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Understanding GST Model Law – Def. of Capital goods, inputs & Input services

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Background

GST is likely to be introduced w.e.f 1st July 2017. The understanding of the input tax scheme and its restrictions is imperative to ensure tax optimization for assesses. Representations have been made and among the many thousands of recommendations made, it is hoped the ones for permitting credit on all inputs, input services and capital goods used for business is given effect to in the final GST law.

In this article, the paper writer has sought to give snapshot of the eligible and ineligible input tax credit under GST model law as well as comparison with existing provisions of Cenvat credit Rules.

Capital goods – Section 2(19)

“Capital goods” means: - goods, the value of which is capitalised in the books of accounts of the person claiming the credit and which are used or intended to be used in the course or furtherance of business

Analysis:

This definition has been drafted in completely different footprint from the earlier issued Model GST Law and current Cenvat Credit Rules 2004. The definition is rational vis a vis intent of legislation i.e. Seamless credit.

- The basic condition for any goods to fit into definition of capital goods is capitalization in the books of accounts.
- Definition also mandate that such goods shall be used or intended to be used in the course or furtherance of “business”. The term business has been defined in the law in very broad manner which leaves less scope for an activity to remain outside its criteria.
- Complete value of credit can be availed in the year of capitalization itself as there is no conditions in the law except for pipelines and tele communications towers u/s 16(1).
- It could simply have permitted credit on all goods used in business without distinguishing inputs and capital goods.
- The restriction placed on credit on motor vehicles and other conveyances, leads to sticking of taxes. Against the concept of seamless credit.
- Where the depreciation is claimed on the tax component of the cost of capital goods under the Income Tax Act, 1961, the input tax credit shall not be allowed on the said tax component. There is similar restriction in present Cenvat credit rules, which is to ensure double benefit is not taken.

Input – Section 2(52):

Under GST Law, (52) “input” means any goods other than capital goods used or intended to be used by a supplier in the course or furtherance of business.

Analysis:

- It covers goods used or intended to be used by supplier. There is no condition that such goods should be used for making an outward supply. However, it should be used for business purpose.
- Further, similar to the present exclusion in the inputs as defined under Rule 2(k) of CCR, once a good qualifies as capital goods, it will not be considered as inputs.
- The inputs need not be used at the place of business. In other words, credit is available on inputs/materials used for providing taxable supply at customer’s site.

Input service – Section 2(53):

Under the GST regime, “input service” means any service used or intended to be used by a supplier in the course or furtherance of business;

Analysis

- Definition is much wider and seeks to cover any service used or intended to be used by supplier in course of business.
 - The services which are proposed to be used by business [such as R&D expenses incurred for project for manufacture and supply of specified goods such as energy efficient vehicle engine] in future could also be covered as input service.

Restrictions on credit:

Input tax credit shall not be available on:

(a) motor vehicles and other conveyance. However, credit on motor vehicles and other conveyances is available in following cases

- a. when they are supplied in the normal course of business or
- b. are used for providing the following taxable services—
 - (i) Further supply of such vehicle or conveyance
 - (ii) transportation of passengers/goods, or
 - (iii) imparting training on driving, flying, navigating such vehicles or

Comment: This restriction is not appropriate when in today’s day and age, vehicles are necessarily used in course of business of supply of taxable goods and/or taxable services

(b) goods and / or services provided in relation to following is not eligible :

food and beverages, outdoor catering, beauty treatment, health services, cosmetic and plastic surgery except in making outward supply of such category, membership of a club, health and fitness Centre, rent a cab, life insurance, health insurance except when notified by govt as obligatory services and travel benefits extended to employees on vacation such as leave or home travel concession;

Comment: This restriction leads to cascading effect as several organizations have major component of employee related costs incurred in course of business of supply of taxable goods and/or taxable services.

(c) goods and/or services resulting in construction of immoveable property: This restricts credit on works contract services when such contract results in construction of immovable property, other than plant and machinery;

Comment: The credit on goods/services being denied w.r.t. immoveable property such as building/civil structures which are used by businesses should be removed.

Goods and/or services resulting in construction of immoveable property: Goods or services acquired by a principal on his own account which are used in the construction of immovable property even when used in course or furtherance of business, other than plant and machinery;

Comment: Same as above comment

(d) **Composition tax credit is restricted:** Goods and/or services on which composition tax has been paid; and

Comment: This restriction discourages procurements being done from persons under Composition tax and blow to small businesses.

(e) Credit on goods and/or services used for personal consumption.

Comment: The restriction on goods/services used for personal consumption is appropriate.

(f) Credit on goods lost, stolen, destroyed, written off or disposed of by way of gift or free samples.

Comment: This may deviate the purpose of seamless credit as goods which are distributed as free samples or gift could be used as promotional measures for business organizations.

(g) Credit of tax paid in terms of section 67, 89 or 90

Comment: Tax paid on account of assessment proceedings where reason of fraud, wilful misstatements or suppression of facts are involved, tax paid against detention and confiscation of

goods are covered here.

Analysis in light of present provisions under Central and State Indirect tax laws:

Restrictions in place, including of credit related to motor vehicles/ immovable property/works contract and goods/services used mainly for personal use of employees are c/f from present definitions of inputs and input services in Cenvat credit rules.

The restriction on availment of credit on composition tax is borrowed from state VAT laws.

Relevant decisions

- **Eligibility to credit on capital goods under existing Cenvat Credit Rules: Credit on construction of tanks and pollution control equipment:** In Commissioner v. SLR Steels Limited (2014 (302) E.L.T. A29 (Kar.)) held that cement, Tor Steel, TMT bars, MS Plates, channel plates, MS Angles and Joists used in construction of iron ore, gas and water storage tanks as well as pollution control equipment. Actual use verified by visit of Assistant Commissioner to factory. Held: Assessee entitled to credit on these items. Department's plea that they were used in manufacture of immovable properties/non-excisable items, and hence not entitled to credit rejected.
- **Raw materials:** In the case of Vikram Cement v. CCE [2006 (194) E.L.T. 3 (S.C.)] where inputs used in mines. Explosives, lubricating oils etc. used in mines entitled to Cenvat credit Appeals allowed.
- **Credit on specific input services under Cenvat Credit scheme:**
 - a. **Credit on outward freight:** In C.C.E., Rothak vs. Haryana Sheet Glass Ltd. (2015 (39) S.T.R 392 (P&H) credit of ST paid by manufacturer for delivery up to buyer's premises where ownership and property of goods transferred at customer's doorstep. Held credit admissible
 - b. **Sales promotion:** In decision of Punjab and Harayana High Court in CCE vs Ambika Overseas 2012 (025) STR 348 (P&H) it was held that canvassing and procuring orders were in relation to sales promotion and would fall under sales promotion activities. Hence respondent is eligible for Cenvat credit on the commission paid
 - c. **Employee group insurance:** In Stanzen Toyotetsu India Pvt. Ltd. Vs C. C. Ex., Bangalore-III [2009 (14) S.T.R. 316 (Tri. - Bang.)] credit on Group Insurance Health Policy for which assessee paid Service tax eligible to avail the credit of Service tax paid by service provider. Affirmed in 2011 (23) STR 444 (Karnataka High Court).
 - d. **Outdoor catering:** Held in Resil Chemicals Pvt. Ltd. Vs C.C. Ex., Bangalore-I 2014 (36) S.T.R. 1260 (Kar.) Outdoor catering service for factory. Obligation to run canteen under Factories Act is neither necessary nor number of employees required to exceed 250. The

canteen is run for welfare of employees so they get best food and are able to perform well in factory premises, which has direct nexus with production of goods. Hence, service tax availed is eligible for credit.

- e. **Pest control:** Pest control services used at factory premises is eligible as input service credit. Similarly held in Hindustan Coca Cola Beverages vs C.C.Ex Hyd (2010 (19) S.T.R. 93 (Tri. - Bang.).
- f. In a recent decision in Reliance Industries Ltd vs C.C.Ex. & ST LTU (Mum) (2016-TIOL-2392-CESTAT-MUM) held that exclusion of certain input services in rule 2(l) of CCR, 2004 by the amendment after 01.04.2011 indicates that such services when used purely for personal use or consumption of any employee, credit is not admissible. Appellant have taken a consistent stand that in their case Outdoor Catering, Club or Association Services, Health and Fitness services are utilized for business meeting held at various places Revenue has not dispelled the claim of the appellant by proving that the services were used for personal consumption of employees in the absence of such evidence, credit admissible even after 01.04.2011.

Please note the decisions referred above at (c) and (d) were in context of earlier input service definition applicable till 31.3.2011 where there was no restriction in place for availment of credit on employee related costs.

Conclusion

The credit under GST was expected to be available as long as goods/ services used in or in relation to business. The carrying forward of the old restrictions in the GST law means that to some extent the old case laws would all be revisited.

It is advisable that manufacturers, service providers ensure eligible credit which were missed out to be availed in past is availed now (before 30th June 2017) without fail. This is to take advantage of a facility given for c/f of the eligible credit availed in last return filed before July 2017 as opening balance of credit under GST law.

In this article the paper writer has analysed the definitions of inputs, input services and capital goods along with its restrictions.

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