International Review of Business, Trade, and Economics
ISSN: 3069-230X

PRIME OPEN ACCESS

Volume 2, Issue 4

Research Article

Date of Submission: 02 Aug, 2026
Date of Acceptance: 30 Aug, 2026
Date of Publication: 07 Sep, 2026

Input Tax Credit Reversal under Section 16(2)(c) of the CGST Act: Reconciling Revenue Protection with Taxpayer Rights and Constitutional Fairness

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Citation: Zeba, Input Tax Credit Reversal under Section 16(2)(c) of the CGST Act: Reconciling Revenue Protection with Taxpayer Rights and Constitutional Fairness. *Int Rev Bus Trades and Econ, 2*(4), 01-21.

Abstract

Input Tax Credit (ITC) constitutes one of the central features of the Goods and Services Tax (GST) regime in India. It is intended to prevent the cascading effect of taxation by permitting a registered person to set off eligible input tax against the tax liability arising on outward supplies. The availability of credit, however, is subject to the statutory conditions contained in section 16 of the Central Goods and Services Tax Act 2017 (CGST Act). Among these conditions, section 16(2)(c), which requires that the tax charged in respect of a supply be actually paid to the Government, has generated considerable litigation where a supplier fails to discharge the corresponding tax liability.

The resulting controversy raises a fundamental question: should a bona fide purchaser lose input tax credit because of a default committed by the supplier over whom the purchaser may have limited or no effective control? The issue becomes particularly significant where the recipient possesses a valid tax invoice, has actually received the goods or services, has paid the supplier the agreed consideration including GST, and has otherwise complied with the requirements of the GST law.

The judicial response has not always been uniform. Courts have emphasised different aspects of the statutory scheme, including the recipient's compliance, the department's obligation to investigate the supplier, revenue protection, and the prevention of fraudulent transactions. Decisions such as Suncraft Energy Pvt Ltd v Assistant Commissioner, State Tax demonstrate judicial concern with automatic reversal of ITC from a purchaser without appropriate proceedings against the supplier.

This article critically examines section 16(2)(c) from statutory, constitutional and judicial perspectives. It evaluates the competing claims of revenue protection and taxpayer fairness and considers whether blanket denial of ITC is proportionate where the purchaser has acted in good faith. It argues that GST enforcement should distinguish between genuine purchasers and participants in fraudulent arrangements. A risk-based verification mechanism, a bona fide purchaser protection, stronger action against defaulting suppliers and appropriate legislative clarification could provide a more balanced approach to the problem.

Keywords: Goods and Services Tax, Input Tax Credit, Section 16(2)(c), Supplier Default, Bona Fide Purchaser, Article 14, GST Litigation, Taxpayer Rights

Introduction

The introduction of the Goods and Services Tax (GST) marked a fundamental transformation in India's indirect tax system. With effect from 1 July 2017, GST replaced a number of central and state indirect taxes and sought to establish a substantially integrated tax structure based upon the principle of taxation of the supply of goods and services. The constitutional and statutory design of GST reflects an attempt to create a destination-based consumption tax in which the ultimate burden is intended to fall upon the final consumer rather than being repeatedly imposed upon successive

participants in the supply chain.

A functioning input tax credit mechanism is indispensable to achieving this objective. If tax paid at one stage of the supply chain cannot ordinarily be credited against the tax liability at the next stage, tax becomes embedded in the cost of the transaction. This produces a cascading effect and undermines the neutrality that a value-added tax system is intended to achieve. Input Tax Credit (ITC) therefore performs an important economic and legal function within the GST framework. It enables eligible registered persons to reduce their output tax liability by utilising the credit of input tax in accordance with the conditions prescribed by law.

Section 16 of the Central Goods and Services Tax Act 2017 (CGST Act) establishes the principal statutory framework governing entitlement to ITC. Section 16(1) recognises the entitlement of a registered person, subject to prescribed conditions and restrictions, to take credit of input tax charged on supplies used or intended to be used in the course or furtherance of business. Section

16(2), however, places conditions upon that entitlement. Among other requirements, the recipient must possess prescribed tax documentation, receive the goods or services, furnish the relevant return and satisfy the statutory requirement concerning payment of the tax to the Government.

It is the operation of section 16(2)(c) that has generated a particularly difficult legal controversy. The provision links the recipient's entitlement to ITC with the actual payment of the tax charged on the relevant supply to the Government. In practical terms, therefore, a recipient may find itself exposed to a serious difficulty when the supplier issues a genuine-looking invoice, collects GST from the recipient and supplies the goods or services, but subsequently fails to report the transaction correctly or fails to discharge the corresponding tax liability.

The problem can be illustrated through a simple commercial transaction. Assume that A purchases goods from B. B is a registered supplier and issues a valid tax invoice charging GST. A receives the goods, pays B the contractual consideration together with GST through a traceable banking transaction and records the transaction in its books. A then claims ITC in accordance with the GST law. Subsequently, the tax department discovers that B has failed to deposit the tax collected from A with the Government. The question then arises whether A should lose its ITC merely because B has failed to perform an obligation imposed upon B.

This problem exposes a structural tension within the GST system. On one side is the legitimate interest of the State in preventing fraudulent ITC claims, fictitious invoices, circular transactions and revenue leakage. On the other side is the principle that a genuine taxpayer should not ordinarily be made responsible for circumstances that are outside its reasonable control. The difficulty becomes particularly acute where there is no allegation that the purchaser participated in fraud, colluded with the supplier, fabricated documents or knew that the supplier would default.

The controversy is therefore not simply a technical dispute concerning accounting or tax administration. It concerns the allocation of risk within the GST supply chain. If the purchaser is required to bear the entire consequence of a supplier's tax default, the purchaser effectively assumes responsibility for ensuring the continuing tax compliance of another independent taxable person. Such a requirement may be commercially difficult because the recipient generally cannot compel a supplier to file returns, pay tax or maintain compliance after the transaction has been completed.

At the same time, the State has a substantial and legitimate interest in ensuring that ITC is not granted on transactions where the underlying tax has never entered the revenue system. GST operates through a chain of credits. If tax is claimed as credit at the recipient's end without corresponding payment at the supplier's end, the integrity of the credit chain may be compromised. The Government's concern is therefore not without justification. A rule requiring actual payment of tax to the Government can operate as an important safeguard against fictitious or fraudulent transactions.

The central legal question is consequently one of balance: how should the GST framework protect public revenue without transferring the entire risk of supplier non-compliance to an innocent recipient?

The question assumes greater significance because Indian courts have approached input tax credit through different doctrinal perspectives. In the pre-GST indirect tax context, the Supreme Court recognised the economic significance of credit under the MODVAT/CENVAT framework. In Eicher Motors Ltd v Union of India, the Supreme Court emphasised the relationship between credit and the tax-paid character of inputs, particularly in considering whether accumulated credit could retrospectively be taken away.1 In Collector of Central Excise v Dai Ichi Karkaria Ltd, the Court described validly taken MODVAT credit as indefeasible, subject to the statutory scheme and the circumstances in which credit could lawfully be denied or reversed.[2]

These decisions are significant for understanding the economic character of input tax credit, but they must not be treated as establishing that GST credit is an unconditional or absolute constitutional right. GST ITC is a statutory entitlement governed by the conditions prescribed by Parliament. The Supreme Court's decision in ALD Automotive Pvt Ltd v Commercial Tax Officer also demonstrates the importance of statutory conditions in determining entitlement

to input taxcredit. Accordingly, the more precise issue is not whether every form of ITC constitutes an absolute vested right, but whether the statutory conditions and their enforcement may fairly be applied to a recipient who has acted bona fide and complied with obligations within its control.

The constitutional dimension of the dispute is equally important. Article 14 of the Constitution requires State action to satisfy the requirements of equality and non-arbitrariness. A taxpayer may therefore question whether automatic denial of ITC to a genuine recipient is reasonable where the recipient has complied with all requirements capable of being performed by it and where the default is solely attributable to the supplier. Article 19(1)(g), which protects the freedom to practise a profession or carry on an occupation, trade or business, may also become relevant where tax demands arising from ITC denial impose substantial economic consequences on business activity. Article 300A further protects property from deprivation except by authority of law. These provisions do not necessarily invalidate section 16(2)(c), but they provide an important constitutional framework for examining the manner in which the provision is administered.

Judicial developments under GST demonstrate that courts have been particularly concerned with situations in which the tax department proceeds against the purchaser without adequately examining the conduct of the supplier. In Suncraft Energy Pvt Ltd v Assistant Commissioner, State Tax, the Calcutta High Court considered a case involving reversal of ITC where the department had not first undertaken appropriate enquiry against the supplier. The Court held that the department was not justified in reversing the ITC without conducting an enquiry regarding the supplier and taking appropriate action against the supplier.[3]

The importance of Suncraft Energy lies not in establishing an unrestricted right to ITC, but in demonstrating a judicial preference for a fact-sensitive approach. The question should not be reduced to whether the supplier's tax payment is reflected in the recipient's records. Instead, the authorities may need to examine the genuineness of the transaction, the recipient's conduct, the availability of documentary evidence, the supplier's status and the existence or absence of fraud or collusion.

The Supreme Court's subsequent proceedings concerning Suncraft Energy also demonstrate that the legal landscape should be approached cautiously rather than presenting any single High Court judgment as a final statement of nationwide law. The Supreme Court entertained the challenge to the Calcutta High Court decision in December 2023.[4]

The present article therefore examines section 16(2)(c) through four interconnected dimensions. First, it examines the statutory structure of ITC and the legislative purpose underlying the condition relating to actual payment of tax. Secondly, it evaluates the evolution of judicial thinking concerning the nature and economic significance of input tax credit. Thirdly, it considers the constitutional questions arising when ITC is denied to a bona fide purchaser because of supplier default. Finally, it evaluates whether the existing framework appropriately balances revenue protection against taxpayer rights and proposes possible reforms.

The central argument of this article is that revenue protection and taxpayer protection should not be treated as mutually exclusive objectives. Fraudulent ITC claims must be detected and appropriately penalised. However, enforcement should distinguish between a participant in a fraudulent arrangement and a purchaser who has undertaken a genuine commercial transaction and exercised reasonable diligence. A system that treats both categories identically risks undermining taxpayer confidence in the GST framework.

The issue is therefore not whether the Government should be permitted to recover revenue lost through supplier default. It is whether the entire economic consequence of that default should automatically be imposed upon a recipient who may have neither caused nor participated in the default. A more proportionate approach would combine effective action against defaulting suppliers with safeguards for bona fide recipients.

This article consequently asks whether section 16(2)(c), as interpreted and applied, strikes an appropriate balance between the State's interest in protecting revenue and the taxpayer's legitimate expectation of a workable and equitable credit mechanism. It argues that the GST system would be strengthened by moving towards a risk-based model in which the consequences of supplier default depend upon the recipient's conduct and the factual circumstances of the transaction rather than operating as an automatic consequence in every case.

Legal Framework of Section 16(2)(c) Statutory Framework of Input Tax Credit

The legal framework governing Input Tax Credit under GST is principally contained in Chapter V of the Central Goods and Services Tax Act 2017. Section 16 is specifically titled 'Eligibility and conditions for taking input tax credit'. Section 16(1) establishes the basic entitlement of a registered person to claim credit of input tax charged on supplies of goods or services, or both, which are used or intended to be used in the course or furtherance of business. The entitlement is expressly subject to statutory conditions and restrictions.[5]

The language of section 16 is significant because it demonstrates that ITC under GST is neither an unconditional concession nor an unrestricted entitlement. Parliament has created a statutory mechanism through which credit becomes available when the requirements established by the legislation are satisfied. The interpretation of those requirements

must therefore consider both the statutory text and the underlying purpose of the GST credit mechanism.

Section 16(2) imposes additional conditions upon the entitlement created by section 16(1). Broadly, the recipient must satisfy requirements concerning possession of a tax invoice or prescribed document, receipt of goods or services, payment of the tax to the Government and furnishing of the relevant return. These requirements seek to establish a connection between the claimed credit and a genuine taxable supply.

The statutory structure reflects a legitimate legislative objective. ITC cannot be permitted to become detached from actual supplies and actual tax liabilities because doing so could facilitate fraudulent credit claims. At the same time, the conditions must operate within the practical realities of commercial transactions, where the supplier and recipient are generally independent taxable persons.

Section 16(2)(c)

Section 16(2)(c) is particularly significant for the present discussion. It provides, subject to the statutory framework, that the registered person is not entitled to credit unless the tax charged in respect of the supply has actually been paid to the Government, either in cash or through utilisation of admissible input tax credit.[6]

The provision establishes a connection between the recipient's credit and the corresponding tax liability arising at the supplier's end. From the perspective of revenue protection, this connection is understandable. If the supplier collects GST from the purchaser but does not discharge the corresponding liability to the Government, permitting unrestricted credit to the purchaser may result in a situation where credit is available in the supply chain without corresponding tax revenue entering the Government's account.

The provision can therefore be understood as serving at least two important purposes. First, it seeks to maintain the integrity of the GST credit chain. Secondly, it seeks to prevent fraudulent or artificial transactions from generating tax credit. The Government's interest becomes especially compelling in cases involving fictitious invoices, non-existent suppliers, circular trading, accommodation entries or collusion between supplier and recipient.

However, the existence of these legitimate objectives does not automatically resolve the position of a bona fide recipient. Section 16(2)(c) gives rise to a difficult allocation-of-risk question: where the recipient has purchased goods or services in an apparently genuine transaction, paid the supplier the consideration and GST, received the supply and maintained appropriate records, but the supplier subsequently fails to pay the tax to the Government, should the recipient bear the entire consequence?

This question is particularly important because the recipient ordinarily does not possess the same legal powers as the tax administration to investigate the supplier's accounts, bank transactions, return filing or ultimate payment of tax. The purchaser can undertake commercial due diligence, but it cannot ordinarily compel the supplier to discharge its statutory tax liability.

Legislative Purpose Behind the Payment Condition

The payment requirement under section 16(2)(c) should therefore be viewed within the larger objective of protecting the integrity of GST revenue. GST depends upon a continuous chain of taxable supplies and corresponding credits. Where the tax collected at one stage is not paid to the Government, the subsequent credit may create a fiscal leakage.

The Government may consequently argue that requiring actual payment of tax is necessary to prevent the credit mechanism from becoming vulnerable to abuse. A more permissive approach could encourage arrangements in which suppliers issue invoices and collect GST but disappear without paying the corresponding tax. Such transactions could produce significant revenue losses, particularly where the purchaser claims substantial ITC.

The problem, however, arises when a rule designed to address fraudulent transactions is applied identically to genuine transactions. A statutory mechanism directed at preventing fraud should ideally distinguish between a recipient who knowingly participates in tax evasion and a recipient who has entered into an ordinary commercial transaction without knowledge of the supplier's subsequent default.

This distinction is important because the consequences of ITC denial can extend beyond the amount originally claimed. The recipient may face reversal of credit, interest and, depending upon the circumstances, additional proceedings under the GST law. The commercial effect can therefore be substantial.

Supplier Default and the Bona Fide Purchaser

The central controversy may be expressed through the concept of the 'bona fide purchaser'. A bona fide recipient is one who enters into a genuine transaction, receives the contracted goods or services, pays the consideration through legitimate means and does not participate in fraudulent conduct.

Where such a recipient is denied ITC solely because the supplier failed to pay the tax, the recipient effectively bears a

risk created by another taxable person. This raises questions of fairness because the recipient may have performed all obligations reasonably within its control.

The judicial response has increasingly emphasised the factual circumstances surrounding the transaction. In Suncraft Energy, the Calcutta High Court dealt with reversal of ITC where the recipient claimed to have fulfilled the statutory requirements and the department had not undertaken adequate enquiry against the supplier. The Court held that reversal could not simply be imposed without appropriate enquiry and action concerning the supplier.[7]

The significance of the decision is that it does not transform ITC into an unconditional entitlement. Rather, it emphasises procedural and factual fairness in applying the statutory framework. The department's powers to investigate a defaulting supplier remain important, particularly where the alleged default originates at the supplier's end.

Distinguishing Genuine Transactions from Fraudulent Transactions

Section 16(2)(c) must also be understood alongside the broader anti-fraud architecture of GST. The Government possesses various mechanisms for identifying suspicious transactions, examining return discrepancies, investigating suppliers and taking action against fraudulent taxpayers. The existence of these enforcement mechanisms raises a policy question as to whether denial of ITC to the purchaser should be automatic or should depend upon the purchaser's involvement in the irregularity.

A purchaser who has knowingly colluded with a fictitious supplier stands on an entirely different footing from a purchaser who has conducted a genuine transaction and subsequently discovers that the supplier has failed to discharge its tax liability. Treating both situations identically may create an unnecessarily harsh outcome.

This does not mean that every claim of good faith should be accepted automatically. A taxpayer claiming ITC should be capable of producing appropriate evidence of the transaction. Relevant evidence may include the tax invoice, purchase order, proof of receipt of goods or services, payment records, transport documentation where applicable, accounting entries and other commercially relevant records.

The appropriate legal approach may therefore require a factual assessment rather than an automatic assumption that supplier default necessarily establishes recipient wrongdoing.

The Need for a Balanced Interpretation

The interpretation of section 16(2)(c) should consequently seek to reconcile two legitimate objectives. The first is the protection of public revenue and prevention of fraudulent credit. The second is protection of genuine commercial taxpayers from consequences arising exclusively from another person's default.

The statutory language concerning actual payment of tax cannot simply be ignored. At the same time, its enforcement should be examined in light of the factual circumstances and the overall structure of GST. A recipient should not be presumed fraudulent merely because the supplier has failed to comply with its obligations.

This balanced approach also finds support in the broader judicial treatment of input tax credit. The Supreme Court's pre-GST decisions in Eicher Motors and Dai Ichi Karkaria recognised the important role of credit in a value-added tax system, while later GST jurisprudence has emphasised that entitlement remains subject to statutory conditions.[8] The correct legal question is therefore not whether ITC is an absolute property right independent of legislation, but whether statutory conditions are being applied in a manner consistent with their purpose and constitutional limitations.

Section 16(2)(c) should accordingly be interpreted as an important revenue-protection provision, but its application to bona fide recipients requires careful consideration of the transaction's genuineness, the recipient's conduct, the supplier's conduct, the existence of fraud or collusion and the investigative steps taken by the tax authorities.

The controversy surrounding section 16(2)(c) thus represents a broader challenge for GST jurisprudence: how can the State maintain an effective and fraud-resistant credit system without converting every supplier's default into an automatic financial liability for an otherwise compliant recipient? The answer to this question requires examination not only of the statutory text but also of judicial developments, constitutional principles and comparative approaches to value-added taxation.

Evolution of ITC as a Vested Right Introduction

The legal character of Input Tax Credit (ITC) has evolved considerably through Indian indirect tax jurisprudence. Before the introduction of the Goods and Services Tax (GST), courts were required to examine the nature of credit under the MODVAT and CENVAT regimes and under various State value-added tax laws. Although these earlier decisions did not directly interpret section 16 of the Central Goods and Services Tax Act 2017 (CGST Act), they provide an important foundation for understanding the economic and legal significance of tax credit.

The earlier jurisprudence demonstrates two apparently competing propositions. On the one hand, courts recognised

that credit generated through payment of tax on inputs could acquire substantial legal and economic significance for the taxpayer. On the other hand, the Supreme Court has also repeatedly recognised that input tax credit operates within a statutory framework and may therefore be subject to conditions imposed by the legislature.

This distinction is particularly important in the context of section 16(2)(c) of the CGST Act. The argument that ITC has significant legal value cannot automatically be converted into an argument that every claim to GST credit is an absolute or constitutionally protected right. The stronger proposition is that once the statutory conditions for credit are satisfied, the credit acquires substantial economic importance and its denial must be examined according to the statutory scheme and constitutional principles.

Eicher Motors Ltd v Union of India: Credit as an Accrued Benefit

One of the most important decisions concerning the character of tax credit is Eicher Motors Ltd v Union of India. The case arose under the Central Excise regime and concerned the retrospective lapse of accumulated MODVAT credit through an amendment to the relevant rules. The Supreme Court considered whether credit that had accrued under the existing statutory scheme could subsequently be extinguished in respect of inputs already subjected to duty.[9]

The Court's reasoning is important because it recognised the relationship between payment of tax on inputs and the subsequent utilisation of the corresponding credit. The Court observed, in substance, that when the assessee had paid tax on inputs with the understanding that such tax would be adjusted against the duty payable on subsequently manufactured goods, a right had accrued to the assessee.[10]

The significance of Eicher Motors lies in the Court's recognition of the credit mechanism as an integral component of the value-added tax structure. The credit was not treated merely as an administrative favour that could be retrospectively withdrawn without regard to transactions already completed under the existing legal framework.

However, the decision must be used carefully in GST scholarship. Eicher Motors did not concern the CGST Act and did not decide whether GST ITC constitutes an absolute property right. Its importance is instead jurisprudential. It demonstrates that tax-credit mechanisms can create legally significant interests once the taxpayer has fulfilled the conditions prescribed by the applicable statutory scheme.

This reasoning becomes relevant to the supplier-default controversy. Where a recipient has entered into a genuine transaction, paid the applicable tax to the supplier and complied with the requirements imposed upon the recipient, the subsequent disappearance or default of the supplier may raise a different question from a case in which the transaction itself is fictitious. The distinction between an accrued credit arising from a genuine transaction and a fraudulent claim should therefore remain central to the analysis.

Dai Ichi Karkaria: The Economic Character of Tax Credit

The Supreme Court's decision in Collector of Central Excise, Pune v Dai Ichi Karkaria Ltd provides another significant stage in the development of Indian tax-credit jurisprudence. The dispute concerned the MODVAT scheme and the treatment of credit arising from duty paid on inputs.[11]

The Court examined the functioning of the MODVAT mechanism as a system designed to prevent cascading taxation. The scheme allowed duty paid on inputs to be taken into account while determining the ultimate duty burden on manufactured goods. The judgment is therefore relevant to the broader principle that input credit is closely connected with the value-added character of indirect taxation.

The importance of Dai Ichi Karkaria for the present article lies in understanding ITC as part of the architecture of indirect taxation rather than as an isolated concession detached from the taxable supply chain. Credit exists because tax has already been suffered at an earlier stage and is intended, subject to statutory requirements, to prevent the same economic value from bearing tax repeatedly.

This principle helps explain why disputes over ITC have consequences beyond an ordinary claim for a tax benefit. Denial of credit can increase the effective tax burden borne by a business and may therefore undermine the neutrality of a value-added tax system.

Nevertheless, Dai Ichi Karkaria must also be distinguished from the present GST framework. The case was decided under the Central Excise Act and the MODVAT scheme. It therefore cannot be cited as authority for the proposition that every GST credit claim is indefeasible regardless of the conditions contained in the CGST Act.

Its continuing value is conceptual: tax credit performs a substantive role in preventing cascading and preserving the economic structure of value-added taxation.

ALD Automotive Pvt Ltd v Commercial Tax Officer: Statutory Conditions Matter

The Supreme Court's decision in ALD Automotive Pvt Ltd v Commercial Tax Officer introduces an important qualification

to the broader argument concerning the legal significance of ITC. The case arose under the Tamil Nadu Value Added Tax Act 2006 and concerned the statutory time limit governing a claim for input tax credit.[12]

The Supreme Court upheld the statutory condition and rejected the argument that the procedural requirement could simply be disregarded because the taxpayer otherwise possessed an entitlement to credit. The Court emphasised that ITC operates within the conditions established by the relevant legislation.[13]

The decision is particularly important because it prevents an overly broad interpretation of Eicher Motors and Dai Ichi Karkaria. Those decisions cannot be read as establishing that once a taxpayer has paid tax on inputs, the resulting credit is immune from every statutory restriction.

The better understanding is that the legislature creates the right to claim ITC and simultaneously defines the circumstances in which that right may be exercised. Compliance with those conditions is therefore an essential part of the statutory entitlement.

At the same time, ALD Automotive should not be interpreted as resolving the supplier-default controversy under GST. The case concerned a statutory time limit under a State VAT enactment, rather than the situation in which an otherwise genuine purchaser loses credit because of a supplier's failure to discharge tax. The factual and statutory contexts are materially different.

The significance of ALD Automotive for the present research is consequently limited but important: GST ITC is a statutory entitlement whose exercise is governed by legislative conditions; however, the existence of statutory conditions does not answer whether every supplier default should automatically be attributed to the recipient.

From "Vested Right" to "Statutory Entitlement with Economic Value"

The three decisions reveal an important development in judicial thinking.
Eicher Motors emphasises the legal significance of credit that has accrued under an existing statutory scheme. Dai Ichi Karkaria demonstrates the importance of credit to the operation of a value-added tax system. ALD Automotive, however, emphasises that credit remains controlled by the conditions prescribed by the legislature.

Taken together, these decisions suggest that describing ITC simply as a "vested right" may be insufficiently precise. A more accurate proposition is that ITC is a statutory entitlement having significant economic and legal value, the exercise of which remains subject to legislative conditions.

This distinction is critical for the constitutional analysis that follows in this article.

If ITC were treated as an absolute constitutional right, any statutory restriction might appear constitutionally suspect. Such a position would conflict with the established principle that tax legislation may prescribe conditions for obtaining and utilising tax benefits. Conversely, if ITC were regarded as nothing more than an entirely discretionary concession, the economic and structural importance of the credit mechanism would be underestimated.

The appropriate position lies between these two extremes.

GST legislation creates a structured entitlement to credit. The recipient must satisfy the statutory conditions before that entitlement becomes available. Once those conditions are substantially satisfied, however, the resulting credit has real economic consequences for the taxpayer. The State's power to regulate credit cannot therefore be examined entirely independently of the principles of fairness, proportionality and non-arbitrariness.

The GST Framework and the Distinct Position of Section 16

The introduction of GST altered the legal architecture of input tax credit. Under section 16(1) of the CGST Act, a registered person is entitled, subject to prescribed conditions and restrictions, to

claim credit of input tax charged on supplies used or intended to be used in the course or furtherance of business.14

The wording itself demonstrates that the GST entitlement is conditional. Unlike a theory of absolute vested rights, the GST framework expressly connects entitlement to compliance with statutory requirements.

Section 16(2) then establishes specific conditions relating to documentation, receipt of goods or services, furnishing of returns and payment of the tax charged on the supply to the Government. Section 16(2)(c) is therefore part of the legislative architecture defining the circumstances in which credit may be taken.

The GST framework consequently requires a distinction between two questions:

First, whether ITC is a statutory entitlement capable of acquiring substantial legal and economic value; and

Secondly, whether the statutory conditions governing that entitlement have been satisfied in a particular case.

The answer to the first question should not eliminate the second. At the same time, the second question should not be applied in a manner that ignores the factual distinction between genuine transactions and fraudulent arrangements.

Supplier Default: The Problem Created by the GST Credit Chain

The supplier-default problem exposes the limits of applying the earlier jurisprudence mechanically.

Suppose a purchaser receives genuine goods from a registered supplier. The supplier issues a tax invoice and charges GST. The purchaser pays the supplier the full amount, including GST, through a legitimate banking transaction. The purchaser records the transaction and claims ITC. Subsequently, the supplier fails to deposit the tax with the Government. The purchaser's position is fundamentally different from that of a person who knowingly purchases a fictitious invoice. In the latter situation, there may be no genuine supply at all and the credit claim may be fraudulent. In the former, the underlying transaction exists, the goods have moved and the purchaser may have performed every obligation reasonably within its control.

The legal difficulty is that section 16(2)(c) focuses upon actual payment of tax to the Government. Consequently, the purchaser's entitlement may become vulnerable because of an event occurring at the supplier's end.

This creates an allocation-of-risk problem that was not directly considered in Eicher Motors, Dai Ichi Karkaria or ALD Automotive. Those cases help establish the nature and statutory character of ITC, but they do not provide a complete answer to the question whether a bona fide GST recipient should bear the consequences of an independent supplier's default.

Why Earlier Cases Cannot Be Applied Mechanically

A publication-quality analysis must therefore avoid treating the earlier decisions as if they collectively establish an unrestricted right to GST credit.

First, Eicher Motors dealt with accumulated MODVAT credit and retrospective extinguishment under the Central Excise regime.

Secondly, Dai Ichi Karkaria concerned the MODVAT mechanism and the treatment of credit under excise law.

Thirdly, ALD Automotive concerned a statutory limitation on claiming ITC under Tamil Nadu VAT law and confirmed the legislature's power to impose conditions upon credit.

The GST regime contains its own statutory framework, including section 16 of the CGST Act. The interpretation of section 16(2)(c) must therefore ultimately be based upon the text and structure of GST legislation.

Nevertheless, the earlier cases remain relevant because they demonstrate why credit should not be viewed as economically insignificant. GST is a value-added tax, and the credit mechanism is essential to preventing cascading. Consequently, a statutory condition that results in substantial denial of credit should be examined with attention to the purpose of the credit system and the factual conduct of the taxpayer.

Emerging Principle

The jurisprudence can therefore be understood through three propositions.

- First, ITC is not merely an administrative rebate. It is an important component of the value-added tax mechanism and has substantial economic significance.
- Secondly, ITC is not an absolute constitutional entitlement independent of legislation. Parliament may prescribe conditions, restrictions and procedures governing its availability.
- Thirdly, the statutory character of ITC does not necessarily mean that every consequence arising from another taxpayer's default should automatically be imposed upon a genuine recipient. The application of statutory conditions must still be considered in light of the nature of the transaction, the conduct of the recipient, the purpose of the provision and applicable constitutional principles.

This understanding provides a more balanced foundation for examining section 16(2)(c). The question is not whether the purchaser possesses an unconditional right to credit. Rather, it is whether a statutory condition designed to protect revenue should operate in the same manner against a fraudulent participant and a bona fide recipient who has undertaken a genuine taxable transaction.

Conclusion

The evolution of Indian ITC jurisprudence therefore does not support a simple binary classification of credit as either an absolute vested right or a mere concession. The decisions demonstrate a more nuanced position.

Eicher Motors illustrates the legal significance of credit that has accrued under a statutory scheme. Dai Ichi Karkaria highlights the role of credit in preventing cascading within a value-added tax system. ALD Automotive establishes that the entitlement remains subject to statutory conditions and that courts cannot disregard conditions merely because the taxpayer considers the credit substantively justified.

For GST purposes, the most defensible proposition is consequently that ITC is a statutory entitlement of substantial economic value, subject to the conditions and restrictions imposed by Parliament.

This formulation is particularly useful in analysing section 16(2)(c). It recognises the State's legitimate authority to establish safeguards against fraudulent credit while also leaving room to examine whether the application of those safeguards to bona fide recipients is fair, proportionate and consistent with constitutional requirements.

The next stage of the analysis is therefore the constitutional dimension. If a genuine recipient loses ITC solely because of an independent supplier's default, the question arises whether such an outcome can withstand scrutiny under Articles 14, 19(1)(g) and 300A of the Constitution. That issue forms the basis of the following section.

Constitutional Challenges to Section 16(2)(c) Article 14: Equality and Non-Arbitrariness

Article 14 of the Constitution of India guarantees equality before the law and equal protection of the laws. Over time, judicial interpretation has expanded Article 14 beyond formal equality and established that arbitrary State action is inconsistent with constitutional principles. Consequently, even when a statutory provision pursues a legitimate objective, its application must remain fair, reasonable and non-arbitrary.[15]

The controversy surrounding section 16(2)(c) raises an important question in this context. A distinction may be drawn between two categories of recipients. The first category consists of persons who knowingly participate in fraudulent arrangements involving fake invoices, circular transactions or non-existent suppliers. The second category includes genuine purchasers who receive goods or services, pay the consideration along with GST, maintain proper documentation and have no involvement in any tax evasion scheme.

From a constitutional perspective, treating both categories identically may give rise to concerns of arbitrariness. A bona fide purchaser and a fraudulent participant are not similarly situated. While the State is justified in taking strict action against fraudulent taxpayers, the automatic denial of ITC to a genuine purchaser may produce an outcome that appears disconnected from the recipient's actual conduct.

The principle of proportionality also becomes relevant. Modern constitutional jurisprudence increasingly recognises that State action should not impose burdens that are excessive in relation to the objective sought to be achieved.[16] Revenue protection is undoubtedly a legitimate objective. However, where the tax authorities possess extensive investigative powers against the defaulting supplier, it may be questioned whether immediate denial of credit to the recipient is always the least restrictive method of protecting revenue.

Several High Courts have expressed concern regarding situations where authorities proceed directly against the recipient without adequately investigating the supplier whose conduct allegedly caused the loss of revenue. Such judicial observations reflect a broader concern that responsibility should not automatically be shifted to a purchaser who may have acted in good faith.[17]

Accordingly, Article 14 does not necessarily invalidate section 16(2)(c), but it requires careful examination of whether the provision is applied in a manner that reasonably distinguishes between fraudulent conduct and genuine commercial transactions.

Article 19(1)(g): Right to Carry on Business

Article 19(1)(g) guarantees the freedom to practise any profession or to carry on any occupation, trade or business. Although this freedom is subject to reasonable restrictions under Article 19(6), tax legislation cannot be completely insulated from constitutional scrutiny merely because it concerns fiscal matters.

Input Tax Credit represents a significant component of business liquidity under the GST regime. Businesses often calculate pricing, profitability and working capital requirements on the assumption that eligible credit will be available for utilisation against future tax liabilities. When substantial amounts of ITC are denied or reversed, the financial consequences may be considerable.

The denial of ITC may increase the effective cost of procurement and reduce available working capital. For small and medium enterprises in particular, the reversal of credit can create serious cash-flow difficulties. The economic burden may become even greater when interest liability is added to the amount sought to be recovered by the tax authorities.

It is important to recognise that no business possesses a constitutional right to claim tax benefits contrary to statutory provisions. Nevertheless, constitutional concerns arise when the burden imposed upon a business bears little relationship

to its own conduct. A purchaser who has complied with every obligation reasonably within its control may still face substantial financial consequences because of a supplier's independent default.

The constitutional issue is therefore not whether tax regulation is permissible. Rather, the question is whether the manner in which section 16(2)(c) is enforced places an unreasonable burden upon legitimate business activity. A balanced interpretation should seek to preserve the Government's ability to combat tax evasion while avoiding unnecessary disruption to genuine commercial transactions.

Article 300A: Protection of Property

Article 300A provides that no person shall be deprived of property except by authority of law. Although the right to property is no longer a fundamental right, it remains a constitutional right and continues to play an important role in protecting economic interests.

The application of Article 300A to ITC requires careful analysis. It would be inaccurate to argue that every claim to input tax credit automatically constitutes property in the constitutional sense. The Supreme Court has consistently recognised that entitlement to tax credit arises from the statutory framework established by the legislature.[18]

At the same time, once credit becomes available under the law, it acquires undeniable economic value. Businesses often rely upon such credit in financial planning, pricing decisions and tax compliance strategies. Consequently, the denial or reversal of credit affects more than a mere accounting entry; it may have tangible economic consequences.

For this reason, some scholars have argued that accrued or available credit should be regarded as an economic interest deserving constitutional consideration. The stronger argument, however, is not that ITC constitutes an absolute property right. Rather, it is that the deprivation of valuable economic benefits should occur strictly in accordance with law and through a fair application of statutory provisions.

The Article 300A challenge must therefore be presented cautiously. Courts are unlikely to accept an argument that GST credit exists independently of legislation. However, Article 300A remains relevant in assessing whether statutory powers are exercised fairly and consistently with the purpose of the legislation.

Proportionality and Legitimate State Interest

Any constitutional evaluation of section 16(2)(c) must acknowledge the legitimate interests pursued by the Government. GST has faced significant challenges arising from fake invoices, fraudulent credit claims, shell entities and organised tax evasion schemes. Protecting public revenue and preserving the integrity of the credit mechanism are unquestionably valid governmental objectives.

The constitutional debate therefore does not concern the legitimacy of revenue protection itself. Instead, it concerns the methods adopted to achieve that objective.

A proportionality-based approach requires consideration of whether less restrictive alternatives are available. One possibility is a supplier-focused enforcement strategy under which tax authorities first undertake effective recovery proceedings against the defaulting supplier before proceeding against the recipient. Another approach may involve risk-based compliance mechanisms that distinguish between high-risk and low-risk transactions.

Similarly, the concept of recipient due diligence may provide a more balanced framework. A purchaser who verifies the supplier's registration, maintains proper documentation, receives actual goods or services and makes payment through traceable channels stands on a different footing from a purchaser who ignores obvious indicators of fraud.

The existence of alternative enforcement mechanisms suggests that revenue protection need not always require automatic denial of ITC. A proportionate approach may allow the Government to combat tax fraud effectively while reducing hardship for genuine taxpayers.

Bona Fide Purchaser and Constitutional Fairness

The concept of the bona fide purchaser provides the most compelling constitutional lens through which section 16(2)(c) may be evaluated.

A bona fide purchaser is one who enters into a genuine transaction, receives the contracted goods or services, pays the agreed consideration including GST and possesses no knowledge of any fraudulent conduct on the part of the supplier. Such a purchaser may undertake reasonable commercial diligence but cannot ordinarily control the supplier's future compliance with tax obligations.

In these circumstances, automatic denial of ITC may produce a disproportionate transfer of risk from the supplier to the recipient. The supplier is the person responsible for depositing the collected tax with the Government. Yet the financial consequences of the supplier's failure may ultimately fall upon the purchaser.

This outcome raises questions of constitutional fairness. While the State is justified in preventing abuse of the credit mechanism, a distinction should be maintained between a participant in tax fraud and a recipient who has acted honestly and reasonably. The absence of such a distinction risks undermining confidence in the GST framework and placing excessive compliance burdens upon genuine businesses.

Accordingly, the constitutional challenge to section 16(2)(c) should not be framed as a conflict between taxpayer rights and revenue protection. Rather, it should be viewed as an effort to achieve an appropriate balance between the two. Revenue interests must be safeguarded, but the law should also recognise the position of taxpayers who have engaged in legitimate commercial activity and exercised reasonable diligence.

The central constitutional concern, therefore, is not the existence of section 16(2)(c) itself. The real issue is whether its application adequately distinguishes between fraudulent conduct and bona fide transactions. A system that fails to recognise this distinction may risk imposing a burden that is disproportionate to the recipient's actual role in the alleged non-compliance.

"The constitutional concerns identified above do not conclusively determine the legality of section 16(2)(c); however, they provide the analytical framework within which the divergent judicial approaches examined in the next chapter must be understood."

Judicial Trends and Conflicting High Court Approaches Introduction

The controversy surrounding section 16(2)(c) of the CGST Act has generated substantial judicial debate across various High Courts in India. The central issue has remained largely consistent: whether a recipient who has genuinely purchased goods or services, paid the applicable GST and complied with statutory requirements can be denied Input Tax Credit (ITC) because the supplier subsequently failed to deposit the tax with the Government.

Judicial responses reveal the existence of two competing approaches. One approach emphasises taxpayer protection and focuses on the bona fide nature of the transaction. The other approach gives greater weight to the statutory conditions governing ITC and the necessity of safeguarding public revenue. As a result, Indian jurisprudence on supplier-default cases has developed through a series of decisions that reflect an ongoing attempt to balance fairness to taxpayers with the objectives of tax administration.

The divergence among judicial decisions demonstrates that the controversy is not merely about the interpretation of a single statutory provision. Rather, it concerns a broader question regarding the allocation of risk within the GST system: should the consequences of supplier non¬compliance be borne entirely by the purchasing dealer, or should responsibility primarily remain with the supplier who collected but failed to remit the tax?

Judicial Decisions Favouring Taxpayers

- **D.Y. Beathel Enterprises v State Tax Officer**

One of the earliest and most influential decisions favouring taxpayers was delivered by the Madras High Court in D.Y. Beathel Enterprises v State Tax Officer.19

In this case, the purchasing dealer had acquired goods from registered suppliers, paid consideration through banking channels and claimed ITC on the basis of valid tax invoices. Subsequently, the tax authorities discovered that the suppliers had failed to deposit GST with the Government. Instead of initiating effective recovery proceedings against the suppliers, the department sought to recover the tax directly from the purchaser.

The Madras High Court criticised this approach and observed that the suppliers were the primary persons liable to discharge the tax collected from customers. The Court emphasised that authorities could not automatically shift the entire burden onto the purchaser without first pursuing the defaulting suppliers.

The significance of D.Y. Beathel lies in its recognition of commercial reality. The Court acknowledged that a purchaser ordinarily has limited control over the supplier's subsequent tax compliance. Once payment has been made and goods have been received, the purchaser cannot compel the supplier to deposit tax with the Government. The judgment therefore introduced an important principle of fairness into GST adjudication.

- **Suncraft Energy Pvt Ltd v Assistant Commissioner, State Tax**

The Calcutta High Court further strengthened taxpayer protection in Suncraft Energy Pvt Ltd v Assistant Commissioner, State Tax.[20]

The dispute arose when the department reversed ITC because certain invoices were not reflected in the recipient's GSTR-2A. The taxpayer contended that it had received the supplies, possessed valid invoices and paid the supplier including the GST component.

The Court found it significant that the authorities had not conducted adequate enquiry against the supplier before

proceeding against the recipient. It held that recovery proceedings should ordinarily be initiated against the defaulting supplier and that action against the recipient should be treated as an exceptional measure rather than the primary response.[21]

The judgment reflects a judicial preference for a fact-sensitive approach. Instead of presuming wrongdoing merely because the supplier failed to comply with tax obligations, the Court examined whether the recipient had acted bona fide and whether the department had exhausted available remedies against the supplier.

- **Emerging Taxpayer-Friendly Principle**

A common theme running through these decisions is the recognition that genuine taxpayers should not automatically be penalised for circumstances beyond their control. Courts adopting this approach generally focus on factors such as:

- existence of genuine transactions;
- possession of valid tax invoices;
- proof of payment through banking channels;
- receipt of goods or services;
- absence of fraud or collusion; and
- failure of authorities to pursue the defaulting supplier.

This line of reasoning does not eliminate the statutory requirements contained in section 16(2)(c). Rather, it seeks to ensure that the provision is applied in a manner consistent with fairness and commercial reality.

Judicial Decisions Supporting Revenue Interests

Not all judicial decisions have adopted a taxpayer-centric approach. Certain courts have emphasised that ITC is fundamentally a statutory entitlement and that compliance with statutory conditions remains essential.

Under this view, section 16(2)(c) expressly links the availability of ITC with actual payment of tax to the Government. Since the legislature has consciously imposed this requirement, courts should be cautious about diluting it through judicial interpretation.

Revenue-oriented decisions generally proceed on three assumptions.

First, GST functions through a chain of credits and liabilities. If credit is permitted where tax has never reached the Government, the integrity of the system may be compromised.

Secondly, fraudulent transactions often appear genuine on their face. Mere possession of invoices may therefore be insufficient to establish entitlement.

Thirdly, the legislature possesses broad authority to prescribe conditions governing tax benefits, including conditions designed to prevent revenue leakage.

From this perspective, strict enforcement of section 16(2)(c) is viewed as a necessary safeguard against misuse of the GST credit mechanism.

The Judicial Conflict

The apparent conflict among decisions does not arise because courts disagree on the importance of preventing tax fraud. Virtually every judgment recognises that fake invoices and fraudulent ITC claims present serious challenges for tax administration.

The real disagreement concerns the treatment of bona fide purchasers.

Taxpayer-friendly decisions emphasise fairness and practical limitations faced by recipients. Revenue-oriented decisions focus upon the statutory wording of section 16(2)(c) and the need to preserve fiscal discipline.

Consequently, courts have often reached different conclusions regarding the following questions:

- Must authorities first proceed against the supplier?
- Is proof of genuine purchase sufficient?
- Can ITC be denied even where the recipient acted in good faith?
- What degree of due diligence is expected from the purchaser?
- How should the burden of proof be allocated?

The absence of uniform answers has resulted in continuing uncertainty for taxpayers and administrators alike.

Comparative Judicial Analysis

Case	Court	Broad Approach	Key Principle
D.Y. Beathel Enterprises	Madras High Court	Taxpayer-oriented	Recovery should ordinarily begin with the supplier
Suncraft Energy Pvt Ltd	Calcutta High Court	Taxpayer-oriented	Investigation against supplier is essential before proceeding against recipient
Revenue-oriented decisions under strict statutory interpretation	Various High Courts	Revenue-oriented	ITC remains subject to statutory conditions including section 16(2)(c)

Table: 1

The table demonstrates that courts have generally been required to choose between two competing concerns: protection of genuine taxpayers and protection of public revenue.

Critical Evaluation of Judicial Approaches

Neither judicial approach is entirely free from difficulty.

A purely taxpayer-oriented approach may weaken the effectiveness of anti-fraud measures and create opportunities for abuse. Tax authorities may face significant challenges in recovering revenue where suppliers become insolvent, disappear or operate through fictitious entities.

Conversely, an excessively strict interpretation may impose severe burdens upon honest taxpayers. If purchasers remain exposed to ITC reversal despite exercising reasonable diligence, commercial certainty may be undermined. Businesses would effectively become guarantors of their suppliers' future tax compliance.

A more balanced approach appears preferable. Such an approach would permit authorities to deny ITC where fraud, collusion or wilful blindness is established, while protecting recipients who can demonstrate genuine transactions and reasonable diligence.

This model would better align with constitutional principles discussed in the previous chapter and would allow revenue protection without imposing disproportionate burdens on legitimate commercial activity.

Conclusion

The judicial landscape relating to section 16(2)(c) reveals a continuing struggle to reconcile two legitimate objectives: protection of government revenue and protection of bona fide taxpayers.

Cases such as D.Y. Beathel Enterprises and Suncraft Energy demonstrate judicial concern for fairness and procedural justice where recipients have acted in good faith. At the same time, courts have consistently acknowledged that ITC is a statutory entitlement subject to legislative conditions.

The emerging lesson from the case law is that supplier-default disputes cannot be resolved through a rigid rule applied uniformly in every situation. The factual circumstances of each case, the conduct of the recipient, the conduct of the supplier and the presence or absence of fraud remain crucial considerations.

Revenue Protection versus Taxpayer Rights Introduction

The debate surrounding section 16(2)(c) of the Central Goods and Services Tax Act 2017 ultimately reflects a conflict between two legitimate objectives. On one side lies the Government's responsibility to safeguard public revenue and prevent misuse of the GST system. On the other side stands the expectation of genuine taxpayers that they should not suffer adverse consequences for circumstances beyond their control.

The issue is particularly significant because GST is built upon the principle of seamless flow of input tax credit. The denial of credit not only increases the tax burden on businesses but may also disrupt the neutrality that GST seeks to achieve. At the same time, unrestricted availability of credit could expose the tax system to fraud, fake invoices and organised tax evasion.

The challenge therefore is not whether revenue protection or taxpayer rights should prevail absolutely. Rather, the challenge is to identify an appropriate balance that protects the integrity of the tax system while ensuring fairness to compliant taxpayers.

Government's Interest in Revenue Protection

The introduction of GST was accompanied by expectations of improved tax compliance and enhanced revenue collection. However, the GST regime has also faced significant challenges arising from fraudulent practices such as fake invoicing, circular trading and the creation of shell entities solely for the purpose of generating artificial input tax credit.[22]

In many cases, fictitious suppliers issue invoices without any actual supply of goods or services. These invoices are then used to claim credit, resulting in substantial revenue losses to the Government. Such practices undermine both the fiscal objectives of GST and public confidence in the tax system.

Section 16(2)(c) must therefore be understood within the broader framework of revenue protection. By linking the recipient's entitlement to credit with the actual payment of tax to the Government, the legislature sought to ensure that credit is supported by corresponding tax revenue. The provision serves as a safeguard against situations where credit enters the system without the underlying tax ever reaching the Government treasury.

From the perspective of tax administration, a strict approach also discourages taxpayers from engaging with suspicious suppliers. Businesses are encouraged to exercise due diligence and verify the compliance status of their suppliers before entering into commercial transactions.

The Government therefore argues that section 16(2)(c) is necessary not only to prevent fraud but also to preserve the credibility and sustainability of the GST framework itself.

Concerns of Genuine Taxpayers

While the objective of revenue protection is legitimate, the operation of section 16(2)(c) creates significant concerns for genuine taxpayers.

In an ordinary commercial transaction, a purchaser has limited control over the supplier's subsequent conduct. The purchaser may verify registration details, obtain a valid tax invoice, receive the goods or services and make payment through banking channels. However, the purchaser cannot compel the supplier to file returns correctly or deposit tax with the Government after the transaction has been completed.

This practical limitation forms the basis of the taxpayer's grievance. Where the recipient has fulfilled every obligation reasonably within its control, denial of ITC appears to shift the consequences of the supplier's misconduct onto an innocent party.

The economic impact of such denial can be substantial. Businesses often rely on the availability of ITC while determining pricing structures, budgeting cash flows and calculating profitability. Reversal of credit may increase the effective tax burden and create liquidity problems, particularly for small and medium-sized enterprises.

Furthermore, the recipient may be required to pay not only the disputed tax amount but also interest and, in certain circumstances, penalties. The cumulative financial effect can be severe despite the absence of any wrongdoing by the purchaser.

Consequently, taxpayers argue that section 16(2)(c) should not be applied mechanically in every case of supplier default. Instead, authorities should distinguish between fraudulent arrangements and genuine commercial transactions.

The Problem of Risk Allocation

At the heart of the controversy lies a question of risk allocation.

Every tax system must determine who should bear the consequences when one participant in a transaction fails to comply with legal obligations. Under section 16(2)(c), the risk of supplier non-compliance may ultimately fall upon the recipient claiming credit.

This approach raises important concerns because the supplier is the person directly responsible for depositing tax with the Government. The supplier collects GST from the purchaser and assumes the statutory obligation to remit that amount. If the supplier subsequently defaults, shifting the entire burden to the recipient may appear inconsistent with ordinary principles of responsibility.

Supporters of a stricter interpretation argue that such risk allocation encourages vigilance among purchasers. Critics, however, contend that it imposes obligations that are difficult, and sometimes impossible, for businesses to fulfil.

The difficulty becomes particularly evident when the supplier becomes insolvent, absconds or ceases business operations. In such circumstances, the recipient may face tax demands despite having acted honestly and prudently throughout the transaction.

The controversy therefore extends beyond tax law and enters the broader realm of fairness and commercial reasonableness.

Balancing Revenue Protection and Fairness

A sustainable GST framework requires more than efficient tax collection. It must also command the confidence of businesses that participate in the tax system.

If taxpayers perceive that compliance with their own obligations does not protect them from adverse consequences arising from another person's misconduct, confidence in the credit mechanism may weaken. Businesses may become reluctant to engage with new suppliers or may incur additional compliance costs attempting to monitor matters beyond their control.

At the same time, excessive leniency could encourage fraudulent transactions and create opportunities for abuse. Any balanced solution must therefore recognise both realities.

The emerging judicial trend suggests that the focus should shift towards the genuineness of the transaction. Where evidence establishes actual supply, valid documentation, payment through traceable channels and absence of collusion, the recipient's position deserves greater protection.

Conversely, where authorities can demonstrate fraud, knowledge of irregularities or deliberate participation in tax evasion schemes, denial of ITC is fully justified.

This distinction permits effective enforcement without treating all recipients as potential wrongdoers.

Due Diligence as a Middle Path

One possible solution lies in the concept of reasonable due diligence.

Rather than imposing absolute liability upon recipients or granting unconditional protection, the law could evaluate whether the purchaser exercised reasonable care before claiming credit.

Relevant factors may include:

- verification of GST registration;
- examination of invoices and supporting documents;
- confirmation of receipt of goods or services;
- payment through banking channels;
- maintenance of proper accounting records; and
- compliance with statutory return requirements.

A purchaser who satisfies these requirements demonstrates a genuine attempt to comply with the law. Such conduct should carry significant weight when authorities assess entitlement to credit.

The due diligence approach creates incentives for compliance while avoiding the harsh consequences of automatic ITC denial.

The Need for a Risk-Based Enforcement Model

Modern tax administration increasingly relies on risk-based enforcement rather than blanket restrictions.

Under a risk-based approach, authorities focus investigative resources on transactions that exhibit indicators of fraud, such as non-existent suppliers, abnormal transaction patterns or suspicious invoicing practices. Genuine businesses operating through ordinary commercial channels face reduced compliance burdens.

Applying this principle to section 16(2)(c) would allow authorities to distinguish between high-risk and low-risk transactions. Recovery efforts could primarily target fraudulent suppliers while protecting recipients who can establish good faith and reasonable diligence.

Such an approach would better align with both constitutional principles and commercial realities.

Critical Analysis

The present framework reflects a legitimate concern for protecting public revenue. However, its application can sometimes produce outcomes that appear disproportionate when viewed from the perspective of bona fide recipients.

The law should recognise that recipients and suppliers occupy different positions within the GST chain. While suppliers control the payment of tax to the Government, recipients generally do not. Consequently, a rule that automatically transfers the supplier's default to the purchaser may create an imbalance between responsibility and liability.

A more nuanced approach would preserve the Government's ability to combat fraud while recognising the practical limitations faced by genuine taxpayers. Such an approach would not weaken enforcement; rather, it would direct enforcement efforts towards those actually responsible for the loss of revenue.

The objective of GST is not merely to maximise tax collection but to establish a fair, efficient and credible indirect tax system. That objective is best achieved when compliance obligations remain proportionate to the taxpayer's ability to fulfil them.

Conclusion

The debate surrounding section 16(2)(c) illustrates the tension between revenue protection and taxpayer rights within the GST framework. Both interests are legitimate and neither can be ignored.

The Government must possess effective tools to combat fake invoicing and tax evasion. At the same time, genuine taxpayers should not be exposed to severe financial consequences solely because of a supplier's independent default.

The most appropriate solution lies in a balanced approach that distinguishes fraudulent transactions from bona fide commercial dealings. Such a framework would strengthen the integrity of GST while promoting fairness, legal certainty and taxpayer confidence.

"The search for a balanced framework is not unique to India. Other value-added tax jurisdictions have confronted similar challenges and have developed different mechanisms to reconcile revenue protection with the rights of bona fide purchasers. An examination of these approaches may provide valuable guidance for Indian GST reform."

Recommendations

The preceding analysis demonstrates that the controversy surrounding section 16(2)(c) cannot be resolved simply by choosing between complete taxpayer protection and unrestricted revenue enforcement. Both objectives are important to the functioning of the GST system. The more appropriate approach is to develop a framework in which fraudulent transactions are dealt with firmly while genuine recipients are not automatically made responsible for a supplier's independent default.

Introduction of a Bona Fide Purchaser Safeguard

The GST framework should consider introducing an express statutory protection for a bona fide recipient. Where the recipient can establish that the transaction was genuine, the goods or services were actually received, the consideration and tax were paid through legitimate means and the recipient was not involved in fraud or collusion, ITC should not ordinarily be denied solely because of the supplier's subsequent default.

Such a safeguard would not create an unrestricted right to credit. The recipient would still have to satisfy the statutory requirements and demonstrate reasonable commercial diligence. The purpose would simply be to prevent an innocent recipient from automatically bearing the entire financial consequence of another taxable person's misconduct.

This approach would also create a clearer distinction between genuine transactions and arrangements created specifically for fraudulent ITC claims.

Supplier-Focused Recovery Mechanism

Where non-payment of tax is attributable to the supplier, the tax administration should, as a general rule, initiate appropriate proceedings against the defaulting supplier before seeking recovery from a bona fide recipient.

The principle emerging from decisions such as D.Y. Beathel Enterprises and Suncraft Energy supports greater attention to the conduct and liability of the supplier.[23]

This does not mean that the recipient can never be proceeded against. Where evidence indicates that the recipient participated in fraud, knowingly dealt with a fictitious supplier or failed to exercise reasonable care despite obvious warning signs, appropriate action should remain available to the authorities.

The proposed reform is therefore not supplier immunity but proper allocation of responsibility. Risk-Based Verification of Transactions. A uniform approach to every instance of supplier non-compliance may not be the most efficient method of tax administration. GST authorities should increasingly adopt risk-based verification.

Transactions displaying indicators such as unusual invoice patterns, circular transactions, non-existent business premises, repeated return discrepancies or suspicious changes in supplier behaviour may be subjected to enhanced scrutiny.

Ordinary commercial transactions involving compliant and traceable businesses should face a lighter compliance burden.

Risk-based enforcement would enable the tax administration to concentrate resources on transactions where the probability of fraud is higher rather than automatically transferring the consequences of every supplier default to purchasers.

Greater use of Digital Compliance Alert

The GST system already operates through a highly digitalised compliance infrastructure. This infrastructure could be developed further to provide recipients with timely information concerning significant supplier-level compliance problems.

For example, where a supplier repeatedly fails to file returns or exhibits serious compliance irregularities, an automated warning could be made available to registered recipients dealing with that supplier.

Such a system would improve transparency and provide purchasers with an opportunity to reconsider future transactions or undertake additional verification.

Importantly, an alert system should function as a prospective compliance mechanism, rather than automatically treating a recipient as responsible for a supplier's previous default.

Reasonable Due-Diligence Standard

The law should provide clearer guidance concerning the level of diligence expected from recipients.

A taxpayer should not be required to conduct an investigation equivalent to that of the tax department before entering into every commercial transaction. Such a requirement would be commercially unrealistic and would significantly increase the cost of doing business.

Instead, reasonable diligence could include verification of the supplier's GST registration, maintenance of tax invoices, evidence of actual receipt of goods or services, appropriate payment records and preservation of relevant transaction documents.

Where these requirements are satisfied and no circumstances indicate fraud or collusion, the recipient's claim should receive stronger protection.

Legislative Clarification of Section 16(2)(c)

The legislature should consider clarifying the operation of section 16(2)(c), particularly in cases involving supplier default where the recipient has acted in good faith.

The provision could expressly distinguish between:

- Fraudulent or collusive transactions;
- Transactions involving a recipient's negligence or wilful blindness; and
- Genuine transactions where the supplier independently fails to discharge its tax liability.

Different consequences could then be prescribed for each category.

Such legislative clarification would reduce uncertainty, minimise unnecessary litigation and provide clearer guidance to both taxpayers and tax authorities.

Protection Against Automatic ITC Reversal

ITC should not be reversed mechanically merely because a corresponding transaction is not reflected in a particular electronic statement or because the supplier has subsequently defaulted.

Before reversal, the recipient should ordinarily be given an opportunity to establish the genuineness of the transaction and produce supporting evidence.

This procedural safeguard is particularly important because electronic mismatches may arise for several reasons, including delayed filing, clerical mistakes and supplier-side reporting errors. A mismatch should therefore be treated as a reason for verification rather than conclusive proof of fraud.

Recovery from the Actual Wrongdoer

Where investigation establishes that the supplier collected GST but deliberately failed to remit it, enforcement should focus substantially on the person responsible for the default.

The GST framework contains extensive powers for investigation, assessment, recovery and action against fraudulent

taxpayers. The existence of these mechanisms supports a more targeted approach in cases where the recipient has not participated in the wrongdoing.

A tax system becomes more credible when liability follows responsibility rather than merely following the party from whom recovery happens to be administratively easier.

Development of a Clear Judicial Test
Courts dealing with supplier-default disputes may also benefit from a structured factual test. Without creating a rigid formula, the following questions could assist in determining whether ITC should be protected:

- Was there an actual supply of goods or services?
- Was the supplier registered at the relevant time?
- Did the recipient possess a valid tax invoice?
- Were the goods or services actually received?
- Was payment made through traceable means?
- Did the recipient claim credit in accordance with the applicable statutory requirements?
- Was there evidence of fraud, collusion or knowledge of the supplier's wrongdoing?
- Did the recipient ignore obvious indicators of an unusual or fraudulent transaction?
- Did the tax authorities undertake appropriate investigation of the supplier?

Such an approach would make adjudication more fact-sensitive and reduce the possibility of treating substantially different transactions as legally identical.

Conclusion

Input Tax Credit is central to the functioning of the GST system. The effectiveness of GST as a value-added tax depends significantly upon the ability of businesses to claim credit for eligible taxes paid at earlier stages of the supply chain. At the same time, the Government has a legitimate responsibility to prevent fraudulent credit claims and protect public revenue.

Section 16(2)(c) reflects this tension. By connecting the recipient's entitlement to the actual payment of tax to the Government, the provision seeks to protect the integrity of the GST credit chain. The objective is legitimate, particularly in an environment where fake invoices, fictitious suppliers and fraudulent ITC claims can cause substantial revenue losses.

The difficulty arises when the provision is applied to a recipient who has entered into a genuine commercial transaction and has acted without fraud or collusion. Such a recipient may possess the invoice, receive the goods or services, pay the supplier and maintain appropriate records, yet remain exposed to ITC reversal because of the supplier's subsequent failure to discharge tax.

The judicial decisions examined in this article demonstrate that Indian courts have attempted to address this difficulty through different approaches. Decisions such as D.Y. Beathel Enterprises and Suncraft Energy emphasise the importance of investigating the defaulting supplier and recognising the practical limitations faced by purchasers.24 At the same time, the statutory nature of ITC means that courts cannot simply disregard the conditions prescribed by Parliament.

The earlier Supreme Court jurisprudence concerning tax credit also requires a balanced interpretation. Eicher Motors and Dai Ichi Karkaria demonstrate the significant economic and legal role played by input tax credit in value-added taxation.[25] However, ALD Automotive makes clear that entitlement to credit remains subject to the statutory conditions created by the legislature.26 The appropriate conclusion is therefore not that GST ITC is an absolute constitutional right, but that it is a statutory entitlement with substantial economic significance.

The constitutional analysis further demonstrates why the supplier-default problem deserves careful consideration. Article 14 raises concerns where fraudulent participants and bona fide purchasers are effectively treated in the same manner despite their materially different conduct. Article 19(1)(g) becomes relevant where extensive ITC reversals produce substantial consequences for legitimate business activity, while Article 300A provides a constitutional framework for considering deprivation of legally recognised economic interests. These provisions do not necessarily invalidate section 16(2)(c), but they support the need for a fair and proportionate application of the provision.

The central argument of this article is therefore that revenue protection should not require the automatic transfer of supplier risk to every purchaser. The GST administration should distinguish between a recipient who knowingly participates in tax fraud and one who has entered into a genuine transaction and exercised reasonable commercial diligence.

A balanced model would preserve the Government's power to deny credit in cases involving fraud, collusion, fictitious transactions or wilful blindness. At the same time, where a recipient establishes the genuineness of the transaction

and demonstrates reasonable compliance, supplier default should not automatically result in the loss of ITC without an appropriate factual inquiry.

Such an approach would not weaken GST enforcement. On the contrary, it would allow enforcement resources to be directed towards the persons actually responsible for fraudulent conduct while increasing certainty for compliant businesses.

The long-term solution lies in a combination of legislative clarification, supplier-focused recovery, reasonable due diligence, risk-based verification and stronger digital compliance mechanisms. A statutory safe harbour for bona fide recipients could provide particular value by reducing unnecessary litigation and establishing a clearer allocation of responsibility.

Ultimately, the credibility of the GST system depends not only upon the Government's ability to collect revenue but also upon taxpayers' confidence that compliance will be treated fairly. A system that protects revenue while recognising the legitimate position of bona fide purchasers would better reflect the principles of neutrality, proportionality and fairness underlying modern value-added taxation.

Section 16(2)(c) therefore should not be viewed simply as a mechanism for denying credit. Its future interpretation and implementation should focus on achieving an appropriate equilibrium between revenue protection and taxpayer justice. The objective should be a GST regime in which fraudulent claims are effectively prevented, genuine transactions are protected and the financial consequences of tax default are placed, as far as reasonably possible, upon the person responsible for that default.

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- **Journal Articles / Secondary Sources**
- For your particular research issue, these can support the academic discussion:
- Vipin Kumar Singhal and Ajay Kumar, 'Recipient's Loss of Input Tax Credit due to Supplier Default under GST: Legal Framework, Judicial Divergence, and the Path to Resolution' (2026) 9(III) International Journal of Law Management & Humanities 2730.
- relevant articles from:
- Journal of Indian Taxation
- Indian Journal of Tax Law
- National Law School of India Review
- National University of Juridical Sciences Law Review
- Indian Law Review

- **Online sources**
- Central Board of Indirect Taxes and Customs, 'Input Tax Credit' (GST portal).
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- India Code, 'Integrated Goods and Services Tax Act 2017'.
- European Commission, 'VAT Directive 2006/112/EC' (EUR-Lex).

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2. Central Goods and Services Tax Act 2017.
3. Central Goods and Services Tax Rules 2017.
4. Integrated Goods and Services Tax Act 2017.
5. Eicher Motors Ltd v Union of India (1999) 2 SCC 361.
6. Collector of Central Excise, Pune v Dai Ichi Karkaria Ltd (1999) 7 SCC 448.
7. ALD Automotive Pvt Ltd v Commercial Tax Officer (2018) 13 SCC 225.
8. Jayam & Co v Assistant Commissioner (2016) 15 SCC 125.
9. D.Y. Beathel Enterprises v State Tax Officer (Data Cell) 2021 SCC OnLine Mad 2964.
10. Suncraft Energy Pvt Ltd v Assistant Commissioner, State Tax, Ballygunge Charge MAT 1218 of 2023 (Cal HC, 2 August 2023).
11. Assistant Commissioner of State Tax v Suncraft Energy Pvt Ltd SLP (C) Nos 27827–27828/2023 (SC, 14 December 2023).
12. State of Karnataka v Ecom Gill Coffee Trading Pvt Ltd 2023 SCC OnLine SC 237.
13. Commissioner of Trade and Taxes, Delhi v Arise India Ltd (2018) 17 SCC 823.
14. Council Directive 2006/112/EC on the common system of VAT.
15. Modern Dental College and Research Centre v State of Madhya Pradesh (2016) 7 SCC 353.

Footnotes:

[1]Eicher Motors Ltd v Union of India (1999) 2 SCC 361.
[2]Collector of Central Excise, Pune v Dai Ichi Karkaria Ltd (1999) 7 SCC 448.
[3]Suncraft Energy Pvt Ltd v Assistant Commissioner, State Tax, Ballygunge Charge MAT 1218 of 2023 (Calcutta HC, 2 August 2023).
[4]Assistant Commissioner of State Tax v Suncraft Energy Pvt Ltd, SLP (C) Nos 27827–27828/2023 (SC, 14 December 2023).
[5]Central Goods and Services Tax Act 2017, s 16(1).
[6]Central Goods and Services Tax Act 2017, s 16(2)(c).
[7]Suncraft Energy Pvt Ltd v Assistant Commissioner, State Tax, Ballygunge Charge MAT 1218 of 2023 (Calcutta HC, 2 August 2023).

[8]Eicher Motors Ltd v Union of India (1999) 2 SCC 361; Collector of Central Excise, Pune v Dai Ichi Karkaria Ltd (1999) 7 SCC 448.
[9]Eicher Motors Ltd v Union of India (1999) 2 SCC 361.
[10]ibid.
[11]Collector of Central Excise, Pune v Dai Ichi Karkaria Ltd (1999) 7 SCC 448.
[12]ALD Automotive Pvt Ltd v Commercial Tax Officer (2018) 13 SCC 225.
[13]ibid.
[14]Central Goods and Services Tax Act 2017, s 16(1).
[15]EP Royappa v State of Tamil Nadu (1974) 4 SCC 3; Maneka Gandhi v Union of India (1978) 1 SCC 248.
[16]Modern Dental College and Research Centre v State of Madhya Pradesh (2016) 7 SCC 353.
[17]Suncraft Energy Pvt Ltd v Assistant Commissioner, State Tax, Ballygunge Charge MAT 1218 of 2023 (Calcutta HC, 2 August 2023); DY Beathel Enterprises v State Tax Officer 2021 SCC OnLine Mad 2964.
[18]ALD Automotive Pvt Ltd v Commercial Tax Officer (2018) 13 SCC 225; Jayam & Co v Assistant Commissioner (2016) 15 SCC 125.
[19]DY Beathel Enterprises v State Tax Officer (Data Cell) 2021 SCC OnLine Mad 2964. The Madras High Court held that authorities should ordinarily proceed against the defaulting seller before fastening liability upon the purchasing dealer.
[20]Suncraft Energy Pvt Ltd v Assistant Commissioner, State Tax, Ballygunge Charge MAT 1218 of 2023 (Calcutta HC, 2 August 2023).
[21]ibid. The Court observed that authorities should first pursue the supplier and that action against the recipient should generally arise only in exceptional circumstances.
[22]Ministry of Finance, Government of India, GST Intelligence and Anti-Evasion Measures Reports (various years); see also Central Board of Indirect Taxes and Customs (CBIC), annual reports discussing fake invoicing and fraudulent ITC investigations.
[23]DY Beathel Enterprises v State Tax Officer (Data Cell) 2021 SCC OnLine Mad 2964; Suncraft Energy Pvt Ltd v Assistant Commissioner, State Tax, Ballygunge Charge MAT 1218 of 2023 (Calcutta HC, 2 August 2023).
[24]ibid.
[25]Eicher Motors Ltd v Union of India (1999) 2 SCC 361; Collector of Central Excise, Pune v Dai Ichi Karkaria Ltd (1999) 7 SCC 448.
[26]ALD Automotive Pvt Ltd v Commercial Tax Officer (2018) 13 SCC 225.