<u>Supreme Court affirms the constitutional validity of Section 16(2)(c) of the CGST Act – No ITC to the recipient unless the supplier actually deposits tax to the Government</u>

The Hon'ble Supreme Court in ***Bhandari Scrap Traders v. Union of India & Ors. [SLP (C) No. 23931 of 2026 dated July 24, 2026]*** dismissed the Special Leave Petitions filed relying on the judgment of the Hon'ble Gujarat High Court in ***Maruti Enterprise v. Union of India & Ors. [R/Special Civil Application No. 18080 of 2023 and allied matters including R/Special Civil Application No. 749 of 2025 dated May 01, 2026]***, thereby affirming that Section 16(2)(c) of the Central Goods and Services Tax Act, 2017 (**"the CGST Act"**) is neither unconstitutional nor liable to be read down, and holding that Input Tax Credit (**"ITC"**) is not available to the recipient unless the tax charged in respect of the supply has actually been paid to the Government by the supplier.

<u>Facts:</u>

M/s. Bhandari Scrap Traders (**"the Petitioners"**) were denied ITC solely on the ground that their suppliers had failed to deposit the tax with the Government. The Petitioners filed a

The Petitioners contended that the genuineness of a transaction stands established by clauses (a), (aa), (b) and (ba) of Section 16(2) of the CGST Act, and clause (c) makes the credit dependent on actual payment of tax by the supplier, which is entirely outside the recipient's control and knowledge, since the supplier's Form GSTR-3B is not accessible to the recipient. Reliance was placed on the maxim ***lex non cogit ad impossibilia*** and on ***On Quest Merchandising India (P) Ltd. v. Government of NCT of Delhi [(2017) 87 taxmann.com 179 (Delhi)]***, wherein the pari materia Section 9(2)(g) of the Delhi VAT Act, 2004 was read down to exclude bona fide purchasing dealers, as affirmed by the Hon'ble Supreme Court in ***Commissioner of Trade & Tax Delhi v. Arise India Ltd. [2022 (60) GSTL 215 (SC)] and Commissioner Trade & Tax Delhi v. Shanti Kiran India (P) Ltd. [(2025) 179 taxmann.com 665 (SC)],*** and on the decision of the Hon'ble Tripura High Court in ***Sahil Enterprises v. Union of***

India & Ors. [(2026) 154 GSTR 108 (Tri.)] reading down Section 16(2)(c) of the CGST Act to protect the genuine buyers.

The Revenue contended that ITC is a concession and not a vested right, and that Section 16(2)(c) cannot be read in isolation but must be read with Section 41(2), Section 53 and Section 155 of the CGST Act read with Rule 37A of the CGST Rules, 2017, under which the recipient reverses the credit upon default of the supplier and is entitled to re-avail the credit once the supplier pays the tax, and hence no parity can be drawn with the Delhi VAT Act.

The Hon'ble Gujarat High Court, vide judgment dated May 01, 2026, upheld the constitutional validity of Section 16(2)(c) of the CGST Act, declined to read it down and expressly disagreed with the view of the Hon'ble Tripura High Court in ***Sahil Enterprises***. Aggrieved thereby, the Petitioners filed Special Leave Petitions before the Hon'ble Supreme Court.

Issue:

Whether Section 16(2)(c) of the CGST Act, which denies ITC to a purchasing dealer where the supplier has failed to actually pay the tax to the Government, is ultra vires Articles 14, 19(1)(g), 265 and 300A of the Constitution of India or is liable to be read down so as to protect bona fide purchasers?

Held:

The Hon'ble Supreme Court in ***SLP (C) No. 23931 of 2026*** held as under:

- Observed that, though a Special Leave Petition has been entertained in relation to the decision of the Hon'ble Tripura High Court in ***Sahil Enterprises v. Union of India & Ors. [(2026) 154 GSTR 108 (Tri.)],*** the detailed exercise undertaken by the Hon'ble Gujarat High Court in the impugned judgment was not undertaken by the Tripura High Court.

- Noted that, the distinction and differences between the provisions of the Delhi VAT Act, 2004 and the CGST Act, brought out by a detailed analysis in the impugned judgment along with the scheme of availing ITC under the GST regime, clearly demonstrate that there is no possibility of drawing parity between the two enactments so as to treat a purchasing dealer under the CGST Act on par with a purported bona fide purchasing dealer under the Delhi VAT Act in relation to ITC, when the supplier fails to pay the requisite tax.

- Further, noted that the Hon'ble Gujarat High Court has rightly referred to Section 41 as well as Sections 73 and 74 of the CGST Act, in the context of the purchasing dealer being entitled to re-avail the reversed ITC after the supplier is made to discharge the tax liability.

- Held that, the High Court was fully justified in holding that no grounds were made out to declare Section 16(2)(c) of the CGST Act as unconstitutional or to read down the provision and expressed complete and respectful agreement with the views of the Hon'ble Gujarat High Court in the case of Maruti Enterprises, thereby affirming and upholding the impugned judgment.

- Accordingly, the **Special Leave Petitions were dismissed**.

Our Comments:

Section 16(2)(c) of the CGST Act provides that, subject to Section 41, no registered person shall be entitled to ITC unless the tax charged in respect of the supply has been actually paid to the Government, either in cash or through utilisation of admissible ITC. Section 41(2) of the CGST Act (as substituted by the Finance Act, 2022) requires the recipient to reverse the ITC along with interest where the supplier fails to pay the tax, and the proviso thereto permits re-availment of such credit once the supplier pays the tax, the mechanism whereof is prescribed in Rule 37A of the CGST Rules, 2017. Further, Section 155 of the CGST Act casts the burden of proving eligibility to ITC on the person claiming it, and Section 53 of the CGST Act obliges fund transfers to the destination State on inter-State supplies, which is why credit unaccompanied by actual payment of tax would disturb the fiscal architecture of GST.

The Hon'ble Gujarat High Court, while upholding the provision, pertinently observed that the recipient is not left remediless since the Revenue is empowered to recover the tax from the defaulting supplier under Sections 73 and 74 of the CGST Act and the recipient can re-avail the reversed credit upon such payment. Notably, the Court also observed that it is high time the Government undertakes a comprehensive re-evaluation of the difficulties faced by honest purchasers, including a robust technology-driven mechanism for real-time verification of invoice-wise tax payments by suppliers, and prompt recovery from erring suppliers.

On the contrary side of the ledger, the Hon'ble Tripura High Court in ***Sahil Enterprises v. Union of India & Ors. [W.P.(C) No. 688 of 2022 dated January 06, 2026]*** upheld the constitutional validity of Section 16(2)(c) of the CGST Act but read it down, following ***On Quest Merchandising India (P) Ltd.***, so as to apply only to transactions which are not bona fide or are collusive or fraudulent. Since the Department had invoked only Section 73 (and not Section 74) of the CGST Act and did not dispute payment of GST of INR 1,11,60,830/- by the assessee to the supplier, the transaction was held to be bona fide, and the Department was directed to allow the ITC. A Special Leave Petition against the said judgment has been entertained and is pending before the Hon'ble Supreme Court, which now stands considerably diluted in view of the affirmation of the Gujarat HC Judgement in *Bhandari Scrap Traders*.

The jurisprudence on Section 16(2)(c) of the CGST Act has been sharply divided. The taxpayer-favourable line, tracing from ***On Quest Merchandising India (P) Ltd.*** (Delhi VAT), was followed under GST by the Hon'ble Gauhati High Court in ***National Plasto Moulding v. State of Assam*** and by the Hon'ble Tripura High Court in ***Sahil Enterprises***.

Per contra, the Hon'ble Kerala High Court in ***M. Trade Links v. Union of India [2024 SCC OnLine Ker 2744] and Nahasshukoor v. Assistant Commissioner [2023 SCC OnLine Ker 11369],*** the

Hon'ble Andhra Pradesh High Court in ***Thirumalakonda Plywoods v. Assistant Commissioner [2023 SCC OnLine AP 1476]*** and the Hon'ble Patna High Court in ***Astha Enterprises v. State of Bihar [2023 SCC OnLine Pat 4395]*** upheld the strict operation of the condition, holding ITC to be a statutory concession availed only on fulfilment of the prescribed conditions. The Hon'ble Supreme Court in ***State of Karnataka v. Ecom Gill Coffee Trading Pvt. Ltd. [(2023) 18 SCC 809]*** had also held that the burden of proving the genuineness of the transaction and actual payment of tax lies on the dealer claiming the credit, and mere production of invoices or payment by cheque is not sufficient.

Reference may also be made to the recent order of the Hon'ble Supreme Court in ***Prime Metals v. Central Board of Indirect Taxes and Customs & Ors. [SLP (C) No. 18577 of 2026 dated May 29, 2026],*** which was widely reported in the context of Section 16(2)(c) of the CGST Act. However, the Hon'ble Supreme Court therein did not adjudicate the constitutional validity of Section 16(2)(c) of the CGST Act and merely declined to interfere with the dismissal of the writ petition by the Hon'ble Rajasthan High Court on the ground of availability of an alternate statutory remedy, expressly leaving the validity question open. It was, therefore, not a ruling on the merits of Section 16(2)(c) of the CGST Act, unlike the present order in *Bhandari Scrap Traders*.

With the Hon'ble Supreme Court now affirming the Gujarat view, the settled position is that availment of ITC is conditional upon actual payment of tax by the supplier to the Government, with the recipient's remedy lying in reversal and subsequent re-availment under Section 41(2) of the CGST Act read with Rule 37A of the CGST Rules, 2017. Taxpayers would be well advised to strengthen vendor due diligence, monitor supplier compliance through GSTR-2B, and incorporate suitable indemnity and tax-withholding clauses in supply contracts to guard against supplier defaults.

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