

# ITC to recipient can be denied on account of non-payment by supplier to government – Madras HC

26 April 2023



## Summary

The Madras High Court (HC) has held that under the GST laws, input tax credit (ITC) is admissible in respect of a supply only when the tax charged for such supply is paid to the government. Further, the HC stated that to ensure that the interests of the Revenue are protected, the GST laws provide for a mandate that the tax liability is defrayed/met either at the hands of the supplier or the purchaser. The substantive or primary liability is of the supplier, and ITC reversal of the buyer can be a protective measure to ensure the Revenue's interest. Furthermore, the HC stated that the Revenue should ensure a mechanism to restore/refund the tax paid by the buyer if the recovery is made from the supplier.

## Facts of the case

- M/s Pinstar Automotive Private Limited (the petitioner) received a pre-assessment notice wherein the Revenue department denied the ITC to the petitioner on certain supplies where suppliers had not paid GST to the government.
- The petitioner contended that it has complied with eligibility requirements of Section 16 of the Central Goods and Services Tax Act, 2017 (CGST Act) and paid the consideration, along with GST, to the supplier within 180 days, and therefore, they are eligible for the ITC.
- The stand was rejected by the respondent who passed an order-in-original, confirming the demand proposed in the show cause notice. Inter alia, the assessing authority has confirmed the addition proposed under the show cause notice.
- Placing reliance on HC's decisions of erstwhile law, the petitioner has filed an appeal before the Madras HC, contending that the ITC should not be denied to them due to the supplier's default.
- Further, the petitioner has chosen to seek rectification of the order-in-original for rectification of errors apparent on the face of the record under Section 161 of the Act.

## Madras HC observations and ruling [Writ Petition No. 8686 of 2023 dated 20 March 2023]

### Mandatory requirements for availing ITC:

Section 16(2) of the CGST Act provides certain mandatory contingencies for the continuity of the ITC to a registered person. Inter alia, one of the conditions is that the tax charged in respect of such supply has been actually paid to the government in cash or through utilisation of the ITC, admissible in respect of the said supply. Thus, there is a mandate cast upon the petitioner/claimant for the ITC to ensure compliance with the provisions, as in the alternative and as a natural consequence of Section 16(2)(c), it would be entitled to the ITC.

- **Provisions of Section 16 of CGST Act should be complied:** The HC held that the conditions of Section 16 are to be read strictly and that there cannot be any jeopardy to the interest of the Revenue. The said section ensures that the interests of the Revenue are protected by providing for a mandate that the tax liability is defrayed/met either at the hands of the supplier or the purchaser, the petitioner in this case. Thus, no fault can be attributed to the Revenue in this regard.
- **Recovery from petitioner is protective measure:** The HC observed that the provisions of Section 16 ensures that the tax liabilities should either be met by the supplier or the recipient. The HC has stated that the substantive or primary liability is of the supplier and ITC reversal of the buyer can be a protective measure to ensure Revenue's interest.

- **Appropriate mechanism to prevent unjust enrichment by way of double benefit to the government:** The HC has directed the Revenue to devise a mechanism for refund or re-availment of the ITC to the petitioner towards the amount recovered from them as and when the recoveries are made from the defaulting suppliers. This is so because the government cannot take double benefit from the recipient as well as the supplier.
- **Writ petition allowed:** The HC stated that it had no intention to intervene in the conclusion of the assessing authority on the reversal of the ITC. However, the HC stated that no opportunity has been granted to the petitioner prior to the passing of the impugned order, and this is a fatal flaw. This procedure followed by the authority is clearly contrary to the third proviso to Section 16 of the CGST Act that necessitates that where the authority proposes to take a view adverse to the applicant, due process must be followed. Thus, the HC directed that the petitioner shall be heard by the issue of notice and orders passed on the Section 161 application within a period of four (4) weeks from today.

## Our comments

Contrary to the present ruling, earlier in the case of M/s D.Y.Beathel Enterprises, the Madras HC held that the purchaser/buyer cannot be asked to reverse the ITC availed when there is a default on the part of the seller to discharge its tax liability to the government. The HC stated that strict action should have been taken against the seller, and the Revenue should initiate recovery proceedings before asking the purchaser to reverse the ITC.

The Supreme Court, in the case of Arise India Limited, had earlier dismissed the special leave petition (SLP) filed by the Revenue and refused to interfere with the order of the Delhi HC, which had held that the relevant provisions under the VAT law are violative to the extent that they disallow the ITC to the purchaser due to the default of the selling dealer in depositing tax.

Even the Karnataka HC, in the case of Simplex Infrastructures Ltd., had held that the ITC could not be denied in the hands of the purchasing dealer merely because the selling dealer had not discharged its VAT liability.

It may be noted that w.e.f. 1 October 2022, Section 41(2) of the CGST Act has been amended to provide that the ITC shall be reversed, along with applicable interest, wherein the supplier has not paid the tax to the government.

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