



## Tax alert: Gujarat High Court rules that ITC is denied to recipients where supplier fails to deposit GST with the Government, even in bona fide transactions

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The Gujarat High Court has held that input tax credit (ITC) is a conditional statutory entitlement contingent upon actual payment of tax by the supplier under section 16(2)(c) of Central Goods and Services Tax Act, 2017 (CGST Act'). The Court upheld the constitutional validity of the provision and declined to read it down for bona fide recipients, while at the same time urging the Government to implement systemic safeguards to protect genuine recipients.

### In a nutshell



The Gujarat High Court has held that ITC is not a vested right but a statutory concession and contingent upon actual payment of tax by the supplier as required as per Section 16(2)(c).

The recipient bears the burden of proving ITC eligibility, which extends beyond mere possession of invoices.



The decisions under the DVAT regime cannot be applied to GST as GST operates under a materially different statutory framework.

The provision under GST law to re-avail credit once the payment is made by the supplier, balances the interests of revenue as well as the recipient.



Mere delay or hardship in availing ITC cannot constitute valid ground for reading down section 16(2)(c).

Upholding the vires of section 16(2)(c), the Court emphasized the need for Government intervention through technological, legislative, and administrative measures to protect bona fide purchasers.



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## Background

- The dispute arose due to denial of ITC to the petitioners on the ground of default, on the part of the suppliers to deposit the tax so collected with the Government, as provided under Section 16(2)(c) of the CGST Act.
- The Gujarat High Court dealt with a batch of writ petitions challenging the constitutional validity of Section 16(2)(c), wherein the petitioners sought either striking down of the provision or its reading down to restrict its application only to cases involving fraud, collusion, or connivance, and to exclude bona fide purchasers from its ambit.
- The petitioners argued that Section 16(2)(c) unjustly penalizes bona fide purchasers for supplier defaults beyond their control, resulting in double.

## High Court (HC) judgement<sup>1</sup>

- Referring to the Statement of Objects and Reasons of the CGST Act, High Court held that entitlement to ITC is intrinsically linked to the actual payment of tax.
- On the issue whether ITC can be denied to the recipient solely on the ground that the supplier has failed to pay tax to the government, Gujarat High Court referred to contrary decisions<sup>2</sup> of different Courts and held that GST regime is fundamentally different from the VAT regime. Under GST, ITC operates across state boundaries, and compliance with Section 16(2)(c) is essential to maintain fiscal balance.
  - Supreme Court decision<sup>3</sup> and Delhi high Court decision<sup>4</sup> were distinguished on the grounds that the decisions under the DVAT regime cannot be applied to GST, which operates under a materially different statutory framework.
  - Tripura High Court<sup>5</sup> followed the aforesaid rulings and applied the doctrine of reading down to the provision of 16(2) (c) of the CGST Act. Gujarat High Court held that Tripura High Court failed to consider that interplay of different provisions under GST law.
  - Both Delhi High Court and Tripura High Court failed to consider Section 155 of the CGST Act which provides that the person claiming the ITC shall discharge the burden of proof that he is eligible for claiming such ITC.
  - Under the GST regime, if the supplier fails to pay tax, the recipient must reverse ITC, however, when the supplier pays tax, the recipient can re-avail the credit in terms of Section 41 of the CGST Act. Thus, the recipient is not permanently deprived of ITC under the GST regime.
  - In the case of inter-State supplies by recipients, Section 53 of the CGST Act mandates transfer of the utilized tax component to the destination State, and permitting ITC based solely on invoices where the supplier has not actually deposited tax would lead to significant revenue loss; reliance was also placed on the Kerala High Court's observations highlighting this concern.
  - Reading down Section 16(2)(c) of the CGST Act would trigger fiscal consequences.
- Explained the interplay between section 16(2)(c), section 41(2) and Rule 37A
  - Section 16(2)(c) mandates that ITC is available only if the supplier has actually paid the tax to the Government, and all conditions under Section 16(2)(a) to (d) must be satisfied collectively.

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<sup>1</sup>Maruti Enterprise vs Union of India TS-312-HC(GUJ)-2026-GST

<sup>2</sup>On Quest Merchandising India (P.) Ltd. [2017] 87 taxmann.com 179/ [2018] 10 GSTL 182 (Del), Shanti Kiran India (P.) Ltd. [2025] 179 taxmann.com 665 (SC). and Sahil Enterprises [2026-VIL-15-TRI]

<sup>3</sup>Shanti Kiran India (P.) Ltd. [2025] 179 taxmann.com 665 (SC)

<sup>4</sup>On Quest Merchandising India (P.) Ltd. [2017] 87 taxmann.com 179/ [2018] 10 GSTL 182 (Del). and Sahil Enterprises [2026-VIL-15-TRI]

<sup>5</sup>Sahil Enterprises [2026-VIL-15-TRI]

- Section 41(2) read with Rule 37A mandates reversal of ITC where the supplier fails to pay tax, while permitting its re-availment upon subsequent payment, thereby maintaining a balance between the interests of the Revenue and the recipient. Accordingly, mere delay or hardship in availing ITC does not constitute a valid ground for reading down Section 16(2)(c).
  - Filing of GSTR-3B by the supplier does not necessarily confirm that tax has been fully paid for a specific invoice or debit note. Section 16(2)(c) is invoked when the corresponding payment of tax in respect of the invoice/ debit note has not been fulfilled.
  - The High Court rejected the plea based on *lex non cogit ad impossibilia*, holding that the GST framework, particularly Section 41 and Rule 37A, provides adequate safeguards to purchasers, and that risks can be mitigated through due diligence and inclusion of indemnity clauses in supply agreements to protect against losses arising from supplier default in tax payment.
  - Under Section 155, the burden of proving ITC eligibility lies on the recipient and cannot be discharged merely through invoices; it requires evidence of actual tax payment by the supplier.
  - Statute does not leave the purchasing dealer remediless, as recovery can be initiated by Revenue against the supplier under Sections 73 and 74 of CGST Act, and credit can be re-availed upon payment by the supplier.
- Ruling
    - Section 16(2)(c) cannot be read down as the provision does not conflict with constitutional or legal principles. The provision is clear, self-explanatory, and unambiguous. It collectively balances the interests of revenue and genuine purchasers.
    - ITC is not a constitutional or vested right but a statutory concession. The conditions for availing ITC must be strictly complied with as per the statutory scheme.
    - In interpreting a taxing statute, equitable considerations are entirely out of place.
    - The Court must interpret a taxing statute in light of what is clearly expressed, it cannot import provisions into the statute so as to supply any assumed deficiency.
    - A provision in a statute must be read along with other related provisions.
    - Taxing statutes are to be interpreted literally, and it is within the domain of the legislature to determine how much tax credit is to be given and under what circumstances.
  - Other comments
    - The HC emphasized the need for the Government to address the challenges faced by genuine purchasers.
    - The government should introduce robust, technology-driven system enabling real-time tracking and verification of tax payments linked to specific invoices, thereby safeguarding honest recipients from supplier defaults.
    - The Government should prioritize recovery of tax from defaulting suppliers instead of placing the burden on purchasers to pursue alternative, cumbersome remedies.
  - While the Court declined to read down Section 16(2)(c) or declare it *ultra vires*, it expressed an expectation that the Government would address the issues faced by genuine purchasers at the earliest.

## Comments

In the recent past, the courts had increasingly leaned towards protecting bona fide recipients for ITC claims denied due to default of supplier to deposit GST. However, Gujarat HC in this case has declined to read down Section 16(2)(c) to apply it only to fraudulent cases and distinguished the jurisprudence laid down in the VAT regime that had read down a similar provision, on the basis that the GST framework is different and section

16(2)(c) needs to be read along with related sections i.e., section 41 and section 155.

To safeguard themselves, businesses need to strengthen vendor due diligence and include indemnity clauses in the supply agreements, clauses linking payment to GST compliance. This has also been emphasized in the judgement.

While acknowledging the hardships faced by the genuine taxpayers and urging the Government to address the issue by legislative changes, appropriate technological enhancements and prioritizing recovery from the defaulting suppliers, the Hon'ble Court has adopted a balanced approach in reaching to the conclusion.



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