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Changing Dimensions of Input Tax Credit under The GST Regime

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ABSTRACT

With the advent of GST on 1st July 2017, the country saw the biggest indirect tax reforms since 1947. Passing of GST has resulted in unification of almost all indirect taxes. GST is reffered to be a destination-based tax that should replace the current Central taxes and duties such as Excise Duty, Service Tax, Counter Vailing Duty (CVD), Special Additional Customs Duty (SAD), VAT (Value Added Taxes) which includes central charges and cesses and local state taxes, Central Sales Tax (CST), Entry Tax, Purchase Tax, Luxury Tax, Taxes on lottery, betting and gambling, state cesses and surcharges and Entertainment tax (other than the tax levied by the local bodies).

It will be a dual levy with State/Union territory GST and Central GST. Moreover, inter–state supplies would attract an Integrated GST, which might be the sum total of CGST and SGST/UTGST. Input Tax Credit or Input Credit means adjusting the input tax paid to the output tax collected. Taxes paid on input of goods, services and capital goods are allowed to be adjusted by way of Input Tax Credit. For example, taxes paid on goods for resale, taxes paid on purchasing services from professionals (like CAS, LLBs) or taxes paid on purchase of machinery to be used in production of goods or services, all can be claimed as Input Tax Credit subject to some conditions, exceptions and restrictions.

In this paper we will be dealing with how Input Tax credit works under GST Regime. This paper covers background of GST, What is Input Tax Credit and what is the eligibility and conditions to claim Input Tax Credit under GST.

I. BACKGROUND OF GST

Goods and Service Tax Act was not created under the 3 lists. It was created under article 246A which was brought in by 101st Constitution Amendment Act, 2016. Article 246A(1) deals with Intra-state supply and power to make law was given to the Parliament & State assembly. Article 246A(2) deals with Inter-state supply and power to make laws was given to the Parliament.

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GST law is not applicable on goods like petroleum crude, high speed diesel, motor spirit(petrol), natural gas and aviation turbine fuel. GST on these goods will be applicable when recommended by the GST council. No GST is applicable on alcohol or liquor.

GST can be termed as a destination or consumption-based tax. The highest rate of GST in India is 28%. GST is paid by supplier. There are 4 rates applicable in India i.e., 5%, 12%,18% and 28%. Also, special rates of 3% and 0.25% are applicable on precious metals like gold, rough diamond etc. India has adopted Canadian model of GST and thus follows dual GST model i.e., CGST and SGST.

Special purpose vehicle i.e., GSTN (Goods and Service Tax Network) was established to carter to the needs of GST. It is the GST website/portal. GSTIN is the Goods and Service Tax Identification Number, which is a 15-digit PAN based alpha-numeric number.

Taxation Principles

There are two taxation principles i.e., Destination based and Origin Principle.

1. Destination principle: Country or state where goods or services are consumed will receive tax. This system is followed in GST.
2. Origin principle: Country/state where goods are originated will receive tax.

Taxation System

1. First point collection: Tax paid at first stage
2. Last point collection: Tax paid at last stage
3. Multipoint collection: Tax collected at different stages
4. Multipoint collection with ITC method: Followed in GST

Problems under Old Tax Laws

1. Multiple taxes
2. Multiple taxable events
3. Cascading effect
4. Double taxation
5. No uniformity
6. Classification issue

Picture after introduction of GST

1. Multiple taxes (17 Indirect Taxes)—brought under GST
2. Multiple taxing events (manufacturing. Services, sale etc)—brought under one taxable event of supply
3. Assesses name (manufacturer, dealer, seller, trader)—Now became Supplier. Supplier is the taxable person.
4. Intra-state trade—Same now
5. Inter-sate—Same now
6. International trade—Brought under Inter-State

II. INPUT TAX CREDIT

Input Tax Credit or Input Credit means adjusting the input tax paid to the output tax collected.

Taxes paid on input of goods, services and capital goods are allowed to be adjusted by way of Input Tax Credit. For example, taxes paid on goods for resale, taxes paid on purchasing services from professionals (like CAS, LLBs) or taxes paid on purchase of machinery to be used in production of goods or services, all can be claimed as Input Tax Credit subject to some conditions, exceptions and restrictions.

Eligibility to claim Input Tax Credit

All Registered persons who didn't opt for composition scheme Taxes that can be claimed as Input Tax Credit:

1. Integrated GST
2. Central GST
3. State GST/Union Territory GST
4. GST Composition cess

Conditions to claim Input Tax Credit

1. Possession of Tax invoice (or Debit note) of purchase issued by registered supplier.
2. Received supply of goods and services
   a. Services, if received by any other person on direction of and on account of such registered person are also covered.

   b. Goods, if received by any other person on direction of such registered person either by way of transfer of documents of title or goods are also covered.

   c. If goods are received in instalments, credit can be taken on receipt of last instalment.

3. Tax charged by supplier is paid to Government either in cash or through utilisation of Input Tax Credit.
4. Supplier has filed GST Return under section 39.
5. Payment made to supplier towards value of supply and tax payable within 180 days of date of invoice.

Restrictions to claim Input Tax Credit

Input tax credit cannot be claimed:

1. Purchase of Passenger motor vehicles if seating capacity <13 persons
2. General insurance, repair and maintenance services used in relation to the motor vehicles on which ITC is not allowed.
3. Purchase of Vessels, Aircraft, etc
4. Purchase of motor vehicles used in transportation of goods if they are used by other than banking company or a financial institution for transportation of cash.
5. Food, beverages, membership fees (of club, health & fitness centre), beauty treatment, plastic surgery, rent a cab, life insurance, health insurance and others
6. Travel benefits
7. Works contract
8. Goods distributed as free samples or gift
9. Goods for personal use
10. Purchase of goods by Non-resident
11. Goods lost destroyed or stolen off Fraud cases
12. By Restaurants
13. If the full value of capital goods (inclusive of tax) is claimed under depreciation.
14. By Goods Transport Agency if they opt for Reverse Charge Mechanism and recipient pays tax @ 5%

Exceptions to Restrictions to claim Input Tax Credit:

1. ITC is allowed in case of passenger motor vehicles if used for:
    a. Further taxable supply of such vehicles
    b. Transportation of passengers which are taxable
    c. Imparting taxable training of motor driving.
2. If Goods Transport Agency opts for forward charge and opts to pay GST @ 12% on the services it can avail ITC on motor vehicles.
3. ITC is allowed in case of Vessels, aircraft, etc if used for:
    a. further taxable supply of such vehicles
    b. transportation of passengers which are taxable
    c. imparting taxable training of flying, navigating such vehicle or conveyances or vessels or aircrafts
    d. transportation of goods

Tenure to avail Input Tax Credit:

Due date of the return for the month of September of next financial year. Annual return is filed for relevant financial year whichever is earlier. A registered person can avail ITC only up to 1 year from the date of issue of tax invoice and up to 5 years in case of capital goods.

Manner to claim Input Tax Credit:

When the supplier fills GSTR1, the amount of tax paid by recipient of goods will be reflected in GSTR 2A of the recipient and amount gets credited to Electronic Credit Ledger of recipient.

Manner to Utilize Input Tax Credit:

1. At first, IGST tax credit must be fully utilized by adjusting with output tax liability of IGST and then with output tax liability of CGST & SGST.
2. Then Input Tax Credit of CGST should be adjusted with output tax liability of CGST.
3. Then Input Tax Credit of SGST should be adjusted by utilizing towards output tax liability of CGST.
4. CGST & SGST can’t be cross utilized.
5. Output tax liability of IGST can be adjusted with Input Tax Credit of CGST & SGST.

Reversal of Input Tax Credit:

1. ITC will be reversed for invoices which were not paid within 180 days of issue. If part of the invoice is paid the ITC will be reversed on a proportionate basis. The ITC reversed has to be added to output liability along with interest thereon.[4]
2. ITC used in the portion of input goods/services used for the personal purpose must be reversed proportionately.
3. If ITC has been availed on block credits or any kind of input tax credit which was not to be availed it has to be reversed at the time of filing regular returns up to the date of filing annual return.
4. When any bank, financial institution or NBFC is separately registered as a business vertical, it is required to reverse 50 % of the ITC if it opts for 50 % of ITC at the time of filing regular returns.[5]
5. After filing GSTR 9 – Annual Return the total ITC on inputs used for non-business or exempt supplies can be more than the total ITC reversed during the year. In that case, the differential amount must be reversed.[6]
6. ITC on capital goods used for the supply of exempt supplies and non-business purposes will also be reversed. The calculation will be similar to the calculation for ITC on inputs used for exempt supplies and personal use.
7. If the taxable person sells capital goods on which Input Tax Credit had been taken then such person is liable to reverse the Input Tax Credit availed and the output tax liability will be higher of the following:
   a. ITC taken on such capital goods less 5 percentage points per quarter of a year or part thereof from the date of invoice
   b. Sale price of capital goods multiplied by GST rate (transaction value).

Input Tax Credit under Reverse Charge Mechanism:

The recipient (i.e., who pays reverse tax) can avail input tax credit if such goods and/or services are used, or will be used, for business. The tax under reverse charge has to be paid through cash only.

Refund of Input Tax Credit

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[4] https://taxguru.in/goods-and-service-tax/input-tax-credit-itc-gst-regime.html
[5] http://50headshots.com/sdk-graco-cayuuni/itc-10-year-return.html
[6] https://cleartax.in/s/reverse-input-tax-credit-under-gstr-2

Refund is allowed only for the inputs of goods. It doesn't include input services and capital goods. Maximum Refund Amount = (Turnover of inverted rated supply of goods and services X Net input tax credit / Adjusted total turnover) – Tax payable on such inverted rated supply of goods and services.[7]

No refund of the unutilized input tax credit shall be allowed:

1. If output supplies are nil rated or fully exempt supplies.
2. If supplier claims refund of output tax paid under IGST Act
3. If the goods are exported out of India.
4. If the supplier of goods or services or both avails of drawback in respect if the central tax or claims a refund of IGST on such supplies.

III. Denial of ITC in case of non-deposit of GST by supplier

The recipient has to fulfil certain conditions as per the GST law before claiming ITC on the purchase of Goods and Services. One of the most controversial conditions of claiming ITC is that the supplier must have deposited the GST to the Govt. treasury in order to claim ITC by the buyer under Section 16(2) (c) of CGST Act, 2017. Also as per recent amendment vide Section 109 of Finance Act, 2021 by inserting new sec 16(2)(aa) in CGST Act, the condition has been inserted that ITC related to invoice and debit note can be claimed only when details related to same has been furnished by the supplier in FORM GSTR-1 and communicated the same to the recipient in GSTR-2A. Both the above conditions need to be fulfilled in order to claim ITC. But in this case, the Government is treating genuine purchasers and guilty purchasers as one and the same.

In cases where the GST has not been deposited by the seller then the department is fastening the liability on the recipient directly instead of catching the seller first and starting the recovery action against the same. In one or the other sense, it has become harassment of the genuine purchaser by Govt. The same view was taken by Madras High court in the case of **D.Y. Beathel Enterprises v. The Sales Tax Officer**[8] where the major part of sales consideration was paid by the buyer to the seller through banking channels. ITC was taken by the buyer based on the same but the seller didn't deposit the tax with the Govt. and SCN was issued passing entire liability on a buyer without involving the seller. The court said that since the action was not initiated against the seller tax can't be recovered from the buyer. As the department already know that seller has collected the tax but not deposited the same,

[7] https://taxguru.in/goods-and-service-tax/refund-gst-refund-under-gst-situations-documents-required-filing.html
[8] 2021 (2) TR 4008

therefore, this should be looked upon seriously.

Following the above view, Chhattisgarh HC has also stayed an order in the case of **M/s Bharat Aluminum Company Ltd v. The State of Chandigarh**[9]. saying that ITC cannot be denied to the purchaser for the reason that seller has not filed returns and the same is not reflected in the GSTR-2A of the buyer. There is a mismatch in GSTR-2A and GSTR-38 due to the same. A demand order along with interest was raised by the department due to the difference in the amount of ITC claimed in GSTR 3B vs ITC reflected in GSTR-2A. As per the Court, recovery from the buyer can be made only in exceptional cases as said by GST council in its 27th meeting[10]: "*There shall not be any automatic reversal of input tax credit from buyer on non-payment of tax by the seller. In case of default in payment of tax by the seller, recovery shall be made from the seller. However, reversal of credit from buyer shall also be an option available with the revenue authorities to address exceptional situations missing dealer, closure like of business by supplier or supplier not having adequate assets etc*"

Hence, it is crystal clear from the aforesaid verdict of the High Court that the recovery proceedings should be imitated first against the supplier of goods or services. If the amount cannot be recovered from him then it should be recovered from the recipient. But the department is normally perusing the reputed purchaser so that amount can be realized easily. But this is a wrong approach on the part of the department.

However, where fraudulent collusion is involved between buyer and seller then only liability can be fastened upon the buyer because here the fraud is executed with the knowledge and consensus of both the parties. Passing of the credit by fake invoices is clearly an example of the same. Only the invoice has been issued and no material is received by the purchaser. Hence, it is clear to both the parties that they are evading the tax. Hence, department action in such situations against the buyer is justified. However, in the case of a genuine buyer, the existing provisions are unconstitutional. High Court is only the recourse of judicial remedy in case of a genuine buyer. However, for the own safeguard of the buyer, he should try to maintain the trail of the entire transaction along with documents like E-way bill, invoice received from the seller in order to claim ITC. Moreover, third-party pieces of evidence like weighment slip, royalty slip, the stamp of check post, stock audit etc., are also very important.

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[9] WP No. 44 or 2013

[10] https://www.taxmanagementindia.com/visitor/detail_article.asp?ArticleID=9772

INPUT TAX CREDIT (ITC) TO BE ALLOWED ON INPUTS INHERENTLY LOST IN MANUFACTURING PROCESS

In re: ARS Steels & Alloy International Pvt. Ltd. vs. the State Tax Officer[11]

Facts Of The Case

The Petitioner is engaged in the manufacture of MS Billets, Ingots and TMT/CTD bars – which attract GST. MS scrap is an input in the manufacture of MS Billets and the later, in turn, constitutes an input for manufacture of TMT/CTD bars. During the manufacturing process, there is a loss of small portion of the inputs due to inherent manufacturing process.

In this regard, Petitioner challenged the assessment orders issued for the periods 2017-18, 2018-19 and 2019-20 by the State Tax Officer to the extent the said orders directed the Petitioner for making a proportionate reversal of Input Tax Credit (**ITC**) claimed in relation to the loss arising from manufacturing process by referring to the provisions of Section 17(5)(h) of the CGST Act.

Judgement

Section 17(1) to (4) of the CGST Act provides for entitlement of ITC to the assessee and whereas, Section 17(5) of the CGST Act provides the list of blocked credits. The Impugned assessment orders rejected a portion of ITC by invoking the provisions of Section 17(5)(h) of the CGST Act[12] which restricts the availment of credit in respect of *"goods lost, stolen, destroyed, written off or disposed by way of gift or free samples."*

The Hon'ble High Court observed that the aforesaid provision indicates loss of inputs that are quantifiable and involve external factors or compulsions. A loss that is occasioned by consumption in the process of manufacture is one which is inherent to the process of manufacture itself and therefore, cannot be equated to any of the instances specified in Section 17(5)(h) of the CGST Act.

Accordingly, Hon'ble Madras High Court ruled that the petitioner is not required to reverse ITC on material losses incurred during the manufacturing process.

BAIL APPLICATION OF CHARTERED ACCOUNTANT DISMISSED IN FAKE ITC AVAILMENT CASE

Abhishek Singhal v. Union of India and Ors.[13]

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[11] TS-287-HC(Mad)-2021-GST
[12] https://taxguru.in/goods-and-service-tax/itc-available-goods-lost-stolen-destroyed-written-off.html
[13] TS-231-HC(Raj)-2021-GST

Facts of the Case

The present matter pertains to bail application filed under Section 439 of Code of Criminal Procedure, 1973 (**Cr. P.C**.) by the Petitioner, a chartered accountant. The Petitioner was arrested for the offence(s) under Section 132(1) (b)/(c)/(f), 4R/20, 132(1)(i) of Central Goods and Services Act, 2017 (**CGST Act**) on the allegation of availment of ITC wrongfully to the tune of INR 6,36,32,492 by creating 38 fake firms.

In view thereof, the Petitioner filed the bail application asserting that that the petitioner is falsely implicated and that he is a chartered accountant by profession and not liable for the offences committed by co-accused persons. Moreover, it was submitted that bail be granted to him as the co-accused persons have already been released on bail by a co-ordinate Bench of Hon'ble High Court. However, Department while opposing the bail submitted that the co-accused persons did not create any fake invoices or availed or passed on any input tax credit, therefore, Petitioner is the main accused who has been absconding.

Judgement

The Hon'ble High Court took the cognizance of the Department's submission and the fact that the Petitioner failed to appear before the Department while notices were issued to him and that he remained absconding for about one year even after filing of complaint before the Trial court. It was further held that the Petitioner, a chartered accountant, is master mind of the crime who created 38 fake firms and availed ITC wrongfully to the tune of INR 6,36,32,492. In view thereof bail application was dismissed by Hon'ble High Court as no case was made out to release the Petitioner on bail under Section 439 Cr.P.C.

BAIL GRANTED TO CHARTERED ACCOUNTANT ARRESTED ON ACCOUNT OF BOGUS ITC AVAILMENT

Bhagwan Sahay Gupta vs. UOI[14]

Facts of the Case

The present matter pertains to bail application filed under Section 439 of Code of Criminal Procedure, 1973 (**Cr. P.C**.) by the Petitioner, a chartered accountant. The Petitioner was arrested for the offence(s) under Section 132(1)(i) (iv) read with Sub-Section (5) of Central Goods and Services Act, 2017 (**CGST Act**) on the allegation of registration of 11 fake firms for availing ITC to the tune of INR 146 crores. It was further alleged that the petitioner charged around INR 3,500 per GST return instead of charging INR 1500 per GST return.

[14] *TS-234-HC(Raj)-2021-GST*

However, no allegation regarding receipt of any amount or any percentage with regard to the wrong ITC was made.

In view thereof, the Petitioner filed the bail application asserting that that the petitioner, a Chartered Accountant, created the firms on the basis of documents provided by the co-accused. However, Department while opposing the bail submitted that the petitioner was aware as he was filing GST returns of non-existent firms.

Judgement

The Hon'ble High Court took the cognizance of the submissions of the Petitioner and the fact that the Petitioner has remained in custody for a period of one year and five months and is also having a child. In view thereof, allowing the application, the Hon'ble High Court directed that Petitioner be released on bail by furnishing a personal bond of INR 1,00,000 together with two sureties of INR 50,000 each to the satisfaction of the Trial Court with the stipulation that he shall appear before that Court.

BAIL GRANTED TO 68 YEAR OLD ASSESSEE ACCUSED OF ITC FRAUD IN ABSENCE OF APPREHENSION OF RUNNING OR TAMPERING/INFLUENCING THE WITNESS

Kewal Chand Jain vs. UOI[15]

Facts Of The Case

The present matter pertains to bail application filed under Section 439 of Code of Criminal Procedure, 1973 (Cr. P. C.) by the Petitioner, a chartered accountant. The Petitioner was arrested for the offence(s) under Sections 132 (1)(B) & (C) read with 132(1)(I) of Central Goods and Services Act, 2017 (CGST Act).

In view thereof, the Petitioner filed the bail application asserting that that the petitioner has been falsely implicated in this matter and the challan has been filed before the competent court of jurisdiction. Moreover, the petitioner has already deposited INR 1.54 crores under protest against demand of INR 9.32 crores to show his *bona fide* and same is duly confirmed by the Department.

Judgement

The Hon'ble High Court considered the material on record and took notice of the fact that i) no apprehension of running away or tempering or influencing the witnesses in any manner has been shown by the Petitioner; ii) challan has already been presented in the court and trial

[15] TS-232-HC(Raj)-2021-GST

is not proceeding due to ongoing Covid-19 problem. It was further observed that the petitioner has already deposited INR 1.53 crores under protest to show his *bona fide* and is not required for any custodial interrogation/investigation. In view thereof, the Hon'ble High Court granted regular bail to the Petitioner, subject to satisfaction of the trial Court.

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