

# Is Seamless Input Credit In GST a Reality?



*One of the much talked about feature of the proposed Goods and Service Tax Law (GST) is – seamless input credit. If this theme is followed in its true spirit, GST would be nearer to the concept as propagated and if not, it may significantly dent the expectations of the masses. In this article we will take a broad view of the input credit provisions contained in the recently released draft of the Model GST Law, and examine whether the proposed input credit scheme is in line with the expectations and the theme of the proposed GST. Read on to see the detailed analysis...*

The current frame works of tax structure permits restricted inter levy credits between excise and service tax. Further no cross credits are available across the sales tax paid and these central taxes. The proposed GST regime shall facilitate seamless credit across the entire supply chain under a common tax base. But the question is whether the rationalisation of input credits is limited to the design of GST which allows cross credits or will be taken ahead to do away with the artificial restrictions on credits in the existing law by way of specifying different types of exclusions from the definition(s) of input service/inputs resulting into denial of credit for legitimate business expense.

Scheme of input tax credit in the Model GST Law can be broadly divided into substantive provisions and procedures, where procedures are equally important because these are inter-twined into timing of taking input credit and quantum of input credit.



**CA. Rohini Aggarwal  
and CA. Ashok Batra**

(The authors are members of the Institute. They can be reached at rohiniaggl@gmail.com or caashokbatra@gmail.com.)

Interesting part of GST is that whereas the basic scheme is on the lines of existing CENVAT Credit Rules (CCR), the procedures are more on the lines of existing State's VAT law. The same are analysed as under:

- The proposed GST comprise of following taxes
- ✓ CGST– Central Goods & Service tax levied by Centre
- ✓ SGST– State Goods & Service tax levied by State
- ✓ IGST– Integrated Goods & Service tax - This tax will be attracted on inter-state supply of goods & services and will be levied and collected by the Central Government.

Accordingly, the term input tax has been defined under GST model law as *the IGST, CGST, and SGST charged for any supply of goods or services used or intended to be used in the course of furtherance of business and also include tax paid under reverse charge mechanism. The 'input tax credit' means credit of input tax so defined.* This definition of 'input tax' is to be read with the detailed scheme of input tax credit narrating the components on which credit would be available, exclusions, documents required for taking credit and various conditions of credit.

The basic scheme of input tax credit as provided under Model GST law is that every registered taxable person is entitled to take credit of input

**The basic scheme of input tax credit in the Model Law is that every registered taxable person is entitled to take credit of input tax admissible to him and the said amount shall be credited to the electronic credit ledger of such person maintained by him in the GST Network. The amount available in the electronic credit ledger may be used for making any payment towards tax payable by him subject to such conditions and within such time as may be prescribed.**

tax admissible to him and the said amount shall be credited to the electronic credit ledger of such person to be maintained in the manner as may be prescribed. The amount available in the electronic credit ledger may be used for making any payment towards tax payable by him subject to such conditions and within such time as may be prescribed. This amount cannot be used for payment of interest, fee or penalty. As the tax would be having three components—CGST, SGST and IGST, the credit eligibility of respective taxes would be as under—

- Amount of IGST available in electronic credit ledger shall be first used against output liability of IGST, then CGST and then SGST— sequence is important.
- Amount of CGST available in electronic credit ledger shall be first used against output liability of CGST, and then IGST— sequence is important. It cannot be used for payment of SGST.
- Amount of SGST available in electronic credit ledger shall be first used against output liability of SGST, and then IGST— sequence is important. It cannot be used for payment of CGST.

Moving a little ahead from the broader framework of input tax definition and basic scheme of input tax credit as proposed in Model GST law, let us now have a look at the overall position of credit as reflected in the provisions of the substantive and procedural law. However, Input tax credit rules under GST are yet to be notified.

To begin with, in the Model GST Law, the components of input tax credit are the same as in the existing law, that is, inputs, input service and capital goods. However, there is a major departure in the credit provisions pertaining to the capital goods—credit for capital goods can be taken in one go like credit on inputs; also credit on capital goods need to be attributed to respective taxable and non taxable or exempt output, and can be claimed only to the extent of the part attributable to the taxable output

in the same manner as is done in case of inputs. Thus substantively, there is no difference in the credit pertaining to the capital goods and inputs. It is only for some small purposes like defining timeframe for reversal of credit on removal of goods to job worker or otherwise, for which the capital goods are treated differently from inputs. For such trivial purposes, the definition of capital goods seems to be too elaborate. A major observation here is that the amount of tax credit pertaining to capital goods would get reduced in GST scenario in comparison to existing tax regime.

The definition of input in Section 2(54) of the Model GST Law is broad and provides that “*input*” means any goods other than capital goods, subject to exceptions as may be provided under this Act or the rules made there under, used or intended to be used by a supplier for making an outward supply in the course or furtherance of business. The definition of “input service” is almost on the similar lines as definition of “inputs”. In this context, Section 2(55) of the Model GST Law says that “*input service*” means any service, subject to exceptions as may be provided under this Act or the rules made thereunder, used or intended to be used by a supplier for making an outward supply in the course or furtherance of business.

These two definitions apparently looks broad and harmless, but a close reading reveals that the inputs and input services would get covered in the definition only when these are used for making an outward supply. It is to be noted here that in the existing regime the goods and services used in relation to manufacture or provision of service are allowed for credit.

The words ‘for making an outward supply’ may lead to interpretational issues where any service or goods procured generally may get questioned ‘not for making outward supply’. The words ‘in relation to supply of services/goods’ could have been a milder version. The intention of the Government, however, does not seem to restrict the credit. This could be expected to be modified to ensure that seamless credit is permissible in new regime of GST. It is also noteworthy to highlight here that the term outward supply shall comprise of both goods and services.

But when we delve further into some other provisions for availing Input Tax Credit under GST Model Law, the overall philosophy seems to be ridden with the miserly approach in granting credit. In the existing regime, the Government disallows CENVAT credit on services or goods used for the

**In the existing regime we wonder why the Government disallows credit on input construction services or goods used for office or factory; or on the motor vehicles used for business purposes; or for input services procured for employees like group medical insurance and the like. These expenditures are legitimate business expenditures and in the existing regime the respective input credit has been denied on these expenditures based on technical constructions as the economic intent would have not justified such disallowances.**

construction of office or factory (unless used for providing similar services); or on the motor vehicles used for business purposes; or on input services procured for personal consumption of employees like group medical insurance, outdoor catering, beauty treatment etc. These expenditures are legitimate business expenditures and in the existing regime the respective input credit has been denied on these expenditures based on technical constructions as the economic intent would have not justified such disallowances. The disappointing part is that the same legacy is being carried on in proposed GST model law also.

One of the conditions to claim the credit which is worth mentioning here is that the goods or services on which credit is claimed should have been received by the supplier. That means credit on goods cannot be taken unless goods have been received and credit for services cannot be taken unless services have been received by the supplier. As far as condition of receipt of goods for availment of CENVAT Credit is concerned, same has also been embedded under the existing provisions of CENVAT Credit Rules, 2004. However, as far as condition of 'receipt of services' for granting credit is concerned, same is not only a departure from the existing concept of allowing credit based on 'receipt of invoice' but also is difficult to implement due to intangible nature of services as ascertaining 'the time' when service has been received and received completely will be a herculean task in most of the transactions and can also become a subject matter of litigation in times to come.

The next point for deliberation here is that in the existing law, credit on goods is allowed on receipt basis and at the same time tax is also payable at the time of removal of goods in case of Central Excise or at the time of issue of invoice in the VAT law

respectively. Thus there is a harmony in the payment of Tax/Duty and availment of credit which is missing in the proposed credit scheme. A plausible solution to the above could be to consider 'time of supply' as 'time of receipt'. This will ensure that when the liability to pay GST on supply of service or goods shall arise, the respective credit is available at the same time. However, this would need a categorical mention in the law. But the interesting part is that if this solution is acceptable to the Government, they may consider removing the related condition as an alternate because the eligibility of credit would arise only when tax has been discharged which in turn would be discharged at the time of supply of goods or services. Further, there is also a condition for availing Credit that the corresponding tax charged by the supplier should be actually paid to the Government. Thus, this will put an additional obligation on recipient of goods/services to keep the check on the same which is not the scenario presently.

Moving further, in the proposed GST Law it has been specified that no Input Tax Credit shall be available in respect of any goods or services after the expiry of one year from the date of issue of Tax Invoice. Further, it has also been specified that taxable person shall not be entitled to take credit in respect of any invoice after filing of return under Section 27 for the month of September following the end of Financial Year, to which such invoices pertain or filing of relevant annual return whichever is earlier. Thus, looking at the aforesaid time limits, it can be inferred that time period granted for claiming Input Tax Credit is unreasonably short particularly in the Indian business scenario.

For instance a taxable person can take input tax credit in respect of any invoice for supply of goods and/or services pertaining to a given financial year, if he includes such invoice in his return filed under section 27 for the month of September following the end of the financial year to which such invoice pertains or in the relevant annual return, whichever is earlier. Note that the last date for filing annual return is 31<sup>st</sup> December. That means, in any case (even if the annual return is filed in December), the credit cannot be taken for the invoice pertaining to a given financial year after 30<sup>th</sup> September of the next year (assuming such return is filed on time). Accordingly, if an invoice for input goods or services is received in the month of March 2018, its credit can be claimed only upto September 2018, that is within 6 months only (assuming such return is filed on time), on expiration of which the Credit would

lapse forever. It is pertinent to point out here that the language used in the aforesaid provision if actual filing of return and not due date of filing return, thus same should be interpreted accordingly.

Another area of concern is denial of credit in case of late registration by a taxpayer. The Model Law provides that in case a person applies for registration after thirty days of commencement of his liability to pay tax, he would not get credit for the period before the date of registration. This position of credit is unfair and in the existing law of the central Excise and Service Tax, it is not followed. The fair position is that if tax liability is imposed on a taxpayer for a given period, respective credit should also be granted for the same period subject to fulfilment of certain conditions. Though in some State VAT Acts, such restricting provisions are there, but these give rise to litigation very often, particularly when the tax position itself is subject to dispute. Any disallowance of credit shall have cascading effect.

### Refund

Refund of unutilised tax credit at the end of a tax period is also allowed in two cases - (i) when the taxpayer is exporting goods or services; and/or (ii) where the credit has been accumulated because of inverted duty structure, that is, where tax rate on inputs being higher than the tax rate on output..

As for refund of input taxes, refund against exports is an obvious provision which is there in the existing law also. Refund of accumulated credits because of inverted duty structure was a much needed provision and certainly would be a delight for industries. It is thoughtful of the Government to introduce this provision.

### Issues Relating to Transition of Credit

Further, moving towards the transitional provisions

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in the Model GST Law, again there are some observations which needs specific attention. The law says that where a person taxable in existing regime is also taxable in GST regime, the CENVAT credit or VAT credit which was there in his last return in the earlier regime and credit not claimed in the return on capital goods would get transferred to his GST electronic credit ledger account. Thus, the credit which is not there in his last return would lapse forever, though the existing law permits credit within one year from the date of invoice for inputs and input services.

In case of transition from non taxable position in existing regime to taxable position in GST regime, the credit is being allowed on stock of inputs lying as raw material or embedded in semi finished or finished goods where related computation is to be done based on Generally Accepted Accounting Principles (GAAP). It is not clear why the similar credit on input services and capital goods is not allowed which can also be computed based on GAAP. Further, in case of transition from taxable to non taxable position, when a person pays out or reverses credit for the credit pertaining to the goods still lying in stock and is still left with the unutilised input credit in his electronic credit ledger, there is a provision which specifies that such unutilised credit shall lapse. Thus, the moot question which is to be emphasised here is that why such amount should not be refunded to such person as he would have already discharged respective output taxes.

### To Conclude

A look at the above discussion reveals that the credit provisions as enunciated in the draft of Model GST Law do not constitute a delight as we were expecting and may spoil further once rules are notified. The question is what could be the possible reason for that—is the intent not to grant the full credit or is it the limitation because of the dual administration model of GST and related procedures to distribute taxes amongst the Governments. The moot question is—whether it is justified to restrict the input credit of the taxpayers for limitation of procedures or whether the procedures should be subjected to little tweaking to grant substantive rights of the taxpayers.

A passing thought is that this discussion is based on the provisions given in the Model GST Law which is a first draft and subject to modifications. Also, the related rules and detailed procedures are yet to be notified. The hopes for a fair credit regime are still on. ■