



ITC now firmly linked to supplier compliance

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IN a recent ruling in *L and T Geostructure LLP vs Union of India & Ors.* [[2025-TIOL-921-HC-MAD-GST](#)], the Madras High Court has upheld the constitutional validity of Rule 36(4) of the CGST Rules. The judgment comes at a time when GST departments across India are aggressively issuing notices based on ITC mismatches between GSTR-2A and GSTR-3B returns. The decision, for now, solidifies the Department's stance, while raising important questions on the limits of delegated legislation and taxpayer rights under the GST regime.

A. Background and the Legal Challenge

The petitioner, *L and T Geostructure LLP*, challenged the vires of Rule 36(4) of the Central Goods and Services Tax [Rules, 2017](#). This Rule restricts taxpayers from claiming Input Tax Credit (ITC) beyond what is auto-populated in GSTR-2A, which itself is based on the supplier's filing in GSTR-1. The petitioner contended that the Rule is:

- Arbitrary, irrational, and violative of Articles 14, 19, and 21 of the Constitution.
- Ultra vires the parent statute, i.e., the CGST Act, particularly Section 16, which governs ITC entitlement.

Evolution of Rule 36(4)

Rule 36(4) was introduced via the CGST (6th Amendment) Rules, 2019, effective from **09.10.2019**. Over time, the ITC entitlement cap has been progressively tightened:

Period	ITC Limit (Over and above eligible GSTR-2A)
09.10.2019 to 31.12.2019	20%
01.01.2020 to 31.12.2020	10%
01.01.2021 to 31.12.2021	5%
01.01.2022 onwards	NIL (100% (i.e., only as per GSTR-2A))

B. Key Arguments by the Taxpayer

1. No Statutory Basis for Restriction under Section 16

Section 16 of the CGST Act does not contain any language authorising the imposition of a percentage-based restriction on ITC. Thus, Rule 36(4) travels beyond the scope of the parent statute and is ultra vires.

2. Power under Section 43 or 43A Not Invoked

The power to impose such restrictions could have stemmed from Section 43 or 43A. However, neither provision has been notified, making any rule relying on them without legislative backing invalid.

3. Violation of Section 164 - Lack of GST Council Recommendation

The petitioner submitted that Section 164, which empowers the Government to make rules, mandates such rules be made on the recommendation of the GST Council. No such recommendation was shown for Rule 36(4), rendering it invalid.

4. Section 16(2) Fully Satisfied

Once a recipient satisfies Section 16(2) - i.e., possession of invoice, receipt of goods/services, tax payment by supplier, and filing of return - there is no legal justification to deny ITC merely due to a mismatch or supplier's non-compliance.

5. Supplier's Default Cannot Affect Bona Fide Recipient

The failure of the supplier to file GSTR-1 or furnish accurate details cannot be a ground to penalize the recipient, especially when tax has already been paid and goods/services have been received.

6. ITC is a Vested Right, Not a Concession

The ITC mechanism under GST is an integral feature designed to avoid tax cascading, and once statutory conditions are met, the credit accrues as a matter of right and not a conditional benefit or concession.

7. Retrospective Impact and Operational Chaos

Applying the rule without transitional measures or proper technological implementation leads to unjust hardship, especially when GSTR-2A was not fully functional or reliable during initial GST years.

C. Government's Counter-Position

1. Rule 36(4) Derives Power from Section 41 and 16(1)

The Government argued that the right to claim ITC is not absolute and is subject to conditions and restrictions as prescribed under the Act and the Rules. Thus, Rule 36(4) is validly made under Section 41 and Section 16(1) read with Section 164.

2. ITC as a Concession, Not a Right

The government emphasized that ITC is a statutory concession, not a constitutional or fundamental right. The State can lawfully regulate or restrict such concession.

3. Rule 36(4) Eases Section 16(2)(c)

Interestingly, the government claimed that without Rule 36(4), Section 16(2)(c) - which mandates that tax must be actually paid by the supplier - would completely bar ITC. Hence, Rule 36(4) actually relaxes the rigour of the statute by allowing some credit despite supplier non-compliance.

4. Purpose: Preventing Revenue Leakage

The restriction is part of a calibrated approach to curb circular trading and fake invoicing - rampant malpractices that had caused significant revenue loss in the pre-GST and early GST years.

D. Court's Observations and Decision

On Historical and Legal Context

- The Court acknowledged that the GST regime was implemented hastily without full IT infrastructure support.
- Inspired by MODVAT/CENVAT, GST was conceptualized as a seamless credit mechanism, but real-world challenges like fake invoicing and supplier default necessitated checks and balances.

On Rule 36(4)'s Validity

- The Court upheld that the expression "*subject to such conditions and restrictions as may be prescribed*" in Section 16(1) permits the Government to impose quantitative restrictions like those under Rule 36(4).
- The restriction does not violate Articles 14, 19, or 21 as the rule has rational nexus with a legitimate objective - curbing tax evasion and ensuring supplier compliance.
- The Court rejected that Rule was not enacted with legislative competence or proper procedure, including recommendation from the GST Council.

E. Implications of the Judgment

This decision will bolster the GST Department's confidence in sustaining ITC denial cases based on GSTR-2A vs GSTR-3B mismatches. It sends a clear signal that:

- Rule 36(4) is here to stay - unless overturned by a higher court.
- Assesseees must tighten vendor compliance mechanisms, ensuring their suppliers timely file GSTR-1s and deposit taxes.
- This may lead to a fresh spate of adjudications where taxpayers' reliance solely on payment and possession of invoice may no longer be sufficient.
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Conclusion

The Madras High Court's ruling firmly cements the principle that input tax credit under GST is not an unfettered right, but a conditional entitlement - one that is now intrinsically linked to a supplier's compliance. While the decision strengthens the government's hand in combating fraud and revenue leakage, it also places a heavier compliance burden on honest taxpayers, who must now not only ensure their own diligence but also monitor the conduct of their vendors. As the GST regime matures, this judgment marks a clear judicial shift toward system-driven accountability, urging businesses to evolve from reactive filings to proactive compliance ecosystems.

Before parting, this line of reasoning, however, invites a crucial question: Does the government's stand imply that once ITC is auto-populated in GSTR-2A, the actual payment of tax by the supplier becomes irrelevant? If Rule 36(4) is considered a relaxation of the stricter bar under Section 16(2)(c), it may suggest a shift toward form-based eligibility, where appearance of credit in GSTR-2A becomes the de facto threshold. Such a view, if accepted, could significantly dilute the rigor of Section 16(2)(c) and also raise a

larger jurisprudential issue - can delegated legislation override or soften the express mandate of the parent Act?

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