CONSTITUTIONAL VALIDITY OF RULE 36(4) OF CGST RULES, 2017[1]

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In the quest of filling the coffers of the State exchequer often at times is committed an error which is not only illogical but at the same time it cannot withstand the basic principles of constitutional, taxation laws and above all Wednesbury principle of reasonableness, similar was an error which was committed by the Central Board of Indirect Taxes and Customs (hereinafter referred as 'CBIC') which vide **Notification No.49/2019-Central Tax** dated 09.10.2019 brought in a major amendment in the Central Goods and Service Tax Rules, 2017 (hereinafter referred to as 'Rules, 2017' by adding **Rule 36**(4) to the 'Rules, 2017'. The said amendment restricted the availment of Input Tax Credit (hereinafter referred as 'ITC') 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 **Sections 37**, shall not exceed 20% 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 **Sections 37**. Later, through another **Notification No.75/2019-Central Tax** dated 26.12.2019 the CBIC further amended the above mentioned Rule, thereby restricting the cap to maximum 10%. The amended provisions i.e. **Rule 36**(4) as it stands on present day is read as follow:

*[(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 **Sections 37**, shall not exceed [10 percent] 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 **Sections 37**.*

The abovementioned provision practically means that in case if the supplier of goods and services has not filed its returns under GSTR-1 then in such a scenario the assessee would only be able to avail ITC as shown under GSTR-2A +10%, against the total ITC available to him. For e.g. Total ITC which is actually available to a particular assesse is 4 lakhs because of various purchases which he made. But, not all suppliers have filed their returns under GSTR-1 or not all invoices have been uploaded by the supplier and the ITC as reflected in their GSTR-2A is Rs. 1 lakh only, then in those cases total ITC which the assesse can avail benefit of, while filing his

returns under GSTR-3B would be Rs.1,10,000/- (1,00,000 + 10% of 1,00,000) against the total ITC of Rs.4 lakhs for which he is eligible.

The provision being unreasonable and arbitrary fails the test of constitutional validity on various grounds, namely;

A The provisions of **Rule 36**(4) are ultravires the provisions of s.16 of CGST Act, 2017.

B The provisions of **Rule 36**(4), restricting the credit is contrary to the provisions of **Sections 37** and 42 of the CGST Act, 2017.

C The restrictions as contained in provisions of Section 43A, which is yet to be notified, cannot be introduced through Rules.

D Restrictions imposed are unreasonable and arbitrary.

E Accrued right of the availment of credit cannot be taken away.

F The credit restriction on the basis of the acts of the supplier, on which the recipient has no control, is violative of Article 14 of the Constitution.

Firstly, **Rule 36**(4) denies to a bona fide assessee, the benefit of ITC only because of the default of the selling dealer to upload the return, on which the recipient has no control, even though the said error was bonafide. This measure qua the recipient is arbitrary, irrational and unduly harsh and, therefore, violative of Article 14, 19, 21 and 300A of the Constitution of India.

A provision similar to **Rule 36**(4) was introduced in the Delhi Value Added Tax Act, 2004 by way of s. 9(2)(g). Section 9(2) set out the conditions where the assessee cannot avail ITC, whereas sub-clause (g) being one of the conditions specifically stated that:

"(g) to the dealers or class of dealers unless the tax paid by the purchasing dealer has actually been deposited by the selling dealer with the Government or has been lawfully adjusted against output tax liability and correctly reflected in the return filed for the respective tax period."

A simple reading of the above mentioned provision shows that it restricted the ITC of assessee if the tax had not been deposited by selling dealer, although paid by the purchasing dealer i.e. assessee. The provision made no distinction between bona fide purchaser and a willful defaulter.

The Delhi High Court while hearing the challenge to Constitutional Validity of the said provision read down that part of the provision which made it arbitrary and violative of Article 14 and held, *that the expression dealer or class of dealers occurring in Section 9(2)(g) of the DVAT Act should be interpreted as not including a purchasing dealer who has bona fide entered into*

purchase transactions with validly registered selling dealers who have issued tax invoices in accordance with Section 50 of the Act where there is no mismatch of the transactions in Annexures 2A and 2B. Unless the expression dealer or class of dealer's in Section 9(2)(g) is read down in the above manner, the entire provision would have to be held to be violative of Article 14 of the Constitution.[2]

The said judgment was challenged by was of Special Leave Petition before the Hon'ble Supreme Court but the said appeal was dismissed while upholding the decision of the Hon'ble High Court.

Secondly, the amended provision is ultra vires section 16 of the CGST Act, 2017. Section 16 of the said Act is plenary legislation which governs the availment of Input Tax Credit. s.16(1) allows Input Tax Credit to be availed subject to such restrictions and limitations as may be prescribed. Sub section 2, which starts with a non obstante clause contains four conditions which have to be satisfied, which are as follows;

(2) Notwithstanding anything contained in this section, no registered person shall be entitled to the credit of any input tax in respect of any supply of goods or services or both to him unless,—

(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.

> ***Explanation.—****For the purposes of this clause, it shall be deemed that the registered person has received the goods or, as the case may be, services—*
> *(i) where the goods are delivered by the supplier to a recipient or any other person on the direction of such registered person, whether acting as an agent or otherwise, before or during movement of goods, either by way of transfer of documents of title to goods or otherwise;*
> *(ii) where the services are provided by the supplier to any person on the direction of and on account of such registered person.*

(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: Provided that where the goods against an invoice are received in lots or instalments, the registered person shall be entitled to take credit upon receipt of the last lot or instalment:

Provided further that where a recipient fails to pay to the supplier of goods or services or both, other than the supplies on which tax is payable on reverse charge basis, the amount towards the value of supply along with tax payable thereon within a period of one hundred and eighty days from the date of issue of invoice by the supplier, an amount equal to the input tax credit availed by the recipient shall be added to his output tax liability, along with interest thereon, in such manner as may be prescribed:

Provided also that the recipient shall be entitled to avail of the credit of input tax on payment made by him of the amount towards the value of supply of goods or services or both along with tax payable thereon.

a. Thus the conditions or restrictions should be only those as prescribed in the statute elsewhere. The above condition of matching of credit and restriction is found specifically covered under Section 43 or Section 43A and therefore, the source of power of **Rule 36**(4) cannot be found in Section 16(1).

b. The requirement of matching of credits are already prescribed under the statutory provisions under section 43 and such requirement has been suspended due to technical difficulties in implementing the same. Hence the said procedure cannot be implemented through backdoor by way of any Rule.

c. Section 43A has been inserted to provide procedure for furnishing return and for availing input tax credit. It would be noted that a specific provision is contained in sub section 4 of the said section. However, the section itself has not been notified and therefore, the Rule which could have been traced to this section cannot be enforced dehors the section being implemented.

Hence, **Rule 36**(4) is beyond the scope, sphere, mandate and concern of the principal Act and it is a well-recognized principle of interpretation of statute that conferment of Rule-making power by an Act does not enable the Rule-making authority to make a Rule which travels beyond the scope of the enabling Act or which is inconsistent therewith or repugnant thereto.[3]

***Thirdly,* Rule 36**(4) travels beyond the scope of the principal act it restricts the credit contrary to the provisions of **Sections 37** and **42** of the Act. The statutory provisions under **Sections 37** read with **Section 42** already provide for matching of the supplier invoice details with inward details of the recipient of supplies who has availed Input Tax Credit on such supplies. These provisions provide uploading of the details of outward supply by the supplier and matching of the same with the input credit availed by the recipient. The statutory provisions itself provide for sufficient time lines to match and rectify errors if any. Where even after errors are being pointed, such adjustments/ rectifications are not undertaken, then the amount of credit to the extent of such

discrepancy, is treated as output tax in the month subsequent to the month in which the error is pointed out. It is stated that the above provisions are in operation and only because the Government is not able to create suitable software for implementation of the above, the said procedure is suspended for the time being. Therefore, the credit cannot be restricted on account of non matching for the reasons that the statutory provisions do not envisage such restriction as well as there is no enabling mechanism with the Government to decide and match the credits, which is accepted by the Government itself. Hence, in terms of the provisions of **Sections 37** and **Section 42**, the credit if not matched to the supplier's details, could only be treated as output tax and no restriction could be placed on the input side. Therefore, the restrictions placed in terms of **Rule 36**(4) are beyond the statutory provisions.

The Division Bench of Rajasthan High Court recently in D.B.C.W.P.No.3559/2020, *M/s. Ravi Infrabuild vs. UOI & Ors.*, issued notices to Union of India, through, Ministry of Finance, (Department of Revenue), Central Board of Indirect Taxes and Customs, New Delhi and Assistant Commissioner, Central Goods and Service Tax Division – B, Udaipur in a Writ Petition wherein vires of **Rule 36**(4) of Rules of 2017 was challenged.

That similar such Writ Petitions have been filed before various other Hon'ble High Courts of the country, which are pending consideration.

Thus said **Rule 36**(4) being ultravires the constitutional principles and being beyond the purview of the parents Act deserves interference and appropriate corrective steps.