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ITC disallowance to buyer for seller's default to pay taxes 'unsustainable'

The Hon'ble Madras High Court in the case of *M/s. Sri Ranganathar Valves Private Limited v. The Assistant Commissioner (CT) (FAC) Velandipalayam Assessment Circle, Coimbatore [W.P. No. 38488 of 2015 dated September 2, 2020]* has held that Input Tax Credit ("ITC") restriction in the hands of buyer, on the ground of tax collected but remaining unpaid to the Government by the seller "cannot be sustained" and "requires re-consideration" while disposing the writ in respect of restriction of the amount of ITC claimed for the months of December 2013 to May 2014.

Facts:

M/s. Sri Ranganathar Valves Private Limited ("**Petitioner/Assessee**") filed the Writ Petition w.r.t. restriction of the amount of ITC claimed for the months of December 2013 to May 2014 for separate orders for every month. The restriction of the amount of ITC has been done predominantly on the head of (a) Prior sufferance of Taxes; (b) ITC on reversal on wastage; and (c) Ineligible claim of ITC on goods.

The Assessing Officer was of the view that some of the sellers from whom the Petitioner had purchased the goods had not paid taxes to the Government and restricted the Petitioner to claim the amount of ITC of Rs. 22,54,760/- for prior sufferance of taxes.

Issue:

Whether restriction on the amount of ITC be imposed for prior sufferance of taxes?

Held:

The Hon'ble Madras High Court in *W.P. No. 38488 of 2015, dated September 2, 2020* held as under:

- Held that ITC restriction on the ground of tax collected but remaining unpaid to the Government "cannot be sustained" and "requires re-consideration". Relying on the case of *M/s. Shri Ranganathar Valves Private Limited v. Assistant Commissioner (CT), (FAC), Velandipalayam Assessment Circle, Coimbatore [W.P. Nos. 41670 to 41680 of 2016 dated November 28, 2016]*, in which the restriction of the amount of ITC for ineligible claim of ITC on goods has been dealt with, directed the Assessing

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Officer (AO) to issue a show cause notice to the Assessee calling for his objections with regard to “ITC on reversal on wastage” and “Ineligible claim of ITC on goods”.

- The Hon’ble Court also relied on **Assistant Commissioner (CT), presently Thiruverkadu Assessment Circle, Kolathur, Chennai v. Infiniti Wholesale Ltd. [[2017] 99 VST 341 (Mad)]**, wherein this Court held that ITC cannot be disallowed on the ground that the seller has not paid taxes to the Government, when the purchaser is able to prove that the seller has collected the tax and issued invoices to the purchaser. As such, restriction of the amount of ITC on this ground, cannot be sustained and requires re-consideration.
- Remanded the issue with regard to restriction of the amount of ITC for prior sufferance of taxes back to the Assessing Officer for fresh consideration.

Comments:

Under GST provisions, Section 16(2)(c) of the Central Goods and Service Tax Act, 2017 (“**CGST Act**”) has been into the controversy for a long while, which imposes a restriction on the buyer to avail ITC only when the tax on the transaction has been paid to the government, which states as below:

Section 16(2)(c) of the CGST Act states as below:

“Notwithstanding anything contained in this section, 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,—

*subject to the provisions of section 41 or section 43A, 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;”*

It provides for a condition wherein the recipient would only be entitled to ITC if the tax charged in respect of such supply has been actually paid by the supplier to the government.

In Pre-GST, the Hon’ble Apex Court in the case of **Commissioner of Central Excise, Jalandhar v. M/s. Kay Kay Industries [Civil Appeal No. 7031 of 2009, dated August 26, 2013]** held that the CENVAT credit is allowable to the assessee even if the supplier had

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not discharged its duty. Manufacturer cannot determine whether his supplier has discharged excise duty on the goods which are supplied to the manufacturer by him. Credit cannot be denied on mere non payment by the supplier. In order to avail CENVAT credit, assessee not expected to verify with Department whether supplier had paid duty on inputs or not and **this would be practically impossible and would lead to transactions getting delayed.**

Further, the Hon'ble Delhi HC in the case of *Arise India Ltd. v. Commissioner of Tax [W.P.(C) 2106/2015 dated October 26, 2017]* discussed the issue at length and held that **it is an impossible task for the buyer to determine which seller would not deposit the tax collected to the Government.** The Court read down Section 9(2)(g) of the Delhi Value Added Tax Act (“DVAT Act”) and noted that the benefit of ITC is denied to a bona fide purchaser. The reason of the default of the selling dealer over whom such purchasing dealer has no control. It should not be made the responsibility of the purchasing dealer to ensure that the tax is deposited by the selling dealer when the transaction is bona fide. This measure qua the purchasing dealer is arbitrary, irrational and unduly harsh and, therefore, violative of Article 14 of the Constitution of India. The HC opined that the only scenario where such provision can apply is when the revenue authorities have some material to show that the buyer and the seller have colluded in order to swindle the Government. However, where the seller has not deposited tax, the authorities should proceed against the seller and not the buyer. **The SLP in this case preferred by the Revenue was subsequently dismissed by the Apex Court stating that it was not inclined to interfere with the HC order.**

Furthermore, this practice of denying credit for non-payment of taxes by a supplier had been prevailing from the Value Added Tax (“VAT”) era, which is unfair and inimical to the businesses and not justifiable to put a legit taxpayers in a trouble while completing the ongoing process of collecting taxes by the authorities. The GST law not only denies credit to the buyer, but it also requires the buyer to reverse ITC along with interest if the seller has not deposited the taxes. Therefore, the buyer has been put at a situation where one is required to determine whether the intentions of the merchants are in the opportune spot or not. This expectation from the buyer needs to be amended and it needs to be assessed that till what extent the buyer should be responsible for no fault on his part. This provisions seriously required reconsideration & corresponding amendment in the GST law to provide real ease of business.

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