

GST – Ensuring credit without artificial fetters

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At the time when this article is being written, the air is thick with optimism and hope that Constitutional Amendment Bill on Goods & Services Tax (GST) will be passed by the Rajya Sabha in this monsoon session itself. It appears that the government is inclined to accept certain amendments and therefore, if it is passed by in the Upper House, it will have to be passed by Lok Sabha again. Once the Bill clears the legislative sanction of the Parliament, approval by majority of State Legislatures is seen as very certain. All these developments may well bring GST from 1st April, 2017. The biggest differentiator of GST vis-à-vis other taxation systems is availability of credit of GST paid on every taxable supply so as to be set off against output supply liability without too many fetters. At present, the model law on GST contains certain indicative provisions relating to credit or Input Tax Credit (ITC) but for the final version and finer details, one has to wait for the government to bring the next version of the draft GST law and also draft ITC Rules. This article attempts to take a broad look at the emerging scenario on ITC.

Capital goods – Why the definition?

The model law on GST contains definitions of capital goods, input and input service. Capital goods are defined almost in an identical manner as they are contained in the present day Cenvat Credit Rules including the references to particular chapter headings of Central Excise Tariff. For tobacco and specified petroleum products which will be out of GST, the existing Central Excise Tariff may be relevant. But for most of the other taxable goods, it is not clear as to the role and relevance of tariff headings in the GST law. Though the Business Process Report on Returns recommend mentioning of HS Code at 2 / 6/ 8 digit level in certain cases in the invoices, the correlation of such codes / headings with respect to eligibility to ITC is not clear.

Even more incomprehensible is retention of such restrictive definition because GST law is required to provide credit of all purchases irrespective of any distinction as long as they are put to business purpose by the taxable person and who uses such credit to offset his GST liability on taxable supplies provided by him. Still more perplexing factor would be the idea of having separate definitions for capital goods and inputs since GST will talk about creditable acquisitions (as Australian GST uses) and the artificial line drawn and maintained vigorously so far by the Revenue Administration between machinery and raw materials will

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become obsolete both conceptually as well as statutorily. Claim of depreciation under Income Tax law on capital goods may be a reason for the proposed provisions maintaining such distinction. But definition clauses are the thresholds to be crossed for availment of credit and the proposed definitions do not suggest the doors will be wide open. The model law on GST points to lurking danger of continuation of the Modvat mindset – credit is a largesse to be bestowed on the tax payers and deniable when the administration chooses to do so. This needs to change as otherwise taxpayers may have to battle disputes over admissibility of credit on a routine factory item like welding electrode.

Inputs – Will discretion be exercised rationally?

The term 'input' is sought to be defined as *'means any goods other than capital goods, subject to exceptions as may be provided under this Act or the rules made thereunder, used or intended to be used by a supplier for making an outward supply in the course or furtherance of business.'* This appears to be reasonable on the face of it but the rider *'subject to exceptions as may be provided'* may provide the handle to the administration to restrict credit on purchases without any rationale or reason because such exceptions can be carved by way of rules also. But one need not anticipate a very constricted definition given the wider and exhaustive meaning attributed through the jurisprudence evolved so far in so far as credit on inputs is concerned and the same will be a legacy which cannot be departed from to a great extent. The inevitable as far as inputs are concerned is that the ITC system will get skewed to certain extent owing to specified petroleum products being kept out and the excise duty paid on such products will not be available as credit under GST law.

Input service – A step in the right direction

Input service is proposed to be defined as (using means clause) any service used or intended to be used by a supplier for making an outward supply in the course or furtherance of business. This definition is also subject to the exceptions as may be provided either under the GST Act or the rules. Compared to the present day Rule 2(l) of Cenvat Credit Rules, 2004, the proposed definition under GST dispensation appears to be lot more leaner and simpler but one has to wait for the ITC Rules before commenting on the same since consequences of statutory wordings are aftershocks which are felt years and decades after the tremor.

Unshackling credit from place of removal

Two issues or disputes gripping the entire industry on inputs and input services vis-à-vis credit namely determination of place of removal and relationship with manufacture are likely to become the ghosts destined to be extinguished eternally once the angel of GST

appears. That credit needs to be artificially restricted to place of manufacture and removal and cannot extend to places where the manufacturer or service provider conducts his business including post-manufacturing activities, is a sad story only to be forgotten once GST is ushered in. The definition of input service, which had a very progressive clause 'activities relating to business' was omitted taking the credit system years back, is set to reappear in GST law. Business is being given an exhaustive definition and it includes any trade, commerce, manufacture, profession, vocation or any other similar activity, whether or not it is for a pecuniary benefit, as the model law indicates.

ITC under VAT laws

The restrictions on ITC under present VAT laws of various State are broadly similar to the current regime of Cenvat credit as most States do not permit credit on goods used for civil construction, office equipment, motor vehicles, fuel used for electricity generation, etc. In general, no set off is allowed when tax is paid under Composition Scheme. When common ITC Rules are framed for both CGST and SGST, one can hope less frugality and more generosity with most goods likely to get covered under the fold of ITC.

ITC under GST – Good days ahead?

The heart of GST is credit mechanism and therefore, one expects the definitions and statutory provisions to entitle the tax payer, without much restrictions, to take and utilise ITC on all the supplies on which input tax has been paid when such supplies are received and used for business purpose of providing taxable output supplies. The draft ITC Rules which the government will float in public domain will be a pointer to the regime which will enable industry to concentrate on business more by easing the transitional pains and cash flow through a broader and liberal credit system.