GSTZONE

Input Tax Credit

Input tax credit: the money, and the risk

The complete guide, plus all 19 sections and rules

Text sourced from the Central Board of Indirect Taxes and Customs

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A Khemchandani Finance initiative

Start here

Input tax credit is the reason GST does not become a tax on a tax. You pay GST on what you buy, charge GST on what you sell, and hand over only the difference. For most businesses the credit is worth more than the profit margin - which is exactly why the law surrounds it with conditions.

Section 16(2) sets five conditions, and they are cumulative. Fail any one and the credit fails entirely: you must hold the invoice, the supplier must have reported it, it must not be restricted in your GSTR-2B, the tax must actually have reached the government, and you must have filed your return.

Two further rules catch people out. You must pay your supplier within 180 days or reverse the credit with interest. And the claim itself expires - 30 November following the financial year, or the date you file the annual return, whichever comes first.

A worked example

What a supplier's default actually costs you

You buy goods worth ₹10,00,000 + 18% GST	**₹1,80,000 credit claimed**	Invoice is genuine, goods received
Supplier never files his GSTR-3B	**Condition 16(2)(c) fails**	Tax never reached the government
Rule 37A reversal by 30 November next year	**₹1,80,000 reversed, plus interest**	Re-claimable only if he eventually files

> **The point:** You did nothing wrong and still lost ₹1.8 lakh of working capital. This is why checking a new supplier's filing history is not paranoia - it is basic commercial diligence.

The mistakes that cost people money

- Claiming from your purchase register instead of GSTR-2B. The register is what you think you bought; 2B is what the law will actually let you claim.
- Forgetting the 180-day payment rule on a supplier you are in dispute with. The credit reverses with interest whether or not the dispute is your fault.
- Filing the annual return early. It closes your own window to claim any credit you later discover you missed for that year.

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Every provision, explained

SECTION 16 · CGST ACT, 2017

Eligibility and conditions for taking input tax credit

You can claim input tax credit on business inputs/services/capital goods only if you hold the invoice, the supplier has filed it (so it shows in your GSTR-2B), it isn't restricted there, the tax is actually paid to government, and you filed your return. Pay the supplier within 180 days or reverse with interest. Claim by 30 November of the next financial year.

- Section 16(2) conditions are cumulative and the credit fails if any one fails: invoice held, supplier filed it (16(2)(aa)), not restricted in GSTR-2B (16(2)(ba)), tax actually paid to Government (16(2)(c)), and return filed.
- The 16(2)(c) condition - tax actually paid by the supplier - is the department's usual ground for reversal. The taxpayer's answer is that he cannot police the supplier; several High Courts have read it down where the buyer proves genuine receipt and payment, but there is no Supreme Court ruling yet, so treat a 16(2)(c) demand as contestable, not hopeless.
- The 180-day rule in the second proviso is on VALUE PLUS TAX, not just tax, and reversal carries interest under s.50. Re-avail in the month you actually pay - there is no time bar on re-availment.
- 16(4) bar: 30 November following the financial year, or the annual return, whichever is earlier. It applies to the DEBIT NOTE by its own date since 01-01-2021, not by the date of the original invoice.
- 16(5) is retrospective relief for FY 2017-18 to 2020-21 - credit taken in any return filed up to 30-11-2021 is protected. 16(6) protects credit where registration was cancelled and later revoked. Both were inserted by the Finance (No.2) Act 2024; a demand raised on 16(4) alone for those years should be met with 16(5).

SECTION 17 · CGST ACT, 2017

Apportionment of credit and blocked credits

Credit is limited to business and taxable (including zero-rated) use; the exempt/personal part is reversed. Some credits are permanently blocked (s.17(5)): most passenger motor vehicles, food and catering, club/health/insurance, works-contract and construction of immovable property on own account, CSR spends, composition supplies, personal use, and goods lost/stolen/gifted. Banks/NBFCs may opt for a flat 50% credit.

- 17(5)(d) - construction of immovable property on own account - was the subject of Safari Retreats (SC, 03-10-2024), which allowed credit where the building is 'plant'. The Finance (No.2) Act 2025 inserted Explanation 2 substituting 'plant or machinery' with 'plant and machinery' RETROSPECTIVELY from 01-07-2017, which nullifies the judgment. Do not advise on the strength of Safari Retreats.
- CSR spends are blocked by 17(5)(fa) with effect from 01-10-2023. Credit on CSR before that date is arguable; after it, it is not.
- Motor vehicles: the block is on passenger vehicles of seating capacity up to thirteen persons. Goods carriages, and vehicles used for further supply, passenger transport or driving instruction, remain eligible - the seating-capacity test is where most notices go wrong.
- The exempt-supply reversal under 17(2) is computed monthly under Rule 42 (inputs and input services) and Rule 43 (capital goods, over 60 months), with a final annual reconciliation by 30 November and interest on any short reversal.
- Banks and NBFCs choosing the 50% option under 17(4) cannot change the choice during the year, and the restriction does not apply to supplies from a distinct person.

SECTION 18 · CGST ACT, 2017

Availability of credit in special circumstances

Special-circumstance credit: you can claim ITC on stock (and capital goods, reduced) when you newly register, register voluntarily, exit composition, or when an exempt supply becomes taxable - claimed within one year of the invoice. On sale/merger/demerger, unutilised ITC transfers to the new entity. On opting into composition or becoming wholly exempt, you must reverse ITC on stock and capital goods.

- The claim is made in FORM ITC-01 within thirty days of becoming eligible, and a chartered or cost accountant's certificate is required where the claim exceeds two lakh rupees (Rule 40).
- Credit on capital goods under 18(1) is reduced by five per cent per quarter (or part) of use before the eligibility date.
- 18(2) bars any 18(1) claim on an invoice older than one year from the date of the invoice - a hard limit separate from 16(4).
- On transfer of business under 18(3) the credit moves through FORM ITC-02, which needs a specific provision for transfer of liabilities and a practising accountant's certificate; on a demerger the credit is split in the ratio of the value of assets.
- 18(6) on sale of capital goods: pay the HIGHER of the credit taken reduced by five per cent per quarter of use, or the tax on the transaction value.

SECTION 19 · CGST ACT, 2017

Taking input tax credit in respect of inputs and capital goods sent for job work

A principal can take ITC on inputs and capital goods sent to a job worker, even if sent directly to the job worker. If inputs are not returned or supplied within one year (capital goods three years), it is treated as a supply by the principal on the date sent. Moulds, dies, jigs, fixtures and tools are outside these time limits.

- The one-year and three-year clocks run from the date the goods are SENT OUT, or from the date the job worker receives them where they are sent directly to him.
- If the goods do not come back in time it is deemed a supply on the day they were sent out - which means tax plus interest from that earlier date, not from the expiry of the period.
- Procedure sits in Rule 45: delivery challan, job-work register, and FORM ITC-04 half-yearly where turnover exceeds five crore rupees and annually below it.
- Moulds, dies, jigs, fixtures and tools sent to a job worker are outside the time limits altogether.

SECTION 20 · CGST ACT, 2017

Manner of distribution of credit by Input Service Distributor

An Input Service Distributor (ISD) is an office that receives invoices for common input services used across multiple GST registrations of the same PAN and distributes that credit to them. Since 1 April 2025 ISD registration is MANDATORY for such common-service credit (including reverse-charge services), no longer optional.

- ISD registration became MANDATORY from 01-04-2025 (Finance (No.8) Act 2024 read with the amended s.2(61) and s.20). Common input services can no longer be distributed by a cross-charge invoice instead of an ISD.
- Since 01-04-2025 the ISD also distributes credit on reverse-charge services received for common use - the ISD raises a self-invoice under the amended Rule 39.
- Distribution is monthly in FORM GSTR-6 by the thirteenth, in the ratio of the recipients' turnover in the previous financial year, keeping central, State, integrated and cess credit separate.
- ISD and cross-charge are different things: an ISD distributes credit on THIRD-PARTY invoices; cross-charge is a supply of service by one distinct person to another and carries its own tax. A head office doing both needs two mechanisms.

SECTION 21 · CGST ACT, 2017

Manner of recovery of credit distributed in excess

If an Input Service Distributor distributes credit in excess of, or contrary to, section 20, that excess is recovered from the recipients with interest, using the demand machinery of sections 73/74 (and, from FY2024-25, section 74A).

- Recovery is from the RECIPIENT of the excess credit, not from the ISD, and it carries interest.
- For periods up to FY 2023-24 the demand runs under section 73 or 74; from FY 2024-25 the single section is 74A.

RULE 36 · CGST RULES, 2017

Documentary requirements and conditions for claiming input tax credit

Documents on which credit may be taken: the supplier's tax invoice, a debit note, a bill of entry, an ISD invoice, or the self-invoice for reverse charge. Credit is available only to the extent the invoice appears in your GSTR-2B, and no credit is allowed on a document where the tax was paid after detection of fraud or detention of goods.

- Sub-rule (4) - the old 5 per cent provisional-credit cushion - is spent: since 01-01-2022 credit is limited strictly to what appears in GSTR-2B, with no tolerance.
- Credit needs the document AND the supply: an invoice in 2B does not by itself prove receipt, and section 155 puts the burden on the claimant.
- No credit on a document where the tax was paid only after detection under sections 74, 129 or 130.

RULE 37 · CGST RULES, 2017

Reversal of input tax credit in the case of non-payment of consideration

Credit reversal on non-payment: where you have not paid the supplier the value plus tax within 180 days of the invoice, the credit is added to your output liability with interest under section 50; you re-avail it in the month you pay. It does not apply to reverse-charge supplies or to deemed supplies without consideration.

RULE 37A · CGST RULES, 2017

Reversal of input tax credit in the case of non-payment of tax by the supplier and re-availment thereof

Where the supplier did not pay the tax by 30 September following the year of the invoice, the recipient must reverse that credit by 30 November of that year, with interest if he does not; it can be re-availed once the supplier actually pays.

- The annual reversal check: if the supplier has not filed GSTR-3B for the period by 30 September following the year of the invoice, the recipient must reverse the credit by 30 November of that year.
- Re-availment is allowed in any return once the supplier files - there is no time bar on the re-availment.
- Build the check into the October compliance calendar; a reversal made after 30 November carries interest.

RULE 38 · CGST RULES, 2017

Claim of credit by a banking company or a financial institution

A bank or financial institution that opts for the 50 per cent scheme under section 17(4) takes only half of the eligible credit each month; credit on inward supplies from a distinct person is not restricted, and the choice cannot be changed during the year.

RULE 39 · CGST RULES, 2017

Procedure for distribution of input tax credit by Input Service Distributor

How an Input Service Distributor distributes credit: month by month, in FORM GSTR-6, in the ratio of the recipients' turnover in the previous year, keeping central, State, integrated and cess credit separate, with the ineligible portion distributed too but marked as such. Mandatory since 1 April 2025.

RULE 40 · CGST RULES, 2017

Manner of claiming credit in special circumstances

Credit in special circumstances under section 18(1) - on becoming liable to register, on voluntary registration, on leaving composition, or when an exempt supply becomes taxable: declare the stock in ITC-01 within thirty days, with a chartered accountant's certificate where the claim exceeds two lakh rupees; credit on capital goods is reduced by five per cent per quarter of use.

RULE 41 · CGST RULES, 2017

Transfer of credit on sale, merger, amalgamation, lease or transfer of a business

On sale, merger, demerger, amalgamation, lease or transfer of a business, the unutilised credit may be transferred by filing ITC-02, provided the transfer is with a specific provision for the transfer of liabilities and is certified by a practising chartered or cost accountant; on a demerger, credit is apportioned in the ratio of the value of assets.

RULE 41A · CGST RULES, 2017

Transfer of credit on obtaining separate registration for multiple places of business within a State or Union territory

Where a person takes a separate registration for another place of business in the same State, unutilised credit is transferred to it in ITC-02A within thirty days, in the ratio of the value of assets held.

RULE 42 · CGST RULES, 2017

Manner of determination of input tax credit in respect of inputs or input services and reversal thereof

The reversal formula for inputs and input services used partly for business and partly for other purposes, or partly for taxable and partly for exempt supplies: common credit is apportioned month by month on the exempt-to-total turnover ratio, with a final annual reconciliation by 30 November of the following year and interest on any short reversal.

- The annual true-up must be done by 30 November following the year; short reversal carries interest from 1 April of the following year.
- 'Exempt supply' for the formula includes reverse-charge outward supplies, transactions in securities, sale of land and sale of completed buildings - values often missed in the ratio.
- Interest is payable on excess credit reversed late, and excess reversal can be reclaimed in the annual computation.

RULE 43 · CGST RULES, 2017

Manner of determination of input tax credit in respect of capital goods and reversal thereof in certain cases

Capital-goods credit used partly for exempt or non-business purposes is spread over sixty months; the exempt share is worked out month by month on the turnover ratio and added to output tax with interest. Where a capital good moves from exclusively exempt to common use, credit is taken after reducing five per cent per quarter of use.

- Capital-goods credit is tracked over sixty months from the invoice date; a change in use from exclusively taxable to common use, or the reverse, has to be tracked asset by asset.
- Keep a capital-goods register with the date, credit taken, months elapsed and use - reconstructing it during an audit is where most disputes are lost.

RULE 44 · CGST RULES, 2017

Manner of reversal of credit under special circumstances

Reversal on cancellation of registration or on shifting to composition: reverse the credit on inputs in stock and in semi-finished and finished goods on the invoice value, and on capital goods on the residual life taken as sixty months. The amount goes in REG-16 or ITC-03, and a chartered accountant's certificate is needed where invoices are not available.

RULE 44A · CGST RULES, 2017

Manner of reversal of credit of Additional duty of Customs in respect of Gold dore bar

A one-time rule for gold dore bars: the transitional CENVAT credit of additional customs duty had to be reversed to the extent of five-sixths when the gold was supplied.

RULE 45 · CGST RULES, 2017

Conditions and restrictions in respect of inputs and capital goods sent to the job worker

Job work: goods go out on a delivery challan, are entered in the job-work register, and must come back within one year for inputs or three years for capital goods (moulds, dies, jigs and fixtures are outside the limit); ITC-04 is filed half-yearly above five crore turnover and annually below it. Goods not returned in time are treated as a supply on the day they were sent out.

When you need more than a guide

This document tells you what the law says. It cannot tell you what it means for your specific numbers, your notice, or your year - and that is usually where the money is.

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