



Whether ITC is required to be reversal on Normal Process Loss: A Practical and Legal Analysis

1. Introduction

In manufacturing and job-work operations, a certain percentage of **process loss** is **inevitable**. Industries like textiles, metals, chemicals, plastics, paper, edible oil, and pharmaceuticals routinely experience **normal loss** due to evaporation, shrinkage, handling, cutting, heat, and chemical reactions.

However, GST authorities often question such losses and demand **Input Tax Credit (ITC) reversal** by invoking **Section 17(5)(h)** of the CGST Act, which restricts ITC on “**goods lost, stolen, destroyed, written off or disposed of by way of gift or free samples.**”

This raises an important question: Does normal manufacturing or job-work process loss amount to “goods lost” requiring ITC reversal?

This article analyses the legal position using industry practices, judicial precedents under both the erstwhile Central Excise regime and the current GST regime, and discusses the landmark judgment judgment by Hon'ble Madras High Court in *ARS Steel & Alloy International Pvt. Ltd. v. the State Tax Officer*

2. Understanding Process Loss: The Textile Industry Example

Consider a typical textile manufacturing scenario:

- A principal sends **1,000 meters** of grey fabric to a job worker for various processes (bleaching, dyeing, washing, calendaring).
- After processing, only **970–980 meters** of finished fabric is returned.



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- **2–3% shrinkage or loss** is natural due to:
 - washing,
 - bleaching chemicals,
 - heat & pressure,
 - cutting & sizing.

The finished fabric is sold in the market **after considering this normal loss**. This is not an **abnormal loss**, nor is the fabric "lost" in the ordinary sense — it is a part of the consumption inherent to the process.

3. Legal Provisions: Section 17(5)(h) of CGST Act

Section 17(5)(h) blocks ITC when goods are:

- **lost, stolen, destroyed, written off**, or
- **disposed of as gifts or free samples.**

Applying the principle of Ejusdem Generis, the term 'lost' appearing alongside 'stolen', 'destroyed' and 'written off' must take colour from the associated expressions and therefore refers to unintended external loss of goods rather than inherent consumption during manufacture



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4. Judicial Precedents Under Central Excise: Strong Support for “Normal Loss”

Under the excise law, the principle was very clear that **Loss inherent in manufacturing or processing does not require reversal of credit.**

Important judgments include:

a. Multimedia Ltd. v. Asst. CCE 57 ELT 209 (SC)

The exact mathematical equation between quantity of raw material purchased and the raw material found in finished goods may not be possible and should not be looked for

b. CCE V/s BOC (India) Ltd.

Loss of input by evaporation during the manufacturing process is to be treated as waste or loss and CENVAT credit on such loss is not required to be reversed

c. Tata Motors v. CCE [2011] 264 ELT 385 (CESTAT)

CENVAT credit is available even if there is a process loss at the place of job worker

d. Hindustan Zinc Ltd. (Rajasthan High Court)

CENVAT credit cannot be denied on inputs lost during the manufacturing process, as loss is inevitable. Process loss is part of manufacturing and not the same as “goods lost.”

Summary of Excise Jurisprudence:

Normal, expected, and technically unavoidable losses **never attracted reversal of credit.**



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5. GST Judicial Interpretation: Continuation of Earlier Principles

In ARS Steel & Alloy International Pvt. Ltd. v. State Tax Officer, the Hon'ble Madras High Court dealt with the issue of whether Input Tax Credit (ITC) is liable to be reversed on normal process loss arising during the manufacture of TMT bars.

The department contended that the quantity of inputs not physically contained in the finished goods amounted to "goods lost" within the meaning of Section 17(5)(h) of the CGST Act.

Rejecting this contention, the Court held that normal process loss occurring due to inherent manufacturing and technical reasons cannot be equated with "goods lost", as the inputs are consumed in the course of manufacture and there is no separate disposal, destruction, or disappearance of goods.

The Court further observed that the principles evolved under the erstwhile CENVAT regime continue to hold relevance under GST and that ITC cannot be denied on normal and unavoidable process loss unless the department establishes abnormal loss involving diversion, theft, suppression, or other irregularities.

6. Arguments Against ITC Reversal (In Favour of Assessee)

Technical Arguments

- **Inevitable Loss:** Consumption due to process is not "loss"; it is a technical necessity.
- **No External Loss:** Section 17(5)(h) covers situations where goods are lost independent of the manufacturing process.
- **Final Output is Taxable:** The entire output is taxed; therefore, credit on inputs (whether consumed fully or partly) must be allowed.
- **Matching Principle:** Input consumed = Output production → ITC intended to avoid cascading.



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Legal Arguments

- Numerous excise judgments treat such loss as part of manufacture.
- ARS Steel clearly interprets Section 17(5)(h) in favour of taxpayer.
- Input tax credit, once validly accrued, is a substantive and vested right and can be denied only by clear statutory restriction.

7. Arguments For ITC Reversal (In Favour of Department)

Technical Arguments

- Department argue that **any quantity not present in the final product** is "lost".
- They rely on literal reading of "goods lost" to include invisible or invisible consumption.

Legal Arguments

- No specific rule under GST defines acceptable or normal loss limits.
- Officers sometimes treat process wastage as disappearance and invoke 17(5)(h).

However, these arguments are generally weaker because they ignore industrial realities and judicial precedents.



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8. Practical Guidance for Industry & Consultants

Businesses should maintain the following records:

- **Process sheets or job-work yield norms** (industry-wise norms exist).
- **Input vs. Output reconciliation statements.**
- **Technical justification from production department.**
- **Past accepted departmental assessments.**
- **Independent third-party validation (if required).**

Good documentation significantly strengthens the case during audits.

9. Conclusion

Normal process loss is an **inherent part of manufacturing** across industries, including textiles, steel, chemicals, and others. Judicial precedents under both Central Excise and GST regimes strongly support that:

The Provision of Section 17(5)(h) has to be read by applying the principal of Ejusdem Generis wherein the term 'lost' appearing alongside 'stolen', 'destroyed' and 'written off' must take colour from the associated expressions and therefore refers to unintended external loss of goods rather than inherent consumption during manufacture

Input Tax Credit (ITC) should not be reversed on normal process loss.

The Madras High Court judgment in **ARS Steel** provides authoritative backing that process loss does not fall under "goods lost" in Section 17(5)(h). While the department may continue raising disputes, taxpayers equipped with strong technical documentation and judicial support have a solid defence.

Warm regards

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