REFUND ON ACCOUNT OF INVERTED DUTY STRUCTURE ALLOWED ONLY FOR INPUTS: VIEW BY THE INDIAN SUPREME COURT

1. INTRODUCTION

The fundamental principle that permeates Goods and Services Tax laws is the multistage tax and seamless availability of credit through the supply chain. The tax which is paid at the earlier stages of the supply chain can be adjusted at a later stage against the output tax liability of the taxpayer. This allows seamless credit to the taxpayer, or in the alternative, a refund of the duties paid at earlier stages (if eligible).

The GST law as it stands today, by way of Section 54(3) of Central Goods and Services Tax Act, 2017 ("**CGST Act**") allows refund of input taxes in only two situations, viz., in export transactions and in transactions involving an inverted duty structure. The latter occurs where inputs are taxed higher than the outputs, resulting in an inverted structure and consequentially, leads to an accumulation of input taxes at the taxpayers' end. However, as per the extant provisions, a taxpayer in the inverted duty structure can claim a refund of only the tax paid on input 'goods' and not 'services'. This restriction was imposed by way of an amendment and was given retrospective effect from July 01, 2017, which became a subject matter of challenge before the High Courts.

In 2019, the Hon'ble Division Bench of the Gujarat High Court ("**Guj HC**") in the matter of *VKC Footsteps India Pvt. Ltd. (VKC) vs. Union of India*[1] upheld the challenge to the provisions and struck down the relevant provision *viz.*, Explanation (a) of Rule 89(5) of the Central Goods and Services Tax Rules, 2017 ("**CGST Rules**") as being contrary to the provisions of 54(3) of the CGST Act. Later, the Hon'ble Division Bench of the Madras High Court ("**Mad HC**") in the case of *Tvl. Transtonnelstory Afcons Joint Venture & Ors.*[2] dismissed the challenge to the provision and restricted the claim of refund under inverted duty structure to inputs alone.

In view of the above, these matters reached the Hon'ble Supreme Court of India ("**Supreme Court**") for finality on this issue. On September 13, 2021, the Supreme Court settled the dust on this issue by upholding the view taken by the Mad HC and setting aside the Guj HC judgment.

In the present article, we analyze the Supreme Court judgement in *Union of India & Ors vs. VKC Footsteps India Pvt. Ltd.*[3].

2. ARGUMENTS RAISED

2.1 On behalf of the Revenue and the Union of India (Revenue), it was contended that:

a) Goods and services are distinct at a Constitutional level. The term inputs as appearing in Section 54(3) cannot be read as input goods as well as input services;

[1] Special Civil Application No 2792 of 2019; 2020 (7) TMI 726.
[2] 2020 (9) TMI 931.
[3] Civil Appeal no 4810/2021.

b) On the interpretation of Section 54(3), it was argued that the expression employed in the main clause of Section 54(3) is 'claim', whereas the provisos restrict this ambit by the use of the expression 'allowed';

c) Further, when the main clause in Section 54(3) used the expression 'any unutilized Input Tax Credit ("**ITC**"**)**, the same is expressly restricted by use of the expression "*no refund of unutilised ITC shall be allowed "in cases other than…*". In other words, expression 'allowed' in the proviso must be contrasted with the expression 'claim' in the substantive part of Section 54(3). A refund can be allowed only in the eventualities envisaged in clauses (i) and (ii) of the first proviso to Section 54(3). The expression "other than" operates as a limitation/ restriction;

d) Further, if the intention of the legislature was to allow refund of unutilised ITC on account of input services and capital goods, in addition to input goods, such an intent would have been conveyed through statutory language, which is at present missing;

e) "Unutilized ITC" could comprise of taxes paid both on input goods and input services, and the first proviso and the main Section 54(3) necessarily have to employ the expression "unutilized ITC" to take care of zero-rated supplies which are exports under the first category. Therefore, the Government could not have used the expression "inputs" in the main clause and first proviso as this would act as a disability to zero rated supplies where Government intended to grant a refund arising out of both input goods and input services; and

f) The provisos under Section 54(3) have to be read and interpreted as restrictions and not as qualifications of any claim;

2.2 On behalf of the Respondent Assessees, the arguments advanced were as follows:

a) By placing reliance upon the provisions of the GST law, the intention of the legislature and the objective behind introducing the GST legislation, it was argued that Section 54(3) of the CGST Act, allows the refund *of any accumulated input tax credit*. This was subsequently narrowed down by the introduction of an explanation to Rule 89(5) of the CGST Rules, therefore, making it beyond the scope of Section 54(3) of the CGST Act;

b) It was further submitted that explanation (a) to Rule 89(5) of the CGST Rules, which confines the refund to "input credit" and excludes credit on "input service" also whittles down the effect of the word "any" in "*any unutilised input tax credit*" provided in Section 54(3) of the CGST Act. This is because "any" in this expression would definitely mean "all" ITC, including input services;

c) Challenge to the scope of Rule 89(5) is only because of the definition of 'Net ITC' in the explanation to the Rule. The explanation defines 'Net ITC' to mean ITC availed on inputs during the relevant period. Section 54(3) allows refund of any unutilized ITC and not only credit on input goods. Thus, the expression "on inputs" employed in Explanation (a) to Rule 89(5) needs to be struck down;

d) Rule 89(5) only provides a procedure for computing refund under Section 54(3) and by imposing an artificial restriction which has not been prescribed in the main statute, it is patently arbitrary and illegal;

e) It was also argued that clause (ii) of the first proviso to Section 54(3) merely prescribes a condition of eligibility subject to which refund of unutilised ITC could be made;

f) In the absence of any distinction between ITC on goods and services at the time of availing or utilizing the credit, it could not have been the intention of the legislature to differentiate between the two only at the time of refund in the case of inverted duty structure.

3. FINDINGS BY THE SUPREME COURT

The Supreme Court affirmed the Mad HC judgement restricting the refund of unutilized input tax credit only to input goods in cases of inverted duty structure. The Supreme Court observed that:

a) Refund is a matter of a statutory prescription and cannot be claimed as a constitutional right. Accepting the argument put forth by the government, the Supreme Court observed that the proviso to Section 54(3) is not a condition of eligibility but a restriction which must govern the grant of refund under Section 54(3);

b) A discriminatory provision under a tax legislation is not *per se* invalid and that cause of invalidity, being that equals are treated as unequally or that unequals are treated as equally, does not arise, as inputs and input services, both under the Constitution of India and the CGST Act, are different species and are not treated as one and the same;

c) Clause (ii) of the first proviso to Section 54(3) is a substantive restriction under which a refund of unutilised ITC can be availed of only when the accumulation can be related to an inverted duty structure on account of input goods alone. The Supreme Court therefore refused to observe or hold any disharmony between Section 54(3) and Rule (89)(5);

d) Rule 89(5) is not without jurisdiction as the Rule has been brought in on account of the rule-making power conferred under Section 164 of the CGST Act.

e) Acknowledging the inequities tied to the formula, it was observed that the formula makes a faulty presumption that the output tax payable on supplies has been entirely discharged from the ITC accumulated on account of input goods and there has been no utilisation of the ITC on input services. Owing to the same, the Supreme Court, has urged the Goods and Services Tax Council ("**GST Council**") to make the necessary policy corrections without them having to overstep into legislative independence.

4. CONCLUSION

The confusion that was prevalent on the eligibility of refund of ITC on input services position owing to the differing views provided by the Guj HC and Mad HC, is now resolved by the Supreme Court. Considering the above observations, it is clear that there is no possibility of claiming refund on account of accumulation of input services. As an immediate sectoral impact, it is likely to affect footwear, textile, fertilizers, construction, and other industries where output tax is lower than the tax paid on inputs.

As a necessary consequence, refund applications or appeals from orders rejecting such applications in such cases will be rejected. More importantly, wherever orders sanctioning refund were issued in the past, it is likely that recoveries would be initiated, along with interest. However, one may find relief in various judgments where it was held that refund already sanctioned on basis of applicable law cannot be termed as "erroneous" on account of a subsequent judicial development. However, it will be litigious, and the

Revenue Department will not accept such an interpretation and the issue will have to be argued before the higher Courts.

Based on the conclusion arrived at by the Supreme Court in the present case, the only positive aspect of this judgement is the acknowledgment of the anomalies in the formula prescribed in the relevant CGST Rules, and the acceptance of the harsh reality of the balance of favour tilting towards the Revenue Department. While the Supreme Court was conscious enough to not overstep the powers and responsibilities of the legislature, it has urged the GST Council to re-consider the formula and take a policy decision regarding the same.

The trade and industry would definitely hope that the GST Council members would re-consider this aspect in the forthcoming council meeting and provide with a resolution keeping in mind the interest of the taxpayers as well.

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