

Input Tax Credit (ITC) under GST Explained with Examples | Beginner's Guide for Students

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Introduction

Input Tax Credit (ITC) is one of the fundamental and most beneficial concepts under the Goods and Services Tax (GST) regime. It allows taxpayers to claim credit for the GST paid on purchases (inputs, input services, and capital goods) which can be used to set off against GST payable on outward supplies.

This blog aims to simplify ITC for students by explaining its meaning, eligibility, restrictions, and practical examples to clarify the provisions.

1. What is Input Tax Credit (ITC)?

ITC is the credit that a registered person can claim for the tax paid on purchases of goods, services, or both which are used for the purpose of business.

Under GST, the cascading effect of taxes (tax on tax) is removed by allowing ITC. The tax paid at each stage is available as a credit at the next stage, reducing the overall cost burden.

2. What Are Inputs, Input Services, and Capital Goods?

Category	Meaning
Input	Goods other than capital goods used or intended to be used in business.
Input Services	Services used or intended to be used in the course or furtherance of business.
Capital Goods	Goods capitalized in books of account and used in business.

There is **no distinction between input and capital goods** for claiming ITC under GST. Full ITC is allowed on capital goods in the year of purchase without any restriction.

3. Conditions for Availing ITC

- Goods/services/capital goods must be used **for the purpose of business**.
- The recipient must be a **registered person under GST**.
- **Invoice or debit note** must be available as proof.
- **Goods/services must be received**.

- Supplier must have paid **tax to the government**.
- ITC must be **claimed within the time limit** prescribed under section 16(4).

4. State-wise Registration and ITC

- GST is divided into:
 - **IGST** (Inter-State transactions)
 - **CGST + SGST/UTGST** (Intra-State transactions)

There is **no centralized GST registration**. A business must obtain separate registration in each state where it operates.

ITC is state-specific, which means:

ITC availed in one state **cannot be used** to pay output tax liability in another state.

5. Reverse Charge Mechanism (RCM) and ITC

Under RCM, the **recipient** of goods/services is liable to pay GST.

- GST paid under RCM is **eligible for ITC** if:
 - The goods/services are used for business.
 - The tax is paid and reflected in GSTR-2B.

6. Composition Scheme and ITC Restriction

- **Taxpayers under the Composition Scheme** cannot collect GST and also **cannot avail ITC** on inward supplies.
- Similarly, if goods/services are purchased from a composition dealer, **ITC is not available**.

7. Cross-Utilization of ITC (Set-Off Rules)

ITC Type	Can Be Used To Pay	Cannot Be Used To Pay
IGST	IGST → CGST → SGST	—
CGST	CGST → IGST	SGST
SGST	SGST → IGST	CGST

These rules ensure proper allocation of tax revenue between Centre and States.

8. When ITC is Not Available

ITC is **not available** in the following cases:

- If GST is **not payable** on outward supply (i.e., supply is **exempt**).
- If goods/services are used for **personal purposes**.
- If goods/services are used for **non-business purposes**.

9. Zero Rated Supplies vs Exempt Supplies

Zero Rated Supplies:

- Export of goods/services.
- Supplies made to Special Economic Zone (SEZ).

These are **tax-free** supplies, but **ITC is allowed** and **refund can be claimed** under Rule 89.

Exempt Supplies:

- Supplies on which GST is not leviable or NIL rate.
- **ITC is not allowed** on inputs/services used for exempt supplies.

10. Practical Example: X Ltd. Case Study

X Ltd. manufactures electric detonators and supplies both domestically and exports.

Details:

- **Domestic Supply:** 10,000 pieces @ ₹120 to Y Ltd. (Kerala)
- **Export Supply:** 25,000 pieces @ ₹140 to A Inc. (Holland)
- **GST Rate:** 18%
- **Input Tax Credit Available:**
 - Situation 1: ₹1,50,000
 - Situation 2: ₹2,90,000

Tax Computation:

Particulars	Situation 1 ₹	Situation 2 ₹
IGST on Domestic Sale	2,16,000	2,16,000
GST on Export	Nil	Nil
Total Output Tax	2,16,000	2,16,000
Less: ITC Available	1,50,000	2,90,000

Particulars	Situation 1 ₹	Situation 2 ₹
GST Payable in Cash	66,000	Nil
Refund Claimable (on exports)	Nil	74,000

Conclusion:

Exports are **zero-rated**. GST is not charged, but **ITC is available** and **refund can be claimed**.

11. Proportionate Reversal of ITC

If inputs or capital goods are used for both **taxable and exempt supplies**, a proportionate amount of ITC must be **reversed** as per formula under GST Rules.

12. ITC on Waste and By-Products

- **Full ITC is allowed** even if part of input results in:
 - Waste
 - Scrap
 - By-products like sludge (non-taxable)

13. Timing of Claiming ITC

- ITC can be claimed **once goods/services are received**.
- It is **not necessary to wait** till goods are used or sold.
- All ITC forms a **common pool**, which can be used as per set-off rules.

14. Definition of “Input Tax” [Section 2(62)]

Input Tax includes:

- CGST, SGST, IGST, UTGST on purchases
- IGST on import of goods
- Tax payable under RCM

But does not include tax paid under Composition Scheme.