ELP

GST INSIGHT

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CENVAT CREDITS UNDER THE GOODS AND SERVICES TAX REGIME

Under the present scheme of taxation, businesses earn tax credits under the CENVAT scheme in respect of specified central levies, and VAT credit under various State VAT laws. Other than LTUs, manufacturers avail their credits at the factory level, whereas service providers avail their credits depending upon their registration status. The CENVAT provisions also include the ISD concept, which facilitates some mobility of credits between different units of the same entity. Credits under the State VAT provisions, on the other hand, are accounted at the State level.

Currently, businesses face two issues vis-à-vis credits, viz. the inability to avail credits of all taxes paid on sourcing, and the accumulation of credits. Both these situations can occur for a variety of reasons, which ultimately end up increasing the cost of doing business. The credit mechanism under GST is therefore a key issue for businesses. In theory, the switchover to the GST regime should facilitate the pass through of all credits, by which the incidence of tax is passed to the consumer without any cascading.

Credit of Central GST and State GST

- Given the Dual GST structure, credits will be accounted separately in respect of Central GST ('CGST') and State GST ('SGST'). It will have to be seen what provisions the CGST legislation contains to account and utilise CGST credits across locations, and how the LTU mechanism will operate in GST. It is expected that SGST credits will continue to be accounted and managed at the State level.

- The credit provisions are likely to follow the principle of value addition, i.e. all taxes charged to businesses in connection with their business activity (goods or services) ought to be creditable. As a corollary, taxes linked to exempt activities will not accrue tax credit.

- Fungibility between CGST credits and SGST credits may not be available. Given coincident taxation by the Centre and States on goods (at the same rate), situations of tax credit accumulation are likely to arise mainly where there is an inverted duty structure on goods, or on account of the rate difference between the expected concessional rate of tax on goods and the rate of tax on services.

- Further, States are not likely to enable fungibility of SGST credits availed in other States.

- Internationally, the tax credit provisions enable a refund of unutilised tax credits to businesses, which minimises the negative effect of accumulated credits on cash flows. Whereas the present CENVAT mechanism does not include such provisions (except in respect of exporters), the VAT legislations provide for a refund of unutilised credit after a period of time. It will have to be seen whether and how such a refund mechanism is incorporated in the CGST and SGST credit provisions.

- There are several points of divergence in terms of the present credit schemes under CENVAT and State VAT. Some key points are listed below:

    - The CENVAT scheme is inclusive and covers nearly all inputs, whereas the VAT input tax credit scheme of several States cherry pick eligible inputs; also, several States have long lists of goods that are ineligible for VAT input tax credit.

    - Credit for service tax is available only on payment, unlike the VAT input tax credit mechanism which is purely invoice based.

    - The VAT input tax credit provisions in States such as Maharashtra link the availment of credit to a threshold level of sale activity.

It is important that the CGST and SGST credit provisions are set out with commonality on such fundamental criteria.

Credit of Integrated GST

Under the GST regime, the Integrated GST ('IGST') would be levied by the Centre (which would be CGST plus SGST) on all inter-State transactions of taxable goods and services.

As per the proposed model, fungibility of CGST and SGST towards IGST and vice versa may be allowed. The credit of CGST may be utilized first against CGST and then towards IGST liabilities, and similarly in case of SGST. IGST may first be utilized against IGST, then CGST and SGST.

Additional 1 per cent tax on Inter-State transactions

The origin based tax of 1 per cent on inter-State supply of goods is to be collected by the Centre for a period of two years and assigned to various States. This proposed additional tax may not be creditable, thus creating a cascading component in the GST credit chain.

Migration of accumulated credits

Presently, there is no clarity on the transitional provisions with respect to accumulated credits (both CENVAT Credit as well as State VAT Credits) as to how these will be dealt with upon the introduction of the GST. Ideally, the transitional provisions should allow for clawback of tax i.e. refund of the accumulated credits or allow a tax credit under GST.