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## Understanding GST Model Law – Input Tax Credit

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*This is the eight in the series of proposed articles on the GST Model law. No 7 was on Input Services tax credit. The purpose is mainly to create awareness and enable one to look at the unintended impact as maybe applicable for each sector/ person. It could also aid in representation needed for amendment of the Model GST Law to make it tax payer friendly and meet the objective of clarity, certainty and transparency.*

### Background

Same as Part- 7 (Please see earlier article)

The GST law provides for credit of GST paid on all the inputs, barring some exceptions. This part has been borrowed from the Central Excise law and in regard to inputs the law is fairly developed. The exceptions include the goods used for personal consumption, construction of immovable property, goods disposed of by way of gift or samples etc.

In this article the paper writer examines the provisions relating to input tax credit on inputs under the GST regime. Also, input definition under Cenvat Credit rules is analysed herein.

### Definition of Inputs - Section 2 (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.

### Paper writer’s comment:

- *Inputs are any goods other than capital goods, used or intended to be used in course of business. The goods of enduring nature therefore would automatically be covered under inputs.*
- *Business includes any trade, commerce, manufacture, profession, vocation, adventure, wager or any other similar activity, whether or not for a pecuniary benefit, and covers activities incidental/ ancillary thereto. The liability as well as the credit would therefore get covered other than specific disallowances.*
- *Inputs include those which are intended to be used in the course or furtherance of business. Example: Inputs used for research/ trial run of production of taxable goods.*
- *Analysis of eligible capital goods on which credit could be taken would be discussed in next article in this series.*

### Ineligible input credits:

1. motor vehicles and other conveyances except when they are used for making following taxable supplies–
  - Further supply of such vehicles or conveyances
  - Transportation of passengers
  - ● Imparting training on driving, flying, navigating such vehicles or conveyances
  - ● Transportation of goods
2. Supply of following goods and services
  - food and beverages,

- outdoor catering,
  - beauty treatment,
  - health services,
  - • cosmetic and plastic surgery,
  - except when used in making outward supply of said category
  - • membership of a club, health and fitness centre,
  - rent a cab, life insurance, health insurance except govt notified services
  - • travel benefits extended to employees on vacation such as leave or home travel concession,
3. 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
  4. goods or services received by a taxable person for construction of an immovable property on his own account
    - • other than plant and machinery
    - • even when used in course or furtherance of business
  5. Goods on which composition tax has been paid (u/s 9- Composition Option)
  6. Goods used for personal consumption
  7. Goods lost, stolen, destroyed, written off or disposed of by way of gift or free samples
  8. Tax paid on account of assessment proceedings where reason of fraud, wilful misstatements
    - or suppression of facts are involved, detention of goods and confiscation of goods

*It may also be noted that:*

1. *Where the inputs are used by the registered taxable person partly for taxable and partly for non-taxable supplies, the credit attributable to the taxable supplies including zero-rated supplies [exports] could be availed. Example: Out of 10 racks purchased in name of HUF engaged in taxable supply of goods, 5 are used for storing non-taxable supplies such as agricultural produce at farm of HUF. Credit on racks used for non-taxable supplies cannot be availed.*
2. *Where the goods are used by the registered taxable person partly for the business and partly for other purposes, the amount of credit shall be restricted to credit attributable to the business purpose. Example: When umbrella purchased by firm is used for personal use of the partner of the business, credit restricted.*
3. *A banking company or a financial institution including non-banking financial institution engaged in supplying services by way of accepting deposits, extending loans or advances shall have option to avail 50% of eligible input tax credit on inputs, capital goods and input services or avail credit to the extent of effecting taxable supplies including zero rated supply.*
4. ***Credit on stocks to person liable to pay tax:*** *A person who has applied for registration within 30 days from the date on which he becomes liable to registration and has been granted such registration shall, subject to prescribed conditions and restrictions, 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 this Act.*
5. ***Credit on stocks for person who takes voluntary registration:*** *A person, who takes voluntary registration shall, subject to such prescribed conditions and restrictions, 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.

6. **Credit on stocks when taxable person ceases to pay composition tax:** Where any registered taxable person ceases to pay composition tax, he shall, subject to prescribed conditions and restrictions, be entitled to take credit of input tax on 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 normal provisions.
7. **Credit on stocks and capital goods when exempt supply becomes taxable supply:** Where an exempt supply of goods or services by a registered taxable person becomes a taxable supply, such person shall, subject to such conditions and restrictions as may be prescribed, be entitled to take credit of input tax in respect of inputs held in stock and inputs contained in semi-finished or finished goods held in stock relating to such exempt supply and on capital goods exclusively used for such exempt supply on the day immediately preceding the date from which such supply becomes taxable. However, in case of capital goods credit shall be reduced by such percentage points as may be specified.
8. A taxable person shall avail input tax credit specified under (c), (d), (e) above in respect of any supply of goods and / or services to him within 1 year from the date of issue of tax invoice relating to such supply.
9. Where any registered taxable person who has availed of input tax credit switches over as a taxable person for paying tax under composition or, where the goods and / or services supplied by him become exempt absolutely, he shall pay an amount, by way of debit in the electronic credit or 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 such switch over or, as the case may be, the date of such exemption. The balance amount of input tax credit lying in electronic credit ledger shall lapse.
10. In case of supply of capital goods or plant and machinery, on which input tax credit has been taken, the registered taxable person shall pay an amount equal to the input tax credit taken on the said capital goods or plant and machinery reduced by the percentage points as may be specified in this behalf or the tax on the transaction value of such capital goods or plant and machinery, whichever is higher. However in case of refractory bricks, moulds and dies, jigs and fixtures are supplied as scrap, the taxable person may pay tax on transaction value.

#### **Comments:**

1. In view of paper writer the input tax credit on all inputs/materials should be permitted when directly/indirectly used in relation to business of supply of taxable goods and/or services.
2. Restricting credit on goods used mainly for business use by employees unjustified. This could lead to litigation / disputes under GST law.
3. Restriction on employee related credit is copy pasted from current input definition given in Cenvat Credit Rules.
4. Goods used in construction of immovable property is restricted even when used in the course of business. This once again could lead to fresh round of litigation under GST law.
5. Composition tax paid credit being restricted leads to cascading of composition tax.
6. Restriction on credit on inputs used solely for personal consumption is reasonable.
7. Credit on goods sent as gift or free samples is restricted, though the same is for furtherance of business as promotional activity. Restricting such credit is unjustifiable.

#### **Comparison with the present regime:**

Definition of input under present Cenvat Credit Rules as under:

The term input is defined in Rule 2(k) of CCR: "input" means:

Eligible Credit:

- all goods used in the factory by the manufacturer of the final product; or
- any goods including accessories, cleared along with the final product, the value of which is included in the value of the final product and goods used for providing free warranty for final products; or
- all goods used for generation of electricity or steam or pumping water for captive use; or
- all goods used for providing any output service;
- All capital goods having value upto Rs.10000 per piece

*Restriction on availment of credit on inputs*

*Excludes:*

- *light diesel oil, high speed diesel oil or motor spirit, commonly known as petrol;*
  - *any goods used for -*
    1. *construction or execution of works contract of a building or a civil structure or a part thereof;*  
*or*
    2. *laying of foundation or making of structures for support of capital goods,*  
*except for the provision of service portion in the execution of a works or construction service as listed under clause (b) of section 66E of the Act;*
  - *capital goods except when (i)used as parts or components in the manufacture of a final product or (ii)value of such capital goods is upto Rs.10000 per piece;*
  - *motor vehicles;*  
*any goods, such as food items, goods used in a guesthouse, residential colony, club or a recreation facility and clinical establishment, when such goods are used primarily for personal use or consumption of any employee; and*
  - *any goods which have no relationship with the manufacture of a final product.*
- It may be noted there is specific restriction to avail credit on inputs used for executing works contract service [material plus labour contract] set out in ST Valuation Rules.

Landmark Decisions on indicative list of eligible credit on inputs under Cenvat Credit Rules Raw materials: In TELCO vs. State of Bihar (1994 (74) E.L.T. 193), the Supreme Court held that the term raw material varies from industry to industry and decided that items like tyres and tubes, which, though are finished products in themselves, can be considered as raw materials for vehicles.

1. Goods used for testing: In the case of Flex Engineering Ltd vs. CCE, U.P 2012 (276) ELT 153 (SC) wherein it was held that goods used for testing machines were inputs used in relation to manufacture of final product, eligible for Cenvat/Modvat credit. Physical presence in final product is not pre-requisite to claim credit. They may very well be indirectly related to manufacture and still be necessary for completion of manufacture of final product, which is complete only when product is rendered marketable
2. Credit on accessories: The Supreme Court in HMM Ltd. vs. CCE - 1994 (74) E.L.T. 19, wherein it was held that metal screw cap put on Horlicks bottle is a component part of the finished product.
3. Furnace oil: In the case of CCE, Meerut-I vs. Silvertone Papers Ltd., 2013 (287) ELT 478 (Tri. Del.) Furnace oil procured and used in boiler on trial basis. Assessee is entitled to credit of duty paid on it.

**Recommendations:**

1. *Goods used for employees – credit should be allowed when it is mainly for business use.*
2. *Goods acquired in for immoveable property used for business should be allowed.*
3. *Composition tax paid input credit should be allowed unless a low merit rate option provided.*

**Conclusion:**

In this article, the paper writer has sought to examine implications on availment of input tax credit on inputs under the GST regime. The revised model law could be referred for further details. For further clarifications kindly mail at [madhukar@hiregange.com](mailto:madhukar@hiregange.com) or [roopa@hiregange.com](mailto:roopa@hiregange.com)

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