# Chapter 5
# Input Tax Credit

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## Statutory Provisions

***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;*

[1]*[(aa) the details of the invoice or debit note referred to in clause (a) has been furnished by the supplier in the statement of outward supplies and such details have been communicated to the recipient of such invoice or debit note in the manner specified under section 37;]*

*(b) he has received the goods or services or both.*

[2]*[Explanation: For the purposes of this clause, it shall be deemed that the registered person has received the goods or, as the case may be, services––*

*(i) 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;*

*(ii) where the services are provided by the supplier to any person on the direction of and on account of such registered person]*

*(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 utilization 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:*

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1 Inserted *vide The Finance Act, 2021, with effect from 01.01.2022 vide Notf no. 39/2021–CT dt 21.12.2021*

2 Substituted *vide The Central Goods and Services Tax (Amendment) Act, 2018 read with Notf no. 2/2019-CT dt. 29.01.2019 - w.e.f. 01.02.2019*. Prior to such substitution it read as*: "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:"*

*Provided further that where a recipient fails to pay to the supplier of 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 [3][~~invoice relating to such~~] debit note pertains or furnishing of the relevant annual return, whichever is earlier.*

*[4][Provided that the registered person shall be entitled to take input tax credit after the due date of furnishing of the return under section 39 for the month of September, 2018 till the due date of furnishing of the return under the said section for the month of March, 2019 in respect of any invoice or invoice relating to such debit note for supply of goods or services or both made during the financial year 2017-18, the details of which have been uploaded by the supplier under sub-section (1) of section 37 till the due date for furnishing the details under sub-section (1) of said section for the month of March, 2019]*

**Extract of the CGST Rules**

***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;*

3 Omitted *vide The Finance Act, 2020 read with Notf no. 92/2020-C.T., dt. 22-12-2020 notified w.e.f. 01.01.2021.*

4 Inserted *vide Order No. 02/2018-CT, dt. 31.12.2018 [The Central Goods and Services Tax (Second Removal of Difficulties) Order,2018]*

(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:*

[5]*[Provided that if the said document does not contain all the specified particulars but contains the details of the amount of tax charged, description of goods or services, total value of supply of goods or services or both, GSTIN of the supplier and recipient and place of supply in case of inter-State supply, input tax credit may be availed by such registered 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, wilful mis-statement or suppression of facts.*

(4) [6]*[No input tax credit shall be availed by a registered person in respect of invoices or debit notes the details of which are required to be furnished under subsection (1) of section 37 unless,-*

*(a) the details of such invoices or debit notes have been furnished by the supplier in the statement of outward supplies in FORM GSTR-1 or using the invoice furnishing facility; and*

*(b) the details of such invoices or debit notes have been communicated to the registered person in FORM GSTR-2B under sub-rule (7) of rule 60.]*

~~(4) [7][Input tax credit to be availed by a registered person in respect of invoices or debit notes, the details of which have not been [8][furnished] by the suppliers under sub-section (1) of section 37, [9][in Form GSTR-1 or using the invoice furnishing facility] shall not exceed [10][5 per cent]. of the eligible credit available in respect of invoices or debit notes the details of which have been [8][furnished] by the suppliers under sub-section (1) of section 37 [9][in Form GSTR-1 or using the invoice furnishing facility]]~~

5 Inserted *vide Notf no. 39/2018-CT dt. 04.09.2018*
6 Substituted *vide Notf no. 40/2021-CT dt. 29.12.2021 w.e.f. 1.01.2022*
7 Inserted *vide Notf no. 49/2019-CT dt. 09.10.2019*
8 Substituted *vide Notf no. 94/2020-CT dt. 22.12.2020 w.e.f. 01.01.2021 for "uploaded"*
9 Inserted *vide Notf no. 94/2020-CT dt. 22.12.2020 w.e.f. 01.01.2021*
10 Substituted *vide Notf no. 94/2020-CT dt. 22.12.2020 w.e.f. 01.01.2021 for "10 per cent". Earlier the rate 20 per cent was substituted by 10 per cent w.e.f. 01.01.2020 vide Notf no. 75/2019 – CT dt. 26.12.2019*

~~[11][Provided that the said condition shall apply cumulatively for the period February, March, April, May, June, July and August, 2020 and the return in Form GSTR-3B for the tax period September, 2020 shall be furnished with the cumulative adjustment of input tax credit for the said months in accordance with the condition above.]~~

~~[12][Provided further that such condition shall apply cumulatively for the period April, May and June, 2021 and the return in Form GSTR-3B for the tax period June, 2021 or quarter ending June, 2021, as the case may be, shall be furnished with the cumulative adjustment of input tax credit for the said months in accordance with the condition above.]~~

***37. Reversal of input tax credit in 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 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:*

*[13][Provided further that the value of supplies on account of any amount added in accordance with the provisions of clause (b) of sub-section (2) of section 15 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.*

[11] Inserted *vide Notf no. 30/2020-CT dt. 03.04.2020*

[12] Substituted *vide Notf no. 27/2021-CT dt. 01.06.2021 for "Provided further that such condition shall apply cumulatively for the period April and May, 2021 and the return in Form GSTR-3B for the tax period May, 2021 shall be furnished with the cumulative adjustment of input tax credit for the said months in accordance with the condition above."*

[13] Inserted *vide Notf no. 26/2018-CT dt. 13.06.2018*

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|---|---|
| *(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.* |

**Related Provisions of the Statute**

| Section or Rule | Description |
|---|---|
| Section 17 | Apportionment of credit and blocked credits |
| Section 31 | Tax invoice |
| Section 34 | Credit and debit notes |
| Section 39 | Furnishing of returns |
| Section 41 | Claim of input tax credit and provisional acceptance thereof |
| | |
| Section 49 | Payment of tax, interest, penalty and other amounts |
| Schedule I | Activities to be treated as supply even if made without consideration |
| Rule 54 | Tax invoice in special cases |
| Rule 86 | Electronic credit ledger |

### 16.1 Introduction

Chapter V of the CGST Act deals with input tax credit. The credit of taxes paid on inputs, capital goods or input services against the output tax payable, forms the cornerstone in a GST regime. GST can be understood as a system of value-added tax on goods and/ or services. It is these provisions on input tax credit that make GST a value-added tax i.e., collection of tax at all points in the supply chain after allowing for credit of taxes paid on inputs/input services and capital goods. The invoice method of value-added taxation has been followed in the GST regime too, viz., the tax paid at the time of receipt of goods or services or both would be eligible for set-off against the tax payable on supply of goods or services or both, based on the invoices with a special emphasis on actual payment of tax by the supplier. The procedures and restrictions laid down in these provisions are important to make sure that there is a seamless flow of credit in the whole scheme of taxation without any misuse.

### 16.2 Analysis

**(i) <u>Relevant definitions:</u>**

*(a)* *Taxable person under section 2(107)* means *a person who is registered or liable to be registered under section 22 or section 24*. As such, the liability to pay tax devolves on every 'taxable person' whether or not registration has been sought. But a careful reading of the input tax credit provisions makes it clear that input tax credit would be available only to a 'registered person' and to a limited extent pre-registration credit is available

under section 18(1) (discussed later). Omission to obtain registration or cancellation of registration, results in forfeiture of input tax credit that may have otherwise been available, but demand for output tax remains, whether the person is registered or not.

NOTE:

The difference between '*taxable person*' and '*registered person*' is important – these are two dissimilar phrases intentionally used in the law – and credit is allowed under section 16(1) only to a '*registered person*' whereas under section 9(1) tax levied is payable by every '*taxable person*' implying that the liability subsists even if not registered but credit is available only if registered.

*(b)* *Input tax credit* means the credit of "input tax" in terms of section 2(63).

*(c)* Input tax in terms of section 2(62) in relation to a registered person, means 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:

— integrated goods and service tax (IGST) charged on import of goods.

— tax payable on reverse charge basis under IGST Act/SGST Act/CGST Act/UTGST Act.

but excludes the tax paid as a composition levy.

Sections 9(3) and 9(4) of the CGST Act [similarly sections 5(3) and 5(4) of the IGST Act] levies tax on goods or services or both on reverse charge.

Therefore, 'input tax credit' is the tax paid by a registered person under the Act whether as a forward charge or reverse charge for the use in the course or furtherance of his business. It is interesting to note that in the definition of "input tax credit", (i) transition credit is not included because transition credit is not tax paid under GST law but (ii) IGST paid on import of goods is included because IGST on imported goods is additional duty of customs equivalent to GST applicable on domestic goods.

*(d)* *Electronic credit ledger:* The input tax credit as self-assessed in the return of registered person shall be credited to electronic credit ledger in accordance with section 41, to be maintained in the manner as may be prescribed. [section 2(46) read with section 49(2)]. Credit in electronic credit ledger is 'provisional' because there are (i) pre-conditions to avail input tax credit (discussed later) and (ii) post-conditions which need to be complied after input tax credit is availed.

*(e)* *Capital goods* means goods, the value of which is capitalised in the books of account of the person claiming the input tax credit and which are used or intended to be used in the course or furtherance of business [Section 2(19)]. It is important to note that Accounting Standard 10 permits capitalization of even 'services' when it is expected that the future economic benefits associated with it will flow to the enterprise and the asset has a cost or value that can be measured reliably. Thus, it can be inferred that:

o economic benefit is expected to be derived from the asset

- o an asset is expected to be available for use by an entity for a long period of time, say, more than a year
- o cost of asset can be ascertained in monetary terms.

Services which are capitalized, as per AS10, will continue to be 'input services'. GST law only admits *'goods'* to be capital goods and the treatment prescribed in respect of 'capital goods' will not apply in relation to services that are capitalized in accordance with AS10.

*(f)* *Input* in terms of section 2(59) means:

- — any goods,
- — other than capital goods,
- — used or intended to be used by a supplier
- — in the course or furtherance of business.

It is important to note that prior to 'actual use' of the inputs, there is only an expectation or intention to use the said inputs 'in the course or furtherance of business'. This is an example of a post-condition, that is, if the inputs which were intended to be used are later: (i) diverted to some non-business use or (ii) lost or destroyed such that they are not available to be so used, the post-condition is not satisfied and input tax credit availed will be liable to be reversed.

*(g)* *Input service* in terms of section 2(60) means:

- — any service
- — used or intended to be used by a supplier
- — in the course or furtherance of business.

It is important to note that 'services' is not a verb but a noun in GST. That is, there are instances when goods which are supplied are required to be 'treated as' supply of services in terms of section 7(1A) read with Schedule II. In such cases, tax paid on such goods will also be 'input service' for the purposes of section 16. For example, software purchased or equipment lease rental under HSN 9973, will be input services.

*(h)* *Works Contract* in terms of section 2(119) means a contract for building, construction, fabrication, completion, erection, installation, fitting out, improvement, modification, repair, maintenance, renovation, alteration or commissioning of any immovable property wherein transfer of property in goods (whether as goods or in some other form) is involved in the execution of such contract.

It is important to note that 'works contracts' is not limited to civil construction although civil construction may be common under HSN 9954. The true test of works contract would be the creation of an 'immovable property' and not merely 'fixed installation'. Refer discussion under section 2(102) [i.e., definition of services] regarding the scope of 'immovable property' in the context of GST law and the principles enshrined under other substantive laws.

***(ii) Section 16***

(a) <u>*Registered person to take credit:*</u> Every registered person subject to section 49 (payment of tax), shall 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. The input tax credit is credited to the electronic credit ledger. Rule 36 of the CGST Rules provides that input tax credit can be taken on the basis of any of the following documents:

(i) Invoice issued under section 31 by the supplier of goods or services or both.

(ii) Debit note issued under section 34 by a supplier of goods or services or both.

(iii) Bill of entry or any similar documents under Customs Act or rules made thereunder for the assessment of integrated tax on imports.

(iv) Invoice prepared in respect of supplies made under reverse charge basis issued under section 31(3)(f).

(v) Invoice or credit note issued by ISD for distribution of credit in accordance with rule 54(1) of the CGST Rules.

It is important to note the words 'input tax charged on any supply of goods or services or both to him' and 'in the course or furtherance of his business' appearing in section 16(1). The words 'him' and 'his' refers to registered (distinct) taxable person claiming input tax credit in question and not the legal entity. Hence , input tax paid in a State must not be in relation to the business of any other distinct taxable person in another State, albeit belonging to the same legal entity.

For example, a company has Branch-A which is a registered taxable person in Andhra Pradesh and conducts a conference in a hotel in Lonavla (Maharashtra) where CGST-MGST is charged by the hotel. This company also has Branch-M which is a registered taxable person in Mumbai. Now the provisions of section 16(1) operate as under :

- CGST-MGST charged by the hotel in Lonavla (Maharashtra) is 'used in the business of Branch-A' in Andhra Pradesh and not in the business of Branch-M in Mumbai.
- The hotel would not be aware of the above fact and would not resist to issue the bill in the name of Branch-M because both are branches of the same company.
- Since, CGST-MGST would be charged by the hotel, input tax credit would not be available to Branch-A as tax paid in Maharashtra is not a creditable tax in Andhra Pradesh;
- Moreover, Branch-M in Mumbai cannot justify this input tax credit as it is not 'used' in *'business'* but it is 'used by another (distinct person)' in 'that other (distinct persons) business'.
- Care should be taken to verify '*whose*' business each input tax credit relates to, that is, who is the exact distinct person eligible to each item of credit.

- In order to avail input tax credit, the company ought to obtain ISD registration in Maharashtra and distribute this credit entirely to Andhra Pradesh.
- Alternatively, if nexus is established between the services of the hotel and the business of Branch-M, input tax credit may be availed by Branch-M. Nexus would be established if Branch-M were to provide inter-branch supply of services to Branch-A as an alternate to registering as ISD [more on feasibility of 'interoperability of cross-charge with ISD' discussed later].

Note - Input tax credit can also be taken on the basis of revised tax invoice.

(b) *Credit in case registration is cancelled:* When only a 'registered person' is entitled to take credit, registration is a pre-requisite to claim credit. And if registration once obtained is later cancelled, no further credits from the date of cancellation could be availed . Not only that, as at the date of such cancellation reversal of credits under section 29(5) would come into operation without any provision for refund of any surplus credit after such reversal too. Care must be taken to ensure that registration is not cancelled so that credits are not endangered. This aspect becomes significant while planning mergers and acquisitions (M&A) where business is transferred on a given date to another existing or new entity. In all these transactions, 'credit preservation' would be a key component in the M&A transaction structure. Credits can be irretrievably lost if there were a break in the registration of the transferor or transferee. Reference may be made to section 85 and rule 41 for detailed discussion about credit transfer in such transactions.

(c) *Credit where registration is suspended:* Suspension of registration is not cancellation of registration. However, during the period of suspension, there is presumption of stoppage of business. As a result, inward supplies during suspension are not admissible as it does not augur with the fact of suspension of registration. Note that suspension may be the result of an 'application' made by the taxable person as noted from rule 21A or some other failure by taxable person. It does not lie with the taxable person to make such application for suspension of registration pending settlement of all dues to enable cancellation of registration and at the same time assert the existence (and continuation) of business by claiming credit on inward supplies. As such, where registration is suspended, credit is not admissible due to the presumption contrary to the requirement in section 16(1) that such 'taxable person' must be a 'registered person' to claim input tax credit.

(d) *Wastage of inputs in the course of production:* Credit in respect of inputs that may have been wasted during the course of production of finished products does not cease to be 'used or intended to be used' in the course or furtherance of business. As such, there is no restriction to read into the language of section 16(1). In fact, the full extent of credit would be available whether the extent of wastage of inputs in the course of production of finished goods is within the normal wastage norms Unless there is a diversion of inputs (in respect of which credit has been availed), there is no embargo on taking and retaining input tax credit. Section 17(5)(h) restricts credit on "goods lost" since these can no longer be used for the purpose of business but does not provide for restriction of credits on "loss of goods" which could be a process loss inherent to the nature of product on which credit has been availed. Therefore, "goods lost" must be given a completely different meaning as compared to "loss of goods" during production / process.

Note that in-process loss occurring in the course of job work would receive different treatment. Further, where there is any (in-process) loss of inputs, credit claimed by the principal would be undisturbed provided such norms are demonstrable in trade practices.

It is interesting to note that the requirement in section 16(1) is that inward supplies must be 'used' in the course or furtherance of business (and where it is 'intended to be used' at the time of receipt of inward supplies, it must be actually used). Where there is inefficient use, that is there is a 'loss' of inward supplies, there is no doubt that they were 'used' although not very efficiently. For this reason, experts hold the view that inward supplies that are 'actually used' will be admissible as input tax credit and whether such use has been efficient or otherwise is beyond the reach of GST law. Reference may be had to the decision of the CESTAT in *Ashok Leyland Ltd. v. CCE, Nagpur [ (2004) 169 ELT 131 (Tri. Mumbai)]* where inputs damaged in 'shop stores' were held to be 'in process losses' and inputs damaged in 'raw material stores' were held to be 'pre-process losses'.

Where inward supplies (of goods) are 'lost', then section 17(5)(h) comes to block input tax credit for the reason that they are not 'used' in the course or furtherance of business. And this follows the ratio in *Ashok Leyland's* decision that unless the inputs are 'used' (in the business) they will not be considered as 'used' and when they are 'lost' then, admittedly they are not 'used' and will fail the test in section 16(1). Refer discussion about 'loss v. lost' (*infra*).

(e) *Input-Output nexus:* While CENVAT Credit Rules, allowed credit on input and input services used for manufacture of excisable goods or for rendering taxable services, the credit under GST law is available on procurements which are "used" or "intended to be used" in the course or furtherance of business. It is important to note the difference between 'use in manufacture' (CENVAT) versus 'used in business' (GST) which is a much broader terminology in GST. Actually, used must be shown even if at the time of availing credit, inward supplies were received into stock with intention to use later for stated purposes and this is referred as 'actual end-use' which is a post-condition to avail input tax credit [discussed later in para (k) below]. Hence, any procurement though not having any direct or immediate connection with the manufacture of finished products or rendering of outward supplies, would also qualify for input tax credit so long as it is "used or intended to be used" for the purpose of business. For e.g., stationery used in the office of Managing Director at Mumbai has no correlation with the equipment manufactured at the company's factory in Aurangabad but the credit of tax relating to such stationery would be available since it is "used or intended to be used" for the purpose of business.

(f) *"One-to-one correlation" of credit from unrelated businesses with single GSTIN:* There is a well-accepted principle in any value added tax system to inquire whether the given set of rules requires 'one-to-one correlation' for credit admissibility and utilization. An example may help to understand this principle better. Say, a proprietor runs a furniture trading business in Indore, Madhya Pradesh and a software services business in Jabalpur, Madhya Pradesh. If the given tax system does not permit cross-utilization of credit (validly availed) in the furniture trading business with the output liability in the software services business then, it can be said that, that tax system requires 'one-to-one correlation'. But, if another tax system (which GST is) allows such cross-utilization, then it can be said that 'one-to-one correlation' is not required. Taking this principle into the furniture business, credit availed in respect of inputs (or input services or capital goods) purchased in the furniture business in Indore may be utilized for payment of output tax in the software services business in Jabalpur. As long as all credits and corresponding output tax liability are contained within one single GSTIN, such cross-utilization is freely permitted.

(g) *Setting-up of business and credit relating to pre-setup expenditure (preliminary and pre-operative) of such business:* It is well known that 'commencement of business' is not the same as 'commencement of entity'. An entity may be incorporated to explore business possibilities, or an entity may be incorporated to implement a business opportunity. Where expenses are incurred without a 'business' in existence, credit is doubtful although the underlying expenses are seemingly business-like and business-linked like rent, consultancy, travel, etc. Revenue expenditure incurred during construction of factory is not permitted to be capitalized with plant or factory building and such expenditure is treated as 'sunk costs'. Reference may be made to decisions in Income-tax in the context of previous year (section 3), expenditure on business (section 28) and preliminary expenses (section 35D) from Kanga and Palkivala's Commentary on Income-tax Act, to appreciate that there is a positive determination of this fact that there are 'sunk costs' of an entity. Experts are divided in opinion that input tax credit is not readily admissible on all expenses of an entity or person as section 16(1) very clearly refers to 'business' when it is 'by a (distinct) person'. It is doubtful if expenses (representing inward supplies) which are admittedly not for the business could be allowed as credit. The principle that flows from those decisions in the context of income-tax law is that 'business is recognized as a business only when it has achieved income generating capacity'. Income generating capacity is when the idea which is being exploited by an entity is not in the 'exploratory phase' where a potential business idea is being evaluated and tested. Income generating capacity is a situation when the idea is already tested and is ready to generate income. Decisions starting from *Western India Vegetable Products* and *Tuticorin Alkali* and contrasted in *Bongaigaon Railway* and *Karnal Co-op*. could be referred.

(h) *Credit involved in sunk costs of abandoned and unfructified projects:* While new businesses may have certain aspects to be examined like - (i) date from when business is said to be commenced (ii) date when inputs are actually used in business, these are aspects where income-tax law appears to be more liberal than GST law. This may be explained with the following examples:

- 'A', a mineral exploration company applies for 10 sectors to search or prospect mineral deposits, discovers 8 sectors to have deposits, finalizes 6 sectors to be viable for extraction and extracts minerals only in 4 sectors. Here, it may be stated that it is the nature of this industry that in order to identify which are those 4 viable sectors to extract mineral, prospecting costs must be incurred on all 10 sectors. There are judicial pronouncements that allow expenditure in unsuccessful sectors (areas where mineral deposits were expected) as admissible deduction in arriving at the gross total income for income-tax purposes because that is the nature of the business and only by starting with all 10 sectors can the company reach those 4 viable sectors to extract deposits and generate income.
- Now, take the case of 'B" a film production company which launches 3 films and it has paid writers and purchased the scripts for all 3 films and then paid fees to directors/actors for 2 films and finds distributors for only 1 film. Now, in computing the gross total income for the film business of this production company, expenditure on film 1 and 2 are not 'used in business' against income earned from film 3. Here, expenditure incurred on film 1 and 2 may be treated as a 'loss-making ventures' to be set-off against the income from film 3 which is 'profitable venture'.

  As to the correctness of the treatment in income-tax, it is a matter that turns on its unique provisions in income-tax law but for GST purposes the treatment depends on the following aspects:

  (a) Factual tests in case A and case B are not identical; in case A it is the nature of the business to 'spend on several to earn from few' and in case B, it is clear that there loss-making ventures have no contributory value to the profitable venture.

  (b) Requirement in section 16(1) is 'actual end-use' so that there is output tax due. And where inward supplies do not result in output tax, credit is ineligible [see sections 17(2) and 17(5)(h) for explanation].

  (c) Although there is no requirement for 'one-to-one correlation' in GST, non-use of inward supplies is not going to pass muster of 'actual end-use' for credit to be admissible. And if non-use (leading to taxable outward supplies) was not a criteria then, sections 17(2) and 17(5)(h) would be otiose. Now, without laying down any rule of a direct link between credit in GST and costs in such projects that are abandoned or unfructified, experts caution that admissibility of credit under section 16(1) cannot be free from further inquiry.

(i) *Credit involved in 'capital or debt' raising activities:* There are a host of instances due to 'remoteness' of connection between taxable outward supplies and the expenditure involving GST credit. Experts caution that absence of a specific embargo in, say, section 17(5) for such cases, is reason enough to claim credit but consider that these expenditures have been riddled with controversy and contested as to whether they are 'used in business'.

(j) <u>*Costing-pricing inter-relationship:*</u> The cost of inputs on which credit has been availed will not be included in the pricing of the product and consequently, not included in the transaction value – this may create a concern as to whether this credit is admissible or not. As explained by Supreme Court *in CCE, Pune v. Dai Ichi Karkaria [(1999) 112 ELT 353]*, the nature of Modvat scheme is such that the cost of purchase of inputs is lowered because credit, does not immediately, directly and proportionately impact the assessable value of the finished product manufactured using the inputs.

(k) <u>*GST credit is subject to 'conditions precedent' and 'conditions subsequent':*</u> GST law has laid down certain conditions in sections 16 to 18 of the CGST Act. Some of these conditions are 'before' claiming input tax credit, while some are 'after' claiming credit. It is true that *in Eicher Motors Ltd. v. UoI [(1999) 106 ELT 3 (SC)],* it was held that Modvat credit is an '*indefeasible right'*. But, every 'right' becomes 'indefeasible' after it is 'vested' and not before. Rights are relevant only when they are legally recognized and by that recognition enforceable in a Court of law for infringement by others who threaten its enjoyment by the holder of those rights. If these attributes are missing, then it is not a right but a mere reward or a benefit allowed due to magnanimity of law. And by that reason, it can be taken away without reason or explanation. But lawful rights once vested become indefeasible and until they are vested, these rights are 'inchoate' (or in formation), that is, there are not 'yet' vested. Non-fulfilment of vesting conditions operates as divesting conditions.

This makes identification of 'vesting conditions' very important. If the vesting conditions are satisfied, then the rights are vested and hence, indefeasible. As a corollary, unless the rights are vested, they remain 'in choate' and can be taken away by operation of law. The law that can take away 'in choate rights' may be conditions linked to vesting or prescription. Conditions linked to vesting of input tax credit in GST, can be found in section 16(2), among others. Notice that every 'taxable person' is liable to pay tax (and be compelled, in accordance with the law prescribed, to pay the tax levied) but only a 'registered person' is eligible to 'take' credit. Care must be taken of the 'effect' of these two central aspects, namely, (a) conditions linked to vesting or (b) prescription. If any of these central aspects are not satisfied, then even if credit is 'provisionally' allowed, will need to be returned back. And until *'conditions precedent'* are not satisfied, credit cannot be taken and in case '*conditions subsequent'* are not satisfied, credit (provisionally) taken must be paid back or returned. Following is a list of conditions linked to claim of input tax credit:

| *Pre-conditions* | | *Post-conditions* | |
|---|---|---|---|
| Registration | 16(1) | Payment to supplier within 180 days | Rule 37 |
| Filing of Form GSTR - 1 by supplier (to enable it to appear in Form GSTR - 2B to recipient) | 16(2)(aa)* | Actual end-use in making taxable outward supplies which are not (i) exempt under Notification No. 11/2017-CT(R), dt.28.06.2017 or (ii) treated to be exempt by conditions in tariff notifications [see expln. 4(iv) to Notification No. 12/2017-CT (R), dt. 28.06.2017]] | 17(1), 17(2), 17(5)(h) and 18(4) |
| Possession of valid tax invoice | 16(2)(a) | | |
| Delivery of goods or services (complete and effective) | 16(2)(b) | Not blocked (default) | 17(5) |
| Payment of tax by supplier | 16(2)(c) | Not ineligible (special category) | Tariff conditions (Rate Notf.) |
| Credit shown in the return filed | 16(2)(d) | Time limit to claim credit | 16(4) |

*(i) Corresponding amendments in State GST laws awaited.

*(ii) The new condition effective from 01.01.2022 mandates that ITC shall be eligible only if the details of the invoice or debit note has been furnished by the supplier in their Form GSTR-1 and the same has been communicated to the recipient.

Note that for amendments in CGST Act to be fully effective, corresponding provisions of SGST Act also must be amended. Same goes for Form GSTR-2B.

(l) <u>*Time limit to avail the input tax credit:*</u> A registered person is not entitled to avail input tax credit on tax invoice/ debit notes after the due date of furnishing of the return under section 39 for the month of September of the subsequent financial year or furnishing of the relevant annual return, whichever is earlier. In fact, not only is registration a pre-requisite (see, 'registered taxable person' alone will be entitled to claim credit) but filing of return under section 39 is also a requirement. Input tax credit is a right that does not 'vest' until the last of the conditions in section 16(2) are fulfilled. Until then, this right i.e., input tax credit is *inchoate* (or incomplete or undeveloped ) and not a vested right.

Rights that are not yet vested can lapse by limitation unless effective steps to actualize those rights are taken by the person. And once the right stands vested, it becomes indefeasible except by operation of subsequent inherent conditions. In other words, input tax credit which is a right (in law) of the taxable person is not fully mature and is not available to the taxable person until all pre-conditions (steps to realize the available rights) have been fulfilled or performed. Section 16(2) lays down these steps that can be fulfilled immediately or in course of time. Only when all these steps are fulfilled, the right that is 'available' becomes a right that could be 'availed'. After the credit is actually availed (by including in Form GSTR-3B), it will be ready for utilization without any time for utilization or any age for its expiration.

Section 18(4) provides a condition (which is informed at the time of availing credit) that credit availed will be liable to be reversed if output tax is exempt at the time of making such outward supply. Other than this situation, all credit availed (after meeting all pre-conditions and post-conditions) will be permanently and indefeasibly available as a vested right to the taxable person. Now, in a situation where the credit that is 'available' is somehow delayed and 'not taken', it would still be available but not beyond the limitation prescribed in section 16(4). Once the limitation period prescribed in section 16(4) sets in, the credit which is 'not availed' by virtue of the limitation prescribed is proper, in view of the principle of reaching finality in respect of all 'available' credits that may 'not' be intended to be availed. Experts suggest that in case of doubt, one can avail the credit and then reverse under protest with intimation to Revenue. This would ensure that the time limitation would not be the reason for not taking ITC, once clarity emerges from Courts.

Section 16(4) provides for time limit for taking credit for invoices and debit notes. Bill of entry is not mentioned in section 16(4) and hence it appears that there is no time limit for taking credit in case of bill of entry.

It would be important to note that the due date for availing credit from debit notes received is based on the date on which the debit note is issued regardless of the year in which the original supply was made. Section 34(3) says "*shall issue to the recipient, one or more debit notes for supplies made in a financial year*". Reference to "*financial year* "is *qua* debit note and not the *qua* original supply made.

*Illustration*

| *Document Type* | *Document Date* | *Earliest date for taking credit* * |
|---|---|---|
| Invoice | 05.07.2021 | Returns for the month of September 2022 |
| Debit Note | 05.03.2021<br>(Debit Note relates to invoice raised on 05.01.2021) | Returns for the month of September 2022 |

| | | |
|---|---|---|
| Debit Note | 05.5.2022<br>(Debit Note relates to invoice raised on 05.01.2021) | Returns for the month of September 2023 |

* Assumed that annual returns have been filed after the filing of the returns for the month of September

**Note:** The intent of law to delink the date of issuance of debit note from the date of issuance of the underlying invoice for purposes of availing input tax credit is evident in the Board *Circular No. 160/16/2021-GST dated 20.09.2021*, which stipulates that:

*(a) W.e.f. 01.01.2021, in case of debit notes, the date of issuance of debit note (not the date of underlying invoice) shall determine the relevant financial year for the purpose of section 16(4) of the CGST Act.*

*(b) The availment of ITC on debit notes in respect of amended provision shall be applicable from 01.01.2021. Accordingly, for availment of ITC on or after 01.01.2021, in respect of debit notes issued either prior to or after 01.01.2021, the eligibility for availment of ITC will be governed by the amended provision of section 16(4), whereas any ITC availed prior to 01.01.2021, in respect of debit notes, shall be governed under the provisions of section 16(4), as it existed before the said amendment on 01.01.2021.*

(m) *Time limit 'limitation' or 'prescription':* Although the time limit prescribed in section 16(4) or even section 18(2) for that matter, has been referred to as 'limitation' (in the above discussions), care must be taken to note the difference between 'limitation' and 'prescription'**. "**Limitation is when a right continues but is no longer enforceable after lapse of certain time". For e.g., input tax credit taken by the exporter in case of zero-rated supplies, the exporter is eligible to claim refund. If the refund claim is not filed within two years from the relevant date, the refund gets barred. This does not mean the credit is liable to be reversed. It will continue and may be utilized to pay any output tax by the same exporter. Here, the two-year time limit to claim refund (on zero-rated supplies made) is a limitation. Note that the right (input tax credit) remains but it is no longer enforceable (even though the condition of making zero-rated supplies is met) to receive the refund." Prescription is when the right itself vanishes after lapse of specified time". For e.g., 'right' to input tax credit (that has clearly satisfied all vesting conditions) itself vanishes by lapse of this time limit specified in section 16(4).

(n) *Deemed receipt of goods***:** Section 16 permits a registered person to avail credit only after he has received the said goods or services or both. However, in case of bill to-ship to transactions (including where such goods are sent for job work), by which the registered person instructs his supplier to ship the goods to another person on his behalf, the date of receipt of goods by such other person shall be deemed to be the date of receipt of goods by the said registered person.

Therefore, what exactly does 'received, mean in this context? Does it refer to actual receipt of goods at factory premises or even constructive receipt of goods would suffice? Broadly, receipt of goods may be said to be complete when goods have been supplied as per the recipient's instructions and the supplier is discharged from any further liability on such goods. The delivery must be complete in all respects to the utmost satisfaction of the recipient. The point of acceptance in cases of pre-requisite of quality control may have to be clear.

For example, when goods imported by a registered person are supplied directly to his customers in India from the port without bringing such imported goods (physically) to his factory premises, the importer would still be entitled to ITC of IGST paid on imported goods although such goods were never received at his factory premises, provided that all the import formalities are fulfilled

The bill -to ship -to model is applicable in case of services also. However, note that this fiction for delivery of goods or services is not an attempt at encroaching upon the place of supply provisions of IGST Act but merely to satisfy the conditions for taking credit in certain cases where someone else collects goods or enjoys the services.

(o) *Goods received in instalments:* If goods are received in instalments against a single invoice, credit can be availed upon receipt of last instalment of the goods.

*Illustration* – A consignment of coal is to be dispatched from Kolkata to Mumbai using five trucks. An invoice was issued to the recipient on March 30, 2021. Four trucks reached the claimant by March 30, 2021 but the truck carrying the final lot of the consignment reached the recipient only on April 2, 2021. In this case, input tax credit for the entire consignment can be availed only in the month of April 2021.

It is important to note that, foreclosure of delivery schedule is permitted. Where goods are delivered to a certain extent and deliveries are foreclosed by the recipient of supply, it is permitted to claim credit only to the extent delivered on pro-rata basis. Foreclosure may not always be possible. This rule is specifically addressed to indivisible equipment that is delivered in parts or lots. In such cases, credit cannot be claimed on incomplete equipment stating foreclosure.

(p) *Receipt of Services:* The recipient can claim credit only upon receipt of services except in a situation mentioned in the Explanation to section 16(2)(b). In the commercial world, while it is easy to demonstrate receipt of goods (by way of physical stock, e-way bill, GRN etc), services are not amenable to such proof-of-delivery due to their transient and intangible nature. Determination of actual receipt of services could be a formidable task especially when the contracting period for provision of service extends beyond a tax period but consideration is received in advance.

Explanation to section 16(2)(b) has been amended to include services. It has been stated that the registered person will be deemed to have received the services where the services are provided by the supplier to any person on direction of and on account of such registered person. Experts see that this amendment could be followed retrospectively even though the amendment does not state it to be retrospective. Reference may be had to tools of interpretation of statutes which state that substantive vested rights cannot be taken away even by an amending Act. Drafting tools like 'proviso' and 'explanation' are often used to bring about an amendment. A *proviso* carves out an exception to advance the object and suppress the mischief sought to be overcome by the extant law. An *explanation* aids in more accurately expressing the legislative intent that always was. As important as it is to understand the 'nature and scope' of amending provisions of equal importance is the 'effect' of these amendments. It is common understanding that when amendments are clarificatory, they will be retrospective, but when they are substantive, they will be prospective. Date of notification brings the amended law into the statute book but merely because amended law takes facts, that occurred previously into consideration, it does not make it an *ex post facto* law and come under challenge. The Supreme Court in *Sundaram Pillai v. Pattabiraman [1985 AIR 582 SC*] laid down some guiding principles on the effect that these drafting tools – proviso and explanation – can have on the construction of the amended law by the amendments so made. And for advancing the mischief that occurred before the explanation to section 16(2) whereby credit could have been denied even though those services are delivered 'on behalf of' the recipient, this explanation would deserve retrospective effect for being clarificatory in nature to avoid the mischief.

The person receiving any services may be different from the person who is liable to make the payment as the recipient under the law. The term 'recipient' under the GST law has been defined to mean the person liable to make the payment. However, there are multiple cases where the payment is made by a particular person, but the services are received by another person. In such a situation, the person liable to make the payment will be deemed to have received the services.

For instance, X is providing advisory services to Z for which the payment is agreed to be made by Y. In this situation, Y will be deemed to have received the services as per the new deeming fiction in the Explanation to section 16(2). Y will be allowed to avail input tax credit even though he is not in actual receipt of the services.

(q) *Failure to pay to supplier of goods or services or both, the value of supply and tax thereon:* Where the recipient (of goods or services or both) has failed to pay the supplier within 180 days from date of invoice, input tax credit availed in proportion to such unpaid amount of the invoice shall be reversed by adding to recipient's output tax liability along with interest as may be applicable. On payment of the value of the invoice, amount of credit reversed may be reclaimed without any time limit as per rule 37(4). It is interesting to note that there is no other provision in GST law where credit once reversed can be reclaimed by the recipient and therefore (i) credit available must be availed within the time limit in section 16(4) and any delay beyond this time limit will result in available credit being forfeited permanently and (ii) credit once availed [within the time limit in section 16(4)] but reversed under rule 37(1) may be reclaimed under rule 37(4) and this time without any time limit to reclaim the reversed credit.

One may note that as per experts, the aforesaid condition does not apply to supplies that are liable to tax under reverse charge and supplies made without consideration as specified in Schedule I. Conspicuous by its absence within this *carved out* provision is, import of goods. Others advise that credit of taxes paid on reverse charge basis or IGST paid on imports must be claimed within September following the financial year when the payment was actually made even though the liability to pay may have been earlier.

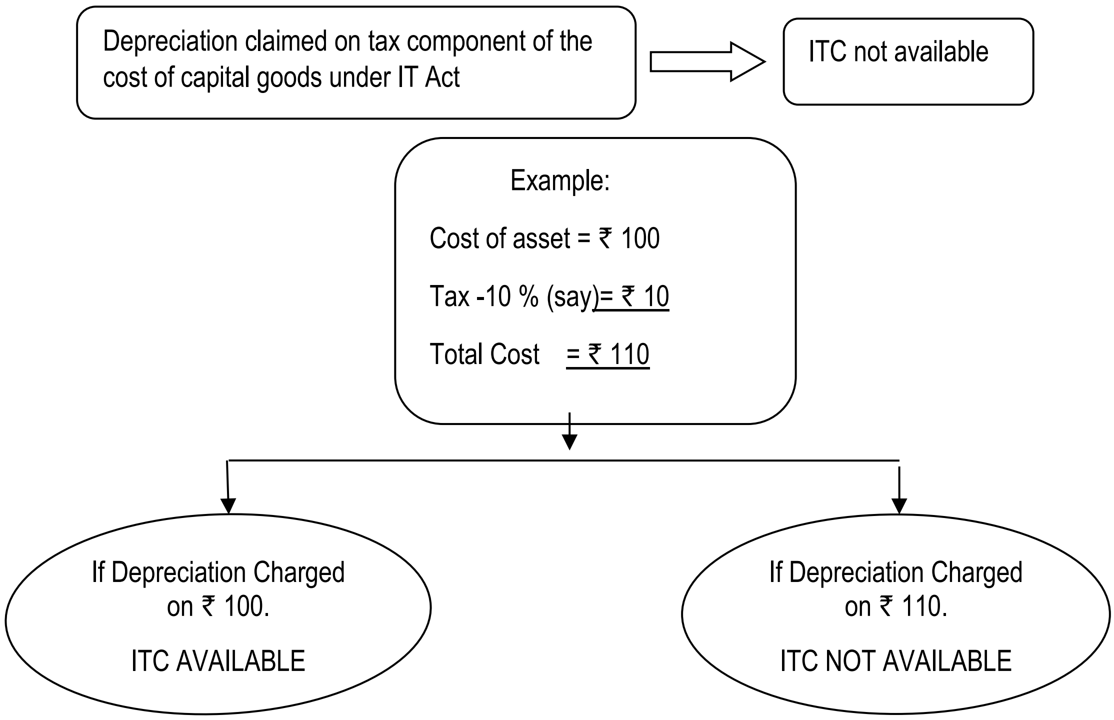
While reverse charge is excluded from the condition of having to make payment within 180 days, GST paid on import of goods does not fall within the ambit of reverse charge under section 9(3) or 9(4) of the CGST Act or section 5(3) or 5(4) of IGST Act although IGST paid on import of goods is akin to reverse charge. The question that now arises is - whether there can be reverse charge liability other than that under section 9(3) and 9(4). The definition in section 2(98) does not permit such an extended application.

The privilege to prescribe pre-conditions for vesting of right to input tax credit belongs to section 16 and therefore, there is no other provision from where any overriding right to claim credit on goods imports may be borrowed or imputed. On the other hand, IGST paid under reverse charge on import of services is covered under section 5(3) of the IGST Act as a result of which an importer of service would be entitled to credit of IGST paid even if payment to the service provider remains unpaid beyond the said period of 180 days.

It would be relevant to note that section 15 of the CGST Act deals with valuation of supplies and provides for adjustment in the value of supply in case the price is not the sole consideration or if the transacting parties are related by recourse to the Rules. Such adjustment to the transaction price being made for only GST purposes (to arrive at the tax payable) but commercially, such amount is neither recorded in the books nor paid by the transacting parties. Hence in all such cases where additions are made to the value of supply, the recipient will not be denied input tax credit since payment is not made to the extent of such additions. CGST Rules have been amended w.e.f. June 13, 2018 to provide that in cases where consideration is in non-monetary form, whether supplies under Schedule I or even such additions to transaction price, they will be deemed to have been paid by the recipient to the supplier.

Another aspect to consider is section 63 of Indian Contract Act where consideration (payment) in respect of executed contracts may be accepted less than the originally contracted sum. Although this is contrary to the terms agreed, it is provided in Indian law for seller to accept less than originally agreed owing to the time value of money and the certainty that comes with immediate payment. When less amount is accepted in place of the amount that was due, it does not give rise to the remedy of specific relief or relief of repudiation of contract as it is already executed. Such admitted reduction in consideration is enforceable under the original contract and does not amount to amendment of original contract or substitution with new contract again for the reason that it is already executed. Now, for GST purposes it is important to note that credit note need to be issued in such instances because the value originally agreed is more than what is payable provided such credit note is issued within the time limit prescribed in section 34. However, paying less than originally agreed would attract reversal of credit (in the hands of the recipient-payer) under rule 37 and this condition is linked to credit note under section 15(3)(b)(ii) regarding reversal of corresponding amount of credit.

*Capital goods on which depreciation is claimed:* Input tax credit will not be allowed on the tax component of the cost of capital goods and plant and machinery if depreciation on such tax component has been claimed under the provisions of the Income -tax Act. This does not imply that credit of the cost of inputs may still be claimed as revenue expenditure. That is not true because AS 2 states that 'cost of purchase does not include taxes subsequently recoverable from a taxing authority'. Experts express the view that accounting method followed in respect of inputs cannot be deviated from accounting method in case of input services.




(r) <u>*Unmatched credit capped at '5 per cent':*</u> Section 16(2)(c) places a burden on the recipient to claim credit 'after' tax has been deposited with the Government by the supplier. This clause operates like a 'condition precedent' to claim credit.

The Government's response to this 'impossible eventuality' is that credit cannot be given in respect of tax not received by exchequer. To balance the two sides, Government has enabled Form GSTR-1 filed by suppliers to appear in Form GSTR-2A/2B (Form

GSTR-2B only from 1.01.2022) to the recipient. Though this by itself is no assurance that supplier has subsequently filed Form GSTR-3B (for the entire turnover reported in Form GSTR-1) the Government considers 'liability to tax admitted in Form GSTR-1' as a basic responsibility that must be ensured. Remember the condition precedent in section 16(2)(c) has not been amended regarding this 'matching' process. If credit appears in Form GSTR-2A/2B [Form GSTR-2B only from 1.01.2022] (by supplier filing Form GSTR-1), that will give some assurance to permit credit to the recipient. The recipient may still claim credit unilaterally without any formal credit matching by claiming *bona fide* credits in Form GSTR-3B.

Rule 36(4) inserted *vide Notification No. 49/2019-CT, dt. 09.10.2019* applies to all returns filed after 9th October 2019, that is, to September returns as well.

This sub-rule (updated, as on date) states that (i) eligible credits appearing in Form-GSTR 2A/2B will be allowed [total credits minus ineligible credits under sections 17(2), 17(5), etc.] and (ii) additional unmatched *ad hoc* credit of 5 per cent of the eligible credits. From 1st January,2022 onwards only Form 2B is to be considered and not Form GSTR -2A *vide Notification No. 40/2021 – Central Tax dated 29.12.2021.*

On one hand, the condition precedent in section 16(2)(c) continues to hover over the taxpayer's shoulders while on the other hand, Form GSTR-2A/2B (Form GSTR-2B only from 1.01.2022) based 'quasi matching' exercise is allowed with a 5 per cent additional relief. Trade is still relying on 'impossible eventuality' where until 8th October 2019 'all' credits were being claimed, and suddenly, this provision seeks to curtail credits of such 'quasi matched' and eligible credits. The limit was 20 per cent which was reduced to 10 per cent w.e.f. 1st January 2020 and to 5 per cent w.e.f. 1st January 2021. However, relaxations were provided while filing returns for the period February to August 2020 which will be applicable on a cumulative basis for these months while filing of return for September 2020.

*Note* - In terms of the procedure for Corporate debtors undergoing insolvency resolution process under the Insolvency and Bankruptcy Code, 2016 as provided in *Notification No. 11/2020-C.T., dated 21-3-2020* read with *Notification No. 39/2020-C.T., dated 5.05.2020,* section 16(4) and rule 36(4) will not restrict credit claim by Corporate Debtor - Resolution Professional, **only in case of the first returns** being filed by Resolution Professional. Hence, only one time measure was provided

(s) Provisional credit: Section 155 makes it incumbent on the registered person to satisfy the eligibility conditions and compliances to take credit. Credit cannot be forced upon the registered persons hands by law or the authorities. If credit that could have been taken is not availed for any reason, then that credit is lost forever. Similarly, where eligibility to any exemption turns out to be inadmissible, input tax credit that could have been claimed had it been known that tax was actually payable on the outward supply, cannot be allowed if the time limit prescribed has expired. Where credit has been taken on the notion that tax is applicable on outward supply, credit so taken (and / or utilized) will be recoverable.

Decisions under CENVAT credit scheme that are popularly referred as 'revenue neutral' are unlikely to guide interpretation in GST as the incidence of tax is on every point of outward supply with credit for taxes paid on inward supplies. Reference may be made to *CCE (A), Ahd v. Narayan Polyplast [(2005) 179 ELT 20 (SC)]* and *CCE, Vadodara v. Narmada Chematur Pharmaceuticals Ltd. [(2005) 179 ELT 276 (SC)]*.

In summary, among others the following facts are crucial for taking input tax credit:

(a) The claimant should be registered under the GST law to avail the input tax credit (except for certain exceptions covered under section 18)

(b) Goods or services must be used or intended to be used in the course or furtherance of his business.

(c) Possession of original tax invoice/supplementary invoice/ debit note/ ISD invoice/ bill of entry and other related documents is a must.

(d) Such tax invoice must contain all the particulars prescribed / specified in Chapter VI of the CGST Rules. It may be noted that the tax invoice or such other documents can contain additional details other than those prescribed but not less than the details required in terms of Chapter VI of the CGST Rules- '*Tax Invoice, Credit and Debit Notes*'. However, this requirement has been relaxed w.e.f. September 4, 2018, by virtue of proviso to rule 36(2), inserted *vide Notification No. 39/2018-C.T., dt. 4.09.2018*. Registered person can avail input tax credit if the documents contain the following minimum details:

- Amount of tax charged
- Description of goods or services
- Total value of supply of goods or services or both
- GSTIN of the supplier and recipient
- Place of supply in case of inter-State supply

(e) Supplier of goods and/ or services must upload the details of such documents in the common portal i.e., GSTN. Subject to section 41 being claim of ITC and provisional acceptance thereof, the supplier must have remitted the tax charged on such supplies.

(f) Vesting condition for claiming input tax credit includes filing return under section 39 and not making supply out of such inward supplies.

(g) Claimant should have received the goods / services. Input tax credit in case of supplies in installment, would be on receipt of last installment of goods.

(h) The law casts an obligation on the recipient of supply availing credit to effect payment to the supplier within a period of 180 days from the date of invoice. If such payment is not effected/partially effected by the recipient to the supplier, rule 37 obligates reversal/ proportionate reversal of input tax credit so availed leading to consequential levy of tax and interest.

Proviso to section 16(2) provides that the taxable person shall be entitled to avail input tax credit after making payment of the amount towards value of supply of goods or services or both along with tax payable thereon. Further, rule 37(4) provides that the time limit specified under section 16(4) shall not be applicable in case of re-credit.

(i) Claim of depreciation on the GST component disqualifies a recipient of capital goods and plant and machinery from taking input tax credit.

(j) ITC cannot be availed after the due date of filing the return for September month of the next financial year or on furnishing the annual return whichever is earlier.

(k) No registered person is permitted to avail any input tax credit pursuant to an order of demand on account of fraud, willful misstatement, or suppression of fact.

Note: The last point is important as in many of the cases in a routine manner the show cause notice would invoke these mala fide intentions and if not contested, the ITC would not be available to the receiver even if otherwise eligible.

### 16.3 Issues and Concerns

(i) A consignment of coal is to be dispatched from Kolkata to Mumbai through five trucks for which the invoice was sent along with the first truck. Four trucks reached the claimant by March 30, 2021 but the truck carrying the final lot of the consignment fell down a gorge and the consignment was never received. Would this deny the input tax credit that should otherwise have been available on coal received on the first four lots? The answer is 'No'. Once the supply is complete, credit is admissible to the extent of quantity received if the remainder of the quantity would not be replenished by the supplier.

(ii) Section 16 allows a recipient of supply to avail credit only when he has received the goods or services or both. For example, in an annual maintenance contract entered into on 1st November 2020, the supplier is under an obligation to render services arising over a period of 12 months (ending 31st October, 2021) but in respect of which an invoice is raised and consideration is received on the date of entering into the agreement i.e., 1st November 2020. In such cases, input tax credit contained in the said invoice is left hanging in the balance considering the fact that input tax credit in respect of an invoice received during the year cannot be claimed after the due date for filing the return for the month of September of the succeeding year. In the given case, the receipt of service is said to be completed (i.e., AMC period ends) on 31st October, 2021, while the time limit for claiming credit is 20th October, 2021. Possible solution to overcome this situation could be to convert the AMC into monthly / quarterly maintenance contracts, if agreeable to the supplier. Alternatively, could it be interpreted that an AMC, is primarily an assurance which is received on the date of entering into the AMC and what follows is only a continuing obligation of the supplier and hence the service may be deemed to have been received on the date of commencement of the AMC. The above issue also arises in case of an insurance contract. It is possible for one to interpret or read down the law in such cases since every business operates on a concept of going concern. These issues would most certainly be put to test in times to come.

(iii) In the case of a recipient who has reversed credit on account of non-payment of consideration within 180 days, can he avail credit in instalments as and when the payment is made to the supplier or should he reclaim the credit only when the entire amount including taxes has been paid to the supplier. Given that the third proviso to section 16(2)(d) allows availing of credit on payment of 'the amount towards the value of supply of goods or services or both' and not 'an amount', reading strictly it may be construed that the entire amount would have to be paid for availing of credit earlier reversed. Consideration paid in non-monetary form is also a consideration and for the scheme to work one needs to read the provisions harmoniously. It is a common practice that some deductions are there in the invoice without GST being deducted. Then can it be said that the whole consideration has not been paid and the credit denied until the whole amount with taxes are paid? The credit should be available for value deductions by customer without impacting the GST as well as non-monetary payments.

### 16.4 Comparative review

| ***Aspect*** | ***Credit under erstwhile system*** | ***Input tax credit under GST*** |
|---|---|---|
| Definition of "capital goods" | Defined in CENVAT Credit Rules | Comparatively wider definition. |
| Definition of "input" | Defined in CENVAT Credit Rules having inclusion and exclusion limbs. | Exhaustive definition and does not contain inclusion or exclusion limb. |
| Definition of "input services" | Defined in CENVAT Credit Rules which has inclusion and exclusion limb. | Exhaustive definition and does not contain inclusion or exclusion limb. |
| Electronic credit ledger | Similar to CENVAT credit register maintained in Form RG23A | Electronic credit ledger required to be maintained for crediting and utilising input tax credit |

While CENVAT Credit Rules identified three components for taking credit, namely input, input services and capital goods, the GST law allows input tax credit on goods and services with goods being further classified into inputs and capital goods.

### Statutory Provisions

**17. Apportionment of credit and blocked credit**

(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.*

*[14][Explanation. -For the purposes of this sub-section, the expression "value of exempt supply" shall not include the value of activities or transactions specified in Schedule III, except those specified in paragraph 5 of the said Schedule]*

(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 subsection (1) of section 18, input tax credit shall not be available in respect of the following namely:-*

(a) *[15][motor vehicles for transportation of persons having approved seating capacity of not more than thirteen persons (including the driver), except when they are used for making the following taxable supplies, namely: —*

(A) *further supply of such motor vehicles; or*

(B) *transportation of passengers; or*

(C) *imparting training on driving such motor vehicles;*

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[14] Inserted *vide Central Goods and Services Tax (Amendment )Act, 2018 w.e.f. 01.02.2019 read with Notf No. 2/2019-CT., dt. 29.01.2019*

[15] Substituted vide Central *Goods and Services Tax (Amendment) Act, 2018 w.e.f. 01.02.2019* read with *Notf No. 2/2019-C.T., dt. 29.01.2019*. Prior to such substitution it read as:" *(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"*

*(aa) vessels and aircraft except when they are used—*

*(i) for making the following taxable supplies, namely: -*

*(A) further supply of such vessels or aircraft; or*

*(B) transportation of passengers; or*

*(C) imparting training on navigating such vessels; or*

*(D) imparting training on flying such aircraft;*

*(ii) for transportation of goods;*

*(ab) services of general insurance, servicing, repair and maintenance in so far as they relate to motor vehicles, vessels or aircraft referred to in clause (a) or clause (aa):*

*Provided that the input tax credit in respect of such services shall be available—*

*(i) where the motor vehicles, vessels or aircraft referred to in clause (a) or clause (aa) are used for the purposes specified therein;*

*(ii) where received by a taxable person engaged—*

*(I) in the manufacture of such motor vehicles, vessels or aircraft; or*

*(II) in the supply of general insurance services in respect of such motor vehicles, vessels or aircraft insured by him;*

*(b) [16]the following supply of goods or services or both—*

*(i) food and beverages, outdoor catering, beauty treatment, health services, cosmetic and plastic surgery, leasing, renting or hiring of motor vehicles, vessels or aircraft referred to in clause (a) or clause (aa) except when used for the purposes specified therein, life insurance and health insurance:*

*Provided that the input tax credit in respect of such goods or services or both shall be available where an inward supply of such goods or services or both 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;*

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[16] Substituted *vide The Central Goods and Services Tax (Amendment) Act, 2018 w.e.f. 01.02.2019 read with Notf no. 2/2019-C.T., dt. 29.01.2019*. Prior to such substitution it read as*: "(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 –*

*(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;*

*(ii) membership of a club, health and fitness centre; and*

*(iii) travel benefits extended to employees on vacation such as leave or home travel concession.*

*Provided that the input tax credit in respect of such goods or services or both shall be available, where it is obligatory for an employer to provide to its employees under any law for the time being in force].*

*(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;*

*(d) goods or services or both received by a taxable person for construction of an immovable property (other than plant and 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 purpose of clause (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;*

*(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-sections (1) and (2) may be attributed.*

*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*

**Extract of the CGST Rules**

**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**;*

*(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.*

**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 '$T_1$';*

*(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 '$T_2$';*

*(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 '$T_3$';*

*(e) the amount of input tax credit credited to the electronic credit ledger of registered person, be denoted as '$C_1$' and calculated as-*

*$C_1$ = T- ($T_1$+$T_2$+$T_3$);*

*(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 '$T_4$';*

*[17][Explanation: For the purpose of this clause, It is hereby clarified that in case of supply of services covered by clause (b) of Paragraph 5 of Schedule-II of the said Act value of $T_4$ shall be zero during the construction phase because inputs and input services will be commonly used for the construction of apartments booked on or before the date of issuance of completion certificate or first occupation of the project, whichever is earlier, and those which are not booked by the said date].*

*(g) '$T_1$', '$T_2$', '$T_3$' and '$T_4$' shall be determined and declared by the registered person at the invoice level in Form **GSTR-2** [18][and at summary level in Form **GSTR-3B**];*

*(h) input tax credit left after attribution of input tax credit under clause [19][(f)] shall be called common credit, be denoted as '$C_2$' and calculated as:*

*$C_2$ = $C_1$- $T_4$;*

*(i) the amount of input tax credit attributable towards exempt supplies be denoted as '$D_1$' and calculated as*

*$D_1$= (E÷F) × $C_2$*

*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:*

*[20][Provided that in case of supply of services covered by clause (b) of paragraph 5 of Schedule II of the Act, the value of 'E/F' for a tax period shall be calculated for each project separately, taking value of E and F as under:-*

*E= aggregate carpet area of each apartments, construction of which is exempt from tax, but are identified by the promoter to be sold after the issue of completion certificate or first occupation, whichever is earlier;*

*F=aggregate carpet area of apartments in the project;*

*Explanation 1: In the tax period in which the issuance of completion certificate or first occupation of the project takes place, value of E shall also include aggregate carpet area of the apartments, which have not been booked till date of issuance of completion certificate or first occupation of the project, whichever is earlier*

*Explanation 2: Carpet area of apartments, tax on construction of which is paid or payable at the rates specified of items (i), (ia), (ib), (ic) or (id), against serial*

[17, 18] Inserted *vide Notf No. 16/2019-CT dt. 29.03.2019 w.e.f. 01.04.2019*

[19] Substituted *vide Notf No.16/2019-CT dt. 29.03.2019 w.e.f. 01.04.2019 for"(g)"*

[20] Inserted *vide Notf No. 16/2019-CT dt. 29.03.2019 w.e.f. 01.04.2019*

*number 3 of the table in the Notification No. 11/2017-Central Tax (Rate), published in Gazette of India, Extraordinary, Part II, Section 3 subsection (i) dated 28th June, 2017, as amended. shall be taken into account for calculation of value of 'E' in view of Explanation (iv) in paragraph 4 of the notification No. 11/2017-Central Tax (Rate), published in the Gazette of India, Extraordinary, Part II, Section 3, Subsection (i) dated 28th June, 2017 vide GSR number 690(E) dated 28th June, 2017, as amended].*

*[21][Provided further] 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 purpose 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 [22][and entry 92A] of List I of the Seventh Schedule to the constitution and entry 51 and entry 54 of List II of the said schedule;*

*(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 '$D_2$', and shall be equal to five per cent. of $C_2$; 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 '$C_3$', where,-*

$$C_3 = C_2 - (D_1+D_2);$$

*(l) [23][the amount '$C_3$','$D_1$', and '$D_2$' shall be computed separately for the Income tax credit of central tax, State tax, Union territory tax and integrated tax and declared in **F**orm **GSTR-3B** or through **F**orm **GST DRC-03**]*

*(m) the amount equal to aggregate of '$D_1$' and '$D_2$' shall be [24][reversed by the registered person in **F**orm **GSTR-3B** or through **F**orm **GST DRC-03]**;*

*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 '$T_1$' and '$T_2$' respectively, and the remaining amount of credit on such inputs or input services shall be included in '$T_4$'.*

*(2) [25][Except in case of Supply of services covered by clause (b) of paragraph 5 of Schedule II of the Act, the input tax credit] determined under sub-rule (1) shall be*

[21] Substituted *vide Notf No. 16/2019-CT dt. 29.03.2019 w.e.f. 01.04.2019 for" Provided"*
[22] Inserted *vide Notf No. 03/2019-CT dt. 29.01.2019 w.e.f. 01.02.2019*
[23] Substituted *vide Notf no. 16/2019-CT dt. 29.03.2019 w.e.f. 01.04.2019 for "(l) the amount 'C3'shall be computed separately for input tax credit of Central tax, State tax, Union territory tax and integrated tax;"*
[24] Substituted *vide Notf no. 16/2019-CT dt. 29.03.2019 w.e.f. 01.04.2019 for "added to the output tax liability of the registered person:"*
[25] Substituted *vide Notf no. 16/2019-CT dt. 29.03.2019 w.e.f. 01.04.2019 for "The input tax credit"*

*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 '$D_1$' and '$D_2$' exceeds the aggregate of the amounts determined under sub-rule (1) in respect of '$D_1$' and '$D_2$', such excess shall be* [26]*[reversed by the registered person in **F**orm **GSTR-3B** or through **F**orm **GST DRC-03**] 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*

(b) *where the aggregate of the amounts determined under sub-rule (1) in respect of '$D_1$' and '$D_2$' exceeds the aggregate of the amounts calculated finally in respect of '$D_1$' and '$D_2$', 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.*

*(3)* [27]*[In case of supply of services covered by clause (b) of Paragraph 5 of Schedule II of the Act, the input tax determined under sub rule (1) shall be calculated finally, for each on going project or project which commences on or after 1st April, 2019, which did not undergo or did not require transition of input tax credit consequent to the change of rates of tax on 1st April, 2019 in accordance with notification No.11/2017-Central Tax (Rate), dated 28th June, 2017, published vide GSR No. 690(E) dated 28th June, 2017, as amended for the entire period from the commencement of the project or 1st July 2017, whichever is later , to the completion or first occupation of the project, whichever is earlier before the due date of furnishing of the return for the month of September following the end of financial year in which the completion certificate is issued or first occupation takes place of the project, in the manner prescribed in the said sub rule with the modification that value of E/F shall be calculated taking value of E and F as under:*

*E= aggregate carpet area of the apartments, construction of which is exempt from tax plus aggregate carpet area of apartments, construction of which is not exempt from tax ,but which have not been booked till the date of issuance of completion certificate or first occupation of the project, whichever is earlier:*

*F=aggregate carpet area of the apartments in the project;*

*and,-*

*a) where the aggregate of the amounts calculated finally in respect of '$D_1$' and '$D_2$' exceeds the aggregate of the amounts determined under sub rule (1) in respect of '$D_1$' and '$D_2$', such exceeds shall be reversed by the registered person in **Form***

[26] Substituted *vide Notf no. 16/2019-CT dt. 29.03.2019 w.e.f. 01.04.2019 for "added to the output tax liability of the registered person"*

[27] Inserted *vide Notf no. 16/2019-CT dt. 29.03.2019 w.e.f. 01.04.2019*

***GSTR-3B** or through **Form GST DRC-03** in the month not later than the month of September following the end of the financial year in which the completion certificate is issued or first completion of the project takes place and the said person shall be liable to pay the 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*

b) *where the aggregate of the amounts determined under sub rule (1) in respect of '$D_1$' and '$D_2$' exceeds the aggregate of the amount calculated finally in respect of '$D_1$' and '$D_2$' such excess amount shall be claimed as credit by the registered person in his return for the month not later than the month of September following the end of financial year in which completion certificate is issued or first occupation takes place of the project.*

*(4) In case of supply of services covered by clause (b) of paragraph 5 of Schedule II of the Act, the input tax determined under sub rule (1) shall be calculated finally for the commercial portion in each project, other than the residential real estate project (RREP),which underwent transition of input tax credit consequent to changes of rates of tax on 1st April 2019 in accordance with notification No. 11/2017-Central tax (Rate), dated 28th June 2017 published vide GSR No. 690(E) dated 28th June 2017, as amended for the entire period from the commencement of the project or 1st July 2017 or whichever is later, to the completion or first occupation of the project whichever is earlier, before the due date of furnishing of the return for the month of September following the end of financial year in which the completion certificate is issued or first occupation takes place of the project, in the following manner.*

*(a)The aggregate amount of common credit on commercial portion in the project ($C3_{aggregate\_comm}$)shall be calculated as under,*

*$C3_{aggregate\_comm}$=[aggregate of amounts of C3 determined under sub rule (1) for the tax periods starting from 1st July 2017 to 31st March, 2019 x ($A_c/A_T$)] + [aggregate of amounts of C3 determined under sub rule (1) for the tax period starting from 1st April 2019 to the date of completion or first occupation of the project, whichever is earlier]*

*Where,-*

*$A_c$ = total carpet area of the commercial apartments in the project*

*$A_T$ = total carpet area of all apartments in the project*

*(b)The amount of final eligible common credit on commercial portions in the project ($C3_{final\_comm}$)shall be calculated as under*

$$C3_{final\_comm}=C3_{aggregate\_comm} \times (E/F)$$

*Where,-*

*E = total carpet area of commercial apartments which have not been booked till the date of issuance of completion certificate or first occupation of the project, whichever is earlier.*

*F = $A_C$ = total carpet area of the commercial apartments in the project*

*(c) where, $C3_{aggregate\_comm}$ exceeds $C3_{final\_comm}$, such excess shall be reversed by the*

*registered person in Form **GSTR-3B** or through Form **GST DRC-03** in the month not later than the month of September following the end of the financial year in which the completion certificate is issued or first occupation takes place of the project 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;*

*(d) where, $C3_{final\_comm}$ exceeds $C3_{aggregate\_comm}$, 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 in which the completion certificate is issued or first occupation takes place of the project.*

*(5) Input tax determined under sub- rule (1) shall not be required to be calculated finally on completion or first occupation of an RREP which underwent transition of input tax credit consequent to change of rates of tax on 1st April, 2019 in accordance with notification No. 11/2017- Central Tax (Rate), dated the 28th June, 2017, published vide GSR No. 690(E) dated the 28th June, 2017, as amended.*

*(6) Where any input or input service are used for more than one project, input tax credit with respect to such input or input service shall be assigned to each project on a reasonable basis and credit reversal pertaining to each project shall be carried out as per sub rule (3)].*

**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 **F**orm **GSTR-2** [28][and **F**orm **GSTR-3B**] 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 [29][and Form GSTR3-B] and shall be credited to the electronic credit ledger;*

*[30][Explanation: For the purpose of this clause, it is hereby clarified that in case of supply of services covered by clause (b) of paragraph 5 of the Schedule II of the said Act, the amount of input tax in respect of capital goods used or intended to be*

[28, 29, 30] Inserted *vide Notf no. 16/2019-CT dt. 29.03.2019 w.e.f. 01.04.2019* *used exclusively for effecting supplies other than exempted supplies but including zero rated supplies, shall be zero during the construction phase because capital goods will be commonly used for construction of apartments booked on or before the date of issuance of completion certificate or first occupation of the project, whichever is earlier, and those which are not booked by the said date].*

*(c)* [31]*[the amount of input tax in respect of capital goods not covered under clauses (a) and (b), denoted as 'A', being the amount of tax as reflected on the invoice, shall credit directly to the electronic credit ledger and the validity of the useful life of such goods shall extend upto 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, input tax in respect of such capital goods denoted as 'A' shall be credited to the electronic credit ledger subject to the condition that the ineligible credit attributable to the period during which such capital goods were covered by clause (a),denoted as '$T_{ie}$', shall be calculated at the rate of five percentage points for every quarter or part thereof and added to the output tax liability of the tax period in which such credit is claimed:*

*Provided further that the amount '$T_{ie}$' shall be computed separately for input tax credit of central tax, State tax, Union territory tax and integrated tax and declared in* ***F****orm* ***GSTR-3B****.*

*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.]*

*(d)* *[the aggregate of the amounts of 'A' credited to the electronic credit ledger under clause (c) in respect of common capital goods whose useful life remains during the tax period, to be denoted as '$T_c$', shall be the common credit in respect of such capital goods:*

[31] Substituted *vide Notf no. 16/2020-CT dt. 23.03.2020 w.e.f. 01.04.2020 for "(c) the amount of input tax in respect of capital goods not covered under clauses (a) and (b), denoted as 'A, being the amount of tax as reflected on the invoice, shall credit directly to the electronic credit ledger and the validity of the useful life of such goods shall extend upto 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, input tax in respect of such capital goods denoted as 'A' shall be credited to the electronic credit ledger subject to the condition that the ineligible credit attributable to the period during which such capital goods were covered by clause (a), denoted as 'Tie', shall be calculated at the rate of five percentage points for every quarter or part thereof and added to the output tax liability of the tax period in which such credit is claimed :*
*Provided further that the amount 'Tie' shall be computed separately for input tax credit of central tax, State tax, Union territory tax and integrated tax and declared in Form GSTR-3B.*
*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."*

[32]*Provided that where any capital goods earlier covered under clause (b) are subsequently covered under clause (c), the input tax credit claimed in respect of such capital good(s) shall be added to arrive at the aggregate value '$T_c$';*]

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

$$T_m = T_c \div 60$$

[33]*[Explanation.- For the removal of doubt, it is clarified that useful life of any capital goods shall be considered as five years from the date of invoice and the said formula shall be applicable during the useful life of the said capital goods.]*

(f) [34]~~*[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 '$T_r$' and shall be the aggregate of '$T_m$' for all such capital goods;]*~~

(g) *the amount of common credit attributable towards exempted supplies, be denoted as '$T_e$', 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* [35][in the State] *of the registered person during the tax period:*

[36]*[Provided that in case of supply of services covered by clause (b) of paragraph 5 of the Schedule II of the Act, the value of E/F' for a tax period shall be calculated for each project separately, taking value of E and F as under:*

*E= aggregate carpet area of the apartments, construction of which is exempt from tax plus aggregate carpet area of the apartments, construction of which is not exempt from tax, but are identified by the promoter to be sold after issue of completion certificate or first occupation, whichever is earlier;*

*F= aggregate carpet area of the apartments in the project;*

*Explanation 1: In the tax period in which the issuance of completion certificate or first occupation of the project takes place, value of E shall also include aggregate carpet area of the apartments, which have not been booked till the date of issuance of completion certificate or first occupation of the project, whichever is earlier.*

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[32] Substituted *vide Notf no. 16/2020-CT dt. 23.03.2020 w.e.f. 01.04.2020 for "the aggregate of the amounts of 'A' credited to the electronic credit ledger under clause (c) in respect of common capital goods whose useful life remains during the tax period, to be denoted as 'Tc', shall be the common credit in respect of such capital goods: Provided that where any capital goods earlier covered under clause (b) are subsequently covered under clause (c), the input tax credit claimed in respect of such capital good(s) shall be added to arrive at the aggregate value 'Tc';*

[33] Inserted *vide Notf No. 16/2020-CT dt. 23.03.2020 w.e.f. 01.04.2020*

[34] Omitted *vide Notf No. 16/2020-CT dt. 23.03.2020 w.e.f. 01.04.2020*

[35,36] Inserted *vide Notf No. 16/2019-CT dt. 29.03.2019 w.e.f. 01.04.2019*

*Explanation 2: Carpet area of apartments, tax on construction of which is paid or payable at the rates specified for items (i), (ia), (ib), (ic) or (id), against serial number 3 of the Table in notification No. 11/2017-Central Tax (Rate) published in the Gazette of India, Extraordinary, Part II, Section 3, Sub-section (i) dated 28th June, 2017 vide GSR No. 690 (E) dated 28th June, 2017, as amended, shall be taken into account for calculation of value of E' in view of Explanation (iv) in paragraph 4 of the notification No. 11/2017-Central Tax (Rate) published in the Gazette of India, Extraordinary, Part II, Section 3, Sub-section (i) dated the 28th June, 2017 vide GSR No. 690 (E) dated 28th June, 2017, as amended].*

*[37][Provided further] 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 [38][and entry 92A] of List I of the Seventh Schedule to the Constitution and entry 51 and 54 of List II of the said Schedule;*

*(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.*

*(i) [39][The amount $T_e$ shall be computed separately for input tax credit of central tax, State tax, Union territory tax and integrated tax and declared in **Form GSTR-3B**].*

*[40][(2) In case of supply of services covered by clause (b) of paragraph 5 of schedule II of the Act, the amount of common credit attributable towards exempted supplies ($Te^{final}$) shall be calculated finally for the entire period from the commencement of the project or 1st July, 2017, whichever is later, to the completion or first occupation of the project, whichever is earlier, for each project separately, before the due date for furnishing of the return for the month of September following the end of financial year in which the completion certificate is issued or first occupation takes place of the project, as under:*

$Te^{final} = [(E1 + E2 + E3) / F] \times Tc^{final}$,

*Where,-*

*E1= aggregate carpet area of the apartments, construction of which is exempt from tax*

*E2= aggregate carpet area of the apartments, supply of which is partly exempt and partly*

[37]Substituted *vide Notf No. 16/2019-CT dt. 29.03.2019 w.e.f. 01.04.2019 for "'Provided"*

[38]Inserted *vide Notf No. 03/2019-CT dt. 29.01.2019 w.e.f. 01.02.2019*

[39]Inserted *vide Notf No. 16/2019-CT dt. 29.03.2019 w.e.f. 01.04.2019*

[40]Substituted *vide Notf No 16/2019-CT dt. 29.03.2019 w.e.f. 01.04.2019 for "(2) The amount $T_e$ shall be computed separately for Central tax, State tax, Union territory tax and integrated tax."*

*taxable, consequent to change of rates of tax on 1st April, 2019, which shall be calculated as under, -*

*E2= [Carpet area of such apartments] x [$V_1$/ ($V_1$+$V_2$)],-*

*Where,-*

*$V_1$ is the total value of supply of such apartments which was exempt from tax; and*

*$V_2$ is the total value of supply of such apartments which was taxable*

*E3 = aggregate carpet area of the apartments, construction of which is not exempt from tax, but have not been booked till the date of issuance of completion certificate or first occupation of the project, whichever is earlier:*

*F= aggregate carpet area of the apartments in the project;*

*$Tc^{final}$= aggregate of a final in respect of all capital goods used in the project and a final for each capital goods shall be calculated as under,*

*$A^{final}$= A x (number of months for which capital goods is used for the project/ 60) and,-*

a) *where value of $Te^{final}$ exceeds the aggregate of amounts of Te determined for each tax period under sub-rule (1), such excess shall be reversed by the registered person in Form **GSTR-3B** or through Form **GST DRC-03** in the month not later than the month of September following the end of the financial year in which the completion certificate is issued or first occupation takes place of the project 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;*

b) *where aggregate of amounts of Te determined for each tax period under sub-rule (1) exceeds $Te^{final}$, 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 in which the completion certificate is issued or first occupation takes place of the project.*

   *Explanation.- For the purpose of calculation of $Tc^{final}$, part of the month shall be treated as one complete month.*

(3) *The amount $Te^{final}$ and $Tc^{final}$ shall be computed separately for input tax credit of central tax, State tax, Union territory tax and integrated tax.*

(4) *Where any capital goods are used for more than one project, input tax credit with respect to such capital goods shall be assigned to each project on a reasonable basis and credit reversal pertaining to each project shall be carried out as per sub-rule(2).*

(5) *Where any capital goods used for the project have their useful life remaining on the completion of the project, input tax credit attributable to the remaining life shall be availed in the project in which the capital goods is further used];*

[41]*[Explanation 1:- For the purposes of rule 42 and this rule, it is hereby clarified that the aggregate value of exempt supplies shall exclude: -*

*(a)* [42][~~the value of supply of services specified in the notification of the Government of India in the Ministry of Finance, Department of Revenue No. 42/2017-Integrated Tax (Rate), dated the 27th October, 2017 published in the Gazette of India, Extraordinary, Part II, Section 3, Sub-section (i), vide number GSR 1338(E) dated the 27th October, 2017~~;]

*(b) the value of services by way of accepting deposits, extending loans or advances in so far as the consideration is represented by way of interest or discount, except in case of 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; and*

c) *the value of supply of services by way of transportation of goods by a vessel from the customs station of clearance in India to a place outside India].*

[43]*[Explanation 2: For the purposes of rule 42 and this rule,-*

*(i) the term ―apartment shall have the same meaning as assigned to it in clause (e) of section 2 of the Real Estate (Regulation and Development) Act, 2016 (16 of 2016);*

*(ii) the term ―project shall mean a real estate project or a residential real estate project;*

*(iii) the term "Real Estate Project (REP)'' shall have the same meaning as assigned to it in in clause (zn) of section 2 of the Real Estate (Regulation and Development) Act, 2016 (16 of 2016)*

*(iv) the term "Residential Real Estate Project (RREP)'' shall mean a REP in which the carpet area of the commercial apartments is not more than 15 per cent. of the total carpet area of all the apartments in the REP*

*(v) the term "promoter" shall have the same meaning as assigned to it in in clause (zk) of section 2 of the Real Estate (Regulation and Development) Act, 2016 (16 of 2016);*

*(vi) "Residential apartment" shall mean an apartment intended for residential use as declared to the Real Estate Regulatory Authority or to competent authority;*

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[41] Inserted *vide Notf No. 55/2017-CT dt. 15.11.2017, Explanation substituted vide Notf no. 03/2018 – CT dt. 23.01.2018. Prior to substitution it read: "Explanation. - For the purposes of rule 42 and this rule, it is hereby clarified that the aggregate value of exempt supplies shall exclude the value of supply of services specified in the Notification of the Government of India in the Ministry of Finance, Department of Revenue No. 42/2017-Integrated Tax (Rate), dated the 27th October, 2017 published in the Gazette of India, Extraordinary, Part II, Section 3, Sub-section (i), vide number GSR 1338(E) dated the 27th October, 2017."*

[42] Omitted *vide Notf No. 03/2019-CT dt. 29.01.2019 w.e.f. 01.02.2019*

[43] Inserted *vide Notf No. 16/2019-CT dt. 29.03.2019 w.e.f. 01.04.2019*

*(vii) "Commercial apartment" shall mean an apartment other than a residential apartment;*

*(viii) the term "competent authority'' as mentioned in definition of ―residential apartment, means the local authority or any authority created or established under any law for the time being in force by the Central Government or State Government or Union Territory Government, which exercises authority over land under its jurisdiction, and has powers to give permission for development of such immovable property;*

*(ix) the term "Real Estate Regulatory Authority" shall mean the Authority established under sub- section (1) of section 20 (1) of the Real Estate (Regulation and Development) Act, 2016 (No. 16 of 2016) by the Central Government or State Government;*

*(x) the term ―carpet area shall have the same meaning assigned to it in in clause (k) of section 2 of the Real Estate (Regulation and Development) Act, 2016 (16 of 2016);*

*(xi) an apartment booked on or before the date of issuance of completion certificate or first occupation of the project shall mean an apartment which meets all the following three conditions, namely-*

*(a) part of supply of construction of the apartment service has time of supply on or before the said date; and*

*(b) consideration equal to at least one instalment has been credited to the bank account of the registered person on or before the said date; and*

*(c) an allotment letter or sale agreement or any other similar document evidencing booking of the apartment has been issued on or before the said date.*

*(xii) The term "ongoing project'' shall have the same meaning as assigned to it in notification No. 11/2017- Central Tax (Rate), dated the 28th June, 2017, published vide GSR No. 690(E) dated the 28th June, 2017, as amended;*

*(xiii) The term ―project which commences on or after 1st April, 2019, shall have the same meaning as assigned to it in notification No. 11/2017- Central Tax (Rate), dated the 28th June, 2017, published vide GSR No. 690(E) dated the 28th June, 2017, as amended];*

**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 subsection (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-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.*

**[44][44A. Manner of reversal of credit of Additional duty of customs in respect of Gold dore bar.**

*The credit of Central tax in the electronic credit ledger taken in terms of the provisions of section 140 relating to the CENVAT Credit carried forward which had accrued on account of payment of the additional duty of customs levied under subsection (1) of section 3 of the Customs Tariff Act, 1975 (51 of 1975), paid at the time of importation of gold dore bar, on the stock of gold dore bar held on the 1st day of July, 2017 or contained in gold or gold jewellery held in stock on the 1st day of July, 2017 made out of such imported gold dorebar, shall be*

[44] Inserted *vide Notf No. 22/2017-CT dt. 17.08.2017*

*restricted to one-sixth of such credit and five-sixth of such credit shall be debited from the electronic credit ledger at the time of supply of such gold dore bar or the gold or the gold jewellery made therefrom and where such supply has already been made, such debit shall be within one week from the date of commencement of these Rules].*

**45. Conditions and restrictions in respect of inputs and capital goods sent to 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, [45][and where the goods are sent from one job worker to another job worker, the challan may be issued either by the principal or the job worker sending the goods to another job worker:*

*Provided that the challan issued by the principal may be endorsed by the job worker, indicating therein the quantity and description of goods where the goods are sent by one job worker to another or are returned to the principal:*

*Provided further that the challan endorsed by the job worker may be further endorsed by another job worker, indicating therein the quantity and description of goods where the goods are sent by one job worker to another or are returned to the principal].*

*(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 [46][~~or sent from one job worker to another~~] [47][during a specified period] shall be included in Form **GST ITC-04** furnished for that period on or before the twenty-fifth day of the month succeeding [48][the said period] [49][or within such further period as may be extended by the Commissioner by a notification in this behalf*

*Provided that any extension of the time limit notified by the Commissioner of State tax or the Commissioner of Union territory tax shall be deemed to be notified by the Commissioner].*

*[50][Explanation. - For the purposes of this sub-rule, the expression "specified period" shall mean. -*

*(a) the period of six consecutive months commencing on the 1st day of April and the 1st day of October in respect of a principal whose aggregate turnover during the immediately preceding financial year exceeds five crore rupees; and*

*(b) a financial year in any other case.]*

*(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*

[45] Inserted *vide Notf no. 14/2018-CT dt. 23.03.2018*

[46] Omitted *vide Notf no 74/2018-CT dt. 31.12.2018*

[47] *Substituted for the words "during a quarter" vide Notf no. 35/2021 – CT dt. 24.09.2021, w.e.f. 01.10.2021*

[48] *Substituted for the words "the said quarter" vide Notf no. 35/2021 – CT dt. 24.09.2021, w.e.f. 01.10.2021*

[49] Inserted *vide Notf no. 54/2017-CT dt. 28.10.2017*

[50] *Inserted vide Notf no. 35/2021 – CT dt. 24.09.2021, w.e.f.01.10.2021*

*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.*

*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.*

**Related Provisions of the Statute**

| ***Section or Rule*** | ***Description*** |
|---|---|
| Section 2(47) | Definition of 'Exempt supply' |
| Section 2(119) | Definition of 'Works contract' |
| Section 16 | Eligibility and conditions for taking input tax credit |
| Section 18 | Availability of credit in special circumstances |
| Section 74 | Determination of tax not paid or short paid or erroneously refunded or input tax credit wrongly availed or utilised by reason of fraud or any wilful misstatement or suppression of facts. |
| Section 129 | Detention, seizure and release of goods and conveyances in transit |
| Section 130 | Confiscation of goods or conveyances and levy of penalty |
| Schedule II | Activities to be treated as supply of goods or supply of services |
| Rule 45 | Conditions and restrictions in respect of inputs and capital goods sent to the job worker |
| Section 16 of IGST Act | Zero rated supply |

### 17.1 Introduction

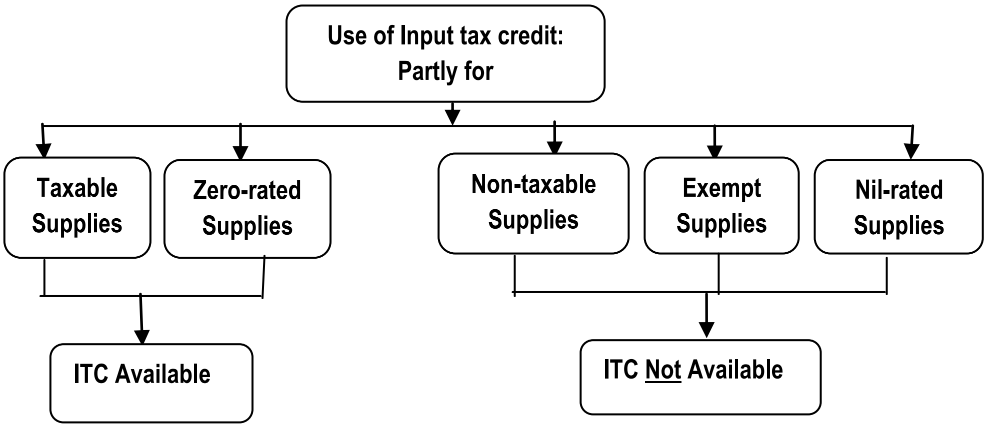
The input tax credit eligibility is based on the fact as to whether the goods or services or both are used for taxable supplies or exempt supplies. Where the goods or services or both are used for both taxable and exempt supplies, only proportionate credit is allowed to a registered person, Further, this section lists out the supplies that are ineligible for input tax credit.

## 17.2 Analysis

### *A. Proportionate credit:*

**ITC based on usage in business**

**ITC BASED ON USE OF INPUTS**




Note: -Attribution of ITC to be made as per rule 42 of the CGST Rules

Exempt supply includes (i) supplies with tariff rate without credit and (ii) supplies taxable on RCM

Alternative to apportionment between taxable and exempt supplies in case of banking companies and financial institutions.

Yearly option to avail a standard rate of 50 per cent of eligible ITC on inputs, capital goods and input services on a monthly basis

### *B. Definition of 'exempt supply'*

It is interesting to note that although an exempt supply is defined in section 2(47), section 17(3) read with explanation (2) to rule 45, for the purposes of input tax credit reversal includes the following transactions as well:

- tax paid under reverse charge
- transaction in securities
- sale of land and subject to clause (b) of Paragraph 5 of Schedule II, sale of building.

Thus, in a way, exempt supply for the purpose of section 17(3) means all such transactions that come within the sweep and ambit of section 2(47) and such other transactions listed in section 17(3) – Is this permissible under law?

Note that the value of supplies in respect of which the outward supplier is not liable to pay tax but the recipient is made liable to pay tax under sections 9(3) and 5(3) of the CGST and IGST Act respectively, would be regarded as 'exempt supplies' for the limited purpose of determining the net available input tax credit. Doubts have been raised whether such supplies should be included as exempt supplies by the recipient who pays the tax under reverse charge. In this context, it would be relevant to note that section 17(3) identifies supplies attracting reverse charge to be exempt supplies in the hands of the supplier effecting such supplies and not in the hands of the recipient who avails such services liable under reverse charge.

Explanation added to section 17(3) is an important amendment to allow taxpayer to avail full credit even if they are not paying GST if the activities or transactions are mentioned in Schedule III except sale of land and completed building. As such, it is important to note that transactions listed in Schedule III are "not supplies" and hence they are neither 'exempt supplies' nor are they 'non-taxable supplies'.

For instance, sale of goods on high seas or merchant trading transactions will not entail any reversal of input tax credit as they are covered under Schedule III after the amendment.

***The CGST (Amendment) Act, 2018***

***[****Read with Notification No. 2/2019-C.T., dt. 29.01.2019****]***

An Explanation has been added to section 17(3) to provide that value of exempt supplies shall not include transactions listed under Schedule III (transactions which are treated "neither as a supply of goods nor a supply of services") except sale of land and completed building. Thus, no credit would be required to be reversed for engaging in transactions referred under Schedule III though no GST is paid on such transactions.

The above Explanation also cover two new entries which have been added to the said Schedule – supply of warehoused goods before clearance for home consumption and supply of goods from one non-taxable territory to another without the goods entering India. No reversal of credit would be required for engaging in these transactions. Experts hold the view that saving from reversal of credit was a treatment that all entries in Schedule III qualify for. And the fact that these supplies (high sea sales and in-bond sales) have been inserted in Schedule III and not included as exemption under section 11 makes it clear that reversal of credit is not to be followed from inception of GST in July 2017. Courts would finally decide this matter but taxpayers at the risk of interest demand, need to take a provisional view whether to retain credit or reverse credit on these 'no supply' transactions.

### *C. Reversal of credit*

#### *1) Reversal of credit based on 'condition of end-use' – inputs and input services*

Input tax credit is admissible based on certain conditions (refer discussion on 'vesting conditions' for input tax credit under section 16 which comprises of precedent conditions or subsequent conditions). Registered persons are responsible for meeting all requirements to correctly claim input tax credit as per section 155. Now, when goods (inputs or capital goods) are received, credit of input tax paid is eligible subject to accepting and agreeing to meet all the associated conditions. But when these goods are not used as accepted and agreed (at the time of taking credit), for whatever reason, then credit availed ought not to have been availed and becomes liable for reversal.

Now, let us examine two provisions dealing with the disqualification that arises after having admitted that credit taken would meet all the associated conditions:

| *Description* | *Section 17(1)* | *Section 17(2)* |
|---|---|---|
| Goods or services received | Both | Both |
| Intended to be used in the course or furtherance of business | Yes | Yes |
| Actual use | Non-business | Business |
| Outward supply is 'actually' taxed | N.A. | No |
| Outward supply is 'non-supply' | N.A. | Yes |

From the above table, it is evident that at the time of taking credit, there must be '*intention'* to use the goods or services for purposes of '*business*' but subsequently there may be changes due to some new development or supervening inconvenience arising later. But, if at the time of taking input tax credit itself there was no such 'intention', then taking credit is more inculpatory than the change (of intention) arising later.

In either case, after taking credit, if the goods or services are:

*(a)* not used for business purposes, then section 17(1) comes into operation demanding reversal of credit on both, goods and services. Whether the goods or services were actually used for business purposes or not may be ascertained from - (i) nature of the goods or services itself or (ii) working backwards from non-business 'output' activities of the registered person and then identifying 'input' goods or services that would have been used or involved in such non-business activities. Where any goods or services are used in such non-business activities, then the whole of the credit is straight away liable to be reversed;

*(b)* used for making outward supplies that are not taxed, then section 17(2) comes into operation seeking reversal of credit on both, goods and services based on a formula prescribed in rule 42 (for inputs and input services) and rule 43 (for capital goods). Exempt supply is defined in section 2(47) but for the limited purposes of section 17(2), section 17(3) provides a special definition of 'exempt supply'. Consider the table below for the description of 'specially exempt supply' and its key differences with the general definition of 'exempt supply':

| *Description and sub-description of outward supplies* | | | | *Specially 'exempt supply'* | *Normal 'exempt supply'* |
|---|---|---|---|---|---|
| Leviable to GST | Tax applicable | Zero-rated | | ✗ | ✗ |
| | | Domestic | Rate with credit | ✗ | ✗ |
| | | | Rate without credit* | ✓ | ✗ |
| | Tax exempted | Zero-rated | | ✗ | ✗ |
| | | Domestic** | (upto 31 Jan 2019) | ✗ | ✗ |
| | | | Interest on loans given (from 23 Jan 2018) | ✗ | ✗ |
| | | | Goods transport by vessel from Indian port (outbound) | ✗ | ✗ |
| | | | All others | ✓ | ✓ |
| Non-leviable to GST | Zero-rated | | | ✗ | ✓ |
| | Domestic | | | ✓ | ✓ |
| No supply (Sch III) | Sale of land or sale of (completed) building (para 5) | | | ✓ | ✗ |
| | Supply of all other (listed in Sch III) | | | ✗ | ✗ |
| Securities (neither 'goods' nor 'services') | | | | ✓ | ✗ |
| Supplies liable to payment of output tax on RCM basis | | | | ✓ | ✗ |
| Central excise duty paid under Entries 84 and 92-A | | | | ✗ | ✓ |
| State excise duty paid under Entry 54 | | | | ✗ | ✓ |
| VAT paid under Entry 51 | | | | ✗ | ✓ |
| CGST, SGST, IGST and Cess paid | | | | ✗ | ✗ |

* *Notification No.11/2017-CT(R), dt. 28.06.2017* specifies at para 4(iv)(b) that where the rate of GST is prescribed (and not '0 per cent ' or 'nil') for services with a condition that input tax credit will not be allowed, then such supplies are to be considered as 'exempt supply' for the purposes of section 17(2) and where they are (a) wholly used for such supplies taxable at a 'rate without credit', then the entire credit will not be allowed and (b) partly used for such supplies taxable as a 'rate without credit', then such credit to be treated under section 17(2).

** Export of services to Nepal and Bhutan against payment in Indian Rupees was excluded from credit reversal but after amendment of definition of export of services to conditionally relax repatriation in INR the same has been deleted from this special relaxation as no longer required since the relief is available in the law itself.

The above table gives a good view of the *specially exempt supplies* prescribed for the purposes of credit reversal. Now, let us examine the nature of reversal of credit that is prescribed.

a) Credit review for reversal is required to be carried out monthly (provisional) and annually (final) for inputs and input services and only monthly (final) for capital goods.

b) Total credit 'taken' in a month comes in for this review and not total credit 'eligible'. Hence, it seems like one can defer claiming credit where the extent of reversal required (by rule 42) is higher in one month than in another month. But note that credit in respect of inputs and input services is required to be revised annually. It may not be possible after all to adjust the credit-data to optimize on reversals.

c) Credit related to Schedule III supplies must always be allowed and cannot come in for any reversal for the reasons that (a) items listed in Schedule III are 'no supply' and (b) the explanation inserted in section 17(3) expressly states this with the only exception of para 5 of Schedule III. Although this explanation was inserted from 1st February 2019, as per decision in *Sundaram Pillai v. Pattabiraman [1985 AIR 582 SC]*, the date of coming into effect of 'explanation' and 'proviso' inserted in a legislation must be examined from the context.

d) The purpose of this exercise is to identify 'common credits' that are used for (a) taxable and credit admissible outward supplies and (b) taxable but credit not admissible and exempt outward supplies and those liable to reverse charge. Merely because inward supplies 'appear' to be common it does not mean they must be common, and their credits be subject to treatment under this rule. Experts are of the view that the requirement in this rule is to exclude credits that are directly related to various end-uses (discussed in detail later) and then 'derive' the pool of common credits. If registered persons are able to segregate apparently common inward supplies at invoice-level (and even on analytical basis, which may be subject to challenge), then there may be (almost) 'nil' common credits. And this is permitted by way of *third proviso* to rule 42(1).

e) Compliance with rule 42 is different for works contract service involving construction of apartment whether of 'ongoing' real estate project or as 'new' real estate which are taxed without input tax credit ('RE Supplies'). The treatment under this rule may be examined in the light of the supplies involved and data qualities from the records of the registered person are extremely important to be sanitized and segregated.

***Non-RE Supplies***

Instead of a detailed discussion running into several pages, the table below attempts to explain the operation of this rule for non-RERA supplies:

| *Outward supplies:* | *Credit on inward supplies (T)* | | | |
|---|---|---|---|---|
| | *Wholly* | *Partly* (C1) = **($T$-$T_1$-$T_2$-$T_3$)** | | *Ineligible* **($T_3$)** |
| Non-business | × ($T_1$) | ($C_2$) ($C_1$-$T_4$) | ×($D_2$) (5%x$C_2$) | × |
| Specially 'exempt supply' (Note 1) | × ($T_2$) | | ×($D_1$) ($C_2$X E/F) | × |
| Zero-rated | ✓ ($T_4$) | | ✓ ($C_3$) | × |
| Domestic (other than above) (Note 2) | | | | × |

*Note 1:*

| *Specially 'exempt supply':* |
|---|
| *Domestic (other than zero-rated):* |
| *Taxable but exempt u/s 11** |
| *Taxable without credit* |
| *Non-taxable sale of land and sale of (completed) building* |
| *Transaction in securities* |
| *Supplies liable to RCM* |

*Note 2:*

| *Domestic (other than all of above):* |
|---|
| *Taxable with credit* |
| *No supply (other than para 5 of Schedule III)* |
| *Interest on loans given* |
| *Transport by vessel from Indian port (outbound)* |

From the above, it is clear that:

- First Credit will have to be identified where it is 'wholly' not allowed ($T_1$, $T_2$ and $T_3$).
- Remainder is credit 'wholly' allowable plus 'common credits' ($C_1$);
- Out of this, credit 'wholly' allowable is identified and allowed ($T_4$);
- From the revised remainder i.e., common credit ($C_2$) is re-allocated to:
  - Specially 'exempt supply' ($D_1$) which is a pro-rata of the revised remainder of credit in the ratio of specially '*exempt supply*' by '*total turnover in the State*';
  - Non-business end-use ($D_2$), which is a ~~straight~~ allocation of 5 per cent of $C_2$;
  - Adjusted remainder will be 'allowable' ($C_3$).

The above computation is required to be carried out monthly and then again at the end of the financial year (not later than Sept following end of year). No variation is expected in $T_1$, $T_2$ and $T_3$ in this year-end review. Variation in $D_1$ and $D_2$ are relevant and upward or downward revision is permitted. In case of upward revision (aggregate of monthly calculation is less than the amount arrived at by annual calculation), the additional amount that ought to be reversed along with interest under section 50(1) from April to September (or earlier when reversals are finally revised) after end of financial year to which such credit relates. In case of downward revision (aggregate of monthly calculation is greater than the amount arrived by annual calculation), the excess reversal may be reclaimed as credit in any month (when reversals are finally revised) but not later than the filing of returns for the month of September following end of financial year to which such credit relates.

***RE Supplies/ Supplies / Inward supplies for promotion of real estate project.***

Simply put, review of common credits in case of RE supplies is not exactly as discussed above in the context of non-RE supplies for the reason of 'timing difference' between year in which inward supplies are received and year in which related outward supplies (of apartments) are made. Having understood the computation of reversal under rule 42, following points may be noted:

a) RE supplies do not cover all works contracts but only construction of apartments as the reference is to para 5(b) of Schedule II (i.e. construction contract) and not para 6(a) of Schedule II (i.e. works contract);

b) Residential real estate projects are subject to CGST at the rate of 2.5 per cent plus SGST/UTGST of 2.5 per mcent or IGST 5 per cent (without ITC) and hence it will be treated as exempt supplies due to the operation of explanation 4(iv)(b) to *Notification No.11/2017-CT(R), dt.28.06.2017*.

   On the other hand real estate projects of commerical apartments do not enjoy the new rate regime and would be treated as taxable supplies.

c) Computation of credit allowable and credit to be reversed are to be determined for each project in the month of completion when the certificate of completion is granted. Hence, until that month, all credits may be taken so as not to miss the time limit under section 16(4) and left unitilized.

| *Particulars* | *Attributes* |
|---|---|
| The total value of tax attributed to inward supplies in a tax period. | $T$ |
| Inward supplies intended to be used exclusively for purposes other than business. | $T_1$ |
| Inward supplies intended to be used exclusively for effecting exempt supplies | $T_2$ |
| Inward supplies not available under sub-section (5) of section 17 | $T_3$ |
| Inward supplies intended to be used exclusively for effecting supplies other than those exempt but including zero rated supplies. | $T_4 = 0$ |
| ITC credited to the electronic credit ledger of registered person. | $C_1 = T - (T_1 - T_2 - T_3)$ |
| Common ITC. | $C_2 = C_1 - T_4$ (or) $C_2 = C_1$ |

| | |
|---|---|
| Aggregate carpet area of the apartments, construction of which is exempt from tax plus aggregate carpet area of the apartments, construction of which is not exempt from tax, but are identified by the promoter to be sold after issue of completion certificate or first occupation, whichever is earlier. | E |
| Aggregate carpet area of the apartments in the project. | F |
| Reversal of common ITC towards exempt supplies. | $D_1$= (E/F) × $C_2$ |
| Reversal of common ITC attributable to non-business purposes. | $D_2 = C_2$ X 5% |
| Eligible common ITC attributed to purposes of business and for effecting supplies other than exempt supplies but including zero rated supplies. | $C_3 = C_2 - (D_1 + D_2)$ |

Please note Reversal of credit under rule 37 attracts interest but not monthly reversal under rule 42. However, credits such as $T_1$, $T_2$ and $T_3$ should not be availed. Interest liabiltiy for claim of credit (between commencement and completion of cosntruction) is alllowed only in respect of $D_1$ and $D_2$. In case credits in the nature of $T_1$, $T_2$ and $T_3$ are availed albeit innocently, this relief from interest will not be available.

d) RE Supplies exempt from tax will comprise of the following :

| *Description* | *Ongoing Project* | *New Project* |
|---|---|---|
| Exempt supplies | Apartments sold after date of OC/CC and hence not taxed | All apartments in new projects that are 'taxable without credit' |
| Taxable supplies | Apartments that are 'taxable with credit' and sold before OC/CC | None, whether sold before or after OC/CC |
| | | Commercial apartments in REP |

e) Rule 42(3) prescribes that review of credit reversals is required to be carried out project-wise on the date of grant of certificate of completion (not later than Sept following). It is accepted in the rule that projects may take more than one finacial year and hence, project duration is considered relevant for this 'project end review' of credit reversal by ignoring any intervening financial year end until completion of said project;

f) Rule 42(4) applies to 'transition project', that is project that was commenced before 1 Apr 2019 which was 'taxable with credit' and option was exercised for the project to be 'taxable without credit'. In such projects, the requirement is to proceed project-wise and with retrospective effect from (i) the date of project commencement or (ii) $1^{st}$ Jul 2017, whichever is earlier (special review period). This adjustment is required only in respect of 'comemrcial units' in a REP project for certain reasons, namely: (**a**) at the time of transition into 'new rate regime', all credits taken would have been reversed in terms of Notification No. 3/2019-CT(R), dt.29.03.2019 which made specific amendments to Notification No. 11/2017-CT(R), dt.28.06.2017 and (**b**) new rate regime applies only to residential apartments as per Entry 3(id) and commercial apartments in REP are 'taxable with credit' as they do not come under the new rate regime. Hence, commercial apartments in REP will be eligible for credit.

g) Review of credit reversal for RE supplies to be carried out only in repect of RREP proejcts with commerical apartments, after the introduction of new rates and not otherwise. The procedure for the reversal of ITC as per rule 42 (4) is as follows:

| *Particulars* | *Attributes* |
|---|---|
| Eligible common input tax credit attributed to the purposes of business and for effecting supplies other than exempted supplies but including zero rated supplies. - *from 01.07.2017 to 31.03.2019* | C3r |
| Total carpet area of the commercial apartments in the project | AC / F |
| Total carpet area of all apartments in the project | AT |
| Eligible common input tax credit attributed to the purposes of business and for effecting supplies other than exempted supplies but including zero rated supplies. - *from 01.04.2019* | C3i |
| Aggregate amount of common credit on commercial portion in the project - *for the entire period from the commencement of the project or 1st July, 2017, whichever is later, to the completion or first occupation of the project, whichever is earlier* | C3A = [C3r X (AC / AT)] + C3i |
| Total carpet area of commercial apartments which have not been booked till the date of issuance of completion certificate or first occupation of the project, whichever is earlier. | E |
| The Amount of Final eligible common credit on commercial portion in the project | C3F = C3A X (E/F) |

- Credits not allowable would have already been reversed towards $T_1$, $T_2$ and $T_3$.
- Special reversals of D1 and D2 would also have been identified and reversed.
- RE supplies would *not* have been considered as 'exempt supplies'. Therefore credit related to RE supplies which are 'exempt' would be carried in $T_4$ and in $C_3$.
- Take out from $T_4$ (if not already done), credits relatable to apartments 'taxable without credit' on a project-wise basis and reverse the same on the date of completion but within September following the end of the financial year of the project completion.
- C3i will be computed monthly upto the date of completion as per the formula prescribed in rule 42 (1)

- Now, the actual amount of C3F 'eligible' will be determined when C3A is to be reduced in the ratio of 'unbooked commerical apartments' by 'total commerical apartments' (of carpet area).
- Variation in C3A and C3F may either be downward or upward. In case of downward revision , additional amount that ought to be reversed along with interest from April to September (or earlier when reversals are finally revised) after end of financial year. In case of upward revision , the excess reversal may be reclaimed as credit in any month (when reversals are finally revised) but not later than filing of returns for the month of Sept following end of year.

In case of RE supplies and non-RE supplies, following values will *not* be included both as exempt supplies and total turnover:

(i) Value of central excise duty paid under Entry 84 and Entry 92-A

(ii) Value of State excise duty paid under Entry 54

(iii) Value of VAT paid under Entry 51 of the VII Schedule to Article 246 of COI

(iv) Value of GST – CGST, SGST, ISGT and Cess paid.

***Illustration: Manner of determination of ITC in respect of inputs or input services and reversal thereof (Rule 42)***

| *Sl. No* | *Particulars* | *Reference* | *CGST* | *SGST/ UTGST* | *IGST* |
|---|---|---|---|---|---|
| 1 | Total input tax on inputs and input services for the tax period May 2021 | T | 1,00,000 | 1,00,000 | 50,000 |
| | Out of the total input tax (T): | | | | |
| 2 | Input tax used exclusively for non-business purposes (Note 1) | $T_1$ | 10,000 | 10,000 | 5,000 |
| 3 | Input tax used exclusively for effecting exempt supplies (Note 1) | $T_2$ | 10,000 | 10,000 | 5,000 |
| 4 | Input tax ineligible under Section 17(5) (Note 1) | $T_3$ | 5,000 | 5,000 | 2,500 |
| | TOTAL | | **25,000** | **25,000** | **12,500** |
| | ITC credited to Electronic Credit Ledger (Note 1) | $C_1 = T - (T_1 + T_2 + T_3)$ | **75,000** | **75,000** | **37,500** |
| | Input tax credit used | $T_4$ | 50,000 | 50,000 | 25,000 |

| | | | | | |
|---|---|---|---|---|---|
| | exclusively for taxable supplies (including zero-rated supplies) | | | | |
| | COMMON CREDIT | **$C_2 = C_1 - T_4$** | **25,000** | **25,000** | **12,500** |
| | Aggregate value of exempt supplies for the tax period May 2021 (Notes 2 and 3) | E | 25,00,000 | 25,00,000 | 25,00,000 |
| | Total turnover of the registered person for the tax period May 2021 (Note 2) | F | 1,00,00,000 | 1,00,00,000 | 1,00,00,000 |
| | Credit attributable to exempt supplies | $D_1 = (E/F) * C_2$ | 6,250 | 6,250 | 3,125 |
| | Credit attributable to non-business purposes (if inputs & input services are used partially for business and non-business purposes) | $D_2 = C_2 * 5\%$ | 1,250 | 1,250 | 625 |
| | Net eligible common credit | $C_3 = C_2 - (D_1 + D_2)$ | 17,500 | 17,500 | 8,750 |
| | TOTAL CREDIT ELIGIBLE (Exclusive + Common) | **$G = T_4 + C_3$** | **67,500** | **67,500** | **33,750** |

Note 1: If the registered person does not have any turnover for May 2021, then the value of exempt supplies (E) and total turnover (F) shall be considered for the last tax period for which such details are available

Note 2: Aggregate value excludes taxes

Note 3: The registered person is expected to make such computation for each tax period and reverse the same in the periodic returns being filed by him. However, on completion of the financial year, input tax credit shall be determined accurately based on actuals, in the same manner as provided in rule 42. A true up is required to be done on an annual basis (between the amounts reversed for each tax period during the year and the amount determined at the end of the financial year) and any excess credit availed needs to be reversed with interest while short credit, if any, needs to be re-availed within 6 months from end of the financial year.

It is to be noted that the registered person would be required to remit excess ITC claimed (as determined in Note 3 above) with interest calculated for the period starting from the first day of April of the succeeding financial year till the date of payment. However, no interest can be claimed if, at the end of the financial year, it is found that short credit was availed.

***2) Reversal of credit based on 'condition of end-use' – Capital goods***

Input tax credit in respect of capital goods is also fettered with the same conditions [refer the above discussion on 'vesting conditions' for input tax credit under section 16(1)] which comprises of precedent conditions or subsequent conditions). Registered person continue to be responsible for meeting all the requirements to correctly claim input tax credit even on capital goods as per section 155. Now, unlike inputs and input services, end-use of capital goods is more objective because output for each month can be determined.

When capital goods are *not used* in making taxable outward supplies, then they too come in for review of credit. Capital goods 'used' do not get 'used up'. Hence, the computations applicable to input and input services cannot be applied to capital goods.

<table>
<tr><th>Description of outward supplies</th><th>Credit on capital goods</th><th>End-use 'swap'</th></tr>
<tr><td>Non-business</td><td rowspan="2">Not credited to ECL; 'ineligible' capital goods</td><td rowspan="5">Credit on 'all' capital goods deemed to accrue on '5% per quarter' (or part). Swap of end use from ineligible to eligible and vice versa will be available to the extent accrued as per rate above.</td></tr>
<tr><td>Specially 'exempt supplies'*</td></tr>
<tr><td>Taxable</td><td rowspan="2">Credited to ECL; 'eligible' capital goods</td></tr>
<tr><td>Zero-rated</td></tr>
<tr><td>End-use not identified exclusive to either of above</td><td>Credited to ECL (A) and subject to adjustment under rule 43; 'common' capital goods</td></tr>
</table>

** interpretation of specially 'exempt supplies' is the same for rule 42 and rule 43.*

Treatment given to RE supplies and non-RE supplies is applicable even to capital goods.

***Non-RE supplies***

In case of non-RE supplies, full credit of 'eligible' and 'common' capital goods will be taken in the month in which they are received by the registered person.

(a) Credit related to capital goods exclusively used to make taxable outward supplies including zero-rated is 'wholly' available.

(b) Credit related to capital goods exclusively used to make non-business and special 'exempt supplies' are 'wholly' *not* available.

(c) Credit related to capital goods that are not identified exclusively to either of the above will be taken as credit subject to treatment under this rule (TC).

(d) Credit subject to treatment will be divided by 60 for each month (TM) of the deemed useful file of 5 years being 60 months [rule 43(1)(c) is prescribed useful life for all capital goods].

(e) Each such capital goods will have its own TM for a given month. Now monthly TM of all such capital goods must be aggregated (TR).

(f) Credit liable to reversal is computed on the ratio of 'specially exempt supplies' by 'total turnover in the State' for the registered person (TE).

(g) The amount so arrived will need to be reversed. Interest will be applicable because total capital goods credit (A) would have been taken in the month of receipt of capital goods (and credited to ECL) and now a 'new TE' would be computed each month based on the ratio.

***RE Supplies***

In case of RE Supplies, capital goods used for non-RE Supplies are excluded from this discussion and previous section may be referred for the applicable treatment. Capital goods used for RE Supplies full credit of 'eligible' and 'common' capital goods will be taken in the month in which they are received by the registered person.

| *Description of outward supplies* | *End-use of capital goods* | | *Credit subject to treatment under rule 43* |
|---|---|---|---|
| | *Exclusively* | *Commonly* | |
| Apartment 'taxable without credit' | ü | ü | û |
| Other exempt construction | ü | ü | û |
| Ongoing project (opted for old rate) | ü | ü | ü |
| Commercial apartment in REP | N.A. | ü | ü |

(a) Credit reversal treatment in respect of capital goods is required to be made project-wise and on the date of grant of certificate of completion.

(b) During construction period, capital goods used for taxable supplies is required to be assumed as 'nil'.

(c) Value of apartment to be considered is their total value and not the value billed or paid upto date of completion.

(d) Credit on 'common' capital goods to be reversed (TE) in case of RE supplies is to be determined in following manner:

- Identify credit relating to 'common' capital goods from 1st July 2017 to date of completion of project
- Carry out all steps to arrive at TE, that is:
    - Take credit individually for each 'common' capital goods *not* monthly but for entire project duration (TC)
    - Aggregate of all invidivual TC will be TC-FINAL
    - Arrive at the factor to reduce total credit to determine eligible and ineligible

| Total carpet area of apartments constructed (project-wise) (F) | | | |
|---|---|---|---|
| Exempt | Taxable without credit | Partly taxable and exempt | Taxable with credit |
| E1 (Area only) | | E2 (Area x Value Exempt / Total Value) * | E3 (Area unsold or unbooked only) ** |

** E2 generally expected to be 'nil' for the reason that in case of apartments under new rate regime credit is not allowed at all. In respect of ongoing projects where old rate regime continues, then full credit is available. Where 'common' capital goods are used for more than one such projects, then 'reasonable basis' (and not this rule) is applicable as per rule 43(4).*

*** E3 will be limited to 'unsold' or 'unbooked' apartments as GST (ongoing project under old rate regime) will apply even if payments are not fully received within date of OC/CC but have been 'sold' or 'booked' before that date.*

- o Ineligible credit will be the net amount new-TE arrived by applying the above factor to the credit on 'common' capital goods TC.
- o Applying this formula to all 'common' capital goods will provide TE-FINAL;

- Variation in TE with new-TE-FINAL may either be downward or upward. In case of downward revision (FINAL is higher), then additional amount that ought to be reversed along with interest from Apr to Sept (or earlier when reversals are finally revised) after the end of financial year. In case of upward revision (FINAL is lower), the excess reversal may be reclaimed as credit in any month (when reversals are finally revised) but not later than returns for the month of Sept following end of year.

(e) Computation of eligible and ineligible is required to be considered on 1/60 basis to begin with although credit may have been entirely availed (where available only) at the time of their receipt by the registered person.

**Illustration: Manner of determination of ITC in respect of capital goods and reversal thereof in certain cases (Rule 43)**

| *Sl. No* | *Particulars* | *Reference* | *IGST* |
|---|---|---|---|
| 1 | ITC on capital goods used exclusively for non-business purposes (Note 1) | $T_1$ | 10,000 |
| 2 | ITC on capital goods used exclusively for effecting exempt supplies (Note 1) | $T_2$ | 10,000 |
| | **Total** | | **20,000** |
| 3 | ITC on capital goods used exclusively for taxable supplies (including zero-rated supplies) (Note 1) | $T_3$ | 50,000 |

| | | | |
|---|---|---|---|
| 4 | ITC on capital goods (other than $T_1$, $T_2$ and $T_3$) (Annexure A) | A= b+f | 3,90,000 |
| 5 | ITC on capital goods whose residual life remains in the beginning of the tax period (Annexure A) | $T_r$ | 6,500 |
| 7 | Aggregate value of exempt supplies for the tax period May 2020 (Note s2 and 3) | E | 25,00,000 |
| 8 | Total turnover of the registered person for the tax period May 2020 (Note 2) | F | 1,00,00,000 |
| 10 | Credit attributable to exempt supplies | $T_e = (E/F) * T_r$ | 1,625 |

Note 1: $T_1$, $T_2$ and $T_3$ should be declared in Form GSTR-2. $T_3$ (being ITC on capital goods used for taxable supplies) and A (being common credit in respect of capital goods) shall only be credited to the electronic credit ledger

Note 2: If the registered person does not have any turnover for May 2020, then the value of E and F shall be considered for the last tax period for which such details are available

Note 3: Aggregate value excludes taxes

**ANNEXURE A**
**ITC ON CAPITAL GOODS WHOSE RESIDUAL LIFE IS REMAINING**

| *Sl. No* | *Particulars* | *Reference* | *Amount* |
|---|---|---|---|
| | For May 2020 | | |
| 1 | Inward supply value of machinery X | A | 12,50,000 |
| | IGST @ 12% | B | 1,50,000 |
| | INVOICE VALUE | | **14,00,000** |
| | Date of inward supply | | **12 April 2020** |
| | Life of the capital goods (in months) - for GST purpose is 5 years | C | **60** |
| | ITC attributable for 1 month | $Tm_1$ =b/c | **2500** |
| 2 | Inward supply value of machinery Y | E | 20,00,000 |
| | IGST @ 12% | F | 2,40,000 |
| | INVOICE VALUE | | **22,40,000** |
| | Date of inward supply | | **21 May 2018** |
| | Life of the capital goods (in months) - for GST purpose is 5 years | G | **60** |
| | ITC attributable for May 2020 (1 month) | $Tm_2$ = f/g | **4000** |
| | Aggregate of ITC on common credits | $T_r = Tm_1 + Tm_2$ | **6500** |

*Note:*

It is important to note that unlike rule 42 which mandates determination of the actual amount of reversal on the completion of the financial year, rule 43 does not prescribe any re-computation at the end of the financial year. This could be presumed to be due to the fact that reversal of input tax credits under rule 43 is based on number of tax periods unlike that of rule 42. But considering the fact that reversal of common credits under rule 43 is also based on the proportion of turnover of exempt supplies to the total turnover in the State for that tax period, due consideration should be given to the fact that any shortage of ITC on account of any reason cannot be subsequently availed under rule 43. On the other hand, any excess credit availed would promptly be subject to scrutiny by the proper officer.

### *D. ITC Restrictions on Banks and NBFCs*

**[**Section 17(4) read with Rule 38 of the CGST Rules**]**

**Banking Company or financial institution including NBFC engaged in accepting deposits, extending loans or advances:** An option is made available to a Banking company or financial institution including NBFC engaged in accepting deposits, extending loans or advances that chooses not to comply with the provisions of sub-section (2) of section 17. As per this option, the ITC availment would be limited to 50 per cent of the eligible ITC on inputs, capital goods and input services each month and lapse the remaining ITC. In such cases, the banking company or financial institution shall:

- Refrain from availing input tax credit related to 'non-business purposes' and those restricted under section 17(5) and such blocked credit needs to be reported in **Form-GSTR 2**.
- Avail full credit on inter-branch supplies between distinct persons of the banking company or NBFC. In other words, if the HO has restricted credit to 50 per cent and those goods or services are involved in inter-branch taxable supplies, the receiving branch is not required to further apply the 50 per cent restriction.

  Further, even if the HO avails some services from branch, it can avail 100 per cent credit. This relief is provided in the *second proviso* to section 17(4).
- NOT be able to change the option once exercised during the remaining part of the financial year.

Interest income is the main source of revenue of banks and NBFCs and the same is exempt under GST *vide* entry 27(a) of *NN 12/2017-CT(R)* and Entry 28(a) of *NN 9/2017-ITR*. The relevant extract of the said Entry is as under:

| *Sl No.* | *Chapter, Section, Heading, Group or Service Code (Tariff)* | *Description of services* | *Rate (%)* | *Condition* |
|---|---|---|---|---|
| *27* | *Heading 9971* | *(a) Services by way of—(a) extending deposits, loans or advances in so far as the consideration is represented by way of interest or discount* (other than interest involved in credit card services); | *NIL* | *NIL* |

Where this option to restrict input tax credit under section 17(4) is not availed, then input tax credit will be available to the extent admissible after complying with rules 42 and 43.

### *E. Restrictions on ITC: Blocked credits under section 17(5)*

Section 17(5) commences with a non-obstante clause "*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:* -". It clearly means that the provisions of section 17(5) overrides sections 16(1) and 18(1). Further, section 17(5) uses the expression '*in respect of*' which connotes a broader meaning. With effect from 01.02.2019, section 17(5) has been amended *vide* the CGST (Amendment) Act, 2018.

*(a) Motor Vehicles*

After such amendment, clause (a) of section 17(5) regarding eligibility/ non-eligibility of input tax credit on vehicles has become more specific. As per amended provisions, firstly, input tax credit on motor vehicles for transportation of goods is not barred, that is, credit is fully admissible subject to any specific restrictions in tariff *Notification No. 11/2017-CTR, dt. 28.06.2017*. Secondly, motor vehicles used for transportation of persons having approved seating capacity of not more than 13 persons (including the driver) are ineligible for input tax credit except if used for following specified purpose:

(a) Further supply of such vehicle or vessel or aircraft; or

(b) Transportation of passengers; or

(c) Imparting training on driving such vehicles.

As per the amended provisions, ITC on motor vehicles with approved seating capacity of more than 13 persons (including the driver) will be available, subject to tariff restrictions, if any.

Motor Vehicles Act, 1988 defines 'motor vehicle'* in section 2(28) as follows:

<table>
<tr><td colspan="2">Any mechanically propelled vehicle</td><td colspan="2">Adapted for use upon roads</td><td colspan="2">Power of propulsion from external or internal source</td></tr>
<tr><td colspan="3">Inclusions</td><td colspan="3">Exclusions</td></tr>
<tr><td colspan="3">Chassis to which body is not attached</td><td colspan="3">Vehicle run on fixed rails</td></tr>
<tr><td colspan="3">Trailer</td><td colspan="3">Vehicle of special type adapted for use only in factory or in enclosed spaces</td></tr>
<tr><td colspan="3"></td><td colspan="3">Vehicle having less than 4 wheels with engine capacity less than 25 cc</td></tr>
</table>

** vehicle is used interchangeably with motor vehicle.*

From the above definition, it is abundantly clear that railway wagons, coal wagons, etc. not being a motor vehicle are eligible for credit. Similarly, two-wheelers and three-wheelers with engine capacity less than 25 cc are also not motor vehicles and thus, will be eligible for credit. Also, it needs to be noted that credit will be available on motor vehicles used for passenger transportation with seating capacity of less than 13 persons if they are used for making specified taxable supplies viz., further supply of such vehicles, transportation of passengers or imparting training on driving. For example, a car registered as commercial vehicle and being used in transportation of passengers (ola/uber cab) will be eligible for credit.

As stated earlier, this restriction applies only in respect of 'passenger transport vehicles' and not for 'goods transport vehicles'. Here, a question arises as to whether construction equipment mounted on crawlers or wheels or rollers even though affixed with a 'mark of registration' would be goods transport vehicles or construction machinery. From the above definition, the point of emphasis is 'adapted for use upon road' and not the fact of 'registration mark'. Test of 'adapted for use upon road' refers to the 'principal function' is its use for transportation by road. Added functionalities or features may ease operations before or after transportation. By its very nature, such construction machineries are 'not adapted' for use on road but for use off-road. Wheels (or crawlers or rollers) fitted are to provide added mobility within the site and for its own transport to other sites, and not for transporting other articles but to work on its own. And then there are tippers and dumpers which are 'adapted' for use on road as earth movers not for excavation but for transporting material after earth excavation along with added features of easy loading or unloading with pneumatic cylinders, etc. Forklifts and other vehicles that have very limited range of mobility but high capacity for lifting or moving loads are also 'not adapted' for use upon road. Care must be taken to classify these vehicles based on the definition contained in the Motor Vehicle Act.

| *Description* | *Mark of Registration* | *Motor Vehicle or Not* | *Creditable or Not* |
|---|---|---|---|
| Truck chassis | Yes | Yes | Yes |
| Truck chassis + goods transport body | Yes | Yes | Yes |

| | | | |
|---|---|---|---|
| Truck chassis + passenger transport body | Yes | Yes | No |
| Truck chassis + ambulance body | Yes | Yes | No |
| Tractor (designed to pull or push a payload – farm or road use) | Yes | Yes | Yes |
| Tractor + Trailer | Yes | Yes | Yes |
| Trailer only | Yes | Yes | Yes |
| Tipper | Yes | Yes | Yes |
| Road-roller | Yes | Yes | Yes |
| Wheel-loader or pay-loader | Yes | No | Yes |
| Excavator | No | No | Yes |
| Fork-lift | No | Yes | Yes |
| Aircraft tug | No | Yes | Yes |

Another aspect to consider is whether credit is admissible in respect of 'test drive' vehicles that are neither 'held for sale' nor 'put to regular use'. As test for ineligible credit is 'further supply', based on broader meaning of the expression 'in respect of', used in sub-section (5), credit will be allowed. Reference may be made to *AM. Motors' case [(2018) 18 GSTL 93 (AAR, Kerala)]* and *Chowgule Industries (P.) Ltd. [(2019) 107 taxmann.in 293 (AAR, Goa)]*. It may be noted that when the 'test drive' vehicles are sold after being used, the same are allowed to be valued as per margin method in terms of *Notification No. 8/2018-C.T. (R), dt. 25-1-2018* only if input tax credit thereon has not been taken.

*(aa) Vessels and Aircraft*

After notification of clause (b) of section 9 of the CGST (Amendment) Act, 2018 w.e.f. 1st February 2019 *vide Notification No. 2/2019-C.T., dt. 29.01.2019*, clause (aa) of section 17(5) makes eligibility/ non-eligibility of input tax credit on 'vessels and aircraft' more specific. As per amended provisions, all vessels and aircrafts are rendered ineligible for credit except when used for the following specified purpose:

(i) For making taxable supplies of:
  (a) such vessel or aircraft themselves; or
  (b) transportation of passengers; or
  (c) imparting training on navigating such vessels; or
  (d) imparting training on flying such aircraft; or
(ii) For transportation of goods.

From the foregoing, it is clear that vessels and aircrafts have a similar embargo like motor vehicles although worded slightly differently. That is, transport of goods is totally eligible for credit in case of motor vehicles as well as vessels and aircraft. Care must be taken to note that this exception (ineligible credit is made eligible in certain exceptions listed) must be strictly adhered to. Further, tariff conditions [conditions linked to rate of GST under *Notification No. 11/2017-CT(R), dt.28.06.2017]* being more specific, will render credit that is covered by this exception to become ineligible again.

Although a notification cannot overrule the statute, note that section 17(5) is an embargo that is applicable to all registered persons. So also, the relaxation of this embargo applies to all registered persons. Now, a taxable person in search of the applicable GST tariff finds that *Notification No. 11/2017-CT(R), dt. 28.06.2017* prescribes the rate of GST with a condition that input tax credit on goods (includes capital goods) is not to be availed. Explanation to section 11 states that where an exemption (partly or fully) is granted absolutely (applicable to all) it must be mandatorily availed. In other words, 'conditional rate' cannot be converted into 'optional rate' by deliberately violating the 'condition' attached to the prescribed rate of tax. One must pay the prescribed rate of GST and also adhere to the condition (and refrain from claiming credit). Refraining from claiming credit obviously refers to credit that is otherwise eligible. Tariff notification is not attempting to override the statute here but is in complete harmony where it firstly recognizes that credit (in respect of motor vehicles, vessels and aircraft) to the extent (that it comes within the exceptions carved out) becomes eligible under section 16(1) read with section 17(5) and secondly, it is this (extent of eligible) credit that is to be refrained from being availed in order to properly comply with the conditions prescribed in the tariff notification. Hence, there is no disharmony between the conditions prescribed in the tariff notification and the provisions of section 17(5).

Another important aspect to highlight is that 'further supply' of vessel or aircraft (also applicable to motor vehicle) does not mean only 'resale' but any 'form' of supply. In other words, 'purchase' of vessel or aircraft (even motor vehicle) when used to let-out on 'lease', will qualify for credit admissibility because the output is 'further supply' although not of the same form. Further supply which can be in 'any' form must not be of such a form where tariff notification places an embargo on claiming credit. 'Hire' is a fare for passage and 'lease' is a right to use. When we buy a flight ticket, we only pay for the trip (or passage along the route) but we do not pay for 'right to use' the aircraft (or vessel or motor vehicle) even when it is a charter. Care must be taken not to interchange these expressions and seek to come under a tariff entry that is free from credit restriction/conditions.

*(ab) Services of upkeep of motor vehicles, vessels and aircraft*

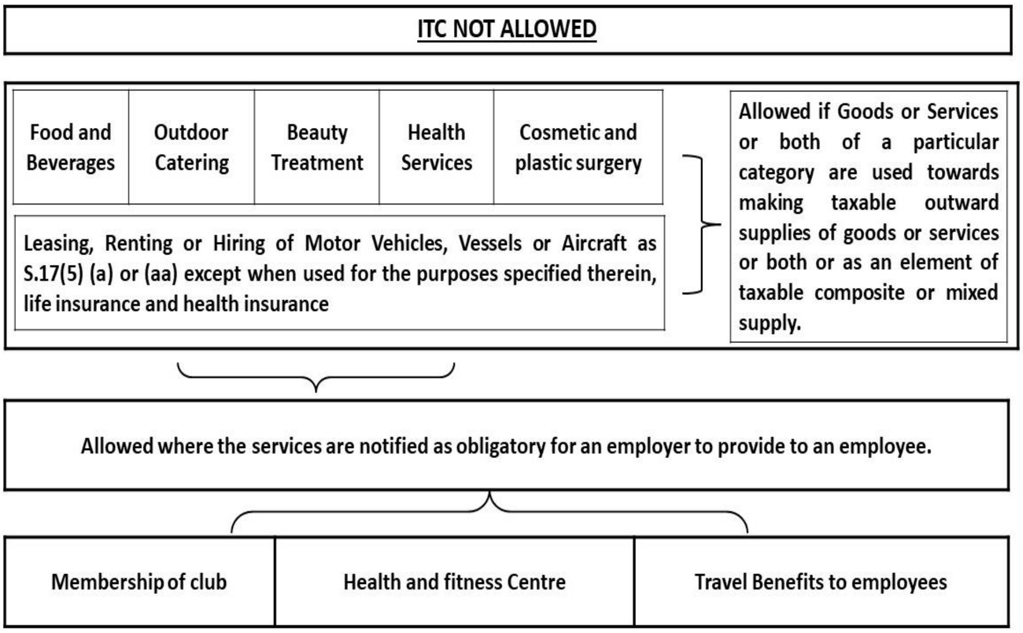
Further, credit of general insurance, servicing, repair and maintenance shall be available so far as it relates to motor vehicle, vessels or aircraft on which credit is available. Furthermore, credit will also be available if the services are received by a taxable person engaged in manufacture of the motor vehicles or in supply of general insurance services in respect of motor vehicles, vessels or aircraft insured by him.

Interestingly, it has been observed that this restriction is being imposed even on authorized service centres (ASC) involved in providing maintenance as their principal supply to customers (owners of motor vehicles). Maintenance charges are an expression that is applicable *qua* owner of motor vehicle. Maintenance charges *qua* authorised service centre are in the nature of sub-contract charges where ASC is the main-contractor of the customer (owner of motor vehicle). ASC will not 'maintain' vehicle belonging to the customer.

Now, maintenance and upkeep charges will be creditable if the underlying motor vehicle (or vessel or aircraft) is also eligible for credit. Note that the tariff notification restriction on credit will not be limited to motor vehicle (or vessel or aircraft) but will extend to its maintenance and upkeep also.

*(b) Supply of goods /and services being*

In the certain specified cases, credit is blocked unless it is used in making a further outward supply as such or as an element of a composite or mixed supply.




As per amended section 17(5), input tax credit of all the above services shall be eligible if it is obligatory on the part of the employer to provide the same to its employees under any law for the time being in force. For example., credit of GST paid on outdoor catering services used in factory may be allowed after effective date, as the Factories Act made it compulsory to provide canteen services if the factory has certain number of employees. Earlier, this credit was not allowed in such cases.

Although credit is restricted on the above supplies, credit would still be allowed if it is used for effecting further taxable supply of the same category, or as an element of a taxable composite or mixed supply. Often in a business scenario, it is extremely difficult to link such inward supplies to taxable outward supplies. For instance, in a rent-a-cab service the input tax credit would be allowed if the corresponding inward supply could be linked to an outward supply of the very same rent-a-cab service; but if rent-a-cab outward supply is provided free of cost then the question that arises is whether input tax needs restriction or output supply is subject to valuation? Assume that in the very same example the rent-a-cab outward supply is provided by a hotel to its guest in the form of free airport transfers, what would be the position of input taxes? The pertinent question would be whether it was for furtherance of business for which the obvious answer would be in affirmative as the cost would have been included in the value of the other (composite or mixed) supply of services. Alternative views may arise due to the facility not being uniformly available to all guests. But care must be taken to reflect on the admissibility of credit when output is subjected to tax.

It would not suffice to merely claim that these restricted supplies are used for further taxable supply in the absence of a clear link between the restricted inward supply and the taxable outward supply. Mere utilization of these restricted supplies for the benefit of the supplier in the course of an outward supply may validate input tax credit on such restricted supplies.

Certain instances where credit on aforementioned restricted categories can be sought to be availed are indicated below:

| *Inward Supplies* | *Credit Eligibility* |
|---|---|
| Food and beverages or outdoor catering | Corporate party organized by hiring an event manager. Event manager is contracted to ensure all arrangements relating to food, guests, lighting, decoration, cab services for pick up and drop etc.<br>Event manager uses the services of a caterer to serve food at the party and engages a rent-a-cab operator to pick-up and drop guests.<br>(i) Credit to event manager for food and rent-a-cab services available since inward supplies have been used for making outward supplies<br>(ii) Credit to company is available since they are availing composite supply of event management and not a standalone supply of various elements contained in organizing such event |
| Renting or hiring of motor vehicles provided to company for transport of female employees who work on night shift | The Karnataka Shops and Establishment Regulations mandate every employer to ensure that cab facility is provided to female employees working during night shift. Cab facility provided for transport of female employees is mandated by statute and credit of the same would be available to the employer. |
| Travel benefits to directors | Travel benefits to employees have been specifically restricted from taking credit but nothing has been mentioned about the travel benefits extended to non-executive directors and hence the same should be available. Credit on transactions for "non-business use" may not apply here since the company is accounting this as a business expenditure in its books of accounts. |

From 1st February, 2019, clause (b) of section 9 of CGST (Amendment) Act, 2018 read with *Notification No. 2/2019-C.T., dt. 29.01.2019,* replaces clause (b) of section 17(5) to bring out the following amendments:

1. Credit shall not be available for the supply of food and beverages, outdoor catering, beauty treatment, health services, cosmetic and plastic surgery, leasing, renting or hiring of motor vehicles, vessels or aircraft referred to in clause (a) or clause (aa) of section 17(5) except when used for the purposes specified therein. In other words, renting or hiring of motor vehicles, vessels and aircraft are blocked only if the purchase of such motor vehicles, vessels and aircrafts are blocked as per clause (a) or (aa). However, input tax credit in respect of such goods or services or both shall be available where an inward supply of such goods or services or both 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.

   Further, credit in respect of life insurance and health insurance will continue to be blocked.

   Where steps are taken to include these inward supplies as an 'element' of an outward supply, then credit cannot be denied. *Proviso* to section 17(5)(b) very clearly saves the credit from being blocked when these inward supplies are themselves involved in making an outward supply (whether as independent supplies and composite or mixed supplies). For example, if a CA issues an invoice for stock review services of ₹ 100,000 and collects reimbursement of lunch expenses of ₹ 5,000, then the invoice of the CA will have a taxable value of ₹ 1,05,000,and the CA will be entitled to avail input tax credit of GST paid on inward supply of catering services since the catering services are involved in the composite supply of 'professional service fee' of ₹ 105,000. Care must be taken to maintain documents supporting general lunch expenses for staff welfare and that specifically incurred by the team carrying out this stock review exercise.

2. ITC on membership of club, health and fitness centre will also be considered as blocked

3. Travel benefits extended to employees on vacation such as leave or home travel concession will also not be available.

4. The provisions have been amended so as to allow ITC in respect of goods or services or both specified above if it is made obligatory for an employer to provide the same to its employees under any law for the time being in force.

*(c) Construction of Immovable Property (other than plant and machinery)*

Works contract services, except where it is an input service for further supply of works contract service

Goods or services or both received by a taxable person for construction of an immovable property on his own account *even when used in course or furtherance of business*

**ITC NOT AVAILABLE**

"Construction" includes re-construction, renovation, additions or alterations or repairs, to the extent of capitalization, to the said immovable property. Note that 'alterations' and 'repairs' are also included in this definition, if capitalized.

It is important to note that credit of GST paid on works contract services would be allowed only if the output supply is also works contract services. Input tax credit attributable to 'works contract services' (including inward supply of goods or services) availed by builders/ developers for providing outward supply of services, would be eligible for ITC.

In respect of inward supply of works contract resulting in immovable property for own use, the corresponding tax credits would be blocked if it is used "for" construction. Hence, costs directly related to construction would not enjoy any input tax credit, but costs which directly do not relate to construction would be entitled to credit.

"Plant and machinery" means apparatus, equipment, 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 land, building or any other civil structures, telecommunication towers; and pipelines laid outside the factory premises. The definition of plant and machinery is also unique in including foundation and support which could be a works contract service for which credit is allowed but excludes '*any other civil structure'*. The intention appears to be put to rest the disputes in the past where foundation and structure which may include civil construction which are part of the plant and machinery were eligible for credit. Specific exlcusion like telecommunication towers may exclude some parts other than the basic tower. These aspects may also be tested in times to come.

In this context it is important to note that a single contract may be awarded for construction including interrior works along with electronic installations comprising of audio-video equipment. As a composite supply, the electronic installations will also be taxed under HSN 9954 and be incapable of being extracted from the total contract price. But if this contract was treated as a mixed supply, the works contract too would be taxed at 28 per cent (assumed for discussion purposes).Can credit of the entire project be claimed including the works contract embedded in the single contract price even though taxed at 28 per cent. Care appears to have been taken to permit credt only in respect of 'plant and machinery' which has been defined in an explanation that is made applicable to 'this section as well as all sections in Chapter VI of the Act'.

Reference may be made to Maharashtra AAR order in the case of *Nipro India Corporation Private Limited (ARA- 33/2017-18/B- 41 Mumbai, dt. 28.05.2018)* where the AAR has travelled to great lengths to collect data of plant and machinery embedded in the contract price and allowed credit to applicant in respect of such plant and machinery although the entire contract was taxed under HSN 9954 as 'works contract service'.

Another aspect to be examined is whether a 'factory building' is a building (and hence, credit restricted) or plant (and hence credit admissible)? Every structure is not immovable property. One should examine if the structure is a 'means of production' or the 'location of production'. Steel structures for gantry crane to move about would not be building but part of the supports for the crane. This area requires some technical insight and cannot be dismissed based on visual inspection by an untrained eye. Plant may be annexed to the ground. Courts have applied the test whether the annexation is the object of permanent beneficial enjoyment of the land. Machinery for metal shaping and electro-plating which was attached by bolts to special concrete bases that could not be removed was not treated to be part of structure or solid beneath as the attachment was not for beneficial enjoyment of the soil or concrete. If they retain their identity and are not for beneficial enjoyment of the land, then they will be creditable as 'plant and machinery' even though they may be annexed to the ground. Plant is erected and then an enclosure is fabricated around the plant, the enclosure is not directly involved in the operation of the plant although it is necessary to provide protection to the plant from weather and other factors that can adversely affect the production with the plant. Tendency could be to vaguely describe the enclosure, or its fabrication may be simultaneously with the plant, but test of identity remains to decide the admissibility or restriction of credit. Examine, if the enclosure is 'passive' component in the working of the factory or an 'active' component.

Also refer the discussion under section 2(52) on the 'effect of affixation' whether it remains movable property or becomes immovable property and whether it promotes better enjoyment of the equipment or enhances value of land to which it is affixed/installed. This inquiry is necessary to test whether the bar on credit applies to equipment affixed/installed or is saved.

*(d) Goods and/or services involved in inward supplies for self-construction of immovable property*

Inward supply of goods and/or services for construction of an immovable property for 'own use' would also not be eligible for input tax credit. This restriction applies even when such immovable property is used in the course or in furtherance of business. Understanding the scope of 'immovable property' is very important. Immovable property is well understood to be land and building but it also includes everything that is attached to or forming part of the land and rights-in-land. Credit is blocked on all inward supplies leading to the establishment of such immovable property. Inward supply of services from real estate agent, architect, interior decorators and contractors are all blocked as these are involved in the establishment of the immovable property. But, if inward supplies such as security, house-keeping and property maintenance are used after construction, then such credits are not blocked as these are received after establishment of the immovable property. One needs to note the fine line that the law draws to prevent indiscriminate extension of this credit blockage beyond the purpose for which it is specified.

Factors to be considered for deciding whether the credits on costs associated with works contract or construction of immovable property are available or not:

(i) *If rent is charged separately for bare shell and the fitouts* – No credit could be availed in respect of inputs used in construction of bare shell whereas credit could be availed on fitouts and related material if they are separable from the construction materials and labour; Separable not by securing a pricing break-down from the supplier but identifiable as a distinct asset class involved in the construction project activity. Often it is seen that in order to fasten turnkey responsibility of supply and installation of equipment and installations, single contract is awarded. Articles that do not form an integral part or create the identity of the immovable property such as electronic installations including audio-video equipment may be included in the same contract but as a separable item of supply with its own price, tax and other terms. Apart from risk of being treated as a mixed supply, there is a potential for loss of credit. Fit-out is a generic expression that includes false roofing and cornice-work, sound-proof panelling, glass partitions, anti-static carpets, loose furniture in lobby and client reception areas, pantry infra with movable furniture and wash-area facilities. Here too, those assets that do not form an integral part or create the identity of the immovable property may be identified separately so that credit can be availed without being lost as an integral part of the interior decoration works which merges inseparably with the immovable property;

(ii) *Lease premium or lease rental for land on which immovable property is constructed* – It is common to take land on lease (on payment of one-time premium and / or recurring rental) for long-term (say) 10 years to 99 years. And then invest in the construction of a building for use as factory, warehouse or office. Rent paid for building is not affected by this clause (d) as the 'lease' of building is not barred under section 17(5). However, the lease of land needs to be carefully understood. On one hand, lease of land may be equated with lease of building and credit claimed, regardless of what the lease is for – building or land only. Unless agreed otherwise, building (that is put-up on that land) belongs to the landowner at the end of lease tenure because of ownership of land all things attached permanently to that land merges with the property in that land and cannot remain the property of the lessee after the end of lease tenure. This merger is due to the construction in a permanent manner and coalescing of the two properties – land apart from building – only at the end of lease (called determination of lease).

Now, in lease, there is an expression 'demise' which needs to be carefully understood. For example, if land is taken on lease and the lessee puts-up a temporary structure of tents and carries on his circus business, the lessee is liable to pay rent (for land) whether the circus is running or the tent-structures (God forbid) get destroyed in a fire accident.

This is because the 'demise' here is the land which continues to remain in the possession the lessee who may re-erect the tent-structures and restart the circus or terminate the lease and vacate the land. There is no third scenario possible and lease rentals will continue to accrue. Contrasted with another example, where the tent-structures are taken on lease from the landowner and if this tent-structure were to be destroyed by a fire accident, there is no rent payable as the demise here is 'tent-structures'. When there is no demise, there can be no tenancy and hence no lease rental payable.

In the case of land taken on lease (and building put-up by lessee), inquiry is required into the 'demise' in respect of which premium and or rentals are paid and then examine if the credit restriction is attracted or not. When parties contract in such a manner so as to themselves treat the land as being distinct from the building thereon, the 'demise' is the 'land alone' and not the 'land and building'. The question that arises is whether the building is where business is carried on or it is the land where the business is carried on. When these two, land and building thereon, have once been accepted as separate and distinct, their uses must also be gone into. And by these tests, building is where business is carried on and GST paid on lease rental for building is not restricted. But land is where the building is put-up and lease rental for land is to put-up (during the years of construction) and retain it there (for the remainder of the lease tenure). Having said that, land is the demise and it is separate from the building put-up on that land. Then, the end-use of land and end-use of building retain their separate identities and then stand the test of credit restriction under this clause.

Relatively simpler issues have been hotly contested in GST and this question is far-reaching and is not without forceful arguments. Reference may be made to the decision of the Orissa High Court in the case of *Safari Retreats Private Limited v. CC-CGST [WP(C) No. 20463 of 2018 vide Order dated April 17, 2019]* where input tax credit has been allowed in respect of GST paid on construction of immovable property that is meant for further lease by the owners. As these are the views of the High Court, in the absence of contradictory decisions of any other jurisdictional High Court or from SC, this decision will continue to have force. Care must be taken while relying on this decision as credit '*availed even if not utilized'* would attract interest at 24 per cent under GST. Considered decision may have to be taken as the quantum of credit may be quite large and so will be the consequences.

(iii) *Accounting treatment in the books* – Are the costs to be capitalized with the building or separately disclosed in the fixed asset register? In the case of separate capitalization credit would be available. Accounting treatment is a good alibi for claiming credit. If an item of expenditure is not permitted to be capitalized as property, plant and equipment (PPE), then the same cannot be treated by GST to be capital goods, whether creditable or not. Similarly, if any item of supply included in the turnkey contract is to be separated from the construction material and labour for putting up the immovable property for the reason that the items do not form an integral part or create the identity of the immovable property, support must be available in the manner of capitalization. If these items actually comprise an independent but simultaneous item supplied, then they would be capitalized separately as an independent asset class or group as it demonstrates characteristics of use, usefulness and useful life that is different from that of the immovable property. Although not impossible, contradictions in accounting treatment with that in GST for claiming credit may generally not be free from litigation. In fact, where there are such contradictions, more transparent explanations and notes may be prepared so as to allow tax authorities to consider if they concur with the uniqueness of the GST treatment.

(iv) *Things which cannot be retrieved without damage to the goods* –These are immovable and hence no credit. As to what is immovable property and what is movable property, the yardstick is no longer 'retrieve without damage' but 'purpose of affixation'. Refer to the detailed discussion on the definition of 'services' under section 2(102) where among other things, it has been explained that *"Based on the three limbs to the definition of 'attached to the earth' in section 3 of Transfer of Property Act, 1882, it appears that if the attachment (of equipment) is for beneficial enjoyment of the land (or building), then equipment becomes immovable property itself. But, if the attachment is for the beneficial enjoyment of the equipment then, equipment remains movable property. These principles were expounded in Subramaniam Chettiar v. Chidambaram Servai AIR 1940 Mad 527 which were reiterated in CCE vs. Solid and Correct Engineering Works (2010) 252 ELT 481 (SC)".*

(v) *HSN Code in the Bill* – If classified under the category of construction, then credit may not be available. There is a settled principle of law that incorrect classification by the supplier should not lead to denial if in the normal circumstances it would be eligible. There is no 'one fits all' rule that can be applied here. HSN may change when it passes the supplier's hands.

(vi) *Separate purchase order and invoice from the vendor to bifurcate between transactions on which one would avail credits and on transactions on which one would not avail credits*- Artificial bifurcation of otherwise inseparable works is not advised. It depends on the nature of the article supplied and the understanding of its installation will guide whether the two can be separated or not. If the parties are the same but operating under two separate documents (PO and Contract), it arouses suspicion. Further, suspicious are clauses where both components are taken together for computing advance, liquidation damages and recoveries and if there are 'cross-fall breach' clauses, then it becomes all the more worrisome.

(vii) *Accounting of transactions and assigning the Project / Cost Code*. Services may also be capitalized along with an asset class or asset group but that does not mean they cease to remain 'input services'.

*(e) Goods or services or both on which tax has been paid under Section 10*

Section 10(4) provides the conditions to be fulfilled for a person falling under composition scheme, with respect of input tax credit. One of the conditions states that a person opting for the composition scheme should not collect any tax from the recipient. As no taxes are paid by the recipient, no input tax credit can be availed by them either. For this reason, any tax paid by supplier under section 10 will be restricted by this clause under section 17(5).

Since, no tax has been charged by the supplier (opting for composition), this restriction may seem academic. But, not quite so, as section 10(4) authorizes the tax authorities not only to take action against erring composition taxpayers for collecting tax, section 17(5)(e) authorizes action against the recipient-taxpayers who may have taken credit of the same, even innocently.

*(f) Goods or services or both received by a non-resident taxable person except on goods imported by him*

A non-resident taxable person (NRTP) is a person who temporarily supplies any goods or services within India even though he is not a resident of the taxable territory. For such NRTPs, a restriction has been cast in respect of the goods or services or both received within India. In respect of the goods or services or both received within India, no input tax credit can be availed. However, he is free to avail the input tax credit of the goods imported from outside India.

Reference may be made to the discussion in the context of section 27 about casual taxable person compared to non-resident taxable person. Indian FDI regulations place a restriction on foreign companies entering India and undertaking 'business-like' activities without establishing a taxable enterprise. And income-tax law will impute a taxable presence in the form of a 'business connection' or 'permanent establishment' in India to subject the income of this presence to tax in India. Conclusions and compliances under income-tax and FDI will impact the conclusions in GST about casual taxable person v. NRTP and hence credit entitlements to each. Care must be taken not to apply clause (f) mechanically. Registration as NRTP may itself need to be examined carefully due to adverse credit consequence to NRTPs compared to casual taxable persons

*(g) Personal consumption*

Goods received by a registered person may be used for 'personal' consumption. It would be apposite to recollect para 4 of Schedule II which states two situations that are relevant for the present purposes, namely, (a) diversion from intended end-use in business and (b) private use of business assets (and the third situation is not relevant for the present discussion).

Business assets may or may not include inputs and capital goods on which input tax credit has been availed. The scope of para 4 of Schedule II is far wider than this clause (g). Presently, the concern is only in respect of 'personal' use which would be a sub-set of para 4 of Schedule II. Reason why it is considered to be a sub-set and not something else outside of Schedule II is because Schedule II completely and comprehensively covers all situations regarding the treatment to be extended to an actual supply or deemed supply by Schedule I.

All assets of an incorporeal taxpayer (any kind of legal entity) are used and consumed by employees or other natural persons. Clause (g) does not get attracted in all those situations to deny credit. The 'nature' of use or consumption must be examined. For example, a software engineer uses the computer provided by the company along with the workstation provided in an air-conditioned environment. None of these are personally consumed because all facilities provided are 'tools-of-trade' that the company must provide in order to avail the work and skill of the software engineer. Then it may seem like all inward supplies used or consumed may be justified in this manner. Not quite so and some criteria could be devised to differentiate – whether it is a means of performing their duties or the rewards after performing their duties – as personal consumption inherently yields no direct and proximate benefit to the company in making outward supplies.

Clause (g) should not be considered as a threat to claim credit if the inward supplies on which credit is being claimed are diligently availed. Section 16(1) permits credit on everything but with an 'end use' criteria – in the course or furtherance of business. Income-tax law also allows deduction in respect of expenses that are 'for earning income' in the business. But these two statutes have different objectives in this regard. Income-tax is determining the 'profit before tax' whereas GST is determining the 'credits in respect of outward supply'.

By this reasoning, it appears that clause (g) could be pressed into service when there is no 'nexus' between items in respect of which credit is availed and outward supplies. Care must be taken not to interpret the language of section 16(1) liberally and without check or limits. Clause (g) provides the check to see if the 'immediate and ultimate' use or consumption of any item is for personal benefit to the person (employee or director or any other person who can consume on behalf) or not. If the immediate benefit is for the said person but the ultimate benefit is for the supplier company, then credit would not be restricted by clause (g).

Inward supplies by company such as raw-material, capital goods including computers, air-conditioning, work areas, factory and office building taken on lease, flight tickets, hotel accommodation, etc. are creditable by the company even though they are for 'immediate' consumption by employees as they are for 'ultimate' benefit by company.

However, inward supplies such as video games, cinema or IPL tickets, theme-party organized, holiday package, etc., are 'unlikely' to be creditable by the company as they are for 'immediate and ultimate' consumption by employees only.

Then there would be an 'in-between' category where though it is 'immediate' consumption by employees, there may be a proportion of 'ultimate' benefit to the company. These cases, discretion must be exercised to identify admissibility of credits to the company. A perfect rule cannot be applied for all cases nor can credit be completely allowed. If the inward supplies are in the nature of 'tools-of-trade' which the employer makes available to the employees to use in order to discharge their duties, such inward supplies will not come within this exclusion. But if the inward supplies are not in this nature, credit will most likely come within this exclusion.

And for these reasons, income-tax rules of allowance/disallowance cannot be applied in GST as every expenditure 'by' the business is allowed in income-tax whereas those 'for' the business are admissible in GST. Refer the discussion under section 16(1) on (i) commencement of business and (ii) used in business, in respect of various expenses and the effect on credit.

Deemed supply to related party (especially employee) is attracted by Schedule I, para 2 even when no consideration is involved. Where employees are involved, gifts that are not remuneration for their employment services is a 'perquisite' above ₹ 50,000/- per annum and therefore comes within the exclusion by Schedule III, para 1. Where any other related persons are involved, care must be taken to examine whether there is a 'diversion of business assets' (not limited to fixed assets but all assets of the business even if it is not capitalized) are used for 'non-business purposes'. Where credit is availed and thereafter, they are 'diverted' care must be taken to address the 'treatment' prescribed in Schedule II, para 4(b). Although Schedule II does not itself define supply, it provides 'classification' whether the supplies are to be 'treated' (as goods or as services), existence of entries in Schedule II arouses questions about taxability of said transactions. Without the transaction, atleast in the opinion of lawmaker, its treatment would not be provided and conversely, existence of a treatment indicates (possible) taxability.

Whether such diversion of business assets is supply or not may be debated but attention must be drawn not only to (i) taxability of such diversion but also (ii) admissibility of credit on such inward supplies. If it is concluded that there is no supply involved in such diversion, then credit could easily come within the disqualification under 'personal consumption' and *vice versa*.

Further, every telephone call made from the office need not be justified as to its *'use in furtherance of business'*. Also, there is no requirement to admit personal element in telephone expenses (and all such inward supplies) without examining the (i) tools-of-trade and (ii) 'immediate and ultimate' benefit consideration discussed above. There is also no requirement to automatically consider all such inward supplies as being liable for reversal of an amount of 5 per cent (as item $D_2$ under rule 42). If there were compulsory element of 'personal consumption' in all such inward supplies then, the treatment of such expenditure in income-tax (in computation of income from business or profession) or its disclosure in CARO cannot be ignored. As all these different legislations are looking for the same 'assertion on facts' by the legal entity of which the registered person is an integral part.

Section 17(5) is given the title of an 'imperfect negative list' and it is deliberate so that there is room to accommodate *bona fide* cases where credit ought to be allowed as there is greater proportion of benefit ultimately flowing to the company. Courts will have final say in the matter that we need to learn from as things unfold.

*(h) Goods lost, stolen, destroyed, written off or disposed of by way of gift or free samples*

Consider an illustration where input 'A' is converted into output 'B' (both being goods) and a certain quantity of output 'B' that are produced but not yet supplied are destroyed by fire within the factory premises. Now, is GST payable on output 'B' or is it sufficient, if input tax credit taken on input 'A' is reversed? Destruction of a part of output 'B' does not satisfy the requirements of 'supply' and therefore, there is no question of payment of tax on the stock of 'B' that are destroyed by fire before they are supplied. This would not have been the case under Central Excise law (as Central Excise Duty was payable on manufacture) as those principles do not find place in GST law. Under the GST law, on destruction of stock of 'B', the only tax that remains to be paid is the proportionate credit availed on input 'A' because goods destroyed are 'A' only in the form of 'B'.

Credit was properly availed on 'A' and was even used properly in the course or furtherance of business in the production of 'B' which was subsequently destroyed before being supplied. This renders the credit availed of 'A' to fail the 'vesting condition subsequent' attached to validity of credit taken under section 16(1) being proper 'end use' of 'A'. Credit is not a 'vested right' at the time of receipt of inputs but only on satisfying all 'vesting conditions', including its participation in a taxable outward supply.

Note that while credit reversal discussed above applies to goods destroyed flows from the operation of a specific provision in section 17(5)(h), no such reversal because though inefficiently used, they are still used as accepted and agreed at the time of taking credit. by this clause [ refer discussion under section 19(3) where abnormal loss in the hands of job-worker will be deemed to be a supply in the hands of principal due to an express provision].

As the 'reasons' for reversal is specifically stated in clause (h), reversal is 'without any interest' consequence. If the credit was 'ineligible' and is reversed, that is ineligible *ab initio*. Such reversal is not the same as reversal due to change of circumstances contemplated in this clause (h) which is a current change requiring reversal.

Therefore, it becomes clear that the words 'in respect of' are not limited to the very articles that are disqualified from claim of input tax credit under this sub-section but also credits 'in respect of' goods or services linked to the disqualified articles are also liable to be disqualified.

Now, in order to discuss this clause (h), it may be appropriate to first describe the scope of the words listed here. A short description of each of the words given above is given below:

(a) LOST – When goods are missing, not traceable or inexplicable absence. The word 'lost' is not to be confused with 'loss'. Loss is explicable but nevertheless a 'loss' but certainly not 'lost'. Explicable loss is 'in-process' loss which may be normal loss. Explicable losses do not attract reversal of credit under clause (h) because the 'credit condition' accepted and agreed at the time of taking credit was that the said goods will be used. And when explicable in-process (normal) loss occurs, the fact that the said goods have been used is undeniable albeit inefficiently for failing to generate produce output.

Lost, on the other hand, is a clear indication due to the inexplicable nature of this situation that the said goods are not used as accepted and agreed. As such, 'lost' attracts reversal of credit but not 'loss'. Explicable means explainable and being able to explain the reasons for the loss does not include any loss due to "not using" the said goods. As additional notes, it merits to mention that full credit may be taken and retained and even utilized in case of goods which are involved in explicable in-process loss, whether normal or abnormal. [The exception is when abnormal loss occurs in the hands of job-worker. Refer detailed discussion in the context of deemed supply by principal under section 19(3)].

With regard to in-process loss of inputs a very interesting decision may be found in *Ashok Leyland Ltd v. CCE, Nagpur [(2004) 169 ELT 131 (Tri.Mumbai)].*

(b) STOLEN – When any goods are found to be less upon physical verification, it may be considered as stolen. This will require reversal of any input tax credit taken earlier. Stolen goods may or may not be covered by insurance. As such, 'insurable interest' in case of goods (inventory or assets) on which GST credit is claimed ought not to be at the carried value in the book as per AS2/AS10 or IndAS2/IndAS16 but value as per "*balance sheet plus GST credit availed*".

(c) DESTROYED – Any goods which get destructed due to any natural calamity like flood, earthquake or a manmade event like fire, water leakage etc. If the goods reach to a certain level of destruction that it cannot be possibly reversed, then this clause gets attracted. Destroyed is not an expression that is used to refer to normal wear and tear or normal ageing deterioration. Destroyed leans towards a 'sudden occurrence', whether it could have been avoided or not, the outcome is relevant and not the reason for this occurrence. It's not an accounting treatment but a fact to be observed or verified.

(d) WRITTEN OFF – If any goods are having a certain value as per the books of accounts but are completely written off due to any reason, this clause will get attracted. This can include goods getting written off due to obsolescence or lapse of time. But 'write-off' must be differentiated from (a) 'write-down', which is a temporary and sometimes reversible accounting treatment in order to more accurately report the carried value of property, plant and equipment under AS 28 or Ind AS 36 and (b) 'charge-off' by claiming 100 per cent depreciation in respect of assets costing below a certain value per unit. Both these instances are not covered by this clause (h). However, due to poor understanding of the differences in each of these words, there may be some misapplication of the provision. Once the time to claim credit in section 16(4) has passed, the reversal will be irreversible even if done under misinformation.

(e) DISPOSED-OFF by way of gift or free samples– Any goods which are disposed through these two mechanisms will be covered here. Key words to note are:

   (a) 'disposed' which is a word that appears in three key places in GST law (all other places it is used are in the context of 'disposal of an application or appeal', it is used 11 times in CGST Act). And they are (i) section 7(1)(a), (ii) para 1, Schedule I and (c) this clause (h). The expression 'disposed' is not used as a synonym of 'sale'. Disposed is akin to discard or get-rid-off or clear away and implies articles that are 'unfit for sale'. The expression 'sale' always implies an assurance of merchantability even if it is offered at a deep discount due to change in trends or end of season, etc. Also, articles are 'unfit for sale' not only when their quality is unsuited (as per law, if any, and as per trade understanding) but also in presentation, quality or quantity, such that it is not suited for effective use. For e.g., tester perfume in 5 ml bottles, shampoo in 10 ml sachets, etc., indicate lack of fitness for sale although the products may be of standard quality but are presented in non-standard quantity that they are 'unfit for use' as they are intended.

   (b) 'By way of' is an expression that refers to 'the way of doing something'. It is not used for 'such as' or 'namely'. Hence, 'disposed off by way of' means 'gift or free sample' are the 'ways' in which goods that are 'unfit' are given away. Given that 'disposed' is one of the forms of 'supply', care must be taken not to reverse credit when in fact, output tax should have been on the outward supply. Any error in this understanding could result in losing the reversed credit (after time lapse) and output tax still being demanded.

Now, 'gift' and 'free sample' may be understood not in isolation but in the context of 'disposal' and these being the 'ways' in which such disposal is taking place. This understanding clears any confusion about gift and free sample of articles of 'merchantable quality'. Gift is a form of transfer if it is irrevocable and hence it is supply. Free sample indicates delivery of goods for use or consumption on non-contractual basis. Articles put-up for distribution are 'unfit for sale'. Not that these articles are sub-standard or even harmful, but they are not in commercial quantity or presentation. For example, perfumes are presented in tester bottles which are very small pinch sized only to enthuse customers to 'use without buying' or shampoo presented in sachets and inserted inside magazines which are of insufficient quantity to satisfy actual bathing use but sufficient for customer to 'use without buying'. 'Lacking merchantability' means any aspect of merchantability that is absent, and quality is only one aspect and others are quantity, etc. When such articles 'lacking merchantability' are given away, that amounts to *"disposal 'by way of' gift or free sample"*. Care must be taken not to gloss over the words "by way of" which greatly affects our conclusions.

But where the articles are 'fit for sale' and delivered (even without consideration) it will be deemed supply under para 1 of Schedule I. Refer detailed discussion of this deemed supply under Schedule I.

Where credit is availed on goods that are 'disposed of', then para 1 of Schedule I is attracted due to the words *"….disposal of business assets where input tax credit has been availed on such assets"*. Once credit is reversed on account of the fact that the said goods are 'disposed off' then, there cannot be a second demand for tax by deeming fiction flowing from Schedule I when the said goods are taken out on account of disposal.

Some examples of goods 'not meant for supply' are as follows:

- Drug samples marked 'Physician's sample not to be sold'
- As per the Legal Metrology (Packaged Commodity) Rules, 2011 sale of packaged commodities by a manufacturer, importer or wholesale dealer to an Industrial consumer shall have the declaration 'Not for retail sale'.

Some experts argue that nothing done in business is free and therefore credit reversal would not always be sufficient compliance as even this activity is in the course and furtherance of business. This matter may also be tested in times to come. Reference may be made to discussion on various examples in the context of valuation under section 15 of 'free supplies' which may actually be for consideration that is in non-monetary form.

*Implications under GST in case of expired medicines*:

In case of pharmaceutical industry, the medicines carry expiry date and it is the duty of the manufacturer to destroy the unsold medicines on the date of expiry. Accordingly, the manufacturer collects such unsold expired medicines from various levels in the supply chain and destroys the expired medicine based on the provisions of the Drugs and Cosmetics Act, 1940. It would be relevant to note that the manufacturer compensates the supply chain for loss due to expired medicine. *Circular 72/46/2018-GST dated 26.10.2018* has been issued to highlight the implications under GST on such expired medicine. These implications have been discussed below by way of an example

Assumption

- Medicine purchased / imported at ₹ 100 and GST paid ₹ 5
- Medicine sold to Distributor at ₹ 1000 and GST charged ₹ 100

| *Scenario* | *Clarification Issued – Options* | *Implications* |
|---|---|---|
| Original Sale 2017-18 (till March 31, 2018)<br><br>Expired stock returned<br>By September 30, 2018 | OPTION 1<br>1. Seller to issue credit note to distributor for ₹ 1000 + 100<br>2. Distributor to reverse credit of ₹ 100<br>3. Seller to reverse credit of ₹ 5 (GST paid on procurement) | Seller to receive expired stock under credit note route (option 1) and thereby restrict credit reversal to the tax paid on procurement |
| | OPTION 2<br>1. Distributor to issue Invoice for ₹ 1000 + 100<br>2. Seller to avail credit of the same.<br>On destruction of goods, seller to reverse credit of ₹ 100 (GST paid on return supply) | |
| Original Sale<br>2017-18 (till March 31, 2018)<br><br>Expired stock returned<br>after September 30, 2018 | OPTION 1<br>1. Seller to issue credit note to distributor for ₹ 1000 + ₹ **0**<br>2. Credit availed by distributor may be affected due to non-payment of consideration for the inward supply and return of stocks. However, distributor would claim compensation of ₹ **100** credit lost by him which may be a separate | Option 1 leads to reversal of credit of ₹ 105 whereas Option 2 leads to reversal of credit of ₹ 100.<br>Effectively, the seller (importer) is required to reverse credit on the selling price which can be a substantial amount. |

| | | |
|---|---|---|
| | taxable supply of 'tolerating and act' (of breach by seller).<br>3. Seller to reverse credit of ₹ 5 (GST paid on procurement) | This needs to be examined specifically in terms of section 18 of the Drugs and Cosmetics Act, 1940 which prohibits sale of expired stock |
| | OPTION 2<br>1. Distributor to issue Invoice for ₹ 1000 + 100<br>2. Seller to avail credit of the same<br>3. On destruction of goods, seller to reverse credit of ₹ 100 (GST paid on sales) | |

It is a wonder how 'expired medicines' can at all enjoy the same HSN as 'medicines'. Surely, something has occurred that brings about this categorization as 'expired'. And when HSN cannot remain the same, inquiry is required into what is the 'object of supply'. Question to inquire is whether they are some other goods or when it is not goods of any kind, whether this repayment of original billed value is therefore a service (in GST terms). It all depends on the contractual arrangement between the parties to see *'who bears the financial risk of expired drugs'*. And this issue is common in all other sectors and there cannot be a 'one-fits-all' rule but in sectors like pharma or food products, there is some limits to contractual liberty that is set by the governing law.

*Circular no. 105/24/2019-GST dated 28.06.2019* (now rescinded) had expressed certain views from Indian Contract Act that was not well received by trade, not so much of the principles brought out, but the delay in issuing such a circular as nearly two-years of business practices had gone in one way. Nothing new was said in this circular because it stated only certain 'application points' from the Contract law. And this circular was withdrawn by GST Council in its 37th meeting and very interestingly *ab initio*. Generally, when circulars were withdrawn under the central excise law, the withdrawal would be 'with reasons' such as, Court ruling to the contrary or change of law or change of thinking by CBEC (as it then was called). By withdrawing *in silentio,* more room seems to be left for the 'application points' brought out in this (now non-existent) circular to be tested in Courts. Experts advise great caution while writing up 'returns policy' in GST regime to consider the risks involved in ignoring these application points which may still be applied to issue notices without citing this circular (non-existent) but by adopting the application points contained in it.

*(i) Any taxes paid in accordance with the provisions of sections 74, 129 and 130*

Section 74 talks about payment of taxes in a situation where taxes are not paid or short paid or erroneously refunded or input tax credit wrongly availed or utilized by reason of *"fraud or willful misstatement or suppression of facts".* If the supplier is making payment of taxes under forward charge due to the aforesaid reasons, no input tax credit will be available to the recipient. In case of reverse charge, if the recipient is making payment of taxes under this section, even the recipient will not be allowed to avail input tax credit.

Section 129 talks about detention, seizure and release of goods and conveyance in transit. Further, section 130 mentions about confiscation of goods and/or conveyance or redemption fine and levy of penalty under other provisions of the Act. In both the cases if any payment is made by any person under these sections, no input tax credit in respect of these will be available.

Through this point, input tax credit is proposed to be blocked wherever *mens rea* is proven/accepted. In such cases, since taxes had not been paid earlier due to any fraudulent intent, no input tax credit is allowed by the law. But the question that comes up, say, in case of reverse charge demanded under section 74, is whether the registered person should claim the tax paid or not, because the question of 'fraud, etc.' will be decided by Tribunal/Court and the time-limit under section 16(4) will encourage registered person to claim credit on payment. Consider a registered person who forfeits credit on the basis of the SCN being under section 74 and later it turns out the Tribunal/Court confirmed demand but sets aside extended period. In other words, as per section 75(2), if 'fraud, etc.' alleged in a notice issued under 74 is not established then the same notice 'will be deemed' to be notice under section 73. In this case, credit was eligible by the registered person but was misguided by the fact that SCN was issued under 74. Great care and attention must be paid even to admit and pay tax demanded due to the direct and indirect implications under this clause (i).

### 17.3 Comparative Review

| *Aspect* | *Credit under old regime* | *Input tax credit under GST regime* |
|---|---|---|
| Proportionate credit | No explicit distinction made between goods or services used for business and non-business | Specific distinction made between goods or services used for business and non-business |
| Works contract credit | Restriction on inputs only | Credit allowed when used for further supply of works contract |
| Credit on inputs used for construction of immovable property | Input or input service used for civil construction not eligible. | Restriction on both inputs and input services. |
| Credit related to works contract and construction w.r.t plant and machinery | Plant and machinery not excluded from restriction of credit | Plant and machinery is excluded from restriction of credit unless depreciation has been claimed on the tax component. |

### 17.4 FAQs

Q1. Where goods or services or both are used for taxable and non-taxable supplies, what would be the input tax credit entitlement for a registered person?

Ans. The input tax credit on goods or services or both used in respect of taxable supplies can only be availed by the registered person

Q2. Whether the taxable supply would include supplies on which tax is payable by recipient on reverse charge basis?

Ans. No.

### 17.5 MCQs

Q1. Which of the following is included for computation of taxable supplies for the purpose of availing credit?

(a) Zero-rated supplies

(b) Exempt supplies

(c) Both

(d) None of the above

Ans. (a) Zero Rated supplies

**Statutory Provisions**

**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 the 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, 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 stock and inputs contained in semi-finished or finished goods held in stock relatable 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 provision for transfer of liabilities, the said registered person shall be allowed to transfer the input tax credit which remains unutilized 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 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 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.*

**Extract of the CGST Rules**

**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) [51][the registered person shall within a period of thirty days from the date of becoming eligible to avail the input tax credit under sub-section (1) of section 18, or within such further period as may be extended by the Commissioner by a notification in this behalf, 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:*

*Provided that any extension of the time limit notified by the Commissioner of State tax or the Commissioner of Union Territory tax shall be deemed to be notified by the Commissioner].*

*(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;*

[51] Substituted *vide Notf No. 22/2017 – CT dt.17-08-2017* w.e.f. 01.07.2017

*(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 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***

*(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.*

[52]*[Explanation: - For the purpose of this sub-rule, it is hereby clarified that the "value of assets" means the value of the entire assets of the business, whether or not input tax credit has been availed thereon.]*

*(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 ITC02 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.*

[52] Inserted *vide Notf No. 16/2019-CT dt. 29.03.2019*

***[53][41A. Transfer of credit on obtaining separate registration for multiple places of business within a State or Union Territory***

*(1) A registered person who has obtained separate registration for multiple places of business in accordance with the provisions of rule 11 and who intends to transfer, either wholly or partly, the unutilised input tax credit lying in his electronic credit ledger to any or all of the newly registered place of business, shall furnish within a period of thirty days from obtaining such separate registrations, the details in Form* ***GST ITC-02A*** *electronically on the common portal, either directly or through a Facilitation Centre notified in this behalf by the Commissioner:*

*Provided that the input tax credit shall be transferred to the newly registered entities in the ratio of the value of assets held by them at the time of registration.*

*Explanation. - For the purposes of this sub-rule, it is hereby clarified that the 'value of assets' means the value of the entire assets of the business whether or not input tax credit has been availed thereon.*

*(2)* The newly registered person (transferee) shall, on the common portal, accept the details so furnished by the registered person (transferor) and, upon such acceptance, the unutilised input tax credit specified in Form GST ITC-02A shall be credited to his electronic credit ledger].

***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*

[53] Inserted *vide Notf No. 03/2019-CT dt. 29.01.2019 w.e.f. 01.02.2019*

*(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 subsection (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.*

**Related Provisions of the Statute**

| ***Section or Rule*** | ***Description*** |
|---|---|
| Section 2(19) | Definition of 'Capital goods' |
| Section 2(59) | Definition of 'Input' |
| Section 2(60) | Definition of 'Input service' |
| Section 25 | Procedure for registration |
| Section 9 | Levy and collection |
| Section 10 | Composition levy |
| Rule 40 | Manner of claiming credit in special circumstances |
| Rule 44 | Manner of reversal of credit under special circumstances |

### 18.1 Introduction

Input tax credit is normally available to a registered person who engages in providing taxable outward supplies and such person not being a composition taxpayer. However, in certain cases, credit would be available on inputs held in stock, inputs contained in semi-finished and finished goods and on capital goods even though the supplier was unregistered or engaged in exempt supplies or was under the composition scheme on the date of procurement of such goods or services. Conversely, instances where input tax credit legitimately availed needs to be reversed has also been dealt with in this section.

### 18.2 Analysis

*Eligibility of input tax credit on inputs held in stock and contained in semi-finished and finished goods held in stock:* The credit on inputs held in stock and inputs contained in semi-finished goods and finished goods held in stock is available in the following manner:

| *Supplier* | *Inputs* | *Input Services* | *Capital Goods* | *Stock to be considered as on* |
|---|---|---|---|---|
| Liable for registration (crosses the prescribed threshold limit) – Applies for registration within 30 days of becoming liable for registration and obtains registration | Available | Not Available | Not Available | Day immediately preceding the date from which he becomes liable to pay tax |
| Voluntary Registration | Available | Not available | Not available | Day immediately preceding the date of grant of registration |
| Composition scheme to regular scheme | Available | Not available | Available | Day immediately preceding the date from which supplier is liable to pay tax under regular scheme |
| Exempt supplies become taxable | Available | Not available | Available* | Day immediately preceding the date from which exempt supplies become taxable |

* Only for capital goods previously used exclusively in making exempt supplies.

- Credit on inputs includes inputs and inputs contained in semi-finished and finished goods. Credit on input services is not available under any circumstance.
- Declaration in **Form GST ITC-01** must be filed within thirty days from the date of becoming eligible to input tax credit. Rule 40 of the CGST Rules requires a declaration to be filed containing details of stocks and capital goods along with a certificate from a

practicing Chartered Accountant or Cost Accountant where the aggregate credit of CGST, SGST/UTGST and IGST so claimed exceeds ₹ 2 lakhs.

- The supplier would not be entitled to credit of goods or services or both after expiry of one year from date of issue of tax invoice (this restriction applies even to capital goods though this may not have been the intention).
- Credit on capital goods shall be reduced by five percentage per quarter or part thereof from the date of invoice.
- Credits are subject to verification of details furnished by the supplier in **Form GSTR-1** or **Form GSTR–4** on the common portal only in case of conversion from composition to regular scheme or when exempt supplies become taxable supplies. Verification is not possible for new registration cases as the supplier was unregistered at the time of procurement.

*NOTE:*

*In case exempt supply becomes taxable:* There is no saving clause in the event the taxable person entertained a *bona fide* belief as to the non-taxability of certain supplies or availability of an exemption which is later overturned by a superior Court and the demand crystallizes. In this scenario, limitation of taking of input tax credit lands a double blow on this taxable person. That is, not only would GST have been paid on inputs, input services and capital goods on which no credit would have been availed (due to this *bona fide* view having been entertained) but also, the full extent of the output tax becomes payable (without any relief towards credit that would otherwise have been available) due to the decision of the superior Court. One needs to exercise caution while entertaining a view about non-taxability or exemption. At the same time, it is not permitted to take a hyper-conservative view – where even with the availability of a clear and absolute exemption, the taxable person chooses to pay GST in order to protect credit from the limitation. This option cannot be taken in view of the mandatory nature of such exemptions as clearly stated in explanation to section 11. It could lead to denial of credits as the supply was not taxable.

Examples:

(i) A person becomes liable to pay tax on 1st August 2021 and has obtained registration on 15th August 2021. Such person is eligible for input tax credit on inputs held in stock as on 31st July 2021.

(ii) A applies for voluntary registration on 5th August 2021 and obtained registration on 22nd August 2021. A is eligible for input tax credit on inputs in stock as on 21st August 2021.

(iii) B, a registered person was paying tax under composition rate upto 30th August 2021. However, w.e.f. 31st August 2021, B becomes liable to pay tax under regular scheme. B is eligible for input tax credit on inputs held in stock as on closure of business hours on 30th August 2021.

***Illustration (Rule 40): Manner of claiming credit in special circumstances***

Akshay Steels Limited is a manufacturer of iron and steel. It procures raw materials and inputs such as iron ore, chemicals, gases, etc. and capital goods including plant and machinery, for the manufacture of such iron and steel. In this example, it has been assumed that iron and steel (which is the outward supply of Akshay Steels Ltd) is exempt from payment of taxes until 31-Mar-2021. Iron and steel became taxable with effect from 01-April 2021. The method of taking of input tax credits on inputs contained in stock and capital goods as on 31-Mar-2021 is covered by this illustration

| *Particulars* | *Amount (₹)* |
|---|---|
| Value of inputs in stock on 31-March-2021 | 1,00,000 |
| IGST @18% | 18,000 |
| *All inputs were procured after 01-Jul-2020* | |
| Value of inputs contained in semi-finished goods held in stock on 31-March 2021 | 4,00,000 |
| CGST @ 6% | 24,000 |
| SGST @ 6% | 24,000 |
| *All inputs contained in semi-finished goods were procured after 01-May-2020* | |
| Value of inputs contained in finished goods held in stock on 31-March 2021 | 50,000 |
| CGST @ 6% | 3,000 |
| SGST @ 6% | 3,000 |
| *Only inputs worth ₹40,000 in finished goods were procured after 01-April 2020* | |
| Capital Goods procured *vide* invoice dated 22.01.2021 | 20,00,000 |
| IGST paid @ 18% | 3,60,000 |
| *Credit available in respect of inputs:* | |
| CGST *(Note 1)* | 26,400 |
| SGST *(Note 2)* | 26,400 |
| IGST *(Note 3)* | 18,000 |
| Total credit available on inputs | **70,800** |
| Value of capital goods used exclusively in relation to exempted goods held on | |

| | |
|---|---|
| 31-March 2021 | 20,00,000 |
| IGST @ 18% | 3,60,000 |
| *Credit available in respect of capital goods:* | |
| Date of invoice of capital goods | 22-Jan-2021 |
| Date from which the exempt goods become taxable | 01-Apr-2021 |
| No. of quarters from date of invoice | 1 |
| Percentage points to be reduced (5% per quarter) (Note 4) | 5% |
| IGST paid on the capital goods used exclusively in relation to goods exempted up to 31-Mar-2020 | 3,60,000 |
| ITC to be reduced by 5% | (18,000) |
| Credit (IGST) available on capital goods | **3,42,000** |

***Working notes:***

*Note 1:* CGST credits on inputs in stock held on 31-March 2021:

| | | | |
|---|---|---|---|
| a | ITC on the value of inputs | | |
| b | ITC on the value of inputs contained in semi-finished goods: All inputs were acquired within 1 year prior to the effective date on which the goods become taxable. Hence, entire ITC would be allowed. | 24,000 | |
| c | ITC on the value of inputs contained in finished goods: Out of the total stock of ₹ 50,000/-, inputs totalling to ₹ 10,000/- are older than 1 year from the effective date on which the goods become taxable. Therefore, ITC to this extent stands disallowed. ITC on inputs contained in stock of ₹ 40,000 would be eligible. [Eligible credit = 40,000 * 6%] | 2,400 | |
| | CGST CREDIT AVAILABLE ON INPUTS | | **26,400** |

*Note 2:* SGST credits on inputs in stock held on 31-March-2021:

| | | | |
|---|---|---|---|
| a | ITC on the value of inputs | | |
| b | ITC on the value of inputs contained in semi-finished goods: *Refer Note 1* | 24,000 | |
| c | ITC on the value of inputs contained in finished goods: *Refer Note 1* | 2,400 | |
| | SGST CREDIT AVAILABLE ON INPUTS | | **26,400** |

*Note 3:* IGST credits on inputs on stock held on 31-March 2021:

| | | | |
|---|---|---|---|
| a | ITC on the value of inputs: All inputs were acquired within 1 year prior to the effective date on which the goods become taxable. Hence, entire ITC would be allowed. | 18,000 | |
| b | Input tax credit on the value of inputs contained in semi-finished goods | - | |
| c | Input tax credit on the value of inputs contained in finished goods | - | |
| | IGST CREDIT AVAILABLE ON INPUTS | | **18,000** |

*Note 4:* Rule 40(1)(a) of the CGST Rules provides that input tax credit on capital goods can be claimed after reducing 5% per quarter of a year or part thereof, from the date of invoice in respect of which capital goods are received. Therefore, the number of quarters is 1, being the first quarter of the year 2021.The reversal of credit would therefore be, to the extent of₹ 18000 (5% of ₹ 3,60,000).

Section 18(4) mandates credit reversal when a registered person switches from regular scheme to composition scheme or goods and services supplied by him become wholly exempt:

- Pay an amount by debiting electronic cash ledger / credit ledger, equivalent to input tax credit of -
  - Inputs held in stock
  - Inputs contained in semi-finished or finished goods held in stock and
  - Capital goods
- On the day immediately preceding the date of such switch over/ date of exemption.
- Balance of input tax credit lying in the electronic credit ledger, after payment of the above said amount, shall lapse.
- Such amount is calculated in the manner to be prescribed under rule 44 of the CGST Rules, accordingly-
  - The amount of ITC relating to inputs held in stock, inputs contained in semi-finished and finished goods held in stock shall be reversed proportionately on the basis of the corresponding invoices on which credit had been availed by the registered taxable person on such inputs. If invoices are not available, ITC can be reversed on the basis of the prevailing market price of the goods on the effective date of switch over/ date of exemption. The details furnished on the basis of the prevailing market value shall be duly certified by a practicing Chartered Accountant or Cost Accountant.
  - ITC involved in the remaining useful life (in months) of capital goods is reversed on *pro rata* basis, taking the useful life as five years.

- ITC to be reversed on inputs and capital goods is calculated separately for ITC of CGST, SGST/ UTGST and IGST
- Reversed amount is added to the output tax liability of the registered person.

PAY AND EXIT SCHEME:

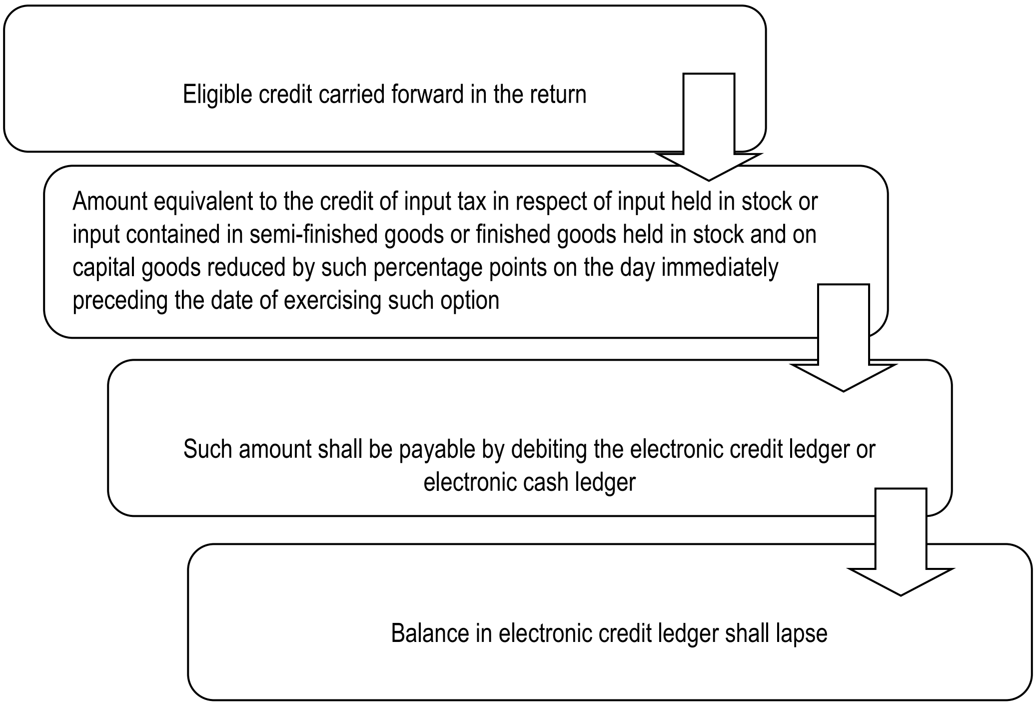



***Illustration 1: Where input tax credit lapses***

| *Sl. No* | *Particulars* | *Reference* | *Amount* |
|---|---|---|---|
| 1 | Value of capital goods | | 1,00,000 |
| | IGST @ 12% | A | 12,000 |
| | Invoice Value | | 1,12,000 |
| 2 | Date of shift to composition scheme | | 01 April 2021<br>(Can be opted in Financial year beginning) |
| 3 | Date of inward supply and use of capital goods | | 02 September 2019 |

| | | | |
|---|---|---|---|
| 4 | Period of use (days) | | 577 |
| | Period of use (months) | | 19 |
| 5 | Residual life in months | B | 41 |
| | (Considering full life as 5 years) | | |
| 6 | ITC attributable to residual life | C = (A*B/60) | 8,200 |
| | (To be added to the output tax liability of the registered person) | | |
| 5 | Balance of ITC as on 31.03.2021 | | 10,000 |
| 6 | ITC utilized for capital goods for residual life | | 8,200 |
| 7 | Balance ITC - would lapse | | 1,800 |

***Illustration 2: Where input tax credit becomes payable***

| *Sl. No* | *Particulars* | *Reference* | *Amount* |
|---|---|---|---|
| 1 | Value of capital goods | | 1,00,000 |
| | IGST @ 12% | A | 12,000 |
| | Invoice Value | | 1,12,000 |
| 2 | Date of shift to composition scheme | | 1st April 2021 |
| 3 | Date of inward supply and use of capital goods | | 2nd September 2019 |
| 4 | Period of use (days) | | 577 |
| | Period of use (months) | | 19 |
| 5 | Residual life in months | B | 41 |
| | (Considering full life as 5 years) | | |
| 6 | ITC attributable to residual life | C = (A*B/60) | 8,200 |
| | (To be added to the output tax liability of the registered person) | | |
| 5 | Balance of ITC as on 31.03.2021 | | 1,500 |
| 6 | ITC utilized for capital goods for residual life | | 8,200 |
| 7 | Balance tax payable | | 6,700 |

***Illustration 3: Where no payment is required***

| *Sl. No* | *Particulars* | *Reference* | *Amount* |
|---|---|---|---|
| 1 | Value of capital goods | | 1,00,000 |
| | IGST @ 12% | A | 12,000 |
| | Invoice Value | | 1,12,000 |
| 2 | Date of shift to composition scheme | | 1st April, 2023 |
| 3 | Date of inward supply and use of capital goods | | 01 September 2017 |
| 4 | Period of use (months) | | 67 |
| | Period of use (years) | | 5 years 7 months |
| 5 | Residual life in months | B | - |
| | (Considering full life as 5 years) | | |
| 6 | ITC attributable to residual life | C = (A*B/60) | 0 |
| | (No payment required) | | |

***Input tax credit and change in constitution of registered person***

The change in constitution of registered person due to sale, merger, demerger, amalgamation, lease or transfer or change in the ownership of business including transfer of liabilities provides for the following:

(i) The registered person is allowed to transfer the input tax credit remaining unutilized in the electronic credit ledger .to such sold, merged, demerged, amalgamated, leased or transferred business.

(ii) Rule 41 prescribes such credit transfer be made on the common portal in **Form GST ITC-02** and in case of demerger, credit to be transferred must be apportioned in the ratio of the value of assets of the new units as specified in demerger scheme. “Value of the assets” has been explained in the said rule to mean the value of the entire assets of the business whether or not input tax credit has been availed on them.

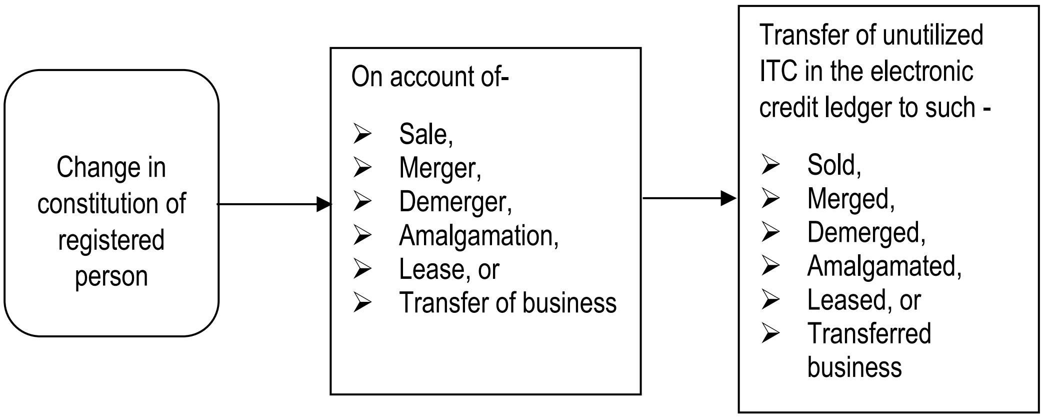
(iii) A practicing Chartered Accountant or Cost Accountant to certify that the arrangement contains a specific provision for the transfer of liabilities.

(iv) Details furnished in **Form GST ITC-02** by the transferor would have to be accepted by the transferee on the common portal. Refer to the discussion on registration in case of such arrangements to examine the timing of seeking registration by the transferee.

(v) The transferee to duly account for the inputs and capital goods received in the books of accounts.

The analysis of the above provision is presented in the following flowchart:

**ITC: CHANGE IN CONSTITUTION OF REGISTERED PERSON**




*Note:* It is pertinent to mention here that the Board *vide Circular No. 96/15/2019-GST, dated 28-3-2019* clarified issues in respect of transfer of input tax credit in case of death of sole proprietor.

Also, Clarification in respect of apportionment of input tax credit (ITC) in cases of business reorganization under section 18(3) of CGST Act read with rule 41(1) of CGST Rules has been provided by the Board *vide C.B.I. & C. Circular No. 133/03/2020-GST, dated 23-3-2020*

***Transfer of credit on obtaining separate registration for multiple places of business within a State (Rule 41A)***

If a registered person wishes to obtain separate registration for multiple places of business in a State, the law provides the mechanism for transfer of unutilized input tax credit lying in the electronic credit ledger to any or all new registrations within 30 days from obtaining such separate registrations. For this purpose, the registered unit needs to submit **Form GST ITC-02A** on the common portal. Such **Form ITC-02A** is to be accepted by the newly registered person on the common portal. Upon such acceptance, the input tax credit is transferred to these newly registered persons.

As regards the proportion of the input tax credit to be transferred, it has been provided that the transfer of input tax credit is to be divided in the ratio of the value of assets held by these persons at the time of registration. Such value of assets is to be taken as the value of the entire assets of the business whether or not input tax credit has been availed on them.

**Supply of capital goods on which input tax credit has been taken**

The registered person shall pay an amount equal to the higher of:

- input tax credit taken on such capital goods as reduced by such prescribed percentage points or
- the tax on the transaction value of such capital goods,

*Note:*

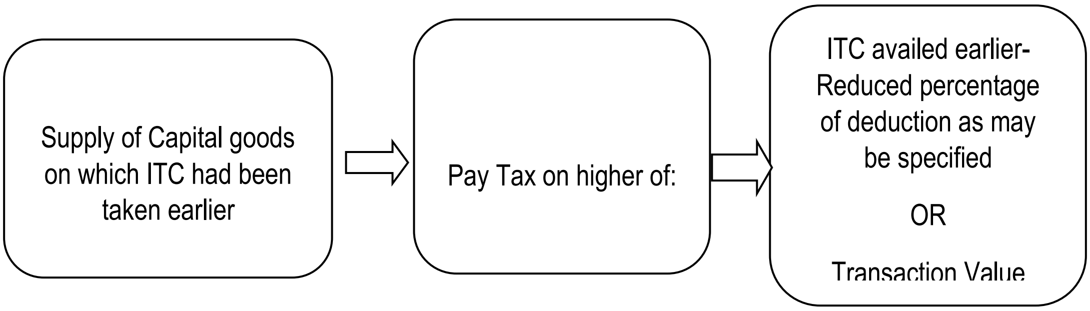
One striking difference becomes evident in Rule 40 in the manner of computation of ITC in respect of used capital goods under clause (a) of sub rule (1) and sub rule (2). While rule (1)(a) deals with input tax credit on capital goods after reducing tax paid on such capital goods by five percentage points *per quarter of a year or part thereof*, rule 40(2) specifies computation of input tax credit by reducing the input tax credit on capital goods at a rate of "five percentage points *for every quarter or part thereof* from the date of the issue of the invoice". Thereby ITC pertaining to remaining useful life of capital goods (in quarters*) is to be considered

From the above we may come to the following conclusion:

- For the purpose of clause (a) of sub-rule (1), 'quarter' shall mean a 'calendar quarter'
- For the purpose of sub-rule (2), the quarter shall be computed from the date on the invoice.

  For example: Capital goods purchased on 25th March 2021 would be reduced by 5 percentage points for the quarter ending March 2021 for the purpose of clause (a) sub-rule (1) while the same assets would be reduced by 5 percentage points for the period between 25.03.2021 to 24.06.2021 and so on in case of sub rule (2).

**SUPPLY OF CAPITAL GOODS ON WHICH ITC IS ALREADY TAKEN**




***Refractory bricks, moulds and dies, jigs and fixtures are supplied as scrap***

The taxable person may pay tax on transaction value under section 15.

- Note- As per Rule 44(6) ITC involved in the remaining useful life (in months) of capital goods is reversed on *pro rata* basis, taking the useful life as five years.

### 18.3 Issues and Concerns

Applicability of section 18(6) is also a concern due to the practice of adopting 'useful life' of assets (being capital goods under GST) of less than 60 months. In such cases, experts are of the view that where full depreciation is claimed within, say, 36 months, it may be treated that the said capital goods have been 'written-off' (by the end of 36 months) so as to attract reversal of credit relatable to balance of 24 months (60 minus 36 months) in terms of section 17(5)(h).

Whether this view is far-fetched or not, it is advisable to (a) depreciate 95% of the cost and carry

5% as long as the said capital goods remain in use or (b) report every year after 36th month that the said capital goods although fully depreciated are 'still in use and possession' of the registered person. These steps could overcome the concerns expressed.

### 18.4 Comparative review

| *Aspect* | *Credit under old regime* | *Input tax credit under GST regime* |
|---|---|---|
| Credit on stock-in-hand | Rule 3(2) of CENVAT Credit Rules, 2004 | Specified persons in specified situations are eligible for input tax credit on stock |
| Credit on sale merger or transfer of business | Rule 10 of CENVAT Credit Rules, 2004 | Specific section covering sale, merger etc |
| Reversal on goods becoming exempt | Rule 11(3) of CENVAT Credit, 2004 | To be reversed as per section 18(4) |

**Statutory Provisions**

**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:*

*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*

**Extract of the CGST Rules**

***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, [54][and where the goods are sent from one job worker to another job worker, the challan may be issued either by the principal or the job worker sending the goods to another job worker:*

*Provided that the challan issued by the principal may be endorsed by the job worker, indicating therein the quantity and description of goods where the goods are sent by one job worker to another or are returned to the principal:*

*Provided further that the challan endorsed by the job worker may be further endorsed by another job worker, indicating therein the quantity and description of goods where the goods are sent by one job worker to another or are returned to the principal]*

*(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 [55][~~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 [56][or within such further period as may be extended by the Commissioner by a notification in this behalf:*

*Provided that any extension of the time limit notified by the Commissioner of State tax or the Commissioner of Union Territory tax shall be deemed to be notified by the Commissioner.]*

*(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*

[54] Inserted *vide Notf No. 14/2018-CT dt. 23.03.2018*
[55] Omitted *vide Notf No. 74/2018-CT dt. 31.12.2018*
[56] Inserted *vide Notf No. 54/2017-CT dt. 28.10.2017*

> *capital 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.*
>
> *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.*

**Related Provisions of the Statute:**

| ***Section or Rule*** | ***Description*** |
|---|---|
| Section 16 | Eligibility and conditions for taking input tax credit |
| Section 143 | Job work procedure |
| Rule 55 | Transportation of goods without issue of invoice |

### 19.1 Introduction

This provision relates to availing credit of input tax on goods sent for job work.

### 19.2 Analysis

***(i) Relevant Definitions***

- *Job work:* Any treatment or process undertaken by a person on goods belonging to another registered person [section 2(68)].
- *Job worker:* A person who undertakes any treatment or process on goods belonging to another registered person.
- *Principal:* A person on whose behalf an agent carries on the business of supply or receipt of goods or services or both.

***(ii) Entitlement of credit on inputs or capital goods:***

The principal can take credit of input tax on inputs or capital goods sent to job-worker subject to fulfilment of the following conditions and restrictions as stipulated in section 19 and section 143 read with rule 45:

- The credit of inputs / capital goods can be taken even if inputs / capital goods were sent directly to job-worker's premises without bringing it to principal's place of business.

- o In case of direct supply, the period of 1 year / 3 years shall be reckoned from the date the job worker receives such inputs/ capital goods.
- o The inputs / capital goods, after completion of job-work, are to be received back by the principal within 1 year / 3 years respectively, of their being sent out.
- o If the inputs / capital goods are not received back within 1 year / 3 years, it shall be deemed that such inputs / capital goods had been supplied by principal to the job worker on the day when the said inputs / capital goods were sent out.
- o In case of non-receipt of the inputs / capital goods within the time prescribed, the principal shall issue an invoice for the same and declare such supplies in his return for that particular month in which the time period of one year/ three years expires.
- o To issue a delivery challan for transfer of inputs/ capital goods to the job-worker including when they are sent directly (to maintain paper trail of transaction)
- o The details of delivery challans for goods dispatched to job worker or received from job worker or sent from one job worker to another during the quarter shall be included in **Form GST ITC-04** to be furnished on or before 25$^{th}$ day of the month succeeding that quarter.
- o Delivery challan shall contain details as prescribed in rule 55 of CGST Rules. All delivery challans issued in respect of inputs sent to a job-worker and those received back are to be reported in Form GSTR-1

***Points to be considered/ Concerns***

- Given that non-receipt of inputs or capital goods within a period of one year and three years respectively would be deemed to be a supply as on the date on which goods were originally dispatched to the job worker, it is preferred that a principal raises a tax invoice and supplies the goods against such invoice at the time of original supply, if he is certain that such goods would not be received within the period specified above. However, this being uncertain, the principal has to bear the burden of interest, as interest would be calculated from the date on which the goods were originally dispatched and not from the date on which the period of one year or three years, as the case may be, expires.
- Some experts are of the view that unless *the* principal is 'registered', the activity would not be 'job-work'. And when the supply – treatment or process – is not job-work, then it would also not be eligible to be classified under HSN 9988 in the Annexure – Scheme of Classification of Services. Although the nature of work performed is the same whether the principal is registered or not, the classification of supplies should be based on another suitable HSN code in Chapter 99 because paragraph 3 of Schedule II of the CGST Act (extracted below) does refers to 'another person's goods' and not 'another registered person's goods'.

*“3. Treatment or process*

*Any treatment or process which is applied to another person’s goods is a supply of services.”*

Hence, due to the registration status of the principal, the treatment or process may or may not qualify as job-work but in either case, the work of the supplier would continue to be ‘treated as supply of services’ though not under HSN 9988.

- It must be noted that while every manufacture may encompass ‘process or job-work’, every job-work need not necessarily result in manufacture. It is for this reason that in the rate *Notification No. 11/2017-CT(R), dt.28.06.2017*, manufacturing services has been separately mentioned for work carried out on *“*physical inputs owned by others”.

  Treatment or process undertaken may or may not result in manufacture [section 2(72)] Where processing of raw material or inputs results in the emergence of a new product it would be manufacture. Whether it results in manufacture or not, the treatment or process would always be ‘treated as supply of services’ in view of the mandate specified in entry no. 3, Schedule II of the CGST Act. Manufacture is a sub-set of job-work. And job-work will not be job-work if the principal is unregistered. Reference may be made to be recent changes in entry no. 26 of *Notification No. 11/2017-CT(R), dt.28.06.2017*, as follows:

| *Sub-entry under entry 26* | *Keywords from Description* | *Sub-entry applicable only* | | |
|---|---|---|---|---|
| | | if Principal is: | | If new article emerges |
| | | Registered | Unregistered | |
| (i), (ia), (ib), (ic) and (id) | Services by way of job work…. | ✓ | ✗ | ✗ |
| (ii), (iia) and (iii) | Services by way of any treatment or process …. | ✓ | ✓ | ✗ |
| (iv) | Manufacturing services…. | ✓ | ✓ | ✓ |

- Now, ‘goods belonging to another’ does not mean 100% of the goods required in the job-work must be provided by the Principal. It is common and often inevitable, for the job-worker to apply his own goods. Goods required for job-work can generally be identified as primary, secondary and ancillary material. If the job-worker applies ancillary material in the course of carrying out the treatment or process, the transaction does not cease to be job-work. Similarly, if the Principal provides only ancillary material, it is not justifiable to regard the transaction as job-work. Hence, a reasonable construction of the definition of paragraph 3, Schedule II requires the Principal to provide the ‘primary material’ at least to qualify a transaction to be termed as 'job work'. Although there are no infallible tests or undisputed guiding principles or no one rule can be prescribed, the classification into primary, secondary, and ancillary itself is a subjective matter. Reasonable construction is required based on the role, each component plays in relation to the finished product in terms of function and identity to determine 'goods belonging to another' correctly.

- Job-working must not be confused with repair or maintenance. Job-working creates the functionality of an article, but repair or maintenance restores or improves the functionality already created and possessed by that article or thing.

- As regards 'movement of goods' by Principal to job-worker, it is not a supply for the reason that the ingredients required to constitute supply [as detailed in the explanation of clause (a) to (c) under section 7(1)] are not satisfied. It is for this reason that section 19(3) and 19(6) are required to 'deem' this movement of goods to be a supply in the event of failure of job-worker to return the processed goods within the permitted time (1 year for inputs and 3 years for capital goods, respectively). Further, sections19(3) and 19(6) 'deem' it to be a supply not on the date of expiry of the permitted time to return them, but retrospectively on the date when the inputs / capital goods were originally sent 'for' job-work.

  Deeming fiction is capable of providing a meaning that is otherwise not available to a word or phrase. Deeming fiction is used with great caution by the lawmakers and when it is used, its construction must be with the same caution and seriousness. Hence, 'movement of goods' for the purpose of job-work is not supply but is 'deemed' to be a supply by failure of a contingency or condition-subsequent.

- As discussed earlier, loss of goods (inputs or capital goods) during the processing or manufacture of output is not liable to reversal of credit under section 17(5)(h). Now, when inputs have been issued to a job-worker and there is some *loss of inputs* in the hands of job worker, whether the same would not be liable for reversal of credit.

Conversion of inputs into processed output on job work basis necessarily involves normal loss. Even if, the extent of *normal loss* has been recorded (as there is no provision in GST law to report the same prior to sending inputs to job worker), non-receipt of inputs does not amount to deemed supply under section 19(3). However, any abnormal loss in job worker's hand will not enjoy this relief but be deemed supply and attract tax in the hands of principal. Time of supply will be the date when the inputs were issued for job work and hence attract interest also. Note the divergence in the treatment of *abnormal loss* in the hands of the principal which is saved due to actual use albeit inefficiently by the principal whereas such abnormal loss in the hands of the job worker is impacted by the 'deeming' fiction in section 19(3). Divergence is not uncommon when legal fiction operates. These implications may be taken care of while complying with the GST law because GST is a self-assessment-based tax and the taxpayer is obliged to inquire into all these aspects and report voluntarily.

- It is section 16 and not section 19 that allows input tax credit, but section 19 permits taking of input tax credit even when the inputs (or capital goods) are not first received at the premises of the Principal but delivered directly to job-worker. Reference may be made to the explanation to section 16(2)(b) that delivery of goods or services to any other person 'on behalf of' or 'on account of' would be sufficient compliance with this condition. This explanation is not only applicable to job-work situation but to others as well.

  Section 19 also does not deny or recover the input tax credit already availed by the principal on the occasion of sending them to the job-worker. When movement of goods for job-work is not a supply, where is the need for a provision to permit continuation of credit that was already availed validly. Since credit has been availed, failure to use the inputs (or capital goods) as 'intended' under section 16(1) would cause a break-down of the credit scheme – to allow credit only when the said goods are subsequently supplied and are taxable. And for this reason, transfer of business assets on which credit availed is 'declared' to be supply in paragraph 1, Schedule I and diversion for non-business use (in certain cases) is 'treated' as supply in paragraphs 4(a) and 4(b), Schedule II. But there is no provision to impute supply characteristics to 'movement of goods for job-work'. This responsibility is cast by sections 19(3) and 19(6).

- This can be contrasted with the 'time of supply' of goods sent-on-approval under section 31(7). Here, the date of acceptance by customer (or end of $6^{th}$ month) is recognized as supply and hence registers 'time of supply'. It is interesting to note that there is a deeming fiction employed here because none is required. In other words, 'sending goods on approval' is not a supply for the same reason that the ingredients required to constitute supply (as detailed in the explanation to clauses (a) to (c) under section 7(1)) are not satisfied. And such a test can validly be applied for verifying whether 'movement of goods for job-work' is supply or not. By applying the same test to 'sending goods on approval', the 'time of supply' is not the date of sending them but the date of their acceptance by customer (or end of $6^{th}$ month). The time of supply in case of non-receipt of the inputs / capital goods within the time prescribed (one year/ three years) by the job-worker, the principal shall issue an invoice and time of supply for the same will be the date when the inputs/ capital goods were issued for job work.

### 19.3 Comparative review

| *Aspect* | *Credit under erstwhile system* | *Input tax credit under GST* |
|---|---|---|
| Definition of "job work" | Defined in CENVAT Credit Rules to mean processing of material supplied to job worker to complete whole or part of manufacturing process | Defined to mean undertaking any treatment or process by a person on goods belonging to another registered person |

| | | |
|---|---|---|
| Eligibility of CENVAT credit to principal manufacturer | Principal is eligible for CENVAT credit | Similar in GST. Principal is eligible for CENVAT credit |
| Conditions for return of inputs and capital goods | For inputs – 180 days<br>For capital goods – 2 years | For inputs – 1 year<br>For capital goods – 3 years |
| Reversal of credit if inputs/capital goods not returned within specified time | Credit to be reversed | To be treated as deemed supply on the day when such inputs/capital goods are sent out |
| Re-credit if goods returned after specified time | Re-credit allowed | No such provision |

### 19.4 FAQs

Q1. Whether the principal is eligible to avail input tax credit of inputs sent to job worker for job work?

Ans. Yes. The principal is eligible to avail the input tax credit on inputs sent to job worker for job work.

### 19.5 MCQs

Q1. The inputs sent to job work have to be received back within:

(a) 1 year

(b) 2 years

(c) 180 days

Ans. (a) 1 year.

Q2. The principal is entitled to avail credit on capital goods sent to job worker directly:

(a) Yes

(b) No

(c) May be

Ans. (a) Yes.

Q3. If the capital goods sent to job worker have not been received within 3 years from the date of sending then which of the following consequences arise : -

(a) Principal has to pay an amount equal to the credit taken on such capital goods

(b) No need to pay amount equal to credit taken on such capital goods

(c) It shall be treated as deemed supply of capital goods to the job worker

(d) None of the above

Ans. (c) It shall be treated as deemed supply of capital goods to the job worker.

## Statutory provisions

**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, 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 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 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 recipient(s) 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 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 of 'recipient of credit' means the supplier of goods or services or both having the same Permanent Account Number as that of 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* **[57]***[under Entries 84 and Entry 92A] of List I of the Seventh Schedule to the Constitution and Entry 51 and 54 of List II of the said Schedule*

**Extract of the CGST Rules**

***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, "$C_1$", to be calculated by applying the following formula –

$$C_1 = (t_1 \div T) \times C$$

*where,*

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

*"$t_1$" is the turnover, as referred to in section 20, of person $R_1$ 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;*

[57] Inserted *vide The Central Goods and Services Tax (Amendment) Act, 2018* read with *Notf No. 2/2019-C.T., dated 29-1-2019- w.e.f. 01.02.2019*

(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 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 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 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. |

**Related Provisions of the Statute**

| ***Section or Rule*** | ***Description*** |
|---|---|
| Section 2(61) | Definition of 'Input service distributor' |
| Section 16 | Eligibility and conditions for taking input tax credit |
| Section 17 | Apportionment of credit and blocked credits |
| Rule 54 | Tax invoice in special cases |
| Rule 65 | Form and manner of submission of return by an Input Service Distributor |

### 20.1 Introduction

This section sets forth the way input tax credit (of services) is distributed to supplier of goods or services or both of same entity having same PAN. Procedure for distribution is given in rule 39 of the CGST Rules.

### 20.2 Analysis

(i) An input service distributor (ISD) shall distribute the eligible ITC in accordance with rule 39 elucidated in the following paras. Both eligible and ineligible credits are to be distributed such that distributable credit is 'nil' each month. It is for the recipient-branch to disallow ineligible credits. Distribution-document must suitably indicate the nature of credit distributed based on HSN, description and delivery details so that recipient-branch can demonstrate on enquiry that the conditions in sections 16 and 17 are duly satisfied and credit retained by such recipient-branch is only eligible credit and not ineligible credit. Experts advise that even in the absence of express mention in rule 54, the responsibilities of recipient-branch cannot be discharged without collecting information in possession of ISD, especially when they share the same PAN.

(ii) ISD is an office of the supplier of goods or services or both where a document (like invoice) of services attributable to other locations are received (since they might be registered separately). Since the services relate to other locations the corresponding credit should be transferred to such locations (having separate registrations) as services are supplied from there. Care should be taken to ensure that an inter-branch supply of services should not be misinterpreted as a distribution by ISD. Remember that an ISD cannot be an office that does any supply of its own but must be one that merely collects invoice for services and issues prescribed document for its distribution.

(iii) ISD cannot normally be used in a situation where there is a liability to pay GST. It can only receive input tax credits on invoices related to input services and distribute such credit in the manner discussed below. An ISD cannot discharge tax liability under reverse charge. This would require obtaining another registration as a regular registered person and discharge RCM liability. An ISD is therefore required to be 'nothing more than an office that receives/distributes credit' without having any of the attributes of a 'place of business' by itself.

*Illustration 1:* Corporate office of XYZ company Ltd., is at New Delhi, having its business locations of selling and servicing of goods at New Delhi, Chennai, Mumbai and Kolkata. If the software license and maintenance is used at all the locations, invoice indicating CGST and SGST is received at Corporate Office. Since software is used at all the four locations, the input tax credit of entire services cannot be claimed at New Delhi. The same has to be distributed to all four locations. For that reason, the New Delhi Corporate office has to act as ISD to distribute the credit.

*Illustration 2:* 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 2021:

Invoice A: ₹ 100,000 @ IGST 18,000 issued by Peace Link Technologies (registered in Uttar Pradesh) for repairs executed in 3 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. Tec Force (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.

Invoice D: ₹ 10,000 @ CGST 900 and 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 2019-21 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 ₹ 10 crore during the previous financial year.

The distribution of credits by the ISD shall be as under:

| *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 | | | | | | |
| • 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.
- 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 and 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 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.

(iv) Distribution of credit where ISD and recipient are located in different States shall be as under in terms of rule 39(1)(e) and (f) of CGST Rules

- CGST as IGST;
- SGST as IGST and
- IGST as IGST

by issuing prescribed document mentioning the amount of credit distributed to recipient of credit located in different States.

(v) In cases where an entity has different registration within the same State, the ISD shall distribute credit of:

- CGST as CGST
- SGST as SGST and
- IGST as IGST

by issuing prescribed document mentioning the amount of credit distributed to recipient being a business vertical.

*Illustration:* If the corporate office of XYZ Ltd being an ISD situated in Bangalore and also having locations at Chennai, Mumbai, Kolkata, Mysore and Belagavi. XYZ Ltd receives invoices indicating ₹ 4 lakhs of CGST and SGST each in case of one service and ₹ 7 lakhs as IGST in case of another service, it shall distribute credit of:

- CGST of ₹ 4 Lakhs as IGST
- SGST of ₹ 4 Lakhs as IGST and
- IGST of ₹ 7 Lakhs also as IGST

*to its locations at Chennai, Mumbai, Kolkata* and shall distribute credit of:

- CGST of ` 4 Lakhs as CGST
- SGST of ` 4 Lakhs as SGST and
- IGST of ₹ 7 Lakhs also as IGST

*to its locations at Mysore and Belagavi, being another business verticals in the State of Karnataka.*

under a prescribed document containing the amount of credit distributed.

(vi) *Conditions to distribute credit by ISD:* The conditions to distribute the credit by ISD to supplier of goods or services or both having same PAN as that of ISD i.e., recipient of credit, are as follows:

(a) Credit to be distributed to recipient under ISD invoice contents/details of which are prescribed under rule 54 of the CGST Rules. Such document should be issued to each of the recipient of credit.

(b) Credit distributed should not exceed the credit available for distribution.

(c) Tax paid on input services used by a particular recipient (registered as supplier), is to be distributed only to that recipient.

(d) Credit of tax paid on input services used by more than one recipient shall be distributed to all of them in the ratio of turnover of the recipient in a State/ Union territory to aggregate turnover of all recipients to whom the input service is attributable and which are operational during the current year.

*Note:* The period to be considered for computation of aforesaid turnovers is the previous financial year of that recipient. If it does not have any turnover in the previous financial year, then previous quarter of the month to which the credit is being distributed.

(vii) For a detailed discussion on tax invoice or credit note or debit note to be issued by an ISD reference may be made to Chapter 8 which clearly indicates the particulars to be included in such a document.

*Illustration 1:* A Ltd as an ISD has input service credit of ₹ 35 lakhs used by more than one location, to be distributed among recipient's locations X, Y and Z. The turnover of X, Y, Z during the preceding financial year, is ₹ 10 crores, ₹ 15 crores and ₹ 5 crores respectively. The credit of ₹ 5 lakhs pertain to input service received only by Z. The credit attributable to X, Y, Z are as follows:

| *Particulars* | *Amount (in ₹)* |
|---|---|
| Total Credit to be distributed as ISD | 35 Lakhs |
| Credit of service used only by Z location | 5 Lakhs |
| Credit available for distribution for all units | 30 Lakhs |
| Credit distributable to X<br>10 crores / 30 crores * 30 Lakhs | 10 Lakhs |
| Credit distributable to Y<br>15 crores /30 crores * 30 Lakhs | 15 Lakhs |
| Credit distributable to Z<br>5 crores / 30 crores * 30 Lakhs = 5 Lakhs<br>Credit directly attributable to Z = 5 Lakhs | 10 Lakhs |

*Illustration 2:* Distribution of input tax credit by an ISD to its units is shown as under:

M/s XYZ Ltd, having its head Office at Delhi, is registered as ISD. It has three units in different States namely 'Delhi', 'Rajasthan' and 'Gujarat' which are operational in the current year. M/s XYZ Ltd furnishes the following information for the month of July 2021 and asks to distribute the credit to various units.

(i) CGST paid on services used only for Delhi Unit: ₹ 300000/-

(ii) IGST, CGST and SGST paid on services used for all units: ₹ 1200000/-

(iii) Total Turnover of the units for the Financial Year 2020-21 are as follows:-

| **Unit** | **Turnover (₹)** |
|---|---|
| Delhi | 5,00,00,000 |
| Rajasthan | 3,00,00,000 |
| Gujarat | 2,00,00,000 |
| Total | 10,00,00,000 |

**Solution**: The Computation of Input Tax Credit distributed to various units shall be as under **: -**

| *Particulars* | *Total Credit Available* | *Delhi* | *Jaipur* | *Gujarat* |
|---|---|---|---|---|
| | | *Credit distributed to all Units* | | |
| CGST paid on services used only for Delhi Unit. | 3,00,000 | 3,00,000 | 0 | 0 |
| IGST, CGST and SGST paid on services used in all units- Distribution on pro rata basis to all the units which are operational in the current year (Refer Note1) | 12,00,000 | 6,00,000 | 3,60,000 | 2,40,000 |
| Total | 15,00,000 | 9,00,000 | 3,60,000 | 2,40,000 |

Note 1: Credit distributed pro rata basis based on the turnover of all the units are as under: -

(a) Unit Delhi: (5,00,00,000/10,00,00,000)*12,00,000 = ₹ 6,00,000

(b) Unit Rajasthan : (3,00,00,000/10,00,00,000)*12,00,000 = ₹ 3,60,000

(c) Unit Gujarat: (2,00,00,000/10,00,00,000)*12,00,000 = ₹ 2,40,000

The relevant period for distribution of credit shall be as under:

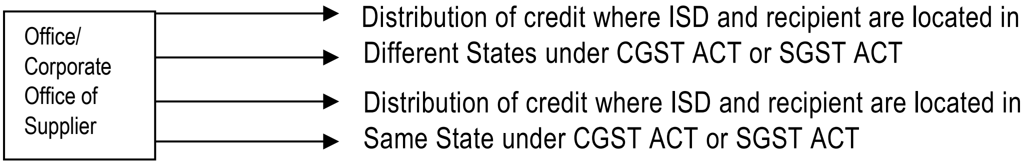
(a) If the recipient of credit has turnover in their States during the preceding financial year of the year in which credit is distributed - such financial year.

(b) If some or all recipients do not have any turnover in their States in preceding financial year of the year in which credit is distributed – 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.

The analysis of above provision in a pictorial form is summarised as follows:

**Input Service Distributor – Section 20.**

- ITC is distributed to supplier of goods or services or both of same entity having the same PAN as the ISD
- Common services used at / for



**INPUT SERVICE DISTRIBUTOR**

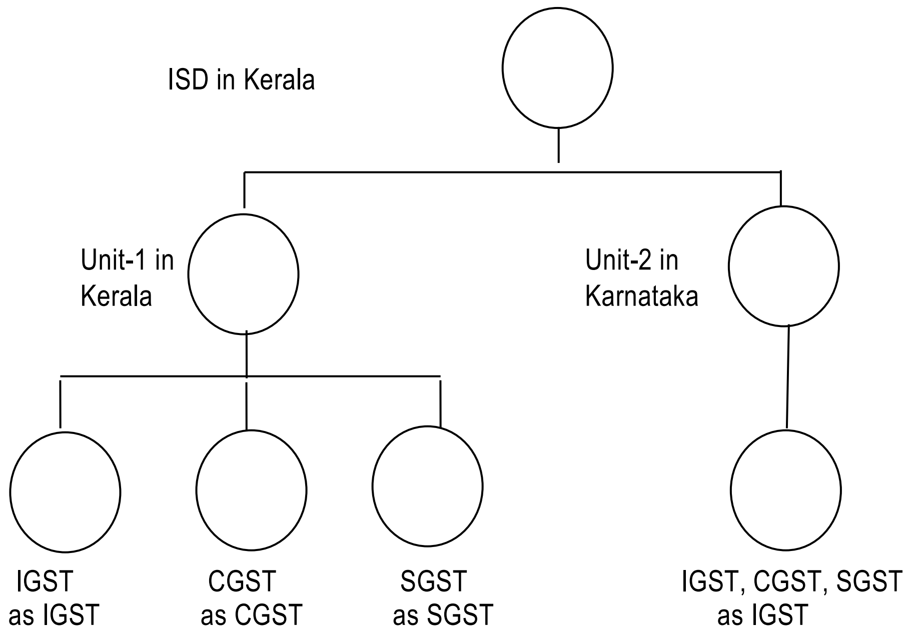



*Illustration 3:* Consider an example where a company has a Branch-M in Mumbai and a Branch-D in Delhi. This company is incorporated in Delhi. Branch-M incurs various expenses towards supply of services in Delhi where CGST-SGST is liable to be charged in Delhi by that supplier. Obviously, credit of this tax cannot be availed by Branch-D as the underlying expense is not '*in relation to business'* of Branch-D and because it is exclusively in relation to business of Branch-M. When credit cannot be claimed by Branch-D and Branch-M does not want to forego this credit, the option available is for Branch-M to obtain ISD registration in Delhi. Now, in the , the same manner, if Branch-D incurs expenses in Maharashtra (say in Nasik), the implications would be that credit will not be allowable to Branch-M for these supplies and Branch-D is eligible to obtain ISD registration in Maharashtra if credit is not to be foregone.

From this example, the following questions arise for careful consideration:

| *Question* | *Response* |
|---|---|
| (i) Is ISD registration required in 'all but one' States for a registered taxable person?<br>(All but one may be all States/UT other than home State) | Yes. If tax charged by the supplier is not IGST but CGST-SGST of the host-State where supplies are taking place, then a registered taxable person would require ISD registration in each those host-States except home-State. |
| (ii) Is ISD registration an entity-level office | Yes, ISD is an entity-level office because |

| | | |
|---|---|---|
| | in a given State or is it a registered taxable persons-specific office in other States (outside the home State of that registered taxable person)? | section 2(61) defines ISD as *"....an office of the supplier …. which receives tax invoice…."* It does not say that it is an "office of the registered taxable person which receives tax invoice…." |
| (iii) | Will ISD registration be required for each registered taxable person in 'all but one' State?<br>(All but one may be all States/UT other than home State) | No. One entity-level ISD registration in all States will suffice for credit distribution requirement of all registered taxable persons having same PAN |
| (iv) | Can an ISD distribute credit of taxes paid in that State alone (whether IGST or CGST-SGST) to registered taxable persons in all other States or only to that State for whose benefit the ISD registration was obtained? | Since ISD is an entity-level registration, one ISD in a State can distribute credit to all registered taxable persons in all other States having same PAN. Further, this ISD can also distribute credit to separately registered business verticals in that State. |
| (v) | When GSTIN registration is obtained in one State, is there any need to also obtain ISD in the same State or is GSTIN and ISD registrations mutually exclusive in a given State? | Yes, ISD registration is required as GSTIN registration does not permit distribution of credit. If taxes are paid which are not related to the business of that registered taxable person in that State, then for want of 'nexus', credit cannot be availed by him. And to save from loss of credit, ISD registration is the only option to distribute this credit whichever registered taxable person (called 'recipient of credit') satisfies this nexus test.<br>Where it is suggested in Q1 that ISD registration will not be required in every State, if costs incurred are cross charged then, requirement of ISD registration may be overcome in this instance.<br>OR<br>No; ISD registration will not be required if cross-charge of supplies is made from the GSTIN available. |
| (vi) | Can a Company which has independent | Yes, the Company could opt to do so. This is |

| | | |
|---|---|---|
| | operations in all 29 States and 2 UTs and is therefore registered in all 31 locations be required to have 31 ISD registrations? | because each registered taxable person is stated to be truly independent of other business (of registered taxable persons) and receives supplies in those host-States where CGST-SGST paid in those host-States is to be distributed to the relevant home-State. |
| (vii) | Is it possible, when GSTIN registration is already available in any given State, for the Company to completely avoid ISD registration? | No, for the reasons stated in (vi) and (i) above, it would not be possible to avoid ISD registration. |
| (viii) | Can a Company, to avoid ISD compliances, decide to avoid ISD registration in every State where it is already having GSTIN registration? | It is possible that a Company may consider the possibility of doing so subject to loss of legitimate credits which could have been availed as an ISD. |
| (ix) | If a Company were to instruct all registered taxable persons in a State who may have credit loss in other States, can it misdirect the suppliers into issuing tax invoice with GSTIN of that State? | Yes, such a practice may not be uncommon in trade for a Company to misdirect a supplier to optimize credits. Care must be taken to avoid such instances; however, supplier's responsibility would not extend to examining the 'nexus' while issuing tax invoice. |
| (x) | Is ISD registration necessary in every State where this 'nexus' test cannot be satisfied by each registered taxable person? | Yes, as explained in (vii) above, ISD registration is necessary in every State where 'nexus' test is not fulfilled. |
| (xi) | If multiple ISD registrations or GSTIN-plus-ISD registrations are unavoidable (as explained above), is there any solution to resolve this multiplicity of monthly and quarterly compliances? | Yes, only if link is established between the 'no nexus' supplies in a State and the registered taxable person in that same State. If no such 'nexus' exists, credit claim by registered taxable person becomes improper. If nexus is established, please examine valuation of inter-branch supply of services per proviso to Rule 28 or as per Rule 30 of the CGST Rules. |

ISD is not merely a matter of compliance but involves great revenue implications to a registered taxable person. Compliance would also not be nominal. So, this is yet another indicator of the business model that has been in place until now has reached end-of-life and a new model needs to be examined. Consider the following example of a CA in practice with branches in 3 States:

| ***Common facts for consideration*** | |
|---|---|
| Head office | Maharashtra |
| Branch offices | West Bengal and Delhi |
| Client base | All 3 States |
| Skills based | Distributed in all offices, based on the assignment, staff from all offices join to complete the assignment |
| Completion | Sign-off only by Partners who are in Maharashtra and West Bengal |

Business models and their comparison are as follows:

| *Criteria* | *Under Erstwhile Law* | *Under GST Law – Option A* | *Under GST Law – Option B* |
|---|---|---|---|
| ST (Service tax) /GST registration | Centralized at Mumbai | All 3 branches | All 3 branches |
| Billing to clients | From all 3 offices | From Mumbai only | From all 3 offices |
| Internal billing | None | Branches issue tax invoice to HO at 'cost plus 10%' as per Rule 30 of the CGST Rules | Every branch including HO to bill each other for their respective contribution on 'revenue split' or 'proportion of contribution' method |
| ST credit of branches | Availed at Mumbai due to centralized registration (ISD registration not required) | Branches and HO avail input tax credit on tax invoices issued by respective suppliers | Branches and HO avail input tax credit on tax invoices issued by respective suppliers including internal bills |
| ST credit at HO | Mumbai credits, entity-level credits and branch-specific credits | HO retains credit of all entity-level credits and avails credit of tax invoice issued by branches | HO retains credit of all entity-level credits |
| Loss, cost or risk | None | IGST outflow on non-credit costs included in valuation and 10% mark-up. Non-credit costs of branches are | Nexus risk on credits:<br>• entity-level costs like audit fee<br>• central vendor bills like data-telecom, |

| | | | |
|---|---|---|---|
| | | salaries, depreciation, etc. | travel, etc.<br>Administrative challenge in assignment-level billing allocation |
| Mitigation | NA | Branch to invoice HO on 30th in respect of client-level billings due on 1st of next month so that the incremental IGST outflow from HO to branches is recovered quickly | GST does not impose any 'one-to-one' correlation of credits. Entity-level credit can be contended to be allowed in HO.<br>Assignment-level billing allocation left to each branch to self-regulate |

There is no doubt that the above are not recommendations but for comparative illustration regarding application of the law to a business and to highlight that it is impossible to continue the erstwhile business model in GST, at least in many sectors.

The illustrations considered in this section are matters to be considered for discussion/ deliberations only and are not views envisaged. The reader may or may not agree with the views in the discussion in this Chapter/section.

Experts express great concern with respect of ISD in GST and call out the following areas of concern:

a) ISD in GST is not identical to ISD in Service tax regime;

b) Taxable person registered in one city in a State is considered a registered person in every city in that State unless another registration in the same State is obtained;

c) ISD in GST is an 'office' that 'receives invoice' and 'distributes credit'. These are the three key principles in section 2(61). In other words, ISD does nothing else, reason being, when there is an office that is a taxable person (making taxable outward supplies), for that office to claim as an ISD, that is, merely receiving invoice and distributing credit is highly questionable;

d) FAQ on Banking, Insurance and Stock Brokers Sector issued by Government (available on cbic.gov.in) *inter alia* states that:

| ***Sr. No.*** | ***Question*** | ***Answer*** |
|---|---|---|
| ***54.*** | *Are services supplied by a Bank to its branch / head-office outside India, which are neither intermediary services nor services* | *GST is a destination-based consumption tax. Such services provided by a Bank or the branch of a foreign Bank in India to its offshore branch / head-office, which are* |

| | | |
|---|---|---|
| | *to account holders, taxable under GST?* | *neither intermediary services nor services to account holders, are inter-State supply of services between distinct establishments (as per section 7(5)(a) read with Explanation to section 8 of the IGST Act, 2017), and will be taxable in India, as the location of the supplier is in India and the place of supply is outside India. Such services will not be treated as exports in view of the sub-clause (v) of section 2(6) of the IGST Act, 2017 read with Explanation 1 to section 8 of the IGST Act, 2017.* |
| ***55.*** | *Will the management oversight or stewardship activities performed in relation to business operations by the Head Office of a Bank to a Branch in India be considered as a supply of services by the Head Office even when there is no consideration charged by the Head Office, nor any expenditure recorded in the books of account of the Branches?* | *As per Schedule – I to the CGST Act, 2017, supply of services between distinct entities will be a taxable supply even in absence of a consideration.* |
| ***56.*** | *If tax is payable on provision of management oversight or stewardship services by a related person, what shall be the value of supply when no invoice is raised, no payment is made by recipient or no entry is made in the books of accounts of the recipient of service? What will be the time of supply?* | *As per Rule 28 of the CGST Rules, 2017, the Bank may obtain a certificate from the Branch or Office providing the estimated cost of rendering the support. It may be backed by a certificate issued by a Chartered Accountant or Cost Accountant.*<br>*In such cases, the time of supply shall be the date when such costs are determined or certificate is received and the GST liability on the said costs shall be discharged accordingly. This can be done before the expiry of the quarter during which such supply was* |

| | | |
|---|---|---|
| | | *made as provided in 2nd proviso to Rule 47 of the CGST Rules, 2017. For this purpose a document may be issued by the entity supplying such services* |

From the above, it can be inferred and observed that:

- HO of a bank is providing taxable service (Q54) to its branches and by implication not ISD. While under service tax, HO of a bank was operating as an ISD. This brings out the dissimilarity in ISD under GST compared to Service tax;
- Services provided by HO is referred (Q55) to as 'management oversight or stewardship services' is liable to tax in terms of para 2 of Schedule I. When HO of a bank is said to provide such services, HO of a company or firm or proprietary concern with more than one registrations cannot be managing with anything less and operating without 'oversight' on the activities of all its distinct persons; and
- Valuation of management oversight or stewardship services (Q56) is referred to rule 28;

e) But trade has continued to operate HO (regional or zonal office also) as ISD under GST and this is an area of great concern.

Concerns highlighted by experts are:

(i) Correctness of ISD registration which ought to have been a cross-charge of services.

(ii) Credit at the receiving locations may not be disputed but outward supply (cross-charge) can be agitated.

(iii) Demands being raised under section 74 (which in this case could well satisfy) may result in forfeiture of credit by branches.

It is therefore advised to revisit all ISD registrations in GST to examine if, in fact, that HO or branch does not provide any taxable supplies in this nature – oversight or stewardship. Experts express concern that co-existence of regular registration and ISD registration in the same premises is dangerous and continuing to ignore the implications could border on being reckless. In case there is advantageous tariff, then the implications can be debilitating and furnish motive for doing so for the enterprise.

### 20.3 Issues and Concerns

ISD registration at a particular location cannot be a location which constitutes "fixed establishment" (FE) under section 2(50) and every FE is also a "place of business" under section 2(85) which attracts requirement of registration under section 22. As a result of this flow of implications, experts express concern that ISD and FE registrations are mutually exclusive. Now, FE is a place which is represented by *"sufficient degree of permanence in human and technical resources"*. As such, if ISD location has (i) a physical premises and (ii) permanent staff employed, such location is less likely to support ISD registration rather than regular registration of FE. Experts caution that ISD location that passes the test of FE location, may be exposed to the risk that (i) output tax may be demanded on the costs at such ISD location and (ii) branches receiving credit would be denied credit of such output tax if demand is supported under section 74 (credit previously distributed as ISD, albeit erroneously) may still be left undisturbed. However, it is also seen that there are several taxpayers holding ISD registration in States where they also have regular registration and this is the area of concern, that the ISD location would, in fact, be a FE location.

### 20.4 Comparative review

These provisions are similar to the provisions contained in rule 7 of CENVAT Credit Rules for distribution of credit of input service by an ISD.

It appears that the distribution of credit among the recipients prescribed in CENVAT Credit Rules has been continued in the GST law. The conditions for distribution of credit for each recipient also appear to be the same as before.

### 20.5 FAQs

Q1. Whether CGST and IGST credit can be distributed by ISD as IGST credit to units located in different States?

Ans. Yes. CGST credit can be distributed as IGST and IGST credit can be distributed as IGST by an ISD for the units located in different States.

Q2. Whether SGST credit can be distributed as IGST credit by an ISD to units located in different States?

Ans. Yes. ISD can distribute SGST credit as IGST for the units located in different States.

Q3. What are the conditions to be fulfilled by ISD to distribute the credit?

Ans. The conditions to be fulfilled by ISD to distribute credit are:

(a) Credit should be distributed to the recipient under prescribed documents, which is issued to each of the recipient of credit.

(b) Credit distributed should not exceed the credit available for distribution.

(c) Tax paid on input services used by a particular recipient (registered as supplier), to be distributed only to that recipient .

(d) Credit of tax paid on input services used by more than one recipient shall be distributed to all of them in the ratio of turnover of the recipient in a State/ Union Territory to aggregate turnover of all recipients to whom the input service is attributable, and which are operational during the current year.

Q4. What are the documents through which the credit can be distributed by ISD?

Ans. An ISD can distribute credit to its recipient units by way of an ISD invoice prescribed in rule 54 of the CGST Rules.

Q5. How to distribute common credit among all the units of an ISD?

Ans. The common credit used by all the units can be distributed by ISD on pro rata basis i.e., based on the ratio of the turnover of each unit to the aggregate turnover of all the units to which credit is distributed.

## 20.6 MCQs

Q1. The ISD may distribute the CGST and IGST credit to the recipient outside the State as_______

(a) IGST

(b) CGST

(c) SGST

Ans. (a) IGST

Q2. The ISD may distribute the CGST credit within the State as____

(a) IGST

(b) CGST

(c) SGST

(d) Any of the above.

Ans. (b) CGST

Q3. According to the condition laid down for distribution of credit, ISD can distribute_____

(a) Credit in excess of credit available

(b) Only certain percentage of total credit available

(c) Credit equal to the total credit available for distribution.

(d) All of the above.

Ans. (c) Credit equal to the total credit available for distribution.

Q4. The credit of tax paid on input service used by more than one recipient is ________

(a) Distributed among the recipients who used such input service on pro rata basis of turnover in the State of such recipient.

(b) Distributed equally among all the suppliers

(c) Distributed only to one supplier.

(d) Cannot be distributed.

Ans. (a) Distributed among the recipients who used such input service on pro rata basis of turnover in the State of such recipient.

**Statutory provisions**

| |
|---|
| ***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 74, as the case may be, shall mutatis mutandis apply for determination of amount to be recovered.* |

**Related Provisions of the Statute**

| ***Section or Rule*** | ***Description*** |
|---|---|
| Section 2(61) | Definition of 'Input service distributor' |
| Section 20 | Manner of distribution of credit by input service distributor |
| Section 73 | Determination of tax not paid or short paid or erroneously refunded or input tax credit wrongly availed or utilised for any reason other than fraud or any wilful mis-statement or suppression of facts. |
| Section 74 | Determination of tax not paid or short paid or erroneously refunded or input tax credit wrongly availed or utilised by reason of fraud or any wilful mis-statement or suppression of facts |
| Rule 65 | Form and manner of submission of return by an input service distributor |

### 21.1 Introduction

The CGST Act clearly lays down that credit distribution is not 'to self', that is, a registered taxable person cannot distribute credit to himself. Each registered person being a distinct person under section 25, must distribute credit to another registered taxable person but having the same PAN to whom the credit is most accurately attributable. The consequence of incorrect distribution, due to inadvertence or misapplication of the provisions, are discussed under the head "Analysis".

### 21.2 Analysis

***(i) Excess Credit distributed in contravention of the provisions***

Excess credit distributed to one or more recipient of credit in contravention of ISD provisions under section 20 is recoverable from the recipient of such credit along with interest. The recovery would be under section 73 or 74.

*Example-1* Total credit available to ISD is 15,00,000/- and the credit distributed to all the units is ₹ 16,50,000/- (i.e., Delhi 10,00,000, unit Jaipur ₹ 4,00,000 and unit Gujarat ₹ 2,50,000). What will be the consequences?

*Solution:* The excess credit of 1,50,000 (₹ 16,50,000- ₹ 15,00,000) distributed would be recovered from the recipient along with interest and the provisions of section 73 or 74 shall apply mutatis mutandis for effecting such recovery.

*Example-2* Total credit available to ISD is ₹ 15,00,000/- and the credit should have been distributed equally to all the units as all units had equal turnover; however, credit was distributed in violation of section 21, as under:

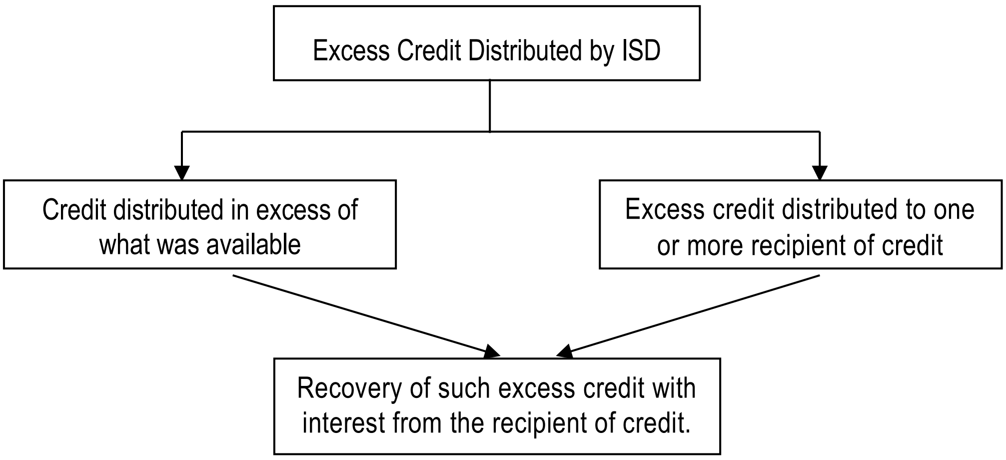
Delhi ₹ 7,00,000, Jaipur ₹ 6,00,000, Gujarat ₹ 2,00,000.

What will be the consequences?

*Solution:* The excess credit of ₹ 2,00,000 (₹ 7,00,000- ₹ 5,00,000) shall be recovered from Delhi and ₹ 1,00,000 (₹ 600,000 – ₹ 5,00,000) shall be recovered from Jaipur along with interest and the provisions of section 73 or 74 shall apply *mutatis mutandis* for effecting such recovery.

The above analysis is summarised in a flowchart as under :

**Excess Credit distributed by Input Service Distributor**




**Note-** The Board *vide Circular No. 71/45/2018-GST* dated 26.10.2018 in respect of recovery of excess ITC distributed by an ISD provides that-

| ***S No*** | ***Issue*** | ***Clarification*** |
|---|---|---|
| *3.* | *Representations have been received regarding the manner of recovery of excess credit distributed by an Input Service Distributor (ISD) in contravention of the provisions contained in section 20 of the CGST Act.* | *1. According to Section 21 of the CGST Act where the ISD distributes the credit in contravention of the provisions contained in section 20 of the CGST Act 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 penalty if any.*<br>*2. The recipient unit(s) who have received excess credit from ISD may deposit the said excess amount voluntarily along with interest if any by* |

### 21.3 Comparative review

Earlier recovery provision was specified in rule 14 of CENVAT Credit Rules. The CENVAT credit taken or utilized wrongly or erroneously refunded, was recoverable along with interest under the provisions of sections 11A and 11AB of the Central Excise Act or sections 73 and 75 of the Finance Act 1994

Earlier, there was no specific provision for excess distribution of credit by ISD. Now specific provision is incorporated in the GST law providing for recovery of amount along with interest. Further, the period for recovery of excess amount distributed is also specified in section 21 of the CGST Act.

### 21.4 FAQs

Q1. Whether the excess credit distributed can be recovered by the Department?

Ans. Yes. Excess credit distributed can be recovered along with interest from the recipient by the Department.

Q2. What are the consequences when credit is distributed in contravention of the provisions of the Act?

Ans. The credit distributed in contravention of the provisions of the Act is to be recovered from the unit to which it is distributed along with interest.