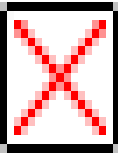


**ITC on inward supplies used exclusively for exempted outward supplies**

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**1. RULE**

6(1) of erstwhile Cenvat Credit Rules, 2004, prescribed that CENVAT credit shall not be allowed on such quantity of input or input services as is used in or in relation to the manufacture of exempted goods or for provision of exempted services. In other words, inputs or input services, which were EXCLUSIVELY used or to be used for provision of exempted activities, Cenvat Credit was not allowed to be taken. I could not find equivalent provision applicable in GST regime. It appears that there is no provision which prescribes that input tax credit (ITC) should not be taken **ab initio**

or to be reversed later, in respect of inputs and input services, which are EXCLUSIVELY / WHOLLY used or to be used in provision of exempted outward supply (other than zero rated supply).

2. Section 16(1) of the CGST Act prescribes that every registered person, subject to conditions and restrictions, are entitled to take credit of input tax charged on any supply of goods or services which are intended to be used in the course or furtherance of his BUSINESS. The definition of the term 'business' as given in Section 2(17) does not prescribe that it should be taxable or chargeable to GST.

3. Now, the question arises, if a registered person engages in a business which is taxable and another business which is exempt from payment GST, whether he can take ITC on the inputs and input services, which are EXCLUSIVELY used in course of exempt business or exempt outward supply.

4.1. Rule 42 of the CGST Rules, 2017, prescribes the manner for determination of input tax credit in respect of INPUTS and INPUT SERVICES and reversal thereof. Whereas, Rule 43 prescribes the manner for determination of input tax credit in respect of CAPITAL GOODS and reversal thereof. Rule 43(1)(a) of the CGST Rules, 2017, prescribes that the amount of input tax in respect of CAPITAL GOODS used or intended to be used EXCLUSIVELY for non-business purposes or for effecting exempt supplies shall be indicated in Form GSTR-2 and Form GSTR-3B and SHALL NOT BE CREDITED to his electronic credit ledger. However, there is no similar provision in respect of INPUTS and INPUT SERVICES in Rule 42.

4.2 Provisions of Rule 42(1) of the CGST Rules read with Section 17(1) & 17(2) of the CGST Act are applicable for inputs or input services, being PARTLY used for business and partly for other purposes, or partly used for taxable supplies (including zero rated) and partly for exempt supplies. These provisions provide for restriction, determination and (proportionate) reversal of ITC to the extent inputs and input services PARTLY used for non-business or exempt supplies. These provisions are not applicable to the inputs and input services EXCLUSIVELY / WHOLLY used for effecting exempt outward supplies.

5.1 In the Cenvat regime, the definition of the term "**input service**", as given in Rule 2(l) of the CCR, 2004, was including '**activities relating to business**', prior to 01.04.2011. Due to the phrase '**activities relating to business**', there was a strong view to the effect that Cenvat credit of all input services should be admissible irrespective of the fact whether such input services have nexus with provision of taxable output service or dutiable final product. Perhaps due this reason, the phrase '**activities relating to business**' has been removed from the definition of the term "**input service**" , as substituted w.e.f. 01.04.2011 vide Notification No. [3/2011-CE \(NT\)](#) dated 01.03.2011.

5.2. In GST regime, Section 16(1) prescribes entitlement of Input Tax Credit on any supply which are used or intended to be used **in course or furtherance of business** , without prescribing that such business should be taxable. In absence of any explicit provision for denial of ITC on inputs and input services

used or to be used EXCLUSIVELY in exempt business (other than zero rated supplies), litigations on this issue are bound to arise.

6. Another question may arise that what would be use of such ITC, when outward supply is exempt. When domestic outward supply is exempt, refund of such unutilised ITC is not admissible, as per first proviso to Section 54(3) of the CGST Act. However, when any ITC has been taken legitimately, it can be accumulated and utilised in future for payment of GST of any taxable outward supply, irrespective of whether the inputs or input services on which ITC has been taken has any nexus with that particular outward supply. In other words, no one to one correlation is required to be proved for inputs and input services with outward supply for the purpose of utilization of ITC. Thus, it is felt that ITC validly taken on any inputs and input services can be utilized for payment of GST on any taxable outward supply.

7. In Central Excise regime, Cenvat credit on inputs and input services used in EXPORT of exempt final product and exempt output service was not allowed to be taken (Instead, there was a mechanism to allow refund of duty or service tax paid on such inputs and input services). Whereas, in GST regime, even if the exempt output supply is exported, it qualifies as ZERO RATED supply; and ITC on inputs and input services used for such zero rated supply is admissible [Section 16(2) of IGST Act refers]. So, if a person is supplying exempted goods domestically and as zero rated supply, it may not be possible for him to identify at the time of receipt of inputs as to how much quantity inputs would be used for domestic supply and how much for zero rated supply. Probably due to this reason, the statutory provisions do not prohibit taking of ITC on inputs and input services meant for use in exempt outward supply, which may be exported as zero rated supply. However, it appears that suitable provisions prescribing reversal of ITC, if the inputs and input services are exclusively used in domestic exempt supplies are missing.

8. When statute provides for reversal of ITC attributable to inputs and input services partly used for exempt supplies, there could not be any intention of law makers to allow input tax credit on inputs and input services used exclusively/wholly for provision of exempt outward supplies (other than zero rated supplies). In view of the above discussion,

**it is felt that suitable amendment in statutory provisions is required so that input tax credit on inputs and input services exclusively meant/used for provision of exempt outward supply (other than zero rated supply) cannot be taken or is required to be reversed.**

**(The views expressed by the author are strictly his personal views.)**

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