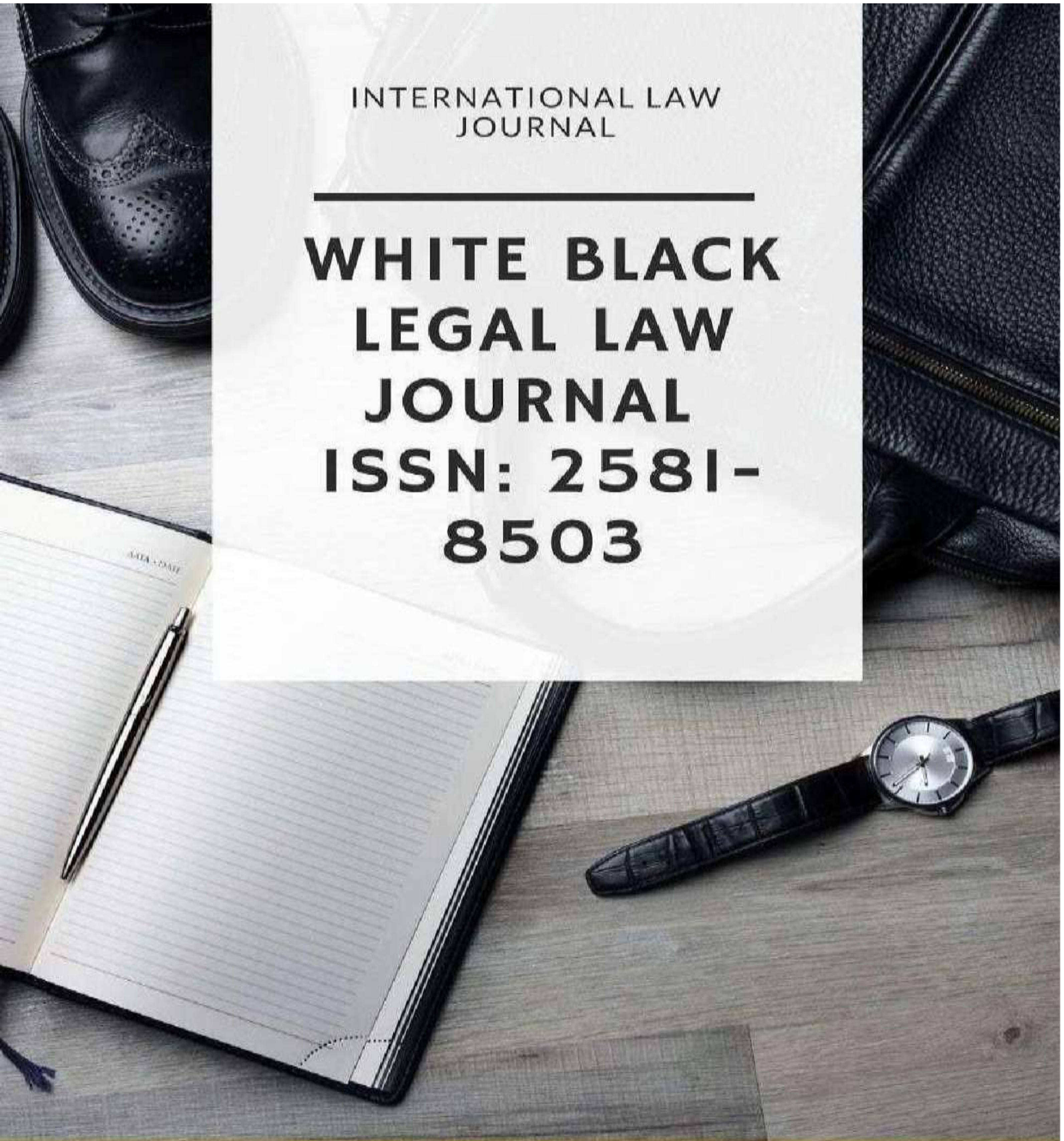

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With this thought, we hereby present to you

AN INTRODUCTION TO INPUT TAX CREDIT UNDER THE GOODS AND SERVICES TAX OF INDIA

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Abstract

The introduction of the Goods and Services Tax (GST) in India is a breakthrough in India's indirect tax regime as it subsumes several central and state taxes into a single regalia. Another important concept that is a part of GST is the Input Tax Credit (ITC) system where businesses are allowed to claim credit for taxes paid on goods or services purchased by them for their business purposes and thus, reduce the tax on their outputs. This paper aims at presenting a detailed discussion of the ITC system under GST, the purpose of the system, and the advantages that accrue from it besides the conditions that make one eligible for the system. It describes how ITC assists in eradicating the incidence of cascading taxes hence enhancing economic efficiency and equity.

Furthermore, the paper also examines the process of ITC claiming and the Electronic Credit Ledger that is used in tracking and using the credit. Implementation of technology on compliance of GST has eased the hassle of working and maintaining tax records and cash flow of businesses. In general, ITC is an important component of the GST system which enhances the overall efficiency of the Indian tax system and therefore helps in the development of businesses.

Key Words: *Goods and Services Tax, Input Tax Credit, Tax Cascading, Electronic Credit Ledger, Tax Compliance.*

Introduction

GST is one of the largest indirect tax reforms in India.[1] It is not only a tax reform but also impacts other systems like information technology, simultaneous center and state relations, federal structure, tax evasion, and so on.

GST has replaced multiple taxes levied by the central and state governments and has brought a change in the structure of the indirect tax system. A similar change in the indirect tax structure took place when different central and state taxes were abolished, and Goods and Services Tax (GST) was introduced with effect from 1st July 2017.

This new tax regime was implemented because the previous system was not efficient, and empirical studies estimate a 20-30% increase in tax under the previous regime.[2] The existing multiple tax systems were highly complex, opaque, and burdened trade and industry because of the narrow tax base and multiple tax structures. As a result, there was a need to shift to an entirely modern and unified tax system.[3] To achieve this objective and overcome such problems, Goods and Services Tax (GST) has been introduced.

The key objectives of the introduction of GST are as follows:

- The objective of this strategy is to make India a single unified common market where the Indian economy and the national market will be seamlessly integrated.
- To cut the cost to GDP and attain the goal of 'One Nation, One Market, One Tax' for the strengthening of the economy.
- To improve taxation mechanisms that are easy to use and rely on technology to encourage foreign investments as well as increase domestic consumption.
- To reduce compliance costs, promote positive change in taxpayer compliance behavior and improve the business environment in India.

India has chosen the dual system of GST whereby there is the Central Goods and Services Tax (CGST) and the State Goods and Services Tax (SGST). There are also two other forms of the GST which are the Integrated Goods and Services Tax (IGST) and the Union Territory Goods and Services Tax (UGST). The most important aspect of GST is that it allows the recipient of

[1] R. Khan and S. Khan, "Reform of Indirect Taxes in India through the Plexus of Goods and Services Tax (GST); A post-COVID 19 Fiscal Stimulus," *International Journal of Multidisciplinary …*, 2022. ijmaberjournal.org
[2] https://cleartax.in/s/old-tax-regime-vs-new-tax-regime
[3] S. Gupta and J. T. Jalles, "Do tax reforms affect income distribution? Evidence from developing countries," Economic Modelling, 2022.

goods or services to get the credit of all taxes paid on inputs, raw materials, capital goods and input services. The purpose of ITC under the GST regime is to use the credit of input tax for payment of output tax only.

Set off of central tax is possible by central or integrated tax while state tax and UTGST can be set off against state tax or UTGST. ITC is advantageous to the taxpayer in the following ways; First, it helps to minimize the cascading effect of tax, Second, it simplifies the administrative process and Third, it encourages compliant taxpayers to enable the utilization of the tax credit.[4]

Purpose of Input Tax Credit

Input Tax Credit (ITC) can be defined as a pivotal element in the entire scheme of Goods and Services Tax (GST) for maintaining the chain of credit transactions.[5] It is an exceptionally designed mechanism that allows businesses to offset the tax paid on purchases against the tax payable on sales. It is one of the most crucial components of GST that seeks to avert economic inefficiencies that are likely to occur if tax is levied on tax. In concordance, ITC seeks to neutralize the cascading effect of taxes at various stages of production up to the distribution of goods or supply of services. Simply put, ITC extends the benefits of tax already paid for a product that has been produced.

The sole purpose of enabling ITC in the GST framework is to mitigate the cascading effect of taxes, which was an intrinsic feature of the preceding indirect tax structure, thereby contributing to the promotion of fair tax practices.[6] This implies that both the State and the Centre have allowed taxable dealers to take the credit of tax paid on the purchase of goods in their respective laws. Since tax is already paid at the purchase stage itself, the tax authorities are able to recover tax at the point of sale.

The procedure for availing ITC is performed to ascertain that the dealers or traders already available in the trading line should make the payment of taxes on the sale of goods after taking into consideration the available tax credits. For instance, in real-life transactions, a dealer taxable at 10 percent of the Output Tax of GST can adjust it against the Input of IGST or

[4] R. Dulloo, G. Naveen, Y. S. Namitha, "GST in India: Not the end but start of the journey," Journal of Commerce, 2022.
[5] C. S. R. A. Kankariya, "An Analysis of Impact of Goods & Services Tax (GST) on Traders of Goods in Jalgaon District," 2021.
[6] P. Shome and P. Shome, "Goods and Services Tax (GST): India Case Study," Taxation History

CGST/SGST paid on purchases of goods during the month, and only the balance should be discharged. Compliance and administration of tax, as well as maintaining records, is as simple as possible and under check. If anybody wishes to claim ITC benefits, there are many simple and fast ways of proving.

Input Tax Credit is essential for the cash flow of a taxpayer, especially in the case of tax on reverse charge or in the case of tax that is required to be discharged, paid as a self-assessment tax by the taxpayer who is involved in the supply of goods and/or services.[7] It makes the credit available in the electronic cash register wallet maintained in the GST portal through tax return and thereafter could use the same as Output Tax while filing the return, thereby reducing the net liability of tax. Instead of every taxable dealer, identifying a taxpayer is beneficial for the purpose of availing input tax credit as well as for registration and compliance purposes.

A person availing of Input Tax Credit is required to maintain the records or documents as well as comply with the requirements for claiming Input Tax Credit. The taxpayer shall take proper measures where the receiver and the taxpayer do not take any credit for the same invoice or document, as it is not a Credit Circular. In computing the ITC, required documents are mandatory so that the transactions would be more closely monitored and outcomes evident.[8]

Eligibility criteria

For a person to be allowed to claim Input Tax Credit, he or she must be a registered person under the GST Act. It is to be noted that only a registered taxpayer is allowed to claim ITC through reverse charge or otherwise. The ones who do not possess a valid registration with the GST cannot get their invoices uploaded and this means that the recipient will also not be able to avail the ITC.

The recipient of supplies that are made by the registered taxpayer should get goods or services or both and these should be recorded against the tax invoice which has been issued by the supplier of the goods or services who is registered under the GST Act.[9]

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[7] I. F. A. Prawira and F. Anggrayni, "How taxpayers behavior takes advantage in tax incentives policy," Studies of applied Economics, 2021.
[8] D. L. J. A. Paco and M. S. Quezon, "Tax awareness and compliance of micro and small enterprises," Journal of Positive School Psychology, 2022.
[9] C. Kessler, "Taxpayer Non-Compliance with Input Tax Credit Rules: Data and Policy Options for Canada," Can. Tax J., 2020.

A person registered under the local GST Act is supposed to fulfill the requirements of the local GST Act for which he has been validly registered for input tax credit including filing of returns, payment of tax due on return by way of credit, maintenance of accounts and other records among others. If goods or services or both are received from non-registered persons who are not coming under the GST Act then no ITC should be claimed. This means that the person has registered himself under GST act to file his return and pay the tax where he has availed input credit.[10]

A person providing goods or services, in part or in full, below the exemption limit or opting not to apply for voluntary registration under the Act is exempt from claiming ITC[11]. Under the provision, one is barred from claiming ITC due to non-compliance if the provisions specifying the unauthorized collection of tax by the registered supplier of goods or services are not fulfilled.

The right to take the credit of the input tax should be established after the return has been made, and the tax shown in the return is claimed.[12]To avail ITC, proper documentation in terms of invoices need to be maintained and one has to have the right documents. Those who are unable to produce the records which contain invoice or debit notes obtained from the registered supplier or any document which contains information like invoice number, date of invoice, tax invoice value etc are not eligible to avail the credit of input tax. Hence when calculating the ITC part, the tax proponents have to be precise in terms of the value as well as the tax credit.

Registered taxpayers

Under the provisions of GST, only registered individuals (except for certain exceptions) can claim Input Tax Credit. The procedure for obtaining GST registration is mentioned in the CGST Act. Registered taxpayers are required to maintain appropriate records, such as accounts and production records. When it comes to tax payable under the use of credit by suppliers, a registered individual is required to pay tax. The complete process of returning, paying tax, and refunds is captured in the CGST Act. The GST Identification Number (GSTIN) is given to those individuals who have completed the registration process. This will end with the

[10] Ibid.
[11] K. Shivaram, "ALL INDIA FEDERATION OF TAX PRACTITIONERS," aiftponline.org
[12] P. Shome, "Taxation history, theory, law and administration," 2021.

cancellation of registration. The process and form of enrollment under GST will be determined at a later date. The appropriate officer may, with effect from the appropriate date, cancel the registration of a registered individual or registered citizen.

Failing to register under GST is a serious breach of the legislation. The failure to register can result in a penalty of up to 10,000 INR or the total amount of tax paid under-reported, whichever is higher.[13] Also, the registered individual must repay the entire credit on all the input goods, input services, and capital goods used to supply the goods or services to other owners or for the provision of exempt goods or services. This can be easily registered via phone apps. In addition, many individuals are subject to mandatory registration but find it inconvenient. The government utilizes technology to automate data submission by using software designed to obtain GST registration.

Conditions for claiming Input Tax Credit

For the claim of Input Tax Credit (ITC), certain conditions have to be satisfied as per the provisions under GST laws in India.

The first requirement to claim ITC is to have a valid tax invoice, debit note, or any other statutory documents.[14] This would be proof of tax payment in case of the purchases made. The supplier should have paid the tax to the government by filing the GST return and shown the tax amount in the invoice as part of the purchase transaction.

The recipient should have complied with the statutory requirements as per the Act, rules, and notifications. He should have reflected the details of purchases in the GST return in Form GSTR-2 and GSTR-3, and filed the return in Form GSTR-3B.[15] The recipient should only use the goods or the services that have been offered to him or her for business purposes only. In case they are of any other nature, then ITC cannot be availed.

The time limit to claim ITC is the earlier date of filing of the return for the month of September of the following year or filing of annual return for the year in question. ITC would also be

[13] A. Sureka and N. Bordoloy, "Impact of Input Tax Credit on Working Capital Requirements of MSMEs in India: An Empirical Study," Financial and Credit Activity Problems of..., 2024.
[14] Ibid at 9
[15] D. Mehta and S. Mukherjee, "Emerging issues in GST law and procedures: An assessment," 2021.

permitted up to the tax period September following the end of the financial year or the furnishing of the relevant annual return whichever is earlier. Thus, if the tax invoice or the invoice itself contains some variation in terms of tax Invoice which is not in accordance with the provisions of law, then the ITC will be blocked. Credit should, however, be granted once there is confirmation of the debit/credit note. The above shall also apply to Input Credit in case of input credit reversal or re-credit. Any corrections to be made should be done in a credit note or debit note and presented to the department. It is therefore important to maintain proper documentation of both the outward supply documentation and the credit or debit note in order to claim input tax credit.

Mechanism for Availing Input Tax Credit

To avail the Input Tax Credit, a registered person must undertake several procedural steps. The very first requirement for claiming the Input Tax Credit is that a registered person should possess a valid document in the nature of a tax invoice or a debit note.[16] When obtaining a tax invoice, one has to ensure that the tax levied thereon is in compliance with the provision of the GST laws and the other particulars which include the name and registration details of the supplier and recipient respectively as well as the place of supply etc. During the process of filing returns, the recipient inputs the details of his purchase as contained in the supplied GST return.

Claiming the Input Tax Credit starts with the reporting of the purchases in the returns by a registered person. Having filed the details of all their inward supplies/inward purchases in their return, the Electronic Credit Ledger of a registered person gets updated.[17]

Having the Electronic Credit Ledger with credits means that the information that is reported by a person is in order and complies with the law. Civic bodies facilitate the provision of Electronic Credit Ledger to every registered person to maintain his or her own cash ledger. An Electronic Credit Ledger enables a taxpayer to keep his or her own credit. Every single ledger represents a type of tax and results in the creation of a running balance of taxes which are extracted from the returns filed.

[16] O. Ivus, M. Jose, and R. Sharma, "R&D tax credit and innovation: Evidence from private firms in India," Research Policy, 2021.
[17] Ibid.

The availability of credit in the electronic credit ledger therefore ensures that the taxpayer has paid the requisite tax corresponding to these credits in the electronic cash ledger. If the matching of the two ledgers is not in agreement, a verification process is required to reconcile the differences. This is an initiative for good tax practices where both suppliers and recipients maintain electronic and accurate records, since every single sale and purchase transaction in a business has long-term implications on their own credit standing and that of the other party.[18]

Electronic Credit Ledger

Input Tax Credit is the hallmark of the GST tax system because it eliminates the cascading effect of taxes on goods and services. The mechanism of availing Input Tax Credit is entirely technology-driven, and an integral part of the process is the handling of the input tax credit ledger rather than physical vouchers of input taxes. The Input Tax Credit available to a registered person is maintained in the Electronic Credit Ledger.[19]

The Electronic Credit Ledger maintained at the common portal for a registered person is the account of credit that a taxpayer has in his file and is available for him to utilize for payment of output taxes. A registered person is entitled to credit on valid tax invoice, debit notes or any other document as may be prescribed once the said person gets registered and is entitled to claim credit then the credit is added to the Electronic Credit Ledger and getting accumulated there.

The time of credit accumulation is co-terminus with every recording by the taxpayer of his purchase transactions. Whenever a proper, regular, and complete input tax invoice or a debit note, or any other document issued by a supplier duly registered is received by a taxable person, and the registered person signs the said document legally known as a 'bill' of the supplier or endorses his proof of purchase and makes payment of his liability, such document gets recorded in the appropriate section of the purchase book of the registered person.[20]

The purchase or debit note, once recorded in the said manner in the purchase book, shall result into the recording of the credit in the Electronic Credit Ledger (ECL) maintained by the

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[18] M. Javaid, A. Haleem, R. P. Singh, R. Suman, "A review of Blockchain Technology applications for financial services," Bench Council, 2022.
[19] K. Dhar and U. Khandelwal, "Impact of goods and services tax on supply chain management," Business Perspectives and …, 2022.
[20] S. Banker, D. Dunfield, A. Huang, and D. Prelec, "Neural mechanisms of credit card spending," Scientific Reports, 2021.

common portal. Hence the primary objective of maintaining a record of the goods and services supplied and the taxes paid by a taxable person is to enable proper crediting in the ECL as maintained above. Thus it is always helpful to have a ready record of all the documents that have been issued and the amount of credits taken while making a purchase. It also assist in reducing any possible future misunderstandings with the tax authorities and also ensure that all the willing as well as unwilling parties to the transaction have a clear understanding of the transaction. Thus, such an approach will make the taxman happy and relaxed. All of this will be achieved in the GST system and the tax compliance will be an additional advantage of doing good business. In the sea of credit, everything that is related to the GST will look more effervescent.

Benefits of Input Tax Credit

The availability of Input Tax Credit is crucial to the concept of GST, as it would, in many ways, help to reduce the total cost of taxation.[21] The structure aims to compensate businesses for the taxes they have paid on their inputs. GST is a single fee that is included in the cost of the item at each phase of the value chain. To remedy the problem, the government allows for the free swapping of taxes at all of the former levels. By letting a business deduct the taxes charged on inputs from the taxes owed on the supplies, it is only required to pay the difference, whether it is to be handed over to the positive tax liability or to accept a refund for the excess tax paid. This would therefore benefit the end consumer rather than the business.

The implementation of the ITC principle has produced positive impacts on corporations and thus there is high level of compliance in different fields across the business world. This is because with the introduction of the GST bill the cascading tax is no longer imposed. Taxes are cascading more and the incidence of tax is not distributed fairly under non-GST structure. The present study suggest that ITC may create wealth and facilitate the improved management of cash flow for a company. Besides the above benefits, the idea of ITC under GST is also used to enhance the overall recognition of the entire supply chain. In addition, higher rates of credit can lead to higher speculation because the seller’s invoices are only allowed once the belief they have in their hands, thus allowing for more control.

[21] S. Agarwal, A. Bubna, and M. Lipscomb, "Timing to the statement: Understanding fluctuations in consumer credit use," Management Science, 2021.

Conclusion

Input Tax Credit (ITC) under the GST is an important element that has improved the effectiveness of the tax system by eradicating the tax-on-tax aspect. This is because through ITC, businesses can offset their tax liabilities on purchases while at the same time promoting compliance with tax laws. The use of Electronic Credit Ledger in the management of ITC has made it easier to report and meet the tax obligations hence enhancing the ease of doing business. Altogether, ITC has demonstrated its significance as an effective mean to enhance the economic efficiency, to provide non-discriminatory approach to taxation, and to contribute to the development of business in India.