

GST | Constitutional Validity of Rule 89(5) of CGST Rules on Inverted Duty Structure Refunds

Supreme Court Judgement - Union of India & Ors vs. VKC Footsteps India Private Limited

On 13 September 2021, the Supreme Court pronounced that the refund of GST in case of an inverted GST structure (i.e., where the GST rate on inputs/input services is higher than the GST rate on supply of goods/services) a refund can be claimed by the registered person as per Rule 89(5); however, the refund amount would be confined only to the excess input tax credit (ITC) on goods and not on the services.

This decision came on the background of conflicting decisions given by Madras High Court and Gujarat High Court. In case of an inverted duty structure, the Honourable Madras HC did not allow the refund to the assessee on the ITC pertaining to input services, while according to the Gujarat High Court, the refund was eligible on the entire ITC, i.e., on the inputs (goods) as well as on input services.

Background

The circumstances of an inverted duty structure arise when the rate of tax on inputs exceeds the rate of tax on output supplies, as a result of which the ITC remains unutilized and is accumulated. Second proviso to section 54(3) of the CGST Act provides for refund of such accumulated ITC.

Rule 89(5) of the CGST Rules prescribes the procedure and the method of calculating the refund amount that a taxpayer is entitled to under section 54 of the Act. The formula prescribed under Rule 89(5) of the Rules for calculating the refund amount in case of an inverted duty structure (IDS) specifically excludes ITC pertaining to input services from the formula, but allow refund for accumulated ITC on input goods.

The Issues and Challenges before the SC

- Whether the Rule 89(5) of the CGST Rules is violative of Article 14 of the Constitution of India in as much as it treats dealers with accumulated credit on inputs (goods) and dealers with accumulated credit on input services differently.
- Whether section 164(3) is unconstitutional in as much as it suffers from the vice of excessive delegation.
- It was argued on behalf of the assessee that registered persons constitute a class within the meaning of sub-section (3) of section 54 and each of them is entitled to claim a refund of unutilized ITC whether its origin lies in input goods or input services. In other words, it has been urged that section 54(3) constitutes one homogenous class of registered persons who have unutilized ITC.

SC Verdict & Ratio Decidendi

- The necessity to treat refund of unutilized ITC of input services at par with a refund of unutilized ITC of input was not accepted as, in the opinion of the SC, there is neither a constitutional guarantee nor a statutory entitlement to a refund of ITC.
- Further, both under the Constitution and the Act, goods and services and corresponding ITC of goods and services are treated as distinct categories, hence it was upheld by the Supreme Court that the Parliament is entitled to make policy choices and adopt appropriate classifications and the court cannot delve into the sphere of policy making.

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- The Supreme Court accepted the arguments advanced by the Government that it is not possible to interpret the clause (ii) of the first proviso to section 54(3) in a way so as to include both inputs and input services within the meaning of *input*.
- The court cannot read the words into the provisions as it will result in expanding the scope of the provision beyond what is permissible by the provision as it stands today.
- If the provision of law is explicitly clear, language unambiguous and interpretation leaves no room for more than one construction, it (the statute) has to be read as it is. In that case, the provision of law has to be tested on the touchstone of the relevant provisions of law or of the Constitution and it is not open to a court to invoke the doctrine of "reading down" with a view to save the statute from declaring it ultra vires by carrying it to the point of "perverting the purposes of the statute."
- It was held that once the principle behind section 54(3) is accepted and upheld, the formula under Rule 89(5) rightly gives effect to this and hence cannot be struck down.
- However, the court did recognize that the formula per Rule 89(5) does result in certain imbalances that are unfavourable to the taxpayer and urged the GST Council to reconsider the formula prescribed for computation of the refund amount.

Therefore

It is now settled that in the case of an inverted duty structure, the assessee is eligible for refund in respect of the unutilized ITC pertaining to the inputs (goods) and not on the input services. Upon the orders of the SC, the GST Council may make minor changes to the formula for calculating the maximum eligible refund in such cases.