



**Payment to vendor - A mandatory
condition for availing ITC:
Multiple absurdities**

While taxes are an intrinsic part of any business, they should never dictate the conduct of a business. The legislature seems to have forgotten this rule as it is meddling with taxpayer's credit period / payment terms under the GST law. Second proviso to Section 16(2) of the Central Goods and Services Tax Act, 2017 ('CGST Act') provides that Input Tax Credit ('ITC') shall be available to recipient only if he makes payment to the supplier within 180 days from the date of invoice.

Introduction

Section 16 of the CGST Act entitles a registered person to avail ITC on supplies used in the course or furtherance of his business, subject to satisfaction of certain conditions stipulated therein.

This article aims to bat around the purpose and validity of second proviso to Section 16(2) of the CGST Act. In terms of this proviso, where a recipient fails to pay to the supplier, the amount towards the value of supply along with tax thereon within 180 days from the date of issue of invoice, an amount equal to ITC availed by the recipient shall be added to his output tax liability, along with interest thereon, in such manner as may be prescribed.

An apparent absurdity in above provision is that law goes beyond the contractual terms agreed between supplier and recipient. In other words, if the recipient makes payment after 180 days, though within the credit period agreed with the supplier, the recipient needs to pay an amount equal to ITC availed and pay interest for period for which ITC was availed.



Background

In order to discuss the validity of the provision, it is relevant to discuss the journey of this provision and the psyche of the legislature behind placing it in GST law.

Till March 31, 2011

The provision was introduced in respect of Cenvat credit on input services, where credit was allowed only after payment was made to the supplier. The rationale of such restriction was logical since as per the provisions prevailing at that time, the service provider used to pay service tax to the Government only when he received payment from the recipient. Hence, receipt of tax by the

Government and eligibility of credit to the recipient were synchronised.

[Source of Rationale: FAQs issued by CBEC (now CBIC) and DGST dated September 1, 2010]

April 1, 2011 to June 30, 2017

In 2011, the credit availment was liberalised and the same could be availed on receipt of invoice. However, credit was required to be reversed if payment was not made to the supplier within 3 months. At this time, the linking of credit availment with payment to supplier was irrational since taxes became due as soon as invoice was issued.

Provisions under GST

Continuing the legacy of this provision under GST law, the Council called it an anti-evasion provision and

extended its applicability to both goods and services after increasing the time period to 180 days.

Interestingly, during the discussions of 28th GST Council Meeting, it was proposed to exclude the words 'along with interest thereon from this proviso. However, in 29th GST Council Meeting, the Council rejected this suggestion by asserting that this change would reduce the incentive for timely payment to suppliers, especially to MSMEs. Ironically, the Micro, Small & Medium Enterprises Development Act, 2006 has its own stringent provisions to safeguard the interests of MSMEs by limiting the payment terms to 45 days.

Validity of the restriction

As discussed above, there is no specific logic with which this provision has been introduced as the provision entirely deals with the commercial part of a transaction. The Government should not be concerned on payment terms between supplier and recipient, since the supplier is liable to pay taxes to the Government on raising of invoice itself. Further, the Government is at a dual advantage i.e. the supplier becomes liable to pay tax as soon as he raises the invoice, and recipient needs to reverse ITC after 180 days if payment is not made to the supplier. It is not the case that the Government is reimbursing the tax to supplier along with interest in case recipient reverses the ITC.

Moreover, if the provision was introduced to enable early payments to MSMEs, then the provision should have made such distinction. The provision under present shape and form applies to all taxpayers uniformly, treating unequal taxpayers equally.

Basis above, the taxpayers can challenge this provision by deliberating that this restriction is arbitrary, unjust and against the freedom of trade and commerce, and hence unconstitutional. In fact, one such challenge is already pending before Delhi High Court in the case of ***Bharti Telemedia Limited v. UOI, 2019-VIL-263-DEL.***

Additionally, levy of interest from date of availment of ITC can also be challenged. Interest, if any, should be levied from 181st day. When the taxpayer validly availed ITC, he should not be punished only because he commercially decides to make payment to the vendor after 180 days. Hence, levy of interest before expiry of 180 days can also be challenged.

Procedural miss from Government's side

Touching upon the procedural aspect, manner of reversal mandated under this provision is prescribed under Rule 37 of the Central Goods and Services Tax Rules, 2017 ('CGST Rules'). The same requires the recipient to furnish the details of value of supply

and tax not paid in FORM GSTR-2 of the month succeeding the month following 180 days from invoice date. Thanks to the indolence of Government, even after almost 3 years of GST implementation, FORM GSTR-2 is still non-operational.

On a similar miss, the Gujarat High Court in the case of ***AAP and Co. v. Union of India, 2019-VIL-314-GUJ*** acknowledged that in absence of any due date of FORM GSTR-3, no interest can be charged for delayed payment of tax. The legislature then brought a retrospective amendment to fill this gap in law and made the levy of interest tenable. No such amendment has been brought in the present case to deal with this inconsistency. Therefore, in the absence of due date of Form GSTR-2, no demand can be made for reversal of ITC or interest thereon, even if payment is not made within 180 days.



Concluding remarks

Till March 2011, the restriction could still be said to be logical since the revenue of Government was linked to payment by the service recipient. Presently, this provision is illogical and is severely impacting taxpayers whose normal payment terms extend beyond 180 days. Non-payment of consideration is a commercial matter and Government should not intervene into it.

Rightly said - *‘In levying taxes and in shearing sheep it is well to stop when you get down to the skin’* – *Austin O’Malley*. The Government in this case has definitely gone overboard and introduced this draconian condition, with no clear objectives behind it.



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