

REFUND OF UNUTILIZED CREDIT AVAILABLE IN RESPECT OF INPUT SERVICES ACCUMULATED ON ACCOUNT OF INVERTED DUTY STRUCTURE

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VKC FOOTSTEPS VS. UOI & ORS. (GUJARAT HIGH COURT)

Introduction

- The issue relating to the eligibility of refund of input tax credit on input services accumulated on account of inverted duty structure, has been under dispute since introduction of GST law and an adverse circular by CBIC lead to denial of such refunds by the Revenue Authorities in many cases. The Hon'ble Gujarat High Court, deciding the issue in favor of the assessee, inter alia held that Explanation (a) to Rule 89(5) of the CGST Rules, 2017 ('CGST Rules'), which seeks to deny refund of unutilized input tax credit, accumulated on account of inverted duty structure, to the extent such credit pertains to "input services", is ultra vires the provision of Section 54(3) of the CGST Act, 2017 ('CGST Act'). The Hon'ble Court further held that the said Explanation (a) should be read down and the term "Net Input Tax Credit" should be read to mean "input tax credit" availed on "inputs" and "input services" as defined under the CGST Act.

Factual Background

- The Petitioner is engaged in the business of manufacture and supply of footwear which attracts GST at the rate of 5%. The Petitioner procures various Input services which attract GST at the rate of 12% or 18%. Given that the rate of GST on Inputs is higher than the rate of tax on outward supply of footwear (**inverted duty structure**), there is accumulation of unutilized credit in electronic credit ledger of the Petitioners.
- Accordingly, the Petitioner applied for refund of unutilized Input tax credit on Inputs as well as Input services in terms of Section 54(3) of the CGST Act read with Rule 89(5) of the CGST Rules. However, the refund to the extent it pertains to unutilized Input tax credit on Input services, was denied by the Respondents. Hence this petition was filed to challenge the validity of Rule 89(5) of the CGST Rules, 2017 to the extent it denies refund of Input tax credit relating to Input services.

Extract of relevant legislation

- Relevant extract of Section 54(3) of the CGST Act which relates to Refund of tax:

"(3) Subject to the provisions of sub-section (10), a registered person may claim refund of any unutilized input tax credit at the end of any tax period:

Provided that no refund of unutilized input tax credit shall be allowed in cases other than—

(i) zero rated supplies made without payment of tax;

(ii) where the credit has accumulated on account of rate of tax on inputs being higher than the rate of tax on output supplies (other than nil rated or fully exempt supplies), except supplies of goods or services or both as may be notified by the Government on the recommendations of the Council."
- Relevant extract of Rule 89 of the CGST Rules which relates to Refund of tax:

(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 and services) x Net ITC ÷ Adjusted Total Turnover} - tax payable on such inverted rated supply of goods and services.

Explanation: For the purposes of this sub-rule, the expressions –

(a) "Net ITC" shall mean input tax credit availed on inputs during the relevant period other than the input tax credit availed for which refund is claimed under sub-rules (4A) or (4B) or both; and ..."

Key Findings of the judgment of Hon'ble Gujarat High Court

- The formula prescribed Rule 89(5) of the CGST Rules to the extent it excludes refund of tax paid on "input service" as part of the refund of unutilized Input tax credit is contrary to the provisions of Section 54(3) of the CGST Act which provides for claim of refund of "any unutilized input tax credit."
- The word "Input tax credit" is defined in Section 2(63) to mean the credit of input tax. The word "input tax" is defined in Section 2(62) to mean the tax charged on any supply of goods or services or both made to any registered person. Thus "input" and "input service" are both part of the "input tax" and "input tax credit".
- From an analysis of the provisions of the Act and Rules and keeping in mind the scheme and object of the CGST Act, it cannot be the intent of law, as interpreted in the Circular No.79/53/2018-GST dated 31.12.2018, to deny the registered person refund of tax paid on "input services" as part of refund of unutilized input tax credit.
- Accordingly, the Court held that Explanation (a) to Rule 89(5) being ultra vires Section 54(3) of the CGST Act, ought to be read down and the term Net ITC should mean 'input tax credit' availed on 'Inputs' and 'Input services' as defined under the CGST Act.

ELP Comments

Various assesseees across the country are facing the issue of accumulation of credit on account of inverted duty structure qua Input services. The refund applications filed by such assesseees have been rejected by the Authorities by relying upon the interpretation laid down in Circular No.79/53/2018-GST dated December 31, 2018.

The judgment of the Hon'ble Gujarat High Court has far reaching impact and would significantly help in improving the cash flow in the ongoing difficult times of COVID – 19.

It is also noteworthy that refund of inverted duty structure is also available to service sector engaged in supplying services at a concessional rate of GST.

A representative list of sectors which may benefit from the said decision are given hereunder:

- Textile
- Mining
- Pharmaceuticals
- Government contractors
- Contractors for low cost housing
- Tractor manufacturers
- Railways suppliers

The non-availability of refund of accumulated credit, as attributable to credit on Input services, results in blockage of credit and consequent financial strain. Resultantly, it is advisable that impacted suppliers file refund claim in a time bound manner especially for F.Y. 2018-19 which is likely to get time barred soon.

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