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Input tax credits – GST Versus CENVAT / KVAT

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Long pending GST law has been implemented in India from 1st July 2017. Though it was introduced in hurry with lot of confusions and lack of clarity in many areas, we have to get used to it and move on. GST may not be actually 'Good and Simple Tax' as described by honorable prime minister Narendra Modi ji. However, this new law has lot of advantages for a businessman especially the manufacturer or trader located in multiple States. One such advantage is seamless credit of tax paid on procurement of goods and services. Simple example is credit of taxes paid on input services by a trader would bring good pricing advantage in GST regime. In this article, we have made effort to analyze the additional credit advantage in GST as compared to Cenvat as per Cenvat credit provisions or ITC under Karnataka VAT law.

In terms of Cenvat credit rules, a manufacturer of excisable goods or provider of taxable services including exporter was eligible for taking the credit of excise duty paid on inputs or capital goods in addition to credit of service tax paid on input services. However, there were lot of restrictions for taking credit. K-VAT provisions allowed for credit of VAT paid on inputs and capital goods used in relation to business with few restricted credits as per the list provided in Schedule V to the K-VAT Act 2003. In GST, even though 'seamless credit' is being publicized, it is actually not so. Following are few restrictions in Cenvat credit and K-VAT which would continue in GST regime as well:

a) Credit of taxes paid on petrol, diesel
b) Credit of taxes paid on food items
c) Credit of taxes paid on motor vehicles except for specified suppliers
d) Credit of tax paid under VAT composition scheme
e) Credit of tax paid on personal consumption services such as beauty treatment, health services, membership of a club, health and fitness center
f) Credit of taxes paid on construction services
g) Credit not allowed if tax amount included in value of goods for income tax depreciation

"Input Tax" in relation to a taxable person means the Goods and Services Tax charged on any supply of goods and/or services to him which are used or are intended to be used, during furtherance of his business. Following are few of the important conditions to be fulfilled:

1. Possession of a tax invoice or debit note or document evidencing payment
2. Receipt of goods and/or services
3. Furnishing of a return
4. Payment to supplier within 180 days from date of invoice
5. Payment of tax by supplier to Government

One of the major difference between GST and Cenvat credit is requirement of matching the credits. This is not a new concept for Karnataka VAT registered dealers as similar concept was already there though not as stringent as GST. In GST, procurements are to be matched with sales of vendors in order to be eligible for credit. Any non-compliance from vendors such non-payment of taxes, non-filing of return, not making entry of sale transactions could lead to denial of credits. In a way, now the tax payers are forced to take credits in GST regime which otherwise could have been ignored by them due to reasons such as defective invoice, tax amount not disclosed, ignorance etc.

Due to paradigm shift in taxation system in indirect taxes and credit concept, following credits would be eligible for tax payers which was earlier restricted:

Credit on motor vehicles – The excise duty or VAT paid on motor vehicle was allowed only for few specified services providers. Those were engaged in providing services were eligible to take credit of excise duty paid on motor vehicles which are designed for transportation of goods. If goods are transported in vehicles designed to carry passengers, credit was not allowed. However, in GST, credit would be allowed on vehicles which are used for transportation of goods. There is no condition that such vehicles should be meant for transport of goods. As a result of this, even if a passenger vehicle is used for transport of goods, GST credit cannot be restricted.

Manufacturers, construction industry, traders, mining can avail the GST paid on vehicles. Those who rent out motor vehicles oruse courier agency would also be eligible.

Vehicle insurance / Vehicle maintenance services –Service tax paid on vehicle insurance or repair/maintenance of vehicle was specifically restricted for credit under Cenvat credit provisions. No such restriction provided in GST regime. Therefore, tax payer would be eligible to claim credit of GST paid on vehicle insurance / repair even on passenger vehicles used for business purpose.

Credit on other capital goods used in office - Excise duty paid on capital goods used in office was not allowed as credit for a manufacturer. As a result of this duties paid on computers, furniture, photocopiers, fax machines, lightings etc was becoming cost to a manufacturer. Karnataka VAT provisions also had restriction on taking credit of VAT paid on air conditioners, coolers, fax machines, photocopiers etc. GST law do not restricts credit on such capital goods used in office as the definition of input is wide enough to cover any goods used for furtherance of business. This would be beneficial for companies who spend in crores for beautification of office premises with furniture, air conditioners.

Taxes paid on inter-state procurement of goods–Central sales tax paid on interstate procurement of goods was not eligible as credit for sales tax / VAT payers. As a result of this, cost of interstate procurement of goods was high in Pre-GST regime. Now, GST paid even on inter-state procurement of goods would be eligible as credit thereby reducing the cost of inters-state purchases.

Credit in installments on capital goods– Cenvat credit provisions allowed only 50% of excise duty / CVD credit on capital goods in the first financial year. Balance 50% credit was being allowed in subsequent financial year. On introduction of VAT in many states, input tax credit was being allowed in installment. GST law allows full credit of taxes paid on purchase of capital goods and thereby resulting in no blockage of funds in form of credit for one year. However, in Cenvat credit provisions, excise duty / CVD paid on capital goods was full allowed even if goods are partially used for exempted activities. In GST, the credit would be allowed based on turnover ratio of taxable activities which is similar to practice which existed in VAT provisions.

VAT credit restriction on inputs stock transferred and fuel – Karnataka VAT provisions did not allow input tax credit to an extent of 2% of VAT paid on goods used as fuel in production such as furnace oil, LPG and other petroleum products. Similarly, credit of 2% was restricted on inputs which are stock transferred to other states other than as a result of sale. This was because the state government was not getting CST revenue on such stock transfers.

In GST all stock transfers for further supply to branches, warehouses or depots would be liable for full GST. There is no concept of credit reversals on account of stock transfers. No restriction placed even on goods like furnace oil, LPG which would be beneficial to tax payers.

Conclusion: If we set aside the fact that there was lack of preparation in introduction of GST, the concept of GST as such would have huge (mostly positive) impact on business entities. There are still few lacunas in the credit provisions which defeats concept of 'seamless' credit. For example, credit restriction of taxes paid on construction services, life and health insurance of employees, outdoor catering services which are very essential in business. Tax professionals need to play a major role in spreading awareness on input tax credits among the tax payers.

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