



**CONTRACTUAL OBLIGATION TO PAY
TO VENDORS AFTER 180 DAYS
A CONTROVERSY ON ITC REVERSAL**



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CONTRACTUAL OBLIGATION TO PAY TO VENDORS AFTER 180 DAYS - A CONTROVERSY ON ITC REVERSAL

Management of cashflows during the COVID-19 pandemic present novel challenges. To manage cash flows, Taxpayers would reshape their payment plans to vendors in this crucial time. The buyers of goods and services would demand extended payment terms from the supplier.

In these situations, it is imperative for the buyers to understand the input tax credit implications on such extended payment plan or credit terms.

Indeed, availing ITC is a substantive right available to a taxpayer, but the said right is restricted by certain conditions which has been provided in GST law. One such condition is the second proviso to section 16(2) of the CGST Act, 2017 which provides that where a recipient **fails to pay** to the supplier of goods or services or both (other than the supplies on which tax is payable on reverse charge basis), the amount towards the value of supply along with tax payable thereon within a period of 180 days from the date of issue of invoice by the supplier, then such taxpayer shall be required to reverse the ITC by adding in his output tax liability along with interest.

The article attempts to analyse the input tax credit implications on extended payment plans or credit terms (beyond 180 days) in light of the meaning of phrase “fails to pay” used in the said proviso. At the outset, it may be noted that the said phrase has not been defined under GST and rule framed thereunder. Various legal dictionary meanings of “failure” imply that for a failure to occur, first of all there must be an obligation to do something.

In *Malaysian Airlines Vs. Union of India* reported at 2010(6) BomCR53 while analysing the imposition of penalty in relation to foreign travel tax for failure to pay tax observed that failure to pay means non- payment, which is nothing but failure to pay when due. In the said case, provisions of Finance Act, 1979 provided for imposition of penalty if amount of foreign travel tax collected is not paid to the government within fifteen days from the date of collection. In this light, Hon’ble Bombay High Court held that failure to pay within this prescribed time frame would mean non-payment or failure to pay. If any person fails to pay within the statutory period of fifteen days, then such person is well within the sweep of the words "failure to pay". Once the period of fifteen days is over and breach in payment of tax is committed, then it is immaterial when the defaulter in future is making the payment. Applying the said judgement, second proviso of the Section 16(2) of the CGST Act should only trigger when payment is due.

Similarly, Allahabad High Court in **Badri Prasad Vs. District Judge, Gonda** reported at 1983 All LJ 41 at 42 held that the parties can said to have 'failed to pay' only if it can be said that they neglected to do something which they were expected to do, or they left some possible or expected action unperformed. In the case in hand, on receipt of notice of demand of action expected from the opposite parties was to tender rent to the petitioner either personally or through some agency recognized by law. Therefore, when on receipt of the notice of demand of rent the opposite parties remitted the rent through money order to the petitioner, they took the action expected them. Further, many High Courts have analysed the meaning of failure in various cases-

- *"The word " failure " means non-fulfilment of an obligation imposed"* - **Royal Calcutta Turf Club Vs. Wealth Tax Officer**, reported at MANU/WB/0114/1983.
- *"Failure means not doing something that one is expected to do"* - **Kavungal Kooppakkattu Zeenath Vs. Mundakkattu Sulfiker Ali** reported at MANU/KE/0271/2008.
- *"Failure means that there is an omission on the part of the person to do something which it is possible for him to do"* - **Thattessara Subbaraya Vs. Chinne Gowda & Ors.** reported at MANU/KA/0096/1972.
- *"The word 'fails' cannot connote the meaning of voluntary refusal. These words do not give a discretion or right to the person"* - **Ram Kishore Vs. Bimla Devi and Ors** reported at MANU/UP/0182/1957
- *"'Failure' means the inability to perform an obligation. Failure in performance of duty means either non-performance or performance below the minimum expected standard and, therefore, this expression does involve when used in the context of performance of duty an attribute of inefficiency or incompetence or negligence or some such vice resulting in the failure."* - **Mian Gulam Jelani Vs. Aligarh Muslim University & Ors.** reported at MANU/UP/0091/2002.

Thus, by virtue of the above interpretations provided for the term 'failure', it is possible to contend that a failure can occur only in the presence of an obligation to do or perform an act. Accordingly, since the words used in the proviso are "fails to pay", it is possible to contend that the above provision would only be triggered when contractually there is an obligation on the recipient to pay the amount and the recipient subsequently fails to pay the amount within 180 days. In absence of any contractual obligation, it can be said that the proviso doesn't apply and ideally there is no requirement of reversal in such cases.

On a different note, there are several decisions under the erstwhile service tax regime where in respect of similar condition under Cenvat Credit Rules, 2004, it has been held that where the service provider has paid the full amount of service tax charged in the invoice to the Government, such condition would not apply. Rule 4(7) would not apply, and the recipient would be eligible to avail the credit even if he has not made full payment of the invoice to the supplier. In a manner, such bunch of decisions also supports the above view on a different front if the GST payment has been already made to the Government.

In view of the Author, second proviso to Section 16(2) of the CGST Act has limited application and is not applicable where contractually there is no obligation to make payment within 180 days as there is no failure on the part of the recipient to make payment to the supplier. It is pertinent for the taxpayers to revisit their contractual arrangements timely to save on the ITC. It would be interesting to wait and watch how Courts interpret the above phrase “fails to pay” in GST context.