

GST LAWS – CONSTRUCTIVE DELIVERY, CIRCULAR TRADING & THE POWER TO ARREST

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1.0 INTRODUCTION

Different High Courts have taken divergent views on arrest provisions under Central Goods and Services Tax Act, 2017 (CGST Act) and corresponding state goods and services tax laws (SGST Acts).

Recently, Telangana High Court denied protection from arrest to persons on charges of tax evasion whereas the Bombay High Court granted pre-arrest protection. While former decision was upheld through its order dated 27.05.2019, the Supreme Court in the course of adjudicating upon the latter recognized the divergence of opinion of various High Courts and agreed to settle the position. In the meanwhile, the Supreme Court declined to interfere with Bombay High Court's decision and also reiterated its decision on Telangana High Court's judgement.

In relation to the above, this paper attempts to study the following:

1. incongruities ingrained in S. 69 of CGST Act (as also SGST Acts);
2. need for filing FIR u/s 154 of Code for Criminal Procedure, 1976 (CrPC);
3. need for invoking Art. 226 or the lack of recourse to S. 438 of CrPC; and
4. recourse to safeguards as provided u/s 41 and 41A of CrPC as available to persons facing threat of arrest under provisions of CGST Act.

Additionally, it appears that GST officials have come to treat transactions involving constructive delivery of goods at par with transactions involving circular trading, which is a worrying trend. In relation to this, this paper attempts to study the following:

1. position of constructive delivery vis-à-vis actual delivery of goods;
2. entitlement of a buyer to avail input tax credit (ITC) upon constructive delivery of goods;
3. circular trading and CGST Act;
4. position of transactions where GST is paid and there is no actual delivery of goods and the buyer avails ITC and the transaction is not that of constructive delivery of goods.

2.0 CONSTRUCTIVE DELIVERY, CIRCULAR TRADING & ITC

It appears that the revenue authorities do not recognize transactions involving constructive delivery of goods as genuine transactions. Such transactions being those where goods are supplied by delivery of documents of title without actual movement, as in the case of warehoused goods or in the case of in-bond transfer of customs bonded warehoused goods. It appears that such transactions have been kept at par with those transactions where goods have been supplied without actual movement of goods (commonly known as circular trading).

While the basis of the taxman's disposition is not known, but the CGST Act (as do the SGST acts) does recognize the distinction between genuine transactions of constructive delivery and the illegal transactions of circular trading, and provides sufficient legal protection to former kinds of transactions and adequate punishment for the latter kinds of transactions.

Reference is drawn to S. 16(1) and Explanation to S. 16(2) (b), which forms part of Chapter IV of the CGST Act, titled as "INPUT TAX CREDIT", which states:

*16. (1) Every registered person shall, subject to such conditions and restrictions as may be prescribed and in the manner specified in section 49, be entitled to take credit of input tax charged on any **supply of goods or services or both to him which are used or intended to be used in the***

course or furtherance of his business and the said amount shall be credited to the electronic credit ledger of such person.

(2) Notwithstanding anything contained in this section, no registered person shall be entitled to the credit of any input tax in respect of any supply of goods or services or both to him unless,--

(b) he has received the goods or services or both.

*Explanation — For the purposes of this clause, **it shall be deemed that the registered person has received the goods** where the goods are delivered by the supplier to a recipient or any other person on the direction of such registered person, whether acting as an agent or otherwise, before or during movement of goods, **either by way of transfer of documents of title to goods or otherwise**; ...*

Since transactions involving constructive delivery are legit transactions, which are carried out for the purposes of furtherance of business, it follows that such transactions fulfil the requirements set out under S. 16(1) for availing input tax credit. The requirements spelled out under S. 16 (2) (b) also seem to conceive of, apply to and include transactions involving constructive delivery of goods. Therefore, if a buyer in a transaction involving constructive delivery of goods has complied with the conditions spelled of under S. 16, he can rightfully claim input tax credit.

Moreover, the specific use of words “*in the course or furtherance of his business*” in S. 16 (1) is indicative of the intent of the legislature to preclude

availability of input tax credit to transactions involving circular trading as the purpose of such transactions is not that of undertaking a business adventure but that of manipulating the banking channels to expropriate credit limits or to launder money.

Reference is also drawn to S. 31 (1) of the CGST Act (as also to corresponding sections of the SGST Acts), which forms part of Chapter VII titled as "TAX INVOICE, CREDIT AND DEBIT NOTES" and states that:

31. (1) A registered person supplying taxable goods shall, before or at the time of, —

*(a) removal of goods for supply to the recipient, **where the supply involves movement of goods**; or*

*(b) **delivery of goods or making available thereof to the recipient**, in any other case,*

issue a tax invoice showing the description, quantity and value of goods, the tax charged thereon and such other particulars as may be prescribed:

Provided that the Government may, on the recommendations of the Council, by notification, specify the categories of goods or supplies in respect of which a tax invoice shall be issued, within such time and in such manner as may be prescribed.

The fact that the legislature has chosen to differentiate between supply of goods involving "*movement of goods*" and supply of goods involving "*delivery of goods or making available thereof to the recipient*", it is indicative of the overall intent of the legislature to recognize transactions involving constructive delivery of goods as inherent part of the GST laws.

A section of the legal fraternity has pointed out that transactions involving constructive delivery of goods may possibly be outlawed by virtue of S. 132 (1) (b) of CGST Act. The fears appear to be unfounded as S. 132 (1) (b) offers sufficient safeguards to such transactions. S. 132 (1) (b) of the act qualifies the act of issuing any invoice or bill without supply of goods or services or both in violation of the provisions of this Act, or the rules made thereunder, leading to wrongful availment or utilisation of input tax credit or refund of tax as punishable offence. The ingredients of S. 132 (1) (b), therefore, are:

1. the act must involve issuing of invoice or bill without supply of goods or services;
2. such issuance of invoice or bill should be in violation of the provisions of the Act or rules made thereunder; and
3. such act must lead to wrongful availment or utilisation of input tax credit or refund of tax – meaning the existence of wrongful intent.

In view of the submissions made in respect of Ss. 16(1) and 31(1), it follows that a transaction involving constructive delivery of goods does not satisfy the first two ingredients as listed above. Further, such transaction is also devoid of the third ingredient, since there is no wrongful intent behind such

transaction and one is rightfully entitled to avail and utilize ITC or refund of tax. Therefore, such transaction is expressly precluded from the purview of S. 132(1)(b).

On the contrary, a transaction involving circular trading meets all requirements of S. 132 (1)(b), in so much as it involves:

1. issuance of invoice or bill without any movement of goods;
2. violation of provisions of the Act (such as S. 132(1)(c)); and
3. wrongful intent on the part of the person availing ITC or refund.

In addition to these, a section of the legal fraternity has also raised concerns regarding whether transactions are susceptible even though applicable GST has been paid by the supplier.

We have already clarified the position of GST laws in so far as it relates to availing tax credit upon receiving constructive delivery of goods.

In otherwise situations, where there has been no actual movement of goods and GST has been paid by the supplier for which the buyer seeks a credit or refund; it is the intent behind such transactions that gains paramount importance as it destroys the very fabric of GST laws in more than one way:

1. it creates a liability on the exchequer, unlike cases involving evasion of custom duties where authorities seek recovery of duties that were due to them and not paid;

2. it unnecessarily overburdens the GSTN to the detriment of other users and negatively impacts its efficacy; and
3. it attempts to derail the nascent and frail GST framework thereby leading to deep and vast ramifications.

Therefore, given that S. 135 of the CGST Act (as also corresponding sections of SGST Acts) rightfully presumes a culpable mental state, the revenue authorities stand on good ground to pursue such transactions and the onus is rightfully on the person availing refund or credit to prove his intent beyond reasonable doubt and not only on preponderance of probabilities.

This completes our analyses on constructive delivery, circular trading and input tax credit and allows us to move to the next part of our analysis.

POWER OF ARREST & SAFEGUARDS FROM ARREST

The CGST Act bestows upon the tax authorities some important powers, namely, inter alia:

1. power to conduct inspection, search & seizure (S. 67) – S. 67(10) adopts the procedure prescribed under CrPC 1973 relating to search and seizure (subject to the substitution “Magistrate” in S. 165(5) of CrPC 1973 with the word “Commissioner”);
2. power to issue summons (S. 70) – S. 70 adopts the procedure of a Civil Court prescribed under Code of Civil Procedure, 1908 in relation to issue of summons to persons to produce document or evidence and confers the status of “judicial proceedings” on proceedings initiated under it; and
3. power to arrest (S. 69) relating to offences specified u/s 132 (cognizable but non-bailable and non-cognizable but bailable).

Now the oddness is that while S. 69 grants power of arrest for cognizable but non-bailable offences, but it does not specifically grant such powers in respect of non-cognizable but bailable offences. Rather it simply bestows the power to grant bail and prescribes procedure thereto concerning non-cognizable but bailable offences and subjects it to the provisions of CrPC 1973.

In other words, provisions of CrPC 1973 have relevance only u/s 69(3) but not u/s 69(1). One may argue that even u/s 69(3) CrPC finds application only after a person has been arrested and, therefore, limited protection against arrest (as under Ss. 41 & 41A of CrPC) is not available to a person against whom reasonable suspicions of committing an offence exist.

This has been rightfully rejected by the Telangana High Court by the said order as it correctly identifies the intent of the legislature who makes reference to provisions of CrPC in various parts of the CGST Act despite treating the proper officer holding an enquiry under the Act like a Civil Court.

The Telangana High Court rightly observes that the duty imposed upon a Police Officer u/s 41A (1) CrPC to summon a person for enquiry in relation to a cognizable offence is what is substantially ingrained in S. 70 (1) of the CGST Act, although S. 69(1) does not contain these safeguards but S. 70(1) takes care of that contingency.

In other words, since powers u/s 69 (1) are exercised after the exercise of powers u/s 70, which, though treated like a Civil Court, carries the status of judicial proceedings as u/s 193 and 228 of IPC, 1860 – the limited protection against arrest as afforded by Ss. 41 & 41A of CrPC becomes in-built.

Thus, a person complying with notices of appearance shall not ordinarily be arrested unless the Commissioner has reasons to believe the contrary. This leads us to the next part of the problem.

While S. 41A (3) of CrPC entitles the Police Officer to arrest such person for “reasons to be recorded”, S. 69 of the CGST Act empowers the Commissioner to authorize arrest if he has “reasons to believe”, i.e. it does not make it mandatory for him to record such reasons on the arrest authorization.

Recognizing the disparity, the Courts have held it to be appropriate where such reasons are at least recorded on file. Even S. 69 (2) of the CGST Act makes it incumbent upon the arresting officer to inform the arrested person about the grounds of his arrest in respect of certain offences – implying that the Legislature was aware of the disparity and latently sought to dispel it.

DETERMINATION OF TAX LIABILITY AS A SAFEGUARD FROM ARREST

By virtue of powers granted u/s 69 of the CGST Act, in certain offences specified u/s 132 of the Act involving tax evasion in excess of INR 20,000,000 (Indian Rupees Twenty million only), tax officials can arrest persons as per procedure prescribed thereunder.

it appears that GST officials have often been unable to make out a prima facie case in terms of the amount of tax evaded to justify arrest proceedings. This argument appears to be strong when held in letter of the law, however, it does not reflect the true intent of the legislature.

It is true to suggest that the said provisions prescribe a threshold in terms of the amount of tax evaded, but the intent of the Legislature is not to operate it as a safeguard against arrest.

It may be appreciated that, other than the threshold, the Act provides sufficient safeguards to a person fearing the threat of arrest under the said provisions. These include those that have been discussed in the preceding section as also certain superfluous checks:

- in order to curb the incidence of arbitrary use of power, the Act rests the power to authorize an arrest with an official of the rank of Commissioner;
- it makes it incumbent upon the Commissioner to have sufficient reasons before authorizing an arrest, and in view of S. 69 (2) of the Act, as also by way of judicial interpretation, such reasons are at least to be recorded in the file, therefore, causing them to be open to judicial scrutiny.

Therefore, existence of a threshold limit for tax evasion is not actually a safeguard available against arrest, for such safeguard shall impute a determination of tax liability, albeit prima facie. This cannot be said to be the intent of the legislature as such determination can only be possible after suitable assessments have been carried out in terms of the Act. For, the arrest of a person may itself be necessary to complete an enquiry to make a true assessment, to prevent a person from compromising or destroying evidence or to accomplish many other objectives as have been laid out by the Supreme Court in relation to fiscal laws.

Thus, the contention that the GST officials are unable to make out a prima facie case in terms of amount of tax evaded cannot strictly be made out as a safeguard to forestall arrest proceedings under the said provisions of the Act.

3.0 GST LAWS, NEED FOR FIR AND PRE-ARREST BAIL

It is to be noted that in terms of S. 69 (1) of the CGST Act (and all SGST Acts), the power to arrest is invoked before registration of First Information Report (FIR), therefore, an aggrieved person does not have recourse to apply to the Court of Session or the High Court for grant of anticipatory bail under S. 438 of CrPC, 1973.

The situation is akin, to an extent, to that of an accused u/s 18 of the Scheduled Castes and the Scheduled Tribes (Prevention of Atrocities) Act, 1989 or to that of an accused booked for an offence in the state of Uttar Pradesh, where S. 438 of CrPC has no applicability.

Therefore, in order to seek protection from pre-trial or pre-prosecution arrest, or in other words a pre-arrest bail, an aggrieved person can take recourse of invoking the jurisdiction of the concerned High Court under Art. 226 of the Constitution of India.

The Supreme Court of India has, through series of judgements on the subject, laid down elaborate guidelines governing the exercise of such power by the High Courts in consonance with the facts and circumstances of each case.

It is, therefore, not amusing to note that the Supreme Court was not inclined to interfere with the pre-arrest bail granted by the Bombay High Court; and at the same time it was not inclined to interfere with the order of the Telangana High Court rejecting pre-arrest bail. Though both cases related to



powers of arrest as enshrined under S. 69 of GST Acts but the facts of each case may have been different causing virtually opposite outcomes for the parties.

Though the Supreme Court has in the past settled the law in terms of powers of the High Courts to grant bail, the fact that it has agreed to intervene in the instant matter seems to imply the inclination of the Supreme Court to settle the position on the powers of arrest under GST laws, more specifically in respect of procedure to be adopted and also in respect of removal of incongruities ingrained in S. 69 of the CGST Act (as also all SGST Acts). e.

4.0 CONCLUSION

It is safe to conclude, on the basis of analysis contained in this paper, that the CGST Act (as also all SGST Acts) does recognize the legality of transactions involving constructive delivery of goods, and renders the availment or utilization of tax credit or refund as legitimate.

It also clearly distinguishes such transactions from those involving circular trading. The focus of GST laws on circular trading appears to emanate from dis-incentivizing such transactions by making them ineligible for tax credits or refunds as also by inflicting punishments for specific acts of circular trading and consequent availment or utilization of tax credits or refunds.

It is to be noted that circular trading is also a subject of Prevention of Money Laundering Act, 2005, and in view of this the focus of GST laws on circular trading, therefore, seems to emanate from its potential to create liability on GST collection pool or the exchequer and consequent danger to the successful implementation of GST throughout the country.

Moreover, constructive delivery of goods is an important mode of delivery in many industries, therefore, any decision of the Supreme Court that settles and clarifies the position of GST laws in its respect is welcome.

Finally, while GST laws provide sufficient safeguards against arrest but these safeguards are prone to interpretation and very likely to lead to litigation.

Also, as suggested by this paper, powers of arrest as enshrined in GST Acts suffer from serious incongruities.

In view of this, the inclination of the Supreme Court to intervene and settle the position of law is a positive and welcome development. It shall smoothen the implementation of GST laws, accentuate the intent behind GST laws to check arbitrary use of power by taxmen, avoid needless litigation and more importantly create necessary deterrents for potential miscreants.

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