

Recovery to be made from defaulting seller instead of denying ITC to purchaser: Madras HC

30 April 2021



Summary

The Madras High Court (HC) in a recent case has held that the purchaser/buyer cannot be asked to reverse input tax credit (ITC) availed when there is default on the part of the seller to discharge his tax liability to the government. The HC stated that strict action should have been taken against the seller and recovery proceedings should be initiated by the revenue before asking the purchaser to reverse the ITC.

Facts of the case

- The petitioner¹ is a trader in raw rubber sheets.
- It availed ITC on purchases made based on the returns filed by the seller. However, it was later on found that the seller had not paid its output tax liability to the government. Therefore, show cause notice (SCN) was issued to the petitioner and it was asked to reverse the ITC availed. Further, orders were passed levying entire liability on the petitioners therein.
- Therefore, the petitioner filed the present writ² challenging the said order.

Madras High Court's observations and ruling³

- **No action against seller:** The HC stated that if the tax had not reached the kitty of the government, then the liability may have to be eventually borne by one party,

either the seller or the buyer. In the present case, the revenue does not appear to have taken any recovery action against the seller.

- **Strict action required against seller:** When it has come out that the seller has collected tax from the purchasing dealers, the omission on the part of the seller to remit the tax in question must have been viewed very seriously and strict action ought to have been initiated against him.
- **Impugned order suffers fundamental flaws:** The revenue didn't ensure the presence of the seller for the purpose of enquiry in spite of being insisted upon by the petitioner. Further, it assumed that there was no involvement of goods and the petitioner had availed ITC on basis of invoice raised. Therefore, the HC stated that the impugned order suffers from fundamental flaws and needs to be quashed.

¹ M/s D.Y.Beathel Enterprises

² W.P.(MD)Nos.2127 of 2021

³ Madras HC Order dated 24 February 2021

- **Petition allowed:** Thus allowing the petition, the HC remitted the matter back to the revenue to conduct enquiry against the seller and initiate recovery action.

Our comments

This is an important and welcome judgment by the Madras HC, which will help provide the required clarity and also is likely to set precedence in similar matters.

Further, the Madras HC has reiterated that the authorities can catch the purchaser/buyer only after appropriate proceedings/enquiry has been done against the seller or it has exhausted all the exceptional situations like missing dealer, closure of business by supplier or supplier not having adequate assets, etc.⁴

The Supreme Court in the case of Arise India Limited had earlier dismissed the special leave petition (SLP) filed by revenue and refused to interfere with the order of Delhi HC, which had held that the relevant provisions⁵ under the VAT law are violative⁶ to the extent they disallow the ITC to the purchaser due to default of selling dealer in depositing tax.

Recently, the Karnataka HC in the case of Simplex Infrastructures Ltd. has also held that the input tax credit cannot be denied in the hands of purchasing dealer merely on the ground that the selling dealer has not discharged his/her VAT liability.

⁴ Press Release of 27th GST Council meeting held on 4 May 2018

⁵ Section 9(2)(g) of the Delhi VAT Act

⁶ Articles 14 and 19(1)(g) of the Constitution of India

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