

# EY Tax Alert

**Kerala HC holds bank's eligibility of 50% ITC cannot be denied where IT depreciation is claimed w.r.t balance ineligible ITC**

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## Executive summary

This Tax Alert summarizes a recent ruling of the Kerala High Court (HC)<sup>1</sup> on the eligibility of banking companies opting for Section 17(4) of the Central Goods and Services Tax Act, 2017 (CGST Act) to avail 50% of input tax credit (ITC), where depreciation has been claimed under the Income-tax Act, 1961 (IT Act) on the remaining portion corresponding to the foregone ITC.

The key observations of the HC are:

- The sole purpose of the restriction under Section 16(3) is to prevent double benefit, namely availing ITC under the CGST Act and claiming depreciation under the Income-tax Act on the same tax component. Where depreciation is claimed on the portion of tax for which no ITC was availed, no such double benefit arises.
- The expression "*the said tax component*" in Section 16(3) applies only to the specific tax component on which depreciation is claimed and cannot be automatically extended to the entire amount of tax paid.
- Under Section 17(4), the law fixes 50% of ITC as relatable to exempt supplies by a deeming fiction. Since Section 16(3) does not apply where depreciation is claimed on ITC in respect of exempt supplies, extending the same to the un-availed portion of ITC under Section 17(4) would be unreasonable.
- Alternatively, once the 50% ITC lapses, it ceases to have the character of a "*tax component*", therefore, does not attract the bar under Section 16(3).

Accordingly, HC set aside the impugned orders to the extent they invoked Section 16(3) in respect of the 50% tax component on which no depreciation had been claimed by the petitioners.

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<sup>1</sup> TS-162-HC(KER)-2026-GST

# Background

- The petitioners are banking companies, registered under the Companies Act.
- As per Section 17(4) of the Central Goods and Services Tax Act, 2017 (CGST Act), banking companies and financial institutions have following options for availing input tax credit (ITC):
  - Reverse proportionate ITC on exempt supplies as specified in Section 17(2) r/w Rules 42 and 43 of the Central Goods and Services Tax Rules, 2017, or
  - Claim 50% of the eligible ITC in the respective months, and the balance credit will be lapsed.
- Further, in terms of Section 16(3), *“where the registered person has claimed depreciation on the tax component of the cost of capital goods and plant and machinery under the provisions of the Income-tax Act, 1961, the input tax credit on the said tax component shall not be allowed.”*
- In the present case, petitioners exercised the second option available under Section 17(4) and accordingly availed 50% of the eligible ITC.
- The balance 50% of the ITC was thereafter capitalised as part of the cost of the relevant assets, and depreciation was claimed on such gross-block assets under the Income-tax Act, 1961 (IT Act).
- Revenue contended that, having claimed depreciation on the tax component after opting for Section 17(4), the petitioners were consequently not entitled to ITC on the entire tax component in light of the stipulations in Section 16(3).
- Consequently, proceedings were initiated under Section 73 and 74 of the CGST Act for respective petitioners.
- Aggrieved by the same, petitioners filed writ petitions before the Kerala High Court (HC).

## High Court’s Ruling

- The sole purpose behind the prohibition contained in Section 16(3) in availing of the depreciation benefits is to avoid the double benefit being availed by the taxpayer, i.e., availing ITC under the CGST Act and claiming depreciation under IT Act on same tax component.

In respect of the portion of tax corresponding to 50% of the ITC that was not availed under the CGST Act, the claim of depreciation under the IT Act on such portion does not result in any double benefit, since no ITC was claimed on that part of the tax.
- The expression *‘the said tax component’* used in Section 16(3) indicates that the prohibition contemplated is w.r.t. the tax component for which depreciation is claimed. The same is not to

be extended to the other portion of the tax component.

- To understand the true purpose and meaning of the above expression, the scheme of availing the ITC as is discernible from Section 17(2) and 17(4) is also to be examined.
- Section 16(3), read with Section 17(2), makes it clear that the prohibition contemplated would not be attracted where the depreciation is claimed for the exempt supplies.
- Section 17(4) instead of bifurcating the taxable supplies and exempted supplies, fixes 50% as the eligible ITC. This creates a deeming fiction that remaining 50% is intended to cover the exempt supplies.

Where such prohibition under Section 16(3) does not apply when the depreciation is claimed for the exempt supplies, then imposing such a restriction w.r.t. unavailed portion of ITC under Section 17(4) would be unreasonable.

- Accordingly, the restriction could be made applicable only w.r.t. the tax component for which the depreciation is claimed by the taxpayer and cannot be brought into force for the portion of ITC for which no depreciation is claimed.
- Further, while interpreting Section 16(3) and 17(4), if an institution avails its 50% eligible ITC, the balance shall be lapsed as per Section 17(4). This means that the unavailed ITC cannot have the nature of a tax component for the purpose of taking credit.

Thus, it will not attract the prohibition under Section 16(3), particularly because depreciation has to be claimed upon the tax component of the cost of capital goods.

- Accordingly, HC allowed the writ petitions and set aside the impugned orders to the extent they invoked the bar under Section 16(3) in respect of the 50% tax component on which no depreciation had been claimed by the petitioners.

## Comments

This ruling is significant in the context of banking sector, where several taxpayers have received show cause notices and audit objections on the issue. The judgment may help the taxpayers to defend their case.

Entities that have already reversed ITC pursuant to departmental objections may consider re-evaluating their position, subject to limitation period and procedural safeguards.

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