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Doctrine of Substantive Compliance: Concessional Rates and ITC Reversal in GST**ASHWARYA SHARMA**

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1. Introduction

The decision of the Madras High Court in *GU Shipping India Pvt Ltd. v. Assistant Commissioner of CGST and Central Excise, Chennai South Commissionerate* [W.P. No. 13829 of 2025, dated 27-2-2025], once again brings to the forefront a nuanced yet critical principle of indirect tax law—one that often gets overshadowed in the rigours of procedural compliance. At its heart lies a fundamental question: can a taxpayer be denied a concessional rate or exemption merely because input tax credit (ITC) was initially availed, even when such credit is subsequently reversed?

At its core, the controversy can be said to be of procedural infractions vis-à-vis substantive conditions. While tax statutes often prescribe conditions relating to non-availment of credit for claiming exemptions whether fully or partially, the real inquiry is whether such conditions are to be interpreted rigidly at the point of initial availment, or pragmatically in light of subsequent corrective actions undertaken by the taxpayer either suo moto or pointed out by the department. It is in this context that judicial pronouncements have consistently leaned towards a substance-over-form approach, recognizing that reversal of credit effectively nullifies the earlier benefit.

The following discussion examines this settled legal position, the rationale underpinning it, and the judicial approach that safeguards taxpayers from denial of legitimate exemption benefits merely on account of initial, but duly rectified, availment of input tax credit. This judgment reinforces a settled yet frequently litigated position: that reversal of credit neutralizes its earlier availment, and therefore, denial of exemption on this ground alone is legally unsustainable. The ruling carries significant implications across sectors and adds to the growing judicial emphasis on substance over form.

2. Factual Background

The petitioner, during the period from July 2017 to 25.01.2018, supplied services of freight and leasing/renting of vessels with crew, classifying the same under HSN 996602 and discharging GST at 18% with ITC, in line with Serial No. 10(ii) of Notification No. 11/2017-CGST (Rate) dated 28.06.2017.

Subsequently, pursuant to an amendment effective 25.01.2018, the petitioner began discharging tax at a concessional rate of 5% under Serial No. 10(ii) for "time charter of vessels for transport of goods." However, the department alleged that the petitioner continued to avail ITC, thereby violating the condition attached to the concessional rate. Consequently, the benefit was denied and tax at 18% was demanded under Serial No. 10(iii). The relevant extract of notification is as follows for ease of understanding:

Till 24.01.2018 the entry read as follows

Chapter, Section or Heading	Description of Service	Rate (per cent)	Condition
Heading 9966 (Rental services of transport vehicles)	(ii) Rental services of transport vehicles with or without operators, other than (i) above.	18%	-

From 25.01.2018 the entry read as follows

Chapter, Section or Heading	Description of Service	Rate (per cent)	Condition
Heading 9966 (Rental services of transport vehicles [with operators])	1[(ii) Time charter of vessels for transport of goods	5%	Provided that credit of input tax charged on goods (other than on ships, vessels including bulk carriers and tankers) has not been taken [Please refer to Explanation No. (iv)].

The condition (explanation no (iv)) is as follows:

4. Explanation.—For the purposes of this notification,—

(iv) Wherever a rate has been prescribed in this notification subject to the condition that credit of input tax charged on goods or services used in supplying the service has not been taken, it shall mean that,—

- (a) credit of input tax charged on goods or services used exclusively in supplying such service has not been taken; and
- (b) credit of input tax charged on goods or services used partly for supplying such service and partly for effecting other supplies eligible for input tax credits, is reversed as if supply of such service is an exempt supply and attracts provisions of sub-section (2) of section 17 of the Central Goods and Services Tax Act, 2017 and the rules made thereunder.

3. Issue before the High Court

The central issue before the Court was whether subsequent reversal of ITC can cure the initial availment defect so as to entitle the taxpayer to concessional tax treatment, or whether compliance must be strictly examined at the time of original availment itself.

4. Proceedings before the High Court

4.1 Grounds of the Petitioner

The petitioner contended that the issue was no longer *res integra* and stood squarely covered by the judgment of the Hon'ble Supreme Court in *Chandrapur Magnet Wires Pvt Ltd. v. CCE 1996 taxmann.com 736*, wherein it was held:

"7. In view of the aforesaid clarification by the Department, we see no reason why the assessee cannot make a debit entry in the credit account before removal of the exempted final product. If this debit entry is permissible to be made, credit entry for the duties paid on the inputs utilised in manufacture of the final exempted product will stand deleted in the accounts of the assessee. In such a situation, it cannot be said that the assessee has taken credit for the duty paid on the inputs utilised in the manufacture of the final exempted product under Rule 57A. In other other words, the claim for exemption of duty on the disputed goods cannot be denied on the plead that the assessee has taken credit of the duty paid on the inputs used in manufacture of these goods."

Reliance was also placed on other decisions which had followed the above decisions reiterating that reversal of credit restores the legal position.

4.2 Submissions of the Respondents

The department argued that the petitioner had availed ineligible ITC and reversed it only after issuance of the impugned order. It was contended that such belated reversal cannot cure the initial breach, and that the benefit of concessional rate was rightly denied.

5. Analysis and Decision of the High Court

5.1 Interpretation of Notification Conditions

The Court examined the language of Notification along with Explanation (iv), which clarifies that where ITC is partly attributable, it must be reversed in accordance with Section 17(2) of the CGST Act.

5.2 Nature of ITC Reversal and Compliance

The Court recognized that the condition of "non-availment" must be interpreted pragmatically. Once ITC is reversed, the effect is as if it was never availed. Thus, the substantive requirement stands fulfilled.

5.3 Procedural Lapse vs Substantive Right

Importantly, the Court observed that denial of benefit was solely due to initial availment of ITC—a procedural lapse that stood rectified. It emphasized that tax administration cannot impose a higher tax burden merely due to inadvertent errors when substantive compliance is ultimately achieved.

5.4 Duty of the Department

A significant observation was that the department is not expected to retain tax that is not legitimately due, nor to augment revenue by denying lawful benefits. The proper course would have been to seek reversal of ITC with applicable consequences, not denial of concessional rate per-se.

6. Legal Position: Settled but Reaffirmed

It is a well-settled principle under indirect tax jurisprudence that the mere initial availment of input tax credit does not, by itself, disentitle an assessee from claiming exemption on the output supply, provided such credit is duly reversed. Courts have consistently held that the substantive condition for availing exemption—namely, non-retention of input credit—stands satisfied once the credit is reversed, whether prior to clearance or even subsequently.

The rationale is straightforward: reversal neutralizes the benefit, restoring the position as if credit was never taken. To deny exemption in such cases would amount to elevating procedural form over substantive compliance. Once credit attributable to exempt supplies is reversed, the condition of non-availment stands fulfilled in substance, and denial of exemption becomes unsustainable in law.

7. Wider Applicability and Sectoral Impact

The significance of this judgment transcends the shipping industry and assumes considerable importance across multiple sectors where concessional rates or exemptions are expressly conditioned upon **non-availment of input tax credit**. The ruling provides a much-needed interpretative safeguard in industries where operational realities often lead to inadvertent credit availment followed by subsequent reversal.

A prominent example is the **hospitality sector**, particularly restaurant services, where GST is payable at 5% subject to the condition of non-availment of ITC. In practice, businesses—especially those operating multiple verticals such as restaurants, cloud kitchens, hotel accommodation and catering services—often face complexities in segregating eligible and ineligible credits. This judgment strengthens the position that even if ITC is initially availed due to system or classification challenges or inadvertent clerical or procedural errors, its subsequent reversal should not disentitle the taxpayer from the concessional 5% regime.

Similarly, the **real estate and construction sector**, particularly in the context of eligible real estate projects and affordable housing, operates under concessional rates linked to strict ITC restrictions. Given the scale and complexity

of procurements, inadvertent availment of credit is not uncommon. The present ruling provides strong support to the proposition that reversal of such credit aligns the taxpayer with the prescribed conditions, thereby preserving the benefit of concessional taxation.

In the **transportation and logistics sector**, including goods transport agencies (GTA) and passenger transport services, concessional rates are often available subject to non-availment of ITC. Operators dealing with mixed supplies and varying contractual structures frequently encounter credit attribution challenges. This decision ensures that procedural lapses in credit availment, once corrected, do not lead to denial of concessional rates.

The **leasing and financial services sector**, particularly in cases involving leasing of assets where differential tax treatments may apply based on credit eligibility, can also derive guidance from this ruling. Inadvertent credit availment in such scenarios, if reversed, should not result in adverse tax consequences beyond what is substantively due.

Further, sectors such as **outbound tour operator services, and certain manpower supply arrangements**, where notifications prescribe concessional rates with ITC restrictions, stand to benefit from this interpretative clarity. These industries often operate in fragmented supply chains with multiple vendors, making absolute real-time compliance with ITC conditions operationally challenging.

Viewed holistically, the judgment reinforces a uniform principle applicable across sectors—that substantive compliance through reversal of ITC satisfies the condition of non-availment, and taxpayers should not be denied legitimate concessional rates merely due to initial, rectified lapses. This approach not only aligns with established jurisprudence but also brings practical relief in a compliance-heavy GST regime.

8. Conclusion

The ruling of the Madras High Court is a reaffirmation of a fundamental tenet of tax jurisprudence—that taxation must align with economic reality and substantive compliance rather than procedural technicalities. By recognizing that reversal of ITC cures the initial availment, the Court has ensured that taxpayers are not penalized disproportionately for rectifiable errors.

In an era where GST compliance is increasingly data-driven and complex, such judicial clarity is both timely and necessary. It not only safeguards legitimate taxpayer rights but also reinforces the principle that the objective of tax administration is to collect due taxes—not to capitalize on inadvertent lapses. The judgment thus stands as a significant precedent, guiding both taxpayers and authorities towards a more balanced and equitable interpretation of the law.

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