

Input Tax Credit Under Gujarat Value Added Tax Act

A Comprehensive Note on Input tax Credit under Gujarat Value added Tax Act

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1.0 Introduction

1.1 Input Tax Credit – at the core of VAT System

One of the differentiating aspects of VAT from traditional method of levying tax on sales is permitting the dealer credit for tax paid on input. The whole concept of VAT is based on the basic principle of levying tax on “**value added**”. There are various methods for arriving at the amount of value added by the selling dealer. However, the most common method prevailing amongst various countries is permitting credit for tax paid on the goods purchased from the tax payable on sales consideration. Therefore, under the ideal tax structure, in order to arrive at the total amount of value added, the whole of the tax paid for all the inputs (raw material, consumable stores, fuel, packing material, capital goods etc.) should be considered. To the extent ITC is denied to the selling dealer by excluding some of the items, less efficient will be the VAT system, leading to double taxation.

2.0 Impact of ITC on business

2.1 ITC as component of Current Asset:

As required by the Guidelines issued by the ICAI, VAT paid is not an expense but is a claim of the dealer. Therefore, it has to be segregated from total amount paid for purchases and shown as claim receivable under the Group “Current Asset, Loans and Advances”. Amount appearing under the said head indicates the extent to which the dealer can reduce his future tax liability or claim refund. Since the dealer is permitted to collect VAT from his buyers, any reduction in liability is a direct benefit.

2.2 Implication of ITC on bottom line of business

VAT being indirect tax, its impact on profitability of an undertaking has not been appreciated fully. This may be due to the indirect tax not hitting the taxpayer directly. However, it should be appreciated that any saving in the form of lower tax component will make impact on the bottom-line in the proportion of sales / purchase and net profit. Therefore, even a small reduction in tax liability on purchases / sales can help in making the product more competitive. What is true in respect of reduction in tax liability is equally true in respect of disallowance of ITC as well. Considering the fact that indirect taxes forming part of sales consideration / purchases, it relatively carries more value as compared to direct taxes, as any reduction / saving in it can add substantial value as the value addition is multiplier of purchases / sales made.

2.3 Planning for ITC

There are three basic issues involved while planning for ITC.

- a) Timing of arising of claim for ITC
- b) Documentation for utilisation of goods
- c) Timing for claim for refund or its utilisation

2.4 Timing of purchases and its impact on ITC

ITC being an asset, it carries with it time value of money. If the amount of ITC remains unutilised, there will be loss of interest. Therefore, monitoring of accumulation of ITC from time to time is vital. If ITC has accumulated to a level where its utilisation for a certain period is not possible, it calls for rescheduling of purchases. In the same manner, if the level of ITC is not sufficient enough to match with the VAT liability arising on sales, rescheduling of dispatch of goods becomes necessary.

2.5 Documentation of utilisation of Goods

Claiming of ITC requires the dealer to maintain records in respect of utilisation of goods on which ITC is claimed. If proper documents are not maintained, there will be loss of ITC. It should be noted that such losses will have to be borne irrespective of the dealer making profit or loss.

2.6 Timing of claim for refund of ITC

State VAT Act provides for refund of excess ITC under certain circumstances. Excess of ITC can be a permanent feature or temporary one. For example, in the case of a dealer wherein export sales form a major part of his sales on regular basis, ITC will get accumulated as a permanent feature. If it is due to mismatching of purchases and sales, it will be a temporary phenomenon. In the former case, claim for refund of ITC should be a regular feature. However, in the later case it cannot be. This is for the reason that excess of ITC will get adjusted in the subsequent few months.

3.0 Basic Framework of ITC under GVAT

3.1 Definition of ITC

S. 2 providing for various definitions is silent about the term “tax credit” or “Input Tax Credit”. However, S. 11(1)(a) defines it indirectly by referring it to the extent to which a purchasing dealer can claim tax credit.

3.2 Classification of ITC

S. 11(3)(a) broadly classifies the ITC on the basis of nature of goods purchased i.e. for trading, raw material and CG. Majority of the provisions relating to ITC are applicable to all of the three categories, it is only in the case of CG additional conditions have been laid down. They are regarding the CG not being second-hand, being accounted for as capital assets and used for continuously for a period of five years. In view of this provisions also exist for disallowance / reduction in ITC claimed for violation of these conditions. All the other conditions as laid down u/s 11(5) and other sections are applicable to all the types of goods.

3.3 Parameters for allowing ITC

What are the parameters on the basis of which purchases made by a dealer are evaluated for claiming of ITC? The GVAT, apart from laying down various general conditions, provides for specific conditions as well. Conditions to be complied are with regard to the nature of goods, its utilisation etc., GVAT also connects it with the nature of business as well.

It should be remembered that it is not that each and every purchases made by the dealer will make him entitle for claiming of ITC. S. 11(3)(a) lays down seven different purposes for which the dealer should have made the purchases.

S. 11(3)(a) lays down three basic conditions to be complied with by the purchasing dealer in order to be eligible to claim tax paid as ITC. The section reads as follow:

“.... Tax credit to be claimed under sub-section (1) shall be allowed to a purchasing dealer on his purchases of taxable goods made in the State, which are intended for the purpose of”.

3.4 Purchase of Taxable Goods

ITC can be claimed on purchase of taxable goods only. S. 2(29) defines the term “taxable goods” as the goods other than those on the sales or purchase of which no tax is payable u/s 5. S. 5(1) refers to the goods which have been specified in Schedule I. S. 5(1A) refers to the goods which have been notified by the Government as exempt.

3.5 Purchases made from within the State

S. 4 define the geographical limit within which all the sales taking place are made taxable under GVAT. Accordingly, sales/purchase taking place in the course of inter-State trade, outside the State, import of goods are outside the purview of GVAT.

3.6.1 What is the meaning of “intention”?

It is required that the dealer should have purchased the goods *with the intention of sale, re-sale, export or using it as raw material* etc. ***It is not each and every purchase made by the dealer for which amount paid as VAT can be claimed as ITC.*** In order to ensure that only the goods, which are related to the business and, are being claimed as input, the condition of intention has been provided for. This condition has to be read with reference to the provision of S. 11(8)(a) which provides for reduction in ITC for use of goods other than the purposes intended as referred to in sub-clause(3). The dealer concerned, though not in a formal sense, undertakes to use the goods for manufacturing / resell / export it. There is, therefore, contravention of such an undertaking when the goods are used for other than permitted purposes.

3.6.2 Whether the requirement of the section refers to the subjective state of mind of the dealer?

The phrase "intended for" is frequently used to connote, "meant for" or "for the purpose of". A question that will arise here is whether it refers to the subjective state of mind of the dealer, meaning thereby, its violation can occur when the dealer changes his intention. If it is not so which are various other circumstances which make the intention to be implemented / executed?

Interpreting the requirement in this respect as a subjective one means that it *merely describes the intention* of the dealer concerned to use the goods for manufacturing / resell / export etc. In such a case, contravention can occur only in those cases where the dealer concerned changes his intention. If intention is taken

as a subjective desire on the part of the dealer concerned to act in a certain manner, then it becomes extremely difficult to ascertain when a contravention occurs. At the time when the purchase is made, the dealer concerned can always be said to have this subjective desire to carry out the intention. If, at any subsequent date, he acts contrary to it, the dealer may, in a number of cases, be able to prevent reduction in VAT by pleading that though he has acted contrary to his intentions; his desire has always been to carry out his intention. For example, he may say that although he desired to resell the goods, he could not find any buyer; or he may say that although he desired to resell the goods, such a sale was not commercially viable; or he may say that although he desired to resell the goods, the goods had been spoiled and he had to throw them away. Such an interpretation would make the levy of tax dependent entirely on a subjective state of mind of the dealer. In that case, the provision in this may respect will become redundant.

3.6.3 Whether the dealer has to take any action to show his intention?

There is no provision in the GVAT, requiring the dealer to submit any particular form or declaration as it was under the Sales Tax Act. However, the dealer is expected to claim ITC for only those items which are for the purposes of sale, resale etc. as laid down in sub-clause (i) to (vii) of S. 11(3)(a). If any of the goods purchased are not falling into the category of purposes laid down, claim can not be lodged for ITC. The only relevant circumstance, which would indicate whether there is contravention of the condition, is the one relating to the disposal of the goods. By dealing with the goods in a manner which is contrary to the provisions of S. 11(3)(a), the dealer's original intention can be said have come to an end. Therefore, if the intention cannot be carried out, it can be said to have come to an end. Hence, there is non-compliance of the condition by the dealer. How can the existence of this intention be ascertained? A VAT Officer cannot go into the subjective state of mind of the dealer. The existence or non-existence of the intention will have to be judged from the conduct of the dealer. If the dealer has dealt with the goods, in such a manner that the goods cannot be resold, exported, manufactured, his conduct will indicate that his intention to manufacture / resell / export the goods has been abandoned.

3.6.4 Whether the dealer has to take any action to display having carried out intention?

No conditions have been laid down for carrying out intention as provided for. The very act of sale / re-sale / manufacturing by the dealer will show that the dealer has carried out his intentions. Secondly, as long as the dealer is carrying on the business, it is presumed that he intends to use the goods purchased for sell, resell, export, manufacture etc. A question may also arise whether it is only in the case of positive action by the dealer of having changed his intention will invoke provisions of the section? If so, it is only in the rare case of discontinuing any product line, as mentioned above, it can be said that the dealer has changed his intention. In order to invoke provisions of S. 11(8)(a) relating to reduction in ITC, it is not necessary for the dealer to show his change in intention. The very fact of dealing with the goods in certain manner or not being in a position to deal with it will itself reflect the intention.

3.6.5 Whether the purchases of unrelated items can disentitle the dealer from claiming ITC?

By laying down the condition with respect to intention, it is ensured that only the goods, which are related to the business, will be purchased. However, how does one ensure the condition in this respect? The dealer, at the time of making application for registration, is required to declare goods proposed to be dealt with and also nature of activity i.e. trading or manufacturing etc. Any purchases not covered under the type of goods declared or nature of activity to be undertaken in the registration certificate, can be said to have been made not with the intention of sale, re-sale etc.

3.6.6 Whether the dealer can be said to have satisfied this condition in respect of closing stock at the end of the year?

A dealer does not make purchases on daily basis for day-to-day requirements. Goods are purchased in bulk, stored and used / sold as and when required. Therefore, in a going concern, there will always be certain quantity of material lying unused which at the end of the year, it will appear as closing stock. The dealer has claimed ITC on purchase of such goods. Does this mean that by not selling / using the goods during the year, the dealer has changed his intention and is, therefore, not entitled to claim ITC on the same? Whether any adjustment relating to proportionate ITC be made? It should be appreciated that, in order to maintain continuity, the dealer should have goods on hand as and when required. If the dealer is expected to buy the goods to the extent of his daily requirements then no business can function. Therefore, keeping goods in stock does not mean change in intention. Sale, re-sale or use as raw material can take place at any point of time in future. As long as the dealer is continuing the said business activity, there is no question of disallowing any ITC on stock lying on hand.

3.6.7 Whether sale of raw material purchased on discontinuation of any product line or for any reason can disentitle ITC?

At times, it so happens that having purchased the raw material, a product line is dropped or discontinued for, say, due to lack of demand or for any technical reason. A question may arise in such cases, what will happen to ITC claimed on such goods? These goods were purchased with the intention of using it as raw material. However, they can no longer be used so. Does it not amount to change in intention? If so, can ITC on it be claimed? Looking to the provisions in this respect, claim for ITC will not be permitted.

Another dimension of this issue will be levying ITC on sale of such goods. Since the dealer is selling the goods, he is required to charge VAT on it. While on the one side ITC for VAT paid is not permitted, tax is levied on its sale.

3.6.8 Whether the circumstances beyond control of the dealer i.e. natural forces, making it impossible for the dealer to carry out the intentions, will disentitle for ITC?

In day-to-day business, there are various circumstances under which it may not be possible for the dealer to sell or consume the entire quantity of goods purchased. For example, chemicals might have been evaporated. Certain quantity is lost in transit or in the process of transfer within the factory premises itself. Can it be said

that the dealer has changed his intention in respect of such goods and not being entitled for claiming ITC?

Loss of goods happens in various ways, at times even before manufacturing process takes place. Goods are received short from the supplier. Having received the goods, shortages do occur in the process of storing. Loss of material does take place even at the time of putting the material in manufacturing process. One can say that the loss, which has taken place in the manufacturing process, the dealer has carried out his intention of having bought the goods for manufacturing process. However, what treatment should be given to such losses, which have taken place before the commencement of manufacturing process?

There will be cases wherein there is a loss of a very small quantity of goods in the course of these goods being resold or manufactured or being exported. In other words, ***the loss has occurred while the dealer was carrying out his intention i.e. the condition laid down u/s 11(3)(a).*** The loss in these cases is such that it was an inevitable loss arising while dealing with the goods in the normal manner in the course of export or resale etc. The goods so lost may form less than, say, 1.00% of the goods, which were purchased. If, while carrying out the intention of purchases made i.e. by reselling or exporting the goods, there is some such inevitable loss arising due to leakage or spillage etc. it cannot be said that the assessee has failed to carry out the intention. Looking to the nature of the commodity, and the manner in which it is required to be transported for the purpose of resale or export, such a loss can be inevitable. In such cases, the dealer has in fact carried out the intention of purchases made in a substantial manner and he cannot be held accountable for every single drop / loss of the commodity which he had purchased.

3.6.9 Whether identifying any machine as impaired will amount to change in intention?

AS- 28 requires the dealer to identify assets, which have become impaired. It signifies that such assets are no longer in use. Whether any machine which has been impaired before the period of five years as laid down u/s 11(8)(b) from its date of purchase, will amount to change in the intention? If so, proportionate ITC will be disallowed.

4.0 **Who can claim Input Tax Credit?**

S. 11(1)(a) permits only registered dealer to claim ITC. The section begins with the words “*a registered dealer who has purchased...*”. Therefore, an URD, even though having paid VAT on his purchases, cannot claim ITC till he has been registered. Thus, what is important is that the dealer should be a registered dealer at the time when he makes purchases.

S. 11(5)(dd) provides that purchases made prior to the date of registration are not entitled for ITC. S. 11(5) has been amended and clause (p) (ii) has been inserted under which a dealer can claim ITC for the taxable goods held in stock on the date of registration which are purchased after 1-4-2008 and during the period of one year ending on the date of registration. This is a limited relief to the dealer who are under the process of registration.

4.1 Claim of ITC by a dealer whose registration is under suspension

S. 2(20) defines “registered dealer” as a dealer registered under the provisions of GVAT, who holds a certificate of registration granted or deemed to have been granted. Therefore, a dealer who has been suspended u/s 27(5A) cannot claim ITC for VAT paid on his purchases. Although there is no reference to such cases in S. 11, S. 27(5A)(3) specifically prohibits such a dealer from claiming ITC during the period of suspension.

5.0 Types of Goods Entitled for ITC

S. 11(1)(a) provides for claim of the VAT paid on the goods, which are taxable. S. 2(29) define the term “taxable goods” as the one in respect of which no tax is payable u/s 5. S.5 covers following types of goods.

- a) Goods covered under Schedule – I
- b) Exemption to purchase / sales of specified class of goods
- c) Purchase / sales by specified class of dealer.
- d) Sale by units granted exemption u/s 49(2) of GST Act.

All the taxable goods can be classified in three categories viz. Goods meant for trading, goods purchased for use in the manufacturing and CG. Thus, in order to be entitled for claiming ITC both the conditions viz. taxability and categorization as mentioned above has to be satisfied.

5.1 Goods covered under Schedule – I

Schedule I covers the goods, which are exempt. It may be noted that since the goods are exempt, the question of ITC on raw material used for such goods does not arise. Such provisions can create anomalous situation. For example, in the case of goods, which are falling under Schedule I and exported, refund of ITC on input of such goods cannot be permitted [see S. 11(1)(a)]. Compare this provision with ITC on goods exported falling into Schedule II. ITC on input of such goods can be claimed as refund.

5.2 Exemption to purchase / sales of specified class of goods

The State Government has issued various Notifications exempting number of goods from VAT. In some of the cases, tax has been exempted in excess of 4.00% only i.e. exemption is partial. Thus, such items will continue to be taxable @4.00% and the amount of tax in excess of it, is considered as exempt. A question that may arise is whether purchases of such goods are entitled for ITC. This is for the reason that items covered under the Notification are given conditional exemption i.e. exemption beyond 4.00% only. Whether such goods lose its character of being entitled for ITC for the reason of it being covered under Notification issued u/s 5(2)? Can they be called exempt goods despite attracting tax @ 4.00%?

Goods covered under Notification issued under section 5(2)(a) are not exempt fully. Some element of tax is fastened to it. What will happen to it if ITC is not permitted? Specific provisions in this respect as referred to in S. 11(5)(g) and (h) are with some clarity. It is provided therein that ITC will be denied only in respect of those goods wherein the tax is exempt wholly.

5.3 Purchase / sales by specified class of dealer.

S. 5(2)(a) empowers the State Government to notify certain transactions of sales / purchase or sales or purchases by a specified class of dealer from payment of tax or any part of it. Till date ~~13~~ Notifications have been issued. S. 11(5)(g) and (h) prohibits ITC for purchases made from such dealers.

5.4 Sale by units granted exemption u/s 49(2) of GST Act.

S. 5(2)(b) covers the cases of the dealers who have been granted tax exemption under section 49(2)(b) of the GST Act. S. 11(5)(g) and (h) prohibits ITC in respect of purchases made from such dealer.

5.5 Goods not connected with the business:

S. 11(5)(k) denies ITC in respect of goods not connected with the business. How to identify goods purchased are connected with the business? What are the criteria? The one, which can come handy, is the certificate of registration. The RC will be carrying details of the goods dealt with in general, and not in particular. However, following are few of the questions, which can help in satisfying the requirements in respect thereof.

Are the purchases made predominately concerned with the making of taxable supplies for a consideration?

Are the taxable purchases that are being made of a kind which, subject to differences of detail, are commonly made by those who seek to use it for manufacturing / sale in its normal course of business?

Does the purchases made have a certain measure of substance in terms of the quarterly or annual value of taxable supplies made?

Are the purchases conducted in a regular manner and on sound and recognised business principles?

If the purchases are made for the purpose of supplies for which there is no consideration then such purchases cannot be entitled for ITC. An activity that involves making no taxable supplies cannot be business. The test of predominant concern is a test of purpose or motivation, that is - what motivates the supplies? The test must be read as asking "What is the real nature of the purchases"; is the real nature of the purchases the making of taxable supplies for consideration or is it something else?

Although a business activity must include the making of taxable supplies for consideration, activities carried out in preparation can be seen as business even if, in themselves, they do not involve the making of any supplies provided the dealer demonstrate they have a clear intention to make taxable supplies.

5.6 Sale of Zero Rated Goods and ITC:

In order to promote industrialization the Government has been promoting development of SEZ. SEZ poses problem from two fronts viz. purchases made by

the developer of SEZ and sales / purchases made by the units located in SEZ. In order to address the issues arising there from, two major amendments have been made in GVAT. They are defining the term “zero rated sales” and insertion of S. 5A known as sale of zero rated goods.

S. 2(37) defines ZRS as a sale of goods by a registered dealer to another registered dealer on which the rate of tax leviable shall be zero but tax credit on the purchase related to that sale is admissible. As in the case of Schedule –I and II, there is no specific schedule covering varieties of goods. However, S. 5A defines it as sale of goods to a developer / co-developer of SEZ and units located in SEZ.

A noteworthy feature here has been that no goods have been defined as zero rated. It is only sale of goods to certain types of dealers have been declared as ZRS. There is no concept of Purchase of Zero Rated Goods. In view of this, the developer/co-developer of SEZ and the units located in SEZ will be able to purchase the goods without paying VAT. Therefore, a dealer in DTA will be able to raise the invoice for sale of goods on the developer / co-developer of the SEZ and the units located therein without charging VAT in the invoice.

6.0 Sources of ITC

6.1 Raw Material

In order to understand the requirements in this respect, the dealers will have to be classified in two categories viz. traders and manufacturers. In the case of a trader, ITC will be flowing from VAT paid on goods purchased. As no ITC is permitted for CG purchased, in the case of traders, there are fewer complexities. However, issues will arise in the case of manufacturers.

In the case of a manufacturer, S. 11(3)(a)(vi) and (vii) permits ITC on raw material used, packing material and CG viz. plant and machineries. S. 2(19) defines raw material as follow:

“raw materials” means goods used as ingredient in the manufacture of other goods and includes processing materials, consumable stores and material used in the packing of the goods so manufactured but does not include fuels for the purpose of generation of electricity;

Raw Material has been defined to include following four types of materials.

- a) Goods used as ingredient in the manufacture of other goods
- b) processing material
- c) consumable stores
- d) material used in the packing of the goods so manufactured
- e) excluding fuels for the purpose of generation of electricity

6.1.1 What is ingredient?

Whilst large number of goods is used for the purpose of manufacturing, it is only the items, which are ingredient in the manufacturing of other goods, can be considered as raw material and being entitled for ITC. Ingredient means a component of a mixture or compound or an abstract part of something. It should be a constituent or a component. It means the goods used should be a component

or constituent of the manufacturing process. It is not the **use** of the goods which is the only deciding factor, but the goods used should be as ingredient in the manufacture of other goods. There may be various goods being used in the manufacturing process but it is only the one which is ingredient in the manufacture is entitled for ITC. There cannot be standard list of items, which can be considered as ingredient. It depends upon the manufacturing process and relative importance of the input, which can make it ingredient.

In this respect observations in the case of *Deputy Commissioner of Sales Tax, Board of Revenue v. Thomas Stephen & Co. Ltd.* [1988] 69 STC 320 are worth noting. Input should be an essential ingredient in the manufacturing process and the fact that the ingredient was actually burnt up or sublimated in the process and did not retain its identity in the end product, will not, necessarily, detract from its being a "raw material". The relevant test is how essential is the ingredient in the manufacture. In the complexity of the chain of chemical reactions in the manufacturing process, undue emphasis on the search for the identity of any individual chemical ingredient in the final product would be artificial and unrealistic.

6.1.2 How to determine ingredient?

A question will arise as to which tests are to be applied for determining 'ingredient'? As we know manufacturing is an integrated process. Should an integrated process of manufacturing be vivisected and relative importance in terms of weight or value is required to be found out?

The ingredients used in the chemical technology of manufacture of any end product will comprise of the following.

- goods which may retain their dominant individual identity and character throughout the process and also in the end-product;
- goods which, as a result of interaction with other chemicals or ingredients, might themselves undergo chemical or qualitative changes and, in such altered form, find themselves in the end-product;
- goods which, like catalytic agents, while influencing and accelerating the chemical reactions, however, may themselves remain uninfluenced and unaltered and remain independent of and outside the end-products and
- goods which might be burnt up or consumed in the chemical reactions.

Problems can arise in respect of last category. One of the valid tests could be that the ingredient should be so essential for the processes culminating in the emergence of the desired end-product, that having regard to its importance in and indispensability for the process, it could be said that its very consumption on burning up is its quality and value as raw material. ***In such a case, the relevant test is not its absence in the end-product, but the dependence of the end-product for its essential presence at the delivery end of the process. The ingredient goes into the making of the end-product in the sense that without its absence the presence of the end-product, as such, is rendered impossible. This quality***

should coalesce with the requirement that its utilisation is in the manufacturing process as distinct from the manufacturing apparatus.

6.1.3 Whether goods used in the manufacture of other goods should become ingredient of the finished goods?

One may be lead to conclude that, in order for an item to be ingredient, it should be physically present in the finished goods. However, it need not be. What is required is that the input should be ingredient for manufacturing of other goods and not of the finished goods. In many cases, large number of inputs gets consumed and may not be physically present in the finished goods. This is particularly in the case of chemical process wherein number of chemicals goes as input at various stages of manufacture. An analysis of the final products may not show any traits of such input goods.

6.1.4 Whether input must participate in the manufacturing process? Or participation in any anterior process can also be considered?

Manufacturing may be a long-drawn process wherein certain inputs may be required at the anterior stage i.e. the stage prior to commencement of manufacture. Such processes being primary requirements of the main manufacturing process without which manufacturing cannot take place, a question may arise whether goods used in such process can be considered as ingredient being eligible for ITC. For example, in the case of a foundry, for the purpose of manufacturing of casting, it is necessary that before the melting of metal takes place, moulds should be kept ready. For the said purpose, sand is required to be processed. Processed sand is used in preparing moulds. Processing of sand and preparing moulds are anterior to melting of metal. However, without processing of sand and making of mould, melting of metal is of no use. Therefore, use of material for processing of sand and making of moulds are ingredient in the manufacture of castings.

6.1.5 Whether participation in any posterior process can also be considered?

At what point the manufacturing process can be said to have ended? In large number of cases, varieties of actions are required to be taken to ensure that the goods already manufactured are as per the required quality. Testing of quality standard may also require consumption of some material. Although such material does not participate directly in the manufacturing, they do form an important part in the whole process. Application of literal meaning of the word “ingredient” may lead one to conclude it as otherwise. However, looking to the scheme of taxation and the role played by such material in the entire process, there is no doubt that they are ingredient. [see CIT v. Orient Paper Mills Ltd. [1974] 94 ITR 73 (Cal)) and J. K. Cotton Spinning and Weaving Mills Co. Ltd. v. STO [1965] 16 STC 563].

6.1.6 What is “in manufacture of goods”?

S. 2(14) defines manufacture as

“manufacture” with its grammatical variations and cognate expressions means includes producing, making, extracting, collecting, altering, ornamenting, finishing, assembling or otherwise processing, treating or adapting any goods; but does not include such manufactures or manufacturing processes as may be prescribed;

The term is wide enough to cover large number of processes. It should be noted that the process of manufacturing need not involve only, say altering or ornamenting. There may be two or three process as well. For example, before making use of input as raw material in the process of manufacture, it may be necessary that input should be altered or extracted or treated. All these may take place anterior to the main manufacturing process. In view of the definition being wide enough, all the processes as referred to will be manufacturing process.

The Supreme Court in the case of J. K. Cotton Spinning and Weaving Mills Co. Ltd. v. STO [1965] 16 STC 563, while interpreting the expression “***in the manufacture of goods***” in section 8(3)(b) of the Central Sales Tax Act, has held that normally it encompasses the entire process carried on by the dealer of converting the raw material into finished goods. It must be construed liberally in the broad commercial sense from the common sense.

In CIT v. Orient Paper Mills Ltd. [1974] 94 ITR 73 (Cal)) it was held that the expression “***manufacturing process***” should be interpreted in its ordinary sense and should not be confined or ***restricted to the actual manufacturing alone***. The processes, which are intimately connected, with actual manufacturing process will also be within the aforesaid expression.

6.1.7 Whether the quantity of raw material used in manufacturing of finished goods only will be entitled for ITC?

As we know, in the manufacturing process, material gets evaporated, damaged, destructed or cannot be used for various reasons. Not only that, it gets damaged at the time of receiving, storage and handling also. Some of such cases are:

- destruction prior to use
- damaged in transit
- destruction at an intermediate stage
- lost in storage
- loss in weight due to atmospheric conditions

Whether loss of material due to its use / non-use can be considered as part of manufacturing process? It should be noted that the goods lost has not participated in the process of manufacturing at any stage and hence has not played any role therein. Should one extend the meaning of manufacturing process to receiving of goods, its storage, handling etc. as well? Stretching of the argument to this extent may look too much. However, it is also a fact that the manufacturer has to transport the goods and store it before the use. Without these activities manufacturing cannot take place. If the process of manufacturing has to be looked into as an integrated one then it has to be extended to its logical end as well. Therefore, ITC on such normal losses can not be denied.

6.2 Processing Material

As we have seen, the first part of the definition of raw material lays down stringent condition i.e. the goods should be “*used as ingredient in the manufacture of other goods*”. Accordingly, as per the said definition, the goods, which are not ingredient in the manufacture of other goods, cannot be called raw material.

However, in a manufacturing process, there are number of items required before actual manufacturing process takes place. Each of such processes requires number of items. Material used in such processes do not participate in the core manufacturing process but, at the same time, without such processes being carried out manufacturing process cannot be complete. It is for these reasons; second limb of the definition assumes importance. The word “processing material” takes care of goods which cannot be categorized as ingredient in the manufacture of other goods.

6.2.1 What is processing material?

GVAT does not provide for the definition of the term “process”/“processing” / “processing material”. Therefore, it will have to be interpreted in normal course of business. The very presence of the term “processing materials” signifies the fact of GVAT having taken note of the role-played by many other items in the manufacturing process. The draftsman is aware of the fact that manufacturing activity does not necessarily mean core manufacturing activity only but various other associated activities / processes as well. The term “process” being relative term, its definition in an absolute term being capable of applicable in all the cases, cannot be laid down. What the dealer has to see is that whether the material used is participating in any process, which helps, or is the cause of, the core manufacturing activity. In view of this, the term “process material” is wide enough to cover practically all the items participating in the manufacturing process.

6.2.2 Whether processing includes manufacturing?

A question that may arise is whether the processing is the same as manufacturing. The Supreme Court in the case of *Union of India v. Delhi Cloth Mills AIR 1963 SC 791* specifically rejected the contention that processing and manufacture can be equated. At page 794 of the report, Das Gupta, J., speaking for the Court observed:

"To say this is to equate 'processing' to 'manufacture' and for this we can find no warrant in law. The word 'manufacture' used as a verb is generally understood to mean as 'bringing into existence a new substance' and does not mean merely 'to produce some change in a substance', however minor in consequence the change may be..... 'Manufacture' implies a change, but every change is not manufacture and yet every change of an article is the result of treatment, labour and manipulation. But something more is necessary and there must be transformation, a new and different article must emerge having a distinctive name, character or use."

In the case of *Additional Commissioner of Income-tax, Kanpur v. Farrukhabad Cold Storage (P.) Ltd., 1976 UPTC 646* it was held that the processing of goods need not lead to manufacture of a new article. From these authorities, it is clear that the processing cannot be equated with manufacture and that processing will not necessarily lead to manufacture.

6.2.3 Whether the word "processing" has been used so as to include or lead to manufacture?

There is nothing to show that the word "processing" includes manufacture. In the case of Dy. Commissioner of Sales Tax (Law), Board of Revenue (Taxes), Ernakulam v. Pto Food Packers [1980] 46 STC 63 (SC) the Supreme Court observed on page 65 as under:

"Commonly, manufacture is the end result of one or more processes through which the original commodity is made to pass. The nature and extent of processing may vary from one case to another, and indeed there may be several stages of processing and perhaps a different kind of processing at each stage. With each process suffered, the original commodity experiences a change. But it is only when the change, or a series of changes, take the commodity to the point where commercially it can no longer be regarded as the original commodity but instead is recognised as a new and distinct article that a manufacture can be said to take place."

In substance, what the Supreme Court laid down is that a manufacture is the end result of one or more processes. It means that several processes precede a manufacture. It, therefore, clearly shows that all types of processing do not amount to manufacture. So, merely from the word "processing" occurring, no inference can be drawn that word includes manufacture. In short, a manufacture is the result of one or more processing but processing does not include manufacture always and everywhere.

6.2.4 Whether mere processing activities not resulting into manufacturing any product will make the dealer entitle for ITC?

In the case of a dealer carrying out only processing and not manufacturing any goods may face a problem. The issue has to be examined from two perspectives. In the first case the goods are processed by the dealer for and behalf of other dealer wherein the material is provided by the principal. In the process some material is consumed on which VAT has been paid. Whether VAT on such material can be claimed as ITC? Since the dealer is merely processing the goods received from other dealer, consideration received is towards processing / labour charges. As it does not attract VAT the question of claiming VAT paid as ITC does not arise.

Consider the facts of the above case slightly in a different situation. The principal instead of getting the material processed, sells it to the other dealer who after completing the process sales it back to the original dealer. Here, since transfer of goods takes place the claim of VAT paid as ITC at two stages will arise. Although this type of arrangement appears to be economical as it helps in recovering VAT paid, it has other legal and commercial implications as well.

6.2.5 Relevance of "Processing Material"

If processing is not the same thing as manufacturing then what is the relevance of the processing material in claiming ITC? Imagine the case of an activity which is not manufacturing in full fledge sense but still requiring consumption of material for the said activity. In the absence of the term processing material claim for ITC

would not have been possible. If one examines various inputs required for manufacturing process then substantial number of items will be falling into this category. It is for this reason this term assumes importance.

6.3 Consumable Stores

6.3.1 What is Consumable Stores?

As in the case of process material, there are other items like lubricating oil, grease, cotton waste etc. which do not form part of core manufacturing activity nor participate in any process anterior or posterior to the manufacturing process. Such materials may not be required on day-to-day basis also. However, without it the process of manufacturing cannot be smooth one. These are petty / miscellaneous items, which get consumed. Apart from that these items may be such that it can be used repeatedly for number of times. In day-to-day business, such items are called consumable stores. This appears to be a controversial item as there is no specific definition of the term “consumable stores”. However, the principles laid down by the Gujarat High Court in the case of *Vasuki Carborundum Works v. State of Gujarat* reported in [1979] 43 STC 294 are noteworthy. In the said case, the assessee was manufacturing crockery and was selling the same as registered dealer. The assessee purchased "kathi" (twine) against declaration in Form 19, to the effect that the goods were to be used in the manufacture of taxable goods for sale. "Kathi" was used for packing the manufactured goods which were sold thereafter. The question arose as to whether "kathi" can be said to be packing material or could it be classified as consumable stores? The High Court held that theoretically, particular process may not be necessary for production of finished goods. But, if that process is an integral part of the ultimate manufacture of that goods, and that in its absence it manufacture of the goods may not be commercially expedient, that activity or process must be considered as manufacturing activity itself. It was held that the goods intended for use in that process or activity should be considered to be goods required for manufacture of taxable goods for sale. On this basis, in the facts of that case, "kathi" was held to be consumable store used in the manufacture of taxable goods.

6.3.2 Whether ITC for VAT paid for purchases for repairs and maintenance items can be claimed?

Despite being in a position to cover most of the items under the above-discussed three categories, a doubt still remains regarding various items purchased for repairs and maintenance of plants and machineries. In the case of manufacturing unit, large numbers of items are purchased to carry out routine maintenance and repairs. These items are not ingredient to the process of manufacture nor are process material. Such items are not required on daily basis but are used only at fixed interval or as and when the need arises. Normally, these items are reflected in the Profit & Loss A/c under a separate heading “Repairs and Maintenance” and not clubbed with “Consumption of Stores”. A question will arise whether ITC can be claimed for such items? Looking to the nature of these items, and the role played by it in smoothening the process of manufacturing, there should not be any problem. However, attempts may be made to deny ITC. This may be primarily due to disclosure of consumption of such items under the category “Repairs and Maintenance” in Profit & Loss A/c and one may not be in a position to relate it to

any particular manufacturing process or activity. But isn't it a fact that the cause for incurring such expenditure incurred is manufacturing activity carried on with the help of plant and machineries? Isn't it also a fact that if such an expenditure is not incurred, it may not be possible to carry out any manufacturing activity as the machines may stop functioning? If one looks at the manufacturing activity in a holistic manner then the relative importance of consumption of material in this respect will be clear.

6.4 Fuels & ITC

Fuels form an important part in the process of manufacturing. Fuels are used for varieties of purposes viz. generating steam, heat treatment, generating electricity etc. Role of fuel in the manufacturing process is accepted by each and every one. In terms of provisions of S. 11(3)(b)(iii), VAT paid on fuel is permitted as ITC requiring reduction @ 4.00%. However, in terms of provisions of S. 11(5)(l) application of fuel for generating electricity is not permitted for ITC.

Therefore, it should be remembered that of all the uses of fuels, it is only the use of fuel for the purpose of generating electricity which is being excluded from the definition of raw material. However, fuel used for heat treatment purpose is entitled for ITC.

There may be a case wherein fuel purchased by the dealer is being used for both the purposes i.e. say, for generating steam and generating electricity. No classification can be made at the point of purchase. It is only at the point of issue of material, use of fuel can be differentiated. In such a case, the dealer will have to maintain detailed records for various use of fuel and quantum of fuels used.

Whether use of fuel for electricity per se will disentitle for ITC?

Reading the provisions of S. 11(5)(l) one gets a feeling that use of fuel *per se* will make the dealer disentitle for VAT paid on it as ITC. Generating electricity with the help of fuel for making use of it for the purpose of manufacturing process will not make any difference. Consider the case of heat treatment of material which can be carried out by using fuel directly and, alternatively, through electricity which is generated in-house. In the former case VAT paid on fuel will be permitted as ITC subject to reduction @4.00% while in the latter case ITC will not be permitted as fuel has been used for generating electricity.

6.5 Material used in packing of goods

S. 10 of GVAT puts packing material at par with finished goods. Though packing material can be separated physically and being charged at different rate of tax, for the purpose of determining VAT liability, its value is considered as part of sales consideration and it attracts the same rate of tax as finished goods. The dealer may source his requirements of packing material either buying directly from the open market or may manufacture the same in-house.

Packing material purchased from the open market is covered by the definition as provided. However, a question may arise in respect of the material, which is not ingredient to the manufacturing process but is being used for the purpose of manufacturing of packing material. Whether VAT paid on such material can be claimed as ITC? As we have seen, the definition of raw material covers all types of eventualities by covering the goods falling into the category of processing material and consumable stores. There is no reason why the process of

manufacturing of packing material cannot be considered as raw material. That being the case, material used for the purpose of manufacturing of packing material should also get the treatment like raw material, consumable stores etc. S. 11(3)(a)(vi) takes care of goods used for packing material.

A point to be noted here is that it is only the packing material for the *goods manufactured* by the dealer for which ITC is permitted. Two interesting issues arise here. Firstly, packing material in excess of requirements and sold in the open market cannot be covered under this category.

Secondly, in the case of a trader, who buys the goods in bulk and repack the same in smaller quantities. For the said purpose, he buys packing material. A question that can arise is whether ITC on purchase of such packing material can be claimed. Logically speaking there is no reason to deny it. However, since the wordings of S. 11(3)(a)(vi) refers to ***“packing of the goods so manufactured”***, ITC on such goods cannot be claimed as it is restricted to the goods manufactured only. To this extent there is a lacuna in the Act which needs to be rectified.

6.6 Capital Goods

6.6.1 What is CG?

As per S. 2 (5) **“capital goods”** means plant and machinery (other than second hand plant & machinery) meant for use in manufacture of taxable goods and accounted as capital assets in the books of accounts. “Capital Goods” is a general term and it includes not only plant and machineries but also varieties of other items like furniture, fixture, electrical equipments, vehicles etc. However, GVAT defines it in a narrow sense and includes plant and machineries only. Not only that, in order to be treated as P & M other conditions are also required to be satisfied.

For the purpose of being entitled of ITC for VAT paid on P & M functional test will have to be applied. It means that a particular machine may be P & M as defined under GVAT however, not be so for other dealer as its function may not be manufacturing. For example, if a manufacturer buys a computer and uses it for the purpose of manufacturing, say, designing or as a part of process control instrument, ITC will be available. However, if the same manufacturer uses the same type of computer in the office as office equipments, ITC is not permitted. In view of this, the question of claiming ITC by a dealer other than a manufacturer does not arise.

6.6.2 What is Plant & Machinery?

As can be seen, S. 2(5) requires four conditions to be satisfied for being eligible to claim ITC. They are:

- P & M should not be second hand one.
- P & M should be used for manufacturing only.
- Goods so manufactured should be taxable under GVAT
- P & M should be accounted as fixed assets in the books of accounts.

As we know there are two separate terms viz. plant and machineries. Each one is having different meaning. Unfortunately, the terms “Plant” and “Machinery” have

not been defined in the GVAT. Not only that its coverage has also not been stated appropriately. For example, whether the said term will cover machineries required for pollution control? Will it cover laboratory equipments? Will it cover equipments used for research and development? In view of this both the term will have to be assigned the meaning as used in our day-to-day life. All these leave enough scope for litigation in future. Given here below are extracts from Central Excise and Income tax Act. A glance at it will give the idea about vastness of the issue.

- Central Excise Act

Rule 2(a): "capital goods" means:-

- (i) all goods falling under Chapter 82, 84,85,90, heading No. 68.02 and sub-heading No. 6801.10 of the First Schedule to the Excise Tariff Act;*
- (ii) pollution control equipment;*
- (iii) components, spares and accessories of the goods specified at (i) and (ii);*
- (iv) moulds and dies, jigs and fixtures;*
- (v) refractories and refractory materials;*
- (vi) tubes and pipes and fittings thereof; and*
- (vii) storage tank,*

- Income Tax Act

S. 43 (3) "plant" includes ships, vehicles, books, scientific apparatus and surgical equipment used for the purposes of the business or profession but does not include tea bushes or livestock or buildings or furniture and fittings;

6.3 Functional Test

As can be seen from the definition in S. 2(5), the term CG is not wide enough to cover varieties of items. Therefore, there will always be a dilemma whether functional tests as laid down by various courts under the Central Excise, Income Tax etc. can be applied. This can be seen from some of the judgments of various courts.

- Supreme Court and High Court Judgments

Hindusthan Rope Works Vs. Asstt. Comm. of Comm. Taxes [1994] 092 STC 0466

*As regards the grinder, we have no manner of doubt that it is directly used in manufacture, as it finishes the product before marketing. Since starter was treated by the authorities as plant and machinery or productive equipment, there is no reason to exclude the main switches. According to us, **main switches ought to have been included like the starters in the plant and machinery**. As regards **welding and drilling machines**, undoubtedly those are required to keep the strander and rope twisting machines in running condition without considerable stoppage of work and, therefore, in a sense one may say that the welding and drilling machines are tools for maintenance.*

According to us, even if the welding and drilling machines are not

directly used in manufacture in the sense that they do not directly manufacture ropes, they are nevertheless plant and machinery and therefore they are liable to be considered at the time of estimating the gross value of fixed assets for the purpose of deciding whether the benefit under section 10F should be extended to the applicant. In other words, in our view the grinder and the main switches are productive equipment and, therefore, they come under plant and machinery. According to us, the welding and drilling machines come under the wider expression "plant and machinery" in section 10F.

Sales Tax Comm. v. Ladha Singh Mal Singh [1971] 28 STC 325 (SC)

The meaning of the word "machine" according to the dictionary in a popular and mechanical sense is more or less "complex combination of mechanical parts as levers, gears, sprocket wheels, pulleys, shafts and spindles, ropes, chains and bands, cams and other turning and sliding pieces, springs, confined fluids, etc., together with the framework and fastenings, supporting and connecting them as when it is designed to operate upon material to change it in some preconceived and definite manner"

D. B. Bhandari v. State of Mysore [1967] 20 STC 25

In simpler language "machinery" is a contrivance whereby several things are put together to work in such a way that force may be applied at a most convenient point in a most convenient way to get a particular work or an item of work done or to produce a specific article. From the above definition it appears that if the cable is sold along with other mechanical contrivances then it may amount to a "machinery". But when the sale is of "cable" alone then in accordance with the meaning given in common and commercial parlance, the "cables" by themselves cannot be considered as "machinery". The notification dated June 13, 1963 has not used the word "plant". There is a distinction between "plant" and "machinery". "Cables" are no doubt plant but not machinery. **Cables may become part of the machinery if they are fitted along with some "machinery" and that composite item may still be called as "machinery" but so long as the sale is effected of the "cables" alone, it cannot be considered a sale of "machinery"** covered by the notification dated June 13, 1963, since it is not known as to whether the said cables will be fitted as part of the machinery or are used for transmission of electric power.

Scientific Engg. House (P) Ltd. v. CIT[AIR 1986 S.C. 338] paragraph 11:

"The classic definition of 'plant' was given by Lindley, L.J in Yarmouth v. France (1887) 19 QBD 647 a case in which it was decided that a cart-horse was plant within the meaning of Section 1(1) of Employers' Liability Act, 1880. The relevant passage occurring at page 658 of the Report runs thus:-

'There is no definition of plant in the Act; but, in its ordinary sense, it

includes whatever apparatus is used by a businessman for carrying on his business-not his stock-in-trade which he buys or makes for sale; but all goods and chattels, fixed or movable, live or dead, which he keeps for permanent employment in his business.'

*In other words, **plant would include any article or object, fixed or movable, live or dead, used by businessman for carrying on his business and it is not necessarily confined to an apparatus which is used for mechanical operations or processes or is employed in mechanical or industrial business. In order to qualify as plant the article must have some degree of durability**, as for instance, in Hinton v. Maden & Ireland Ltd. (1960) 39 ITR 357 knives and lasts having an average life of three years used in manufacturing shoes were held to be plant. In CIT Andhra Pradesh v. Taj Mahal Hotel, 82 ITR 44 : (AIR 1972 SC 168) the respondent, which ran a hotel, installed sanitary and pipeline fittings in one of its branches in respect whereof it claimed development rebate and the question was whether the sanitary and pipeline fittings installed fell within the definition of plant given in S. 10(5) of the 1922 Act which was similar to the definition given in S. 43(3) of the 1961 Act and this court after approving the definition of plant given by Lindley L.J. in Yarmouth v. France as expounded in Jarrold v. John Good and Sons Ltd. (1962) 40 Tax Cas 681 (CA) held that sanitary and pipeline fittings fell within the definition of plant."*

In our opinion, the issue sought to be raised above is squarely covered by the above judgment though rendered in the context of the provisions contained in the Income Tax Act. Electric cables which have been used by the assessee in the present case were certainly meant for carrying on its business and was sufficiently durable, as such, it was certainly a 'plant' within the meaning of Rule 57Q of the Rules.

6.4 What is second-hand machinery?

S. 2(5) requires that the P & M should not be second hand one. However, the said term has not been defined in GVAT or GVAR. Therefore, one will have to go by the meaning assigned to it in day-to-day life. As we know, once an item is purchased by a person, from the perspective of all other persons, it becomes used one. When its owner sells it in the market, it is referred to as second hand. This is applicable even in the case of an item, which has been used for a day only. Even sometimes, item not used by the owner and sold in the same condition, is also referred to as second hand one. Of course, its value will differ, based on the condition of the item. What is important here is that since the commodity has not been sold by the manufacturer / dealer, and is being sold by a user, it is being labeled as second hand.

Therefore, if we apply the same terminology, under GVAT, once a manufacturer purchases P & M, its sale will be labeled as second hand. Hence, its sale, even on the next day of its purchase, will disentitle the buying dealer of such machine the ITC.

6.5 Purchases meant for use in manufacture of taxable goods

S. 2(29) defines “Taxable Goods” as goods other than those on the sales or purchase of which no tax is payable under section 5. S. 5 have been titled as “Exemptions”. S. 5(1) covers cases of the goods covered under Schedule-I containing various items on which no tax is payable. S. 5(2)(a) empowers the State Government to specify any class of sales or purchases or sales or purchases of any goods by any specified class of dealer. S. 5(2) covers cases of exemption granted u/s 49(2) of the Gujarat Sales Tax Act.

Looking to the terminology used, it is clear that except the manufacturer, no one else can take the benefit of tax credit on capital goods. The concept of “value addition” has been assigned restricted meaning as applicable to manufacturing process only.

6.6 What is the meaning of the term “accounted as capital asset”?

In the case of a dealer, following standard accounting policies and practices, such provisions carries no value, as the P & M have to be accounted as capital assets. Here, it is not clear in what respect accounting for such items in the books as capital asset can make any difference in computation of VAT liability, particularly when full tax credit is being made available in the first tax period itself.

An interesting aspect is that claim for tax credit in this respect is required to be made in Form No. 201, Part III, Item No. 7 along with the claim for raw material etc. Thus, identity of tax credit in respect of P & M claimed is not maintained. This is in contrast to separate records maintained in respect of CENVAT claimed on P & M under the Central Excise Act.

A problem will arise in the case of a dealer who treats certain item as consumable stores and claim it as raw material as defined u/s 2(19), but during the course of assessment proceedings the Assessing Officer treats it as Capital Goods. Theoretically, it should not pose any problem as ITC as CG will be applicable. However, in reality, the dealer will not be able to claim ITC as these items have been treated as consumables and written off. Since, by the time assessment process is over, the accounts have already been closed. It will not be possible for the dealer to account for these items as capital assets in his books of accounts. As a result, the dealer will loose tax credit totally, both as raw material and capital goods as well.

6.7 Use of material for fabrication of CG for use in manufacture of goods

At times, the manufacturer, for various reasons, finds it easy, convenient and economical to fabricate machines required for in-house. For the said purpose, certain items are purchased specifically while petty items may be utilized forming part of consumable stores. Two questions will arise here. Firstly, whether ITC can be claimed for VAT paid on the material purchased, which has been used for the purpose of fabrication of machines. Secondly, VAT paid on consumable stores items used in fabrication process will be entitled for ITC?

Here, it should be noted that the dealer is not engaged in the business of manufacturing machines. His main business activity is manufacturing of the goods as mentioned in RC. Apart from that, as far as items of consumable stores are

concerned the same were purchased with the intention of making use of it for manufacturing. A question that arises here is whether the dealer is not violating the condition laid down u/s 11(3)(a)? Material purchased for fabricating of machine is not raw material of the finished goods manufactured by the dealer.

As far as claiming ITC under the category of CG, a problem will arise when one applies the provisions of S. 11(3)(a) (vii) which provides that ITC can be claimed for purchase of CG for manufacturing taxable goods. However, S. 2(5) defines CG as plant and machineries meant for use in manufacturing of taxable goods. Thus, ***what is permitted is purchase of plant and machines and not the material, which can be used for fabrication of plant and machines.***

7.0 When to claim ITC

Since ITC is part of computation of tax liability, it is required to be claimed through periodical returns to be filed. Rule 2(g) requires the dealer to file periodical returns on monthly / quarterly / half-yearly basis. In certain cases, the requirement for filing the periodical returns gets shifted from quarterly to monthly depending upon tax liability. However, in large number of cases, monthly returns are required to be filed.

As far as other condition for claiming ITC is concerned, S. 11(4) provides that ITC cannot be claimed until the dealer has *received* original Tax Invoice. Rule 15(2) requires that ITC can be claimed in the tax period in which the dealer *records* Tax Invoice in his books of accounts. The terminology used in S. 11(4) is not appropriate. Since the process of claiming ITC is through filing of periodical returns wherein details of purchase and sales as appearing in the books of accounts are provided, it is necessary that claim should be made in the month in which the Tax Invoice has been recorded.

GVAT does not require the dealer to record Tax Invoice in a particular period. Does it mean that the dealer can record the Tax Invoice in a period as he pleases? Can there be time lag between the consumption and accounting of the material in the books of accounts? Will it be permissible under GVAT to consume the goods in one period and record its purchase in the accounts in the next month? Alternatively, will it be permitted to account for the goods in one-month and its receipt and consumption in the subsequent month? Receipt of goods and its recording in the accounts have not been synchronized. However, the dealer will have to follow the Accounting Principles as laid down by the ICAI in various AS.

8.0 How to claim ITC?

Under the GVAT the dealer is not required to file any separate form or return for the purpose of claiming ITC. The process of filing of monthly / quarterly returns will take care of it. The dealer is required to provide data regarding sales and purchases, make computation of tax liability and deduct ITC availed on purchases. Thus, filing of periodical return itself is claim for ITC.

9.0 Quantum of ITC

9.1 Quantum of ITC permitted for set-off

In terms of the provisions of S. 11(1)(a)(i), claim for ITC is equal to the amount of tax collected from the purchasing dealer by the selling dealer. As per the

provisions of S. 11(1)(a)(ii), ITC cannot exceed tax payable by the purchasing dealer to a RD who has sold such goods. In addition to it, Explanation to S. 11 provides that the amount of ITC on any purchase of goods shall not exceed the amount of tax actually paid or payable under GVAT in respect of the same goods.

Under normal circumstances, VAT paid will be claimed as ITC. However, what will happen if the selling dealer has, through oversight, applied higher rate of tax or charged more amount of tax due to arithmetical error? Alternatively, take the case where the selling dealer has charged lower amount of tax than required to do so.

In the first case, since the purchasing dealer has paid higher tax, logically he is entitled to claim the entire amount as ITC. However, the methodology followed in Form 201, for the purpose of claiming ITC, will not permit to do so. As can be seen from Part-III of Form 201, the format is hard coded. The dealer is required to compute ITC @ 4.00% or 12.50% on total amount of purchases. The dealer is **not** required to claim ITC, which he has **paid** to the selling dealer. Therefore, for the purchasing dealer there is no alternative except claiming excess amount paid from the selling dealer.

Under the second scenario, wherein the selling dealer has charged lesser amount than what is required, the dealer cannot claim correct amount of ITC as he has not paid it to selling dealer [See provisions of S. 11(1)(a)]. Also see in this respect Explanation to S. 11 which specifically provides that the amount of ITC on any purchases shall **not exceed the amount of tax actually paid or payable** in respect of the same goods. In this case, Part - III of Form 201 will not match with the ITC as derived by applying the rate of tax to purchases made. A noteworthy aspect of the Form 201 is that the dealer is not required to state the amount of ITC paid to the selling dealer. If required to do so, such cases would have been detected.

9.2 Whether URD tax paid on goods not entitled for ITC will also be permitted?

S. 11(1)(a)(ii) permits credit for tax paid on URD purchases. Proviso to S. 11(5) also permits credit for tax paid u/s 9(1) and (2). Now, URD purchases can be of both the types i.e. the goods on which ITC is permitted and not permitted. As far as the goods on which ITC is permitted, there cannot be any problem, as instead of paying VAT to the selling dealer, it has been paid to the Government as Purchase Tax. However, what will happen in the case of items which are not entitled for ITC and purchased from URD? Since purchases are from URD, tax u/s 9 will have to be paid. However, S. 11(1)(a)(ii) permits the credit of tax paid u/s 9(1) or (2). In such case provisions of S. 11(5)(g) will prevail and the dealer will not be permitted to avail ITC.

10.0 Calculation of Input Tax Credit

S. 11(1)(b) requires the dealer to claim ITC in a prescribed manner. Rule 15(3) requires the dealer to claim ITC as provided in Form 201. These are periodical forms to be filed by the dealer.

Form 201 is exhaustive as the dealer is required to provide various details regarding sales, purchase etc. However, the portion as applicable to computation of ITC is discussed herewith.

FORM 201						
PART – III						
INPUT TAX						
	Description					Value of goods (Rs.)
7	Purchase of capital goods from registered dealers					
8	Purchases of taxable goods other than capital goods from registered dealers.					
9	Purchases of taxable goods from a person other than registered dealer.					
	Total					
Calculation of input tax						
	Rate of tax.	Commodity	HSN Code	Turnover of purchase	Tax charged in respect of item 7 & 8	Tax paid in respect of item 9 or Entry tax
	1	2	3	4	5	6
	1.00%					
	4.00%					
	12.50%					
	Other					
	Purchase value on which entry tax is paid		Rs..		XXXXXXXXXX	
	Sub-total					
10	Total: (column 5 + column 6)					

Requirements under item no. 7 & 8 appear to be ambiguous. A combined reading of item 7, 8, and 9 gives an impression that all the purchases made by the dealer are required to be reported herein. However, all the items purchased may not be entitled for ITC. Looking to the title of Part-III i.e. Input Credit, it appears that data in respect of the goods in respect of which the dealer is entitled for ITC need only be reported.

Secondly, value of purchases of **all the taxable goods** as defined u/s 2(29) should be provided. Here, the term “goods” will have the same meaning as assigned to it u/s 2(13). It includes all kinds of movable property.

Item No. 7, 8 and 9 are required to cross tally with total purchases during the tax period. One would have expected bifurcation of ITC for each one of them separately. This is for the reason that Rule 15(6) does not permit refund in respect of ITC on CG. As can be seen from Part III and Part IV, identity of ITC on CG is not maintained. It is not clear how the provisions of Rule 15(6), regarding non-payment of refund on CG, will be complied with.

Column No. 5 refers to “tax charged” by the selling dealer. It should be noted that it is the actual amount charged by the selling dealer, which is required to be shown here. Therefore, if the selling dealer has made any mistake in his Tax Invoice, the figures here will not match with the rate as applied to corresponding purchases. One of the reasons for requiring the dealer to report “tax charged” may be to ensure consistency with the data reported by the selling dealer. If the selling dealer has charged more tax, and if the buying dealer has paid it so, ITC be allowed as paid by the buying dealer as the State has already collected the tax from selling dealer. In the same way, if the selling dealer has collected lower amount of VAT then the buying dealer can claim such lower amount only. In this case, the buying dealer cannot claim higher amount of VAT, which should have been charged. This is for the reason that the State cannot grant ITC for which it has not collected any VAT.

11.0 Reduction of ITC

11.1 What is reduction of ITC?

S. 11(3)(b) and S. 11(8) provides for reduction of ITC. However, both the sections refer to different sets of circumstances.

In the case of a trader, S. 11(3)(b)(i) provides for reduction of ITC when the goods are consigned or dispatched to under branch transfer or to his agent outside the State of Gujarat. In the case of manufacturer, clause (ii) provides for reduction of VAT paid in respect of raw material / packing material used for the goods which have been used for branch transfer etc. outside the State of Gujarat. The amount of reduction, in both the cases, is provided for is @4.00% of turnover of purchases. Difficulties may arise in computing amount to be reduced in this respect.

11.1.1 Rationale for Reduction in IC

The objective of providing for reduction in IC is to nullify the effect of loss in revenue arising on account of branch transfer etc. wherein the State will not be deriving any revenue. Keeping this factor in mind and the prevailing rate of tax of CST @4.00%, reduction in IC was fixed @4.00%. However, with the Central and all the State Governments deciding, in principle, to phase out CST, the rate of tax in this respect is being reduced progressively. Accordingly, it has been reduced to 2.00% for the current year. However, S. 11(3)(b) has failed to take cognizance of this reality. As a result of this, a dealer transferring the goods to other State will be saving the CST @2.00% but will be losing the ITC @ 4.00% on purchases. There being no corresponding amendment in the GVAT, this anomaly will continue.

11.1.2 Anomalies Galore

The first problem is in the case of trader dealing in various identifiable commodities, whether reduction should be in proportion of turnover of purchases of the same type of commodities or purchases of all the commodities? It should be noted that there is no specific provision giving an option to the dealer to make computation on the basis of records maintained by the dealer. Even S. 11(11) which expects the dealer to apply fair and reasonable method to determine the extent to which goods are sold, consumed etc., is silent on this aspect. In view of this, fair and reasonable methods adopted by the dealer in respect of computation of reduction of ITC may not be acceptable.

Secondly, reduction to be carried out is with reference to total purchases. Purchases can be of taxable and exempt items as well. Moreover, it can be of capital goods also. In view of amendment effected w. e. f. 1-4-2008 only taxable turnover of purchases are required to be considered.

Thirdly, in the case of fuel, S. 11(3)(b)(iii) requires the dealer to reduce the amount of claim of ITC by 4.00%. Should purchase of fuel be also considered for reducing ITC as required u/s 11(3)(b)(i) or (ii)? If so, it will amount to double reduction. Although, there is no clarity on this aspect, it appears that the reduction should be carried out only once and not twice. Therefore, at the time of making computation u/s 11(3)(b)(i)/(ii) the figures of purchase should not include amount in respect of purchase of fuel.

11.1.3 Fuel & Reduction of ITC

Sub-clause (iii) requires reduction of ITC in respect of fuels, which have been used for manufacture of goods. Provisions in this respect may appear to be confusing when read with reference to S. 11(5)(l), (ll) and (m). However, both the sections are independent and reduction is in respect of fuels, which have been used for manufacture of goods. S. 2(19) treats fuel used for electricity not as raw material at all. S. 11(5)(l), (ll) and (m) also take care of various other types of fuel. In nutshell, ITC of VAT paid on fuel used for manufacturing purposes will be permitted in excess of 4.00% only. GVAT was amended and Additional tax has been imposed. An interesting point to be noted here is that despite the rate of CST having been brought down from 4.00% to 2.00% there are no corresponding changes therein. Thus, transfer of goods under branch transfer will become more costly.

11.1.4 Reduction of ITC - commodities having rate of tax less than 4.00%

In the case of commodities having the rate of tax of less than 4.00% may pose a problem. However, Proviso to S. 11(3)(b) provides that if the rate of tax is less than 4.00%, reduction in ITC will be at such reduced rate.

11.2 Whether reduction can be made on the basis of actual records maintained?

As per the provisions, the reduction is required to be made on the basis of total purchases made. However, a dealer may be in a position and has, in fact, maintained separate records, both in terms of quantity and value, in respect of goods transferred to the Branch. Whether reduction will be based on purchases or on the basis of records maintained by the dealer? There is no clarity. S. 11(11) expects the dealer to maintain fair and reasonable records to claim ITC and reduction thereof. However, there is no reference to following the figures as appearing in the records maintained by the dealer.

11.3 Use of goods subsequently fully or partially for the purposes not permitted

The dealer has, having claimed ITC in the past, may not be in a position to use the goods for the purposes as enumerated in S. 11(3)(a) or in the circumstances as referred to in S. 11(5). In such a case, in terms of provisions of S. 11(8)(a), the dealer will have to reduce the ITC proportionately. The section does not provide for any methodology in which such reduction has to be carried out. However, powers have been given to the Government to prescribe the method.

11.4 CG not used continuously for a full period of five years

In the case of CG, ITC is permitted on the condition that the plant and machinery will be used continuously for a period of five years. S 11(8)(b) provides that in case of breach of condition, ITC availed will be reduced proportionately. While this condition will be applicable in the case of sale of plant and machineries, issues will arise in the cases where machines disclosed as impaired as laid down under AS-28 of ICAI or in the case of fire when the entire machine is destroyed. While in the case of asset declared as impaired, there is no doubt that there is breach of condition as laid down u/s 11(8)(b). In the case of fire, looking to the provisions, there will be reduction of ITC. This is for the reason that there is no question of the dealer having intention to use the machine for five years as S. 11(8)(b) specifically lays down the condition of five years.

Reduction can also arise in the case of giving the machine on hire or lease basis. This is despite the fact that, VAT is being paid on charges received, treating it as transfer of right to use the goods. This is for the reason that GVAT does not provide for ITC in respect of goods utilized for transfer of right to use the goods. In such case, ITC claimed will be lost and VAT liability will arise in respect of the amount received as lease / hire charges.

12.0 Disallowance of ITC

S. 11(5) contains a long list of cases wherein ITC is not allowed. All these are varied cases; some of them are based on the nature of the goods, how the goods are utilized, status of the dealer etc.

12.1 Disallowance on the basis of purchases from a specified class of Dealer

Clause (a) and (b) of S. 11(5) pertains to purchases made from a dealer who is unregistered or from a person who is not liable to pay tax under GVAT. A person may not be liable to pay tax for various reasons. For example provisions of S. 3 regarding incidence of tax may not be applicable to a person. A person may not be liable to pay the tax due to the nature of sale. S. 4 describe certain types of transactions, which are not liable for tax. S. 5 cover the cases of goods, which are declared as exempt. Therefore, the condition may appear to be related to the dealer, however it extends to nature of goods and the type of transaction as well.

12.2 Purchases from dealer under Composition Scheme

Clause (c) covers the cases of purchases from a dealer who is under CS. A dealer under CS is not permitted to issue TI. However, if issued so and having collected the tax with malafide intention, will not entitle the purchasing dealer to claim for ITC. Looking to the scheme of composition and issue of TI, a dealer under CS can pose serious problem for the buying dealer. There is nothing in the scheme to segregate a dealer under CS from a dealer under VAT. It is presumed that a dealer under CS will not issue TI. However, there is no mechanism under which the buying dealer can confirm the status of a selling dealer. Therefore, what will happen, if a dealer under CS, issues TI and the buying dealer buys the goods under bonafide belief for being entitled for ITC. While the VAT Department may take penal action against such erring dealer under CS, the victim will be the buying dealer as VAT paid will not be permitted as ITC.

12.3 VAT paid before incidence of tax arises u/s 3(3)

S. 3(3) covers three cases wherein the point of time at which the liability to pay tax arises. Under sub-clause (a) liability to pay tax under GVAT arises w.e.f. 1-4-2006. Therefore, ITC cannot be claimed on purchases made prior to 1-4-2006. Clause (b) covers the case wherein the dealer is not required to pay the tax, for his turnover being less than threshold limit. Liability to pay tax in such cases arises immediately the turnover exceeds threshold of turnover. In any case, even in such a case also, if such a dealer is not registered he will continue to be unregistered dealer. Therefore, the question of disallowance of ITC will remain. Clause (c) covers the cases wherein the dealer is being registered as per the provisions of GVAT.

12.4 Purchases made prior to the date of registration

Clause (dd) provides for disallowance for VAT paid for purchases made prior to the date of registration. In order to be eligible for registration, S. 3(3) provides for certain volume of business to be carried out by the dealer. In terms of insertion of clause (p)(ii) in S. 11(5) a registered dealer is permitted to claim ITC for the taxable goods held in stock on the date of registration. However, such goods should have been purchased after 1-4-2008 and should not be older than one year from the date of registration.

12.5 Purchases made in the course of inter-state trade

Since tax paid on inter-state purchases will be collected by the other state government, naturally the question of ITC in respect of such tax does not arise.

12.6 Goods disposed of otherwise than in sale / resale or manufacture

Clause (f) refers to utilisation of goods. It provides for disallowance in the case of use of goods for other than sale, resale or manufacture. Here, the sub-clause is silent about the provisions of S. 11(3)(a) laying down purchase of goods for various purposes. While S. 11(3)(a) covers seven cases, sub-clause (f) make cursory reference to use of goods. One would have expected both the provisions to be in tandem.

12.6.1 Whether goods given on loan will disentitle for ITC?

In certain industries, the practice of giving material on loan is prevailing. Such goods are returned after sometime to the original dealer. A question that may arise is whether the act of giving VAT paid goods to other dealer will amount to disposal of the goods otherwise than sale etc. Whether in such a case, VAT paid by the dealer will be withdrawn / disallowed in the month in which goods are given as loan? The dealer, who has purchased the goods, loses physical control of VAT paid goods. Not only that, such goods lose its identity in the process of manufacture by the loanee. The lender dealer has legal right to receive the exact quantity of goods or consideration for the same. However, ownership of goods gets converted into right to receive goods / consideration. It is this process of conversion which may disentitle to ITC. Since, giving of goods purchased as loan is not within the permitted category of uses of the goods purchased as laid down u/s 11(3)(a), the question of disallowance will arise.

12.6.2 Whether goods given to job worker will disentitle for ITC?

A manufacturer outsources certain processes by providing VAT paid goods to job-worker for processing. After completion of the process, the job-worker returns the processed material. In this case, ownership of the goods remains with the manufacturer though the goods remain physically in the custody of the job-worker. There is nothing in the GVAT, which requires the goods to remain in the physical custody of the buying dealer. Therefore, transfer of goods to job-worker should not disentitle ITC.

12.6.3 Whether sale of goods by a manufacturer without carrying out any process will disentitle ITC?

Normally, a manufacturer buys the goods for making use of it in manufacturing process. At times, the goods are found surplus or of no use. In such a case, it is being sold. A question may arise whether the dealer is entitled for ITC on purchase of such goods? Here, the dealer has not used the goods for manufacturing but has disposed it off by selling it. Therefore, the question of disallowance of ITC may arise. It should be noted that the dealer is required to pay VAT on the sale of such excess material.

12.7 Purchase of Goods specified in Schedule I or exempt wholly u/s 5(2)

S. 11(5)(g) provides for disallowance in respect of items falling under Schedule-I or notified as exempt u/s 5(2). At a first glance, requirement in this respect will appear superfluous for the reason that the selling dealer is not required to charge any tax on such goods. If no tax has been charged in VAT Tax Invoice, the question of claiming ITC cannot arise. However, consider the case of a dealer selling the goods who has charged tax in respect of items covered under Schedule-I. The dealer purchasing the goods has also paid / accounted for the same accordingly. A question will arise whether the purchasing dealer can claim ITC on such goods? It should be noted that the selling dealer has collected and paid VAT on such goods as well. Theoretically, the purchasing dealer should be entitled for ITC as the selling dealer has already paid it. However, in view of specific provisions of S. 11(5)(g), the purchasing dealer will not be entitled for ITC as the items purchased are falling under Schedule-I. The only alternative left open for selling dealer (and the buying dealer having no alternative), in such a case, is to issue credit note for VAT collected wrongly.

12.8 Whether goods notified as exempt subsequent to its purchase will disentitle for ITC?

Notifications exempting goods u/s 5(2) are issued at no fixed time. Thus, the goods may be taxable for a part of the tax period as well. The question is whether the goods which were taxable at the point of purchase but exempt at the time of computing tax liability, ITC can be allowed? It should be noted that disallowance of ITC is in respect of goods which were exempt at the point of purchase and not at the time of computation of tax liability. Therefore, in such a case, ITC should be permitted.

12.9 Whether the goods notified as exempt partially u/s 5(2) will disentitle for ITC?

Notifications issued u/s 5(2) are of two types viz. goods wherein exemption is granted fully and the one in which exemption is granted partially. In number of cases, exemption has been granted for the rate of tax exceeding 4.00%. Thus, the dealer is liable to pay tax at least @4.00%. Whether, in such a case, ITC can be

claimed for tax paid @ 4.00%? Clause 5(g) covers the cases of purchases wherein exemption is granted to the full extent there should not be any problem in claiming ITC paid to the extent of @4.00%.

12.10 ITC on Purchase of goods used for manufacture of exempt goods

Clause (h) provides for the disallowance of ITC in respect of the goods, which are being used for manufacture of the exempt goods. This is for the simple reason that the Government is not getting any revenue on exempt goods, and therefore, the question of ITC should not arise in such a case.

12.11.0 Purchase of CG for manufacture of exempt goods

Clause (i) covers the cases of the CG, which are used for the purpose of manufacturing exempt goods. Here, a question may arise in respect of a manufacturer who undertakes manufacturing of both the types of goods i.e. exempt and taxable. How to disallow ITC in respect of machines, which are being, used both for exempt and taxable goods? There is no clarity on this aspect.

12.11.1 How to compute disallowance in the case of CG when exemption is granted subsequent to availing of ITC?

In the case of P & M, it may so happen that notifications u/s 5(2) may be issued subsequent to availment of ITC. Whether the provisions of S. 11(8)(b) can be invoked? It covers the case wherein the P & M are not used for a continuous period of five years. Since, in such a case P & M, are still in use, the question of disallowance should not arise.

12.12 Purchase of vehicles of any type and its equipments, accessories or spare parts

Clause (j) covers the cases of purchase of vehicles and its equipments. This clause covers the cases of vehicles, which are being used for movement of goods within the plant as well. Unfortunately, this clause is oblivious of the fact that in the case of plant spread over thousands of square meters, movement of goods from one part of the plant to another is essential condition for manufacturing process.

12.13 Purchase of property or goods not connected with the business of the dealer

Clause (k) refers to the goods “not connected with the business”. How to determine “the business of the dealer”? On what basis connection of purchase of goods with the business of the dealer will be determined? Should there be 100% connection or even a partial connection can serve the purpose? What are the parameters for evaluating connection? Does this sub-clause empower the assessing officer to sit in the judgement and determine requirements of various goods to be purchased for the business? Dealer will have to face such questions.

Another noteworthy deviation in this respect has been the use of word “property” in place of “goods”. Is it accidental or with some intention? As might have been observed throughout the GVAT, this is the only clause containing the term “property” in the context of ITC. In our day-to-day life we use the term “property” in the context of real estate i.e. land or building implying immovable property. However, in legal context, it refers to “something owned, any tangible or intangible possession that is owned by someone”. Since the term “goods” refers to something tangible use of the term “property” may be in the context of “intangible” commodities as referred to in S. 2(13).

12.14 Purchase of goods which are used as fuel in generation of electrical energy meant for captive use or otherwise

Sub-clause (l) refers to the use of fuels, which has been used for generating electrical energy. Generation of electricity can be for both i.e. for captive consumption or for sale. As far as sale of electricity is concerned, the question of claiming ITC should not arise as sale of electricity, not being part of the definition of the term “goods” as defined u/s 2(13), will not attract VAT. The clause also covers the case of a dealer using fuel for generating electricity for captive consumption.

12.15 Purchase of petrol, HSD, crude oil and lignite

Clause (ll) covers the cases of various petroleum products generally which are being used for vehicles or generating electricity. Since both the activities have not been considered fit case for ITC, there is nothing new for this kind of requirement. However, the said clause is also applicable to the cases wherein, as a part of manufacturing process, use of petrol or HSD etc. is essential. Although in terms of definition of “raw material” as given u/s 2(19) such commodities are at par with other raw material, clause (ll) will make them disentitle for ITC.

12.16 Purchase of goods used as fuel in motor vehicles

Clause (m) provides for denial of ITC on VAT paid for purchase of fuels for use in vehicles. This will also cover the case of fuels used in the vehicles, which are being used within the factory premises for movement of goods.

12.17 Purchase of CG used in transfer of property in goods involved in execution of works contract

GVAT provides for ITC in respect of CG except in two cases viz. WC and transfer of right to use the goods. S. 11(5)(mm) prohibits ITC in respect of CG used in WC. It reads as follow:

Purchase of capital goods used in transfer of property in goods (whether as goods or in some other form) involved in execution of works contract

S. 2(23)(b) defining the term “sale”, covers the case of transfer of property in goods involved in execution of contracts. S. 2(24)(b), while defining the term “sales price”, provides that in the case of works contractor, it will be arrived at by deducting labour charges from the amount of consideration received. In these days of severe competition, the dealer is required to deploy hi-tech machines for executing works contracts. At times, value of such machines runs in to crores of rupees. In the case of a manufacturer, VAT paid on such types of machines is permitted as tax credit. However, in the case of works contractor, it is not the case. Consider the case of a manufacturer buying crane / forklift for the purpose of shifting of material in the factory from one place to another. He will be entitled for ITC as the machine is being used for the purpose of manufacturing goods. However, if the same type of crane / forklift is deployed by a works contractor at the site, will not entitle him for ITC. Consider the case of the same works contractor who instead of buying the crane and loosing tax credit on it, takes it on hire. He will be entitled for the amount paid as hire charges while calculating taxable turnover.

12.18 ITC and Transfer of Right to Use Goods

S. 11(5) (mmm) provides for disallowance of ITC on goods purchased which have been transferred with the right to use. It reads as follow:

S. 11(5)(mmm)

of the goods for which right to use is transferred for any purpose (whether or not for a specified period), for cash, deferred payment or other valuable considerations;

S. 2(23) while defining the term “sale”, includes amount received for transfer of right to use any goods for any purpose. As we know, credit for taxes paid on input is at the core of the scheme of VAT. It is for this reason that tax paid on capital goods used for the business is being allowed as tax credit, although in deferred manner. In the case of business of transferring right to use goods, capital goods form major portion of the total investment. However, ITC is not permitted on purchase of such goods. Here, it may be noted that the dealer is totally debarred from claiming any tax credit. Mark the word **“of the goods”**. S. 2(13), defining the “goods” is an exhaustive one, making it impossible for such dealers to claim any tax credit.

12.19 Purchase of goods from a dealer after his name having been published u/s 27(11) or S.97

S. 11(5) (mmmm) provides for the cases of dealers whose RC has been suspended or cancelled. Requirement in this respect are perfectly in order for there cannot be question of providing ITC in respect of goods purchased from a dealer who is not registered under GVAT. However, compliance of this condition by a buying dealer will be most difficult one. The process of cancellation / suspension of RC of the dealers will be an ongoing one. S. 15 cast the burden of proof on the dealer claiming ITC. Therefore, VAT department will have to establish a link to communicate it to the public at large. The buying dealer will have to ensure status of the selling dealer at the point of purchase.

Another aspect to be noted in this respect is that even the bonafide purchases by a dealer will disentitle for ITC. Generally, dealers who engage in the activities of issuing bogus bills, do also engage into trading activities. However, provisions of sub-clause (mmmm) will take in its fold even the case of the transactions where goods have been purchased in reality and payment of VAT has been made by purchasing dealer. Not only that the purchasing dealer has used the goods for sale or resale or manufacturing purposes well supported by the documentary evidences. However, in view of specific provisions of clause (mmmm), ITC will not be permitted.

13.0 **ITC and adjustment in sale, return of goods etc.**

In the case of cancellation of sale, adjustment in sale consideration or return of goods, the question of corresponding adjustment in VAT charged on such sales will arise. S. 11(10) provides for making such adjustment by purchasing dealer in the tax period in which the CN or DN has been issued. It should be noted that, in contrast to the provisions of Rule 15(2) wherein ITC is required to be claimed in the month in which TI is recorded in the books of accounts, CN / DN are required

to be accounted for in the month in which the same has been issued by the selling dealer. Another aspect to be noted is that CN /DN issued by the purchasing dealer has no legal sanctity under GVAT. S. 8(2) provides for the selling dealer as the originating / source of generating DN / CN. Also note the provisions of S. 61 specifically requiring the selling dealer to issue DN / CN.

Adjustment in ITC can be on both the counts i.e. increase or decrease. In the case of defective goods or goods returned by the purchasing dealer, the question of reduction in ITC will arise. However, it cannot be done till the purchasing dealer has received CN from the selling dealer. In the same manner, the purchasing dealer will be entitled for additional ITC, if the selling dealer has issued any DN on the purchasing dealer.

At times, such CN / DN are not responded immediately, mainly due to disputes. Purchasing dealer may not respond it for a long time. Since CN /DN are required to be incorporated in the month in which they are issued, delay in responding to it will cause lapse in claiming ITC or non-payment of additional VAT. In fact, in many cases, the question of filing of revised return will arise.

14.0 **Reversal of Input Tax Credit**

GVAT provides for two eventualities under which ITC utilized is required to be reversed. The first case is with regard to claim of ITC in the case of VAT paid on plant and machineries. S. 11(8)(b) reads as follow:

Where the capital goods referred to in sub-clause (vii) of clause (a) of sub-section (3) are not used continuously for a full period of five years in the State, the amount of tax credit shall be reduced proportionately having regard to the period falling short of the period of five years.

Provisions with respect to utilisation of CG “**continuously for a full period of five years**” lack clarity. One can understand the requirement for a period of five years. However, the words “**continuously for a full period**” must be with certain objectives. Does it mean that the P & M should be used for 24 x 7 x 365 x 5? Issues will arise when the machines cannot be used for certain period, say, due to seasonal nature of manufacturing process or lack of demand during a certain period of the year.

Second eventuality is in the case of ITC in closing stock at the time of entering into CS by a dealer. Recently Rule 28 and 28C, relating to CS for a retail trader and restaurants, were amended through a Notification bearing no. GHN-18 dt. 22-5-2007. This has been done to remove a lacunae in the scheme of composition. In both the cases rule 3A has been inserted. It reads as follow:

“Any registered dealer opting to pay lump sum tax under section 14 has already claimed the ITC for the goods held in the stock on the date of effect of permission to pay lump sum tax, shall reverse such tax credit and the amount of such reversal of tax credit shall be paid by him.”

This provision is applicable in the case of a dealer who was under the VAT scheme and is shifting to CS. As per the inserted rule, the dealer is required to reverse the ITC lying in the stock of goods at the time of entering into CS and the

amount of ITC is required to be paid. In the case of a dealer who has already utilized ITC fully there cannot be any issue. However, what will happen in the case of a dealer who is having unutilized ITC? Clause (p)(iii) has been inserted in S. 11(5) w. e. f. 1-4-2008. As per the new provision a dealer under CS, moving to VAT chain, is permitted to claim ITC for the taxable goods held in stock which are purchased after 1-4-2008 and during the period of one year ending on the date of entering into VAT chain.

It should be appreciated that claiming of ITC and utilization of ITC are two different things. All the amount of ITC claimed need not be utilized in the form of discharging the VAT liability or claim for refund. Some balance of ITC may be remaining unutilized as appearing in the Form No. 201. Therefore, the dealer proposing to shift from VAT to CS should ensure that there is no unutilized ITC.

15.0 Utilisation of ITC

Having computed the entitlement for ITC, a question arises in what respect it can be beneficial to a dealer? Rule 18(2) contains the provisions under which tax liability arising during the month can be adjusted against ITC for the current month. In the eventuality of tax liability being lesser than ITC, excess amount of it can be adjusted against liability under CST [see Rule 18(2)(a)]. Any amount still remaining unadjusted can be carried forward to the next month. It can be claimed against the tax liability arising in future.

There may be cases wherein ITC will always be in excess of tax liability arising on account of sales. For example, in the case of a 100.00% EOU or dealer having exports of substantial part of production on regular basis, there may not be any tax liability. In such a case, refund will have to be claimed.

In this respect, provisions of S. 11(12) should be noted. It provides for non-transferability of the right to claim ITC. Thus, the right of the dealer to claim is conditional in the sense that it can be used for adjustment against future VAT liability only. Whether this right to claim refund in the case of merger, demerger, conversion or succession continues is a debatable matter. Provisions of S. 51 to 53 refers to liability under the GVAT and take care of various procedural requirements therein. However, S. 11 is silent on the issue.

16.0 Refund of excess credit on CG

If tax credit is provided for in the statute, the question of refund has to arise.

Provisions for refund of excess ITC are contained in S. 37, 40 and Rule 15(6), (7), (7A), (8), 18(B)(1)(a) and 37. S. 37 authorises the Commissioner to grant provisional refund while S. 40 authorises the Commissioner to grant refund in respect of purchases made from a specific class of a dealer.

Rule 15(6) provides for the broad contour for the amount which can be claimed as refund and the time frame thereof. It provides for the outer limit beyond which the claim for refund cannot be made. The Rule provides for “ITC admissible in the year remaining unadjusted against the output tax”. It means that refund can be claimed after completion of the year only.

Rule 15(7) deal with the refund arising on account of export of goods while rule (7A) takes care of refund arising on account of inter-state sale. Rule 8 is a procedural one requiring the dealer to provide copies of invoices of purchases on which ITC has been claimed.

Rule 18(1)(B)(1)(a) provides for refund of tax paid by a dealer under the Remission Scheme. Provisions of Rule 37 lay down the procedure to be followed and various documents to be submitted for claiming refund.

Provisions of Rule 15(6) are noteworthy. Read the provisions and the words highlighted herein below.

16.1 Refund of ITC on CG

*Where the tax credit **(other than tax credit on capital goods)** admissible in the year remains unadjusted against the output tax as per section 11, such amount shall be refunded not later than expiry of two years from the end of the year in which such tax credit had become admissible:*

As will be clear, ITC is required to be bifurcated into two parts viz. ITC on raw material etc. purchased and on CG. If at the end of the year, ITC on raw material etc. remains unadjusted, excess of ITC can be claimed as refund. However, ITC on CG cannot be claimed as refund. This requires prioritizing utilisation of ITC in each tax period. In order to implement provision of this rule, it is essential that separate identity of ITC on CG be maintained. Unfortunately, Form 201 is silent in this aspect. There is no provision in Form 201 for keeping track of ITC on raw material etc. and CG.

16.2 Are the provisions of S. 15(6) relevant?

At the first glance, such provision may look like arbitrary and not required. However, consider the case of a manufacturing unit where commencement of production may takes place after a long time. Does this mean that the dealer can claim refund of ITC without adding any value in the form of manufacturing of any taxable goods? Therefore, when we look at the provisions of Rule 15(6) from this perspective, it appears perfectly in order. However, at the same time, appropriate care has not been taken to ensure its proper implementation.

16.3 Claim of refund by 100% EOU

In the case of 100% EOU there is not going to be any tax liability on sale of goods. Hence, the question of adjustment of ITC against tax liability does not arise at all. What will happen in such cases? Whether such units will have to loose their claim for ITC on CG? Since, in such cases, both the outlets i.e. adjustment against tax liability and claim for refund are closed, ITC on CG may become redundant. One may be wondering whether that can be the objective?

16.4 Refund of Tax Credit on Export of Exempt Goods

Another interesting question arises is in respect of exempt goods. In the case of export of taxable goods, input credit in respect of goods exported will be permitted as refund. However, what will happen if the goods exported are exempt under Schedule I or u/s 5(1A)? Refer to S. 11(5)(g) which reads as follow:

S. 11(5) “ credit **shall not be allowed** for purchases:

.....

(g) of the goods specified in the Schedule I or the goods exempt from the whole of tax by a notification u/s 2 of S. 5

In view of this, the dealer is not entitled for refund, as tax credit cannot be claimed under the above clause. This appears to be inequitable. What is the difference between goods exported which is falling under Schedule II and the one, which is falling under Schedule I? ***In both the cases output tax is not being paid.*** Therefore, equity requires that if tax credit is made available in one case, the same should be made available in the other case as well. Apart from that, since goods are exempt from tax, credit for packing material will not be available although such packing material, in the normal course, will be taxable. Packing material, in this case, will not be taxable as the goods packed therein are exempt. Thus, as a result of such a provision, input credit on both, the goods and its packing material, will be lost.

17.0 **Works Contract and ITC**

17.1 *Is ITC permitted under WC?*

Ever since the judgment of the Madras High court in the case of Gannon Dunkerly, taxation of WC under sales tax has raised various controversial issues. However, all the State and the Central Government have accepted levying tax on the value of property passing in execution of the contract. Appropriate provisions have been made in VAT laws and CST as well. Under the old system of sales tax, in majority of the cases, goods used in execution of the contract were purchased locally i.e. within the State, and therefore, the question of levying tax did not pose any additional tax outflow. However, with the introduction of VAT, in the case of WC wherein value of property passing in each case attracts the tax, taxability has become a major issue. In view of this, VAT paid on goods, property in which is passing to the buyer, should also be permitted for ITC. Till this stage, there is no problem. However, the issue becomes complex as large number of WC cannot be vivisected. Therefore, it becomes difficult to arrive at the value of property passing in the goods and identifying appropriate ITC.

Looking to this scenario, let us see the provisions of GVAT in this respect. Since the nature of WC being of a typically different nature, one would have expected specific provisions for availing ITC and utilisation thereof. However, provisions in GVAT are sketchy and not consistent with the basic principle of taxing value addition. The basic principles for availing ITC are based on purchases made for seven different purposes as listed in S. 11(3)(a). However, there is no reference to purchases made for executing WC. If property in goods passing while executing the WC is taxable, there is no reason why purchase of such goods should not be eligible for ITC. One can have solace in stretching the provisions of clause (vi) regarding purchase of raw material made for manufacturing of taxable goods. Attempts will be made for denying ITC on the ground of WC not being manufacturing activity and, consequently, all the purchases in respect thereof not being entitled for ITC. However, the dealer will have to depend on extended definition of “manufacture” as given in S. 2 (14).

17.2 *WC and ITC on CG*

Provisions of S. 11(5)(mm) totally prohibits ITC in respect of CG purchased by a dealer engaged in execution of WC. ITC on CG purchased is permitted for manufacturing operations, denial of it for WC defies logic. If a manufacturing unit is entitled for ITC on CG, as CG are adding value, there is no reason why ITC should not be permitted on CG in the case of WC.

18.0 Composition Tax and ITC

Since the dealer under composition scheme is paying the tax at concessional rate, the question of ITC does not arise. However, the problem arises when the dealer under composition scheme moves in and out of it.

18.1 ITC in the case of entry into CS

In terms of Rule 28 and 28C, ITC in respect of stock in hand at the time of moving into CS is to be reversed and required to be paid as well. In the case of a dealer not having any unutilized ITC, this may not pose any problem as the dealer has already availed the benefit of ITC. However, imagine the case of a dealer having unutilized ITC. In view of specific provisions of rule 3A, tax will have to be paid twice on the same goods.

18.2 ITC in the case of exit from CS

A dealer may be required to move out of CS due to the turnover crossing the threshold limit or on his own volition. In the case of running business, the dealer will always have some amount of stock. A part of this stock will be consisting of VAT paid in respect of which no ITC has been claimed as the same not being permitted under CS. In order to take care of such contingencies, Clause (p)(iii) has been inserted in S. 11(5) whereby the dealer is permitted to take ITC on VAT paid on the goods held in stock at the time exit from CS. Here, the dealer is required to comply with two conditions viz. such goods should have been purchased after 1-4-2008 and should not be older than one year. Dealers exiting from CS in the initial period of 2008-09 may be looser as the goods lying in the stock will be that of the period prior to 1-4-2008.

19.0 ITC and Second hand Goods

In the case of VAT, in view of levy of tax at every point of sale, second-hand goods poses problem of double taxation. In the case of second-hand goods, it has already moved out of value-chain and before losing its entire economic value, re-enters the value-chain (market). At the point of re-entry, the question of payment of tax u/s 9 will arise, as the seller will not be a registered dealer. Secondly, on its sale by a registered dealer, VAT will be applicable. Thus, to the extent of economic value in the goods there will be double taxation. At present, under GVAT, except in the case of sale of second-hand cars, there are no specific provisions for granting ITC when such goods enter into value-chain.

19.1 ITC on sale of gold, silver and its ornaments

Indian society being traditional, gold and silver forms an important form of saving. All of us are aware of sale of gold, silver and its ornaments during financial contingencies. A typical nature of these items is that they are not consumed in physical sense. Moreover, with the process of time, its economic value rises. Sale of gold etc. to the goldsmith by the ordinary people is treated as URD purchases. However, no ITC will be available in respect of such goods. Sale

of such second-hand gold ornaments, whether in the same form or converted by the goldsmith, will attract VAT second time.

20.0 Sales Promotion & ITC

In these days of cutthroat competition, the dealer is required to launch various schemes for the purpose of boosting sales / maintaining relative strength of the product in the market. Varieties of methodologies are being applied. At times, the dealer may give goods free of cost or at reduced rate. The dealer may also buy certain goods not related to his business and may give it as free of cost or at substantial reduced rate to his customers. A question will arise here whether the dealer can claim ITC in respect of goods, which have been given as free of cost??

Before appreciating the issues involved in such cases, it will be better to have an idea about various types of schemes launched.

Free gifts of goods for no consideration

Goods are given away and there is no monetary or non-monetary consideration.

Gifts to employees

Rewarding employee with a gift of goods manufactured or purchased on which ITC has been claimed.

Buy 1 get 1 free

Goods offered together in 1 promotion for a single price - such as "buy 1 get 1 free" or "buy 3 for the price of 2" or "buy an item X and get a free of item Y". This is normally referred to as a combined or multiple supply and the total amount paid by the customer will usually cover all the goods offered.

Linked Supplies Concession

The "*linked supplies concession*" applies where a minor article is linked, not necessarily physically, with a main article and sold with it at a single price. An example would be an empty plastic storage jar attached to a box of cereals.

Multi-save promotions where the manufacturer subsidises the promotion.

These are offers of "buy 3 for the price of 2" or "buy 2, get a third free" where manufacturers make payments to retailers towards the costs of such promotions.

Goods given away through a retailer

(a) Where the public buy from a retailer and send a proof of purchase to the manufacturer to receive further goods (from the manufacturer), or coupons are included by the manufacturer inside the product or as part of the packaging and the coupons are collected and redeemed later for goods - the redemption goods are provided for no consideration

(b) Where retailers act as agents of the manufacturer in giving reward goods to those customers making qualifying purchases and the manufacturer has provided the reward goods to the retailer (for no consideration) specifically for this purpose.

Newspaper promotions

A promotion is run with a newspaper company whereby vouchers are printed in the newspaper along with the promotion of the product and the public have to collect the vouchers in order to get reward goods, the goods are liable to VAT.

Goods given to publishers for use as magazine inserts

Goods are supplied to publishers for a consideration or free of cost.

All of these have different implications for claim of ITC. The dealer will have to take into account specific features of the scheme and accounting aspect thereof, otherwise the chances of losing claim for ITC is high.

21.0 R & D and ITC

R & D activities have become a must for a manufacturing enterprise. Particularly in the case of pharmaceutical industry, one cannot survive without at least carrying out some development activities. Research activities may not add any value to the existing products immediately, but it certainly adds value to the business in the longer run. One cannot deny the role played by inputs going into such activities. Role of development activities is slightly on a better footing as it directly leads to benefits in terms of lower consumption of material or better quality, in respect of existing products.

What treatment should VAT paid on the goods purchased for R & D activities get? Applying the litmus test for determining eligibility of the goods for ITC, doubt will arise. At a first glance, purchases made for research activities will not fit into the provisions of S. 11(3)(a) i.e. intention of the dealer to purchase the goods for the purpose of use as raw material for manufacture of taxable goods. Goods used for research are not ingredient to manufacturing of other goods nor process material or consumable stores. Therefore, lack of clarity may lead to denial of ITC.

22.0 Utilisation of Goods and ITC

S. 11(8)(a) emphasizes on the utilization of the goods. It provides for reversal of ITC in case if the goods are not used fully or partly for the purposes as specified etc. This will pose various issues some of which are as follow:

22.1 Proof for Utilisation of Goods

Whether the dealer is required to prove utilisation of goods on which ITC is claimed? Whether positive act of showing utilisation of the goods is required? There is no clarity on this issue. However, if the dealer has maintained proper records to document receipt, issue / consumption of goods then there should not be any need for displaying positive use of goods.

22.2 Time element of utilization

Is it necessary that the goods should have been used in the same tax period in which it has been purchased? Or is it necessary that it should be used in the year in which it has been purchased? A business is a continuous activity and, therefore, cannot be evaluated in watertight compartment based on time element. Various time limits laid down in the statute is for the purpose of assessing tax liability and it is based on the assumption of the business as a going concern. In fact, S.

11(5)(n) provides specifically for disallowance of ITC in the case of closure of business. Therefore, any attempt to disallow ITC on the ground of goods not being used in a particular year will be stretching the matter too far and will defeat the very objective of taxation under VAT.

22.3 Criterias for consumability?

Whether the assessing officer can sit on the judgement and deny ITC on the basis of consumability of any particular goods? There is nothing in the GVAT authorizing the assessing officer to apply the subjective test. Provisions of S. 11(3)(a) lays down various purposes for which the goods should be purchased. Which items of the goods should be purchased for carrying on the business is the dealer's discretion. Nor are there any provisions in GVAT authorizing the assessing officer for applying any particular method of manufacturing or conducting the business in a particular manner.

22.4 Repetitive / one-time use of goods

Is it necessary that the goods entitled for ITC should be used one-time only? Can there be repetitive use of such goods? In the case of consumable stores, there are various items, which can be used for more than one time. As long as the goods are used for manufacturing process there is no reason to deny ITC for the goods being used on repetitive basis.

22.5 ITC and goods used for quality control /Inspection

Any manufacturing process without carrying out inspection / quality control is incomplete. Therefore, VAT paid on goods for inspection / quality control, though not participating in the manufacturing process directly, is entitled for ITC.

23.0 Burden of Proof for claiming ITC

S. 15 cast the burden of proof on the dealer. It provides that the burden of proof for being eligible for ITC lies on the dealer. It covers both the eventualities i.e. eligibility of the dealer to claim ITC and eligibility of the goods for being entitled for ITC. This may raise certain operational issues. Provisions of S. 15 should be read with reference to the provisions of S. 11(5), which lays down various conditions for disallowing ITC. For example, consider the provisions of S. 11(5)(a) and (b) which requires the dealer to ensure that the selling dealer is a registered one. It presupposes that the buying dealer has to be more cautious particularly while making purchases from an unknown person. But the point is how to demonstrate that the selling dealer was not a suspended dealer or who's RC was not cancelled during a particular period of time? Only recourse is to refer to VAT Department website on daily basis. In the absence of appropriate infrastructure facilities, it will be difficult for the dealer to comply with the requirements in this regard.

24.0 Whether ITC can be permitted in the case of goods sold at lesser value than cost?

It is not necessary that the dealer will be making profit in respect of the entire buy and sell transactions. There may be situation where goods may be required to be sold at substantially lower than the cost price. In such a scenario, there will be value reduction rather than value addition. Since the tax liability is computed globally, element of VAT as applicable to loss made will get adjusted against

VAT liability in respect of other goods where value addition has taken place. It is for these reasons assessing officer may be tempted to disallow ITC on the goods wherein loss has been incurred. A question that may arise is whether disallowance of ITC in such a case is justified?

It is true that no activities carried on continuously by a taxable person can ever be business if the profit motive is absent. It is also equally true that the dealer cannot make profit in each and every transaction of buy and sell. There is nothing in the natural meaning of the word business so as to restrict its scope, and there is nothing in the context of the taxing provisions as a whole to require one to read “business” in a narrow way i.e. making profit in all the transactions. The tax is, after all, not a tax on profit or income, but on taxable supplies by taxable persons, and to make liability to tax dependent on the motive with which the activities are carried on would lead to the unreasonable result.

What is important is that one has to look into the activities of the taxable person in course of which taxable supplies are made. If these activities are predominately concerned with the making of taxable supplies to consumers for a consideration, one can say that the dealer is in the “business” of making taxable supplies, and that the taxable supplies which he makes are supplies made in the course of carrying on that business, especially if the supplies are of a kind which are made commercially by those who seek to profit from them. There is no justification for the necessity of there being any “profit element” in these activities.

24.1 Fair Market Value and ITC

S. 34A provides for assessment on the basis of fair market value. Here the question is whether the provisions of S. 34A can be invoked in the cases where the dealer has sold the goods at lower than the cost of purchase / manufacture. S. 34A specifically provides for the intention of the dealer to pay tax at lower than the tax otherwise payable. It is for this reason the dealer has to become cautious to document the whole process of aggressive marketing; otherwise subsidization of a commodity at the cost of other may result into loss of ITC.

25.0 Accounting System & ITC

Section 11(11) expects the dealer to apply fair and reasonable method to determine the extent to which goods are sold, used, consumed or supplied or intended to be sold, used, consumed or supplied. Mark here the absence of words reduction, disallowance or reversal of ITC. All of them have to go by the methods given under the GVAT. Whether they are fair and reasonable is a matter of debate.

Methods to be applied for being fair and reasonable

Which methods the dealer should apply so that it can be said that provisions of S. 11(11) have been complied with? The ICAI has laid down various AS which can help in this respect. Since, the standards have been laid down by an apex body, and professionally competent to do so, the dealer following the same, should not face any problem.

26.0 Documentation and ITC

GVAT provides extensively for maintaining books of accounts, records and documents. S. 11(2) requires the dealer to maintain books of accounts as may be

prescribed. S. 62 also require the dealer to maintain true accounts of the value of the goods purchased, sold, supplied in the form and the manner as may be prescribed. Rule 45 provides for a long list of items detailing various types of records to be maintained. Apart from that S. 11(5)(o) refers to denial of ITC in case of original invoice not containing details of tax charged. S. 60 contain the exhaustive requirements in respect of TI. While all these records will help in claiming ITC but may not be of help in the case of reduction or reversal of ITC.

27.0 ITC and Assessment

Since the Government is permitting credit at extensive scale, there are bound to be provisions for keeping a check on claims for ITC by the dealers. GVAT and GVAR makes detailed provisions for audit, scrutiny etc. of the periodical returns filed by the dealer. Of all the conditions laid down for selecting the cases for scrutiny / assessment etc., criteria based on ITC are predominant.

S. 32 relating to Scrutiny of Returns and provisional assessment authorizes the Commissioner to assess provisionally the cases wherein ITC is carried forward for subsequent return or refund has been claimed. Sub-clause (v) contains the cases wherein ITC claimed by the dealer is more than “*admissible*”.

S. 34 providing for Audit Assessment authorizes the Commissioner to audit the assessment made u/s 33. One of the conditions for invoking the provision in this respect is the Commissioner not being satisfied about the bonafides of ITC. Clause (e) and (f) of Rule 31(3) provides for two eventualities based on ITC claimed. According to clause (e) one of the reasons for audit assessment can be if the ITC claimed by the dealer is more than 10.00% as compared to last year. According to clause (f), another criteria for audit assessment is if the amount of ITC carried forward is more than 20.00% of the output tax payable in a particular year.

S. 35(1) relating to “Turnover escaping assessment” provides for reopening of the assessment. One of the conditions for invoking the provision is allowing the ITC wrongly.

As can be seen from all these, ITC plays an important role in assessment process.

28.0 Relevance of ITC in GVAT Audit

S. 63 provides for audit under GVAT. Criteria for getting the accounts audited have been fixed with reference to turnover. As such, it may appear that audit under GVAT has no role to play in selection criteria of audit. However, the format of audit report and various details required to be provided therein will make clear that claim of ITC, its entitlement, arithmetical accuracy etc. plays a major role. Rule 44(b)(i) expects the auditor to certify correctness of the tax credit claimed by the dealer. Clause 1(7) of Form 217 requires the auditor to state that the computation of ITC admissible in respect of purchases made during the period of review and adjustment to ITC claimed in the previous period is correct. Item No. 2 and 3 of Clause 4 of requires the auditor to state ITC u/s 11 and 12 as computed by him and declared by the dealer in the Annual Return filed.

29.0 Conclusion

Introduction of VAT was supposed to emerge as new era in the field of indirect taxation. However, looking to the provisions of GVAT, one is left in doubt that number of basic principles have not been followed or given go-bye.

Since assessment has not started yet, VAT administration's approach in dealing with ITC is not clear. To what extent the spirit of VAT will be followed in granting ITC is a moot point. Looking to the present scenario, one only wishes that VAT should not result into extended form of erstwhile set-off provisions under sales tax laws.

Abbreviation used

CG	Capital Goods
CN	Credit Note
CS	Composition Scheme
CST	Central Sales Tax
DN	Debit Note
GST	Gujarat Sales Tax Act
GVAR	Gujarat Value Added Rules
GVAT	Gujarat Value Added Tax Act
ITC	Input Tax Credit
ICAI	The Institute of Chartered Accountants of India
P & M	Plant & Machinery
R & D	Research & Development
SHPM	Second-hand Plant & Machinery
ST	Sales Tax
URD	Unregistered Dealer
VAT	Value Added Tax
WC	Works Contract