

Utilization of ITC (Input Tax Credit): the core provision of GST

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ABSTRACT

GST is destination-based tax and Input Tax Credit is the core provision of GST. Input Tax Credit lays the base of GST, which helps to avoid the cascading effect of taxes in GST. ITC is considered to be the backbone of the GST regime. In fact, it is the provision of ITC which essentially make GST a value added tax i.e., collection of tax at all points of supply chain after allowing credit of tax paid at earlier points. The GST regime promises seamless credit on goods and services across the entire supply chain, and this is only possible through the core provision of Input Tax Credit. This paper intends to elucidate the core concept of GST i.e., Input Tax Credit which has enabled the entire nation suppliers and recipients of taxable supplies to take the benefit of tax paid while purchasing inputs.

1. Introduction

Input Tax credit has its origin in the concept of MODVAT [Modified Value Added Tax] which was introduced in India in 1986. MODVAT was introduced only at the manufacturing level, where the manufacturer could avail credit of duties paid on inputs and capital goods (used in manufacturing final output) out of the duties payable on output. Thereafter in 2004 MODVAT was replaced by CENVAT which provided credit of input tax as well as of input services out of the output tax or output services (respectively). Under the Cenvat scheme, the manufacturer of final product or provider of taxable service was allowed to take credit of duty of excise as well as of service tax paid on any input received in the factory or any input service received for final product. In 2005 VAT was introduced in India based on the concept of Input Tax Credit.

The VAT legislations allowed Input tax credit of VAT on inputs & capital goods in transactions within the same state, but not on inputs & capital goods coming in the state from outside the state [on which Central Sales Tax [CST] was levied]. However, the credit chain remained fragmented on account of State-Level VAT as the credit of central taxes could not be set off against a State levy and vice versa. The chain further got distorted as ITC was not available on inter-State purchases. This resulted in cascading of taxes leading to increase in costs of goods and services.

2. GST: A Destination Based Tax

Uninterrupted and seamless chain of input tax credit (ITC) is one of the key features of Goods and Services Tax. One of the most important features of the GST system is that the entire supply chain would be subject to GST to be levied by Central and State Government concurrently. As the tax charged by the Central or the State Governments would be

part of the same tax regime, the credit of tax paid at every stage would be available as set-off for payment of tax at every subsequent stage. Under GST, ITC will follow supply chain not only in intra-State transactions but also in inter-State transactions. Moreover, credit of tax paid at the time of import of goods and services would also be creditable. This is expected to result into significant reduction in cascading of taxes.

3. Comprehending GST using the concept of ITC

Let us understand the nuances of GST in detail with the help of a hypothetical example in which there are four stages of value addition, beginning with the first stage which has no purchased inputs to last fourth stage where goods are sold to the final consumer.

- **Stage I Supplier** - deals with collection of lacs (lac is the scarlet resinous secretion of lac insects) from the forest.
- **Stage II Supplier** - Purchases lac from Supplier I, further processes it, adds value to it and sells it to the Supplier III.
- **Stage III Supplier** - Purchases processed lac from Supplier II, further processes it, adds further value to it and sells it to the retailer.
- **Stage IV Retailer** - Purchases from Supplier III, adds value by procuring, stocking and selling supply to the final consumer.

If these four stages are assumed to exist then let us understand how GST would be levied at every stage in the supply chain and yet will remove the deficiencies of cascading effect, double taxation and ensure transparency. We also assume that the combined GST rate. i.e. Central GST (CGST) and State GST (SGST)] is 10%.

Table No. 1. GST Integrated Value Added Tax Regime

	Input price 1	Value Added 2	Total Value Added (1)+(2)=(3)	Combined GST @10% on (3)=(4)	SP (3)+(4) =(5)	Tax paid to Govt. (6)
A Stage I Supplier	–	100	100	10	110	10

B Stage II Supplier	110 (100+10 Input Tax)	50	150 (100+50)	15	165	OT 15 Less: ITC 10 NTP = 05
C Stage III Supplier	165 (150+15 Input Tax)	40	190 (100+50+40)	19	209	OT 19 Less: ITC 15 NTP = 04
D Retailer/ Stage IV Supplier	209 (190+19 Input Tax)	30	220 (100+50+40 +30)	22	242	OT 22 Less: ITC 19 NTP = 03

Total Tax paid to the Govt. = Rs. 22 (10 + 5 + 4 + 3)

The chart illustrated above explains in layman language, how the concept of ITC is used in GST to avoid double taxation or cascading effect of taxes.

Input Tax Credit = Input Tax Credit simply means Credit allowed of tax paid on Inputs i.e. Input Tax.

Output Tax = Output Tax is the tax paid on output.

Under GST, when a person purchases inputs from his supplier, he pays tax to his supplier. Like in this example, when B purchased input from A, B paid tax amounting Rs. 10 to A.

Now when B supplies goods to C, he charges tax amounting to Rs. 15. Now in the earlier regime, the tax paid on inputs were absorbed in the cost of product or service (hence made the product of service more expensive & also lead to double taxation). But in the GST, the tax paid on inputs, like here Rs. 10 shall be deducted (allowed as credit) from the output tax, like here out of Rs. 15 and B shall only be liable to pay Rs. 5 more.

Net tax payable = Output Tax – Input Tax Credit

Table No. 2. Net tax liability for all suppliers

	A	B	C	D
Output Tax	10	15	19	22
Less : ITC	Nil	10	15	19
Net Tax Payable	10	05	04	03

Total Tax paid by the consumer = 22 (which is 10% of price).

Government collects total tax amounting to 22.

- From A = 10
- From B = 05
- From C = 04
- From D = 03

Total S .P of product = 242

Here, OT is Output Tax and ITC is Input Tax credit.

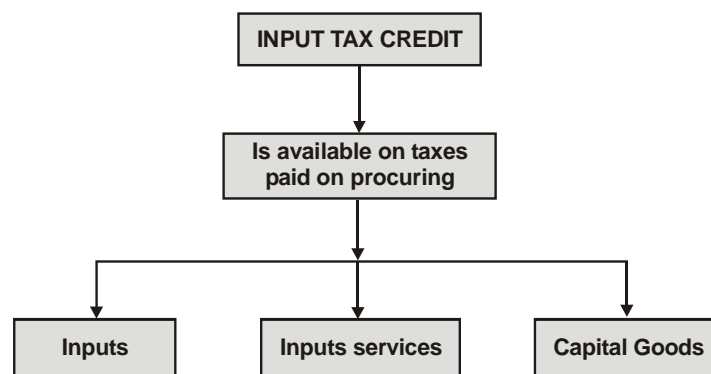
Table No. 1 has made it clear, how the GST regime would function. Every supplier is eligible to claim set off (credit) of the tax he has already paid while purchasing from his seller. This helps to avoid the cascading tax, double taxation, reduces price of supply, reduces tax burden for the consumer and also ensures transparency.

4. Input Tax Credit under GST

Input means any goods other than capital goods used or intended to be used by a supplier in the course or furtherance of business. –According to Section 2(59) of CGST Act

Input Service means any service which is used or intended to be used by the supplier in the course of business or furtherance of business. –According to Section 2(60) of CGST Act).

Capital Goods means goods, the value of which is capitalised in the books of account of the person claiming the credit and which are used or intended to be used in the course or furtherance of business. – According to Section 2(19) of CGST Act.



5. Utilization of Credit (ITC)

GST is a destination-based consumption tax, that promotes seamless flow of credit, by allowing the registered

persons to claim credit of taxes paid already by them (while purchasing inputs / services / capital goods).

In the previous Indirect Tax Regime:

- Credit of Central Taxes - could not be set off - against State Taxes

- Credit of State Taxes - Could not be set off - against Central Taxes
- No Credit was available of CST [Tax on Interstate Sales] paid, out of VAT [Tax on Intrastate sales] liability
- No credit was available of VAT paid out of CST liability.

6. Seamless flow of credit under GST

- Since GST is a destination-based consumption tax, revenue of SGST ordinarily accrues to the consuming States. The inter-State supplier in the exporting State is allowed to set off the available credit of IGST, CGST and SGST/UTGST (in that order) against the IGST payable on inter-State supply made by him.
- The buyer in the importing State is allowed to avail the credit of IGST paid on inter-State purchase made by him. Thus, unlike the earlier scenario where the credit chain used to break in case of inter-State sales on account of non-VATable CST, under GST regime there is a seamless credit flow in case of inter-State supplies too.
- The revenue of inter-State sale does not accrue to the exporting State and the exporting State transfers to the Centre the credit of SGST/UTGST used in payment of IGST.
- The Centre transfers to the importing State the credit of IGST used in payment of SGST/UTGST.
- A Common Portal was which could act as a clearing house and verify the claims and inform the respective Governments to transfer the funds. This was possible only with the help of a strong IT Infrastructure.

7. Provisions relating to Utilization of Credit (ITC)

Sub-section (4) and (5) of Section 49 of CGST Act provides for utilization of credit. The provisions relating to utilization of credit are also made in section 9 of UT GST Act. These provisions are reproduced given below:

1. **IGST Credit.** As per provisions contained in section 49 of CGST Act and SGST Act and section 9 of UT-GST Act, the credit of IGST available in the electronic credit ledger shall be utilized for payment of IGST; thereafter for payment of CGST or SGST or UT GST in that order. Thus, IGST credit can be utilized for payment of all the 4 taxes, but the utilization shall be done in the order specified above.
2. **CGST Credit.** As per section 49(5)(b) of CGST Act, credit balance in electronic credit ledger on account of CGST shall be first utilized for the purpose of payment of CGST and the amount remaining if any shall be utilized for payment of IGST. It is specifically provided under clause (e) that balance in CGST cannot be utilized for payment of SGST or UT GST.
3. **SGST Credit.** As per section 49 of SGST Act, credit balance in electronic credit ledger on account of SGST shall be first utilized for the purpose of payment of SGST and the amount remaining if any shall be utilized for the purpose of IGST. Again, it is specifically provided under clause (f) that balance of

SGST or UT GST cannot be used for payment of CGST.

4. **UT GST Credit.** As per section 9 of UT-GST Act, Credit balance in electronic credit ledger on account of UT GST shall be first utilized for the purpose of payment of UT GST and the amount remaining if any shall be utilized for the purpose of IGST. The balance of UT-GST shall not be utilized for payment of CGST. Further balance of IGST shall be utilized for payment of IGST and thereafter for CGST, SGST and UT-GST in that order.

No Cross-utilization of:

- (i) CGST cannot be utilized towards payments of SGST or UTGST.
- (ii) SGST or UTGST cannot be utilized towards payments of CGST.

Latest Amendment on Order of Utilization Of ITC- Clarification in Respect of Utilization of Input Tax Credit Under GST - Reg.

Circular No. 98/17/2019-GST dated April 23, 2019

Section 49 was amended and section 49A and section 49B were inserted vide Central Goods and Services Tax (Amendment) Act, 2019 [hereinafter referred to as the CGST (Amendment) Act]. The amended provisions came into effect from 1st February 2019.

Various representations have been received from the trade and industry regarding challenges being faced by taxpayers due to bringing into force of section 49A of the Central Goods and Services Tax Act, 2017 (hereinafter referred to as the CGST Act). The issue has arisen on account of order of utilization of input tax credit of integrated tax in a particular order, resulting in accumulation of input tax credit for one kind of tax (say State tax) in electronic credit ledger and discharge of liability for the other kind of tax (say Central tax) through electronic cash ledger in certain scenarios. Accordingly, rule 88A was inserted in the Central Goods and Services Tax Rules, 2017 (hereinafter referred to as the CGST Rules) in exercise of the powers under section 49B of the CGST Act vide notification No. 16/2019-Central Tax, dated 29th March, 2019. In order to ensure uniformity in the implementation of the provisions of the law, the Board, in exercise of its powers conferred by section 168 (1) of the CGST Act, hereby clarifies the issues raised as below.

The newly inserted section 49A of the CGST Act provides that the input tax credit of Integrated tax has to be utilized completely before input tax credit of Central tax/State tax can be utilized for discharge of any tax liability. Further, as per the provisions of section 49 of the CGST Act, credit of Integrated tax has to be utilized first for payment of Integrated tax, then Central tax and then State tax in that order mandatorily. This led to a situation, in certain cases, where a taxpayer has to discharge his tax liability on account of one type of tax (say State tax) through electronic cash ledger, while the input tax credit on account of other type of tax (say Central tax) remains un-utilized in electronic credit ledger.

The newly inserted rule 88A in the CGST Rules allows utilization of input tax credit of Integrated tax towards the payment of Central tax and State tax, or as the case may be,

Union territory tax, in any order subject to the condition that the entire input tax credit on account of Integrated tax is completely exhausted first before the input tax credit on account of Central tax or State/Union territory tax can be utilized. It is clarified that

after the insertion of the said rule, the order of utilization of input tax credit will be as per the order (of numerals) given below:

Input tax Credit on account of	Output liability on account of Integrated tax	Output liability on account of Central tax	Output liability on account of State tax/Union Territory tax
Integrated tax	(I)	(II)-In an order and in any proportion	
(III) Input tax Credit on account of Integrated tax to be completely exhausted mandatorily			
Central tax	(V)	(IV)	Not permitted
State tax/Union Territory tax	(VII)	Not permitted	(VI)

Utilisation of ITC- New Rule 49A

ITC of IGST to be used in this order:

1. To pay Output Tax of IGST
2. Then to pay Output Tax of CGST/ or/ SGST/ or / UTGST-- in any order in any proportion

ITC of CGST to be used in this order:

1. First to pay Output Tax of IGST
2. Then to pay Output Tax of CGST.

ITC of SGST/UTGST to be used in this order:

1. First to pay Output Tax of IGST
2. Then to pay Output Tax of SGST/UTGST.

CGST cannot be used to pay SGST/UTGST. Similarly, SGST/UTGST cannot be used to pay CGST.

8. Conclusion:

The GST regime promises seamless credit on goods and services across the entire supply chain with some exceptions like supplies charged to tax under composition scheme and supply of exempted goods and/or services. ITC is considered to be the backbone of the GST regime. In fact, it is the provision of ITC which essentially make GST a value added tax *i.e.*, collection of tax at all points of supply chain after allowing credit of tax paid at earlier points.

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