

THE INPUT TAX CREDIT PARADOX: AN ANALYSIS OF RULE 36(4) OF THE CENTRAL GOODS AND SERVICES TAX (CGST) RULES, 2017 WITH SPECIFIC EMPHASIS ON ITS LEGAL VALIDITY

- Abir Satsangee and Shabd Roop Satsangee*

ABSTRACT

Allowing credits for taxes paid on inputs of previous stages is the *sine quo non* of any value added tax regime. From 1st of July, 2017, in a landmark display of cooperative federalism, India has ushered in a new Indirect Tax regime of Goods and Services Tax (hereinafter “GST”) for seamless flow of Input Tax Credit (hereinafter “ITC”) and to create a ‘One Nation, One Tax’ encompassing all supplies of goods and services. However, with the cases of ITC related frauds on a constant rise, the GST Council, the overseeing constitutional body for making recommendations to the Union and State Government on issues related to GST, decided to impose certain restrictions on availment of ITC. In pursuance of the same, sub-rule (4) to Rule 36 of the Central Goods and Services Tax Rules, 2017 (hereinafter “CGST Rules”) has been inserted vide Notification no. 49/2019-Central Tax dated 09.10.2019. This sub-rule imposes a restriction on the quantum of credit that a taxpayer can avail on a monthly basis. This paper aims to explore the legal validity of the restriction imposed on availment of ITC by a tax-payer only up-to the extent of 20% (the same has been further brought down to 10%) of the eligible credit available in respect of invoices declared by his supplier in FORM GSTR-1 on constitutional as well as other grounds on which the legal validity of Rule 36(4) may be tested in the Courts of Law. The paper is divided

* Abir Satsangee is a Chartered Accountant. Shabd Roop Satsangee is an Articled Assistant at Sahib P. Satsangee & Co., Chartered Accountants. The views expressed are personal.

into five sections. The first section gives an introduction of the concept of ITC. The second section analyses the provisions contained under the GST laws regarding ITC. The third section aims to test Rule 36(4) on the touchstone of the Constitution of India and the fourth section explores other grounds on which its validity may be tested in the Courts of Law. The fifth section summarises the discussion and gives suggestions and the way forward.

I. INTRODUCTION

India has ushered in a landmark reform in its Indirect Tax regime with the introduction of GST with effect from 1st July, 2017. One of the major reasons behind this shift was to replace multiple indirect taxes at different points of the value chain with one single tax on ‘supply’ of goods and services and provide seamless flow of taxes paid on inputs in order to prevent the cascading effect of taxes.

In order to prevent ‘Tax-on-Tax’ (also termed as the ‘Cascading Effect’), it is necessary to allow the credit of taxes paid on inputs of previous stages. This ensures that the tax is levied only on the ‘value added’, which is the ‘*sine quo non*’ of any value added tax regime. If ITC is not available, the same becomes a cost of purchase and hence leads to an increase in prices of goods and services –

Illustration 1 – Input Tax Credit and the Cascading Effect

	Particulars	With Input Tax Credit	Without Input Tax Credit
(a)	Purchase price of Inputs	100.00	100.00
(b)	Input Tax @ 18% [(a)*18%]	18.00	18.00
(c)	Cost of Inputs [Includes Input	100.00	118.00

	Tax when Credit is not available]		
(d)	Value Addition by Supplier	100.00	100.00
(e)	Total Cost [(c)+(d)]	200.00	218.00
(f)	Assumed Margin per unit	10.00	10.00
(g)	Selling Price [(e)+(f)]	210.00	228.00
(h)	Output Tax @ 18% [(g)*18%]	37.80	41.04
(i)	Selling Price (Including Tax)	247.80	269.04
(j)	Net Tax payable by dealer	$37.80 - 18.00 = 19.80$	41.04
(k)	Total Tax received by Government [(b)+(j)]	$18.00 + 19.80 = 37.80$	$18.00 + 41.04 = 59.04$
(l)	Total Value of goods/services without Taxes [(i)-(k)]	210.00	210.00
(m)	Tax as % of Total Value	18.00%	28.11%

The difference between the taxes paid in the above two scenarios is of Rs. 21.24, which is equal to Tax @ 18% on the Rs. 118.00, the amount paid for inputs. From the above illustration, it is apparent that Rs. 100.00 which had been tax earlier is being taxed again and not only that, even Rs. 18.00 which was paid as taxes is being taxed again. This leads to cascading of taxes and increases the effective tax rate on goods and services which has gone up to 28.11% from 18% in the instant case.

To address this concern in particular, it was stated in the Statement of Objects and Reasons of the Central Goods and Services Tax Bill, 2017, (hereinafter “the Bill”) that the proposed legislation will simplify and

harmonise the indirect tax regime in the country and ensure seamless flow of ITC.

It is expected to reduce cost of production and inflation in the economy, thereby making the Indian trade and industry more competitive, domestically as well as internationally. Due to the seamless transfer of input tax credit from one stage to another in the chain of value addition, there is an in-built mechanism in the design of goods and services tax that would incentivise tax compliance by taxpayers.¹

Further, the Statement of Objects and Reasons also states that the Bill aims to broad base the input tax credit by making it available in respect of taxes paid on any supply of goods or services or both used or intended to be used in the course or furtherance of business.²

Keeping the above intention of the Legislature in mind, the relevant provisions of the GST laws are analysed in the next section of this paper.

II. RELEVANT PROVISIONS UNDER THE GST LAWS

A. Broad Framework

The GST laws consist of the Central Goods and Services Tax Act, 2017 (hereinafter “CGST Act”), the Integrated Goods and Services Tax Act, 2017 (hereinafter “IGST Act”), the GST Acts passed by the respective States/Union Territories and the Goods and Services Tax (Compensation to States) Act, 2017 along with the Rules made thereunder.

¹ Central Goods and Services Tax Bill, 2017, Bill No. 57 of 2017, Statement of Objects and Reasons, ¶4 (2017).

² *Id.*, ¶5.

The provisions regarding ITC are contained in the CGST Act and Rules made thereunder and are *pari materia* to the provisions contained in the GST Acts passed by the respective States/Union Territories. Further, provisions of the CGST Act regarding ITC have been *mutatis mutandis* made applicable with reference to the IGST Act.³

Chapter V of the CGST Act, consisting of Sections 16 to 21, contains the provisions regarding ITC. Section 16 deals with eligibility, conditions and time period for taking ITC. Section 17 deals with apportionment of ITC in cases where the goods or services or both are used for dual purposes (business and other than business or for effecting taxable or non-taxable supplies). It also provides a list of supplies on which ITC cannot be availed. Section 18 provides for availability of credit in special circumstances like new registration, exempted supplies becoming taxable and vice versa, etc. Section 19 deals with provisions regarding ITC in case of job work. Section 20 and 21 are related to provisions regarding Input Service Distributor.

Further, Chapter IX of the CGST Act, which contains provisions regarding returns, includes Section 41, 42 and 43A,⁴ which deal with claim, provisional acceptance and matching of ITC in the Returns.

Further, Chapter X, which deals with payment of tax, contains provisions regarding maintenance of an Electronic Credit Ledger and utilisation of the ITC reflected in it in Section 49.

³ Integrated Goods and Services Tax Act, 2017, No. 13, Acts of Parliament, 2017, § 20.

⁴ Central Goods and Services Tax Act, 2017, No. 12, Acts of Parliament, 2017, § 43A, *inserted vide* Central Goods and Services Tax (Amendment) Act, 2018, No. 31 of 2018, § 18 [hereinafter **CGST Act, 2017**].

For the purposes of this paper, Sections 16, 41, 49, 42 and 43A of the CGST Act are relevant and have been analysed further.

B. Eligibility to Claim ITC

Section 16 of the CGST Act entitles every registered person 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 amount of ITC claimed shall be credited to the electronic credit ledger of such person. However, this claim is to be made in the manner specified in Section 49 and is subject to such conditions and restrictions as may be prescribed.⁵

C. Conditions for Claiming ITC Provided in the Act

However, Sub-section (2) to Section 16 states that notwithstanding anything contained in Section 16, no registered person shall be entitled to any ITC in respect of any supply of goods or services or both to him, unless the following conditions are fulfilled –

- (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;
- (b) he has received the goods or services or both.
-
- (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; and
- (d) he has furnished the return under section 39:⁶

⁵ CGST Act, 2017, § 16(1).

⁶ *Id.*, § 16(2).

Further, the recipient needs to reverse the ITC availed along with in case of non-payment of the value and tax to the supplier within 180 days from the date of issue of the invoice.⁷

Further, the CGST Act also provides that the cut-off date for availment of ITC for a financial year is the due date of furnishing of the return under section 39 for the month of September following the end of financial year to which such invoice or invoice relating to such debit note pertains or furnishing of the relevant annual return, whichever is earlier.⁸

D. Conditions Prescribed in Rule 36 Prior to Insertion of Rule 36(4)

Rule 36 of the Central Goods and Services Tax Rules, 2017 (hereinafter “CGST Rules”) prescribes the documentary requirements and conditions for claiming ITC.

Sub-rule (1) provides that ITC can be availed by a registered person on the basis of a Tax Invoice, a Self-Invoice issued u/s 31(3)(f), a debit note issued by supplier u/s 34, a Bill of Entry/any similar document prescribed under the Customs Act, 1962 or an ISD Invoice.⁹

Sub-rule (2) further provides that the ITC shall be availed only if the said document contains all the details specified in Chapter VI of the CGST Rules (or at least the details of the amount of tax charged, description of goods or services, total value of supply of goods or services or both, Goods and Services Tax Identification Number (hereinafter

⁷ *Id.*, second proviso to § 16(2).

⁸ *Id.*, § 16(4).

⁹ The Central Goods and Services Tax Rules, 2017, Rule 36(1) [hereinafter **CGST Rules, 2017**].

“GSTIN”) of the supplier and recipient and the place of supply in case of inter-State supply) and the relevant information as contained in such document is furnished in FORM GSTR-2 by the recipient.¹⁰

Further, no ITC can be availed in respect of any tax that has been paid in pursuance of any order where any demand has been confirmed on account of any fraud, wilful misstatement or suppression of facts.¹¹

E. Manner of Claiming ITC and Its Matching

The CGST Act provides for provisional claiming of ITC and its finalisation after matching the details of inward supplies (purchases) furnished by the recipient with the details of outward supplies (sales) furnished by the suppliers.

Section 41 provides that every registered person shall, subject to such conditions and restrictions as may be prescribed, be “entitled to take the credit of eligible input tax, as self-assessed, in his return” and such amount shall be “credited on a provisional basis” to his electronic credit ledger and this credit can be utilised only for payment of self-assessed output tax.¹²

Further, the ITC as ‘self-assessed’ in the return of a registered person shall be credited to his electronic credit ledger, in accordance with “section 41 or section 43A”, to be maintained in such manner as may be prescribed¹³ and the amount available in the electronic credit ledger may be used for making any payment towards output tax under this Act or

¹⁰ *Id.*, Rule 36(2).

¹¹ *Id.*, Rule 36(3).

¹² CGST Act, 2017, § 41.

¹³ *Id.*, § 49(2), as amended *vide* the Central Goods and Services Tax (Amendment) Act, 2018, § 20 (2018).

under the Integrated Goods and Services Tax Act in such manner and subject to such conditions and within such time as may be prescribed.¹⁴

It may be noted that Rule 69 of the CGST Rules prescribes the mechanism regarding matching of claim of input tax credit.

It prescribes the claim of input tax credit on inward supplies including imports, provisionally allowed under section 41, shall be matched under section 42 after the due date for furnishing the return in FORM GSTR-3 on the parameters of GSTIN of the supplier; GSTIN of the recipient; invoice or debit note number and date; and the tax amount.¹⁵

It also provides that where the time limit for furnishing the Return specified under section 37 (Return of outward supplies in FORM GSTR-1) and the Return specified under section 38 (Return of inward supplies in FORM GSTR-2) has been extended, the date of matching relating to claim of input tax credit shall also be extended accordingly.

It may be noted that the time period of filing of FORM GSTR-2 and FORM GSTR -3 for the month of July 2017 to March 2018, was extended from time to time and ultimately it was decided by the GST council that a revised time-line would be worked out by a Committee of officers.¹⁶ In cognizance of the same, the system-based reconciliation envisaged under the GST laws was to be kept in abeyance till such new time-lines were notified.¹⁷ In absence of the same, the current process of claiming ITC is on the basis of self-assessment in the return filed under Section 39 in FORM GSTR-3B.

¹⁴ *Id.*, § 49(4).

¹⁵ CGST Rules, 2017, Rule 69.

¹⁶ Minutes, 23rd GST Council Meeting, Nov. 10, 2017, ¶76.

¹⁷ Ministry of Finance, Circular No. 26/26/2017-GST (issued on Dec. 29, 2017).

F. The Bone of Contention – Rule 36(4)

With rise in the menace caused by fake invoices and the resultant wrongful availment of ITC coming into light, the GST Council in its 37th Meeting held on 20th September 2019, decided to impose certain restrictions on availment of ITC by the recipients.¹⁸

In this regard, the Press Release of the GST Council stated: “In order to nudge taxpayers to timely file their statement of outward supplies, imposition of restrictions on availment of input tax credit by the recipients in cases where details of outward supplies are not furnished by the suppliers in the statement under section 37 of the CGST Act, 2017.”¹⁹

In furtherance of the same, Notification No. 49/2019-Central Tax, dated 09.10.2019 was issued which inserted Sub-rule (4) to Rule 36 of the CGST Rules as under:

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 37.²⁰

Through the above Rule, a restriction on the quantum of ITC that a taxpayer can avail on self-assessment basis has been imposed by stating

¹⁸ Shubham Vijay & Shabd Satsangi, *A Nudge or a Shove: An Analysis of Rule 36(4) of the CGST Rules, 2017*, [2019] 111 Taxmann.Com 21 (Article), ¶1.

¹⁹ Press Release (Law and Procedure Related Changes), 37th Meeting of the GST Council (Sep. 20, 2019), ¶4, available at http://cbic.gov.in/resources/htdocs-cbec/press-release/Final_Press%20Release_GSTPW_20092019.pdf.

²⁰ CGST Rules, 2017, Rule 36(4), *inserted vide* Notification No. 49/2019-CT, dt. 09.10.2019.

that a taxpayer can avail ITC pertaining to outward supplies not declared by his supplier in FORM GSTR-1 (and reflected in FORM GSTR-2A) only up-to the extent of 20% of the eligible credit available in respect of invoices declared by his supplier in FORM GSTR-1.²¹

The same can be explained with the help of the following illustration –

Illustration 2 – Restriction on Availment of ITC under Rule 36(4) up to 31/12/2019

	Particulars	Amount
(a)	ITC pertaining to supplies received by the Taxpayer	1,000.00
(b)	Eligible ITC reflected in GSTR-2A	750.00
(c)	ITC which can be claimed in GSTR-3B [(b)*120%]	900.00
(d)	ITC which is deferred due to Rule 36(4) [(a)-(c)]	100.00

The same has been subsequently reduced to 10% of the eligible credit available in respect of invoices or debit notes reflected in FORM GSTR-2A with effect from 01/01/2020.²² In light of the same, the above illustration is reworked as under –

Illustration 3 – Restriction on Availment of ITC under Rule 36(4) w.e.f. 01/01/2020

	Particulars	Amount
(a)	ITC pertaining to supplies received by the Taxpayer	1,000.00
(b)	Eligible ITC reflected in GSTR-2A	750.00
(c)	ITC which can be claimed in GSTR-3B [(b)*110%]	825.00
(d)	ITC which is deferred due to Rule 36(4) [(a)-(c)]	175.00

²¹ See *supra* note 18, ¶3.

²² CGST Rules, 2017, Rule 36(4), *amended vide* Notification No. 75/2019 – CT, dt. 26.12.2019, with effect from 01.01.2020.

Therefore, with the insertion of Rule 36(4), the eligibility of the recipient to claim ITC has been made dependent on the timely filing of GSTR-1 by the supplier.

Further, the Government has clarified, *inter alia*, the following points with reference to Rule 36(4) vide Circular No. 123/42/2019– GST, dated November 11, 2019 –

1. Compliance to be done on Self-Assessment Basis

The Government has clarified that the conditions and eligibility for the ITC that may be availed by the recipient shall continue to be governed as per the provisions of Chapter V of the CGST Act and the rules made thereunder. The restriction provided under Rule 36(4) is not imposed through the common portal and it is the responsibility of the taxpayer that credit is availed in terms of the said rule and therefore, the availment of restricted credit in terms of sub-rule (4) of rule 36 of CGST Rules shall be done on self-assessment basis by the tax payers.²³

2. The Restriction is imposed on a Consolidated Basis and not Supplier wise

The restriction imposed is not supplier wise. The credit available under sub-rule (4) of rule 36 is linked to “total eligible credit” from all suppliers against all supplies whose details have been uploaded by the

²³ Ministry of Finance, Circular No. 123/42/2019– GST (issued on November 11, 2019), ¶3.

suppliers. Further, invoices where ITC is ineligible would not be considered for calculating the limit under Rule 36(4).²⁴

3. Cut-off Date for Calculation of ITC for a Particular Tax Period

Another issue which arose in implementation of Rule 36(4) was that FORM GSTR-2A is a dynamic document, therefore what would be the amount of ITC that is admissible to the taxpayers for a particular tax period.

In this regard, it has been clarified that the cut-off date for calculations would be the due date of filing of the returns in FORM GSTR-1 of the suppliers for the said tax period. Therefore, the taxpayer may have to ascertain the ITC admissible for a particular tax period from his auto populated FORM GSTR-2A “as available on the due date of filing of FORM GSTR-1 under sub-section (1) of section 37”.²⁵

4. Availability of Balance ITC

It has been clarified that the balance ITC may be claimed by the taxpayer in any of the succeeding months provided details of requisite invoices are uploaded by the suppliers. In other words, taxpayer may avail full ITC in respect of a tax period, as and when the invoices are uploaded by the suppliers to the extent of 83.33% of Eligible ITC (90.91% w.e.f. 01/01/2020).²⁶

²⁴ *Id.*, at 2.

²⁵ *Id.*, at 2.

²⁶ *Id.*, at 4.

III. ANALYSIS OF THE CONSTITUTIONAL VALIDITY OF RULE 36(4)

A. Fundamental Right to Carry on Business

1. Right to Carry on Business is subject to Restrictions

Article 19 of the Constitution of India grants all citizens the fundamental right to practise any profession, or to carry on any occupation, trade or business.²⁷

However, such freedom does not preclude the State from making any law imposing, in the interests of the general public, reasonable restrictions on the exercise of the right to do business.²⁸

The constitutionality of a statute imposing any restrictions on the right granted under Article 19(1)(g) can be challenged by showing that the restrictions imposed by the statute are unreasonable, either because the restrictions go in excess of the object of the statute, or activities which are not against the public interest are included within its ambit, or because the procedure laid down in the statute for curbing such activities is unreasonable or unjust or arbitrary.²⁹

It may be noted that as the fundamental rights are granted to citizens only, a non-citizen cannot challenge the validity of laws under Article 19.³⁰ For the purpose of Article 19(1)(g), a company incorporated under the Companies Act is a non-citizen.³¹ However, the fundamental

²⁷ INDIA CONST. art. 19(1)(g).

²⁸ *Id.*, art. 19(6).

²⁹ *Harlalka v. Union of India*, 1970 AIR 520 (Cal).

³⁰ *Monstant-Joan v. Union of India*, 2010 AIR(NOC) 87 (AP).

³¹ *State Trading Corporation of India v. Commercial Tax Officer*, 1963 AIR 1811 (S.C.).

rights of the shareholders of a company are not lost when they associate to form a company.³²

Keeping the above in mind, the question that whether Rule 36(4) is in violation of Article 19(1)(g) has been restricted to the analysis of the following two points –

- i. Whether Rule 36(4) imposes a restriction on carrying on business?
- ii. Whether such restriction is reasonable and in interest of the general public?

2. Whether Rule 36(4) imposes a restriction on carrying on business?

The term ‘restriction’ has been defined as an official limit or control on what people or companies are allowed to do, or on what can happen.³³ A restriction is a rule or order that limits what you can do or that limits the amount or size of something; a fact or situation that limits you or prevents you from doing what you want to do.³⁴

Sub-section (1) of Section 16 of the CGST Act provides for conditions and restrictions subject to which the input tax credit shall be credited to the electronic credit ledger. Basis the same, the Law Committee of the GST Council made a recommendation that necessary

³² Bennett Coleman & Co. v. Union of India, 1973 AIR 106 (S.C.).

³³ *Restriction*. CAMBRIDGE BUSINESS ENGLISH DICTIONARY (Cambridge University Press, Cambridge, 2011), available at <https://dictionary.cambridge.org/dictionary/english/restriction>.

³⁴ *Restriction*. COLLINS COBUILD ENGLISH LANGUAGE DICTIONARY (Collins, London, 1987).

restriction may be prescribed through amendment of rule 36 of the CGST Rules, 2017.³⁵

Therefore, Rule 36(4) is in the nature of imposing a restriction on the ITC a dealer can take on his purchases.

3. Test of Reasonableness of the Restriction

‘Reasonable’ means that which is in accordance with reason, and which is associated with logic and not arbitrariness. It implies intelligent care and deliberation that which reason dictates.³⁶

The following aspects need to be considered for determining whether a restriction is reasonable or not:

(a) A restriction is reasonable if it is not arbitrary or of an excessive nature beyond what is required in the interest of the public.³⁷

Prior to introduction of Rule 36(4), provisions regarding an elaborate matching mechanism were already in place in the CGST Act. Even the ITC on supplies not declared by the seller in GSTR-1 could be claimed by the recipient by including the details of such supplies in his FORM GSTR-2,³⁸ which were then to be made available to the supplier in FORM GSTR-1A and FORM GSTR-1 furnished earlier by the supplier was to stand amended to the extent of modifications accepted by him.³⁹ Therefore, the CGST Act permits availment of 100% ITC even if respect

³⁵ *Agenda for 37th GST Council Meeting*, GOODS AND SERVICES TAX COUNCIL, File No: 434/37th GSTCM/GSTC/2019, Aug. 26, 2019, at 56.

³⁶ Gajraj Yadav, *A Study of Fundamental Right to Occupation in India*, MAHARSHI DAYANAND UNIVERSITY, 2011, at 31.

³⁷ *P.P. Enterprises v. Union of India*, 1982 AIR 1016 (S.C.), ¶8.

³⁸ CGST Act, 2017, § 38(1).

³⁹ CGST Rules, 2017, Rule 59(4).

of supplies not declared by including the details of such supplies in FORM GSTR-2, which are then subject to acceptance by the supplier.

However, the envisaged matching mechanism including FORM GSTR-2, GSTR-1A and FORM GSTR-3 could not be operationalized because of technical glitches and due to the same there was no matching of credit in the system. Therefore, the possibility of fraud, adverse impact on the revenue and encouragement to suppliers to file FORM GSTR-1 was cited as a key reason to introduce Rule 36(4).⁴⁰

Rule 36(4) is an indirect attempt to put the onus of the matching on the taxpayers instead of operationalising the matching mechanism already provided for in the law which allowed availment of 100% ITC if the requisite details were disclosed. Due to non-operationalisation of the matching mechanism, the tax-payers were exercising their right to claim ITC by declaring such details in aggregate in GSTR-3B on a self-assessment basis instead of invoice-wise details in GSTR-2. Rule 36(4) seeks to restrict this right.

Further, no justification has been provided for the 20% cap which was introduced by Rule 36(4) and the same has now been further reduced to 10% without any justification.

Even if prevention of fraud may be considered as in furtherance of public interest, the adverse impact it may have on small businesses has not been considered while framing Rule 36(4).⁴¹

⁴⁰ See *supra* note 35, at 56.

⁴¹ See *supra* note 18, ¶7.6.

(b) The restriction must have a reasonable relation with the object which the legislation seeks to achieve, and must not go in excess of that object.⁴²

A Standard Operating Procedure (SOP) for tackling GST fraud cases involving the use of fake invoices for wrong availment of ITC is already in place⁴³ and a new return system is ready to be operationalised from 1st April, 2020.

Similarly, the government itself had given relaxations on filing of FORM GSTR-1 by making it quarterly for taxpayers having turnover up to Rs. 1.5 Crore and non-imposition of automatic late fee in case of late filing of GSTR-1 were the main factors which were causing poor filing of FORM GSTR-1.

Further, there is already a provision in the CGST Rules for blocking e-way bill generation in case of non-filing of GST Returns.⁴⁴

Therefore, adequate alternative measures to achieve the objects sought to be achieved by Rule 36(4) are already in place. Instead of enforcing the already existing provisions in place, Rule 36(4) seeks to penalise the recipients for the default by suppliers which seems to be unreasonable.

(c) The reasonableness of a restriction has to be determined in an objective manner and the standpoint of the interest of the general public and not

⁴² Kochuni v. State of Madras, 1960 AIR 1080 (S.C.).

⁴³ See generally Ministry of Finance, Office Memorandum - F.No. GST/INV/FAKE INVOICES/18-19, dated 12.05.2019, ¶3.

⁴⁴ CGST Rules, 2017, Rule 138E, inserted vide Notification No. 74/2018-CT dt. 31.12.2018, made effective from 21.08.2019 vide Notification No. 25/2019-CT dt. 21.06.2019.

from the point of view of the person upon whom the restrictions are imposed.⁴⁵

Blocking of ITC would lead to increase in cost of doing business and would ultimately lead to higher prices for the consumers due to cascading of taxes. Further, it would also impact the small vendors in the supply chain as it would discourage procurements from small taxpayers who have opted for quarterly filing of GSTR-1, as the same will appear in GSTR-2A of the recipient only at the end of the quarter and it would lead to working capital blockage at the recipient's end for up to 3 months. This problem would be compounded in case the supplier misses to upload the invoice or uploads incorrect details as any amendment can be made only in the next GSTR-1.⁴⁶

Therefore, Rule 36(4) not only affects the recipients on whom the restriction has been imposed, but also their suppliers and the consumers at large.

- (d) A law cannot be said to be unreasonable merely because, in a given case, it operates harshly.⁴⁷
- (e) Whether a restriction is reasonable or not shall depend on many factors, viz., the nature of the right infringed, the purpose of the restriction, the extent and the nature of the mischief required to be

⁴⁵ See *supra* note 36, at 31.

⁴⁶ See *supra* note 18, ¶7.6.

⁴⁷ *Pathumma v. State of Kerala*; 1978 AIR 771 (S.C.).

suppressed and the prevailing social and other conditions at the time.⁴⁸

It may be noted that the detailed Agenda note to the 37th GST Council meeting in which this restriction was imposed highlights declining revenue collection as a key factor behind implementing Rule 36(4).

Even though most of these issues will get addressed in the new return system, considering the concerns regarding declining revenue collection from GST, it is felt necessary to put in place a mechanism to curb such wrongful availment of credit. Accordingly, it is proposed that reasonable restriction may be imposed on self-assessed input tax credit availed in FORM GSTR-3B in respect of those invoices, the details of which have not been uploaded by the supplier as required under sub-section (1) of section 37 of the CGST Act i.e. which is not reflected in FORM GSTR-2A. This will also encourage filing of FORM GSTR-1 by suppliers thus bridging the gap in the tax payable as per supplier declaration in FORM GSTR-1 and the credit availed by the recipient in FORM GSTR-3B.⁴⁹

From the above it seems that, Rule 36(4) aims to artificially inflate the tax-collection figures by putting restrictions on availing credit which was otherwise legally available to the recipients merely by citing that few instances of frauds/wrongful availment of credit have come into light.

Further, Rule 36(4) does not prevent the mischief it is intended to prevent, *i.e.*, fraud/wrongful availment of credit, as the restriction has to be followed by the tax-payers on self-assessment basis instead of being automatically imposed from the portal.

⁴⁸ Singh v. Delhi Administration, 1973 AIR 1091 (S.C.).

⁴⁹ See *supra* note 35, at 56.

(f) An enactment be reasonable must satisfy the test of reasonableness also with regard to its procedural aspects.⁵⁰

In this regard, Rule 36(4) has several short-comings –

i) The burden of implementation of Rule 36(4), and indirectly, the entire matching mechanism, is on the recipient. Forcing the recipient to reconcile the invoices at extra time and cost, where even the Common Portal is unable to do so is unreasonable.

ii) The data reflected in GSTR-2A available on the Common Portal is not time-stamped. Further, on due date of filing of FORM GSTR-1, the Common Portal is usually unable to handle the volume of taxpayers filing the returns. Therefore, the clarification by the Circular that ITC should be calculated as per the GSTR-2A data available on the due date of filing of FORM GSTR-1 under sub-section (1) of section 37 is unreasonable.

iii) Further, in case of quarterly filers of GSTR-1, the State is collecting the taxes on the monthly basis, but under Rule 36(4), the ITC of the same would be available to the recipient only after the end of the quarter.

(g) While determining the reasonableness of a restriction imposed on any fundamental right, the Courts have, to decide the point for themselves, and any opinion expressed by the Legislature thereon is hardly relevant.⁵¹

⁵⁰ Arora v. Commissioner of Police, 1961 AIR 705 (S.C.).

⁵¹ Ram v. Singh, 1962 AIR 1476 (S.C.).

(h) Reasonableness of a restriction imposed upon a fundamental right has to be judged in the context of the scheme of an Act and not territorially.⁵²

One of the major legislative intents behind the introduction of GST was to reduce the multiplicity of indirect taxes and ensure a seamless flow of credit is available to the recipients to remove cascading of taxes and reduce cost of production and inflation.⁵³

Rule 36(4) goes against the very spirit of ensuring seamless availability of ITC to the recipient.

From the above analysis, it may be seen that Rule 36(4) falls short on multiple criteria that are used to judge the reasonableness of a restriction.

B. Right to Equality

Article 14 of the Constitution of India provides that the State shall not deny to any person equality before the law or the equal protection of the laws within the territory of India.⁵⁴

It may be noted that the percentage of mismatch between the credit availed in GSTR-3B and the Credit reflected in GSTR-2A of the taxpayer is not uniform across different categories of taxpayers.⁵⁵ The following data set shows that the maximum unmatched credit is in the bracket of taxpayers having turnover between 10 crores and 25 crores.

⁵² *Quemin v. Union of India*, 1970 AIR 35 (Goa).

⁵³ *See supra* note 1 and 2.

⁵⁴ INDIA CONST. art. 14.

⁵⁵ Minutes, 23rd GST Council Meeting, Nov. 10, 2017, at 81.

Table 1: Percentage of Mismatched ITC between GSTR-3B and GSTR-2A⁵⁶

Year\ Turnover	0-20 Lacs	20 Lacs - 50 Lacs	50 Lacs - 1 Crore	1 Crore - 1.5 Crore	1.5 Crore - 2 Crore	2 Crore - 5 Crore	5 Crore - 10 Crore	10 Crore - 25 Crore	25 Crore - 50 Crore	50 Crore - 100 Crore	Above 100 Crore
17-18	2	23	2	1	1	3	3	49	3	3	11
18-19	3	2	3	2	2	6	6	22	8	8	38

Further, Rule 36(4) does not distinguish between the *bona fide* cases where a mismatch is due to any act/omission of the supplier and *mala fide* cases where bogus/fraudulent credits are sought to be claimed through collusion between supplier and recipient.⁵⁷

Painting all recipients with the same brush without even substantiation of *mens rea* and putting in a blanket restriction on all taxpayers, where data analytics can help in pinpointing fraudulent taxpayers, is treating the innocent and the guilty as equally guilty and is in violation of Article 14 of the Constitution.

Further, similar provisions on disallowance of ITC on the default of the selling dealer in depositing tax under the Delhi VAT Act have been held to be violative of Article 14 in the case of *Arise India Limited*.⁵⁸ The Special Leave Petition filed by the Revenue against the same has also been dismissed by the Hon'ble Supreme Court.

⁵⁶ *Id.*

⁵⁷ Sudipta Bhattacharjee, *Amendments Trying to Block Mis-Matched ITC & Nullify Favorable Court Orders – Nuances & Legal Tenability*, GSTSUTRA (Oct. 14, 2019), <http://gstsutra.com/experts/column?sid=587&page=1>.

⁵⁸ *Arise India Limited v. Commissioner of Trade & Taxes*, MANU/DE/3361/2017 (Delhi H.C., 2017).

IV. OTHER ISSUES REGARDING LEGAL VALIDITY OF RULE 36(4)

A. Can a Restriction on ITC on a Cumulative Basis be imposed under Section 16(1)?

It may be noted that in terms of Section 16(1) such “restrictions” have to be qua the ITC charged on “any” supply. Considering that the other conditions and restrictions for claiming ITC provided under Section 16 and Rule 36 are related to individually identifiable supplies (possession of invoice, invoice to contain specific details, tax paid on such invoice, suppliers received against such invoice), it is a valid contention that whether Section 16(1) grants the authority to impose restrictions on the cumulative value of ITC charged on all the supplies or it merely permits imposition of restriction only qua the tax charged on a particular supply.⁵⁹

B. Section 43A is yet to be notified

Section 43A of the CGST Act provides for a similar restriction in respect of availment of ITC beyond 20% of the ITC reflected in the returns of the purchaser.⁶⁰ However, the same has not been notified yet.

If the same restriction could have been imposed under Section 16(1), there was no need to insert such a provision under Section 43A. Hence, unless Sec. 43A is notified, Rule 36(4) cannot be made to restrict the ITC in such manner.⁶¹

⁵⁹ Abhya Desai, *20% ITC Restriction – An Analysis*. YAGNESH DESAI & CO., CHARTERED ACCOUNTANTS.

⁶⁰ CGST Act, 2017, § 43A(4).

⁶¹ See *supra* note 59.

C. Lack of Proper Machinery

The legal validity of a law can be brought into question on the grounds that it lacks proper machinery for its implementation.⁶²

Putting the onus of implementation of Rule 36(4) entirely on the taxpayer, not ensuring availability of time-stamped GSTR-2A data, not providing a mechanism to track entries which are subsequently updated in GSTR-2A in previous months and not devising a mechanism to ensure monthly reflection of purchases made from quarterly filers are some of the areas which create a bottleneck in the implementation of Rule 36(4).

D. The Doctrine of *Lex Non Cogit ad Impossibilia*

'Lex Non Cogit ad impossibilia' is an age-old maxim meaning that the law does not compel one to do that which one cannot possibly perform. Where the law creates a duty or charge and the party is disabled to perform it, without any default in him and has no remedy over it, there the law will in general excuse him.⁶³

It is impossible for the recipient to ensure that his supplier files his GST returns on time and that too with the correct details. Further, the reconciliation work would involve monthly as well as year-to-date reconciliations which would only add to the cost of the compliance for the recipient. Therefore, Rule 36(4) penalises the *bona fide* recipient without any default on his part and without any remedy over such defaults made by his supplier.

⁶² Jagannath Singh v. State of U.P., 1962 AIR 1563 (S.C.).

⁶³ Inter College Kusmaul, Gorakhpur v. the State of U.P. (All. H.C., Jan. 2006).

V. RELAXATION IN RULE 36(4) ON ACCOUNT OF COVID-19

In the 39th GST Council Meeting held on 14th March, 2019, it was decided that the existing system of furnishing FORM GSTR-1 & FORM GSTR-3B shall continue till September, 2020.

Further, due to wide spread of the COVID-19 pandemic, a proviso has been inserted in the Rule 36(4) vide notification No. 30/2020 - Central Tax, dated 03.04.2020, to provide that the said condition shall apply cumulatively for the period February, March, April, May, June, July and August, 2020 and that the return in FORM GSTR-3B for the tax period of September, 2020 shall be furnished with cumulative adjustment of input tax credit for the said months in accordance with the condition under Rule 36(4).

VI. CONCLUSION

Although, Rule 36(4) aims to curb fraudulent availment of ITC, it also imposes an unreasonable restriction on the *bona fide* and compliant taxpayers which is subject to challenge in the courts of law on the grounds of being in violation of Articles 19 and 14 of the Constitution of India.

Rule 36(4) would create more problems for the legitimate taxpayers due to issuance of mismatch notices in bulk and is a classic example of missing the woods for the trees in order to catch a few errant taxpayers.

When adequate checks and balances have already been provided under the CGST Act, implementing of such restrictions could have been deferred until the New Returns under GST become operational as they

have the machinery mechanism to implement this restriction in a hassle-free manner for taxpayers.

With the relaxation provided under Rule 36(4) due to COVID-19 pandemic coinciding with the deferred due date for implementation of the New Returns under GST, one can say that Rule 36(4) has been deferred, to some extent, with a one-time adjustment allowed in September, 2020 before transitioning to the New Returns under GST.