Chapter-2
Transitional Credit Under GST

Chapter 2: Transitional Credit Under GST

State Taxes and Excise Department

2.1 Introduction

Goods and Services Tax is a significant reform in the field of indirect taxes in our country, which replaced multiple taxes levied and collected by the Centre and States. GST is a destination-based tax on supply of goods or services or both, which is levied at multi-stages wherein the taxes will move along with supply. To ensure the seamless flow of input tax from the existing laws to GST regime, a 'Transitional arrangements for input tax' was included in the GST Acts to provide for the entitlement and manner of claiming input tax in respect of appropriate taxes or duties paid under existing laws. Transitional credit provisions are important for both the Government and business. For business, the transitional credit provisions ensure transition of accumulated credits from the legacy returns, input tax in respect of raw materials, work in progress, finished goods held in stock as on the appointed day as well as credit in respect of capital goods into the GST regime. The provisions enable taxpayers to transfer such input credits only when they are used in the ordinary course of business or furtherance of business. Section 140 of the CGST Act 2017 (and SGST Acts/ UTGST Acts) enables the taxpayers to carry forward the Input Tax Credit (ITC) earned under the existing laws to the GST regime. The section, read with Rule 117 of CGST Rules 2017, prescribes elaborate procedures in this regard. All registered taxpayers, except those who are opting for payment of tax under composition scheme (under section 10 of the Act), are eligible to claim transitional credit by filing TRAN 1 returns within 90 days from the appointed day. The time limit for filing TRAN 1 returns was extended initially till 27.12.2017. The due date for filing TRAN 1 was further extended to 31.03.2020, vide CBIC order No.01.2020-GST dated 07.02.2020, for those taxpayers who could not file TRAN 1 due to technical difficulties and those cases recommended by the GST Council.

2.2 Audit objectives

The audit of transitional arrangements for input tax credit under GST was taken up with the following audit objectives:

i. Whether the mechanism envisaged by the Department for selection and verification of transitional credit claims was adequate and effective.

ii. Whether the transitional credits carried over by the assesses into the GST regime were valid and admissible.

2.3 Audit Criteria

The criteria against which the audit objectives and sub-objectives are to be verified are as under:-

i. The provisions of Section 140 of the CGST Act 2017 and SGST Act 2017 read with Rules 117 of the CGST Rules 2017 and SGST Rules 2017,

ii. Notifications/Circulars issued by CBIC, Himachal Pradesh State Government Tax Department and relevant instructions issued by the CBIC field formations.

2.4 Audit Scope and Methodology

The audit of Transitional credit claim involved scrutiny of returns, TRAN 1 and TRAN 2, filed by the taxpayers under the transitional arrangements for input tax provided for under Section 140 of the GST Act. Audit verification involves the scrutiny of process and outcomes of departmental verifications along with detailed independent verification of selected claims in 13 Revenue districts in the State.

2.5 Sample Selection

A sample of 592 cases (73 *per cent* of the cases *i.e.*, 431 were from ITC category 5C) covering high-risk cases pertaining to major industrial hubs/economic centres of the State were selected for audit. The Revenue district wise detail of sample selection is as under:

Bilaspur 20, Chamba nine, Hamirpur 50, Kangra 78, Una 47, Shimla 76, Sirmour 53, Baddi 128, Kullu 22, Mandi 42, Solan 67.

2.6 Results of Audit

A sample of 592 cases were test checked across 11 divisions of Himachal Pradesh State Commissionerate during 2020-21. Test checks of these cases revealed various irregularities under following categories as depicted below in **Table-2.1**:

Table-2.1: Results of Audit

Sr. No.	Nature of Audit Observation (indicative only)	Audit Sample		Number of deficiencies noticed	
		Number	Amount in lakh	Number	Amount in lakh
1.	Excess carry forward of input tax credit	431	7,865.5	79	1,247.00
2.	Excess claim of Transitional Credit due to mismatch between Annual and Quarterly returns	592	16,550.69	22	149.91
3.	Irregular claim of transitional credit without filing TRAN-2	592	16,550.69	6	38.29
4.	Irregular availing of transitional credit without filing the ER-1/ST-3 returns	431	7,865.5	7	52.71

Sr. No.	Nature of Audit Observation (indicative only)	Audit Sample		Number of deficiencies noticed	
		Number	Amount in lakh	Number	Amount in lakh
5.	Irregular claim of transitional credit on goods in stock without duty paid documents	38	636.85	1	9.88
6.	Excess carry forward of Input tax credit on account of capital goods	25	2,441.05	1	9.42

Significant cases have been detailed in following paragraphs:

2.7 Audit Observations

On the examination of records of Transitional Credit cases in eleven Commissionerates, certain deficiencies were noticed which are as under:

2.7.1 Excess carry forward of Input Tax Credit of ₹ 1,247.00 lakh

As per Section 140(1) of the CGST Act 2017and SGST Act, 2017, a registered person, other than a Composition taxpayer, is entitled to take, in his Electronic Credit Ledger, the amount of VAT credit carried forward in the return relating to the period up to 30 June 2017, furnished under the existing law by filing TRAN 1 return within 90 days from the appointed day. The registered person shall not be allowed to take the credit unless the said credit was admissible as VAT Credit under the existing law (HP VAT Act 2005) and is also admissible as ITC under CGST Act, 2017.

During audit of 11 divisions of HP State Commissionerate, it was noticed that in 79 cases[1] out of 431 selected Transitional Credit cases, transitional credit had been carried forward in TRAN-1 (under Table 5C) in excess than claimed in the last legacy return of June 2017. This resulted in excess carried forward transitional credit of ₹ 1247.00 lakh as per detail attached in **Appendix-2.1**.

This has resulted in non-observance of the provisions of Section 140 of the CGST Act 2017 and SGST Act, 2017.

On this being pointed out (March & April 2021), the DCST&Es concerned stated (March & April 2021) that the cases of carry forward of transitional credits would be examined as per applicable GST Act at the time of assessment of cases.

2.7.2 Excess claim of Transitional Credit amounting to ₹ 149.91 lakh due to mismatch between Annual and Quarterly returns

As per Section 140(1) of the CGST Act 2017 and SGST Act, 2017, a registered person, other than a Composition taxpayer, is entitled to take, in his Electronic Credit Ledger, the amount of VAT credit carried forward in the return relating to the period up to 30 June 2017, furnished under the existing law by filing TRAN 1 return within 90 days

[1] Chamba one, Hamirpur three, Una nine , Kangra four, Dharmshala two, Nurpur two, Palampur four, Shimla 11, Sirmaur nine, Baddi 21, Kullu two, Mandi two and Solan nine.

from the appointed day. The registered person shall not be allowed to take the credit unless the said credit was admissible as VAT credit under the existing law (HP VAT Act 2005) and is also admissible as ITC under CGST and SGST Act, 2017.

During audit of 11 divisions of HP State Commissionerate, it was noticed in 22 cases[2] out of 592 selected Transitional credit cases, that the ITC balance shown in the Annual and the Quarterly/ Monthly returns was different. In 21 cases, ITC carried forward in Quarterly return and TRAN 1 was higher than ITC carried forward in the Annual return and in one case, ITC carried forward in Annual return and TRAN 1 was higher than ITC carried forward in Quarterly Return. Thus, the ITC carried forward figures of Annual/Quarterly return do not match with the figures of TRAN-1. This resulted in excess ITC claimed as transitional credit in TRAN 1 amounting to ₹ 149.91 lakh in comparison to the Annual/Quarterly returns as detailed in **Appendix-2.2**.

On this being pointed out (March & April 2021), the DCST&Es concerned stated (March & April 2021) that these cases will be examined as per applicable GST Act.

2.7.3 Irregular claim of transitional credit without filing of TRAN-2 ₹ 38.29 lakh

As per the proviso under Section 140(3) of the CGST Act 2017 and SGST Act, 2017 and Rule 117 (4) of the CGST Rules 2017 and SGST Rules, 2017 TRAN 2 can be filed by the dealer who does not have a VAT invoice for stock held by them on 30 June 2017 to claim tax credit on stock.

During audit of 11 divisions of HP State Commissionerate, it was noticed that in six cases[3] out of 592 selected Transitional Credit cases, no TRAN 2 return was available on the GSTN portal but transitional credit amounting to ₹ 38.29 lakh had been claimed in GSTR 9 (annual return) without filing TRAN 2 which was irregular, the details of which are attached in **Appendix-2.3**.

On this being pointed out (March & April 2021), the DCST&Es concerned stated (March & April 2021) that these cases will be examined as per applicable GST Act.

This resulted in non-observance of the provisions of Section 140 of the CGST and SGST Act, 2017.

2.7.4 Irregular carry forward of ITC without filing Annual Return of ₹ 52.71 lakh

As per Section 140(1) of the CGST Act 2017 and SGST Act, 2017, a registered person, other than a Composition taxpayer, is entitled to take, in his Electronic Credit Ledger, the amount of VAT credit carried forward in the return relating to the period up to 30 June 2017, furnished under the existing law by filing TRAN 1 return within 90 days from the appointed day.

2 Chamba one, Bilaspur two, Una four, Kangra four, Nurpur one, Dharmshala two, Shimla five and Mandi three.

3 Chamba one, Hamirpur two, Nurpur one, Una one and Shimla one.

The taxpayer should have filed all the returns for the last six months period immediately preceding the appointed date.

During audit of 11 divisions of HP State Commissionerate, it was noticed that in seven cases[4] out of 431 selected Transitional Credit cases, the dealers had carried forward ITC amounting to ₹ 52.71 lakh in the TRAN-1 form without filing the last Annual return (for the period 2016-2017). The details of which are attached in **Appendix-2.4**.

On this being pointed out (March & April 2021), the DCST&Es concerned stated (March & April 2021) that these cases would be examined as per applicable GST Act. This resulted in non-observance of the provisions of Section 140 of the CGST Act, 2017 and the SGST Act, 2017.

2.7.5 Irregular carry forward of transitional credit under table 7(c) and irregular claim of ITC of ₹ 9.88 lakh

As per Section 140 of the GST Act, 2017, a registered person, other than a Composition taxpayer, is entitled to take, in his Electronic Credit Ledger, the amount of VAT credit carried forward in the return relating to the period up to 30 June 2017, furnished under the existing law by filing TRAN 1 return within 90 days from the appointed day.

As per section 140(3), a registered person, who was not liable to be registered under the existing law, or who was engaged in the manufacture of exempted goods or provision of exempted services, or who was providing works contract service shall be entitled to take, in his electronic credit ledger, credit of eligible duties in respect of inputs held in stock and inputs contained in semi-finished or finished goods held in stock on the appointed day.

During audit of 11 divisions of HP State Commissionerate, it was noticed that in one case[5] out of 38 selected samples, the input tax credit as per the last legacy return was ₹ 11.69 lakh. However, scrutiny of TRAN-1 revealed that total claim of ₹ 21.57 lakh (₹ 9.88 lakh in table 5c and ₹ 11.69 lakh in table 7c) was carried forward as input tax. The scrutiny of return/invoices revealed that only ₹ 11.69 lakh was admissible as input tax credit under 5c instead of table 7c which resulted in irregular claim of input tax credit of ₹ 9.88 lakh.

On this being pointed out (March & April 2021), the DCST&E Baddi stated that (March & April 2021) the proper officer concerned has been directed to look into the matter and the outcome would be intimated.

2.7.6 Carry forward of Input tax credit on account of capital goods without supporting documents

Rule 140(2) provides that a registered person other than opting to pay tax under section 10, shall be entitled to take in his electronic credit ledger, credit of the unavailed

4 Chamba one, Hamirpur two, Una two, Kangra one and Palampur one.

5 M/s Smilax Pharmaceuticals, Baddi (GSTIN 02ACNPG5021C1ZD).

input tax credit in respect of capital goods not carried forward in return furnished under the existing law by him, for the period ending with the day immediately preceding the appointed day. The unavailed input tax credit means the amount that remains after subtracting the amount of input tax credit already availed in respect of capital goods under the existing law. As per Section 11 (6) of HP VAT Act 2005, the input tax credit on capital goods shall be limited to plant and machinery directly connected with the manufacturing or processing of the finished goods, the input tax credit as admissible under this section shall commence from the date of commencement of commercial production and shall be adjusted against tax payable on turnover of sales over a period of three years.

Scrutiny of records of TRAN-1 of the dealers of Shimla district revealed in one case[6] that as per the List of Purchases (LP_1) document the tax paid on purchase of capital goods was ₹ 5.55 lakh. Further, the dealer had not shown any other purchase of capital goods during last three years hence, no unavailed ITC on capital goods of previous years was available. The dealer had claimed ITC of ₹ 5.55 lakh in last quarterly return ending June 2017, which was available to be carried forward to TRAN-1. However, the dealer had also claimed ₹ 9.42 lakh under table 6B in TRAN-1 as unavailed credit on capital goods. Thus, ITC of ₹ 9.42 lakh was carried forward in excess than available.

2.7.7 Non-production of records

During audit of the eleven divisions of HP State Commissionerate, 592 cases of transitional claims were checked and records of 92 taxpayers viz., invoices, books of accounts for verification of claims in respect of transitional credits relating to unavailed credit on capital goods, Credit on duty paid stock and Input/Input Services in transit were not made available to Audit. In the absence of these records, Audit could not verify the correctness of transitional claims of ₹ 3.43 crore of these dealers.

The records were requested (from February 2021 to April 2021) from the Excise and Taxation department, HP Shimla and the reply of the Department was awaited (August 2022).

2.8 Conclusion

There were instances of excess carry forward of input tax credit than the last legacy returns and excess claims of transitional credits due to mismatch between Annual and Quarterly returns. It was noticed that transitional credits were allowed without filing of requisite returns. Further, transitional credit on goods in stock was allowed without duty paid documents and excess carry forward of Input tax credit on capital goods was allowed. All these deviations resulted in loss of revenue to the State Government.

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6 Shivin C A Store (GSTN NO. 02ADEFS7502G1ZF).

The Audit findings mentioned in Paragraphs 2.7.1 to 2.7.5 were referred to the State Government in January 2022 while that mentioned in Paragraph 2.7.6 was referred in April 2022 and reply was awaited for all Audit findings (August 2022).

2.9 Recommendation

A risk-based verification of Transitional Credit cases may be carried out by the department in time bound manner.