Whether the provisions of ITC providing conditions for payment of tax by the supplier, valid?

-Adv. Krishna K. and CA Padmanathan.K.V

Economic Basis of Goods and Services Tax

The spread of Value Added Tax (also called Goods and Services Tax – GST) has been the most important development in taxation over the last half-century. Limited to less than 10 countries in the late 1960s, it has now been implemented by about 136 countries; in these countries (including OECD[1] member countries) it typically accounts for one-fifth of total tax revenue. The recognized capacity of VAT to raise revenue in a neutral and transparent manner drew all OECD member countries (except the United States) to adopt this broad-based consumption tax. Its neutrality of principle towards international trade also made it the preferred alternative to customs duties in the context of trade liberalization[2].

There are many differences in the way value added taxes are implemented around the world and across OECD countries. Nevertheless, the OECD Guideline recognizes some common core features that can be described as follows:

- Value added taxes are taxes on consumption, paid, ultimately, by final consumers.
- The tax is levied on a broad base (as opposed to e.g., excise duties that cover specific products);
- In principle, business should not bear the burden of the tax itself since there are mechanisms in place that allow for a refund of the tax levied on intermediate transactions between firms.
- The system is based on tax collection in a staged process, with successive taxpayers entitled to deduct input tax on purchases and account for output tax on sales. Each business in the supply chain takes part in the process of controlling and collecting the tax, remitting the proportion of tax corresponding to its margin *i.e.*, on the difference between the VAT paid out to suppliers and the VAT charged to customers. In general, OECD countries with value added taxes impose the tax at all stages and normally allow immediate deduction of taxes on purchases by all but the final consumer.

The Goods and Services Tax (GST) law was introduced in India with effect from 1st July 2017 to replace a number of indirect taxes being levied by the Union and the State Governments and

---

[1]Organization for Economic Co-operation and Development

[2] OECD, 'International VAT/GST Guidelines' (February 2006), Preface

to remove cascading effect of taxes and provide for a common national market for goods and services[3].

The First Discussion Paper on Goods and Services Tax in India published in 2009 subserves two important fiscal goals. First, a comprehensive and continuous chain of set-off benefits from the original producer's point and service provider's point up to the retailer's point which reduces the burden of all cascading effects, including the burden of CENVAT and service tax. Second, an instrument in widening the coverage of tax base and improve tax compliance. Both these aspects of the GST regime have to be harmonized.

This aspect merits importance because while interpreting the provisions of GST Law, it is necessary to bring about a harmony that would preserve the balance between the need, on the one hand of ensuring against a cascading effect of tax and on the other hand, promoting regulatory compliance. The first element is preserved by a multi-point levy and collection of tax which allows a set-off of taxes paid in the course of intermediate transactions. The second element of compliance is ensured by envisaging that every business in the supply chain is associated in the process of collecting the tax and by remitting the proportion of tax corresponding to its own margin to the Government.

Input Tax Credit under GST Regime

In simple terms, input tax is defined as the credit of input tax under the Central Goods and Services Tax Act, 2017 (CGST Act)[4]. "Input tax" in relation to a registered person, means the central tax, State tax, integrated tax or Union territory tax charged on any supply of goods or services or both made to him and includes–

(a) the integrated goods and services tax charged on import of goods;
(b) the tax payable under the provisions of sub-sections (3) and (4) of section 9;
(c) the tax payable under the provisions of sub-sections (3) and (4) of section 5 of the Integrated Goods and Services Tax Act;
(d) the tax payable under the provisions of sub-sections (3) and (4) of section 9 of the respective State Goods and Services Tax Act; or

[3]The Constitutional Amendment (122nd) Bill 2014, Statement of Objects and Reasons

[4]CGST Act s 2(63)

(e) the tax payable under the provisions of sub-sections (3) and (4) of section 7 of the Union Territory Goods and Services Tax Act,

but does not include the tax paid under the composition levy.[5]

Section 16 of the CGST Act provides for the eligibility and conditions for 'taking' input tax credit. Section 41, on the other hand, provides for the 'availment' of input tax credit.

Every registered person shall, subject to such conditions and restrictions as may be prescribed and in the manner specified in section 49, be entitled to take credit of input tax charged on any supply of goods or services or both to him which are used or intended to be used in the course or furtherance of his business and the said amount shall be credited to the electronic credit ledger of such person.[6]

Section 16(2) lays down the conditions for taking credit. Section 16(2) reads as under:

(2) Notwithstanding anything contained in this section, no registered person shall be entitled to the credit of any input tax in respect of any supply of goods or services or both to him unless,—

(a) he is in possession of a tax invoice or debit note issued by a supplier registered under this Act, or such other tax paying documents as may be prescribed;

(aa) the details of the invoice or debit note referred to in clause (a) has been furnished by the supplier in the statement of outward supplies and such details have been communicated to the recipient of such invoice or debit note in the manner specified under section 37;

(b) he has received the goods or services or both.

Explanation.-For the purposes of this clause, it shall be deemed that the registered person has received the goods or, as the case may be, services—

(i) where the goods are delivered by the supplier to a recipient or any other person on the direction of such registered person, whether acting as an agent

[5]CGST Act, s 2(62)

[6]CGST Act, s 16(1)

or otherwise, before or during movement of goods, either by way of transfer of documents of title to goods or otherwise;

(ii) where the services are provided by the supplier to any person on the direction of and on account of such registered person.

(ba) the details of input tax credit in respect of the said supply communicated to such registered person under section 38 has not been restricted;

(c) subject to the provisions of section 41[ ][7], the tax charged in respect of such supply has been actually paid to the Government, either in cash or through utilisation of input tax credit admissible in respect of the said supply; and

(d) he has furnished the return under section 39:

Provided that where the goods against an invoice are received in lots or instalments, the registered person shall be entitled to take credit upon receipt of the last lot or instalment:

Provided further that where a recipient fails to pay to the supplier of goods or services or both, other than the supplies on which tax is payable on reverse charge basis, the amount towards the value of supply along with tax payable thereon within a period of one hundred and eighty days from the date of issue of invoice by the supplier, an amount equal to the input tax credit availed by the recipient shall be added to his output tax liability, along with interest thereon, in such manner as may be prescribed:

Provided also that the recipient shall be entitled to avail of the credit of input tax on payment made by him of the amount towards the value of supply of goods or services or both along with tax payable thereon.

On a plain reading of the section 16(2)(c), it appears that in order to take input tax credit by the recipient, the tax charged by the supplier has to be actually paid to the Government either in cash or through utilization of input tax credit admissible in respect of the said supply, *subject to* the provisions of section 41.

[7]Omitted by the Finance Act, 2022 w.e.f. 01-10-2022 before it was read as "or section 43A"

The term *"subject to"* was interpreted by Supreme Court in ***K.R.C.S.Balakrishna Chetty v The State of Madras***[8]**,** in the context of section 5 of Madras General Sales Tax Act, 1939 which exempted such dealers from payment of sales tax under Section 3 of the Act subject to such restrictions and conditions as might be prescribed, including the conditions as to licenses and license fees. The Court held that the use of the words *"subject to"* has reference to effectuating the intention of the law and the correct meaning, in the Court's opinion, is *"conditional upon"*.

Taking input tax credit in terms of section 16(2)(c) of the Act is *conditional upon* the provisions of section 41 of the Act, which reads as under:

> **Availment of input tax credit**
>
> 41. (1) Every registered person shall, subject to such conditions and restrictions as may be prescribed, be entitled to avail the credit of eligible input tax, as self-assessed, in his return and such amount shall be credited to his electronic credit ledger.
>
> (2) The credit of input tax availed by a registered person under sub-section (1) in respect of such supplies of goods or services or both, the tax payable whereon has not been paid by the supplier, shall be reversed along with applicable interest, by the said person in such manner as may be prescribed:
>
> > Provided that where the said supplier makes payment of the tax payable in respect of the aforesaid supplies, the said registered person may re-avail the amount of credit reversed by him in such manner as may be prescribed

It is clear from section 41 that a recipient shall be entitled to avail input tax credit on self-assessment basis and if the tax payable in respect of such supplies on which input tax credit has been claimed, has not been paid by the supplier, the recipient shall be liable to reverse the credit along with applicable interest.

Reference can be made to sub-section (3) of section 50, which states that where the input tax credit has been wrongly availed and utilized, the registered person shall pay interest on such input tax credit wrongly availed and utilized, at such rate not exceeding twenty-four per cent as may be notified by the Government, on the recommendations of the Council, and the interest

[8]1961 SCR (2) 736 para 13

shall be calculated, in such manner as may be prescribed. The Central Government has notified rate of interest as 18%[9].

The proviso to sub-section (2) of section 41 further states that recipient can re-avail the input tax credit reversed if the supplier makes the payment of tax. However, the proviso is silent with regard to the interest already paid.

This leads to collection of interest on the same amount, once from the supplier's hands under section 50(1) on the output tax and again, from the recipient's hands under section 50(3) for input reversal under section 41. It is a trait law that interest is compensatory in character and is imposed on an assessee who has withheld payment of any tax as and when it is due and payable. The levy of interest is geared to actual amount of tax withheld and the extent of the delay in paying the tax on the due date[10].Collection of interest twice on the same amount seems to violate this principle.

In order to take input tax credit, section 16(2)(c) requires the supplier to pay the tax either by cash or by input tax credit *"admissible"* in respect of *"said supply"*. Where the supplier is discharging the tax liability by set-off of input tax credit, such credit must be *admissible* to him. It casts onerous responsibility on the recipient to establish whether the input tax credit utilized by supplier is admissible or not. Similarly, if on a later date, the department disallows the input tax credit utilized by supplier as inadmissible, the recipient may also be required to reverse the credit.

Similarly, the expression *"said supply"* insists upon a nexus between the input tax credit claimed and supply under consideration. There appears to be a dichotomy between Section 16(1) which allows the benefit of input tax credit on any inward supply of goods or services or both used or intended to be used for the purpose of business and thereby dispensing with the nexus theory[11], and section 16(2)(c)which insists upon such nexus by use of the expression "said supply".

Burden of Proof

[9]Notification No. 13/2017 Central Tax dated 28-06-2017 as substituted by Section 116 of the Finance Act, 2022 read with (Sixth Schedule) w.e.f. 01-07-2017 before it was read as, "24"

[10]*Pratibha Processors v Union of India* [2002-TIOL-273-SC-CUS] para 13

[11]One-to-one correlation between input and output was prescribed as condition for availment of credit under the MODVAT regime

The controversy regarding restricting credit in the hands of assesse in case of default by seller is not something new to GST Law and it can be traced back to the erstwhile MODVAT regime. In ***Larsen and Toubro Ltd. v Commissioner of Customs & C. Ex., Nagpur***[12], the Mumbai Bench of CEGAT had held that assesse is not be blamed for the mistake of seller of goods, namely, Indian Oil Corporation and allowed the MODVAT Credit to the assessee.

Under the erstwhile Excise Duty regime, Rule 57G of the Central Excise Rules, 1944read as under:

> (1) Every manufacturer intending to take credit on the duty paid on inputs…

Placing reliance upon the underlined words, the department contented that unless the duty has been actually paid on inputs, no MODVAT credit can be availed by the assessee. The Tribunal held in favour of assessee and against the department, stating that assessee was not at fault. On appeal, the Jharkhand High Court[13],it was observed as under:

> "6. This argument does not appeal to us. Once a buyer of inputs receives invoices of excisable items, unless factually it is established to the contrary, it will be presumed that when payments have been made in respect of those inputs on the basis of invoices, the buyer is entitled to assume that the excise duty has been/will be paid by the supplier on the excisable inputs.
>
> 7. The buyer will be therefore entitled to claim Modvat credit on the said assumption. It would be most unreasonable and unrealistic to expect the buyer of such inputs to go and verify the accounts of the supplier or to find out from the department of Central Excise whether actually duty has been paid on the inputs by the supplier. No business can be carried out like this, and the law does not expect the impossible."

The High Court held that buyer is entitled to assume that the seller has paid the excise duty on excisable inputs and avail MODVAT credit as it is unrealistic to expect him to verify the accounts of each supplier. The above decision of Jharkhand High Court was subsequently followed in the ***Commissioner of Central Excise Customs & Service Tax v M/S. Juhi Alloys Ltd., Anil Kumar Shukla***[14] by Allahabad High Court.

---

[12]2001 (127) E.L.T. (807)

[13]*Commissioner of C. Ex., East Singhbhum v. Tata Motors Ltd.*2013 (294) E.L.T. 394 (Jhar.)

[14]2014 (302) E.L.T. 487 (All.)

In ***Commissioner of Central Excise, Jalandhar v M/S. Kay Kay Industries***[15]**,** the issue before the Supreme Court was whether it is obligatory on the part of the manufacturer of the final products to satisfy the adjudicating authority that appropriate duty of excise had been paid as per Rule 57A(6) and the notification issued thereunder. The Apex Court held as under:

> "25. Mr. Prasad, learned counsel for the revenue has vehemently urged that it was requisite and, in a way imperative, on the part of the assessee to verify from the concerned authority of the department whether the excise duty had actually been paid or not. The aforesaid submission leaves us unimpressed. As we notice Rule 57A (6) requires the manufacturer of final products to take reasonable care that the inputs acquired by him are goods on which the appropriate duty of excise as indicated in the documents accompanying the goods, has been paid. The notification has been issued in exercise of the power under the said Rule. The notification clearly states to which of those inputs it shall apply and to which of the inputs it shall not apply and what is the duty of the manufacturer of final inputs. Thus, when there is a prescribed procedure and that has been duly followed by the manufacturer of final products, we do not perceive any justifiable reason to hold that the assessee-appellant had not taken reasonable care as prescribed in the notification. Due care and caution was taken by the respondent. It is not stated what further care and caution could have been taken. The proviso postulates and requires "reasonable care" and not verification from the department whether the duty stands paid by the manufacturer-seller. When all the conditions precedent have been satisfied, to require the assessee to find out from the departmental authorities about the payment of excise duty on the inputs used in the final product which have been made allowable by the notification would be travelling beyond the notification, and in a way, transgressing the same. <u>This would be practically impossible and would lead to transactions getting delayed.</u> We may hasten to explicate that we have expressed our opinion as required in the present case pertaining to clauses 4 and 5 of the notification."

In ***The Commissioner of Central Excise Customs & Service Tax v M/S. Juhi Alloys Ltd., Anil Kumar Shukla***[16]**,** the question for consideration before the Allahabad High Court was whether

---

[15]2013 TIOL 41 SC CX

[16]2014 (302) E.L.T. 487 (All.)

the assessee was eligible to avail CENVAT credit in terms of Rule 9(3) of CENVAT Credit Rules, 2004. Rule 9(3) read as under:

> (3) The manufacturer or producer of excisable goods or provider of output service taking CENVAT credit on input or capital goods or input service, or the input service distributor distributing CENVAT credit on input service shall take all reasonable steps to ensure that the input or capital goods or input service in respect of which he has taken the CENVAT credit are goods or services on which the appropriate duty of excise or service tax as indicated in the documents accompanying the goods or relating to input service, has been paid.

In this case, the Allahabad High Court held as under:

> "7.In the present case, both the Commissioner (Appeals) and the Tribunal have given cogent reasons to indicate that the assessee had taken reasonable steps to ensure that the inputs in respect of which he has taken the cenvat credit are goods on which the appropriate duty of excise, as indicated in the documents accompanying the goods, has been paid. Admittedly, in the present case, the assessee was a bona fide purchaser of the goods for a price which included the duty element and payment was made by cheque. The assessee had received the inputs which were entered in the statutory records maintained by the assessee. The goods were demonstrated to have travelled to the premises of the assessee under the cover of Form 31 issued by the Trade Tax Department, and the ledger account as well as the statutory records establish the receipt of the goods. In such a situation, it would be impractical to require the assessee to go behind the records maintained by the first stage dealer. The assessee, in the present case, was found to have duly acted with all reasonable diligence in its dealings with the first stage dealer.
>
> …
>
> 9.Ultimately, the issue in each case is whether, within the meaning of Rule 9 (3) of the Rules of 2004, the assessee has taken reasonable steps to ensure that the inputs in respect of which he has taken cenvat credit were goods on which appropriate duty of excise was paid. Once it is demonstrated that reasonable steps had been taken, which is a question of fact in each case, it would be contrary to the Rules to cast an impossible or impractical burden on the assessee."

Under the erstwhile MODVAT/ CENVAT regime, there was no provision similar to section 16(2)(c) casting a burden on the assessee has to prove that the seller has actually paid the duty to the Government. The Courts took a view that it is unreasonable and impractical for the assessee to verify the records of the supplier to find out whether he has paid the duty and Courts allowed the MODVAT/ CENVAT credit to the assessee where he has taken "reasonable care".

Per contra, section 155 of the CGST Act states that where any person claims that he is eligible for input tax credit under this Act, the burden of proving such claim lie on such person. The person who takes input tax credit under the GST Law is under an obligation to prove that the supplier has actually paid the tax to the Government.

Constitutional Validity

Equality is the touchstone of the Indian Constitution. Article 14[17] of the Constitution guarantees every person equality before the law and equal protection of the laws. Equal protection means the right to equal treatment in similar circumstances.[18] Equal protection of the laws is a positive concept.[19] The word "laws" herein denotes specific laws.[20]

The apex Court has extended the guarantee of equal protection which embraces the entire realm of 'State action'. It would extend not only when an individual is discriminated against in the matter of exercise of his rights or in the matter of imposing liabilities upon him but also in granting privileges.[21] The basic principle is that there should be no discrimination between one person and another if their position is the same as regards the subject-matter of the legislation as held in *Chiranjit Lal's*[22] case.

In order to pass the test for permissible classification two conditions must be fulfilled, namely:

(1) the classification must be founded on an intelligible differentia which distinguishes persons or things that are grouped together from others left out of the group, and

---

[17] Art. 14: *The State shall not deny to any person equality before the law or the equal protection of the laws within the territory of India.*

[18] *ShrikishanvState of Rajasthan*, (1955) 2 S. C. R. 531

[19] *State of U. P. v DeomanUpadhyaya*, A. I. R. 1960 S. C. 1125

[20] *Sri Srinivasa Theatre v Govt. of T. N.* (1992) 2 S. C. C. 643

[21] *John Vallamattom & anr. v Union of India*(2003) 6 SCC 611

[22] *Chiranjit Lal vU. O. I.*, A. I. R. 1951 S. C. 41

(2) the differentia must have a rational nexus with the object sought to be achieved by the statute in question.[23]

Later the above test has been widened by the apex Court ruling that Article 14 also strikes against arbitrariness of State action[24]. So much so, Article 14 embodies a guarantee against arbitrariness.

A taxing statute justified under Article 265 is not wholly immune from the attack on the ground of violation of Article 14 of the Constitution of India[25]. In *Ashirwad Films v Union of India*[26] the apex Court followed the doctrine of reasonable classification laid down in *Anwar Ali Sarkar's* case. Here the purchaser claims the benefit of input tax credit with respect to the tax collected from him by the supplier. But for the supplier's fault the purchasing dealer is being harassed. Such a statutory provision cannot be construed as a reasonable taxing power.

Article 19(1)(g)[27] confers every citizen the right to practice any profession, or to carry on any occupation, trade or business. However, this right is not absolute, and it is subject to reasonable restriction under imposed under Article 19(6).

The phrase "reasonable restriction" connotes that the limitation imposed on a person in enjoyment of the right should not be arbitrary or of an excessive nature, beyond what is required in the interests of the public. The word "reasonable" implies an intelligent care and deliberation, that is, the choice of a course which reason dictates. Legislation which arbitrarily or excessively invades the right cannot be said to contain the quality of reasonableness and unless it strikes a proper balance between the freedom guaranteed in article 19(1) (g) and the social control permitted by clause (6) of article 19, it must be held to be wanting in that quality[28].

When the recipient has already paid the applicable tax to the supplier, denial of input tax credit on account of the failure of the supplier to deposit the same will lead to undue hardship to the

---

[23]*State of West Bengal v Anwar Ali Sarkar*, A. I. R. 1952 S. C. 75; *Budhan Chaudhary v State of Bihar* [1955] 1 SCR 1045

[24]*E. P. Royappa v State of T. N.* A. I. R. 1974 S. C. 555; *Maneka Gandhi* v. *Union of India* ,A. I. R. 1978 S. C. 597; *R.D Shettty* v. *Airport Authority* ,A. I. R. 1979 S. C. 1628.

[25]*K.T.Moopil Nair v The State of Kerala* AIR 1961 SC 552 and *State of Kerala v. Haji and Haji* AIR 1969 SC 378

[26](2007) 7 VST 714

[27]Article 19: *Protection of certain rights regarding freedom of speech, etc.-(1) All citizens shall have the right-(g) to practice any profession; or to carry on any occupation; trade or business*

[28]*Chintamanrao v State of M.P* 1950 SCR 759

recipient and cannot be considered as a "reasonable restriction" on right to carry on business. In ***Indsur Global Ltd. v Union of India***[29]**,** the Gujarat High Court held that:

> "34. By no stretch of imagination, the restriction imposed under sub-rule (3A) of rule 8 to the extend it requires a defaulter irrespective of its extent, nature and reason for the default to pay the excise duty without availing cenvat credit to his account can be stated to be a reasonable restriction. It leads to a situation so harsh and a position so unenviable that it would be virtually impossible for an assessee who is trapped in the whirlpool to get out of his financial difficulties. This is quite apart from being wholly reasonable, being irrational and arbitrary and therefore, violative of Article 14 of the Constitution. It prevents him from availing credit of duty already paid by him. It also is a serious affront to his right to carry on his trade or business guaranteed under Article 19(1)(g) of the Constitution. On both the counts, therefore, that portion of sub-rule (3A) of rule must fail."

Unlike MODVAT/CENVAT provisions of Central Government, many of the State Legislations contained provisions which were similarly worded to Section 16(2)(c) of the CGST Act. The constitutional validity of these provisions was challenged before various High Courts. Notable amongst these were Section 48(5) of the Maharashtra VAT Act, 2002,which was challenged as violative of Article 14 of the Constitution before the Bombay High Court in ***Mahalaxmi Cotton Ginning Pressing and Oil Industries v State of Maharashtra & Ors***[30]. Section 48(5) of MVAT Act read as under:

> (5) For the removal of doubt it is hereby declared that, in no case the amount of setoff or refund on any purchase of goods shall exceed the amount of tax in respect of the same goods, actually paid, if any, under this Act or any earlier law, into the Government treasury except to the extent where purchase tax is payable by the claimant dealer on the purchase of the said goods effected by him:

In the alternative, the Petitioner sought that if its validity was upheld, the words *"actually paid"* to be read down to mean *"ought to have been paid"*.

The Court held that Section 48(5) contains a declaration of a peremptory nature, evidenced from the use of the words that in no case shall the amount of set off or refund exceed the amount

---

[29]2014 (310) ELT 833 (Guj.)

[30]2012-TIOL-370-HC-MUM-VAT

of tax actually paid into the Government Treasury. The words *"in no case"* are prohibitory in their intendment. The words *"actually paid"* are also of significance. The words *"actually paid"* into the government treasury signify that a claim for set off cannot be in excess of the tax in respect of which the set off is claimed that has been deposited into the treasury. The plain and natural meaning of the expression *"actually paid"* into the treasury is that the tax on purchases of which a set off is claimed must actually and physically have been deposited into the treasury. A constructive or notional deposit would not fulfill the mandate of the provision. The State Legislature has used language of a mandatory nature that leaves its intent beyond any doubt. The exception which is carved out in the substantive part of subsection (5) is where a claimant dealer is liable to pay purchase tax on the purchase of the said goods effected by him. The proviso creates an exception where tax is deferred or deferrable under any Package Scheme of Incentives implemented by the State Government. In that event a deeming fiction is created by the proviso under which the tax is deemed to have been received in the Government treasury for the purposes of the subsection. In all other cases, an actual deposit of taxes is mandated before a set off is allowed.

The Court also observed that the legislature did not contemplate the grant of a set off without any tax being received into the Government Treasury. The grant of a set off without the receipt of tax into the treasury would result in a loss of revenue, a consequence which the provision for set off does not contemplate. The Court upheld the validity of section 48(5) as under:

> "53. In the view which we have taken in these proceedings, the constitutionality of the provision of Section 48(5) is upheld. ... The right to obtain a set off is a right conferred by statute and the legislature while recognizing an entitlement to a set off in certain circumstances is lawfully entitled to prescribe the conditions subject to which a set off can be obtained. If the legislature, as in the present case, prescribes that a set off should be granted only to the extent to which tax has been deposited in the treasury on the purchase of goods, it is within a reasonable exercise of its legislative power in so mandating. This does not offend Article 14. A plea of hardship cannot result in the invalidation of a statutory provision in a fiscal enactment which is otherwise lawful. At the same time, we have set out in detail the assurance which has been placed before the Court by the State Revenue in the present case of the steps that would be taken to pursue recoveries against selling dealers who have either not filed returns or, having filed returns have not deposited the tax collected from the purchasing dealer in whole or in part."

It is pertinent to note here that the State Revenue placed assurance before the Bombay High Court that steps would be taken to pursue recoveries against the selling dealers who have either not filed returns or, having filed returns have not deposited the tax collected from the purchasing dealer in whole or in part.

Similarly, the Constitutional validity of Section 9(2)(g) of Delhi VAT Act was also challenged before the Delhi High Court in ***Arise India Limited v Commissioner of Trade & Taxes, Delhi and others***[31]**.** Section 9(2)(g) of the Delhi VAT Act, 2004, which read as under:

> (g) to the dealers or class of dealers unless the tax paid by the purchasing dealer has actually been deposited by the selling dealer with the Government or has been lawfully adjusted against output tax liability and correctly reflected in the return filed for the respective tax period.

The Delhi High Court held that Section 9(2)(g) of the Delhi VAT Act, to the extent it disallows Input Tax Credit (ITC) to purchaser due to default of selling dealer in depositing tax, as violative of Articles 14 and 19(1)(g) of the Constitution of India. The High Court noted that there is a distinction between those categories specified in Section 9(2)(a) to (f) of DVAT Act which disentitle grant of ITC and one u/s 9(2)(g), whereas conditions specified in clause (a) to (f) are within the control of and can be vouched for by the purchasing dealer, the condition under Section 9 (2) (g) is not within his control. It requires the purchasing dealer to ensure, for the purposes of claiming ITC that the selling dealer has deposited VAT with the Government or has lawfully adjusted it against such selling dealer's output tax liability. This is not within the control of the purchasing dealer.

The Delhi High Court held that section 9(2)(g) of the DVAT gives the Department a free hand in deciding to proceed either against the purchasing dealer or the selling dealer or even both when it finds that the tax paid by the purchasing dealer has not actually been deposited by the selling dealer with the Government or has not been lawfully adjusted against the selling dealer's output tax liability and correctly reflected in the return filed by such selling dealer in the respective tax periods. It uses the phrase, "dealer or class of dealers" which could include either the purchasing dealer or the selling dealer. In the situation envisaged by Section 9(2)(g) itself, clearly the defaulting party is the selling dealer. He has collected the VAT from the purchasing dealer and failed to deposit it with the Government or failed to lawfully adjust it against his output tax liability and has failed to correctly reflect that in his return. For all these

[31]TS-314-HC-2017(Del)-VAT

defaults committed by the selling dealer, the purchasing dealer is expected to bear the consequence of being denied the ITC.

While denial of ITC could be justified where the purchasing dealer had acted without due diligence, failure to distinguish *bona fide* purchasing dealers was certainly hit by Article 14 of the Constitution, i.e. by proceeding with the transaction without first ascertaining if the selling dealer is a registered dealer having a valid registration, denial of ITC to a purchasing dealer who has taken all the necessary precautions fails to distinguish such a diligent purchasing dealer from the one that has not acted *bonafide*. The High Court further remarked as follows:

> "It is trite that a law that is not capable of honest compliance will fail in achieving its objective. If it seeks to visit disobedience with disproportionate consequences to a bona fide purchasing dealer, it will become vulnerable to invalidation on the touchstone of Article 14 of the Constitution."

Accordingly, the Delhi High Court held that failure by Legislature to distinguish between *bona fide* and *non-bona fide* purchasing dealers, results in Section 9(2)(g) applying equally to both the classes of purchasing dealers, which would certainly be hit by Article 14 of Constitution.

The Delhi High Court distinguished the decision of Bombay High Court in ***Mahalaxmi***[32]**,** stating that Section 48(5) of the MVAT Act requires the selling dealer to have "actually paid" the tax collected by him with the Government for the purposes of the purchasing dealer availing ITC, whereas Section 9(2)(g) of the DVAT Act requires the selling dealer to either "deposit" the tax collected or lawfully adjust it against his output tax apart from correctly reflecting the sale in his returns.

More importantly, the Court held that there is no provision in the MVAT Act similar to Section 40A of the DVAT Act. Section 40A of the DVAT Act takes care of a situation where the selling dealer and the purchasing dealer act in collusion with a view to defrauding the Revenue. In fact, the operative directions in ***Mahalaxmi*** indicate that such a measure was suggested by the State Government itself to go after defaulters, *i.e.*, selling dealers failing to actually pay the tax. The Department there undertook to upload on its website the details of the defaulting dealers. It was further undertaken that once there was a final recovery of the tax from the selling dealer, refund would be granted to the purchasing dealer.

---

[32] ibid 30

The Delhi High Court read down section 9(2)(g) of the DVAT Act precluding the Department from denying ITC to a purchasing dealer who has bona fide entered into a purchase transaction with a registered selling dealer who has issued a tax invoice reflecting the TIN number. In the event that the selling dealer has failed to deposit the tax collected by him from the purchasing dealer, the remedy for the Department would be to proceed against the defaulting selling dealer to recover such tax and not deny the purchasing dealer the ITC. Where, however, the Department is able to come across material to show that the purchasing dealer and the selling dealer acted in collusion then the Department can proceed under Section 40A of the DVAT Act.

The Supreme Court in ***Commissioner of Trade & Taxes, Delhi and others v Arise India Limited and others***, dismissed the Special Leave Petition filed by the Revenue against the decision of Delhi High Court.

The need for the law to distinguish between honest and dishonest dealers was also acknowledged by the Punjab and Haryana High Court in ***Gheru Lal Bal Chand v. State of Haryana***[33]where the constitutional validity of a similar Section 8 of the Haryana DVAT Act, 2003 ("HVAT Act') was being considered. It was held that:

> "In legal jurisprudence, the liability can be fastened on a person who either acts fraudulently or has been a party to the collusion or connivance with the offender. However, law nowhere envisages imposing any penalty either directly or vicariously where a person is not connected with any such event or an act. Law cannot envisage an almost impossible eventuality. The onus upon the assessee gets discharged on production of Form VAT C-4 which is required to be genuine and not thereafter to substantiate its truthfulness by running from pillar to post to collect the material for its authenticity. In the absence of any malafide intention, connivance or wrongful association of the assessee with the selling dealer or any dealer earlier thereto, no liability can be imposed on the principle of vicarious liability. Law cannot put such onerous responsibility on the assessee otherwise, it would be difficult to hold the law to be valid on the touchstone of Articles 14 and 19 of the Constitution of India. The rule of interpretation requires that such meaning should be assigned to the provision which would make the provision of

[33](2011) 45 VST 195 (P&H)

the Act effective and advance the purpose of the Act. This should be done wherever possible without doing any violence to the language of the provision. A statute has to be read in such a manner so as to do justice to the parties. If it is held that the person who does not deposit or is required to deposit the tax would be put in an advantageous position and whereas the person who has paid the tax would be worse, the interpretation would give result to an absurdity. Such a construction has to be avoided.

In other words, the genuineness of the certificate and declaration may be examined by the taxing authority, but onus cannot be put on the assessee to establish the correctness or the truthfulness of the statements recorded therein. The authorities can examine whether the Form VAT C-4 was bogus and was procured by the dealer in collusion with the selling dealer. The department is required to allow the claim once proper declaration is furnished and in the event of its falsity, the department can proceed against the defaulter when the genuineness of the declaration is not in question. However, an exception is carved out in. The event where fraud, collusion or connivance is established between the registered purchasing dealers or the immediate preceding selling registered dealer or any of the predecessors selling registered dealer, the benefit contained in Form VAT C-4 would not be available to the registered purchasing dealer. The aforesaid interpretation would result in achieving the purpose of the rule which is to make the object of the provisions of the Act workable, i.e., realization of tax by the revenue by legitimate methods."

In ***LGW Industries &Ors v Union of India &Ors.***[34], though constitutional validity of Section 16(2)(c) was challenged before the Calcutta High Court, the Court did not consider the same as the denial of ITC was not on the grounds of non-deposit of tax in the Government account by the suppliers which have been collected from the petitioners. In this case, GST authorities on inquiry, came to know that the suppliers from whom the petitioners/buyers are claiming to have purchased the goods in question are all fake and non-existing and the bank accounts opened by those suppliers are on the basis of fake documents and petitioners' claim of benefit of input tax credit are not supported by the relevant documents, and the case of the respondents is also that the petitioners have not verified the genuineness and identity of the aforesaid

[34]2021 (12) TMI 834

suppliers who are registered taxable persons (RTP) before entering into any transaction with those suppliers.

The Court remanded the matter back with the direction that if it is found upon considering the relevant documents that all the purchases and transactions in question are genuine and supported by valid documents and transactions in question were made before the cancellation of registration of those suppliers and after taking into consideration the judgments of the Supreme Court and various High Courts which have been referred in this order and in that event the petitioners shall be given the benefit of input tax credit in question.

The constitutional validity of Section 16(2)(c) of the CGST Act has been challenged in more than 34 writ petitions before various High Courts, some of which are as follows:

a. ***Bharati Tele-Media Limited, v Union of India and Others***[35]
b. ***Unifab Engineering Project Pvt. Ltd. and anr. v Deputy Commissioner CGST And CEX***[36]
c. ***Surat Mercantile Association, v Union of India***[37]
d. ***Aniruddha Banerjee (BD) v Senior Joint Commissioner, State Tax, Large Tax Payers Unit &Ors***[38]
e. ***M/s. Sri Gobind Alloys (P) Ltd., v Union of India and Others***[39]
f. ***M TRADE LINKS v Union of India***[40]
g. ***Sahil Enterprises v Union of India***[41]

The Union of India had moved two transfer petitions before the Hon'ble Supreme Court seeking the transfer of two Writ Petitions pending before the Hon'ble High Courts of Madhya Pradesh and Andhra Pradesh involving challenges to the constitutional validity of Section 16(2)(c) of the Act. The Supreme Court, by its judgment in the case of ***UOI v Cummins Technologies***

---

[35]WP(C) No. 6293/2019 (Delhi High Court)

[36]Writ Petition (L) No. 23044 of 2021 (Bombay High Court)

[37]Special Leave Application No. 15329 of 2020. (Gujarat High Court)

[38]WPA 10217 of 2021 (Calcutta High Court)

[39]WP(C) No. 16242 of 2021 (Orissa High Court)
[40]WP(C) No. 31559/2019 (Kerala High Court)

[41][2021] 129 taxmann.com 233 (TRIPURA)

India Pvt. Ltd[42]declined to entertain the transfer petitions as various High Courts are already seized of the matters.

The main contentions in these writ petitions are that Section 16(2)(c) of the CGST Act fails to distinguish between *bona fide* and *non-bona fide* buyers. Treating errant purchaser and *bona fide* purchaser alike is violative of Article 14 of the Constitution.

Presently, there is no mechanism under the GST Law to ascertain whether the supplier has actually deposited the tax to the Government or not. Hence, the condition imposed by section 16(2)(c) of the Act appears to be arbitrary and unduly harsh on the recipient.

With effect from 01-10-2022, section 16 and section 38 has been amended[43]and accordingly, the details of inward supplies on which the supplier has defaulted in making payment of tax shall be communicated to the recipient. However, the relevant rules is yet to be prescribed in this regard.

Doctrine of Impossibility

Lex non cogit ad impossibilia (the law does not compel a man to do what he cannot possibly perform[44]) and ***impossibilum nulla oblignto est*** (law does not expect a party to do the impossible) are two well-known common law doctrines. The above maxim has been approved by the Supreme Court in various cases including:

a. ***Mohammad Gazi v State of MP***[45]
b. ***Raj Kumar Dey And Others v TarapadaDey And Others***[46]
c. ***State of MP v Narmada Bachao Andolan***[47]
d. ***Indore Development Authority v Manoharlal & Ors. Etc.***

In ***Raj Kumar Dey and others* case**, the Court held as under:

> "We have to bear in mind two maxims of equity which are well settled, namely, "ACTUS CURIAE NEMINEM GRAVABIT"-An act of the Court shall prejudice

---

[42]2021-TIOL-245-SC-GST-LB

[43] By the Finance Act, 2022

[44]Rupin Pawha, *Broom's Legal Maxims*(13thedn, Universal, Lexis Nexis 2019)162

[45][2000] 4 SCC 342
[46]1988 SCR (1) 118

[47][2011] 7 SCC 639

no man. In Broom's Legal Maxims. 10th edition, 1939 at page 73 this maxim is explained that this maxim was founded upon justice and good sense; and afforded a safe and certain guide for the administration of the law. The above maxim should, however, be applied with caution. The other maxim is "LEX NON COGIT AD lMPOSSIBILIA" (Broom's Legal Maxims-P. 162)-The law does not compel a man to do that which he cannot possibly perform. The law itself and the administration of it, said Sir W. Scott, with reference to an alleged infraction of the revenue laws, must yield to that to which everything must bend, to necessity; the law, in its most positive and peremptory injunctions, is understood to disclaim, as it does in its general aphorisms, all intention of compelling impossibilities, and the administration of laws must adopt that general exception in the consideration of all particular cases."

In several occasions, the High Courts have applied these legal maxims while deciding income tax cases. In ***CIT v Cello Plast***[48], Bombay High Court held as follows:

"***Lex non cogit impossibila*** (law does not compel a man to do that which he cannot possibly perform) and ***impossibilum nulla oblignto est*** (law does not expect a party to do the impossible) are well known maxims in law and would squarely apply to the present case. The statue viz. Section 54EC of the Act provides for exemption from tax to long term capital gain provided the same is invested in bonds of Rural Electrification Corporation Limited or National Highway Authority of India. However, as the bonds were not available, it was impossible for the respondent-assessee to invest in them within six months of the sale of their factory building. Therefore, in the circumstance one would have to interpret Section 54EC of the Act to ensure that it does not lead to injustice."

While dealing with the question as to whether an assessee can be faulted for not declaring the amount of capital gain on acquisition of land, when the amount of compensation itself is not determined, Hon'ble Allahabad High Court in the case ***CIT v Premkumar***[49]held as follows:

---

[48](2012) 209 Taxmann 617

[49](2008) 214 CTR 452 (All)

> "***'Lex non cogit ad impossibilia'*** is an age-old maxim meaning that the law does not compel a man to do which he cannot possibly perform. Requiring the assessee to file a proper and complete return by including the income under the head 'Capital gain' would be impossible for the assessee, in cases of the nature referred above."

In the context of condition for taking input tax credit only when supplier has paid the tax, the Delhi High Court in ***Arise India***[50]**,** held that assessee cannot be compelled to do impossible.

The High Court held that a purchasing dealer cannot be expected to keep track of whether selling dealer has in fact deposited tax or adjusted it lawfully against output tax liability, and unless Commissioner has placed information in the public domain, it is impossible for purchasing dealer to ascertain selling dealer's failure to make a correct disclosure of the sales made in his return.

In this case Delhi High Court held as follows:

> "…the purchasing dealer is being asked to do the impossible, i.e. to anticipate the selling dealer who will not deposit with the Government the tax collected by him from those purchasing dealer and therefore avoid transacting with such selling dealers. Alternatively, what Section 9(2)(g) of the DVAT Act requires the purchasing dealer to do is that after transacting with the selling dealer, somehow ensure that the selling dealer does in fact deposit the tax collected from the purchasing dealer and if the selling dealer fails to do so, undergo the risk of being denied the ITC. Indeed Section 9 (2) (g) of the DVAT Act places an onerous burden on a *bona fide* purchasing dealer."

In ***R.S. Infra-Transmission Ltd. V. State of Rajasthan***, the Hon'ble Rajasthan High Court observed as follows:

> "The contention of Mr. R.B. Mathur is that Rule 18 will take care of the situation. However, while considering the matter, we have to look into the matter whether the benefit envisaged under the Rajasthan VAT Act especially under sub-Section (1) shall be allowed only after verification of deposit of the tax payable by the selling dealer in the manner as notified by the Commissioner. We are in complete agreement that it will be impossible for the petitioner to prove that the selling

[50] ibid 31

dealer has paid tax or not as while making the payment, the invoice including tax paid or not he has to prove the same and the petitioner has already put a summary on record which clearly establish the amount which has been paid to the selling dealer including the purchase amount as well as tax amount. In that view of the matter, we are of the opinion that Rule 18 if it is accepted, then the respondents will to take undue advantage and cause harassment."

Similarly, in ***Gheru Lal,*** Punjab and Haryana High Court also noted that law cannot envisage an almost impossible eventuality.

In ***M/S. Tarapore & Company, Jamshedpur vs. The State of Jharkhand***[51]**,** the provisions of Jharkhand VAT Act which stated that that the ITC was to be claimed or allowed on any purchase of goods, only to the extent the amount of tax was actually paid with respect to the said goods in the Government Treasury was challenged by the Jharkhand High Court. The Court made a very important observation:

"13. Having heard learned counsels for both the sides and upon going through the peculiar facts of this case, we find that the petitioner firm had acted absolutely in a bona fide manner, as is also apparent from the impugned order dated 20.11.2017, as contained in Annexure-5 to the writ application, and had discharged its tax liability by paying the VAT amount to the selling dealer and had filed its return within time, claiming the applicable ITC, but it was solely due to the laches on the part of the selling dealer, that the return had not been filed by the selling dealer, and the tax amount was not deposited in the Government Treasury. As such, it is apparent that the amount of tax and interest has been saddled upon the petitioner firm and has also been realised by way of garnishee order, which have been challenged in the other writ application, for no fault on part of the petitioner, but solely due to the fault of the selling dealer. We are satisfied that the petitioner had discharged its liability under the VAT Act, and there being no mechanism under the JVAT Act, by which, the petitioner could compel the seller also to discharge their duty, it was not within the competency of the petitioner to compel the selling dealer to file the return within the stipulated time, and deposit the tax collected from the petitioner in the Government Treasury."

[51] 2020 (1) TMI 414 – JHARKHAND HIGH COURT

The Jharkhand High Court held that there was no mechanism under the JVAT Act which enabled the assessee to compel the seller to discharge their duty. Therefore, the Court held that credit cannot be denied in the hands of buyer solely die to default on part of selling dealer.

Recovery of tax from supplying dealer

In ***Tata Iron and Steel Company v. State of Bihar***[52]**,**a Constitution Bench of the Supreme Court, while considering the provisions of the Bihar Sales Tax Act, 1947 observed that the primary liability to pay sales tax, so far as the State is concerned, is on the seller. Though sales tax legislation may permit the seller who is a registered dealer to collect the sales tax as a tax from the purchaser that does not do away with the primary liability of the seller to pay the sales tax[53].This principle was reiterated by Supreme Court in ***Central Wines v. Special Commercial Tax Officer***[54]**.**

This position is same under the GST law also as the primary responsibility to pay GST is on the supplier. Where the supplier makes any default in the payment of tax, GST Law contains statutory mechanisms to collect tax from defaulting supplier by issuing show cause notice under section 73 and 74, initiating recovery proceedings under section 79, provisional attachment under section 83 and so on.

The intention of the Government with regard to the denial of ITC on account of default of supplier can be understood from the presentation made by Joint Secretary (Tax Research Unit-II), CBIC in the 28thGST Council meeting[55], extracted as under:

> "…***There would be no automatic reversal of input tax credit at the recipient's end where tax had not been paid by the supplier. Revenue administration shall first try to recover the tax from the seller and only in some exceptional circumstances like missing dealer, shell companies, closure of business by the supplier, the input tax credit shall be recovered from the recipient by following the due process of serving of notice and personal hearing.*** He stated that though

[52]AIR 1958 SC 452

[53]Upheld in *George Oakes (Private) Ltd. v State of Madras*, AIR 1962 SC 1037 and *Khazan Chand v. State of Jammu and Kashmir*, AIR 1984 SC 762

[54](1987) 2 SCC 371

[55]Para 18.3 of the Minutes of 28thGST Council Meeting held on 4th August 2018

this would be part of IT architecture, in the law there would ***continue to be a provision making the seller and the buyer jointly and severally responsible for the recovery of tax***, which was not paid by the supplier but credit of which had been taken by the recipient. This would ensure that the security of credit was not diluted completely."

It appears that intention of Government in case of default by the supplier to pay the tax collected, is to first proceed against the supplier and not against the purchasing dealer. In the context of Karnataka VAT, the Karnataka High Court in ***Onyx Designs v. The Assistant Commissioner of Commercial Taxes, Bangalore***[56], held that the benefit of input tax cannot be deprived to the purchaser dealer, if the purchaser dealer satisfactorily demonstrates that while purchasing goods, he has paid the amount of tax to the selling dealer. If the selling dealer has not deposited the amount in full or a part thereof, it would be for the revenue to proceed against the selling dealer. Indisputably, the petitioner has purchased the goods from a registered dealer not from an unregistered dealer. Section 9 of the KVAT Act provides collection of tax by registered dealers. If there is any default on the part of such registered dealers in not remitting the tax, so collected into the Government treasury or any designated bank and furnish monthly returns as specified under Section 35 to the prescribed authority, the proceedings are required to be initiated against such registered selling dealers in accordance with the provisions of the KVAT Act.

The Hon'ble Madras High Court in *Asst. Commissioner v Infiniti Wholesale*[57] has held that the error, if any is not attributable to the dealer in claiming ITC based upon the invoice generated by its seller, but it is liable against the so-called seller. The High Court has followed the same view in *Sri Ranganathar Valves υ Assistant Commissioner (CT), (FAC), Velandipalayam Assessment Circle, Coimbatore*[58] and set aside the orders restricting the amount of ITC to the purchasers.

In ***D.Y.Bethel Enterprisesv State Tax Officer***[59], the Madras High Court held that where the purchasing dealer has paid tax to the seller and the seller has not remitted the same to the

[56]2019 (6) TMI 941 – KARNATAKA HIGH COURT

[57] (2017) 99 VST 341 [3]

[58]W.P.Nos.38488 to 38493 of 2015

[59]2021 (3) TMI 1020 – MADRAS HIGH COURT [13]

Government, the department has to first examine the seller in the enquiry proceedings and initiate recovery proceedings against him before issuing notice to the purchasing dealer. The court held that omission on the part of the seller must be vouched seriously and action has to be taken against him before proceeding against the purchasing dealer.

If tax due has not been paid to the Government by the supplier, it is for the Department to enquire and initiate recovery proceedings against him rather than to deny the input tax credit in the hands of genuine recipient.

Conclusion

The purpose of allowing input tax credit is to obviate the cascading effect of the tax burden on the ultimate consumer. This element of legislative policy is to be balanced with the need for securing transparency in tax compliance and ensuring against a loss of legitimate revenue owing to Government. The balance between these two aspects is drawn by ensuring that while input tax credit is available in respect of the tax paid on goods or service or both at an earlier stage, the input tax credit is based on the actual payment of tax into the government treasury.

The primary responsibility to pay tax is on the supplier of goods or services. Therefore, the Government policies must be focused on recovering the tax from the supplier in case of his default rather than denying credit in the hands of the recipient arbitrarily. Input tax credit can be denied in the hands of the recipient only when any fraud or collusion between the supplier and recipient is established by the Revenue. Thus, failure to distinguish between *bona fide* and *non-bona fide* recipient may render the Section 16(2)(c) as unconstitutional.

Denial of credit in the hands of the recipient on account of non-payment of tax by supplier, in any circumstances other than fraud or collusion, would cast a burden on the recipient which is not only beyond his control but also impossible for him to perform. Such a restriction, which does not distinguish between genuine and fraudulent recipient, would transgress the fundamental right to equality guaranteed under Article 14 of the Constitution.

Bibliography

Organization for Economic Co-operation and Development, 'International VAT/GST Guidelines'(February 2006) <https://www.oecd.org/ctp/consumption/36177871.pdf> accessed 16 Oct 2022.

Basu D. D., *Shorter Constitution of India* (Wadhwa and Co., Nagpur, 13th edition)

Ishwara Bhatt, *Fundamental Rights – A Study of their Inter-relationship* (Eastern Law House 2004)

Seervai H.M., *Constitutional Law of India*, vol. 1, 2 and 3 (Tripathi Publishing Co., 3rd edition 1983)

Shailesh Sheth, 'Supplier sins and Recipient repents' (12 January, 2022)<https://taxindiaonline.com/RC2/inside2.php3?filename=bnews_detail.php3&newsid=42662> accessed 17 Oct 2022

Vishwanath K,'Input Tax Credit - Can GST law excuse the taxpayer?' <https://www.vilgst.com/?ll=ocq1xNJrYWKrrK1lrqLCqMfTX5WioWSamKyahaLG05qVn5moZZiqrb%2BkwMRhaGNrY56rpQ%3D%3D> accessed 20 Oct 2022