Refinement in formula for claiming refund of ITC in case of Inverted Duty Structure

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As per Section 54(3) of CGST Act, 2017 *subject to the provisions of sub-section (10), a registered person may claim refund of any unutilised input tax credit at the end of any tax period:*

Provided that no refund of unutilised input tax credit shall be allowed in cases other than—

   i.   *zero rated supplies made without payment of tax;*

   ii.   *where the credit has accumulated on account of rate of tax on inputs being higher than the rate of tax on output supplies (other than nil rated or fully exempt supplies), except supplies of goods or services or both as may be notified by the Government on the recommendations of the Council:*

Further, Rule 89(5) of CGST Rules, 2017 prescribes the formula for claiming refund of ITC accumulated due to rate of tax on inputs being higher than the rate of tax on output supplies i.e. inverted duty structure.

As per Rule 89(5) of CGST Rules, 2017, *in the case of refund on account of inverted duty structure, refund of input tax credit shall be granted as per the following formula:-*

Maximum Refund Amount = {(Turnover of inverted rated supply of goods and services) x Net ITC ÷ Adjusted Total Turnover} - tax payable on such inverted rated supply of goods and services.

Explanation:- For the purposes of this sub-rule, the expressions –

   a)   *Net ITC shall mean input tax credit availed on inputs during the relevant period other than the input tax credit availed for which refund is claimed under sub-rules (4A) or (4B) or both; and*

   b)   *"Adjusted Total turnover" and "relevant period" shall have the same meaning as assigned to them in sub-rule (4)*

As per the above mentioned formula, the following challenges are being faced by the refund applicants:

- As the Net ITC as per the above formula mean the ITC availed on inputs only, the refund of ITC on input services is not eligible to the refund applicants.
- The above formula for calculating the amount of refund makes a presumption that the output tax payable on supplies has been entirely discharged from the ITC accumulated on accounts of input goods and there has been no utilization of the ITC on input services.

To overcome the challenges being faced by the refund applicant, the Honorable Gujarat High Court in case of **VKC Footsteps India Pvt. Ltd. Vs UOI** [2020 (7) TMI 726] held that Explanation (a) to Rule 89(5) of the CGST Rules, 2017 to be ultra vires the provisions of sub-section (3) of section 54 of the CGST Act, 2017. The respondents are directed to allow the claim of the refund made by the petitioners considering the unutilised input tax credit of "input services" as part of the "net input tax credit"(Net ITC) for the purpose of calculation of the refund of the claim as per Rule 89(5) of the CGST Rules,2017 for claiming refund under Sub-section 3 of Section 54 CGST Act,2017.

However, the above decision has been reversed by the Honorable Supreme Court [Civil Appeal No 4810 of 2021]. The Supreme Court, after going through the arguments put forth by both the Parties, held that;

- *Refund is not a constitutional right but a statutory right and therefore, the legislature, in its wisdom, and through statute, can decide how the refund is to be granted.*
- *Under proviso (ii) to Section 54(3) of the CGST Act, 2017, the legislature has used the word "inputs" which, as defined in the act, means only input goods. Therefore, there is no disharmony between Rule 89(5) of the CGST Rules and Section 54(3) of the CGST Act. If the legislature had any intention of giving the credit of tax paid on input goods and input services, the legislature would not have restricted the scope of refund in inverted duty structure to only "inputs".*
- *Rule 89(5) was framed under Section 164 of the CGST Act and therefore, Rule 89(5) is not without jurisdiction.*
- *An inequitable and discriminatory provision in tax legislation does not make it discriminatory per se. The court observed that input goods and input services constitute two different classes and therefore, the argument that equals are being treated unequally does not hold water.*
- *The Supreme Court did acknowledge that the formula in Rule 89(5) of the CGST Rules 2017 is inequitable and therefore, urged the GST Council to take the necessary corrective action.*

Thus, the Honorable Supreme Court after reversing the Judgment pronounced by the Honorable Gujarat High Court and looking into the ambiguity in the formula for claiming refund of ITC in

inverted duty structure, Honorable Supreme Court urged the GST Council to take the necessary corrective action in this regard.

In this regard, the GST Council in its 47th meeting held on 29.06.2022 recommended as follows:

Change in formula for calculation of refund under rule 89(5) to take into account utilization of ITC on account of inputs and input services for payment of output tax on inverted rated supplies in the same ratio in which ITC has been availed on inputs and input services during the said tax period. This would help those taxpayers who are availing ITC on input services also.

To comply with the above recommendations, CBIC vide Notification No. 14/2022-Central Tax dated 05-07-2022 has made an amendment in the formula under Rule 89(5) of CGST Rules, 2017 which now reads as under:

Maximum Refund Amount = {(Turnover of inverted rated supply of goods and services) x Net ITC ÷ Adjusted Total Turnover} – {tax payable on such inverted rated supply of goods and services x (Net ITC ÷ ITC availed on inputs and input services)}

The above change in the formula is done to take into account such that reduction of output tax on inverted rated supplies is to be done in the same ratio in which ITC has been availed on input and input services during the relevant period. Now, this would help those taxpayers who are availing ITC on input services also which has been explained by of the following Illustration:

Particulars	Amount
ITC on Inputs	6,00,000
ITC on Input Services	4,00,000
Total ITC	**10,00,000**
Total Turnover	1,50,00,000
Turnover of Inverted Duty Supplies	50,00,000
Turnover other than Inverted Duty Supplies	1,00,00,000
Output Tax on Inverted Duty Supplies (Rate @ 5%)	2,50,000

Now, in the above illustration, the amount of refund eligible to the applicant before the amendment in the formula is calculated as follows:

(6,00,000 x 50,00,000 ÷ 1,50,00,000) – 2,50,000 = -50,000 or Nil

However, the amount of refund eligible to the applicant after the amendment in the formula is calculated as follows:

$(6,00,000 \times 50,00,000 \div 1,50,00,000) - (2,50,000 \times 6,00,000 \div 10,00,000) = 50,000$

Thus, the applicant is eligible for the refund of INR 50,000 as per the above illustration as the output tax on inverted duty supplies is bifurcated in the ratio of ITC on inputs to the total ITC which includes ITC on input services also.

Now, after this amendment, the anomaly in the refund formula has been removed leading to resolution of unnecessary disputes among the industry claiming the refund on account of inverted duty structure.