

At the outset and before moving to specific areas which requires reconsideration under Rule 42 and Rule 43, it would be apt to provide that entire scheme of reversal under Rule 42 and Rule 43 should be looked into and it's a very subjective scheme with such gaps wherein a taxpayer would not be able to comply with the provisions either in entirety or without loss of genuinely eligible credit as some of the provisions under Rule 42 and Rule 43 take away genuinely eligible credit of the taxpayer.

1. **5% of Flat reversal of Common credit if any input or input service out of the common credit used for non business purpose:** Presently Rule 42 requires a registered person to arrive at the common credit i.e. inputs and input services which cannot be identified on an invoice level basis that whether they have been used for making taxable supply or exempted supply. At times it is not at all possible to make such distinction.

Now consider an example wherein a person is purchasing wood and consumables from which he is manufacturing goods which are both taxable and exempted from the levy of tax. It is next to impossible for a registered person in such a case to identify which inputs have been used for making taxable supply and which inputs have been used for making exempt supply. In such a case, entire credit becomes common credit for such a registered person.

Rule 42 requires two kinds of reversal for common credit i.e.

a) Reversal of Common credit in the ratio of Taxable and Exempt Turnover

b) 5% Flat Reversal of the entire common credit wherein any input or input services has been used for non business purpose. The term non-business purpose has not been defined under the law. However, as a normal parlance we can define it as a use which is not related to the business. Rule 42 does not lay down any specific limit of the non-business purpose, and uses the language that ***“if common inputs and input services are used partly for business and partly for non-business purposes”***. This is a sweeping language has a very wide ranging implications. Therefore, any non-business use as small as 0.01% of the entire common credit would trigger a reversal of 5% of the entire common credit.

Particulars	Amount
Taxable Turnover	Rs 98 Lakh
Exempted Turnover	Rs 2 Lakh
Total Input Tax Credit	Rs 18 Lakh
Common Credit	Rs 15 Lakh

Say for e.g. one might say that out of the entire common credit of Rs 15 Lakh, a person has a small expenditure of non-business nature under telephone expenses or travelling expenses (which is inherent in such expenditure and cannot be identified on invoice level basis), therefore 5% flat reversal of the entire common credit would have to be made irrespective of any limit. This is a very harsh provision. **The impact of such minuscule use not identifiable at invoice level would result in loss of credit Rs 75 Thousand for the registered person.**

Particulars		Credit Reversal
Reversal in the Ratio of Exempted turnover	15 Lakh/100 Lakh*2 Lakh	30 Thousand
5% Flat Credit Reversal	15 Lakh * 5%	75 Thousand

Suggestion: The rule requires reconsideration as adhoc reversal treating 5% of the entire common input tax credit being used for non business purposes is unparallel and harsh. It is not at all possible in certain areas where both taxable and exempted goods are being manufactured from the common input to identify at the invoice level which input has been used for taxable supplies and which has been for exempted supplies. It has to be borne in mind common Credit includes Input Tax Credit relating to Raw Materials and Input service used in manufacturing of both taxable and exempted goods for which proportionate reversal is already made and now making an additional reversal such goods treating 5% of them as being used in non business purpose is entirely uncalled for.

Thus, in the above background, just because these inputs and input services are part of common credit, it does not mean that wherein any part of common inputs or inputs services has been used for non business purposes, it should trigger flat reversal of 5% of the entire common credit.

This is irrational and taxpayer should be allowed to opt for the input tax credit in respect of which he intends to opt for reversal for non business purpose rather than a 5% flat reversal of common credit.

2. Provision for Flat 5% reversal of common credit results in reversal in excess of common credit:

Consider an example wherein a person in purchasing wood and consumables from which he is manufacturing goods which are both taxable and exempted from the levy of tax. It is next to impossible for a registered person in such a case to identify which inputs have been used for making taxable supply and which inputs have been used for making exempt supply. In such a case, entire credit becomes common credit for such a registered person.

Particulars	Amount
Taxable Turnover	Rs 2 Lakh
Exempted Turnover	Rs 98 Lakh
Total Input Tax Credit	Rs 18 Lakh
Common Credit out of total Input Tax Credit	Rs 15 Lakh

Reversal in such a scenario comes out to be as follows:

Particulars	Credit Reversal (Rs in Lakh)
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Reversal in the Ratio of Exempted turnover	15 Lakh /100 *98	14.70
5% Flat Credit Reversal	15 Lakh * 5%	.75
Aggregate Reversal		15.45

In the above example, reversal is of Rs 15.45 Lakh as against common credit of Rs 15 Lakh. This is an absurd situation wherein total reversal comes out to be Rs 15.45 Lakh as against common credit of Rs 15 Lakh.

Suggestion: The reversal of 5% should be rationalized in place of an adhoc 5% reversal of entire common input and input service regardless of the fact that whether such input and input services have been used for non business purpose.

This is irrational and taxpayer should be allowed to opt for the input tax credit in respect of which he intends to opt for reversal for non business purpose rather than a 5% flat reversal of common credit and if at all reversal of 5% is kept under the law on the common credit then , reversal of 5% should be made on the credit left after deducting reversal of inputs credit used for exempt supplies, rather than on the entire common credit.

3. Need to Rationalize provision for Reversal of Input Tax Credit under Rule 42 wherein input or input services purchased in one financial year have been used for exempted /taxable supply in the next financial year:

The law prescribes the procedure wherein entire input tax credit in a particular financial year has to be reversed in the ratio of exempted supply as against total turnover during the financial year.

Now supposedly, a person has made a purchase of Rs 20 Lakh in the year 2017-18 out of which exempted sales of Rs 10 Lakh were made during 2017-18 and rest of the material was in hand as on 31st March 2018. The raw material was used in manufacturing and supply of taxable goods in 2018-19.

In the present scenario, law requires reversal of common credit in the year when the input or input services are received. Therefore, in the year 2017-18, entire input credit of the registered person would be reversed as entire sales during the year 2017-18 was of exempted goods. The registered person would not be able to utilize the credit of such inputs in 2018-19 in which taxable supplies have been made although from the use of input and input services received in the year 2017-18.

Now taking the reverse case scenario, wherein a person has made a purchase of Rs 20 Lakh in the year 2017-18 out of which taxable sales of Rs 1 Lakh were made during 2017-18 and rest of the material was in hand as on 31st March 2018. The raw material was used in manufacturing and supply of exempted goods in 2018-19.

In the present scenario, law requires reversal of common credit in the year when the input or input services are received. Therefore, in the year 2017-18, no input credit would be reversed as entire sales during the year 2017-18 was of taxable goods. The registered person would be able to carry forward entire credit of such inputs in 2018-19 in which exempted supplies have been made although from the use of input and input services received in the year 2017-18 as law prescribes under section 17(2) read with rule 42 for reversal of input tax credit during the financial year and not beyond the particular financial year.

Suggestion: There is a need to rationalize Rule 42 with a view to allow credit in genuine cases and disallow credit wherein input or input services purchased in one financial year have been used for exempted supply in the next financial year.

4. Exempted and Aggregate Turnover to be considered for the purpose of Input Tax Credit Reversal under Rule 42 and Rule 43

Consider that a taxpayer has two units in the same state under same GSTIN and he maintains two separate books of accounts for the units. The turnover and other details of the two units is as follows:

Particulars	Unit-1	Unit-2	Aggregate
Taxable Turnover	-	100 Lakh	100 Lakh
Exempted Turnover	100 Lakh	100 Lakh	200 Lakh
Total Credit (A)	15 Lakh	15 Lakh	30 Lakh
Specifically Allowable Credit (B)	-	5 Lakh	5 Lakh
Specifically Disallowed Credit (C)	15 Lakh	-	15 Lakh
Common Credit ((A)-(B+C))	Nil	10 Lakh	10 Lakh

Now for the purpose of reversal of the Input Tax Credit for the purpose of Rule 42 (and in case of capital goods Rule 43), exempted turnover would be considered that of GSTIN rather than of Unit-2 only wherein there both supply of exempted and taxable goods and entire credit of Unit-1 has already been reversed by the taxpayer. Therefore Reversal which would have been 5 Lakh (i.e. $10 \text{ Lakh} \times 100 \text{ Lakh} / 200 \text{ Lakh}$) considering turnover of Unit-2 only would increase to Rs 6.67 Lakh considering aggregate turnover of GSTIN for the purpose of reversal of Input Tax Credit (i.e. $10 \text{ Lakh} \times 200 \text{ Lakh} / 300 \text{ Lakh}$).

Suggestion: The provision for reversal requires reconsideration and registered person should be allowed to reverse the credit on exempted turnover for a particular unit if separate accounts have been maintained rather than considering the turnover of the entire GSTIN.

5. Interest to be paid for reversal of Input Tax Credit under Rule 43 of CGST Rules, 2017:

A Registered person can claim Input Tax credit of Tax paid on purchase of capital goods in the month when the capital goods are received. Subsequently, Input Tax Credit is required to be reversed on a monthly basis for the next sixty months if the capital goods are used for the purpose of supply of exempted goods as well as taxable goods. The rule provides that on such reversal being made for every month during the period of sixty months, registered person would be liable to pay applicable Interest for the reversal made from the date of availment of input tax credit.

This is a very harsh provision and requires reconsideration. The registered person has claimed credit of tax paid on receipt of capital goods as per the provisions of CGST Act, 2017 and at the time of purchase he does not know whether and how much he would be using the capital goods in the supply of capital goods. If the credit has to be reversed, it is because of circumstances which were not known to him at the time of availment of Input Tax Credit. Thus the provision to burden him with additional liability of interest for reversal requires reconsideration. Further the language of the provision does not make any distinction for the liability of interest between the cases wherein the registered person was able to adjust entire input tax credit against the output tax liability or in cases wherein, the excess balance was lying in his electronic ledger and he was not able to adjust any part of the credit of the capital goods.

Suggestion: The provision regarding payment of Interest on the reversal of credit on capital goods requires reconsideration and should be done away with as the registered person does not know at the time of availment of credit regarding the quantum of the capital goods to be used for taxable or exempt supplies and if the taxpayer does not reverse the credit on capital goods as per procedure laid down in Rule 43, then applicable interest should be paid but from the date when the reversal was required to be made rather than from the date when the credit was availed.