

DA TAX UPDATE INDIRECT TAX

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Darda Advisors LLP

Refund of input services under IDS update

Issue -25

**Refund
under
GST**



Supreme Court denied refund of input services credit under Inverted Duty Structure - Rule 89(5) of CGST Rules, 2017

The Honorable Supreme Court uphold the validity of Rule 89(5) of CGST Rules, 2017 and denied refund of input services credit under Inverted Duty Structure (IDS). The divergence between the views of the Gujarat High Court on the one hand, and the Madras High Court on the other, forms the subject matter of this batch of appeals. We have briefly captured the key aspects and conclusions of the judgment of Honorable Supreme Court along with questions to ponder:

Key findings by Honorable Supreme Court

Section 54(3) of CGST Act, 2017

- The Court while interpreting the provisions of Section 54(3) must give effect to its plain terms. *The Court cannot redraw legislative boundaries on the basis of an ideal which the law was intended to pursue.* Likewise, when the first proviso to Section 54(3) has provided for a restriction on the entitlement to refund it would be impermissible for the Court to redraw the boundaries or to expand the provision for refund beyond what the legislature has provided.

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Key findings by Honorable Supreme Court

- 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.
- 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. Reading the expression ‘input’ to cover input goods and input services would lead to recognising an entitlement to refund, beyond what was contemplated by Parliament.
- The proviso to Section 54(3) is not a condition of eligibility (as the assessee’s Counsel submitted) but a restriction which must govern the grant of refund under Section 54(3).

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Key findings by Honorable Supreme Court

- When there is neither a constitutional guarantee nor a statutory entitlement to refund, the submission that goods and services must necessarily be treated at par on a matter of a refund of unutilized ITC cannot be accepted. Such an interpretation, if carried to its logical conclusion would involve unforeseen consequences, circumscribing the legislative discretion of Parliament to fashion the rate of tax, concessions and exemptions. If the judiciary were to do so, it would run the risk of encroaching upon legislative choices, and on policy decisions which are the prerogative of the executive. We are therefore unable to accept the challenge to the constitutional validity of Section 54(3).

Validity of Rule 89(5) of CGST Rules in exercise of the rule-making power under Section 164 of the CGST Act

- The rules may interstitially fill-up gaps which are unattended in the main legislation or introduce provisions for implementing the legislation. So long as the authority which frames the rules has not transgressed a provision of the statute, it cannot be

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Key findings by Honorable Supreme Court

deprived of its authority to exercise the rule making power.

- Thus, we find that 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.

Vires of Rule 89(5) vis-à-vis Section 54(3) of the CGST Act

- The challenge to Rule 89(5) as a piece of delegated legislation on the ground that it is ultra vires Clause (ii) of the first proviso to Section 54(3) is therefore lacking in substance. There is therefore no disharmony between Rule 89(5) on the one hand and Section 54(3) particularly Clause (ii) of its first proviso on the other hand.
- Explanation (a) to Rule 89(5) in defining ‘Net ITC’ to mean ITC availed on inputs (goods) is, as a matter of fact, entirely in line with the main provision, Section 54(3).

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Key findings by Honorable Supreme Court

Validity of the formula prescribed in Rule 89(5) of CGST Rules, 2017

- The purpose of the formula in Rule 89(5) is to give effect to Section 54(3)(ii) which makes a distinction between input goods and input services for grant of refund. Once the principle behind Section 54(3)(ii) of the CGST Act is upheld, the formula cannot be struck down merely for giving effect to the same.
- The aberrations which have been pointed out by the Mr Sridharan and Mr G Natarajan certainly indicate that the formula is not perfect.
- We are equally cognizant of the fact that the proposed solution, that is prescribing an order of utilisation of the ITC accumulated on input services and input goods, may tilt the balance entirely in favour of the assessee as that would make a contrary assumption that the output tax is discharged by the ITC accumulated on account of input services entirely.

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Key findings by Honorable Supreme Court

- While we are alive to the anomalies of the formula, 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.
- We are affirmatively of the view that this Court should not in the exercise of the power of judicial review allow itself to become a one-time arbiter of any and every anomaly of a fiscal regime despite its meeting the jurisdictional framework for the validity of the legislation, including delegated legislation.
- The reading down of the formula as proposed by Mr Natarjan and Mr Sridharan by prescribing an order of utilisation would take this Court down the path of recrafting the formula and walk into the shoes of the executive or the legislature, which is impermissible. Accordingly, we shall refrain from replacing the wisdom of the legislature or its delegate with our own in such a case. However, given the anomalies pointed out by the assesseees, we strongly urge the GST Council to reconsider the formula and take a policy decision regarding the same.

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Conclusion by Supreme Court

- The judgment of the Madras High Court needs to be affirmed by dismissing the appeals challenging that verdict while the appeals against the judgment of the Gujarat High Court by the Union of India should be allowed.
- Having considered this batch of appeals, and for the reasons which have been adduced in this judgment, we affirm the view of the Madras High Court and disapprove of the view of the Gujarat High Court. We accordingly order and direct that:
 - i. The appeals filed by the Union of India against the judgment of the Gujarat High Court dated 4 July 2020 in VKC Footsteps India Pvt. Ltd. (supra) and connected cases are allowed and the judgment shall be set aside;
 - ii. The appeals filed by the assesseees against the judgment of the Madras High Court in Tvl. Transtonnelstroy Afcons Joint Venture (supra) and connected cases dated 21 September 2020 shall stand dismissed. As a consequence, the writ petition filed by the assesseees shall also stand dismissed. There shall no order as to costs; and

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Conclusion by Supreme Court

- iii. The observations in paragraphs 104 to 111 shall be considered by the GST Council to enable it to take a considered view in accordance with law.

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Questions to ponder?

- Possibility to appeal to Larger Bench as the decision is announced by Single Judge.
- Whether any such matter can be further considered by the Honorable Supreme Court as multiple writ petitions are pending at various High Courts or will be disposed of basis the judgment of Honorable Supreme Court.
- Whether GST Council will take the matter and amend the formula under Rule 89(5) of CGST Rules or remove IDS to avoid such anomalies or litigations.
- Whether the assessee who have claimed the refund of input services under IDS need to refund back the amount with interest?
- Whether the said amount would be recredited to Electronic Credit Ledger.
- Whether the limitation period under GST law would be considered before issuance of any notices to people already claimed the refund.

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www.dardaadvisors.com



da@dardaadvisors.com

Our Locations

Hyderabad

6-3-1086, 5th Floor, Vista Grand Towers, Raj Bhavan Road, Somajiguda, Hyderabad - 500082, TS

Chennai

13, T.K. Mudali Street, Choolai, Chennai - 600112, Tamil Nadu

Delhi-NCR

N 93, Ground floor, Mayfield garden, Sector 51, Gurgaon, Haryana - 122018

Bhilwara

Moti Chambers, 62&63, Sancheti Colony, Pur Road. Bhilwara - 311001, Rajasthan

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