

## Common Issues raised in GST Department Audit

CA Roopa Nayak

### Background

Recently, there have been a spate of audit intimations being issued for conducting audit u/s 65 by GST Department covering period of upto past 5 years. In the course of audit done by dept under section 65 of the CGST Act, certain issues/objections could be raised. The assesses have to carefully examine the matter, give their explanation.

When objections are raised and the submissions done by auditee with facts, workings reconciliations, legal grounds[applicable provisions of Act/rules] and supporting circulars/landmark decisions in writing/ to official mail id of concerned officer, it can lead to dropping points at that stage itself, avoidance of issuance of SCN's, and no ensuing demands with interest penalty and requirement of pre-deposit at appeals stage[10+10%] either.

The paperwriter has examined the issues being raised at time of audit by department and the validity of the same under the law.

### Common issues and its implications

1. **Excess ITC availed in GSTR 3B vs 2A/2B:** The ITC cannot be denied merely due to the non-reflection of invoices in GSTR-2A/2B when all the conditions specified under Section 16 of CGST Act, 2017 have been satisfied.
  - Reflecting of ITC in GSTR-2A/2B is not prescribed under GST law till 31.12.2021. It was inserted only wef 1.1.2022[ vide section 16(2)(aa)wherein sets out that the invoice details are furnished by supplier in GSTR 1 and be communicated to recipient in 2B].
  - The input tax credit is an indefeasible and vested Right. Reliance can be placed in the case of Shabnam Petrofils Private Limited vs. Union of India (2019) 29 G.S.T.L. 225 (Guj.), Eicher Motors Ltd. Vs UOI – 1999 (106) ELT 3 (SC), Dai Ichi Karkaria vs. UOI - 1999(112) ELT 353(SC).
  - The facility of GSTR-2A is ONLY for assesses facilitation and credit cannot be denied merely because it is not reflected in GSTR 2A. Refer press release 18<sup>th</sup> October 2018.
  - **Diya Agencies Vs. State Tax Officer** (Kerala High Court) - WP(C) No. 29769 of 2023, the Hon'ble Kerala High Court highlights that, denying input tax credit based solely on discrepancies in GSTR-2A is unjust.
  - **Goparaj Gopalakrishnan Pillai v. State Tax Officer-1 [WP(C) NO. 29855 OF 2023], the Hon'ble Kerala High Court** ruled in favour of the petitioner, by stating that the excess Input Tax Credit (ITC) claimed in Form GST-3B, which

was not reflected in GSTR-2A, should not be a reason for denying the right to claim Input Tax Credit (ITC).

- Credit on the IGST paid at the time of import of goods shall be availed even if the same does not appear in GSTR 2A/2B
- To avoid disputes, suggest to maintain reconciliation of ITC availed in GSTR 3B, with 2A/2B, ITC in 9/9C and books of account.

## 2. Denial of credit due to nonpayment of taxes by vendors

- It is near impossible to keep a track of the payment of tax by the supplier/vendor to the government under the existing scheme of returns as the tax is paid in GSTR-3B as the vendor pays the taxes by declaring it in a consolidated manner the principle of **Lex Non-Cogit Ad Impossibilia** i.e., The law does not compel a man to do that which he cannot possibly perform, as was held in the case of:
  - Indian Seamless Steel & Alloys Ltd Vs UOI, 2003 (156) ELT 945 (Bom.)
  - Hico Enterprises Vs CC, 2005 (189) ELT 135 (T-LB). Affirmed by SC in 2008 (228) ELT 161 (SC).
  - Commr of CE vs Tata Motors Ltd (2012(294) ELT 394 (Jhar);
- Since the law cannot compel the taxpayers to comply with impossible conditions, whereby **auditee does not have access to the portal to check whether supplier has actually paid or not.**
- Even assuming that the taxes were not paid by vendors on the invoices, the substantial benefit of credit should not be denied due to the default [if any] by vendors. Further, the benefit of the input tax credit cannot be denied to a bona fide purchaser, because of the default of the selling dealer.
- Numerous decisions confirm such view. In the case of Kay Kay Industries (2013-TIOL-41-SC-CX). that the **manufacturer cannot determine whether his supplier has discharged excise duty** on the goods which are supplied to the manufacturer by him.
- The Hon'ble Supreme Court, in the case of Commissioner of Trade & Taxes, Delhi and others Vs. Arise India Limited and others **[TS-2-SC-2018-VAT]**. The Hon'ble High Court of Delhi held Section 9(2)(g) of Delhi VAT Act **to the extent it disallows Input tax credit("ITC") to the purchaser due to default of selling dealer in depositing tax**, as violative of Articles 14 and 19(1)(g) of the Constitution of India.

- Held **D.Y Beathel Enterprises Vs The State tax Officer** (Data Cell) [2021-TIOL-890-HC-MAD-GST] if the default is made by non-payment of tax by the seller, the recovery shall be made from the seller.
3. **Denial of credit due to cancelled registration of vendors:** ITC cannot be denied for the valid transactions. If it is found upon considering the relevant documents that all the purchases and transactions in question are genuine and supported by valid documents and transactions were made before the cancellation of registration of those suppliers than the benefit of input tax credit shall be given to the recipients. Held in LGW Industries Ltd and Ors vs UOI [2021-TIOL-2308-HC-KOL-GST]

**Denial of credit alleging blocked credit u/s 17(5):**

- a. **ITC on Passenger Transport:** ITC is eligible when vehicle is used for business [pick and drop of employees from office to home]+ the passenger transport vehicle[such as bus] has capacity of more than 13 including driver.
- b. **ITC on insurance:** Credit is eligible on fire, burglary, stock, building insurance, goods in transit, cash in transit insurance. Credit on life, health insurance blocked. Can be availed when obligatory to provide by employer to employee under any law in force. Such as Employee health insurance mandated under Employees State Insurance Act, 1948.
- c. **Air travel/Hotel accommodation:** ITC is eligible when nexus is established, usage in course of business of auditee, it cannot be denied. Not personal consumption.  
**ITC on air ticket service charges is eligible** when air travel performed for purpose of company business. CCE vs Fine Care Biosystems (2009 (244) ELT 372 (CESTAT) and Goodluck Steel Tubes Ltd. Vs C. C. Ex., Noida 2013 (32) S.T.R. 123 (Tri. - Del.)  
**Hotel accommodation eligible-** One Advertising & Communication Services Ltd. vs C.S.T., Ahmedabad (2012 (27) S.T.R. 344 (Tri. - Ahmd.).
- d. **Credit related to immovable property vs movables, plant and machinery:** Section 17(5)(d) restriction is specifically relating to the goods/services used for constructing immovable property, capitalized to immovable property block meant for self use. There is no intention of denying credit on the movable property, plant and machinery specifically in Section 17(5). Also there is no restriction to avail credit on the goods/services used for construction of immovable property but written off to P&L.

e. The ITC on **movable goods is eligible-**

- such as office equipment could be computers, projectors, stabilisers;
- Electrical fittings such as fan;
- Furniture; furnishings;
- Security systems; fire fighting systems cannot be denied, even if capitalized to immovable property block as long as supported by valid vendor tax invoices clearly setting out the nature of the inwards supply done to the auditee.

Goods which can be disassembled/dismantled and could be used in other premises without causing any damage to the property, are said to be movable goods. Held in the case of Sirpur Paper Mills [1998 (97) E.L.T. 3 (S.C.)],

f. Similarly credit is eligible on **plant and machinery, even when it is immovable.**

Examples could be credit on HVAC system, Lifts/sewage treatment plant. Note:

Section 3(26) of the General Clauses Act, 1897 defines "Immovable Property" to include land, benefits to arise out of the land, and things attached to the earth, or permanently fastened to anything attached to the earth.

Immovable property means the items which once fixed to earth cannot be moved/removed without substantial damage.

g. **ITC availed on Sales promotion vs gifts:** Credit on goods given as gifts is blocked.

A 'gift' is commonly defined as a voluntary transfer of property by one to another, without any consideration or compensation therefor.

The Supreme Court cited the definition of 'gift' from Corpus Juris Secundum, Volume 38 in the case of Sonia Bhatia v. State of UP [1981] 2 SCC 585.

When goods such as TV/fridge are given for sales promotion, there is corresponding obligation on the dealers/distributors to lift more goods[more sales and discharge of GST on such outward supplies].

Also when goods are given under schemes such as buy 1 get 1, the value of the so called "freebie" would in normal business course be included in/factored in pricing of the goods being sold[embedded in price], and on which GST is being suffered.

This reasoning is supported in circular 92/11/2019-GST dated 07.03.2019

Consequently the ITC need not be reversed on business promotion expenses.

h. **Personal use/consumption or for official use:** Credit is eligible on employee related expenses, as long as it is incurred in course of discharge of office duties/functions.

Examples could be uniforms, ID cards, safety helmets, mobile phone for official purpose.

In Steel Authority Of India Ltd vs. CCE (2014 (301) ELT 592 (CESTAT Delhi) credit on shoes used by workers in the Steel plant held eligible.

- i. **Canteen facility:** ITC is eligible on canteen facility even though consumed by person, when it is mandatory for employer to provide facility to employee under law for time being in force. Example canteen facility provided under Factories Act is eligible credit and cannot be denied citing personal consumption.

#### 4. **Non payment of Reverse charge liability under section 9(3) r/w notification 13/2017-CT(R); Section 9(4)**

Only specific categories of expenses notified under Section 9(3) are liable for RCM, such as legal services, goods transport agency (GTA), etc. Accordingly, identify such applicable transactions from the “Expenses” on which duly discharged GST under RCM on the same.

A detailed reconciliation can be prepared, clearly bifurcating:

- Expenses liable under RCM
  - Expenses not covered under RCM provisions to avoid demands of tax on same.
- a. **RCM on import of services:** All payments made to foreign vendors towards services supplied to Indian recipient entity are not liable to tax as import of services. First need to determine what is place of supply[POS], within or outside India vide section 13(2) to (13) of IGST Act.  
**Few examples** could be: Place of supply of training done in physical presence outside India, accommodation/food consumed outside, travel done outside India, repair services performed physically on goods outside India, Trade exhibition in Germany- All instances where POS outside India-no RCM.
  - b. **Freight paid for transport of goods by road:** When the transporter of goods by road service issues a consignment note/Lorry Receipt then it would be covered as GTA service. Tax liability to be paid by registered recipient.  
When consignment note is not issued, can consider not as GTA but GTO, GST exemption is there, and not liable to pay tax under RCM.  
Post 18.7.2022: GST need not be paid under RCM on GTA service when the vendor has opted to discharge tax liability under forward charge[FCM].

- c. **RCM on director remuneration:** GST is not leviable when the director is employee and paid remuneration as services by employee to employer in course of employment covered in Entry 1 Schedule III, neither supply of goods nor services. Circular 140/10/2020 – GST can be referred.

Company not liable to pay tax under RCM on amounts paid to Directors for services supplied[example- architect services in their personal Capacity]. Ref: Circular No. 201/13/2023-GST.

- d. **RCM on renting of commercial premise/residential premise:** GST under RCM was made applicable on renting of commercial premise by unregistered person to registered person wef 10.10.2024. **Not taxable for period prior to that date under RCM.** Renting of residential premises is taxable wef 18.7.2022 in hands of registered person.

Note 1: **Prior to the dates of introduction of the levy u/s 9(3), no GST under RCM can be demanded for the specified services.**

Note 2: Even if GST were to be paid under RCM on procurements of specified services from unregistered suppliers[such as import of consulting services from abroad ]/unregistered supplier procurements on which there was valid liability, **and such tax voluntarily paid now[during course of audit] ITC can be availed[for past years paid now, under self invoice of current date].** Ref: Circular 211/2024

#### **Reconciliation issues:**

- 5. **Turnover mismatches: Turnover in 3B vs GSTR 1, unreconciled turnover in GSTR 9C, GSTR 3B vs sales register, Differences between GSTR-3B, GSTR-1, and Audited Financial Statements (P&L).** Common causes include "Income from Other Sources" being misclassified or exempt income not being reported in returns. The department also cross-references TDS/TCS data from the Income Tax portal with GST returns. In all cases, reasons for difference to be provided along with reconciliation statement to establish correctness of taxes paid.
- 6. **Mismatch of GST paid under reverse charge and credit availed:** Reasons for difference to be provided along with reconciliation statement of RCM taxes paid and credit of such taxes being availed.

#### **Conclusion**

#### **Proactive Measures**

To mitigate audit risks, it is suggested to get done:

**Pre-Dept Audit review:** Conducting a GST review by competent professional before the department arrives helps identify and pay valid liabilities (like RCM) voluntarily with interest, thereby avoiding the **100% penalty** typically imposed in a Show Cause Notice. In this article the paper writer has given practical issues and the replies which if properly drafted could certainly help to avoid/reduce frivolous objections and relief by way of dropping of demands at the stage of audit itself[prior to SCN].

For any queries mail to [roopa@hnaindia.com](mailto:roopa@hnaindia.com)