Input Tax Credit Review Audit under GST

The GST audit under Section 35(5) of CGST Act, 2017 has not been notified till date. However, the industry and trade needs to carry out input tax credit (ITC) review before the last date of filing of September 2018 return [20th October 2018]. It is understood that there could be a number of errors of understanding, system errors and transactional mistakes in the year 2017-18. The registered persons would have a chance to ensure total reconciliation and proper availment is carried out before this time limit expires. Those who miss this window may have to face disputes and litigation if they were to avail the ITC after this date.

The article provides some insights into the possible coverage in this ITC review providing draft a step wise ITC review list with comments. Some of the common expected errors in ITC have also been provided for ensuring that the ITC review is effective. Also, the article provides a sample reconciliation statement of ITC. Read on to know more…

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Steps in ITC Review

i. Understand the business: The general background of industry, company, challenges in indirect taxes faced by them, type of vendors and type of customers. This would help in conduct of the review.

ii. Confirm the existence of adequacy of systems and controls: Internal controls in

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indirect taxes have not been put in most organisation and change to GST may have further delayed it. Reliance on the normal audits checks may not be adequate due to various reasons. The transactions which may not be reflected in the books of account like stock transfers to different states, agent/ principal supply, supplies with related parties which are without consideration, reverse charge, etc. are normally not accounted in the financial system in the form of usual inward-outward supplies. These aspects may need confirmation of proper systems to comply and reconcile the liabilities as well as the credits.

iii. Review of procurement policy of the organisation including imports: The importance of the tax clause to ensure optimisation of the credits and ensuring vendor has paid taxes owed on the supply. Further the knowledge of credits to the procurement team may be limited.

iv. Invoice Validity: The requirement of payment on taxes only if indicated in the invoice along with specified particulars. Also, confirm that all invoices where credit has been taken are available for verification and preserved properly.

v. Review the nature of services and goods- the nature of expenses incurred to ascertain GST impact and to assess GST credits: Any goods and services used in furtherance of business are eligible for credit other than those blocked. All major value of inputs, capital goods and services need to be identified.

vi. Review of Sources: The question of procurements made only through registered dealer/ manufacturer/service provider needs to be confirmed. In case of procurement from unregistered dealer, the possibility of credit chain being broken and consequent increase in costs to be confirmed.

vii. Review the system of claiming credit: The time of supply would be important for availing credit in respect of Inputs, Capital goods and RCM expenses. Verify if the goods and services are actually received and in a verifiable manner.

viii. Review the major agreements/ orders: This can be done by review of sample invoices based on which credits are claimed to study impact under GST with respect to taxations and credits.

ix. Review of expenses liable for GST under RCM: Most of the RCM payments could also be eligible for credits. If so, whether paid and availed, to avoid payment of irrecoverable interest.

x. Studying the nature of books of accounts maintained: The books to capture and identify that ITC has been availed. Review of financial ledgers to ensure that ITC are taken on all eligible heads. There may be a need to have bifurcation of accounts to enable the capture of such information.

xi. Review of treatment of purchase returns to study the possible impact under GST: The tax paid on purchases returns on GST invoice is equal to credit on inputs.

xii. Review the foreign currency payments: To ascertain RCM liability and availment of ITC.

xiii. Review of goods/services at Branches/ Business verticals: Confirm if invoices are addressed properly for goods/services received at locations. Ensure that credit capture system and reconciliation is available in all branches within and outside the State. If expenses incurred at other than branches registered in the State, confirm that an input service distributor registration exists.

xiv. Review terms of purchase orders vis-à-vis purchase invoices: Defective invoices can

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lead to disputes at a later date. They can, however, be rectified once identified.

xv. Review of rate of taxes: This would be more important for goods or services supplied. It may also be value additive for the vendors if the customer confirms the taxes. This should not be the responsibility of the customer but as on date, it could be.

xvi. Review of method of capitalising the work in progress: This is to examine whether ineligible credits exist or eligible credits are not availed. This should be as per Accounting Standards and GST law.

xvii. Review of credit availment mechanism and conditions to be fulfilled for credit: The need for having received the goods or services; the issue of a valid invoice, goods and/or services used in furtherance of business. There may be a need to suggest improvement to automatically record the credit which can later be confirmed. This would be important in bringing down the cost of procurement of goods or services.

xviii. Review if the payments are made within stipulated time for taking credit: There is a time limit for making payment to vendors i.e., within 180 days. If it exceeds, ITC needs to be reversed with interest. However, an amendment for without interest reversal has been proposed for amendment in the CGST Bill. On payment to the vendor, the credit can be claimed back. System to capture such reversals in recoverable accounts and their periodic nullifying may be suggested.

xix. Review if discounts agreed and valuation adopted by vendors: Ensure that they are in line with law and do not lead to loss of credits or double taxation.

xx. Review of debit notes and credit notes on sampling basis: This is to ascertain the impact on ITC: To confirm that the credit be availed only if receiver/ customer had reversed the credit.

xxi. Review of credit register: Look for patterns and confirm evidence captured/ filed in order to satisfy the scrutiny by internal / external auditors.

xxii. Review of import documents, job work inward invoices, stock transfer inward invoices, etc. Some of these may not be accounted in the system as they are not financial entries but have an impact on ITC.

xxiii. Review if there are transactions of personal nature: In such cases credit is not available.

xxiv. Review of goods issued free of cost (FOC) or as samples: At times the value of such FOC supplies may have to be included in the final supply at which time if the credit of such FOC is lost it may not be competitive, as credit in between has been lost.

xxv. Review of credit apportionment in case of supply of taxable and exempted supplies: The capture of credit, specific to each and only the common credits being allocated, is a preferred way forward.

xxvi. Review of credit availment in case of assets put partially for non-business /non-taxable use: The reversal for personal use needs to be confirmed.

xxvii. Review of various returns filed under GST such as GSTR 1 and GSTR 3B and identification of differences in ITC if any, between GSTR 3B and GSTR 2A. [Reconciliation to be provided by Auditee].

xxviii. Review of TRAN-1, TRAN-2 filed: This is to be confirmed with what was eligible and if any excess availed to be reversed. If short availed disclosure could be made as last date is over. Court could provide additional time.

xxix. Review of disputable credits: These credits could be availed and reversed with intimation to revenue avoid time limitation.

While discharging GST under reverse charge on services under Section 9(3), the auditor needs to understand place of supply especially for export or import of services. The old service tax law and the GST Act differ and there are some transactions which no longer attract GST. If paid, then refund can be sought as it is within limitation.

xxx. Review of credit accumulations: Reason to be ascertained and option, if any, exercised for encashment of such credits through refund or rebate.

xxxi. Review of important ratios: The credit availed and utilised to total GST, ITC/ Total purchases and expenses among others.

xxxii. Common Errors: Identifying and correcting the errors observed in the above review and also confirming with a list of common errors (provided further) .

xxxiii. Identification of transactions with distinct persons eg. support services by HO to factory situated in a different state. If so, cross charge of the same is to be looked into.

xxxiv. Identification of barter activities or transactions which may not reflect in books of accounts. In the same line identification of non-monetary consideration in any exchange transaction, which leads to revision of valuation.

Common Errors in ITC

The errors are expected to be mainly centered around vendor compliances impacting ITC, doubtful credits, missed or short credits. Excess or duplicate credits, debit/credit note adjustments, capital goods credit vis-à-vis capitalisation, reversal for exempt supplies and reverse charge. We examine some of them in more detail hereunder:

1. **Considering ITC balance to payoff liability under reverse charge.**
   - Recipient cannot utilise ITC for discharging RCM liabilities. GST portal also does not allow such adjustment while filing returns.
   - ITC can be claimed in the same month where taxes are paid by the recipient under RCM in end of previous month.

2. **Discharging GST under reverse charge on services under Section 9(3).**
   - Auditor needs to understand place of supply especially for export or import of services.
   - The old service tax law and the GST Act differ and there are some transactions which no longer attract GST. If paid, then refund can be sought as it is within limitation. *Illustration: Rent a cab or manpower services which were liable for RCM under earlier tax regime but are not notified services under GST regime.*

3. **ITC could be claimed on the taxes paid under RCM on the GTA services.**
   - ITC is only restricted for provider of GTA service who pays at 5%. The customer who pays taxes under RCM could avail ITC if eligible.

4. **Treating export of goods/services as exempted goods/services and not availing eligible credits related to same.**
   - Refund of taxes paid on the goods or services could be availed by the person making the exports even when output GST is not paid on exported goods/exported services.

5. **Non-reversal of ITC in cases where payment is not made to supplier within 180 days from the date of invoice.**
   - Reversal of ITC with interest is required. (recently the amendment for no interest has been made- but retrospective applicability not made clear).
   - The care to enable re-credit on future payment can be suggested.

6. **Inter-State purchases made from unregistered persons.**
   - Procure goods only from a registered vendor and avail eligible ITC.
   - ITC availed on the basis of invoice of registered dealer provided by the unregistered person would not be available.

ITC could be availed only on receipt of invoice and goods (constructive receipts on instruction of purchaser included).

Further availing ITC on the basis of photocopies may be disputed.

- No restriction for availing 100% of ITC on the purchase of capital goods. [50% credit was in earlier central excise regime].

7. Availing ITC on supplies specifically blocked under Section 17.

- Not allowed and if availed has to be reversed.

8. Availing credit when the same is restricted by rate notification.

- Where ITC was availed when the conditional of notification restricts. Credit to be reversed with interest.

9. Availing ITC merely on receipt of invoice without actual receipt of goods/services.

- ITC could be availed only on receipt of invoice and goods (constructive receipts on instruction of purchaser included).

10. Non-reversal of proportionate ITC in respect of exempted supplies, non-business purpose use.

- Non-business, non-taxable or exempt supplies are not eligible for credit. It would amount to non-compliance of Rule 42 and 43 of the CGST Rules, 2017. Supplies, where rate notification restricts availment of ITC (eg restaurant) shall be treated as exempt supplies for the purposes of computation of ITC reversal under Rule 42 & 43 of CGST Rules, 2017.

11. Non-availment of ITC on bank charges.

- ITC could be availed as there is no specific restriction under Section 17(5).

12. Non-reversal of ITC in respect of goods lost, stolen, destroyed, written off or distributed as gifts/free samples.

- Where ITC is availed and then the goods lost, stolen, destroyed, written off or distributed as gifts/free samples, ITC has to be reversed with interest.
- Written off could mean fully written off and therefore provision may not impact this.
- Inputs destroyed before putting into the production process would be covered.
- Inputs sent as samples are covered in this section. Inputs contained in final products would not be impacted.

13. Delay in availing ITC.

- Avail the ITC on monthly basis and utilise for payment of output liability.
- The absence of proper mechanism/checklist to determine the eligibility of ITC of various purchase/procurement transactions.

Following is the format of ITC reconciliation for making the auditor's job easier:

Sample Reconciliation Format - ITC for year 2017-18		
Sl. No.	**Particulars**	**Total**
	Input Tax Credit as per Books	xx
Less:		
A.	Credit relating to other registered persons/distinct persons	
B.	Credit on which input tax credit is not available due to the following:	
i.	ITC used for transaction which are not a supply as per Schedule III or the definition of supply	
ii.	ITC on Inward supplies received from composition suppliers	
iii.	ITC on Goods / services are not used in the course or furtherance of business under Section 17(1)	
iv.	Credit ineligible as the goods/services received are used wholly for effecting exempt supplies (excluding exports)	
v.	Credit ineligible under Section 17(5)(a) : On motor vehicles and other conveyances	

vi.	Credit ineligible under Section 17(5)(b)(i) : On food and beverages, outdoor catering, beauty treatment, health services, cosmetic and plastic surgery	
vii.	Credit ineligible under Section 17(5)(b)(ii) : On membership of a club, health and fitness centre	
viii.	Credit ineligible under Section 17(5)(b)(iii) : On rent-a-cab, life insurance and health insurance	
ix.	Credit ineligible under Section 17(5)(b)(iv) : On travel benefits extended to employees on vacation	
x.	Credit ineligible under Section 17(5)(c) : On works contract services when supplied for construction of an immovable property	
xi.	Credit ineligible under Section 17(5)(d) : On goods / services received for construction of an immovable property on own account	
xii.	Credit ineligible under Section 17(5)(g) : On goods or services or both used for personal consumption;	
xiii.	Credit ineligible under Section 17(5)(h) : On goods lost, stolen, destroyed;	
xiv.	Credit ineligible under Section 17(5)(h) : On goods fully written off;	
xv.	Credit ineligible under Section 17(5)(h) : On goods disposed of by way of gift;	
xvi.	Credit ineligible under Section 17(5)(h) : On goods disposed of by way of free samples;	
xvii.	Credit ineligible under Section 17(5)(i) : In respect of tax paid in accordance with the provisions of sections 74, 129 and 130;	
xviii.	Credit not taken as the recipient's GSTIN was not mentioned / mentioned incorrectly	
xix.	Credit reversed under Section 17 (4) for a banking company / financial institution / non banking financial company	
xx.	Credit not taken as the place of supply is outside the State	
C.	Proportionate reversal of Credit under Section 17(2): Reversal for exempt supplies.	
D.	Credit reversed under Section 16(2) (d) due to non payment in 180 days	
E.	Credits which will be taken in the subsequent year	
F.	Credits reversed under protest: This maybe due to doubt or direction of revenue	
G.	Any other (please specify)	
	Adjusted ITC Amount as per financials (in the State)[sub-total]	xx
Add:		
A.	Credit under Section 140-143- Transitional	
B.	Credit available under Section 18 on registration opting out of composition etc.	
C.	Credit reversed due to 180 days now availed.	
D.	Credit on purchase of capital assets	
E.	Credit on prepaid expenses of this year if missed	
F.	**Missed credit from 1st July 2017 till 31st March 2018**	
G.	Adjustments in Valuation Section 15	
H.	Any other (please specify)	
	Final Adjusted as per financials	xx
	Amount of ITC as per Annual Return (in a State)	xx
	Difference if any to be analysed	x

The article could be expanded or customised to the needs of the client depending on industry differences. This is not an in-depth analysis for which a good commentary on GST audit maybe referred in addition to the Background material of the ICAI which is updated till May 2018. ■