Madras High Court decision on transition of cesses: A case of too little, too late

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Authors note:

This article examines the judgement delivered in the case of Sutherland Global Services Services ***[***TS-938-HC-2019(MAD)-NT***]*** *as it stood on 7 November 2019 i.e. at the time the authors sent it for publication. The Madras High Court has since revised its judgement, wherein the Court has expressly held that cesses shall be allowed to be transitioned into the GST regime even under the amended CGST Act. The Court has observed that though section 140(1) was amended to allow transition of eligible duties" only, section 140(8) was not hit by any such amendment and contained no limitation. Further, the Court towards the end of para 49, appears to clarify that its conclusions with respect to transition-eligibility of cesses under section 140(1) would stand even in the context of the amended CGST Act. Readers are advised accordingly.*

Transition of tax credits accrued in the previous tax regime into the new GST regime has grown to be a rather litigious issue. Writs are being filed by assessees in various High Courts to safeguard their rights to past tax credits, which they claim to be vested and consequently, indefeasible. While High Courts across the country have recognized the assessee s right to past input tax credits and appropriately intervened in cases where such right had been unduly jeopardized, the revenue authorities have attempted to restrict such rights to the best of their abilities.

The Madras High Court, in ***Sutherland Global Services*** **[**TS-938-HC-2019(MAD)-NT**]** was recently called upon to decide whether Education Cess, Higher Education Cess and Krishi Kalyan Cess accrued in the previous tax regime could be carried forward into the GST regime. Considering that this was going to be the first ever instance of a High Court adjudicating on the transition-eligibility of cesses, the judgement was an eagerly awaited one.

It may be noted that the transitional provisions under the Central Goods and Services Tax Act, 2017 (CGST Act) were amended by way of the Central Goods and Services Tax (Amendment) Act, 2018 (CGST Amendment Act) in two significant ways. Firstly, the provisions of Section 140(1) were amended whereby the expression CENVAT Credit" having an expansive meaning was flanked with the words of eligible duties", and such eligible duties were specified. Secondly, Explanation 3 to Section 140 was inserted to clarify that eligible duties and taxes" excluded cesses not expressly included.

It should be noted that the disputed cesses do not feature in the list of eligible duties and taxes" provided in the CGST Act. These cesses do, however, constitute CENVAT credit" under the CENVAT Credit Rules, 2004 (effective up to 30 June 2017), but not under the CENVAT Credit Rules, 2017 (effective from 1 July 2017). Against this backdrop, the Madras High Court s decision requires examination.

The Court observed that CENVAT credit of a particular cess could solely be used to offset the output liability of that particular cess. However, with the withdrawal of Education and Higher Education Cesses in

2015 and of Krishi Kalyan Cess in 2017, the accumulated credit of these cesses could not be utilised to offset any output tax liability. At this juncture, the Court laid down an important principle that tax credits do not lapse merely on account of loss of their fungibility, in the absence of express provision to the contrary. In the present case, there was no statutory backing to the contention that the accumulated credit of cesses had lapsed. The Court further went on to hold that since the revenue authorities had allowed the petitioner to carry forward the same in its returns, it was impermissible for them to now question their eligibility.

The Court relied heavily on the decision of the Supreme Court in the case of *Eicher Motors*[1] wherein it was held that the right to credit accrues on the date the tax on inputs is paid and such right continues until the credits are adjusted against an output liability. The decision of the Delhi High Court in the case of ***Cellular Operators Association of India [***TS-44-HC-2018(DEL)-EXC***]***[2] relied upon by the respondents was ably distinguished on the ground that the issue therein was whether the credit of cesses, a vested right, could be used to offset the liability of Excise Duty or Service Tax. The issue before the Delhi High Court thus pertained to utilisation of the vested right against a different kind of output liability, and not with the existence of the right *per se*.

The Court concluded by holding that cesses were not hit by the restrictions contained in provisos to Sections 140(1) and 140(8) and as such represented closing CENVAT credit carried forward in the returns. In view of this, the Court allowed the petitioner to transition the accumulated credit of cesses into GST. Curiously, the Court, at the end of its decision, referred to the amendments introduced by the CGST Amendment Act, but dismissed the same stating that the amendment introducing Explanation 3 to Section 140 has not been operationalised yet.

It is apposite to note here that not all provisions of the CGST Amendment Act amending the transitional provisions of the CGST Act have been operationalised yet **[*see exclusions in* Notification No. 2/2019-Central Tax dated 29 January 2019]**. However, the provision inserting Explanation 3 to Section 140 (introduced vide clause 28(d) of the CGST Amendment Act) is among those which *have been operationalised with effect from 1 February 2019*.

In addition, the Court in its decision refers to the assertion of the petitioner that cesses constituted CENVAT credit within the meaning of the Central Excise Act and the rules made thereunder, despite the fact that the CENVAT Credit Rules, 2017 assign a limited scope to the said expression, effective 1 July 2017.

It is trite law that an explanation is not a substantive provision and cannot expand the scope of the main provision. Relying upon this, a case may be made that the Court has allowed transition of cesses into the GST regime *sub-silentio* even in the context of the amended CGST Act.

The present decision, however, has neither expressly discussed the above nor delved into the *vires* of the explanation inserted, which is ostensibly of a retrospective character. Though the Court has cited the amended transitional provisions and has also referred to the amendments in isolation, albeit briefly, the analysis and observations do not seem to take into cognisance the restrictions introduced by the CGST Amendment Act. In this context, the authors find it difficult to conclude that the present decision carries precedential value in the context of the amended CGST Act and it is in this very respect, that the decision represents a case of too little, too late.

An analysis of the amended transitional provisions juxtaposed with the available jurisprudence surrounding the right to input tax credit could have given rise to certain significant principles having a near universal impact in the context of transitional provisions under GST. As things stand, however, the High Court appears to have fallen short of preventing the amendment from becoming a *fait accompli*.

The views of the author(s) in this article are personal and do not constitute legal/professional advice.

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[1] 1999 (106) E.L.T. 3 (S.C.)

[2] 2018 (14) G.S.T.L. 522 (Del.)