

Restriction on Input Tax Credit- Amendment to Rule 36(4) of CGST Rules

Input Tax Credit (ITC) 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. To know more about amendment to Rule 36(4) of CGST Rules, read on...



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"In legal jurisprudence, the liability can be fastened on a person who either acts fraudulently or has been a party to the collusion or connivance with the offender. However, law nowhere envisages imposing any penalty either directly or vicariously where a person is not connected with any such event or an act. Law cannot envisage an almost impossible eventuality...."

Gheru Lal Bal Chand vs. State of Haryana (2011) 45 VST 195 (P&H)

Those were the words of wisdom of Hon'ble P&H High Court that were relied upon by Hon'ble Delhi High Court when it struck down provisions of Delhi VAT Act that imposed the burden of forfeiture of credit on a buyer, for default in remitting taxes by the supplier in these words:

".....All this points to a failure to make a correct classification on a rational basis so that the denial of ITC is not visited upon a bona fide purchasing dealer. This failure to make a reasonable classification, does attract invalidation under Article 14 of the Constitution, as pointed out rightly by learned counsel for the Petitioners."

Arise India Ltd. vs. CT&T W.P.(C) 2106/2015 (Del.)

Despite this guidance against imposing such 'impossible eventuality' which Section 9(2)(g) in Delhi VAT Act attempted, it seems to be canvassed again in Section 16(1)(c) of Central GST Act. This only shows the Government's determination to deny credit to recipient if supplier fails to deposit GST; and face another trail similar to the one in Arise India. But

until then, trade is faced with this determination that presents itself in the form of Rule 36(4) that was notified to apply to all returns filed from 9th October, 2019.

Authority to 'prescribe' ways in which eligible credits would be restricted lies in Section 43A of Central GST Act but that section is yet to be notified; however, restricting unmatched credits "up to 20 per cent" has already been rolled out by a new Rule 36(4). Whether this too is an 'impossible eventuality' will certainly be put to Courts to answer but September returns will require trade to self-assess the extent of 'credit overdraft' that will be tolerated in the form of this new rule. GST promised to allow seamless flow of credit, but this seems farther from that truth.

Arguments 'For' and 'Against'

The case for the Government is that 'credit cannot be allowed of tax that has not reached the Government'. And 'seamlessness' is actually a promise to 'flow what's there to be flowed'. And if tax has not reached the Government, there's nothing to 'flow' to the recipient. If a Recipient can take care to verify that right quantity and quality of supplies were delivered and that Supplier can take care to issue invoice and collect payment in time, can Government be expected to look into remittance of this tax with no responsibility shouldered by parties involved in carrying out the taxable supply? Can parties to the taxable supply still take shelter under 'impossible eventuality'?

The case of trade is entirely different because the recipient cannot be held responsible

for failure of supplier. Hon'ble Supreme Court has held that tax credit is 'indefeasible and vested right' in *Eicher Motors Ltd. vs. UoI 1999 (106) ELT 3 (SC)*. Question would, therefore, revolve around 'time of vesting'. If it is a right that is 'not yet vested' (or inchoate right), then such unvested rights are for non-vesting. And if right has already vested, then its indefeasible and leaves no room for the Government to unsettle it. In fact, Hon'ble Gujarat High Court, although on other grounds, reiterated this principle while striking down a questionable proviso in notification 20/2018-CT(R) dated 26th July, 2018 in *Shabnam Petrofils (P) Ltd. vs. UoI in CA 16213 of 2018 (Guj.)* that attempted to 'lapse' vested credits.

Jury is out as to on whose side does 'balance of convenience' lie; and whether this was the real meaning of responsibility that taxpayer bargained for while seeking "minimal Government, maximum governance". Government would say "yes", because GST is a 'self-assessment' tax where tax administration has retained authority to interfere only by exception, howsoever extensive and pervasive these exceptions may be.

Returns in GST

GSTR 1-2-3 was presented as the 'framework' that would help taxpayers validate credits. That perhaps would permit reasonable framework, but when GSTR 2-3 remains suspended, for no fault of taxpayer, it is only fair that these 'credit checks' also stay suspended. But that does not seem to be acceptable

and probably because there is unprecedented revenue shortfall to meet requirements of planned projects and States' demands. Government has allowed itself time required to put necessary IT-systems in place, but no such time will be allowed for trade to validate credits on their own. It is this one-sidedness of the decision that seems to have irked trade and reaching back to draw from the wisdom in Arise India.

Allowing more than two years of unquestioned credits through GSTR 3B is not something that anyone asked for, because August 2017 was a time of necessity when such 'interim' solutions provided first-aid. 'New Simplified Returns' that was to roll from October 2019 (now deferred to April 2020) offered to be the 'dress rehearsal' of the ultimate GSTR 1-2-3 regime. Suddenly, when trade was getting used to 'GSTR 1 and 3B' and grappling with 'GSTR 9-9A and 9C', comes this missile in the form of Rule 36(4) that states:

"(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."

Financial health of the country can be improved with financial discipline. It is imperative to have the matching principle in place to reduce revenue loss to the exchequer along with providing a strong IT-system

to enable taxpayer shoulder the responsibility of contributing towards Nation building. It is with this objective that Section 43A was introduced under the CGST (Amendments) Act, 2018 but could not be notified until all States (and two UTs) also amended their statutes. And this process of legislative change, which prevents sudden amendments to the law that actually assured States to handover power over tax legislations in their territories to the collective wisdom of GST Council. And if that uniformity in lawmaking brings in inflexibility, it must be accepted, even if it is excruciatingly slow. Exercising delegated power under section 164 and making rules that nearly accomplish what the section ought to do, that too when the said section is not (yet) operational, is a clear trespass on limits to executive's power.

Questions to be answered

Although these questions will be answered by our Courts, here are a few questions we need to answer right now:

1. *From which date the amendment in the Rule will be applicable?*

This notification is published in the official gazette on 9th October, 2019 and hence this provision will be applicable from that said date. As a result, taxpayers will be required to carry out this 'credit matching' exercise for all returns being filed after 9th October, 2019. There are views that change in law will apply prospectively based on the doctrine of ex post facto legislation. But that doctrine applies only to substantive rights and filing of

returns is a matter of procedure. Changes in the procedural laws would become applicable immediately even for past compliances left unattended within the originally prescribed date. Authority for this understanding may be found in *Garikapatti Veeraya vs. N. Subbiah Choudhury 1957 AIR 540 (SC)*.

2. *What will be periodicity of applying this rule?*

This rule will require to be applied on a monthly basis. Suppliers who are, lawfully, permitting quarterly filing of GSTR 1 will bring great anxiety to their customers who will be the Recipient left to suffer credit denial (actually deferral) until tax paid actually shows up on GSTR 2A.

3. *Does eligible credit include IGST paid on imports or GST paid under section 9(3) reverse charge?*

No, this provision is applicable in respect of credit that flows from GSTR 1 filed under section 37. Credit of taxes paid by Recipient flows from Section 38 and hence, IGST on imports and taxes paid on reverse charge mechanism will 'not' form part of this 'credit matching' exercise.

4. *How to calculate 20% of eligible credit?*

Following steps may be considered:

- Download total credits appearing in GSTR 2A up to date;
- Exclude (1) credits already taken up to previous month's GSTR 3B;
- Exclude (2) 'ineligible

credits' to arrive at 'total available credits' for the month;

- Exclude (3) 'available but deferred' credits, that is, where other conditions of Section 16(2) are not yet satisfied;
- Now, remaining balance will be 'eligible credits for the month'; and
- Identify total credits as per books and avail of this in GSTR 3B so much that does not exceed 20 percent of above and include in GSTR 3B for the month.

Credits appearing in GSTR 2A only means that Suppliers have uploaded tax invoice in GSTR 1 but the other conditions in Section 16(2) still need to be satisfied before credit can be availed by the Recipient. Please take care that GSTR 2A is a cumulative or year-to-date document. So, ensure that this 'credit matching' exercise is carried for the cumulative value of credits appearing in GSTR 2A after excluding credits that have already been taken up to the previous month.

The taxpayer will be provisionally eligible to avail credit in respect of 'unmatched' 20 per cent which must be re-examined next month so that unmatched do not remain unmatched forever. Meaning thereby a taxpayer has an input tax credit for ₹1,50,000 out of which ineligible credit is of ₹ 10,000 and ₹ 10,000 paid under reverse charge. ITC for which invoices not uploaded by the supplier is ₹ 30,000. Then eligible Credit as per this rule will be ₹ 100,000. The taxpayer can take credit of un-uploaded invoices up to 20% of this

₹ 100,000 i.e., ₹ 20,000. Hence, in current example, though taxpayer received input tax credit for ₹ 130,000 will be eligible only for credit of ₹ 120,000.

Please take note of the carry over exercise from earlier months to be first matched before the subsequent months' 20 per cent entitlement is arrived at. Another question that still remains though is, if GSTR 2A is a cumulative balance, will the value arrived at by Recipient on 20th October, 2019 remain the same if balance of September 2019 is checked on, say, 1st January, 2020?

5. Does this rule override Section 16(2) and sustain though Section 43A is yet to be notified?

Yes, although such a restriction is not mentioned in Section 16(2), it may hardly pass the judicial scrutiny. As the question that Courts may go into is whether in the absence of Section 43A, does Section 16 itself authorise this Rule 36(4). And if yes, where was the need for Section 43A or what more was intended to be done by enacting Section 43A that could not already be done under section 16. Conferment of rule-making authority to make a rule beyond the scope of or inconsistent or repugnant to the Act would not be looked favourably by Courts. Rules so made will have to be consistent with the provisions of the statute and be demonstrated how they advance the object of the statute and not exist independent of it. If a rule goes beyond rule-making power conferred by the parent statute or supplants any provision for which power is not conferred, it becomes ultra vires. The rule

must be in accordance with the parent statute and cannot travel beyond.

Subordinate legislation, such as a rule, may implement, provide machinery and lay down procedure, for carrying out objectives of a statute and not contradict the statute.

Authorities for this salutary principle may be found in:

Additional District Magistrate (Revenue) vs. Siri Ram, AIR 2000 SC 2143.

Union of India vs. Srinivasan, (2012) 7 SCC 683.

Hodge vs. Hodge, (1963) 1 All ER 359 (366) CA.

J.K. Industries Limited vs. Union of India, (2007) 13 SCC 673, 767-68 (para 133), relying on Britnell vs. Secy. of State for Social Security, (1991) 1 WLR 198

Please also recollect the words of Hon'ble P&H High Court about 'impossible eventuality' that buyer cannot be denied credit for the supplier fault. If the buyer has received supply, possesses the invoice and has paid for the same then, he must be allowed the credit and not punished for an impossibility at his end.

6. Will it resolve fundamental issues of bogus billing, ITC Frauds, fake invoices?

Though the intention of introducing this rule could address the loss of Government revenue, it may not be met with much success because credit is reflected by filling of supplier's GSTR 1 and that itself does not establish payment of tax by the supplier. So, even if credit appears in GSTR 2A, Recipient may not have really satisfied

credit-condition in Section 16(2)(c) and one still cannot say that the question of bogus or fraudulent credit will be resolved with this amendment.

7. Will it be simple for the taxpayer to comply with this amended rule?

No, in fact, complying with this rule has cast a very onerous burden. Previously, Recipient could rely on genuineness of his Supplier and bona fides of inward supplies and their intended end-use. And reconcile GSTR 2A with 3B periodically without any requirement of monthly reconciliation. Recipients are forced to wait till the last of their Suppliers file GSTR 1s and then file GSTR 3B and if they would want to file returns sooner (and avoid last minute rush) would have to work with a lesser amount of credit than otherwise eligible to avail and utilise. Additionally, accounting for such 'available but deferred' credits in another control account leaving more room for errors.

8. Will it increase the cost of compliance?

Yes, not only administrative cost but also potential interest liability (on account of revision in GSTR 2A balances by Suppliers) and working capital locked in the entire system which will add to cost of supplies depending on price negotiations.

9. Can credit which is not availed previously be availed subsequently?

As the rule is silent on the same, it can be availed by the taxpayer when the supplier uploads those invoices as such credit becomes 'available' in the

month when those invoices are reported by respective Suppliers. The taxpayer may avail such credit in subsequent month but the same should be availed before the time limit for availing of the credit expires.

10. Are SMEs and small business affected by this provision?

No, there's no special dispensation in this new Rule 36(4) for SMEs. That is, in cases where the supplier is eligible to file quarterly GSTR1 then its customer will not be able to avail credit on a monthly basis. Which in turn creates an issue of working capital. The taxpayer can avail credit only if such not uploaded invoices are below 20% limit. As a result, the dominant customer will ask his supplier to upload the invoices on a monthly basis to avail credit of such small supplier. Hence, this Rule 36(4) may lead large businesses not to prefer procurement from SME-suppliers filing their GSTR1 on a quarterly basis.

11. What steps are to be taken when credit that is provisionally allowed is reflected in subsequent months?

All credit appearing in every month will form part of the first step on the 'credit matching' exercise required to be carried out every month, whether it is from current or any earlier month. Care must be taken not to retake credit that had already formed part of the 20 per cent of unmatched credit permitted by this Rule 36(4).

12. When will tax authorities review compliance with this rule?

Any review of compliances in GST must be by way of scrutiny of returns under section 61 or audit under section 65/66. Otherwise, there is no occasion for tax administration to specifically review compliance with this rule as a matter of routine. Further, as GSTR 2A is dynamic credit balance 'as on' any given date when the report is generated, it would be nearly impossible to 'review' compliance with this rule. Unmatched credit availed (bona fide or mala fide) in a given month of the total credit reflecting in GSTR 2A on a particular day may change in subsequent months when the report is generated. Given that GSTR 1 filings will progressively improve over a few months, the balance will only improve and thereby increase the amount falling within this 20 per cent window. So, when tax authorities take by review of this unmatched credit amount, everything may turn out fine.

That leaves on ly those taxpayers who claim 'non-existent' credits that will be affected by this rule. And therefore, taxpayers who have bona fide inward supplies may not have much to fear due to this rule. Perhaps now, the real merits of this rule may be visible.

13. What will be required if the ITC calculated is wrong at the time of availing and it is more than 20% of eligible ITC?

Utilisation of such 'non-existent' credit will amount to underlying tax liability remaining 'unpaid'. The taxpayer in such case will be required to reverse such credit and interest will be payable on such 'unpaid tax liability' under section 50(1). Some experts are of the view that interest may be

attracted under section 50(3). Do please note that mismatched credits attract interest under section 50(3) but non-existent credits stand on a different position.

14. How to address compliance in the best possible way?

Review 'accounts payable' or 'bill passing' procedures and introduce 'credit check' as one of the pre-conditions for processing vendor bills. GST will eventually move towards invoice matching and this could be a bitter pill that will ensure good and healthy compliance for the enterprise.

Regular reconciliation of GSTR 2A with credit in books of accounts is required to be done after 10th for previous month meticulously and follow-up with supplier for uploading of invoices. Moreover, selection of tax-compliant suppliers has to be done to avoid unnecessary business loss.

Conclusion

Whether this new Rule 36(4) is lawful or not, right now, we need to come to terms with it because its here and Government seems determined to impose even its called 'impossible eventuality'. Government is perhaps ready for another round in Courts but more confident as its armed with this brand-new GST law. So the question that we are all faced with today is whether "India will arise" to this new challenge, that remains to be seen! ■