Input Tax Credit under GST in India: An Overview

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Abstract

Goods and Services Tax (GST) is considered as one of the biggest reform in the Indian tax system ever since 1947. GST subsume all the indirect taxes prevailing in the country and experts felt that it will help the economy to grow and improve the tax collection and brings transparency. GST provides an opportunity to transform businesses. GST has eliminated the state boundaries and it rates are facilitating to pay lesser tax on tax incidences and tax rates are uniform across the country. The most widely discussed aspect in the GST is Input Tax Credit(ITC) which means at the time of paying tax on output, the business man can reduce to the extent of tax paid on inputs or purchases. This study is covering aspects like time limit to avail ITC, how to calculate input tax credit and situations where ITC cannot avail. Studies have mentioned that Input Tax Credit under the GST regime may result into blockage of working capital of the firm in the initial months.

Key words: Goods and Services Tax, Input Tax Credit, Working capital

Introduction

India is a democratic and republic country having constitution being a supreme law of land. All the laws including Income Tax Act are subordinate to the Indian constitution. As per the constitution of India 'no tax shall belevied or collected except by Authority of Law'. There are three lists in the Seventh Schedule, which empower Central and State Governments to levy and collect taxes. The Government of India can collect taxes which are mainly divided into two categories- Direct and Indirect taxes. Tax levied on the income of the individuals is called Direct taxes like Income tax, surcharge and Gift tax. Taxes which are not collected directly but collected on the purchases of goods and/ or services is defined as Indirect Taxes. These taxes are levied on the seller of goods or the service provider unfortunately it is been passed on to the customer thereby it is the customer who has to bear the tax. Indirect tax is levied on the manufacturer or service provider and later on they can be recovered the same from the customer. Indirect taxes are collected from customers irrespective of their economic background.

There are many indirect taxes in India like services attract service tax, manufacturing companies pay excise duty and similarly on imports customs duty levied. The following are some of the indirect taxes applicable in India before GST came into exist.

1. Service Tax
2. Excise duty
3. VAT
4. Securities Transaction Tax
5. Stamp Duty
6. Entertainment Tax
7. Customs Duty

GST is the biggest tax reform of the Government of India has taken up since 1947. It has changed the entire indirect tax system which is considered as most complicated tax structure. GST subsume all the indirect taxes prevailing in the country and experts felt that it will help the economy to grow and improve the tax collection and brings transparency. This is an exploratory study done based on available secondary resources. The present study focused on basic aspects of GST with special emphasis on Input Tax Credit and its mechanism. Literature has been collected from journals, magazines and newspapers.

Rationale for the Study

Under the Indirect tax system, tax is levied at multiple stages by different authorized agencies at varying rates on the full value of goods. GST is intended with a motto "One nation

One Tax". GST subsumed various indirect taxes prevailing in India. Under GST, tax will be levied only on the value added at each stage not like earlier where Tax on Tax was collected. It is a single tax (collected at multiple points) with a full set-off for taxes paid earlier in the value chain. Thus, the final consumer will bear only the GST charged by the last dealer in the supply chain with set-off benefits at all the previous stages. As the concept of GST is relatively new and especially Input Tax Credit has not understood by many, hence this paper is focused on providing basic aspects of GST and Input Tax Credit. Input tax credit mechanism and set off provisions is helpful to all the dealers and manufacturers.

Review of Literature

Saurabh Gupta, Sarita, Munindra kumar Singh, Komal, CA HemrajKumawat (2017), authors examined Indian Model GST with other countries. The GST tax rate structure has been listed out like Australia 10%, France 19.6%, Canada 5%, Germany 19%, Japan 5%, Singapore 7%, Sweden 25%, and India 18%. Under the GST in India items like Alcoholic liquor for human consumption, Aviation turbine fuel, Diesel, Petrol etc.are not come under the purview of GST. The authors concluded that GST procedure should be simple and easy to understand for every one which would help in reduction of tax evasion.

Prakash E. Humbad (2017), mentioned that GST subsumes many indirect taxes prevailing in India and it is a One nation and One Tax. The key element of GST is Input tax credit where as in the earlier tax structure some of the taxes are not eligible for tax credit. As per the pre GST tax system few taxes are cannot be availed for tax credit. Only registered taxable person can avail tax credit within time limits. More than 196 countries in the world are levying GST which is beneficial to both dealers as well as consumers. The author also explained about the process for availing of Input Tax Credit.

Manoj Kumar Rathod (2017), explained about the basic aspects of GST structure in India. At present India is having complex indirect tax structure having cascading effects. The author felt that GST is a hope, which may bring change in the indirect tax structure in the country and also mentioned that India is moving towards uniform market with one single tax structure. The author covered GST basics and challenges too.

Lourdunathan, F and Xavier, P (2017), found that there is a mixed response and opinions among manufacturers, traders and customers about GST. It basically helps to achieve One Nation and One tax market. Authors explained about input tax credit set-off and subsuming of several indirect taxes and also opined that GST facilitate to improve the revenue collection for both Centre and State governments. Many positive aspects have been highlighted by the authors like Electronic filing of tax returns, refunds, payments using GSTNET portal etc. There are built checks on trade transactions, seamless credit and return processing are some of the benefits need to be covered in educating all the stakeholders by continuous conduct of seminars and workshops.

Shilpa Arora (2017), attempted to find the impact of GST on start-up firms. Since 2010 onwards start-ups have grown tremendously and it is providing self employment and employment to unemployed capable candidates. Start-ups provide solutions to problems and also attracting international investors like Softbank, Tiger Global etc. The author felt that taxation is one of the major roadblock for growth of start-ups and must have easy and transparent tax structure. GST has both positive and negative impact on start-ups. The positive factors for Indian start-ups are Transparency and reduced compliance cost, Improvement in Logistics efficiency, Reduced logistics cost, Higher threshold limit, Common registration and Simpler taxation. At the same time, the author mentioned negative factors of GST on start-ups are not a single rate of taxation, Increase in tax rate for service providing start-ups, Frequency of filing of return and Cross set off of levy is not allowed.

Dr. Gaurangkumar, C. Barot (2017), explained that the first indirect tax structure like Modified Value Added tax was given by VP Singh in 1986 and now GST was introduced based on Kelkar task force recommendations. The newness in this paper is that the author has come out with accounting entries under GST. The author has concluded that in India there are 17 indirect taxes and 23 types of cesses. 19 % goods and services covered under the slab of 28% tax rates while 81 % Goods and services covered under the 18% tax rate slab in GST. 3% tax is levied on gold and silver supply.

Research Methodology

This is an exploratory study focusing on basic aspects of GST and Input Tax Credit. Literature review plays a key role for this kind of studies. Hence, the present study has been carried out with the help of secondary data resources like newspapers, financial dailies, websites and reports released by Government of India etc. GST as an academic topic for research is still at the developing stage in India. Research articles availability is limited.

Issues with Current Indirect Tax Structure

The Indirect tax system in India has multiplicity of taxes on goods and services. Central and state governments used to levy different taxes. For instance, on manufacturing of goods excise duty, on imports and exports customs duty, service tax on services used to levy by central government. Similarly, state governments used to impose taxes like VAT, Entry tax, Purchase tax, Octroi and duty on liquor. There are many taxes and cesses existed such as surcharges, entertainment tax, luxury tax, stamp duty and road tax. Multiple taxation is one of the major issue where in taxes need to be paid on tax. For a manufacturing firm taxes need to be paid on inputs first and later output tax on finished goods which includes tax paid on inputs. This is causing a burden of multiple taxation or Tax on Tax with a cascading effect. Apart from this sales tax structure is such that there was a multi-point sales taxation at different levels of distributive trade then along with input tax load, burden of sales tax paid on purchase at each level was also added, thus aggravating the cascading effect further. The following are the major challenges with the pre GST indirect tax structure. 1. Multiplicity of duties / taxes 2. Lack of uniformity of provisions in state vat statutes 3. Sale of goods vs provision of services 4. Inability of state to levy tax on services. 5. Distortion of tax base with multitude of exemptions 6. Cascading effect of taxes 7. Lacklustre indigenous production due to CENVAT and 8. complexities in tax administration. According to H Rajesh Prasad, VAT commissioner there were around 1.4 lakh cases pending for refund since 2005 of which 72,000 refund cases were cleared in a span of around six months registered with the value-added tax (VAT) department which paves way to shift to GST regime. There are another 68,000-odd cases are still to be dealt with and the VAT department is trying to expedite the process before switching to the GST regime (AmbikaPandit, 2017).

An Overview of GST

Goods and Services tax law in India is a destination based tax structure. Tax is levied in every stage of the value addition in the entire supply chain right from manufacturer to ultimate consumer. It is levied on both goods and/or services. GST law has replaced many of the Indirect taxes existed in the country. There are different taxes applicable under GST in India. They are IGST, CGST and SGST/UTGST.

The Tax structure under GST is as follows:

Transaction	GST Regime	Old Regime	
Sale within the State	CGST + SGST	VAT + Central Excise/Service tax	Revenue will be shared equally between the Centre and the State
Sale to another State	IGST	Central Sales Tax + Excise/Service Tax	There will only be one type of tax (central) in case of inter-state sales. The Centre will then share the IGST revenue based on the destination of goods.

Source: https://cleartax.in/s/gst-law-goods-and-services-tax.

Input Tax Credit and Its Mechanism

One of the major advantages of GST law is input tax credit which helps in elimination of cascading taxes prevailing before the GST law come into the force in the country. Input Tax can be easily understood if we break the words like Input and Tax credit. Inputs are the materials or services bought by manufacture to make products which is the output. Tax reduction to the manufacturer on the output tax payable is the Tax credit. Input credit means at the time of paying tax on output, you can reduce the tax you have already paid on inputs. For instance, a manufacturer tax need to pay GST on finished product is Rs. 300 and the tax paid on material purchased is Rs. 100. In this situation manufacturer can claim Input Tax Credit of Rs. 100 and the remaining Rs. 200 out of Rs. 300 to be paid should be deposited. In nutshell, input tax credit means that when a manufacturer pays the tax on his output, he can deduct the tax he previously paid on the input he purchased. Here, while paying the tax on his output, he can deduct or take credit for the tax he paid while purchasing inputs (Tojo Jose, 2017).Input Credit Mechanism is available under the GST Act for a manufacturer, supplier, agent, e-commerce operator, aggregator or any of the person(s) registered under GST are eligible to claim Input Tax Credit.

Calculation of Input Tax Credit

Mr. X is manufacturer of steel utensils like spoons, plates, etc. Assume that he bought Rs. 500 worth of raw steel to make a pressure cooker and Rs. 100 worth of other raw materials. Let assume that the GST for steel is 18%. Also, assume that the GST he paid is 28% of other raw materials. Hence, Mr. X has paid Rs. 28 on other raw materials and Rs. 90 on raw steel which he used as inputs. So, the total input tax paid was INR 118 by the manufacturer. After considering the cost of manufacturing steel pressure cooker using the raw materials and including a decent profit, Mr.X decided to sell the pressure cooker to a distributor at Rs. 800 + GST. Assume that the steel utensil attracts a GST of 18%.Now the tax on it will be Rs. 144. Therefore, the manufacturer will prepare invoice for the pressure cooker for Rs. 944.Hence; Mr.X is collecting Rs 144 as GST on sale from the distributor. The manufacturer had paid Rs. 118 towards GST during the purchase of his input raw materials. Hence, out of Rs 144 of GST, Mr.X can now claim a credit of Rs.118 which he has already paid towards GST for inputs and deposit the difference of Rs. 26 with the government. This tax credit is available at all succeeding stages, retailers and distributors charge GST and can claim the Input Tax Credit.

Conditions to avail Input Tax Credit: The following conditions are to be fulfilled to avail Input Tax Credit (TejasGoenka, 2017)

✓ The trader/ dealer should have Tax Invoice / Debit or Credit Note / Supplementary Invoice issued by a supplier registered under GST Act.
✓ The said goods/services have been received.
✓ Returns (Form GSTR-3) have been filed.
✓ The tax charged has been paid to the government by the supplier.
✓ Credit for goods against an invoice received in lots /instalments can be availed only on last lot in instalment.
✓ The timelines for entitlement of credit against a particular invoice shall lapse on the expiry of one year from date of issue of invoice.

After filing the outward supply particulars in GSTR-1 by the supplier, the buyer can see the particulars in the GSTR 2A which will be auto populated. There will be a provision for making modifications, additions (if any) and acceptance in GSTR 2, the Input Tax credit will be credited to the buyer's electronic credit ledger on a provisional basis. The addition and modification done by the recipient in Form GSTR-2 will be made available to supplier in Form GSTR- 1A for his acceptance. Input credit will be available only when the monthly returns (Form GSTR-3) are filed by the supplier along with payment tax. The final acceptance of Input Tax credit will be communicated in Form GST MIS-1(TejasGoenka, 2017).

The following example helps to understand the flow of availing input tax credit:

Super Cars Ltd, a manufacturer of cars purchased 30 tons of steel from Ratna Steels. Ratna Steels supplied steel and issued tax invoice on 5th July with GST of 2, 40,000.

1. On 5th July, Super Cars Ltd satisfies the condition of Receiving Goods and Tax Invoice.

2. On 10th August, Ratna Steels furnishes outward supply through Form GSTR-1 Return.

3. From 11th August, Super Cars Ltd has visibility of their purchase through auto-populated Form GSTR-2A.

4. From 11th to 15th August, Super Cars Ltd can make additions or modifications, if any. In this example, it is assumed that there are no additions or modifications and super Cars Ltd. submits the Form GSTR-2.

5. Now, ITC of Rs. 2,40,000 is credited to Super Cars Ltd on a provisional basis.

6. Once the Form GSTR-3 (Monthly Return) along with tax payment is remitted by Ratna Steels, Super Cars Ltd is eligible for ITC of Rs. 2,40,000.

7. The final acceptance of ITC will be communicated in Form GST MIS-1.

Eligibility for Input Tax Credit under GST

➢ A person will be entitled to Input Tax Credit under GST in respect of inputs held in stock or in semi finished state immediately preceding the date of which he becomes liable to pay tax, if he has applied for new registration.
➢ Voluntary registration can be taken by any person. He can pay tax even when his turnover is less than the specified limit. He can take Input Tax Credit under GST in respect of the goods which are held in stock on the day immediately preceding the registration date.
➢ If a person who has opted for composition scheme switches over to the normal scheme, then he shall be entitled to take Input Tax Credit under GST in respect of "goods held in stock" on the day immediately preceding the date when he becomes liable to pay tax as normal taxpayer.

Utilization of CGST's Input Tax Credit under GST: For Instance, the Input Tax Credit under GST of CGST shall be first utilized for payment of output CGST followed by IGST if the balance still in the account. CGST input tax credit cannot be used to adjust SGST.

Utilization of SGST's Input Tax Credit under GST: SGST Input Tax Credit shall be first used to pay SGST and then payment of IGST but cannot be used to pay CGST.

Utilization of IGST's Input Tax Credit under GST: The Input Tax Credit under GST of IGST shall be first used to pay IGST, followed by CGST and at last for the payment of SGST.

Goods or Services on which GST Input Tax Credit is not available (Ashish Ahuja, 2017): GST Input Tax Credit is not allowed on the following:

✓ Input Tax Credit where the dealer deals in supply of fully or partially exempted Goods or Services.

✓ Motor Vehicles except when it's used for transportation business or in the business of selling of such motor vehicles or training of such motor vehicles

✓ food & beverages

✓ outdoor catering

✓ beauty treatment

✓ health services

✓ cosmetic & plastic surgery

✓ membership of club, health and fitness cente

✓ rent a cab, health insurance and fitness center (except where they are obligatory under any law)

✓ travel benefit to employees on vacation like Leave Travel allowance (LTC)

✓ work contract services for construction of real estate

✓ tax paid to composition dealer

✓ gst on tax paid by non-resident taxable person except gst on goods imported by him

✓ goods and/or services used for personal consumption

✓ goods lost, stolen, destroyed, written off, gift or free samples

In the above, in most cases if such goods and/or services are used to provide taxable services, GST Input Tax Credit is allowed.

Situations where one CAN NOT claim Input Tax Credit (ITC): Input Tax Credit (ITC) is unavailable for claim u/s 16(9) under the following circumstances:

➢ If goods and services are acquired for personal use.

➢ In the case of goods and services acquisition on a contract which may result in a reduction of immovable property apart from plant & machinery.

➢ If one has paid tax in GST composition scheme for goods and services received.

➢ In case an immovable property is built apart from plant and machinery using the goods and services and this immovable property is not transferred.

➢ In the case where employees have used the goods and services for personal purposes.

➢ When the cost of capital goods depreciation is claimed, then Input Tax Credit cannot be claimed.

Issues and Challenges in Input Tax Credit

The compliance system under GST regime creating challenging situations to the business units. Small and poor credit rating firms do have tough time. According to India Rating Research, there will be Rs. 50,000 crore blockage for the first two months due to Input Tax Credit and also increase in the tax rate from 15% to 18% this could lead to temporary shortage in the cash flows to the firms. For a large and good credit profile firms it would be easy to manage the situation. It is also estimated that if the average VAT rate is 14% then one lakh crores of these companies will be blocked in the Input Tax Credit. In the transition period, if half of the amount hangs in between, then at least Rs 50,000 crore will be blocked for two months in which 85% of revenue will be leased to companies whose annual turnover is more than Rs. 500 crores (SubodhKumawat 2017).

Under the GST regime, stock transfers to the branches of the same company in different locations including states are taxable. GST has to be paid in the month of stock transfer but Input tax credit can be availed when the stock is sold by the concern branch. This results into blockage of working capital. Companies in FMCG and Pharma sectors will take a bigger beating apart from the companies dealing with seasonal products (Ajay Srivastava, 2017). The role and responsibility of the recipient of the goods has increased in the GST regime because he has to pay the tax and file the returns. After due compliance by both supplier and recipient, the recipient of the goods is allowed to claim input tax credit. If the supplier/recipient does not pay tax, the tax payable because of such mismatch will be added to the output tax liability of the recipient. For a sector like retail where a large number of small firms supply goods, it would be difficult to ensure that everyone has paid tax on the invoices raised.

In case a GST registered firm is making purchases from an unregistered firm will not get Input Tax Credit. Similarly, if a registered firm under composition schemes buys goods from unregistered firms, the purchaser will be required to pay tax under reverse charge. These provisions are keeping the firms at a disadvantage position or forcing them to register though legally exempted.

Conclusion

In GST input Tax Credit is considered as backbone which allows collection of taxes at all points by allowing the credit for inputs. The rules laid in the GST law are important for ensuring seamless flow of credit in the entire scheme of transition without any scope for misuse. The major advantage under GST provisions are such that it would eliminate the cascading effect prevailing in the pre GST regime. Before the GST come into existence cross credit of VAT against services tax/exercise or vice versa was not allowed whereas under GST it is only one tax and all other taxes are subsumed. Hence, there is no restrictions for setting off input tax credit.

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