

ITC ON NORMAL LOSSES



CA Deep Chheda

Email : deep@cbcandco.com

“Seamless availability of Input Tax Credit has been one of the bedrock principles of Indirect taxation all over the world and GST Law in India is no exception. However, it is safe to say that availment and utilization of ITC under GST in India is anything but seamless.”

Seamless availability of Input Tax Credit has been one of the bedrock principles of Indirect taxation all over the world and GST Law in India is no exception. The core idea behind allowing input tax credit is that the taxes paid on purchases should not become a cost for the dealers which would lead to cascading effect of taxes and ultimately increase the cost to the end consumer.

As simple as this logic sounds, the reality is a bit more complicated. In theory, the GST law allows for seamless ITC, however, there are a lot more restrictions which the taxpayers need to navigate through before availing and utilizing the ITC. Safe to say that availment of ITC under GST is anything but seamless.

While eligibility and conditions for availment have been prescribed in Section 16 of CGST Act, restrictions in availment of ITC have been laid down in Section 17 of the Act. The focus of this article is the 'Blocked credit' under Section 17(5) of CGST Act and specifically Clause (h) which denies input tax credit on inputs which are lost, stolen, destroyed, etc.

➤ Analysis of Section 17(5)(h)

As per Section 17(5)(h), ITC cannot be availed on goods which are:

- Lost;
- Stolen;
- Destroyed;
- Written off;
- Disposed by way of gift or free samples

On simple reading of the above it is evident that if any goods which are no longer available for use due to any of the above circumstances, then ITC will not be available on such goods.

However, there are various businesses wherein the inputs are lost under the normal process of manufacturing / supply which we generally term as 'Normal Loss'. Whether loss of inputs as normal loss also falls within Section 17(5)(h) and ITC should be denied on that as well?

➤ Principles of 'Nosctitur A Sociis' and 'Ejusdem Generis'

'*Nosctitur a sociis*' is a rule of construction and interpretation of law. It is a Latin term which means the 'meaning of an unclear or ambiguous word should be determined by considering the words with which it is associated in the context' i.e. the meaning and context of a word must be interpreted from the company it keeps.

Similarly, Principle of 'Ejusdem Generis' is latin for "of the same kind." When a law lists classes of persons or things, concept of 'Ejusdem Generis' is used to clarify such a list. For example, if a law refers to automobiles, trucks, tractors, motorcycles, and other motor-powered vehicles, a court might use ejusdem generis to hold that such vehicles would not include airplanes, because the list included only land-based transportation.

When we apply these principles to Section 17(5)(h) it appears that the circumstances mentioned therein are those which we do not face in day-to-day life. For eg. it does not happen every day that the goods are stolen while being transported or a raging fire destroys the goods in the go down every night.

Applying the principles of Noscitur a Sociis / Ejusdem Generis it is clear that the term 'lost' in clause (h) can be interpreted as goods which are lost due to abnormal/unusual circumstances which do not occur on a regular basis and may not be under the control of the taxpayer.

Whereas 'normal loss' is a part of the manufacturing/supply process and is already considered as an element of cost in the sale price of goods and therefore cannot be said to be an extraordinary circumstance which is beyond the control of the taxpayer.

➤ Erstwhile Law

“Normal loss is an inherent part of the manufacturing process”

Hon'ble Supreme Court in the case of **M/s Asahi India Safety Glass Ltd. – 2015-TIOL-129-SC-CX** has held that final goods are a cumulative result of the multiple processes the inputs go through during manufacturing and it would be impossible or commercially inexpedient to manufacture goods without the integral stages of manufacture. Therefore, when inputs have undergone the manufacturing process, the MODVAT credit should be allowed.

When inputs undergo the manufacturing process, they are worked upon and it leads to some 'normal loss' of these inputs which is integral to the entire process of manufacturing the final goods. Hence, relying on the judgement of the Hon'ble Supreme Court, it can be said that ITC should be allowed on such goods because they have gone through the manufacturing process and that 'normal loss' is an integral part of the process without which it may not be possible or commercially expedient to manufacture the goods.

Further, Division Bench of Hon'ble Madras High Court in the case of **M/s Rupa & Co. Ltd. - 2015-TIOL-2125-HC-MAD-CX** has specifically held that it is not possible that the quantity/weight of finished goods would be the exact same as the quantity/weight of the inputs used in manufacturing without there being any wastage or loss. Therefore, CENVAT credit shall be allowed on the entire quantity of inputs that have gone into the manufacturing. Relevant extract of the judgement is as follows:

13. To say that what is contained in finished product is only a quantity of all the inputs of the same weight as that of the finished product would presuppose that all manufacturing processes would never have an inherent loss in the process of manufacture. The expression 'inputs of such finished product' contained in finished products' cannot be looked at theoretically with its semantics. It has to be understood in the context of what a manufacturing process is. If there is no dispute about the fact that every manufacturing process would automatically result in some kind of a loss such as evaporation, creation of by-products, etc., the total quantity of inputs that went into the making of the finished product represents the inputs of such products in entirety.

16. Therefore, our answer to question (a) would be that the appellant was right in making a claim for CENVAT credit, with reference to the total quantity and the value of the inputs that went into the making of the fabric.

From the above judgements it is a settled principle that normal loss is a part of the manufacturing process and that CENVAT credit should not be denied on the same.

➤ **Judicial Pronouncement under GST**

Hon'ble Madras High Court once again had the opportunity to interpret whether input tax credit shall be allowed on 'Normal Loss', this time under GST Law. Relying on the above judgement in the case of M/s Rupa & Co. Ltd. (supra) it was held that normal loss of inputs is occasioned by consumption of inputs and is inherent to the process of manufacture itself. Therefore, ITC should be allowed on normal loss. Relevant extract of the judgement is as follows:

10. The impugned assessment orders reject a portion of ITC claimed, invoking the provisions of clause (h) extracted above. This relates to goods lost, stolen, destroyed, written off or disposed by way of gift or free samples. In my considered view, the loss that is occasioned by the process of manufacture cannot be equated to any of the instances set out in clause (h) above.

11. The situations as set out above in clause (h) indicate loss of inputs that are quantifiable, and involve external factors or compulsions. A loss that is occasioned by consumption in the process of manufacture is one which is inherent to the process of manufacture itself.

15. In the light of the discussion as above, I am of the view that the reversal of ITC involving Section 17(5)(h) by the revenue, in cases of loss by consumption of input which is inherent to manufacturing loss is misconceived, as such loss is not contemplated or covered by the situations adumbrated under Section 17(5)(h).

Department has not yet filed any appeal in the Supreme Court against the aforesaid judgement.

➤ **Conclusion**

Several industries like textiles, marbles, crockery, chemicals, printing, electronics, pharmaceuticals, etc. suffer normal loss in their manufacturing process and it is almost inevitable to manufacture goods without having any wastage. On multiple occasions, even the Courts have held that manufacturing without normal loss is practically impossible.

Considering the principles of 'Noscitur A Sociis' and 'Ejusdem Generis', it can be said that circumstances mentioned in Section 17(5)(h) for reversal of ITC can be interpreted as those which cover extraordinary or unusual situations and do not cover 'normal loss' which is an ordinary part of the manufacturing process.

Further, relying upon the judgement of Hon'ble Supreme Court and Hon'ble Madras High Court in the erstwhile as well as GST regime, it can be safely concluded that taxpayers need not reverse any ITC on any 'normal loss' which is a part of the manufacturing process.

