



**TAXIENT
INSIGHTS**

Week 1 & 2 of January 2026

January 22, 2026

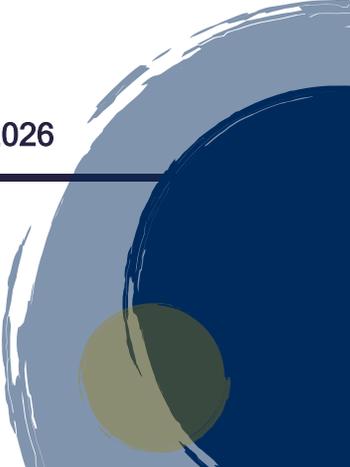


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1. WRIT PETITIONS

1.1. ITC cannot be denied to a bona fide purchaser for supplier default

The Petitioner challenged the constitutional validity of Section 16(2)(aa) of the Central Goods and Services Tax Act, 2017 ('CGST Act') and Assam Goods and Services Tax Act, 2017. The primary legal question before the Gauhati High Court was:

"Whether the condition imposed under Section 16(2)(aa) of the CGST Act and AGST Act, which makes the availability of ITC to a recipient contingent on the supplier's compliance in furnishing invoice details in GSTR-1, is arbitrary, unconstitutional, and places an impossible burden on the purchasing dealer."

The Court observed that Section 16(2)(aa) imposes an unreasonable and impractical burden on the purchasing dealer. Since the GST framework does not provide any mechanism for a purchaser to ensure a supplier's compliance, denial of ITC for reasons beyond the purchaser's control is arbitrary. The Court also noted that denying ITC to a bona fide purchaser for a supplier's default effectively shifts the incidence of tax from the supplier to the buyer. This contradicts the core GST objective of avoiding cascading taxes and taxing only the 'value additions' at each stage of the supply chain.

The Court acknowledged the provision's laudable objective to curb fraudulent ITC claims and enhance supplier compliance. However, it simultaneously recognized the provision's iniquitous effect on honest taxpayers, who are penalized for the defaults of others. Considering these aspects, the Court did not strike down the provision as unconstitutional but held that Section 16(2)(aa) must be read down. Accordingly, before denying ITC to a bona fide purchaser on account of a supplier's default, the purchaser must be given an opportunity to establish their bona fides through tax invoices and other supporting documents. This reading down is to remain in effect until the CBIC introduces a practical solution. Accordingly, the petition was disposed of with the above directive, providing substantial relief to the assessee.

[Mcleod Russel India Limited v. Union of India & Ors., 2025-VIL-1262-GAU]

In another ruling, the Petitioner was denied ITC amounting to ₹1,11,60,830/-. The denial was predicated on the grounds that their supplier collected the GST but failed to deposit it with the government, thereby contravening the condition stipulated in Section 16(2)(c). The primary legal question before the Court was:

"Whether Section 16(2)(c) of the CGST Act, which makes ITC availment conditional on the supplier having actually paid the tax to the government, is constitutionally valid and whether it can be invoked to penalize a bona fide purchaser for the default of a selling dealer."

The Court observed that Section 16(2)(c) places an impossible and onerous burden on a bona fide purchasing dealer. A purchaser has no statutory mechanism to ensure their seller's

compliance and cannot be expected to guarantee that the supplier will deposit the collected tax. To deny credit in such a scenario is deemed arbitrary and unreasonable. The Court consciously diverged from the contrary views taken by several other High Courts. It reasoned that those judgments had failed to consider the Supreme Court's implicit approval of the Delhi High Court's pro-assessee view in the cases of **Commissioner of Trade and Tax Delhi v. M/s Arise India Ltd., 2018-VIL-01-SC** and **M/s Shanti Kiran India (P) Ltd v. The Commissioner Trade and Tax, Delhi, 2013-VIL-04-DEL**. Those cases, dealing with a similar provision under the erstwhile VAT regime, established that a purchasing dealer cannot be penalized for a seller's default. The Court also placed significant weight on the fact that the department had invoked Section 73 (for tax not paid for reasons other than fraud) against the Petitioner, not Section 74 (which deals with fraud or wilful misstatement). This implicitly confirmed the department's own acceptance of the bona fide nature of the transaction.

Basis above, the Court held that while Section 16(2)(c) is not unconstitutional, it must be read down to apply only to transactions that are not bona fide. The order denying ITC to the Petitioner was set aside.

[M/s Sahil Enterprises v. Union of India & Ors., 2026-VIL-15-TRI]

Taxient Comments: The central theme emerging from both the Gauhati and Tripura High Court rulings is the establishment of the 'bona fide purchaser' defense. The judiciary is drawing a clear line between legitimate businesses acting in good faith and fraudulent actors engaged in tax evasion. These rulings provide a strong legal basis to challenge any notice or order from tax authorities that seeks to deny ITC solely on the grounds of supplier non-compliance (i.e., failure to report in GSTR-1 or failure to deposit tax). If taxpayer has fulfilled all its obligations and can demonstrate the bona fide nature of the transaction, such a denial is now highly contestable.

Having stated above, it is also important to maintain a realistic perspective. Despite these favorable rulings, the tax department may continue to litigate this issue. It is a known fact that several other High Courts have previously taken a stricter, pro-revenue stance, including those in Kerala, Patna, Madhya Pradesh, Madras, and Andhra Pradesh. Therefore, these rulings provide significant immediate relief. They also form a strong basis for litigation. However, a definitive nationwide resolution is still required. This resolution will likely require one of two measures. The first is a conclusive judgment of the Supreme Court on these specific provisions. The second is a clarificatory amendment or Circular issued by the CBIC that aligns with the principle of protecting bona fide taxpayers.

1.2. Merely uploading notice/order on portal is not 'Communication'

A batch of Petitioners challenged adjudication orders, arguing they were passed ex-parte. Their core grievance was that the underlying SCNs and the final orders were not physically served on them but were only uploaded to the GSTN Common Portal. This resulted in the assesseees being unaware of the proceedings and the final orders, consequently losing their statutory right to file an appeal within the prescribed limitation period.

The High Court drew a critical distinction between permissible modes of service and the 'deeming fiction' of service. The Court clarified that while electronic service via portal upload [Section 169(1)(d)] or email [Section 169(1)(c)] is legally permitted, the law does not create a 'deemed service' for these modes. This legal fiction, which establishes constructive service, is explicitly limited by Section 169(2) and (3) to physical modes like personal tendering [clause (a)], registered post [clause (b)], publication [clause (e)], and affixation [clause (f)].

Furthermore, the Court interpreted the word 'communicated' in Section 107 which governs the appeal limitation period as requiring a higher standard than mere upload or receipt. Communication necessitates that the assessee has actual or constructive knowledge of the contents of the order. This standard is not met by simply making an order available on a portal, especially when, as the GSTN itself admitted, there is no technical mechanism to track if or when a taxpayer has viewed or downloaded the document. Consequently, the Court set aside the individual adjudication orders and remitted the matters for fresh consideration, conditional upon the petitioners depositing 10% of the disputed tax demand.

[M/s Bambino Agro Industries Ltd. v. State of UP & Another, 2025-VIL-1353-ALH]

Taxient Comments: The Court's observation is correct in recognizing that while electronic service through portal upload is legally permissible, but it cannot be equated with deemed service. This distinction assumes particular importance when examined in light of the term 'communicated' as employed in Section 107. Unless constructive knowledge of the notice or order can reasonably be attributed to the taxpayer, effective access to statutory remedies and fair adjudication stand compromised. Treating mere portal upload as conclusive service, without ensuring actual or constructive communication, risks undermining the principles of natural justice. Significantly, this ruling serves as a vital tool for taxpayers whose appeals have been rejected as time barred solely on the ground that the limitation period was computed from the date of portal upload.

1.3. Uploading notices/order under 'Additional Notices/Orders' tab is not valid service

The Petitioner challenged the adjudication order arising from a demand-cum-show cause notice issued to the Petitioner for an alleged discrepancy between its GSTR-3B returns and E-Way Bill reports. Importantly, both this notice and the subsequent ex parte adjudication order were uploaded to the GST portal under the 'Additional Notices/Orders' tab. The Petitioner contended that they were unaware of this tab and, as a result, missed the communications entirely. This prevented their participation in the proceedings, and they only learned of the adverse order upon being informed by the authority's office, by which time their statutory rights had been extinguished.

The Court held that uploading notices under the less accessible 'Additional Notices/Orders' tab does not constitute sufficient or valid service in accordance with the law. The failure of proper

service was deemed a flagrant violation of the principles of natural justice, as the Petitioner was denied a reasonable opportunity to be heard. The Court further found that a subsequent order rejecting the Petitioner's rectification application under Section 161 was arbitrary and unreasoned. Finding both the initial service and the subsequent rectification rejection to be legally untenable, the Court set aside both the ex parte order and the rectification rejection order, remanding the matter to the State Tax Officer for a fresh hearing.

[Jindal Steel Limited v. Comm. of CT and GST, 2026-VIL-33-ORI]

Taxient Comments: The High Courts have consistently been remanding matters on the ground of non-service, taking a uniform view that mere uploading of an order on the portal, particularly in a less accessible tab, does not constitute valid service. These rulings are favorable to taxpayers who were deprived of an opportunity to present their case due to non-communication of notices or orders, as they restore the right to a fair adjudication before the authority.

1.4. Non applicability of GST on transfer of leasehold rights

The Petitioner assigned its leasehold rights to a third party. The Assistant Commissioner of CGST issued a SCN demanding GST on such transfer of leasehold rights. The Revenue contended this transfer was a 'supply of services' under Section 7(1) of the CGST Act, 2017. In response, the Petitioner challenged the validity of this SCN.

The Court held that the assignment of leasehold rights does not constitute a taxable supply of services under the GST Act. The Court placed significant reliance on the Gujarat High Court's earlier judgment in **Gujarat Chamber of Commerce and Industry vs. Union of India, 2025-VIL-21-GUJ**. In that case, the Gujarat High Court examined an identical issue and concluded that assigning leasehold rights is a transfer of 'benefits arising out of 'immovable property' and, as such, is not subject to GST. The Court also noted that the transaction was a transfer of 'benefits arising out of an immovable property,' which by its very nature had 'no nexus whatsoever with the business of the Petitioner company.' Because the transaction was not connected to the company's core business activities, it failed the essential test of being a supply 'in the course or furtherance of business' as required by Section 7(1) of the CGST Act. Basis this, the Court allowed the writ petition, quashing and setting aside the SCN.

[Aerocom Cushions Private Limited v. AC (Anti-Evasion), 2026-VIL-36-BOM]

Taxient Comments: This decision highlights the critical importance of the phrase '*in the course or furtherance of business*' within the definition of supply. It reinforces that not every transaction undertaken by a corporate entity is automatically liable to GST, rather, the nature of the transaction and its nexus with the entity's core business activities are determinative. Notably, since the introduction of GST, this phrase was widely perceived as having a broad scope, covering almost all business transactions, marking a departure from the erstwhile regime where disputes often arose over whether a transaction was '*used in manufacture*' for credit eligibility. It

was therefore assumed that such controversies would no longer arise under GST. However, this ruling has effectively revived that debate, requiring businesses once again to assess whether a transaction genuinely relates to their core business to satisfy the test of being *'in the course or furtherance of business.'*

2. CESTAT RULINGS

2.1. CESTAT upholds the test for classification of goods as 'Parts' or 'Accessories'

The Revenue - Appellant filed appeal before the CESTAT disputing the correct classification of imported goods described as 'Actuator Assy. Clutch' and 'Tube Connector Assy.-Clutch'. The Revenue - Appellant argued the components were essential part to the 'Intelligent Manual Transmission clutch system,' while the Assessee - Respondent contended they were 'accessories to the clutch assembly system' and not parts of the clutch itself.

The CESTAT revisited the foundational principles laid down by the Supreme Court for distinguishing between 'parts' and 'accessories.' It relied on the decision in **Saraswati Sugar Mills v. Commissioner of Central Excise, Delhi (2011-VIL-06-SC-CE)**, wherein a 'part' was defined as an integral component essential to the constitution of the final article, without which the article would be incomplete. The CESTAT also referred to **Pragati Silicons Pvt. Ltd. v. Commissioner of Central Excise, Delhi (2007-VIL-50-SC-CE)**, which held that an 'accessory' is supplementary or subordinate in nature and is not required to be essential for the actual functioning of the product.

The CESTAT further noted that the tariff schedule itself makes a conscious distinction by expressly including the term 'accessories' under tariff item 8708 7000, whereas tariff item 8708 9300 is restricted only to 'parts.' Applying these principles, the CESTAT held that the Actuator and Tube Connector were not integral to the basic functioning of the clutch. Rather, they merely enhance its operation by reducing the effort required by the driver while shifting gears. Hence, qualify as accessories.

[Comm. of Customs vs. Hyundai Transys India Pvt. Ltd., 2026-VIL-64-CESTATE-CHE-CU]

In another case, the Appellant filed an appeal before the CESTAT against the order-in-original denying the exemption applicable to the goods imported by the Appellant, on the ground that fire extinguishers and their parts are not considered to be parts of aircraft.

The CESTAT allowed the appeal by way of remand, directing the Revenue to reconsider the case in light of new evidence presented by the Appellant. It placed significant reliance on the Ministry of Defence declarations, which certified that the fire extinguishers were mandatory aircraft components essential for flight safety certification. The CESTAT also affirmed the principle that a component specifically designed for, exclusively used in, and functionally integral to a larger machine should be considered a 'part'.

[PC of Customs vs. HAL Transport Aircraft Division, 2026-VIL-75-CESTATE-DEL-CU]

Taxient Comments: While these CESTAT decisions are not binding precedent, but they provide a clear roadmap of current judicial methodology on the 'parts vs. accessories' debate. They establish a dual-pronged test for taxpayers to consider, a textual test derived from the Hyundai

ruling, focusing on the precise wording of the tariff, and a functional test from the HAL case, focusing on an item's necessity, integration, and certification.

Based on these rulings, taxpayer should assess the classification of their goods against the following checklist to build a resilient and defensible position:

- **Textual analysis:** Does the specific tariff heading for the primary good explicitly include the word 'accessories' or 'systems'? As seen in the Hyundai case, the absence of these terms is a strong indicator that accessories and system components are excluded from being classified as 'parts'.
- **Functional necessity:** Is the item integral and necessary for the primary good to be considered complete and to perform its core function? Or is it supplementary, enhancing performance, automating a manual process, or adding convenience?
- **Mandatory requirement:** Is the item a mandatory pre-requisite for the final product to receive essential legal, safety, or operational certification (e.g., a flight safety certificate)? A 'yes' answer strongly supports classification as a 'part'.
- **Specific design & exclusive use:** Can taxpayer provide documentation (e.g., engineering drawings, technical specifications) proving the item is specifically designed for and is exclusively used with the primary good, having no practical standalone utility?

3. OTHER STATUTORY & REGULATORY UPDATES

3.1. Recent changes in tax rates for the Tobacco and Pan Masala sector

Increase in GST rates

- Pursuant to the recommendations of the 56th GST Council Meeting to place pan masala, gutkha, cigarettes, and chewing tobacco products including zarda, unmanufactured tobacco, and bidis under the highest GST slab, the Government has issued **Notification No. 19/2025 - Integrated Tax (Rate)** dated **December 31, 2025**. This notification inserts new entries in Schedule II (18%) for bidis and Schedule III (40%) for all other specified products under the principal rate notification, i.e., **Notification No. 9/2025 - Integrated Tax (Rate)** dated **September 17, 2025**.
- Accordingly, pan masala, gutkha, cigarettes, and chewing tobacco products will attract GST at the rate of 40% with effect from February 1, 2026.

Change in valuation framework

- Simultaneously, the Government has overhauled the valuation framework applicable to specified tobacco products for GST purposes. Section 15(5) of the CGST Act, 2017 empowers the Government to notify special categories of supplies in respect of which distinct valuation rules may be prescribed.
- In exercise of this power, **Notification No. 19/2025 - Central Tax** dated **December 31, 2025** has been issued to notify pan masala, gutkha, cigarettes, and chewing tobacco as specified goods subject to a special valuation mechanism. Further, **Notification No. 20/2025 - Central Tax** dated **December 31, 2025** has inserted Rule 31D in the CGST Rules, 2017, prescribing the valuation methodology for such products.
- Under Rule 31D, the value of supply of the notified products is linked to the Retail Sale Price (RSP) declared on the package. Where the RSP is inclusive of all applicable taxes, the tax component is required to be computed using the following formula:

$$\text{Tax amount} = (\text{Retail sale price} * \text{tax rate in \% of applicable taxes}) / (100 + \text{sum of applicable tax rate})$$

Abolishment of Compensation Cess

- In line with the stated policy objective of phasing out the GST Compensation Cess, the Government has amended **Notification No. 1/2017 - Compensation Cess (Rate)** dated **June 28, 2017** to prescribe a 'Nil' rate of Compensation Cess for all remaining goods covered under the Compensation Cess rate schedule.
- Consequently, with effect from February 1, 2026, no GST Compensation Cess shall be leviable on supplies of pan masala, gutkha, cigarettes, and chewing tobacco products.

Increase in Excise Duty rate

- To ensure that the overall tax incidence on tobacco products does not reduce consequent to the removal of Compensation Cess, the Central Excise (Amendment) Act, 2025 has been notified vide **Notification No. 3/2025 - Central Excise (N.T.)** dated **December 31, 2025**, effective from February 1, 2026. The amendment introduces higher excise duty rates on cigarettes and other tobacco products, including both smoking and chewing tobacco.
- Additionally, the Government has issued a fresh **Notification No. 3/2025 - Central Excise** dated **December 31, 2025**, superseding the earlier **Notification No. 3/2019 - Central Excise** dated **July 6, 2019**. The new notification prescribes the revised effective rates of excise duty applicable to the sector.

Taxient Comments: From a policy perspective, the recent changes reflect a clear shift in the Government's approach from a multi-levy structure (GST plus Compensation Cess) to a recalibrated dual-tax regime comprising higher GST rates coupled with enhanced excise duty. While the abolition of Compensation Cess appears, on paper, to simplify the indirect tax structure, the simultaneous increase in GST rates to 40% and the upward revision of excise duty ensure that the overall tax incidence on tobacco and pan masala products remains revenue-neutral, if not higher. Accordingly, the changes should be viewed less as a tax relief measure and more as a restructuring of the tax burden across different statutes.

The introduction of RSP linked valuation under Rule 31D marks a significant departure from transaction value based assessment and substantially reduces scope for under valuation disputes. However, it also increases compliance rigidity, particularly for manufacturers and importers, as tax liability is now directly linked to declared retail prices, leaving limited flexibility to respond to market or promotional pricing strategies.

Fate of unutilized Compensation Cess credit

A critical issue arising from these changes is the treatment of unutilized GST Compensation Cess credit lying in the electronic credit ledger of taxpayers operating in the tobacco and pan masala sectors. With the effective abolition of Compensation Cess from February 1, 2026, such credit becomes functionally redundant, as there is no corresponding output Cess liability against which it can be utilized.

Under the existing statutory framework, Compensation Cess credit is a restricted credit and cannot be cross utilized against GST or excise duty liabilities. Further, there is no explicit provision under the CGST Act, Compensation Cess Act, or the relevant notifications permitting either refund or migration of such accumulated Cess credit upon withdrawal of the levy. In the absence of a specific enabling provision, the Cess credit is likely to lapse, resulting in a potential financial write-off for taxpayers.

This raises a legitimate equity concern, particularly for compliant taxpayers who accumulated Cess credit in the ordinary course of business and had a reasonable expectation of future utilisation. Historically, Courts have taken a cautious view on lapsing of validly earned credits, especially where such lapsing occurs due to a policy change rather than taxpayer conduct. Accordingly, constitutional challenges on grounds of arbitrariness and violation of vested rights cannot be ruled out, unless the Government issues a clarificatory mechanism for refund or transition.

3.2. Health Security se National Security (HSNS) Cess w.e.f. February 1, 2026

- The Government of India has introduced the **Health Security and National Security (HSNS) Cess Act, 2025**, along with the related Rules, to levy a new cess (HSNS Cess) on manufacturers of Pan Masala (Tariff Item 2106 90 20) based on their manufacturing capacity. This legislation marks a significant departure from traditional taxation by instituting a capacity-based levy on the manufacturing of specific goods. Refer our earlier detailed update [‘Understanding the Health Security se National Security \(HSNS\) Cess Act, 2025: A Compliance Guide’](#) to know more about this change.

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