

EY Tax Alert

Kerala HC strikes down Rule 96(10) of CGST Rules since its inception

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Executive summary

This tax alert summarizes a recent ruling of the Kerala High Court (HC)¹ on the validity of Rule 96(10) of the Central Goods and Services Tax Rules, 2017 (CGST Rules).

The key observations of the HC are:

- ▶ Section 16 of the Integrated Goods and Services Tax Act, 2017 (IGST Act) does not restrict the right of an exporter to claim a refund of either tax paid on exports or input tax credit (ITC) on inputs and input services used in the export of goods or services.
- ▶ The phrase "*subject to such conditions, safeguards, and procedure as may be prescribed*" in Section 16 and similar phrase in Section 54 of the Central Goods and Services Tax Act, 2017 (CGST Act) does not permit imposition of conditions or limitations that would effectively negate the right to refund provided by Section 16.
- ▶ Rule 96(10) creates unequal treatment between exporters seeking refunds of ITC under Section 16(3)(a) of the IGST Act read with Rule 89 of the CGST Rules and those under Section 16(3)(b).
- ▶ If the Court finds provisions of plenary or subordinate legislation manifestly arbitrary, those provisions must be struck down.
- ▶ The Rule creates a restriction not contemplated by Section 16 of the IGST Act on the right to refund.

Basis above, HC struck down Rule 96(10) of the CGST Rules for the period prior to its deletion.

¹ TS-700-HC(KER)-2024-GST

Background

- ▶ Section 16 of the Integrated Goods and Services Tax Act, 2017 (IGST Act) read with Section 54 of the Central Goods and Services Tax Act, 2017 (CGST Act) allows exporter either to export goods or services with payment of tax and claim refund of the tax so paid, or export without payment of tax and claim refund of the input tax credit (ITC).
- ▶ Rule 96(10) of the Central Goods and Services Tax Rules, 2017 (CGST Rules) restricted refund of integrated tax paid on exports of goods or services where the registered person availed benefit of specified Notifications².
- ▶ Various taxpayers filed writ petitions before the Kerala High Court (HC) challenging the validity of Rule 96(10) primarily on the ground that it is *ultra vires* Section 16 of the IGST Act.

Taxpayer's Contentions

- ▶ Rule 96(10) of the CGST Rules takes away the right of the exporter to claim refund of tax which is a right granted by the substantive provisions of the IGST Act.
- ▶ A comparison between Rule 89 and Rule 96 of the CGST Rules reveals an unreasonable classification between exporters seeking refunds. Exporters under Rule 89 can claim a refund of unutilized input tax credit without restrictions, while those paying IGST and seeking refund under Rule 96 face limitations. This distinction is not authorized by the statute, making the provisions of Rule 96(10) potentially *ultra vires* Section 16 of the IGST Act.
- ▶ Even if say only 10% of the inputs have been procured after availing the benefit of any of the specified notifications, the entire refund is denied to exporters.
- ▶ SC in various cases³ has held that subordinate legislation has to be subservient to plenary legislation and restrictions imposed in Rule 96(10) goes contrary to the express provisions of Section 16.
- ▶ The phrase "*subject to such conditions, safeguards, and procedure as may be prescribed*" in Section 16 is not meant to regulate the right to a refund.

It only allows the rule-making authority to prescribe necessary conditions, safeguards, and procedures to prevent revenue leakage, without impacting the right to claim a refund.

Gujarat High Court in case of *Zenith Spinners v. Union of India*⁴ held that the phrase "*conditions, safeguards and procedures*" in Section 16(3)(b) of the IGST Act and "*conditions, limitations and safeguards*" in Section 54(6) of the CGST Act should not be construed as granting the Government the power to impose restrictions that entirely revoke the rights granted under the Act.

Revenue's Contentions

- ▶ Right of refund under Section 16 of the IGST Act is always subject to the provisions of Section 54 of the CGST Act and Section 54(3) permits the imposition of conditions in claiming refund.
- ▶ SC in case of *VKC Footsteps*⁵ found that the right to refund is not absolute and the State may, in contemplation of its fiscal objectives, seek to impose a restriction on the right to refund.
- ▶ Rule 96(10) is fully in conformity with the provisions of Section 16 and is not *ultra vires* to any of the provisions.
- ▶ The Rule must be interpreted in the manner as an exemption notification is interpreted. SC in case of *Commissioner of Customs (Import), Mumbai vs. Dilip Kumar and Company*⁶ held that in case of any doubt, the interpretation of an exemption must be in favor of the Revenue.
- ▶ While a person opting to claim refund of IGST in terms of Rule 96 will be entitled to claim refund of credit on purchase of capital goods, such right is not available to persons who may opt to seek a refund of ITC on input goods and inputs services by following procedure contemplated in Rule 89.

Therefore, it is at the option of the exporter to adopt either of the options contemplated by the provisions of Section 16 and it is for him to decide which is the method more beneficial to him.

HC Ruling

- ▶ Section 16 itself does not restrict the right of an exporter to claim refund of either IGST paid on exports or tax paid on input services or input goods used in the export of goods or services subject to the provisions of Section 54 of the CGST Act and the Rules made thereunder.

² Notification No. 48/2017 - Central Tax, Notification No. 40/2017- Central Tax (Rate), Notification No. 41/2017 - Integrated Tax (Rate), Notification No. 78/2017-Customs and Notification No. 79/2017-Customs

³ (2006) 12 SCC 583; (2016) 7 SCC 703; (2017) 9 SCC 1

⁴ (2020) 14 SCC 520

⁵ (2022) 2 SCC 603

⁶ (2018) 9 SCC 1

- ▶ However, post amendment in section 16 w.e.f. 1 October 2023, the provision empowers the Government to notify class of persons or goods or services, which can be exported on payment of IGST, and the supplier may claim refund of the tax so paid.

Notification⁷ was issued notifying the class of goods or services which are not permitted to be exported on payment of IGST. None of the goods or services that are subject matter of the writ petitions find a place in the said Notification.

- ▶ SC in case of VKC Footsteps (*supra*) was considering a question as to whether the words inputs used in Section 54(3) of the CGST Act includes only input goods and not input services.

SC in the said case was dealing with a restriction imposed by plenary legislation and not with a case where the subordinate legislation has travelled beyond the scope of the plenary legislation.

- ▶ The words "*subject to such conditions, safeguards and procedure as may be prescribed*" in Section 16(3) of the IGST Act and Section 54 of the CGST Act, does not permit imposition of conditions or restrictions that would nullify the rights granted under Section 16.

These provisions are meant to prescribe procedures without eliminating the right to refund.

Gujarat HC in the case of Zenith Spinners (*supra*) had held that the authority, by issuing Notification, cannot exceed the jurisdiction by providing for a situation which either restricts the rights granted under the Rule or make the Rule itself redundant.

The said decision was affirmed by the SC⁸.

- ▶ Rule 96(10) has resulted in hostile discrimination amongst exporters who opt to apply for a refund under Rule 89 and those who opt to apply for refund in the manner prescribed under Rule 96.
- ▶ SC in case of Shayara Bano (*supra*) had held that when the Court finds the provisions of plenary or subordinate legislation manifestly arbitrary, those provisions must be struck down.
- ▶ Rule 96(10) creates a restriction not contemplated by Section 16 on the right to refund.

Accordingly, Rule 96(10) of the CGST Rules is *ultra vires* the provisions of Section 16.

- ▶ Considering the fact that Rule 96(10) has been deleted *vide* Notification No. 20/2024 prospectively w.e.f. 8 October 2024, it held that notwithstanding the deletion of Rule 96(10)

prospectively, it falls upon this Court to declare upon its validity for the prior period.

Comments

The decision is likely to benefit taxpayer in cases where the tax authority has commenced action to recover refunds that have already been issued.

It is relevant to note that rule 96(10) is also challenged in various writ petitions before other HCs.

Taxpayers may need to examine if the principle from this ruling could be relevant to Rule 36(4) of the CGST Rules during the initial phase, where it limited the availment of input tax credit on invoices or debit notes not reported by suppliers in the returns (beyond the prescribed threshold), even when all the stipulated conditions in the CGST Act were met.

⁷ Notification No. 5/2023 - Integrated Tax

⁸ (2020) 14 SCC 520

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