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NEWS ALERT

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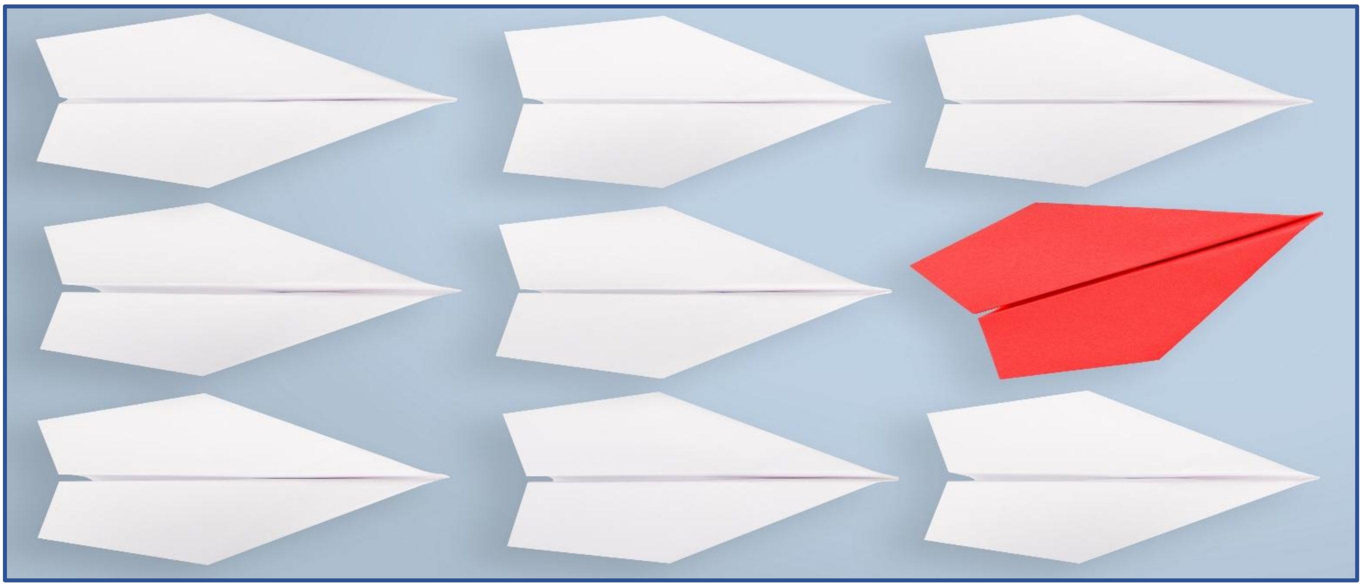

Input Tax Credit is admissible only where the supplier has actually remitted tax to the Government

- Bhandari Scrap Traders v. Union of India[1]

In a significant ruling on the eligibility of Input Tax Credit ('ITC') under the GST regime, the Supreme Court, in the case of taxpayer, dismissed the Special Leave Petitions challenging the constitutional validity of Section 16(2)(c) of the Central Goods and Services Tax Act, 2017 ('the Act'). The Court affirmed the judgment of the Gujarat High Court ('HC') in *Maruti Enterprise*[2], thereby upholding the requirement that tax charged on a supply must <u>actually be paid</u> to the Government by the supplier as a pre-condition for availment of ITC.

The key observations of the HC in the case of Maruti Enterprise (supra) are discussed below:

1. <u>Whether Section 16(2)(c) of the Act imposes an impossible condition</u>

   The taxpayer contended that Section 16(2)(c) of the Act places an impossible burden on recipients by requiring them to ensure that the supplier has deposited the tax with the Government. According to the taxpayer, compliance with this condition depends entirely on the conduct of a third party over whom the recipient exercises no control. They further argued that denial or reversal of ITC due to supplier default could cause severe financial hardship and liquidity constraints for genuine recipients.

[1] SLP(C) No. 23931/2026 etc.

[2] R/SPECIAL CIVIL APPLICATION NO. 18080 of 2023 and Ors

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Rejecting the challenge, the HC held that the GST framework does not leave recipients without a remedy. Reference was made to Section 41(2) of the Act and Rule 37A of the CGST Rules, 2017, which provide for reversal of ITC where tax has not been paid by the supplier, and permit re-availment of such credit once the supplier subsequently discharges the tax liability. The Court therefore concluded that the provision does not impose an impossible condition but merely regulates eligibility for availing a statutory benefit.

2. <u>Whether denial of ITC results in double taxation</u>

The taxpayer argued that once GST has been paid to the supplier, denial of ITC effectively shifts the tax burden back to the recipient, thereby defeating the fundamental GST objective of eliminating cascading taxes and avoiding double taxation.

The HC disagreed and held that ITC is not an unconditional or vested right but a statutory concession subject to fulfillment of prescribed conditions. Since the statutory scheme permits reversal and subsequent re-availment of ITC upon payment of tax by the supplier, the recipient is not permanently deprived of the credit. Accordingly, denial of ITC in such circumstances cannot be characterised as double taxation.

3. <u>Whether VAT jurisprudence applies to the GST regime</u>

The taxpayer argued that the principle discussed in the case of On Quest Merchandising India Pvt. Ltd.[3] and Shanti Kiran India Pvt. Ltd.[4] under VAT regime should also apply under the GST framework, namely that a bonafide recipient should not lose ITC because of supplier default.

Revenue, however, submitted that the GST framework is fundamentally different from the VAT regime. The GST legislation contains specific provisions concerning reversal and re-availment of ITC, inter-State credit settlement mechanisms, and revenue sharing arrangements between the Centre and the States, none of which existed under VAT laws. Accepting this contention, the HC held that precedents rendered under the VAT regime cannot be mechanically applied to GST disputes.

4. <u>Burden of proof on the recipient</u>

The taxpayer argued that it is unreasonable to require a recipient to prove a fact that is solely within the knowledge of the supplier. The taxpayer contended that Section 155 of the Act cannot be interpreted to require proof of circumstances entirely outside the recipient's control.

The HC held that Section 155 of the Act has a direct nexus with section governing claim of ITC. It observed that the expression ‘eligible’ for ITC includes satisfaction with all conditions prescribed under such section. Consequently, a taxpayer must establish fulfillment of all statutory requirements, including actual payment of tax by the supplier to the Government.

5. <u>Whether Section 16(2)(c) of the Act can be read down</u>

The taxpayer alternatively prayed that Section 16(2)(c) of the Act be read down so that ITC is

[3] [2017] 87 taxmann.com 179/ [2018] 10 GSTL 182 (Del)

[4] [2025] 179 taxmann.com 665 (SC)

denied only where the recipient knew, ought to have known, or actively participated in fraud, collusion or tax evasion.

The HC declined to adopt such an interpretation. It held that the language of Section 16(2)(c) of the Act is clear, unambiguous, and self-explanatory. The doctrine of reading down cannot be employed to rewrite a taxing statute or introduce exceptions that the legislature has consciously not incorporated. The Court reiterated that all conditions under Section 16(2) of the Act are cumulative and must be satisfied before a taxpayer becomes entitled to ITC.

JMP Insights - *The judgment by the SC in Bhandari Scrap Traders and its affirmation of the Gujarat HC ruling in the case of Maruti Enterprise is that Section 16(2)(c) now stands on a strong legal footing and represents the prevailing judicial position under GST law.*

Taxpayers can no longer rely solely on invoice-based compliance. Vendor tax compliance becomes a critical prerequisite for preserving ITC. The mere fact that the transaction is genuine is no longer sufficient protection. Businesses will need to move beyond checking invoices and system-generated forms towards vendor monitoring.

While the HC has upheld the provision, they have noted the need for a tracking mechanism to verify actual deposit of tax by the supplier. The judgement opens the doors for legislative and technological reforms rather than constitutional invalidation of the law.

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Should you wish to discuss any of the above issues in detail or understand the applicability to your specific situation, please feel free to reach out to us on coe@jmpadvisors.in.

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