

The Supreme Court upholds the constitutional validity of Rule 89(5) of the CGST Rules- Refund is not available in respect of credit on input services accumulated on account of inverted duty structure - *UOI & Ors. Vs. VKC Footsteps India Pvt. Ltd.*

Introduction

- Hon'ble Supreme Court *inter alia* held that the challenge to Rule 89(5) of the Central Goods and Service Tax Rules, 2017 (**CGST Rules**), as a piece of delegated legislation, on the grounds that it is ultra vires clause (ii) of the first proviso to Section 54(3) of the Central Goods and Services Tax Act, 2017 (**CGST Act**) is lacking in substance.
- The Court observed that the impact of the first proviso to Section 54(3) of the CGST Act and Explanation 1 to Section 54 is that a refund of unutilized input tax credit (**ITC**) shall be allowed only in cases falling under clauses (i) and (ii) to first proviso. The Court also held that the expression 'only' is not a judicial addition to statutory language but follows plainly from the expressions "no refund" of unutilized ITC shall be allowed "in cases other than". The Court further held that clause (ii) of the first proviso is a restriction and not a mere condition of eligibility.
- Moreover, being cognizant with the anomalies of the formula in Rule 89(5) of the CGST Rules, the Court held that an anomaly per se cannot result in the invalidation of a fiscal rule which has been framed in exercise of the power of a delegated legislation. However, the Hon'ble Court also urged the GST Council to reconsider the formula by taking a considered view in accordance with law.

Factual Background

- A batch of appeals were filed before the Hon'ble Supreme Court for deciding the validity of Rule 89(5) of the CGST Rules on the grounds that it is ultra vires Section 54(3)(ii) of the CGST Act in view of the divergent views of the Gujarat High Court in the case of *VKC Footsteps India Pvt. Ltd. v. Union of India* [TS-585-HC-2020(GUJ)-NT] and the Madras High Court in the case of *Tvl. Transtonnelstroy Afcons Joint Venture v. Union of India* [TS-800-HC-2020(MAD)-NT].

Key Findings

- The impact of the first proviso to Section 54(3) of the CGST Act is that a refund of unutilized ITC shall be allowed only in cases falling under (i) and (ii). The expression 'only' is not a judicial addition to statutory language but follows plainly from the expressions "no refund" of unutilized ITC shall be allowed "in cases other than".
- The expression "in cases other than" is a clear indicator that clauses (i) and (ii) of the first proviso are restrictive and not conditions of eligibility.
- The legislative draftsman has made a clear distinction between clause (i) and clause (ii) of the first proviso and it was in this context that the opening words of Section 54(3) of the CGST Act have used the expression "may claim refund of any unutilized ITC";
- Explanation 1 to Section 54 of the CGST Act is a clear indicator that in respect of domestic supplies, it is only unutilized credit which has accumulated on the rate of tax on input goods being higher than the rate of output supplies of which a refund can be allowed.
- Imposing a restriction of the kind given in clause (ii) of the proviso lies within the realm of policy.
- While it is true that the plural expression 'inputs' has not been specifically defined, but there is no reason why the ordinary principle of construing the plural in the same plane as the singular should not be applied. Further, to construe 'inputs' so as to include both input goods and input services would do violence to the provisions of Section 54(3) and would run contrary to the terms of Explanation-I which have been noted earlier.
- The intent of Parliament is evident by the use of a double – negative format by employing the expression "no refund" as well as the expression "in cases other than". In other words, a refund is contemplated in the situations provided in clauses (i) and (ii) and no other.
- Clause (ii) of the proviso, when it refers to "on account of" clearly intends the meaning which can ordinarily be said to imply 'because of or due to'. When proviso (ii) refers to "rate of tax", it indicates a clear intent that a refund

would be allowed where and only if the inverted duty structure has arisen due to the rate of tax on input being higher than the rate of tax on output supplies.

- A statutory provision may not visualize every eventuality which may arise in implementing the provisions of the Act. Hence it is open to the rule making authority to frame rules, so long as they are consistent with the provisions of the parent enactment. Thus, the absence of the words “as may be prescribed” in Section 54(3) does not deprive the rule making authority to make rules for carrying out the provisions of the Act.
- The Court observed that the formula prescribed in Rule 89(5) of the CGST Rules seeks to deduct the total output tax from only one component of the ITC, namely ITC on input goods and that such a position is at odds with reality, where the ITC on both input goods and input services is accumulated in the electronic ledger and is then utilized for the payment of output tax. On noticing the anomalies of the formula, the Court held that an anomaly per se cannot result in the invalidation of a fiscal rule which has been framed in exercise of the power of delegated legislation.
- Given the anomalies pointed out by the assesseees, the Court strongly urged the GST Council to reconsider the formula and take a policy decision regarding the same.

ELP Comment

The decision will adversely impact many taxpayers who are grappling with the issue of accumulation of credit on account of inverted duty structure qua Input services. More particularly, industry sectors such as Textile, Mining, Pharmaceuticals, Government contractors, Tractor manufacturers, Railways suppliers would face the heat in form of reduced cash inflows in the ongoing difficult times of COVID – 19.

The only relief they can expect is that the GST Council, based on the recommendations of Hon’ble Supreme Court, tilt the formulae under Rule 89(5) of the CGST Rules slightly in favour of such taxpayers. There is also a likelihood that some of the sectors may witness an increase in the rate of output tax.

We hope you have found this information useful. For any queries/clarifications please write to us at insights@elp-in.com or write to our authors:

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