

Background Material on Seamless Credit



The Institute of Chartered Accountants of India
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Foreword

In earlier indirect tax regime, the credit mechanism for indirect taxes levied by the Union Government was governed by the CENVAT Credit Rules, 2004; and the credit mechanism for state-level VAT on sale of goods was governed by the States under their respective VAT Acts and Rules GST. In the year 2004, the credit across goods and services was integrated vide the CENVAT Credit Rules, 2004 to mitigate the cascading effects of central levies namely, central excise and service tax. However, the credit chain remained fragmented on account of State-Level VAT as the credit of central taxes could not be set off against a State levy and *vice versa*. The chain further got distorted as Input Tax Credit (ITC) was not available on inter-State purchases. The GST regime promises seamless credit on goods and services across the entire supply chain with some exceptions like supplies charged to tax under composition scheme and supply of exempted goods and/or services. ITC is considered to be the backbone of the GST regime.

The Institute considering the importance of ITC concept has decided to bring publication on "*Background Material on Seamless Credit*" which contains detailed discussion on Input Tax Credit mechanism (e.g. meaning, purpose, effect, conditions, negative list, comparison with earlier law, etc).

Efforts put in by CA. Madhukar N. Hiregange, Chairman, CA. Sushil Kumar Goyal, Vice-Chairman and other members of the Indirect Taxes Committee of ICAI are appreciable for undertaking this task.

I welcome the readers for a fruitful and enriching experience.

Date: 16.10.2017

Place: New Delhi

CA. Nilesh S. Vikamsey

President

ICAI

Preface

Goods and Services Tax (GST) was implemented in our country on 1st July, 2017. The main object for this major tax reform is stated to broad base and replace multiple taxes and remove the cascading effect of multipoint taxes. Further it was to lead to a Common National Market. Tax under the GST is required to be paid at each stage of value addition while allowing the credit of the taxes paid at the earlier stages, therefore, eliminating the cascading effect of Taxes prevailing in the erstwhile indirect taxes regime. Thus, finally reducing the cost of the goods and services benefiting all the stakeholders. Further, since the credit would be available on all goods and services across India, therefore, there would be no differences in prices of goods and services due to taxes in any corner of India and therefore establishing a common national market. The seamless credit is also expected to make the Goods and Services competitive with the International Market along with the strengthening of the rupee.

In the past under service tax and central excise a majority of disputes were in regard to the CENVAT credit. The GST provisions have been an amalgam of CENVAT and credit provisions of local VAT. It is expected that the need for matching and cumbersome procedures set out may not enable SMEs to be able to comply. Hopefully simplification maybe resorted to in this regard in the next few months.

The Indirect Taxes Committee has come out with this “Background Material on Seamless Credit” with a view to apprise nitty-gritties of credit available under GST. The effort has been made to cover all aspects of credit like purpose of credit, Scheme of Input Tax Credit in GST, Significance of registration for claiming credit in GST, Conditional credit in case of abatement in rate of tax, Purpose of deferment of credit on capital goods etc. We are sure this research paper would help the reader in acquiring specialized knowledge and cope-up with the challenges and complexities in the GST Credit Mechanism.

We thank CA. Nilesh Vikamsey, President, CA. Naveen ND Gupta, Vice-President, ICAI for providing us the space to deliver and support for this game changing law initiative. We would like to acknowledge the members of the Indirect Taxes Committee, especially CA. Arun Kumar Agarwal, CA. A Jatin Christopher, CA. Ashok Batra, CA. Rohini Aggarwal and CA. Vaibhav Jain for their contribution and support provided in bringing out this research

paper. We also appreciate the Secretariat for their unstinted support and efforts.

We welcome the readers to an intellectual learning spree. Interested members may join the IDT update facility. We also welcome suggestions at idthc@icai.in and may visit website of the Committee www.idthc.icai.org.

CA. Madhukar Narayan Hiregange
Chairman
Indirect Taxes Committee

CA. Sushil Kumar Goyal
Vice-Chairman
Indirect Taxes Committee

Date: 18.10.2017

Place: New Delhi

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Chapter 1

Purpose of Credit

The Constitution (122nd Amendment) Bill, 2014, which was ultimately enacted as Constitution (101st Amendment) Act, 2016, was placed in the Parliament with a 'Statement of Objects & Reasons' which very categorically mentioned the object as conferring taxing powers to the Union and States for levying GST on every transaction of Sale of Goods and Services or both. GST has replaced a number of erstwhile Central, State and local taxes. The main object for such major tax reform is stated to be the removal of the cascading effect of taxes and provide for a Common National Market.

The GDP of an economy consists of both supply of goods as well as services. From an economist's view point both goods and services contribute to the GDP and both satisfy human needs. Therefore, there is no difference between goods and services from this perspective. While introducing Service tax in India for the first time in 1994, the Finance Minister Dr. Manmohan Singh referred to this perspective in the Parliament. He said it is therefore a discrimination against goods in favour of services, while taxing goods and not services. With this analogy, he justified introduction of the levy of tax on services. However the service tax was not eligible for credit at that point of time.

Any product which is manufactured in India reaches the final consumers through a production – distribution chain. The producer's price consists of manufacturing cost, administrative cost and selling and distribution costs. All these costs comprise of cost of various goods/ materials and services. For example, manufacturing cost comprise of direct material, direct labour, and production overhead. While the costs of materials, if indigenous, suffer Central Excise and VAT, and if imported, suffer CVD/SAD, the costs of services/ overhead suffer service tax.

The goods and services in India were subjected to different levies by the Centre and the State under separate legislations, in terms of the provisions of the Constitution of India. The goods indigenously manufactured were subjected to central excise duty, and that imported into India were subjected to additional customs duty and/or special additional duty levied by the Centre. Further, the goods were subjected to VAT levied by the State, while the services were subjected to service tax levied by the Centre. The objects of taxation for all the different levies are different. The incidence of central

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excise duty was manufacture of goods, for VAT it was sale of goods, and for Service tax it was provision of services; import of goods into India attracted levy of CVD/SAD.

Central excise duty on manufactured goods and service tax on provision of services were levied and collected by the Centre, while VAT or CST on sale of goods were levied and collected by the States. Therefore, adjustment of credit of Central taxes and State taxes was not allowed against each other. Moreover, in case of movement of goods from one State to another, CST was collected and retained by the originating State, while goods moved to the destination State. Therefore, no credit was allowed in the destination State in respect of taxes paid (CST) in the originating State. All these restrictions lead to cascading effect significantly on the value of goods/services.

For example, say Iron ore is extracted in the State of Odisha, and sold to a Sponge Iron factory in West Bengal at ₹ 20,000 PMT on charge of CST @ 2%. In West Bengal, the ore is converted into sponge, and sold to a dealer in Jharkhand @ ₹ 30,000 PMT on charge of CST @ 2%. In Jharkhand, the sponge is converted into Ingots, and sold to a dealer in Andhra Pradesh @ ₹ 35,000 PMT on charge of CST @ 2%. In Andhra Pradesh, say the ingot is converted into steel products and sold to a dealer in Tamil Nadu @ ₹ 40,000 PMT on charge of 2% CST. In this example, the value of iron ore extracted in Odisha, which was ₹ 20,000/-, is suffering tax at all the four stages, viz. while moving from Odisha to WB, from WB to Jharkhand, from Jharkhand to AP and from AP to TN. However, as the tax is retained in the originating State at each stage, credit of the same is not allowed at the destination State. Therefore, the tax at each of the stages becomes a part of the cost. The price of the steel products selling at TN, being ₹ 40,000/- PMT includes the cost of iron ore, which is ₹ 20,000/- on which tax is paid four times, without any credit. Similarly the value addition of ₹ 10,000 (30,000-20,000) made at WB also suffers tax thrice, the value addition of ₹ 5,000/- made at Jharkhand suffers tax twice, and the value addition of ₹ 5,000/- made at AP suffers tax once, without any credit being passed on. This led to making the products costlier. Moreover, once the tax becomes a part of the cost, while levying the tax at every subsequent stage, the same is calculated on the value of earlier tax paid as well. This is called cascading effect.

From the discussion it becomes clear that taxes are paid by the intermediaries at different stages of production and distribution cycle. But finally these taxes are passed on to the final consumers. As the tax is passed

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on to the final consumer it is not an expense to the intermediaries. As long as this cascading effect is not eliminated, there is no transparency as to how many times tax is paid on the different elements of the cost. The system of tax collection is naturally not an efficient one, and the products become less competitive.

An efficient tax system demands that there should be no cascading effect. The total amount of tax paid on different elements of the cost of the product should be clear and transparent from the document/ invoice. The internationally adopted best practice for this is to allow credit of tax paid at every stage earlier, while levying tax at any stage of the production and distribution chain. The basic purpose of allowing credit is therefore to eliminate cascading effect, and making the products competitive. Under the credit system, the intermediaries charge tax on the goods and services provided to their customers and claim credit of taxes paid on procurement of their goods and services. This helps to:

- (i) avoid or minimize cascading effect of taxes;
- (ii) minimize tax incidence on the ultimate consumer of goods / services;
- (iii) ensure levy of tax only on value addition by respective assessee; and
- (iv) eliminate or minimize possibilities of levy of tax on tax.

Chapter 2

Effect of Credit on Cost of Purchase

As per Accounting Standard 2 issued by the Institute of Chartered Accountants of India, [corresponding IND AS 2] costs of purchase consist of the purchase price including duties and taxes (*other than those subsequently recoverable by the enterprise from the taxing authorities*), freight inwards and other expenditure directly attributable to the acquisition. Trade discounts, rebates, duty drawbacks and other similar items are deducted in determining the costs of purchase.

The above definition of cost of inventories as per AS 2 is modified to the extent that the highlighted portion above is deleted in Income Computation and Disclosure Standards (ICDS II). The issue relating to whether the value of closing stock of the inputs, work-in-progress and finished goods must necessarily include the element for which CENVAT credit is available has been a matter of considerable litigation.

As per section 145A of the Income Tax Act, 1961 valuation of inventory for the purposes of determining the income chargeable under the head "Profits and gains of business or profession" shall be in accordance with the method of accounting regularly employed by the assessee and further *adjusted to include* the amount of any tax, duty, cess or fee (by whatever name called) actually paid or incurred by the assessee to bring the goods to the place of its location and condition as on the date of valuation. For the purpose of section 145A any tax, duty, cess or fee (by whatever name called) under any law for the time being in force, shall include all such payment *notwithstanding any right* arising as a consequence to such payment.

As per the requirements of section 44AB of the Income-tax Act, 1961, auditors are also required to provide details of deviation, if any, from the method of valuation prescribed under section 145A, and the effect thereof on the profit or loss in Form 3CD.

The ICAI in its Guidance Note on Tax Audit under section 44AB of the Income-tax Act, 1961 ('the guidance note') has stated as follows:

"23.23 The adjustments envisaged by section 145A will not have any impact on the trading account of the assessee. In other words, both under exclusive method of accounting and inclusive method of accounting, the gross profit in the trading account will remain the same."

Chapter 3

Effect of Credit on Assessable Value

The issue as to whether the duty paid on the inputs (and for that matter input services), which is eligible for input credit, shall form part of the value (assessable value) for the purpose of levy of duty on the final products has been the subject matter of litigation quite often,. In the case of *Collector of Central Excise, Pune vs. Dai Ichi Karkaria Ltd.*, (1999) 112 E.L.T. 353 (S.C.), vide order dated 11.08.1999 this issue came up before the Apex Court.

The facts of the case were that the manufacturer purchased raw material and used it in the manufacture of an intermediate product. He then used the intermediate product in the manufacture of a final product. The raw material and the intermediate product were liable to excise duty and they were specified goods for the purposes of the then MODVAT (input credit) scheme. The assessable value of the intermediate product for the purposes of excise duty was to be determined on the basis of its cost. In determining the assessable value of the intermediate product, the cost of the raw material was to be taken into account. The question was:

- (a) is part of the cost of the raw material the price paid by the manufacturer to its seller, as contended by the Revenue, or
- (b) is it the price of the raw material less the excise duty thereon, which has been paid by the seller and for which the manufacturer is entitled to credit under the MODVAT scheme, to be utilised against the payment of excise duty on products manufactured by him, including the intermediate product, as contended by the manufacturer?

The Department was of the view that the assessable value of the intermediate product will include the price paid by the manufacturer to its seller, including the duty paid thereon, although the same is eligible for the then MODVAT credit.

The learned Attorney General on behalf of Revenue submitted that, the credit under the MODVAT scheme taken by the manufacturer, equal to the excise duty paid on the raw material, was not to be taken into account to reduce the price paid by the manufacturer to the seller of the raw material. In other words, the price paid by the manufacturer to the seller of the raw material was part of its cost to the manufacturer and it had to be taken into account in computing the assessable value of the excisable product.

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The Apex Court observed : “the cost of the excisable product for the purposes of assessment of excise duty under Section 4(1)(b) of the Act read with Rule 6 of the Valuation Rules should be reckoned as it would be reckoned by a man of commerce. We think that such realism must inform the meaning that the Courts give to words of a commercial nature, like cost, which are not defined in the statutes which use them. A man of commerce would, in our view, look at the matter thus: “I paid ₹ 100/- to the seller of the raw material as the price thereof. The seller of the raw material had paid ₹ 10/- as the excise duty thereon. Consequent upon purchasing the raw material and by virtue of the MODVAT scheme, I have become entitled to the credit of ₹ 10/- with the excise authorities and can utilise this credit when I pay excise duty on my finished product. The real cost of the raw material (exclusive of freight, insurance and the like) to me is, therefore, ₹ 90/-. In reckoning the cost of the final product I would include ₹ 90/- on this account.” This, in real terms, is the cost of the raw material (exclusive of freight, insurance and the like) and it is this, in our view, which should properly be included in computing the cost of the excisable product.” [Para 24]

“The view we take about the cost of the raw material is borne out by the Guidance Note of the Institute of Chartered Accountants of India, and there can be no doubt that this Institute is an authoritative body in the matter of laying down accountancy standards”. [Para 25]

The answer the Question involved in these appeals, is that in determining the cost of an excisable product covered by the MODVAT scheme under Section 4(1)(b) of the Act read with Rule 6 of the Valuation Rules ,the excise duty paid on raw material also covered by the MODVAT scheme, is not to be included. [Para 26]

In another case of *CCE v. Atic Industries Ltd.* (1992)(7 TMI 161 – CEGAT, New Delhi vide Order dated 14.07.1992 the Excise Tribunal examined a similar issue. Briefly stated the facts of the case were that the respondents are engaged in the manufacture of various types of Dyes and Dye Intermediates. They were served with 6 Show Cause Notices under Section 11A for the period December 1987 to April 1990 seeking recovery of a sum of ₹ 3,14,70,136.64 on the ground that they had failed to pay proper Central Excise duty by not including the element of MODVAT Credit availed on the inputs in the value of their final products. The aforesaid demands were confirmed by the Assistant Collector by his Order dated 29-6-1990. The respondents being aggrieved by the order passed by the Assistant Collector filed an appeal before the Collector (Appeals), Ahmedabad. In the impugned

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Order dated 20-12-1990 the Collector (Appeals) set aside the Order passed by the Assistant Collector on the ground that having regard to the relevant provisions of the law there could be no justification to include the MODVAT Credit availed on the inputs by the assesseees in the assessable value of his final products. Against the Order passed by the Collector (Appeals), the Department preferred an appeal to the Tribunal..

While examining the issue, the Tribunal referred to its earlier judgment in case of *CCE v. Incab Industries n* (1990) 45 ELT 342 where in at paragraph 17 it was observed as follows-

“As stated in the earlier paragraphs the benefit under MODVAT is given to avail the credit of duty paid on the inputs while paying duty on the final product. It has and it cannot have any effect on the assessable value which is to be determined in accordance with Section 4 of the Act. Further, the assessable value is to be determined in accordance with the provisions of the Act and the MODVAT Credit is provided by the rules and the rules cannot have any overriding effect on the provisions of the Act.”

Relying on its own judgment, the Tribunal held as follows-

“In the respondent’s case, the wholesale price as declared was ascertainable and if was also approved by the Department. Further there was no allegation that the appellants and their customer were related persons. Under these circumstances we are inclined to agree with the Collector (Appeals) that there was no justification whatsoever to include the MODVAT Credit availed by the respondents in the assessable value of the final product.”

Thus, it is a settled principle of law that the amount of duty/ tax paid on inputs / input services, which is eligible for credit, cannot be included in costing of the final products for determining the assessable value.

Chapter 4

Is Input Tax Credit a Right, Benefit, Reward or Privilege?

Often an issue that arises is whether the credit of input tax is a right to the assessee, a benefit allowed under the law, a reward or a privilege. One school of thought is that credit is an indefeasible right of the assessee, as observed by the Supreme Court in the case of *Collector Of Central Excise, Pune v Dai Ichi Karkaria Ltd .*, (1999) 8 TMI 920 in the context of the MODVAT scheme. It was stated that unless there is anything to the contrary, a person is entitled to take credit without any limitation in time.

The Supreme court in the case of *Eicher Motors Ltd. v. Union of India* (1999) 106 E.L.T. 3 (S.C.), again in the context of MODVAT, said that the credit is as good as tax paid.

Going by the stand that credit is an indefeasible right and equivalent as tax paid, credit should be available as and when claimed for. A taxable person utilizes input tax credit in respect of a tax period based on the current purchases as well as preceding months purchases if the credit has not been availed in those months. The law generally does not specifically or directly restrict the availment of input tax credit pertaining to the earlier periods, subject to a time limit. A taxable person may pay the output tax payable, either in cash or through the input tax credit account. This is paid by way of reducing the output tax payable, by the amount of input tax credit available with him.

The other school of thought is that it is not the right of the 'dealers' to get the benefit of input tax credit but a statutory benefit conferred to a dealer as observed by the Apex Court in the case of *Jayam & Co. v. Assistant Commissioner & Anr* (2016) 9 TMI 408. In the absence of an appropriate Input Tax Credit / CENVAT Credit Scheme, the dealer has no right of claim of input tax credit. The entitlement is created by the statute and entirely governed by the Statutory terms and conditions. Some High Courts have adopted this whenever any challenge to any restriction on input tax credit provisions had come before it.

The CGST Act provides a restriction on availment of credit beyond a specified period of one year from the invoice date. As it is a statutory benefit conferred to a dealer, an entitlement that is created by the statute, it shall be

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entirely governed by the statutory terms and conditions. Therefore, the time limit for claim of such a benefit along with other terms and conditions shall be required to be adhered to. Such time limit and other conditions may however create hardship in various situations where the recipient is not in a position to claim the benefit in time due to genuine reasons.

Credit Allowable on FG Held to be Liable to Duty and Claim of Exemption Overturned

It is a settled principle of law that in case a manufacturer has been claiming exemption from payment of duty under a *bona fide* belief about such exemption, then subsequently on such exemption being overturned, credit of duties and taxes paid on the inputs and input services used for manufacture of such final products on which exemption is overturned, should be allowed while determining the amount of duty payable.

The Supreme Court in case of *Formica India Division v. CCE*, (1995) 77 ELT 511 had taken this view. There was a dispute regarding allowability of credit on inputs used for manufacture of the final products, if duty is to be paid on the final products. The Supreme Court allowed the credit in this case, even after considering the fact that the prescribed procedure for availment of credit was not followed.

In case of *CCE v. Chemplast Sanmar*, (2009) 239 ELT 398 (Mad) (DB), the assessee was claiming exemption. Subsequently the claim of exemption was overturned and the final product was held to be liable to duty. The Court held that the CENVAT credit of inputs shall be available, even if the required procedure was not followed.

Similarly, in case of *SEW Construction Ltd. v. CCE*, (2011) 32 STT 120, the demand was confirmed for the period prior to registration. CENVAT credit on inputs was also allowed, provided that is not otherwise deniable. However, in the GST Law, since the statute itself provides for the time limit and other conditions, it is doubtful whether the credit would be allowed in a case where the procedure was not followed, similar to the situations as discussed above.

Chapter 5

Defects in the Erstwhile Laws- Exclusions under the State VAT, Central Excise, Service Tax Leading to Cascading Effect

CENVAT credit scheme was designed to avoid cascading effects but it was seen that the Government was diluting this basic philosophy of the rule by introducing many restrictions leading to cascading effect. In the earlier regime of central excise or even for that matter in the State VAT Laws, the terms 'inputs', 'input services' and 'capital goods' are defined with certain negative lists. Such negative lists restrict the scope of inputs, input services or capital goods, which in turn restricts the scope of availing input tax credit. This has been done to increase the revenue of the Government. There are some provisions in the erstwhile laws, viz. CENVAT Credit Rules, 2004 and the State VAT laws of different States, which restrict the flow of credit.

CENVAT Credit Rules, 2004

- (1) The definition of "capital goods" excludes motor vehicles falling under tariff heading 8702, 8703, 8704, 8711 used in the factory by manufacturers. Thus a manufacturer who purchases motor vehicle for transportation of goods within the factory. cannot claim CENVAT credit on it.
- (2) The definition of "inputs" consists of certain exclusions which also restrict the flow of credit like petrol, inputs used for construction or execution of works contract of a building or civil structure except when used for providing such services, motor vehicles, goods which have no direct relationship with the manufacture of the final product, goods primarily used for personal use or consumption of any employee such as food items, goods used in a guest house etc.
- (3) The definition of "input service" also consists of exclusions like service provided by way of renting of motor vehicle, service of general insurance business, servicing, repair and maintenance of motor vehicles which is not capital goods with certain exceptions, service portion in the execution of works contract and construction services

Defects in the Erstwhile Laws- Exclusions under the State VAT,...

except when the outward service is construction or works contract service, service provided in relation to outdoor catering, beauty treatment, health services etc. which are used for personal use or consumption of employee.

- (4) The CENVAT credit in respect of capital goods received in a factory or in the premises of the provider of output service shall be taken only for an amount not exceeding fifty per cent of the duty paid on such capital goods in the same financial year.
- (5) Another restriction of one year from the date of invoice has been imposed for availment of credit of inputs/input services, which very often leads to loss of credit.

State VAT Laws

- (1) Purchases of goods from within the State are only eligible for claiming ITC.
- (2) ITC is usually available (eg. In West Bengal) only for raw material used for manufacturing, packing materials, capital goods and its spare parts. Consumable stores, goods specified in the negative list, inter-state purchases are not eligible for ITC.
- (3) Many States provide that ITC can be claimed by the purchaser only when the payment of tax is made to the Government by the seller, and the same is furnished by the seller in his return.
- (4) In case of cross transactions, eg. purchase and sale with the same party, or trade discounts/ incentives received from suppliers, normally payments are made through crossed account payee cheques, net of such adjustments.

In such cases, ITC is often dis-allowed to the extent of the amount payable to the suppliers, which is adjusted against say, corresponding sales made to the same party, or discounts/ incentives receivable from the same party.

All such provisions lead to cascading effect, in genuine cases, which is against the very basic philosophy of Value added tax. This very defect in the erstwhile laws is sought to be removed through this new system of taxation in GST. Although some of the legacies continue to find place in the new law, some of these issues have well been addressed.

Chapter 6

Scheme of Input Tax Credit in GST

Section 9 of the CGST Act provides for levy of a tax called the CGST/ SGST on all intra-State supplies of goods and/or services and collection in such manner as may be prescribed.

Section 16 provides that every registered taxable person shall be entitled to *take credit of input tax, as self assessed* (which is actually subject to being proved by the claimant to be a valid claim) in his return and such amount shall be credited, *on a provisional basis*, to his electronic credit ledger to be maintained in the manner as may be prescribed.

It further provides that *every registered person shall be entitled to take credit of input tax* charged on *any supply* of goods or services to him which are used or intended to be used *in the course or furtherance of his business*.

“Input tax” for this purpose has been defined in clause (62) of section 2 to mean 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—

- (a) the integrated goods and services tax charged on import of goods;
- (b) the tax payable under the provisions of sub-sections (3) and (4) of section 9;
- (c) the tax payable under the provisions of sub-sections (3) and (4) of section 5 of the Integrated Goods and Services Tax Act;
- (d) the tax payable under the provisions of sub-sections (3) and (4) of section 9 of the respective State Goods and Services Tax Act; or
- (e) the tax payable under the provisions of sub-sections (3) and (4) of section 7 of the Union Territory Goods and Services Tax Act, but does not include the tax paid under the composition levy;

“Input tax credit” as defined in clause (63) of section 2 means credit of ‘input tax’ as defined in sub-section (62).

Thus, input tax means tax charged on any inward supply of goods and/or services. Credit of tax charged on any such supply shall be available if such supplies are used either *in the course of business* or *in the furtherance of business*.

Scheme of Input Tax Credit in GST

Therefore, to that extent there is a departure in GST regime in the scheme of credit from the earlier laws regime. The CENVAT credit scheme under the CENVAT Credit Rules, 2004 provides for credit of tax/ duty paid on *inputs*, *capital goods* and *input services*. The definitions of “inputs”, “capital goods” and “input services” therefore assumes significance. A very strict interpretation of the definitions is therefore warranted under the earlier laws. However, in the GST regime, since broadly all inward supplies of goods and/ or services are eligible, the terms “inputs”, “capital goods” and “input services” are not very significant. In fact, such terms have not even been used in the substantive provisions for input tax credit, as discussed above.

However, there are some specific circumstances, where there is a differential treatment of inward supplies of goods and services under GST. In case of *capital goods*, depreciation and input tax credit are mutually exclusive in terms of sub-section (3) of section 16. Credit of tax paid on *transitional stock of inputs* has been allowed in terms of the provisions of section 18 in case of a newly registered taxable person, either due to incurring liability for the first time, taking voluntary registration, ceasing to pay tax under composition scheme or an exempted supply becoming taxable one. Specific provision has been made for credit of inward supply of goods, which are sent for job work. Distribution of credit pertaining to inward supplies of services (input services) has been provided. In respect of various transitional issues while moving from earlier tax regime to GST regime, the inward supplies of goods and services (inputs and input services) are necessarily required to be differentiated. Apart from such specific circumstances, there is no need to distinguish inward supplies of goods and services.

The term “business” has been given a very wide meaning in clause (17) of section 2. “Business” includes-

- (a) any trade, commerce, manufacture, profession, vocation, adventure, wager or any other similar activity, whether or not it is for a pecuniary benefit;
- (b) any activity or transaction in connection with or incidental or ancillary to (a) above;
- (c) any activity or transaction in the nature of (a) above, whether or not there is volume, frequency, continuity or regularity of such transaction;
- (d) supply or acquisition of goods including capital goods and services in connection with commencement or closure of business;

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- (e) provision by a club, association, society, or any such body (for a subscription or any other consideration) of the facilities or benefits to its members
- (f) admission, for a consideration, of persons to any premises; and
- (g) services supplied by a person as the holder of an office which has been accepted by him in the course or furtherance of his trade, profession or vocation;
- (h) services provided by a race club by way of totalisator or a licence to book maker in such club;
- (i) Any activity or transaction undertaken by the Central Government, a State Government or any local authority in which they are engaged as public authorities shall be deemed to be business.

Section 17 of the CGST Act, 2017 however provides for restriction on claiming credit of tax paid on certain specified supplies of goods and services. This restriction is placed irrespective of the fact that such supplies are used for making some taxable outward supplies.

Thus, the scope of input tax credit under the GST regime is *prima facie* very wide as compared to the erstwhile CENVAT Credit Rules, 2004 or the State Value Added Tax Acts. In the CENVAT credit scheme, the inputs/ input services to be eligible for CENVAT credit should ₹ necessarily be used in or in relation to manufacture of final products, or that for providing a taxable output service. Similarly, under the State VAT laws, mostly the ITC was allowed only in respect of raw materials, packing materials and capital goods. Even consumables were not eligible for input tax credit in many States, although the same may be integrally connected with the sale of taxable goods.

As the object of taxation in GST is supply, which is a much wider concept than manufacture and removal in central excise, or that of sale of goods in State VAT, the scope of input tax credit should also be commensurately wider. The law in GST is not conservative to restrict the benefit of input tax credit by any means, especially since the Statement of Objects and Reasons for the Constitution amendment included elimination of cascading effect. However, such a conservative approach to ITC seems to have been continued to some extent even in the GST regime. Under the GST law, for claiming the benefit of ITC, it is necessary that the inward supply of goods or services is used in the course of business or in furtherance of business. This seems to be a narrower concept than that of supply. As the object of taxation

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in GST would be *supply*, which by itself is a very *wider* concept than that of *business*, ideally the input tax credit should also have been allowed on any inward supply which is *used* in the course of a taxable *supply*. The use of the inward supply may have been linked to the taxable outward supply, and not restricted to use in the course or furtherance of business. The scope of supply is wider enough to cover *something more than business*, as defined. Moreover, often the specified supplies of goods and services as provided in section 17 are used for making taxable supplies, but the credit on such supplies has been restricted. Therefore, every inward supply used in relation to a taxable outward supply should be made eligible for input tax credit. Otherwise, the scheme of input tax credit does not match with the philosophy of GST.

Chapter 7

Meaning of 'Furtherance of Business' – Impact of Credit

Section 9 provides for levy of tax on supply of goods and/ or services. "Supply" has been defined in section 3, which includes

- (a) all forms of supply for a consideration by a person *in the course or furtherance of business*,
- (b) importation of service, for a consideration *whether or not in the course or furtherance of business*, and (3) a supply specified in Schedule I, made or agreed to be made without a consideration.

Thus, "supply" has to be in the course of business or in furtherance of business, except when it is specifically provided otherwise, to be exigible to tax under GST. Moreover, the inward supplies of goods and/ or services should be used in the course of business or in furtherance of business. Thus, the phrase 'furtherance of business' assumes significance. Whenever it says the supply to be charged to tax should be made in the course or furtherance of business, it means the supply should be integrally connected with the business or it should have an effect of furthering the business. In other words, it should be a part of the objectives of the business.

The meaning of "supply made in the course or furtherance of business" given in the FAQ on GST released by CBEC says - No definition or test as to whether the activity is in the course or furtherance of business has been specified under the CGST Act. However, the following business test is normally applied to arrive at a conclusion whether a supply has been made in the course or furtherance of business:

1. Is the activity, a serious undertaking earnestly pursued?
2. Is the activity pursued with reasonable or recognizable continuity?
3. Is the activity conducted in a regular manner based on sound and recognised business principles?
4. Is the activity predominantly concerned with the making of taxable supply for consideration/ profit motive?

Meaning of 'Furtherance of Business' – Impact of Credit

The test may ensure that occasional supplies, even if made for consideration, will not be subjected to GST. The issue of taxing an occasional supply may however be subject to disputes.

Similarly, when the inputs and/ or input services are said to be used in furtherance of business, the use of such supplies should help in achieving the objectives of the business in a better and effective way. The inward supplies must necessarily have a direct or indirect nexus with the outward supplies.

Thus in view of the above provisions it can be concluded that inward supply of such goods and services which are not in the course or furtherance of business, shall not be eligible for input tax credit.

Chapter 8

Significance of Registration for Claiming Credit in GST

Section 16 provides that every registered person shall in the manner specified in section 49, *be entitled to take credit of input tax* charged on any supply of goods or services to him which are used or intended to be used in the course or furtherance of his business. To be entitled to take credit of input tax, the person should be registered as a taxable person under the GST law.

Sub-section (1) of Section 18 provides that a person who has applied for registration under the Act within thirty (30) days from the date on which he becomes liable to registration and has been granted such registration shall be entitled to take credit of input tax in respect of inputs held in stock and that 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.

Sub-section (2) of that section provides that a person, who takes voluntary registration under sub-section (3) of section 25 shall be entitled to take credit of input tax 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 of grant of registration.

Sub-section (3) provides that where any registered taxable person ceases to pay composition tax under section 9, he shall be entitled to take credit of input tax in respect of inputs held in stock, 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 section 9:

Sub-section (4) provides that where an exempt supply of goods or services by a registered taxable person becomes a taxable supply, such person shall be entitled to take credit of input tax in respect of inputs held in stock and inputs contained in semi-finished or finished goods held in stock relating 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:

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Thus in case of a new registrant or an erstwhile registrant becoming liable to pay tax other than under the composition levy, either due to incurring liability for the first time, taking voluntary registration, ceasing to pay tax under composition scheme or an exempted supply becoming taxable one, he can claim input tax credit of taxes paid on the transitional stock. This is strictly on the pre-condition that the taxable person is registered under the GST law. The credit on transitional stock under the above four conditions shall be subject to such other conditions and restrictions as may be prescribed.

Further, section 19 provides that the “principal” referred to in section 143 shall, subject to such conditions and restrictions as may be prescribed, be allowed input tax credit on inputs sent to a job-worker for job-work. Section 143 provides that a registered taxable person (referred to as “principal”) may send any inputs and/ or capital goods, without payment of tax, to a job worker for job-work. To avail the facility of sending inputs and/ or capital goods to a job worker without payment of tax, and still claiming input tax credit of the tax charged thereon, it is essential that the principal is a registered taxable person.

Therefore unless a supplier is a registered taxable person, he is not entitled to claim input tax credit of tax charged on his inward supplies of inputs, input services and capital goods, which are used for providing the taxable supplies. Disallowance of credit will increase the cost of the outward supplies of goods and services made by a supplier and will have a significant effect on his operational profit.

Where the aggregate turnover exceeds the threshold limit of twenty lakhs rupees in a financial year (10 lakhs for special category states), the taxable person becomes liable to obtain registration in terms of section 22, within a period of thirty days from the date on which he becomes so liable. A taxable person when registered, can charge tax at the stipulated rates on the invoices raised to the recipients for a supply. In case registration is not obtained, tax may not be allowed to be charged and collected from the recipients of such supplies made by him. In that case, the amount received against the supply effected may be treated as inclusive of tax, which will be a significant cost to the operations of the supplier. Once registration is obtained, tax can be collected on the full value of supply. The deposit amount shall however be reduced by the credit that be availed by the supplier. This will reduce cost and add to profitability. This is possible only

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when registration is obtained and procedures as prescribed thereafter are followed properly.

For Claiming Credit in GST Registration is Significant: A Retrograde Step

CENVAT Credit Rules had provided in Rule 3(1) that a manufacturer or producer of final products or a provider of output service is allowed to take credit of specified duties and taxes. It does not provide for allowing credit only to a registered person.

The Central Goods and Services Tax Act, 2017 on the other hand restricts the credit of input tax to a registered person only. As per Section 16(1) of the Act every registered person shall be entitled to take credit of admissible input tax.

Under the erstwhile regime *registration with Department was not a pre-requisite for claiming credit*. This view has already been upheld by Karnataka High Court in the case of *mPortal India Wireless Solutions Pvt Ltd* [(2012) 27 S.T.R. 34 (Kar.)]. This view has further been recently confirmed by the Karnataka High Court in the case of *Kyocera Wireless (India) Pvt Ltd* [(2016) 43 S.T.R. (Kar)].

However in the CGST Act the aforesaid position will be distinguished as the law specifically restricts availment of input tax credit to the registered persons only. This provision is certainly a retrograde step, as credit has consistently been held to be a right and not a benefit. Credit is an indefeasible right of the assesses, as observed by the Supreme Court in the case of *Collector Of Central Excise, Pune v Dai Ichi Karkaria Ltd* (1999) 8 TMI 920 in the context of the MODVAT scheme. It was stated that unless there is anything to the contrary, a person is entitled to take credit without any limitation in time. The Supreme court in the case of *Eicher Motors Ltd. v. Union of India* (1999) 106 E.L.T. 3 (S.C.), again in the context of MODVAT, said that the credit is as good as tax paid. The provision denying credit in the absence of registration, which is only a procedural provision, is nothing but restricting the right of the assesses, treating the same as a benefit provided under the statute.

This is certainly a retrograde step, against the principle laid down by the Supreme Court. Reports suggest that apprehensions of misuse of the input tax credit scheme in the federal structure of the economy lead to such law, based entirely on the matching concept, for which registration is a mandatory

Significance of Registration for Claiming Credit in GST

requirement. Arguments are being placed that without such restrictions, GST in India cannot be conceptualized. It is further stated that successful implementation of GST requires more and more involvement of dealers to come into the GST chain (specifically those who are in value chain) so that cascading effect can be minimized. This provision will force dealers to come into the net of GST, as the recipients will not be interested to procure goods / services from unregistered suppliers.

Chapter 9

What are the 'Vesting' Conditions for Credit?

Section 16 provides that every registered taxable person shall be entitled to take credit of input tax charged on any supply. Thus, there are few vesting conditions as follows-

- i) The first and foremost condition is that the taxable person should be a *registered person* for claiming credit. No credit is allowed to a taxable person unless he is registered under the law. For example, a person may not be paying tax on his outward supplies under the *bona fide* belief that such supplies are not liable to tax. Subsequently the Department of Revenue may seek to charge tax thereon, contending it to be taxable, without allowing any credit for the tax charged on the corresponding inward supplies which were used for such outward supplies.
- ii) Secondly, the goods and/ or services received should be used or intended to be used by the recipient *in the course of his business or in the furtherance of his business*. As long as the inward supplies are used either in the course of business, or in the furtherance of business, credit of tax paid thereon can be availed. The term "business" for this purpose has been defined in clause (17) of section 2. In case the inward supply of goods and/ or services received is attributable to an activity which is outside the purview of business, no credit can be availed.
- iii) Apart from the above, there are other vital conditions as follows- Section 41 provides that every registered taxable person shall be entitled to take credit of input tax, as self-assessed in his return and such amount shall be credited, on a provisional basis, to his electronic credit ledger. The claim of input tax credit in respect of invoices and/or debit notes relating to inward supply that match with the details of corresponding outward supply shall be finally accepted.

Section 16 further provides that notwithstanding anything contained in section 16, but subject to the provisions of section 41 regarding taking the credit on provisional basis, the registered taxable person shall be

What are the 'Vesting' Conditions for Credit?

entitled to the credit of any input tax in respect of any supply of goods and/or services subject to the conditions specified below –

- (iv) -The person is *in possession of a tax invoice* or debit note issued by a supplier registered under this Act, or such other taxpaying document(s) as may be prescribed.

-He has *received* the goods and/or services. In case the goods and/ or services were supplied by the supplier at the end of a month, and the same is received by the recipient in the subsequent month, the credit can be claimed only in the subsequent month after the said goods/ services are received.
- (vi) The **tax charged** in respect of such supply has been **actually paid** to the account of the appropriate **Government**, either in cash or through utilization of input tax credit admissible in respect of the said supply. This can be ensured only by ensuring that the inward supply details is matched with the corresponding outward supply details furnished by the suppliers.
- (vii) He has furnished the **return** under section 39. In other words, until and unless the statutory return is filed, showing the claim of input tax credit in the electronic credit ledger, no credit will be allowed.
- viii) In respect of the goods against an invoice **received in lots or installments**, the credit shall be allowed upon receipt of the last lot or installment. Usually, under the central excise law, there is a provision that in case of removal of different parts and components of a plant and machinery (say) in different lots, either separate invoices are to be prepared or a consolidated invoice may be prepared with specific permission in this regard. In GST, there may not be any such condition for issuance of invoice in respect of removal of every lot/ installment. It may so happen that only one consolidated invoice is issued in respect of different lots/ installments. In such a case, the credit can be claimed only on receipt of the last lot/ installment covered by such invoice/ debit note.
- ix) In case of inward supply of services, a recipient is mandatorily required to **pay** to the supplier of services, the amount towards the **value of supply along with tax** payable thereon within a period of three months from the date of issue of invoice by the supplier.

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- x) In case of failure to make the payment as above within the specified period of three months, an amount equal to the input tax credit availed shall be added to his output tax liability, along with interest thereon.
- xi) In respect of capital goods, input tax credit is allowed only if depreciation is not claimed on the tax component of the cost of such capital goods under the Income Tax Act.
- xii) The input tax credit in respect of any invoice or debit note for supply of goods or services can be claimed latest by the earlier of the following-
 - furnishing of the return under section 39 for the month of September following the end of financial year to which such invoice or invoice relating to such debit note pertains; or
 - furnishing of the relevant annual return.

For example, in respect of any invoice issued either in April 2018 or in March 2019, the credit can be claimed latest by the date of filing the return for the quarter ended September 2019, or the date of filing of annual return for the financial year 2018-19, whichever is earlier.

Chapter 10

Need for Definition of Inputs and Capital Goods

In any business, goods or services are procured upon payment of different kinds of indirect taxes. The goods or services procured, for sales as such or for use in the manufacture of final products or in providing output service or outward supply (in GST regime all taxable event will merge in supply of goods and or services), may be broadly categorized into inputs, capital goods and input services.

As under the erstwhile regime, credit is specifically allowed on inputs, capital goods and input services, therefore definition of the said terms assume significance. Accordingly if any goods / services do not qualify the definition of input / capital goods / input services, then credit is not allowed under the erstwhile scenario.

In the GST regime, as per Section 16(1) of the CGST Law, every registered taxable person shall be entitled to *take credit of input tax* charged on any supply of goods or services which are used or intended to be used in the course or furtherance of business. The term input tax has been defined to mean IGST, CGST and SGST charged on any supply of goods and / or services to a taxable person and includes tax payable under reverse charge but does not include tax paid under composition scheme.

The law does not distinguish between inputs, input services or capital goods for the purpose of availment of credit, although the terms 'input', 'input service' and 'capital goods' have been defined.

In the GST law input, input services and capital goods have been defined in the following manner –

- **Input** – any goods other than capital goods used or intended to be used by a supplier in the course or furtherance of business,
- **Input service** – any service used or intended to be used by a supplier in the course or furtherance of business,
- **Capital goods** – goods, the value of which is capitalized in the books of accounts of the person claiming the credit and which are used or intended to be used in the course or furtherance of business.

Background Material on Seamless Credit

The provisions of section 16(1) providing for input tax credit of tax charged on any inward supply of goods and/ or services, do not use the terms input, input service and capital goods. However, there are certain specific transactions where there is a differential treatment for credit of tax paid on goods and that on services. Thus, although such definitions are not required for availment of input tax credit in general, recognition of goods or services as inputs or capital goods or input services assumes significance in the following circumstances-

- i) In case of *capital goods*, depreciation and input tax credit are mutually exclusive in terms of sub-section (3) of section 16. There is no such provision for disallowance of credit in respect of the tax component on inputs and input services, where the cost of inputs and input services along with the tax element has been debited in the profit & loss account.
- ii) Credit of tax paid on *transitional stock of inputs* has been allowed in terms of the provisions of section 18 in case of a newly registered taxable person, either due to incurring liability for the first time, or taking voluntary registration, or ceasing to pay tax under composition scheme or an exempted supply becoming a taxable one. Corresponding provision for credit of tax paid on input services per se has not been allowed during such transition. This is possibly considering the fact that input services, being intangible, cannot be in stock at any point of time.
- iii) Provision is made for payment of an amount equal to the input tax credit taken on the capital goods, or the tax on the transaction value of such capital goods, whichever is higher, in case of *supply of such capital goods*. [Section 18(6)]
- iv) Specific provision has been made for credit of inward supply of goods, which are sent for *job work*. The goods sent for job work, after taking the credit, need to be returned within a specified period. While in case of inputs the time period is one year, in case of capital goods the time period is three years. [Sections 19, 143];
- v) Distribution of credit pertaining to inward supplies of services (input services) has been provided.
- vi) In respect of various transitional issues while moving from earlier tax regime to GST regime, the inward supplies of goods and services

Need for Definition of Inputs and Capital Goods

(inputs and input services) are necessarily required to be differentiated.

Apart from such specific circumstances, there is no need to distinguish inward supplies of goods and services in the GST regime.

Chapter 11

Negative List for ITC

Based on the character, definitions are generally of two types (i) inclusive - i.e. providing what all is covered by specification while leaving the scope open to others also to be covered within the ambit of the provision, (ii) exclusive (or 'means' definition) - i.e. those providing an exhaustive meaning to the term and no other meaning is permissible.

In the earlier regime of central excise or even for that matter in the State VAT Laws, the terms 'inputs', 'input services' and 'capital goods' are defined with certain negative lists. Such negative lists restrict the scope of inputs, input services or capital goods, which in turn restricts the scope of availing input tax credit.

Under the GST law the terms 'input's, 'input services' and 'capital goods' have been defined in a simplified manner without any exclusion clause. However Section 17(4) of the CGST Act provides a negative list of goods / services on which no input tax credit will be allowed. The basic purpose of providing exclusion clauses or negative lists is to restrict the scope of input tax credit, which certainly results in proportionate cascading effect. The supplies on which ITC has been unconditionally denied are as follows-

- (a) *Motor vehicles and other conveyances* - In effect, a taxable person, be it a manufacturer of goods, a re-seller of goods or a service provider, will not be entitled to take credit of tax charged on the motor vehicles received by him. Very often companies / organisations use motor vehicles to provide transport facility to their employees/ workers for commuting from home to work, work to home, or even from work to different places on duty. Due to such denial of credit, there has to be some cascading effect.

The credit would, however, be allowed when such motor vehicles/ conveyances are used in respect of the following supplies-

- (A) further supply of such vehicles or conveyances, eg. An auto dealer.
- (B) transportation of passengers, eg. A tour operator or a passenger transport operator like State Road Transport Corporations etc.

Negative List for ITC

- (C) imparting training on driving, flying, navigating such vehicles or conveyances, eg. A motor training school.

Credit is also allowed when the motor vehicle or conveyance, as the case may be, is used for transportation of goods.

- (b) Supply of specified goods and services, namely,
- (i) *Food and beverages, outdoor catering, beauty treatment, health services, cosmetic and plastic surgery, which are usually used for personal consumption.* However, a company organizing a conference of dealers/ distributors etc. often avail the supplies of food & beverages, outdoor catering etc. Tax charged to them on such supplies would not be eligible for input tax credit, resulting in increased cost of such activities. However, where such inward supply of goods or services of any particular category is used by a registered taxable person for making an outward taxable supply of the same category of goods or services, credit is allowed.
 - (ii) *Membership of a club, health and fitness centre* is also not eligible for credit. In present times, many companies or many commercial buildings have health centres, where the executives of the companies can go and re-energize themselves through workouts. This cost is kept outside the purview of ITC chain, which would make it costlier.
 - (iii) *Rent-a-cab, life insurance and health insurance.* An exception to this is such services received where 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. This exception is restricted to those employers who provide such facilities to their employees under a statutory obligation. In other words, where an employer provides similar facilities to their employees as a HR policy without any statutory obligation, the same would be outside the purview of credit chain, making the facilities costlier.
 - (iv) *Travel benefits extended to employees on vacation such as leave or home travel concession.* This would also discourage any such benefit being provided by an employer to an employee.
- (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. Thus, works contract services received for construction of an office building, laboratory building, factory shed/ godowns, boundary walls etc. would

Background Material on Seamless Credit

not be eligible for input tax credit. However, a specific exclusion is made in relation to works contract service for construction of plant & machinery. Therefore, works contract services availed in relation to construction or setting up of a new plant, say a paper mill or a cement plant, at site, would be eligible for credit, irrespective of the argument whether such plant & machinery is attached to earth like an immovable property or not. It seems such services, to the extent relating to foundation or support structures for plant & machineries, would also be eligible for credit.

- (d) Goods or services 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.

“Construction” for this purpose is stated to include re-construction, renovation, additions or alterations or repairs, to the extent of capitalization, to the said immovable property.

‘Plant and Machinery’ means apparatus, equipment, machinery, pipelines, telecommunication tower fixed to earth by foundation or structural support that are used for making outward supply and includes such foundation and structural supports but excludes land, building or any other civil structures.

- (e) Goods and/or services on which tax has been paid under section 10 which provides for levy of tax under *composition scheme*. Under the scheme, the proper officer may permit a registered taxable person, whose aggregate turnover in the preceding financial year did not exceed seventy five lakh rupees (refer Notification No. 8/2017-Central Tax dated 27th June, 2017), to pay, in lieu of tax payable by him, an amount calculated at the prescribed rate, of the turnover in a State, during the year. For Special Category States, the aggregate turnover limit has been fixed at fifty lakh rupees except for Uttarakhand which has opted for limit of Seventy Five Lakhs rupees.
- (f) Goods and/or services used for personal consumption.
- (g) *Goods lost, stolen, destroyed, written off or disposed of by way of gift* or free samples. Credit in such cases is denied although it may be reasonably argued that such loss or destruction is in the course of business.
- (h) Tax paid in terms of sections 74, 129 or 130. Section 74 provides for payment of tax along with interest and penalty in cases where tax has

Negative List for ITC

not been paid or short paid by reason of fraud, or any willful misstatement or suppression of facts to evade tax. Section 129 provides for payment of applicable tax following detention or seizure of goods and the conveyance used as a means of transport for carrying such goods, in transit in contravention of the provisions of the Act.

Chapter 12

Apportionment of Credit between Taxable and Exempt Supplies

Section 16 provides that *every* registered taxable person shall in the manner specified in section 44, *be entitled to take credit of input tax* charged on any supply of goods or services to him which are *used* or intended to be used *in the course or furtherance of his business*. In case any inward supply of goods and/ or services is used for non-business purpose, the credit thereon is not allowed. Therefore, section 17(1) provides that where the goods and/or services are used *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.

Further, section 49(4) provides that the amount available in the credit ledger may be used for making any payment towards output tax in such manner and subject to such conditions and within such time as may be prescribed. Section 17(2) provides that where the goods and / or services are used *partly for effecting taxable supplies* including zero-rated supplies under this Act or under the IGST Act, 2016 and *partly for effecting exempt supplies* under the said Acts, the amount of credit shall be restricted to so much of the input tax as is *attributable to the said taxable supplies* including zero-rated supplies.

Exempt supplies for this purposes shall include supplies on which recipient is liable to pay tax on reverse charge basis under sub-section (3) of section 9. This means although the supplies taxed under reverse charge are liable to tax, the credit chain will break. The benefit of credit cannot be passed on, which will lead to cascading effect.

Special provision is made for 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. Such companies have been given the option either to claim proportionate credit attributable to the taxable supplies only, or avail of, every month, an amount equal to fifty per cent of the eligible input tax credit on inputs, capital goods and input services in that month. This is similar to the provision under the earlier regime of CENVAT Credit Rules, 2004. The option under this once exercised shall not be withdrawn during the remaining part of the financial year.

Apportionment of Credit between Taxable and Exempted Supplies

The Central or a State Government may, by notification prescribe the manner in which the proportionate credit referred to herein above may be attributed.

Rule 42 of the CGST Rules provides for the manner in which ITC in respect of inputs or input services when partially used for taxable supplies and partly for other purposes, shall be apportioned.

It is to be noted that Rule 42 of the CGST Rules provides for a mechanism wherein the taxable person is required to segregate the total ITC of input and input services attributable to exclusively for taxable supplies including zero-rated supplies, exempt supplies, ITC of input and input services attributable exclusively other than business purposes. Then the common ITC of input and input services shall be segregated into ITC attributable to exempted supplies, which shall be segregated by using a proportionate method and 5% of such common ITC shall be considered to be used for non-business purposes. The apportioned ITC attributable to exempted supplies and non-business purposes shall be added to the output tax liability of the taxable person. An example explaining the entire process as to apportionment of ITC of input and input services is given hereunder:

Reference	Particulars	Amount
T	Total ITC involved on inputs and input services in a tax period	10,00,000/-
T1	The amount of input tax, out of 'T', attributable to inputs and input services <i>intended to be used exclusively for purposes other than business</i>	20,000/-
T2	The amount of input tax, out of 'T', attributable to inputs and input services intended to be used <i>exclusively for effecting exempt supplies</i>	20,000/-
T3	The amount of input tax, out of 'T', in respect of inputs and input services on which <i>credit is not available under sub-section (5) of section 17</i>	20,000/-
C1	$C1 = T - (T1 + T2 + T3)$ The amount of input tax credit credited to the electronic credit ledger of registered person	9,40,000/-

Background Material on Seamless Credit

	<p><i>It is to be noted that practically, a taxable person will start his calculation from C1, as C1 is the credit of electronic ledger balance, the same shall be available with him all the time.</i></p> <p>Further , C1 is the common input tax available with the taxable person</p>	
T4	The amount of input tax credit attributable to inputs and input services <i>intended to be used exclusively in relation to taxable supplies</i> but including zero rated supplies.	5,00,000/-
C2	<p>$C2 = C1 - T4$</p> <p>This is the common input tax including</p> <p>(a) the amount of input tax credit attributable towards exempt supplies and</p> <p>(b) the amount of credit attributable to non-business purposes if common inputs and input services are used partly for business and partly for non-business purposes;</p>	4,40,000/-
D1	<p>This is the portion of input tax will be added to the output tax liability: [the amount of input tax credit attributable towards exempt supplies]</p> <p>$D1 = (E \div F) \times C2$</p> <p>'E' is the aggregate value of exempt supplies during the tax period, (assuming 25 lacks) and</p> <p>'F' is the total turnover in the State of the registered person during the tax period (assuming 1 crore)</p> <p>Provided that where the details pertaining to turnover during the said tax period are not available then the value of 'E/F' shall be calculated by taking values of 'E' and 'F' of the last tax period for which details of such turnover are available.</p>	1,10,000/-
D2	This is the portion of input tax that will also be to the output tax liability: [the amount of	22,000/-

Apportionment of Credit between Taxable and Exempted Supplies

	credit attributable to non-business purposes] D2= C2*5%	
C3	C3 = C2 - (D1+D2) C3 shall be the remainder of the common credit which shall be the eligible ITC attributed to the purposes of business and for effecting supplies other than exempted supplies but including zero rated supplies.	3,08,000/-

It is to be noted that D 1 and D2 shall be added to the output tax liability of the taxable person.

To summarise, the taxable person shall have the amount of eligible ITC in his electronic credit ledger account (C1) and after computing D1 and D2 (as specified above), the taxable person would be required to add D1 and D2 in its output tax liability. Thereby, C3 has no practical applicability; it will be automatically reflected in the return.

Further, the above computation shall be made on a monthly basis and for the entire year before the due date for furnishing of the return for the month of September by a taxable person. If the , total of (D1 +D2) computed monthly exceeds the year end computation of (D1+D2) then such excess credit shall be claimed in its electronic credit ledger. However, if the total of (D1 +D2) the year end computation exceeds monthly computation of (D1+D2) then such excess credit shall be added back to the output liability and will be liable for payment with interest. Further, the above computation needs to be done for IGST, CGST and SGST separately each month.

Chapter 13

Input Service Distributors

A company may have different factories and/ or branches located in different States (or even may be within the same State) from where goods and/ or services are supplied, on payment of GST. These factories/ branches are tax-paying units of the same company having the same PAN (Permanent Account Number under the Income Tax Act). Thus, tax is payable at each of the tax-paying units, State-wise or registration-wise. The tax liability may be discharged either in cash or from the input tax credit account. Therefore, the credit of tax charged from the company by different suppliers of inward supplies need to be apportioned to the tax-paying units. Bills for supply of services are however normally raised on the company at their head office or registered office or corporate office, as the case may be. The law provides for taking input tax credit on the basis of an invoice or bill or any other duty paying document only. The credit of tax charged on the bills for inward supply of services can, therefore, be taken at such head office or registered office or corporate office, as the case may be. The law therefore provides for registration of such office under the GST law for taking the credit and distribution of the credit to various tax paying units. Such an office is termed as input service distributor.

"Input Service Distributor" has been defined in clause (61) of section 2 to mean an office of the supplier of goods and / or services which receives tax invoices issued under section 31 towards receipt of input services and issues a prescribed document for the purposes of distributing the credit of CGST (SGST under the State Acts) and / or IGST paid on the said services to a supplier of taxable goods and / or services having same PAN as that of the office referred to above.

Distribution of Credit Where the Distributor and Recipient are in Different States

Section 20 provides for the manner of distribution of credit by an input service distributor. Where the Distributor and the recipient of credit are located in different States, the Input Service Distributor shall distribute the credit of CGST as CGST or IGST and IGST as IGST or CGST. Similarly the Input Service Distributor shall distribute the credit of SGST as SGST or IGST.

Distribution of Credit Where the Distributor and Recipient are in the Same State

Where the Distributor and the recipient of credit, being a business vertical, are located in the same State, the Input Service Distributor shall distribute credit of CGST and IGST as CGST. Similarly the Input Service Distributor shall distribute the credit of SGST and IGST as SGST.

The credit in both the situations as above shall be distributed by way of issue of a prescribed document. The document shall contain, inter alia, the amount of input tax credit being distributed or being reduced thereafter. The manner of distribution of the credit shall be prescribed separately by way of Rules.

Conditions for Distribution

The Input Service Distributor may distribute the credit subject to the following conditions:

- (a) The credit can be distributed against a prescribed document issued to each of the recipients of the credit so distributed. Generally such a document may be called an ISD Invoice. Such document (say ISD Invoice) shall contain details as may be prescribed.
- (b) The amount of the credit distributed shall not exceed the amount of credit available for distribution.
- (c) The credit of tax paid on input services attributable to a recipient of credit shall be distributed only to that recipient. For example, a manufacturer may have three different factories in three different States, say Assam, West Bengal and Jharkhand, producing three different products, say pens, pencils and erasers respectively. In such case, the credit of tax paid on an input service which is specifically attributable to one product, say pens, need to be distributed only to the factory where pens are manufactured, so that it can be used for payment of tax on pens only.
- (d) The credit of tax 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. Say, an advertisement relates to only pens and pencils manufactured by the company. The credit of tax paid on the advertisement shall be distributed to the factories manufacturing pens and pencils only, i.e. to the States of Assam and West Bengal, and not to the factory manufacturing erasers, i.e. the State of Jharkhand. Further, such distribution shall be *pro rata* on the basis of the turnover in a State of such recipient, during the relevant

Background Material on Seamless Credit

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. In this case, the credit shall be distributed in the ratio of the turnover of the State of Assam and West Bengal manufacturing pens and pencils.

- (e) The credit 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 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. For example, the office rent in respect of the head office in Kolkata, is attributable to all the recipients. Therefore, the credit of tax paid on the office rent shall be distributed in all the three States, in their ratio of turnover.

Relevant Period

For the purpose of determining the ratio as above for distribution of credit, the “relevant period” shall be as follows-

- (a) If the recipients of the credit have turnover in their States in the financial year preceding the year during which credit is to be distributed, the said financial year; or
- (b) If some or all recipients of the credit do not have any turnover in their States in the financial year preceding the year during which the credit is to be distributed, the last quarter for which details of such turnover of all the recipients are available, previous to the month during which credit is to be distributed.

Turnover

“Turnover” for this purpose means the aggregate value of turnover, as defined under sub-section (6) of section 2. “Aggregate turnover” means the aggregate value of all taxable supplies, exempt supplies, exports of goods and/ or services and inter-State supplies of a person having the same PAN, to be computed on all India basis and excludes taxes, if any, charged under the CGST Act, SGST Act and IGST Act, as the case may be.

Recovery of Credit Distributed in Excess

In case of excess distribution of credit to one or more recipients in contravention of the provisions contained in section 21, such excess credit so distributed shall be recovered from such recipient(s) along with interest.

Input Service Distributors

The provisions of section 73 or 74 relating to demand and recovery of tax, as the case may be, shall apply *mutatis mutandis* for effecting such recovery.

Example: XYZ LTD. has an ISD which has availed IGST from its 4 (four) locations (A,B,C,D,) in the following manner:

- Invoice P: 1,00,000/- (IGST) attributable solely to A location
- Invoice Q: 1,00,000/- (IGST) attributable solely to A & B location
- Invoice R: 1,00,000/- (IGST) attributable to all locations

Particulars	A	B	C	D
Respective Turnover	10,00,000/-	20,00,000/-	30,00,000/-	40,00,000/-
Distribution of ITC of Invoice P				
ITC distributed (Invoice P was attributable to P only)	1,00,000/-	-	-	-
Distribution of ITC of Invoice Q				
Pro-rata ratio (turnover of location/aggregate turnover of all such locations)	33.33%	66.67%	-	-
ITC distributed	33,333/- (1,00,000*33.33%)	66,667/- (1,00,000*66.67%)	-	-
Distribution of ITC of Invoice R				
Pro-rata ratio (turnover of location/aggregate turnover of all such locations)	10%	20%	30%	40%
ITC distributed	10,000 (1,00,000*10%)	20,000 (1,00,000*20%)	30,000 (1,00,000*30%)	40,000 (1,00,000*40%)

Background Material on Seamless Credit

Following is a comprehensive illustration explaining the working of ISD as per Section 20 of the CGST Act and Rule 39 of the CGST Rules:

- Example: Yoko Infotech Ltd. has its head office in Mumbai, for which it additionally has an ISD registration. The company has 12 units across India including its head office. It receives the following invoices in the name of the ISD at Mumbai, for the month of January 2018:
- Invoice A: ₹ 100,000 @ IGST 18,000 issued by Peae Link Technologies (registered in Uttar Pradesh) for repairs executed in 2 units – Bangalore, Kolkata, Gurgaon (Note: Gurgaon location is not registered as it is engaged in making only exempt supplies);
- Invoice B: ₹ 300,000 @ CGST 27,000, SGST 27,000 issued by M/s. TechForce (registered in Pune) for repairs executed in 3 units – Mumbai, Bangalore, Kolkata;
- Invoice C: ₹ 500,000 @ IGST 90,000 issued by M/s. Georgia Marketing (registered in Bangalore) for marketing services for the company as a whole;
- Invoice D: ₹ 10,000 @ CGST 900 & SGST ₹ 900 issued by M/s. Gopal Coffee works (registered in Mumbai) for supply of beverages during the month to its Mumbai unit.
- All taxes have been considered at 18% (CGST and SGST at 9% each).

The turnover of each of the units during the year 2016-17 is: Mumbai: 1 crore; Bangalore 2 crore; Kolkata 1 crore; Gurgaon 2 crore; each of the other 8 units: 50 lakhs, resulting in the aggregate turnover of the company in the previous financial year, of 10 crores.

Distribution of credits by the ISD:

Particulars	Invoice	Bangalore	Kolkata	Mumbai	Gurgaon	8 units	Total
Invoice A							
T/o in State	Note 1	2 crore	1 crore	-	2 crore	-	5 crore
Pro-rata ratio		40%	20%	-	40%	-	100%
Credit	18,000	7,200	3,600	-	7,200	-	18,000
Type	IGST	IGST	IGST	-	IGST	-	
Invoice B							
T/o in State	Note 2	2 crore	1 crore	1 crore	-	-	4 crore
Pro-rata ratio		50%	25%	25%	-	-	100%
CGST Credit	27,000						
• Distribution		13,500	6,750	6,750	-	-	27,000
Type	CGST	IGST	IGST	CGST	-	-	
SGST Credit	27,000						

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• Distribution		13,500	6,750	6,750	-	-	27,000
Type	SGST	IGST	IGST	SGST	-	-	
Invoice C							
T/o in State	Note 3	2 crore	1 crore	1 crore	2 crore	0.5 * 8 crore	10 crore
Pro-rata ratio		20%	10%	10%	20%	5% * 8 units	100%
Credit	90,000	18,000	9,000	9,000	18,000	4,500 * 8 units	90,000
Type	IGST	IGST	IGST	IGST	IGST	IGST	
Invoice D							
Attributable to	Note 4	-	-	Yes	-	-	-
Credit (ineligible)	900	-	-	900	-	-	900
Type	CGST	-	-	CGST	-	-	
Credit (ineligible)	900	-	-	900	-	-	900
Type	SGST	-	-	SGST	-	-	

Credit of CGST, SGST and IGST on invoice		Total eligible credits distributed as CGST, SGST and IGST as applicable (Refer Note below)					
CGST	27,000	-	-	6,750	-	-	6,750
SGST	27,000	-	-	6,750	-	-	6,750
IGST	108,000	52,200	26,100	9,000	25,200	4,500 each (viz. total of 36,000)	148,500
TOTAL	162,000	52,200	26,100	22,500	25,200	36,000	162,000

It can be seen from the illustration that credit of CGST of ₹ 27,000 is distributed as CGST credit only to the extent of ₹ 6,750; likewise, credit of SGST of ₹ 27,000 is distributed as SGST credit only to the extent of ₹ 6,750. This is because, the intra-State service billed to the ISD is attributable to 1 unit in the same State as the ISD and 2 other units located in different State. Thus, the balance of CGST credit and SGST credit is distributed as IGST to such units. This is the reason why the credit of IGST lying with the ISD prior to distribution is only ₹ 108,000 while the credit of IGST that is distributed aggregates to ₹ 148,500.

Note 1: The credit of IGST should always be distributed as IGST credit to all the units to which the service is attributable, regardless of where they are located.

- The credits should be distributed only to those units to which the service is attributable. Given that the service mentioned in the case of Invoice A is attributable only to Bangalore, Kolkata and Gurgaon, the entire input tax credit applicable to the case should be distributed to the said 3 units, on a pro rata basis in the ratio of their respective 'Turnover in State' to the aggregate of the 3 'Turnover in State' (i.e., 2 Cr + 1Cr + 2 Cr). Further, no differentiation is made as to whether the unit is registered or not, and therefore, credit attributable to the Gurgaon unit is distributed to that unit although it is not registered, which implies, it is a loss of credit.

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- The 'turnover in State' is arrived at a value for the 'relevant period'. Since all 12 units were operational during the preceding financial year, the relevant period would be the preceding financial year.

Note 2: The credit of CGST and SGST should be distributed as IGST credit to all the units located outside the State in which the ISD is located, and as CGST and SGST respectively, in case of distribution of credit to a unit located in the same State as the ISD. Thus, the CGST and SGST credits are distributed as IGST credits to Bangalore and Kolkata, and as CGST & SGST respectively, to Mumbai.

- Given that the service supplied in terms of Invoice B is attributable only to Bangalore, Kolkata and Mumbai, the entire input tax credit applicable to the case should be distributed to the said 3 units, on a pro rata basis in the ratio of their respective 'Turnover in State' to the aggregate of the 3 'Turnover in State' (i.e., 2 Cr + 1Cr + 1 Cr).

Note 3: The credit of IGST is distributed as IGST credit to all the units to which the service is attributable.

- Invoice C relates to a supply of service that is attributable to all the units, and hence, the credits would be distributed on a pro-rata basis of the 'Turnover in State' of each of the units, to the aggregate of 'Turnover in State' of all the 12 units, i.e., ₹ 10 Cr.;
- For convenience of presentation, only one column is shown to reflect the distribution to each of the 8 units, having the same 'turnover in State', and to which the same invoice is attributable.

Note 4: Given that the services for receipt of food and beverages would not be eligible input services, the taxes relating to Invoice D should be distributed as ineligible input tax (900 + 900), and the distribution must be done separately.

Since the service is wholly attributable to the Mumbai unit, the distribution is done only to such unit.

- (i) **Distribution of credit where ISD and recipient are located in different States under CGST Act:** ISD can distribute as prescribed, credit of CGST as CGST or IGST and credit of IGST as IGST or CGST by issuing prescribed document mentioning the amount of credit distributed to recipient of credit located in different States.

Illustration: In the above illustration, if the corporate office of XYZ Ltd being an ISD situated in Delhi receives invoices indicating ₹ 4 lakhs

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of CGST in one service and ₹ 7 lakhs as of IGST in another case, it can distribute both CGST of ₹ 4 Lakhs as CGST or as IGST and credit of IGST of ₹ 7 Lakhs as IGST or CGST to its locations at Chennai, Mumbai and Kolkata under a prescribed document containing the amount of credit distributed.

- (ii) **Distribution of credit where ISD and recipient are located in different States under SGST Act:** ISD could distribute as prescribed credit of SGST as IGST only (and not as SGST of other State) by issuing a prescribed document containing the amount of credit ***distributed.***

Illustration: In the above illustration, the corporate office of XYZ Ltd., also received SGST of ₹ 6 Lakhs along with ₹ 4 Lakhs of CGST. It can distribute SGST credit as SGST or IGST to its locations at Chennai, Mumbai and Kolkata under a prescribed document containing the amount of credit distributed.

- (iii) **Distribution of credit where ISD and recipient are located within the State under CGST Act:** In cases where an entity has different registrations within the same State, it may have to distribute credit to such location also similar to locations with different registrations outside the State. In order to enable the same, it is Provided that ISD can distribute in the prescribed manner, credit of CGST and IGST as CGST by issuing prescribed document mentioning the amount of credit distributed to recipient being a business vertical.

Illustration: ABC Ltd., having its office at Bangalore is having another business vertical in Mysore which is separately registered. In such a case out of input tax credit of ₹ 4 lakhs of CGST and ₹ 10 lakhs of IGST the credit attributable to ABC Ltd, Bangalore, can be distributed partially or fully, to Mysore location as CGST.

- (iv) **Distribution of credit where ISD and recipient are located within the State under SGST Act:** Similar to the premises of CGST as indicated supra under CGST Act, even under the SGST Act, it is Provided that an ISD can distribute in the prescribed manner, credit of SGST and IGST as SGST (of the same State and none other State) by issuing prescribed document mentioning the amount of credit distributed to recipient being a business vertical.

Illustration: In the same example of ABC Ltd., above the input tax credit say ₹ 6 lakhs of SGST and 10 Lakhs of IGST can be distributed as SGST.

Background Material on Seamless Credit

Note: However, since IGST is already transferred as CGST under CGST Act, again the same ₹10 Lakhs cannot be transferred as SGST as it would violate the condition contained in Section 17(3)(b). Therefore the IGST credit has to be distributed either under SGST Act or CGST Act. In order to make this aspect clear there should be clarity in law which requires amendment.

Chapter 14

Conditional Credit in Case of Abatement in Rate of Tax

The basic purpose of allowing credit is to avoid cascading effect. However there must be a correlation between input tax and output tax i.e. only those input tax credits should be allowed which cause any output tax liability.

In indirect tax structure there is a standard tax rate which is applicable generally on most of the goods or services as the case may be. However there may be some composite activity which may comprise of such activity which is not liable to tax under a statute. In that case determination of value for such statute may become a difficult job.

For example, construction of complex (residential / commercial) involves supply of material as well as provision of service and also the value of land. Service tax can be charged only on the service portion. In this situation it becomes very difficult to determine the value of service involved in the construction of the complex. In order to mitigate this issue, 70% abatement has been prescribed on account of material cost and value of land which are not liable to service tax. It is to be noted here that construction service providers are not entitled to avail CENVAT credit on inputs used for providing construction service (if availing the abatement benefit). This seems to be logical too, since no service tax is being paid on material by the service provider the allowance of credit on inputs will be against the value added tax scheme.

In the erstwhile regime, the abatement under service tax law or State level VAT laws are provided to deduct the value of goods or services respectively. In GST regime as entire supply of goods and services will be liable to tax, the requirement of abatement on this ground will be drastically reduced. However as some items are outside the purview of GST, the requirement of abatement may still be there. For example, land is outside the purview of GST. Accordingly for determination of value of construction service by a builder under GST regime, abatement may be required for exclusion of value of land. However the scope of taking input tax credit will be widened by way of allowing input tax credit of inputs (goods) too. Input tax credit pertaining to the extent of land, if any, may be restricted.

Therefore in GST regime, minimum abatement will ensure higher credit as abatement can bring conditional credit only.

Chapter 15

Purpose of Deferment of Credit on Capital Goods

Capital goods in the input tax credit scheme generally refer to plant & machineries etc. The benefit of such plant & machineries, being fixed assets as per the generally accepted accounting principles, are to be available over a longer period of more than one financial year, may be five to ten years, or even more. Credit of tax paid on such capital goods, if allowed immediately in the financial year in which the same is received, will lead to mismatch of the credit with the corresponding output tax liability. This may adversely affect the revenue of the Government in the long run. Therefore to avoid such mismatch of allowing the credit in advance than the actual use of the assets, part of the credit on such goods is generally deferred for a financial year or two.

The earlier regime of CENVAT credit scheme provides for claim of CENVAT credit of duties paid on capital goods over a period of two financial years. Similarly, the input tax credit under the State VAT Laws in some States is staggered. There is no such staggering of credit in GST.

Rule 43 of the CGST Rules provides for the manner in which ITC in respect of Capital goods when partially used for taxable supplies and partially for other purposes shall be apportioned. It is to be noted that Rule 43 requires a taxable person to segregate ITC attributable to (a) capital goods used *exclusively for non-business purposes* or used or intended to be used exclusively for effecting exempt supplies and (b) used or intended to be used exclusively for effecting supplies other than exempted supplies but including zero-rated supplies. Once this segregation is done then the taxable person shall have common ITC which shall be further segregated into common credit attributable towards exempted supplies. It is to be noted that the useful life of such capital goods shall be taken as five years from the date of invoice for such capital goods. An example explaining the entire process as to apportionment of ITC of Capital goods for the month April 2018 is given hereunder:

Purpose of Deferment of Credit on Capital Goods

TABLE-A (FACT SHEET)

Particulars	Machine A	Machine B	Machine C	Machine D	Machine E
Purchase date	1 st April, 2018	1 st April, 2018	1 st April, 2018	1 st April, 2018	1 st January, 2018
Purchase Price	1,00,000/-	1,00,000/-	1,00,000/-	1,00,000/-	1,00,000/-
IGST	18,000/-	18,000/-	18,000/-	18,000/-	18,000/-
Invoice value	1,18,000/-	1,18,000/-	1,18,000/-	1,18,000/-	1,18,000/-
Utilisation of Machine	Exclusively for non-business purposes	Exclusively for effecting exempt supplies	Exclusively for effecting supplies <i>other than</i> exempted supplies but including zero-rated supplies	Partly for exempted supplies and partly for taxable supplies	For one quarter used exempted, now used for both taxable supplies and exempted supplies
Total common credit (A)	N.A	N.A	N.A	18,000/-	17100/- [18,000- {(18,000*5 %)}1 quarter] Note 1

Note 1. ITC shall be reduced at the rate of five percentage points for every quarter or part thereof.

Background Material on Seamless Credit

TABLE-B- REVERSAL OF ITC

Reference	Particulars	Amount
T1	The amount of input tax, out of 'T', attributable to Capital goods: (a) used or intended to be used <i>exclusively</i> for non-business purposes or (b) used or intended to be used <i>exclusively</i> for effecting exempt supplies The same shall be indicated in FORM GSTR-2 and shall not be credited to his electronic credit ledger	36,000/-
T2	The amount of input tax, out of 'T', attributable to Capital goods used or intended to be used <i>exclusively</i> for effecting supplies <i>other than</i> exempted supplies but including zero-rated supplies The same shall also be indicated in FORM GSTR-2 and shall be credited to the electronic credit ledge.	18,000/-
Tc	Total common credit (aggregate of A)	35,100/-
Tm for machinery D	The amount of input tax credit attributable to a tax period on common capital goods during their useful life: (18,000/60)	300/-
Tm for machinery E	The amount of input tax credit attributable to a tax period on common capital goods during their useful life: (17,100/ 60)	285/-
Tr= Tm (D)+ Tm (E)	Aggregate of Tm	585/-
Te= (E/F)x Tr	The amount of common credit attributable towards exempted supplies which need to be added to output tax liability E' is the aggregate value of exempt supplies during the tax period, (assuming '25 lacs) and	146.25/-

Purpose of Deferment of Credit on Capital Goods

	<p>'F' is the total turnover in the State of the registered person during the tax period (assuming '1 crore)</p> <p>Provided that where the details pertaining to turnover during the said tax period is not available then the value of 'E/F' shall calculated by taking values of 'E' and 'F' of the last tax period for which details of such turnover are available.</p> <p>Te shall be computed separately for central tax, State tax, Union territory tax and integrated tax</p>	
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Chapter 16

Credit to Job Worker or Manufacturer Supplier

Section 2 (68) of the CGST Act defines “job work” to mean undertaking any treatment or process by a person on goods belonging to another registered taxable person and the expression “job worker” shall be construed accordingly.

The GST Act, vide Section 143 permits a registered taxable person (referred to as the “principal”) to send any inputs and/or capital goods, without payment of tax, to a job worker for job-work. Such goods may even be sent from there subsequently to another job worker and likewise. This is of course under intimation and subject to such conditions as may be prescribed. Within *one year*, the *inputs* sent for job work shall either be *brought back* without payment of tax or be *supplied* from the place of job worker on payment of tax within India, or for export with or without payment of tax, as the case may be. The time limit for *capital goods* other than moulds and dies, jigs and fixtures, or tools to be brought back is *three years*.

Section 19 provides for taking input tax credit in respect of inputs as well as capital goods sent for job work. Accordingly the “principal” shall be entitled to take credit of input tax on inputs and capital goods even if the same have been directly sent to the job worker without first being brought to the principal’s place of business.

The inputs sent to a job worker for job work, on which credit has been claimed, need to either be received back or supplied within a period of *one year*. The time limit for capital goods to be brought back is *three years*. In case the inputs are neither received back nor supplied by the principal within one year of the same being sent to the job worker, it shall be deemed that such inputs had been supplied by the principal to the job worker on the day when it was sent to him [Section 19 (3)]. Accordingly, tax along with interest for one year would be payable on the same. Similar would be the consequence in case of capital goods not received back within three years.

When inputs/capital goods are sent directly to the job worker the period of one/three year(s) shall be counted from the date of receipt of inputs/ capital goods by the job worker. The time limit of three year(s) for bringing back the capital goods after job work shall not be applicable in case of moulds and dies, jigs and fixtures, or tools sent for job work [Section 19 (7)].

Chapter 17

Transitional Credit to New Assesses

Section 18 of the CGST Act provides for credit of input tax in respect of transitional stock. Transitional stock for this purpose would mean inputs held in stock and inputs contained in semi-finished or finished goods held in stock on the specified day. Transitional credit has been allowed in case of a new registrant under four different circumstances as follows-

- i) **New Registration:** A person who has applied for registration under the Act within thirty days from the date on which he becomes liable to registration and has been granted such registration. Transitional stock in this case would refer to the stock as on the day immediately preceding the date from which he becomes liable to pay tax under the provisions of this Act.
- ii) **Voluntary Registration:** A person, who takes a voluntary registration under sub-section (3) of section 25. Transitional stock in this case would refer to the stock as on the day immediately preceding the date of grant of registration.
- iii) **Person Exceeding the Turnover Limit for Composition Levy:** Any registered taxable person who ceases to pay tax under composition levy as provided in section 10. Transitional stock in this case would refer to the stock as on the day immediately preceding the date from which he becomes liable to pay tax under section 9. In this case, even the capital goods are eligible for transitional credit as reduced by such percentage points as may be prescribed in this behalf.
- iv) **Withdrawal of Exemption:** An exempt supply of goods or services by a registered taxable person becoming a taxable supply, may be due to withdrawal of the exemption. Transitional stock in this case would refer to the stock relating to such exempt supply and 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 such percentage points as may be prescribed in this behalf.

The transitional credit as above would be allowed subject to such conditions and restrictions as may be prescribed. In any case, the input tax credit as above in respect of any supply forming part of the transitional stock shall be

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restricted to tax invoices issued not more than one year prior to the transitional stock date.

Change in Constitution

Where there is a change in the constitution of a registered taxable 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 taxable person shall be allowed to transfer the input tax credit that remains unutilized in its books of accounts.

The amount of credit under the above four circumstances shall be calculated in such manner as may be prescribed.

Chapter 18

Reversal of Input Tax Credit

Section 18(4) provides for reversal of credit in respect of transitional stock as on the date on which a registered taxable person switch over to payment of composition levy under section . 10 or where the goods and / or services supplied by him becomes exempt absolutely vide section 11.

The registered taxable person as above shall pay an amount equivalent to the credit of input tax in respect of inputs held in stock and inputs contained in semi-finished or finished goods held in stock. The reversal of credit on capital goods shall be as reduced by such percentage points as may be prescribed, on the day immediately preceding the date of such switch over or, as the case may be, the date of such exemption. The payment shall be made by way of debit in the electronic credit or cash ledger, as the case may be.

The amount payable shall be calculated in such manner as may be prescribed. After payment/ reversal of such amount, the balance of input tax credit, if any, lying in his electronic credit ledger shall lapse.

Section 18(6) provides that in case of supply of capital goods or plant and machinery, on which input tax credit has been taken, the person shall pay an amount equal to the input tax credit as reduced or the tax on the transaction value of such goods, whichever is higher. In case of refractory bricks, moulds and dies, jigs and fixtures supplied as scrap, the taxable person may pay tax on the transaction value of such goods.

Reversal In Case of De-registration

Section 29 of the CGST Act provides for cancellation of registration by the proper officer either under the CGST Act or under the SGST Act. Such cancellation is possible either on his own motion or on an application being filed by the registered taxable person, including by his legal heirs, in case of death of such person. Different circumstances are specified therein for cancellation of the registration.

Section 29(5) provides for reversal of credit attributable to *transitional stock* on cancellation of registration. Transitional stock here would mean inputs held in stock and inputs contained in semi-finished or finished goods held in stock on the day immediately preceding the date of cancellation. Every registered taxable person who is de-registered shall pay an amount

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equivalent to the credit of input tax in respect of the transitional stock, or the output tax payable on such goods, whichever is higher.

The payment of the amount may be made by way of debit in the electronic credit or cash ledger. The amount payable as above shall be calculated in such manner as may be prescribed.

In respect of capital goods, the amount payable shall be equal to the input tax credit taken on the said capital goods reduced by the percentage points as may be prescribed in this behalf or the tax on the transaction value of such capital goods whichever is higher. Transaction value would mean the price actually paid or payable for the said supply of goods where the supplier and the recipient of the supply are not related and the price is the sole consideration for such supply.

Chapter 19

Does GST Allow ‘Endless’ Credit or is there Any Disallowance

One of the major advantages sought to be achieved from implementation of GST is the removal of cascading effect by facilitating seamless flow of credit. The “Statement of Objects and Reasons” to the Constitution (122nd Amendment) Bill, 2014, enacted as the Constitution (101st Amendment) Act, 2016 categorically includes *elimination of cascading effect*. This would be achieved by providing for the availment of Input tax credit to the purchasing dealer in respect of the tax charged by the supplying dealer.

Section 17(5) restricts the area of input tax credit by providing a negative list of supplies of goods and/ or services for credit. Apart from that, there are other provisions also in the CGST Act, which breaks the idea of endless credit chain in GST.

1. **Tax Actually Paid to Government**

Clause (c) of sub-section (2) of section 16 makes the credit conditional in as much as that the tax charged in respect of such supply has been actually paid to the account of the appropriate Government, either in cash or through utilization of input tax credit admissible in respect of the said supply. This condition places an onus on the supplier taking the credit, to ensure that the tax charged by the supplier of inward supply of goods and/ or services has actually paid the tax thereon. This can be ensured only by ensuring that the inward supply details is matched with the corresponding outward supply details furnished by the suppliers.

2. **Furnishing of Return Necessary**

Clause (d) of the said sub-section provides another condition that the supplier taking credit has furnished the return under section 39. In other words, until and unless the statutory return is filed, showing the claim of input tax credit in the electronic credit ledger, no credit will be allowed. In case of failure for any reason to file the return, the input tax credit which is otherwise legitimately available, shall not be allowed.

3. Matching With Details of Corresponding Outward Supply

The concept of granting input tax credit under the CGST Act is based on the matching concept of uploading data and filing of valid returns. Section 41 provides that every registered taxable person shall be entitled to take credit of input tax, as self-assessed in his return and such amount shall be credited, *on a provisional basis*, to his electronic credit ledger. The claim of input tax credit in respect of invoices and/or debit notes relating to inward supply that match with the details of corresponding outward supply shall be finally accepted.

Section 42 provides for matching, reversal and reclaim of input tax credit. The details of every inward supply furnished by a 'recipient' for a tax period shall be matched with the corresponding details of outward supply furnished by the corresponding 'supplier' in his valid return for the same tax period or any preceding tax period. In case of imported goods, the credit claimed shall be matched with the additional duty of customs paid under section 3 of the Customs Tariff Act, 1975. Matching shall also be done for duplication of claims of input tax credit.

The claims of input tax credit that match with the details of corresponding outward supply or with the additional duty of customs paid shall be finally accepted and such acceptance shall be communicated to the recipient.

Where there is a discrepancy between the input tax credit claimed by a recipient and the corresponding tax declared by the supplier, or the outward supply is not declared by the supplier in his valid returns, the discrepancy shall be communicated to both the supplier and the recipient. Similarly the duplication of claims of input tax credit shall also be communicated to the recipient.

In case the discrepancy is not rectified by the supplier in his valid return for the month in which discrepancy is communicated, the amount of credit claimed in excess shall be added to the output tax liability of the recipient, in his return for the month succeeding the month in which the discrepancy is communicated. Interest at the specified rate shall be paid on the amount so added from the date of availing of credit till the corresponding additions are made under the said sub-sections.

Does GST Allow 'Endless' Credit or is there Any Disallowance

In case the supplier subsequently declares the details of the invoice and/or debit note within the time specified, the recipient shall be eligible to reduce, from his output tax liability, the amount added as above.

In case of inward supply of services, a recipient is mandatorily required to pay to the supplier of services, the amount towards the value of supply along with tax payable thereon within a period of three months from the date of issue of invoice by the supplier. In case of failure to make the payment as above within the specified period of three months, an amount equal to the input tax credit availed shall be added to his output tax liability, along with interest thereon.

4. Time Limit for Claiming Credit

The input tax credit in respect of any invoice or debit note for supply of goods or services has *to be claimed within the financial year* to which such invoice or debit note relates. It can also be claimed after the end of the financial year, latest by the earlier of the following-

- furnishing of the return under section 39 for the month of September following the end of financial year to which such invoice or invoice relating to such debit note pertains; or
- furnishing of the relevant annual return.

For example, in respect of any invoice issued either in April 2018 or in March 2019, the credit can be claimed latest by the date of filing the return for the quarter ended September 2019, or the date of filing of annual return for the financial year 2018-19, whichever is earlier.

5. Burden of Proof

Section 155 provides that if any person claims that he is eligible for input tax credit the burden of proving such claim or claims shall lie on him. This is in fact against the basic principle of self-assessment.

6. Goods Not Leviable to Tax Under GST

Some products like electricity, specified petroleum products including HSD oil, tobacco, alcoholic liquor for human consumption and real-estate are for the time being expected to be outside the ambit of GST. GST will not be charged on sale of such goods/ properties. Instead, they will continue to be liable to tax under the earlier regime. GST provides for "input tax credit" which denotes credit of 'input tax' as defined in sub-section (55). "Input tax" in relation to a taxable person,

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means the IGST, including that on import of goods, CGST and SGST charged on any supply of goods or services to him and includes the tax payable under sub-section (3) of section 8, but does not include the tax paid under section 9. Therefore, while inward supplies of power and fuel, eg. Electricity and diesel oil would be received by a manufacturer, or even by a service provider or re-seller to some extent, on payment of tax, no credit shall be allowed in respect of such tax paid thereon. This would lead to significant cascading effect.

7. Composition Levy

Tax paid under section 10, i.e. the composition levy is not included in the “input tax”, and is therefore outside the credit chain. Section 10 provides for composition levy, i.e. payment, in lieu of tax, of an amount calculated at the prescribed rate of the turnover in a State during the year. Sub-section (3) of section 10 provides that a taxable person paying tax under the composition levy, shall not collect any tax from the recipient nor shall he be entitled to any credit of input tax. Therefore, the tax paid by such a person on his supplies as well as the tax payable by him under section 10 shall be a part of the cost of such goods supplied by him. Such tax amount in entirety will be outside the purview of input tax credit chain, making the products costlier to the extent of such tax amount.

8. Supplier Below Threshold Limit of Turnover

Section 22 provides for registration of a person liable to be registered under Schedule V of the CGST Law. Entry 1 in Schedule V provides for registration of a supplier if his aggregate turnover in a financial year exceeds twenty lakh rupees. Therefore, supplies received by an unregistered person having an aggregate turnover below the threshold limit of twenty lakh rupees, are not eligible for credit. The credit chain therefore breaks and the credit of tax paid on such supplies is not passed on to the buyers receiving inward supply of goods and/ or services from such unregistered persons.

Chapter 20

Why Credit cannot be Allowed on All Inward Supplies?

Section 16 provides that every registered taxable person shall be entitled to take credit of input tax charged on any supply of goods or services to him which are used or intended to be used in the course or furtherance of his business.

As defined in clause (17) of section 2, "Business" includes –

- (a) any trade, commerce, manufacture, profession, vocation, adventure, wager or any other similar activity, whether or not it is for a pecuniary benefit;
- (b) any activity or transaction in connection with or incidental or ancillary to (a) above;
- (c) any activity or transaction in the nature of (a) above, whether or not there is volume, frequency, continuity or regularity of such transaction;
- (d) supply or acquisition of goods including capital assets and services in connection with commencement or closure of business;
- (e) provision by a club, association, society, or any such body (for a subscription or any other consideration) of the facilities or benefits to its members, as the case may be;
- (f) admission, for a consideration, of persons to any premises; and
- (g) services supplied by a person as the holder of an office which has been accepted by him in the course or furtherance of his trade, profession or vocation;
- (h) services provided by a race club by way of totalisator or a licence to book maker in such club;
- (i) Any activity or transaction undertaken by the Central Government, a State Government or any local authority in which they are engaged as public authorities shall be deemed to be business.

The scope of the term "business" is very wide, which covers all types of commercial activities.

Background Material on Seamless Credit

The object of taxation under the GST regime is “supply” of goods and/ or services. Section 17(2) provides that where the goods and / or services are used partly for effecting taxable supplies including zero-rated supplies and partly for effecting exempt supplies, the amount of credit shall be restricted to so much of the input tax as is attributable to the said taxable supplies including zero-rated supplies.

Section 7 of the CGST Act provides the meaning and scope of ‘supply’. Supply as defined, includes all forms of supply of goods and/or services made or agreed to be made for a consideration by a person in the course or furtherance of business. It also includes importation of services and also a supply specified in Schedule I, made or agreed to be made without consideration. Schedule I covers supply of goods or services between related persons or between distinct persons as specified in section 25, when made in the course or furtherance of business.

Going by the concept of supply as contemplated in GST, the object of taxation is very wide, compared to the one under the earlier Central Excise Law, State VAT Laws and the earlier Service Tax Law, viz. manufacture of goods, sale of goods and provision of service respectively. Therefore, the scope of input tax credit under GST should also be wider enough to cover all kinds of inward supplies, which are used for effecting an outward supply which is taxable, irrespective of the purpose or specific end use. Moreover, one of the basic objectives of GST has been stated to be elimination of cascading effect, or to facilitate seamless flow of credit, ideally the credit should have been allowed in respect of all inward supplies, having a direct or indirect nexus with the taxable outward supplies.

All the supplies of goods and services included in the negative list in section 17(5) undisputedly contribute to the value of the final product or outward supply of services. All such activities are integral part of any business effecting supply of some goods/ services or the other. Acquisition or hiring of motor vehicles, catering services, health club or fitness centres, travel benefits to employees on leave, works contract services for various purposes, construction and/ or repairs of immovable properties etc. are very often necessary and essential for smooth running of the business.

Moreover, while it may be an economically and socially desirable proposition to allow composition levy to small assesseees, it does not seem to be very logical to disallow credit of tax paid and charged by a supplier of inward supplies, or even for that matter the credit of tax paid on the inward supplies used by the assessee under the composition levy.

Why Credit cannot be Allowed on All Inward Supplies?

Therefore, there may not be sufficient justification in restricting the credit in respect of such supplies. This would invariably lead to cascading effect, which is against the prime objective of GST.

For example, if a car is purchased by a company for the CEO, it is to be used in the course or furtherance of business. The CEO is an integral part of the business. Even cost incurred by the company for his health insurance, leave travel benefit given to him etc. are all essential ingredients of cost to the company. The company should be entitled to take credit of the input tax charged on it. The car or insurance or the travel benefit may be said to be used by the CEO for his private/personal use, but from the company's perspective it is an integral part of their cost, which should be eligible for input tax credit.

Key Aspects the GST Council Should Consider for Seamless Flow of Credit

Input tax credit is the backbone of the GST regime. GST is nothing but a value added tax on goods and services combined. It is these provisions of Input Tax Credit that make GST a value added tax i.e., collection of tax at all points after allowing credit for the inputs. The procedures and restrictions laid down in these provisions are important to make sure that there is seamless flow of credit in the whole scheme of transition without any misuse. Thus, the clarity of rules of availment and utilization will have significant impact on making GST taxpayer-friendly .

One of the biggest advantages expected from the implementation of GST is that it would remove cascading effect by facilitating seamless flow of credit. This would be given effect by removing the restrictions placed in the erstwhile CENVAT credit rules on availment of credit which lead to break in the credit chain and consequent cascading effect which further leads to increase in cost of goods and services. Thus linking of invoice to invoice may eliminate any possibility of revenue leakage.

Chapter 21

Conditions for Exemption

'Exemption' refers to waiver a specified taxable event from tax under a taxing statute. In case of exemption, tax may not be required to be paid under the statute. Such exemption may be absolute/ unconditional or it may be a conditional one. In case of unconditional exemption there remains no option to pay tax, whereas in case of conditional exemption tax may be required to be paid if conditions of such exemption are not fulfilled.

However the effect of exemption must be given in terms of the conditions for such exemption. Sometimes an exemption to a particular product or service is allowed subject to the condition that no CENVAT credit shall be claimed in respect of either inputs or input services or both. In such cases it is necessary that the condition of non-availment of CENVAT credit is followed meticulously. In this regard Hon'ble **Supreme Court**, in the case of **Orissa Extrusions** vs CCE, Bhubaneswar, held that *the exemption notification must be assumed to have been consciously so worded and due effect must be given to the assessee there under*. Although the Supreme Court in *Amrit Paper's* case has overruled *Orissa Extrusion's* case, the principle laid down right from *Super Cassettes* all the way upto *Ashok Iron* has not been disturbed and therefore, the principle in *Orissa Extrusion* can shed a lot of light in our understanding of credits and conditional exemptions.

Therefore for allowing the benefit of exemption, the conditions should be viewed in isolation i.e. without mixing up with other provisions.

Chapter 22

Allowability of Credit

The purpose of allowing credit is to minimize the cascading effect. However allowability of credit is related to use of inputs or input services or capital goods, in manufacturing of dutiable goods or provision of output service. In simplified terms, it can be said that input credits which lead to output liabilities are allowable.

The issue earlier came up before the Tribunal and was examined by a 5 Member Bench in the case of *Khanbhai Esoofbhai v. CCE, Calcutta* (1998) 11 TMI 141 (CEGAT, New Delhi). The Tribunal vide Order dated 17.11.1998 held that *there can be no finalized credit unless the inputs are used in manufacture of final products liable to excise duty and either excise duty on the final product is paid or the inputs are otherwise disposed of for home consumption or export etc. Till such events occur the MODVAT credit is only provisional and cannot be said to be final and irrevocable.*

In this case there was a batch of 18 appeals referred to the Larger Bench for consideration of an important question of law. The question raised related to continued availability of MODVAT Credit under the Central Excise Rules, 1944 and the legality of the assessee's claim to retain the said credit when the final product becomes fully exempt from payment of duty. Or, on the flip side, was it legal and proper for Revenue to seek recovery of MODVAT Credit correctly taken and utilized by an assessee on (a) inputs lying in stock and (b) inputs used in manufacture of final products lying in stock, when the final products become exempt from duty or when the assessee opts for full exemption under a notification. There were conflicting views expressed by different Benches of the Tribunal on this question. While some of the decisions supported the view that Rule 57C would require reversal/recovery of credit taken others have held that the Rules do not provide for any such recovery or demand for reversal of such credit.

The Tribunal in this case held as under-

"We are of the view that the above extracts of the Allahabad High Court judgment, fully cover the issue raised before us. Respectfully following the ratio we hold that MODVAT credit taken in respect of inputs which are in stock as well in respect of inputs used in the manufacture of final products which have become exempt, would be inadmissible and will have to be reversed."

Background Material on Seamless Credit

In terms of the said judgment, primarily credit is allowed on provisional basis and such credit is finalized only when the taxable event incurs .. In the GST regime, as per the CGST Act, the credit is also allowed on provisional basis. However the credit gets finalized on fulfillment of certain conditions like payment of tax to the Government, filing of return, matching of the details of inward supplies with the corresponding outward supply details of the supplier etc.

Chapter 23

Credit on Accessories

Sometimes manufacturers of final products supply some bought-out accessories along with their final products, cleared on payment of duty. While including the value of such bought-out items/ accessories in the assessable value of the final products, the manufacturers claim credit of duty paid on such items. The Department at times object to the claim of credit in respect of such accessories.

The issue came up for examination before the Tribunal in the case of *Bajaj Tempo Ltd. v. CCE, Indore* (2006) 10 TMI 41(CESTAT, New Delhi.) With regard to credit of first aid box, , it was held that there is no dispute over the fact that value of the first-aid box/kit was included in the value of the vehicles, when the vehicles were cleared by the appellant on payment of duty.

The short question that arises for consideration is whether first-aid kit/box should be treated as an accessory of the final product namely, motor vehicle since it was cleared along with the final product and therefore be considered as “input” for the purpose of admissibility of the MODVAT/CENVAT credit.

These would clearly be accessories which will be included in the definition of ‘input’ so as to entitle the appellant to avail MODVAT credit in respect of the value of such inputs which admittedly was included in the value of the vehicle manufactured and removed on payment of duty.

In GST regime, the value of accessories being included in the value of the motor vehicles, the credit in respect of such accessories will be allowed without dispute, as the same have a nexus with the outward supply of vehicles along with such accessories.

Chapter 24

Cum-Duty Calculation

The earlier law, i.e. Section 66B of the Finance Act, 1994 provides for levy of Service tax. Section 73 of the Act provides for demand of service tax short levied or short paid. While service tax burden is borne by the service recipients, it is collected by the service providers and remitted to the Government. The law provides that the gross amount charged and collected for provision of services should be treated as inclusive of Service tax unless the same is paid by the recipient separately. Therefore where no tax is collected separately, the gross amount has to be treated as the cum duty value to quantify the tax liability, assuming that it contains tax element as well.

The earlier law of Central excise Act, 1944, namely the Explanation to Sub-section (1) of section 4 provides that *price-cum-duty, excluding sales taxes and other taxes, if any, actually paid, shall be deemed to include the duty payable on such goods.*"

In the case of *Bhagawati Security Services v., Commissioner of Central Excise, Meerut - I* (2006) 3 STR 763 (Tri. Del) the appellants did not raise any service tax bill to their service receivers. They paid service tax calculated on these invoices for which they never received any payment from their client. The Tribunal found that there was a force in the appellant's contention that if service tax is to be paid, it has to be worked out on the basis of gross amount received by them as being inclusive of service tax.

In another case namely *Commissioner of Central Excise v. Maruti Udyog Ltd.* (2002) 141 ELT 3 (SC), the Supreme Court granted cum-duty benefits to the assessee. In many subsequent cases the said judgment is cited to decide the issue in favour of the assessee.

In the case of *Gem Star Enterprises (P) Ltd., V. Commissioner of Central Excise* (2007) 7 STR 342 (Tri. Bangalore), the appellants requested to treat the amount received by them from their customers as cum-tax amount and to re-compute the tax liability. The Commissioner (Appeals) did not appreciate the stand of the appellant. The Tribunal did not agree with the Commissioner (Appeals). This principle is applied in Central Excise cases also in the light of *Maruti Udyog Ltd.*, (Supra) as stated above. The same principle is applied here also.

Cum-Duty Calculation

Vide Finance Act, 2006, clause (2) was inserted in Sec. 67 of the Finance Act, 1994 with effect from 18.04.2006 which provided that where the gross amount charged by a service provider, for the service provided or to be provided is inclusive of service tax payable, *the value of such taxable service shall be such amount as with the addition of tax payable, is equal to the gross amount charged.*

The amount realized from the client is treated as gross amount inclusive of service tax and accordingly the value of taxable service and service tax liability will be computed. *Example :* Value of taxable services (TV)

$$= ₹ 100$$

$$\text{Amount Billed} = ₹ 100 + \text{ST } 12.36$$

$$= ₹ 112.36$$

$$\text{Amount received} = ₹ 100/-$$

In terms of sub-section (2) of section 67, ₹ 100 should be treated as the gross amount inclusive of service tax. Hence, the service tax liability will be computed by reverse calculation, i.e,

$$\text{Taxable Value} = 100 \times 100/112.36 = ₹ 88.99 \text{ (₹ 890/-)}$$

$$\text{Service tax + Edu. Cess} = ₹ 10/- \text{ (approx)}$$

CGST Act : Section 15(1) of the CGST Act provides that value of taxable supply shall be the transaction value i.e., the price actually paid or payable for the said supply of goods and/or services. However no specific mention is made as to how valuation will be made in such a case where the consideration received is inclusive of taxes, or where no tax is charged at all. Based on the principles followed in various judicial pronouncements, the same should still be treated as a cum-duty value, and the tax amount payable should be determined accordingly.

Chapter 25

Limitation of Credit In Case of Non-Payment Even In *bona fide* Cases

Under the GST Act a registered person shall be entitled to avail credit of input tax charged on any supply of goods or services subject to the following conditions –

- he is in possession of taxpaying documents,
- he has received goods / services,
- tax has actually been paid to the Government,
- he has filed return.

Further, the second proviso to Section 16(2) provides that if a recipient fails to pay to the supplier the value of supply along with tax payable thereon within 180 from the date of issue of invoice, the same shall be added to his output liability. Similar provision exists in the erstwhile law as well, but restricted to services only. Third proviso to Rule 4(7) of the CENVAT Credit Rules, 2004 provides that in case the payment of the value of input service and the service tax paid (or payable) as indicated in the invoice is not made within three months from the date of the invoice then the manufacturer or the service provider shall pay an amount equal to the CENVAT credit so availed.

In this regard the Tribunal in the case of *Hindustan Zinc Limited* [(2014) 34 S.T.R. 440 (Tri-Del)] has held that *Rule 4(7) would be applicable only in a situation where the service provider has issued the invoice but he has not paid the service tax. But where there is no dispute that service tax has been paid by the service provider on the full invoice value, even though he has not received full payment from the service recipient and part of the payment due to him has been withheld by the service recipient due to some reason, this rule would not be applicable.*

Going by the analogy of the said judgment the scope of second proviso to Section 16(2) of the CGST Act gets reduced. Under the erstwhile law reversal of credit on account of non-payment is provided in the Rules, whereas the same provision has been included in the CGST Act, 2017. Therefore the said judgment may not favour the recipients and will lead to reversal of the credit under GST regime as well.

Chapter 26

Purpose of Nexus Test in CENVAT Credit Rules, 2004

A manufacturer or producer of final products or a provider of output services is allowed to take credit (hereinafter referred to as "CENVAT credit") on:

- (a) any inputs or capital goods received in the factory of manufacturer of final product or by the provider of output service; and
- (b) any input service received by the manufacturer of final product or by the provider of output services.

Hence it is clear that CENVAT credit shall be allowed only on three different types of supplies, viz. inputs, capital goods and input services.

Inputs have a restricted horizon. It includes only those goods that are used *in the factory for the manufacture of final product*, or any goods which are cleared along with the final product. For service providers, all goods that are used for providing any output service may be regarded as inputs, subject to certain exceptions.

In other words, any goods (not being an exception) which are not used in the factory or are not cleared along with the final product are not considered as an input. Therefore no credit shall be allowed in respect of such goods.

Input service on the other hand means any service used by a provider of output service or used by a manufacturer, whether *directly or indirectly, in or in relation to the manufacture* of final product and clearance of final product upto the place of removal.

Therefore it is imperative that there must be a nexus between the inputs or input services or capital goods and the final products manufactured or output services provided.

Similarly in GST, the credit shall be allowed only in respect of inward supply of goods and/ or services which are used in the course or in the furtherance of business. Thus, to be eligible for input tax credit, the inward supply of goods and/ or services to have a nexus with the outward supply / business. This may be subject to few exceptions as provided separately.

Moreover, section 17(2) of the GST law provides that where the goods and / or services are used partly for effecting *taxable supplies* including zero-rated

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supplies and partly for effecting *exempt supplies*, the amount of credit shall be restricted to so much of the input tax as is attributable to the said taxable supplies including zero-rated supplies.

The nexus test is therefore equally valid even under the GST regime.

Chapter 27

Purpose of Negative List of Credits in VAT law

The essence of Value Added Tax or for that matter Goods & Services Tax is in providing set-off for the tax paid earlier. This is sought to be given effect under the earlier State VAT Laws generally through the concept of input tax credit/rebate. This input tax credit in relation to any period means setting off the amount of input tax by a registered dealer against the amount of his output tax.

As per sub-section (4) of section 22 of the WBVAT Act, 2003 (for example), the input tax credit or input tax rebate is allowed to the extent of amount of tax paid or payable by the purchasing dealer on his purchase of taxable goods, other than such taxable goods as specified in the negative list appended to section 22 of the WBVAT Act, 2003. Further as per clause (e) sub-section (12) of the said section, no input tax credit or input tax rebate shall be allowed for purchases of such goods and under such circumstances, as are specified in the negative list appended to the said section.

Therefore, the input tax credit is allowable to the extent of the amount of tax paid or payable in respect of local purchases of taxable goods made from registered dealers only. Goods specified in the negative list are left out of the scope / chain of input tax credit. Generally, the State VAT Laws in India have allowed credit of raw materials, packing materials and capital goods. Consumables for example are largely kept outside the ambit of input tax credit chain.

The negative list specifies description of goods not eligible for input tax credit and exceptions thereto with respect to goods. The exceptions are mainly for the registered dealers who are in the business of dealing in such goods i.e such credit is to be allowed in respect of goods purchased by a registered dealer for the purposes specified in sub-section (4) of the said section.

The purpose of negative list in VAT laws is to restrict the area of input tax credit making it narrower. This concept ought to have been done away with in the GST regime. As the object of taxation in GST is supply, which is much wider than sale of goods, all inward supplies used for making a taxable outward supply should be eligible for input tax credit, essentially to facilitate seamless flow of credit.

Chapter 28

Comparison between Erstwhile Law and GST Law – Restrictions Continuing

The erstwhile law provides for certain restrictions defeating the spirit of seamless flow of input tax credit. One of the main objects for introduction of GST, as stated in the *Statement of Objects and Reasons* to the Constitution (122nd Amendment) Bill, 2014 was to eliminate cascading effect, thereby enabling free flow of input tax credit. However, the main essence of GST seems to get defeated because of imposition of certain restrictions on seamless flow of input tax credit somewhat similar to the restrictions already prescribed in the erstwhile law. A comparison of the restrictions on allowance of input tax credit in the erstwhile laws vis a vis GST would emerge as follows:

1. **Registration:** To get the benefit of input tax credit, one has to be registered under the statute under which the benefit is claimed. Claiming benefit without taking registration is not permissible in GST regime. Such restriction is there under some of the State VAT laws, but not under the CENVAT law. The scope of such restriction is widened in GST.
2. **Use of goods and/or services:** One of the restrictions in the erstwhile laws, that continues in GST is the use of the goods and/or services by the registered person in the business operations. In GST, the registered person is entitled to take credit of input tax charged on any supply of goods or services or both which are used or intended to be used in the course or furtherance of business. The taxable event in GST is supply, which travels beyond a sale and/or business, involving within its fold even non-business supplies as well, the restriction of use in the course or furtherance of business is continued for input tax credit.
3. **Tax invoice:** The input tax credit shall not be allowed unless the registered person is in possession of tax invoice issued by a supplier registered under GST regime. Under the erstwhile laws for claiming CENVAT credit, Courts have held that it is enough if it is established that the goods and/ or services have been received, and duty/ tax thereon has been paid. The CENVAT Credit Rules however

Comparison between Erstwhile Law and GST Law – Restrictions...

specifically provide that credit can be claimed only if the assessee is in possession of tax invoice or bill. Similar provision is to continue in the CGST Act as well. Such provision often leads to denial of credit in case of loss/ non production of invoices during departmental verification, even in bona fide cases.

4. **Tax Actually Paid to Government:** The concept of conditional credit for the recipient under some of the State VAT laws provides for the payment of tax to the Government by the seller. Similarly under GST regime, clause (c) of sub-section (2) of section 16 makes the credit conditional. The tax charged in respect of an inward supply actually paid to the account of the appropriate Government, either in cash or through utilization of input tax credit, is only admissible in respect of the said supply.
5. **Mismatch:** Sections 42 and 43 of the CGST Act, 2017 provide for matching, reversal and reclaim of input tax credit or reduction in output tax liability. The concept of matching the details of inward supplies with the outward supplies in GST regime is similar to the mismatch concept under State Vat laws. Denial of credit on the grounds of the matching concept of uploading data and filing of valid returns restricts the free flow of credit. In fact, as the Supreme Court held time and again that credit is an indefeasible right of the assessee, and not a benefit, the credit in the hands of recipient cannot be denied on the ground of non-compliance on the part of the supplier. The statutory provision contrary to this legal principle continues in the GST regime.
6. **Time Limit for Claim of Credit:** Under GST regime, the input tax credit in respect of any invoice or debit note for supply of goods or services shall not be allowed after the due date of furnishing of return under section 39 for the month of September following the end of financial year to which such invoice or debit note pertains or furnishing of the relevant annual return, whichever is earlier. Similar restrictions are imposed under the third proviso to sub-rule (1) to Rule 4 of the CENVAT Credit Rules, 2004 which states that *“the manufacturer or the provider of output service shall not take CENVAT credit after one year of the date of issue of any of the documents.....”*.

Annexure

Statutory Provision : ITC

Chapter V – ITC (CGST Act, 2017)

16. Eligibility and Conditions for taking Input Tax Credit

- (1) Every registered person shall, subject to such conditions and restrictions as may be prescribed and in the manner specified in section 49, be entitled to take credit of input tax charged on any supply of goods or services or both to him which are used or 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.
- (2) Notwithstanding anything contained in this section, no registered person shall be entitled to the credit of any input tax in respect of any supply of goods or services or both to him unless, —
 - (a) he is in possession of a tax invoice or debit note issued by a supplier registered under this Act, or such other tax paying documents as may be prescribed;
 - (b) he has received the goods or services or both.

Explanation — For the purposes of this clause, it shall be deemed that the registered person has received the goods where the goods are delivered by the supplier to a recipient or any other person on the direction of such registered 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;
 - (c) subject to the provisions of section 41, the tax charged in respect of such supply has been actually paid to the Government, either in cash or through utilisation of input tax credit admissible in respect of the said supply; and
 - (d) he has furnished the return under section 39:

Provided that where the goods against an invoice are received in lots or instalments, the registered person shall be entitled to take credit upon receipt of the last lot or instalment:

Provided further that where a recipient fails to pay to the supplier of

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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 one hundred and eighty 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, along with interest thereon, in such manner as may be prescribed:

Provided also 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.

- (3) Where the registered person has claimed depreciation on the tax component of the cost of capital goods and plant and machinery under the provisions of the Income-tax Act, 1961, the input tax credit on the said tax component shall not be allowed.
- (4) A registered person shall not be entitled to take input tax credit in respect of any invoice or debit note for supply of goods or services or both after the due date of furnishing of the return under section 39 for the month of September following the end of financial year to which such invoice or invoice relating to such debit note pertains or furnishing of the relevant annual return, whichever is earlier.

17. Apportionment of credit and blocked credits

- (1) 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.
- (2) Where the goods or services or both are used by the registered person partly for effecting taxable supplies including zero-rated supplies under this Act or under the Integrated Goods and Services Tax Act and partly for effecting exempt supplies under the said Acts, the amount of credit shall be restricted to so much of the input tax as is attributable to the said taxable supplies including zero-rated supplies.
- (3) The value of exempt supply under sub-section (2) shall be such as may be prescribed, and shall include supplies on which the recipient is liable to pay tax on reverse charge basis, transactions in securities, sale of land and, subject to clause (b) of paragraph 5 of Schedule II, sale of building.

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- (4) 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 sub-section (2), or avail of, every month, an amount equal to fifty per cent. of the eligible input tax credit on inputs, capital goods and input services in that month and the rest shall lapse:

Provided that the option once exercised shall not be withdrawn during the remaining part of the financial year:

Provided further that the restriction of fifty per cent. shall not apply to the tax paid on supplies made by one registered person to another registered person having the same Permanent Account Number.

- (5) Notwithstanding anything contained in sub-section (1) of section 16 and sub-section (1) of section 18, input tax credit shall not be available in respect of the following, namely:—
- (a) motor vehicles and other conveyances except when they are used—
 - (i) for making the 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) the following supply of goods or services or both:—
 - (i) food and beverages, outdoor catering, beauty treatment, health services, cosmetic and plastic surgery except where an 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 the same category of goods or services or both or as an element of a taxable composite or mixed supply;
 - (ii) membership of a club, health and fitness centre;
 - (iii) rent-a-cab, life insurance and health insurance except where —

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- (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 the same category of goods or services or both or as 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 an 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 (other than plant or machinery) on his own account including when such goods or services or both are used in the course or furtherance of business.
Explanation – For the purposes of clauses (c) and (d), the expression “construction” includes re-construction, renovation, additions or alterations or repairs, to the extent of capitalisation, to the said immovable property;
 - (e) goods or services or both on which tax has been paid under section 10 or;
 - (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 accordance with the provisions of sections 74, 129 and 130.
- (6) The Government may prescribe the manner in which the credit referred to in sub-35 sections (1) and (2) may be attributed.

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Explanation - For the purposes of this Chapter and Chapter VI, the expression "plant and machinery" means apparatus, equipment, and machinery fixed to earth by foundation or structural support that are used for making outward supply of goods or services or both and includes such foundation and structural supports but excludes—

- (i) land, building or any other civil structures;
- (ii) telecommunication towers; and
- (iii) pipelines laid outside the factory premises.

18. Availability of credit in special circumstances

- (1) Subject to such conditions and restrictions as may be prescribed—
 - (a) a person who has applied for registration under this Act within thirty days from the date on which he becomes liable to registration and has been granted such registration shall be entitled to take credit of input tax 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 provisions of this Act;
 - (b) a person who takes registration under sub-section (3) of section 25 shall be entitled to take credit of input tax 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 of grant of registration;
 - (c) where any registered person ceases to pay tax under section 10 or, he shall be entitled to take credit of input tax in respect of inputs held in stock, 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 section 9:

Provided that the credit on capital goods shall be reduced by such percentage points as may be prescribed;

- (d) where an exempt supply of goods or services or both by a registered person becomes a taxable supply, such person shall be entitled to take credit of input tax in respect of inputs held in

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stock and inputs contained in semi-finished or finished goods held in stock relating 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:

Provided that the credit on capital goods shall be reduced by such percentage points as may be prescribed.

- (2) A registered person shall not be entitled to take input tax credit under sub-section (1) 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.
- (3) 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 provisions for transfer of liabilities, the said registered person shall be allowed to transfer the input tax credit which remains unutilised in his electronic credit ledger to such sold, merged, demerged, amalgamated, leased or transferred business in such manner as may be prescribed.
- (4) Where any registered person who has availed of input tax credit opts to pay tax under section 10 or, where the goods or services or both supplied by him become wholly exempt, he shall pay an amount, by way of debit in the electronic credit ledger or electronic cash ledger, equivalent to the credit of input tax 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, on the day immediately preceding the date of exercising of such option or, as the case may be, the date of such exemption:

Provided that after payment of such amount, the balance of input tax credit, if any, lying in his electronic credit ledger shall lapse.
- (5) The amount of credit under sub-section (1) and the amount payable under sub-section (4) shall be calculated in such manner as may be prescribed.
- (6) In case of supply of capital goods or plant and machinery, on which input tax credit has been taken, the registered person shall pay an amount equal to the input tax credit taken on the said capital goods or plant and machinery reduced by such percentage points as may be

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prescribed or the tax on the transaction value of such capital goods or plant and machinery determined under section 15, whichever is higher:

Provided that 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 determined under section 15.

19. Taking input tax credit in respect of inputs and capital goods sent for job work

- (1) The principal shall, subject to such conditions and restrictions as may be prescribed, be allowed input tax credit on inputs sent to a job-worker for job-work.
- (2) Notwithstanding anything contained in clause (b) of sub-section (2) of section 16, the principal shall be entitled to take credit of input tax on inputs even if the inputs are directly sent to a job worker for job-work without being first brought to his place of business.
- (3) Where the inputs 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 clause (a) or clause (b) of sub-section (1) of section 143 within one year of being sent out, it shall be deemed that such inputs had been supplied by the principal to the job-worker on the day when the said inputs were sent out:

Provided that where the inputs are sent directly to a job worker, the period of one year shall be counted from the date of receipt of inputs by the job worker.

- (4) The principal shall, subject to such conditions and restrictions as may be prescribed, be allowed input tax credit on capital goods sent to a job worker for job work.
- (5) Notwithstanding anything contained in clause (b) of sub-section (2) of section 16, the principal shall be entitled to take credit of input tax on capital goods even if the capital goods are directly sent to a job worker for job-work without being first brought to his place of business.
- (6) Where the capital goods sent for job work are not received back by the principal within a period of three years of being sent out, it shall be deemed that such capital goods had been supplied by the principal to the job worker on the day when the said capital goods were sent out:

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Provided that where the capital goods are sent directly to a job worker, the period of three years shall be counted from the date of receipt of capital goods by the job worker.

- (7) Nothing contained in sub-section (3) or sub-section (6) shall apply to moulds and dies, jigs and fixtures, or tools sent out to a job worker for job work.

Explanation – For the purpose of this section, “**principal**” means the person referred to in section 143.

20. Manner of distribution of credit by Input Service Distributor

- (1) The Input Service Distributor shall distribute the credit of central tax as central tax or integrated tax and integrated tax as integrated tax or central tax, by way of issue of a document containing the amount of input tax credit being distributed in such manner as may be prescribed.
- (2) The Input Service Distributor may distribute the credit subject to the following conditions, namely:–
- (a) the credit can be distributed to the recipients of credit against a document containing such details as may be prescribed;
 - (b) the amount of the credit distributed shall not exceed the amount of credit available for distribution;
 - (c) the credit of tax paid on input services attributable to a recipient of credit shall be distributed only to that recipient;
 - (d) the credit of tax paid on input services attributable to more than one recipient of credit shall be distributed amongst such recipients 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;
 - (e) the credit 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

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turnover of all recipients and which are operational in the current year, during the said relevant period.

Explanation - For the purposes of this section, —

- (a) the “**relevant period**” shall be—
 - (i) if the recipients of credit have turnover in their States or Union territories in the financial year preceding the year during which credit is to be distributed, the said financial year; or
 - (ii) if some or all recipients of the credit do not have any turnover in their States or Union territories in the financial year preceding the year during which the credit is to be distributed, the last quarter for which details of such turnover of all the recipients are available, previous to the month during which credit is to be distributed;
- (b) the expression “**recipient of credit**” means the supplier of goods or services or both having the same Permanent Account Number as that of the Input Service Distributor;
- (c) the term “**turnover**”, in relation to any registered person engaged in the supply of taxable goods as well as goods not taxable under this Act, means the value of turnover, reduced by the amount of any duty or tax levied under entry 84 of List I of the Seventh Schedule to the Constitution and entry 51 and 54 of List II of the said Schedule.

21. Manner of recovery of credit distributed in excess

Where the Input Service Distributor distributes the credit in contravention of the 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 recipients along with interest, and the provisions of section 73 or section 74, as the case may be, shall, mutatis mutandis, apply for determination of amount to be recovered.

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36. Documentary requirements and conditions for claiming input tax credit.-
- (1) The input tax credit shall be availed by a registered person, including the Input Service Distributor, on the basis of any of the following documents, namely,-
 - (a) an invoice issued by the supplier of goods or services or both in accordance with the provisions of section 31;
 - (b) an invoice issued in accordance with the provisions of clause (f) of sub-section (3) of section 31, subject to the payment of tax;
 - (c) a debit note issued by a supplier in accordance with the provisions of section 34;
 - (d) a bill of entry or any similar document prescribed under the Customs Act, 1962 or rules made thereunder for the assessment of integrated tax on imports;
 - (e) an Input Service Distributor invoice or Input Service Distributor credit note or any document issued by an Input Service Distributor in accordance with the provisions of sub-rule (1) of rule 54.
 - (2) Input tax credit shall be availed by a registered person only if all the applicable particulars as specified in the provisions of Chapter VI are contained in the said document, and the relevant information, as contained in the said document, is furnished in FORM GSTR-2 by such person.
 - (3) No input tax credit shall be availed by a registered person in respect of any tax that has been paid in pursuance of any order where any demand has been confirmed on account of any fraud, willful misstatement or suppression of facts.
37. Reversal of input tax credit in the case of non-payment of consideration.
- (1) A registered person, who has availed of input tax credit on any inward supply of goods or services or both, but fails to pay to the supplier thereof, the value of such supply along with the tax payable thereon, within the time limit specified in the second proviso to sub-section (2) of section 16, shall furnish the details of such supply, the amount of

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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 one hundred and eighty days from the date of the issue of the invoice:

Provided 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 sub-section (2) of section 16.

- (2) The amount of input tax credit referred to in sub-rule (1) shall be added to the output tax liability of the registered person for the month in which the details are furnished.
 - (3) The registered person shall be liable to pay interest at the rate notified under sub-section (1) of section 50 for the period starting from the date of availing credit on such supplies till the date when the amount added to the output tax liability, as mentioned in sub-rule (2), is paid.
 - (4) The time limit specified in sub-section (4) of section 16 shall not apply to a claim for re-availing of any credit, in accordance with the provisions of the Act or the provisions of this Chapter, that had been reversed earlier.
38. Claim of credit by a banking company or a financial institution.- A banking company or a financial institution, including a non-banking financial company, engaged in the supply of services by way of accepting deposits or extending loans or advances that chooses not to comply with the provisions of sub-section (2) of section 17, in accordance with the option permitted under sub-section (4) of that section, shall follow the following procedure, namely,-
- (a) the said company or institution shall not avail the credit of,-
 - (i) the tax paid on inputs and input services that are used for non-business purposes; and
 - (ii) the credit attributable to the supplies specified in sub-section (5) of section 17, in FORM GSTR-2;
 - (b) the said company or institution shall avail the credit of tax paid on inputs and input services referred to in the second proviso to sub-section (4) of section 17 and not covered under clause (a);
 - (c) fifty per cent. of the remaining amount of input tax shall be the input tax credit admissible to the company or the institution and shall be furnished in FORM GSTR-2;

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- (d) the amount referred to in clauses (b) and (c) shall, subject to the provisions of sections 41, 42 and 43, be credited to the electronic credit ledger of the said company or the institution.
39. Procedure for distribution of input tax credit by Input Service Distributor.
- (1) An Input Service Distributor shall distribute input tax credit in the manner and subject to the following conditions, namely,-
- (a) the input tax credit available for distribution in a month shall be distributed in the same month and the details thereof shall be furnished in FORM GSTR-6 in accordance with the provisions of Chapter VIII of these rules;
- (b) the Input Service Distributor shall, in accordance with the provisions of clause (d), separately distribute the amount of ineligible input tax credit (ineligible under the provisions of sub-section (5) of section 17 or otherwise) and the amount of eligible input tax credit;
- (c) the input tax credit on account of central tax, State tax, Union territory tax and integrated tax shall be distributed separately in accordance with the provisions of clause (d);
- (d) the input tax credit that is required to be distributed in accordance with the provisions of clause (d) and (e) of sub-section (2) of section 20 to one of the recipients 'R1', whether registered or not, from amongst the total of all the recipients to whom input tax credit is attributable, including the recipient(s) who are engaged in making exempt supply, or are otherwise not registered for any reason, shall be the amount, "C1", to be calculated by applying the following formula -

$$C1 = (t1 \div T) \times C$$

where,

"C" is the amount of credit to be distributed,

"t1" is the turnover, as referred to in section 20, of person R1 during the relevant period, and

"T" is the aggregate of the turnover, during the relevant period, of all recipients to whom the input service is attributable in accordance with the provisions of section 20;

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- (e) the input tax credit on account of integrated tax shall be distributed as input tax credit of integrated tax to every recipient;
- (f) the input tax credit on account of central tax and State tax or Union territory tax shall-
 - (i) in respect of a recipient located in the same State or Union territory in which the Input Service Distributor is located, be distributed as input tax credit of central tax and State tax or Union territory tax respectively;
 - (ii) in respect of a recipient located in a State or Union territory other than that of the Input Service Distributor, be distributed as integrated tax and the amount to be so distributed shall be equal to the aggregate of the amount of input tax credit of central tax and State tax or Union territory tax that qualifies for distribution to such recipient in accordance with clause (d);
- (g) the Input Service Distributor shall issue an Input Service Distributor invoice, as prescribed in sub-rule (1) of rule 54, clearly indicating in such invoice that it is issued only for distribution of input tax credit;
- (h) the Input Service Distributor shall issue an Input Service Distributor credit note, as prescribed in sub-rule (1) of rule 54, for reduction of credit in case the input tax credit already distributed gets reduced for any reason;
- (i) any additional amount of input tax credit on account of issuance of a debit note to an Input Service Distributor by the supplier shall be distributed in the manner and subject to the conditions specified in clauses (a) to (f) and the amount attributable to any recipient shall be calculated in the manner provided in clause (d) and such credit shall be distributed in the month in which the debit note is included in the return in FORM GSTR-6;
- (j) any input tax credit required to be reduced on account of issuance of a credit note to the Input Service Distributor by the supplier shall be apportioned to each recipient in the same ratio in which the input tax credit contained in the original invoice was distributed in terms of clause (d), and the amount so apportioned shall be-
 - (i) reduced from the amount to be distributed in the month in

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- which the credit note is included in the return in FORM GSTR-6; or
- (ii) added to the output tax liability of the recipient where the amount so apportioned is in the negative by virtue of the amount of credit under distribution being less than the amount to be adjusted.
- (2) If the amount of input tax credit distributed by an Input Service Distributor is reduced later on for any other reason for any of the recipients, including that it was distributed to a wrong recipient by the Input Service Distributor, the process specified in clause (j) of sub-rule (1) shall apply, *mutatis mutandis*, for reduction of credit.
- (3) Subject to sub-rule (2), the Input Service Distributor shall, on the basis of the Input Service Distributor credit note specified in clause (h) of sub-rule (1), issue an Input Service Distributor invoice to the recipient entitled to such credit and include the Input Service Distributor credit note and the Input Service Distributor invoice in the return in FORM GSTR-6 for the month in which such credit note and invoice was issued.
40. Manner of claiming credit in special circumstances.
- (1) The input tax credit claimed in accordance with the provisions of sub-section (1) of section 18 on the inputs held in stock or inputs contained in semi-finished or finished goods held in stock, or the credit claimed on capital goods in accordance with the provisions of clauses (c) and (d) of the said sub-section, shall be subject to the following conditions, namely,-
- (a) the input tax credit on capital goods, in terms of clauses (c) and (d) of sub-section (1) of section 18, shall be claimed after reducing the tax paid on such capital goods by five percentage points per quarter of a year or part thereof from the date of the invoice or such other documents on which the capital goods were received by the taxable person.
 - (b) the registered person shall within a period of thirty days from the date of his becoming eligible to avail the input tax credit under sub-section (1) of section 18 shall make a declaration, electronically, on the common portal in FORM GST ITC-01 to the effect that he is eligible to avail the input tax credit as aforesaid;

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- (c) the declaration under clause (b) shall clearly specify the details relating to the inputs held in stock or inputs contained in semi-finished or finished goods held in stock, or as the case may be, capital goods–
 - (i) on the day immediately preceding the date from which he becomes liable to pay tax under the provisions of the Act, in the case of a claim under clause (a) of sub-section (1) of section 18;
 - (ii) on the day immediately preceding the date of the grant of registration, in the case of a claim under clause (b) of sub-section (1) of section 18;
 - (iii) on the day immediately preceding the date from which he becomes liable to pay tax under section 9, in the case of a claim under clause (c) of sub-section (1) of section 18;
 - (iv) on the day immediately preceding the date from which the supplies made by the registered person becomes taxable, in the case of a claim under clause (d) of sub-section (1) of section 18;
 - (d) the details furnished in the declaration under clause (b) shall be duly certified by a practicing chartered accountant or a cost accountant if the aggregate value of the claim on account of central tax, State tax, Union territory tax and integrated tax exceeds two lakh rupees;
 - (e) the input tax credit claimed in accordance with the provisions of clauses (c) and (d) of sub-section (1) of section 18 shall be verified with the corresponding details furnished by the corresponding supplier in FORM GSTR-1 or as the case may be, in FORM GSTR- 4, on the common portal.
- (2) The amount of credit in the case of supply of capital goods or plant and machinery, for the purposes of sub-section (6) of section 18, shall be calculated by reducing the input tax on the said goods at the rate of five percentage points for every quarter or part thereof from the date of the issue of the invoice for such goods.
- 41 Transfer of credit on sale, merger, amalgamation, lease or transfer of a business.

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- (1) A registered person shall, in the event of sale, merger, de-merger, amalgamation, lease or transfer or change in the ownership of business for any reason, furnish the details of sale, merger, de-merger, amalgamation, lease or transfer of business, in FORM GST ITC-02, electronically on the common portal along with a request for transfer of unutilized input tax credit lying in his electronic credit ledger to the transferee:

Provided that in the case of demerger, the input tax credit shall be apportioned in the ratio of the value of assets of the new units as specified in the demerger scheme.

- (2) The transferor shall also submit a copy of a certificate issued by a practicing chartered accountant or cost accountant certifying that the sale, merger, de-merger, amalgamation, lease or transfer of business has been done with a specific provision for the transfer of liabilities.
- (3) The transferee shall, on the common portal, accept the details so furnished by the transferor and, upon such acceptance, the un-utilized credit specified in FORM GST ITC-02 shall be credited to his electronic credit ledger.
- (4) The inputs and capital goods so transferred shall be duly accounted for by the transferee in his books of account.

42. Manner of determination of input tax credit in respect of inputs or input services and reversal thereof.

- (1) The input tax credit in respect of inputs or input services, which attract the provisions of sub-section (1) or sub-section (2) of section 17, being partly used for the purposes of business and partly for other purposes, or partly used for effecting taxable supplies including zero rated supplies and partly for effecting exempt supplies, shall be attributed to the purposes of business or for effecting taxable supplies in the following manner, namely,-
- (a) the total input tax involved on inputs and input services in a tax period, be denoted as 'T';
 - (b) the amount of input tax, out of 'T', attributable to inputs and input services intended to be used exclusively for the purposes other than business, be denoted as 'T1';
 - (c) the amount of input tax, out of 'T', attributable to inputs and input services intended to be used exclusively for effecting exempt supplies, be denoted as 'T2';

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- (d) the amount of input tax, out of 'T', in respect of inputs and input services on which credit is not available under sub-section (5) of section 17, be denoted as 'T3';
- (e) the amount of input tax credit credited to the electronic credit ledger of registered person, be denoted as 'C1' and calculated as-
$$C1 = T - (T1 + T2 + T3);$$
- (f) the amount of input tax credit attributable to inputs and input services intended to be used exclusively for effecting supplies other than exempted but including zero rated supplies, be denoted as 'T4';
- (g) 'T1', 'T2', 'T3' and 'T4' shall be determined and declared by the registered person at the invoice level in FORM GSTR-2;
- (h) input tax credit left after attribution of input tax credit under clause (g) shall be called common credit, be denoted as 'C2' and calculated as-
$$C2 = C1 - T4;$$
- (i) the amount of input tax credit attributable towards exempt supplies, be denoted as 'D1' and calculated as-
$$D1 = (E \div F) \times C2$$

where,

'E' is the aggregate value of exempt supplies during the tax period, and

'F' is the total turnover in the State of the registered person during the tax period:

Provided that where the registered person does not have any turnover during the said tax period or the aforesaid information is not available, the value of 'E/F' shall be calculated by taking values of 'E' and 'F' of the last tax period for which the details of such turnover are available, previous to the month during which the said value of 'E/F' is to be calculated;

Explanation: For the purposes of this clause, it is hereby clarified that the aggregate value of exempt supplies and the total turnover shall exclude the amount of any duty or tax levied under entry 84 of List I of the Seventh Schedule to the Constitution and entry 51 and 54 of List II of the said Schedule;

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- (j) the amount of credit attributable to non-business purposes if common inputs and input services are used partly for business and partly for non-business purposes, be denoted as 'D2', and shall be equal to five per cent. of C2; and
- (k) the remainder of the common credit shall be the eligible input tax credit attributed to the purposes of business and for effecting supplies other than exempted supplies but including zero rated supplies and shall be denoted as 'C3', where,-
$$C3 = C2 - (D1+D2);$$
- (l) the amount 'C3' shall be computed separately for input tax credit of central tax, State tax, Union territory tax and integrated tax;
- (m) the amount equal to aggregate of 'D1' and 'D2' shall be added to the output tax liability of the registered person:

Provided that where the amount of input tax relating to inputs or input services used partly for the purposes other than business and partly for effecting exempt supplies has been identified and segregated at the invoice level by the registered person, the same shall be included in 'T1' and 'T2' respectively, and the remaining amount of credit on such inputs or input services shall be included in 'T4'.

- (2) The input tax credit determined under sub-rule (1) shall be calculated finally for the financial year before the due date for furnishing of the return for the month of September following the end of the financial year to which such credit relates, in the manner specified in the said sub-rule and-
 - (a) where the aggregate of the amounts calculated finally in respect of 'D1' and 'D2' exceeds the aggregate of the amounts determined under sub-rule (1) in respect of 'D1' and 'D2', such excess shall be added to the output tax liability of the registered person in the month not later than the month of September following the end of the financial year to which such credit relates and the said person shall be liable to pay interest on the said excess amount at the rate specified in sub-section (1) of section 50 for the period starting from the first day of April of the succeeding financial year till the date of payment; or

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- (b) where the aggregate of the amounts determined under sub-rule (1) in respect of 'D1' and 'D2' exceeds the aggregate of the amounts calculated finally in respect of 'D1' and 'D2', such excess amount shall be claimed as credit by the registered person in his return for a month not later than the month of September following the end of the financial year to which such credit relates.
43. Manner of determination of input tax credit in respect of capital goods and reversal thereof in certain cases.-
- (1) Subject to the provisions of sub-section (3) of section 16, the input tax credit in respect of capital goods, which attract the provisions of sub-sections (1) and (2) of section 17, being partly used for the purposes of business and partly for other purposes, or partly used for effecting taxable supplies including zero rated supplies and partly for effecting exempt supplies, shall be attributed to the purposes of business or for effecting taxable supplies in the following manner, namely,-
 - (a) the amount of input tax in respect of capital goods used or intended to be used exclusively for non-business purposes or used or intended to be used exclusively for effecting exempt supplies shall be indicated in FORM GSTR-2 and shall not be credited to his electronic credit ledger;
 - (b) the amount of input tax in respect of capital goods used or intended to be used exclusively for effecting supplies other than exempted supplies but including zero-rated supplies shall be indicated in FORM GSTR-2 and shall be credited to the electronic credit ledger;
 - (c) the amount of input tax in respect of capital goods not covered under clauses (a) and (b), denoted as 'A', shall be credited to the electronic credit ledger and the useful life of such goods shall be taken as five years from the date of the invoice for such goods:

Provided that where any capital goods earlier covered under clause (a) is subsequently covered under this clause, the value of 'A' shall be arrived at by reducing the input tax at the rate of five percentage points for every quarter or part thereof and the amount 'A' shall be credited to the electronic credit ledger;

Explanation.- An item of capital goods declared under clause (a) on its receipt shall not attract the provisions of sub-section (4) of section 18, if it is subsequently covered under this clause.

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- (d) the aggregate of the amounts of 'A' credited to the electronic credit ledger under clause (c), to be denoted as 'Tc', shall be the common credit in respect of capital goods for a tax period:

Provided that where any capital goods earlier covered under clause (b) is subsequently covered under clause (c), the value of 'A' arrived at by reducing the input tax at the rate of five percentage points for every quarter or part thereof shall be added to the aggregate value 'Tc';

- (e) the amount of input tax credit attributable to a tax period on common capital goods during their useful life, be denoted as 'Tm' and calculated as-

$$T_m = T_c \div 60$$

- (f) the amount of input tax credit, at the beginning of a tax period, on all common capital goods whose useful life remains during the tax period, be denoted as 'Tr' and shall be the aggregate of 'Tm' for all such capital goods;

- (g) the amount of common credit attributable towards exempted supplies, be denoted as 'Te', and calculated as-

$$T_e = (E \div F) \times T_r$$

where,

'E' is the aggregate value of exempt supplies, made, during the tax period, and

'F' is the total turnover of the registered person during the tax period:

Provided that where the registered person does not have any turnover during the said tax period or the aforesaid information is not available, the value of 'E/F' shall be calculated by taking values of 'E' and 'F' of the last tax period for which the details of such turnover are available, previous to the month during which the said value of 'E/F' is to be calculated;

Explanation.- For the purposes of this clause, it is hereby clarified that the aggregate value of exempt supplies and the total turnover shall exclude the amount of any duty or tax levied under entry 84 of List I of the Seventh Schedule to the Constitution and entry 51 and 54 of List II of the said Schedule;

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- (h) the amount T_e along with the applicable interest shall, during every tax period of the useful life of the concerned capital goods, be added to the output tax liability of the person making such claim of credit.
- (2) The amount T_e shall be computed separately for central tax, State tax, Union territory tax and integrated tax.
- 44. Manner of reversal of credit under special circumstances.
 - (1) The amount of input tax credit relating to inputs held in stock, inputs contained in semi-finished and finished goods held in stock, and capital goods held in stock shall, for the purposes of sub-section (4) of section 18 or sub-section (5) of section 29, be determined in the following manner, namely,-
 - (a) for inputs held in stock and inputs contained in semi-finished and finished goods held in stock, the input tax credit shall be calculated proportionately on the basis of the corresponding invoices on which credit had been availed by the registered taxable person on such inputs;
 - (b) for capital goods held in stock, the input tax credit involved in the remaining useful life in months shall be computed on pro-rata basis, taking the useful life as five years.

Illustration:

Capital goods have been in use for 4 years, 6 month and 15 days.

*The useful remaining life in months= 5 months
ignoring a part of the month Input tax credit taken on
such capital goods= C*

*Input tax credit attributable to remaining useful life= C multiplied
by 5/60*

- (2) The amount, as specified in sub-rule (1) shall be determined separately for input tax credit of central tax, State tax, Union territory tax and integrated tax.
- (3) Where the tax invoices related to the inputs held in stock are not available, the registered person shall estimate the amount under sub-rule (1) based on the prevailing market price of the goods on the effective date of the occurrence of any of the events specified in sub-

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section (4) of section 18 or, as the case may be, sub-section (5) of section 29.

- (4) The amount determined under sub-rule (1) shall form part of the output tax liability of the registered person and the details of the amount shall be furnished in FORM GST ITC-03, where such amount relates to any event specified in sub-section (4) of section 18 and in FORM GSTR-10, where such amount relates to the cancellation of registration.
- (5) The details furnished in accordance with sub-rule (3) shall be duly certified by a practicing chartered accountant or cost accountant.
- (6) The amount of input tax credit for the purposes of sub-section (6) of section 18 relating to capital goods shall be determined in the same manner as specified in clause (b) of sub-rule (1) and the amount shall be determined separately for input tax credit of central tax, State tax, Union territory tax and integrated tax:

Provided that where the amount so determined is more than the tax determined on the transaction value of the capital goods, the amount determined shall form part of the output tax liability and the same shall be furnished in FORM GSTR-1.

45. Conditions and restrictions in respect of inputs and capital goods sent to the job worker.
 - (1) The inputs, semi-finished goods or capital goods shall be sent to the job worker under the cover of a challan issued by the principal, including where such goods are sent directly to a job-worker.
 - (2) The challan issued by the principal to the job worker shall contain the details specified in rule 55.
 - (3) The details of challans in respect of goods dispatched to a job worker or received from a job worker or sent from one job worker to another during a quarter shall be included in FORM GST ITC-04 furnished for that period on or before the twenty-fifth day of the month succeeding the said quarter.
 - (4) Where the inputs or capital goods are not returned to the principal within the time stipulated in section 143, 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 and the said supply shall be declared in FORM GSTR-1 and the principal shall be liable to pay the tax along with applicable interest.

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Explanation.- For the purposes of this Chapter,-

- (1) the expressions “capital goods” shall include “plant and machinery” as defined in the Explanation to section 17;
- (2) for determining the value of an exempt supply as referred to in sub-section (3) of section 17-
 - (a) the value of land and building shall be taken as the same as adopted for the purpose of paying stamp duty; and
 - (b) the value of security shall be taken as one per cent. of the sale value of such security.