INVERTED DUTY STRUCTURE: PERPLEXITY IN REFUND

1.1 Literal Concept of Inverted Duty Structure

The term "Inverted Duty Structure" (IDS) refers to the scenario where the rate of tax on the inputs is higher than the rate of tax on the output supplies. In such a situation, the ITC received by a registered person remains unutilised, and if the same is not refunded to the taxpayer, it would increase the cost of production and would result in cascading effect by disallowing the seamless flow of credit of the GST paid. For instance, in the case of fertilizers, the rate of output tax is 5%. However, the raw materials required to manufacture the final product (such as ammonia and sulphur) are taxable at the rate of 18%. This leads to a situation of credit accumulation in the hands of the supplier, which in turn leads to capital blockage, if not refunded.

1.2 Legislative Provisions

Section 54 of the GST Act provides the substantive right to claim a refund of any unutilised input tax credit at the end of any tax period. The section is extracted hereunder for reference:

> ***Refund of tax.***
>
> *54. (1) Any person claiming refund of any tax and interest, if any, paid on such tax or any other amount paid by him, may make an application before the expiry of two years from the relevant date in such form and manner as may be prescribed:*
>
> *………………………*
>
> *(2) ………………….*
>
> *(3) Subject to the provisions of sub-section (10), a registered person may claim a 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) …………………..;*
>
> *(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:*
>
> *X.X.X.X.X.X.X."*

Sub-rule (5) of Rule 89 of GST Rules provides the procedural law for claiming the refund of 'unutilised input tax credit'. The relevant portion of Rule 89 is extracted hereunder for reference:

> *"Rule 89. Application for refund of tax, interest, penalty, fees or any other amount-*
>
> *"XXXXX.*

From 01.07.2017 to 18.04.2018

(5) 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) x Net ITC ÷ Adjusted Total Turnover} - tax payable on such inverted rated supply of goods

Explanation.- For the purposes of this sub-rule, the expressions "Net ITC" and "Adjusted Total turnover" shall have the same meanings as assigned to them in sub-rule (4)."

From 18.04.2018 to 13.06.2018 (NN 21/2018 – CT dated 18.04.2018)

(5). 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" shall have the same meaning as assigned to it in sub-rule (4).

From 13.06.2018 Onwards (NN 26/2018 – CT dated 13.06.2018 WREF 01.07.2017)

(5) 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) [1]"Adjusted Total turnover" and "relevant period" shall have the same meaning as assigned to them in sub-rule (4)

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[1] Substituted vide Notification No. 74/2018 – Central Tax dated 31-12-2018 before it was read as
(b) Adjusted Total turnover shall have the same meaning as assigned to it in sub-rule (4)

From the chain of amendments reproduced above, it is clear the refund of the unutilised input tax credit has been restricted only to inputs and that too by way of making retrospective amendment in the rules.

1.3 Jurisprudence under the Goods and Services Tax Regime

VKC. Footsteps India Pvt. Ltd. Vs. Union of India - R/Special Civil Application No. 2792 of 2019 dated July 24, 2020

- **Gist of the case**

  Rule 89(5) has been held as ultra vires to the provisions of Section 54(3) of GST Act and direction has been given that the refund of GST paid on 'input services' shall be considered for the calculation of refund under Rule 89(5) of CGST Rules.

- **Contentions of Assessee**
  a. GST is a consumption tax where the tax burden is borne by the final consumer and business does not bear the burden of tax since business is allowed to take credit of the tax paid on anterior supplies received by it. In case rate of inward supplies is higher than the rate of outward supplies, the true nature of consumption tax would be defeated as unutilised input tax credit would keep on accumulating. In such circumstances, the best way to mitigate the tax cost is to allow refund thereof. On this premise, section 54(3) is enacted in the GST Act.
  b. Section 54(3) refers to the refund of 'any unutilised input tax credit'. The exclusion of 'input service credit' whittles down the effect of the word "Any" in the aforesaid phrase. Though the term "any" has not been defined under the CGST Act, however, as per Black's Law Dictionary (4th Ed., 1968) "Any" means "one out of many; an indefinite number; one indiscriminately of whatever kind and quantity.
  c. The Government framed the rule 89(5) for the limited purpose of estimating the input tax credit relatable to inverted rated supplies. In the grab of fixing a formula, the refund has been restricted to the extent of 'inputs' only which is not permissible. Therefore, this rule is not for the purpose of carrying out the provisions of the Act.

- **Decision of Court**
  a. Refund of 'inputs' as well as 'input services' is allowed under 'inverted duty structure'.
  b. The department is directed to allow the claim of refund made by the petitioners.
- **Comments**
  a. The decision is welcomed and is going to benefit taxpayers.
  b. It is advisable to re-check the status of compliances made in past and lodge claim for refund of 'input services', wherever applicable. For the assistance of taxpayers, various situations have been visualised with our advise to follow:

S.No.	Status of claims	Present status	Way forward

1	Refund claimed and pending for adjudication	Order awaited	Additional submissions should be made at the time of the personal hearing.
2	Refund claimed and rejected	Three months to file an appeal are not expired	Either of the following shall be done: a) File appeal Or b) File writ petition under Article 226 of the Constitution of India
3		Pending before First Appellate Authority	Additional submissions should be made at the time of the personal hearing.
4		Rejected by First Appellate Authority	Either of the following shall be done: c) Wait for the constitution of GST Appellate Tribunal and file appeal Or d) File writ petition under Article 226 of the Constitution of India
5		Three months to file the appeal are expired	File writ petition under Article 226 of the Constitution of India
6	Refund not claimed	Within period of 2 years from relevant date	File refund application
7		Time barred	No remedy.
8	Refund claimed for 'inputs' only	Within period of 2 years from relevant date	File refund claim either under the category of 'Any Others' or submit manual application under

			same category. Correspondingly debit the balance lying in electronic credit ledger by way of filing Form DRC-03
9		Time barred	No remedy.

1.4 Legal Scrutiny of claims which have become barred by time

Hon'ble Supreme Court in case of ***Mafatlal Industries V Union of India*** reported as 1996 (12) TMI 50 held eligibility to claim refunds in three situations; (i) unconstitutional levy, (ii) illegal levy, and (iii) mistake of law. The refund claims falling in either of the classes has to be adjudged as per the settled decision in case of Mafatlal (*supra*). The relevant extract of the judgment is reproduced hereunder:

"*17. We must, however, pause here and explain the various situations in which claims for refund may arise. They may arise in more than one situation. One is* ***where a provision of the Act under which tax is levied is struck down as unconstitutional*** *for transgressing the constitutional limitations. This class of cases, we may call, for the sake of convenience, as cases of* ***"unconstitutional levy".*** *In this class of cases, the claim for refund arises outside the provisions of the Act, for this is not a situation contemplated by the Act.*

18. Second situation is ***where the tax is collected by the authorities under the Act by mis-construction or wrong interpretation of the provisions of the Act, Rules and Notifications or by an erroneous determination of the relevant facts****, i.e., an erroneous finding of fact. This class of cases may be called, for the sake of convenience, as* ***illegal levy****. In this class of cases, the claim for refund arises under the provisions of the Act. In other words, these are situations contemplated by, and provided for by, the Act and the Rules.*

19………………………..
20. …………………………………
21. ………………………

22. There is as yet a third and an equally important category. It is this: a manufacturer (let us call him "X") pays duty either without protest or after registering his protest. It may also be a case where he disputes the levy and fights it out up to first Appellate or second Appellate/Revisional level and gives up the fight, being unsuccessful therein. It may also be a case where he approaches the High Court too, remains unsuccessful and gives up the fight. He pays the duty demanded or it is recovered from him, as the case may be. In other words, so far as `X' in concerned, the levy of duty becomes final and his claim that the duty is not leviable is finally rejected. But it so happens that sometime later - may be one year, five years, ten years, twenty years or even fifty years - the Supreme Court holds, in the case of some other manufacturer that the levy of that kind is not

exigible in law. (We must reiterate - we are not speaking of a case where a provision of the Act whereunder the duty is struck down as unconstitutional. ***We are speaking of a case involving interpretation of the provisions of the Act, Rules and Notification****.) The question is whether `X' can claim refund of the duty paid by him on the ground that he has discovered the* ***mistake of law*** *when* ***the Supreme Court has declared the law in the case of another manufacturer*** *and whether he can say that he will be entitled to file a suit or a writ petition for refund of the duty paid by him within three years of such discovery of mistake? …………………………*

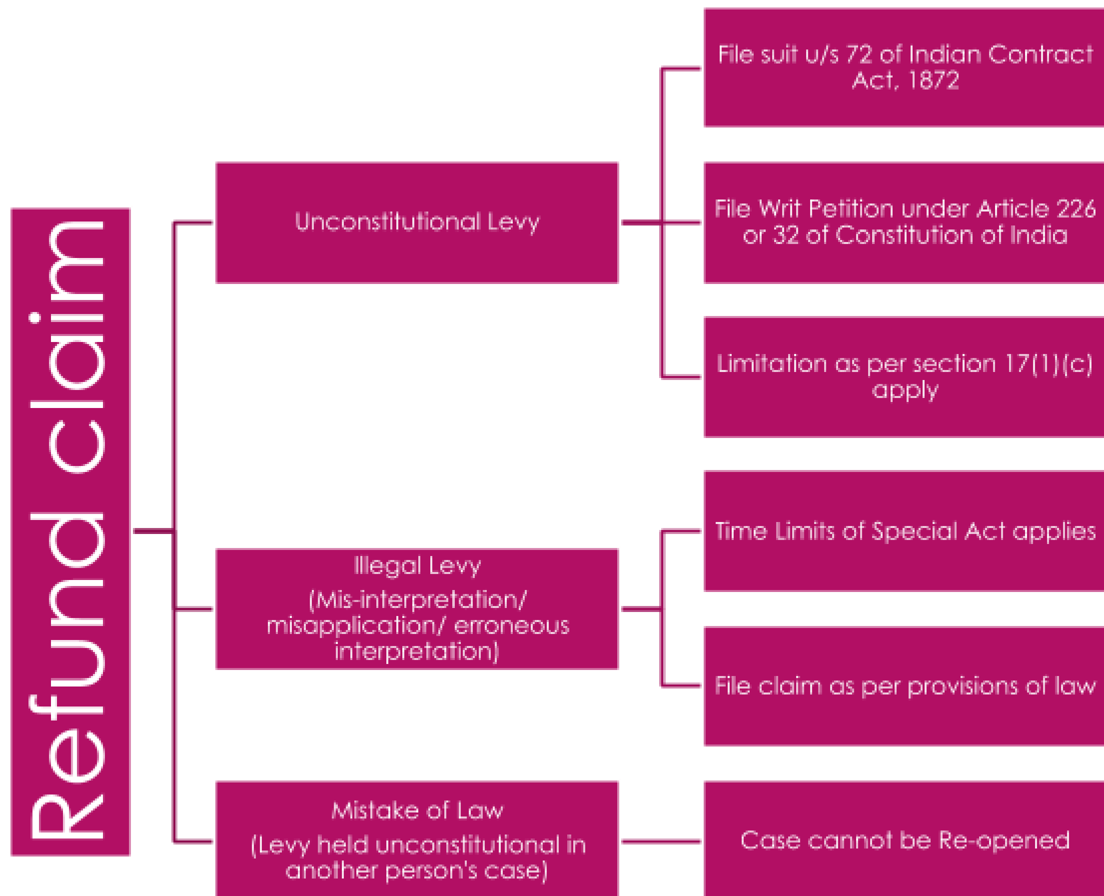
………………………………………

99. ………………………….. Where a refund of tax/duty is claimed……………. - by mis-interpreting or mis-applying the provisions of the Central Excises and Salt Act, 1944 read with Central Excise Tariff Act, 1985 or Customs Act, 1962 read with Customs Tariff Act or by mis-interpreting or mis-applying any of the rules, regulations or notifications issued under the said enactments, ***such a claim has necessarily to be preferred under and in accordance with the provisions of the respective enactment before the authorities specified thereunder and within the period of limitation prescribed therein****……………… While the jurisdiction of the High Courts under Article 226 - and of this Court under Article 32 - cannot be circumscribed by the provisions of the said enactments, they will certainly have due regard to the legislative intent evidenced by the provisions of the said Acts and would exercise their jurisdiction consistent with the provisions of the Act. The writ petition will be considered and disposed of in the light of and in accordance with the provisions of Section 11B. This is for the reason that the power under Article 226 has to be exercised to effectuate the rule of law and not for abrogating it…………*

Where, however, a refund is claimed on the ground that(ii) the provision of the Act under which it was levied is or has been ***held to be unconstitutional, such a claim, being a claim outside the purview of the enactment, can be made either by way of a suit or by way of a writ petition.*** *This principle is, however, subject to an exception: where a person approaches the High Court or Supreme Court challenging the constitutional validity of a provision but fails,* ***he cannot take advantage of the declaration of unconstitutionality obtained by another person on another ground****; this is for the reason that so far as he is concerned, the decision has become final and cannot be re-opened on the basis of a decision on another person's case; this is the ratio of the opinion of Hidayatullah, CJ. in Tilokchand Motichand and we respectfully agree with it.*

…………… In such cases, ***period of limitation would naturally be calculated taking into account the principle underlying Clause (c) of sub-section (1) of Section 17 of the Limitation Act, 1963…………….****"*

Therefore, the Hon'ble apex court upheld the legibility to claim refunds in three broad categories and decided as under:



The present situation shall not be termed as a situation of 'unconstitutional levy' because if it is so categorized, then the cases of assessee's who gave up their fights either at first appellate level or at adjudicatory levels would be categorized as 'mistake of law' and they would not be allowed to file suit or writ petition for recovery of taxes so paid/rejected on the basis of favorable decision rendered in case of another person. The present situation shall be categorized under 'Illegal levy' where the claims shall be made as per the provisions of GST law and within a period of two years from relevant date. Since the claims are rejected by authorities on the basis of erroneous interpretation of law, taxpayer has right to challenge the rejections orders/ appellate orders before jurisdictional High Courts by way of filing writ petition under article 226 of Constitution of India.

1.5 Conclusion

The Inverted Duty Structure has been introduced to tackle the issues pertaining to unutilized ITC and to remove the cascading effect. If the unutilized ITC is not refunded, then he has to either add the unutilized ITC in the cost of output, or he himself has to bear the losses. It is evident that the trader or any other person are equally affected by the Inverted Duty Structure and stand on an equal pedestal, and further, no difference would be caused if the inputs and output supply is the same.

The Government should not deny the genuine and legitimate claims of refunds of the accumulated unutilised ITC of the taxpayer merely to reduce the burden on the exchequer. In this regard, it is relevant to quote the recent finding of the Hon'ble Madras High Court in the case of ***M/s. Precot Meridian Limited Vs Commissioner of Customs*** wherein after relying on the matter of *CCR, Bolpur v. Ratan Melting and Wire Industries*, the Hon'ble Court observed that "it is held that circulars cannot prevail over the statute. Circulars are issued only to clarify

the statutory provision, and it cannot alter or prevail over the statutory provision." Further, the Hon'ble Delhi High Court in a recent decision in case of ***Pitambra Books Pvt. Ltd. v. Union of India***, while citing its earlier decision ruled that "Circulars might mitigate rigours of law by granting administrative relief beyond relevant provisions of the statute; however, Central Government is not empowered to withdraw benefits or provisions of the statute." Therefore, a taxpayer must make a legal check in cases of circulars which imposes restrictions so that his claims remain valid in the eyes of law.

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