

When the Supplier Defaults: The Gujarat High Court Reopens the Great ITC Debate under GST

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1. Introduction

Few concepts under the GST regime have generated as much litigation, uncertainty and commercial anxiety as **Input Tax Credit ("ITC")**. Conceived as the backbone of GST and the very mechanism intended to eliminate cascading of taxes, ITC has, over the years, transformed into one of the most fiercely contested areas of indirect taxation. Amongst the numerous disputes surrounding ITC, perhaps none has been more contentious than the recurring controversy where the purchasing dealer, despite having paid tax to the supplier and possessing valid tax invoices, is sought to be denied credit on account of the supplier's default in depositing tax with the Government. This persistent conflict between the statutory conditions under [Section 16\(2\)\(c\)](#) of the CGST Act and the practical realities of trade has created a continuing battle between bona fide recipients and the tax administration.

The controversy strikes at the heart of GST jurisprudence - whether a compliant recipient can be punished for the failure, fraud or omission of an independent supplier over whom the recipient may have little or no control. While the department frequently invokes Section 16(2)(c) to fasten liability upon recipients, taxpayers have consistently argued that such interpretation defeats the foundational promise of GST as a seamless credit-based tax system. The resulting litigation has produced divergent judicial opinions, constitutional

challenges and significant debate on the extent of due diligence expected from recipients in a modern indirect tax framework.

In this background, the judgment of the Gujarat High Court in ***Maruti Enterprise Vs Union Of India & Ors.*** ([2026-VIL-432-GUJ](#)) becomes another significant addition to the ever-expanding jurisprudence surrounding ITC under GST law.

2. Factual Background

The writ petitions involved constitutional challenge to Section 16(2)(c) of the CGST Act, which conditions availability of ITC upon actual payment of tax by the supplier to the Government.

The petitioners, being purchasing dealers, contended that despite possessing genuine tax invoices, having received goods and reflecting transactions in statutory returns, they were denied ITC solely because the suppliers had allegedly failed to discharge their output tax liability through Form GSTR-3B.

The petitioners challenged the constitutional validity of Section 16(2)(c) primarily on the grounds of arbitrariness, impossibility of compliance, hostile discrimination and violation of Articles 14 and 19(1)(g) of the Constitution of India.

3. Arguments of the Petitioners

3.1 Impossibility of Verifying Supplier Compliance

The petitioners argued that a purchasing dealer has no statutory, contractual or technological mechanism to verify whether the supplier has actually deposited tax with the Government. While a recipient may verify registration status and invoice reflection in GSTR-2A/2B, access to the supplier's GSTR-3B and tax payment details is completely unavailable.

Accordingly, Section 16(2)(c) effectively compels a purchaser to perform an impossible task, thereby offending the doctrine of "**Lex Non Cogit Ad Impossibilia**", namely that law does not compel performance of impossibilities.

3.2 Bona Fide Purchasers Cannot Be Penalised

The petitioners emphasized that clauses (a), (aa), (b) and (ba) of Section 16 already safeguard genuineness of transactions by requiring possession of tax invoices, receipt of goods/services and reflection in GSTR-2B. Thus, once these statutory conditions are satisfied, denial of ITC merely because of subsequent supplier default punishes a bona fide recipient for circumstances entirely beyond his control.

Heavy reliance was placed on the judgments in:

- *On Quest Merchandising India (P.) Ltd. vs. Government of NCT of Delhi* [[2017-VIL-544-DEL](#)];
- *Commissioner of Trade & Tax, Delhi vs. Arise India Ltd.* [[2018-VIL-01-SC](#)];
- *Commissioner Trade & Tax, Delhi vs. Shanti Kiran India (P.) Ltd.* [[2025-VIL-83-SC](#)];
- *Sahil Enterprises* - [[2026-VIL-15-TRI](#)]

The petitioners argued that failure to distinguish between honest purchasers and collusive dealers amounted to hostile discrimination violative of Article 14.

3.3 Double Taxation and Cascading Effect

Another important argument advanced was that denial of ITC results in indirect double taxation. According to the petitioners, once GST has already been collected from the purchaser by the supplier, denial of ITC effectively taxes the same transaction twice - first through retention by the supplier and second through denial of credit to the recipient.

It was argued that such interpretation defeats the very object of GST as reflected in the Statement of Objects and Reasons of the CGST Bill, 2017, which sought elimination of cascading taxes.

3.4 ITC as a Vested Right

The petitioners also contended that once ITC stands reflected in Form GSTR-2B and is validly availed on genuine transactions, such credit becomes a vested right. Subsequent denial based upon supplier default was argued to be arbitrary and confiscatory in nature.

4. Arguments of the Respondent State

4.1 Burden of Proof Lies Upon Claimant of ITC

The State strongly relied upon [Section 155](#) of the CGST Act, which places the burden of proving admissibility of ITC upon the claimant. It was argued that ITC is not an unconditional or constitutional right, but merely a statutory entitlement subject to satisfaction of prescribed conditions.

4.2 Importance of Fiscal Integrity Under GST

The State emphasized that GST is a destination-based consumption tax operating through an integrated credit chain across States. Particular reliance was placed on [Section 53](#) of the CGST Act, under which tax collected on inter-State supplies is apportioned to destination States.

According to the State, if ITC were allowed merely on invoice basis despite non-payment by suppliers, originating States would be forced to transfer revenue never actually received, thereby causing severe fiscal imbalance.

4.3 Scheme of Section 41 and Rule 37A

The respondents argued that Section 16(2)(c) cannot be read in isolation and must be interpreted along with [Section 41\(2\)](#), and [Rule 37A](#) of the CGST Rules.

Under this framework, if the supplier fails to pay tax, the recipient is temporarily required to reverse ITC. However, once the supplier subsequently deposits the tax, the recipient becomes entitled to re-avail such credit.

Hence, according to the State, the statutory framework merely postpones ITC rather than permanently extinguishing it.

4.4 Distinction Between GST and VAT Regimes

The State further argued that reliance upon *On Quest Merchandising* and allied VAT judgments was misplaced because the statutory framework under GST materially differs from the earlier VAT regime. Unlike the DVAT Act, the GST regime contains Sections 41, 53 and Rule 37A, which create a more integrated fiscal mechanism involving both Centre and States.

5. Question Before the Hon'ble High Court

The issue before the High Court was whether Section 16(2)(c) of the CGST Act, which conditions availment of ITC upon payment of tax by the supplier to the Government, is unconstitutional, arbitrary or liable to be read down.

6. Discussion and Findings of the High Court

6.1 Importance of the Statement of Objects and Reasons

The High Court began its analysis by examining the Statement of Objects and Reasons of the CGST legislation. The Court observed that the statutory framework itself envisages ITC only in respect of "taxes paid". Therefore, actual payment of tax into the Government treasury constitutes a foundational pillar of the GST credit mechanism.

6.2 Distinction Between GST and VAT Jurisprudence

One of the most significant aspects of the judgment is the Court's distinction between the earlier VAT framework and the GST regime. The Court observed

that the Delhi High Court in *On Quest Merchandising* was influenced by the limited architecture of the DVAT regime, where ITC remained confined within a single State.

Under GST, however, inter-State credit flows involve fiscal transfers between originating and destination States through the IGST mechanism. Consequently, supplier default has far wider fiscal implications. The Court therefore held that the reasoning adopted in VAT-era precedents cannot be mechanically imported into GST jurisprudence.

6.3 Reading of Section 16(2)(c) Along With Section 41

The High Court repeatedly emphasized that Section 16(2)(c) cannot be read in isolation. The Court referred extensively to Section 41(2), which mandates reversal of ITC where the supplier fails to deposit tax, but simultaneously permits re-availing once tax payment is subsequently made. According to the Court, this mechanism sufficiently balances protection of revenue with interests of genuine purchasers.

6.4 No Absolute or Vested Right to ITC

Rejecting the argument that ITC constitutes a vested right, the Court reiterated the settled principle that ITC is a statutory concession subject to fulfilment of conditions prescribed by legislation. The Court observed that unless tax collected by the supplier is actually remitted to the Government, the recipient cannot insist upon ITC as an indefeasible right.

6.5 Doctrine of Impossibility Rejected

The High Court acknowledged practical difficulties faced by purchasers but nevertheless held that such hardship alone cannot invalidate a statutory provision. The Court observed that purchasers may safeguard themselves through contractual mechanisms such as indemnity clauses and commercial due diligence while dealing with suppliers.

6.6 Reading Down Declined

The Court ultimately refused to invoke the doctrine of reading down. It held that Section 16(2)(c), when read harmoniously with Sections 41, 53 and Rule 37A, forms part of a coherent statutory scheme intended to preserve integrity of the GST framework and prevent fraudulent credit chains.

6.7 Significant Observations of the Court

While upholding constitutional validity of Section 16(2)(c), the Court made important observations acknowledging genuine hardships faced by purchasing dealers. The Court observed that the Government must seriously reconsider the disproportionate burden currently placed upon bona fide purchasers and should introduce robust technology-driven mechanisms enabling real-time verification of supplier tax payment against invoices. The Court also stressed the need for stronger recovery action against defaulting suppliers instead of disproportionately targeting recipients.

7. Practical Challenges Emerging from the Judgment

Although the judgment upholds the statutory framework, it simultaneously exposes the severe commercial and operational challenges now confronting businesses under GST.

The decision effectively requires purchasers to undertake continuous vendor surveillance despite lacking statutory access to suppliers' tax payment data. In practical business environments involving thousands of transactions and multiple vendors across States, such monitoring becomes commercially unrealistic.

The judgment may also significantly alter commercial contracting practices. Businesses are now likely to insist upon extensive indemnity clauses, escrow mechanisms, retention arrangements and periodic vendor compliance audits to safeguard ITC exposure. Smaller businesses, however, may lack the bargaining

power or technological capability to implement such safeguards. Also, in sectors operating on thin margins and large credit cycles, such reversals can create serious financial distress.

Most importantly, the judgment once again highlights the absence of a transparent invoice-level verification system under GST. While recipients are expected to ensure supplier compliance, the law still does not provide them with effective technological tools to conclusively verify actual tax payment by suppliers.

8. Conclusion

The judgment in *Maruti Enterprise* marks another major development in the evolving jurisprudence surrounding **Section 16(2)(c)** and supplier default under GST.

While the Court has upheld the constitutional validity of the provision by emphasizing the integrated fiscal architecture of GST, the ruling also underscores the continuing tension between revenue protection and commercial practicality. The judgment reflects a clear judicial inclination to preserve integrity of the GST credit chain even at the cost of placing substantial compliance burdens upon purchasing dealers.

At the same time, the Court's observations acknowledging the hardships faced by bona fide recipients are equally significant. The ruling implicitly recognizes that the present GST framework has not yet fully resolved the long-standing dilemma of balancing protection of Government revenue with fairness towards honest taxpayers.

The controversy surrounding supplier default and denial of ITC is therefore far from settled. Given the conflicting judicial approaches emerging from various High Courts and the enormous commercial implications involved, the issue

appears destined for authoritative determination by the Supreme Court of India in the near future.

Until then, businesses may have little option but to strengthen vendor compliance frameworks, contractual protections and due diligence mechanisms, while continuing to navigate one of the most uncertain and litigated areas under the GST regime.

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(The views expressed in this article are strictly personal.)