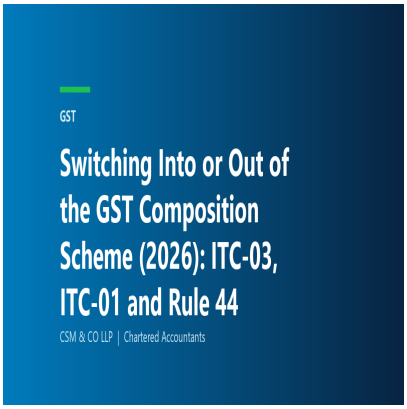


Switching Into or Out of the GST Composition Scheme (2026): ITC-03, ITC-01 and Rule 44

Description

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Quick summary

- Switching from regular GST to the Composition Scheme means paying back the input tax credit on stock and capital goods held on the day before the switch, in FORM GST ITC-03, within 60 days of the start of the financial year.
- Switching back from the Composition Scheme to regular GST means the opposite: input tax credit on stock and capital goods can be claimed again, in FORM GST ITC-01, within 30 days of becoming eligible.
- Capital goods credit is not reversed or reclaimed in full - it is reduced by 5 percentage points for every quarter (or part of a quarter) since the invoice date.
- A claim in FORM GST ITC-01 above Rs 2 lakh needs certification by a practising Chartered Accountant or Cost Accountant.
- These rules sit in section 18 of the CGST Act and rules 3, 40 and 44 of the CGST Rules, separate from the quarterly CMP-08 and annual GSTR-4 compliance covered in our main Composition Scheme guide.

Our main guide to the Composition Scheme covers who can opt in, the flat rates, and the CMP-02/CMP-08/GSTR-4 compliance cycle. This post covers a narrower question that trips up almost every business making the switch either way: **what happens to the input tax credit already sitting in your books?**

New to GST terms such as “input tax credit” or “electronic credit ledger”? See the technical terms explained in simple words further down.

Why the switch matters for input tax credit

A composition dealer pays a flat rate of tax out of pocket and is not entitled to input tax credit at all. A regular taxpayer is entitled to credit on most purchases. The moment a business crosses from one status to the other, the law has to settle what happens to credit already claimed, or not yet claimed, on stock and capital assets sitting in the business on that date. Section 18 of the CGST Act, 2017 (Availability of credit in special

circumstances) governs both directions.

Switching from regular GST to the Composition Scheme: pay back the credit

Under **section 18(4)** of the CGST Act, a registered person who has availed input tax credit and then opts to pay tax under section 10 (the Composition Scheme) must pay an amount equal to the credit of input tax on:

- inputs held in stock,
- inputs contained in semi-finished or finished goods held in stock, and
- capital goods,

as they stood on the day immediately preceding the date of exercising the option. This amount is paid by debit to the electronic credit ledger or electronic cash ledger. **Any balance of input tax credit left in the ledger after this payment lapses** - it cannot be carried forward or refunded.

FORM GST ITC-03 and the 60 day limit

Rule 3(3) of the CGST Rules requires every registered person opting for the Composition Scheme to file **FORM GST CMP-02** before the start of the financial year, and to furnish the stock and credit-reversal statement in **FORM GST ITC-03** within **60 days from the commencement of the relevant financial year**, calculated in the manner set out in rule 44(4).

Switching from the Composition Scheme back to regular GST: reclaim the credit

The reverse move is covered by **section 18(1)(c)** of the CGST Act. Where a registered person ceases to pay tax under section 10 (voluntarily, or because turnover crosses the limit), they become entitled to take credit of input tax on:

- inputs held in stock,
- inputs contained in semi-finished or finished goods held in stock, and
- capital goods,

as they stood on the day immediately preceding the date from which they become liable to pay tax under section 9 (the normal levy).

FORM GST ITC-01 and the 30 day limit

Rule 40 of the CGST Rules requires this claim to be made electronically in **FORM GST ITC-01**, within **30 days of becoming eligible** to avail the credit (or such further period as the Commissioner allows by notification).

- The declaration must give full details of the stock or capital goods it relates to, as on the relevant day.
- **If the aggregate claim across central tax, State tax, Union territory tax and integrated tax exceeds Rs 2 lakh, it must be certified by a practising Chartered Accountant or Cost Accountant.**
- The claim on inputs is verified against the corresponding supplier's FORM GSTR-1 (and FORM GSTR-1A, where filed) or FORM GSTR-4, on the common portal.

Capital goods are never credited or reversed at full value

Both directions work out to the same depreciation-style result, though the two rules word it differently. **Rule 40(1)(a)**, for claiming credit back, says it directly:

> The input tax credit on capital goods is calculated by reducing the tax originally paid on those capital goods by **5 percentage points for every quarter of a year, or part of a quarter**, counted from the date of the invoice (or other receipt document) for those capital goods.

Rule 44(1)(b), for reversing credit on the way into the scheme, is worded in months rather than quarters: the credit is reduced pro-rata over a **five-year (60-month) useful life**, based on the remaining useful life in months on the date of the switch. The two formulas land on the same number, since 1/60th a month for three months is the same 5% that Rule 40 states directly per quarter - so the worked example below holds either way, even though Rule 44 itself never uses the words “5 percentage points per quarter”.

In practice, this means a capital asset invoiced a long time before the switch carries little or no credit to reverse or reclaim by the time 20 quarters (5 years, or 60 months) have passed, since the credit base is fully used up by then under either rule’s wording.

A worked example

A trader buys machinery for Rs 10 lakh plus Rs 1.8 lakh GST (18%) and claims the full Rs 1.8 lakh as input tax credit. Fourteen months (five completed quarters) later, the trader opts into the Composition Scheme.

Step	Amount
Original input tax credit on the machinery	Rs 1,80,000
Reduction: 5 percentage points x 5 quarters = 25%	Rs 45,000
Credit to be reversed in FORM GST ITC-03	Rs 1,35,000

The same 5-percentage-points-per-quarter formula would apply in reverse if the trader later opted back into regular GST and reclaimed credit on the same machinery in FORM GST ITC-01, counted from the invoice date, not from the date of the earlier reversal.

How CSM & Co LLP can help

Getting the ITC-03 or ITC-01 timing and valuation wrong is one of the most common, and most expensive, mistakes businesses make when switching GST status - a missed 60 day or 30 day deadline, or an uncertified claim above Rs 2 lakh, can turn into a dispute with the department later. Please reach out to our team and we will be happy to help with the stock valuation, the filing, and the CA certification where required.

Technical terms explained in simple words

Term	What it means
Input tax credit	The GST a business already paid on its purchases, which it can normally subtract from the GST it collects on its sales.
Electronic credit ledger	The online account on the GST Portal that holds a taxpayer's available input tax credit.
Electronic cash ledger	The online account on the GST Portal that holds a taxpayer's cash deposited for paying GST.
Capital goods	Goods such as machinery or equipment used in the business over several years, as opposed to goods bought for resale or immediate use.
FORM GST ITC-03	The form used to declare and pay back input tax credit when switching into the Composition Scheme or when supplies become wholly exempt.
FORM GST ITC-01	The form used to claim back input tax credit when switching out of the Composition Scheme, on fresh registration, or when exempt supplies become taxable.
Quarter (for this calculation)	A three-month block counted from the capital good's invoice date, used only to work out how much of its credit has "worn off" for this reversal or claim - not a calendar quarter.

Frequently asked questions

What happens to input tax credit when I switch from regular GST to the Composition Scheme?

You must pay back, by debit to your electronic credit or cash ledger, an amount equal to the input tax credit on inputs held in stock, inputs in semi-finished or finished goods, and on capital goods, as they stood on the day before the switch. Any input tax credit left in your ledger after that payment lapses.

Which form is used to reverse this credit?

FORM GST ITC-03, filed within 60 days of the start of the financial year for which you opt into the scheme, as required by rule 3(3) of the CGST Rules.

What happens to input tax credit when I switch back from the Composition Scheme to regular GST?

You become entitled to claim input tax credit again, on inputs held in stock, inputs in semi-finished or finished goods, and on capital goods, as they stood on the day before you became liable to pay tax under section 9.

Which form is used to reclaim this credit?

FORM GST ITC-01, filed within 30 days of becoming eligible to avail the credit, under rule 40 of the CGST Rules.

How is the credit on capital goods calculated, since they are not new?

It is reduced by 5 percentage points for every quarter, or part of a quarter, that has passed since the date of the invoice for that capital good - not reversed or reclaimed at the full original amount.

Does a FORM GST ITC-01 claim need certification?

Yes, if the aggregate claim across central tax, State tax, Union territory tax and integrated tax exceeds Rs 2 lakh, the declaration must be certified by a practising Chartered Accountant or Cost Accountant.

Official sources

- CBIC Tax Information Portal – Section 18, CGST Act, 2017 (Availability of credit in special circumstances)
- CBIC Tax Information Portal – Rule 3, CGST Rules, 2017 (Intimation for composition levy)
- CBIC Tax Information Portal – Rule 40, CGST Rules, 2017 (Manner of claiming credit in special circumstances)
- CBIC Tax Information Portal – Rule 44, CGST Rules, 2017 (Manner of reversal of credit under special circumstances)
- GST Portal

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