

Indian Fertilizer Industry: A Look at Tax Regulations and Subsidy Implications on GST Refunds

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Typically, companies within fertilizer industry adopt one of two strategies: they either manufacture fertilizers entirely within India or import them in large quantities, subsequently repackaging them into smaller units ready for domestic distribution. However, the Indian market is under significant regulation by the Government of India (GOI), with a large part of the value of the company's outward supplies subsidized by the government. Taking this into account from a GST perspective, this industry anticipates the accumulation of Input Tax

Credit (ITC) primarily due to two reasons, which are as follows –

1. An inverted tax structure owing to the high GST charged on packing materials as well as several input services
2. Valuation of output at subsidized rates set by the government.

However, the companies encounter a few hurdles when attempting to liquidate the accumulated pool of ITC which are detailed as under –

a) Packing material considered as insignificant input

- While bulk-imported fertilizers are the primary input in the fertilizer supply chain, there is another vital input involved when these fertilizers are distributed in the retail market, and that's packing material. These packing materials could take various forms, including bags, bottles, boxes, etc., used for the final product's marketplace delivery. Therefore, these packing materials are deemed to be an integral input in the supply chain process of fertilizers.
- As per Clause (ii) of the proviso to sub-section (3) of Section 54 of the CGST Act, the refund provision only applies in cases where the ITC has accumulated due to the "rate of tax on inputs being higher than the rate of tax on output supplies". Here, the use of the plural 'inputs' clearly indicates that a refund of accumulated ITC isn't restricted to ITC of a single input. There could be multiple inputs that are used or consumed for making the output supplies. The said provision doesn't require comparing the tax rate on the principal input with the tax rate chargeable on the principal output supply.
- Accordingly, to test the eligibility for claiming a refund under the inverted duty structure, the tax rates of all inputs must be compared with the tax rate applicable on the output. If the ITC accumulation is due to the rate of tax on inputs exceeding the rate of tax on output supplies, the taxpayer's claim for a refund on accumulated unutilized ITC would squarely fall under the GST Law provisions.
- Therefore, in the fertilizer industry's current scenario, where the tax rate on packing materials is higher than the tax rate on fertilizer as an output, it would qualify under the refund provisions. Further, [Circular 125/44/2019-GST](#) clarifies that packing material is considered an input as long as these materials are used for business purposes and/or effecting taxable supplies. Thus, the refund could then be claimed based on the methodology prescribed under Rule 89(5).
- However, various judicial authorities, including one in the case of Indian Potash, have pronounced

a different view. In the said case, the Hon'ble Commissioner Appeals of Ahmedabad observed that the share of imported fertilizers on the total taxable value of input supplies ranged from 97.7% to 98.93%, while that of other inputs ranged between 2.3% to 1.07%. As the appellant is engaged in only retail packing, the cost of the output is predominantly contributed by the input fertilizer, and the cost of the packing material used is not highly significant in the final cost of the output, in terms of both value and quantity. Thus, it's clear that the tax paid on the input, viz packing material, is not substantial enough to cause an accumulation of ITC, leading to the denial of a refund under Rule 89(5).

b) Refund restricted in light of [Circular No.135/05/2020](#) - The Dilemma of same input and output

- In spite of the clear language of Section 54(3) of the CGST Act and Rule 89(5) of the CGST Rules, read in conjunction with [Circular No. 79/53/2018-GST dated 31 December 2018](#) issued by CBIC, refund rejections are occurring solely based on a statement outlined in Circular 135/05/2020. The statement reads, *'It is hereby clarified that the refund of accumulated ITC under clause (ii) of sub-section (3) of section 54 of the CGST Act would not be applicable in cases where the input and the output supplies are the same'*.
- However, it's worth noting that context for which the above clarification was sought. The clarification provided at point 3 of the said circular was contextualized by a background where ITC accumulation arises due to a different tax rates being applicable on a product at different points in time. Moreover, an illustration was also provided to further clarify this scenario, which centred around trading activity.
- *An applicant trading in goods has purchased, say goods "X" attracting 18% GST. However, subsequently, the rate of GST on "X" has been reduced to, say 12%.*
- On understanding this, it is fair to say that scenarios involving the supply of goods without any value addition, i.e., trading of goods, are excluded from the ambit of section 54. However, Circular No. 135/05/2020 is not applicable where ITC has accumulated due to the tax rate on certain inputs being higher than the tax rate on the output supply. This is true even if one of the primary input and output is charged at the same tax rate.
- In the fertilizer industry, fertilizers are supplied after certain processes such as unpacking, repacking, and labelling. These processes do add a minimal degree of value addition on the goods sold. Moreover, these goods are not subjected to a change in the tax rate, i.e., the tax rate on fertilizer as an input and output remains the same. Thus, it could be inferred that this particular circular is not applicable to this industry.
- Similar view was also ruled by the Hon'ble High Court of Delhi in case of Indian Oil Corporation Limited ('IOCL') [\[TS-626-HC\(DEL\)-2023-GST\]](#) wherein the refund claimed by IOCL under Rule 89(5) was considered as admissible. The relevant extract of the same is produced as under -
- *....This is because it ignores the rate of tax chargeable on inputs other than LPG, which are admittedly higher than the rate of GST chargeable on the bottled LPG. More importantly, it disregards the fact that the ITC has accumulated on account of the rate on tax on such inputs being higher than the output supply - bottled LPG....*
- Additionally, various judicial authorities have stipulated that any restriction on refunds in cases where inputs and outputs are the same, through the circular, is beyond the powers provided by the Act. A taxpayer's refund claim, admissible under Section 54 of the CGST Act, couldn't be denied due to a Circular issued by the CBIC under

Section 168(1) of the CGST Act. Details of these rulings are listed as follows -

- a) The Hon'ble Hight Court of Guahati in case of BMG Informatics (P) Ltd [\[TS-487-HC\(GAUH\)-2021-GST\]](#)
 - b) The Hon'ble High Court of Rajasthan in case of Baker Hughes Asia Pacific [\[TS-338-HC\(RAJ\)-2022-GST\]](#)
 - c) The Hon'ble High Court of Calcutta in case of Shivaco Associates
- c) Value reduction on outward supply due to subsidy

- The reduction of the value of outward supply due to the government subsidy aligns with the valuation provisions outlined in Section 15 of the CGST Act. These provisions mandate taxpayers

to exclude the value of subsidies provided by the Central and State Government while determining the taxable value on which GST is payable. Hence, the accumulation of ITC on account of the decreased value of the outward supply isn't a discretionary action but a compulsion to ensure compliance with regulatory provisions.

- Furthermore, it's essential to note that existing laws on refunds due to inverted duty structures, as stipulated under Section 54(3) of the CGST Act and Rule 89(5) of the CGST Rules, don't impose restrictions on scenarios where the taxable value of the output supply is lower than that of the input supplies. In simpler terms, there's no requisite condition within the prescribed sections, rules, or circulars indicating that a refund would only be admissible if the value of the outward supply exceeds the value of the inward supply.
- This matter was also highlighted in the 50th GST Council Meeting. The Law committee, in point 4.19 of the meeting minutes, recommended that refunds should be available in cases where a government subsidy is provided. This recommendation applies as long as there's some inversion of the tax rate, irrespective of whether the accumulation of the ITC may also be due to the taxable value of the output supply being lower than the value of inputs because of the subsidy.
- The main objective of subsidy provided by the Government in case of fertilizers is to empower the farmers in India and reduce the role of mediators in fertilizer costs. In case refunds are denied to the companies on account of the subsidies provided by the Government, the same would essentially lead to an increase in cost for the fertilizer industry (as the cost cannot be passed on to the farmers) and defeat the objective of the Government.

In sum, companies in the Indian fertilizer industry face a distinct set of challenges, primarily arising from the non-acknowledgement of packing materials as significant inputs and the subsidized taxable value of output due to government subsidies. An equitable and uniform regulatory environment, which recognizes the significance of all inputs in the fertilizer value chain and considers the intent of government subsidies aimed at empowering farmers, is crucial for the industry's sustainable operation.