

Reversal of ITC and its interest liability

The credit of GST paid on the purchases like raw materials/services used for manufacturing or selling products is known as an Input tax credit (ITC). If the input tax credit is wrongly claimed, then it should be reversed by making payment to that extent of wrongly availed ITC. In certain situations, even if the basic conditions for claiming ITC is satisfied, ITC claimed must be reversed (e.g. Blocked Credits like health insurance, food & beverages expenses, etc.) Reversal of ITC means the credit of inputs, input service and capital goods utilized earlier would now be added to the output tax liability, effectively nullifying the credit claimed earlier. Depending upon when such reversal is done, payment of interest may also be required.

THE REVERSAL OF ITC IS TO BE DONE IN THE FOLLOWING SCENARIOS:

- The recipient fails to pay consideration to the supplier (whether fully or partly) for a particular supply. (Rule 37 of CGST Rules)
- ITC has been availed on 'blocked credits' as per Section 17(5) of CGST Act.
- Inputs have been used to make a full or partial exempt supply or supply which is not for business purpose or used for personal consumption. (Rule 42 of CGST Rules)
- Inputs used in goods that were given out as free samples or used in goods that were lost, destroyed, stolen, etc.
- Cancellation of GST registration or switches to Composition Scheme. (Rule 44 of CGST Rules)
- Inputs taken on Capital Goods for supply of wholly exempt goods or taxable and exempt goods. (Rule 43 of CGST Rules)
- Depreciation under the Income Tax Act has been claimed on the GST component of capital goods purchased.
- Reversal of 50% of ITC by banking and other financial companies under special rules.
- Credit note issued to Input Service Distributor (ISD). (Rule 39 of CGST Rules)

Some of the above provisions are discussed in detail below:

➤ **Reversal of ITC under Rule 37:**

You being a recipient, if you fail to pay the invoice amount to the supplier within 180 days the ITC has to be reversed. If part of the invoice is paid the ITC will be reversed on a proportionate basis.

➤ **Reversal of ITC under Rule 42 & 43:**

Both rules pertain to reversal of Inputs utilised for supplies that are exempt or used for personal consumption. If the credit can **specifically be attributable** to a supply – either taxable, non-taxable, or supply consumed for personal use, such ITC amount should be distinguished from the total ITC since it can be easily identified. Taxpayer must reverse that amount of ITC directly attributable to a particular supply that is non-taxable/used for personal consumption, only when wrongly availed.

ITC amount that **cannot be attributable** to a specific supply but is used for partly making **both** the taxable **and** non-taxable supplies/supplies used for personal consumption need to be reversed proportionately to the extent of supplies that are non-taxable/used for personal consumption. The remaining ITC left is eligible for claim.

The calculation differs for:

- Inputs or input services- covered by Rule 42.
- Capital goods- covered by Rule 43.

➤ **Reversal of ITC under Rule 44:**

The aim of this rule is to reverse all the ITC that has been availed by a registered person in the event that he chooses to pay tax under the composition scheme or his registration gets cancelled for any reason. For inputs held in stock or contained in semi-finished goods and finished goods in stock, the ITC which is to be reversed should be calculated proportionate to corresponding invoices on which credit was taken. In case of capital goods, ITC availed will be based on the useful life (in months) and shall be computed on a pro-rata basis.

➤ **Reversal of ITC the availment of which is blocked under Section 17(5):**

Inputs on goods or services used for personal consumption, inputs on goods which are lost, stolen, destroyed or written off or disposed of by way of gift or free samples, and any ITC availed which is blocked as per Section 17(5) needs to be reversed by the recipient.

INTEREST ON REVERSAL OF ITC

Chapter X of the CGST Act, 2017 enumerates the provisions relating to 'payment of tax'. Section 50 in this Chapter lays down the circumstances in which interest would be required to be paid.

The Section provides for payment of interest in two circumstances: -

- a. Where a person liable to pay tax fails to pay the same [Section 50(1)].
- b. Where a person makes an undue or excess claim of input tax credit under the provisions relating to matching of ITC [Section 50(3)].

It appears that the first provision (a) would cover all cases where there is a shortfall in payment of tax which *inter alia* may be on account of payment of tax using irregularly availed credit. In other words, there may be short payment of tax by utilization of ineligible credits.

By plain reading of the section it conveys that mere availment of credit, without utilization, may not fall within the scope of this provision as it would get triggered only due to failure to pay the tax.

The second provision provides for levy of interest where undue or excess claim of input tax credit has been made because of mismatch in the returns. This provision would not cover a scenario wherein an ineligible credit has been availed by an assessee for reasons other than that of excess availment.

Section 50 does not provide for payment of interest for mere wrongful availment of credit, except wherein an ineligible credit has been availed by an assessee. Once there is no interest payable under section 50, an argument can be advanced that the CGST Act does not provide for a provision to demand interest in cases where availment of credit is irregular.

As the provisions relating to recovery of interest under CGST Act does not envisage the scenario of irregular availment of credit, it appears there cannot be any levy of interest on mere wrongful availment of credit for reasons other than those covered under Section 50(3) viz. wrongful availment on account of mismatch [Section 50(3) is explained in the next part].

Also in the judgement by Hon'ble Patna High Court it was held, in the case of M/S Commercial Steel Engineering Corporation Vs State of Bihar, that interest is not leviable on ITC which is availed however not utilized for payment of tax.

Rate of Interest on Reversal of ITC:

Section 50(3) specifies that interest rate should not exceed 24% p.a. and intends to exclusively cover cases of contravention as per section 42 (10) and section 43 (10). Whereas section 50(1) is a residuary section which covers all cases other than cases falling under section 50(3). Interest rate specified u/s 50(1) is 18% p.a.

Section 42(10) specifies that interest should be charged at 24% p.a. only in those cases where there is reclaiming of ITC as per Section 42(7) which was reversed by the recipient when he has claimed ITC in excess of tax declared by the supplier in his GSTR-1 or supplier has not declared such supplies in his GSTR-1.

Similar provisions are contained in section 43 and are dealing with credit note.

Hence the rate of interest for reversal of ITC is 24% p.a. only in case of reclaim of credit reversed earlier. In other cases interest will be paid @18% p.a. u/s 50 (1).

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