Supplier sins and Recipient repents - Part-III

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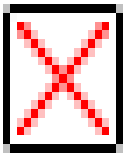
"The flea sinned, the reed-mat got the beating."
[Kashmiri Proverb]



[**IN Part I**, we had a brief look at the 4 (four) conditions prescribed in clauses (a) to (d) of S. 16(2) of the CGST **Act, 2017** which are in force as on date and which a taxpayer is required to fulfil so as to be eligible to ITC.

In **Part II,**
the statutory provisions relating to FORM GSTR-2A and their bearing on the entitlement of the taxpayer for availing ITC on the taxable supplies received by him were briefly analysed.]

Rule 36(4) - Absurdity!

As discussed earlier, even though **FORM GSTR-2A**
was always being generated on the common portal since the inception of the GST law, a large number of taxpayers were oblivious or indifferent to its existence. It was only with the insertion of sub-rule (4) in R.36 of the CGST **Rules, 2017** ('the Rules') by Not. No. **49/2019-(CT)** dt. 09.10.2019 w.e.f. 09.10.2019 that this **FORM** suddenly caught the attention of taxpayers!

Prior to insertion of sub-rule (4) in R.36, the recipient taxpayers used to avail of ITC on all taxable inward supplies received during the relevant tax period under the cover of the tax invoices, subject to the fulfilment of the prescribed conditions. To put it simply, taxpayers used to take ITC based on the supplies booked by them during the relevant tax period. In case, it later came to the notice of the department that the ITC availed on any inward supply received by the taxpayer was not admissible to him, say, due to non-compliance with the condition at clause (c) of sub-section (2) of S.16 of the CGST Act, 2017 ('the Act'), the department then initiated action for the denial of ITC to the taxpayer on such supplies and such other action as deemed fit.

However, alarmed at the mounting cases of fraud involving fake invoices ('Invoice mills') and false claims for ITC or refund coming to the surface coupled with the huge gap between the number of registered taxpayers vis-Ã -vis the number of **FORM GSTR-1** being filed, the GST Council appears to have brain-stormed over the ways and means to check the menace of frauds and non-compliance. Sub-rule (4) of R. 36 is the product of this brainstorming exercise!

For ease of understanding, R.36(4), as was introduced w.e.f. 09.10.2019, is reproduced below:

> ***"R.36 (4)- Input tax credit to be availed by a registered person in respect of invoices or debit notes, the details of which have not been uploaded by the suppliers under sub-section (1) of section 37, shall not exceed 20 per cent of the eligible credit available in respect of invoices or debit notes the details of which have been uploaded by the suppliers under sub-section (1) of section 37."***

Thus, the sub-rule (4), on its introduction, sought to restrict the availment of the ITC in respect of the invoices/debit notes, the details of which had not been uploaded by suppliers through **FORM GSTR-** 1 i.e. **unreconciled supplies** to not **exceeding 20%** of the ITC available in respect of the invoices/debit notes, the details of which have been uploaded by the suppliers through **FORM GSTR-1 i.e. the reconciled supplies** . The upper limit of '**20 per cent'** was subsequently reduced to **'10 per cent'** by Not. No. **75/2019-CT** dt. 26.12.2019. Finally, by Not. No. **94/2020-CT** dt. 22.12.2020, sub-rule (4) was once again amended in the following manner:

- the word ' **uploaded'** was substituted by **'furnished';**

- the expressions, ' **FORM GSTR-1'** and ' **Invoice - furnishing facility' (IFF)** were specifically inserted in the provision;

- the then existing upper ceiling of **'10 per cent'** was further **reduced to '5 per cent'.**

The above amendments have come into effect from **January 01, 2021** .

At the outset, it may be reiterated that the **FORM GSTR-2A** , though referred to in Rule 59(3) from inception i.e. from July 1, 2017, did not have nor does it still have any legal backing or support under any provisions of the parent Act i.e. CGST Act, 2017. With the insertion of sub-rule (4) in R. 36 by Not. No. **49/2019-CT** ***ibid*** , the Central Government only made a vain attempt to impart some credibility to **FORM GSTR-2A** in an indirect manner! Needless to say, a taxpayer, who is eager to comply with R. 36(4) has been referring to **FORM GSTR-2A** so as to ascertain his entitlement to ITC in case of '**unreconciled supplies**'. However, it is interesting to note that there is no mention of **FORM GSTR-2A** in R.36(4) at all!

Be that as it may, a close examination of sub-rule (4) of R.36 will reveal that it is in direct conflict with the clause (c) of S.16(2) of the Act. For ease of understanding, clause (c) of S.16(2) is reproduced below:

> ***"S.16 (2) (c) - subject to the provisions of section 41 or section 43A, 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"***

Thus, if a supplier has not paid the tax charged by him on his outward supplies made during the relevant tax period, the recipient taxpayer will not be entitled to ITC on such supplies at all, in terms of clause (c) of S.16(2) reproduced above. Now, when the details of the invoices/debit notes in respect of any inward supplies received by the recipient taxpayer are found to be not uploaded by the supplier through **FORM GSTR-1** , a logical inference can be drawn that the supplier concerned has not discharged the tax liability on such supplies. No doubt, this would require investigation as to the factual position. However, the non-discharge of tax liability by the supplier on his supplies will render the recipient taxpayer ineligible to ITC on such supplies altogether in view of the restriction prescribed under clause (c) of S.16(2) of the Act. Under these circumstances, can the provision of sub-rule (4) of R.36 extending partial ITC even in respect of such supplies be considered as valid? **The answer is explicitly 'No'.**
Merely because sub-rule (4) of R.36 appears to be a beneficial, though restrictive (in the sense that it extends the benefit of the partial ITC for unreconciled supplies), it does not acquire validity when it is in direct conflict with S.16(2)(c) of the parent Act.

In **Hukamchand vs. UOI - AIR 1972 SC 2427,** the Hon'ble Apex Court observed:
"The power to make subordinate legislation is derived from enabling Act and it is fundamental that the delegate on whom such a power is conferred has to act within the limits of authority conferred by the Act." The Hon'ble Court further observed that ***"fact that the rules framed under the Act have to be laid before each House of the Parliament would not confer validity on a rule if it is made not in conformity with provisions of the Act."***

In **General Officer Commanding-in-Chief vs. Subhash Chandra Yadav - AIR 1988 SC 876,** it was held that
"the Regulations had to be judged on a three-fold test namely: (1) whether the provisions of the Regulations fall within the scope and ambit of the power conferred on the delegate; (2) whether the Regulations made are to any extent inconsistent with the provisions of the enabling Act; and (3) whether they infringe any of the fundamental rights or other restrictions or limitations imposed by the Constitution."

There is yet another angle from which the issue of Constitutionality of sub-rule (4) of R.36 can be looked at. Not. No. **49/2019-CT** ***ibid***, ***inter alia***, inserting sub-rule (4) in R.36 and the subsequent Notification Nos. **75/2019-CT** ***ibid*** and **94/2020-CT** ***ibid*** amending the said sub-rule (4) are issued in exercise of the rule-making powers vested in the Central Government under S. 164 of the Act.

S. 164, ***inter alia***, empowers the Central Government:

- to make, on the recommendation of the GST Council, by notification, rules for carrying out the provisions of the Act [sub-section (1)]; and

- without prejudice to the generality of the provisions of sub-section (1), to make rules for all or any of the matters which by this Act are required to be, or may be, prescribed or in respect of which provisions are to be made by rules, [sub-section (2)]

The aforesaid 3 (three) notifications, inter alia, amending the provisions including R. 36 of the CGST Rules, 2017 are issued under S. 164 of the Act " **on the recommendation of the Council.â€Ÿ**
It can therefore be inferred that the powers in these cases have been exercised by the Central Government as vested in it under sub-section (1) of the S. 164 of the Act. It is interesting to note here that " **recommendations of the GST Councilâ€Ÿ**
is not a pre-condition for the exercise of the powers by the Central Government under sub-section (2) as the all-pervading words â€œ **on the recommendation of the Council** â€• are conspicuous in their absence in sub-section (2)!Â

The question that therefore, arises is: ***"whether the insertion of sub-rule (4) be considered as giving effect to the provisions of the Act?"***

The answer cannot be anything but in the negative. The provisions of the Act which may be considered as relevant in the context of S. 164(1) are those of S. 16(1), S. 41 and S. 43A of the Act. However, a careful reading of S. 164 would show that sub-rule (4) of R. 36 cannot be said to be 'for the provisions of S. 16(1)' at all. Similarly, S. 41 is also not relevant for the purposes of S. 164(1) of the Act. So far as S. 43A is concerned, it has not even been notified to date. One, therefore, wonders for which provisions of the Act, sub-rule (4) has been inserted in R. 36?

In **Kunj Bihari Lal Butail vs. State of H.P.- AIR 2000 SC 1069,** the Hon'ble the Supreme Court observed
that the delegated power to legislate by making rules for carrying out the purpose of the Act is a general delegation without laying down any guidelines and cannot be so exercised to bring into existence substantive right or obligation or disabilities not contemplated by the provisions of the Act.

One may here visualise the conflict between S. 16(2) and S. 164 of the Act. As stated earlier, sub-section (2) of S. 16 starts with a ' ***non-obstante clause'*** and overrides all other provisions of S. 16. Having said that, its overriding nature is confined to the provisions of S. 16 only. On the other hand, S. 164 provides for the general rule-making powers by the Central Government. So one may argue that sub-rule (4) inserted in R. 36 by Not. No. 49/2019-ST is in exercise of these powers vested in the Central Government under S. 164 and bringing S. 16(2) into the picture is neither justified nor warranted.

While the argument, at first blush, may look attractive, it may ultimately prove to be hollow! Aside from the fact that the very exercise of the powers under S. 164 is improper insofar as the insertion of sub-rule (4) in R. 36 is concerned, even if its propriety is accepted then too, S. 16(2) shall prevail over S. 164, the former being specific and the latter being general in nature. It is also pertinent to note here that while sub-section (2) of S. 16 overrides all other provisions of S. 16, clause (c) thereof is made '**subject to S. 41 and S. 43A of the Act'.**

As held in **South India Corporation (P) Ltd. vs. Secretary, Board of Revenue, Trivandrum - AIR 1984 SC 207**
"the phrase 'subject to' conveys the idea of a provision yielding place to another provision or provisions to which it is made subject."
Thus, clause (c) of S. 16(2) can be said to have been made subservient or obedient to S. 41 and S. 43A. Now, we have already seen that though S. 41 would prevail over S. 16(2)(c), the occasion for the former provision to display its dominance over the latter will arise only when the very condition laid down in clause (c) is fulfilled. If that condition itself is not satisfied, then S. 41 will not come into play at all. Consequently, S. 41 cannot be said to have laid down the foundation on which the edifice of sub-rule (4) of R. 36 is built by employing S. 164 of the Act! So far as S. 43A is concerned, suffice it to say that the provision is not notified as yet and it is futile to trace the enabling power in this provision for the purposes of sub-rule (4) inserted in R. 36 of the Rules. It is, therefore, evident that even when viewed from this perspective, sub-rule (4) of R. 36 is an invalid and unconstitutional piece of legislation.

Further, the input tax credit is a vested right and where the conditions as prescribed under S.16(2) have been fulfilled, there cannot be any restriction on or denial of credit in any manner on the basis of non-uploading of the details of the supplies on the System by the supplier. It is a settled law that an accrued right of ITC availment cannot be taken away on such pretext. See, the Supreme Court's decision in Eicher Motors India Ltd. vs. UOI - **2002-TIOL-149-SC-CX-LB.**

Moreover, restricting the benefit of ITC to a bonafide purchaser, only because of the default of the supplier to upload the details of outward supplies on the common portal severely impacts the working capital of the purchaser and substantially diminishes its ability to continue the business. This clearly violates his right to carry on the trade or business guaranteed under Art.19(1)(g) of the Constitution.

It may further be added here that as the restriction also deprives the purchaser of the enjoyment of the property, it is positively violative of the provision of Art. 309A of the Constitution.

Yet another reason why the provision remains susceptible to serious constitutional challenge is its discriminatory nature and unreasonableness. The provision i.e. R. 36(4) ***inter alia***, restricts ITC in case of **unreconciled supplies**
to not exceeding 5% of ITC available on **reconciled supplies.**
This would mean that if the quantum of ITC involved in the unreconciled supplies is less than 5% of the total ITC involved in the reconciled supplies, the provisions of R. 36(4) cannot apply at all. One may here refer to illustration No.3 under the clarification at Para 4 of Circular No. **123/42/2019-GST** (F. No. 20/06/14/2019-GST) dt. 11.11.2019 issued by the Board, ***inter alia***
, clarifying various issues arising in the context of sub-rule (4) of R. 36 of the Rules.

Last, but not the least, the provision is also unreasonable inasmuch as it restricts the entitlement to ITC of a recipient taxpayer for reasons on which he has no control and though he has otherwise complied with all the statutory requirements so as to be eligible for ITC. In effect, the provision expects the recipient taxpayer to do the impossible and certainly fails on the touchstone of 'reasonableness'. Besides, the provision is also incapable of being implemented in certain situations. Consequently, both, on the counts of 'discrimination' and 'unreasonableness', sub-rule (4) is susceptible to challenge as being violative of Art. 14 of the Constitution of India.

In view of the above, the author is clearly of the view that sub-rule (4) of R. 36 is ***ultra vires***
the Act and an unconstitutional and invalid piece of legislation and cannot stand the scrutiny of law.

It is, therefore, not surprising that the constitutionality of sub-rule (4) of R. 36 is under challenge before different High Courts.

To conclude, as sub-rule (4) of R. 36 itself is an invalid piece of legislation, the resort to **FORM GSTR-2A**
and denial of ITC (full or partial) solely on the basis thereof to the recipient taxpayer is an act which is wholly without authority of law. The provision is not only arbitrary and impractical but is also a demonstration of a classic case of knee jerk reaction to serious issues of tax frauds and non-compliance.**Â**

[To be continuedâ€¦]

[The views expressed are strictly personal.]

See Part I & Part II

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