

Input Tax Credit of GST: A ride destined towards "Cascading Effect"

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Introduction

In GST law, government has always intended to allow ITC in respect of those invoices which are fed into the online system by the suppliers and taxes thereon are fully paid. However, observing the limitations of GSTN system to initiate online matching post filing of valid returns, [Rule 36\(4\)](#), was inserted on 09.10.2019 by which restrictions were imposed for availing ITC in excess of amount appearing in Form GSTR-2A. Therefore, the registered persons were motivated to furnish Form GSTR-1 so that adequate ITC reflects in Form GSTR-2A of the recipients. However, the objective of government did not get fulfilled by this restriction.

Observing the practice wherein taxpayers were only furnishing Form GSTR-1 without filing return in Form GSTR-3B, [Rule 59\(6\)](#), was inserted on 01.01.2021 by which restrictions were imposed on filing of Form GSTR-1 if the return in Form GSTR-3B for preceding two months (later on reduced to one month w.e.f. 01.01.2022) is not filed. Hence, government ensured that Form GSTR-2A contains the details of tax paid invoices only subject to variation of two / one month for which corresponding supplier did not file Form GSTR-3B. To cure this, a column regarding filing status of GSTR-3B in Form GSTR-2A was to be referred which shows remark as "Not Filed".

A static statement of ITC in Form GSTR-2B was introduced w.e.f. 01.01.2021 wherein details in respect of those invoices were communicated which have been furnished during a tax period by the corresponding suppliers. Doing so, it was ensured that ITC is availed only in respect of tax paid invoices and is not availed prior to payment of taxes by the corresponding suppliers. In Finance Act, 2022, various amendments were made in GST law in furtherance of aforesaid objective which have been made effective from 01.10.2022 vide [Notification Number 18/2022-CT](#) dated 28.09.2022. As a result of these amendments, ITC can only be taken in respect of invoices which appears in Form GSTR-2B and are not communicated as restricted.

The journey of circumscribing the role of online matching to manual matching, and now ensuring that ITC is availed only in respect of invoices which are fed into online system by the suppliers is as under:

A. Restrictions imposed from 09.10.2019 onwards

1. Prescribing Form GSTR-3B as a return.

1.1 On 09.10.2019, retrospective amendments were made to prescribe Form GSTR-3B as a return. Simultaneously, [Rule 61\(6\)](#) was retrospectively omitted^[1] which provided for reconciliation of claims made in Form GSTR-3B with the claims to be made finally in Form GSTR-3 which could either be additional payment of taxes or addition claim of ITC.

1.2 Hon'ble Supreme Court in the case of UOI vs Bharti Airtel Ltd and Ors. reported as [2021-VIL-87-SC](#), did not discuss the validity of said retrospective amendment but undoubtedly clarified the position of law that a registered person has to do self-assessment of his claims and make the same in his returns filed for the relevant periods; that electronic communication between taxpayers as well as auto-population of records in Form GSTR-2A, matching thereof are only facilitator provisions. If any errors or omissions are observed, the taxpayer is

required to rectify the same in the return filed for the period in which said errors or omissions are observed.

1.3 Therefore, for the period FY 2017-18 (July 2017 onwards), FY 2018-19 and FY 2019-20 (upto 09.10.2019), the self-assessed ITC even though in excess of amounts appearing in Form GSTR-2A can be subject to judicial scrutiny wherein aforesaid Supreme Court decision won't have a precedent value.

2. Circumscribing online matching to manual matching by inserting Rule 36(4).

2.1 Having observed huge unmatched credit and failure to implement electronic matching, it was decided in 37th GST Council Meeting held on 20th September 2019 that a reasonable restriction shall be imposed on credits appearing in Form GSTR-2A so that amount of unmatched credit be reduced and taxpayers are encouraged to declare the details of supplies in Form GSTR-1.

2.2 Rule 36(4) was inserted vide [Not. No. 49/2019-CT](#) dated 09.10.2019 in the GST Rules. Said sub-rule is reproduced below:

*"(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."*

2.3 [Circular No. 123/42/2019-GST](#) dated 11.11.2019 was issued by CBIC on the subject of "Restriction in availment of input tax credit in terms of sub-rule (4) of Rule 36 of CGST Rules, 2017". Said Circular have further put the entire onus and

burden on the recipient for implementing Rule 36(4). Relevant portion thereof is reproduced hereinbelow:

"3.This being a new provision, the restriction is not imposed through the common portal and it is the responsibility of the taxpayer that credit 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."

2.4 The GST Council, thereafter, recommended to further tighten the rigours of Rule 36(4) on two separate occasions. W.E.F. 01.01.2020, the restriction was reduced to 10%. W.E.F. 01.01.2021, the restriction was reduced to 5%.

2.5 At the outset, this rule was ultra-virus as there was not any provision in the Act governing this rule and as admitted in the circular, this was completely a new provision. The government / Board appeared to have intended to shift the onus of condition from 'payment of taxes to the credit of Government' to 'reflection of invoice in Form GSTR-2A'.

3. Restrictions on E-Way Bill. Facility to generate E-Way Bill was restricted from 23.11.2019 onwards if GSTR-1 for preceding two months was not filed.

B. Restrictions made more stringent from 01.01.2021 onwards

4. E-invoice.

4.1 Taxpayers having aggregate turnover in excess of Rs. 500 Crores were mandated to generate e-invoice in respect of B2B transactions from 01.10.2020 onwards. Later on, this limit was reduced on four occasions - to Rs. 100 Crores

from 01.01.2021^[2], to Rs. 50 Crores from 01.04.2021^[3], to Rs. 20 Crores from 01.04.2022^[4] and to Rs. 10 Crores from 01.10.2022^[5].

4.2 As per online functionality, e-invoice auto-populates in Form GSTR-1 of the supplier, and Form GSTR-2A of the recipient, on T+2 days. However, in Form GSTR-2A, the column for IRN shows details pursuant to filing of Form GSTR-1.

4.3 Thus, Government effectively ensured that invoices issued by registered persons auto-populates in Form GSTR-2A of the recipients. As the e-invoice is now applicable on persons having aggregate turnover above Rs. 10 crores, the automation covers large number of registered persons.

5. Restrictions in filing of Form GSTR-1, GSTR-3B.

5.1 Initially e-invoice was made applicable on registered persons having aggregate turnover above Rs. 500 Crores. From 01.01.2021 onwards, said limit was reduced to Rs. 100 Crores. However, a huge class of registered persons were still subject to manual issuance of invoices.

5.2 Observing that taxpayers are only filing Form GSTR-1 without filing of return in Form GSTR-3B to circumvent the provisions of rule 36(4) so that adequate ITC reflects in Form GSTR-2A, facility to furnish statement of outward supplies in Form GSTR-1 was restricted by the government if the return in Form GSTR-3B for preceding two months (later on reduced to preceding month w.e.f. 01.01.2022) is not filed.

5.3 As a result thereof, government ensured that Form GSTR-2A shows only such invoices which are tax paid. In case where GSTR-3B was not filed, a remark "not filed" was made available in the column meant for filing status of Form GSTR-3B.

6. Provision to suspend the Registration if anomalies are observed in GSTR-1 and GSTR-3B. From 01.01.2021 onwards, provision inserted that registration can be suspended if significant differences or anomalies are observed *inter-alia* in Form GSTR-1 and GSTR-3B. Therefore, it was ensured that taxpayers makes full payment of taxes in Form GSTR-3B.

7. Introducing Static Form GSTR-2B. Observing the difficulties in claim of ITC on account of dynamic nature of Form GSTR-2A, a static statement in Form GSTR-2B was introduced w.e.f. 01.01.2021.

C. Statutory backing given to various provisions from 01.01.2022 onwards

8. Condition for entitlement to ITC [Section 16(2)(aa)]. On 01.01.2022, a new condition for entitlement to ITC was made effective. It provided that ITC can be availed if the invoice is furnished in Form GSTR-1 and the same has been communicated to the recipient in Form GSTR-2A/ Form GSTR-2B. Therefore, rule 36(4) can be said to have a corresponding provision in the Act.

9. Condition for entitlement to ITC [Section 16(2)(ba)]. From 01.10.2022, a new condition for entitlement to ITC has been made effective. It provides that ITC cannot be availed if the same has been communicated as restricted in Form GSTR-2B.

10. Simultaneously, section 42, 43 and 43A have been omitted from CGST Act, 2017 from 01.10.2022. Also, [Section 38](#) has been substituted entirely to provide for availment of ITC as per communication made in Form GSTR-2B.

11. W.e.f. 01.10.2022, it has also been provided that facility to furnish Form GSTR-1 would be restricted if GSTR-1 for any of the previous tax periods is not

furnished, and facility to file GSTR-3B would be restricted if GSTR-1 for same tax period is not filed [Refer [section 37\(4\)](#) and [section 39\(10\)](#) of the CGST Act, 2017].

D. ITC deferment leading to Cascading Effect

D.1 In their efforts to enforce the matching manually, it appears to the author that government has created a mirror image of [section 16\(2\)\(c\)](#) in the form of section 16(2)(aa) and 16(2)(ba).

D.2 As per provisions incorporated in original GST Act, ITC self-assessed in return was taken to electronic credit ledger on a provisional basis and said provisional credit has to be converted into final credit once matching is carried out with valid return i.e., a return in which supplier has made full payment of taxes. In result, provisional ITC becomes final if invoice is furnished in GSTR-1, tax is fully paid in GSTR-3B by the supplier.

D.3 Now as per the amended Act, in light of restrictions that GSTR-1 cannot be filed if Form GSTR-1 for preceding tax period is not filed, and GSTR-3B cannot be filed if GSTR-1 for same tax period is not filed, ITC will be communicated in Form GSTR-2B only in respect of those invoices which are furnished in GSTR-1 and tax in respect whereof is fully paid in GSTR-3B.

D.4 The only difference is that in pre-amended period, matching has to be carried out post filing of valid return and results thereof were to be communicated through statutorily prescribed forms. Whereas in amended regime, entitlement to ITC is based on Form GSTR-2B which effectively communicates the matched results subject to a minor variation of one tax period.

D.5 On account of restrictions imposed in availing ITC which are proposed to be prescribed in light of circumstances mentioned in section 38(2)(b), there may be situations wherein cash flow of a business organisation would be severally affected. In result, a recipient may end up paying GST in cash despite having adequate ITC.

For example,

In the month of September 2022, Mr. X has ITC as per books of accounts for Rs 50,000, ITC as per GSTR 2B is Rs 40,000 and the output tax liability for the month is Rs 50,000. The ITC of Rs. 10,000/- is not appearing in GSTR 2B as the suppliers filed the GSTR 1 after the due date. Therefore, the same will appear in the GSTR 2B for the month of October 2022.

In this case, Mr. X can claim the ITC of Rs 40,000 on account of restriction imposed in availing ITC and he has to pay GST in cash of Rs 10,000 despite having adequate ITC in the books of accounts. The balance of ITC of Rs. 10,000/- which is not appearing in GSTR 2B will be carried forwarded to subsequent month and this will lead to accumulation of the ITC balance in the electronic credit ledger.

Therefore, it can be said that the bonafide recipient has to pay for the errors, non-compliances made on part of the suppliers.

Conclusion

It is notable that the provisions regarding punishing a bonafide recipient for the errors, omissions or non-compliances on part of corresponding suppliers by way of disallowing, either permanently or temporarily, as the case may be, the ITC is effectively adding to cascading effect of taxes which has never been the objective for introducing GST. Such kind of provisions also have a judicial precedent wherein the same were held as unconstitutional. The result of [sections](#)

[16\(2\)\(c\)](#) read with sections [41](#), [42](#) and rules [69](#) to [72](#) is not different as compared to sections 16(2)(aa), 16(2)(ba) read with section 38(2)(b).

These provisions deny to a bonafide recipient, the benefit of the input tax credit only because of the default of the supplier/vendor over whom the recipient has no control. This is invidious classification having no rationality and divorced from the object sought to be achieved. The condition mentioned in section 16(2)(aa), 16(2)(ba) read with restrictions mentioned in section 38(2)(b) punishes the recipient on account of subsequent conduct of the supplier, who have collected the GST from the recipient and have failed to deposit it with the government or have failed to lawfully adjust it against his output tax liability, irrespective of whether the recipient is innocent, and without there being any mechanism with the recipient to ensure that the tax he pays to supplier is guaranteed to be deposited by the supplier with government.

It is strongly advised to do self-assessment of ITC claims in returns filed for a relevant tax period as also upheld by Hon'ble Supreme Court in the case of ***Bharti Airtel*** (*supra*). However, in light of restrictions inserted vide section 38(2)(b)(iv) and awaiting the rules to be prescribed in this regard, the manner of doing the same may be subject to judicial scrutiny.

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(The views expressed in this article are strictly personal.)

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- [1]. [Not. No. 49/2019-CT](#) dated 09.10.2019
[2]. [Not. No. 88/2020-CT](#) dated 10.11.2020
[3]. [Not. No. 05/2021-CT](#) dated 08.03.2021
[4]. [Not. No. 01/2022-CT](#) dated 24.02.2022
[5]. [Not. No. 17/2022-CT](#) dated 01.08.2022