L&S UPDATE
An e-update to clients from Lakshmikumaran & Sridharan

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GST

Refund of ITC accumulated on input services due to inverted duty structure

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exceeding expectations
SINCE 1985

CLAUSE (II) OF PROVISO TO SECTION 54(3) OF CGST ACT IS *INTRA VIRES* CONSTITUTION OF INDIA

RULE 89(5) OF CGST RULES IS *INTRA VIRES* CGST ACT AND CONSTITUTION OF INDIA

Issue

a) Whether the amended Rule 89(5) of the Central Goods and Services Tax Rules (**'CGST Rules'**) is *ultra vires* Section 54(3) of the Central Goods and Services Tax Act, 2017 (**'CGST Act'**) and the Constitution of India?

b) Whether clause (ii) of proviso to Section 54(3) of the CGST Act is *ultra vires* the Constitution of India?

Relevant facts

The assessees in the batch of Writ Petitions before the Madras High Court were engaged in businesses wherein the rate of tax on inputs / input services exceeded the rate of tax on output supplies. This resulted in a 'inverted duty structure' leading to accumulation of Input Tax Credit (**'ITC'**) in their hands..

Clause (ii) of proviso to Section 54(3) of the CGST Act provides that refund is allowed where the unutilised credit has accumulated on account of rate of tax on inputs being higher than the rate of tax on output supplies.

The manner in which such refund is allowable is laid down in Rule 89(5) of the CGST Rules. Since its introduction, the Rule has undergone changes which could be understood from the table:

As introduced on July 01, 2017	As amended by Notification 21/2018-CT dated April 18, 2018	As amended by Notification 26/2018-CT dated June 13, 2018
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 *Net ITC included input tax credit availed on **inputs and input services**	Maximum Refund Amount = {(Turnover of inverted rated supply of goods and services) x *Net ITC ÷ Adjusted Total Turnover} - tax payable on such inverted rated supply of goods and services *Net ITC included input tax credit availed on inputs only The aforesaid Notification did not specify any date for the applicability of the amendment	The Notification carried out the same amendment as that of Notification No. 21/2018-CT but in addition gave retrospective effect to the amendment from July 01, 2017.

Aggrieved by the amendment to the extent the refund was not allowed on ITC in respect of input services, the validity of amended Rule 89(5) as being *ultra vires* Section 54(3) of the CGST Act was challenged while also challenging the constitutional validity of Clause (ii) of proviso to Section 54(3).

Relevant arguments on behalf of the assessees

On the vires of Rule 89(5) of the CGST Rules

- Proviso to Section 54(3) ought to be construed by bearing in mind the words of Section 54(3) which states that refund of 'any unutilised ITC' would be available.

- The proviso acts as an entry barrier. Once the entry barrier is crossed, the entitlement to refund would be governed by Section 54(3) and not by the proviso.

- Clause (i) of proviso to Section 54(3) of the CGST Act which deals with refund of unutilised ITC in case of zero-rated supplies allows refund of both inputs and input services which indicates that the legislative intent is not to limit such refund only to input goods.

- Division Bench of the Gujarat High Court in the case of *VKC Footsteps India Pvt. Ltd.* v. *Union of India* [2020 VIL 340 Guj], has held that the amended Rule 89(5) is *ultra vires* Section 54(3) as the registered person may claim a refund of 'any unutilised input tax credit' under Section 54(3), whereas there is restriction to the credit accumulated only from 'inputs' in Rule 89(5).

- Section 164 of the CGST Act cannot be resorted to create disabilities that are not contemplated by the CGST Act.

- The term 'inputs' used in clause (ii) of proviso to Section 54(3) should be construed as per common parlance. If so construed, it would mean both input goods and input services. The meaning ascribed to the word 'input' under Section 2(59) of the CGST Act should not be adopted since the context requires adopting the meaning as per common parlance.

- Even if the meaning of inputs is to be construed as per statutory definition, it is a fit case to read the words 'input services' into Section 54.

- The principle that tax statute should be construed strictly and literally is applicable only to charging and exemption provisions but not to other provisions.

On the vires of Rule 89(5) of the CGST Rules

- If clause (ii) of proviso to Section 54(3) of the CGST Act is interpreted as being applicable only to assessees who use input goods and not to those who use input services, it would amount to discrimination between persons who are similarly situated by making an invidious classification.

- Goods and services are treated in identical fashion with regard to all the aforesaid four elements of taxation i.e., taxable event, the taxable person, the rate of tax and the measure of tax. The differentiation between goods and services, in GST legislation, is only from the viewpoint of administrative convenience.

- In order to uphold the constitutional validity of the Section, the principle of reading down should be resorted to. Thus, the word 'inputs' must be read in its wide, common parlance meaning, to include input services as well.

- As per Article 38 of the Constitution of India, the legislation should be interpreted in such a manner that inequalities are mitigated. This principle is applicable even in the context of tax legislations.

Relevant arguments on behalf of the Revenue

On the vires of Rule 89(5) of the CGST Rules

- Historically, goods and services have been subjected to different treatment and merely because the GST provisions deal with both goods and services, it cannot be concluded that all the benefits that are available to a person who avails input goods should be extended to those who avail input services.

- The expression 'any unutilised input tax credit' in Section 54(3) is the genus and the sub-clauses thereto are the species. The sub-clauses perform the function of curtailing the ambit of Section 54(3). The expression 'where the credit has accumulated on account of rate of tax on inputs' qualifies and curtails the expression 'refund of any unutilised input tax credit' in Section 54(3).

- A proviso performs various functions such as curtailing, excluding, exempting or qualifying the enacted clause. In fact, the proviso may even take the shape of a substantive provision.

- Rule 89(5) merely supplements Section 54(3)(ii) and that it fulfils the purpose of eliminating arbitrariness in determining the entitlement to refund on the basis of Section 54(3)(ii).

- Section 164 is couched in extremely wide language, and that the only limitation is that the rules should be for fulfilling the purposes of the CGST Act. No restriction must be read into the rule making power.

- A refund provision should be treated on par with an exemption provision and should be construed strictly. Any ambiguity should be resolved in favour of revenue.

- The word 'inputs' in Section 54(3)(ii) of the CGST Act is intended to carry the meaning ascribed to the said word in Section 2(59) of the CGST Act. As could be observed from Explanation to Section 54, Parliament has consciously and intentionally used either the defined term 'inputs' or 'input services' as appropriate in Section 54.

- The Gujarat High Court in the case of VKC Footsteps India failed to consider the proviso to Section 54(3).

- The unutilised input tax credit does not lapse merely because the registered person is unable to claim a refund of the same.

On the vires of clause (ii) of Proviso to Section 54(3) of the CGST Act

- It is the settled position that reading down is intended to provide a restricted or narrow interpretation and not for the purpose of providing an expansive or wide interpretation. Reading 'input services' into 'inputs' would lead to an expansive interpretation.

- Parliament has wide latitude in tax legislations. Classification of registered persons into those who are entitled to a refund of unutilised input tax credit and those who are not by differentiating between those who procure input goods and input services is legitimate as both the CGST Act as well as the Constitution clearly differentiate between goods and services.

Decision of the Madras High Court

- Though Section 54(3) allows refund of 'any unutilised ITC', clause (ii) of proviso to Section 54(3) uses the words **'accumulated on account of'** rate of tax on inputs being higher than rate of tax on output supplies. If the proviso is interpreted merely to be a condition to claim refund of entire unutilised ITC, the words **'accumulated on account of'** would become redundant.

- The proviso, in addition to prescribing a condition also performs the function of limiting the quantity of refund.

- Rule 89(5), as amended is thus within the rule making power under Section 164 and is in line with Section 54(3).

- The unamended Rule 89(5) wherein refund was available on both inputs and input services exceeded the scope of Section 54(3).

- The decision of the Gujarat High Court did not consider the scope, function and impact of proviso to Section 54(3).

- Both the statutory definition and the context point that the word 'inputs' encompasses all input goods, other than capital goods, and excludes input services.

- Under GST law, goods and services are treated similarly in certain respects but differently in other respects. Even with regard to rate of tax, almost all services attract a uniform rate of 18%, whereas goods are taxes at rates that vary considerably.

- Refund claim, other than a claim for excessive taxes paid inadvertently on account of the erroneous interpretation of applicable law or the declaration of a provision as unconstitutional is in the nature of a benefit or concession.

- Right of refund is purely statutory and cannot be availed of except strictly in accordance with the prescribed conditions.

- The Parliament has wide latitude for classification. Thus, the non-conferment of the right of refund to the unutilised input tax credit from the procurement of input services cannot be said to be violating Article 14 of the Constitution of India.

Ratio

- Refund is a statutory right and the extension of the benefit of refund as specified in clause (ii) of proviso to Section 54(3) is a valid classification and a valid exercise of legislative power. Thus, clause (ii) of proviso to Section 54(3) is constitutionally valid.

- Further, Rule 89(5) of the CGST Rules, as amended, is in conformity with Section 54(3) and thus *intra vires* the CGST Act and the Constitution of India.

IMPLICATIONS AND COMMENTS

- This decision would affect assessees in the jurisdiction of Tamil Nadu who have applied for refund of credit accumulated on input services due to inverted duty structure.

- In case of assessees who are in jurisdictions other than Gujarat and Tamil Nadu, the decisions of both the High Courts will not be binding but will have a persuasive value.

[*Transtonnelstroy Afcons Joint Venture and Ors. v. Union of India and Ors.* – Judgment dated September 21, 2020 in WP. Nos. 8596, 8597, 8602, 8603, 8605, 8608, 14799, 21432 32308, 32311, 32314, 32316, 32317, 32327, 34219 and 34221 of 2019 and 12028, 12037, 12040, 12041 and 12042 of 2020, Madras High Court]

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