

## PART-I

### NON PAYMENT OF TAX BY SUPPLIERS –REVERSAL OF ITC BY RECIPIENTS

#### **Introduction**

The Goods and Services Tax (GST) regime in India was introduced with the objective of creating a seamless flow of input tax credit (ITC) and eliminating cascading of taxes. However, in order to ensure compliance at every stage of the supply chain, the law places certain conditions on the recipient for availing ITC. One such critical condition is the **actual payment of tax by the supplier** to the Government.

#### **Legal Framework**

Section 16(2) of the CGST Act, 2017, prescribes the conditions for eligibility of ITC. Specifically, **Section 16(2)(c)** states:

*“No registered person shall be entitled to the credit of any input tax in respect of any supply of goods or services or both to him unless the tax charged in respect of such supply has been actually paid to the Government, either in cash or through utilisation of input tax credit admissible in respect of the said supply.”*

Further, **Rule 37 of the CGST Rules** provides that ITC shall be reversed if the recipient fails to pay the value of supply along with tax within 180 days from the date of invoice.

#### **Recipient’s Responsibility**

The law effectively casts a burden on the recipient to ensure that:

- The supplier has furnished the invoice in their returns (reflected in GSTR-2A/2B).
- The tax on the supply has been paid by the supplier to the Government.

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Under the GST law, recipients of goods or services have a crucial responsibility to ensure that the input tax credit (ITC) they claim is valid and compliant with statutory conditions. One key requirement under **Section 16(2)(c)** of the CGST Act, 2017 is that ITC can be availed only if the supplier has actually paid the tax to the Government. Although the GST law does not provide a direct mechanism for the recipient to verify whether the supplier has actually paid the tax, the matching of GSTR-2B with GSTR-3B of the supplier serves as an indirect tool for verification

Failure of the supplier to pay tax could result in reversal of ITC along with interest liability on the recipient, even when the recipient has made full payment to the supplier. To mitigate this risk, recipients should adopt due diligence measures such as vendor screening, contractual safeguards, and routine reconciliation of GST data. In case of supplier default, the recipient must reverse the ITC and can re-avail it once the supplier pays the tax. Thus, recipients must not only focus on their own compliance but also monitor the compliance behavior of their vendors to protect their ITC claims.

### **Consequences of Non-Payment by Supplier**

If it is found that the supplier has not paid the tax:

- **ITC is required to be reversed by the recipient.**
- Interest under **Section 50(1)** becomes payable on the reversed ITC.
- The recipient may re-avail such ITC once the supplier actually pays the tax to the Government (as per **proviso to Section 16(2)(c)**).

This principle has also been upheld in various judicial pronouncements where the Courts have recognized that the recipient's eligibility is contingent on supplier compliance, albeit expressing concerns about the fairness of this requirement.

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### Recent Developments

- The GST Council and the CBIC have acknowledged this difficulty and proposals for safeguards (such as blocking defaulting suppliers from issuing invoices) have been discussed.
- The introduction of GSTR-2B and real-time ITC matching aims to reduce such instances.

### Best Practices for Recipients

- ✓ **Vendor Due Diligence:** Before entering into contracts, assess vendor GST compliance track record.
- ✓ **Regular Reconciliation:** Frequently reconcile GSTR-2B with books and GSTR-3B to identify potential defaults.
- ✓ **Include protective clauses in contracts:** Clauses ensuring supplier tax compliance and indemnity provisions in case of default.
- ✓ **Timely follow-up:** Act promptly if discrepancies are noticed in GSTR-2B vis-à-vis ITC availed.

The current litigation under GST regime is the availment of input tax credit by the recipients of supply in the event of a fault in the actual payment of tax by the suppliers to the government.

Let us go deeply into the basis on which the dispute is raised by the department, the decisions passed by the Hon'ble High Courts, the stand taken by the department not only in the cases where the supplier has failed to deposit the tax with the government but also in those where the tax has been deposited with the government and the supplier turned out to be a bogus entity, and how the department's stand is apparently contradictory to the ratios laid down by several High Courts

Section 16 of the Central Goods and Services Tax Act, 2017 ("CGST Act") deals with the eligibility and conditions for availment of input tax credit by a taxpayer. Clause (c) of sub-section (2) of Section 16 imposes an important condition insofar

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as the availment of input tax credit is concerned, which states that the tax charged in respect of the supply must be actually paid to the government either by way of cash or by utilisation of input tax credit.

In the event of failure to file the statutory returns and consequent deposit of tax with the government at the end of the supplier, the department resorts to the said clause (c) to propose the denial of corresponding input tax credit to the recipients. Now, this poses problems for a genuine taxpayer/recipient who has not only paid the tax to his supplier but is also being denied the consequent benefit of input tax credit.

The constitutionality of clause (c) of Section 16(2) of the CGST Act has been challenged before several High Courts over the course of the last six years. Let us look at some of the important decisions wherein, the issue at hand has been discussed.

### **Following are some of the important judgments:**

In the case of Suncraft Energy Pvt. Ltd. vs. Assistant Commissioner, State Tax MAT 1218 of 2023 dated 02.08.2023 by Calcutta High Court the Hon'ble Calcutta High Court has held that before directing the recipient to reverse the ITC, the department ought to have taken an action against the supplier. The reversal of ITC cannot be demanded unless it is an exceptional case where the department is able to prove collusion between the supplier and recipient or where the supplier is missing.

Aggrieved by the Impugned Order, the Petitioner filed a Special Leave Petition before the Hon'ble Supreme Court of India.

The Hon'ble Supreme Court in the case of THE ASSISTANT COMMISSIONER OF STATE TAX, BALLYGUNJGE CHARGE & ORS. VERSUS SUNCRAFT ENERGY PRIVATE LIMITED & ORS - 2023 (12) TMI 739 - SC ORDER dismissed the Special Leave Petition and reaffirmed the order passed by the Hon'ble Calcutta High Court in the aforementioned case.

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In the recent case of Diya Agencies vs. State Tax Officer WP(C) No. 29769 of 2023 dated 12.09.2023 by Kerala High Court , the Hon'ble Kerala High Court held that where the ITC claimed by the petitioner is bonafide and genuine, the same cannot be denied merely because of the fact that the amount was not reflected in Form GSTR-2A of the petitioner. If the supplier does not remit the amount paid to him by the petitioner, the petitioner cannot be held responsible.

The Hon'ble Madras High Court, in the case of D.Y. Beathel Enterprises vs. State Tax Officer W.P.(MD) No.2127 of 2021 dated 24.02.2022 held that where the factum of payment of tax by the recipient to the supplier has been established, the omission on the part of the seller to remit the tax to the government must be viewed very seriously and strict action ought to be initiated against the seller.

In the case of Balaji Exim vs. Commissioner, CGST W.P.(C) 10407/2022 dated 10.03.2023 by Delhi High Court,, the Hon'ble Delhi High Court held that a taxpayer is not required to examine the affairs of its supplying dealers. The input tax credit cannot be questioned unless it is established that the taxpayer did not receive the goods or pay for them.

The Calcutta High Court, in the case of M/s. Gargo Traders v. The Joint Commissioner, Commercial Taxes [WPA No. 1009 of 2022 dated June 12, 2023], held that a recipient of goods/services cannot be denied input tax credit (ITC) if the supplier becomes non-existent or their registration is retrospectively cancelled. The court directed the Revenue Department to consider the documents provided by the assessee to substantiate the genuineness of the transaction.

Finally we also would like to convey that in the case of TVL. Cleon OptobizPvt Ltd Vs Assistant Commissioner (ST) the Madras High court held that the court acknowledges the petitioner's submission of invoice copies, e-way bills, and proof of payment. The court notes that the petitioner was not informed about the discrepancy in the goods dealt with by them and the supplier. The matter is remanded for reconsideration by the assessing officer. The held that retrospective

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cancellation of registration of the supplier cannot lead to denial of credit in the hands of the recipient.

From the above it is established beyond doubt that the Hon'ble Courts have consistently held that where the recipients are able to establish the genuineness of the transactions executed by them, they cannot be punished for a fault committed on the part of the suppliers. It has been held that casting such an onerous burden on the recipients is unreasonable and that the department always has the option of initiating proceedings against the erring suppliers. Further, in the absence of appropriate machinery being provided by the government, the recipients cannot be expected to do the impossible by keeping a track on the actions of the suppliers.

### **Department contention**

The Central Board of Indirect Taxes and Customs had issued a Press Release dated 04.05.2018 stating that in the event of non-payment of tax by the supplier, there shall not be any automatic reversal of credit by the recipient. In case of default, the recovery shall be made from the supplier and requiring the reversal of credit by the recipient shall only be an option available in exceptional circumstances. This was reiterated by the Goods and Services Tax Council in its 28th Meeting held on 21.07.2018.

While one of the very common grounds used to initiate litigation is the non-payment of tax by the suppliers to the government which leads to violation of clause (c) of sub-section (2) of Section 16 of the CGST Act, the corresponding credit is also being denied in such cases where the tax liability stands discharged to the government but the department alleges that the suppliers are ingenuine or had obtained the GST registration fraudulently.

### **Before parting ways**

We conclude that CBIC has already issued several circulars and instructions with an intent to provide a clarity in respect of the said issue, it is necessary that the departmental officials are provided with further clarity in respect of such

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exceptional cases where actions should be taken against the recipients. This will be in line with what was initially envisaged by CBI Cat at the time of issuance of the Press release and the decision of the GST Council and will also provide the much needed relief to the taxpayer

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## PART-II

### FREQUENTLY ASKED QUESTIONS

1. What triggers ITC reversal due to supplier default?

Non-payment of GST by the supplier to the government

2. Which section governs ITC eligibility?

Section 16 of the CGST Act

3. What is the department's approach in ITC disputes?

They may deny ITC or recover it from suppliers.

4. What are the judicial precedents in such disputes?

Courts generally favor recipients if genuine transactions are proven.

5. How can recipients safeguard ITC claims?

Ensure suppliers file returns and pay taxes on regular basis.

6. What is GSTR-2B?

It is an auto-populated return showing eligible ITC.

7. What is the timeline for ITC claim reversal?

ITC must be reversed if the supplier doesn't pay taxes within a specified period.

8. How does supplier fraud affect ITC?

Recipients may lose ITC unless genuine efforts are proven.

9. What steps should recipients take in disputes?

Maintain all documentation and prove the genuineness of transactions.



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10. Can suppliers with canceled registrations impact ITC?

Yes, ITC may be denied if the supplier's registration is canceled retrospectively.

11. Are there exceptions to ITC reversal rules?

Yes, courts often provide relief in genuine cases.

12. What penalties apply for wrongful ITC claims?

Penalties include fines, interest, and potential prosecution.

13. What is the role of reconciliation in ITC claims?

Regular reconciliation ensures ITC eligibility.

14. What is the impact of Section 16(2)(aa)?

ITC is denied if invoices are not reflected in GSTR-2B due to the supplier's non-filing or incorrect filing of GSTR-1.

15. What happens if the supplier does not pay tax but has filed GSTR-1?

The department may deny ITC to the recipient unless courts intervene in their favour.

16. How do delayed supplier filings affect ITC?

Delayed filings may lead to temporary ITC denial.

17. Are suppliers solely liable for ITC disputes?

No, recipients must also ensure compliance.

18. Can ITC be denied for technical errors?

Courts generally discourage denial for minor errors.

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19. What is the department's stance on exceptional cases?

Exceptional cases may warrant ITC denial.

20. Can input tax credits be reclaimed post-reversal?

Yes, if compliance is subsequently ensured.

21. Are there timelines for ITC rectifications?

ITC claims can be rectified within the financial year.

22. What documentation is crucial for ITC claims?

Tax invoices, e-way bills, and payment proofs.

23. What steps should be taken if ITC is denied due to supplier default?

- a. Contact the supplier and request compliance.
- b. Maintain records of communication and payments.
- c. Consider legal action or alternative remedies.

24. Does non-payment of tax always lead to ITC denial?

Courts mandate supplier actions first before denying ITC.

25. How can taxpayers ensure ITC compliance?

Conduct regular vendor checks and reconciliation.

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**PART-III**

**RELATED CIRCULAR/NOTIFICATIONS/CASE LAWS**

***M/S. D.Y. BEATHEL ENTERPRISES V. THE STATE TAX OFFICER***

***MADRAS HIGH COURT W.P. NO.: 8596 OF 2020 FEBRUARY 24, 2021***

**Issue:** In this case, the petitioner contested the reversal of ITC on the grounds that the supplier had not remitted the collected tax to the government.

**Held:** The Madras High Court held that the authorities should first seek recovery from the defaulting supplier before directing the recipient to reverse the ITC. The court emphasized that the recipient should not be penalized without establishing their involvement in any collusion or willful negligence.

Thanks and Regards

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