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Businesses face losses in tax credits due to suppliers' defaults

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With the Centre revving up the tax compliance drive using the technology infrastructure of goods and services tax (GST), businesses are facing delays or losses in tax credits owing to supplier defaults.

Industry watchers said the losses could be as much as 7% of the working capital of large companies having sales of over ₹500 crore. It could be worse for mid and small companies.

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The government seems to be putting the onus on businesses to ensure tax compliance by their material and service suppliers.

Considering that GST is levied on value additions at every stage of the supply chain, non-compliance at any stage by an entity impacts flow of input tax credit across the supply chain. Businesses are denied credit when their suppliers default in remitting the collected indirect tax amount to the exchequer. In fact, under the system, authorities find it hard to issue credit for taxes they have not received.

Therefore, large businesses often have to nudge their vendors to comply with the tax obligations to claim tax credits as the extent of tax credit available without the vendor submitting transaction details to the authorities has been scaled back over the last few months.

Many businesses are now refusing to source materials and services from entities that are not meeting compliance obligations, which is driving the formalization in the economy and is forcing suppliers to fall in line, said industry observers.

According to an analysis by online tax service provider ClearTax for its customers with sales of over ₹500 crore, around 7% of an enterprise's working capital is blocked in input tax credit. Also 6-10% of the total input tax credit available is delayed by an average of two months. "This problem could be severe for micro, small and medium enterprises," said Archit Gupta, founder and chief executive officer, ClearTax.

The analysis also showed that 3-7% of input tax credit on the FY20 books of enterprises was never filed by suppliers despite regular follow-ups. "With the regulation changing often, enterprises are worried about loss of input tax credit or ITC and heightened oversight by the department due to mismatch between return forms," Gupta added.

According to Rajat Mohan, senior partner at chartered accountants firm AMRG and Associates, tax credits hinge on how businesses manage their processes and leverage their influence over vendors to ensure timely compliance. "The government has allowed monthly tax credit availability based on monthly invoice uploads even in cases where the vendors file quarterly returns, its success depends on the adoption by the industry. Compliance level has in general improved sharply since the early days of GST and may be a work in progress," said Mohan.

Almost 6-10% of the total input tax credit available is delayed by an average of two months, ClearTax analysis said

An email query to the finance ministry remained unanswered till press time.

Since October 2019, the authorities have scaled back the extent of tax credits available to businesses where vendors have not uploaded details. Now it is capped at 5% compared to 20% in October 2019. "Clearly, enterprises need deep solutions to tackle this issue. One aspect of which is making sure vendor payments are linked to vendor compliance," said Gupta. GST, which envisages seamless flow of tax credits based on tax payment and submission of transaction details at every stage of the supply chain, allows close monitoring of compliance.