**ITC refund under inverted rate structure –retrospective application**



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**Introduction**

Inverted duty structure refund has been subject matter of numerous interpretational issues since introduction of this concept in GST law. The Council in its 47th Meeting tweaked the formula for claiming refund. In this article, an attempt has been made to analyse the application of the amendments made in the [1] formulae prescribed for the calculation of refund of unutilized ITC accumulated due to an inverted rate structure and [2] the impact of the withdrawal of the refund benefit for certain commodities.

**Refund of unutilized ITC owing to the inverted rate structure**

Section 54(3)(ii) of the GST Act allows a refund of unutilized ITC accumulated on account of the GST rate on **inputs** being higher than the GST rate on **output supplies.** The word “inputs” is not defined under GST, however, **“input” is defined under Section 2(59) to mean any goods other than capital goods.** Thus, two interpretations came into the picture viz.;

* **First interpretation: -** “inputs” would be read as a plural of the “input” and the refund of unutilized ITC would be restricted to the ITC of input goods; and
* **Second interpretation: -** there is no difference between goods and services and a refund of ITC availed on input services would be eligible in the schema.

The Madras High Court followed the first interpretation**[[1]](#footnote-1)**. Whereas the Hon’ble Gujarat High followed the second interpretation.**[[2]](#footnote-2)** The matter reached the Hon’ble Supreme Court and the ruling of the Hon’ble Madras High Court was made the law of the land.

However, in this ruling, the Hon’ble Supreme Court[[3]](#footnote-3) noted that the formulae prescribed for the calculation of a refund suffer from an anomaly and recommended GST Council to take appropriate policy decision for removal of anomaly.

**Anomaly in the formulae of calculation of refund amount**

Rule 89(5) of the GST Rules prescribes a formula for the calculation of refund of unutilized ITC on account of an inverted rate structure. The formula as it stood before July 2022 is as follows:

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

Applying the legal principle pronounced by the Apex Court, “Net ITC” was to include only such ITC attributable to “inputs” i.e. input goods. With this understanding, let us understand the application of the formulae with an example.

|  |  |  |
| --- | --- | --- |
| **Calc.** | **Particulars** | **GST** |
| A | ITC on input goods | 25 |
| B | ITC on input services | 15 |
| C=A+B | Total ITC | 40 |
| D | Inverted rate turnover | 100 |
| E | Adjusted Total turnover | 150 |
| F | Output tax on inverted rate turnover | 12 |
| F=A\*D/E-F | Refund eligible | 4.67 |

On a perusal of the above formulae, it transpires that **refund was allowed only of the ITC availed on input goods** (A) whereas the **output tax deducted (F) was the output tax paid by utilizing both viz. ITC of input goods as well as ITC of input services**. This anomaly resulted in the sanction of reduced refund claims or denial of claim in some cases, hence, the formulae created an imbalance against applicants.

In this regard, the Hon’ble Supreme Court noted that the GST Council should ascertain whether the deduction of output tax in the formulae could be allowed to be made in the proportion of ITC on input goods and input services.

**Amendment in the formulae**

In terms of the remarks made by the Hon’ble Supreme Court, the GST Council, in its 47th GST Council Meeting, proposed the following change which was incorporated in Rule 89(5) w.e.f. 05 July 2022 vide Notification No. 14/2022-CT;

*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)}.***

Accordingly, as per the revised formulae, the deduction of output tax would be in proportion to the ITC availed on goods. Thus, a revised calculation of the refund amount in the above example per the amended formulae is as follows:

|  |  |  |
| --- | --- | --- |
| **Calc.** | **Particulars** | **GST** |
| A | ITC on inputs | 25 |
| B | ITC on services | 15 |
| C=A+B | Total ITC | 40 |
| D | Inverted rate turnover | 100 |
| E | Adjusted Total turnover | 150 |
| F | Output tax on inverted rate turnover | 12 |
| **G=F\*A/C** | **Output tax on inverted rate turnover in proportion to input goods** | **7.5** |
| H=A\*D/E-G | Refund eligible | 9.17 |

On a conjoint reading of the above two tables, it is clear that earlier, the taxpayer was entitled to a refund of INR 4.67 and after the change, the taxpayer would be entitled to a refund of INR 9.17. Accordingly, with the above amendment, the anomaly that existed before has been rectified to certain extent.

**Whether the benefit of the amendment could be taken for the past period?**

As discussed above, the change would be a breather for the industry, however, at the same time, we may need to look at the past and analyse if the amendment could be utilized for the past periods. In this regard, the application of the above amendment for past period refunds is as tabulated below;

|  |  |  |
| --- | --- | --- |
| **N.** | **Situation** | **Retrospective applicability of amendment** |
| 1 | Refund pertains to ITC accumulated post-July 2022 | The amendment would apply |
| 2 | Refund pertains to ITC accumulated before July 2022 | |
| A | Refund applications wherein ITC of input services was claimed and which are presently in litigation. | As per the Hon’ble Supreme Court’s order, the refund of ITC of input service is not eligible. However, the applicants may file additional submissions to claim the benefit of the new formulae. The grounds for retrospective application of the formulae are as discussed below. |
| B | A refund application has not been filed but the limitation period to file a refund has not expired. | The amendment may apply to such refund applications. The grounds for retrospective application of the formulae are as discussed below.  It is also noteworthy that vide Notification No. 13/2022-CT, the Government has instructed to exclude the period from March 2020 to February 2022 to claim the refund. Therefore, a benefit of this notification could also be availed to claim past refunds. |

**Retrospective application of the formulae**

It is apposite to note that at the time of implementation of GST, as per the formulae prescribed under Rule 89(5), the refund was eligible for both viz. ITC w.r.t. input goods and input services. Accordingly, the output tax was deductible w.r.t. GST paid by utilization of ITC of input goods and ITC of input services. **Thus, there was a balance in refund amount vis a vis output tax deduction.**

However, vide Notification No. 21/2018-CT dated 18 April 2018, the definition of Net ITC was amended retrospectively to include only ITC of input goods whereas the deduction of output tax was for tax paid through input goods and input services. **Thus, after the retrospective amendment, there was an anomaly created which created an imbalance in the favour of revenue.**

Accordingly, when looking from this angle, it could be construed that the instant change is done to restore the balance which existed before the retrospective amendment in line with the Government’s consistent policy not to allow refund of unutilised credit of input services.

In the light of the above, it is noteworthy that amendments made to restore the position which existed before the creation of anomalies are clarificatory and have a retrospective effect. See **WPIL Ltd vs CCE[[4]](#footnote-4), Ralson (India) Ltd. Vs Commissioner[[5]](#footnote-5).**

Applying the above legal principle in the instant case, it could be construed that the change in the formulae is nothing but a restoration of the balance that existed earlier with an intent to restrict the benefit of refund on input goods. Thus, the change would have a retrospective effect. Accordingly, the new formulae could be applicable for refund of credits accumulated in the past period.

Additionally, it is apposite to note that as Rule 89(5) prescribes a method to calculate the amount of refund eligible under the inverted rate schema, it could be construed that the revised method would apply to all the refunds claimed after the amendment as the refund claims filed after the amendment would be governed by the procedure prescribed under Rule 89(5) as on the date of refund application.

Moreover, it is a settled legal principle that when the law intended to give benefit to the person then, the procedural amendments made in line with such intent would have retrospective application. See **Vatika Township Pvt. Ltd.[[6]](#footnote-6)**

Based on the above discussion, authors are of the view that the amendment should have a retrospective application.

**Impact of withdrawal of refund benefit for specified commodities (edible oil and coal)– whether retrospective or prospective**

The Government, vide Notification No. 09/2022-Central Tax (Rate) dated 13 July 2022 has notified that refund of ITC accumulated owing to inverted rate structure would not be allowed for several commodities such as various types of oils, coals, lignite, peat etc. In this regard, the impact of the above change is as tabulated below;

|  |  |  |
| --- | --- | --- |
| **S.N.** | **Scenario** | **Whether a refund would be eligible?** |
| 1 | Refund applications have already been filed and refund yet to be received | Yes, the amendment would not apply to such refund applications. |
| 2 | Refund applications have already been filed and refund is in litigation | Yes, the amendment would not apply to such refund applications. |
| 3 | Refund application for refunds pertaining to ITC accumulated before the issuance of the notification has not been filed yet | Yes, because changes which are oppressive to taxpayers cannot be interpreted to have a retrospective effect. See **Ashish Katiyar[[7]](#footnote-7)** and **Shabnam Petrofils[[8]](#footnote-8)** |
| 4 | Refund applications for refunds pertaining to ITC accumulated after the issuance of the notification | The amendment would be applicable and the refund would not be eligible. |

**Plan of action by business**

In light of the above, the business working in industries wherein there is an inverted rate structure such as textile, solar, FMCG and pharmaceutical sector, whose inputs are taxable at a higher rate than, the output supplies should do the following;

* Make a list of refund applications already filed;
* If the refund applications are in litigation then, make additional submissions for claiming the benefit;
* If the refund applications are not yet filed then, file the same as per the changed formulae as soon as possible in view of the amended time limit;
* For the future, the businesses may evaluate permutations and combinations as to what should be the optimum period for filing of refund that would allow them to have the maximum refund benefit in their business as per the amended formulae; and
* For suppliers dealing in oil and coal, file all the refund applications pertaining to the previous period as soon as possible with the amended formulae and claim the benefit.

**Conclusion:**

The amendment has been positive step by the Council to consider the impact of ITC accumulation on account of services. It is now relevant for all taxpayers stuck with accumulated ITC under inverted structure if the amended provision could be of help to them for filing refund claim and take requisite actions at the earliest to ensure that the benefit is availed.

*(Views expressed are personal views of the authors. Your comments or feedback welcomed at* [*ashish@hiregange.com*](mailto:ashish@hiregange.com) *or* [*poojajajwani@hiregange.com*](mailto:poojajajwani@hiregange.com)*)*

1. See Tvl. Transtonnelstroy Afcons Joint Venture Writ Petition Nos 8596, 8597, 8602, 8603, 8605 and 8608 of 2019 [↑](#footnote-ref-1)
2. See VKC Footsteps India Pvt. Ltd., R/ Special Civil Application No 2792 of 2019 [↑](#footnote-ref-2)
3. See UOI Vs VKC Footsteps India Pvt. Ltd., Civil Appeal No. 4810 of 2021 [↑](#footnote-ref-3)
4. 2005 (181) ELT 359 (SC) [↑](#footnote-ref-4)
5. 2015 (324) ELT A34 (SC) [↑](#footnote-ref-5)
6. (2015) 1 SCC 1, para 33 [↑](#footnote-ref-6)
7. 2019 (11) TMI 1246 [↑](#footnote-ref-7)
8. 2019 (8) TMI 159 [↑](#footnote-ref-8)