# Input Tax Credit in GST

Uninterrupted and seamless chain of input tax credit (hereinafter referred to as, “ITC”) is one of the key features of Goods and Services Tax. ITC is a mechanism to avoid cascading of taxes. Cascading of taxes, in simple language, is ‘tax on tax’. Under the present system of taxation, credit of taxes being levied by Central Government is not available as set-off for payment of taxes levied by State Governments, and *vice versa*. 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, credit of tax paid at every stage would be available as set-off for payment of tax at every subsequent stage.

Let us understand how ‘cascading’ of taxes takes place in the present regime. Central excise duty charged on inputs used for manufacture of final product can be availed as credit for payment of Central Excise Duty on the final product. For example, to manufacture a pen, the manufacturer requires, plastic granules, refill tube, metal clip, etc. All these ‘inputs’ are chargeable to central excise duty. Once a ‘pen’ is manufactured by using these inputs, the pen is also chargeable to central excise duty. Let us assume that the cost of all the above mentioned inputs is say, Rs.10/- on which central excise duty @10% is paid, means Re.1. The cost of the manufactured pen is say Rs.20/-, the central excise duty payable on the pen @10% will be Rs.2/- . Now the manufacturer of the pen can use the duty paid on inputs, i.e. Re.1/- for payment of duty on the pen. So he will use Re.1 paid on inputs and he will pay Re.1/- through cash (1+1=2), the price of the pen becomes Rs. 22/-. In effect he actually pays duty on the **‘value added’** over and above the cost of the inputs. This mechanism eliminates cascading of taxes. However, when the pen is sold by the manufacturer to a trader he is required to levy VAT on such sale. But under the present system, the manufacturer cannot use the credit of central excise duty paid on the pen for payment of VAT, as the two levies are being levied by Central and State government respectively with no statutory linkage between the two. Hence he is required to pay VAT on the entire value of the pen, i.e. Rs.22/-, which actually includes the central excise duty to the tune of Rs.2/-. This is cascading of taxes or tax on tax as now VAT is not only paid on the value of pen i.e. Rs.20/- but also on tax i.e. Rs.2/-.

Goods and Services Tax (GST) would mitigate such cascading of taxes. Under this new system most of the indirect taxes levied by Central and the State Governments on supply of goods or services or both would be combined together under a single levy.

GST comprises of the following levies:

1. Central Goods and Services Tax (CGST)[also known as Central Tax] on intra-state or intra-union territory without legislature supply of goods or services or both.
2. State Goods and Services Tax (SGST) [also known as State Tax]on intra-state supply of goods or services or both.
3. Union Territory Goods and Services Tax (UTGST) [also known as Union territory Tax] on intra-union territory supply of goods or services or both.
4. Integrated Goods and Services Tax (IGST)[also known as Integrated Tax] on inter-state supply of goods or services or both. In case of import of goods also the present levy of Countervailing Duty (CVD) and Special Additional Duty (SAD) would be replaced by Integrated tax.

The protocol to avail and utilise the credit of these taxes is as follows:

|  |  |  |
| --- | --- | --- |
| **Credit of** | **To be utilised first for payment of** | **May be utilised further for payment of** |
| CGST | CGST | IGST |
| SGST/UTGST | SGST/UTGST | IGST |
| IGST | IGST | CGST, SGST or  UTGST |

**Credit of CGST cannot be used for payment of SGST/ UTGST and credit of SGST / UTGST cannot be utilised for payment of CGST.**

Some of the technical aspects of the scheme of Input Tax Credit are as under:

1. Any registered person can avail credit of tax paid on the inward supply of goods or services or both which is used or intended to be used in the course or furtherance of business.
2. The pre-requisites for availing credit by registered person are:
   * He is in possession of tax invoice or any other specified tax paying document.
   * He has received the goods or services. “Bill to ship” scenarios also included.
   * Tax is actually paid by the supplier.
   * He has furnished the return.
   * If the inputs are received in lots, he will be eligible to avail the credit only when the last lot of the inputs is received.
   * He should pay the supplier the value of the goods or services along with the tax within 180 days from the date of issue of invoice, failing which the amount of credit availed by the recipient would be added to his output tax liability, with interest [rule 2(1) & (2) of ITC Rules]. However, once the amount is paid, the recipient will be entitled to avail the credit again. In case part payment has been made, proportionate credit would be allowed.

Documents on the basis of which credit can be availed are:

* Invoice issued by a supplier of goods or services or both
* Invoice issued by recipient alongwith proof of payment of tax
* A debit note issued by supplier
* Bill of entry or similar document prescribed under Customs Act
* Revised invoice
* Document issued by Input Service Distributor

The Input Service Distributor (ISD) may distribute the credit available for distribution in the same month in which it is availed. The credit of CGST, SGST, UTGST and IGST shall be distributed as per the provisions of Rule 4(1)(d) of ITC Rules. ISD shall issue invoice in accordance with the provisions made under Rule 9(1) of Invoice Rules.

ITC is not available in some cases as mentioned in section 17(5) of CGST Act, 2017. Some of them are as follows:

* + motor vehicles and other conveyances except under specified circumstances.
  + goods and / or services provided in relation to
    1. food and beverages, outdoor catering, beauty treatment, health services, cosmetic and plastic surgery, except under specified circumstances;
    2. membership of a club, health and fitness center;
    3. Rent-a-cab, life insurance, health insur-ance except where it is obligatory for an employer under any law;
    4. travel benefits extended to employees on vacation such as leave or home travel concession;
* Works contract services when supplied for construction of immovable property, other than plant &machinery, except where it is an input service for further supply of works contract;
* Goods or services received by a taxable person for construction of immovable property on his own account, other than plant & machinery, even when used in course or furtherance of business;
* goods and/or services on which tax has been paid under composition scheme;
* goods and/or services used for private or personal consumption, to the extent they are so consumed;
* Goods lost, stolen, destroyed, written off, gifted, or free samples;
* Any tax paid due to short payment on account of fraud, suppression, mis-declaration, seizure, detention.

Special circumstances under which ITC is available:

* A person who has applied for registration within 30 days of becoming liable for registration is entitled to ITC of input tax in respect of goods held in stock (inputs as such and inputs contained in semi-finished or finished goods) on the day immediately preceding the date from which he becomes liable to pay tax.
* A person who has taken voluntary registration under section 23(3) of the CGST Act, 2017 is entitled to ITC of input tax in respect of goods held in stock(inputs as such and inputs contained in semi-finished or finished goods) on the day immediately preceding the date of registration.
* A person switching over to normal scheme from composition scheme under section10 is entitled to ITC in respect of goods held in stock(inputs as such and inputs contained in semi-finished or finished goods) and capital goods on the day immediately preceding the date from which he becomes liable to pay tax as normal taxpayer.
* Where an exempt supply of goods or services or both become taxable, the person making such supplies shall be entitled to take ITC in respect of goods held in stock (inputs as such and inputs contained in semi-finished or finished goods) relatable to exempt supplies. He shall also be entitled to take credit on capital goods used exclusively for such exempt supply subject to reductions for the earlier usage as prescribed in the rules.
* ITC, in all the above cases, is to be availed within 1 year from the date of issue of invoice by the supplier
* In case of change of constitution of a registered person on account of sale, merger, demerger etc, the unutilised ITC shall be allowed to be transferred to the transferee.
* A person switching over from composition scheme under section 10to normal scheme or where a taxable supply become exempt, the ITC availed in respect of goods held in stock (inputs as such and inputs contained in semi-finished or finished goods) as well as capital goods will have to be paid.
* In case of supply of capital goods or plant and machinery, on which ITC is taken, an amount equivalent to ITC availed minus the reduction as prescribed in rules (5% for every quarter or part thereof0 shall have to be paid. In case the tax on transaction value of the supply is more, the same would have to be paid.

## **Input Tax Credit (ITC) under GST: A Comprehensive Overview**

### **Introduction**

One of the cornerstone features of the Goods and Services Tax (GST) regime is the seamless and uninterrupted flow of Input Tax Credit (ITC), which is designed to eliminate the cascading effect of taxation—commonly referred to as ‘tax on tax’. Under the erstwhile indirect tax framework, cross-utilization of credit between the Centre and the States was not permissible, leading to inefficiencies and inflated costs throughout the supply chain.

With GST, a unified and harmonized tax structure is implemented, where the supply of goods and services is taxed concurrently by the Central and State Governments. Consequently, taxes paid on procurements are credited and set off against taxes payable on outward supplies at every stage, thus effectively taxing only the **value addition** at each point in the supply chain.

### **Understanding Cascading Effect – The Pre-GST Scenario**

To illustrate the cascading effect, consider the manufacture of a pen. The inputs—plastic granules, refill tubes, metal clips—are subject to Central Excise Duty. Suppose these inputs cost ₹10 and attract a 10% duty, i.e., ₹1. The pen, post-manufacture, costs ₹20 and attracts a 10% excise duty of ₹2. The manufacturer utilizes the ₹1 input duty credit and pays ₹1 in cash. Therefore, the effective tax is only on the ₹10 value added.

However, when the pen is sold to a trader, Value Added Tax (VAT) is levied on the full sale value of ₹22, including the ₹2 excise duty, resulting in double taxation. The inability to set off Central taxes against State levies exemplifies the cascading of taxes.

### **GST: Eliminating Cascading through Seamless ITC**

The GST regime addresses this inefficiency by subsuming a host of indirect taxes and enabling cross-utilization of credits across Central and State levies (subject to certain restrictions). The applicable GST components include:

* **Central GST (CGST):** Levied on intra-state/intra-union territory supplies by the Centre.
* **State GST (SGST):** Levied on intra-state supplies by the respective State Governments.
* **Union Territory GST (UTGST):** Applicable on intra-union territory supplies without a legislature.
* **Integrated GST (IGST):** Levied on inter-state supplies and imports.

### **Cross-Utilization Hierarchy of ITC**

| **Credit of** | **To be Utilized First for Payment of** | **May Also Be Utilized for** |
| --- | --- | --- |
| CGST | CGST | IGST |
| SGST/UTGST | SGST/UTGST | IGST |
| IGST | IGST | CGST, SGST/UTGST |

**Note:** Cross-utilization between CGST and SGST/UTGST is strictly prohibited.

### **Eligibility and Conditions for Availing ITC**

A registered person is eligible to claim ITC on the tax paid on inward supplies of goods or services, provided they are used in the course or furtherance of business. The following conditions must be satisfied:

* Possession of a valid tax invoice or specified tax-paying document.
* Actual receipt of goods or services (including ‘bill-to-ship-to’ arrangements).
* Tax charged by the supplier has been paid to the government.
* Filing of the requisite returns under Section 39.
* In cases of receipt in multiple lots, credit is allowed only upon receipt of the final lot.
* Payment to the supplier (including tax) must be made within 180 days of invoice issuance; failing which, the ITC is reversed with interest. However, credit can be re-availed once payment is made.

### **Eligible Documents for Availing ITC**

* Tax Invoice issued by supplier
* Invoice issued by recipient (in reverse charge cases)
* Debit note from supplier
* Bill of Entry or equivalent document under Customs Act
* Revised Invoice
* Document issued by Input Service Distributor (ISD)

### **Input Service Distributor (ISD) Mechanism**

An ISD can distribute input tax credit of services to its branches having the same PAN, even if they are located across different States. Distribution is to be done in the same month in which the credit is availed, as per Rule 4(1)(d) of the ITC Rules. ISD invoices must conform to Rule 9(1) of the GST Invoice Rules.

### **Blocked Credits under Section 17(5) of CGST Act**

Certain categories of ITC are specifically disallowed:

* Motor vehicles (except under specified conditions)
* Personal consumption, lost, stolen, destroyed, or gifted goods
* Membership of clubs, health centers, fitness centers
* Food, beverages, catering, beauty treatment, health services (exceptions apply)
* Works contract services (except for further supply)
* Goods/services for construction of immovable property (excluding plant & machinery)
* Travel benefits extended to employees (LTC, etc.)
* Tax paid under composition scheme
* Tax paid as a result of fraud, suppression, misdeclaration, seizure or detention

### **Special Circumstances for Availing ITC**

1. **New Registration:**
   * ITC is available on stock and semi/finished goods held on the day before becoming liable for registration, if applied within 30 days.
2. **Voluntary Registration:**
   * ITC allowed on goods in stock or contained in semi/finished goods prior to the registration date.
3. **Switch from Composition to Regular Scheme:**
   * ITC is permitted on stock and capital goods on the day preceding the switch.
4. **Exempt to Taxable Supply:**
   * ITC on inputs, semi-finished/finished goods, and eligible capital goods used exclusively for such exempt supplies can be claimed (with specified reductions for prior use).
5. **Corporate Restructuring:**
   * In cases of mergers, demergers, or business transfers, unutilized ITC can be transferred to the new entity.
6. **Reversal upon Switching Back or Exemption:**
   * Taxpayers reverting from regular to composition scheme or becoming exempt must reverse ITC on stock and capital goods.
7. **Supply of Capital Goods:**
   * If ITC was availed on capital goods, tax payable on supply shall be higher of:
     + ITC availed minus 5% per quarter of usage, or
     + Tax on transaction value.

### **Conclusion**

The ITC mechanism under GST promotes transparency, reduces cost inefficiencies, and ensures tax neutrality across the value chain. It not only simplifies compliance but also enhances competitiveness by preventing tax cascading. However, businesses must meticulously adhere to documentation, timely compliance, and conditions prescribed to avail and retain the benefit of ITC. A robust understanding of the ITC framework is thus essential for ensuring tax optimization and regulatory alignment under the GST regime.