Central Excise vs EID parry reported at 2013 (293) ELT 10 (Mad)

¹¹ Union of India vs DSCL Sugar Ltd reported at 2015 (322) ELT 769 (SC)

¹² Notification no.6/2015-C.E. dated 01.03.2015, Circular no. 1027/15/2016 DT. 25.04.2016

B. Sales Tax/VAT

While we have seen a series of decisions in excise, the sales tax also had its spate of decisions on allowing input tax credit, reference can be made to decision of Hon'ble Supreme Court¹³ wherein it was held that as long as inputs are used in manufacture of taxable goods for sale, generation of waste/sludge in the process does not detract the fact that inputs namely 'sulphuric acid' in case of refinery and 'cotton' in case of cotton mills were used in the manufacture of taxable goods for sale. It also held that concurrent use for manufacture of another item of goods which may or may not be taxable is immaterial.

C. Way forward under GST

Thus, we can see input tax credit stands allowed in entirety under erstwhile tax laws. If the position continues under GST law, then such inputs will qualify for ITC as T₄ – Rule 42 (1)(f) of CGST Rules, 2017. If not the same will become part of C₂ – common credit (Rule 42 (1)(h) of CGST Rules, 2017).

Issue stands clearly answered by Hon'ble Supreme Court decision¹⁴ setting aside the decision of Hon'ble High Court of Karnataka.

In the facts of the said case, Oil is extracted from the Sun-flower Oil cake and de-oiled Sun flower cake (by-product) is the residue. The by-product is exempted under KVAT Act. Hon'ble High Court held that dealer was eligible for input tax credit on purchase of sunflower oil cake on the ground that dealer did not set up any industrial unit for the purpose of manufacturing de-oiled cake and the entire raw-material named as Sunflower Cake purchased is for the manufacture of Sunflower Oil.

Hon'ble Supreme court set aside order of High Court, on the

ground that ITC was allowed in the Karnataka VAT Act based on sale of taxable goods and is not relatable to manufacture (decision in context of Bombay General Sales Tax Act referred in foot note no. 13 referred to manufacture of taxable goods for sale, whereas KVAT Section 17 & Rule 131 only referred to sale of goods, no link to manufacture), hence ITC to be determined based on sale of goods. As sunflower Oil (taxable goods) and de-oiled Sunflower cake (exempt goods) both was sold, credit has to be attributed to the extent of taxable goods.

As emphasis under GST law (particularly Section 17 of CGST Act, 2017, Rule 42 & Rule 43 of CGST Rules, 2017) is on supply effected, hence what is relevant is supply made and such inputs will become common credit i.e. C₂.

Is 'look-through' limitless?

The above makes it clear that 'look through' is not confined but it needs to be tread cautiously. It is not that any & every conceivable link between inward supply & in the course or furtherance of business is entitled for ITC.

Decision of Iberdrola Real Estate Investments (Case C-132/16) under European Union VAT law are exceptional; where input tax deduction was permitted on services received and used in the renovation of waste water infrastructure.

The said service was rendered to the municipality at free of cost but still ITC was allowed on the ground that there was sufficient link between service received and economic activities of taxpayer (holiday village project – taxpayer was involved in the leasing business and will

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connect his sewerage to waste water pumping system after renovation). Even there the opinion of Advocate General indicated that it was mere casual link – not sufficient for input tax deduction and also indicated that there could be possibility of being granted permit by municipality to Iberdrola - in which case there will be supply from municipality to Iberdrola. In the absence of facts, AG did not further venture to determine whether at all permission is a service and is there a cross supply etc.. What it brings to fore is the caution that 'look through' approach is not to be viewed as an ITC enabler for cases having casual link between 'inward supply' and 'course or furtherance of business', it is only a defence when there is sufficient link.

Conclusion:

Tersely, registered person can reasonably adopt 'look through' approach in determining the input tax credit under GST law with an exception for negative list of credits [Section 17(5)] - wherein 'look at' approach needs to be employed. ■

¹³ Commissioner of Sales Tax vs Bharat Petroleum Corporation Limited & Phulgaon Cotton Mills Limited reported at 1992 85 STC 220 SC

¹⁴ The State of Karnataka vs M.K. Agro Tech.(P) Ltd. in Civil Appeal no.15049-15069 of 2017 dated 22.09.2017