Refund of Unutilised Credit – Closure of Unit – Possibility Thereof

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We are all aware that one of the cardinal principles of any taxation regime of any country is that to see that the domestic vendors export services or goods but not the taxes. To neutralise the tax burden borne by the domestic vendors in pursuit of exports, the Government, normally allows the tax borne by the vendors/exporters as refund. The refund is normally allowed only to the extent of unutilised input tax credit. In simpler words, if the exporter has domestic supplies also, then he can first use the credit to set off the tax liability on the domestic supplies and then approach the Government for the balance unutilised portion as refund. We have written previously on the refunds under the GST laws , please read An Incisive analysis on Refund of TRAN Credit | SBS Blog before proceeding to read this piece.

In this article, we wish to explore the possibility of claiming the refund of unutilised input tax credit which arises because the registration is voluntarily cancelled, or business is discontinued in that state. Let us take a case study and explore the legal possibilities for utilisation of credit. ABC Co is in State of Telangana and majorly engaged in provision of works contract services. ABC Co has work orders in many states in India and has obtained registration under GST laws in each such states. Hence, ABC Co has a registration in State of Telangana and other states, wherever it had works in hands.

Let us assume that ABC Co (TG)[1] has procured various inputs and input services for provision of works contract services over a period. However, at the end of 31st March, there is a huge balance of credit which was unutilised. ABC Co is confident that there would not be any works orders in the TG State and the management has come to a decision of closing the registration in TG State. The question that would arise is, what would be the fate of unutilised input tax credit in the TG State.

Can the same be transferred to other active states where there would be a potential output tax liability? Or Can, the same be claimed as refund in the TG State? Let us proceed to explore both the scenarios.

Scenario 1: Possibility of Transfer of Credit to Other Active States:

The entire GST law is based on the concept of destination-based consumption tax. In other words, the tax must reach a state where the goods or services are consumed. In the above facts, the services or goods are consumed in TG state and accordingly there is no provision under the GST laws to transfer the unutilised credit to other states where there are active operations and tax payable. In fact, under the erstwhile regime, specifically under the service tax law, there was an option for the registered person to obtain a centralised registration and accumulate the credit at entity level and use the same for payment of taxes at entity level.

There was no such option under the GST laws. The GST laws state that where a person is required to obtain registration in more than one state, in respect of each such registration, be treated as distinct person. Considering this particular provision, the unutilised credit in one state cannot be used against

[1] This represents the GST Registration in State of Telangana

payable in other state, which puts the entire entity at a disadvantageous position when compared to the previous regime.

This raises an important question as to, what is the necessity of treating the registration in each state as distinct entity. One of the primary reasons would be to treat supplies between the states within the same entity to be taxable to see that each consumption state would get its fair share of tax. But that being satisfied now, leads to another major problem which the legislation could not foresee. Though there are various mechanisms to transfer the credit from one registration to another registration (either cross charge or Input Service Distributor), such transfer is possible only if the services or goods are also consumed in other state. There cannot be transfer of credit from one state to another state without simultaneous supply of goods or services.

Hence, the conclusion which we could arrive is that this scenario works out only in cases, where the credit can be moved along with underlying goods or services and not credit alone. In situations, where the credit is higher than the output payable in a particular state and the registered person does not expect any business in such state, there would not be any way of utilising the balance credit.

Scenario 2: Application of Refund:

In this scenario, the registered person instead of transferring the credit to other active states, can explore the possibility of claiming the same as refund. However, the road to claim the refund is not clear and let us explore as to why we say that.

Section 54 of CT Act[2] deals with refund of tax. Explanation (1) to Section 54 states that 'refund' includes refund of tax paid on zero-rated supplies of goods or services or both or on inputs or input services used in making such zero-rated supplies, or refund of tax on the supply of goods regarded as deemed exports, or refund of unutilised input tax credit as provided under sub-section (3).

Further, Section 54(3) provides that a registered person may claim refund of any unutilised input tax credit at the end of any tax period and it provides that no refund of any unutilised input tax credit shall be allowed in cases other than zero rated supplies made without payment of tax or where the credit has been accumulated because of inverted rate of duty.

In addition to the above, Section 29 of CT Act which deals with 'cancellation or suspension of registration' stipulates that a registered person having regard to the circumstance that the business is discontinued, may apply for cancellation of registration in the prescribed manner. Section 29(5) stipulates that every registered person whose registration is cancelled shall pay an amount, by way of debit of electronic credit ledger or electronic cash ledger, equivalent to credit of input tax in respect of inputs held in stock and inputs contained in semi-finished or finished goods held in stock or capital goods or plant and machinery on the day immediately preceding the date of cancellation or the output tax payable on such goods, whichever is higher, calculated in the manner prescribed.

On a combined reading of all the above, it is evident that the current regulations do not provide for refund of unutilised input tax credit in case of discontinuation or closure of business. This is evidently clear from the language used in Section 54(3) restricting the scenarios only to two under which the

[2] Central Goods and Services Tax Act, 2017

unutilised input tax credit is allowed for refund, where discontinuation/closure is not one of them. Hence, on a plain reading of the provisions of Section 54, the unutilised input tax credit on the reason that the business is closed or discontinued is not available.

Further, the provisions of Section 29 states that at the time of cancellation, the registered person should reverse the credit of inputs (the section is silent on input services) and capital goods or plant and machinery or pay output tax on such goods whichever is higher. The tax authorities may take this as an aid for interpretation of the intention of the legislature to seek the reversal of unutilised credit (on inputs and capital goods) at the time of closure or discontinuation.

Hence, from the above, it appears that claiming of refund of unutilised credit due to reason that the business is discontinued or closed is not technically permissible. Having said that, by using the jurisprudence available under the earlier law, there may be a possibility of applying refund in the scenarios where the unit is closed, or business is discontinued. Let us have a look at some of these judgments.

The recent decision of Honourable CESTAT[3] of Chennai in the mater JU Pesticides & Chemicals Private Limited[4]. The Honourable Tribunal in the above matter, stated that Rule 5 of CCR[5] (equivalent to Section 54(3) of CT Act) does not speak of refund in a situation where the manufacturing unit is closed, and the said rule does not also specifically prohibit refund when a unit closes down and accordingly the unit which is closed can apply refund especially when the tax suffered amount in form of Cenvat Credit is lying with the tax authorities. The Tribunal also stated that, when the Constitution mandates that there shall not be any collection of tax without authority of law, there cannot also be the retention of tax by the tax authorities, without the authority of law and accordingly granted refund.

The earliest of decisions is the Karnataka High Court in the matter of Slovak India Trading Co Limited[6][7]. The assessee was engaged in the manufacture of shoes for Bata India Limited. They have applied for refund of unutilised input credit which was available at the time of closure of unit. The refund application was rejected at the levels before the CESTAT. The CESTAT has allowed the refund application stating that the refund cannot be rejected when the assessee goes out of Modvat Scheme or when the company is closed. The High Court agreed with the reasoning of the Tribunal and stated that there is no express prohibition in Rule 5 of CCR.

There are other host of judgments which held that credit can be claimed as refund at the time of closure of business. Applying the same to the current situations, ABC (TG) can try to claim the refund on the reason of closure of the unit.

[3]Customs, Excise and Service Tax Appellate Tribunal
[4][2021] 131 taxmann.com 339 (Chennai – CESTAT)
[5]Cenvat Credit Rules, 2004
[6] 2006 (7) TMI 9 – Karnataka High Court
[7] SLP dismissed by Supreme Court in 2007 (1) TMI 556 – SC Order