2A vs 3B Mismatch - Grounds to challenge!

INDIA EXPERT

BACKGROUND

Taxpayers has been witnessing various notices related to mismatch between 2A and 3B and the departmental authorities have been seeking reversal of credit. In a recent favourable judgment, the Madurai Bench of the Hon'ble Madras High Court in the case of ***M/s. D.Y. Beathel Enterprises v. The State Tax Officer (Data Cell)***[1], held that the approach taken by the revenue authorities in reversing the Input Tax Credit ("ITC") availed by the Petitioners for the for the fault of the sellers is incorrect. The primary point of dispute in this case was Section 16 (2)(c) of the Central Goods and Services Tax, 2017 ("CGST Act") which puts an essential condition on the buyers availing ITC to ensure that the tax paid on a transaction is actually deposited to the Government by the sellers.

In this case, the Petitioners entered into a transaction with the sellers and paid the consideration along with tax component. Further, based on the returns filed by the

[1] 2021-TIOL-890HC-MAD-GST.

sellers, the Petitioner availed ITC. However, on investigation conducted by the Respondents, it came to light that the sellers did not in fact deposit the tax collected. Acting on such information, the Respondent ordered the Petitioners for reversal of the ITC availed. The Court while relying upon an order passed by this court earlier in the case of ***Sri Vinayaga Agencies v. The Assistant Commissioner***[2] and the Press Release of the 27th GST Council Meeting[3] which restricted automatic reversal of ITC in case of default of payment of tax by the seller except for *"exceptional situations like missing dealer, closure of business by supplier or supplier not having adequate assets etc."*[4] (*emphasis supplied*), held that the authorities erred in ordering reversal of ITC claimed by the Petitioners without properly enquiring the sellers and ordered for fresh enquiry in this matter.

It is important to note that although this case is a welcome step towards the problems faced by buyers due to the unreasonable condition posed by Section 16 (2)(c) of the CGST Act and would act as a precedent henceforth, it did not read down or comment on the constitutionality of the provision.

Section 16(2)(c) of the CGST Act imposes an essential condition on availing ITC and states that no buyer shall be entitled to avail ITC in respect of any supply of goods and/or services unless the "*tax charged in respect of such supply has been actually paid to the Government*". This provision is often argued as unfair, arbitrary and unjust to genuine buyers as it essentially mandates an unreasonable onus on the buyers to ensure that the seller has deposited the tax component charged by him in the invoice. This not only requires buyers to bear the loss of ITC, which he is lawfully entitled to but also obligate them to pay interest on the reversal of ITC under Section 50.

[2] (2013) 60 VST 283 (Mad.).
[3] Press Release of the 27th GST Council Meeting dated May 04, 2018.
[4] *Id.*

This article attempts to analyse the validity of such proceedings based on the legality of such condition under Section 16 (2)(c) of the CGST Act and various grounds to fight such mismatch notices.

GROUNDS TO FIGHT MISMATCH NOTICES

1. SECTION 42 AND 43 ARE IN ABEYANCE

The condition for availment of ITC that "tax charged in respect of the subject supply has been actually paid to the Government" is subject to the provisions of Section 41.

In this respect, it is to be noted that Section 41 of the CGST Act entitles every registered person to provisionally take the credit of eligible input tax, as self-assessed, in his return and such amount shall be credited on a provisional basis to the electronic credit ledger. This provisional credit becomes final after matching, reversal and reclaim of ITC carried out in the manner laid down under Section 42 of the CGST Act.

Section 42(3) of the CGST Act states that where the input tax credit claimed by a recipient in respect of an inward supply is in excess of the tax declared by the supplier for the same supply or the outward supply is not declared by the supplier in his valid returns, the discrepancy shall be communicated to both such persons in such manner as may be prescribed.

Further, section 42(5) states that the amount in respect of which any discrepancy is communicated under subsection (3) and which is not rectified by the supplier in his valid return for the month in which discrepancy is communicated shall be added to the output tax liability of the recipient, in such manner as may be prescribed, in his return for the month succeeding the month in which the discrepancy is communicated.

Further, the mechanism for matching of ITC as envisaged in Section 42 of CGST Act, is provided under the Central Goods and Services Rules, 2017 ("CGST Rules"). As per

Rule 69 of the CGST Rules, the prescribed details relating to the claim of ITC 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.

Further, Rule 71 of the CGST Rules states that any discrepancy in the claim of ITC in respect of any tax period, specified in sub-section (3) of section 42 and the details of output tax liability to be added under sub-section (5) of the said section on account of continuation of such discrepancy, shall be made available to the recipient making such claim electronically in FORM GST MIS-1 and to the supplier electronically in FORM GST MIS-2 through the common portal on or before the last date of the month in which the matching has been carried out.

Sub rule 4 of the aforesaid rule states that where the discrepancy is not rectified under sub-rule (2) or sub-rule (3), an amount to the extent of discrepancy shall be added to the output tax liability of the recipient in his return to be furnished in FORM GSTR-3 for the month succeeding the month in which the discrepancy is made available.

On perusal of the aforesaid provisions, it can be said that there is a specific mechanism for reversing the credit in case of the discrepancy in the ITC availed by the recipient against the output liability of the supplier. However, this complete mechanism for matching of ITC has been kept in abeyance due to technical glitches prevailing in the GSTN System.

Having said above, now it may be further noted that condition of payment of tax to government under Section 16(2)(c) is also subject to Section 43A of the CGST Act. Section 43A lays down the procedure in relation to furnishing of return and availing ITC. As per sub-section (2) of Section 43A, notwithstanding anything contained in Section 41, Section 42 or Section 43, the procedure for availing of ITC by the recipient and verification thereof shall be such as may be prescribed. However, it is pertinent to note that neither the Section 43A has been notified yet nor any manner for verification of ITC has been prescribed.

Hence, Section 43A is not applicable in present case and Section 41 and Section 42 would continue to apply which are itself kept in abeyance.

On the basis of above submissions, it can be summarized that Section 16(2)(c) i.e., condition of payment of tax to Government, is subject to the provisions of Section 41 read with Rules 69 and 71. However, the ITC matching, reversal mechanism laid down under Section 41 read with rules is kept in abeyance. Therefore, till the provisions in this respect are given effect, the recipients are entitled to claim the ITC on the basis of tax invoice issued by vendor without any consideration that such tax invoice is being reflected in GSTR-2A or not.

As held by Hon'ble Supreme Court in ***Tata Chemicals Limited* v. *Commissioner*, 2015 (320) ELT 45 (SC)** when law requires a particular thing to be done in a particular manner, it must be done in that manner only or not done at all. Therefore, ideally recipient cannot be asked to comply with this condition and reverse ITC when he has no mechanism to ensure whether supplier has paid tax to the government or not.

2. DOCTRINE OF IMPOSSIBILITY

The Department cannot arbitrarily reject the ITC on account of mismatch between ITC claimed in Form GSTR-3B vis-a-vis ITC reflecting in Form GSTR -2A on the GST portal. In authors view, as per Section 16(2)(c) of the CGST Act, benefit of ITC cannot be denied to the Noticee on account of default of the supplier, over whom the Noticee does not have any control, in paying tax to the Government after having collected the same from the Noticee. It is also submitted that in the Value Added Tax (VAT) regime, a similar provision was struck down.

A Noticee cannot be denied the right to credit due to circumstances that are beyond the control of the Noticee. At this juncture, the legal maxim, ***lex non cogit ad impossibilia***, merits attention. This maxim postulates that law cannot compel a man to do that which cannot possibly be performed. This principle has been reiterated in a catena of judgments wherein the Hon'ble Courts have accepted its admissibility

and have elucidated on its definition through references in various illustrious authorities.

Reliance in this regard can be placed in the case of State ***of MP V. Narmada Bachao Andolan [(2011) 7 SCC 639],*** wherein the court applied this maxim and held that thus,
where the law creates a duty or a charge and the party is disabled to perform it without any fault on his part and has no control over it, the law will in general excuse him.

The Delhi High Court in the case of ***Arise India Ltd. V. Commissioner of Trade and Taxes [TS-314-HC-2017(Del)-VAT],*** has held that therefore, there was need to restrict
the denial of ITC only to the selling dealers who had failed to deposit the tax collected by them and not punish bona fide purchasing dealers. The latter cannot be expected to do the impossible. It is trite that a law that is not capable of honest compliance will fail in achieving its objective. If it seeks to visit disobedience with disproportionate consequences to a bona fide purchasing dealer, it will become vulnerable to invalidation on the touchstone of Article 14 of the Constitution.

As substantiated above, the law cannot compel the Noticee to do the impossible i.e., to ensure that the Supplier has paid the tax to the Government. It is unjust to deny credit to the Noticee on failure on part of Supplier to furnish details on the same in time. The law cannot compel the Noticee to do the impossible, and thus in authors view, the demand raised on basis on the mismatch needs to be dropped.

3. COLLUSION BETWEEN BUYERS AND SELLERS

Perhaps the most blatant flaw in Section 16(2)(c) is the fact that it imposes an unreasonable burden on a recipient who might otherwise be bonafide. It makes the recipient responsible for the actions of the supplier, even where the two of them may be unrelated. Thus, it penalizes the recipient for the fault of a third party, i.e the supplier, even in the absence of collusion between the two.

In the VAT regime, there are a number of judgments that highlight this problem in the law and the disadvantage it imposes on the recipient. In ***On Quest Merchandising India Pvt. Ltd. v. Govt. of NCT of Delhi,*** the assessee had paid tax to the supplier but the same was not deposited by the supplier to the Government.[5] The Delhi High Court read down the provision and held that where the purchaser is bonafide and there is absence of mala fide intention, connivance or wrongful association of the purchaser with the supplier, this provisions should not apply. Similarly, in ***Sri Vinayaga Agencies v. The Assistant Commissioner,*** the Madras High Court laid down that law could not empower tax authorities to reverse the ITC availed on a plea that the selling dealer has not deposited the tax.[6] It can revoke input credit only if it relates to the incorrect, incomplete or improper claim of such credit by a dealer.

However, in the cases of ***Gheru Lal Bal Chand v. State of Haryana*** and ***Arise India Limited v. Commissioner of Tax,*** the Court allowed the revenue authorities to impose such condition and investigate the buyers if there exists a collusion between the buyers and the sellers acting in detriment of the Government. In the case of *Gheru Lal Bal Chand*, the Court stated that the genuineness of the VAT C-4 certificate can be examined by the revenue authorities to check whether the buyer and seller has been in collusion, and in case such collusion is established allowed the revenue authorities to initiate proceedings against the defaulter and can prevent the buyer from availing the benefit of ITC. Further, in the case of *Arise India,* the Court opined similarly and held that in case the revenue authorities discover that the buyer and the seller has acted in collusion in detriment of the Government, the revenue authorities can restrict the buyer from availing the benefit of ITC under Section 9 of the Delhi VAT Act, and can initiate proceedings against the defaulters under Section 40A of the Delhi VAT Act.

Therefore, the legality of the condition under Section 16(2)(c) also depends on the relationship between the buyer and the seller and can only be imposed in cases where

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[5] *Id.*
[6] *Supra*, note 2.

parties are working in collusion because in such cases recipient steps into the shoes of the supplier and becomes the same person and not otherwise.

4. SELLER AS AN AGENT

The CGST Act provides for the payment of taxes from the seller to the government, however this provision renders the burden of such tax on the buyer. The seller is only entrusted with tax amount paid to him by the buyer until he pays this tax to the government; this in turn, makes the seller an agent of the government.

Firstly, in the case of ***Corporation Bank v. Saraswati Abharansala***[7], the Supreme Court opined the selling dealer who collects the tax, as an agent of the Government. Therefore, a bona fide buyer cannot be put in jeopardy when he has complied with the obligations. Furthermore, the purchasing dealer has no means to ascertain and secure compliance by the selling dealer. Similarly, the Supreme Court while adjudging on appeal in the case of ***Atul Fasteners Ltd. v. State Of Punjab & Ors.***[8], held that the selling dealer while collecting the taxes from its customers was acting as an agent of the Government.[9] However, in the case of ***Central Wines, Hyderabad and Ors. vs. Special Commercial Tax Officer and Ors***[10], the Court has made it evident that a dealer who sells the goods does not act as an agent for the State in collecting the sales tax from the persons to whom he sells the goods. The Court gave the following reasoning "*If he was acting as an Agent he would be required to take reasonable care of the sale proceeds as a bailee. He would also be required to set apart the same without intermingling with his own money, for, he cannot use the monies belonging to the State for his own private purposes. If the intention of the legislature was to make him an agent, the legislature would have imposed penal liability on the vendor if he were not to collect the taxes.*"[11] The Court instead held that the seller acts as an agent of the buyer while collecting the tax.

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[7] MANU/SC/8276/2008.
[8] (2007) 7 VST 274 P&H.
[9] 2007 (4) TMI 262 SC.
[10] MANU/SC/0582/1987.
[11] *Ibid.*

Therefore, it can be concluded that there is no settled law as to the treatment of the seller as an agent of the buyer or the state. However, as no legislation can act in detriment of its welfare obligations, it would be just to consider the seller as an agent of the government, thereby protecting the interests of a bona fide buyer.

5. RECIPIENT'S LIABILITY DUE TO THE SELLER'S DEFAULT

The often controversial condition of Section 16 (2)(c) also penalizes the recipient for the seller's default which has been argued to be unfair and unjust on the recipient buyers. Recently, the Hon'ble Madras High Court in the case of ***M/s. Shri Ranganathar Valves Private Limited v. Assistant Commissioner (CT)***[12], has held that restricting the buyer's right to avail ITC on the ground of the tax collected but remaining unpaid to the Government by the seller "cannot be sustained" and ordered reconsideration of the approach taken by the authorities.

Further, this issue was also dealt by the Supreme Court in the pre-GST era, in the case of ***Commissioner of Central Excise, Jalandhar v. M/s. Kay Kay Industries***[13], where the manufacturer-seller had given a wrong certificate on the invoices regarding the duty paid under Rule 96ZP of Central Excise Rules, 1944. The Court held that the MODVAT credit is allowed to the assessee even in cases where the supplier fails to discharge the excise duty on the goods which are supplied by him to the manufacturer. The Court while opining that the credit cannot be denied on the mere ground of non-payment by the supplier, held that in order to avail MODVAT credit, Rule 57A (6) of the Rules only requires "reasonable care" and not verification from the Department whether the duty stands paid by the manufacturer-seller. Similarly, in the Hon'ble Delhi Tribunal in the case of ***CC & CCE v. M/s Juhi Alloys Ltd***[14], while allowing the buyer his due credit, held that the buyer can take steps which are in their control, beyond which the buyer cannot be expected to verify the records of the supplier to check whether the supplier has done any default.

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[12] 2020-TIOL-1611-HC-MAD-VAT.
[13] AIT- 2013-147-SC.
[14]

CONCLUDING REMARKS

After thorough examination of the provisions and the judicial interpretation of the statute, it can be concluded that the condition of Section 16 (2)(c) of the CGST Act imposes an unreasonable restriction on bona fide buyers in availing ITC. Therefore, it is advisable for buyers to safeguards their rights contractually in circumstances where the supplier fails to deposit the due tax charged on the transaction. Also, on introduction of Section 43A which makes supplier and recipient jointly liable for the payment to the government may impact the position discussed in this write-up.

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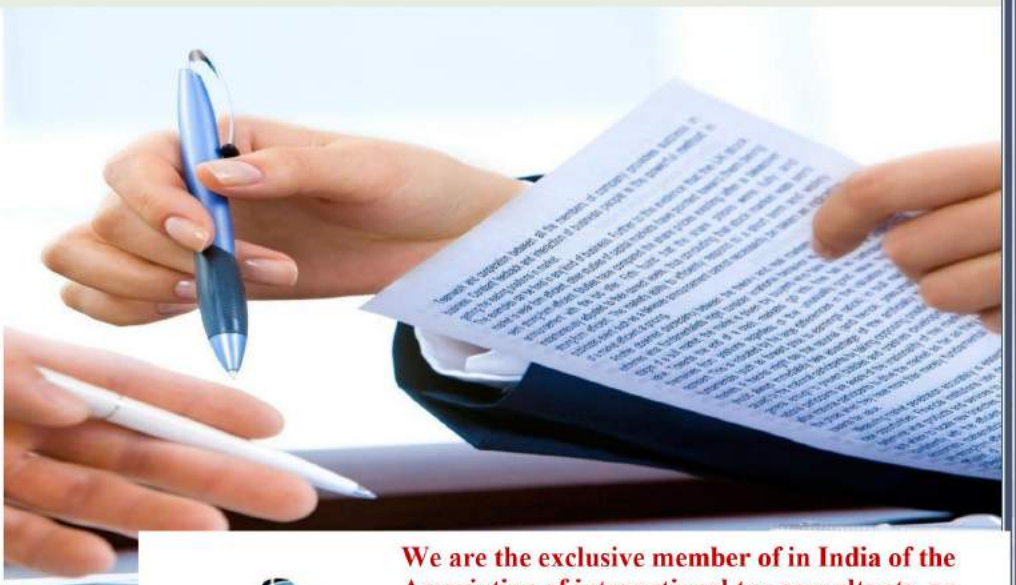

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