

### **8.1 CONCEPTS OF INPUT TAX AND OUTPUT TAX**

Input tax is the tax paid or payable in the course of business on purchases of any goods made from a registered dealer of the State. Output tax means the tax charged or chargeable under the Act, by a registered dealer for the sale of goods in the course of business.

In simple words input tax is the tax a dealer pays on his local purchases of business inputs, which include the goods that he purchases for resale, raw materials, capital goods as well as other inputs for use directly or indirectly in his business. Output tax is the tax that a dealer charges on his sales that are subject to tax.

### **8.2 INPUT TAX CREDIT (ITC)**

The essence of VAT is in providing set-off for the tax paid earlier, and this is given effect through the concept of input tax credit/rebate. This input tax credit in relation to any period means setting off the amount of input tax by a registered dealer against the amount of his output tax.

It is reiterated that tax paid on the earlier point is called input tax. This amount will be adjusted/rebated against the tax payable by the purchasing dealer on his sales. This credit availability is called input tax credit; it can also be referred to as tax credit on a sale within the State or in the course of inter- State trade or commerce.

#### **8.2.1 Scope of input tax credit**

Input tax credit shall be allowed to a registered dealer for purchase of any goods made within the State from a dealer holding a valid certificate of registration under the Act. Further, the input tax credit will be given to both manufacturers and traders for purchase of inputs/supplies meant for both sale within the State as well as to other States, irrespective of when these will be utilized/sold.

Even for stock transfer/consignment transfers/branch transfer of goods out of the State, input tax paid in excess of 4% (now 2% as CST rate is 2%) will be eligible for tax credit. It is also to

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be noted that in some States partial input tax credit is available in respect of inputs used for manufacture of exempted goods.

### 8.2.2 Input tax credit available on capital goods

Input tax credit on capital goods will also be available for traders and manufacturers. Tax credit on capital goods may be adjusted over a maximum of 36 equal monthly instalments. The States may at their option reduce this number of instalments. The State of Maharashtra has decided to give full input tax credit in the month of purchases only. However, if the capital asset is sold within the period of 36 months proportionate input credit will be withdrawn. There is a negative list for capital goods (on the basis of principles already decided by the Empowered Committee) not eligible for input tax credit.

The concepts relating to input tax credit on capital goods have been discussed in para 8.9 of this chapter.

## 8.3 VAT LIABILITY

The Value Added Tax (VAT) is based on the value addition to the goods, and the related VAT liability of the dealer is calculated by deducting input tax credit from tax collected on sales during the payment period (say, a month).

If, for example, input worth Rs. 1,00,000/- is purchased and sales are worth Rs. 2,00,000/- in a month, input tax rate and output tax rate are 4% and 12.5% respectively, then input tax credit/set-off and calculation of VAT will be as shown below:

- |                                      |   |                |
|--------------------------------------|---|----------------|
| (a) Input purchased within the month | : | Rs. 1,00,000/- |
| (b) Output sold in the month         | : | Rs. 2,00,000/- |
| (c) Input tax paid                   | : | Rs. 4,000/-    |
| (d) Output tax payable               | : | Rs. 25,000/-   |
| (e) VAT payable during the month     | : | Rs. 21,000/-   |
- after set-off/input tax credit

$$[(d) - (c)]$$

Subject to the provisions relating to credit for input tax, the net tax payable by a taxable person for a tax period can be calculated on the basis of the following formula:

$$A - B$$

where

A = Total of the tax payable in respect of taxable supplies made by the taxable person during the tax period and

B = Total input tax credit allowed to the taxable person for the tax period.

In short, net tax payable is total tax liability minus input tax credit i.e. net tax is the difference between output tax and tax credit.

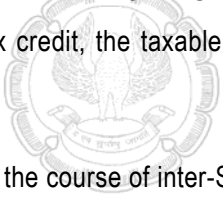
Following example illustrates how excess VAT credit can be availed:

|                                                                    |           |
|--------------------------------------------------------------------|-----------|
| Tax paid on purchases made in the State within a month (input tax) | Rs.10,000 |
| Tax charged for sales in the State within a month (output tax)     | Rs.4,500  |
| CST Charged for inter-State sales within a month                   | Rs.15,000 |
| ITC                                                                | Rs.10,000 |
| VAT liability (Rs.4,500 - 10,000)                                  | Nil       |
| Excess credit                                                      | Rs.5,500  |
| CST to be paid to Govt.(Rs.15,000- 5,500)                          | Rs.9,500  |

In the present case CST to be paid to Govt. is Rs.9,500 (CST of Rs.15,000 will be reduced by excess VAT Credit of Rs.5,500/-)

#### 8.4 ELIGIBLE PURCHASES FOR AVAILING INPUT TAX CREDIT

For the purpose of claiming input tax credit, the taxable goods should be purchased for any one of the following purposes:

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- (i) for sale/resale within the State;
  - (ii) for sale to other parts of India in the course of inter-State trade or commerce;
  - (iii) to be used as-
    - (a) containers or packing materials;
    - (b) raw materials; or
    - (c) consumable stores,
 required for the purpose of manufacture of taxable goods or in the packing of such manufactured goods intended for sale in the State or in the course of inter-State trade or commerce;
  - (iv) for being used in the execution of a works contract;
  - (v) to be used as capital goods required for the purpose of manufacture or resale of taxable goods;
  - (vi) to be used as
    - (a) raw materials;
    - (b) capital goods;
    - (c) consumable stores and

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(d) packing materials/containers

for manufacturing/packing goods to be sold in the course of export out of the territory of India;

(vii) for making zero-rated sales other than those referred to in clause (vi) above.

### **8.4.1 Common goods used for taxable goods and tax-free goods**

Provisions have been made in most of the States to provide that the purchases should be used for manufacture etc. of taxable goods. Taxable goods means goods other than the goods which are specified in the Schedule for tax-free goods.

Where the purchased goods are used partially for the purpose specified above, input tax credit shall be allowed proportionate to the extent the purchases are used for the purposes specified above.

## **8.5 PURCHASES NOT ELIGIBLE FOR INPUT TAX CREDIT**

Input tax credit may not be allowed in the following circumstances:

- (i) purchases from unregistered dealers;
- (ii) purchases from registered dealer who opt for composition scheme<sup>1</sup> under the provisions of the Act;
- (iii) purchase of goods as may be notified by the State Government;
- (iv) purchase of goods where the purchase invoice is not available with the claimant or there is evidence that the same has not been issued by the selling registered dealer from whom the goods are purported to have been purchased;
- (v) purchase of goods where invoice does not show the amount of tax separately;
- (vi) purchase of goods, which are being utilized in the manufacture of, exempted goods;
- (vii) goods in stock, which have suffered tax under an earlier Act but under VAT Act they are covered under exempted items;
- (viii) purchase of goods used for personal use/consumption or provided free of charge as gifts (partial credit is available in the State of Maharashtra);
- (ix) goods imported from outside the territory of India (commonly known as high seas purchases);
- (x) goods imported from other States viz. inter-State purchases.

## **8.6 CARRYING OVER OF TAX CREDIT**

Input tax credit is first to be utilized for payment of VAT. The excess credit can be then adjusted against the central sales tax (CST) for the said period. After the adjustment of VAT

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<sup>1</sup> The concepts relating to composition scheme have been discussed in Chapter 9 of Section B of this Study Material.

and CST, excess credit, if any, will be carried over to the end of the next year. If there is any excess unadjusted input tax credit at the second year, then the same will be eligible for refund. However, some States have decided to grant refund after the end of the first financial year itself.

#### Illustration

|                                                                   |               |
|-------------------------------------------------------------------|---------------|
| (a) Inputs purchased within a month                               | Rs. 10,00,000 |
| (b) Outputs sold in the month                                     | Rs. 7,50,000  |
| (c) Input tax paid @12.50% on (a)                                 | Rs. 1,25,000  |
| (d) Tax @12.5% on sale of goods of Rs.7,50,000/- during the month | Rs. 93,750    |
| (e) Net VAT payable during the month (d) - (c)                    | NIL           |
| (f) Tax credit to be carried to the next month (c) - (d)          | Rs. 31, 250   |

#### 8.7 REFUND TO EXPORTERS WITHIN THREE MONTHS

The White Paper provides for the grant of refund of input tax paid if the goods are exported out of the country. Under the basic design of the White Paper this refund is to be granted within a period of 3 months from the end of the period in which the transaction for export took place.

#### 8.8 EXEMPTION OR REFUND TO SEZ AND EOU UNITS

Units located in Special Economic Zone (SEZ) and Export Oriented Units (EOU) are granted either exemption from payment of input tax or refund of the input tax paid within three months. State Governments may reduce the time period of 3 months.

#### 8.9 CONCEPT OF INPUT TAX CREDIT ON CAPITAL GOODS

A dealer has to purchase capital goods, which may include plant and machinery, furniture, fixture, electrical installations, vehicles etc. Similarly, a dealer may be creating capital assets himself by purchasing materials for capital assets like, building materials etc. Normally all the above items are taxable and the dealer has to pay sales-tax on purchase of the above goods. Each State-VAT legislations may define 'capital goods' differently.

Normally, under VAT system the dealer should get full credit for tax paid on such purchases, more particularly when the basic principle is to avoid the cascading effect. These assets are used for the business and while fixing sale price of the business products the dealer has to include some portion towards the cost of the acquisition of these assets as part of the sale price. If the input credit is not allowed in full then certainly, to the extent of disallowance, the principle of VAT gets defeated. For example, a dealer has purchased furniture for his business, costing Rs.1,00,000/-. Assuming that the vendor has charged tax to him @ 12.5%, he will incur an additional cost of Rs.12,500/- by way of VAT. Now, if the credit for VAT paid is

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allowed, the dealer can consider the cost of acquisition at Rs.1,00,000/-. If the credit of tax paid is not allowed then he has to consider the cost of purchase at Rs.1,12,500/-. While marking up his price on account of establishment cost he has to consider this cost of furniture as one of the components. If cost remains higher, obviously to that extent the mark up will go up. If the cost is lower i.e. after considering input credit of Rs.12,500/- the cost will be lower and to that extent the mark up will also be lower, resulting in an overall lower sale price.

When tax paid on purchases is included in cost, the said tax indirectly gets reflected in the sale price and hence there is also an element of tax upon tax. This cascading effect can very well be imagined from the above example. Depending upon the volume of capital goods and the tax component on the same the magnitude of the cascading effect can be imagined. When the tax is collected on sales, indirectly there is collection of tax on the cost of capital goods also which includes tax paid on purchase of such assets.

### **8.9.1 Policy in the white paper**

The policy lays down that in relation to capital goods set off will be available to traders and manufacturers. The most important factor is that the White Paper recognizes the fact that set off is to be given to both traders and manufacturers. It is well known that under traditional sales-tax system, in some States, partial credit was allowed on capital goods to the manufacturers but no credit was allowed to traders. The White Paper, taking into account the very basis of VAT system, laid down a policy statement that set off will be allowed to both manufacturers and traders.

However as per the White Paper, the State Governments can provide to give set off on a staggering basis, at the most in 36 instalments. This is subject to the policy of individual States. The States, like Maharashtra, have provided set off in one slot and the same is to be claimed immediately on effecting purchase.

### **8.9.2 Restrictions on credit relating to capital goods**

It should be noted that credit on capital goods is not being allowed across the floor. As per the White Paper, there will be a negative list for capital goods which will be based on certain pre-agreed principles by the Empowered Committee. The capital goods mentioned in the negative list would not be eligible for input tax credit. However, it appears that the States have taken their own decisions to provide negative lists or reduction in set off in respect of capital goods.

### **8.9.3 Procedural requirements for claim of set off**

Barring the items covered by the negative list and subject to retention rules, the dealers are entitled to set off on capital goods like any other purchases. Thus, the dealer will have to bifurcate their purchase into capital goods eligible for set off and capital goods not so eligible.

In respect of eligible capital goods the dealer will be required to follow the procedural requirements for claiming set off successfully. For example, dealers will be required to support purchase of capital goods with tax invoice. In the absence of such tax invoice set off will be disallowed.

Once a dealer is entitled to set off he has to further comply with the relevant provisions in respect of allowability. If it is subject to certain installments, the dealer will be required to claim set off accordingly in his returns. If the set off is subject to prior permission, the same should be duly obtained.

The allowable set off on capital goods will be, of course, part of normal set off. The dealer will be able to adjust this set off against his other VAT liability. For example, dealer can adjust his set off as per the following illustration:

|       | Particulars                                                         | (Rs.)    |
|-------|---------------------------------------------------------------------|----------|
| (i)   | VAT paid on procurement of inputs/supplies worth Rs.1 lakh @ 12.50% | 12,500   |
| (ii)  | VAT paid on procurement of capital goods of Rs.10 lakhs @ 12.50%    | 1,25,000 |
| (iii) | VAT credit available in the month                                   | 1,37,500 |
| (iv)  | VAT on sales of Rs.10,00,000 during the month @ 12.50%              | 1,25,000 |
| (v)   | VAT payable during the month                                        | Nil      |
| (vi)  | Carry over of tax credit for set off during the next month          | 12,500   |

It may be mentioned here that the set off under VAT Acts are subject to one very important condition. It is generally provided in VAT Acts that the set off on any goods should not exceed the tax received on the same goods in Government Treasury. For example, section 48(5) of the Maharashtra VAT Act provides that a dealer will not be entitled to set off more than the amount received in the Government Treasury. Therefore, if the vendor fails to make the payment of tax to the Government, the purchaser's claim of set off will be denied in spite of the fact that he has paid the tax to his vendor. If at any earlier stage some tax was paid, to that extent, the set off can be claimed.

Therefore, the purchasing dealer, desirous of claiming set off, should also look into the credentials of the vendor so as to be sure that he will get the set off of tax paid to him.

### Self-examination questions

1. Differentiate between input tax and output tax.
2. Who can avail input tax credit?
3. Can input tax credit be carried forward? Discuss.
4. Enumerate the eligible purchases in respect of which input tax credit can be availed.
5. Mention the purchases which are not eligible for input tax credit.
6. How will the input tax credit be availed when common inputs are used for taxable and tax-free good?
7. Explain whether units in SEZ and EOU units are required to pay input tax on purchases made by them?

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8. Can input tax credit be availed on capital goods? Explain.
9. Discuss the procedural requirements to be fulfilled in order to claim input tax credit on capital goods.
10. Discuss the policy contained in the White Paper with regard to availment of input tax credit on capital goods.

