

Whether Seamless Credits Available under GST?



GST, a comprehensive consumption tax regime, was introduced on 1st July, 2017 with the prime objective of integration of multiple indirect tax levies. India imposed GST under extant regime and for removal of their cascading effect. Imposition of 'GST' as a destination based tax on value addition has consolidated India into a single market. This would then lead to development of an efficient and harmonised consumption tax system in the country. Having said so, in order to achieve this task of fiscal consolidation, it is imperative that the GST regime ensures seamless flow of credits across the supply chain i.e. establishment of a continuous chain of set-off from the originating manufacturer's point and/or services provider's point up to the final retailers level. If GST regime is a machine to propel momentum of India's growth, then devising a seamless credit mechanism is certainly its fuel. Read on to know more...

With the above perspective in mind, discussed below are the provisions of the Input Tax Credit ('ITC') under the GST Act implemented on 1st July, 2017,

its advantages, and key issues emanating from such provisions.

I. Model of Seamless Credits

Under the extant indirect tax regime, non-fungibility of ITC often results into tax cascading. Manufacturers were not eligible for input Central Sales Tax ('CST') credit. Service providers were not eligible for input Value Added Tax ('VAT') credit and credit on Special Additional Duty ('SAD') paid on imports. Traders were not eligible for credit of



**CA. Virender Chauhan
and CA. Sonam Chauhan**

(The authors are members of the Institute who may be reached at vkc.smile@gmail.com.)

input excise duty and service tax, input CST credit and credit of Countervailing Duty ('CVD') paid on imports. All these restrictive tax credits resulted into higher pricing of goods and services with burden being shifted on the final consumer.

The basic architecture of GST is such that it would generate a continuous chain of set-offs with no breaks, hence, complete elimination of tax cascading effect. Input Integrated GST ('IGST') is creditable against output IGST, Central GST ('CGST') and State GST ('SGST') liability respectively. Input CGST is creditable against output CGST and IGST liability. Input SGST is creditable against output SGST and IGST liability.

Important definitions

- (a) **Input Tax** [Section 2(62)] means the Central tax, State tax, Integrated tax or Union territory tax charged on any supply of goods or services or both made to him and includes the integrated tax charged on import of goods and tax payable on reverse charge basis under the CGST, SGST/ UTGST and IGST Act but does not include the tax paid under composition levy.
- (b) **Input tax credit** [Section 2(63)] means the credit of input tax.
- (c) **Input** [Section 2(59)] means any goods other than capital goods used or intended to be used by a supplier in the course or furtherance of business.
- (d) **Input Service** [Section 2(60)] means any service used or intended to be used by a supplier in the course or furtherance of business.
- (e) **Capital Goods** [Section 2(19)] means goods, the value of which is capitalised in the books of account of the person claiming the input tax credit and which are used or intended to be used in the course or furtherance of business.

II. Provisions governing eligibility of ITC [Section 16 of the CGST Act, 2017]

(i) General Entitlement

Section 16 of the CGST Act provides that every registered person-

- shall be entitled to take ITC charged on any supply of goods or services or both to him;
- which are used/ 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, subject to fulfillment of prescribed conditions and within the time specified

[Section 49 i.e. Payment of tax of the CGST Act, 2017].

Levy	Creditable against [Section 49(5)]
SGST/ UTGST	First SGST/ UTGST, then IGST
CGST	First CGST, then IGST
IGST	First IGST, second CGST, then SGST/ UTGST

CGST cannot be used against SGST or vice versa.

Certain persons not eligible to take ITC are non-registered taxable person, supplier under composition scheme or those exclusively engaged in making exempt or non-taxable supplies, agriculturist and government or any local authority making specified supplies.

(ii) Entitlement of ITC– Satisfaction of cumulative conditions

Further, Section 16(2) beginning with a non-obstante clause over-riding the general entitlement of ITC provides that no registered taxable person shall be entitled to ITC in respect of any supply of goods and/or services to him unless:

- (a) he is in possession of a tax invoice issued by supplier of goods or services or debit note or an invoice issued by the registered supplier of goods or services to an unregistered dealer or an ISD invoice or bill of entry ;
- (b) he has received the goods and/or services. An explanation to Section 16(2)(b) of the CGST Act creates a deeming fiction where the goods are delivered by the supplier to a recipient or any other person on the direction of such taxable 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, that such goods have been received by such taxable person. This provision is of significance in case of Bill to-Ship to model;
- (c) subject to the provisions of Section 41 (Provisional acceptance of ITC), tax charged in respect of such supply has actually been paid to the account of the appropriate Government, either in cash or through utilisation of ITC admissible in respect of the said supply; and
- (d) he has furnished the return under Section 39.

A combined reading of the above provisions indicates that once an eligible ITC is availed by the registered person on self-assessment basis in the return, the same would stand credited to his electronic credit ledger maintained at the common GST portal.

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(iii) Entitlement of ITC—Other miscellaneous provisions

- (a) **Goods received in lots:** In case the goods against an invoice are received in lots or instalments, the registered taxable person shall be entitled to take ITC upon receipt of the last lot or installment.
- (b) **Failure to pay value of supply:** The second proviso to Section 16(2) read with Rule 37 says that where a recipient fails to pay to the supplier of goods or services or both, other than the supplies on which tax is payable on reverse charge basis, the amount towards the value of supply along with tax payable thereon within a period of 180 days from the date of issue of invoice by the supplier, an amount equal to the input tax credit availed by the recipient shall be added to his output tax liability in the month immediately following the said period from the date of issue of invoice, along with interest thereon, by furnishing details of such supply, the amount of value not paid and the amount of input tax credit availed of proportionate to such amount not paid to the supplier in Form GSTR-2 for the month immediately following the period of 180 days from the date of issue of the invoice.

However, the third proviso to Section 16(2) says that the recipient shall be entitled to avail of the credit of input tax on payment made by him of the amount towards the value of supply of goods or services or both along with tax payable thereon.

Proviso to Rule 37 says that the value of supplies made without consideration as specified in Schedule I of the said Act shall be deemed to have been paid for the purposes of the second proviso to Section 16(2).

Further, as per Rule 37(3), the interest on such tax shall be liable to be paid at the rate notified vide N/No. 13/2017-Central Tax dt. 28-Jun-17 at the rate of 18% for the period starting from the date of availing credit on such supplies till the date of payment of output tax liability added.

Illustration I: ABC Ltd., a registered firm, has purchased certain input goods of ₹1,00,000/- (excluding tax applicable @ 18%) on 15th July, 2017 and claimed ITC accordingly while filing the return for the month. Payment of such input goods purchased is not made upto 11th January, 2018 (i.e. 180 days from the date of issue of invoice).

Now, as per second proviso to Section 16(2), an amount equal to ITC on such input goods i.e. ₹18,000/- ($\text{₹}1,00,000 \times 18\%$) shall be added to the output tax liability, along with interest, while filing the return for the month of February.

Illustration II: If in Illustration I, ABC Ltd. pays the full amount i.e. ₹1,18,000/- to the supplier on 15th February, 2018, then what will be the situation?

As per third proviso to Section 16(2), ABC Ltd. shall be entitled to avail the input tax credit of ₹18,000/- while filing the return for the month of February.

- (c) **No ITC if depreciation charged on tax component:** In case the registered taxable person has claimed depreciation on the tax component of the cost of capital goods under the provisions of the Income-tax Act, 1961, the ITC shall not be allowed on the said tax component.

(iv) Time limit for claim of ITC

A registered person shall not be entitled to take ITC

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in respect of any invoice or debit note for supply of goods or services or both after:

- due date of furnishing of the return [Section 39] for the month of September following the end of FY to which such invoice or invoice relating to such debit note pertains; or
- furnishing of the relevant annual return, whichever is earlier.

Key issues:

- That the definition of "Capital goods" as contained in Section 2(19)-CGST Act, 2017 contains words and letters "value" and "capitalised". These two words may create interpretational issues and may require further clarification.
- On perusal of the above cumulative conditions and applicable provisions of GST Act, it may be noted that one of the conditions prescribed would require confirmation of payment of GST liability as well as filing of valid return by the supplier of input goods/services. Hence, claim of ITC being an indefeasible right of an assessee [Apex Court judgement of *Dai Ichi Karkaria Ltd (112 ELT 353)*] will stand overruled no more holds true. This may pose a very big practical challenge and may impair ability to avail legitimate ITCs.
- A registered person is liable to pay tax on advances. However, no input tax credit will be available on such payment as all the requisite conditions for avialment of input tax credit is not being fulfilled.
- The condition contained in Section 16(2) restricting ITC in the hands of the recipient unless tax is paid by the supplier may go against the jurisprudence as contained in [*CCE vs. Kay Kay Industries (2013) 42 GST 50 (SC)*].

III. Apportionment of ITC and blocked credits [Section 17 of CGST Act, 2017]

(i) ITC restricted to supplies for business purposes

ITC may be claimed by a registered person only when the goods or services or both are used for the purposes of business. ITC attributable to purposes other than business shall not be allowed. Where the goods or services or both are used by the registered person partly for the purpose of any business and partly for other purposes, the amount of credit shall be restricted to so much of the input tax as is attributable to the purposes of his business.

Rule 43 provides apportionment method in respect of capital goods where the useful life of capital good shall be taken as 5 years from the date of invoice.

The credit is attributed to the purposes of business as per the manner prescribed in Rule 42 and Rule 43 of Chapter V of the CGST Rules, 2017.

(ii) ITC restricted to taxable supplies

Further, it has been provided that where the goods or services or both are used by the registered person partly for effecting taxable supplies including zero-rated supplies and partly for effecting exempt supplies , the amount of ITC shall be restricted to so much of the input tax as is attributable to the said taxable supplies including zero-rated supplies.

The value of exempt supply shall be such as may be prescribed, and shall include supplies on which tax is payable on reverse charge basis, transactions in securities, sale of land, and, subject to paragraph 5(b) of Schedule II, sale of building.

The credit is attributed for effecting taxable supplies as per the manner prescribed in Rule 42 and Rule 43 of Chapter V of the CGST Rules, 2017. Rule 42 of CGST Rules, 2017 enunciates apportionment method where registered person is required to apportion the total ITC of input and input services attributable to exclusively

(a) taxable supplies including zero-rated supplies, exempt supplies for business purposes, and

(b) supplies for purposes other than business.

Then the common ITC of input and input services shall be apportioned into IT C attributable to exempt supplies and taxable supplies, which shall be apportioned by using proportionate method (based on turnover) and 5% of such common ITC shall be considered to be used for non-business purposes. The segregated ITC attributable to exempted supplies and supplies for non-business purposes shall be added to the output tax liability of the said person.

Rule 43 provides apportionment method in respect of capital goods where the useful life of capital good shall be taken as 5 years from the date of invoice.

(iii) ITC –Banking Sector

A specific provision relating to banking sector provides that a banking company or a financial institution including a non-banking financial company, engaged in supplying services by way of accepting deposits, extending loans or advances shall have the option to either comply with the provisions of Section 17(2) of the CGST Act, 2017, or avail of, every month, an amount equal to 50% of the eligible ITC on inputs, capital goods and input services in that month and the rest shall lapse. Such option once exercised shall not be withdrawn during the remaining part of the FY.

The restriction of 50% shall not apply to the tax paid on supplies made by one registered person to another registered person having the same PAN.

The said company or institution shall not avail the credit of tax paid on inputs and input services that are used for non-business purposes and the credit attributable to supplies specified in Section 17(5) (blocked credits), in Form GSTR-2.

(iv) Non-creditable items for the purposes of ITC

The Section 17(5) of the CGST Act, 2017 beginning with a non-obstante clause provides specific exclusions from eligibility of ITC, as listed below:

- (a) Motor vehicles and other conveyances, except when they are used:
 - (i) For making following taxable supplies, namely-
 - (A) Further supply of such vehicles or conveyances, or
 - (B) Transportation of passengers, or
 - (C) Imparting training on driving, flying, navigating such vehicles or conveyances.
 - (ii) For transportation of goods.
- (b) Supply of goods and services, namely:
 - (i) Food and beverages, outdoor catering, beauty treatment, health services, cosmetic and plastic surgery except where such inward supply of goods or services or both of a particular category is used by a registered taxable person for making an outward supply of the same category of goods or services or both, or as an element of taxable composite or mixed supply,

- (ii) Membership of a club, health and fitness centre
- (iii) Rent-a-cab, life insurance, health insurance except where-
 - (A) the Government notifies the services which are obligatory for an employer to provide to its employees under any law for the time being in force, or
 - (B) such inward supply of goods or services or both of a particular category is used by a registered person for making an outward taxable supply of same category of goods or services or both or as a part of a taxable composite or mixed supply, and
 - (iv) Travel benefits extended to employees on vacation such as leave or home travel concession.
- (c) Works contract services when supplied for construction of immovable property, other than plant and machinery, except where it is an input service for further supply of works contract service.
- (d) Goods or services or both received by a taxable person for construction of an immovable property on his own account, other than plant and machinery, even when used in course or furtherance of business.
- (e) Goods or services or both on which tax has been paid under composition scheme [Section 10].
- (f) Goods or services or both received by a non-resident taxable person except on goods imported by him.
- (g) Goods or services or both used for personal consumption.
- (h) Goods lost, stolen, destroyed, written off or disposed of by way of gift or free samples, and
- (i) Any tax paid in terms of following:
 - (i) Tax not paid or short paid or erroneously refunded or ITC wrongly availed or utilised by reasons of fraud or any willful misstatement or suppression of facts [Section 74]
 - (ii) Detention or release of goods and conveyance in transit [Section 129]; or
 - (iii) Confiscation of goods or conveyance and levy of penalty [Section 130].

Key issues:

- Whether services like car insurance, repairs and maintenance of cars etc. availed for motor vehicles, eligible for ITC?
- Whether ITC available in case of use of own vehicles for transportation of goods for mining companies, food companies etc.?
- Whether ITC is allowed when vehicles used for transportation of items other than goods viz. money, securities, petroleum products, alcohol etc.
- Whether ITC is allowed on use of dumpers and tippers by works contractors?
- It may be suggested that credit may be allowed for renting a cab in the course of business.
- Whether assessee would be entitled to ITC of following-
 - Pick and drop facility for employees
 - Food provided to employees
 - Medical or healthcare kit for employees
 - Group insurance for employees
 - Security expenses of staff quarter
 - Insurance of staff quarter
- Whether ITC would be allowed once the confiscated goods [Section 17(5)(i)] are released on payment of tax and then sold after charging output tax?
- The inclusion of RCM turnover in exempt supply may entail double taxation [Section 17(3)]
- Whether ITC is allowed on cab facility provided by a hotel to its guest and whether it can be considered as a transportation service provided to passenger?

IV. Availability of credit in special circumstances [Section 18]***(i) ITC - New Registrants***

A person who has applied for registration under Section 22 within 30 days from the date on which he becomes liable for registration and has been granted such registration, shall, subject to the conditions prescribed in Rule 40, be entitled to take ITC in respect of inputs held in stock and inputs contained in semi-finished or finished goods held in stock on the day immediately preceding the date from which he becomes liable to pay tax. Under the extant indirect tax regime, ITC of pre-registration period was also available. The time limit of 30 days has been clearly introduced to encourage tax compliance.

(ii) ITC - Voluntary Registration

A person who takes voluntary registration shall, subject to the conditions prescribed in Rule 40, be entitled to take ITC in respect of inputs

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(iii) ITC - Conversion of composition taxpayer into regular taxpayer

Where any registered person ceases to pay tax under the composition scheme [Section 10], he shall, subject to the conditions prescribed in Rule 40, be entitled to take ITC in respect of inputs held in stock, and inputs contained in semi-finished or finished goods held in stock and on capital goods on the day immediately preceding the date from which he becomes liable to pay tax under the relevant Act [Section 9]. Further, ITC on capital goods shall be reduced by five percentage points per quarter of a year or part thereof from the date of the invoice or such other documents on which capital goods were received by the taxable person.

(iv) ITC - Conversion of exempt supply into taxable supply

Where an exempt supply of goods or services by a registered person becomes a taxable supply, such person shall, subject to the conditions prescribed in Rule 40, be entitled to take ITC in respect of inputs held in stock and inputs contained in semi-finished or finished goods held in stock relatable to such exempt supply and on capital goods exclusively used for such exempt supply on the day immediately preceding the date from which such supply becomes taxable. The credit on capital goods shall be reduced by 5% points per quarter of a year or part thereof from the date of the invoice or such other documents on which capital goods were received by the taxable person.

(v) Claim of ITC on invoices up to one year

A taxable person shall not be entitled to take ITC

under Section 18(1) of the CGST Act, in respect of any supply of goods or services or both to him after the expiry of one year from the date of issue of tax invoice relating to such supply.

(vi) Transfer of ITC in case of change in constitution of business

Where there is a change in the constitution of a registered person on account of sale, merger, demerger, amalgamation, lease or transfer of the business with the specific provision for transfer of liabilities, the said registered person shall be allowed to transfer ITC that remains unutilised in its books of accounts to such sold, merged, demerged, amalgamated, leased or transferred business in the manner prescribed in Rule 41.

(vii) Regular taxpayer switching to composition taxpayer

Where any registered person who has availed of ITC switches over as a taxable person for paying tax under composition scheme [Section 10] or, where the goods or services or both supplied by him become exempt absolutely, he shall pay an amount, by way of debit in the electronic credit or cash ledger, equivalent to the ITC in respect of inputs held in stock and inputs contained in semi-finished or finished goods held in stock and on capital goods, reduced by such percentage points as may be prescribed in Rule 44, on the day immediately preceding the date of such switch over or, as the case may be, the date of such exemption. Further, after payment of such amount, the balance of ITC, if any, lying in his electronic credit ledger shall lapse.

(viii) Availability of ITC in special circumstances – Other miscellaneous provisions

- Payment on sale of capital goods: In case of supply of capital goods or plant and machinery, on which ITC has been taken, the registered taxable person shall pay an amount equal to the ITC taken on the said capital goods or plant and machinery reduced by five percentage points per quarter of a year or part thereof from the

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date of the invoice or such other documents on which capital goods were received by the taxable person as per Rule 40(2) or the tax on the transaction value of such capital goods or plant and machinery, whichever is higher.

- Tax on supply of scrap of capital goods: Where refractory bricks, moulds and dies, jigs and fixtures are supplied as scrap, the taxable person may pay tax on the transaction value of such goods.

Key issues:

- Law does not provide seamless credit of input service/capital goods. [Section 18(1) and Section 18(2)]
- In case a tax payer applies for registration late reasons beyond his control, legitimate claim of ITC may be denied to him. [Section 18(1)]
- Law does not provide rationale for lapse of balance ITC lying in electronic credit ledger in case a regular taxpayer switches to composition scheme. Further, what will happen in a situation when such person deals in both exempt and taxable supplies? [Section 18(4)]
- Whether ITC would be allowed [Section 18(1)] in case a person applies for registration beyond the prescribed period of 30 days due to interpretational issues or for reasons beyond his control.
- The lawmakers may give reasons for withholding credit of input service and capital goods for new registrants [Sections 18(1) and 18(2)].

V. Taking ITC in respect of inputs sent for job work [Section 19]

(i) Principal entitled for ITC in respect of inputs/ capital goods sent for job-work

The “principal” shall, subject to such conditions and restrictions as may be prescribed in Rule 45, be allowed ITC on inputs/ capital goods sent to a job-worker for job-work.

Even in case if the inputs/capital goods are directly sent to a job worker for job-work without their being first brought to his place of business (i.e. condition contained in Section 16(2)(b) need not be fulfilled), the “principal” shall be entitled to take credit of ITC on inputs/ capital goods, as the case may be.

(ii) Deemed supply of inputs/capital goods to job-worker after prescribed period

Where the inputs [or capital goods] sent for job-work are not received back by the “principal”

after completion of job-work or otherwise or are not supplied from the place of business of the job-worker in accordance with relevant provisions [Section 143] within a period of one year [three years in case of capital goods] of their being sent out, it shall be deemed that such inputs [or capital goods] had been supplied by the principal to the job-worker on the day when the said inputs [or capital goods] were sent out. Further, where the inputs [capital goods] are sent directly to a job worker, the period of one year [or three years in case of capital goods] shall be counted from the date of receipt of inputs [or capital goods] by the job worker. However, these provisions relating to deemed supply shall not apply to moulds and dies, jigs and fixtures, or tools sent out to a job worker for job work.

VI. Manner of distribution of credit by Input Service Distributor ('ISD') [Section 20]

(i) Where distributor and recipient are located in different States

<i>Section 20 Inter-State Transfer</i>	
<i>Head Office (ISD) can transfer</i>	<i>Branch Office(Tax Payer)</i>
<i>CGST</i>	<i>CGST, IGST</i>
<i>IGST</i>	<i>IGST</i>
<i>SGST</i>	<i>SGST, IGST</i>
<i>UTGST</i>	<i>UTGST, IGST</i>

(ii) Where distributor and recipient are located in the same State

<i>Section 20 Intra-State Transfer</i>	
<i>Head Office (ISD) can transfer</i>	<i>Branch Office(Tax Payer)</i>
<i>CGST</i>	<i>CGST</i>
<i>IGST</i>	<i>IGST</i>
<i>SGST</i>	<i>SGST</i>
<i>UTGST</i>	<i>UTGST</i>

(iii) Conditions for distribution of credit

The ISD may distribute ITC subject to the following conditions, namely:

- ITC can be distributed against a prescribed document issued to each of the recipients of the credit so distributed, and such document shall contain details as prescribed in Rule 36;
- Amount of ITC distributed shall not exceed the amount of credit available for distribution;

ITC paid on input services attributable to more than one recipient of credit shall be distributed only amongst such recipient(s) to whom the input service is attributable and such distribution shall be *pro rata* on the basis of the turnover in a State or turnover in a Union territory of such recipient, during the relevant period, to the aggregate of the turnover of all such recipients to whom such input service is attributable and which are operational in the current year, during the said relevant period as prescribed in Rule 39.

- ITC paid on input services attributable to a recipient of credit shall be distributed only to that recipient;
- ITC paid on input services attributable to more than one recipient of credit shall be distributed only amongst such recipient(s) to whom the input service is attributable and such distribution shall be *pro rata* on the basis of the turnover in a State or turnover in a Union territory of such recipient, during the relevant period, to the aggregate of the turnover of all such recipients to whom such input service is attributable and which are operational in the current year, during the said relevant period as prescribed in Rule 39;
- ITC of tax paid on input services attributable to all recipients of credit shall be distributed amongst such recipients and such distribution shall be *pro rata* on the basis of the turnover in a State or turnover in a Union territory of such recipient, during the relevant period, to the aggregate of the turnover of all recipients and which are operational in the current year, during the said relevant period.

The terms 'relevant period,' 'recipient of credit' and 'turnover' have been specifically defined under the CGST Act, 2017 [under Explanation to Section 20].

VII. Manner of recovery of credit distributed in excess [Section 21]

Where the ISD distributes the credit in contravention of the above provisions contained in [Section 20] resulting in excess distribution of credit to one or more recipients of credit, the excess credit so distributed shall be recovered from such recipient(s) along with interest in the manner prescribed under the CGST Act [provisions of Section 73 or 74, as the case may be, shall apply *mutatis mutandis* for effecting such recovery]. ■