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Case study on input tax credit under GST

Sujit Ghosh

**Advocate, Delhi High Court & Supreme
Court of India**

Partner & National Head, Advaita Legal

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Input tax credit under GST: Relevant provisions

❖ **Section 2 (54) – ‘input’** – defined as:

*“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;**”*

❖ **Section 2(19) – ‘capital goods’** –

“capital goods” means goods, the value of which is capitalised in the books of account of the person claiming the input tax credit and which are used or intended to be used in the course or furtherance of business

❖ **Section 2(55) – ‘input service’** – defined as:

*“any service, 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;**”*

❖ **Section 2(57) - input tax** – defined as

*““input tax” in relation to a taxable person, means the {IGST and CGST}/{IGST and SGST} charged on any supply of goods and/or services to him **which are used, or are intended to be used, in the course or furtherance of his business** and includes the tax payable under sub-section (3) of section 7;”*

❖ **Section 16 (Eligibility and conditions for taking input tax credit)** and **Section 17 (Apportionment of credit and blocked credits)**

Input tax credit: Triggers for availment of ITC

- ❖ **Trigger 1 - Section 16(1) allows availment of ITC subject to the satisfaction of the following twin conditions:-**
 - Supplies should be made to a registered person; and
 - Such supplies are meant to be used or intended to be used by such registered person in the course or furtherance of his business.

- ❖ **Trigger 2 - As per Section 16(2), ITC is available if the following conditions are fulfilled:**
 - Possession of a tax invoice or duty paying document
 - Receipt of goods/services
 - Tax charged has been paid to the Government
 - Filing of Return

- ❖ **Trigger 3 – ITC as is claimed should not be restricted as per the stipulations under Section 17(5) of the CGST Act**

Trigger 1 - Course or furtherance of business

- ❖ **'In the course or furtherance of business' – broad amplitude**
 - Legislative intent for availment of input tax credit under the CGST Act - inputs must be used in the course or furtherance of business.
 - Interestingly, the usage of the words “*in the course of or furtherance of business*” for ITC availment under GST laws is a **significant liberalization** in comparison to the condition under the pre-GST regime which was predicated on inputs and input services being used “*in the manufacture of goods*” or “*provision of output services*”.
 - **'business' has been defined under Section 2(17) of the CGST Act in the following manner:-**
 - (17) “*business*” includes :-
 - (a) *any trade, commerce, manufacture, profession, vocation, adventure, wager or any other similar activity, whether or not it is for a pecuniary benefit;*
 - (b) *any activity or transaction in connection with or incidental or ancillary to sub-clause (a);*
 - (c) *any activity or transaction in the nature of sub-clause (a), whether or not there is volume, frequency, continuity or regularity of such transaction;*
.....;

Trigger 1 - Course or furtherance of business

- **Term 'business' under the CGST Act has been defined expansively to include *inter alia* any trade, commerce, manufacture, etc. and “any activity or transaction in connection with or incidental or ancillary” to the same**
 - **State of Tamil Nadu v. Binny Ltd. Madras; AIR 1980 SC 2038** - sale of provisions to workmen employed in the factory where textiles were being manufactured was incidental to the business of manufacture of textiles and such sales fell within the definition of the term 'business' under the Tamil Nadu Sales Tax Act.
 - **Royal Talkies Hyderabad v. Employee State Insurance Corporation; (1978) IILJ 390 SC** the test for an activity to be construed as incidental to business, **such work as is sought to be treated as incidental should not be extraneous or contrary to the purposes of the establishment but it need not be integral or essential to it either.** Applying this test, canteen maintained by the cinema owner was held to be incidental to the business of exhibiting films.

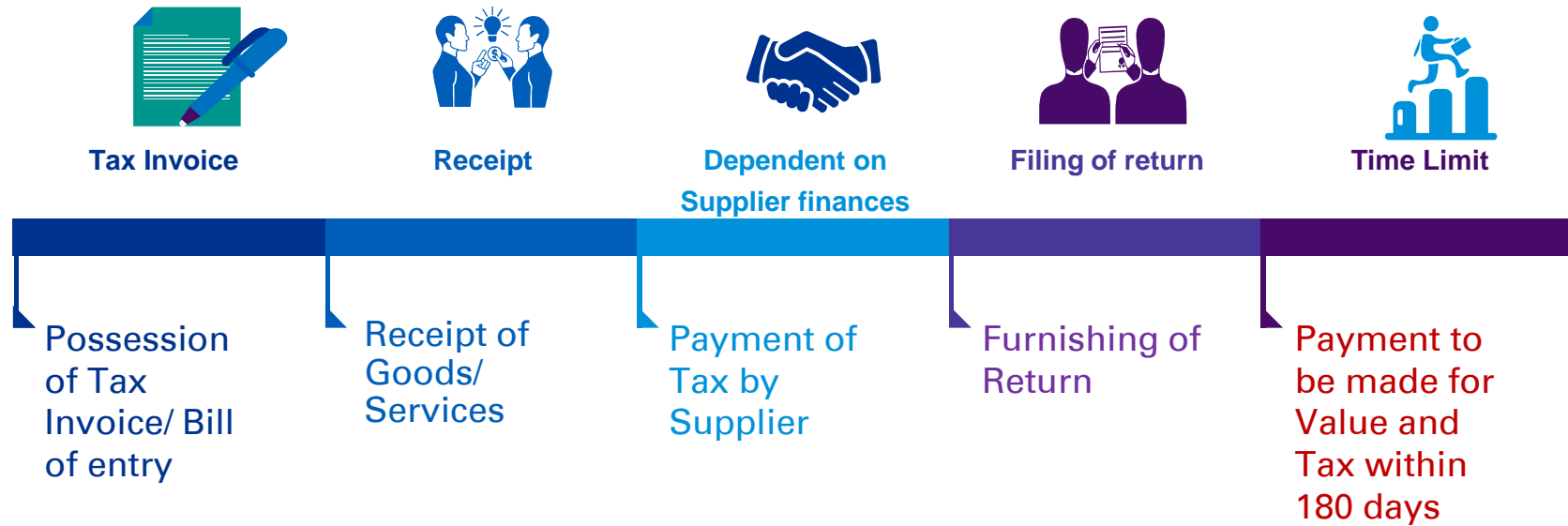
- **Case study – ITC vis a vis captive power plants**
 - **In CENVAT Credit Rules, Rule 2(k) defining the term 'inputs' of the CENVAT Credit Rules, 2004 specifically included the goods used for generation of electricity for captive use – 'input' definition under GST doesn't have that inclusion**
 - **Nonetheless, given that the test for credit availment under GST is the broader test of 'in the course of business', ITC under GST will be available for goods/services used in captive power generation**

Trigger 1 - Course or furtherance of business (Contd.)

Activities held to be incidental to business

Sl.No.	Case	Decision
1.	State of Tamil Nadu Vs Burmah Shell Oil Storage and Distributing Co. of India Ltd. And Anr.; AIR 1973 SC 1045	Where the primary business of the Petitioner was trading in oil and oil related products it was held that periodic selling of scrap, unserviceable oil drums, old furniture, etc. was an activity ancillary and incidental to its business.
2	Hindustan Zinc Limited Vs. Commercial Tax Officer 1990 WLN (UC) 220	Where the main business of the Petitioner was manufacture and dealing of non-ferrous items, it was held sale of tender forms was an activity which was ancillary and connected to its business
3.	United India Insurance Co. Ltd. Vs. Commissioner of Commercial Taxes, Bangalore and Anr. 1986 (2) KarLJ107	The petitioner was carrying its business in General Insurance and was selling used goods received against settlement of claim. The activity of selling used goods was held to be ancillary to its main business.
4.	Citi Bank Vs. Commissioner of Sales Tax 2016 IAD (Delhi) 581	The petitioner was engaged in banking business and in certain cases would recover dues from the defaulters, by auctioning of assets of the defaulters. The activity of selling of assets hypothecated to the bank was held to be incidental to its business.

Trigger 2- Conditions for availing input tax credit under GST



Additional condition - Capital Goods

No Depreciation Claimed

- *Need to ensure payment along with taxes has been disbursed to the vendors within 180 days*
- *Need to identify list of key vendors and ensure taxes have been paid by them to appropriate Government*
- *Identify list of probable defaulters (vendors) in terms of registration, invoice, payment, etc.*

Trigger 2- Issues

- ❖ **GST paid on advance payments cannot be claimed as input tax credit** under GST until such time as the goods/ services have been actually received in accordance with the conditions for ITC availment – **major cash flow issue!**
- ❖ Goods procured against an invoice are to be received in batches or instalments, credit can be availed only upon the receipt of the last installment
- ❖ Where a recipient fails to pay the supplier the amount of consideration against the supply along with the tax payable within a period of three months from the date of invoice, the credit claimed would be reversed along with interest.*
- ❖ Where a recipient pays the tax to the supplier, but the supplier has not paid the tax – the receiver will not be allowed to take credit of tax paid. Unduly onerous condition for ITC availment on the recipient.

* The proposed amendment to the proviso of Sec 16(2) issued by the GST Council seeks to remove the liability of interest in such a scenario.

Trigger 3 - Restrictions on availment of input tax credit

Goods or services used for non business purposes or used for personal consumption

Goods or services used for exempt supplies (Value of exempt supply would include supplies on which the recipient is liable to pay tax on reverse charge basis)

Motor vehicles and other conveyance (except when used for transportation of goods, making further taxable supplies of such vehicles, making taxable supply of transportation of passengers or imparting driving training)

Goods or services received for construction of an immovable property and works contract service when supplied for construction of an immovable property (other than plant and machinery)

Goods or services on which tax has been paid under composition tax scheme

Goods lost, stolen, destroyed, written off or disposed of by way of gift or free samples

Specific goods or services such as food, outdoor catering, health services, membership of clubs, rent-a-cab, travel benefits extended to employees on vacation, life and health insurance etc.
However, credit of the services which are obligatory for an employer to provide to its employee under any law would be eligible

Trigger 3 - Input tax credit restrictions: Case study on works contract

❖ Restriction to ITC on works contract services [Section 17(5) (c) of CGST Act]

“(c) **works contract services when supplied for construction of an immovable property (other than plant or machinery) except where it is an input service** for further supply of works contract service.

- Restriction imposed on availment of ITC of GST **paid on works contract services which are used for construction of immovable property**

Construction ” includes re-construction, renovation, additions or alterations or repairs, **to the extent of capitalization***, to the said immovable property

** No credit restriction on renovation/repair of a factory building if such expenses are not capitalized*

- **However, following exceptions carved out (where ITC would be available)-**
 - **Where such services are input services for further supply of works contract service;** Thus, if the company procures ‘works contract service’, resulting in the construction of immovable property, and **utilizes the same for further providing leasing services as its output service then, the company would not be covered by this exception and thus not eligible to avail Input Tax Credit of the works contract service**
 - **Where the immovable property in question qualifies as ‘plant and machinery’**

Trigger 3 - Input tax credit restrictions: Case study on works contract

- ❖ Restriction to ITC on works contracts also applies [Section 17(5)(d) of the CGST Act] in the following case –

*“(d) goods or services or both received by a taxable person for construction of an immovable property (other than plant or machinery) **on his own account** including when such goods or services or both are used in the course or furtherance of business.*

- The phrase ‘**on his own account**’ – raises several issues on procurement & contracting pattern

Trigger 3 - Input tax credit restrictions: Case study on works contract

❖ Exception for 'Plant & Machinery' - defined to mean –

*apparatus, equipment and machinery fixed to earth by foundation or structural support that are used for making outward supply and includes such foundation and structural supports **but excludes***

- (i) land, building or any other civil structures*
- (ii) Telecommunication towers*
- (iii) Pipelines laid outside factory premises*

➤ Pre-GST judicial precedents provide that a unit which fulfill the following tests or conditions would be considered as '*plant and machinery*' – **may continue to be relevant even post-GST in interpreting the GST definition:**

- **Functional test** – Structures that are designed and meant only for the particular use of facilitating the manufacturing/production process and no other use
- **Essentiality test** – Structures that are an essential amenity for carrying on taxpayer's business
- **'Setting' v. 'means' test** – Structures, are the 'means' of carrying on the business and not merely a 'setting' for carrying on the business

Trigger 3 - Input tax credit restrictions: Case study on works contract

❖ Exception for 'Plant & Machinery' – (contd.)

- “Pipelines laid outside the factory premises” under Explanation to Section 17 –
 - **Possible view: Those words intend to restrict credit only in a scenario where factories use long distance pipelines to draw water/other raw materials from sources far away from the factory.**
 - Reference may be made to the decision in the case of *Jaypee Bela Plant v CCE, Bhopal*, [2005 (180) E.L.T. 31 (Tri-Delhi)] where it was clearly held that pipes and tubes constituting a pipeline which is used for carrying water from a reservoir situated 5/6 kms away from the factory for use in the manufacture of the finished products, were eligible for credit
 - ✓ “Pipelines laid outside the factory premises” ought to be interpreted by applying the ‘*Mischief Rule of statutory interpretation*’
 - ✓ To conclude that **exclusion of ‘pipelines laid outside....’ from ‘Plant and machinery’ is solely intended to deny the benefits of judicial precedents like Jaypee Bela and thus, should not include pipelines used for providing the output service of transport of liquids/ gases by a person engaged in the business of transport of gases/liquids**

Trigger 3 - Input tax credit restrictions: Case study on free supplies

- ❖ Recent news reports about DGGST investigations on freebies/extras being provided by various pharma and FMCG companies – like ‘**Buy-one-get-one-free**’ or ‘**20% extra**’ schemes

- ❖ **Potential grounds for seeking input credit reversal in such cases and rebuttals thereof**
 - **Ground 1:** Tax authorities may allege that **input GST credit for offering such freebies/extras are not ‘in the course of business’** and thus ineligible for credit.
 - ✓ **Rebuttal:** *ex facie erroneus!* such supplies are being made to remain competitive in the market and sell more products and thus are clearly ‘*in the course of business*’

 - **Ground 2:** Tax authorities may rely upon the specific credit restriction under Section 17(5) ie., “*goods lost, stolen, destroyed, written off or disposed of by way of gift or free samples*” to allege that **such extra supplies are like ‘gifts’** and thus ineligible for credit.
 - ✓ **Rebuttal:** ‘Gift’ has a specific connotation in law. As per *Corpus Juris Secundum*, Volume 38:
*‘gift’ is commonly defined as a **voluntary** transfer of property by one to another, **without any consideration or compensation** therefor. A ‘gift’ is a gratuity and an act of generosity and does not require a consideration; if there is a consideration for the transaction, it is not a gift.*
Promotional activity in the nature of ‘buy one get one’ or “20% extra” will not qualify as ‘gift’ –
 - ❑ consideration for the freebie/extra being offered under the said promotional schemes is inbuilt in the price being charged and thus such freebie/extra cannot be said to be without consideration/compensation.
 - ❑ The ‘get one’ product is not available unless the ‘buy one’ is purchased by the consumer – freebies are not exactly voluntary and are contingent upon purchase of the ‘get one’ product

Illustrative Advance Rulings on ITC

- ❖ **M/s Bahl Paper Mills Ltd., 2018-VIL-43-AAR (Uttarakhand)** - Whether ITC will be available for office fixtures, furniture, AC plant and sanitary fittings on its newly constructed building?
 - Authority held that as per explanation to Section 17 of the CGST Act 2017, credit is not available in respect of land, building or any other civil structure, and **since sanitary fittings are an integral part of the building, credit on the same was denied.**
 - **However, in case of office fixtures and air conditioners was allowed since the same were used in furtherance of business.** The Authority referred to the **CBIC Board Circular No. 943/04/2011-CX dated 29.04.2011** (where furniture and stationary used in office within the factory were held to be used in relation to manufacturing business and credit was allowed) and the case of **M/s Balkrishna Industries v. CCE, Jaipur-I (2016 (335) ELT 559 (Tri-Del)) (credit of duty paid on ACs installed in office was allowed).**
- ❖ **BASF India Limited, 2018-VIL-85-AAR (Maharashtra)*** - Whether High Sea Sales of goods would be an exempt supply and consequently, whether the ITC of inputs or input services used would have to be reversed to the extent of making such high sea sales:
 - Authority held that goods sold on high seas sales basis, while being inter-state supplies, were an exempt supply being non-taxable supplies in as much as no duty is leviable on these goods and duty if any becomes applicable only after they cross the customs clearance. Therefore, input tax credit of inputs or input services to the extent of such high sea sales would have to be reversed.

* **Recently proposed GST amendments** in Schedule III and Section 17(3) pertaining to value of 'exempt supply' for credit reversal – no credit reversal will be required for 'High Sea Sales' or 'In-Bond Sales', even though the high-sea/in-bond seller would not be liable to pay IGST thereon. **This would effectively overrule the BASF advance ruling.**

Overview of proposed GST amendments about ITC

- ❖ Explanation to Section 16(2)(b) - Extends deeming fiction to services as well, wherein, registered person is deemed to have received the services even if supplied to any other person on the direction of and on account of the registered person. Formerly, this condition was restricted to only supply of goods
- ❖ Proviso to Section 16(2) – Removes the liability of the recipient to pay interest on amount equal to ITC where he fails to pay the consideration against the supply and applicable tax to the recipient within 180 days from date of issue of invoice.
- ❖ Sec 17(3) – Allows ITC on activities or transactions in Schedule III (other than sale of land and subject to Para 5(b) of Schedule III, sale of building) by excluding it from the scope of ‘exempt supplies’.
- ❖ Sec 17(5) – Expands and clarifies the scope of ITC availability in the case of motor vehicles; Allows ITC in respect of supply of goods / services / both by an employer to an employee where such supply is obligatory under any existing law
- ❖ Clause (c) of Explanation to Sec 20 – Excludes the amount of tax levied under Entry 92A of List I of Constitution from the value of turnover for the purposes of distribution of credit .
- ❖ Section 43A – Inserted to enable a new return filing procedure which may change procedure for availing input tax credit
- ❖ Section 49(5) – Restricts utilisation of credit of State tax or Union territory tax against payment of Integrated tax to only a case where there is no balance available in the credit of Central tax.



ADVAITA LEGAL

ATTORNEYS AND
ADVOCATES

THANK YOU

Delhi

2nd Floor, Block F,
International Trade
Tower, Nehru Place
New Delhi 110019
Tel +91 11 30671300
Fax +91 11 30671304

Mumbai

Lodha Excelus, 1st Floor,
Apollo Mills Compound,
N.M. Joshi Marg,
Mahalakshmi,
Mumbai 400 011
Tel +9122 39896000
Fax +91 22 39836000

Key Contacts

Sujitghosh@advaitalegal.com

sudiptab@advaitalegal.com

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