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TAX FLASH NEWS

5 April 2023

Provision restricting the export value for claiming refund is held as ultra vires

Rule 89(4) of the Central Goods and Services Rules, 2017 (CGST Rules) prescribes a formula for the calculation of refund in case of a zero-rated supply of goods or services or both without payment of tax. The term 'turnover of zero-rated supply of goods' for the purpose of refund formula has been defined in Rule 89(4)(C). This term was substituted vide Notification[1] to cover 'the value which is 1.5 times the value of like goods domestically supplied by the same or, similarly placed supplier'. The Karnataka High Court held[2] these words as ultra vires the provisions of the Central Goods and Services Tax Act, 2017 and the Integrated Goods and Services Tax Act, 2017 and violative of Articles 14 and 19 of the Constitution of India.

Facts of the case

- The Petitioner is engaged in developing innovative designs for real-world applications in fields of military applications, etc., wherein the customised products provide effective visualisation in different and challenging environments.

- The Petitioner filed refund applications in May 2020 for exports made from May 2018 to March 2019. The Department issued show cause notice on the ground that the Petitioner had not given proof, which was required to be given in terms of the amended Rule 89(4)(C) and therefore, the refund claims could not be considered. The Department, without considering the reply of the Petitioner, passed an order rejecting the refund claim.

Petitioner's contentions

- Rule 89(4)(C) is ultra vires Section 54 of the CGST Act read with Section 16 of the IGST Act, i.e. Section 16 of the IGST Act seeks to make exports tax-free by 'zero-rating'. In contrast, the impugned Rule 89(4)(C) aims to do just exactly the opposite by restricting the quantum of refund of tax used in making such exports.

- The rule in whittling down the refund is ultra vires in view of the well-settled principle of law that Rules cannot override the parent legislation.

- Rule 89(4)(C) is ultra vires Article 269A read with Article 246A of the Constitution of India, as the Parliament has no legislative competence to levy GST on the export of goods.

- Rule 89(4)(C) is violative of Article 14 and 19(1)(g) of the Constitution of India, i.e. quantum of unutilised input tax credit is restricted only in cases where the export of goods is made without payment of duty under bond/LUT and not in cases where export of goods is made on payment of duty.

- Words 'like goods' and 'similarly placed supplier' in the impugned rule are completely open-ended and are not defined anywhere in the GST Act or Rules. It is not possible to have any 'like goods' and 'same or similar placed supplier' for the unique and customized products being manufactured by the Petitioner.

- When it is impossible for any exporter to show proof of the value of 'like goods' domestically supplied by the 'same or, similarly placed, supplier', the refund itself cannot be denied to such an exporter.

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[1] Notification No. 16/2020-Central Tax dated 23 March 2020
[2] Tonbo Imaging India Pvt Ltd v. Union of India & 3 Ors. [2023-VIL-198-KAR]

- Refund claims of the Petitioner are for the period prior to the date of notification of substitution of Rule 89(4)(C).

Revenue's contentions

- The Petitioner has not submitted the proof that the export turnover mentioned in the refund claim is 1.5 times the value of like goods domestically supplied by the same or similarly placed supplier. Hence, zero-rated turnover declared by the Petitioner cannot be accepted for the purpose of calculation of eligible refund amount.

- The impugned amendment was based on the GST Council's 39th meeting minutes. (As per the 39th GST Council agenda, it was observed that there is a possibility of taking undue benefit by inflating the value of the zero-rated supply of goods. As the intent of the refund is to offset the tax paid on the inward supplies, it is proposed that a ceiling may be fixed for the value of the export supply only for the purpose of calculation of refund.)

High Court's decision

The Karnataka High Court allowed the writ petition in favour of the Petitioner. It upheld the contentions of the Petitioner and declared the impugned offending words, 'or the value which is 1.5 times the value of like goods domestically supplied by the same or, similarly placed supplier' appearing in Rule 89(4)(C) of the CGST Rules, 2017 as ultra vires the provisions of the CGST Act, 2017 and IGST Act, 2017 and violative of Articles 14 and 19 of the Constitution of India. Below are other inferences apart from Petitioner's contentions for the basis for the conclusion:

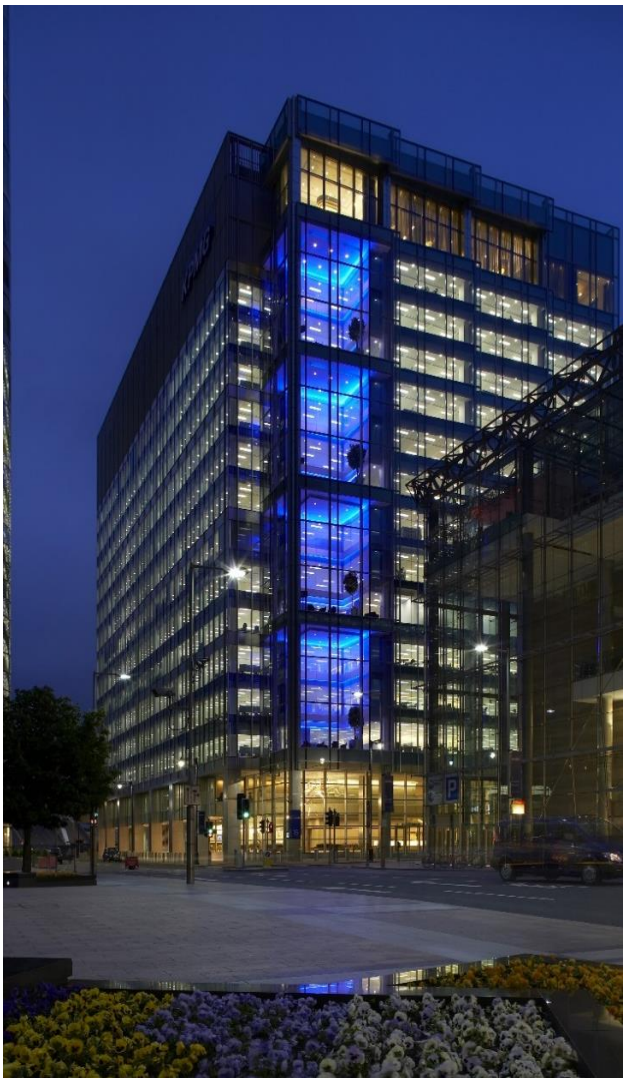
- One of the fundamental principles to make exports competitive in the international market is that taxes are not added to the cost of exports. This intention cannot be carried out by merely exempting the output goods or services.

- Rule 89 of the CGST Rules contains the machinery provisions to operationalise Section 54 of the CGST Act, where exports are done without payment of output tax under bond or LUT.

- The reasons for such amendments based on possible misuse without adequate defining data cannot be countenanced as having a reasonable basis in law. The issue of misuse cannot be generalised. Every such misuse is required to be ascertained and verified before asserting that there has been misuse. The law cannot be amended on the premise of distrust.

Our comments

The amendment had created lot of challenges for exporters as comparing export value with domestic transaction did not seem to be proper. Hence, several representations were made by exporters to amend the definition of "zero-rated supply of goods" but to no avail. Since the rule has been held as ultra vires, there are vast implications primarily benefitting the exporters. One needs to wait and see whether the Department would appeal against this decision or amend the legislation.



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