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EY Tax Alert

SC allows full ITC on inputs used in manufacture of taxable goods along with exempt by-products under UP VAT Act

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Executive summary

This Tax Alert summarizes a recent judgement of the Supreme Court (SC)[1] interpreting input tax credit (ITC) related provisions under the Uttar Pradesh Value Added Tax Act, 2008 (UP VAT Act).

Assessee was engaged in manufacture of rice bran oil (RBO) which was taxable. During the manufacture, an exempt by-product *i.e.,* de-oiled rice bran (DORB) was also produced.

As per Section 13(1)(f) of the UP VAT Act, where goods manufactured are sold at a price lower than the cost price, ITC is allowed to the extent of tax payable on the sale value of final goods.

As the sale price of RBO was lower than the manufacturing cost, assessing authority rejected the claim of full ITC on the ground that the term "goods" in Section 13(1)(f), means only "taxable goods".

SC observed that Section 13(1)(f) was introduced in the scheme of UP VAT Act to limit ITC where goods (including taxable, exempt, by-products or waste products) manufactured were being sold at a price lower than the cost price of purchases.

The definition of "goods" under Section 2(m) does not differentiate between exempt and taxable goods and equally the word "goods" under Section 13(1)(f) should not be qualified by the word "taxable".

Reliance placed by Allahabad High Court (HC) on SC decision in case of M.K. Agro Tech Private Limited[2] is incorrect. The said judgement was relating to the provisions under the Karnataka Value Added Tax Act, 2003 which are quite different when compared to the UP VAT Act in regard to the scheme of ITC.

Basis above, SC held that for the purpose of section 13(1)(f), "goods manufactured" will also include exempt goods and thus, allowed full ITC on inputs used in manufacture of RBO and DORB by the assessee.

[1] TS-574-SC-2023
[2] 2017 (16) SCC 210

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Background

- Assessee is a registered dealer under Uttar Pradesh Value Added Tax Act, 2008 (UP VAT Act) and is engaged in manufacture and sale of rice bran oil (RBO) and physical refined RBO which are "taxable goods".
- During the manufacturing of RBO, a by-product *i.e.,* de-oiled rice bran (DORB) is produced which falls under the category of "exempted goods" as per S.No. 4 of Schedule – I of the UP VAT Act.
- By processing the inputs, assessee produces 13.77% of RBO (i.e., taxable goods) and 83.63% of by-product i.e DORB (i.e., exempted goods).
- Section 13(1)(a) of the UP VAT Act enables a dealer to claim input tax credit (ITC) on the purchases made by them to a specified extent.
- In terms of Section 13(1)(f), where goods manufactured by utilizing purchased goods are sold at the price which is lower than the cost price, the amount of ITC is allowed to the extent of tax payable on the sale value of manufactured goods.
- As per Section 13(3)(b), where during the manufacture of VAT goods, exempt and non-VAT goods (except as by-product or waste product) are produced, the amount of input tax credit (ITC) can be claimed to the extent they are used or consumed in manufacture of taxable goods other than the non-VAT goods and exempt goods.
- Explanation (iii) to Section 13 provides that during the manufacture of any taxable goods, if any exempt goods are produced as by-product or waste product, it shall be deemed that the purchased goods have been used in the manufacture of taxable goods.
- Basis above provisions, assessee claimed full ITC of the tax paid on inputs. However, the assessing authority rejected the claim of full ITC on the ground that as per Section 13(1)(f), ITC can be availed on inputs only *vis-à-vis* the taxable sales.

  As the sale price of the final taxable goods (excluding the sale of by-product which is exempt) was less than the manufacturing cost, ITC should be restricted to the extent of tax payable on final goods.

  In other words, the term "goods" in Section 13(1)(f), means only "taxable goods".
- The dispute reached Allahabad High Court (HC). Placing reliance on the decision of Supreme Court (SC) in the case of M.K. Agro Tech Private Limited[3], HC took a view that assessee was not entitled to claim full ITC on inputs as the case stood covered by Section 13(1)(f).
- Aggreived by the same, assessee filed an appeal before SC.

Assessee's contentions

- HC failed to note the fact that the present case is squarely covered by the provisions of Section 13(1)(a) read with Section 13(3)(b) and Explanation (iii) to Section 13 of the UP VAT Act.
- The entire edifice of the HC judgement is based on incorrect application of the decision of *M.K. Agro Tech (supra)* as the statutory provisions under the Karnataka Value Added Tax Act, 2003 (KVAT Act) are distinct and different in all respects from UP VAT Act.
- UP VAT Act specifically carves out an exception for by-products and waste products and allows ITC on the same even if those are exempt or non-VAT goods.
- The definition of the word "goods" under Section 2(m) does not differentiate between exempted and taxable goods and equally, the word "goods" under Section 13(1)(f) cannot be qualified by the word "taxable".

  If the legislative intent was to qualify "goods" with the word "taxable", it could have been said so by the Legislature in Section 13 itself.
- While construing taxation statutes, the courts should apply the strict rule of interpretation.
- When the competent legislature mandates taxing certain business/objects in certain circumstances, it cannot be expounded/interpreted to those which were not intended by the legislature.

Revenue's contentions

- Section 13(3)(b) would apply only to a situation where in the manufacturing of "VAT goods", "exempt goods" and "non- VAT goods" are not being produced as the "by-product" or "waste product".
- In the case on hand, the cumulative sale price of the RBO and DORB respectively is more than the cost price and in such circumstances, Section 13(3)(b) read with Explanation (iii) would have no applicability.
- Section 13(1)(f) starts with a non-obstante clause having an overriding effect on the provision of Section 13(1)(a).
- The words and expressions used in the above provision require a textual interpretation matching with the contextual interpretation that Section 13(1)(f) seeks to remedy the mischief caused by the words used in Section 13(1)(a).
- Section 13(1)(f) restricts the amount of ITC to the extent of tax payable on the sale value of goods or manufactured goods, in specific cases, i.e., when costing of the manufactured taxable goods is lower than the costing of the taxable inputs.

[3] 2017 (16) SCC 210

SC Ruling

- The statement of objects and reasons for the enactment of Section 13(1)(f) by way of 2010 Amendment Act was to provide for –

  (d) limiting the input tax credit to the extent of tax payable on the sale value of goods or manufactured goods in cases where goods purchased are resold or goods manufactured or processed by using or utilizing such purchased goods are sold at a price lower than purchase price or cost price;"

- The plain reading of the aforesaid would indicate that the legislative intent was never to limit or circumscribe the scope of "goods" as outlined in Section 13(1)(f) to only "taxable goods".

- The mischief addressed by virtue of introducing Section 13(1)(f) to the scheme of the UP VAT Act was where goods (including taxable, exempt goods, by-products or waste products) manufactured were being sold at a price lower than the cost price, then in such cases the extent of permissible or allowable ITC would be limited to the tax payable on the sale value of the goods.

- If the legislative intent of the 2010 Amendment had been to limit the scope and ambit of "goods" under Section 13(1)(f) solely to "taxable goods", then there was nothing to prevent the Legislature from expressly using the phrase "taxable goods" in the said provision.

- Wherever the legislative intent was to qualify "goods" with the word "taxable", it has been so done by the Legislature in Section 13 itself.

- A taxing statute has to be construed strictly[4].

- It is difficult to accept the the case put up by the Revenue, as doing so would permit the assessing authority to do something indirectly what he cannot do directly *i.e.,* get around the mandate of the exception carved out by Section 13(3)(b) read with Explanation (iii) by invoking Section 13(1)(f) of the UP VAT Act.

- Further, the decision of *M.K. Agro Tech (supra)*, is not applicable to the present case as the provisions under the KVAT Act are quite different compared to the UP VAT Act in regard to the scheme of ITC.

- SC in the above-said case examined Section 17 of the KVAT Act read with Rule 131 of the KVAT Rules, 2005 and held that ITC was admissible to the extent of inputs used in the "sale" of taxable goods.

  However, in the present case, the ITC pertains to "manufacture" and not "sale".

- Explanation (iii) to Section 13 read with Section 13(3)(b) of the UP VAT Act seeks to create deeming fiction where during the manufacture of any taxable goods, any exempt goods are produced as by-products or waste product, it shall be deemed that the purchased goods have been used in the manufacture of taxable goods.

- The reliance by HC on *M.K. Agro Tech (supra)* is incorrect. It is not applicable to the facts of the present case, and same cannot be relied upon to deny full ITC to the assessee.

- In view of above, SC allowed assessee's appeal and set aside the order passed by the HC.

Comments

a. The SC judgement is likely to benefit the taxpayers with similar pending litigations, particularly, in cases where ITC related provisions under the respective State VAT laws were akin to the provisions of UP VAT Act.

b. Even under the central excise law, CENVAT credit was eligible on inputs where such inputs were contained in any waste, refuse or by-products (whether or not the same were exempt) arising during the manufacture of the final taxable product.

c. The ruling may not be applicable under the GST law in absence of similar provisions.

[4] (1999) 3 SCC 346 and (2004) 10 SCC 201

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