15.08.2016 **H&A/GST-Part 9**

Understanding GST Model Law – Tax credit on Capital goods

By CA Madhukar N Hiregange
CA Roopa Nayak

This is the ninth in the series of articles to understand the GST Model Law. The purpose is mainly to create an awareness and enable one to look at the unintended impact on his her sector. It would aid in making representations to make this law tax payer friendly, simple and transparent.

The GST Model Law has been put in public domain to get the feedback for amendments. This law requires in the opinion of the paper writers amendment to avoid cascading and reach the objective of seamless credit.

Introduction:

Input tax credit under GST is one of the most important aspects as it goes to reduce the costs of taxes at each stage in supply chain from supplier to end customer. It prevents tax on tax and ensures that tax is paid only on the value added at each stage. Most of the times, the GST payable may be far in excess of the gross margin of the assessee.

Under present law, cenvat credit on eligible capital goods, inputs or input services used for manufacture of dutiable goods or for providing the taxable services could be availed. The net tax could be paid after setting off the cenvat credit availed.

Cenvat scheme is a beneficent piece of legislation and unless it is shown that the items are specifically excluded from the definitions of the terms “inputs”, “input service” or “capital goods”, Cenvat Credit cannot be denied.

It was expected that credit on all goods[inputs and/or capital goods] would be available when used for business by taxable person. However the old credit restrictions seem to have been copy pasted from Cenvat Credit Rules.

In this backdrop, the paper writer has examined the provisions relating to credit on capital goods under the Model GST law.

Definition of Capital goods – Section 2(20)

“Capital goods” means: -

A. the following goods, namely:-
   i. all goods falling within Chapter 82, Chapter 84, Chapter 85, Chapter 90, heading 6805, grinding wheels and the like, and parts thereof falling under heading 6804 of the Schedule to this Act;
   ii. pollution control equipment;
   iii. components, spares and accessories of the goods specified at (i) and (ii);
   iv. moulds and dies, jigs and fixtures;
   v. refractories and refractory materials;
   vi. tubes and pipes and fittings thereof;
   vii. storage tank; and

viii. motor vehicles other than those falling under tariff headings 8702, 8703, 8704, 8711 and their chassis but including dumpers and tippers used-
   1) at the place of business for supply of goods; or
   2) outside the place of business for generation of electricity for captive use at the place of business; or
   3) for supply of services,

B. motor vehicle designed for transportation of goods including their chassis registered in the name of the supplier of service, when used for
   i. supplying the service of renting of such motor vehicle; or
   ii. transportation of inputs and capital goods used for supply of service; or
   iii. supply of courier agency service;

C. motor vehicle designed to carry passengers including their chassis, registered in the name of the supplier of service, when used for supplying the service of-
   i. transportation of passengers; or
   i. renting of such motor vehicle; or
   ii. imparting motor driving skills;

D. Components, spares and accessories of motor vehicles which are capital goods for the taxable person.

Paper writer's comments:

- *Regressive measure of linking eligible capital goods to chapter headings, such as 84, 85, 90 under GST.*
- *Credit on certain specified motor vehicles is illogically restricted for certain categories to manufacturers + restricted only to specified service providers.* ***Restrictions=no seamless credit****.*
- *The coverage is not wide enough to include the capital goods normally used by the service providers like furniture.*
- *Credit on goods falling in specified headings such as paint booths, lifts, elevators etc which may at times be embedded in the immovable property shall be eligible-****no restriction thereon****.*
- *Ownership of the capital goods is not relevant in the GST law. Delink credit on motor vehicles from registration in name of supplier of taxable service.*
- *The inputs used in fabrication of capital goods should also be eligible considering the beneficial objective of credit scheme.*

Capital goods definition under present Cenvat Credit Rules

- The definition of capital goods is given in Cenvat Credit Rules 2004.
- Definition is restrictive. Only what is specified therein is covered.
- Capital goods used 1)in factory of manufacture of final product; or 2) for providing output service.
- At present following are covered: tools, knives falling under chapter 82, machines covered in chapter 84, electrical machinery under chapter 85, measuring, checking and testing machines falling in chapter 90 grinding wheels of heading 6804; pollution control equipment
- Components, spares and accessories of above[need not fall in above headings].
- moulds and dies, jigs and fixtures;

- refractories and refractory materials;
- tubes and pipes and fittings thereof;
- storage tank;
- motor vehicles other than those excluded;
- CG used outside factory for generation of power used captively in factory.
- motor vehicles used for providing specified services such as transport of passengers/ courier agency service
- Credit on dumpers and tippers is eligible as capital goods.

Decisions on eligibility to credit on capital goods under existing Cenvat Credit Rules

- **Plant/machinery**: Capital goods can be machines, machinery, plant equipment, apparatus, tools or appliances. Any of these goods if used for producing or processing of any goods or for bringing about any change in any substance for the manufacture of final product would be 'Capital goods', and, therefore, qualify for availing credit. Similarly held in C.C.Ex. Coimbatore vsJawahar Mills Ltd (2001 (132) E.L.T. 3 (S.C.).
- **Parts/Spares of machinery:** Components/spares/accessories of machineries need not fall in chapter 82, 84, 85, 90. The only requirement is that they should be part, component or accessory of machinery. Held in CCE vsRashtriyaIspat Nigam Ltd(2011 (267) ELT 311 (AP HC) that "capital goods" would not only include goods falling under Chapters 82, 84, 85 and 90 of the Central Excise Tariff Act but also components, spares and accessories of such goods.
- **Steel panels/channels:** In Rajasthan Spinning & Weaving Mills (2010 (255) ELT 481 (SC) held by applying user test that steel plates and MS channels used in fabrication of chimney for DG set is eligible as accessory to capital goods.
- **Capital goods becoming immoveable property:** Credit on inputs used in manufacture capital goods such as storage tanks/pollution control equipment is eligible even if it becomes immoveable property. Held in CCE vs SLR Steels (2012 (280) E.L.T. 176 (Kar.).

Recommendations:

i. *The credit on all goods [without distinguishing inputs/capital goods] should be allowed, when used for business.*
ii. *For such goods used both for business and personal purposes, such as motor car used for personal use of partner of business, a flat percentage could be applied say 30% being ineligible, balance is eligible.*

It is of paramount importance that at earliest representation to be done through trade/commerce associations with assistance of competent professionals to the Finance Ministry to remove all restrictions and enable credit on all goods[inputs+CG]without restriction when used for business.

The model law is in public domain. Representation done in next 2-3 months could ensure all restrictive provisions in draft law are amended/removed to enable ease of doing business. Representation done now could have more impact than what could be possible once the law is in place.[expected GST introduction sometime between April to Oct 2017]

Conclusion:

Though the Cenvat credit scheme is a beneficial scheme, the restriction on availment of credits would lead to situations where the credit would become a cost at each stage, leading to some amount of cascading. The brunt of these barriers to credits would be ultimately borne by the end customer.

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