

Understanding GST Model Law – Input Tax Credit

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This is the seventh in the series of proposed articles on the GST Model law. 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

The cenvat credit scheme under present law was intended to be a beneficial scheme to allow the supplier of taxable goods and/or services to avail cenvat credit, including on input services related to business.

However Cenvat credit rules have placed several artificial restrictions on availment of input service credit on construction [other than to persons engaged in taxable services of construction/works contract], motor vehicles related credit and employee credit on expenses primarily incurred in relation to business.

The restrictions lead to break in the credit chain and consequent cascading effect, leading to increase in costs of goods and services. There has been expectation under GST that credit connected to business would be allowed without any restrictions.

The model law sets out that every registered taxable person who carries on any business at any place in India/State, shall be entitled to take credit of input tax admissible to him which shall be credited to the electronic credit ledger of such person.

The amount of credit of IGST available in the electronic credit ledger shall first be utilized towards payment of IGST, CGST and SGST, in that order. The amount of credit of CGST shall first be utilized towards payment of CGST and the amount remaining, if any, towards the payment of IGST. The input tax credit on account of CGST shall not be utilized towards payment of SGST.

In this backdrop, the paper writers have examined the provisions relating to input services credit under the GST regime and also compared with the existing eligibility to input service under Cenvat Credit Rules.

Definition of Input service – Section 2 (55)

“Input service” means any service, subject to exceptions as may be provided under this Act or the rules made there under, used or intended to be used by a supplier for making an outward supply in the course or furtherance of business.

Business is defined in inclusive manner as under:

- (a) any trade, commerce, manufacture, profession, vocation or any other similar activity, whether or not for a pecuniary benefit, whether or not there is volume, frequency, continuity or regularity of such transaction;
- (b) any transaction in connection with or incidental or ancillary to above;

- (c) supply or acquisition of goods including capital assets and services in connection with commencement or closure of business;
- (d) provision by a club, association, society, or any such body (for a consideration) of the facilities or benefits to its members;
- (e) admission of persons to any premises for a consideration,; and
- (f) services supplied by a person as the holder of an office which has been accepted by him in the course or furtherance of his trade, profession or vocation

Comments:

1. Input service covers any service used or intended to be used by supplier to make outward supply in course of business, subject to exceptions/restrictions.
2. The services which are proposed to be used to make outward supply by business [such as expenses incurred for business during project gestation period] in future could also be covered as input service.
3. The definition of business under GST law has borrowed the first two limbs from the 'business' definition under CST law. Transactions not resulting in profit would also be covered as per the definition as long as the intention was to make profit.

Ineligible credit:

Credit shall not be available in respect of the following:

- motor vehicles, except when supplied in the usual course of business or **are used for providing taxable services of –**
 - Transportation of passengers
 - Transportation of goods
 - Imparting training or motor driving skills[shall we remove as this is motor vehicles related shall we cover in article on capital goods]?
- services provided in relation to -
 - food and beverages,
 - outdoor catering,
 - beauty treatment,
 - health services,
 - cosmetic and plastic surgery,
 - membership of a club,
 - health and fitness centre,
 - life insurance,
 - health insurance and travel benefits extended to employees on vacation such as leave or home travel concession,when such services are used primarily for personal use or consumption of employee
- services acquired by principal in the execution of works contract
- when such contract results in construction of immovable property,
- other than plant and machinery.
- services on which composition tax has been paid (u/s 8)
- services used for private or personal consumption to the extent they are consumed.

It may also be noted as under:

- 1. Where the input services 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.*
- 2. Where the goods and/or services 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.*

Comments:

- 1. In view of paper writer the restrictions on credit availment is step backward from promise of permitting all credit related to business [other than that related to non-taxable/ exempted supplies].*
- 2. The restrictions lead to increase in costs as taxes stick on to supply of goods and services, brunt of which finally borne by common man.*
- 3. Credit is being permitted only for motor vehicle used for providing specified taxable services-transport of passengers/goods/motor driving. The logic of restricting motor vehicle credit is incomprehensible when motor vehicles are essential for business be it manufacture or services.*
- 4. Services in relation to food/drink, outdoor catering, life/health insurance/membership of club, etc is restricted when used mainly for personal use of employees. Could lead to fresh round of litigation to be decided in post GST regime++ another 5-7 years.*
- 5. Restriction on motor vehicle/employee related credit is copy pasted from current input service definition given in Cenvat Credit Rules.*
- 6. Service acquired in execution of works contract is restricted. This once again could be litigated and is not fair.*
- 7. Composition tax paid credit being restricted leads to cascading of composition tax*
- 8. Restriction on credit on input services used solely for private consumption is reasonable.*

Comparison with the present regime: Input service definition in Cenvat credit rules

- Credit is permitted on following:

Any service,-

- used for providing an output service; or
- used by a manufacturer, whether directly or indirectly, in or in relation to the manufacture of final products and clearance of final products upto the place of removal,
- and includes

services used in relation to

modernisation, renovation or repairs of a factory, premises of provider of output service or an office relating to such factory or premises, advertisement or sales promotion, market research, storage upto the place of removal, procurement of inputs, accounting, auditing, financing, recruitment and quality control, coaching and training, computer networking, credit rating, share registry, security, business exhibition, legal services, inward transportation of inputs or capital goods and outward transportation upto the place of removal;

Restricted input service credit in present CCR:

- The ST credit on execution of works contract and construction of new buildings/civil structures or laying of foundation or making structures for support of capital goods is restricted [other than to persons providing construction/works contract services].
- Renting of motor vehicle credit to extent related to motor vehicle which is not eligible capital goods.
- Services such as general insurance, servicing, repair and maintenance to extent related to motor vehicle except when used by manufacturer of motor vehicle or insurance co in respect of motor vehicle insured/re-insured by such person

Specific instances of eligible credit which is not being availed under present provisions due to ignorance/disputes by dept

Input service credit such as renovation/repair of building, architect, landscaping, project management consultant, consulting engineer services is eligible to all manufacturers of dutiable goods/ providers of taxable/exported services.

- There has been litigation with Tribunals and High Courts holding in favour of assessee by allowing credit related to catering, air travel, accommodation, group mediclaim, personal accident insurance of employees, when used for business.
- Similarly credit is allowed on car parking, garden maintenance.

Decisions permitting credit on specific input services under Cenvat Credit scheme:

Repair maintenance: In Red Hat India Pvt Ltd vs. Principal Commr, Service Tax, Commissionerate, Pune (2016-TIOL-1300-CESTAT-MUM) appellants are engaged in the providing export of services and filed refund claim under Rule 5 of Cenvat Credit Rules, 2004. As regards Works contract service, credit has been taken as this service is related to monthly maintenance of photocopier, computer and building premises of the appellant. After extracting rule 2(l) of the CCR, the Bench held -As per rule 2(l) of CCR, 2004, Works Contract Services are excluded only when used for construction services. Works contract services used for maintenance of office equipment and building are to be treated as Input Services, credit admissible and eligible for refund.

It is relevant this was decision under new input service definition applicable wef 1.4.2011.

Outdoor catering: Held in Stanzen Toyotetsu India Pvt. Ltd. vs. C. C. Ex., Bangalore-III 2009 (14) S.T.R. 316 (Tri. - Bang.) Affirmed in 2011 (23) STR 444 (Karnataka High Court) held outdoor caterer services for providing food to staff. Facility provided because of statutory obligation imposed under Section 46 of Factories Act, 1948 and it becoming condition of Service as far as employees concerned. Expenses incurred considered in fixing price. Activity may be welfare measure but not charity provided by employer to employees. Test whether service utilised for manufacture directly or indirectly or used in relation to activities relating to business. Credit available

Employee group insurance/accident insurance: In Milipore India Ltd Vs CCE Bangalore -II (2009 (236) ELT 145 (Tri-Bang). Affirmed in 2012 (26) STR 514 (Karnataka High Court) there was no restriction on availment of such insurance credit. This decision was followed in Reliance Industries decision (2015-TIOL-181-CESTAT-MUM).

Air travel by company directors/employees: Expenditure incurred on air travel by employees/directors of the company for official purpose is eligible for credit subject to proper documentary evidence. Similarly held in CCE vs Fine Care Biosystems (2009 (244) ELT 372 (CESTAT) and Goodluck Steel Tubes Ltd. Vs C. C. Ex., Noida 2013 (32) S.T.R. 123 (Tri. - Del.).

Lodging/Boarding: One Advertising & Communication Services Ltd. vs C.S.T., Ahmedabad (2012 (27) S.T.R. 344 (Tri. - Ahmd.)). wherein it was held payment of Service tax on hotel rent for chief executive for business and client meeting. Issue directly relatable to assessee's business. Therefore, credit admissible

Commission agent: The decision of Punjab and Harayana Hon'ble High Court in the case of CCE vs Ambika Overseas (2012 (025) STR 348 (P&H) wherein 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 accordingly the objection requires to be dropped.

Mobile phones in the name of employees: In CCE, Goa vs. Hindustan Coca Cola Beverages (P) Ltd. (2015 (39) STR 360 (Bom) wherein held Credit of Service Tax paid on mobile phones used by employees/staff of manufacturer admissible.

Gardening services: In CCE & ST, LTU, Chennai vs. Rane TRW Steering Systems (2015 (39) S.T.R. 13 (Mad.)) wherein it was held housekeeping and gardening services where an employer spends money to maintain their factory premises in an eco-friendly manner, tax paid on such services would form part of the cost of final products and the same would fall within the ambit of "input services" and therefore assessee is entitled to claim the benefit. Thus, Housekeeping and landscaping services included in the scope of term "input services".

Group insurance: In CCE & ST, LTU, Bangalore vs. Micro Labs Ltd. 2012(26) STR 383 (Kar) held Group Insurance Health Policy though a welfare measure is an obligation cast under statute that employer has to obey. Policy taken by assessee is service constituting activity relating to business which covered under input service definition. Service tax paid on all services utilised directly or indirectly in or in relation to final product eligible as credit.

The decisions referred above other than (i) 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.

Recommendations:

1. Transfer 5 petroleum products from sales tax to GST and enable their credit whether used for generation of electricity or for furtherance of business. Only personal use be restricted.
2. Bring electricity also into the tax net to avoid cascading as that is essential to large degree for manufacturing, and to smaller extent in case of supply of services.
3. Permit credit on input service related to motor vehicle having nexus to taxable supply of goods and/or services.
4. Services in relation to food/drink, outdoor catering, life/health insurance/membership of club, etc should be allowed when it is essentially for business use.
5. Services acquired in execution of works contract for business should be allowed.

6. Composition tax paid credit should be allowed which was concept which was adopted in service tax in 2007 itself.

Conclusion:

In this article the paper writers have examine the provisions of credit on input services under GST regime briefly. The concepts of matching etc, job work credits and procedural aspects have not been examined in this article. The model law could be referred for further details. The rules which are still to be prescribed would be required to be studied for full understanding.

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