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Inverted Tax Refund – foundation shaken by Judiciary!

Inverted Tax Structure ('ITS') is a perinnial Indirect Tax issue and GST law continues this prodigy. ITS is a situation where tax on inputs (goods & services) exceeds tax on output leading to credit accumulation with taxpayer. Under pre-GST laws, taxpayers were not granted refund of unutilized credit due to ITS and this led to working capital blockage for taxpayers. Under GST regime, the Government was pragmatic enough to allow refund in such situation.

Background

Section 54 of the Central Goods & Services Tax Act, 2017 ('CGST Act') deals with refund. Section 54(3) allows taxpayer to claim refund of unutilized Input Tax Cedit ('ITC') where rate of tax on inputs exceeds rate of tax on output. Importantly, the law does not allow refund where rate of tax on input services exceeds rate of tax on output.

Rule 89(5) of the Central Goods & Services Tax Rules, 2017 ('CGST Rules') prescribes formulae to compute refund of unutilized ITC due to ITS. The CBIC issued ***Circular No 79/53/2018-GST dated December 31, 2018 ('Circular')*** clarifying various issues related to such refund. Both Rule and Circular allowed refund only on inputs (not on input services and capital goods) though there was no such restriction under parent provision (Section 54(3) of the CGST Act).

High Court ruling

The validity of Rule 89(5) of the CGST Rules was challenged before the Gujarat High Court in the case of ***VKC Footsteps India Pvt. Ltd. vs. Union of India [2020-VIL-340-GUJ]*** to the extent it denied refund of unutilized ITC on input services due to ITS.

The High Court noted the definition of terms 'Input Tax Credit' (credit of Input Tax) and 'Input Tax' (GST charged on supply of goods or services) under the CGST Act. It held that Section 54(3) does not restrict refund only to inputs. Section 164(1) confers general rule making power to the Government to carry out provisions of the CGST Act. The Court held Rule 89(5) to be ultra vires to the extent it denies refund of unutilized ITC on input services not being *'for the purpose of carrying out the provision of the CGST Act'.*

Importantly, the Court did not hold Rule 89(5) to be ultra vires to the extent it denies refund of unutilized ITC on capital goods.

Analysis

The above ruling is favorable for taxpayers operating in industries facing ITS (Tractor, E-vehicle, Edible Oil, Footwear etc.). Apart from future, this judgment will also have far-reaching implications for past refund claims.

Under Section 54 of the CGST Act, ITC includes GST paid on capital goods. Thus, refund of unutilized ITC on capital goods in ITS is equally eligible. The rationale equally applies to refund on capital goods in zero-rated supplies (physical exports, supplies made to SEZ etc.). The restriction of refund on capital goods for zero-rated supplies under Rule 89 of the CGST Rules runs contrary to parent provision viz. Section 54.

For past, taxpayers can claim refund on input services and capital goods in all scenarios viz. (i) Refund claims filed and adjudicated, (ii) Refund claims filed and not adjudicated, or (iii) Refund claims yet to be filed. Section 54 does not restrict filing multiple refund claims for same tax period. Thus, taxpayers can file supplementary refund claims where refund claims are already filed (whether adjudicated or pending adjudication). These supplementary claims need to be filed within time limit prescribed under GST law.

Another related dispute is likely to usurp is determination of time limit of 2 years from 'relevant date' for seeking refund. As per Section 54, relevant date for ITS refund means due date of furnishing return under Section 39 of the CGST Act for relevant tax period. Before February 1, 2019, this 'relevant date' was end of financial year to which refund pertained. It is settled legal position that a statute of limitation is procedural in nature. When a subsequent amendment prescribes shorter period of limitation, such shorter period will apply as long as no substantial right is affected. Thus, taxpayers need to correctly determine limitation period if they file supplementary refund claims for period prior to February 2019.

There could be procedural challenges in filing these claims like GST portal not supporting filing of supplementary refund claims etc. Such bollenecks on GST portal cannot come in the way of substantial right of taxpayers. Taxpayers must file manual refund claim in such a scenario.

To sum up

It is disappointing to see nature of this debate. The whole purpose of GST law was to eliminate distinction between goods and services for taxation purpose. To that extent, discrimination for input services and capital goods for refund lacks merit. It will be in everyone's interest that revenue buries this dispute and allows refund on input services and capital goods as well.

The revenue is likely to challenge this judgment before the Supreme Court. Basis present statutory provisions, this ruling is likely to be affirmed by the Apex Court. As this was an inadvertent drafting error in GST law, the revenue may also retrospectively amend GST law.

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