Section 16(2)(c) and the Pre-2022 GST Framework: A Distinction Without a Difference?

Introduction: The controversy surrounding Section 16(2)(c)

Section 16(2)(c) of the Central Goods and Services Tax Act, 2017 ("CGST Act") makes a taxpayer's entitled to take Input Tax Credit ("ITC") subject to condition that tax charged in respect of such supply has been actually paid to the Government. Although this seems logical on paper and safeguards the public revenue so as to ensure that tax credit and tax deposited in the exchequer matches up, but, in reality there is a huge potential conflict. For instance, a buyer can have paid the supplier the full value of the invoice, including the GST amount. The buyer has received the supply and has accounted for the inward supply in his books. However, what if the supplier has not paid the tax amount to the State? The buyer then is at the risk of losing his ITC.

This has been a huge area of debate, that has resulted in multiple constitution challenges across India. While the validity of Section 16(2)(c) has been upheld as constitutional by the Gujarat High Court in Maruti Enterprise v. Union of India and by the Supreme Court in Bhandari Scrap Traders v. Union of India (July 2026), wherein the court refused to read down Section 16(2)(c) in favour of a 'bona fide recipient'. Despite the validation of the constitutional status of the said provision by the Apex Court, it continues to be a contentious point of law. Most notably, in the current litigation before the Delhi High Court, in the case of Bharti Telemedia Ltd. v. Union of India, the litigants are trying to circumvent the validity of this provision by bringing to focus the GST regime that existed prior to 1 October 2022 and in which the statutory framework for provisional credit and the matching mechanism functioned differently from the post-2022 amended regime.

The authors in this blog discuss the validity of such contention to distinguish Section 16(2)(c) in pre-2022 regime on the original framework of provisional ITC in the original GST law.

Reconstructing the pre-2022 challenge: The statutory mismatch

The complete pleadings and arguments in the Delhi High Court proceedings that are still pending are not public. Therefore, the arguments here presented are the authors' interpretation of how a pre-1 October 2022 argument could be made. This does not mean that the authors are submitting that the subsequent contentions have been argued in the said orders.

A. The original statutory framework

When the CGST Act came into force in 2017, it had a design where there was a statutory framework with provisional credit coupled with a formal matching mechanism for returns. Section 41 of the original Act permitted the registered person to declare the self-assessed input tax credit in his electronic credit ledger on a provisional basis. Furthermore, Section 42 of the original Act prescribed the structure for matching of inward and outward supply details, generation of discrepancies, and crediting or revoking the credit where discrepancies are not rectified. Section 43 of the original Act prescribed similar mechanism for matching of reduction in output tax liability of the supplier.

However, the provisioned system of GSTR-1, GSTR-2, and GSTR-3 returns and the automatic matching and communication system for discrepancies as mentioned in Sections 42 and 43 of the original Act was never implemented.

B. What operated instead?

Instead of implementing the original matching mechanism, the tax administration moved towards workarounds and interim rules. The primary filing for outward supplies and summary returns became the GSTR-1 and GSTR-3B forms. The GSTR-2A (and later GSTR-2B) forms were used as auto-populated statements that showed disclosures by the supplier but did not form part of a complete statutory matching process under Section 42. Also, Rule 36(4) of the CGST Rules under Circular No. 123/42/2019-GST was introduced to restrict input tax credit on account of invoices not declared in the GSTR-2A form. As the FORM GSTR 2 and GSTR 3 were not implemented, the Circular Nos. 24/24/2017-GST and 125/44/2019-GST prescribed mechanisms for procedural aspects such as undertakings in connection with the provisional ITC for applications for refunds.

Although these rules and circulars helped the government keep a track of compliance and reconcile records, they were fundamentally different from the original statutory matching mechanism.

C. The possible constitutional challenge

If the original regime of Section 16(2)(c) were to be contested, the argument would start with the basic principle of administrative law that the circulars cannot substitute for a rule or regulation that was envisaged to be implemented. The circulars such as Circular Nos.

24/24/2017-GST and 125/44/2019-GST prescribing the undertakings in connection with the provisional credit, which is contrary to the operation of Section 16(2)(c) as read with Section 42(2). A petitioner can contend that the executive circulars cannot replace a regulatory process that was envisaged to be prescribed via the rules or regulations and Section 16(2)(c) cannot be conditioned with something different from what is settled by the Supreme Court. The Hon'ble Supreme Court in the case of CTO v. M/s Bombay Machinery Store, 2020 held that such administrative circulars cannot add or substitute the statutes.

The next leg of the argument can start by showing how this can be arbitrary and disproportionate. A statutory regime was supposed to operate where provisional credit was provided but was coupled with an operational matching and reconciliation system that was never implemented. In this case, the restriction under Section 16(2)(c) can be shown to be arbitrary and to put a disproportionate burden on a bona fide purchaser on whom the default of the supplier is placed. This argument is supported naturally by the previous VAT cases such as On Quest Merchandising India Pvt. Ltd. v. Government of NCT of Delhi & Ors, 2017 and Arise India Ltd. v. Commissioner of Trade and taxes, Delhi, 2017, which held that the bona fide buyers should not be subjected to default by the seller who could not reasonably monitor the upstream tax.

Does the pre-2022 distinction survive?

Although the pre-2022 distinction to 16(2)(c) sought to be created by the petitioners has been accepted by the Delhi High Court and has a possible constitutional challenge; in the considered opinion of the Authors, its legal significance may be insufficient to sustain the possible constitutional challenge. The reason for such opinion is as follows: -

1. **The existence of alternative administrative mechanism**

The non-operationalization of sections 42 and 43 did not leave the ITC mechanism within the GST system without any verification framework.

Notwithstanding the Circulars providing for 'undertakings', through forms GSTR-1, GSTR-3B, GSTR-2A and GSTR-2B, a verification framework existed pre 2022 to monitor facilitation and reconciliation of ITC. Further, in combination to these forms, Rule 36(4) of the CGST Rules (as it was prior to the 2022 amendment) restricted the amount to 5%, which the taxpayer could claim for invoices or debit noted not supported by suppliers in their outward supply statements, such as GSTR-1.

So, a blanket argument that non-operationalization of sections 42 and 43 had resulted in 'no existing administrative mechanism' for reconciliation and facilitation of ITC may not see the light of the day. The argument is limited to the extent that the administrative mechanism was not operationalized in the manner contemplated by sections 42 and 43.

2. **The temporal distinction does not affect the constitutionality of 16(2)(c)**

The reasoning of the judgements in Maruti Enterprise and Bhandari Scrap Traders to uphold the constitutionality of section 16(2)(c), was: -

- While On Quest Merchandising and Arise India protected 'Bona-fide purchasers', the decision had been rendered under the VAT regime, which was materially different as ITC was confined within the 'originating state'. In contrast, the GST regime is a destination-based tax, hence ITC must operate seamlessly across state lines for inter-state supplies. Therefore, any reading down of section 16(2)(c), even for bona fide purchasers, would have cascading fiscal consequences.
- The treatment of ITC under the new GST framework was imagined as a statutory concession, which is subject to the conditions and restrictions prescribed under the Act.

Once analyzed closely, it leads to the natural conclusion that the court's reasoning in both the judgements was not confined to any temporal limits. It rather rested on broader fiscal considerations and the nature of ITC, which was never imagined as a constitutional or vested right. Therefore, even if the argument is accepted that the original framework under sections 42 and 43 differed from the subsequent enacted framework, the substantive justification for upholding the constitutionality of section 16(2)(c), surpasses any temporal limits and threatens to render the temporal distinction sought to be created by the petitioners as 'artificial'.

Conclusion: What Can the Assesses Expect?

For the assesses, the pre-2022 distinction might present a possible avenue to challenge the application of Section 16(2)(c), particularly given that the statutory matching mechanism under Sections 42 and 43 was never operationalised. However, the prospects of succeeding on this ground remain uncertain. The existence of alternative verification mechanisms and the broader reasoning adopted in Maruti Enterprise and Bhandari Scrap Traders even for bona-fide purchasers, as opposed to the earlier VAT regime decisions, may significantly weaken the

challenge. Assesses may therefore expect the courts to examine whether the earlier statutory framework created a materially different legal position, rather than treating the non-implementation of the matching mechanism as sufficient, by itself, to invalidate Section 16(2)(c). Until the issue is conclusively settled, the pre-2022 distinction remains a potential litigation ground, but not a guaranteed defence against the denial of ITC.