L&S UPDATE

An e-update to clients from Lakshmikumaran & Sridharan

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GST

Refund of credit accumulated on input services, due to inverted duty structure – Explanation (a) to Rule 89(5) of CGST Rules held *ultra vires* Section 54(3) of CGST Act

UPDATE NO. 29 OF 2020

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ISSUE

Whether the amended Rule 89(5) of the Central Goods and Services Tax Rules, 2017 (**"CGST Rules"**) is *ultra vires* Sections 54(3) and 164(1) of the *Central Goods and Services Tax Act, 2017* (**"CGST Act"**)?

RELEVANT FACTS

The assessee was engaged in manufacture and supply of goods attracting GST @ 5%. Majority of the inputs/input services used by the assessee attracted GST at the rate of 12% / 18%, thereby resulting in accumulation of Input Tax Credit (**"ITC"**) in the hands of the assessee.

The formula prescribing refund, as per Rule 89(5) of CGST Rules originally introduced, read as follows:

> *"(5) In the case of refund on account of inverted duty structure, refund of input tax credit shall be granted as per the following formula –*
> *Maximum Refund Amount = {(Turnover of inverted rated supply of goods) x Net ITC ÷ Adjusted Total Turnover} - tax payable on such inverted rated supply of goods*
>
> ***Explanation***- *For the purposes of this sub rule, the expressions "Net ITC" and "Adjusted Total turnover" shall have the same meanings as assigned to them in sub-rule (4)."*

By way of *Notification No. 21/2018-Central Tax,* dated April 18, 2018, a revised formula was prescribed under Rule 89(5) of CGST Rules resulting in denial of refund of credit accumulated on account of "input services". Further, by way of *Notification No. 26/2018-Central Tax,* dated June 13, 2018, the said formula was made effective from July 1, 2017.

Aggrieved by the same, the petitioners had challenged the validity of amended Rule 89(5) of CGST Rules as being *ultra vires* Section 54(3) of CGST Act in as much as it denied refund of ITC accumulated on account of "input services".

RELEVANT ARGUMENTS ON BEHALF OF THE ASSESSEE

- GST being a consumption tax, tax burden is borne only by the final consumer and not the business. In order to avoid cascading effect of taxes in the form of unabsorbed excess tax on inputs with consequent increase in cost of product, a mature GST law provides for refund of accumulated unutilised excess input tax credit.

- Rule 89(5) of CGST Rules, under the garb of fixing formula for determining pro-rata amount of credit relatable to inverted duty structure turnover *vis-à-vis* total turnover, has instead, erroneously restricted the refund of ITC to inputs alone.

- There is nothing either in Section 54(3) of CGST Act or under proviso (ii) to said section to restrict refund to ITC on inputs.

- Restrictive formula prescribed in Rule 89(5) of CGST Rules, in effect, whittles down the effect of the word "any" employed in Section 54(3) of CGST Act. Such an exercise cannot be considered as a rule "for carrying out the provisions of the Act", thereby rendering it violative of rule-making power conferred by Section 164(1) of CGST Act.

- Whereas refund of unutilized ITC in respect of tax paid on input services is permitted in case of zero-rated supplies, there is no *intelligible differentia* supporting rejection of refund of such ITC accumulated on account of inverted duty structure alone. On this count, the amended rule is discriminatory.

RELEVANT ARGUMENTS ON BEHALF OF REVENUE DEPARTMENT

- Rule 89(5) of CGST Rules only provides the mode of calculation of refund available, and to that extent, there is no embargo placed by Section 54(3) of CGST Act.

- Rule-making power conferred by Section 164 of CGST Act is worded in the widest possible manner. Therefore, amendment made to Rule 89(5) of CGST Rules is *intra vires* the provisions of the CGST Act.

JUDGEMENT OF THE GUJARAT HIGH COURT

- Sub-section (3) of Section 54 of CGST Act, 2017 provides for claim of refund of "any unutilised input tax credit". The phrase "input tax credit" is defined in Section 2(63) of CGST Act to mean the credit of input tax. The phrase "input tax" as defined in Section 2(62) of CGST Act means the tax charged on any supply of goods or services or both made to any registered person.

- The term "input" is defined in Section 2(59) of CGST Act to mean any goods other than capital goods, and "input service" as per Section 2(60) of CGST Act means any service used or intended to be used by a supplier. Thus "input" and "input service" are both part of the "input tax" and "input tax credit".

- Therefore, as per provisions of Section 54(3) of CGST Act, the legislature has provided that registered person may claim refund of "any unutilised input tax credit". By way of Rule 89(5) of CGST Rules, such claim of the refund cannot be restricted only to "input", excluding the "input services" from the purview of "input tax credit".

- Moreover, clause (ii) of proviso to sub-section (3) of Section 54 of CGST Act also refers to both supply of goods or services and not only supply of goods as per amended Rule 89(5) of the CGST Rules.

- Intent of the government by framing the rule restricting the statutory provision cannot be the intent of law as interpreted in *Circular No. 79/53/2018-GST*, dated December 31, 2018.

RATIO DECIDENDI

- Explanation (a) to Rule 89(5) of CGST Rules which denies the refund of "unutilised input tax" paid on "input services" as part of "input tax credit" accumulated on account of inverted duty structure is *ultra vires* the provision of Section 54(3) of CGST Act.

- Consequently, Explanation (a) to Rule 89(5) of CGST Rules was read down to the extent it denied refund of ITC as accumulated on account of "input services".

IMPLICATIONS AND COMMENTS

- This decision comes as a relief to all assessees suffering from accumulation of excess ITC on account of inverted duty structure caused due to higher rate of tax on "input services". Going forward, subject to Section 54(3) of CGST Act, assessee may seek refund of entire ITC.

- Those assessees who had to pay back the refunds granted prior to June 13, 2018 may also benefit from this decision.

- Section 54(1) of CGST Act provides a two-year time period for filing refund claims. Those assessees who had initially sought refund only for ITC on "inputs" may now file a fresh claim for refund of ITC on "input services".

- However, the decision will not come to the aid of those assessees where the rejection of refund was not contested, and the appellate period has expired. In other words, if the initial refund claim was rejected, this decision can only be used to favour the assessee if window for filing appeal has not expired already.

- Though the decision is not an authority on refund of ITC accumulated on account of "capital goods", based on this ratio, one may approach the judiciary to appropriately challenge non-inclusion of ITC on capital goods for refund.

[*VKC Footsteps India Pvt. Ltd.* v. *Union of India and others* – Judgement dated July 24, 2020 in R/Special Civil Application No. 2792 of 2019 and others, Gujarat High Court]

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