

Rule 86A of CGST Rules: Safeguarding Revenue or Hindering Business? A Critical Analysis



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Rule 86A of the CGST Rules, introduced to curb fraudulent Input Tax Credit (ITC) claims, empowers tax authorities to block ITC in specific cases. However, its application has led to legal controversies, particularly regarding negative blocking and the lack of statutory backing. Various High Courts have ruled differently on its validity, procedural fairness, and scope. While the rule aims to protect revenue, concerns over natural justice persist. This article critically analyses the rule's conditions, judicial interpretations, and practical implications, emphasizing the need for clear guidelines and a balanced approach to ensure fairness while preventing tax evasion.

Rule 86A of the Central Goods and Services Tax (CGST) Rules, 2017 [Inserted vide Notification No. 75/2019 – Central Tax dated 26-12-2019], was introduced as a measure to tackle the issue of fraudulent input tax credit (ITC) claims, especially those arising from fake invoices. This rule empowers tax authorities to block the use of ITC in a taxpayer's electronic credit ledger (ECL) under specific circumstances. However, the interpretation and application of Rule 86A have resulted in considerable legal challenges and divergent views among various High Courts. This article examines the key aspects of Rule 86A, including the conditions for its invocation, its consequences, and the major points of contention that have emerged, drawing from various case laws. While aimed at curbing fraudulent claims, the rule's implementation has led to significant operational disruptions for businesses, raising concerns over its fair application.

Origin of Rule 86A

The GST Council in its 38th GST Council Meeting held on 18th December 2019 [Agenda Item 6(ii): Proposed amendments in the CGST Act, 2017], had decided to insert Rule 86A so as to block ineligible input tax credits and control the menace of fake invoices immediately. The insertion of Rule 86A was done to control the fraudulent availment of ITC and to block ineligible credits. Consequently, the Central Board of Indirect Taxes and Customs (CBIC) implemented the rule via Notification No. 75/2019-Central Tax, effective from December 26, 2019.

Conditions for Invoking Rule 86A

Rule 86A authorizes a Commissioner or an officer authorised by him on his behalf who shall not be below the rank of Assistant Commissioner to block the debit of ITC from the Electronic Credit Ledger (ECL).

This action can be taken if the officer has “reasons to believe” that the input tax credit available in the ECL has been fraudulently availed or is ineligible. The reasons to believe must be based on specific conditions outlined in the rule, which are:

- The ITC has been availed on the strength of tax invoices or debit notes issued by a registered person who is non-existent or not conducting business from the declared place.
- The ITC has been availed without the actual receipt of goods or services.
- The ITC has been availed on the strength of tax invoices or debit notes issued by a registered person, whose tax has not been paid to the government.
- The recipient of ITC has been found non-existent or not to be conducting any business from any place for which registration has been obtained.
- The recipient of ITC is not in possession of a valid tax invoice or other required documents.

The reasons to believe must be based on verifiable evidence such as financial records, GST returns, or transaction history, rather than mere suspicion or presumption.

In a nutshell, Rule 86A of the CGST Rules empowers the Commissioner or his subordinates to freeze the debit in the electronic credit ledger, provided he has reasons to believe that the credit of input tax available in the electronic credit ledger has been fraudulently availed or is ineligible.

Rule 86A of CGST Rules, 2017 is broadly divided into two parts:

- a. The opening part of the rule deals with the conditions required to be fulfilled in order to invoke the powers under the rule.
- b. The second part of the rule provides for the consequences in case Rule 86A is invoked.

In other words, in case the conditions prescribed for the invocation of Rule 86A are not fulfilled, the officer cannot invoke the rule, and in such scenario, the consequences provided in the rule becomes *ex facie* inapplicable.

Key Requirements

Several key conditions must be met before Rule 86A can be invoked:

- **Availability of Credit:** Input tax credit must be available in the electronic credit ledger on the date the competent authority decides to invoke Rule 86A.

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- **Reason to Believe:** The authority must have a genuine reason to believe that the credit has been fraudulently availed or is ineligible. This reason must be based on credible information and not mere suspicion.
- **Recording of Reasons:** The reasons for such belief must be recorded in writing.
- **Provisional Nature:** The action taken under Rule 86A is provisional and temporary, pending further investigation.

Controversies and Interpretations

The implementation of Rule 86A has led to significant disputes, primarily centred on the following issues:

- **Negative Blocking of ECL:** A major point of contention is whether Rule 86A permits the creation of a negative balance in the ECL if the ITC is not available or has already been utilized. **Several High Courts have ruled against negative blocking, holding that it is beyond the scope of Rule 86A and illegal.** These courts emphasize that the rule is intended to block available credit, not to create a liability for future credit. The power under Rule 86A is to disallow debit of an amount equivalent to available credit, not to recover tax.
- **The meaning of “Available”:** Courts have debated the meaning of “available” in the context of Rule 86A(1). Some argue that “available” refers only to the credit existing in the ECL at the time of the order, while others contend that it includes credit that was previously available but has already been utilized.
- **Provisional vs. Recovery:** It is well established that Rule 86A is a provisional measure for protecting revenue, not a mechanism for recovery of tax dues. Tax adjudication proceedings are governed by Sections 73 and 74 of the CGST Act.
- **Guidelines for Invocation:** Several High Courts have emphasized the need for the government to establish clear guidelines for invoking Rule 86A.

to prevent misuse and ensure fairness. The power should not be exercised in a mechanical manner but rather based on a careful examination of the facts.

Validity of restriction imposed by Rule 86A

As per Rule 86A(3), the act of restricting debit of ITC from the ECL shall cease to have effect after the expiry of period of one year from the date of imposing such restriction. Hence, the Rule 86A can not be invoked for a period beyond one year from the date of imposing such restriction. In some cases, tax authorities have attempted to extend ITC blocking beyond one year by issuing fresh restrictions, a practice which has been challenged in courts as circumventing the statutory time limit.

Governing Act for Rule 86A?

It is worthwhile to note that, Rule 86A is without any enabling provision in the Statute. There is no specific provision in the GST Law, which empowers the GST department to exercise such powers. In absence of such enabling provisions, the legal validity of Rule 86A can definitely be challenged at higher forums. Unlike Section 73 and 74, which explicitly empower tax authorities to demand or adjudicate tax dues, Rule 86A lacks a corresponding provision in the CGST Act, raising questions about its legality

Personal Hearing before invoking Rule 86A

It may be noted that Rule 86A has no provision for personal hearing before invoking the blocking of ITC. While Section 73 mandates a show-cause notice before confirming a demand, Rule 86A allows blocking ITC without prior intimation, making it a stringent provision. Such a step is clearly in violation of principles of natural justice.

The Hon'ble Karnataka HC in the matter of **K-9 Enterprises, Kwality Metals Versus The State Of Karnataka, The Assistant Commissioner Of Commercial Taxes, LGSTO [2023 (8) TMI 170]**, para 29 had held that:

It is in this background, I am inclined to follow the principle stated by the High Court of Bombay in Dee Vee Projects Ltd.'s case supra, wherein it is held that given the nature of power provided under Rule 86A though the statute does not provide for a personal hearing before passing any order under the said Rule, it has to be read into the provisions of the said Rule which is not expressly provided therein, so that a post-decisional or remedial hearing could be granted to the person/assessee affected by blocking of his electronic credit ledger.

Para 30: Considering the scope, applicability and the manner of power exercised by the competent authority under Rule 86A of the Rules of 2017, it may not be feasible for the authority to have a normal pre-decisional hearing and since the nature of order passed under Rule 86A is provisional, it would be reasonable to consider granting a post-decision hearing to the petitioners which would comply with the principles of natural justice. Though post-decision hearing is not a substitute for pre-decisional hearing, in situations where pre-decisional hearing is likely to frustrate the interest and purpose of the Statute, the mechanism of post-decisional hearing will be the only alternative.

Applying the above principles, one can infer that although the rule does not provide for a pre-decisional hearing, a post-decisional hearing could be considered by the tax authorities. This is to ensure the principles of natural justice are upheld, especially given the potential impact on business operations.

The Court further held that-

The first requisite of the Rule which is required to be considered by the competent authority is with regard to the basis of material available before taking any action for blocking of electronic credit ledger. The second pre-requisite is of recording the reasons in writing for invoking the powers under Rule 86A of the Rules of 2017.

Unless the aforesaid two pre-requisites are fulfilled, the competent authority cannot invoke the powers under Rule 86A of the Rules of 2017 for the purpose of disallowing the debit of the determined amount to the electronic credit ledger or to block the electronic credit ledger even to the extent of amount fraudulently or wrongly availed by the petitioners/assessee.



Negative Blocking of ITC

One common practice by the tax authorities is blocking of ITC beyond what is available in the ECL on the date of blocking. The entire ITC availed and utilised by the taxpayer in the past is blocked by the revenue even though such balance does not exist or there is NIL balance as on the date of the blocking of ITC. Such an act by the revenue authority causes prejudice to the taxpayer. In such circumstances and as a result of such negative balance, if the taxpayer would file return by claiming input tax credit, the taxpayers would be required to pay an additional amount of output tax under the provisions of the GST Act to the extent of negative balance of the input tax credit in the electronic credit ledger.

In this regard, it is pertinent to discuss the following case laws which have dwelled upon the issue of negative blocking of ITC and its constitutional validity.

Favour of the taxpayer

In the case of **Samay Alloys India Pvt Ltd Versus State Of Gujarat [2022 (61) G.S.T.L. 421 (Guj.)]** it was held that-

The Rule 86A empowers the proper officer to disallow debit from the electronic credit ledger for an amount equivalent to the amount claimed to have been fraudulently availed. Accordingly, the rule provides for restriction on an amount and not on the very credit which is fraudulently availed. Accordingly, the rule can be invoked even when the credit fraudulently availed is utilised.

The Revenue may legitimately argue that such an interpretation may make the entire Rule 86A toothless as parties can claim and immediately utilise the credit fraudulently availed by filing monthly returns. Accordingly, it may be practically impossible to invoke Rule 86A in large number of cases. This may be the actual implication of the present interpretation, however, the Government in its wisdom has framed Rule 86A and this rule is not framed to recover the credit fraudulently availed. In case where credit is fraudulently availed and utilised, appropriate proceeding under the provisions of Section 73 or Section 74, as the case may be, can be initiated. Secondly, Rule 86A is not the rule which provides for debarring the registered person from using the facility of making payment through the electronic credit ledger. In case the intention was to disallow future debits or credit in electronic credit ledger, the text of the rule would be entirely different.

It was further held that heading of Rule 86A itself is suggestive of its scope and applicability. The heading reads "conditions of use of amount available in electronic credit ledger". It appears on plain reading

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of the heading itself that Rule 86A can be invoked only if the amount is available in the electronic credit ledger and not otherwise. It is a settled rule of interpretation that the section heading or marginal note can be relied upon to clear any doubt or ambiguity in the interpretation of the provision to discern the legislative intent.

Another Landmark judgement in case of **Best Crop Science Pvt. Ltd. v. Principal Commissioner 2024 SCC OnLine Del 6714** held that-

Rule 86A (1) of the Rules does not contemplate an order, the effect of which is to require a taxpayer to replenish his ECL with valid availment of ITC, to the extent of ITC used in the past, which the Commissioner or an officer authorized by him has reasons to believe, was fraudulently availed or was ineligible. Such an interpretation would in effect amount to construe an Order under Rule 86A (1) of the Rules as an order for recovery of tax. This is obvious because the taxpayer would now have to incur a larger cash outflow for payment of taxes as he would be denied utilization of validly availed ITC, which he would require to accumulate to compensate for the ITC availed and utilized which the Commissioner or an officer authorized by him, has reasons to believe was fraudulently availed or was ineligible.

Rule 86A of the Rules is not a machinery provision for recovery of tax or dues under the CGST Act. It is not

a part of the scheme of the machinery provisions for assessment and determination of the tax and dues as payable under the CGST Act. It is an emergent measure for protection of revenue by temporarily not allowing debit of available ITC in the ECL, which the Commissioner or an officer authorized by him has reasons to believe has been wrongfully availed.

Against the taxpayer

In the case of **TVL. Skanthaguru Innovations Pvt. Ltd. Versus Commercial Tax Officer [(2024) 25 Centax 379 (Mad.)]** it was held that-

Thus, a conjoint reading of 1st and 2nd parts of Rule 86A would clearly reveal that the word "available in the ECL" referred in 1st part would mean that the amount available after the fraudulent availment of credit at any point of time, whether it was available in the ECL or utilised at the time of passing the blocking orders. Hence, the 2nd part of Rule 86A empowers the Authorities not to allow the debit of amount equivalent to the fraudulently availed credit for discharge of liabilities under Section 49. If it was already utilised, the Officials are also empowered to pass blocking orders to the extent of amount equivalent to such credit, which was already utilised, along with the unutilised fraudulently availed ITC amount available in the ECL at the time of passing the blocking orders.

Further, in the provisions of Rule 86A, nowhere it has been stated that the negative blocking is prohibited. When the Statute has not stated anything in the statutory term, it has to be construed that the word "blocking" includes both positive and negative blocking. If the intention of the legislature is not to allow the negative blocking, they are supposed to have specifically prohibited the same by virtue of proviso or otherwise. In this case, no such prohibition is available and hence, in the absence of any such prohibition for negative blocking, the blocking referred in Rule 86A has to be construed for both positive and negative blocking. Therefore, the question of barring of negative blocking would not arise

Further in case of **Basanta Kumar Shaw Versus Assistant Commissioner Of Revenue, Commercial Taxes & State Tax, Tamluk Charge [2022 (65) G.S.T.L. 436 (Cal.)]**, the Hon'ble HC held that-

The word "available" occurring in Rule 86(1) cannot be read in isolation and it has to be read along with the remaining words which is "in the electronic credit ledger has been fraudulently availed or is ineligible", "has been fraudulently availed" would undoubtedly denote a situation which has occurred in the past. This becomes clear if we peruse the allegations contained in the SCN.

The appellant has used the expression "negative blocking". We find no such expression in Rule 86A. It appears that such expression is used in common parlance among dealers. If the statute does not use the expression negative balance, such theory cannot be imported to justify the contention that there should be a positive balance to invoke Rule 86A. Such interpretation would render the rule redundant and it can be also rewarding the assessee at times. Thus, we are of the clear view that the Rule 86A(1) read in its entirety will clearly show that there is no requirement under the Rule that the electronic credit ledger should contain sufficient balance for the purpose of blocking the credit by invoking the said rule.

Conclusion

Rule 86A of the CGST Rules is an important tool to prevent fraudulent ITC claims. However, its implementation requires careful adherence to the stipulated conditions and principles of natural justice. The ongoing debates and varying interpretations across High Courts highlight the need for clear guidelines, proper application of mind, and a balanced approach by tax authorities. It is imperative for authorities to recognize that Rule 86A is a provisional measure and not a substitute for proper assessment and recovery proceedings under the CGST Act. Furthermore, the courts have consistently held that a negative blocking of the ECL is not permissible under Rule 86A.

Going forward, the government should consider issuing detailed guidelines on the exercise of powers under Rule 86A, ensuring that blocking is based on objective criteria rather than discretionary judgment. Additionally, incorporating a mandatory review mechanism for blocked ITC cases would improve transparency and prevent arbitrary action.

As the saying goes, "With great power comes great responsibility." Therefore, it is crucial that the powers granted under Rule 86A are exercised judiciously and only in cases where it is absolutely necessary.



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