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Concept of Valuation and Input Tax Credit in GST – Special Facets

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Overview

This article explores certain special facets of valuation and Input tax credit (ITC) schemes under the GST law, reflecting on how these concepts have evolved in the Indirect tax regime of India and in the years after the implementation of GST. It traces the evolution from transaction value to broader constructs like open market value, examines certain statutory inclusions and exclusions that influence value determination, and highlights the growing role of deeming fictions and amendments on specific issues like corporate guarantees. On ITC, it assesses the gap between the promise of seamless credit flow and expanding statutory and policy-driven constraints, including blocked credits, rate conditions denying ITC, etc. It also makes pragmatic reflections on structural improvements, such as greater fungibility of credit that could better align the GST regime with its foundational objectives. The article underscores the interplay between legislative design and administrative implementation, noting areas where recent reforms have eased compliance and those where litigation risk and policy incoherence persist.

Introduction

Implementation of GST in the year 2017 has been a path-breaking milestone in the evolution of the Indian Indirect tax regime. With a significant

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number of Central and State levies getting subsumed into the GST, this milestone paved

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the way for a unified Indirect tax regime in the country. The recent rollout of GST 2.0 has been a further historic step in the evolution journey.

The foundation of GST is to eliminate any cascading effect of taxes by allowing the seamless flow of Input tax credit ("ITC"). Valuation is another fundamental aspect of the GST law impacting the tax liability of the assessee. In this article, we will deliberate on some of the special facets of valuation and ITC schemes under the Central Goods and Services Tax Act, 2017 ("CGST Act") read with the Central Goods and Services Tax Rules, 2017 ("CGST Rules").

VALUATION

Under the erstwhile Indirect tax regime, different laws had their own valuation mechanisms, such as transaction value, MRP-based value, sales price, tariff valuation, etc. In essence, these mechanisms sought to tax a transaction based on its intrinsic value in an arm's length transaction.

Some of the unique and new features of the valuation mechanism under the GST regime are discussed in the ensuing paragraphs.

Open Market Value

The CGST Act has carried forward the transaction value mechanism, while introducing the concept of Open Market Value ("OMV") for the first time. The basic guiding principle continues to be determining a fair and objective value that is not affected by relationships or other impacting factors. Interestingly, OMV can also be nil, and this position is being adopted for personal guarantees issued by directors given the mandate by the RBI. However, this position is not sought to be accepted for corporate guarantees.

Subsidy from the Government

The inclusion or exclusion of subsidy received from the Government was long-litigated under the erstwhile Indirect tax laws, with several landmark decisions such as *CCE, Jaipur-II v. Super Synotex (India) Ltd*.[1] and *CCE Raigad v. Uttam Galva Steels Limited and others*[2] adopting distinguishing positions.

The CGST Act put this controversy at rest by providing a specific exclusion for "any subsidy given by the Central Government or a State Government" from the definition of consideration under Section 2(31) as well as exclusion provided under Section 15(2)(e) of the CGST Act. It is noteworthy that the exclusion does not apply to subsidies granted by government entities.

Circular No. 190/02/2023- GST issued by the CBIC had clarified the position that an incentive in the nature of a subsidy directly linked to the price of the services does not form part of the transaction value. However, the AAR in the case of *M/s. Hitze Boilers Private Limited*[3] had clarified that when a subsidy is separately received by a supplier in an escrow account and does not impact the supply price between the supplier and the recipient, the same cannot be excluded from the value of supply.

While some interpretational issues on the subject continue to persist around the specific nature of a Government subsidy and the mode of grant, as a concept, exclusion of Government subsidy from the value of supply brings the desired clarity.

1 *2014-TIOL-19-SC-CX.*
2 *2016 (331) ELT 0261 (Tri. – Bom.).*
3 *2023 (9) TMI 1122 – AAR, Karnataka.*

Interest on delayed payment

Interest on delayed payment of consideration was not treated as an additional consideration for the principal supply under the erstwhile regime. In fact, the valuation rules[4] under the erstwhile Service tax regime, it provided a specific exclusion for such interest.

Section 15(2) of the CGST Act has provided a specific inclusion for such interest or late fee in determining the value of the underlying supply, albeit provided that the time of supply to the extent of such interest would arise only upon receipt thereof. It is interesting to examine if this inclusion can lead to applicability of GST on interest charged for delay in settlement of financial transactions, such as payment to stockbrokers, which do not involve any underlying service by way of extending loan or deposits (interest on which is specifically exempted).

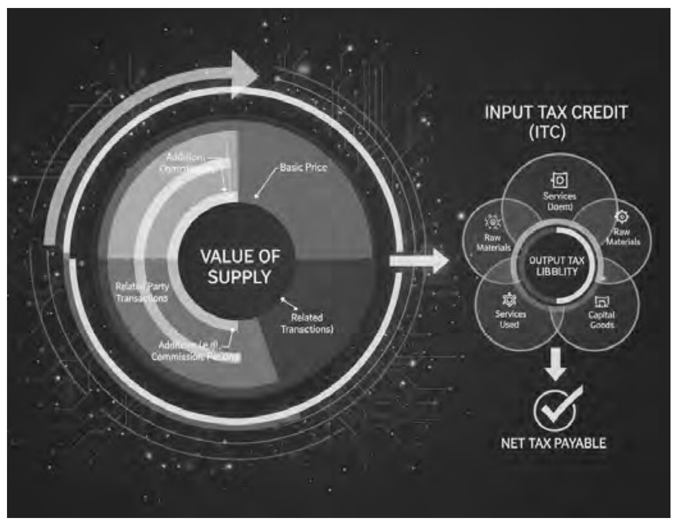
Proviso to Rule 28 – a game changer for related party transactions

The specific valuation immunity provided under the second proviso to Rule 28 of the CGST Rules for cases where the recipient is eligible for full ITC has been a breather for businesses. Circular no. 199/11/2023-GST issued by the CBIC in the context of distinct person transactions further liberally interpreted the scope of the proviso, benefiting the industry at large. However, the interpretation of what constitutes "full ITC" in itself and whether the same needs to be construed with respect to the specific supply transaction or overall credit position of the recipient continues to be an area of potential controversy. This is surely a welcome concept. The point to ponder is why the same concept should not be extended to transactions between unrelated parties where GST is required to be paid under RCM by the recipient eligible for full ITC.

Corporate guarantee valuation

Whether transactions of corporate guarantee constitute any "supply" considering their nature and intent continues to be a debatable issue. The arguments of stewardship function and shareholder activity may justify that extending such guarantees does not amount to supply at all.

Amendment of Rule 28 of the CGST Rules in the year 2023 to provide deemed valuation of 1% p.a. or actual consideration, whichever is higher, for such transactions and specific non-applicability of valuation immunity brought them to the forefront of controversy. The subsequent retrospective amendment introduced in July 2024 and the corresponding clarification[5] as regards acceptance of invoice value in cases where the recipient is eligible for full ITC did some course-correction. However, the fundamental legal issue as regards whether a deemed valuation mechanism like this is permissible under the

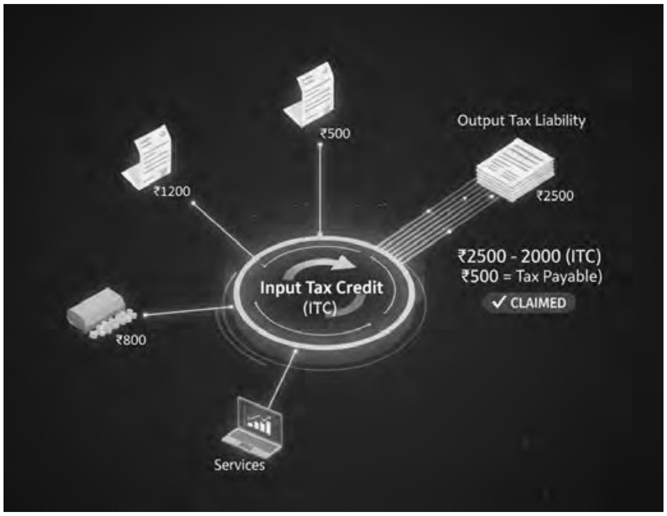


scheme of valuation provisions under the CGST Act continues to persist.

In most cases, commercial value of potential service by way of granting such guarantees is considered to be in the range 0.20 to 0.30% of guarantee amount for the entire tenure. As opposed to this, deeming of 1% of gross value

4 Rule 6(2)(iv) of the Service Tax (Determination of Value) Rules, 2006.

5 Circular No. 225/19/2024-GST dated 11.07.2024.



of guarantees on per year basis seems to defy the fundamental principle of OMV.

The controversy as regards taxability of corporate guarantees per se and valuation mechanism introduced vide Rule 28(2) of the CGST Rules continues to be sub-judice, and various High Courts have issued interim stay orders in the matter[6].

Discounts

The GST regime carried forward the concept of permitting the deduction of only pre-agreed and pre-sale discounts from the erstwhile regime. Section 15(3) of the CGST Act, as it stands before incorporating amendments proposed by the 56th GST Council Meeting, permits the deduction of a discount granted post supply only if such a discount is established in terms of a pre-existing agreement, is specifically linked to relevant invoices, and corresponding ITC is reversed by the recipient.

The roll-out of GST 2.0 sought to relax these conditions by permitting the deduction of all discounts as long as the corresponding ITC is reversed by the recipient.

6 *JSW Steel Limited v. DGGST [2024 (10) TMI 1031 – Delhi High Court], Sterlite Power Transmission Limited v. UOI [2024 (3) TMI 1311 – Delhi High Court], Schloss HMA Pvt. Ltd. v. UOI [2025 (1) TMI 589 – Bombay High Court], Vedanata Limited v. UOI [2025 (1) TMI 590 – Bombay High Court].*

Circular No. 251/08/2025-GST, issued in this regard, has clarified that unless an agreement for promotional activities with specific consideration is entered into between a manufacturer and dealer, post-supply discounts cannot be treated as consideration for such services. Similarly, it has been clarified that post-sale discounts by the manufacturer to the dealer may be treated as consideration only in cases where the manufacturer has "some agreement" with an end customer to supply goods at a discounted price.

The proposed amendment and the Circular issued thereafter are likely to settle several issues around discount deductibility in favour of the assessee. However, the controversy as regards the treatment of post-supply discounts by the manufacturer to the dealer and the treatment thereof as additional consideration may still persist. The authorities may potentially seek to read "some agreement" referred to in the Circular broadly to construe knowledge of a discounted price on the part of the end customer in the nature of an agreement.

In most cases, commercial value of potential service by way of granting such guarantees is considered to be in the range 0.20 to 0.30% of guarantee amount for the entire tenure.

Deeming fictions

While the overall scheme of Section 15 of the CGST Act, read with the corresponding rules, seeks to determine the value of supply with respect to transaction value or corresponding market values, there are several instances where a deeming fiction on valuation is created by way of entries or conditions in rate notifications. These include the deeming fiction for one-third deduction of land value in cases of construction services, including transfer of land,[7] and 70:30 deemed value of renewable energy devices vs. services in case of EPC contracts for supply of such devices with other goods and services[8].

The validity of such deeming fictions has been challenged before Courts on several grounds, such as arbitrariness and lack of nexus with the charge, etc. The one-third deduction of land value, even in cases where the actual value of land is available, was found to be unconstitutional by the Gujarat High Court in the case of *Munjaal Manishbhai Bhatt v. Union of India*[9] and the matter is now pending before the Supreme Court, wherein interim relief[10] was already granted. Similarly, the Karnataka High Court has granted a stay on recovery proceedings initiated by relying on the 70:30 deemed ratio of goods vs. services in the case of *DGGST, Chennai v. Vestas Wind Technology Pvt. Ltd*[11].

On an overall basis, the valuation mechanism under the GST law is based on the holy grail of the transaction value mechanism.

Unlike several deemed valuation mechanisms for works contracts under the erstwhile VAT laws, which were upheld by the Supreme Court on account of being optional[12], these valuation mechanisms under the GST law are mandatory and apply even where actual values may be available.

On an overall basis, the valuation mechanism under the GST law is based on the holy grail of the transaction value mechanism. While the measures such as valuation immunity may reduce litigation, several deeming fictions referred to above may continue to fuel controversies and dilute the objective of transaction value-based taxation.

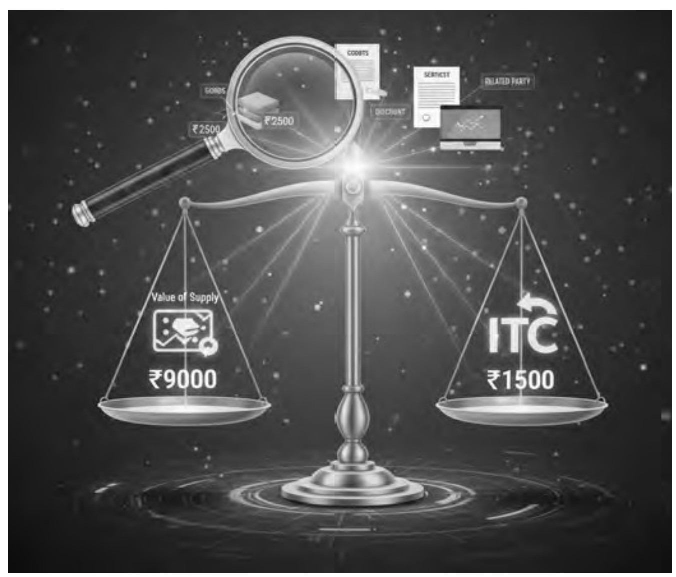
INPUT TAX CREDIT

Elimination of the cascading effect of taxes is crucial for a successful GST and was also one of the foremost objectives that paved the way for the introduction of GST. Globally also, "right to deduct" and "Input tax credit" have been treated as cornerstones of VAT/GST legislations.

Blocked credits

While reasonable restrictions on ITC are a common feature of VAT/GST legislations in several countries, the CGST Act adopts comparatively broader restrictions through its concept of "blocked credits". This construct, reminiscent of the erstwhile CENVAT regime, represents a notable departure from the concept of seamless credit flow.

Among these restrictions, those contained in Section 17(5)(c) and (d) of the CGST Act, relating to works contract services and goods or services used for the construction of immovable property,



7 Para 2 of the Notification No. 11/2017 – Central tax (Rate)

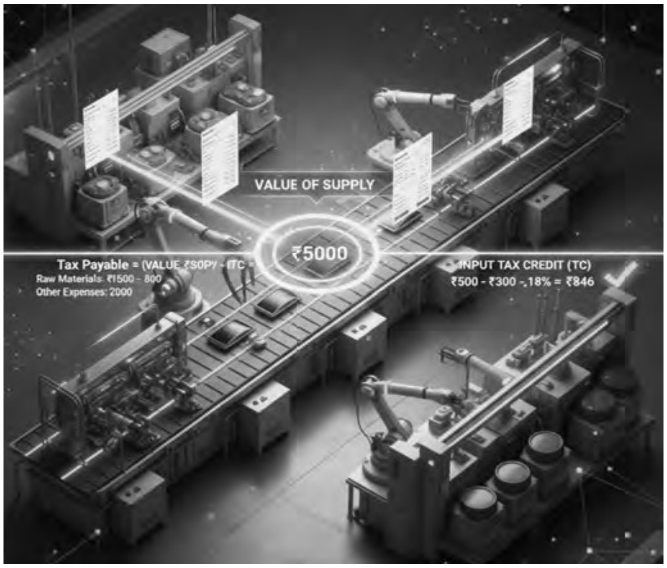
8 Entry no. 437 of the Notification no. 1/2017 – Central tax (Rate) read with Entry 38 of the Notification No. 11/2017 – Central tax (Rate)

9 2022 (5) TMI 397 – Gujarat High Court

10 2024 (10) TMI 1697 – Supreme Court

11 WP 26470/2025, Karnataka High Court

12 State of Kerala v. Builders Association of India [(1997) 2 SCC 183].



are particularly misaligned. The development of immovable property, whether factories, office premises, or warehouses, is an essential economic activity for most enterprises. Denying credit for goods and services used in such construction introduces a cascading tax burden, distorting the supply chain. But for the explicit restrictions introduced in the law to restrict such credits, the nexus of such procurements with taxable outward supplies is well established in several judicial precedents[13]. Considering that such transactions are treated as capital in nature, ITC could be provided over a reasonable period of time. But altogether denial of ITC on the same seems unjustifiable.

The events from the Supreme Court's expansive interpretation of "plant or machinery" in Commissioner of *CGST v. Safari Retreats Pvt. Ltd*.[14] to the subsequent retrospective amendment to nullify the effect of that ruling illustrates only one dimension of the evolving ITC landscape and its potential to create uncertainty for investors. The broader policy concern lies in the legislative inclination to curtail credit on high-value transactions like these, potentially prioritizing short-term revenue considerations over the foundational GST principle of seamless credit flow.

ITC on insurance benefits granted to employees

Section 17(5)(b) of the CGST Act *inter-alia* restricts ITC on life insurance and health insurance policies. Notably, this blocked credit entry seeks to treat insurance benefits at par with beauty treatments, club memberships, renting of vehicles, etc., which are categories generally associated with personal consumption or non-business expenditure.

The revised GST rate structure unveiled with GST 2.0 has provided exemption from GST to all individual life and health insurance policies where the *insured is not a group*[15]. In contrast, group insurance policies typically procured by corporations as part of employee welfare programs fall outside the scope of this exemption. The underlying reasoning appears to be that such group policies are used by businesses in the course of their operations and therefore should remain taxable.

On one hand, ITC on group insurance is denied on the premise that it constitutes personal or non-business expenditure. On the other hand, these very policies are excluded from the exemption applicable to individual insurance on the assumption that they serve a business purpose. This divergent treatment of a fundamental employee welfare measure like insurance raises questions about the internal coherence of the GST framework and warrants a reconsideration of the policy rationale.

Lower rate of GST with no ITC

The enabling ITC provisions of Sections 16 and 17 of the CGST Act grant entitlement of

13 *CCE, Visakhapatnam II v. Sai Samhita Storages Pvt. Ltd. [2011 (270) ELT 33 (AP)], Navratan S.G. Highway Properties Pvt. Ltd. v. Commissioner of Service Tax, Ahmedabad [2012 (28) STR 166 (Tri.-Ahmd.)], Intime properties Ltd. v. CCE [2023 (11) TMI 892 – CESTAT Hyderabad].*

14 *2024 (10) TMI 286 – Supreme Court.*

15 *Entries 36C and 36D of Notification no. 12/2017 – Central tax (Rate) inserted vide the Notification no. 16/2025 – Central tax (Rate).*

ITC on supplies which are used or intended to be used in the course of business of making taxable outward supplies. Thus, fundamentally, the provisions of the CGST Act do not seem to envisage a scenario where a supply is charged to GST, and yet, ITC is not granted at all.

However, as the law has evolved, several categories of supplies have been notified for a lower rate of GST with a condition to not avail ITC, either as an optional scheme or as a mandatory rate structure. With the roll-out of GST 2.0, the list has been further expanded by prescribing no-ITC lower GST rates for supplies such as restaurant services, hotel accommodation, etc.

The enabling ITC provisions of Sections 16 and 17 of the CGST Act grant entitlement of ITC on supplies which are used or intended to be used in the course of business of making taxable outward supplies.

This approach implies deliberate denial of ITC to several industry sectors as a whole and thus, seems like going back to the pre-GST era of cascading effect of taxes. As long as a rate of GST is prescribed for outward supplies, denial of GST merely due to a reduced rate is unjustified.

Fungibility of ITC

Widely canvassed as one nation one tax, the dual GST structure of India has created three taxes in the form of CGST, SGST and IGST to align with the federal Constitutional structure of India. With a robust IT infrastructure in place, inter-State fungibility of credit pools of CGST and IGST is a measure that is practical as well as hugely beneficial for the industry. As the GST law in India matures, structural improvements like these could go a long way.

Similar to this, fungibility of SGST ITC with CGST could also be implemented as the next step. With the settlement mechanism between the Center and the States already in place, such a measure would only be an extension of the current set-off mechanism, where SGST credits are eligible for utilization against IGST and vice-versa.

The next round of reforms in the Indian GST law ought to address such structural issues and improvements.

Administrative implementation

The administrative implementation of the ITC mechanism under the CGST Act has been inconsistent and at the discretion of each jurisdictional officer. In several cases, it has been left to the assessee to prove their claim of self-assessment ITC and submit repeated reconciliation statements. Issuance of show cause notices demanding substantial amounts of ITC claims merely on the allegation of possible mismatch or potential contraventions is not uncommon.

Despite several High Court decisions[16] stressing that in case of a mismatch of ITC or non-payment by the supplier, automatic demand or ITC reversal cannot be sought from the recipient availing ITC, these issues continue to persist for many taxpayers.

Conclusion

The valuation and ITC-related provisions under the GST law seem to be a mixed bag. While significant strides have been made in certain areas, a lot still remains to be done. The rising disputes on ITC are clearly indicative of the gap between the intent vis-à-vis its implementation. We have come a long way from the era of Sales tax, Modvat, and CENVAT. However, the Government still has "promises to keep" and definitely, "Miles to go before I (we) sleep".

16 *D.Y. Beathel Enterprises v. State Tax Officer [2021 (3) TMI 1020 – Madras High Court], Suncraft Energy Pvt. Ltd. v. Assistant Commissioner of SGST [2023 (8) TMI 174 – Calcutta High Court], RT Infotech v. Additional Commissioner [2025 (6) TMI 116 – Allahabad High Court].*