GST: A good and simple tax – controversial issues and possible solutions

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Introduction:

With the advent of modernization and globalization, taxation plays a vital role in shaping the economic and political landscape of a country. In India, the introduction of the Goods and Services Tax (GST) in the year 2017 has had a profound impact and is considered as a significant development in the realm of indirect taxation.

This tax structure replaced the erstwhile indirect tax regime which contained various taxes such as service tax, value added tax, luxury tax etc. The GST regime aims to streamline the indirect tax regime in India and is in furtherance of the incumbent Government's policy of **"One Nation, One Tax."**

On introducing and implementing GST in India, The Hon'ble Prime Minister termed GST as *a good and simple tax* and quoted that it would mark the shift from a complex web of indirect taxes that existed in the previous regime by creating a uniform market across India and facilitate the ease of doing business.

It would be incorrect for us to assume that GST is only a fiscal reform as the same is also a reflection of the changing dynamics of our economy and is aiding us in transforming into a unified single market economy. However, GST is a dynamic and ever-changing tax regime that has been subject to various amendments, adjustments etc. since its inception and the same reflects the changing economic landscape of the country.

The purpose of this research is to understand how a tax regime, particularly the GST has helped India in its journey to achieve its objectives, how efficient the regime has been in doing the same until now. The scope of the study will tend to analyse the ambit of the six-year-old GST, from the purview of its stake holders i.e. The States and The Business in the existing legal framework, to check if GST is beneficial for the people or to the Government.

In this context, the researcher identifies two major research problem to delve into in the course of the research. One from the State's perspective and other from the Business perspective.

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1. Cooperative federalism calls for proper division of State and Central powers, it is necessary to ascertain whether the country's GST regime work in favour of ensuring proper division of powers while simultaneously ensuring the efficient operation of our taxing system. Does surrendering powers to the GST council a step in the right direction for cooperative federalism?

2. Input Tax Credit (ITC) imposes a one-sided obligation on the recipient to ensure the supplier has discharged his burden by paying the tax to the Government without any mechanism to ascertain the same which squarely turns to stand against the objective of the Act and the intention of the legislature. Despite various High Courts identifying the hardships, there has been no change in the position and the executive is continuing to shift their role to the shoulders of the taxpayer. In this premise, the research analyses the impact of denial of ITC to the taxpayers and businesses in India and also critically examines the constitutionality of such sections.

1. GST and Cooperative Federalism

Co-operative federalism is the type of governance that every democratic country strives to achieve, it is a flexible method of governance that allows for efficient allocation of power and resources that are necessary for the functioning of a State, it also allows for proper settlement of inter-State disputes.

Many States over the years have tried to inculcate co-operative federalism through their taxation legislations, a more precise term would be 'fiscal federalism', more particularly taxation regimes have been employed in countries such as America and Australia. Decisions related to taxation matters is the marriage of interests of both State and Centre, it allows for the both the State and Central Government to reach a consensus before establishing a taxation regime.

India's aim of achieving fiscal federalism wasn't something that was brought only recently by the Government's implementation of GST, it has been in operation since the 1980s. Before GST was implemented, India's fiscal federalism system was centred

around tax-sharing arrangements between the Centre and the State in the form of tax reforms[2].

The purpose of this study is to understand how a tax regime, particularly the GST has helped India in its journey to achieve total cooperative federalism and how efficient the regime has been in doing the same until now. Another objective of this study is to compare India's GST regime with that of other countries that have employed similar taxation systems to achieve fiscal-federalism.

1.1 Administering a GST Regime in India

The main reason as to why a GST regime is favoured by States is due to its 'neutrality' irrespective of the nature of product and services, the distribution chain and other factors, it is suggested that India needs a unified GST regime which is highly suitable for federal nation States.[3] GST is seen as major improvement over the previous VAT system.

The excise that was applied at manufacturing level gave rise to several definition deficiencies, moreover as per the constitutional agreements taxation powers were levied on the Central Government, which made it difficult to tax goods supplied in a composite form bundling both goods and services, States also demanded taxing powers as tax from States made up to half of the nation's GDP, the previous system also brought in the infamous cascading effect and along with it several administrative deficiencies.[4]

As the main purpose of GST regime is to establish a tax system that is both 'neutral in application, simpler to administer and economically efficient,' the Thirteenth Finance Commission also noted that GST cannot be implemented without the individual States losing financial autonomy, since VAT revenue led to a considerable portion of the State's revenue. [5]

The best solution was to find a system within the existing tax regime where both levels of the Government will hold concurrent powers to tax the domestic trade in goods and

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[2] Nirvikar Singh, *The Political Economy of India's Fiscal Federal System and Its Reforms*, 37 OUP 26, 35-36 (2007).
[3] Rao, Govinda and Rao Kavitha (2005): *"Trends and Issues in Tax Policy and Reform in India",* Working Paper, National Institute of Public Finance and Policy, New Delhi.
[4] Satya Poddar, *GST Reforms and InterGovernmental Considerations in India*, Working Paper No.1/2009-DEA, submitted before the Department of Economic Affairs (Ministry of Finance) Government of India (2009).
[5] M Govinda Rao, *The 13th Finance Commission's Report: Conundrum in Conditionalities*, 45 EPW 46, 49-50 (2010)

services, thus leading to India operating with a dual GST system a 'concurrent levy to be imposed by the State and the Centre, backed by multiple statutes,' simultaneously, the basic features of the law such as the definitions must be uniform which might give rise to a few discrepancies.[6]

1.2 <u>The Civics of GST</u>

The discussion paper of the Thirteenth Finance Commission has spoken in detail about the administration of the taxation system, the discussion spoken on various topics such as identifying the places that require harmonization, taxing procedures which also answers the tempting question of 'is it not possible to implement a process of single registration and single return?' which could lead to the taxpayer enjoying a simpler process, the paper seems to suggest a system which *"will be binding on both the Centre and the States would be worked out whereby the harmonious rate structure could be upheld, if necessary with a collectively agreed by a constitutional amendment",* this however would fail to materialize as States in India are quite vocal about fiscal autonomy.[7]

Finally, the policy makers supported the establishment of two separate set of agencies one for State and another for the Centre, this is a decision that is a right step in the political direction, having a unified GST regime would not work in a country with strong bureaucratic rivalries between the State and the Centre, having a unified levying power is not politically feasible.

1.3 <u>GST and federalism go hand in hand</u>

A rather serious issue stuck out like a sore thumb during the pandemic, multiple States in India were suffering from stagnant income and no State could survive without borrowings from the Central Government which released up to Rs. 75,000 crores of GST dues to various States, considering Kerala's situation which suffered from both the pandemic and a series of flash floods leading to increased expenditures, the Finance Minister of Kerala Mr. K.N. Balagopal explained the growing concern amongst various States such as its sister State, Tamil Nadu regarding the predominance of the Centre over

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[6] Praveen Kishore, *Administering Goods and Services Tax in India: Reforming the Institutional Architecture and Redesigning Revenue Agencies*, 47 EPW 84, 85-87 (2012).
[7] R Kavita Rao, *Goods and Services Tax in India: An Assessment of the Base*, 45 EPW 49, 52-53 (2010).

the GST council and the way in which it maximises control over this institution is against the spirit of federalism, he also brought it to light the instance where the Centre claimed it has powers to tax extra-neutral alcohol when there is an constitutional provisions which speaks to the opposite effect.[8]

1.4 India and its Cooperative Federalism:

India's primary problem with cooperative federalism is cooperation. The Government of India, by ensuring the following significant initiatives[9],

- Creation of the GST Council and assuring the States of a guaranteed revenue flow.
- Creation of GST Council, will give a platform for States to express their concerns which were resolved amicably after long spell of deliberations.
- Further, Government of India assured each State a minimum growth of 14% per year for five years over their revenues.

convinced the States, which proved to be decisive in bringing the States on board. India was able to bring the States together only on the promise that they would be compensated for the losses they suffer due to this mechanism and promised that this would facilitate an ease in administration. On this notion, by the 101 Constitutional Amendment the States were required to give up their sovereign function to a constitutionally set up body; the GST Council, to achieve the tag: ***ONE NATION-ONE TAX.*** This pooling of sovereignty squarely did not only take away the power of the States to legislate laws but also their say over it. Though, the Constitution of India reads as, "GST Council may recommend" the States with differencing opinion cannot have a law enacted for their State otherwise. This will add up to the burden for businesses in that State.

Like all countries, the States of India are also heavily dependent on Centre's transfers to cover majority of their expenditures; in the 1990s the Central Government battled deficits as much as 6% of the total GDP much of this deficit could be tracked back to the Centre's transfers, it became clear that the Centre will not be successful if it were to wage a lone

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[8] Vihas Dhoot, *Spirit of Cooperative Federalism is Essential for GST to Succeed*, The Hindu (21 July.2021, 10:26 IST), https://www.thehindu.com/business/spirit-of-cooperative-federalism-is-essential-for-gst-to-succeed/article35452449.ece

[9] Ministry of Information and Broadcasting, Government of India, *One Nation – One Tax,* https://static.pib.gov.in/WriteReadData/specificdocs/documents/2023/may/doc202351190701.pdf (2017)

battle against the deficit and requires the assistance of the stat as well, this involves the States ramping up their taxation rates which will without doubt have dire consequences on the welfare of citizens.[10]

India's revenue sharing systems have always been cumbersome, as the ratio of total loan taken by the Centre to the spending of the States come up to 54.4%, while Australia's comes up to 43.4%, not a glaring difference until we realise that the total population of Australia is equal to that of some smaller States of India, this is due to the massive population that leads to a 'vertical fiscal imbalance' which reflects the difference in the revenue making capacities of the Centre and the State.[11]

An important aspect of India's GST regime apart from revenue neutrality, it is a system of revenue sharing between the Centre and State, one of India's progressive steps in introduction of GST to uphold fiscal federalism is bringing in the concept of 'GST compensation', which guaranteed that States would be provided full compensation for the estimated loss of their revenues based upon an assumed growth rate (14%) for five years, thus helped convince the hesitant States to join GST.[12]

Despite the implantation being a mammoth task, it was revealed that the revenue neutrality, a *sine qua non* for any taxable reform to be acceptable, has not been ensured on account of the equality in SGST and CGST along with high pitched rate reduction after the introduction in GST especially for those in the 28% category, further, contrary to the expectations, there has been no evidence of increased tax effort among the Indian States indicating that GST has not been helpful in improving the revenue position of the States.[13]

2. <u>ITC Conundrum</u>

The introduction of GST has paved the way for many reforms that have changed the manner in which business functions. An important facet and feature of GST is the system of seamless ITC; one of the benefits advanced was capital intensive industry

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[10] Pramit Battacharya, *India's Statistical System: Past, Present and Future,* Working Paper Submitted to *CARNEGIE* on June 28, 2023.
[11] Nirvikar Singh, *Indian Fiscal Federalism: Political Economy and Issues for Reform*, Working Paper Submitted to *Stanford Centre for International Development* on March 1995.
[12] Rao, R. K, *New Assumptions, New Estimates: Scrutinising a New Report on Revenue Neutral Rate*, 50 EPW 63. 65-66 (2016).
[13] K J Joseph, *India's GST Paradigm and the Trajectory of Fiscal Federalism: An Analysis with Special Reference to Kerala*, 71 IEJ 1, 22-23 (2023).

would benefit under GST which will reduce the project cost; even there were discussions that foreign direct investments were delayed expecting GST to be implemented.

It is pertinent to note that ITC is not a novel introduction in the GST regime but was an integral feature of the erstwhile regime, however, the introduction of ITC in GST has resulted in a paradigm shift and has aided uninterrupted flow of ITC from the manufacturer to the end consumer. ITC is useful for suppliers as they can adjust the GST that they have already paid on purchase across sectors while they are selling the goods or services and hence, reducing their tax liability. It ensures that tax is levied only on the value addition that is made at every stage of supply rather than levying tax on the entire sale price.

As per section 16 of the Central Goods and Service Tax Act, 2017 (the Act), ITC can be availed by every registered person, and it can be availed only in cases where tax has been paid on any supply which is in course and furtherance of business. The system of ITC has undergone myriad transformations since its inception like VAT, MODVAT &CENVAT regime and even after the introduction of GST, it has undergone transformation.

This research aims to focus on controversies between expected and in-hand; more prominently on Section 16 &17 of the Act with Rules 36 & 86 of Central Goods and Service Tax Rules, 2017 (CGST Rules,2017), to understand the ramifications of the provisions, the problems revolving it and finally attempts to identify the workable solutions for the same.

2.1 <u>An analysis of Section 16 of the CGST Act, 2017</u>

2.1.1 Section 16(4) of the CGST Act, 2017

It is evident that the conditions stipulated under Section (u/s) 16 must be satisfied for a registered taxpayer under the GST to avail ITC. The issue that arises is with relation to at what point does availing of ITC become the vested right of the registered person- whether it becomes a vested right once the rules and provisions are followed or whether it becomes a vested right once the registered person complies with Section 16(2)?

Section 16(2) has an overriding effect on Section 16(4): There is a school of thought that believes that Section 16(2) overrides Section 16(4) as Section 16(2) begins with a non-obstante clause. The clause begins with the words "notwithstanding anything contained in this section" and States that the conditions prescribed in Section 16(2)(a) to Section 16(2)(d) must be satisfied by the registered taxpayer in order to avail ITC.

Furthermore, Section 16(4) does not contain a non-obstante clause and only specifies the time period within which ITC can be availed. Some scholars believe that as Section 16(2) begins with a non-obstante clause, it would override the other provisions, thereby, making Section 16(4) otiose.

The courts in the case of ***State of West Bengal v Union of India***[14]and ***ICICI Bank Ltd. v. SIDCO Leathers Ltd.,***[15]have delved into the manner of interpreting non-obstante clauses and held that the *"non-obstante clause will not be an impediment for the operation of the enactment or the provision in which the non-obstante clause occurs."*

Considering this it can be understood that the presence of a non-obstante clause in Section 16(2) does not serve as a hindrance to the applicability of Section 16(3) and Section 16(4) because the provisions do not conflict or contradict each other. All the three clauses are restrictive clauses and are essentially complimenting each other and the three clauses limit or restrict the scope of Section 16(1).

On inference, the basic objective of Section 16(2) is to ensure that the enabling provision, i.e., Section 16(1) is not misused in any manner and Section 16(2) stipulates certain conditions that must be satisfied to avail ITC. Section 16(4) does not become otiose or inapplicable since the presence of the non-obstante clause in Section 16(2).

By applying harmonious construction, it can be concluded that both Section 16(2) and Section 16(2) are intended to serve the same objective.

In the case of ***Eicher Motors Ltd. & Anr. v. Union of India,***[16] the court held that the MODVAT credit is an "indefeasible right." Once the right gets vested by an authority of law, it cannot be infringed in any manner.

[14]AIR 1963 SC 1241.
[15] [2006] 67 SCL 383 (SC).
[16] (1999) 152 CTR (SC) 273.

The court in the case of ***ALD Automotive Pvt. Ltd. v. Commercial Tax Officer & Ors.***[17] held that the ITC is a *"concession or benefit that is given to the supplier under the statutory framework."*

In the current framework, the mere compliance with Section 16(2) does not make ITC a vested right as there are many other conditions that the registered taxpayer must satisfy in order to avail ITC.

Currently, The Patna High Court in ***Gobinda Constructions vs Union of India***[18]**,** held that Section 16(4) of the Act is constitutionally valid and is not in violation of Article 19(1)(g) and Article 300 (A) of the Constitution of India and is not inconsistent with or in derogation of any of the Fundamental Rights guaranteed under the Constitution of India. The Court also held as under:

(i) There is always a presumption of constitutional validity of a legislation, with the burden of showing the contrary, lying heavily upon someone who challenges its validity.

(ii) Fiscal legislation having uniform application to all registered persons cannot be said to be violative of Article 19(1)(g) of the Constitution.

(iii) The concession of ITC u/s 16(1) of the CGST Act/ BGST Act is dependent upon the fulfilment of the conditions laid down under various provisions including sub-section (4) thereof.

Though this stands as the latest Precedent under the Law, it is prudent for us understand and interpret the usage of the term **"take credit"** in Section 16(4).

The phrase take credit has been used in Section 16, at multiple instances, such as in Section 16(1) uses "entitled to take credit", Section 16 (2) uses, "entitled to the credit", Section 16(4) uses, "entitled to take ITC", thus making it important to ascertain the meaning of the phrase, "take credit", for the intended meaning of the legislation.

At this juncture the case of ***Union of India vs Bharti Airtel Ltd***[19] holds relevance. In this case, the supplier initially paid the output tax liability in cash as his input credits did not

[17] (2019) 13 SCC 255.
[18] 2023-VIL-623-PAT
[19] [2021] 131 Taxmann.com 219 (SC).

reflect in GSTR 2A while filing his return in GSTR 3B. Later, on reflection of the credit in GSTR 2A seeks to amend his return and is expecting refund of the cash paid.

The Supreme Court, when dealing about Section 16 and the eligibility of the registered user to "take credit" of input tax which is charged during the supply of the goods or services or both to the registered person, which is used by him or he intended to use in course or the furtherance of their business held, that, as per the Act, the registered person must do self -assessment of ITC, reckon its eligibility to ITC and of output tax liability including those amount which is lying as balance in cash or of credit ledger, which must be done primarily based of the registered person's record maintained in office and are mandated by the law to be preserved and updated from time to time.

The court further stated that the registered person could even do so without the common e-portal, the way it was done during the pre-GST era. The court also observed the portal is mere facilitator for feeding and retrieving information and is not necessarily the primary source for doing self-assessment by the registered person. The agreements, invoices, challans, receipts of the goods and services, account books which are maintained either manually or via electronic mode could be regarded as the primary source for assessment.

It can be seen that the taking of ITC, as provided u/s 16(1) of the Act is bifurcated into two parts. The first one involves being "entitled to take credit of input tax," and the second one includes the aspect of "shall be credited to the electronic credit ledger of such person."

Section 16(4) does not cover RCM: The said restriction though is a controversy; it completely takes a topsy turvy when the tax is charged under the Reverse charge Mechanism (RCM). When a registered supplier makes supplies for which the recipient is responsible for paying tax under the RCM, as in the case of Goods Transport Agency, there may be laxity on the part of the recipient when it comes to reporting the GST invoices that were issued because the recipient rises self-invoice u/s 31(3)(f) of the Act and records it to claim ITC and this is not restricted by the time limit set out in section 16(4).

We can understand this with the following example; for instance, supplier A who raised invoice on 30 March, 2022, files the return on 30 January, 2023 he loses his right to claim

the credit over the invoice as it is restricted u/s 16(4). Whereas on the same instance, if the recipient who is liable to pay tax under RCM does so, he can reap the benefits not restricted by section 16(4) as the said put a bar only on invoice and debit note and not on self-invoices.

As a result, a registered supplier, who satisfies all of the requirements of Section 16(2) of the Act aside from the requirement of filing return by the stipulated time would be ineligible to receive the ITC that is legally due because of the said provision where as it is not the case for the recipient on his payment.

2.1.2 Section 16(2) (aa): An Analysis

The insertion of clause (aa) in section 16(2) of that Act has caused so many effects. This amendment had come into effect from 1st January, 2022. By this section, a condition was prescribed that a registered person would not be considered eligible to the ITC of goods or services unless the invoice details which is issued by the GST registered suppliers has been reported by the supplier in his/her outward return and all the relevant details must be communicated to the recipient as mentioned u/s 37 of the Act. If a supply is made by the registered supplier, then there is a requirement to report the supply in the outward tax return and the applicable GST is to be paid when the monthly return is filed in Form GSTR-3B.

The main intention of this legislature is to make sure that the exchequer gets the GST for Government to allow credit to the recipient; for the system wants the outward supplies are reported by the supplier by discharging tax liability within the stipulated time period and by making ITC eligible on the purchases by the recipient.

While this being good for the Government, the business does not work like that and there are many models in business as well there are business exigencies in which the recipient have no control on the supplier in making the supplier to comply. Thus, this provision makes the Government to Win and the trade to lose; especially the SME and MSME, who are caught between scissors, are biggest losers.

While the concept of this section is regarded as most appropriate for the Government, whether the tax administration by a Welfare State focussing on collection rather than turning situation as Win-Win is correct?

2.1.3 Section 16(2)(c): An Analysis

GST boasted a seamless flow of ITC by imposing a single tax for easier set-off against inputs purchased. While this has been an attractive feature, the fulfilment of the same has been marred by several obstacles. A significant barrier is found in Section 16(2)(c) of the Act. As per this provision, one condition to avail ITC is that the recipient must ensure that the Supplier has submitted the tax due with the Government.

However, this has placed an undue burden on the recipient to ensure the same. This has been constitutionally challenged before several High Courts on the ground that it does not distinguish between a bona fide and mala fide taxpayers,[20] violating fundamental right to trade and profession.[21]

Acknowledging the undue hardships placed on the recipient, severa High Courts as that of Madras,[22] Calcutta,[23] Delhi,[24] etc. have recognized the disproportionate burden. However, most cases have merely referred a notice to the Union for the same.

To add fuel to the fire, the provisional ITC made available through Rule 36(4), of CGST Rules was also removed and through Section 38, GSTR 2B was introduced; this GSTR2B is automatic pulling of eligibility for the recipient from GSTR 2A.

This means there has been negligible change in the position of the recipient. In this regard, the section of the paper seeks to critically analyse and identify the rationale behind upholding this provision, the legitimacy of the High Court orders and their consequences, and whether the core objective of GST has been defeated when observing the overall picture.

At the outset, condition put forth u/s 16(2)(c) of the Act is purely an obligation of the supplier and not within the purview of the recipient. For instance, though recipient has complied with regard to possession of invoice, receipt of goods or service and filing of return they are served with the notice seeking to reverse the ITC on only one ground that it is not appearing in GSTR 2A.

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[20] LGW Industries Ltd. v. Union of India [W.P. 23512(W) of 2019]
[21] Indsur Global Ltd. v. Union of India [2015] 53 taxmann.com 131/49 GST 445 (Guj.).
[22] DY Beathel Enterprises v. STO (Data Cell) [2021] 127 taxmann.com 80/86 GST 400(Mad.).
[23] LGW Industries Ltd. v. Union of India [W.P. 23512(W) of 2019
[24] Bharti Telemedia Ltd. v. Union of India [W.P. (C) 6293/2019

The condition specified in section 16(2)(c) is an impossible task sought to be performed by the recipient for the reasons that most of the times the payment is made to the vendor much before the due date for the GSTR 3B to be filed and the recipient have no control on the supplier.

In this pretext, it is relevant to quote the **"doctrine of impossibility" derived from the latin phrase *Lex non Cogit Ad impossibilia*** which means, that a man cannot be compelled by the law to do something which is impossible for him to perform. In the case of ***State of MP v. Narmada Bachao Andolan***[25], the Supreme Court has observed that the law will excuse a person who was disabled to perform a duty created by law without any fault of his.

This doctrine plays a significant role even in the present case, as the assessee is never be placed in a position where he can check upon the fulfilment of obligation by supplier and force the seller to pay the tax to the Government in the absence of mechanism provided.

And,***"'Impossibilumnullaobligntoest' - law does not expect a party to do the impossible"*** is another maxim that encapsulates the idea that nobody can be obliged to perform what he cannot perform. The onus that section16(2)(c) puts on the buyer is almost impossible to perform. If the buyer has acted bonafide, prima facie there are no grey areas in a transaction and the buyer has paid the tax to the seller, the buyer should be absolved of his responsibilities to ensure that the tax has been paid to the Government. If the seller fails to do it, it is the duty of the tax enforcement machinery, which has the required financial resources, manpower and legal authority, to track the errant seller and realise the same from him. The restrictions put in section16(2)(c) in respect of purchasing dealer are arbitrary, irrational and unduly harsh. Reference can be made here to the decisions made in ***State of Kerala v. Haji and Haji***[26] and ***Commissioner of Customs v. Parker Industries***[27]**.**

Further, it is pertinent to consider the settled principle of ***"Doctrine of Reading Down"*** which means, to sustain a law by interpretation. Doctrine of reading down is a principle of interpretation of law used by courts when there are two interpretations possible and

[25] [2011] 7 SCC 639) (SC)
[26] AIR 1969 SC 378
[27] 2007 (207) ELT 658 (Punj. & Har.)

giving it one selected interpretation can save the provision from being struck down. This doctrine is basically evolved in line of doctrine of purposive construction of Statute.

The doctrine of reading down of statutes be used to save the constitutionality of a Provision and to save the taxpayer as well. In ***Commissioner of Trade and Taxes Delhi vs Arise India Limited,***[28]A similar provision under Delhi VAT Act was struck down by the Courts and was rendered in favour of the assessee. It was argued in this case that such provisions do not make difference between honest taxpayer and a tax evader. Hence, it is irrational and arbitrary and liable to be struck down. Though the Delhi High Court did not strike down the provision but it used "Doctrine of Reading Down" to save an innocent buyer.

And, in ***LGW Industries Ltd. v. Union of India,***[29] the Calcutta High Court held that if it is found that all the purchases and transactions in question by the buyer are genuine and supported by valid documents and the transactions were made before the cancellation of registration of those suppliers, the petitioners shall be given the benefit of ITC.

In case of ***Bharat Aluminium Company Ltd. v. Union of India Ors***[30]***,*** the Chhattisgarh High Court has granted ad-interim relief on issue of denying ITC to the Petitioner, on the basis of mis-matching of ITC availed in Form GSTR-3B with the details furnished by suppliers in Form GSTR-2A for the period 2018-19.

Further the reliance is placed on the decision on the High Court of Karnataka in the case of Onyx Designs wherein it is held that the benefit of ITC cannot be denied on account of non-payment of GST by the supplier to the exchequer.

Recently, In the cases of ***Sun Craft Energy Private Limited and Another vs The Assistant Commissioner, State Tax, Ballygunge Charge and Others***[31] and ***Diya Agencies vs The State Tax Officer, The State Tax Officer, Union of India, The Central Board of Indirect Taxes & Customs***[32]***,*** the Calcutta and the Kerala High Court held that non reflection of invoice in Form GSTR-2A is not a sufficient ground to deny the assessee

[28] [2017 (10) TMI 1020 – Del.]
[29] [2022] 134 taxmann.com 42 (Cal.)
[30] [2021] 128 taxmann.com 11/87 GST 639
[31] 2023 (8) TMI 174 - Calcutta High Court
[32] 2023 (9) TMI 955 - Kerala High Court

ITC. The Assessee had filed a Writ Petition before the High Court of Kerala challenging an assessment order passed by the Revenue. The Revenue had denied ITC on the ground that as per the GSTR-2A, in respect of inward supply, the taxpayer is only eligible for input tax of the amount shown in GSTR- 2A. The Kerala High Court held that if the assessing officer is satisfied that the claim of ITC is bona fide and genuine, the Assessee should be given ITC. The Court further held that the invoice not reflecting in Form GSTR-2A is insufficient to deny ITC to the assessee.

Moreover, the intention of the law makers was to retain the sec 16 unaltered, but allow the ITC with regard to the invoices which are not reflected in GSTR 2A. This is drawn from the press releases (which has no legal sanctity; but binding the Revenue Authorities) and circulars which are again binding the Revenue Authorities; the same are discussed in brief with relevant portion.

a) **Clause (iv) of Press Release Dated 04-05-2018:** No automatic reversal of credit: There shall not be any automatic reversal of ITC from buyer on non-payment of tax by the seller. In case of default in payment of tax by the seller, recovery shall be made from the seller however reversal of credit from buyer shall also be an option available with the Revenue Authorities to address exceptional situations like missing dealer, closure of business by supplier or supplier not having adequate assets etc.

b) **CBIC Circular No. 59/33/2018-GST dated the 4th September, 2018:** *In view of the difficulties being faced by the claimants of refund, it has been decided that the refund claim shall be accompanied by a print-out of FORM GSTR-2A of the claimant for the relevant period for which the refund is claimed. The proper officer shall rely upon FORM GSTR-2A as evidence of the accountal of the supply by the corresponding supplier in relation to which the ITC has been availed by the claimant. It may be noted that there may be situations in which FORM GSTR-2A may not contain the details of all the invoices relating to the ITC availed, possibly because the supplier's FORM GSTR-1 was delayed or not filed. In such situations, the proper officer may call for the hard copies of such invoices if he deems it necessary for the examination of the claim for refund. It is emphasized that the proper officer shall not insist on the submission of an invoice (either original or*

duplicate) the details of which are present in FORM GSTR-2A of the relevant period submitted by the claimant.

c) **Press Release dated 18th October 2018**: It has been clarified vide Press Release dated 18th October 2018 that furnishing of outward details in FORM GSTR-1 by the corresponding supplier(s) and facility to view the same in FORM GSTR-2A by the recipient is in the nature of **taxpayer facilitation and does not impact the ability of the taxpayer to avail ITC on self-assessment basis in consonance with the provisions of sec 16 of the Act.** The apprehension that ITC can be availed only on the basis of reconciliation between FORM GSTR-2A and FORM GSTR-3B conducted before the due date for filing of return in FORM GSTR-3B for the month of September, 2018 is unfounded as the same exercise can be done thereafter also.

d) **Minutes of 27th GST Council Meeting dated 04.05.2018:** *The Secretary explained that "it had been consistent stand of many States that availability of ITC should not be linked with payment of taxes. He added that even if the seller did not pay taxes after uploading the invoice online, the first liability of paying taxes would remain with the seller. If the seller did not pay the taxes, the State concerned following due process of issuing notice and adjudication etc. can recover the tax from the seller.* ***However, where ultimately the seller did not pay the tax, the purchaser is not absolved of the responsibility to pay tax in the proposed model****."*

e) **Minutes of 28th GST Council Meeting dated 21.07.2018:** *"There would be no automatic reversal of ITC 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 ITC shall be recovered from the recipient by following the due process of serving of notice and personal hearing. He Stated that though 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."*

Thereby, it was always the intention of the Legislature that in case of default by the supplier, the department shall first proceed against the supplier but not against the

recipient; and only in the circumstances the recipient is not traceable for the reasons that he is fake or closed the business, then shall approach the recipient.

Thus, the recipient who has been slapped with notice demanding reversal is empowered by way of Press Release and Council Meeting decisions, to demand the action taken by the revenue to collect from the supplier. However, the action taken by revenue on the supplier should be within a reasonable time; there are instances where reversal is demanded against the cancellation of registration in 2022 for the supplies made in the year 2018.

Subsequently, effective from 09.10.2019 the legal position was altered little vide notification 49/2019 dated 08.10.2019 by inserting sub rule 4 to rule 36 of CGST Rules 2017 restricting the availment of ITC only to an extent of eligible credit available in GDSTR 2B and further to an extent of 20% of the eligible credit on the credit not reflecting in 2B.

And, Later the amount was reduced to 10% w.e.f. 01.01.2020 and further reduced to 5% w.e.f. 01.01.2021. However, effective from 01.01.2022, businesses can avail ITC only if it is reflected in their GSTR-2B.

Based on the above legal position and precedents it is the case that if the recipient possess invoice, has the proof of receipt of goods/service, made payment to vendor and filed return u/s 39, the recipient should be allowed to enjoy the reaps as he had complied all that possible from his end and the supplier remitting tax to the exchequer is not in their scope.

By applying common sense, it is unfathomable for the recipient to check whether the supplier has complied with the relevant provisions to claim ITC. As a result, the mentioned provision has become a nightmare for the taxpayers in the country. The restrictions placed u/s 16(2)(c) of the CGST Act in respect of the recipients are irrational, arbitrary and unduly harsh which directly impacts on businesses and taxpayers in the country.

2.2 An analysis on Section 17 of the CGST Act, 2017:

The main objective behind rolling out GST was to remove the cascading effect by facilitating seamless ITC. The availment of ITC respites on the fulfilment of eligibility

and conditions rolled out u/s 16 of the Act. However, section 17 of the Act imparts certain additional restrictions blocking credit in such cases.

This clearly breaks the flow of credit, which was supposed to seamless, though the chain of events is not broken. Thus, Law introduces a paradox; simultaneously impose restrictions, even when the business activities are legitimately pursued. This contradiction lies as our heart of inquiry u/s 17.

The law States that pursuant to fulfilling the conditions set out in section 16 of the Act, ITC becomes a vested right in favour of the taxpayer as per Article 300A of the Indian Constitution. Resultantly, stipulation of further conditions u/s 17 of the Act to dispute such credit on other grounds is not sustainable. To overcome this defect, Section 17(5) begins with a non-obstante clause. It is not that Law Makers cannot lay such restrictions. It is more about deviation from what was canvassed by the Government with the stake holders.

Nevertheless, in the case **of *Rana Nahid v. Sahidul Haq Chisti*[33],** the Supreme Court held that *"The non obstante clause cannot be lightly assumed to bring in the effect of supersession. It should not be allowed to demolish or extinguish the existing right unless the legislative intention is clear, manifest and unambiguous".*

Hence a view may be taken (though far-fetched) that the provision cannot possibly take away a right by addition of non-obstante clause since the same is contrary to the object of the Act.

Further, in the parliamentary discussion the Centre convinced the States for an objective which ultimately didn't transpire into Act with the same letter and spirit.

Blocked credit, as contemplated u/s 17, is the greatest injustice to the seamless credit. Section 17 of the Act diverge from the norm of seamless ITC, even when the supply and tax chain persist without hindrance. In this context, the concept of "Block Credits" takes centre stage.

It’s a myth that while ITC on vehicles with seating capacity less than 12+1 is blocked and allowing if it is more than 12+1, even when used for plying workers from their place to the factory and return is totally against the principle and policy. More, specifically, our

[33] [2020] 7 SCC 657

analysis zooms in on section 17(5) of the Act, with a particular emphasis on clauses (c) and (d).

The test of manifest arbitrariness embedded in Article 14 has been recognized by the Apex Court in the case of ***Shayara Bano v. Union of India***[34]**.** The court held that *"Manifest Arbitrariness, therefore, must be something done by the legislature capriciously, irrationally and/or without adequate determining principle."* In a case of manifest arbitrariness, the courts are empowered to invalidate legislation as well as subordinate legislation.

The Safari Case, a notable legal precedent, enters this complex equation. In ***Safari Retreats (P) Ltd. v. CCGST***[35]***,*** the constitutionality of Section 17(5)(d) of the Act was challenged on the basis of Article 14 and 19(1)(g) of the Indian Constitution.

In this case, Petitioners were engaged in the business of construction of shopping malls for the purpose of letting it out to tenants on rental basis. In the process, petitioners procured huge quantities of input supplies such as cement, lift, escalator, paint etc. for construction of the mall and the same was leviable to GST. The ITC of goods and/ or services procured for construction of an immovable property is blocked u/s 17(5)(d) of the Act. The petitioner approached the Revenue Authorities for claiming the ITC and utilising it for payment of output tax. However, the Revenue denied ITC on these inward supplies and directed the petitioner to pay tax on the outward supplies received by way of rent from the tenants of shopping mall.

The shortest question in terms of the restrictions is that, when the output service (renting of immovable property) is taxable, why restricting ITC on all input services attributable to creation and maintenance of that immovable party without which output tax is impossible.

Section 17(5)(d) of the Act States as follows:

> *"(5) Notwithstanding anything contained in sub-section (1) of section 16 and sub-section (1) of section 18, ITC shall not be available in respect of the following, namely:*

[34] [2017] 9 SCC 1.
[35] [2019 SCC OnLine Ori 443]

> *…(d) goods or services or both received by a taxable person for construction of an immovable property (other than plant or machinery) on his own account including when such goods or services or both are used in the course or furtherance of business.*
>
> *Explanation.-For the purposes of clauses (c) and (d), the expression "construction" includes re-construction, renovation, additions or alterations or repairs, to the extent of capitalisation, to the said immovable property;"*

Accepting the petitioner's contention, the Odisha High Court **read down** the provision to prevent it from being declared unconstitutional, however, the case is now pending before the Supreme Court for final verdict. While it provides an interpretation of these provisions, it refrains from annulling them outright, leaving businesses in the contracting services sector grappling with uncertainty regarding their applicability.

The dissection of these intricate provisions uncovers the nuances within section 17(5) of the Act portraying the glaring contradictions that clauses (c) and (d) introduce in the context of ITC denial for contracting services. The complexities of block credits in contracting services, differ from other clauses of blocked credits due to their exemptions offer guidance to businesses operating in this sector.

Application of *Shayara Bano* test in the present case reveals the impugned provision poses a threat of arbitrariness and also accords similar treatment to differently situated registered persons. The clauses stipulate that if the supply and tax chain continue, ITC can be availed without restrictions. However, clauses (c) and (d) differs and restricts even there is course and furtherance of business. This aspect was addressed under the safari case; however, the court provided an interpretation rather than striking down the provisions, leaving the question of their applicability still a concern.

Conclusion:

The GST is expanded by Hon'ble PM in an innovative way as "Good and Simple Tax" amidst the controversy prevailing about the simplicity of GST while it's regarded as good for the Country. GST was implemented with very many promises to the stakeholders which included revenue neutrality; guaranteed revenue flow to the States and seamless credit to the trade, which in practical turned out to be seems-less credit than what ought to have been. **Thus, the**

complex web that existed in the previous regime continues here in spite of a uniform market across India and ultimately hampering the ease of doing business.

Under this premise, the controversial issues lingering around GST are discussed in this paper and this portion of the writeup tends to highlight the Road Ahead in the light of workable solutions for all the stake holders.

1. Cooperative Federalism:

A properly enforced legislation operating along with efficient and effective collection mechanisms is necessary for the functioning of this tax regime, it is easy to simply establish a single tax office for the entire country, it would be simple and efficient but against the spirit of federalism.

Taxation in its most basic sense is a mode of revenue collection by a State, obviously, the Central Government of each country has an upper hand in getting more revenue, while the individual States do not which leads to a vertical fiscal imbalance putting the Centre on a higher pedestal of both economic and political power.

To reduce this disparity, fiscal federalism was birthed, as the name suggests it is a method to ensure that the spirit of cooperative federalism is upheld in the monetary sense and the taxation regime of a country has a direct role to play.

In India, it is clear that there is an abysmal difference in the revenue making capacities of Centre versus State, and GST increased the jeopardy as it shifted from Consumption Tax to Destination Based Tax. Hence most manufacturing States depend on the Centre for their expenditure and GST compensation, which has unfortunately been less than successful in bringing about fiscal federalism.

The States were bought in to consent for the pooling in of sovereignty only on the promise of maintaining revenue neutrality and in cases where it was not achieved the Centre promised to compensate them with GST compensation. But the Centre squarely failed in compensating the States in need at the right time.

GST was introduced to India by making the Constitutional amendment with Parliament approval. Revisiting the amendment to the constitution is a big task which is close to impossible. In this premise, the author tries to cull out a solution to duly implement the cooperative federalism in its true sense.

The cooperative federalism can be duly achieved by compensating the States on a regular interval irrespective of the financial difficulties of the Central Government which shall come from the political will. Further, this compensation shall not be limited on a time frame. The Centre shall establish a mechanism to conduct a periodical survey to check which of the States continue to remain a manufacturing State without great consumption; for whom it shall be ultimately hard to achieve the revenue neutral rate. These States shall be compensated on par for their trade contribution to the Country on a whole.

The Centre shall duly oblige with maintaining a constant supply of compensation credit to State which emanates from their promise. This will only make the concept of Pooled Sovereignty a sensible one by creating a "Federal Market" and promoting "anti-coercion" principle which aims to protect the Centre and the States interest and their sovereign choices.

One can understand that implementing a tax regime is a mammoth task for policy makers, it has to conform with the demographic factors of a country keeping in mind the political climate of a country all while ensuring that the spirit of fiscal federalism is protected, while GST may not be as effective as promised, it is certainly a step in the right direction, to ensure fiscal federalism but it is the high time for the policy makers to rectify the surfeits to uphold federalism both in spirit and in fiscality.

2. <u>ITC:</u>

The system of ITC allows business houses to offset the taxes that they have paidwhile purchasing goods and services against the taxes they collect while selling the goods and services to prevent the cascading effect. The system of ITC is believed to be the backbone of the GST regime as it has proved to be beneficial to end user.

But few provisions of the law make it really difficult for the trade to pass on the ITC benefit in the pricing to the end customer, which were discussed elaborately earlier in the paper. Here the author is contemplating to understand both the sides, law makers and the business, to find out workable solutions to minimize the controversies persisting in the GST law as below:

Solution to combat the lacuna in Section 16(2)(c):

The intent behind creation of this provision is welcoming where the Government says that Credit is available only when the Supplier has submitted the tax due with the Government. But the problem here is the mechanism adopted by the Government to implement it. Where, the Government places an undue burden on the recipient to ensure the same. ***This approach is strongly condemned and the Madras and Calcutta High Courts have also questioned the same. The Government should come with a practical mechanism to make the supplier duly deposit the tax to the Government, by which the difficulty brought in section 16(2)(aa) is also remedied.***

The Courts have repeatedly said that recipient cannot be penalised for the fault of the supplier and held in many cases by allowing the ITC on confirmation of other conditions – conditions proving the movement of material and due payment made towards that supply. The reliance is placed on the plethora of judgments, where the High Courts have decided by holding that for the fault of supplier (*not remitted tax and/or filed return in spite of collecting the tax charged through the invoice from the buyer*) the recipient cannot be penalised.

Hence, in the case of ITC not reflecting in favour of the recipient, it is the supplier who is responsible and the department should go behind them instead of conveniently demanding from the recipient.

Solution to combat the flaw in Section 16(4):

The legislative goal in adding Section 16(4) was never to eliminate the ITC, which is rendered eligible by abiding by the general legal framework. But to fix time frame and that time frame is the time available for the Business to file it's Income Tax Return. Annual Return paves way for correcting the mistakes, either beneficial or adverse to the business, as the same is done while doing Tax Audit.

The difficulty emerges as a result of Section 16(4)'s tight language and application; as per plain reading, irrespective of the difficulties and realities, ITC is not available after the due for filing return of a particular month in subsequent year for the Financial Year.

Section 16(4) contemplates the outer time limit for availing ITC for a financial year. This time limit was September of subsequent year in the earlier years of GST era and now it's November of the subsequent year. Denoting, that for the Financial Year 2021-22, the ITC

cannot be availed beyond the due date for filing return for the month of Nov 2022, which is 20th Dec 2022.

When the Income Tax Return of the business can be filed belatedly with or without valid reasons, but with late fee or penalty and on fulfilment of certain other conditions; and, that being the base for filing annual return under GST, the time frame for availing ITC should be in line with time frame available for the income tax return. But in the current scenario, the purpose is defeated.

Therefore, the suggestion is that:

1. The payment of late fee towards the delay in filing GSTR 3B, shall be deemed and treated as return filed in time; by which it will exonerate all the compliances attached to filing of GSTR 3B; **OR**
2. Fix the due date as the month in which the business is filing IT Return; so that all the businesses filing return belatedly are legitimately benefited.

Solution with regard to Section 17(5), to rescind and amend Section 16(1):

The current section blocking the availment of credit has to be struck down as it creates a legal fiction with uncovered scope. The law makers cannot envisage, exhaustively, all the business scenarios wherein the input services are relatable to the output services and restrict where it is not relatable.

Therefore, instead of blocking the credit u/s 17(5) it should be in line with section 16(1) on fulfilment of conditions in section 16(2) to (4) of the Act without any further restrictions or conditions. For E.g.: section 17(5)(1) envisages only three transactions while few other transactions which are falling in the ambit of the same principle laid down for the thee listed scenarios are restricted.

Hence, it shall be replaced in the below discussed context.

"The ITC shall not be allowed when the supply chain is disconnected, *which shall include inputs consumed for other purposes (*the personal use by the employees of the business)".

Hence, ITC shall be disallowed only when there is no further taxable supply from the input consumed by the business. In all other occasions where there is furtherance of

business the ITC shall be promptly allowed by amending Section 16(1) with insertion of the following term, "***until the supply chain is disconnected".***

On such insertion section 16(1) shall read as follows:

> *"(1) 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* ***<u>until the supply chain is disconnected</u>*** *and the said amount shall be credited to the electronic credit ledger of such person".*

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