Half-hearted refunds for inverted duty structure supplies

By Reena Khair & Shreya Dahiya

Even after four years of the introduction of Goods and Service Tax, there is a lack of clarity on many substantive and procedural issues. One such issue is the absence of complete relief from the ill effects of an inverted duty structure, that is where the GST rate paid on purchases is more than the GST rate payable on sales, resulting in an accumulation of credits. The difficulty arises because the taxpayer has to pay tax to its vendors on its purchases in cash. If it is unable to fully offset this tax against its output supplies, there will remain balances in the Credit Ledgers, affecting liquidity as well as creating an additional tax burden.

Even though the accumulation of credit could be a result of the rate of tax on inputs or input services being higher than the rate of tax on output supplies, Section 54 of the CGST Act, 2017 read with Rule 89 of the CGST Rules, 2017 appears to provide for refund of accumulated credit only in respect of inputs. The fate of credits relating to input services remains unclear.

Initially, when GST was introduced in 2017, Rule 89 allowed refund of credits for both goods and services, but by a retrospective amendment, the refund of credit has been restricted to inputs. The retrospective amendment is not only inequitable but has resulted in litigation before different High Courts yielding divergent views on the issue.

The Gujarat High Court in its judgment, in the case of VKC Footsteps India Pvt. Ltd. Vs. Union of India has struck down that part of Rule 89 which denies refund of unutilized credit on input services as ultra vires Section 54 of the Act. The Gujarat High Court has observed that keeping in mind the scheme and object of the CGST Act, it cannot be the intent of the government, while framing the rules, to restrict the statutory provision providing for refund of tax paid on input services, as part of refund of unutilized tax credit.

Taking a contrary position, the Madras High Court, in the case of TVL. Transtonnelstroy Afcons Joint Venture Vs. Union of India, has held that Section 54 provides for benefit only on unutilized credit accumulated on account of inputs used in the provision of output supplies and not on input services. The High Court also holds that differentiation between inputs (goods) and input services is a valid classification and not violative of Article 14 of the Constitution of India.

Noting the difference in opinion of the Madras and Gujarat High court, the Supreme Court is now seized of the matter and will take a final view on the issue. In the interim taxpayers have been left to suffer the ill effects of the inverted duty structure and face uncertainty in taking business and financial decisions.

The GST Council has also considered this issue from time to time but has not offered any tangible solutions to the problem, so far. The Government has assured industry, that this issue will be addressed by the Council in its upcoming meetings.

While we wait for the outcome of the cases pending before the Supreme Court, the government must look beyond revenue considerations, and remove the ambiguity in the GST law. This anomaly puts those facing inverted duty structure at a significant disadvantage as compared to other taxpayers, who are able to pass on their tax liability in full to their customers. Needless to say, that the inverted duty structure is a creation of the Government and not the taxpayer, and therefore there appears to be no justification for the reluctance to allow refund of the tax paid on input services, where credits accumulate due to the lack of avenues for utilization.

The failure to adequately address this problem has meant higher manufacturing costs for production units in textiles, steel, rubber, footwear, etc., who are already suffering from the slow demand due to the covid pandemic. If the Government is serious about programs like the Make in India and Atmanirbhar Bharat, it will have to be more proactive in finding answers to problems affecting the viability and competitiveness of manufacturing in India.

For any queries, you may reach Reena Khair at reena.khair@kochhar.com

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