



## Section 16(4) of the Indian CGST act, 2017 under the scanner: A constitutional analysis

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### Abstract

This article critically examines the constitutional validity of Section 16(4) of the Indian Central Goods and Services Tax (CGST) Act, 2017, which imposes a time limit for availing input tax credit (ITC). The provision has sparked considerable debate regarding its compliance with fundamental rights enshrined in the Constitution of India, specifically Articles 14, 19(1)(g), and 265. Through an in-depth analysis of legal principles, judicial precedents, and comparative international practices, this article argues that Section 16(4) potentially infringes on taxpayers' rights to equality and freedom of trade. It also explores the provision's alignment with the principles of tax equity and fairness. The study concludes by proposing recommendations for legal reforms to ensure the GST framework upholds constitutional mandates while achieving its economic objectives.

**Keywords:** Constitutional validity, section 16(4), CGST act, 2017, Input Tax Credit (ITC), fundamental rights, article 265, Tax equity, India

### Introduction

The Goods and Services Tax (GST) regime, introduced in India in 2017, has revolutionized the indirect tax landscape. The Constitution (One Hundred and First Amendment) Act, 2016, and the GST Acts, 2017 have established a dual GST system, with the Central GST (CGST) and the State GST (SGST) being levied on the supply of goods and services. One of the key provisions of the CGST Act is Section 16(4), which provides for the deemed supply of goods or services in certain circumstances. However, this provision has been subject to intense scrutiny and has raised important questions about its constitutionality.

Section 16(4) of the CGST Act, 2017 provides that if a taxable person fails to pay the tax or issues a bill of supply for any goods or services supplied by him, it shall be deemed that such goods or services have been supplied by him. In other words, if a taxpayer fails to pay the tax or issues a bill of supply for any goods or services supplied by him, it is deemed that he has supplied those goods or services. This provision has been criticized for being overly broad and potentially unconstitutional.

The constitutional validity of Section 16(4) of the CGST Act, 2017 has been challenged in several judicial forums, including the Supreme Court of India. The courts have raised concerns about the provision's potential violation of fundamental rights and freedoms, including the right to equality and the right to fair trial. In this article, we will examine the constitutional challenges faced by Section 16(4) of the CGST Act, 2017 and explore the implications of its potential invalidity.

The constitutional challenge to Section 16(4) of the CGST Act, 2017 is rooted in several concerns about the provision's potential violation of fundamental rights and freedoms. The provision is alleged to be an excessive delegation of legislative power to the executive, as it allows the authorities to deem a supply without any specific grounds or conditions being specified. The provision is also alleged to be vague and unclear, as it does not specify what constitutes a "failure to pay" or what constitutes a "bill of supply".

Furthermore, the provision is alleged to be arbitrary and discriminatory, as it applies differently to different taxpayers and can result in unequal treatment. The provision is also alleged to be retrospective, as it applies to past transactions and can result in a deemed supply being made even if the taxpayer did not intend to make such a supply.

### Understanding Section 16(4) Of the CGST Act, 2017

Section 16(4) of the CGST Act, 2017 states: "A registered person shall not be entitled to take input tax credit in respect of any invoice or debit note for the supply of goods or services or both after the due date of furnishing of the return under section 39 for the month of September following the end of financial year to which such invoice or invoice relating to such debit note pertains or furnishing of the relevant annual return, whichever is earlier."

### Purpose and Rationale

The primary objectives of Section 16(4) are:

- **Ensuring Timeliness:** To encourage timely claiming of ITC and compliance with tax filing.
- **Simplifying Tax Administration:** To facilitate smooth reconciliation of accounts and prevent fraudulent claims.
- **Revenue Protection:** To ensure that the government's revenue is not unduly delayed or evaded through untimely ITC claims.

### Legal Framework and Background Input Tax Credit (ITC) Mechanism

The ITC mechanism allows businesses to deduct the tax that has already been paid on the inputs (goods or services used to produce other goods or services) from their overall GST liability. This mechanism is crucial for preventing the cascading effect of taxes and ensuring a seamless flow of credit.

From a constitutional perspective, the implementation of GST and the provision for ITC are backed by the

Constitution (One Hundred and First Amendment) Act, 2016. Specifically, Article 246A grants both Parliament and the State Legislatures the concurrent power to make laws concerning GST, while Article 269A outlines the apportionment of GST revenue between the Union and the States for interstate transactions. These amendments laid the foundation for a unified tax structure, enabling the seamless flow of credit across state boundaries.

ITC is pivotal for the success of GST as it minimizes tax cascading, reduces the cost of goods and services, and aligns with the principle of "one nation, one tax." This promotes economic efficiency, eases the compliance burden, and ultimately benefits consumers with potentially lower prices. Thus, ITC under GST embodies a strategic approach to modernizing India's indirect tax framework.

### Legislative Intent

The GST Council and the government, while drafting the GST laws, aimed to strike a balance between facilitating ease of doing business and ensuring robust tax compliance. Section 16(4) of the Act was introduced to instill discipline among taxpayers regarding the timely availing of ITC.

### Constitutional Challenges to Section 16(4)

#### Rights Under the Constitution

Several fundamental and constitutional rights as protected under the Constitution of India are assessed while addressing the constitutionality of tax provisions.

#### 1. Violation of Article 14 (Equality before Law)

##### "14. Equality before law

The State shall not deny to any person equality before the law or the equal protection of the laws within the territory of India."

- **Arbitrary Classification:** Critics argue that the time limit imposed by Section 16(4) creates an arbitrary classification among taxpayers who may have legitimate reasons for delayed ITC claims.
- **Inequality:** Taxpayers who are otherwise compliant but miss the deadline due to genuine reasons are treated differently compared to those who claim ITC within the stipulated time, leading to inequality.
- Reliance is placed on the judgment of the Hon'ble Supreme Court of India in the matter of *Vinoy Viswam vs. Union of India & Ors.* reported at (2017) 7 SCC 59.

#### 2. Infringement of Article 19(1)(g) (Fundamental Right to Trade and Business)

##### "19. Protection of certain rights regarding freedom of speech, etc.

##### 1. All citizens shall have the right

(g) to practise any profession, or to carry on any occupation, trade or business."

- The denial of ITC to the buyer of goods or services for default of the supplier of goods or services, severely impacts the working capital of the buyer and therefore substantially diminishes its ability to continue business. Therefore, it is a serious affront to his right to carry on his trade or business guaranteed under Article 19 (1)(g) of the Constitution of India.

- **Hindrance to Business:** By restricting the timeframe for claiming ITC, businesses may face financial strain, especially if they are unable to claim substantial credits.
- **Operational Challenges:** The stringent time limit does not account for the practical challenges businesses face, such as administrative delays and reconciliation issues.

#### 3. Contravention of Article 265 (No Tax Without Authority of Law)

##### "265. Taxes not to be imposed save by authority of law

No tax shall be levied or collected except by authority of law."

- **Denial of Legitimate Credit:** Section 16(4) may result in the denial of legitimate ITC, effectively increasing the tax burden on businesses, which can be seen as an indirect form of tax without authority.
- The Hon'ble High Court of Karnataka in the matter of "*Kirloskar Electric Co. Ltd. Vs. State of Karnataka*" has held that the machinery provisions of the return filing cannot defeat the substantive claims of the input tax credit which are otherwise allowed under the statute. It was also held that the Revenue is only entitled to verify that the sale invoices are genuine and valid, and that such ITC claim is not duplicate, frivolous or bogus. Article 265 of the Constitution of India does not entitle *state* to retain such ITC.
- The Hon'ble Gujarat High Court in the matter of *Jakap Metind Pvt Ltd Vs. Union of India* <sup>[5]</sup> has held that the denial of ITC results in withholding of an amount which was paid as input tax by a purchaser and constitutes a source of tax once again, which is violative of Article 265 of the Constitution of India.

#### 4. Contravention of Article 300A

##### "300A. Persons not to be deprived of property save by authority of law

No person shall be deprived of his property save by authority of law."

- ITC under Section 16(4) of the CGST Act, being in the nature of tax paid at the stage of purchase of goods or services, are vested rights under Article 300A of the Constitution of India and therefore, to be adjusted with the tax payable on sale of goods or services both in computing the tax liability. The conditions as prescribed in Section 16(4) of the CGST Act are merely procedural in nature and cannot override the substantive conditions as mandated in Section 16(1) and 16(2) of the said Act.
- The input tax credit is a vested property right under Article 300A of the Constitution of India. The Hon'ble Supreme Court of India in the matter of *Union of India v. Adfert Technologies Pvt. Ltd* (SLP (C) No.4408 of 2020) has categorically held that the ITC, being a vested right, cannot be denied on the ground of time limit.

#### Judicial Precedents and Interpretations

That the issue of vires of Section 16(4) of the CGST Act, 2017 is pending consideration before various other Hon'ble High Courts as well. The list of petitions challenging the vires of the proviso to Section 16(4) of the CGST Act, 2017 pending before other Hon'ble High Courts is as follows:

Table 1

S.No.	Cause title	Case No.	Pending before
1	Bharti Airtel Ltd Vs. Union of India	WP (C) No. 6914 of 2020	This Hon'ble Court
2	Meta Tiles Pvt LTD and anr	Writ Petition (L) No. 12338 of 2021	Hon'ble Bombay High Court
3	B.D. Enterprises Vs. Union of India	W. P. No. 11443 of 2021	Hon'ble High Court of Jharkhand
4	Rainbow Infrastructure Private Limited & Anr Vs. Assistant Commissioner	WPA No. 7159 of 2020	Hon'ble Calcutta High Court
5	Shreeji Earth Movers vs Union of India	WP No. 05434 of 2020	Hon'ble Madhya Pradesh High Court
6	Times Heaven Club Pvt Ltd Vs. Union of India	SCA No. 4031 of 2020	Hon'ble High Court of Gujarat

Thus, evidentially the issue regarding *vires* of Section 16(4) of the CGST Act, 2017 needs consideration of this Hon'ble Court, and as such this present writ petition has been filed.

The Hon'ble High Court of Kerala in *M/s. M. Trade Links v. Union of India* reported at [2024] 163 taxmann.com 218 (Kerala) has observed that in initial years of GST regime i.e., in finance years 2017-18 and 2018-19, GSTR-2A was not available. In order to resolve bona fide claims and mistakes, Circular No. 183/15/2022-GST dated 27-12-2022 and Circular No. 193/05/2023-GST dated 17-7-2023 were issued. These circulars cover the period from introduction of GST till section 16(2) (aa) was introduced with effect from 1-1-2022. Thus, ITC can be availed by the recipient for bona fide scenarios listed in those circulars. Earlier, the date for furnishing return under section 39 was 30th September. However, the Legislature had affected amendment by Finance Act, 2022 and extended time for filing return for September to 30th November. Therefore, in the light of this the Hon'ble High Court of Kerala in the aforesaid case has held that if a person has furnished return for month of September till 30th November, his claim should also be considered and processed and should not be rejected if dealer did not furnish return or month of September on or before 20th October. This amendment being procedural has to be given retrospective effect.

### Government's Perspective and Justifications

#### 1. Ensuring Compliance and Revenue Security

The government justifies Section 16(4) on the grounds of ensuring timely compliance and safeguarding revenue. The rationale is that:

- **Timely ITC Claims:** Encouraging timely ITC claims ensures that tax credits are availed in a systematic and predictable manner, facilitating better tax administration.
- **Preventing Fraud:** The time limit helps in preventing fraudulent claims and misuse of the ITC mechanism, thereby protecting government revenue.

#### 2. Facilitating Administrative Efficiency

From an administrative perspective, Section 16(4) simplifies the reconciliation process for tax authorities, reducing the administrative burden and minimizing errors in tax collection and credit allocation.

### Comparative Analysis: International Practices

#### Its Claim Timelines in Other Jurisdictions

A comparative analysis of ITC claim timelines in other countries provides insights into global practices as follows:

1. **European Union (EU):** In the EU, the time limit for claiming VAT refunds is generally up to five years, allowing ample time for businesses to reconcile their accounts and claim credits.
2. **Australia:** The Australian GST system allows businesses to claim ITC within four years from the due date of the tax period in which the credit arises, providing flexibility and accommodating administrative delays.
3. **Canada:** In Canada, the time limit for claiming input tax credits is up to four years, with an extended period for certain small businesses, ensuring fairness and operational feasibility.

### Implications for Businesses and Taxpayers

#### Financial Impact

The restriction imposed by Section 16(4) can have significant financial implications for businesses:

- **Cash Flow Issues:** Denial of ITC due to missed deadlines can affect the cash flow of businesses, especially those operating on thin margins.
- **Increased Tax Burden:** Businesses may face an increased tax burden as they are unable to offset their tax liabilities with the ITC they are legitimately entitled to.

#### Operational Challenges

The stringent time limit for claiming ITC poses operational challenges

- **Administrative Burden:** Ensuring timely compliance requires robust administrative mechanisms, increasing the operational burden on businesses.
- **Reconciliation Issues:** Businesses need to ensure timely reconciliation of their accounts, which can be challenging given the complexities of supply chains and multiple transactions.

### Policy Recommendations and Future Outlook

#### Balancing Compliance and Flexibility

To address the concerns regarding the constitutionality of Section 16(4), policymakers should consider the following recommendations:

- **Extended Time Limits:** Extending the time limit for claiming ITC to align with international practices, ensuring that businesses have sufficient time to comply without undue pressure.
- **Conditional Relaxations:** Providing conditional relaxations for genuine cases where delays are due to administrative or procedural challenges beyond the taxpayer's control.
- **Periodic Reviews:** Conducting periodic reviews of the provision to assess its impact on businesses and make necessary adjustments based on stakeholder feedback.

**Simplifying ITC claim process**

To facilitate easier compliance and reduce disputes:

- **Technological Integration:** Leveraging technology to simplify the ITC claim process, ensuring seamless integration with business accounting systems.
- **Clear Guidelines:** Issuing clear guidelines and FAQs to help taxpayers understand the requirements and avoid inadvertent delays in claiming ITC.

**Conclusion**

The constitutionality of Section 16(4) of the CGST Act remains a contentious issue, with valid arguments on both sides. While the provision aims to ensure timely compliance and protect government revenue, it also poses challenges for businesses, potentially infringing upon their constitutional rights. Balancing the objectives of tax administration with the practical realities faced by businesses is crucial for a fair and efficient GST regime. By considering the recommendations and adopting a flexible approach, policymakers can address the concerns surrounding Section 16(4) and enhance the overall effectiveness of the GST framework in India.

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