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**"ANALYSING THE EFFECTIVENESS OF INPUT TAX
CREDIT MECHANISM UNDER GST: LEGAL
CHALLENGES AND JUDICIAL TRENDS"**

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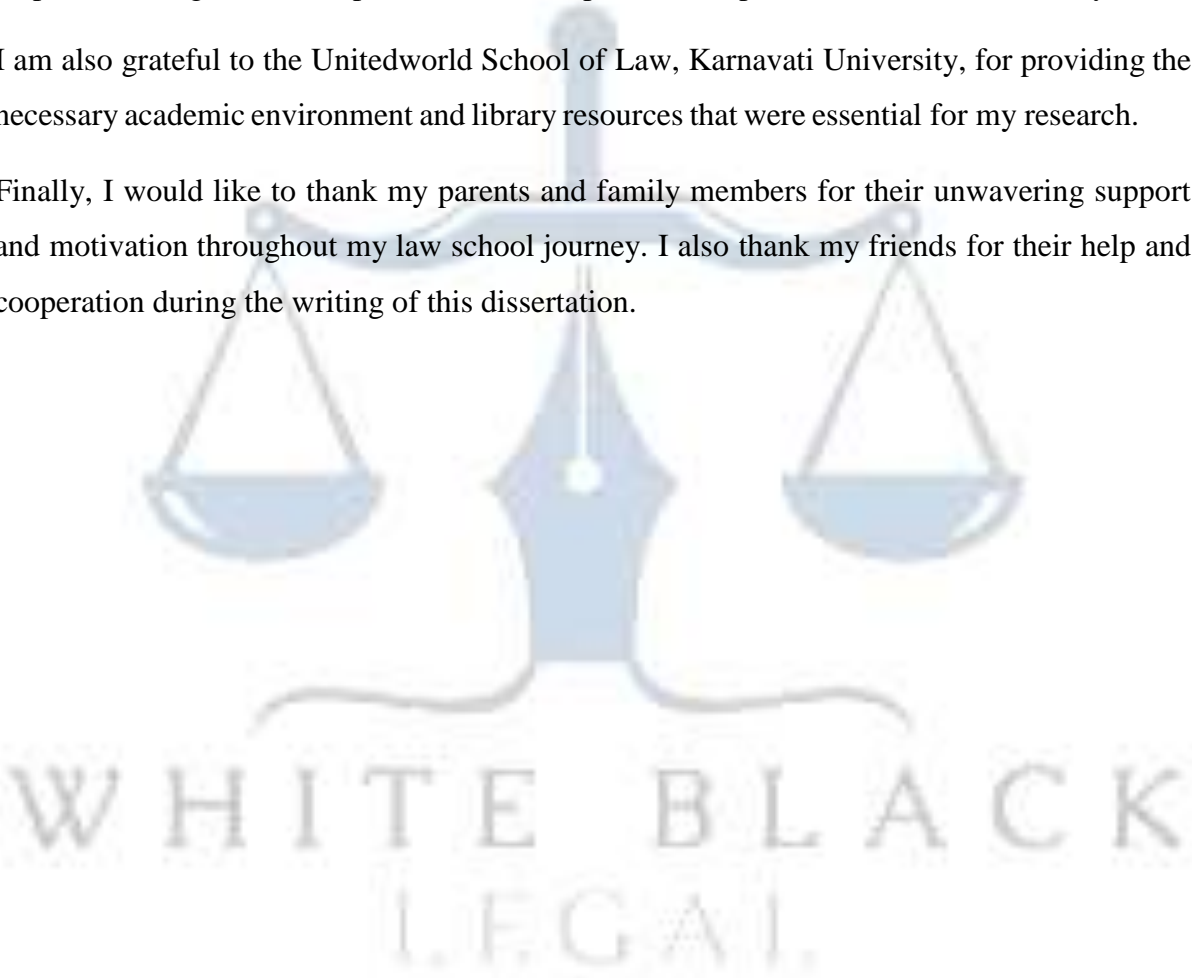


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LIST OF ABBREVIATIONS

Abbreviation	Full Form
AAR	Authority for Advance Ruling
Art.	Article
CENVAT	Central Value Added Tax
CGST	Central Goods and Services Tax
CGST Act	Central Goods and Services Tax Act, 2017
CoC	Committee of Creditors
EU	European Union
GST	Goods and Services Tax
GSTIN	Goods and Services Tax Identification Number
GSTR	Goods and Services Tax Return
HC	High Court
IGST	Integrated Goods and Services Tax
ITC	Input Tax Credit
Ltd.	Limited
MODVAT	Modified Value Added Tax
MSMEs	Micro, Small and Medium Enterprises
Pvt.	Private
Rule	Rule under GST Law
SC	Supreme Court
SCC	Supreme Court Cases
SGST	State Goods and Services Tax
VAT	Value Added Tax

ABSTRACT

The Goods and Services Tax (GST) has introduced a new system of indirect taxation in our country, and its main aim has been to eradicate the cascading effects of taxes and attain tax neutrality. The most important aspect of this new system of taxation is the Input Tax Credit (ITC) mechanism, whereby a taxpayer can claim credit for taxes paid earlier. However, in spite of its conceptual soundness, its implementation has given rise to a host of legal and procedural problems.

In this dissertation, we propose to examine the effectiveness of the ITC mechanism under the GST regime by studying its framework, conditions, and legal problems associated with its implementation. The legal problems associated with its implementation, such as the denial of ITC, procedural problems, and technological problems, are also studied in this research. Further, we also propose to study judicial trends to understand how ITC has been viewed by courts and how its implementation has been assessed from a legal perspective.

The research has shown that even though ITC is an important aspect of the new system of taxation, its effectiveness has been marred by problems and has, therefore, emphasized the need for its reforms.

Keywords:

Goods and Services Tax (GST); GST Portal; Input Tax Credit (ITC); Indirect Taxation; Cascading Effect; Tax Neutrality; Supplier Default; Compliance Burden; Judicial Trends; Working Capital; Tax Neutrality

CHAPTER I

1. INTRODUCTION

The introduction of Goods and Services Tax (GST) has marked a paradigm shift in the taxation policy of India, replacing a multitude of taxes with a single tax regime¹. This new taxation policy has been introduced with the aim of providing greater efficiency, transparency, and economic integration, and eliminating the cascading effects of taxation through a mechanism called Input Tax Credit (ITC). The ITC mechanism allows taxpayers to claim a credit for taxes paid on inputs, ensuring that taxes are imposed only on value additions in the supply chain.² However, despite its foundational importance, the implementation of the ITC mechanism has also faced a host of legal, procedural, and technological problems, such as denial of credit due to default by suppliers, strict compliance, and judicial divergences, leading to a sense of insecurity regarding its efficacy and effectiveness³. This has also resulted in a sense of insecurity among taxpayers, thereby raising questions regarding its efficacy and effectiveness, not only from a taxpayer's perspective, but also from a broader perspective, such as its impact on business and taxpayer rights. In addition, the dynamic nature of the GST policy, with a constant influx of amendments and changes in compliance, has also resulted in a sense of insecurity among taxpayers, and its implementation through technological tools such as the GST portal and return-filing mechanism has also introduced a new gamut of problems, such as data mismatches and technical glitches, leading to a denial of credit, and thereby raising questions regarding its efficacy and effectiveness, and whether it places an undue burden on taxpayers, despite its aim to simplify taxation and its introduction to ease compliance and reduce costs.

¹ Constitution (One Hundred and First Amendment) Act 2016; see also Arvind Subramanian, 'The GST: Making India's Growth More Inclusive' (Economic and Political Weekly, 2016) <https://www.epw.in> accessed 15 February 2026.

² Central Goods and Services Tax Act 2017, s 16(1).

³ Madhukar N Hiregange and Adv Manoj Kumar P, GST Law and Practice (Bloomsbury Publishing India 2022) ch 7.

1.1

BACKGROUND OF INDIRECT TAXATION IN INDIA

Indirect taxation development in India is an intricate interaction between the fiscal policy, probation, and economic conditions. The indirect tax system governing India before the introduction of the good services tax was exhibited by a multi-layered system that was divided into small pieces where both the central and the state governments played independent roles in the taxation process.⁴ These two systems that was sanctioned by the constitution assumed no coherence and uniformity hence leading to the emergence of big inefficiencies in the tax system.

Goods and Services Tax (GST) is one of the ground-breaking reforms in the indirect tax structure of India. Prior to the introduction of GST, India had a complex and fragmented indirect tax system in the form of a number of central and state duties including the excise duty, the service tax, the value added tax (VAT), and the central sales tax, entry tax, and other cesses. This layering of taxes led to inefficiency of administration, non-uniformity among the states and to a great deal of cascading of taxes as credit of taxes paid at lower stages was limited or not possible. In a bid to counter this, GST came in with a view of consolidating most of the indirect taxes into one comprehensive tax system that is applicable throughout the country.⁵

On the central level, levies like Central Excise Duty and Service Tax were the main regulators of the taxation of goods and services. The Central Excise Duty was levied on production or manufacture of goods whereas the Service Tax was levied on the particular of the services. On the same note, State Governments also levied taxes including Value Added Tax (VAT), Entry tax, Luxury tax, Entertainment tax and purchase tax. All these taxes had different legislative and procedural contexts which tended to intersect with jurisdictions and interpretation clashes.⁶

The implementation of the system of Value Added Tax could be deemed as a progressive move towards rationalization of the indirect taxation because it was supposed to give credit to the taxes paid at an earlier stage of the supply chain.

⁴ Raja J Chelliah, Report of the Tax Reforms Committee (Ministry of Finance, Government of India 1991) Part I, ch 3.

⁵ Central Excise Act 1944 (India); Finance Act 1994 (India) (Service Tax provisions); Central Sales Tax Act 1956 (India).

⁶ Central Excise Act 1944 (India), s 3; Finance Act 1994 (India), s 65B(44) (definition of 'service').



Nonetheless, the viability of VAT was intrinsically minimal because of its narrow-based scope. It was functioning mainly at the state level and was not able to hook on with the central taxes, e.g., the excise duty and services tax. The cross-utilization of the credits in goods and services was therefore not available in a big way and that is why the ripple effect of the taxation continued.

The cascading effect also popularly termed as the tax-on-tax effect proved to be among the worst demerits of the pre-GST regime. Through this arrangement, the tax charged at one level would be considered in the tax base to be charged at the next level leading to an overvalued tax to the ultimate consumer. Not only did it make the cost of goods and services in general higher but it also skewed the pricing mechanism and made the markets less efficient.⁷

Furthermore, the inaccuracy of equal tax rates in all states posed a obstacle to the interstate trade and business. Companies that do business in more than one state had to satisfy different tax requirements, have different regs, and live by different procedural standards. Such a plethora of compliance requirements enhanced the cost of administration and slowed down the ease of doing business.⁸

The pre-GST regime was characterized too by high level of litigation, due to uncertainties in the tax laws, and disputes over such interpretations by the authorities.⁹ Concerns on classification of goods and services, financing and valuation and suitability of input credits were mostly a source of disputes, and thus added weight to the judicial system. Besides these issues, lack of a well-developed technological infrastructure also increased the inefficiencies of the system. The tax administration was tedious due to a manual process and less transparency and integration of data.

Therefore, the indirect tax system existed in India before GST, although it had a number of reforms, was still flawed. This became more urgent to have an integrated and comprehensive tax system that could rectify these structural defects, and, hence the GST came into the picture.

⁷ Kelkar Task Force on Indirect Taxes, Report of the Task Force on Implementation of Fiscal Responsibility and Budget Management Act (Ministry of Finance 2004) para 4.2.

⁸ Empowered Committee of State Finance Ministers, A Model and Road Map for GST in India (2009) ch 2.

⁹ Standing Committee on Finance (15th Lok Sabha), Report on the Constitution (115th Amendment) Bill 2011 (Lok Sabha Secretariat 2013) para 9.

1.2 Genesis and Objectives of GST

The advent of the Goods and Services Tax is an emergent milestone in the fiscal history of India, and change of paradigm of a disjointed tax system to a coherent and overall tax system, i.e., indirect taxation. The process of GST was neither sudden nor accidental; on the contrary, it was the final result of decades of debate, policy testing and progressive reforms directed to streamlining and rationalizing the taxation system.

The conceptual base of GST is dated back to the first half of the 21st century when the necessity of the destination-based consumption tax was first officially acknowledged. Several committees and task forces investigated the practicability of GST implementation over the years and finally, in the year 2016, the Constitution (One Hundred and First Amendment) Act came into force. This amendment in the constitution essentially changed the way taxation powers were allocated between the Centre and the States, which facilitated the possibility of having a dual GST model¹⁰.

GST has a guiding philosophy that is summed up in the phrase one nation one tax one market. The aim of this principle is to do away with the pluralism of taxes and within a seamless national marketplace goods and services can freely pass through state borders without a variety of taxes levied on them. GST will eliminate variations in taxation levels, between central and state governments, by consolidating the broad range of central and state taxes into one structure by means of uniformity, simplicity, and transparency.

The elimination of cascading effect of taxation is one of the major goals of GST. GST facilitates the smooth passage of the input tax credit through the supply chain so that the tax is charged at any time only on the addition of value at every point.¹¹ This not only minimizes the total value of tax but also increases the level of efficiency of taxation system. The other important goal of GST is to spur economic integration. GST can aid the formation of a single national market by eliminating the inter-state obstacles and unifying the taxation rates which will eventually result in the free flow of goods and services. This, in its turn, makes it more competitive and entices investment.

¹⁰ Constitution (One Hundred and First Amendment) Act 2016, inserting Arts 246A, 269A, and 279A in the Constitution of India.

¹¹ Central Goods and Services Tax Act 2017, s 16; Integrated Goods and Services Tax Act 2017, s 5.

GST is also supposed to enhance compliance with the tax by implementing the technology-based approach. ¹²Essentially, the human intervention has been minimized as a result of introduction of an online portal whereby registration, registration of returns and payment of tax can be done with high level of transparency. The invoice matching and the data reconciliation system is formed to form a self-policing system in which the conformity of one taxpayer is associated with the conformity of another.

Moreover, GST aims at expanding the tax base and raise revenue collection rates through cutting the reduction of tax evasion. Different tax systems can also be integrated into a single system resulting in improved monitoring and enforcement and hence improved overall effectiveness in tax administration. ¹³The GST implementation has shown a number of challenges irrespective of its noble goals and objectives. Problems associated with complexity of compliance, technology snags, and ambiguity have become matters of concern. Specifically, the operation of the input tax credit mechanism has been examined with an ominous interest since it directly affects the efficacy of the GST system.

1.3 **CONCEPTUAL FOUNDATION OF INPUT TAX CREDIT**

The GST mechanism is based on the concept of the Input Tax Credit, which reflects the basic principle of taxation being limited solely to value addition, and not the total amount of the transaction. It is a transition away to a credit-based tax system (as opposed to a cumulative tax system), where taxes paid at one level may be offset against the tax liability paid at future levels. Input Tax Credit is based on the concept of tax neutrality. In a neutral tax system, business decisions are not affected by the burden of taxation and market effects are not distorted by taxation. ¹⁴ITC will make sure that companies are not punished to

¹² GST Council, 'Report of the IT Strategy for GST' (GST Council Secretariat 2016) <<https://gstcouncil.gov.in>> accessed 10 March 2026.

¹³ Economic Survey 2016–17 (Ministry of Finance, Government of India) vol II, ch 4, 91.

¹⁴ Alan Schenk and Oliver Oldman, Value Added Tax: A Comparative Approach (Cambridge University Press 2007) ch 6, 145.

participate in different stages of production or distribution, ensuring efficiency and competitiveness.

ITC is based on legal rights, primarily the one under Section 16 of the Central Goods and Services Tax Act, 2017¹⁵, giving the right to claim input tax on supplies as per the course or furtherance of business to each registered person. Yet, the right is limited by some conditions and restrictions, which play an important role in the practical implementation. The logic of ITC is closely associated with the notion of value addition. Local businesses also create value to goods or services at every level of the supply chain and only that value is subject to GST. ITC makes this process possible by permitting businesses to offset the tax paid on inputs with their output tax liability, which means that tax is practically being imposed on the value added.

Economically, the ITC mechanism is important in lowering production cost and increasing business competitiveness¹⁶. Removing the cascading effect of taxes will reduce the total tax bill and allow businesses to provide goods and services at a lower price. This, on its part, will help the consumers and lead to an economic growth. ITC promotes formalization of the economy through incentives given to the businesses to conduct their operations in the tax regime.¹⁷ Because compliance depends on the availability of credit to both the supplier and a recipient, businesses have a reason to keep good records and obey regulatory provisions.

The simplicity of the idea of ITC, however, stands in stark opposition to its application in the form of GST. Multiple conditions, combined with technological and procedural issues, have turned ITC into a controversial matter. The condition that tax be paid actually by the supplier, such as, has put an extra strain on the recipient, casting doubts on the concept of fairness and equity.

Therefore, the theoretical framework of ITC, although consistent with the goals of GST, has brought to light certain critical flaws that should be subject to critical scrutiny.

¹⁵ Central Goods and Services Tax Act 2017, s 16(2)(a)–(d) (conditions: valid invoice, receipt of goods/services, supplier's payment of tax, filing of return).

¹⁶ National Institute of Public Finance and Policy (NIPFP), 'Impact of GST on Indian Economy' (NIPFP Working Paper No 214, 2018) <<https://www.nipfp.org.in>> accessed 12 February 2026

¹⁷ World Bank, 'Ease of Doing Business Report 2020' (World Bank Group 2020) 42 <<https://www.doingbusiness.org>> accessed 15 March 2026.

1.4

STATEMENT OF PROBLEM

Although the Input Tax Credit model, with reference to the GST, is meant to be an efficient and smooth process, it has faced many legal, procedural, and technological hiccups, which compromise its efficiency. Not only have these issues made it more difficult to comply with taxes, but they also have led to widespread litigation, thus casting doubt on the very premise of the GST system. It is one of the most controversial questions related to the refusal to provide ITC because of the non-conformance of the supplier. In a legal system where the current laws are applicable, the right of the recipient over ITC depends upon the supplier fulfilling his or her obligations in terms of payment of taxes and filing of returns¹⁸. This results in a scenario where bona fide taxpayers suffer the cost of defaults by third parties who they may have little to no control over. This type of framework begs critical questions about the principles of natural justice and fairness.¹⁹

The other serious matter has to do with the procedural rigidity of the ITC mechanism. The need to be strict on documentation and return filing timelines has seen the denial of credit despite the substantive conditions being met. That has contributed to an increased controversy over whether procedural requirements ought to prevail over substantive rights.

Changes to GST rules and legislation have also contributed to the issue, causing uncertainty and confusion amongst taxpayers.²⁰ The legal framework is not very stable hence it is hard to carry out activities and adhere to regulation guidelines in order to manage a business. Technology hassles are equally very significant in the inefficiency of the ITC mechanism. Problems like inaccuracies in returns, data reflection delays, technology hiccups in the GST portal have seen credit denied or reversed and in many cases without the faults having ever been the fault of the taxpayer. This dependence on digital infrastructure, which is theoretically positive, has brought with it new complexities in terms of practice.

¹⁸ Central Goods and Services Tax Act 2017, s 16(2)(c); Central Goods and Services Tax Rules 2017, r 36.

¹⁹ A V Dicey, Introduction to the Study of the Law of the Constitution (10th edn, Macmillan 1959) 202; see also Union of India v Tulsiram Patel AIR 1985 SC 1416.

²⁰ CBIC Circular No 123/42/2019-GST dated 11 November 2019; CBIC Circular No 183/15/2022-GST dated 27 December 2022.

To top these issues, courts have invoked different interpretations of the ITC, a factor that has only complicated the framework. Treatment of nature and scope of ITC has given inconsistency and unpredictability in the law as different courts have taken different approaches to ITC interpretation.

In combination, these problems point to a major mismatch between the hypothetical goals of GST and its actual application planning. The ITC mechanism that was supposed to make taxing easier and more efficient has turned out to cause controversy and uncertainty. So, this study is an attempt to critically analyse the efficacy of the ITC mechanism in GST with special regard to the legal issues with the judgmental tendencies determining it's working.

1.5 Hypothesis

The argumentative proposition of the present dissertation is that while the origin of the Input Tax Credit is statutory in nature being a legislative grant, it evolves into a constitutionally secured vested property right under Article 300A of the Constitution of India in the hands of taxpayer on the fulfilment of the substantive conditions of the transaction. This makes statutory disallowance of ITC based on actions of third-party suppliers, and the arbitrary bar by executive fiat against the Electronic Credit Ledger that is without following the principles of natural justice, ultra vires to the constitutional guarantees and inherently incompatible with the anti-cascading principle of natural justice the GST system seeks to achieve.

1.6 RESEARCH QUESTIONS

1. Whether Input Tax Credit under GST constitutes a vested right or a conditional concession, and to what extent can such credit be denied on account of non-compliance by the supplier?
2. To what extent do procedural requirements under the GST framework override substantive rights of taxpayers, and what are the key legal challenges arising from such an approach in the implementation of the ITC mechanism?

3. How have judicial interpretations shaped the scope and application of Input Tax Credit under GST, and whether the existing framework effectively fulfils the objectives of GST in ensuring tax neutrality and economic efficiency?

1.7 **RESEARCH METHODOLOGY**

The dissertation adopts a primarily doctrinal legal research approach, largely relying on the analytical analysis of primary and secondary texts. The primary sources are the Constitution of India, the bare text of the Central Goods and Services Tax Act, 2017, the respective CGST Rules, 2017, and the various notifications and circulars by the Central Board of Indirect Taxes and Customs (CBIC). Crucially, as a methodological foundation, the main emphasis of the study is on a critical analysis of the precedents set so far by the Supreme Court of India and other State High Courts, side-by-side with the analysis of the reports of the GST Council meetings and the Value Added Tax (VAT) system of the European Union and the Goods and Services Tax system of Australia. The arguments have been summarised to understand the evolution of the law from its inception to the recent law amendments by the Finance Act 2025. Through this multi- dimensional approach in doctrine, all aspects of the law and the practical application of the law are examined in detail through the process of judicial review.

1.8 **CHAPTERIZATION**

The current dissertation includes five chapters that discuss a particular aspect of the research problem in a logical and sequential way.

Chapter I: Introduction and Research Framework

This chapter will discuss the fundamentals of the work, the background of indirect taxation in India, the introduction of GST, the conceptual introduction of Input Tax Credit, problem statement, research questions, research hypothesis, scope and limitations, research methodology, literature review and a brief chapterization of the work.

Chapter II: Development, International Comparison and Statutory provisions of Input Tax credit under GST

This chapter deals with the evolution of the Input Tax Credit system from the pre-GST era to the present system. It also compares it with other tax regimes in the world and provides a detailed discussion of statutory provisions of ITC under the Central Goods and Services Tax Act, 2017, conditions for claiming ITC, its limitations and the process involved.

Chapter III: Legal problems of the input tax credit

This chapter is a critical analysis of the various legal and practical challenges of the ITC structure such as the denial of credit for a supplier's default, procedural hurdles, retrospective amendments, constitutional provisions and technological wastage in GST.

Chapter IV: Evolution of judicial practices and case studies

This chapter is dedicated to the evolution of judicial practice with respect to ITC in the GST. It highlights some of the findings of the Supreme Court and other Higher Courts, stressing the different interpretations, the development of the doctrine and of the judicial function in creating the scope and importance of the ITC provisions.

Chapter V: Economic Impact, Reforms and Conclusion

The final chapter explores the economic effects of the ITC mechanism to businesses and to the tax system as a whole. It also identifies the shortcomings and suggests necessary legal, policy and technological reforms. The chapter is complemented with the concluding remarks and a summary of the findings.

1.9

LITERATURE REVIEW

Sr. No	Nature of Literature	Name of Literature	Covered / Review	Research Gap in Literature	Intended Research
1	Journal Article	Sukumar Mukhopadhyay, "Input Tax Credit under GST – Conceptual Issues and Practical Challenges" (2018) 48(3) Economic and Political Weekly 44	Analyses the conceptual design of the ITC mechanism under GST, focusing on eligibility conditions under s 16 CGST Act, the invoice-matching system and initial implementation difficulties faced by businesses in 2017–18.	The article does not examine post-2019 amendments such as Rule 36(4) cap on ITC or the shift from GSTR-2A to GSTR-2B, nor does it address constitutional validity of ITC denial based on supplier non-compliance.	This dissertation extends the analysis to cover the legal and constitutional dimensions of ITC denial, judicial trends post-2019, and the impact of technological reforms on ITC availability.
2	Journal Article	R Kavita Rao and Sacchidananda Mukherjee, "Evolution of GST in India: A Critical Review" (2019) 54(31) Economic and	Provides a comprehensive review of the structural evolution of GST from the Kelkar Task Force recommendations to implementation,	Does not focus specifically on the legal challenges arising from ITC denial, supplier-default liability on recipients, or the growing	This dissertation specifically analyses legal challenges and judicial trends that have emerged in ITC litigation, filling the gap left by macro-economic

		Political Weekly 32	examining revenue performance, rate rationalisation and the design of the ITC mechanism across the dual GST model.	body of judicial interpretation shaping ITC rights post- 2018.	GST evaluations.
3	Research Paper	Pinaki Chakraborty, "GST in India: An Assessment of the First Year" (NIPFP Working Paper No 233, National Institute of Public Finance and Policy 2018)	Assesses the first year of GST implementation, covering revenue buoyancy, return-filing compliance rates, GSTN portal performance issues and the cascading effect on MSMEs. Discusses early ITC-related compliance failures.	Being limited to the first year, the paper does not capture the evolution of ITC jurisprudence, the impact of Finance Act amendments (2021–2024), or the Supreme Court judgments in VKC Footsteps (2022) and Bharti Airtel (2021).	This dissertation covers the full arc of ITC litigation from 2017 to 2025, including landmark SC judgments and constitutional challenges not available at the time of Chakraborty's study.
4	Legal Report	Comptroller and Auditor General of India, "Performance	Official audit of GST implementation covering systemic	The report is an administrative audit document, not a legal analysis. It does	This dissertation uses the CAG findings as empirical foundation and

		<p>Audit on Implementation of Goods and Services Tax" (CAG Report No 11 of 2022, Government of India 2022)</p>	<p>deficiencies in the GSTN portal, data mismatches in GSTR-2A/2B, ITC fraud trends, delayed refunds and compliance burden on taxpayers. Identifies over ₹45,000 crore of irregular ITC claims.</p>	<p>not evaluate the constitutional validity of ITC denial, examine judicial trends or propose legal reforms to the ITC framework.</p>	<p>builds upon them with a doctrinal legal analysis of ITC denial and constitutional challenges, which the audit report does not undertake.</p>
5	<p>Journal Article</p>	<p>Mahesh C Purohit, "Goods and Services Tax: An Appraisal" (2017) 52(47) Economic and Political Weekly at 15</p>	<p>Critically evaluates the design of GST at the time of its enactment, assessing GST as a dual GST, a rate structure, the destination principle and the design of Input Tax Credit (ITC) as a mechanism to avoid cascading effect.</p>	<p>The article was written at the launch of the GST and is predictive and descriptive. It does not tackle real-world disputes, judicial interpretations and s 16(2)(c) procedural inflexibility that have been faced after it.</p>	<p>This thesis offers the expected empirical and legal analysis of post-implementation practice that Purohit's article is unable to provide, analysing how the judiciary has dealt with cases and problems encountered in the administration of the ITC.</p>

6	Journal Article	Arvind P Datar, "GST and Input Tax Credit: Legal Framework and Issues (2020)	The article provides a doctrinal analysis of the statutory framework of the Input Tax Credit under the CGST Act, particularly Section 16-18. It critically sets out the multifaceted eligibility criteria for ITC, procedural compliance obligations and the interaction between the statutory and the delegated law (such as Rule 36(4)). The article deliberates on interpretative ambiguities and reflects the dynamic nature of compliance requirements in GST.	While embarking on a doctrinal exercise, the article fails to adequately consider the evolving judicial debates around ITC, in terms of procedural compliance and substantive entitlement. It also lacks a constitutional perspective, thereby overlooking the constitutionality of restrictive provisions as against fundamental freedoms.	This work builds on the doctrinal framework by including a judicial and constitutional analysis, exploring judicial interpretations of ITC provisions and how they harmonise with notions of justice, proportionality and certainty.
7	Research Paper	EY India, "GST: Perspective on	This paper offers a comprehensive empirical and	It takes an economic and operational	This dissertation could fill this gap by

		the Impact of Input Tax Credit on Businesses" (2019)	operational assessment of ITC in the GST regime and its effects on business cash flows, supply chains and working capital. It emphasises the criticality of free flow of credit and the challenges faced by businesses in the GST roll-out.	approach, with little legal reasoning or legislative interpretation. The paper does not extend to litigation trends, constitutional or legal implications, or the impact of denial of ITC for non-compliance.	combining economic with legal perspective and undertaking a multi-approach scrutiny of ITC including doctrinal interpretation, jurisprudential trends and constitutional implications.
8	Journal Article	V S Datey, "GST Ready Reckoner" (2021)	This book is a complete and coherent commentary on the provisions of GST, providing elaborate accounts of ITC, restrictions, blocked credits and procedural safeguards for ensuring compliance. It stands out for its clarity in understanding	The existing work is primarily descriptive and explanatory, with little critical analysis of difficult legal questions, judicial variations, and constitutional issues related to ITC denial.	This dissertation is an attempt to complement the descriptive framework with an analysis of judicial interpretation, doctrinal disputes and the significance of ITC restrictions.

			provisions, and is professionally oriented.		
9	Government Report	GST Council Secretariat, Report on the Trends in GST Revenue and ITC (2023))	This report gives a statistical insight into the trends of ITC claims, mismatches, compliance and crux. It gives us a glimpse into systemic problems, and technological and administrative roadblocks under the GST.	This report is "statistics- only", and fails to provide an in-depth analysis in the legal, judicial and constitutional context. It does not make any legal analysis of the problems highlighted.	This dissertation uses these empirical findings as a starting point to build a strong legal and doctrinal analysis, which provides a deeper understanding of the statistical data, and its ramifications in tax law.
10	Journal Article	S Krishnan, "Denial of Input Tax Credit and Constitutional Validity" (2022)	This article deals with the constitutional implications of ITC denial, in relation to Articles 14 and 19(1)(g) of the Constitution. It explores important questions of arbitrariness, proportionality	It offers a narrowly-focused analysis, with little discussion of seminal court cases and as yet insufficient doctrinal development. It fails to adequately address	This dissertation adds to the constitutional debate by analysing precedents, examining the legitimacy of restrictions on ITC, and the constitutional implications of these restrictions.

			and reasonableness of taxpayer restrictions.	conflicting judicial reasoning in various courts.	
11	Research Paper	PwC India, "GST Compliance and ITC Challenges" (2020)	The paper identifies key compliance issues, such as mismatches in invoices, filing delays and reversal of ITC for procedural error. The paper offers real-world insights into the challenges taxpayers encounter.	The paper does not explore the legal recourse available to taxpayers, nor the attitude of the courts to compliance disputes, therefore it does not provide a complete picture.	This dissertation adds to research by studying the transformation of compliance issues into court disputes and court actions on these disputes.
12	Journal Article	Nani A Palkhivala (Commentary References)	It is reflective of fundamental constitutional principles of taxation such as equity, reasonableness and taxpayer rights to not be arbitrarily dealt with by the state.	The work is not specific to the GST and does not discuss the issues related to ITC or recent tax problems.	The present dissertation explores these principles in the context of GST, as applied to ITC disputes.
13	Book	Girish Ahuja & Ravi Gupta, "Systematic	This book offers a systematic exposition of	This book does not critically examine	The present dissertation builds upon this

		Approach to GST" (2022)	GST provisions, including provisions on ITC, its exclusions and compliance requirements.	judicial developments and doctrinal debates.	by playing out judicial and doctrinal analysis.
14	Journal Article	KPMG India, "GST, Compliance and Beyond" (2021)	It explores the rise in the compliance burden under GST, including reconciliation of input tax credit (ITC) and IT problems.	It does not address the legal implications and judicial reactions to such issues.	The dissertation explains the connection between compliance burdens and litigation/judicial issues.
15	Research Paper	Deloitte India, "Input Tax Credit: Practical Challenges and Solutions" (2022)	The paper lists technical challenges like supplier default, documentation problem and system inefficiencies affecting the ITC claims.	It does not take a doctrine and constitutional view to these problems.	This dissertation examines these problems from a judicial and constitutional perspective.
16	Journal Article	Abhishek Rastogi, "Analysing Trends in GST Litigation in India" (2023)	The paper provides a comprehensive sketch of the burgeoning litigation under the GST regime,	Although rich in empirical insights, the article does not delve deep into a doctrinal and jurisprudential	This dissertation goes beyond the descriptive level, exploring the evolving scope of ITC entitlement,

			<p>especially in relation to Input Tax Credit (ITC). It charts the flow of litigation across High Courts providing finer detail of incessant issues such as derision of ITC on account of supplier failure, procedural oversight and system incompatibilities. It acknowledges the growing judicial burden, and contemplates the uncertainties in GST administration.</p>	<p>exploration of the root causes of such disputes. It lacks an adequate analysis of the philosophical balance between taxpayer rights and revenue protection and the constitutional debate to sustain contentious ITC provisions.</p>	<p>through doctrinal and constitutional analysis, on how courts approach the issue and its impact on the tax administration and jurisprudence.</p>
17	Government Report	Ministry of Finance, "GST Annual Report" (2022–23)	<p>The report is a comprehensive and data-heavy account of the performance of the GST, containing robust statistics on the</p>	<p>The report is administrative and statistical by nature, free from any discussion on legal disputes, semantic</p>	<p>This dissertation takes the data in such reports and analyses it in a legal and constitutional framework to highlight the</p>

			ITC claims, utilisation, compliance and collection. It is a testament to the macroeconomic importance of ITC to the GST system, and its importance for tax administration and revenue stability.	uncertainties and constitutional issues surrounding the denial of ITC. It also fails to consider the growing disparity between the policy and operational aspects of GST.	inefficiency and inconsistencies of the ITC system.
18	Journal Article	Tarun Jain, "Input Tax Credit and Its Restrictions under GST" (2021)	The article offers a comprehensive discussion of statutory limitations on ITC, especially Section 17(5) and blocked credits. It categorises various exclusions and delves into their underlying purpose, thus elucidating the restrictive nature of ITC rules.	The research is focused on statutory interpretation rather than judicial interpretation and the constitutional analysis. It does not critically assess these restrictions' congruence with the core principle of tax neutrality, or their impact on taxpayers.	My research builds on the statutory analysis by including judicial and constitutional analysis, to evaluate the validity and equity of ITC restrictions within the broader legal context.

19	Research Paper	The Federation of Indian Chambers of Commerce & Industry (FICCI), "GST Reforms and Industry Perspective" (2023)	The paper represents an industry view on GST reforms, including issues related to ITC, such as compliance costs, delayed refunds and ITC mismatch. It presents the challenges for businesses and raises the need for policy changes.	The paper largely focuses on industry, with no specific legal and doctrinal framework. It is not based on judicial interpretations and constitutional doctrines, which restrains its analysis.	This dissertation combines industry insights with legal insights to present a comprehensive assessment of ITC challenges, promoting interactions between policy and court perspectives.
20	Journal Article	Shreya Singhal (Comparative Reference)	The paper presents a high-level view of digital governance and digital compliance, and the problematics of technologically enabled governance models. It offers a range of insights into digital	This research is not explicitly linked to GST; it does not explicitly explore issues relating to the technology used in GST, such as portal inefficiencies and data mismatches.	This study expands on such insights to GST by critically examining the technology behind the GST portal and its impact on ITC, and, thus, links the theory of digital governance to taxation.

			compliance frameworks and regulatory space.		
21	Book	V S Datey, "Indirect Taxes Law and Practice" (2022)	This book is a comprehensive and definitive treatment of indirect tax law, including a comprehensive coverage of GST and ITC. It is well-organised in its explanation of various conditions, procedures and statutory laws that make it an essential resource for practitioners and academics.	The book is comprehensive, but relatively non-critical in its discussion of jurisprudence or constitutional arguments. It fails to discuss the jurisprudence on ITC as a legal right.	This doctoral thesis adds a deeper, advanced doctrinal and jurisprudential study of such books, in relation to the interaction between statutory law and case law.
22	Journal Article	ICAI, "Background Material of GST"	It offers a systematic and technical introduction to GST laws that includes guidance on the eligibility for ITC, compliance and	The material is pedagogic and does not engage in a critical manner with legal debates, judicial inconsistencies, and constitutional	My doctoral thesis introduces a critical legal analysis to the technical material by examining the interpretation and contest of the procedural

			documentation requirements. It is an invaluable resource on the functioning of GST.	issues. Finally, it is not focused on the normative significance of ITC denial.	rules in the courts.
23	Research Paper	World Bank "VAT Systems: International Comparison"	The paper provides a broad overview of VAT systems, with a particular focus on the notion of seamless credit flow and neutrality. It makes the case for best practices in ITC and key design features of efficient tax systems.	The research fails to explain the unique legal, constitutional and administrative issues with the Indian GST. It does not consider local jurisprudence.	This dissertation examines and contextualises best practices from across the world in the Indian legal context, questioning the extent to which the Indian ITC system complies with international principles of tax neutrality and efficiency.
24	Journal Article	European Commission, "VAT Directive Analysis"	The article provides an in-depth analysis of the EU VAT Directive, focusing on the foundational principles of tax neutrality, proportionality,	The analysis is jurisdiction-specific and does not directly address the complexities of the Indian GST system, particularly its	This dissertation undertakes a comparative analysis, drawing parallels between EU VAT principles and Indian GST law to evaluate

			and the uninterrupted flow of input tax credit. It underscores the importance of ensuring that ITC remains a substantive right rather than a conditional concession.	unique compliance structure and judicial landscape.	the extent to which Indian ITC provisions adhere to or deviate from globally accepted norms.
25	Research Paper	OECD, "Consumption Tax Trends"	The report provides a macro-level analysis of global consumption tax systems, including trends in GST/VAT implementation, ITC utilisation, and compliance mechanisms. It highlights the centrality of ITC in ensuring economic efficiency and preventing cascading taxation.	The study adopts a broad economic perspective and does not delve into jurisdiction-specific legal challenges, particularly those arising within the Indian GST framework. It lacks doctrinal and judicial analysis.	This dissertation synthesises global economic insights with domestic legal analysis, offering a nuanced evaluation of ITC that incorporates both macroeconomic considerations and micro-level judicial interpretation.

CHAPTER II

2. EVOLUTION, COMPARATIVE ANALYSIS & STATUTORY FRAMEWORK OF ITC

PART A -EVOLUTION OF THE INPUT TAX CREDIT IN INDIA.

2.1 MODVAT and CENVAT regime: formation and restriction

The development of the Indian Input Tax Credit system may be followed to the implementation of the Modified Value Added Tax (MODVAT) program in 1986. ²¹Before this reform, the Indian system of indirect taxation had been typified by a cascading nature, where excise duty is charged on the entire value of the manufactured goods, without any credit being granted on the taxes paid on the inputs. This had an effect of a tax-on-tax effect which has greatly inflated production costs and makes the domestic industries less competitive. The implementation of MODVAT was a radical break of this ancient system. It enabled manufacturers to get the credit of the excise duty on inputs which they used in manufacturing final goods. ²²This mechanism aimed at providing that tax is charged on added values at every production point to make the system of taxation consistent with the doctrine of efficiency and neutrality.

The MODVAT scheme also experienced a number of adjustments with time and was ultimately substituted with the use of the CENVAT (Central Value Added Tax) system in 2000. ²³ The credit regime regarding the CENVAT regime broadened the coverage of credit to input services and capital goods beyond only inputs. ²⁴It was an important development, accepting the growing interconnection of the goods and services in the new economy. Regardless of these improvements, the system of the

²¹ Government of India, Ministry of Finance, Budget Speech 1986–87 (Lok Sabha 1986); Central Excise Rules 1944 (as amended by Central Excise (Amendment) Rules 1986).

²² Central Excise Rules 1944, r 57A (inserted in 1986); Collector of Central Excise, Baroda v Dhiren Chemical Industries (2002) 2 SCC 127.

²³ CENVAT Credit Rules 2001 (GSR 600(E) dated 11 May 2001); replaced by CENVAT Credit Rules 2004 (GSR 600(E) dated 10 September 2004).

²⁴ CENVAT Credit Rules 2004, rr 2(a), 2(k), 2(l) (definitions of 'capital goods', 'input', and 'input service').



MODVAT/CENVAT had a few flaws that were inherent. To begin with, the credit mechanism was also limited when it came to central taxes only and not at state level taxes like Value Added Tax (VAT). Such overcoming of integration implied that businesses were not able to avail credit throughout the supply chain and such a cascading impact were continued to an extent.

Secondly, the system was described as highly complex system. Eligibility of credit was commonly pegged in the classification of goods and services and as a result this subject to disputes between taxpayers and tax authorities. There was a tendency to confuse the inputs, the capital goods and the input services and this brought about interpretational ambiguities.

Thirdly, the compliance burden was high due to procedural inflexibilities and documentation needs. Companies had to keep detailed records and follow stringent terms of using credit. Any slight default may lead to grant of the credit and thus compromise the effectiveness of the system. Moreover, the credit mechanism was ineffective because of the lack of a well-developed technological base. The use of manual processes made the process more prone to errors and took a longer time to reconcile credits.

Basically, though the MODVAT and CENVAT regimes were considered significant milestones to fully geared towards value added taxation mechanism, it failed to present seamless credit mechanism.²⁵ These constraints demonstrated the necessity to have an inclusive change that would bring about a unified tax regime and remove leakages in the provision of input tax credit at various levels of the supply chain.

2.2 Judiciary recognition of ITC

The history of the development of the Input Tax Credit scheme in India has not been the only field in which the developments of the legislative nature alone have made the impact but judicial interpretation has played the key role in shaping the history of

²⁵ State-level Value Added Tax Acts (various states, 2003–2008); Report of the Vijay Kelkar Task Force on Implementation of FRBM Act (2004) Annex II.

development of the scheme. The judiciary especially the Supreme Court has been excellent in specifying the nature and scope of ITC particularly in the pre-gst regime.

Eicher Motors Ltd. v. Union of India²⁶ is one of the landmark births in such a case. The Supreme Court in this instance decided on whether credit accrued under the scheme of credit under the MODVAT scheme can be limited in a later amendment. The Court considered that credit which is received was once respectably earned it was a vested right of the taxpayer and could not be deprived of it arbitrarily. This decision highlighted the fact that input credit, having been accrued became part of the property of the taxpayer and is immune to retrospective deprivation.

In the same case: ***Dai Ichi Karkaria Ltd. v. Union of India***²⁷, the Supreme Court restated the character of MODVAT credit as an indefeasible right. The Court noted that credit is just as good as tax paid and can be used by the manufacturer, anytime as long as the conditions are under the law. The ruling also bolstered the juridical rule that ITC is not a mere concession but robust right which taxpayers are entitled to enjoy. All these rulings provided a legal basis on the jurisprudence of ITC, as a vested right, and part of the value-added taxation regime. The acknowledgment of ITC as a right meant that any tax payer had a guarantee that the credit mechanism was stable and predictable thus creating faith in the tax mechanism. It is to be noted, though, that this judicial acknowledgement was mostly covered within the framework of the MODVAT/CENVAT regime. The courts hereby pointed out that as long as the legislature has the freedom to control the terms in which the credit is availed, the legislation must not be capricious or unreasonable.²⁸

These decisions are important because their relevance has persisted. Even during the GST period, taxpayers tend to use such precedents as an argument that ITC should not be withheld under technical or procedural reasons. Nonetheless, as it will be seen in other chapters, with the move towards GST there has been a relocation in judicial principle, with judicial bodies becoming more and more prone to regard ITC as a conditional right and not necessarily an absolute one.

²⁶ *Eicher Motors Ltd v Union of India* (1999) 2 SCC 361 (SC), holding that MODVAT credit once earned is a vested right and cannot be deprived arbitrarily by subsequent amendment.

²⁷ *Dai Ichi Karkaria Ltd v Union of India* (1999) 7 SCC 448 (SC), reiterating that CENVAT/MODVAT credit is as good as tax paid and constitutes an indefeasible right.

²⁸ *Whirlpool Corporation v Registrar of Trade Marks* (1998) 8 SCC 1 (SC) (doctrine of vested rights); *Mafatlal Industries Ltd v Union of India* (1997) 5 SCC 536 (SC) (limits on retroactive fiscal legislation).

2.3

Transition to GST Structural and Conceptual Shift

Introduction of the Goods and Services Tax saw a radical change in conceptual and structural approach of the Input Tax Credit mechanism in India. Although the pre-GST regime was a forerunner to the value-added taxation regime, GST has attempted to provide an inclusive and unified system of value-added taxation which will facilitate smooth movement of credit throughout the entire supply chain. Under the GST, there has been minimal differentiation in goods and services that have enabled cross utilization of credit.²⁹ This is a great improvement compared to the previous system where the tax on goods and services was separated, thus limits credit was oftentimes limited. The GST structure is made to make sure that it is the value addition where the tax is imposed with the focus of ITC being central to fulfilling this aim.

Nevertheless, there has also been a significant change in terms of legal characterization of ITC when the shift towards GST is considered. In contrast to the MODVAT /CENVAT system, wherein ITC was commonly considered to be a right of passage, ITC is a conditional right under the GST. Section 16 of the Tax on goods and services, central, 2017, expressly provides a registered person a right to ITC upon the compliance with known conditions.

These conditions include:

- Holding of a valid tax invoice.
- Receipt of goods or services
- Supplier payment of tax.
- Filing of returns

The change of these conditions to a more compliance-oriented approach can be seen. The dependency between the supplier and the recipient that tax needs to be paid in fact, by the supplier, such as the introduction of dependency, is not as high as in the previous regime. This change has great implications to taxpayers. The contractility of ITC also heightens the effect of denial of credit especially when the supplier misses on his/her

²⁹ Integrated Goods and Services Tax Act 2017, s 5; Central Goods and Services Tax Act 2017, s 16 (permitting cross- utilisation of IGST credit against CGST and SGST).

part. Another concern that arises is whether it is fair to subject such conditions on recipients that have been acting in good faith.

PART B – COMPARATIVE ANALYSIS

2.4 United Kingdom VAT System in the Input Tax Credit

Value Added Tax (VAT) system is one of the most organized and advanced systems of the indirect tax within the United Kingdom, in terms of the execution of input tax credit.³⁰ With the UK VAT structure, companies are allowed to claim the VAT paid on inputs (input tax) against the VAT paid on the output (output tax) and thus make sure that tax is imposed on addition of value at every level of the supply chain. Input tax credit entitlement in the UK is mostly regulated by law and HM Revenue and Customs administrative policies. The first aspect that is inherent in availing input tax is having a valid VAT invoice which is the register of a transaction. The credit is mostly allowed once this condition is met, and the transaction is carried out on genuine basis and in case of taxable business purposes. One interesting aspect concerning UK system is its taxpayer concept whereby the onus of supplier non-compliance is not imposed on the recipient as a rule.³¹ This has always been pointed out in the courts and in tax authorities whereby a bona fide purchaser who has been acting in good faith and has been exercising reasonable diligence should not be denied input tax credit on the basis that the supplier failed to pay the tax. The UK model therefore translates to a strike of balance between efficiency in administration and protection of the taxpayer. The system reduces litigation and provides some certainty in the administration of taxes by concentrating on documentation and good faith actions instead of being overly reliant on the compliance of the supplier.

³⁰ Value Added Tax Act 1994 (UK), s 24 (input tax); HM Revenue & Customs, 'VAT Guide' (Notice 700, HMRC 2023) <<https://www.gov.uk/guidance/vat-guide>> accessed 5 March 2026.

³¹ *Axel Kittel v Belgium and Belgium v Recolta Recycling SPRL* (Joined Cases C-439/04 and C-440/04) [2006] ECR I- 6161 (CJEU), adopted in UK jurisprudence; *Mobilx Ltd v HMRC* [2010] EWCA Civ 517.

2.5

European Union VAT Model input Tax credit

The VAT framework in the European Union is guided by the EU VAT Directive that provides a common framework of application by member states but has the freedom of slight variation in the application³². One of the core values that lay the foundation of EU VAT system is tax neutrality and, as such, tax does not turn into an expense of business that undertakes the economic activity. The right to input tax credit is regarded to be an essential and a part of VAT system within EU. The Court of Justice of the European Union has made it clear severally in reaction to the non-denial of input tax credit that it should be an exception to the rule. The judicial opinions have always been that the credit cannot be refused to a taxable person to the extent that the substantive requirements are met unless there is room of fraud, abuse of law or involvement in tax evasion which is wilful. In the EU approach, much attention is paid to the content of transactions rather than formalities. Input tax credit is usually allowed even in cases of minor lapses in the process as long as the key requirements, which include the actual supply of goods or services, and payment of tax are met. More so, the EU framework insulates the recipients against the effects of defaulting suppliers, unless such defaulting suppliers are proved to have been aware or participated in frauds by the recipient.³³ This is a means of strengthening the legal certainty and preserving the principle of neutrality.

2.6

Comparative Observations

(i) Supplier Default and Bona Fide Taxpayer Protection.

One main divergence between the UK/EU VAT and the Indian GST regime is how to treat the default of suppliers. The law in the UK and the interpretation of the law in the EU to a large part has cushioned the recipient of the adverse consequences occurring out of non-compliance of suppliers where the recipient has been acting in good faith and in compliance with the documentary conditions given to her. The emphasis is more on the authenticity of the transaction and not the future behavior of the supplier.

³² Council Directive 2006/112/EC of 28 November 2006 on the Common System of Value Added Tax [2006] OJ L347/1 (EU VAT Directive), Arts 167–192.

³³ Optigen Ltd v Customs and Excise Commissioners (Case C-354/03) [2006] Ch 218 (CJEU); Kittel (n 36) (innocent purchaser protected unless aware of or participant in fraud).

However, according to Central Goods and Services Tax Act, 2017, input tax credit depends on several statutory conditions to be met, such as the fact that the supplier actually pays tax to the government. This brings dependency which puts the recipient at risk of things which they cannot influence, therefore compromising the security of credit rights. The issue posed by this deviation is much more to do with equity and proportionality, especially where the recipient has no reasonable way of enforcing the compliance of the supplier.

(ii) Simplicity vs. Regulatory Control

The other significant point of difference appears in the trade-off between complexity and regulatory regulation. The UK and EU VAT systems focus on simplicity, transparency, and compliance and have fewer requirements to be satisfied in the availability of input tax credit. It is focused on eliminating red tape and supporting trade as well as burdens on administration, which in effect promote voluntary compliance and minimization of disputes. In contrast, the Indian GST system follows rather a control-style design, which is detailed, integrates technology (i.e. invoice matching), and is rigid and resolute in its compliance. Although these are to be taken to reduce tax evasion and increase revenue collection efforts, they also bring complexity and raise the chances of a lawsuit. Therefore, the UK and EU models are a reflection of a trust-based model that is founded on the protection of the taxpayer whereas the Indian model is a model that is based on a compliance approach that centers on enforcement. The Indian GST regime has the challenge of opting to balance these competing objectives to come up with the best overall balance.

Concluding Remark

As revealed in the comparative analysis, the Indian GST system may not appear to be in line with the global best practices because even though it is structurally comprehensive, it does not treat input tax credit the way other systems do. The UK and EU models have shown that tax neutrality, judicial predictability, and safeguard of bona fide taxpayers is systemic equal indices to accomplish both effectiveness and conformity without subjecting bona fide taxpayers with inappropriate burdens. These

are important insights in deciding the efficacy of ITC mechanism in India as well as in advancing later reforms.

PART C – STATUTORY FRAMEWORK UNDER GST

2.7 The legal basis of input tax credit

The reference legal basis of the mechanism of the Input Tax Credit (ITC) in India lies mostly in the Central Goods and Services Tax Act, 2017 (CGST Act),³⁴ according to which the scheme of GST is implemented. The conceptualization of ICT in the Act reduces ICT to a statutory right which is no more than conditional. This gives it a tremendous break to the previous MODVAT/CENVAT jurisprudence.

The essence of integration of ITC into the statutory framework is to see to it that cascading taxation is eliminated by letting the taxes paid at an earlier point in the supply chain being credited. But, in contrast to previous regimes, the law on the GST clearly states that this right is conditional to the observance of the procedural and substantive conditions.

The legislative construction bears a twin purpose:

- To help high flow of credit within the value chain.
- To protect income by introducing restrictions and controls.

In that way, we can construct that the legal feature of ITC, with GST, is not facilitative, but also regulatory, and significant in terms of both efficiency and compliance enforcement of taxes.

³⁴ Central Goods and Services Tax Act 2017 (Act No 12 of 2017), Preamble and ss 2(63), 16–21.

2.8 Section based Analysis on ITC Provisions

Section 16 – Eligibility and Conditions³⁵

The cornerstone provision in regard to the ITC is section 16 of the CGST Act. It provides the fundamental requirements that need to be met in obtaining credit. These include:

Having a document that records a legal invitation to supply the goods: The taxpayer should have a legally binding document or an invoice/prescription that shows supply. This is necessary so that it is traceable and authentic in the transactions.

Goods of services received: It is under that receipt of the goods or services received will only entitle the presentation of the ITC. This circumstance averts untimely or fraudulent claims.

Payment of tax by supplier: This is one of the most controversial terms as it requires the supplier to have paid tax to the government. This turns it into a reliance on compliance by the supplier and has resulted in significant litigation.³⁶

Submission of returns: The recipient is required to make returns under the GST law, where credit claims are to be clearly disclosed and must be reunified in the system.

Section 17- Apportionment and Blocked Credits

In accordance with Section 17 1 of the New Jersey Plan, the apportionment shall be by number of inhabitants; furthermore, in accordance with Section 17 11 of the New Jersey Plan, the apportionment shall be for thrice the term of the governor or Senate seat to which it applies.

Part 17 concerns the allocation of credit, and specifies types of blocked credit

Business vs Non-Business Use: The restriction of business is limited to the usage of inputs in business career. Credit should be reversed proportionally where the goods or services are consumed partly in business and partly in personal use.

³⁵ Central Goods and Services Tax Act 2017, s 16(2)(a); Central Goods and Services Tax Rules 2017, r 36(1)(a) (tax invoice as mandatory document)

³⁶ Central Goods and Services Tax Act 2017, s 16(2)(c); Arise India Ltd v Commissioner of Trade and Taxes Delhi (2018) 52 GSTR 1 (Del HC) (constitutional challenge to this condition).

17(5) -Blocked Credits: ³⁷According to this section, there are certain items and service where ITC is not applicable, which include:

- Motor cars (except on occasion)
- Catering and food, outdoor catering.
- Club membership, health and fitness.
- In some cases, works contract services.

The blocked credit features is an obviously definite policy selection to limit ITC especially in those regions where it is deemed likely to abuse or unnecessary to the business man or woman. Nonetheless, the sheer breadth of the document and the vague nature of the interpretation of some of the entries has resulted in a great deal of controversy.

Section 18: ³⁸Availability in Special Cases

Section 18 controls ITC in a certain condition as the following:

- New registration under GST
- Voluntary registration
- Change composition scheme to regular scheme.
- Accessibility of transition credits within a move in between pre-GST and GST regime.

This is to provide a balance that seeks to avoid the unfair detriment of business in regards to structural alteration in businesses in terms of taxation. The adoption of transitional credit provisions however has been difficult due to technical and procedural issues.

Sections 19 to 21: ISD, Recovery, Matching

Section 19 concerns ITC as regards to inputs being sent to job work, which gives flexibility to the manufacturing processes.

³⁷ Central Goods and Services Tax Act 2017, s 17(5)(a)–(h); Safari Retreats Pvt Ltd v Chief Commissioner of CGST (2019) 25 GSTL 341 (Ori HC) (validity of blocked credit on construction services).

³⁸ Central Goods and Services Tax Act 2017, s 18(1)(a)–(d); Central Goods and Services Tax Rules 2017, r 40.

Section 20 outlines the concept of the so-called Input Service Distributor (ISD)³⁹ which is recommended to distribute the credit among various units of a business.

Compliance framework is enhanced by section 21 recovering excess or wrongly availed ITC. These clauses all contribute to doing the operationalization of ITC in intricate business setups and ensuring that it has control at the regulatory level. The province of Newfoundland and Labrador adheres to a comprehensive framework outlining laws, financial policies, regulatory authorities, institutional mandates, government jurisdiction, and business laws within the nation.

2.9 Rules and Compliance Framework

The province of Newfoundland and Labrador follows an exhaustive framework which defines laws, financial policies, regulatory authorities, institutional mandates, government jurisdiction, and business laws in the country.

The rules are provided to be supplemented by detailed rules under the Central Goods and Services Tax Rules, 2017.

Rule 36(4): ⁴⁰Under this rule, ITC is limited to invoices which are recorded in the auto- created statements of the recipient (e.g. GSTR-2B), attributing access to credit to compliance.

Rule 42 and 43: ⁴¹This rule is an indication of the mechanism that are used to reverse ITC in exempt supplies or mixed use (business and non-business). The equations presented in these rules are not simple to compute.

The GST compliance structure is very elaborate and technology oriented indicating the effort to come up with a strong and clear system. These laws are, however, complicated and are likely to increase compliance to the detriment of taxpayers.

³⁹ Central Goods and Services Tax Act 2017, s 20; Central Goods and Services Tax Rules 2017, rr 39(1)–(2) (ISD mechanism and distribution).

⁴⁰ Central Goods and Services Tax Rules 2017, r 36(4) (inserted by Notification No 49/2019-CT dated 9 October 2019, later amended by Notification No 39/2021-CT dated 21 December 2021).

⁴¹ Central Goods and Services Tax Rules 2017, rr 42–43; CBIC Circular No 79/53/2018-GST dated 31 December 2018 (clarification on apportionment).

2.10 Matching Concept & Return System

One major invention that has distinguished the GST regime is the invoice matching idea that aims to guarantee precision and bar frauds of credit card claims.

That system is based on several returns:

GSTR-1:⁴² Supplier, details of outward supplies.

GSTR-2A and GSTR-2B: Automatic generated statements of inward supplies to the recipient.

Theoretically, ITC should only be provided when the information presented by the supplier is in accordance with the claims presented by the recipient. In practice, however, the matching mechanism has encountered some problems:

- Technical hiccups in the GST portal.
- Sluggish or inaccurate filings by the suppliers.
- Faults causing denial or reversal of ITC.

All these have led to confusion and courtroom battles, casting doubt on the practicability of strong matching conditions.

2.11 Time Limits and Amendments

Section 16(4)⁴³ of the CGST Act stipulates the period within which ITC is to be availed whereby the period is usually during the due date at the month of September after the end of the financial year or when annual return is filed whichever is earlier. This provision has been amended over time to find solutions to practical challenges of taxpayers. However, this has not been the case as strict time limit has most of the time led to denial of legitimate credits as a result of procedural delays.

⁴² Central Goods and Services Tax Rules 2017, rr 59 (GSTR-1), 60 (GSTR-2A), 60B (GSTR-2B); CBIC Circular No 148/04/2021-GST dated 18 May 2021 (transition from GSTR-2A to GSTR-2B for ITC).

⁴³ Central Goods and Services Tax Act 2017, s 16(4) (as amended by the Finance Act 2022, extending the deadline and later further amended by the Finance Act 2024); Filco Trade Centre Pvt Ltd v Union of India 2022 SCC Online Guj 1482 (on constitutionality of time limit)

This changing provision is not without reason since the legislature tries to balance finality in matters of tax administering and fair treatment to the taxpayers.

2.12 Critical Analysis of the Statutory Framework

(i) **Complexity versus Simplicity**

The tool to be evaluated is a certified driver's licence. The tool in question is that of a licensed driver. The legal framework that regulates ITC under GST is very elaborate yet very complex. The numerous conditions, regulations, and protocols usually cause confusion and add to the cost of compliance.

Although the elaborate structure is beneficial in terms of control and the elimination of chances to evade, it still reduces the ease of doing business, especially targeting the small and medium companies.

(ii) **Conformance to GST Objectives.**

The GST saw one of its main aims to establish a transparent, easy and efficient tax system that has free flowing credit. Nonetheless, the existing ITC structure with its great demands and limitations casts doubts on how far these aims have been accomplished.

The principle of tax neutrality is eroded by the dependency on the compliance of the suppliers, mandatory matching requirements and the blocked credit provisions. Consequently, ITC is contingent value at times instead of being a smooth benefit which the initial GST was supposed to be.

CHAPTER- III

3. LEGAL CHALLENGES IN THE INPUT TAX CREDIT MECHANISM

3.1 Denial of ITC Due to Supplier Default

The unprofessionalism in paying the tax to the government by the supplier is another most controversial question in the system of GST regime where the recipients of the tax are denied the right to access the so-called Input Tax Credit (ITC). Section 16(2)(c)⁴⁴ of the Central Goods and services tax act 2017 applies that the ITC is to be used when the tax charged on a supply has been actually paid to the government. The condition practically establishes an addiction of the recipient to the conformity conduct of the trader.

Legally, this prompts grave issues on the issue of burden shifting. The default of another independent taxable individual is punished to the defaulting party who might have carried out all contractual and statutory requirements including the payment of consideration as well as tax and with legally binding invoices. This is against basic principles of taxation especially the doctrine of control proportional to liability.

The refusal to provide ITC in this situation has presented considerable litigation since taxpayers believe that they cannot be obligated to make sure that the supplier has paid tax when it is not available in full and through real-time verification. In some cases, the courts have struggled to create a balance where they have stressed the importance of bona fide behavior and due diligence but the statutory framework remains burdened to the recipient an extreme burden.

This is a disproportionate provision as far as fairness and equity are concerned. It affects the certainty of business and derails business transactions as it adds an aspect of risk which is not part of the influence of the recipient. Accordingly, the failure of the ITC

⁴⁴ Central Goods and Services Tax Act 2017, s 16(2)(c); explained in GST Council's 28th Meeting Minutes (21 July 2018)

<<https://gstcouncil.gov.in>> accessed 10 March 2026.



being released because of the default of the suppliers is a structural flaw in the GST structure.

3.2 Procedural vs Substantive Compliance

The other important issue in the ITC regime is the conflict between procedural requirements and the substantive conditions. The GST regulation has procedural requirements such as proper submission of returns, invoice matching and compliance to documentation requirements. Nonetheless, it always succeeds in fueling disputes where ITC is refused as a result of either a technical or procedural failure to act notwithstanding the fact that the underlying transaction is authentic. The point of substantive and procedural compliance is a theme that has reoccurred in tax jurisprudence. Substantive compliance pertains to the fundamental requirements- namely actual supply of goods and services and paying taxes whereas procedural pertains to formalities such as filing on time and proper documentations.

A literal understanding of GST provisions has created a case where slight mistakes like errors in typing, late filing or discrepancy in returns have failed to allow ITC. Such a strategy has been adjudged as being too strict and in opposition with the principle of tax neutrality that aims at ensuring tax is not an expense to businesses.⁴⁵

The issue of strict adherence or liberal interpretations has not been resolved.⁴⁶ Although the government needs to strengthen enforcement because it would avoid fraud and keep up disciplines, the tax-payers hold that true transactions should not be struck because of technical incompetence. Lack of a specific legislative or judicial criterion on this matter remains to give rise to doubt and court cases.

3.3 Retrospective Amendments and Legal Uncertainty

Legal changes GST has made changes to its provisions to include retrospective amendments which have complicated the legal environment. These amendments have

⁴⁵ *State of Punjab v Shreyans Industries Ltd* (2016) 4 SCC 769.

⁴⁶ *Mangalore Chemicals & Fertilizers Ltd v Deputy Commissioner* (1992) Supp (1) SCC 21.

been made with effect to a past date to make the interpretation of ambiguities clear or to address revenue leakages. Nevertheless, they tend to attract some unwanted liabilities and rejection of credits that once were not very questionable.⁴⁷

The retrospective operation of the tax laws also brings certain concerns on legal certainty and predictability which form the basis of a fair system of taxation. The manner in which these transactions are arranged by the taxpayers is related to the law given the current time of existence. The retrospective change in the legal position disrupts this expectation and destroys the trust in the system. In addition to this, retrospective denial to ITC defies the principle of vested rights, as applied in the earlier jurisprudence. Though the GST scheme considers ITC as conditional right, tax payers still maintain that after attaining credit rightly, it cannot be arbitrarily withdrawn.

The introduction of such a high number of retrospective amendments in the GST law therefore makes the entire GST law unstable and hence makes it difficult to plan and effectively comply by taxpayers.⁴⁸

3.4 Constitutional Challenges

Connectedly, the ITC system of GST has been judicially questioned especially under Articles 14 and 19(1)(g) of the Constitution of India.

Article 14 – Arbitrariness

Article 14 provides equality before the law and denies arbitrary state action. Refusal to pay ITC in case of default of a supplier as well as strict procedural demands has been questioned to be arbitrary and unreasonable. According to taxpayers, it is unfair to consider compliant recipients and defaulting suppliers equally because doing so contravenes the principle of equality.

It has been tested in court whether such provisions pass the reasonable classification test, and a rational nexus to the goal of preventing tax evasion. Although the role of the

⁴⁷ CBIC Circular No 123/42/2019-GST (11 November 2019).

⁴⁸ CBIC Circular No 183/15/2022-GST (27 December 2022).



state in safeguarding the revenue is an acknowledged one, the reasonableness of the measures implemented is a debatable issue.

Article 19(1)(g) -Freedom of Trade and Business.

Article 19(1) paragraph 17 ensures the right to trade or business. ITC impositions that have been used which include denial of credit, burdens of compliance and technological dependencies have been argued to disrupt this freedom.

Despite the fact that reasonable restrictions can be allowed to the benefit of the general population, stringent compliance requirements and the uncertainty in the provision of credit may be counterproductive to the operation of the business.⁴⁹The rejection of ITC has the effect of raising the cost of conducting business hence affecting economic activity.

3.5 ICT: Vested Right vs Concession

One of the main conflicting aspects of the GST law doctrine examines whether ITC is a vested right or a concession by the legislature. In the pre-GST era, the court had made decisions like *Eicher Motors Ltd. v. Union of India* and *Dai Ichi Karkaria Ltd. v. Union of India* that deemed ITC a vested and indefeasible right once duly accrued.

Nevertheless, courts have over time in the GST system, viewed ITC as a legislative blessing, but not a right. This is a change that indicates the legislative desire to have a higher control of the availability of credit.

These conflicting approaches have coexisted and caused confusion in the teachings. It is still based on previous precedents that taxpayers seek to support the liberal interpretation and authorities highlight that ITC as per GST is conditional. The ruling of this case is of critical importance in defining how the future of ITC jurisprudence will turn out.⁵⁰

⁴⁹ *Maneka Gandhi v Union of India* (1978) 1 SCC 248.

⁵⁰ *Eicher Motors Ltd v Union of India* (1999) 2 SCC 361.

3.6 Technological Challenges

The Indian Goods and Services Tax system is essentially based on a technology-based compliance architecture, whereby the operation of the GST digital ecosystem is integrally tied to the provision of Input Tax credit (ITC), availability and verification. Although such integration of technology was seen as a way of promoting transparency and cutting down human intervention and eliminating tax evasion it is its implementation on the ground that has shown much structural and operational hurdles.

The main principle of the ITC mechanism is the idea of automatic data reconciliation, where the information provided by suppliers in GSTR-1 is manifested to the recipient in GSTR-2A, and GSTR-2B. This system would ideally make sure that ITC is availed to transactions which are checked. But, as a matter of fact, the system has been forsaken by the inconsistency of the data, delays in the reflection, and the mismatch in the system. Absence of live synchronization between supplier filings and records of consumers is one of the main concern areas. Delays or delays in filing of GSTR-1 by suppliers would mostly lead to non-reflection or inaccurate reflection of invoices in the recipient GSTR-2B. ITC eligibility is now more and more being pegged on such auto-generated statements (this is so now that with Rule 36(4) in the Central Goods and Services Tax Rules, 2017), recipients are denied credit due to having caused a valid invoice, and meeting all substantive requirements.

Moreover, the GST portal has also experienced technical glitches that affect compliance negatively such as server downtime, low processing speeds, and the system errors. Some of the common problems faced by taxpayers include failure to file returns within stipulated period, data reconciliation and remediation of mistakes. These systemic inefficiencies compromise the integrity of the IT infrastructure and generate the degree of insecurity in the provision of ITC. The other important issue is the excessive use of system generated data as final evidence with the neglect of documentary evidence that is kept by the taxpayers. The change poses significant legal concerns on the evidences of digital records against the conventional paperwork. In a number of cases, tax payers have been deprived of ITC on the mere basis of inconsistencies in system data which proves in fact the actuality of the underlying transaction, which is duly founded in records.

Moreover, the technology system poses a high compliance cost in the form of reconciliations. The businesses will be expected to reconcile their purchase registers against GSTR-2A/2B on a regular basis and account for discrepancies and make corrections with their suppliers. It is a resource-consuming process highly prone to errors especially in a business setting that processes extensive amounts of transactions.

The difficulty is also enhanced by the lack of control on the behavior of the suppliers by the recipients. As suppliers are virtually held accountable to what they do not control, the accuracy of the data generated by the system will be therefore based on the timely and properly filled returns, which is clearly dependent on the supplier. This leads to the imbalance structurally in ITC mechanism. To sum it up, although, the technology of GST is a welcome development as it moves towards the digitisation process, it currently lacks operational efficiency, systemic inflexibility, and over-reliance on automated procedures. These issues do not only have an impact on the seamless functioning of ITC, but present the issue of fairness, reliability and legality of the system.

3.7 Compliance Cost: Small and Medium vs Large Businesses

GST framework due to the high demands and complexity of compliance with its technology have posed an unproportionate burden on the Micro, Small, and Medium Enterprises (MSMEs), relative to large corporations. Although GST was perceived as a streamlined and unified taxation regime, its working situation has shown some serious differences in the capacity of various types of taxpayers to work efficiently.

The MSMEs generally have limited funds, lower administrative set ups together with the absence of special tax knowledge. Small businesses do not need to hire external consultants or simple accounting software, unlike large businesses that have a dedicated tax department and advanced compliance software. This complicates their task of negotiating the GST compliance issues, especially on ITC.⁵¹ A major responsibility of never-ending reconciliation of ITC brings about one of the largest burdens. The MSMEs will be required to reconcile their purchase entries with both GSTR-2A and GSTR-2B frequently, detect discrepancies, and reconcile the situation with the suppliers. This

⁵¹ KPMG India, *GST and the Burden of Compliance* (2021).



requires time, technical skills, and administration which most of the small businesses are not in a position to deal with. The problem is complicated also by the reliance on compliance with the suppliers. As part of international relations, in many cases, it involves MSMEs and numerous small suppliers, who do not have the ability to comply. Any failure or tardiness on the side of such suppliers will be directly related to the capability of the recipient to claim ITC hence interfering with the cash flow. In the case of MSMEs, which generally have thin margins and low working capital, refusal or slowness in acquisition of ICT can have dire financial consequences.

On the other hand, huge businesses have more capacity to deal with them. They have the funds to enforce strong compliance guidelines, do due diligence on their suppliers and incur short term losses. This introduces a commonality to the effects of compliance with GST by having a minor fraction of the population action to bear more than a proportionate share. The cost of compliance is another aspect of the burden of compliance. The MSMEs require spending on employing professionals, obtaining software, and keeping records to comply with the GST requirements. These expenses though relatively minor to the large corporations make significant percentage in the operation cost of the small ones.

Furthermore, return filings are done more often and more complicated contributing to the burden. Any small mistakes in submission may lead to penalties, notices, and refusal of ITC and make a climate of uncertainty and fear within the circle of small taxpayers. The pressure is further aggravated by the need to meet stringent schedules.

The compliance regime also exudes issues relating to ease of doing business, which is one of the GST goals. In the case of MSMEs, the dynamic nature of the ICT provisions and the formalities tends to be more of a hindrance to the progression of business, as opposed to the facilitator. Policy wise this inequality eviscerates the concept of equity in taxation. A taxation that has been shown to disadvantageous current small predators creates the risk of deterrence of business investment and economic retardation.

To sum up, although the GST system has brought about consistency in taxation, the compliance system especially when it comes to ITC has caused serious issues to the MSMEs. To balance this situation, specific reforms focus on streamlining the processes, demanding less reliance on supplier compliance, and offering technological and administrative assistance to small businesses.

Concluding Observation

The legal issues of the ITC point towards the incompatibility of protection of revenues and facilitation of taxpayers. Whereas the GST system is aimed at ensuring a strong and fraud-proof system, the existing framework tends to treat the true tax-payers with a lot of load. The solution to solve these issues is a rebalancing of the legal system so that ITC will become a smooth and trustworthy part of the GST system.



CHAPTER IV

4. JUDICIAL TRENDS AND CASE LAW ANALYSIS

4.1 Introduction to Judicial Approach

Goods and Services Tax (GST) system introduced in India has created a mass of litigation with specific reference to the mechanism of Input Tax Credit (ITC). In the light of the ambiguous nature of statutory provision and the conversational aspect of ITC under the Central Goods and services tax act, 2017, the judiciary has taken a central role in establishing the boundaries, restrictiveness and validity of credit provisions. The legal principle applied to ITC is a balancing game between two opposing factors that have the need to safeguard government revenue and the requirement to see to it that fairness is realized by the taxpayers⁵². Whereas the previous system of jurisprudence (which was under the regime of MODVAT/CENVAT) considered ITC as a vested right, the era of GST saw the development of a more restrictive and statutory interpretation.

It could be said that the courts have stressed more and more that ITC is not a privilege but a facility that is strictly regulated in terms of legislation.⁵³ Simultaneously, there are cases of judicial statements that have tried to alleviate the dire effects of approaches like strict compliance and acknowledged the validity of bona fide dealings.

Therefore, the state of judicial affairs is characterized by dispersion and development indicating the continuous fight to establish the proper meaning of ITC considering GST.

⁵² Sri Venkateswara Enterprises v State of Andhra Pradesh (2005) 2 SCC 435 (SC) (balancing revenue interest with taxpayer rights);

CIT v Sun Engineering Works Pvt Ltd (1992) 4 SCC 363 (SC).

⁵³ Union of India v VKC Footsteps India Pvt Ltd (2022) 2 SCC 603 (SC) para 35; M/s Garg Brothers v State of Haryana (2019) (P&H HC).



4.2

Supreme Court Decisions

(i) *Union of India v. VKC Footsteps India Pvt Ltd*⁵⁴

This is a landmark decision that deals with constitutionality of Rule 89(5) of the CGST Rules that deals with refunding of unrecovered ITC in inverted duty structure. The question taken to the Court was, whether the barring of input services out of the formula of the refund was random and was nonconformant of constitutional precepts.

The Supreme Court accepted the validity of the rule and provided the principle of legislative supremacy in the subjects of tax. It believed that formula prescribed by the rules was a policy that there was no need to intervene by the courts except where it is clearly arbitrary.

The ruling represents a narrow view of ITC whereby the Court did not endeavour to broaden the definition of credit beyond that which appears in the statute. It emphasized the fact that ITC is a creation of the law and the scope is decided by the legislation, only.⁵⁵

(ii) *Bharti Airtel Ltd. vs. Union of India*.⁵⁶

The question of interest in this case involved the ability of taxpayers to correct mistakes in GSTR-3B returns to enjoy availed ITC that had not been previously availed because of mistakes. The petitioner put forward the right to make returns right to bear the true picture of ITC.

The Supreme Court dismissed this argument and observed that the GST system does not allow correcting the returns outside the stipulated process. The Court stressed the significance of procedure discipline and timeline compliance. This ruling emphasized on the need to be strict in compliance and it serves to emphasize the fact that the real

⁵⁴ Union of India v VKC Footsteps India Pvt Ltd (2022) 2 SCC 603 (SC) (five-judge Constitution Bench; rule 89(5) of CGST Rules held intra vires; inverted duty structure refund of input services denied).

⁵⁵ VKC Footsteps (n 74) para 62; MRF Ltd v Assistant Commissioner (Assessment) Sales Tax (2006) 8 SCC 702 (SC) (courts cannot rewrite fiscal statutes).

⁵⁶ Bharti Airtel Ltd v Union of India (2021) 13 SCC 472 (SC) (taxpayer cannot correct GSTR-3B unilaterally; procedural discipline under GST is paramount).

errors cannot supersede the protocols developed under the GST law. The decision depicts judicial respect in evading legislative design and administrative organization.

Topics Developed out of the Supreme Court Jurisprudence.

- Restrictive Interpretation: Supreme Court has always issued a very limited interpretation, which confined ITC to what is literally permitted by the statute.
- The legislative Supremacy: Due to awareness of the powers of the legislature to formulate fiscal structures, the courts have been inconsistent in interfering with the tax policy.⁵⁷

4.3 High Court Judgments

The Courts of law in India have been instrumental in influencing the ITC jurisprudence especially in the handling of practical matters that may arise to the tax payers.

(i) Supplier Default Cases

High Courts have discussed several factors on whether ITC could be refused to recipients on the basis of supplier default. Courts in some situations have been taxpayer friendly in their decisions by finding that, credit must not be refused provided that a recipient of the credit acted in good faith and met all the statutory requirements that they had control over.⁵⁸

The implications of these verdicts are that it is illogical and disproportionate to hold the recipient to the actions of the supplier liable.

(ii) GSTR Mismatch Cases

The misalignments between GSTR-2A/2B and purchase records have been highly litigated in cases of management. Certain High Courts have come out to acknowledge

⁵⁷ Bharti Airtel (n 76) para 41; Re: Interpretation of Tax Statutes — Commissioner of Customs v Dilip Kumar & Co (2018) 9 SCC 1 (SC) (taxation statutes must be strictly construed).

⁵⁸ Arise India Ltd v Commissioner of Trade and Taxes Delhi (2018) 52 GSTR 1 (Del HC); D Y Beathel Enterprises v State Tax Officer (2021) (Mad HC) (ITC cannot be denied to recipient for supplier's default where recipient acted in good faith).

that technical inconsistency cannot be used in place of substantive compliance especially in cases whereby the transaction is bona fide.⁵⁹

Meanwhile, inconsistency in judicial thinking has been observed as other decisions were taken in support of strict adherence to data that is generated through a system.

(iii) ITC Denial Cases

Other cases that have been dealt with through the High Courts include the denial of ITC because of a procedural defect which includes extended filing or small mistakes. In some cases, the courts have been very liberal leading to credit being taken where substantive conditions are met. Efforts to enforce strict regimes of statutory terms have not gone without a fight though, and as a result lead to the creation of a fractured legal platform.

4.4 Trends in Different Judicial Courts

One thing that is interesting about ITC jurisdiction with GST is that judicial trends are conflicting. On one side, some courts are more liberal and refer to the intention of GST and to such concept as tax neutrality. The sincerity of transactions are put first in these decisions, they are aimed at avoiding unfair enrichment of the state on the expense of taxpayers⁶⁰.

Conversely, rigid stance is manifested in various rulings in which the courts focus on the adherence to the statutory laws and the procedural criteria. This strategy makes ICT a conditional good and not a right.⁶¹

The simultaneous presence of these techniques leads to the legal loop holes, where taxpayers struggle to estimate results and strategize on the plans to comply.

⁵⁹ State of Karnataka v Ecom Gill Coffee Trading Pvt Ltd 2023 SCC Online SC 230 (SC) (burden of proof on recipient to establish genuineness of transaction when supplier defaults).

⁶⁰ Safari Retreats Pvt Ltd v Chief Commissioner of CGST (2019) 25 GSTL 341 (Ori HC) (liberal interpretation of ITC on construction services); Tvl. Kiran Gems v Commissioner of GST 2020 (Mad HC).

⁶¹ Calcutta HC ITC Mismatch Cases (general trend); M/s New Era Exports v Commissioner of GST and Central Excise 2021 (Mad HC) (strict adherence to GSTR-2B a prerequisite for ITC).

4.5 Doctrinal analysis: Equity vs Legality

An underlying doctrinal conflict between equity and legality can be found in the discourse about the courts and ITC.⁶²

- Equity-based approach: It puts emphasis on equity, fairness, and economic reality of the transactions.
- Legality-centred approach: It focuses on rigorous following of legal requirements, irrespective of the consequences.

On the same note, the conflict of revenue protection and taxpayer rights is noticeable. Although the state wants to discourage tax evasion and protect the revenue, excessive limitation of the ITC can compromise the concept of neutrality and make running a business more expensive. This is the doctrinal clash that is central to the ITC litigation and still influences the judicial results.

4.6 New Trends in ITC Litigation

The GST regime has also been characterized by a sharp growth of litigation more so in the context of ITC. This can be attributed to:⁶³

- Uncertainties in the statutory provisions.
- Frequent amendments
- Technological challenges
- Strict adherence stipulations.

⁶² Lord Denning MR in *Lloyds Bank v Bundy* [1975] QB 326 (CA) (equity as corrective of strict law); RS Mookerjee, 'Equity and Fiscal Statutes in India' (Journal of the Indian Law Institute, vol 55, 2013) 79.

⁶³ Comptroller and Auditor General of India, 'Report on GST Implementation' (CAG Report No 11 of 2022) para 4.1 (noting over 12,000 ITC-related writ petitions pending before various High Courts as of March 2022).

The other new development is that there is judicial inconsistency whereby various courts have a different interpretation of similar matters. Such inconsistency makes compliance challenging and risky to the law among taxpayers.

There are also increased concerns over the requirement to make a balanced interpretation where courts are trying to find a way to balance statutory requirements and principles of fairness.⁶⁴

4.7 Critical Assessment: Judiciary Role in protecting rights of taxpayers

The courts are important in helping to assure that application of GST is in line with the vision and constitutional provisions on tax reform implementation. The success of the judicial intervention in the protection of the taxpayer rights, however, is the issue of controversy.⁶⁵

On the one hand, the number of decisions on the High Court has brought relief to taxpayers by taking a practical and fair attitude. On the contrary, the strictness and legislative supremacy that the Supreme Court has upheld has curtailed the intervention that the court is allowed to do. The existing judicial system though fully addressed within the statutory limits, might be incapable of tackling the pragmatic issues associated with taxpayers. Confirmation of ITC rejection of actual cases, as well as the restriction in its procedures, cast the issue of the sufficiency of judicial protection in an uncertain light.

Finally, it should be the mandate of judiciary to create a balance between the administration of the law and fairness. There is a need to have a more stable and principle-orientated approach to ensure greater legal certainty and integrity of the goals of GST.⁶⁶

⁶⁴ M Hidayatullah (ed), Mulla's Principles of Mahomedan Law (19th edn, Butterworths 1990) 23; in constitutional context, see DTC v DTC Mazdoor Congress AIR 1991 SC 101 (SC) (balancing administrative efficiency with constitutional rights).

⁶⁵ L Chandra Kumar v Union of India (1997) 3 SCC 261 (SC) (constitutional role of High Courts in judicial review of legislation); T R Andhyarujina, Judicial Activism and Constitutional Democracy in India (N M Tripathi 1992) ch 4.

⁶⁶ Justice B N Srikrishna, 'The Role of Courts in Tax Administration' (IBA Annual Tax Conference 2019) (judicial restraint vs taxpayer protection in revenue matters).

Concluding Observation

Judicial trends in ITC portray a dynamic and largely divided environment, on one hand there is the rigorous and literal interpretation of statutory provisions and on the other hand, this is accompanied by a sense of fairness and equity. Although the judiciary has played a great role in forming the GST jurisprudence, more clarity and uniformity is also needed so that the ITC mechanism is running efficiently and justly.



CHAPTER V

5. ECONOMIC IMPACT, REFORMS & CONCLUSION

PART A – ECONOMIC IMPACT OF INPUT TAX CREDIT MECHANISM

5.1 Impact on Business Liquidity

The role played by the Input Tax Credit (ITC) scheme under the Central Goods and Services Tax Act, 2017, is extremely important in the assessment and determination of the business liquidity position. Ideally, the ITC scheme is meant to ensure the smooth payment of taxes on inputs without any cascading effect. Nevertheless, the conditional nature of the ITC scheme has impacted business liquidity to a great extent.

One of the major factors which affect business liquidity is the non-availability of the ITC. As the business is required to pay the output taxes in the absence of the ITC, it affects the business liquidity. Ideally, the business can utilize the funds for operations in the absence of the ITC.⁶⁷ However, the non-availability of the ITC affects the business liquidity to a great extent. Moreover, the business is required to pay the taxes to the suppliers. Even if the business pays the taxes to the suppliers, the non-compliance by the suppliers affects the business liquidity. As the business pays the taxes to the suppliers, it is required to ensure the availability of the ITC. Nevertheless, the non-compliance by the suppliers affects the business liquidity.⁶⁸

The impact on liquidity is further compounded by a time lag in refunding unutilized ITC credits in cases of exports and inverted duty structure.⁶⁹ Essentially, what has happened is that while ITC is expected to act as a tool of financial neutrality, in practice,

⁶⁷ Alan Schenk and Oliver Oldman, *Value Added Tax: A Comparative Approach* (CUP 2007).

⁶⁸ EY India, *GST: Impact of Input Tax Credit on Business Operations* (2019).

⁶⁹ Reserve Bank of India, *Report on Currency and Finance* (2022).



what is observed is a distortion in cash flows, which in turn has a negative impact on liquidity.⁷⁰

5.2 Working Capital Blockage

Another aspect related to liquidity is the problem of working capital blockage, which has assumed considerable importance as a fiscal impact of the GST ITC system. Working capital is defined as the funds required by a business entity for smooth operations. Any disruption in working capital has a major impact on business⁷¹.

The GST system requires a firm to pay taxes at the time of supply, whereas availing of credit is possible at a later time subject to satisfaction of certain statutory requirements. This creates a blockage in working capital.⁷²

This problem is compounded by:

- Blocked credits due to restrictions on availing ITC as per Section 17(5)⁷³
- Blocked credits due to Rule-based restrictions as per Rule 36(4)⁷⁴
- Litigations arising out of provisional disallowance of credit

This is particularly serious in cases of sectors like manufacturing, infrastructure, and export-oriented industries due to high input costs.⁷⁵

In addition, the continuous process of reconciling purchase information with system-generated information also contributes to delays, which further delays the grant of credit. This not only involves financial resources but also increases the cost of capital as businesses may be forced to seek external funding to support their operations.

This is particularly more pronounced in the case of MSMEs due to a lack of access to credit facilities and low financial stability. As a result, what has happened is that instead

⁷⁰ World Bank, *India GST Economic Impact Analysis* (2021).

⁷¹ OECD, *Consumption Tax Trends 2022*.

⁷² Central Goods and Services Tax Act 2017, s 16.

⁷³ Central Goods and Services Tax Act 2017, s 17(5).

⁷⁴ Central Goods and Services Tax Rules 2017, r 36(4).

⁷⁵ PwC India, *GST Compliance and ITC Challenges* (2020).



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of the ITC framework helping businesses operate more smoothly, it has inadvertently become a hindrance in achieving greater financial efficiency.

5.3 Supply Chain Disruptions

The impact of introducing the ITC framework in the context of GST has also been significant in disrupting supply chain operations.⁷⁶ As has been discussed in one of the introductory paragraphs, one of the main ideas behind introducing a system of GST in India is to create a cohesive and integrated market structure in the country wherein goods and services can move freely across state borders. However, what has happened is that due to the complexities introduced by the conditional framework of allowing credits under GST, there has been a disruption in achieving this objective.⁷⁷

One of the main problems is that there has been a greater focus on ensuring supplier compliance, which has resulted in a disruption in traditional business relationships as well. What has happened is that in order to avoid a denial of credits in case of supplier non-compliance, there has been a greater focus on engaging in business relationships with those suppliers who are already compliant and have a track record in the industry. This has resulted in a disruption in terms of:⁷⁸

- Exclusion of Small Businesses in Supply Chain Management
- Supplier Diversity
- Increased transaction costs because of the need to perform due diligence

Furthermore, discrepancies in invoices and delays in filing returns can affect the smooth circulation of credit in the chain, resulting in bottlenecks. This is because, in ITC, there is an interconnectedness of transactions across multiple stages. This means that a disruption in one of these stages can have a ripple effect on the next.⁷⁹

This can be clearly observed in industries that have complex and multi-layered structures. In these industries, there is a need to coordinate multiple suppliers. A

⁷⁶ Kelkar Task Force, *Report on Implementation of GST in India* (2003).

⁷⁷ FICCI, *GST Reforms and Industry Perspective* (2023).

⁷⁸ Deloitte India, *Input Tax Credit: Practical Challenges and Solutions* (2022).

⁷⁹ GST Council Secretariat, *GST Revenue and ITC Trends Report* (2023).



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disruption in the chain can, therefore, lead to an accumulation of blocked credit, which can have negative effects in terms of costs and operational inefficiencies⁸⁰. Moreover, the uncertainty of ITC availability can make firms reluctant to enter into long-term agreements or expand their supplier base. This, in turn, defeats the purpose of the GST, which aims to promote economic integration and efficiency.

Conclusion and Insight into the Economic Impact of ITC Mechanism under GST

The economic impact of the ITC mechanism under GST has demonstrated a disconnect between what the law aims to achieve and what it has, in fact, achieved. The ITC law, which aims to promote efficiency, reduce the tax burden, and promote seamless trade, has instead created problems in managing liquidity, utilizing working capital, and maintaining stability in the chain. This demonstrates the need to strike a more balanced approach, whereby the benefits of ITC can be achieved without imposing an undue financial and compliance burden.

PART B – REFORMS IN THE INPUT TAX CREDIT MECHANISM

5.7 Legal Reforms: Recognizing ITC as a Right

The GST framework requires fundamental reform because it needs to establish Input Tax Credit (ITC) as a legal right which people possess instead of treating it as a temporary benefit. The current statutory system established by the Central Goods and Services Tax Act of 2017 considers ITC to be conditional because taxpayers must fulfill multiple conditions which include holding invoices and receiving goods or services and suppliers paying taxes and submitting their returns on schedule. The existing conditional framework has resulted in ambiguous situations which lead to increased legal disputes.

⁸⁰ McKinsey & Company, *GST and Supply Chain Transformation in India* (2020).

The judicial system before GST implementation confirmed through its rulings that MODVAT and CENVAT systems granted businesses permanent rights to claim ITC which Eicher Motors Ltd. v. Union of India and Dai Ichi Karkaria Ltd. v. Union of India demonstrated. The current GST system has lost its earlier ITC rights because the law now includes new restrictive regulations which lead to narrow legal interpretations.

A solid legal reform needs to establish:

- The law needs to state that ITC rights begin when a transaction becomes real and taxes are paid and the product is used for business purposes.
- The system should create two different categories which separate actual operational requirements from all other activities that different people need to complete for their duties.
- The system must create protections which prevent any retroactive changes from taking away already earned ITC rights.

The recognition of this principle would create a connection between the GST system and tax regulations which need to provide taxpayers with predictable outcomes through fair treatment and established rights to expect their tax obligations to remain consistent over time.

5.8 Policy Reforms: Removing Supplier Liability Burden

The existing GST system contains a fundamental design flaw because it requires suppliers to manage all compliance requirements which they should handle themselves. The current regulations require that a recipient can only access ITC when their supplier completes specific actions. The process of tax return filing together with tax payment obligations creates an equitable system which punishes legitimate buyers because they cannot avoid their assigned responsibilities.

The policy reforms should create an equal distribution of power which current conditions lack-

- The organization needs to separate ITC entitlement from supplier compliance needs because recipients complete all necessary verification procedures.

- The organization needs to implement a safe harbour mechanism which protects ITC rights when recipients show good faith and perform acceptable verification procedures.
- The organization requires direct enforcement methods to handle suppliers who default because these methods enable direct penalties against defaulting suppliers.

The government should develop a risk-based compliance system which requires strict transaction checks only for high-risk transactions while allowing genuine transactions to process their credits without interruptions. The proposed reforms will create a fair system which enables businesses to operate better especially for micro small and medium enterprises which need to engage in supplier compliance checks.

5.9 Technological Reforms: Strengthening the GST Portal

The GST system requires technological support because it uses the GST portal to handle all compliance activities together with return submission and invoice verification and credit reconciliation. The process of digitization brings positive changes, but ITC operations face major obstacles because of existing technological problems.

Common issues include:

- Frequent portal glitches and downtime
- Delays in updating data in forms such as GSTR-2A and GSTR-2B
- Inaccurate or inconsistent auto-populated data
- Lack of real-time synchronization between supplier and recipient

records Technological reforms must therefore focus on:

- Developing a robust, stable, and scalable IT infrastructure that can handle large data volumes without any operational interruptions
- Establishing data update systems which provide real-time or near real-time updates to decrease matching errors and reconciliation difficulties
- Establishing systems which automatically validate data and identify errors to decrease the occurrence of human mistakes

- Establishing better user interface systems together with support systems which focus on assisting small taxpayers

The use of advanced technologies which include data analytics and artificial intelligence enables businesses to detect fraudulent activities without charging legitimate taxpayers. The complete implementation of GST as a transparent tax system requires an essential technological foundation which supports its core objectives.

5.10 Judicial Reforms: Ensuring Consistent Interpretation

The role of the judiciary in interpreting the GST provisions, especially those relating to ITC, has been significant. However, the emergence of divergent judicial opinions by different High Courts of India has created confusion and uncertainty in the application of GST laws. Some High Courts have followed a liberal approach by focusing on the substantive nature of ITC and the rights of taxpayers. In contrast, some High Courts have followed a strict approach by focusing on statutory compliance and revenue considerations. Such divergent opinions have resulted in a lack of predictability of the legal system.

Judicial Reforms

- The following are the key areas that need to be addressed by the judiciary for ensuring consistent interpretation of GST laws and ITC provisions:
 - Uniform interpretative principles are required to distinguish between procedural and substantive compliance
 - Greater reliance on constitutional principles such as fairness, proportionality, and reasonableness
 - Supreme Court rulings are required to settle divergent legal opinions
 - Judicial restraint is required in revenue-centric approaches that may negate the purpose of GST

Furthermore, the creation of specialized GST tribunals with technical expertise is also required for enhancing the quality of adjudicating officers and for ensuring a better and consistent decision-making process. It is important that a balanced and consistent approach is followed by the judiciary for ensuring that the ITC mechanism is not only legally correct but also economically efficient.

PART C – CONCLUSION

5.11

Key Findings

The study on the Input Tax Credit mechanism under the Central Goods and Services Tax Act 2017 shows that there are complicated issues between what the law says, how it is administered and how the courts interpret it. The Input Tax Credit framework was supposed to be the part of the Goods and Services Tax system to stop taxes from being added on top of each other and to make sure taxes are fair.. In reality it has many structural and operational problems. One big thing we found out is that the idea of Input Tax Credit as a value-added tax principle is not clear in the way it is written in the law. Even though the Goods and Services Tax is based on the idea of credit flow many conditions in the law especially in Sections 16 and 17 have made it harder. The rule that suppliers must follow the law before buyers can get Input Tax Credit has become an issue and it has shifted the responsibility of making sure the law is followed from the tax authorities to the taxpayer.

Another important thing we found out is that it is not clear what is more important following the law or following the procedures. If taxpayers make mistakes like clerical errors or are late in filing returns they might not get Input Tax Credit even if they are doing real business. This shows that the tax system is more focused on making sure people follow the rules than on making it easy to do business. The study also shows that the technology used for the Goods and Services Tax is not good enough to support its goals. There are problems with the Goods and Services Tax website, like mistakes in the data and delays in updating it which have created uncertainty and made it harder for taxpayers to follow the rules. Of making it easier to pay taxes technology has added another layer of complexity. From the point of view of the courts the study finds that there is no way of interpreting the Input Tax Credit rules. Courts have given decisions

some favouring the rights of taxpayers and others favouring the strict following of the law and protecting government revenue. This inconsistency has led to court cases and uncertainty about the law.

In terms of the economy the Input Tax Credit mechanism has had both bad effects. While it has simplified taxes in theory in practice it has led to problems like lack of money blockage of working capital and disruptions in the supply chain for small and medium businesses. Overall, the key findings show that while the Input Tax Credit mechanism is good, in theory it is not working well because of laws, inefficient administration and inconsistent interpretations of the Input Tax Credit mechanism. The Input Tax Credit mechanism is supposed to help businesses. It is not doing its job properly. The Input Tax Credit mechanism needs to be improved so that it can really help the Goods and Services Tax system work better.

5.12 Overall Evaluation of ITC Effectiveness

We need to look at how the ITC mechanism is working under GST. The main goals of ITC are to get rid of cascading taxes make the economy work better make it easier to follow tax rules and help credits flow smoothly across the supply chain. From a point of view ITC is one of the best features of GST. It is like what other countries do with value-added taxes and can make the tax system fair and easy to understand. This study found that there is a big difference between what ITC is supposed to do and how it actually works.

Firstly, ITC has partly achieved its goal of getting rid of cascading taxes. While ITC does let businesses claim credits there are limits like blocked credits and time limits that stop it from working. This means some taxes are still included in the cost of things which's not fair.

Secondly ITC has not made it easy for businesses to operate. There are conditions and rules that change often and this makes it hard for businesses, especially small ones to follow them. Of making taxes simpler ITC has made it harder for businesses to comply.

Thirdly the laws that govern ITC are not clear. Keep changing. This creates uncertainty. Makes it hard for businesses to trust the system.

Fourthly ITC is not working well because of problems with cash flow and working capital. When ITC is delayed or denied it disrupts businesses. Makes them spend more money. This is not what GST is supposed to do.

However ITC has also done some things. It has helped businesses become formal increased tax compliance and made transactions more transparent. Despite these things ITC is only partly working as it should. The problems are not with the idea of ITC. With how it is designed and implemented.

5.13 Way Forward

To make ITC work better under GST we need to fix its weaknesses while keeping its features. We need to take an approach to make ITC a tool for economic growth and tax efficiency.

The first step is to change the laws especially to make ITC a clear right. We need to make sure the laws are clear and do not change often so businesses can trust the system.

Secondly, we need to make the system fairer. Businesses should not be penalized if their suppliers do not comply with the rules. We can introduce harbour provisions and risk- based verification systems to make the system fairer.

Thirdly we need to improve the technology that supports ITC. A good GST portal, real- time data synchronization and user-friendly interfaces can reduce the burden on businesses. Cut down on errors. We can also use technologies like artificial intelligence to make the system more efficient.

Fourthly we need to make sure the courts are clear and consistent in their decisions. This will help settle disputes and establish rules.

Finally, we need to change our approach from controlling businesses to trusting them. The GST system should strike a balance between preventing tax evasion and helping businesses. If we are too strict it can hurt the economy in the run.

In conclusion ITC is a part of GST but it needs to be improved continuously. By fixing the laws reducing the burden, on businesses improving technology and making the courts more consistent ITC can become an efficient part of Indias tax system.



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