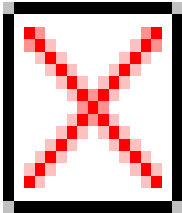


IDS - Input Services & capital goods - Awaiting their fate

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GST legislation prescribes multiple tax rates on supply of goods and services reliant upon the form and nature of supply. However, there are instances wherein the rates of tax on inward supplies are higher than the rate of tax on outward supplies. Such situation has been referred as **"Inverted duty structure"** (IDS). The IDS invariably results in accumulation of input tax credit (ITC) and thereby blockage of working capital.

Presently, the only option available to such sectors with IDS is to obtain the refund for unutilized ITC ¹

. However, the refund mechanism/formulae as amended retrospectively for deriving at the eligible refund amount enables the taxpayer to obtain refund for **inputs only and does not include input services within its ambit**.

The restriction has resulted to substantial financial burden for IDS affected sectors such as textiles, e-commerce companies etc. Various writ petitions have also been filed before High Courts challenging the retrospective amendment in the GST provisions restricting the refund of input services.

A welcoming judgment was pronounced by the ***Gujarat High Court in case of VKC Footsteps India Private Limited*** - [2020-TIOL-1273-HC-AHM-GST](#)

wherein it had struck down the GST provision which restricts the benefit of refund of ITC on inputs only and disallows the refund for tax credit relating to input services. The honorable court had stated that the refund cannot be restricted to inputs excluding input services and such denial is violative of GST Provisions, which entitles the registered person to claim refund of **"any"**

unutilized ITC. Further, the court had held that the Act makes no distinction between zero rated supply and IDS which allows refund of both inputs and input services therefore the GST rules cannot contradict the Act by restricting the refund only to inputs excluding the input services. Besides, the court observed that keeping in mind scheme and object of the GST law, denying a registered person refund of tax paid on input services as part of refund of unutilized ITC cannot be the intent of law. Accordingly, it directed the tax authorities to allow petitioner's refund claim considering the unutilized ITC of input services as part of the net ITC for the purpose of calculation of refund claim. The observations made by the HC were exhaustive and seemed rational and aimed to resolve the ambiguity persisted in the law.

However, contrary to this judgment of Gujarat High Court, the

Madras High Court has recently in case of Tvl. Transtonnelstroy Afcons Joint Venture - [2020-TIOL-1599-HC-MAD-GST](#), dismissed the writ petition challenging the constitutional validity of provisions related to refund in case of IDS. The Madras High Court stated that we are unable to subscribe to the conclusions derived by Gujarat High Court in case of VKC Footsteps as the relevant refund provisions are clear and limit a registered person to claim refund of ITC on inputs only. The word **"inputs"**

encompass all input goods, other than capital goods, and excludes input services. The Court further mentioned that the Gujarat High Court has failed to take in to consideration the scope, function and impact of the relevant refund provisions.

Key observations made by Madras High Court are enumerated below:

The legal provision seems to be clearly and manifestly well established:

The Madras HC observed that while interpreting any statute, one of the cardinal rules of interpretation is that every word of the statute should be given meaning and one should not construe a statute in such a way as to render certain words redundant. The relevant provision qualifies the enacting clause by also limiting the source/type and, consequently, quantity of unutilized ITC in respect of which refund is permissible. Hence, it does not merely set out the two cases i.e. zero-rated supply and IDS, in which registered persons become eligible for a refund of

unutilized ITC. The proviso performs the larger function of also limiting the entitlement of refund to credit that accumulates as a result of the rate of tax on input goods being higher than the rate of tax on output supplies. Accordingly, the court mentioned that the legal position seems to be clearly and manifestly well established.

The provisions are intra-vires to the Act and in conformity with the Statute:

The mechanism to determine Net ITC as per the present provisions has been restricted to provide for refund only on unutilized input tax credits that accumulates on account of input goods only. Hence, refund is permitted only in respect of unutilized ITC that accrues as a result of higher rate of tax on input goods vis-à-vis output supplies. Accordingly, the court observed that the amended provisions excluding the input services is in conformity with the statute and is intra-vires to the Act.

Refund provisions does not infringe the Constitution: Further, it held that the refund provisions does not infringe the constitution ² and that refund is a statutory right and the extension of the benefit of refund only to the unutilized credit on inputs under IDS by excluding accumulated ITC on account of input services is a valid classification and a valid exercise of legislative power. Therefore, it is not necessary to interpret the amended provision and the definition of Net ITC therein to include the words input services.

Classification is valid, non-arbitrary and far from invidious:

The HC stated that the goods and services have been treated differently from time immemorial. While there has been a legislative trend towards a more uniform treatment as between goods and services, the distinction has certainly not been obliterated as is evident on perusal of the CGST Act including provisions which are specifically targeted at goods and services separately. Hence, keeping in mind the factors like inherent differences between goods and services, the wide Parliamentary latitude as regards classification *qua* tax, which is affirmed by the Supreme Court; and the nature and character of refund as a creation of statute and subject to statutory eligibility conditions, we conclude that the classification is valid, non-arbitrary and far from invidious.

The moot question that arises is whether the authorities are empowered to restrict the refund for only specified category through a "**proviso**" to the refund provision and whether strict interpretation of the law should be made while granting some benefit to the taxpayers. As observed by Madras High Court, the "**proviso**" which restricts the refund eligibility for IDS is an integral part of the GST provisions and the importance and role of a "**proviso**" cannot be overlooked.

At this juncture, with the present legal framework, refund for inputs only may be available and not for input services and capital goods. Considering the contradictory rulings, the matter is likely to reach the Apex Court and, accordingly, the businesses will have to wait until the matter attains finality.

[The views expressed are strictly personal.]

¹ Section 54 of Central Goods and Services Tax [Act, 2017](#) to be read with Rule 89 of Central Goods and Services Tax [Rules, 2017](#)

²Article 14 of the Constitution of India.

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