

## Chapter VI: Transitional Credits under GST

### 6.1 Introduction

The Goods and Service Tax (GST) replaced multiple taxes levied and collected by the Centre and States. GST, a destination-based tax on supply of goods or services or both, is levied at multi-stages wherein the taxes will move along with supply. The tax is levied simultaneously by the Centre and States on a common tax base and tax will accrue to the tax authority having jurisdiction over the place of supply. Central GST (CGST) and State GST (SGST) /Union Territory GST (UTGST) is levied on intra state supplies, whereas Integrated GST (IGST) is levied on inter-state supplies. Availability of input tax credit of taxes paid on inputs, input services and capital goods for set off against the output tax liability is one of the key features of GST. This avoids cascading effect of taxes and ensures uninterrupted flow of credit from the seller to buyer. To ensure a seamless flow of input tax from the existing laws<sup>138</sup> into the GST regime, 'Transitional arrangements for input tax' were included in the GST Acts to provide for the entitlement and manner of claiming input tax in respect of appropriate taxes or duties paid under the existing laws.

### 6.2 Transitional arrangements for input tax

Section 140 of the CGST Act 2017 (and SGST Acts/UTGST Acts) enables the taxpayers to carry forward the Input Tax Credit (ITC) earned under the existing laws to the GST regime. The section, read with Rule 117 of CGST Rules 2017, prescribes elaborate procedures in this regard. Under transitional arrangements for ITC, the ITC of various taxes paid under the existing laws such as Central Value Added Tax (CENVAT credit), State Value Added Tax (VAT) etc. are eligible to be carried forward into GST under the relevant sub-sections of Section 140 of the Act. The claims are to be preferred in the appropriate tables mentioned below, in two forms –Tran 1 and Tran 2.

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<sup>138</sup> Central Excise, Service Tax and State Value Added Tax

**Table 6.1: Forms and Tables prescribed for claiming Transitional credit**

Form	Table No	Transitional credit component
Tran 1	5(a)	Closing balance of credit from the last legacy returns
Tran 1	6(a)	Un-availed credit on capital goods
Tran 1	7(a)A	Credit on duty paid stock with invoices
Tran 1	7(a)B	Credit on duty paid stock without invoices
Tran 1	7(b)	Credit on Inputs/input services in transit
Tran 1	8	Transfer of credit by centrally registered units
Tran 1	11	Credit in respect of tax paid before the appointed day (01 July 2017) and supply made after the appointed day
Tran 2	4	Credit afforded on stocks claimed without invoices

All registered taxpayers, except those opting for payment of tax under composition scheme (under section 10 of the Act), are eligible to claim transitional credit by filing Tran 1 return within 90 days from the appointed day. The time limit for filing Tran 1 return was extended initially till 27<sup>th</sup> December 2017. However, considering that many taxpayers could not file the return within the date due to technical difficulties, sub-rule 1A was inserted under Rule 117 of CGST Rules, 2017<sup>139</sup> to accommodate such taxpayers. The due date for filing Tran 1 was further extended to 31<sup>st</sup> March 2020<sup>140</sup> for those taxpayers who could not file Tran 1 due to technical difficulties and those cases recommended by the GST Council.

### 6.3 Trends and perspectives

The transitional credit being a one-time flow of input tax credit from the legacy regime into the GST regime, can be availed both by the taxpayers migrating<sup>141</sup> from the previous regime as well as new registrants under GST. A total of 10.13 lakh<sup>142</sup> taxpayers had claimed the benefit of transitional credit of ₹ 1,72,584.96<sup>143</sup> crore under the Act, out of which 3.46 lakh taxpayers constituting 34 *per cent* of the taxpayers were on the Central side. The transitional credit claims of these 3.46 lakh taxpayers accounted for ₹ 1, 34,029.23 crore constituting 78 *per cent* of the total transitional credit claimed under the Act. The distribution of the credit claimed by these taxpayers under various sub-sections of the Section 140 of the Act is depicted in Chart 6.1.

<sup>139</sup> Vide Notification 48/2018 CT dated 10<sup>th</sup> September 2018

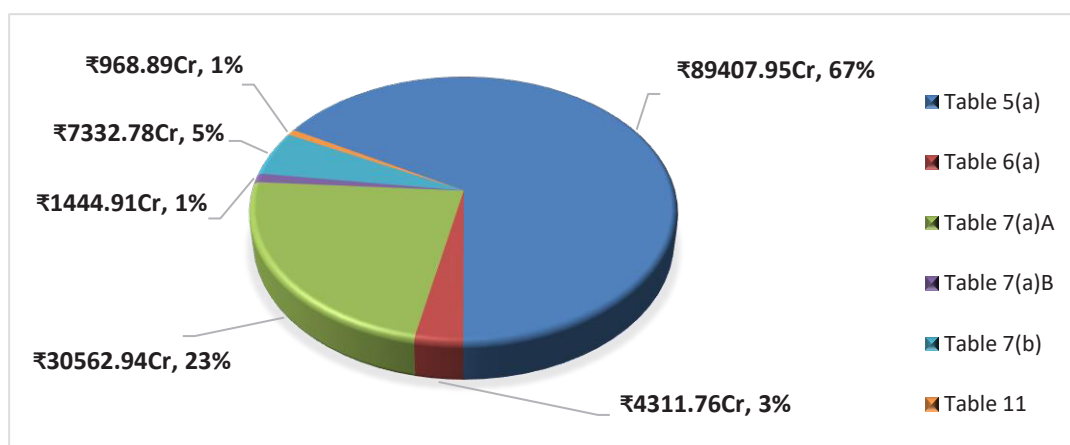
<sup>140</sup> Vide CBIC order No.01.2020-GST dated 07<sup>th</sup> February 2020

<sup>141</sup> Taxpayers registered under existing Central Excise and Service Tax laws, now registered under Rule 24 of CGST Rules, 2017

<sup>142</sup> Figures extracted (July 2021) from GSTN- Goods and Services Tax Network

<sup>143</sup> Source: GSTN (December 2021)

**Chart 6.1: Table-wise break up of transitional credit claims**

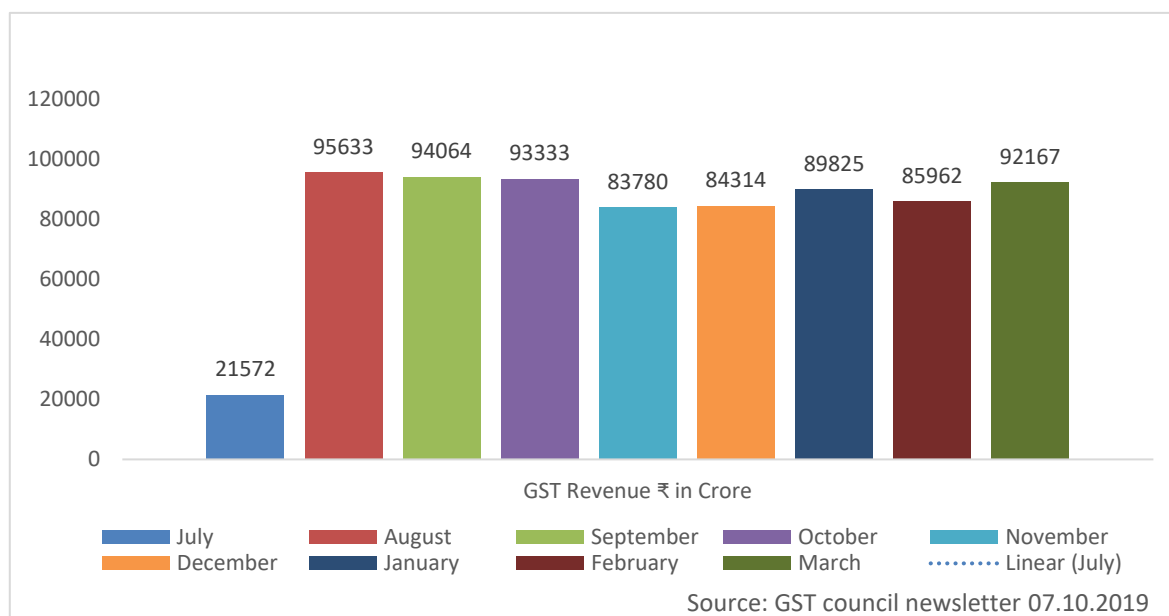


The transitional credit claims broadly flow from two sources viz., Legacy Returns and Books of Account. A significant majority of 70 *per cent* of claims represented by claims in Tables 5(a) and 6(a) flowed through the legacy returns as they signify claims declared as per legacy rules and the remaining 30 *per cent* represented by claims in other tables flowed from the books of accounts as they denote fresh declarations while transitioning into the GST regime.

**a) Impact of transitional credit claims on GST collection:** Transitional credit being the input tax credit carried forward from the legacy tax regime, would get set off against the tax liability under GST. The data on GST revenue collection provides a broad perspective of the impact of transitional credit claimed vis-à-vis the GST revenue, especially during the transition period. The Chart 6.2 on monthly GST revenue<sup>144</sup> collection suggests that the bulk of the transitional credit had potentially been utilized for the payment of tax for the month of July 2017 itself.

<sup>144</sup> GST revenue collection consist of CGST, SGST, IGST and Cess

**Chart 6.2: GST Revenue Snapshot for the year 2017-18**



**b) Transitional credit as a focus area:** In this context, the Central Board of Indirect Tax and Customs (CBIC), or the Board, had considered verification of transitional credit as a focus area for the year 2018-19 and identified the top 50,000<sup>145</sup> taxpayers in the order of transitional credit claimed, across the country, for detailed verification. The transitional credit claims of these 50,000 taxpayers constitute the majority of transitional credit claims on the Central side.

#### 6.4 Audit objectives

Transitional credit claims directly impact GST revenues as the credit is eligible for set off against the output tax liability of taxpayers. Thus, the audit of transitional credit was taken up with the following objectives seeking assurance on:

- i. whether the mechanism envisaged by the Department for verification of transitional credit claims was adequate and effective; and
- ii. whether the transitional credits carried over by the taxpayers into GST regime were valid and admissible.

#### 6.5 Audit scope and sample

The audit scope comprised review of the CGST component of transitional credit claims filed by the taxpayers under Section 140 of the CGST Act 2017

<sup>145</sup> Transitional credits of 50,000 taxpayers in order of transitional credit availed - source Antarang data set: Antarang is the Intranet platform for officers of the Central Board of Indirect Taxes and Customs

from the appointed date<sup>146</sup> to the end of March 2020. The top 50,000 cases of CGST portion of transitional claims (Antarang data set), identified by the Board, constituted the population from which the audit sample was drawn. A pan-India sample of 8,514 cases was drawn based on data analysis of the 50,000 cases and its associated data sets on the following parameters:

- i. Taxpayers who had claimed Transitional credit under table 5(a) in excess of the closing Cenvat credit balance available as per the legacy returns filed for the period immediately preceding the appointed day.
- ii. Taxpayers whose Cenvat claim in the last six months immediately preceding the appointed day showed a growth of 25 *per cent* or more.
- iii. Transitional claims of manufacturers or service providers who had claimed transitional credit under column 7B of Table 7a.
- iv. Transitional claims in Table 5(a) or 6(a) without corresponding legacy data.

Based on the above parameters, these 50,000 cases were categorized into two strata:

Strata I: The list of taxpayers satisfying any of the data analytic checks, which would constitute potentially risk prone cases for verification; and

Strata II: The list of taxpayers not satisfying the data analytic checks, which are comparatively less risk prone.

The sample size of 8,514 cases represented a transitional credit of ₹ 82,754.77 crore and constituted about 62 *per cent* of the total transitional credit on the Central side. 75 *per cent* of the sample size was drawn from Strata I and 25 *per cent* from Strata II. A scorecard approach based on the risk and materiality was used for selection of individual cases from each of the Strata. The strata wise sample size and its representation vis-à-vis the respective population is given in Table 6.2:

**Table 6.2: Strata wise sample size vis-à-vis the respective population**

Description	Strata I	Strata II
Population*	28,813	20,240
Sample size	6,392	2,122
Percentage of coverage	22.18	10.48

*\*claims less than Rs.20 lakh were excluded from the 50,000 cases.*

Out of the sample of 8,514 claims, 3,938 taxpayers come under the Central Tax jurisdictions and 4,573 taxpayers are under the State GST jurisdictions<sup>147</sup>. The sample was distributed among nine field Audit Offices of the C&AG

<sup>146</sup> The date on which the provisions of this Act come into force, ie 1<sup>st</sup> July 2017

<sup>147</sup> Information in respect of three cases was not available

represented by the respective Director General/ Principal Director of Audit (Central).

## **6.6 Audit methodology**

The methodology adopted for audit of transitional credit claims involved data analysis for determining the nature and extent of audit followed by review of records pertaining to Tran returns maintained in the field formations, verification process adopted by the department, follow up action taken on the deviations detected and the process adopted for implementation of cross-jurisdictional functions regarding transitional credit. It also involved an independent examination of selected transitional credit claims. The verification of Tran returns was carried out by leveraging the SSOID<sup>148</sup> access to the CBIC-GST application supplemented by review of underlying records either at the Audit Commissionerates or at jurisdictional offices under the Executive Commissionerates. The findings in this report were discussed during the Exit Conference held with CBIC in February 2022.

The draft SSCA report was issued to the Ministry for comments on 12 January 2022. Audit findings and recommendations were discussed with the Department during Exit Conference held on 7 February 2022. The Ministry's reply, received in February 2022, has been incorporated in the Chapter wherever applicable.

## **6.7 Audit criteria**

Section 140 of the CGST Act 2017 governs the transition of Cenvat credit from legacy Central Excise and Service Tax provisions. This section, read with Rule 117 of the CGST Rules 2017, and relevant Notifications/Circulars issued by CBIC, constituted the criteria for this audit.

## **6.8 Scope limitation**

The audit of transitional credits was primarily dependent upon the extent of verification records maintained by the Department and accessing the underlying records maintained by the taxpayer. As the sample selection was out of the population identified by the Department for verification, it was envisaged that the CBIC departmental field formations would provide verification records and the associated underlying records of taxpayers, which established the basis of verification by the department. Detailed audit of the

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<sup>148</sup> Single Sign On Id (SSOID) is a secure authenticated access to CBIC-GST application

selected sample of transitional credit claims was carried out by the nine field audit offices.

In spite of requisitions and follow up, the CBIC departmental formations did not produce records of 954 claims. As a result, 11 *per cent* of sample size representing ₹ 6,849.68 crore of transitional credit claimed could not be audited. Further, in another 2,209 cases representing ₹ 19,660.72 crore of credit claimed, records were partially produced as the relevant underlying records determining the eligibility of credit were not produced, which constituted a substantial scope limitation. Additionally, record keeping by the departmental field formations varied widely and maintenance of records for verified cases was inadequate in many of the jurisdictions.

The details of non-production, partial production and inadequate maintenance of verification records in jurisdictional formations are brought out in the subsequent paragraphs.

### 6.8.1 Non-production of records

The jurisdiction wise non-production of records is given in **Table 6.3**.

**Table 6.3: Non-production of records reported by Field Audit Offices**  
Amount in crores of ₹

Jurisdictional zone of CBIC	Sample		Non-production	
	Number of claims	Amount of Credit	Number of claims	Amount of Credit
Meerut	494	3,466.03	294	1,676.82
Bhopal	633	4,157.63	162	1,057.78
Ranchi	273	1,663.38	111	792.93
Delhi	333	2,071.34	70	593.34
Lucknow	146	1,186.63	67	334.14
Bengaluru	511	5,691.79	61	542.19
Hyderabad	635	2,166.10	61	39.99
Visakhapatnam	406	1,871.16	48	204.62
Mumbai	435	23,987.95	21	500.03
Chandigarh	173	986.10	19	42.33
Other zones <sup>149</sup>	4,475	35,506.66	40	1,065.51
<b>Total</b>	<b>8,514</b>	<b>82,754.77</b>	<b>954*</b>	<b>6,849.68</b>

\* Note: Out of this, Ministry stated (February 2022) that 103 cases have since been produced to Audit, which would be audited and reported upon separately.

The non-production constituted 11 *per cent* of the sample size in terms of number and 8 *per cent* in terms of amount of credit claimed. For these cases, neither the departmental records nor the taxpayer records were provided for

<sup>149</sup> Kolkata- 13 cases (₹ 449.95 crore), Pune -9 cases (₹ 134.81 crore), Chennai – 5 cases (₹ 17.06 crore), Nagpur -5 cases (₹ 22.17 crore), Thiruvananthapuram- 2 cases (₹ 27.64 crore), Vadodara – 4 cases (₹ 410.31 crore), Panchkula- 2 cases (₹ 3.56 crore)

audit. The top 50 claims that could not be audited represent transitional credit of ₹ 3,954.21 crore. The top five cases among these amounted to ₹ 1,275.22 crore.

Ministry, while providing (February 2022) a detailed response, admitted non-production of records in 282 cases, did not admit non-production of records in 250 cases, and stated that the remaining 422 cases were being reconciled and assured that all these cases would be provided in due course.

Out of the 250 cases where Ministry did not admit non-production of records, the Ministry stated that in 95 cases taxpayers were not forthcoming with the records. Even though the Department may have pursued production of records with the taxpayers, the fact remains they have not been produced for audit. The remaining cases pertained to either the taxpayers being in a different jurisdiction (52 cases) or cases that have since been produced to Audit (103 cases). These cases will be reviewed subsequently by Audit.

### 6.8.2 Partial production of records

The jurisdiction wise partial production of records is given in **Table 6.4**. In these cases, the underlying records<sup>150</sup> for evaluating the eligibility of the credit were not produced.

**Table 6.4: Partial production of records reported by Field Audit Offices**  
*Amount in crores of ₹*

Jurisdictional zone of CBIC	Sample		Partial production	
	Number of claims	Amount of Credit	Number of claims	Amount of Credit
Kolkata	1,232	3,188.24	917	2,157.56
Panchkula	312	7,274.11	226	6,157.92
Meerut	494	3,466.03	195	1,772.63
Delhi	333	2,071.34	167	1,164.26
Guwahati	379	1,559.58	151	1,343.08
Hyderabad	635	2,166.10	83	512.89
Lucknow	146	1,186.63	79	852.50
Visakhapatnam	406	1,871.16	76	430.12
Chennai	582	7,024.07	67	1,099.35
Ahmedabad	180	3,824.00	57	2,185.89
Vadodara	234	3,454.18	53	867.98
Other zones <sup>151</sup>	3,581	45,669.33	138	1,116.54
<b>Total</b>	<b>8,514</b>	<b>82,754.77</b>	<b>2,209*</b>	<b>19,660.72</b>

\* Note: Out of this, Ministry stated (February 2022) that 333 cases have since been produced to Audit, which would be audited and reported upon separately

<sup>150</sup> Duty paid documents, Asset ledger, Stock statements etc.,

<sup>151</sup> Bhopal- 50 cases (₹ 537.26 crore), Chandigarh- 41 cases (₹ 184.06 crore), Thiruvananthapuram-14 cases (₹ 14.35 crore), Ranchi- 25 cases (₹ 319.91 crore), Jaipur- 8 cases (₹ 60.96 crore)



The partial production accounted for 26 *per cent* of the sample size in terms of number and 24 *per cent* in terms of amount of credit claimed. Of these, the amount of transitional credit claimed by the top 50 cases amounted to ₹ 11,347.81 crore. The top five cases of partial production amounted to ₹ 5,116.15 crore.

Of the cases where records were partially produced, Audit observed irregularities in 539 cases involving a transitional credit claim of ₹ 6,606.34 crore, representing a potential risk exposure as Audit could not perform all the envisaged detailed audit checks due to absence of the relevant underlying records.

Ministry, while providing (February 2022) a detailed response, admitted partial production in 980 cases, did not admit partial production of records in 638 cases, and stated that the remaining 591 cases were being reconciled and assured that all these cases would be provided in due course.

Out of 638 cases where Ministry did not admit partial production of records, the Ministry stated that in 225 cases taxpayers were not forthcoming with the records. Even though the Department may have pursued production of records with taxpayers, the fact remains that they have not been produced for audit. The remaining cases pertained to either the taxpayers being in a different jurisdiction (80 cases) or cases that have since been produced to Audit (333 cases). These cases will be reviewed subsequently by Audit.

### **6.8.3 Inadequate maintenance of verification records**

The mechanism of carrying out verification of transitional claims differed between the jurisdictions. In some jurisdictions, the Audit Commissionerates carried out the verification while in the majority of the jurisdictions the verification was carried out both by the Executive Commissionerates and by the Audit Commissionerates. Though the CBIC had issued (March 2018) a guidance note<sup>152</sup> prescribing a set of checks for verification of CGST transitional credit, it did not specify the nature, extent, and period of maintenance of documentation of the verification process carried out by the departmental field formations. The record keeping by the Audit Commissionerates and the Executive Commissionerates varied widely and was inadequate in many of the jurisdictions. Out of the sample size of 8,514 cases, of which 954 cases were not produced to Audit, the department had verified 6,999 claims. However, verification reports in respect of 1,800 claims out of 6,999 claims were not produced to Audit. The top five cases of non-production of verification reports amounted to ₹ 3,270 crore.

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<sup>152</sup> Chairman CBIC reference - D.O.F. No.267/8/2018-CX.8 dated 14<sup>th</sup> March 2018

Audit observed irregularities in 1,132 cases (16.17 *per cent*) out of 6,999 cases (including partial production) verified by the Department; due to inadequate maintenance of verification records the efficacy of verification process carried out by the departmental field formations could not be evaluated fully.

Ministry provided (February 2022) a response to the top five cases of non-production of verification records and stated that in four cases either the verification is yet to be concluded or verification reports have since been provided to audit, while in one case the Ministry assured a reply in due course.

These cases, along with other cases of non-production, are envisaged to be audited and reported upon separately.

## **6.9 Audit findings**

Considering that the detailed audit addressed issues from a systems perspective as well as from an implementation perspective, the audit findings have been categorized as systemic and compliance findings. While systemic issues address the adequacy and effectiveness of the envisaged verification mechanism, the compliance issues address the deviations from the provisions of the Act/Rules. As brought out in para 6.8 above, non-production of underlying records of taxpayers and departmental verification records constituted a significant limitation of scope of our audit. Subject to this constraint, the outcome of detailed audit of the transitional credit cases produced to Audit has been included in the subsequent paragraphs.

### **6.9.1 Systemic issues**

The systemic issues comprised a review of the verification mechanism envisaged by the department in terms of extent of coverage against the targets, policy/procedural gaps in the verification mechanism, challenges with dual control and efficiency of the recovery process.

Apart from the statutory requirements prescribed under both Legacy as well as GST laws, the Board had specified transitional credit verification as one of the key focus areas for the year 2018-19. The Board while identifying cases of transitional credit claims, accorded priority to verification of cases where the closing balance of Cenvat Credit between October 2016 and June 2017 had shown a growth of 25 *per cent* or more. The guidance note of March 2018 issued by the Board contained a checklist for verification of transitional credit claims and stated, inter-alia, that CGST officers have jurisdiction for verification of transitional credit of CGST component irrespective of the current jurisdiction of taxpayers (Centre or State) in GST. The CBIC jurisdictional formations took up verification in four phases to be completed by March 2019.

Audit review indicated inadequacies in the verification mechanism envisaged by the Department. The verification process was not yet completed even after a lapse of more than two years from the targeted completion date. In respect of verified cases, the recovery rate was lower.

Out of the audit sample of 8,514 cases, the Department has not verified 1,515 cases (18 *per cent*) and recovery actions were not initiated in 1,042 cases (12 *per cent*). Most of these cases, i.e. 846 cases pending for verification and 562 cases pending for recovery action were under the State jurisdiction suggesting that provisions of Section 6(1) of the Act establishing dual control were not enforced effectively in some zones, despite clarification in the guidance note. Audit also noticed that, in Meerut and Lucknow zones, the cases were pending verification due to non-resolution of jurisdictional issues within/between Central Tax Commissionerates.

#### 6.9.1.1 Progress of verification

Audit noticed that 8,849 cases, out of the 50,000 identified cases, were pending verification as of November 2021. Ministry attributed the pendency to non/partial submission of documents by taxpayers, units being closed/defunct/under National Company Law Tribunal (NCLT) proceedings, Show Cause Notices being issued and verification being in progress for cases where documents were received. Audit indicated that pendency in verification was also influenced by jurisdictional issues:

**(i) Cross jurisdiction:** Out of the 8,849 cases which are yet to be verified, 1,515 cases were represented in the audit sample, of which 846 cases constituting 56 *per cent* of the cases pending verification were under the jurisdiction of the States. The issue was predominant in five zones as shown in **Table 6.5** suggesting that dual control provisions envisaged under Section 6(1) of the Act and Department's guidance note specifying that CGST officers shall have the jurisdiction for verification of Transitional credit of CGST irrespective of the present jurisdiction of the taxpayer, could not be effectively implemented in these zones.

**Table 6.5: Cases pending verification under the State jurisdiction**

Zone	Claims yet to be verified	Under State jurisdiction
Delhi	181	113
Kolkata	668	400
Meerut	119	93
Bhopal	98	53
Panchkula	92	49
Other zones	357	161
<b>Total</b>	<b>1,515</b>	<b>846</b>

**(ii) Co-ordination amongst central jurisdictional formations:** The information on reasons for pendency of verification was not forthcoming from 19 out of the 21 zones. From the data provided by Lucknow and Meerut zones it emerges that 318 cases, as detailed in **Table 6.6**, were not verified due to lack of co-ordination and clarity between various formations within the Commissionerate or between Commissionerates on deciding the departmental formation that should verify the transitional credit claim.

**Table 6.6: Cases pending verification for jurisdictional issues**

Zone	CGST Commissionerates	Cases pending verification	Number of cases not verified due to jurisdictional issue		Percentage of pendency
			Within Commissionerate	Between Commissionerates	
Meerut	Ghaziabad	181	81	10	50
Meerut	Noida	318	133	44	56
Lucknow	Kanpur	36	Nil	31	86
Meerut	G B Nagar	29	12	7	66
	<b>Total</b>	<b>564</b>	<b>226</b>	<b>92</b>	<b>56</b>

Ministry stated (February 2022) that all 81 cases of Ghaziabad Commissionerate have since been re-allotted to jurisdictional ranges/divisions. Ministry further stated that now no case was pending verification at Kanpur Commissionerate, and 26 out of the 29 cases have since been verified at G B Nagar Commissionerate (the remaining three cases have been forwarded to Noida Commissionerate).

#### **6.9.1.2 Follow up measures to recover ineligible claims**

As per Rule 121 of CGST Rules 2017, transitional credit wrongly availed and credited to Electronic Credit Ledger (ECL)<sup>153</sup> under sub-rule (3) of rule 117 may be recovered under section 73 or, as the case may be, under section 74 of the Act. Further, adequacy of the verification mechanism is determined by the outcome of the examination, continued follow up and initiation of recovery measures against the irregularities detected.

The Ministry of Finance stated (June and November 2021) that verification of transitional credit claims had resulted in detection of irregular ITC to the tune of ₹ 8,378 crore out of which ₹ 3,135 crore had been recovered. Ministry of Finance also stated that out of the detected irregularities, recoveries were yet to be effected from 4,172 taxpayers and attributed the lower rate of recovery to taxpayers contesting the case, not complying with the detection despite follow up and filing appeals in High Courts.

<sup>153</sup> Electronic Credit Ledger refers to the ledger mentioned under Section 49(2) of CGST Act, 2017, to which the amount of ITC claimed shall be credited

Out of 4,172 cases where recoveries were not initiated, 1,042 cases were covered in our sample of which 562 cases were under the jurisdiction of the States. In detailed audit, we noticed that in 32 claims, where the verification had resulted in detection of ineligible credit amounting to ₹ 68.89 crore, recovery measures were not initiated even after a lapse of two years of verification. The inordinate delay in initiation of recovery measures may potentially hamper the realisation of revenue due to the Government. An illustrative case is given below:

Verification of transitional credit claims of a taxpayer under Ahmedabad South Central Tax Commissionerate, by the Audit Commissionerate had resulted in detection of ineligible carry forward of credit of Education Cess, Secondary and Higher Education Cess, Krishi Kalyan Cess and Clean Energy Cess amounting to ₹ 23.58 crore (September 2018). The taxpayer did not agree with the contention of the Department and did not reverse the irregular credit claimed. However, the Department had not initiated any action to recover the ineligible credit pointed out even after a lapse of three years from the verification.

When Audit pointed this out (March 2021) the Ministry stated (February 2022) that a draft SCN had been submitted to the competent authority.

#### **6.9.1.3 Conclusion and Recommendations**

Overall, 37 *per cent* of the cases selected for detailed audit were either not produced or partially produced for audit, which constituted a significant limitation on Audit scope. Further, most of the jurisdictions did not maintain/produce basic verification records.

From a system's perspective, Audit observed that though the Department had identified the top 50,000 cases for verification as a priority for 2018-19, the exercise was not yet completed, and the Department was yet to verify 8,849 cases. The rate of recovery of detected irregularities was low. Cross jurisdictional issues and lack of co-ordination in Central Tax jurisdictions in some zones impeded verification and initiation of recovery actions. In view of these findings, we recommend the following:

The Department may:

1. *Ensure production of records for cases for which envisaged detailed audit checks could not be completed. These will be reviewed subsequently by Audit.*
2. *Address the issue of inadequate maintenance of verification records in the jurisdictional formations as they are not amenable to review in the present form.*

3. *Expedite verification of CGST portion of transitional credit claimed by the taxpayers under the State administration in the zones where the bulk of the non-verified cases are under the State jurisdiction.*

Ministry provided an updated status of verification and stated (February 2022) that another 4,770 cases had since been verified and 4,079 cases were pending verification, and that irregular ITC detection had gone up to ₹ 10,965.91 crore out of which ₹ 3,596.10 crore had been recovered. Ministry also stated that the Board was actively monitoring the expeditious verification of transitional credit claims.

### **6.9.2 Compliance issues**

The compliance issues pertain to the validity and admissibility of the transitional credits carried over by the taxpayers into GST regime. Taxpayers were required to claim transitional credits in the various specified Tables<sup>154</sup> of Tran 1 and Tran 2 Forms as applicable. Broadly, these tables provide for credit in respect of Cenvat credit carried over from the legacy Returns ER1 (Central Excise) and ST3 (Service Tax), unavailed Cenvat credit in respect of capital goods, Cenvat credit in respect of inputs/semi-finished goods/finished goods held in stock and Cenvat credit of inputs or input services in transit. The sample identified for audit represented claims under each of these tables.

Audit review disclosed significant irregularities in the transitional credit claims of taxpayers across various categories regulated by the sub sections of Section 140, Section 142(11) as well as Section 50(1) of the CGST Act 2017 pertaining to payment of interest. The summary of the nature and extent of compliance deviations noticed in the audited sample is given in **Table 6.7**:

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<sup>154</sup> Tran 1-Tables: 5(a)-Closing Credit balance of legacy returns; 6(a)-Unavailed credit on capital goods; 7a(A)-Credit on duty paid stock with invoices; 7a(B)-Credit on duty paid stock without invoices; 7(b)-Credit on inputs or input service in transit; 8-Transfer of credit by centrally registered units; 11-Credit of tax paid on advances: Tran 2-Table 4: Credit afforded on stocks without invoices

**Table 6.7: Summary of nature of observations and deviation rates**

Nature of observations	Sample audited		Deficiencies noticed		Deficiencies as percentage of audited sample	
	Number	Amount (₹ in crore)	Number	Amount (₹ in crore)	Number	Amount
Ineligible duties transitioned- All Tables	7,560	75,905.09	299	52.57	3.96	0.07
Irregular claim on closing balances- Table 5(a)	5,164	61,547.78	335	502.20	6.49	0.83
Irregular claim on unavailed credit on capital goods- Table 6(a)	3,279	2,740.53	402	231.02	12.26	8.43
Ineligible credit of duty paid goods in stock with documents-Table 7(a)A	4,151	7,262.27	148	56.48	3.57	0.78
Ineligible credit of duty paid goods in stock without documents-Table 7(a)B	579	260.02	75	13.18	12.95	5.06
Ineligible credit on inputs or input services in transit -Table 7(b)	3,514	3,842.89	397	75.29	11.30	1.96
Irregular credit by Centralised registered units- Table 8	254	*	7	20.97	2.76	
Irregular credit of tax paid on supplies attracting VAT and Service Tax-Table 11	373	465.67	23	25.83	6.17	5.55
<b>Total</b>			<b>1,686</b>	<b>977.54</b>		

\* Credit already featured under closing balance category

As evident from the table above, Audit noticed 1,686 irregularities in 1,438 cases amounting to ₹ 977.54 crore. Relatively higher number of irregularities were noticed in following categories viz; ineligible credit of duty paid goods in stock without documents, irregular claim on unavailed credit on capital goods, ineligible credit on inputs or input services in transit and irregular claim on closing balances. Out of the 1,438 cases where irregularities were noticed in the audit sample, 1,132 cases had already been verified by the Department. The irregularities noticed amounted to ₹ 735.69 crore in the 1,132 cases that had already been verified by the Department.

The nature and extent of compliance deviations have been elaborated in the subsequent paragraphs. In each section, for a perspective on materiality, while providing the respective population size extracted from GSTN we have also provided the representation of the top 100 cases<sup>155</sup> of the population in the audit sample and have distinctly indicated the deviations observed in these cases. In addition, the outcome of data analysis of the transitional credit data in GSTN has been appropriately featured. Further, we have typically included the money value of the top five irregularities noticed in each section and have

<sup>155</sup> less than 100 cases in some sections where the claims were comparatively lower.



featured illustrative cases for an appreciation of the nature and significance of the deviations.

### 6.9.2.1 Ineligible duties carried forward

Section 140 of the CGST Act provides for transition of eligible duties paid on inputs and input services under existing laws into GST regime. Eligible duties for the purpose of the section are as defined under Explanation 1 and 2 under the Section. A retrospective amendment was carried out vide CGST Amendment Act, 2018 (No.31 of 2018) dated 29<sup>th</sup> August 2018, which restricted the applicability of 'Cenvat credit' under Section 140 of the Act, to 'Cenvat credit of Eligible duties' as specified in Explanation 1 and 2 thereunder. Further, Explanation 3 specifically excludes any cess which has not been specified in Explanation 1 or 2 and any cess which is collected as additional duty of Customs under sub-section (1) of section 3 of the Customs Tariff Act, 1975 from the expression 'credit of Eligible duties'.

Thus, the Cenvat credit of Education Cess, Secondary and Higher Education Cess, Krishi Kalyan Cess, Swatch Bharat Cess and Clean Energy Cess were not eligible duties for transition to GST.

Audit examined 7,560 transitional credit claims involving total transitional credit of ₹ 75,905.09 crore. These encompass claims under the different sub-sections under Section 140 of the Act, preferred under various tables of Tran 1 return. Out of these cases, Audit noticed non-compliance in 299 cases involving claim of ineligible duties amounting to ₹ 52.57 crore. The deviations were in the category of ineligible cess credit carried forward; credit claimed on VAT; and credit claimed on Personal Ledger Account (PLA)<sup>156</sup> balances.

When this was pointed out, the Ministry/Department accepted the audit observations in 161 cases with ineligible amount of ₹ 31.05 crore, of which ₹ 13.41 crore was recovered in 121 cases.

### Ineligible Duties transitioned

A total of 299 taxpayers had claimed ineligible duties amounting to ₹ 52.57 crore

Table 5(a)- 259 claims involving ineligible duties of ₹ 42.95 crore.

Table 7(a)A- 15 claims involving ineligible duties of ₹ 2.64 crore.

Table 7(b)- 16 claims involving ₹ 0.46 crore.

Table 8- One claim involving ₹ 0.23 crore.

Table 11- 12 claims involving ₹ 6.27 crore.

<sup>156</sup> PLA is a mandatory requirement of Rule 8A of Central Excise Rules for deposit of Central Excise duty; Circular No.249/83/96-CX dated 11<sup>th</sup> October 1996



The top five irregularities noticed under this category amounted to ₹ 15.83 crore. An illustrative case is featured below.

A taxpayer coming under the jurisdiction of Bhubaneswar Central Tax Commissionerate had claimed transitional credit of duty paid on coal held in stock under section 140(3) of the CGST Act, amounting to ₹ 3.07 crore. During verification of the claim, Audit noticed that the transitional credit included Clean Energy Cess of ₹ 2.56 crore on coal in Table 7(a) A of Tran 1 return, which was not eligible.

When this was pointed out (July 2021), the Ministry while admitting the audit observation intimated (February 2022) that action was being initiated to recover the ineligible credit claimed by the taxpayer.

#### **6.9.2.2 Closing balance of the credit in the last returns (Table 5(a) of Tran 1)**

As per Section 140(1) of the CGST Act 2017, a registered person, other than a person opting to pay tax under Section 10, shall be entitled to take in his ECL the amount of Cenvat Credit of Eligible duties carried forward in the return relating to the period ending with the day immediately preceding the appointed day, furnished by him under the existing law in such manner as may be prescribed. The registered person shall not be allowed to take credit in the following circumstances.

- (i) where the said amount of credit is inadmissible as input tax credit under the Act; or
- (ii) where he has not furnished all the returns required under the existing law for the period of six months immediately preceding the appointed date; or
- (iii) where the said amount of credit relates to the goods manufactured and cleared under such exemption notification as are notified by the Government

Table 5(a) of the Tran 1 returns was specified for the claim under this section. On pan-India basis, a total of 1,07,408 taxpayers had claimed transitional credit of Cenvat credit amounting to ₹ 89,407.95 crore carried forward from the legacy returns under Section 140(1) of the Act. The top 100 claims under this category accounted for 48 *per cent* of the total transitional credit claimed in this category. Audit examined 5,164 claims under this category, of which 64 claims were from the top 100 claims.

Audit noticed deviations in 335 claims involving transitional credit of ₹ 502.20 crore, which included nine claims out of the top 100 claims. The deviations were in the categories of ineligible credit carried forward; credit claimed without filing legacy returns; and excess credit carried over.

**(i) Ineligible credit carried forward**

Eligibility of the credit to be carried forward from the legacy returns filed for the period ending with the day immediately preceding the appointed day was determined under Section 16 and 17 of CGST Act. The registered person is not entitled to the credit of any input tax unless he is in possession of a duty paid document and has received the goods or services or both.

Further, Section 17 of the Act specifies the nature of supplies on which input tax credit shall not be available, which *inter-alia* includes a) works contract services when supplied for construction of an immovable property (other than plant and machinery) except where it is an input service for further supply of works contract services and b) goods or services or both received by a taxable person for construction of an immovable property on his own account including when such goods or services or both are used in the course of furtherance of business.

Audit noticed irregularities in 91 claims where taxpayers had transitioned ineligible credit amounting to ₹ 174.18 crore. Ineligible credits transitioned in this category were on account of works contract services used for the construction of buildings; inputs used for construction of buildings for own account; credit claimed on services or goods not received by the taxpayers; and credit claimed on time barred documents.

When this was pointed out, the Ministry/Department accepted the audit observations in 26 cases with irregular amount of ₹ 66.64 crore, and ₹ 17.78 crore has been recovered in 11 cases. The top five irregularities noticed in this category amounted to ₹ 82.31 crore. Two illustrative cases are featured below.

**a)** A taxpayer coming under the jurisdiction of Bhubaneswar Central Tax Commissionerate had carried forward Cenvat Credit of ₹ 54.75 crore under Section 140(1) of the Act. The closing balance of Cenvat credit available as per the ST3 return for the period ending June 2017 was transitioned into GST under Table 5(a) of Tran 1 return. On scrutiny of the claim, Audit noticed that the credit claimed by the taxpayer included the credit on inputs like TMT bars and input services like works contract services used for civil constructions. As the taxpayer was not engaged in supply of works contract services, the input tax credit claimed in these categories was not allowed as per section 17 of the Act.

Hence the credit claimed of ₹ 30.31 crore on account of the ineligible inputs and services was not eligible for transition.

When this was pointed out (February 2021), the Ministry while accepting the observation, intimated (February 2022) that action was being initiated to recover the ineligible credit from the taxpayer.

**b)** A taxpayer coming under the jurisdiction of Belgaum Central Tax Commissionerate was a manufacturer of Cement under legacy central excise regime. The taxpayer had claimed transitional credit of closing balance of Cenvat credit, carried forward from his legacy returns, amounting to ₹ 21.45 crore. During verification, Audit noticed that the taxpayer had closed his manufacturing activity completely from November 2015 and no clearance of manufactured products happened since then. However, the taxpayer had claimed Cenvat credit on capital goods and input services amounting to ₹ 19.07 crore during 2016-17. As the goods or services were not used in the factory of the manufacturer for taxable activity, the transitional credit claim of ₹ 19.07 crore was *ab initio* ineligible.

When this was pointed out (October 2021), the Ministry stated (February 2022) that the taxpayer intended to start the production and accordingly credit was claimed. However, the production could not be started due to some policy issues. The credit is eligible as neither the existing law nor the GST law cast any embargo for claiming the Cenvat credit.

The reply is not tenable as the Cenvat credit was eligible only when the goods or services were used for manufacturing dutiable goods or for provision of taxable services as per Rule 2(a)(k)(l) of the Cenvat Credit Rules, 2004. In this case, as the factory was closed and no manufacturing activity was happening, goods and services were not used for taxable activity to claim the Cenvat credit.

#### **(ii) Credit claimed without filing legacy returns**

Transitional credit under Section 140(1) is permissible only when the taxpayer had furnished all the returns required under the existing law for the period of six months immediately preceding the appointed date. Pan-India data analysis of the transitional credit claims under this category (Table 5(a)) disclosed that 34,824<sup>157</sup> taxpayers, who did not furnish legacy returns for the period ending June 2017, had claimed transitional credit amounting to ₹ 43,548.32 crore.

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<sup>157</sup> Data extracted from GSTN for the taxpayers who had not filed legacy returns/not filed within the due date under ST/CE but claimed transitional credit in Table 5(a)

Audit during detailed examination of sampled cases noticed 30 claims where taxpayers had carried forward Cenvat credit without filing legacy returns. The irregular transition of credit in these cases amounted to ₹ 60.32 crore.

When this was pointed out, the Ministry/Department accepted the audit observations in three cases with irregular amount of ₹ 3.30 crore and ₹ 0.43 crore had been recovered in two cases. The top five irregularities noticed in this category amounted to ₹ 21.71 crore. An illustrative case is featured below.

A taxpayer coming under the jurisdiction of Bengaluru East Central Tax Commissionerate had claimed transitional credit of Cenvat credit carried forward from the legacy Central Excise (ER1) and Service Tax (ST3) returns, under Table 5(a) of Tran 1 returns amounting to ₹ 12.01 crore. The amount of credit carried forward in ER1 and ST3 returns furnished for the period ending with the month immediately preceding the appointed day was ₹ 4.07 crore and ₹ 7.94 crore, respectively. The taxpayer had filed Tran 1 returns for the above claim during the month of November 2017 and the amount was credited to the ECL on 27<sup>th</sup> December 2017. Audit noticed that the taxpayer had not filed ST 3 returns for the period ending with June 2017, at the time of filing the Tran 1 return. The ST3 return for the said period was filed during the month of September 2018, after a lapse of almost 10 months from date of filing Tran 1. Therefore, the taxpayer was not eligible to claim Cenvat credit in respect of the returns, which was not furnished at the time of claiming transitional credit. The ineligible transitional credit amounted to ₹ 7.94 crore.

When this was pointed out (October 2021), the Ministry stated (February 2022) that the issue was under examination.

### **(iii) Excess credit carried over from legacy returns**

The Cenvat credit balance in the return furnished by a taxpayer for the period ending with the day immediately preceding the appointed day under the existing law was eligible for transition under the section. Under the legacy regime, every assessee had to submit a return electronically through ACES system (Automation of Central Excise and Service Tax) as specified under Rule 7 of Service Tax Rules 1994 and Rule 12(5) of the Central Excise Rules, 2002. In this context, ACES system included a red flag facility to mark the transitional credit claims where the credit carried forward by the taxpayer was not as per the system with the last return filed under Central Excise/Service Tax.

Pan-India data analysis of the claims under this category disclosed potential excess claim in 828 cases<sup>158</sup> amounting to ₹ 1,048.07 crore, wherein the

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<sup>158</sup> GSTINs having ITC claims more than the Cenvat Credit Balance in the legacy returns

taxpayers had transitioned credit in excess of the Cenvat credit balance in the legacy returns filed for the period ending June 2017.

During detailed examination of the sampled cases, Audit noticed that in 214 claims the taxpayers had transitioned Cenvat credit of ₹ 267.70 crore in excess of the credit balances in legacy returns furnished for the period ending with the day preceding the appointed day.

When this was pointed out, the Ministry/Department accepted the audit observations in 97 cases with irregular amount of ₹ 71.64 crore, and ₹ 6.28 crore was recovered in 36 cases. The top five irregularities noticed in this category amounted to ₹ 85.97 crore. An illustrative case is featured below.

A taxpayer coming under the jurisdiction of Mumbai East Central Tax Commissionerate had claimed transitional credit of Cenvat credit, carried forward from the legacy return furnished for the period ending June 2017, amounting to ₹ 0.44 crore. The credit claimed was reflected in their ECL on 27<sup>th</sup> December 2017. On scrutiny of the claim, Audit noticed that the ECL of the taxpayer was again credited with transitional credit of ₹ 19.62 crore on 16<sup>th</sup> January 2019, for which the credit was not available as per the legacy returns. Thus, the credit claimed amounting to ₹ 19.62 crore was not in accordance with the provisions.

When this was pointed out (July 2021), the Ministry, while accepting the observation, intimated (February 2022) that the taxpayer had been directed to reverse the excess credit.

### **6.9.2.3 Un-availed credit on capital goods (Table 6(a) of Tran 1)**

As per Section 140(2) of the CGST Act 2017, a registered person other than a person opting to pay tax under section 10, shall be entitled to take in his ECL, credit of un-availed Cenvat Credit in respect of capital goods, not carried forward in a return, furnished under the existing law by him for the period ending with the day immediately preceding the appointed day. Provided that the registered person shall not be allowed to take credit unless said credit was admissible as Cenvat credit under existing law and is also admissible as input tax credit under this Act.

The unavailed Cenvat credit means the amount that remains after subtracting the amount of Cenvat credit already availed in respect of capital goods by the taxable person under the existing law from the aggregate amount of Cenvat credit to which the said person was entitled in respect of the said capital goods under the existing law.

Credit in respect of un-availed portion of capital goods was to be claimed in Table 6(a) of Tran 1 return. A total of 19,244 taxpayers had claimed transitional

credit of Cenvat credit in respect of capital goods amounting to ₹ 4,311.75 crore. The top 100 claims under this category accounted for 58 *per cent* of the total transitional credit claimed under this category. Audit examined 3,279 claims in this category including 64 from the top 100 claims covering 33 *per cent* of the total transitional credit claimed under this category.

Audit noticed irregularities in 402 claims, including 17 claims from the top 100 claims, involving irregular transitional credit amounting to ₹ 231.02 crore. The deviations were due to irregular credit claimed; and availing of 100 *per cent* credit on capital goods as unavailed portion of Cenvat credit on capital goods, which was inadmissible.

**(i) Irregular credit claimed**

As per the proviso under Section 140(2) of the Act, transitional credit shall not be allowed unless the credit was admissible as Cenvat credit under the existing Cenvat Credit Rules, 2004 and is also admissible as input tax credit under the Act. As per Rule 2(a) of Cenvat Credit Rules, 2004, capital goods means the goods, which were used:

1. in the factory of the manufacturer of the final products but does not include any equipment or appliances used in an office.
2. for providing output services

Thus, the credit on capital goods is permissible only on the goods, which were used in the manufacturing or provision of services under the existing laws, and are also being used for taxable supply under GST.

In 27 claims, Audit noticed that the taxpayers had claimed irregular credit on capital goods amounting to ₹ 45.05 crore. The deviations were on account of credit taken on the capital goods, which were ineligible for credit under the existing laws.

When this was pointed out, the Ministry/Department accepted the audit observations in 12 cases with irregular amount of ₹ 31.21 crore, and ₹ 0.73 crore was recovered in four cases. The top five irregularities noticed in this category amounted to ₹ 40.07 crore. Two illustrative cases are featured below.

**a)** A taxpayer coming under the jurisdiction of Bhubaneswar Central Tax Commissionerate had claimed transitional credit of unutilised Cenvat credit on capital goods under section 140(2) of the CGST Act. The credit was claimed on the components and parts of Nitric Acid and Ammonium Plants imported during April 2017 for the manufacturing unit. The credit claimed on these goods amounting to ₹ 29.07 crore was credited to the ECL of the taxpayer during December 2017. During verification of the claim, Audit noticed that the capital goods were stored in a warehouse as stated in the Bill of Entry and the

taxpayer had neither received the goods in the factory of production nor used them for manufacturing activity to claim the Cenvat credit on the goods under the provisions of the existing law. Therefore, credit was not claimed in their legacy Central Excise Returns (ER1) and the entire amount was claimed as unavailed portion of Cenvat credit under the GST transitional provisions. As per the proviso under Section 140(2), the taxpayer was eligible for transition of unavailed portion of Cenvat credit only when the credit was also eligible under the existing law, which was not fulfilled in this case. Hence, the transitional credit claimed by the taxpayer under Table 6(a) of Tran 1 return in respect of the goods not used for manufacturing was irregular. The irregular credit transitioned in this case amounted to ₹ 29.07 crore.

When this was pointed out (March 2021), the Ministry while accepting the observation intimated (February 2022) that the taxpayer was under the State jurisdiction and the draft show cause notice would be forwarded for recovery of irregular credit.

**b)** A taxpayer coming under Guwahati Central Tax Commissionerate had claimed transitional credit of unavailed Cenvat credit in respect of capital goods under Table 6(a) of Tran 1 return amounting to ₹ 4.44 crore. The taxpayer was covered under the erstwhile centralised registration under Service tax provisions (AAACB2894GST036) for which the Centralised unit (06AAACB2894G1ZR) coming under Gurugram Central Tax Commissionerate had already claimed transitional credit as per Section 140(8) of the CGST Act. Further, the credit claimed by the Gurgaon unit was also distributed among the units covered under the erstwhile centralised registration. As such, the other units of the centralised registrant were not eligible to claim the benefit of transitional credit provisions of the Act. Thus, the transitional credit claimed by Guwahati unit, being one of the units covered under the erstwhile centralised registration, amounting to ₹ 4.44 crore under Section 140(2) of the Act was irregular.

When this was pointed out (August 2021), the Ministry stated (February 2022) that a show cause notice was being issued to the taxpayer to safeguard revenue.

Audit noticed another 19 cases pertaining to the other registered units of same taxpayer covered under the Centralised registration claiming transitional credit of ₹ 159.22 crore under Section 140(2). As the Centralised unit had already claimed the transitional credit and distributed the credit to the units covered under the centralised registration as per section 140(8) of the Act, these individual claims from other registered units have a potential risk exposure of irregular credit.



**(ii) Availing of 100 per cent credit on capital goods**

The unavailed portion of Cenvat credit represents the balance of credit in respect of goods on which portion of credit had already been taken under the legacy rules. As per Rule 4(2)(a) of Cenvat Credit Rules, the credit in respect of capital goods at any point of time in a financial year shall be taken only for an amount not exceeding 50 per cent of the duty paid on such capital goods in the same financial year. Hence, the section provides for transition of 50 per cent of the credit in respect of capital goods on which credit was claimed under the legacy returns. The restriction is in line with the provisions of existing rules to safeguard against potential misuse of credit on goods that are either ineligible for credit or on which benefit of depreciation on the Cenvat credit portion was claimed under Section 32 of the Income Tax Act 1961. This view was expressed in para 5.1 of the Boards' guidance note.

Audit noticed irregularities in 375 claims wherein taxpayers had claimed 100 per cent credit on the capital goods as unavailed portion of Cenvat credit on capital goods. Irregular transitional credit involved in these claims amounted to ₹ 185.96 crore.

When this was pointed out, the Department accepted the audit observation in 124 cases with irregular amount of ₹ 43.31 crore, and ₹ 2.78 crore was recovered in 28 cases. The top five irregularities noticed in this category amounted to ₹ 74.23 crore. An illustrative case is featured below.

A taxpayer coming under the jurisdiction of Udaipur Central Tax Commissionerate had claimed transitional credit of unavailed portion of Cenvat credit on capital goods under Section 140(2) of the Act amounting to ₹ 15.56 crore. On scrutiny of the claim, Audit noticed that the taxpayer had claimed 100 per cent credit in respect of the capital goods, which was not permissible under the extant provisions.

When this was pointed out (July 2021), the Ministry stated (February 2022) that the taxpayer was eligible for credit as the credit was not claimed earlier.

The reply is inconsistent with para 5.1 of the Boards' guidance note, which states that "if no credit was availed earlier, credit of entire amount cannot be availed through this Table."

Audit is of the view that the Department may ensure that the records of taxpayers, who have carried forward 100 per cent of the credit, on capital goods in GST regime, are examined to rule out availment of a portion (50 per cent) of the credit in the previous legacy returns of 2016-17 and 2017-18 (first quarter). Further, the Department needs to take a uniform



position on this issue by clarifying the instructions contained in Para 5.1 of the Board's guidance.

#### **6.9.2.4 Credit on duty paid stock (Table 7(a) A and B of Tran 1)**

As per Section 140(3) of the Act, a registered person, who was not liable to register under the existing law or who was engaged in the manufacture of exempted goods or provision of exempted services or who was providing works contract service and was availing of the benefit of notification No. 26/2012—Service Tax, dated 20th June, 2012 is entitled to take, in his ECL, credit of eligible duties in respect of inputs held in stock and inputs contained in semi-finished or finished goods held in stock on the appointed day subject to the following conditions.

- (i) such inputs or goods are used or intended to be used for making taxable supplies under this Act;
- (ii) the said registered person is eligible for input tax credit on such inputs under this Act;
- (iii) the said registered person is in possession of invoice or other prescribed documents evidencing payment of duty under the existing law in respect of such inputs;
- (iv) such invoices or other prescribed documents were issued not earlier than twelve months immediately preceding the appointed day; and
- (v) the supplier of services is not eligible for any abatement under this Act:

Provided that where a registered person, other than a manufacturer or a supplier of services, is not in possession of an invoice or any other document evidencing payment of duty in respect of inputs, then, such registered person shall also be allowed to take credit at such rate and in such manner, subject to such conditions as may be prescribed, including that the said taxable person shall pass on the benefit of such credit by way of reduced prices to the recipient.

#### **A) Claims with duty paid documents**

The credit under this category is claimed under column 7A of Table 7(a) of Tran 1 return. A total of 1,91,301 taxpayers had claimed transitional credit of eligible duties paid on inputs, semi-finished goods or finished goods held in stock on the appointed date amounting to ₹ 30,562.94 crore. Out of this, the credit claimed by 13,989 migrated<sup>159</sup> taxpayers accounted for 98 *per cent* of the total

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<sup>159</sup> Taxpayers who were registered under existing Central Excise and Service Tax laws and are registered under Rule 24 of CGST Rules, 2017.

credit under this category. Audit examined 4,151 claims under this category including 2,004 claims of migrated taxpayers.

Audit noticed deviations in 148 claims involving irregular transitional credit of ₹ 56.48 crore, including 61 deviations from the claims of migrated taxpayers. The irregularities were in the nature of credit claimed on duty paid goods either not in stock or in excess of declared stock; irregular credit claimed by works contract suppliers; credit claimed on time barred documents; credit claimed by ineligible taxpayers; and credit claimed without supporting duty paid documents.

Significant audit findings under each of the categories are discussed in the subsequent paragraphs.

**(i) Credit claimed on duty paid goods either not in stock or in excess of declared stock**

Transitional credit of duty paid on goods is available if the registered person had held such goods in stock on the appointed day. The taxpayer should claim the credit of duty paid on such goods with the prescribed documents evidencing duty payment.

In 12 claims, Audit noticed that the taxpayers had claimed credit on goods either not in their possession on the appointed day or on the quantity of goods in excess of the stock held on the appointed day, involving irregular credit amounting to ₹ 14.78 crore.

When this was pointed out, Ministry/Department accepted the audit observations in seven cases with irregular amount of ₹ 12.04 crore, and ₹ 0.08 crore was recovered in four cases. The top five irregularities noticed in this category amounted to ₹ 14.52 crore. Two illustrative cases are featured below.

**a)** A taxpayer coming under the jurisdiction of Pune-1 Central Tax Commissionerate had claimed transitional credit of ₹ 13.60 crore in respect of duty paid goods held in stock on the appointed date under section 140(3) of the Act, in respect of which the taxpayer was in possession of the duty paid documents. During verification, Audit noticed that in many duty paid documents the consignee was different from the claimant, evidencing that the taxpayer was not in possession of the goods for which credit was claimed on the appointed day. Thus, the claim of the taxpayer of ₹ 9.26 crore based on the invoices against other consignees, at different State jurisdictions, was irregular.

When this was pointed out (August 2021), the Ministry, while accepting the audit observation, intimated (February 2022) that DRC-01A<sup>160</sup> had been issued to the taxpayer.

**b)** A taxpayer coming under the jurisdiction of Howrah Central Tax Commissionerate had claimed transitional credit of duty paid on finished goods held in stock on the appointed day under section 140(3) of the Act. The taxpayer had filed the details of goods held in stock on the appointed date in respect of which duty paid documents were available. During verification of the claim, Audit noticed that the taxpayer had claimed credit on the quantity of goods in excess of the declared quantity of stock as on the appointed day resulting in excess credit. The excess credit of duty claimed on these goods amounted to ₹ 1.37 crore.

When this was pointed out (April 2021), the Ministry, while accepting the audit observation, intimated (February 2022) that an amount of ₹ 0.04 crore had been recovered from the taxpayer.

**(ii) Irregular credit claimed by works contract suppliers**

A registered person who was providing works contract services under the existing law is eligible to claim the credit on duty paid goods held in stock on the appointed date subject to the condition that he was availing the benefit of Notification 26/2012-Service tax dated 20<sup>th</sup> June 2012. The notification was available for the service providers who were engaged in providing construction of building or civil structure or part there of intended for sale to a buyer, where the value of taxable services includes the land value.

Audit noticed that the works contract suppliers who had not availed the benefit of the above said notification, claimed transitional credit of duty paid stock held on the appointed date; the irregular credit claimed in 11 such claims amounted to ₹ 5.49 crore.

When this was pointed out, the Ministry intimated (February 2022) that show cause notices had been issued in two cases. The top five irregularities noticed in this category amounted to ₹ 5.09 crore. Two illustrative cases are featured below.

**a)** A taxpayer coming under the jurisdiction of Visakhapatnam Central Tax Commissionerate had claimed transitional credit of duty paid stocks held on the appointed date under Section 140(3) of the Act. Amount of credit claimed by the taxpayer under Table 7(a)A of Tran 1 return under this category

<sup>160</sup> The proper officer shall, before service of notice to the person chargeable with tax, interest and penalty, under sub-section (1) of Section 73 or sub-section (1) of Section 74, as the case may be, shall communicate the details of any tax, interest and penalty as ascertained by the said officer, in Part A of FORM GST DRC-01A.”

amounted to ₹ 1.75 crore. During examination, Audit noticed that the taxpayer, as works contract service provider under legacy service tax provisions, had not claimed the benefit of notification 26/2012 ST dated 26<sup>th</sup> June 2012. Hence, the taxpayer was ineligible to claim the benefit of transitional credit in respect of duty paid stock held by him on the appointed date. Accordingly, the credit of ₹ 1.75 crore representing duty paid goods held in stock transitioned by the taxpayer under the section was irregular.

When this was brought to the notice (August 2021), the Department stated (December 2021) that the taxpayer was eligible for credit under the section as the taxpayer was engaged in works contact services.

The reply is not tenable as the taxpayer was not availing benefit of Notification 26/2012-Service tax dated 20<sup>th</sup> June 2012 under the existing law, which was an essential condition for claiming transitional credit on stocks for the works contract service providers.

Ministry stated (February 2022) that the observation was being examined.

**b)** A taxpayer registered under Kochi Central Tax Commissionerate had claimed transitional credit of duty paid goods held in stock on the appointed date, under Table 7(a) A of Tran 1 return, for which duty paid documents were in possession. The credit transitioned by the taxpayer under Section 140(3) of the Act amounted to ₹ 0.98 crore. On verification of the claim, Audit noticed that the taxpayer was providing works contract services for industrial or commercial constructions on sub-contract basis by paying tax under Rule 2(A)(ii) of Service tax (Determination of value) Rules, 2006. Thus, the taxpayer was not availing the benefit of notification 26/2012 ST dated 26<sup>th</sup> June 2012, which was required for claiming the transitional credit benefit under Section 140(3) of the Act. Hence, the credit of ₹ 0.98 crore claimed by the taxpayer was irregular.

When this was pointed out (March 2021), the Ministry stated (February 2022) that the taxpayer was at present under the State GST jurisdiction, and the matter was under correspondence with them.

**(iii) Credit on duty paid stock claimed without supporting or eligible documents**

Credit under the section is permissible only on the basis of duty paid invoices or other prescribed documents duly indicating the evidence of payment of duty under the existing law in respect of the goods on which credit is claimed.

In 18 claims, Audit noticed that the taxpayers had claimed credit of duty paid on the goods held in stock without having the prescribed duty paid documents evidencing payment of duty. Irregular credit claimed in these cases amounted to ₹ 8.93 crore.

When this was pointed out, the Ministry/Department accepted the audit observations in five cases with irregular amount of ₹ 3.46 crore, and ₹ 0.04 crore was recovered in one case. The top five irregularities noticed in this category amounted to ₹ 3.10 crore. An illustrative case is featured below.

A taxpayer coming under Bhopal Central Tax Commissionerate jurisdiction had claimed transitional credit of ₹ 1.26 crore on duty paid goods held in stock on the appointed date under Table 7(a)A of Tran 1 return. During verification of the claim, Audit noticed that the taxpayer was not in possession of the invoices or documents evidencing payment of Central Excise duty on the said goods under the existing Central Excise Act, 1944. Thus, the transitional credit claimed by the taxpayer of ₹ 1.26 crore was ineligible as the taxpayer had not borne the Central Excise Duty for which claim was made.

When this was pointed out (March 2021), the Ministry stated (February 2022) that the observation was being examined.

#### **(iv) Credit claimed on time barred documents**

One of the conditions specified for claims under Section 140(3) of the Act was that the invoices or other prescribed documents were issued not earlier than twelve months immediately preceding the appointed day. Hence, the credit on documents or invoices issued earlier than 30<sup>th</sup> June 2016 were not eligible for credit under the Act.

In 53 claims, Audit noticed that taxpayers had claimed transitional credit of duty paid on good held in stock on the appointed day based on the documents issued earlier than 12 months from the appointed day. Irregular transitional credit claimed on these documents amounted to ₹ 3.38 crore.

When this was pointed out, the Ministry/Department accepted the audit observations in 36 cases with irregular amount of ₹ 2.12 crore, and ₹ 0.76 crore was recovered in 21 cases. The top five irregularities noticed in this category amounted to ₹ 1.81 crore. An illustrative case is featured below.

A taxpayer coming under the jurisdiction of Bengaluru North West Central tax Commissionerate had claimed transitional credit of ₹ 65.08 crore under the Table 7a(A) of Tran 1 return for the duty paid goods held in stock on the appointed day. On verification of the duty paid documents produced in support of the claim, Audit noticed that some of the duty paid documents, for

which credit was claimed, were issued earlier than 12 months from the appointed date. Hence, the same were time barred for claiming the credit under the Act. The irregular credit claimed on these time barred documents amounted to ₹ 0.40 crore.

When this was pointed out (October 2021), the Ministry stated (February 2022) that the issue was under examination and action would be taken to safeguard the revenue.

**(v) Ineligible credit claimed**

Credit under Section 140(3) of the Act is permissible in respect of eligible duties paid on inputs held in stock and inputs contained in semi-finished goods or finished goods held in stock on the appointed day. Hence, the credit in respect of input services is not envisaged under the section. Further, the eligibility of credit on the goods depends upon the condition that the goods are used or intended to be used for making taxable supplies under the Act for which input tax is eligible.

In 54 claims, Audit noticed that the taxpayers had transitioned ineligible credit involving transitional credit of ₹ 24.24 crore. The ineligible credits represented credit claimed on input services and other ineligible credits comprising excess credit claimed and credit claimed by taxpayer claiming abatement under the Act.

When this was pointed out, the Ministry/Department accepted the audit observations in 26 cases with irregular amount of ₹ 2.60 crore, and ₹ 0.31 crore was recovered in 11 cases. The top five irregularities noticed in this category amounted to ₹ 18.10 crore. An illustrative case is featured below.

A taxpayer coming under the jurisdiction of Bengaluru East Central Tax Commissionerate was a registered importer dealer under the legacy Central Excise Act. The taxpayer had claimed transitional credit of ₹ 10.41 crore, under Table 7(a) of Tran 1 return as duty paid goods held in stock at the job workers' premises. The taxpayer had claimed that these goods were supplied to his job-worker through challans as per job-work provisions of the Central Excise Act. Audit noticed that the taxpayer was not entitled to claim the benefit of job-work provisions under the erstwhile Central Excise Act, as he was neither a registered manufacturer nor had followed the prescribed procedures<sup>161</sup> for job work manufacturing. Further, the taxpayer had not paid excise duty on the goods claimed to be manufactured through job-workers nor furnished any

<sup>161</sup> Notification 214/86 CE Dated 25<sup>th</sup> March 1986 specifies the conditions and procedures for job-work manufacturing, which inter alia requires permission from the Commissioner of Central Excise.

assessment returns to that effect. The taxpayer, as registered importer dealer, was actually supplying goods to the job-worker through the Cenvat invoices or bill of entries as mentioned in the Excise returns filed by the taxpayer. Hence, the Cenvat credit of duty paid goods consigned to the job workers as on the appointed date does not qualify under Section 140(3), and the irregular credit claimed amounted to ₹ 10.41 crore.

When this was pointed out (October 2021), the Ministry stated (February 2022) that the case had been entrusted to anti-evasion wing for detailed verification.

### **B) Claim without duty paid documents**

A registered person when not in possession of documents evidencing payment of duty, was also eligible for taking credit in respect of duty paid goods held in stock if he passed on the benefit of such credit by way of reduced prices to the recipient. This scheme of deemed credit was available only to taxpayers other than a manufacturer or a supplier of services who was not in possession of invoice or any other document evidencing payment of duty in respect of inputs held in stock as on the appointed day. The scheme was applicable for a period of six months from the appointed date and the credit shall be availed subject to the conditions specified under Rule 117(4) of CGST Rules.

As per the proviso to Section 140(3) of the CGST Act, a registered person can be allowed to take input tax credit on goods held in stock on the appointed day in respect of which he is not in possession of any document evidencing payment of central excise duty. The registered person availing of this scheme had to specify separately the details of stock held on the appointed day in accordance with the provisions of clause (b) of Rule 117(2) of CGST Rules 2017. However, the benefit of input tax was restricted to 60% of tax payable on such goods, which attract CGST at the rate of nine *per cent* or more, and 40% of tax payable for other goods on supply of such goods after the appointed date. The amount of input tax credit shall be credited to ECL after the central tax applicable on such supply has been paid, as declared in Tran 2 return.

A total of 89,653 taxpayers had claimed transitional credit of duty paid goods held in stock without duty paid documents as declared in column 7B of Table 7(a) of Tran 1 return. Out of this, 27,328 taxpayers declared the supply of goods on payment of GST in Tran 2, against which the transitional credit of Central Tax amounting to ₹ 1,444.91 crore was afforded to the ECL of the taxpayers. Audit examined 579 claims under this category.



Audit noticed deviations in 75 claims involving irregular transitional credit of ₹ 13.18 crore. Deviations were of the nature of ECL credited from both Tran 1 and Tran 2 or credit afforded in ECL without filing Tran 2; credit claimed on stocks not declared or more than that declared in Tran 1 and ineligible credits claimed.

Significant audit findings under each of the categories are discussed in the subsequent paragraphs.

**(i) Input tax credited to ECL from both Tran 1 and Tran 2 or without filing Tran 2**

Taxpayers had to furnish details of stock held on the appointed date on which credit was claimed in Table 7(a)7B of Tran 1 return. Eligible credit in respect of the goods was to be credited to ECL of the taxpayer on filing Tran 2 returns duly indicating the supply of these goods on payment of GST. The proportionate credit afforded to the ECL would be based on the rate of tax paid on the supplies declared in Tran 2 returns.

Pan-India analysis<sup>162</sup> of the claims preferred under Table 7(a)B of Tran 1 return and the amount of central tax credited to ECL against such claims disclosed that the 'eligible duties' declared under Table 7(a)B of Tran 1 had been credited to ECL before furnishing Tran 2 returns detailing supply of goods on payment of GST. Audit observed that the lack of proper validation in the GSTN had resulted in affording irregular credit through Tran 1 return in 2,102 claims amounting to ₹ 114.96 crore. Out of these, 1,792 taxpayers had received credit without filing Tran 2 returns, and ECL was credited twice in respect 310 taxpayers.

Audit noticed that 1,792 taxpayers had received irregular transitional credit of ₹ 92.71 crore without filing Tran 2 returns, based on mere declaration of stocks made under Tran 1. In respect of 310 taxpayers, who had filed Tran 2, the ECL was credited twice- ₹ 22.25 crore on filing Tran 1 and ₹19.86 on filing Tran 2, resulting in an irregular credit of ₹ 22.25 crore. Detailed audit of sample cases in CBIC field formations confirmed these irregularities in 66 claims involving irregular credit of ₹ 10.60 crore.

When this was pointed out, the Ministry/Department accepted the audit observations in 36 cases with irregular amount of ₹ 5.82 crore, and ₹ 4.10 crore was recovered in 18 cases. The top five irregularities noticed in

<sup>162</sup> Analysis GSTN data on amount credited to ECL as per Table 7(a)B of Tran 1 and Credit afforded on filing Tran 2 or cases where Tran 2 not filed.



this category amounted to ₹ 5.02 crore. Two illustrative cases are featured below.

**a)** A taxpayer coming under the jurisdiction of Bengaluru North West Central Tax Commissionerate had claimed credit in respect of duty paid goods held in stock under Table 7(a) B of Tran 1 return. On verification of the claim, it was noticed that the taxpayer had claimed credit of ₹ 2.25 crore on the goods valued at ₹ 26.80 crore through Tran 1 against which no supporting documents were available. Audit further noticed that the input tax of ₹ 2.25 crore claimed was credited to ECL even before the taxpayer filed Tran 2 return. Further, the ECL of the taxpayer was again credited with ₹ 1.06 crore when these goods were supplied on payment of GST and subsequently declared in Tran 2. This resulted in double credit to the ECL, and the credit of ₹ 2.25 crore afforded without filing of Tran 2 was irregular.

When this was pointed out (October 2021), the Ministry stated (February 2022) that the credit from Tran 1 was incorrectly transferred to electronic credit ledger due to GST portal issue. In this case, the credit was not utilised and the taxpayer had reversed the amount in GSTR-3B.

**b)** A taxpayer coming under the Central Tax jurisdiction of Ghaziabad Commissionerate had claimed transitional credit of eligible duties paid on goods held in stock under proviso to Section 140(3) of the Act. The taxpayer had declared the details of stock of electronic goods falling under chapter heading 84 and 85, valued at ₹ 7.21 crore. The eligible duties in respect of these goods were claimed under column 6 of Table 7(a)B of Tran 1 amounting to ₹ 1.17 crore, which was credited to the ECL as input tax credit under CGST on 29 August 2017 without the taxpayer filing Tran 2. On verification of the claim, Audit noticed that the taxpayer had filed Tran 2 for the period from July 2017 to December 2017 declaring supply of these goods on payment of GST and the corresponding CGST credit of ₹ 0.30 crore attributed to the supply was credited to the ECL during March 2018. This resulted in double credit to the ECL, and the credit of ₹ 1.17 crore afforded through Tran 1 was irregular.

When this was pointed out (September 2021), the Ministry stated (February 2022) that the issue was under examination, and the revenue would be protected.

**(ii) Credit claimed on stocks not declared or in excess of declaration in Tran 1**

According to Rule 117(2)(b) of CGST Rules, 2017, the registered person claiming transitional credit of eligible duties under section 140(3) of the CGST Act is required to specify separately the details of stock held on the appointed day in Tran 1. Rule 117(4)(b)(iii) of the said rules specifies the submission of Tran 2 return detailing the supply of such goods effected during the subsequent six tax periods from the appointed date indicating payment of tax on such supplies.

Audit noticed irregularities in nine claims involving irregular transitioning of credit amounting to ₹ 2.58 crore. Irregularities included claiming credit on goods not in stock on the appointed date; and claiming credit on goods supplied in excess of stock declared in Tran 1.

When this was pointed out, the Ministry/Department accepted audit observations in four cases with irregular amount of ₹ 1.11 crore. The top five irregularities noticed under this category amounted to ₹ 2.42 crore. Two illustrative cases are featured below.

**a)** A taxpayer coming under the Central Tax jurisdiction of Mumbai East Commissionerate had claimed transitional credit of ₹ 21.75 crore under Table 5(a), 6(a) and 7(b) of Tran 1, under Section 140(1), (2) and (5), respectively. The taxpayer had not declared any duty paid goods held in stock on the appointed date in Table 7(a)B, and was thus not eligible for credit under Section 140(3) of the Act. However, Audit noticed that the ECL of the taxpayer was credited with CGST component based on the supply of duty paid goods as declared in Tran 2. This was contrary to the provisions of Section 140(3) of the Act. Hence, the amount of credit afforded to ECL on the basis of Tran 2 filed during the period from July 2017 to December 2017, amounting to ₹ 1.12 crore was irregular as the goods were not held in stock on the appointed date.

When this was pointed out (July 2021), the Ministry stated (February 2022) that the observation was being examined.

**b)** A taxpayer coming under the Central Tax jurisdiction of Chennai North Commissionerate had claimed transitional credit of eligible duties on goods held in stock on appointed date. The motor vehicle parts on which credit was claimed were valued at ₹ 0.99 crore. On verification of the claim, it was noticed that the taxpayer had claimed credit of duty paid on goods not declared in the details of closing stock furnished in Tran 1 return and on some goods the supply was shown more than the quantity of stock declared in Tran 1. These

goods were supplied on payment of duty during the period from July 2017 to December 2017 and declared in the Tran 2 returns. Thus, the taxpayer by declaring supply of goods in excess of the stock held, received excess credit in the ECL. The credit claimed on goods which were not in stock on the appointed date had resulted in excess credit of ₹ 0.57 crore in the ECL.

When this was pointed out (July 2021), the Ministry, while accepting the observation, intimated (February 2022) that a show cause notice demanding ₹ 0.64 crore had been issued to the taxpayer.

#### **6.9.2.5 Inputs/input services in transit**

Section 140(5) of the Act provides that a taxpayer shall be entitled to take credit of eligible duties and taxes in respect of inputs or input services received on or after the appointed day but the duty or tax in respect of which has been paid by the supplier under existing law, subject to the condition that the invoice or any other duty or tax paying document of the same was recorded in the books of account of such person within a period of 30 days from the appointed date or within such further extended 30 days period as permitted by the Commissioner.

The credit under Section 140(5) was to be claimed under Table 7(b) of Tran 1 return. Under this category, a total of 25,959 taxpayers had claimed transitional credit of ₹ 7,332.78 crore in respect of inputs or input services received on or after the appointed date, but the duty or tax on which was paid under the existing law. The top 100 cases in this category accounted for 36 *per cent* of the total transitional credit claimed under this category. Audit examined 3,605 claims involving transitional credit of ₹ 3,649.41 crore, which included 67 claims out of the top 100 claims under this category.

Audit noticed irregularities in 397 claims involving irregular transitional credit of ₹ 75.29 crore, which included irregularities in seven claims from the top 100 claims. Irregularities were in the nature of availing credit on invoices not accounted for within the prescribed time limit; transitioning ineligible or excess credit; and irregular credit claimed on capital goods.

Significant audit findings under each of the categories are discussed in the subsequent paragraphs.

**(i) Credit claimed on invoices /documents not accounted for within the prescribed time**

Section 140(5) of the Act envisages that the credit under this category was admissible when the invoice or any other duty or tax paying document of the same was recorded in the books of account of the taxpayer within a period of 30 days from the appointed day. The proviso under Section 140(5) provided for extension of this time limit for a further period not exceeding 30 days by the Commissioner<sup>163</sup>, on sufficient cause being shown.

A pan-India analysis of the transitional credit data under this category, extracted from GSTN, showed 5,711 claims being non-compliant with the mandatory condition of accounting the supplies within the stipulated time, even when the time limit was considered as 60 days from the appointed date. The amount of transitional credit involved in these claims was ₹ 127.91 crore. Detailed audit confirmed non-compliance in 249 claims resulting in transitioning of irregular credit of ₹ 54.46 crore.

When this was pointed out, the Ministry/Department accepted the audit observations in 101 cases with irregular amount of ₹ 16.13 crore, and ₹ 0.51 crore was recovered in 27 cases. The top five irregularities noticed in this category amounted to ₹ 17.30 crore. An illustrative case is featured below.

A taxpayer coming under the Central Tax jurisdiction of Dibrugarh Central Tax Commissionerate had claimed transitional credit of ₹ 3.18 crore in respect of inputs or input services received on or after the appointed day under section 140(5) of the Act. On scrutiny of the claim, it was noticed that the taxpayer had taken credit of ₹ 2.89 crore on certain input services which were not accounted for within the time limit specified. The taxpayer had not received any extension of time limit from the jurisdictional Commissioner to avail the credit on these tax paying documents. Hence, the credit claimed on the documents which were not accounted for within the specified time limit was contrary to the provisions resulting in irregular claim amounting to ₹ 2.89 crore.

When this was pointed out (August 2021), the Ministry, while accepting the observation, stated (February 2022) that a show cause notice had been issued.

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<sup>163</sup> The Commissioner has power to condone the delay in accounting the tax paid documents beyond 30 days from the appointed date, for a further period not exceeding 30 days on sufficient cause shown.

**(ii) Irregular credit claimed on capital goods**

Section 140(5) of the Act provides for the transition of eligible duties and taxes in respect of inputs or input services received on or after the appointed day. Hence, the provision does not envisage transition of Cenvat credit on capital goods received on or after the appointed day.

In 40 cases, Audit noticed that the taxpayers had transitioned Cenvat credit of duty paid on capital goods amounting to ₹ 7.06 crore under this category.

When this was pointed out, the Ministry/Department accepted the audit observations in 13 cases with irregular amount of ₹ 2.20 crore, and ₹ 0.60 crore was recovered in four cases. The top five irregularities noticed under this category amounted to ₹ 4.40 crore. Two illustrative cases are featured below.

**a)** A taxpayer coming under Madurai Central Tax Commissionerate had claimed transitional credit of ₹ 4.54 crore under section 140(5) of CGST Act on inputs and input services received on or after the appointed date. On verification of the claim under Table 7(b) of Tran 1 return, it was noticed that the taxpayer had claimed credit on rolling resistance testing machine, mixer feeding system and parts of the machines used in the manufacture of tyres which come under capital goods whereas section 140(5) of CGST Act provides for transition of duty or tax paid in respect of inputs or input services only. Therefore, the credit claimed of ₹ 1.64 crore on these goods was irregular.

When this was pointed out (April 2021), the Ministry stated (February 2022) that the matter was referred to the Audit Circle which had verified the transitional credit claim of the taxpayer and final reply would be furnished on receipt of their report.

**b)** A taxpayer coming under the jurisdiction of Mangaluru Central Tax Commissionerate had claimed transitional credit of ₹ 1.27 crore under section 140(5) of the Act on inputs and input services received on or after the appointed date. Audit noticed that the taxpayer had claimed Cenvat credit of duty paid on paper making machines, transformers, other machines and parts of machines which the taxpayer had declared as capital goods. As the provisions do not provide for transition of duty paid in respect of capital goods, the transitional Cenvat credit claimed in respect of these goods amounting to ₹ 1.05 crore was irregular.

When this was pointed out (March 2021), the Ministry stated (February 2022) that DRC-01A had been issued to the taxpayer and SCN will be issued within due date if tax dues are not paid by the taxpayer.

**(iii) Ineligible or excess credit claimed**

Section 140 (5) of the Act, provides for transition of eligible duties or taxes paid on inputs or input services, which are received by the taxpayer on or after the appointed day, but the eligibility is determined by the usage of such supplies.

In 108 claims, Audit noticed that the taxpayers had claimed Cenvat credit on goods or services ineligible for transition. These include the Cenvat credit claimed on documents that are time barred; Cenvat credit on goods or services *ab initio* ineligible under Cenvat credit rules; supplies not used in furtherance of business etc. The transitional credit involved in these cases amounted to ₹ 13.77 crore.

When this was pointed out, the Ministry/Department accepted the audit observation in 41 cases with irregular amount of ₹ 4.19 crore, and ₹ 0.76 crore was recovered in 10 cases. The top five irregularities noticed in this category amounted to ₹ 2.72 crore. Two illustrative cases are featured below.

**a)** Credit under Section 140 (5) of CGST Act is permitted in respect of eligible duties and taxes paid under the existing law. A taxpayer coming under Agartala Central Tax jurisdiction had claimed transitional credit of ₹ 0.93 crore in respect of goods received on or after the appointed date. During verification of the claim, Audit noticed that the taxpayer had claimed credit on the basis of documents which did not contain duty paid details, indicating the taxpayer had not borne the incidence of duty. Hence, the credit claimed by the taxpayer amounting to ₹ 0.93 crore was ineligible for transition.

When this was pointed out (August 2021), the Department accepted the audit observation and issued a show cause notice demanding the ineligible credit claimed.

**b)** As per Rule 4(1) of Cenvat Credit Rules, 2004, the Cenvat credit in respect of inputs may be taken immediately on receipt of the inputs in the factory of the manufacturer or the in the premises of the provider of output service, provided that the manufacturer or the provider of output service shall not take Cenvat credit after one year of the date of issue of any of the documents specified in Sub-Rule (1) of Rule 9.

A taxpayer coming under Hyderabad Central Tax jurisdiction had claimed input tax credit of ₹ 1.17 crore in respect of goods received on or after the appointed date under Section 140(5) of CGST Act. However, during verification of the claim it was noticed that the taxpayer had claimed credit in respect of duty paid documents that were time barred for claiming credit as per Cenvat credit rules. Further, the goods were cleared earlier than one year from the appointed date, which does not satisfy the condition that the goods were received on or after the appointed date. Hence, the credit claimed amounting to ₹ 0.36 crore on these invoices was irregular.

When this was pointed out (March 2021), the Ministry while admitting the observation intimated (February 2022) that a show cause notice was being issued.

**6.9.2.6 Credit in respect of registered persons with centralized registration under the existing law (Table 8 of Tran 1)**

As per Section 140(8) of CGST Act 2017, a registered person having centralised registration under the existing law who has obtained a registration under GST Act shall be allowed to take, in his ECL, credit of the amount of Cenvat credit carried forward in a return, furnished under the existing law by him, in respect of the period ending with the day immediately preceding the appointed day in such manner as may be prescribed. The credit claimed under the sub section is eligible for transfer to any of the registered persons having the same Permanent Account Number (PAN) for which the centralized registration was obtained under the existing law.

Credit under this category was to be claimed for transfer under Table 8 of Tran 1 return. A total of 974<sup>164</sup> taxpayers had claimed and transferred transitional credit of ₹ 16,284.83 crore under Section 140(8) of the Act. The top 20 records under this category accounted for 65 *per cent* of the transitional credit claimed and distributed. Audit selected 284 claims under this category involving transitional credit of ₹ 10,435.49 crore and audited 254 cases involving ₹ 10,032.55 crore.

Audit noticed irregularities in seven claims, either due to irregular credit transfer or excess credit claimed amounting to ₹ 20.97 crore.

The top five irregularities noticed under this category amounted to ₹ 20.47 crore. Two illustrative cases are featured below.

<sup>164</sup> Pan-India transitional credit data extracted from GSTN

**(i) Irregular credit transfer**

The credits under Section 140(8) are eligible for transfer to any of the registered persons having the same Permanent Account Number (PAN) for which the centralized registration was obtained under the existing law. Audit noticed in five cases, the taxpayers had transferred credit to other registered persons who were not part of the centralized registration obtained under the existing law.

A taxpayer coming under Hyderabad Central Tax Commissionerate jurisdiction had transitioned closing balance of Cenvat credit of ₹ 20.79 crore into GST from his legacy service tax returns filed for the month of June 2017. The taxpayer had centralised registration under the existing service tax provisions, covering two of his registered premises at Hyderabad and Chennai. However, the taxpayer, from the claim furnished under Table 8 of Tran 1 return, had transferred ₹ 11.18 crore to his other registered premises which were not covered under the centralised registration under the existing law. This was irregular as the credit transfer is permissible only to the registered persons having the same PAN for which the centralized registration was obtained under the existing law.

When this was pointed out (August 2021), the Ministry stated (February 2022) that, with the introduction of GST, the Cenvat credit accumulated with the erstwhile centralized registrants was allowed to transition to all its constituent entities, whose activities were hitherto monitored and taxes were paid centrally. Thus, the provisions were designed to allow them to distribute the accumulated credit across these constituents irrespective of the fact that they were part of the erstwhile centralized registration.

Reply of the Ministry is not tenable as the units which were not part of the erstwhile centralized units were not part of the erstwhile value added tax chain, and hence were not eligible for credit accumulated under legacy rules. Further, section 140(8) of the Act specifically mentions that the credit claimed by the centralized units is eligible for transfer only to the registered persons for which the centralized registration was obtained under the existing law.

**(ii) Excess credit claimed**

The transition of credit under Section 140(8) is subject to the condition that the registered person had furnished his return for the period ending with the



day immediately preceding the appointed day within three months of the appointed day, and the said return is either an original return or a revised return where the credit has been reduced from that claimed earlier. Further, the credit shall be admissible as input tax credit under GST Act.

A taxpayer who is centrally registered provider of taxable services under the existing law falling within Bengaluru East Central Tax jurisdiction had claimed the transitional credit of Cenvat credit from the legacy returns under section 140(8) of the Act. The taxpayer had carried forward Cenvat credit into his ECL and distributed the ITC among its other units having the same PAN number. During verification of the claim, it was noticed that the taxpayer had revised the legacy return for the period ending with the day immediately preceding the appointed date. The original return with the closing balance of Cenvat credit amounting to ₹ 112.38 crore was filed on 14 August 2017 and the revised return with closing balance of Cenvat credit ₹ 118.99 crore was filed on 28 September 2017, within the stipulated 90 days from the appointed date. However, it was observed that the ECL of the taxpayer was credited with the amount carried over from the revised return, which had higher Cenvat credit amount. This was in contravention to the rule provisions which stipulated that revised amount is permissible only when the credit had been reduced from that claimed earlier. The deviation from the rules provisions had resulted in excess credit of ₹ 6.61 crore.

When this was pointed out (October 2021) the Ministry, while accepting the audit observation, stated (February 2022) that a show cause notice was being issued.

**6.9.2.7 Credit in respect of tax paid on supply both under Value Added Tax Act and under Finance Act, 1994 (Table 11 of Tran 1)**

As per Section 142(11)(c) of the CGST Act, where tax was paid on any supply both under the Value Added Tax Act (VAT) and under Chapter V of the Finance Act, 1994 (Service tax) on which tax shall be leviable under this Act, the taxable person shall be entitled to take credit of value added tax or service tax paid under the existing law to the extent of supplies made after the appointed day. Further, Rule 118 of CGST Rules, specifies that the registered person to whom the provisions of 142(11) of the Act applies shall submit a declaration in Tran 1 furnishing the proportion of supply on which VAT or Service tax has been

paid before the appointed day but the supply is made after the appointed day, and the input tax credit admissible thereon.

Transitional credit in such instances was to be claimed in Table 11 of Tran 1. A total of 3,034 taxpayers had claimed transitional credit of service tax paid under the provisions of Finance Act 1994, amounting to ₹ 968.89 crore for the supplies made after the appointed date under Section 142(11)(c) of the Act. The top 20 claims under this category accounted for 51 *per cent* of the total transitional credit claimed under the table. Audit examined 373 claims under this category involving transitional credit of ₹ 465.67 crore, which included 12 claims out of the top 20 claims.

Audit noticed irregularities in 23 claims involving transitional credit of ₹ 25.83 crore, which included three claims from the top 20 claims. Audit noticed irregular credit claimed on supplies not liable for tax under GST; supplies completed prior to the appointed date; credit claimed without payment of service tax and credit taken twice on same supplies.

Significant findings are illustrated in the following paragraphs.

**(i) Irregular Credit on Service Tax paid on advances**

Credit under Section 142 11(c) is permissible on the supplies where tax was paid under both VAT and Service tax rules, on which tax shall also be leviable under this Act.

A taxpayer coming under Secunderabad Central Tax Commissionerate had claimed transitional credit of ₹ 3.33 crore under Table 11 of Tran 1 return. The credit claimed was in respect of service tax paid on mobilisation advances against which the supplies were made after the appointed date. However, the Authority of Advance Ruling<sup>165</sup> vide order No.03/ARA/2020 dated 31<sup>st</sup> March 2020 had ruled that the taxpayer was not liable to pay GST on the mobilisation advances transitioned into GST regime. Thus, the taxpayer would not pay GST on the supply made after the appointed date against the mobilisation advances transitioned into GST. However, we noticed that the taxpayer had claimed transitional credit on the service tax paid on mobilisation advances that remained unadjusted as on the appointed date, which is irregular as the

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<sup>165</sup> Authority of Advance Ruling is the authority constituted under the provisions of Section 96 of the CGST Act, 2017 empowered to issue rulings on the clarifications sought by the taxpayers.

tax is not liable on the supply to that extent. The irregular credit claimed by the taxpayer in this regard amounted to ₹ 3.33 crore.

When this was pointed out (September 2021), the Ministry stated (February 2022) that the reliance placed on the Advance ruling is misplaced as the said decision pertains to GST, whereas the instant case relates to availing transitional credit on service tax paid on advances received prior to the appointed date, for which supply was made after the appointed date on payment of GST.

Department, therefore, needs to specifically confirm that GST was paid by the taxpayer on the supply to the extent of consideration received as mobilisation advance.

**(ii) Irregular credit claimed on supplies made prior to the appointed date**

Credit under Section 142 11(c) is permissible on service tax paid on advances to the extent of supplies made after the appointed date. However, Audit noticed instances wherein the taxpayers had claimed transitional credit of service tax paid on advances received prior to the appointed date for which supply was also completed prior to the appointed date.

In 12 cases, Audit noticed that the taxpayers had claimed ineligible credit amounting to ₹ 11.67 crore. The irregularities were in the nature of credit claimed on the supplies made prior to the appointed date; and ineligible credit claimed under the section.

When this was pointed out, the Ministry/Department accepted the audit observations in eight cases with irregular amount of ₹ 7.95 crore, and ₹ 0.58 crore was recovered in one case. The top five irregularities noticed in this category amounted to ₹ 10.76 crore. Two illustrative cases are featured below.

**a)** A taxpayer coming under the jurisdiction of Mumbai South Central Tax Commissionerate had claimed transitional credit under Table 11 amounting to ₹ 45.55 crore. On verification, it was noticed that the credit claimed by the taxpayer included Cenvat credit on the input services on which tax was paid under reverse charge basis. As the supplies in this case were made prior to the appointed date for which payment was also made under the existing rules,

credit was irregular. The irregular credit transitioned in this case amounts to ₹ 5.82 crore.

When this was pointed out (February 2021), the Ministry stated (February 2022) that DRC-01A had been issued to the taxpayer and a show cause notice was being prepared.

**b)** A taxpayer engaged in works contract supply coming under the jurisdiction of Bengaluru East Central Tax Commissionerate had claimed transitional credit of ₹4.07 core, being service tax paid on advances received prior to the appointed date under Section 142(11)(c) of the CGST Act. Verification of the claim revealed that in many instances the credit was claimed in respect of the projects for which supplies had already been completed to the extent of advances received, indicating completion of provision of services to that extent. However, the taxpayer claimed credit stating that the supply was to be made after the appointed date, which is irregular. The irregular credit claimed in this case amounted to ₹ 2.47 crore.

When this was pointed out (October 2021), the Ministry stated (February 2022) that the observation was not admitted but no reasons were recorded.

The reply of the Ministry is not tenable as it did not substantively address the issue pointed out.

**(iii) Credit claimed without payment of Service tax**

As per section 142(11)(c) of the CGST Act, the credit is permissible on the value added tax or service tax paid under the existing law.

In 10 claims, Audit noticed that the taxpayers had taken ineligible credit amounting to ₹ 10.83 crore under the section without payment of service tax

When this was pointed out, the Ministry/Department accepted the audit observations in six cases with irregular amount of ₹ 5.05 crore, and ₹ 1.24 crore was recovered in two cases. The top five irregularities noticed in this category amounted to ₹ 10.23 crore. An illustrative case is featured below.

A taxpayer under Mumbai East Central Tax Commissionerate, engaged in supply of construction services, had claimed transitional credit of service tax under Section 142(11)(c) of CGST Act. The credit was claimed in respect of service tax of ₹ 2.17 crore paid on advances received during the month of June

2017. However, verification of service tax returns (ST3) of the taxpayer for the relevant period revealed that the taxpayer had not discharged any service tax liability during the period in respect of the advances received. Hence, the credit claimed in this case was without discharging service tax liability under the provisions of chapter V of the Finance Act, 1994. The irregular credit claimed amounted to ₹ 2.17 crore.

When this was pointed out (September 2021), the Ministry, while accepting the audit observation, intimated (February 2022) that ITC of ₹ 1.23 crore had been recovered. Further, action was being taken to recover the balance ITC of ₹ 0.41 crore while the remaining ITC of ₹ 0.53 crore pertained to SGST credit taken against VAT payment.

#### **6.9.2.8 Non-payment of interest on ineligible transitional credit**

Rule 117(3) of CGST Rules, 2017 specifies that the amount of credit specified in the application in Form GST Tran 1 shall be credited to the ECL of the applicant maintained in Form GST PMT 2 on the common portal. As per Rule 121, the recovery of amount credited under sub-Rule (3) of Rule 117 may be initiated under Section 73 or, as the case may be, Section 74 of the Act. The proceedings under Section 73 or 74 shall require the taxpayer to pay the credit along with interest payable thereon under Section 50 of the Act.

Further, Section 50(1) of the Act stipulates that every person liable to pay tax in accordance with the provisions of this Act or rules made thereunder but fails to pay the tax or any part thereof to the Government within the period prescribed, shall for the period for which the tax or any part thereof remains unpaid, pay interest at 18 *per cent*.

Audit noticed that in 60 cases, the irregular transitional credit claimed by the taxpayers amounting to ₹ 95.20 crore was recovered. However, the interest on irregular credit claimed amounting to ₹ 2.92 crore was not recovered.

When this was pointed out, the Ministry/Department accepted the audit observations in 29 cases with interest amount of ₹ 1.30 crore, and ₹ 0.27 crore was recovered in 16 cases. The top five irregularities noticed in this category amounted to ₹ 1.28 crore. An illustrative case is featured below.

A taxpayer coming under the jurisdiction of Jamshedpur Central Tax Commissionerate had claimed transitional credit amounting to ₹ 3.90 crore, which was credited to the ECL on 19<sup>th</sup> December 2017. Out of this, the taxpayer had paid back irregular transitional credit of ₹ 1.28 crore on 31<sup>st</sup> January 2020. Though the Department had directed the taxpayer to pay the interest on the irregular credit claimed, the taxpayer contested the interest liability and the same was not recovered. However, Audit noticed that the taxpayer had utilized the irregular credit of ₹ 1.28 crore towards CGST payment during the month of December 2017 itself. Hence, the irregular credit claimed had resulted in short payment of duty attracting interest liability under Section 50(1) of the Act. The non-payment of interest worked out to ₹ 0.49 crore.

When this was pointed out (September 2021), the Ministry stated (February 2022) that the show cause notice would be issued to protect the revenue.

#### **6.9.2.9 Conclusion and recommendations**

Out of 7,560 cases that were examined in detail, Audit observed 1,686 compliance deviations in 1,438 cases amounting to ₹ 977.54 crore, constituting a deviation rate of 22 *per cent*. Irregularities noticed were relatively higher in following categories viz; ineligible credit of duty paid goods in stock without documents, irregular claim with respect to unavailed credit on capital goods, ineligible credit on inputs or input services in transit and irregular claim on closing balances. Out of 1,438 cases, where Audit noticed irregularities, 1,132 cases constituting 79 *per cent*, had already been verified by the Department. The irregularities noticed in these 1,132 cases amounted to ₹ 735.69 crore. Considering the extent of Department's verification, the deviation rate suggested that verification process carried out by the Department suffered from certain inadequacies.

Further, data analysis disclosed that transitional credit claims through Table 7aB of Tran 1 were leading to excess credits in many cases as ECL was getting incorrectly populated from both Tran 1 and Tran 2. Pan-India data analysis also indicated a significant number of cases where transitional credit claims in Table 5a had exceeded the closing balance of legacy return.

In view of the above compliance findings, Audit recommends the following:

The Department may:

1. Ensure verification of the high risk claims reflected in Table 7(a)B of Tran 1 (Credit on duty paid stock without invoices) and the cases where the transitional credit claim under Table 5(a) (Closing credit balance of legacy returns) was in excess of the closing balance of legacy return.
2. Initiate remedial measures for the compliance deviations pointed out during this audit before the claims become time barred.



(SATISH SETHI)

New Delhi

Dated: 31 March 2022 Principal Director (Goods and Services Tax-II)

Countersigned



(GIRISH CHANDRA MURMU)

New Delhi

Dated: 31 March 2022 Comptroller and Auditor General of India

