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Can the buyer be denied the ITC on account of the fraud or malpractices committed by the supplier?

The Goods and Services Tax (GST) cannot be expected to be completely insulated from the adverse impact of the tax cascade prevalent in any Indirect tax system. However, with a view to mitigate – if not completely eliminate – this adverse impact of the tax cascade, the Input Tax Credit (ITC) system is universally prevalent under the GST or VAT. A seamless and comprehensive ITC system is the soul of GST.

In terms of Section 16(1) of the CGST Act, 2017, every registered person is entitled to avail the ITC of the input tax (GST) charged on any input or input service used or intended to be used in the course or furtherance of business, subject to the prescribed conditions. One of the 4 (four) existing pre-conditions prescribed under Section 16(2) relates to the supplier of goods or services or both. As per this condition, the buyer (recipient) would get the benefit of ITC only if the supplier has paid/deposited the GST charged on his supply of goods or services or both. The roots of this condition lies in the judgement dated 11.05.2012 of the Hon'ble Bombay High Court in the Mahalaxmi Cotton Ginning & Oil Industries' case. In this case, the constitutionality and validity of Section 48(5) of the Maharashtra VAT Act, 2005 which contained a provision similar to the present provision of Section 16(2)(c) of the CGST Act, 2017, was under challenge. The Hon'ble High Court, however, had dismissed a batch of Writ Petitions with some significant observations and directions. The existing provision contained in Section 16(2) (c) reflects the controversial provision of Section 48(5) of the MVAT Act, 2005. It may be noted here that no such provision ever existed under Central Excise or Service Tax regime.

The question that arises here is: "can the buyer of the goods or services be denied the benefit of ITC on account of fraud or malpractices committed by the supplier?" If a bonafide buyer procures the goods or services under a valid tax invoice and avails the ITC of the GST charged on it and if, either deliberately or for any other reason, the supplier does not deposit the tax payable in the Government's coffers, how far such denial of ITC to the bonafide buyer is legal and justified? Undisputedly, varied types of frauds are being committed under GST system that operate through invoice credit mechanism since the system is quite susceptible to the frauds. The practice of issuing bogus or fake invoices and availment of illegal ITC on the basis thereof is quite common and the unscrupulous element are on rampage in so far as this practice is concerned. While the inevitability of taking such fraud cannot be disputed, the questions do arise when a bonafide buyer is sought to be denied the benefit of ITC merely on account of the fraud or breach of statutory provision committed by the supplier.

The issue as to whether a bona fide buyer can be denied credit on account of the failure on part of the supplier to remit tax to the credit of the Government has been extensively dealt with by the Hon'ble Punjab & Haryana High Court in *M/s. Gheru Lal Bal Chand vs. State of Haryana & Anr.* [2012 (2) SCC 781 (P&H)], wherein the Hon'ble Court has finally held as follows:

"Law cannot put such onerous responsibility on the assessee otherwise, it would be difficult to hold the law to be valid on the touchstone of articles 14 or 19 of the Constitution of India. A statute has to be read in such a manner so as to do justice to the parties. If it is held that the person who does not deposit or is required to the tax would be put in an advantageous position and whereas the person who has paid the tax would be worse, the interpretation would give result to an absurdity.

To conclude, no liability can be fastened on the purchasing registered dealer on account of non-payment of tax by the selling registered dealer in the treasury unless it is fraudulent, or collusion or connivance with the registered selling dealer or its predecessors with the purchasing registered dealer is established.”

In the end, as far as the bonafide and honest taxpayers (buyers) is concerned, the existing provision denying the ITC for the fraud or fault of the supplier is certainly illegal and unconstitutional and for such taxpayer, the High Court is the only recourse for the resolution of their grievance.

Q & A:

- Q. If a supplier does not pay the GST on his supply, can the buyer be denied the ITC?
- A. In terms of Section 16(2)(c) of the CGST Act, 2017, the department may proceed to deny the benefit of ITC to the buyer in case the supplier does not pay the GST on his supply.
- Q. In case the buyer is not involved in the fraud committed by the supplier, can the buyer still be denied the ITC in the above circumstances?
- A. On the plain reading of Section 16(2)(c), the answer to the question can only be in affirmative. However, in light of the principle of law established by various judgements of the Hon'ble High Courts and the Supreme Court, it can be argued that in case the buyer is not nor is proved to be involved in the fraud committed by the supplier, the buyer cannot be denied the benefit of ITC.
- Q. What remedy is available to the buyer who is being denied the ITC due to the mischief committed by the supplier?
- A. Unfortunately, neither the departmental authorities nor the Tribunal can declare the existing relevant provision of Section 16(2) (c) as unconstitutional. Under these circumstances, the aggrieved taxpayer has no other alternative but to file the Writ Petition before the Jurisdictional High Court challenging such denial.

(Concluded)