An Incisive analysis on Refund of TRAN Credit

Introduction:

Whether the credit accumulated in the last returns filed under the previous regime can be taken to electronic credit ledger in terms of section 140 of the CT Act1 by filing TRAN-01 even after the time limit prescribed under Rule 117 of the CT Rules2 has been subjected to vexatious litigation and has caught the Nation's attention with contrary decisions of various High Courts and the retrospective amendments to Section 140. The matter has finally landed before the Honourable Supreme Court3. Read our extensive analysis on the above matter at The Vires, Right & Retrospectivity - Transitional Credit.

On the other hand, another issue related to credit of previous regime which is annoying the exporters is whether they are entitled to claim refund of the credit of the erstwhile regime that was carried forward into electronic credit ledger by filing TRAN-01 i.e. TRAN credit.

CBIC[4] vide their Circular No. 125/44/2019-GST dated 18.11.2019[5] clarified that the TRAN credit is not of the nature of accumulated credit under the GST laws and the same cannot be claimed as a refund against exports undertaken under LUT[6] without payment of IT[7].

In this backdrop an attempt is made in this article to examine the legal validity of the said clarification given by the circular and whether such clarification will also hold good even in case where refund claim was filed in cases where exports are undertaken with payment of tax.

<u>Refund Options under GST Law:</u>

Before we address on the validity of the clarification, let us understand the refund process available to the exporters under the GST law. In terms of section 16 of the IT Act[8], the goods or services exported outside India are considered as zero-rated supplies. Sub-section (3) of the said section provides that the person making zero-rated supply shall be eligible to claim the refund of input taxes in either of the following manners:

- The supplier may supply the zero-rated supplies under bond or LUT without payment of IT and claim the refund of the unutilised input tax credit (This is referred to as Option I henceforth).
- The supplier may supply the zero-rated supplies on payment of IT and later on claim refund of the IT paid on these supplies (This is referred to as Option II henceforth).

[1] Central Goods and Services Tax Act, 2017
[2] Central Goods and Services Tax Rules, 2017
[3] Union of Ind vs Brand Equity Treaties Limited, 2020(6) TMI 517-SC Order
[4] Central Board of Indirect Taxes and Customs
[5] Superseded the earlier Circular No. 37/11/2018-GST dated 15.03.2018 which also had similar restriction
[6] Letter of Undertaking
[7] Integrated Tax
[8] Integrated Goods and Services Tax Act, 2017

Under the Option I, no tax is being paid on the goods or services exported. Further, the input taxes paid on the input goods or services procured and used for the purpose of exporting the output goods or services shall be refunded. While no tax is being paid on output and the input taxes paid are allowed to be claimed as refund, the exports are made zero-rated without any tax burden on the exporter.

Under the Option II, tax is required to be paid on the output goods or services exported. However, while paying the tax[9], the input tax credit accumulated on the input goods or services or capital goods[10] procured and used for the purpose of exports will be used. By setting off the input tax with output tax and claim of such output tax paid as refund will render the exports zero-rated without any tax burden on the exporter.

Clarification of the CBIC Circular:

With the above understanding of the two types of refund options enshrined under the GST law for exporters to claim refund of the tax paid by them, we will now proceed to understand the clarification given by the circular that the TRAN credit cannot be claimed as refund by exporters. The said clarification is given with respect to Option I and is silent about the claim under Option II. The relevant extracts of the circular are reproduced as under:

50. Refund of unutilized input tax credit is allowed in two scenarios mentioned in sub-section (3) of section 54 of the CGST Act. These two scenarios are zero rated supplies made without payment of tax and inverted tax structure. In sub-rule (4) and (5) of rule 89 of the CGST Rules, the amount of refund under these scenarios is to be calculated using the formulae given in the said sub-rules. The formulae use the phrase 'Net ITC' and defines the same as "input tax credit availed on inputs and input services during the relevant period other than the input tax credit availed for which refund is claimed under sub-rules (4A) or (4B) or both". ***It is clarified that as the TRAN credit pertains to duties and taxes paid under the existing laws viz., under Central Excise Act, 1944 and Chapter V of the Finance Act, 1994, the same cannot be said to have been availed during the relevant period and thus, cannot be treated as part of 'Net ITC' and thus no refund of such unutilized TRAN credit is admissible.***

(emphasis supplied by us)

[9] A general misconception is that the payment being mentioned in Option II as payment of tax in cash. It is to be noted that payment of tax in cash would not release the accumulated credit in any manner. Hence, the payment used in Option II has to be understood that payment being made in credit.

[10] There is no restriction for claiming the credit of tax paid on capital goods in Option II. This is also clarified by CBIC in one of its circular, while dealing with invoices to be submitted under both the options. Whether this is a conscious decision or accidental mistake is not known, but it clearly discriminates Option I on this ground. In our view, capital goods should be allowed or not to be allowed under any of method, but not allowed under one method and allowed under the other method. Since the intention of the government is not to export taxes but only services/goods, the credit of capital goods should be allowed in any method. However, this is not the aspect of present deliberation.

Validity of the Circular for Refund Claim under Option I:

Rule 89 of the CT Rules provide for the procedure under which refund claim is to be filed by exporter to claim refund of the accumulated input tax credit. The above clarification of CBIC is based on the reasoning that the TRAN credit does not fit into the meaning of 'Net ITC' as defined under Rule 89. The said rule provides for the manner and procedure which restricts the claim of refund only to the credit accumulated on inputs and input services. Sub-rule (4) of this rule provides that the refund of accumulated credit on account of zero-rated supplies shall be granted as per the formula prescribed therein. The extracts of this formula and the relevant explanation given for the phrase 'Net ITC' is reproduced as under:

Refund Amount = (Turnover of zero-rated supply of goods + Turnover of zero-rated supply of services) x Net ITC ÷Adjusted Total Turnover

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

In terms of the above formula prescribed, refund of accumulated credit shall be granted in proportionate to turnover of zero-rated supplies to the total adjusted turnover. Further, the formula provides that the ratio of turnover related to zero-rated supplies to total turnover shall be applied on 'Net ITC'. The said term 'Net ITC' has been defined to mean the input tax credit availed on inputs and input services during the relevant period.

Further, the term 'relevant period' has also been defined in Rule 89(4) of the CT Rules as the period for which claim has been filed which could only mean that any period during the GST regime. It is in view of this reason; the circular has concluded that the TRAN credit cannot be considered as input tax credit claimed during the relevant period.

With the above understanding of reasons given by the CBIC Circular in denying the refund of TRAN credit, let us understand the term 'input tax credit' as defined vide Section 2(63) of CT Act to mean 'credit of input tax'. The expression 'input tax' is defined vide Section 2(62) to mean, CT, ST[11], IT or UTT[12] charged on supply of goods or services or both made to him and includes taxes paid under reverse charge and excludes composition levy.

By placing reliance on these definitions, the CBIC has taken a view that the TRAN credit claimed by an exporter would not come within the ambit of the input tax credit to fit under the expression 'Net ITC' to claim a refund under Option I on a reasoning that 'input tax' and 'input tax credit' are defined to mean and include taxes that are levied under GST laws but not those that are in the nature of TRAN credit.

However, considering the overall scheme of the GST laws and other provisions of the GST laws, we understand that such interpretation leads to absurdity and is required to be liberally interpreted to include TRAN credit also within their scope. Our reasoning for the view that TRAN credit is also in the nature of 'input tax' is detailed hereunder, on three counts, namely, credit once moved to GST regime would be 'input tax', interpretation of section 49(5) of CT Act and interpretation of Section 142(4).

[11] State Tax
[12] Union Territory Tax

TRAN Credit = Input Tax Credit:

In terms of section 140 of the CT Act, the credits pertaining to central excise and service tax are permitted to be carried forward into the GST regime as central tax. Similarly, under the corresponding section under ST Act, the credit pertaining to VAT[13] and entry tax are permitted to be carried forward into the GST regime as state tax. Therefore, considering the provisions of section 140 under CT Act and the corresponding ST Act, we understand that the TRAN credit brought forward into GST regime would acquire the nature of central tax and state tax, as the case may be. This is evident from the fact that these credits are reflected in electronic credit ledger maintained in GST portal under CT and ST columns.

Further, as per the provisions of section 140 read with Rule 117, the TRAN credit is required to be taken into electronic credit ledger on or before prescribed due date for filing the form TRAN-01. Upon filing of TRAN-01, the credit will be available in the electronic credit ledger account maintained in the GST portal for the month in which such TRAN-01 is filed. This process will aid in arguing that TRAN credit is also a credit claimed during the relevant period during which TRAN-01 is filed to come within the purview of 'Net ITC' as defined in Rule 89.

Understanding TRAN Credit in hue of Section 49(5):

Further, the above interpretation draws support from the provisions related to payment of tax under section 49 of the CT Act. The manner in which input tax credit accumulated in electronic credit ledger shall be used against payment of output tax has been provided under sub-section (5) of section 49.

Under this sub-section (5), the manner of utilisation of input tax credit with the output tax liability has been provided. The input taxes referred for set-off with output tax liability are CT, ST, IT and UTT alone. Based on literal interpretation of the language of the definitions of 'input' and 'input tax credit' as reproduced above, if a view is taken that these terms do not cover TRAN credit carried forward under CT Act and corresponding ST Act, then it leads to an absurd interpretation that section 49 has not provided for the manner of utilisation of TRAN credit for set-off with output tax and therefore TRAN credit cannot be set-off with output tax. This was never the intention of the statute and this would render the whole benefit given by way of TRAN credit as otiose.

Considering the whole object of the GST laws and the absurd results that may cause if the definition of the terms 'input' and 'input tax credit' are understood not to include TRAN credit carried forward as central tax or state tax, we differ with the view expressed by the CBIC in the above circular.

Interpretation of Section 142(4):

Further, it is worth to refer to the transitional provisions of section 142(4) relating to claim of refund under the erstwhile tax laws which are reproduced as under:

(4) Every claim for refund filed after the appointed day for refund of any duty or tax paid under existing law in respect of the goods or services exported before or after the appointed day, shall be disposed of in accordance with the provisions of the existing law:

[13] Value Added Tax

Provided that where any claim for refund of CENVAT credit is fully or partially rejected, the amount so rejected shall lapse:

Provided further that no refund shall be allowed of any amount of CENVAT credit where the balance of the said amount as on the appointed day has been carried forward under this Act

Section 142(4) of the CT Act facilitates the refund of CENVAT Credit in connection with exported goods or services if such claim has been filed under the previous laws before or after the appointed day[14]. Such claim shall be processed in accordance with the provisions of the previous laws. The first proviso provides that in a case where the claim for refund of CENVAT Credit is fully or partially rejected, the rejected amount will get lapsed and there cannot be any scope to carry forward of such rejected amount into the GST regime. On the other hand, the second proviso to the said sub-section provides that no refund of CENVAT Credit amount shall be allowed if the said amount was carried forward into GST regime.

In simple words of Section 142(4), the CENVAT credit (that is the TRAN credit) can be claimed as refund under the provisions of previous laws[15], despite of the fact that ***such credit is used for export of goods or services post appointed day***. The mention of export of goods or services post appointed day creates confusion and generates two contradictory interpretations. First, we shall deal with the line of interpretation which favours the current argument that TRAN credit is akin to the input tax credit. Later, we shall explore the second line of interpretation.

The usage of phrase 'in respect of goods or services export before or ***after the appointed day***' in subs. (4) can be understood that, the said provision is merely dealing in accommodating claiming of refund of credits which are involved in transitional phase. Say in case of export of goods, the goods are removed from the factory prior to the appointed day and are shipped with let export order after the appointed day. Similarly, in case of services, the invoices are issued prior to the appointed day and the export proceeds are realised after the appointed day.

In view of the reason to facilitate refund claim for the exports initiated as per the provisions of existing law, the provisions of section 142(4) has provided that the refund claim of taxes paid towards such goods or services exported during the transitional phase either prior to or after the appointed day as per the provisions of the existing law. Further, as the main provision is dealing with 'refund' under the existing law, the second proviso should also be interpreted to be denying the 'refund' claim of CENVAT Credit under the existing law only and not under GST law if the same has been carried to the GST regime.

The second line of interpretation is completely in contradiction with the above view, which we shall detail now. Section 142(4) of the CT Act facilitates the refund of CENVAT credit in connection with exported services if such claim has been filed before or after the appointed day. Such claim shall be processed in accordance with the provisions of the previous law. The first proviso provides that in a case where the claim for refund of CENVAT Credit is fully or partially rejected, the rejected amount will get lapsed and there

[14] The day on which GST Laws are brought into force i.e. 01.07.2017.

[15] Central Excise Act, 1944 or Finance Act, 1994, depending upon export of goods or services, as the case may be

cannot be any scope to carry forward of such rejected amount into the GST regime. On the other hand, the second proviso to the said sub-section provides that no refund of CENVAT Credit amount shall be allowed if the said amount was carried forward into GST regime.

Thus, in view of the above transitional provisions related to refund claim, the law expressly states that refund of any tax or duty paid under the existing law which are used for exports before or after the appointed day, shall be disposed in accordance with the provisions of existing law. Hence, the refund of any service tax or central excise, which was used for export of goods/services before or after the appointed day has to be filed on the basis of provisions of the existing law.

Since the due date for filing refund of credit of service tax paid on input services which are used for export of services (either before or after the appointed day) exhausts within one year[16] from relevant date of export, the refund for such credit of such tax cannot be filed now. Even filed the same would be disposed as time barring and resultantly such credit would get lapsed under the first proviso to Section 142(4).

Since the refund of service tax/excise duty is to be claimed only under the provisions of the existing law, there cannot be any refund claim under the new law for the said credit. The operative part of the section has made clear the same by using the phrase '… **goods or services before or after the appointed day**…'. If the phrase used only for the goods or services before the appointed day, then there would be a scenario to explore the possibility of claiming refund under the GST laws for the services exported under GST laws. In absence of such position, the claiming of refund of TRAN credit under GST laws is not possible.

Therefore, doubt exists about the claim of TRAN Credit as refund under the GST law by considering the provisions of section 142(4) of the CT Act. However, it is also worth to note that CBIC has not referred to these provisions as a reason to deny the refund claim of TRAN credit under Option I.

Summing up the discussion on the possible contradiction to the interpretation adopted by CBIC and how the provisions of section 142(4) of the CT Act with respect to the refund claim of TRAN Credit are prone to different interpretations, the claim of refund claim under Option I requires strict legal examination.

Considering the clarification given by CBIC, the application form prescribed for claiming refund in form GST RFD-01A is made available in GST portal with an inbuilt control that no refund of TRAN credit can be claimed under Option I. Technically as on date, no exporter is in a position to claim refund of the TRAN credit under Option I by filing the required application in GST portal.

Taking into consideration the above discussed legal implications on refund claim of TRAN Credit under Option I, we will now proceed to examine the possibility of such refund claim under Option II.

[16] In terms of section 11B of the Central Excise Act, 1944

Validity of the Claim under Option II:

As discussed above, in terms of section 16(3) of the IT Act, the refund of input taxes paid towards export of goods or services can be claimed by paying IT on the value of the goods or services exported. The applicable IT can be paid by using accumulated ITC. Rule 96(9) of the CT Rules provides for refund claim of the IT paid on export of the goods or services. The said rule also provides that the refund claim shall be filed and claimed in accordance with the procedure prescribed under Rule 89.

Thus upon the combined reading of the provisions of section 16(3) of the IT Act, Rule 96 and Rule 89 of the CT Rules, in a case where goods or services are exported with payment of IT, the refund can be claimed as per the procedure prescribed under Rule 89. While making the tax payment on the services exported, credit can be used. There is no express restriction in any of the provisions of the GST law that the TRAN credit cannot be used for payment of IT on the goods or services exported.

However, in such cases where TRAN credit was used payment of tax on exports, there is a great probability that the department officers may deny the refund claim under Option II considering the contrary position taken by CBIC under Option I by applying the legal principle *'expressio unius est exclusio alterius'* i.e. the expression of one thing is the exclusion of the other.

This implies that clarification given under circular with respect to Option I provide that the taxpayer is barred from claiming refund of TRAN credit under GST regime and thereby the said claims under Option II is also not permissible. Further, the interpretation associated with the transitional provisions of section 142(4) of the CT Act might also come as an obstacle to claim of refund of TRAN credit.

However, in light of the above discussion, the paper writers are of the view that issue involved is well balanced and is undoubtedly lead to a close fight between the exporters and the tax authorities in the courts of law. Any exporter caught in this tangle by inadvertent carry forward of their TRAN credit into GST is left with no option but to fight by claiming refund claim under Option II.

Conclusion:

Basis the above discussion, we doubt that the reasoning given by CBIC in their Circular to deny the exporters the refund claim of TRAN credit under Option I may not legally withstand. Further, as discussed above, interpretation associated with section 142(4) of the CT Act would also assume significant influence on this issue. These provisions can be challenged in the courts. Unlike the first Option I, except the provisions of section 142(4), no other provision of the GST law is contrary to the refund claim of such TRAN credit under Option II by undertaking exports by paying IT. Further, the portal is also not prohibiting the exporter to claim refund of TRAN credit under this option. Therefore, instead of blocking their TRAN credit ideally in their electronic credit ledger, an exporter can venture out to claim refund under Option II and seek the appellate remedies available to him in case the said claim is rejected by the department officers by relying on the impugned circular given with respect to Option I or based on the provisions of section 142(4).