

By-products or waste products emerging during the manufacturing process cannot be treated as exempted goods to restrict ITC - SC

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Summary

The Supreme Court (SC) has held that if, during the manufacture of any taxable goods, any exempt goods are produced as by-products or waste products, it shall be deemed that the purchased goods have been used in the manufacture of taxable goods. The SC stated that the definition of 'goods' under the Uttar Pradesh Value Added Tax Act, 2008 (UP VAT Act) does not differentiate between exempt and taxable goods. The plain reading of the aforesaid definition would indicate that the legislative intent was never to limit or circumscribe the scope of 'goods' as outlined in the UP VAT Act to only 'taxable goods.' Accordingly, the SC has held that the assessee is eligible for full input tax credit (ITC) on the purchase of rice bran under relevant provisions of the said Act.

Facts of the case:

- M/s Modi Naturals Ltd. (the assessee) is a company engaged in the business of manufacture and sale of rice bran oil (RBO) and physical refined RBO. The assessee is a registered dealer under the UP VAT Act, and the RBO manufactured by the assessee falls within the ambit of 'taxable goods' under the UP VAT Act.
- For the purpose of manufacturing RBO, the assessee procures rice bran (inputs/purchased goods) and follows the solvent extraction process.
- During the manufacturing process of RBO, a by-product in the form of de-oiled rice bran (DORB) is also produced. DORB falls within the category of exempted goods under S. No. 4 of Schedule – I of the UP VAT Act.
- The assessee claimed full ITC of tax paid on the purchase of rice bran.
- The Deputy Commissioner took the view that in terms of Section 13(1)(f) of the UP VAT Act, the assessee could have availed the ITC on the inputs only vis-à-vis the taxable sales, as the sale price of the final goods was lesser than the manufacturing cost of the purchased goods and rejected the ITC claimed by the assessee.
- The Additional Commissioner accepted the case put up by the assessee that the word 'goods' in Section 13(1)(f) of the UP VAT Act could not be restricted to only 'taxable goods' and held that the assessee was entitled to claim full ITC for AY 2015-16 which was also upheld by the Commercial Tax Tribunal.
- However, for the AY 2013-14, the Additional Commissioner proceeded to remand the matter to the Tax Fixation Officer for passing the re-tax fixation order.
- The Revenue approached the Allahabad High Court (HC) for revision of the orders passed by the Commercial Tax Tribunal. The HC allowed both the revision applications filed by the Revenue and held that in terms of Section 13(1)(f) of the UP VAT Act, the assessee is not entitled to claim full ITC on the inputs.
- Aggrieved, the assessee approached the SC.

Issues before the SC:

- Whether the assessee is entitled to claim the full amount of tax paid towards the purchase of raw rice bran as ITC on the basis of the provisions of Section 13(1)(a) read with S. No. 2(ii) of the

Table appended thereto and Section 13(3)(b) read with Explanation (iii) of Section 13 of the UP VAT Act?

- Whether the scope of the word 'goods' as defined under Section 2(m) of the UP VAT Act as outlined in Section 13(1)(f) of the UP VAT Act should be limited to only 'taxable goods'?
- Whether the decision of the court in the case of M.K. Agro Tech had any application to the case on hand?

SC observations and ruling [Civil Appeal No (S). 5822-5823 of 2023, Order dated 06 November 2023]:

- **Intent of legislative amendment:** The plain reading of the relevant provisions 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.' In cases where the goods (including taxable, exempt goods, by-products or waste products) manufactured were being sold at a price lower than the cost price, the extent of permissible or allowable ITC would be limited to the tax payable on the sale value of the goods or manufactured goods.
- **Definition of 'goods' under UP VAT Act:** The definition of 'goods' u/s 2(m) of the UP VAT Act referred to above does not differentiate between exempt and taxable goods, and equally, the word 'goods' u/s 13(1)(f) of the UP VAT Act has also not been qualified by the word 'taxable'. The goods which are manufactured/produced by using or utilising the purchased goods and whose sale price is being considered for applying Section 13(1)(f) of the UP VAT Act ought to be taxable goods.
- **Scope and ambit of goods under the UP VAT Act:** Wherever the legislative

intent was to qualify 'goods' with the word 'taxable', it has been so done by the legislature in Section 13 of the UP VAT Act itself. If the legislative intent of the 2010 amendment was to limit the scope and ambit of 'goods' u/s 13(1)(f) solely to 'taxable goods,' there was nothing that could have prevented the legislature from expressly using the phrase 'taxable goods' in Section 13(1)(f) of the UP VAT Act.

- **General principles for interpretation of taxing statutes:** It is well accepted that a statute must be construed in accordance with the intention of the legislature, and the courts should act upon the true intention of the legislation while applying the law and while interpreting the law.
- **Assessee entitled to full ITC:** A bare perusal of the scheme under Section 13(1)(a) of the UP VAT Act makes it abundantly clear that in cases where the purchased goods (in the present case rice bran) are used in the manufacture of taxable goods (in the present case RBO and physically refined RBO) except the non-VAT goods, and where such manufactured goods are sold within the state or in the course of inter-state trade and commerce, the registered dealers (like the assessee herein) are entitled to claim ITC of the full amount. The charging section of the UP VAT Act, therefore, entitles the assessee to claim the full amount of tax paid on the purchases as ITC.
- **ITC in cases where the manufacture results in the production of by-products or waste products:** Explanation (iii) to Section 13 provides that if during the manufacture of any taxable goods, any exempt goods are produced as by-products or waste products, it shall be deemed that the

purchased goods have been used in the manufacture of taxable goods.

Explanation (iii) to Section 13, therefore, forbids the assessing authority as well as the assessee from raising any dispute in regard to the allowability of the ITC in cases where exempted goods are being produced as a by-product or waste product during the process of manufacture.

- **SC decision in the case of M.K. Agro Tech not applicable:** The decision in the case of M.K. Agro Tech is not applicable to the case on hand as the provisions under the Karnataka VAT Act are quite different compared to that of the UP VAT Act in regard to the scheme of ITC.

Our comments

In the case of Hindustan Zinc Limited, the SC had held that when a by-product emerges as a technical necessity, it cannot be said that any inputs have been used for the manufacture of the by-product, thereby requiring ITC reversal.

Several tribunals, including the Mumbai Tribunal in the case of M/s JSW Steel Ltd., have observed that credit for that quantity of raw materials shall be allowed, which is required for the manufacture of the intended quantity of final products, irrespective of the fact that certain by-products emerge as a technical necessity.

This is a welcome ruling by the SC and shall provide relief to the manufacturing sector and will set precedence in similar matters. Further, an analogy can also be drawn under the Goods and Services Tax (GST) regime since a mere generation of by-products or waste should not lead to the reversal of ITC.

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