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MECHANISM OF INPUT TAX CREDIT UNDER GST – AN OVERVIEW

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Abstract: Goods and service tax (GST) is a comprehensive and destination-based tax system. Compared to the earlier indirect tax regime, GST provides seamless input tax credit across the entire supply chain but certain recent amendments in the act have interrupted the continuous flow of credit which in turn affecting the ease of doing business in India. This research paper highlights the mechanism of input tax credit and some of the problems faced by the taxpayers in claiming the input tax credit.

Index Terms - Goods and Service Tax (GST); Input tax credit (ITC); subsumed; taxpayer.

1. INTRODUCTION

GST was introduced in India as “One Nation One Tax”. It came into effect from midnight of 1st July 2017. Many indirect taxes were merged into GST. In the previous indirect tax system, there were “n” number of taxable events for example, the taxable event in service tax was provision of service, for central excise duty it was manufacture, for VAT it was intra-state sale of goods, and so on, but under GST there is a single taxable event that is “supply”. Hence GST is levied on supply of goods or services made in the course of business.

It is nearly impossible for a large country like India to follow a single GST model as the distribution of revenue among various states will be very difficult and conflicts may increase between central and state. As a result, India follows the dual GST model. Both Central and State government has the authority to levy and collect tax on supply of goods or services or both. GST comprises Central Goods and Service Tax (CGST), State Goods and Service Tax (SGST) / Union Territory Goods and Service Tax (UTGST) and Integrated Goods and Service Tax (IGST). CGST is levied and collected by the central government on intra-state supply of goods or services. SGST/UTGST is levied and collected on intra-state supply of goods or services by the state or union territory as the case may be. IGST is levied and collected by the central government on inter-state supply of goods or services.

Every person supplying goods or services should compulsorily get registered under GST if his aggregate turnover crosses the prescribed threshold limit during a financial year. Such registered persons are required to furnish the GST return monthly or quarterly based on their aggregate turnover and type of their business. An annual return should also be filed by all the registered persons. The GST returns include details of sales, purchases, tax paid on purchases (input tax), tax collected on sales (output tax), debit notes, credit notes, etc. There are 22 types of GST returns prescribed under the GST law. The returns that are filed by majority of registered persons in their course of business are mentioned below:

- GSTR-1:** It contains all the outward supplies made by the registered person during the prescribed period. GSTR-1 should be filed monthly if the aggregate turnover of the registered person is more than Rs.1 crore and option is given to file either monthly or quarterly for such registered persons whose aggregate turnover is up to Rs.1 crore.
- GSTR-3B:** It is a summary of all outward supplies made, output tax, input tax, tax liability ascertained and tax paid. It is a monthly return to be filed by every registered person.
- GSTR-9:** It is an annual return containing all outward and inward supplies made during the financial year.
- GSTR-2A and GSTR-2B:** They are auto-populated (system generated) returns which are made available to the taxpayers. They reflect the inward supplies based on the information furnished by the suppliers in their GSTR-1. GSTR-2A is a dynamic return whereas GSTR-2B is a static return that is the details of inward supplies in GSTR-2A will be updated on continuous basis but in GSTR-2B the details will be updated on constant basis.

2. REVIEW OF LITERATURE

Sharma (2017) focused on the favorable and unfavorable impacts of GST on micro, small and medium enterprises [MSME]. The study found that GST would lead to an increase in job opportunities and economic development of the nation. The author opined that GST reduces the tax burden for both manufacturers and end consumers by taking advantage of input tax credit.

Nandal & Diksha (2018) studied the perception and level of satisfaction of traders and manufacturers towards GST. The study was confined to three districts of Haryana. The paper was predominantly based on primary data, a total of 200 respondents were selected on random sampling basis and responses were collected using the 5-point Likert scale. The findings of this study revealed that most of the respondents had an optimistic view towards GST and were satisfied with the new indirect tax regime. The authors suggested that government should conduct training and awareness programs to get a better understanding of the GST law.

Chakraborty (2018) studied the impact of GST on micro, small and medium enterprises and how the new indirect tax system has created pressure on GDP growth of India in the short run. She noticed that GST had both positive and negative impacts on MSME and her study also found that introduction of GST has hampered the growth rate of GDP. The author concluded that in long run the rollout of GST will have a positive effect both on MSME and GDP growth rate.

Sharma & Suniti Saini (2019) identified the awareness of GST among businessmen. The study was limited to Mandsaur city. The paper is based both on primary and secondary data. The author found that 82 per cent of the respondents required more clarity regarding the rules and regulations and 42 per cent of the respondents were less happy with the tax rates specified under GST. The study concluded that the impact of GST on Indian economy is likely to be more positive if efforts are made to give more clarity in the legislation.

3. OBJECTIVES OF THE STUDY

- To analyze the seamless credit available on purchases made by the registered persons under GST in comparison with the previous indirect tax regime.
- To study the problems faced by a registered person while claiming ITC.

4. RESEARCH METHODOLOGY

This study is based on data collected via secondary sources from various journals, books, newspapers, circulars and notifications issued by CBIC, articles and publications from various websites that are relevant and reliable are taken into consideration.

5. CONCEPT OF INPUT TAX CREDIT

According to section 2(63) of CGST Act, 2017, input tax credit means the credit of input tax. So, to understand the meaning of input tax credit one should know what input tax means. Input tax means the tax (CGST, SGST/UTGST or IGST) paid by the registered person on purchases made by him during the course of his business. It includes the IGST paid on import of goods or services and also the tax paid on reverse charge mechanism, but it does not include tax paid on purchases made by a registered person under composition levy. Thus, ITC in simple words means a registered person while paying tax on taxable outward supplies can reduce his tax burden by taking credit of tax that he has already paid on purchases made. Let us understand the meaning of input tax credit with an example. For example, a wholesaler purchased a mobile phone from the manufacturer for Rs.20,000 on which he paid GST at 18 per cent amounting to Rs.3,600 which is an input tax to the wholesaler. If the wholesaler makes a further supply of the same product by adding some value say Rs.5000 to the retailer, he will collect GST from the retailer at 18 per cent on Rs.25,000 i.e., Rs.4,500. So, the wholesaler will deduct Rs.3,600 from Rs.4,500 as input tax credit and will pay the remaining Rs.900 to the government.

Hypothetical illustration of mechanism of input tax credit:

Manufacturer	Wholesaler	Retailer	Consumer
Production Cost + Profit: 1,00,000 GST @ 5% = 5,000	Cost: 1,00,000 Profit: 10,000 Sale Price: 1,10,000 GST @ 5% = 5,500	Cost: 1,10,000 Profit: 15,000 Sale Price: 1,25,000 GST @ 5% = 6,250	Buying Price = 1,31,250
Input Tax Credit = NIL (assumed)	Input Tax Credit = 5,000	Input Tax Credit = 5,500	Input Tax Credit = NIL
Output Tax Liability = 5,000	Output Tax Liability = 500 (Output tax – Input tax) (5,500-5000)	Output Tax Liability = 750 (Output tax – Input tax) (6,250 – 5,500)	Tax Borne by the Consumer 5,000 + 500 + 750 = 6,250
Note: Output Tax Liability = Rate of GST x Value addition made by the respective registered person			

Eligibility and Conditions to claim ITC:

Every person who is into the business cannot claim ITC on purchases made by him, one should satisfy all the conditions specified in section 16 of CGST Act, 2017.

Eligibility to claim ITC that are specified in Section 16(1) of CGST Act, 2017:

1. The first and foremost criteria to claim ITC is to compulsorily get registered under GST. In other words, only a registered person can claim input tax credit.
2. The goods or services should be used only for business purposes. If a registered person uses goods or services for his personal use, he cannot claim ITC on that product or service.

Some of the important conditions specified in Section 16(2) of CGST Act, 2017 that are to be satisfied in order to claim ITC:

1. A registered person should possess either invoice or debit note issued by the supplier.
2. In order to claim ITC by the recipient, the supplier should have filed the return and should have deposited the tax to the government.
3. The registered person should make payment to the supplier, the entire value of goods or services within 180 days from the date of issue of invoice.

5.1 SEAMLESS CREDIT AVAILABLE UNDER GST REGIME

In the earlier indirect tax system, there were many types of taxes like service tax, VAT, central sales tax, excise duty, etc. Some of the indirect taxes were levied and collected by the central government and some were levied and collected by the respective state government. The taxes that were collected by the central government cannot be set off against the taxes collected by the state government and vice versa as there was no integration between CENVAT and State level VAT. This led to cascading effect i.e., tax on tax. For example, a furniture dealer was not able to set off service tax paid on rent for his showroom against the VAT that he collected from the sale of furniture. Several taxes levied by states were not subsumed in the VAT hence multiple taxes were levied on a single transaction.

In the GST regime, majority of indirect taxes are subsumed. GST is a comprehensive tax structure that provides seamless credit across the entire supply chain. GST is levied on value addition at each stage of the supply chain and allows the credit of tax paid at earlier stages and hence it eliminates cascading effect which was prevailing under the previous indirect tax regime. If a registered person under GST satisfies all the conditions specified in section 16 of CGST Act 2017, he can claim ITC in relation to all of his inputs across India. As GST is levied only on value addition by the respective registered person it minimizes the cost burden for ultimate consumers and also helps in reducing the possibility of levy of tax at different stages.

5.2 PROBLEMS FACED BY REGISTERED PERSONS WHILE CLAIMING ITC

Under the GST regime, tax must be paid on an accrual basis i.e., the supplier should pay the tax to the government on goods or services supplied by him even if he has not received any payment for the same. This itself creates a burden to the taxpayers. But certain provisions and recent amendments in GST Act have become a nightmare to the business sector. Some of the hurdles in claiming ITC are analyzed in this article.

Section 16(2)(aa) of CGST Rules, 2017 restricts the claim of input tax credit. It restricts the taxpayer to claim ITC not more than what is being reflecting in his GSTR-2B. The reasons for a particular transaction not reflecting in the recipient's GSTR-2B is mainly because of fault made by the supplier, either he would have wrongly mentioned the GSTIN of the recipient or he would have omitted that particular transaction in his GSTR-1, in some cases the supplier might have failed to file his GSTR-1. Hence for the default made by the supplier, the government is penalizing the recipient by not allowing to claim ITC. In some circumstances even though the supplier has filed GSTR-3B and paid the tax to the government which was collected from the recipient, this rule does not permit the recipient to claim ITC.

Second proviso to section 16(2) read with rule 37 of CGST Rules, 2017 says that in order to claim ITC, the recipient must have paid the entire value of goods or services within 180 days from the date of issue of invoice. The basic intention of this provision is to protect the liquidity position of small businessmen. But this condition adversely affects the large-scale business sector because the value involved in their transaction will be huge and it is very difficult to settle the entire amount within 180 days. In some cases, even if the supplier and recipient both agree to extend the credit for a longer period, this rule forces the recipient to make the payment within 180 days so that the said recipient will be allowed to claim his input tax credit.

As per section 17(5) [Blocked Credits], a registered person cannot claim input tax credit on certain specified goods and services even though such goods and services are used in the course or furtherance of business. One of such services mentioned under section 17(5) is works contract service. Works contract means a contract of building, construction, erection, installation, etc. of any immovable property. Let us assume, there is a situation where an assessee gets a building constructed and let out the same for rent. It is a taxable supply and he has to charge GST at 18 per cent on rent that he collects from his tenant. In this case the assessee does not have any input tax except the tax that he paid on works contract service and he cannot set off that credit against the output tax to discharge his liability. This leads to cascading effect.

Rule 86B of CGST Rules, 2017 restricts the utilization of ITC available in electronic credit ledger. Electronic credit ledger reflects the input tax credit available for a registered person. As per this rule if a taxpayer's aggregate turnover exceeds Rs.50 lakhs per month, he cannot utilize more than 99 per cent of input tax credit that is reflecting in his credit ledger. In other words, the said registered person should pay at least one per cent of his output tax liability in the form of cash. This rule ultra vires all the provisions relating to input tax credit. Even though the said rule does not affect small and medium businesses, it creates a burden on the working capital of large taxpayers. This rule unnecessarily forces the large taxpayers to discharge their liability only in the form of cash which in turn affects their liquidity.

6. CONCLUSION

Currently, businessmen and industrialists are facing an immense crisis due to the ongoing Covid-19 pandemic. Taxpayers are going through a liquidity crunch and their sales figures have declined drastically and it is questioning their utmost survival. The purpose of certain provisions and amendments made in relation to input tax credit is to exercise control over the fraudulent way of claiming input tax credit. But just to restrict or avoid such malpractices committed by minority taxpayers it is having an adverse impact on the majority of taxpayers. The government should safeguard the honest taxpayers and ensure business friendly environment. Hence the government should liberalize the existing GST rules in relation to claiming input tax credit and should allow the taxpayers to avail seamless input tax credit.

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