Tax Alerts cover significant tax news, developments and changes in legislation that affect Indian businesses. They act as technical summaries to keep you on top of the latest tax issues. For more information, please contact your Ernst & Young advisor.

EY Tax Alert

CBIC clarifies on removal of restriction of refund of accumulated ITC on fabrics under GST

Executive summary

This Tax Alert summarizes a recent Circular issued by the Central Board of Indirect Taxes and Customs (CBIC), clarifying the applicability of Notification No. 20/2018-Central Tax (Rate) dated 26 July 2018. Notification provided for lapsing of input tax credit (ITC) accumulated on account of inverted duty structure on fabrics for the period up to 31 July 2018.

The Circular inter alia clarifies the following:

- Notification seeks to lapse the accumulated ITC on account of only the inputs and not input services and capital goods.
- The amount of ITC to lapse will be calculated basis the formula as prescribed in Rule 89 (5) of the CGST Rules.
- ITC on inputs contained in stock as on 31 July 2018 shall be excluded while determining Net ITC as per the formula.
- Accumulated ITC on exports does not lapse as the formula under Rule 89(5) excludes zero-rated supplies.
- A detailed calculation of accumulated ITC lapsed shall need to be furnished at the time of filing of first refund claim.

Circular No. 56/30/2018-GST dated 24 August 2018
Background

- Central Board of Indirect Taxes and Customs (CBIC) has issued a Circular clarifying on removal of restriction of refund of accumulated input tax credit (ITC) on fabrics under Goods and Services Tax (GST).
- Notification No.5/2017-Central Tax (Rate) dated 28 June 2017 notified goods in respect of which no refund of unutilized ITC will be allowed, where the credit has accumulated on account of rate of tax on inputs being higher than the rate of tax on the output supplies of such goods. The said Notification mainly included fabrics.
- Vide Notification No. 20/2018-Central Tax (Rate) dated 26 July 2018, CBIC removed the above restriction on fabrics prospectively with effect from 1 August 2018.
- In the same Notification, a proviso was inserted to the effect that the accumulated ITC lying unutilized, after payment of tax up to the month of July 2018 on the inward supplies received up to 31 July 2018, shall lapse.
- The present Circular aims to remove certain doubts basis representations received from trade and industry.

Clarifications

No lapse of accumulated ITC on account of input services and capital goods

- The Circular clarifies that the restriction of refund of accumulated ITC, vide Notification No.5/2017, was applicable only in respect of inputs. The said Notification did not put any restriction in relation to ITC on input services and capital goods. The Notification No. 20/2018-CT (Rate) dated 26 July 2018 seeks to lapse up to 31 July 2018 only the ITC which is subject matter of the Notification No. 5/2017.
- Thus, it is the ITC refundable in terms of Section 54 of Central Goods and Services Tax (CGST) Act 2017, but restricted for the period up to 31 July 2018, that would lapse.
- The Notification, therefore, does not impact the ITC availed on input services and capital goods.

Legislative power to lapse ITC

- The Circular further clarifies that the legislative power to lapse ITC flows inherently from the power to deny refund of accumulated ITC on account of inverted structure.

Manner of calculation

- The Circular clarifies that the formula as prescribed in Rule 89 (5) of the CGST Rules shall be used to determine the amount of ITC which shall lapse. Such formula shall apply mutatis mutandis as it applies for determination of amount of refund of ITC on account of inverted duty structure.
- The amount shall be determined for the months from July 2017 to July 2018 as applicable.
- The accumulated ITC (determined by the said formula), lying unutilized in balance after making the payment of GST for the month of July 2018, shall lapse.
- The formula as per Rule 89(5) is as follows-
  \[ \text{Maximum Refund Amount} = (\text{Turnover of inverted rated supply of goods and services}) \times \frac{\text{Net ITC}}{\text{Adjusted Total Turnover}} - \text{Tax payable on such inverted rated supply of goods and services}. \]
- The Circular has given numerical illustrations to explain the calculation.
- Application of formula as per Rule 89(5) ensures that accumulated ITC relating to capital goods and input services does not lapse.

Treatment of closing stock as on 31 July 2018

- A representation was made to the government on whether input tax relating to closing stock would lapse as such a situation would lead to double taxation.
- The Circular clarifies that the Notification 20/2018-CT (Rate) dated 26 July 2018 seeks to lapse only the credit that has been accumulated on account of inputs.
- Therefore, the ITC on inputs contained in stock (including inputs lying as such), as on 31 July 2018, shall be excluded for determination of Net ITC while applying the formula.
- For this purpose, the ITC relating to inputs contained in stock may be determined in the manner as provided in S. No. 7 of Form GST ITC-01.

Treatment of fabrics which do not have inverted duty structure

- The Circular clarifies that the condition of lapsing of ITC would apply only if ITC on inputs have accumulated on account of inverted duty structure.
- Thus, the proviso will not apply in case of inputs which do not suffer inverted duty structure.

Accumulated ITC in relation to exports

- The refund of ITC in relation to exports is separately determined under Rule 89 (4).
- The application of formula of Rule 89(5), ensures that accumulated ITC on exports does not lapse as the formula excludes zero-rated supplies.
- Therefore, the proviso has no applicability to the ITC relating to zero-rated supplies.
Procedure required to be followed for lapsing of accumulated ITC

- The amount of accumulated ITC liable to be lapsed, calculated basis the formula, shall be furnished by the taxpayer on self-assessment basis, in GSTR 3B for the month of August 2018.

- Verification of accumulated ITC amount so lapsed may be done at the time of filing of first refund (on account of inverted duty structure on fabrics) by such person.

- A detailed calculation sheet in respect of accumulated ITC lapsed is, therefore, required to be prepared by the taxable person and furnished at the time of filing of first refund claim on account of inverted duty structure.

Comments

Proviso inserted in the notification to lapse ITC accumulated till 31 July 2018 had given rise to various apprehensions. While the Circular issued by CBIC has attempted to address most of them, the clarification on the legislative power to lapse ITC instead of merely denying the refund of such accumulated ITC due to inverted duty structure could be adverse to all such fabric manufacturers who had an option to utilize such ITC against taxable supplies in future.

Requirement to calculate and furnish the details of accumulated ITC to be lapsed in the return for August 2018 and at the time of filing first refund claim could pose a challenge for the fabric industry as the failure to meet such compliance may attract consequences.