

A2Z Taxcorp LLP

Landmark judgment on Section 16(2)(c) of the CGST Act holds the provision valid but ITC of a genuine buyer cannot be reversed mechanically for default of the supplier

The Hon'ble Punjab and Haryana High Court in ***Shaurya Alloys Pvt. Ltd. v. State of Punjab and Another [CWP No. 34296 of 2024 (O&M) and connected matters dated October 01, 2026]*** disposed of a batch of 424 writ petitions challenging the vires of Section 16(2)(c) of the Central Goods and Services Tax Act, 2017 ("**the CGST Act**") and upheld the constitutional validity of the provision, but held that Section 16(2)(c) read with Section 155 of the CGST Act cannot be construed as a standalone provision so as to mechanically saddle the purchasing dealer with reversal of Input Tax Credit ("**ITC**") merely because the supplier has failed to deposit the tax or its registration has been cancelled retrospectively. The Hon'ble High Court, after considering the rulings in ***Bhandari Scrap Traders, Sahil Enterprises, G.R. Infra Projects and Tata Steel***, laid down fourteen binding guidelines governing the invocation of Section 16(2)(c) of the CGST Act by the proper officers and directed that all the show cause notices and orders under challenge be decided afresh in the light of those guidelines.

Facts:

M/s. Shaurya Alloys Pvt. Ltd. and several other registered purchasing dealers of Punjab, Haryana and the Union Territory of Chandigarh ("**the Petitioners**") were issued show cause notices and, in many cases, adjudication orders under Sections 73 and 74 of the CGST Act, proposing or confirming the denial and reversal of ITC under Section 16(2)(c) of the CGST Act. The action was founded on the allegation that the suppliers of the Petitioners had not paid the tax to the Government, or had discharged it by utilising inadmissible ITC, or that the registration of the supplier (or of a dealer higher up in the supply chain) had subsequently been cancelled with retrospective effect. In a large number of cases, the registration of the purchasing dealer itself was cancelled retrospectively on the same footing.

The Petitioners contended that:

A2Z Taxcorp LLP

- They were in possession of valid tax invoices, had received the goods and had paid the consideration along with tax to the suppliers through banking channels, and the grievance was confined to genuine transactions only and not to cases of fraud, collusion or non-receipt of goods.
- The original scheme of matching, reversal and reclaim of ITC under Sections 37, 38, 41, 42 and 43 of the CGST Act read with Form GSTR-2 and Form GSTR-3 was never implemented, and was ultimately omitted with effect from October 01, 2022. Rule 37A of the Central Goods and Services Tax Rules, 2017 (“**the CGST Rules**”) providing for re-availment of reversed ITC was inserted only with effect from December 26, 2022. Thus, the purchasing dealer had no statutory means to ascertain whether the supplier had actually deposited the tax.
- Requiring the purchasing dealer to ensure the deposit of tax by the supplier attracts the maxim *lex non cogit ad impossibilia*, and Section 16(2)(c) of the CGST Act is therefore violative of Articles 14, 19(1)(g), 21, 265 and 300A of the Constitution of India. In the alternative, the provision ought to be read down so as to apply only to cases of fraud, collusion or non-existent suppliers.
- The Revenue has an efficacious remedy against the defaulting supplier under Sections 75(12), 76 and 79 of the CGST Act and Rule 88C of the CGST Rules, and the purchasing dealer cannot be made a guarantor for the supplier, resulting in double taxation.

The Revenue (“**the Respondents**”) contended that:

- ITC is not a vested right but a statutory concession, available only upon strict fulfilment of all the conditions of Section 16(2) of the CGST Act, and the burden of proving eligibility lies on the claimant under Section 155 of the CGST Act.

A2Z Taxcorp LLP

- Discharge of output tax by the supplier through fraudulent or ineligible ITC does not amount to “actual payment” of tax within the meaning of Section 16(2)(c) of the CGST Act.
- The validity of Section 16(2)(c) of the CGST Act already stands upheld by the Hon’ble Gujarat High Court in *Maruti Enterprise v. Union of India* and affirmed by the Hon’ble Supreme Court in *Bhandari Scrap Traders v. Union of India*, and writ petitions filed at the stage of show cause notice are premature.

Issues:

- Whether Section 16(2)(c) of the CGST Act, which makes the ITC of the recipient conditional upon actual payment of tax by the supplier to the Government, is ultra vires Articles 14, 19(1)(g), 265 and 300A of the Constitution of India or is liable to be read down?
- Whether ITC can be denied to or reversed from a purchasing dealer in a routine manner solely on account of non-payment of tax by the supplier or the retrospective cancellation of the registration of the supplier, without examining the genuineness of the transaction and without recourse to the statutory remedies available against the supplier?

Held:

The Hon’ble Punjab and Haryana High Court in ***CWP No. 34296 of 2024 (O&M) and connected matters*** held as under:

- Observed that, the CGST Act originally contained an elaborate mechanism of matching and reconciliation through which any default of the supplier would have come to the knowledge of the purchasing dealer in a time-bound manner. That mechanism was never implemented and was omitted with effect from October 01, 2022, and prior to

A2Z Taxcorp LLP

the insertion of Rule 37A of the CGST Rules with effect from December 26, 2022 there was no provision for re-availment of reversed credit even where the supplier subsequently paid the tax.

- Noted that, Section 76 of the CGST Act specifically deals with tax collected but not paid to the Government and it cannot be rendered otiose by indiscriminate invocation of Section 16(2)(c) of the CGST Act, which would spare the person actually liable and burden the purchasing dealer who has already paid the tax on the transaction.
- Noted that, in a large number of cases Section 16(2)(c) of the CGST Act was invoked in a routine and mechanical manner only because the registration of the supplier had been cancelled, and that the mere availability of Rule 37A of the CGST Rules cannot be a general justification for retrospectively denying ITC.
- Held that, Section 16(2)(c) of the CGST Act does not suffer from any constitutional infirmity, as actual payment of tax to the Government is the very foundation of ITC. The vice of impossibility does not inhere in the text of the provision but arises only when it is applied mechanically. In view of *Maruti Enterprise* and *Bhandari Scrap Traders*, judicial discipline also counsels against reading down the provision. The challenge to the vires was accordingly repelled.
- Held that, Section 16(2)(c) read with Section 155 of the CGST Act cannot be construed as a standalone provision. Before fastening liability on the purchasing dealer, the proper officer must examine, after due opportunity of hearing, the circumstances in which the supplier failed to deposit the tax, the genuineness of the transaction and the mechanism available for recovery from the supplier in the relevant period. However, where collusion, fraud, a non-existent supplier or non-receipt of goods or services is established, the consequences under Section 16(2)(c) of the CGST Act would follow.

A2Z Taxcorp LLP

- Held that, relying upon the rulings of the Hon'ble Supreme Court in ***G.R. Infra Projects Limited v. State of Madhya Pradesh [decided on August 19, 2026]*** and ***Tata Steel Limited v. Union of India [2026 INSC 920 dated August 25, 2026]***, where Section 74 of the CGST Act is invoked, the foundational facts leading to the inference of fraud, wilful misstatement or suppression on the part of the noticee must emanate from the notice itself and cannot be supplied later by a counter affidavit. The fraud of the supplier does not, by itself, become the fraud of the purchasing dealer, unless the notice discloses the facts connecting the purchasing dealer with such fraud.
- **Laid down binding guidelines for invocation of Section 16(2)(c) of the CGST Act, *inter alia*, that:**
 - Cancellation (including retrospective cancellation) of the registration of the supplier, 'nil' or short tax in the return of the supplier, or an alert from another authority may be a starting point for inquiry but cannot by itself be the basis for denial of ITC.
 - Before issuing the show cause notice, the proper officer shall record satisfaction on the particulars of the supplier, invoices and ITC involved, the precise nature and circumstances of the default, and the status of recovery proceedings against the supplier under Sections 73, 74, 75(12) read with Section 79, or Section 76 of the CGST Act. The investigation should establish some direct link of the purchasing dealer with the supplier.
 - The show cause notice shall disclose these particulars and the relied upon documents such as alert notices, statements, e-way bill, toll and banking data shall be supplied to the noticee.
 - Where Section 74 of the CGST Act (or Section 74A of the CGST Act on the ground of fraud, wilful misstatement or suppression of facts) is invoked, the notice shall

A2Z Taxcorp LLP

itself contain the foundational facts from which fraud on the part of the noticee is inferred. A bald recital of these expressions shall not suffice, the deficiency cannot be cured by a counter affidavit, and the fraud of the supplier shall not be attributed to the purchasing dealer without connecting facts.

- The purchasing dealer may discharge the burden under Section 155 of the CGST Act by producing the tax invoice and proof of receipt of goods or services such as e-way bills, transport receipts, weighbridge slips and stock records, which the proper officer must deal with in the order.
- Where tax on the same supply has been recovered from or deposited by the supplier, the same tax shall not be realised twice and the purchasing dealer shall be entitled to re-avail the credit under the proviso to Section 41(2) of the CGST Act and Rule 37A of the CGST Rules, subject to Section 17(5)(i) of the CGST Act.
- The law as it stood in the relevant tax period shall be applied, and a later condition such as Section 16(2)(aa) of the CGST Act (effective January 01, 2022) shall not be applied to an earlier period. For periods prior to December 26, 2022, the absence of a re-avilment mechanism shall be borne in mind.
- Where the denial of ITC is premised on the retrospective cancellation of the registration of the supplier, the proper officer shall examine the grounds and the effective date of such cancellation and whether they have any bearing on the genuineness of the particular supply made to the purchasing dealer.
- The registration of the purchasing dealer shall not be cancelled, much less retrospectively, merely because its supplier's registration was subsequently cancelled, without independent satisfaction under Section 29(2) of the CGST Act.

A2Z Taxcorp LLP

- Personal hearing under Section 75(4) of the CGST Act shall be granted, a request for cross-examination shall be decided by a reasoned order, and the final speaking order shall record a specific finding on each disputed condition of Section 16(2) of the CGST Act.
 - A deposit made by the purchasing dealer during investigation, whether through Form GST DRC-03 or otherwise, shall not dispense with the requirement of a proper show cause notice disclosing the foundational facts, and the character and effect of such deposit shall be determined on the facts of each case.
 - **The guidelines shall govern all proceedings pending before the proper officers as well as proceedings initiated hereafter.**
- Directed that, where the proceedings are at the stage of show cause notice, the Petitioners may file a reply or supplementary reply within eight weeks, and where orders have already been passed, the proper officer shall re-visit the matter and pass a fresh reasoned order after personal hearing. The impugned orders and the amounts already deposited or recovered shall abide by the fresh orders, no fresh coercive recovery shall be made in the meantime, and all pleas on merits are left open.
 - Hence, the matters stand remanded back to the proper officers for fresh adjudication in accordance with the guidelines, with liberty to the Department to proceed against the defaulting suppliers.

Our Comments:

Relevant provisions

Section 16(2)(c) of the CGST Act, which lies at the heart of the controversy, reads as under:

A2Z Taxcorp LLP

“(2) 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,—

—

...

(c) subject to the provisions of section 41, 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;”

The clause is expressly “subject to Section 41” of the CGST Act. Section 41, as substituted with effect from October 01, 2022, permits availment of ITC on self-assessment basis and requires its reversal with interest where the supplier has not paid the tax, with re-availment once the supplier pays. Rule 37A of the CGST Rules (effective December 26, 2022) links such reversal to the non-filing of Form GSTR-3B by the supplier up to September 30 following the end of the financial year. Section 155 of the CGST Act casts the burden of proving eligibility to ITC on the claimant, whereas Sections 75(12), 76 and 79 of the CGST Act and Rule 88C of the CGST Rules arm the Revenue with direct means of recovery against the supplier who has collected but not deposited the tax. The ruling harmonises these provisions: the condition of actual payment remains, but the Revenue must first look at the transaction and at the supplier before turning to the buyer.

Pari materia judgments:

- The Hon’ble Delhi High Court in ***On Quest Merchandising India Pvt. Ltd. v. Government of NCT of Delhi [W.P.(C) No. 6093 of 2017 dated October 26, 2017]*** read down Section 9(2)(g) of the Delhi Value Added Tax Act, 2004 and held that ITC cannot be denied to a bona fide purchasing dealer for the default of the selling dealer, in the absence of collusion. The Special Leave Petition of the Revenue was dismissed by the Hon’ble

A2Z Taxcorp LLP

Supreme Court in ***Commissioner of Trade and Taxes, Delhi v. Arise India Ltd. [SLP (C) No. 36750 of 2017 dated January 10, 2018]***.

- The Hon'ble Supreme Court in ***Commissioner Trade and Tax Delhi v. Shanti Kiran India (P.) Ltd. [2025 SCC OnLine SC 2389 dated October 09, 2025]*** upheld the grant of ITC to bona fide purchasers where the selling dealers were registered on the date of the transaction and their registration was cancelled subsequently.
- The Hon'ble Supreme Court in ***State of Maharashtra v. Suresh Trading Company [(1997) 11 SCC 378]*** held that retrospective cancellation of the registration of the selling dealer cannot affect a purchaser who acted on the strength of a registration certificate that was valid on the date of the transaction.
- The Hon'ble Punjab and Haryana High Court in ***Gheru Lal Bal Chand v. State of Haryana [2011 SCC OnLine P&H 13205]*** held under the Haryana VAT law that no liability can be fastened on the purchasing dealer for non-payment of tax by the selling dealer unless fraud, collusion or connivance is established.
- The Hon'ble Calcutta High Court in ***Suncraft Energy Pvt. Ltd. v. Assistant Commissioner, State Tax [MAT No. 1218 of 2023 dated August 02, 2023]*** held that ITC cannot be reversed from the recipient without first proceeding against the supplier, except in exceptional situations such as a missing supplier or collusion. The Special Leave Petition of the Revenue was dismissed by the Hon'ble Supreme Court on December 14, 2023.
- The Hon'ble Madras High Court in ***D.Y. Beathel Enterprises v. State Tax Officer [W.P.(MD) No. 2127 of 2021 dated February 24, 2021]*** held that the Revenue cannot proceed only against the buyer while omitting to take recovery action against the seller who collected the tax.

A2Z Taxcorp LLP

- The Hon'ble Tripura High Court in ***Sahil Enterprises v. Union of India [W.P.(C) No. 688 of 2022 dated January 06, 2026]***, the Hon'ble Gauhati High Court in ***National Plasto Moulding v. State of Assam [W.P.(C) No. 2863 of 2022 dated August 05, 2024]*** and the Hon'ble Karnataka High Court in ***Instakart Services Private Limited v. Union of India [2026 SCC OnLine Kar 2469]*** applied the *On Quest* principle to Section 16(2)(c) of the CGST Act and protected bona fide purchasers. A Special Leave Petition against *Sahil Enterprises* is stated to be pending before the Hon'ble Supreme Court.
- The Hon'ble Supreme Court in ***G.R. Infra Projects Limited v. State of Madhya Pradesh [decided on August 19, 2026]*** and ***Tata Steel Limited v. Union of India [2026 INSC 920 dated August 25, 2026]*** held that a notice under Section 74 of the CGST Act must itself set out the foundational facts leading to the inference of fraud, wilful misstatement or suppression of facts, and that a mechanical recital of these expressions cannot be made good by a counter affidavit filed before the Court.

Contrary judgments:

- The Hon'ble Gujarat High Court in ***Maruti Enterprise v. Union of India [R/Special Civil Application No. 18080 of 2023 dated May 01, 2026]*** upheld the validity of Section 16(2)(c) of the CGST Act and declined to read it down, holding that ITC is a statutory concession and that Section 41(2) of the CGST Act and Rule 37A of the CGST Rules adequately protect the recipient. This view was affirmed by the Hon'ble Supreme Court in ***Bhandari Scrap Traders v. Union of India [2026 SCC OnLine SC 1570 dated July 24, 2026]***, which held that no parity can be drawn between the Delhi VAT law and the CGST Act.
- The Hon'ble Patna High Court in ***Aastha Enterprises v. State of Bihar [CWJC No. 10395 of 2023 dated August 18, 2023]*** held that ITC is not available to the purchaser where

A2Z Taxcorp LLP

the supplier has not paid the tax to the Government, even if the purchaser has paid the tax to the supplier.

- The Hon'ble Kerala High Court in ***M. Trade Links v. Union of India [W.P.(C) No. 31559 of 2019 dated June 04, 2024]*** upheld the constitutional validity of Section 16(2)(c) of the CGST Act.
- The Hon'ble Supreme Court in ***State of Karnataka v. Ecom Gill Coffee Trading Pvt. Ltd. [Civil Appeal No. 230 of 2023 dated March 13, 2023]*** held under the Karnataka VAT law that the burden of proving the genuineness of the transaction lies on the purchasing dealer and that mere production of invoices and payment by cheque is not sufficient.

Our view:

This is a landmark ruling on Section 16(2)(c) of the CGST Act, which steers a middle course between the bona fide purchaser line of cases and the strict view taken in *Maruti Enterprise*. After *Bhandari Scrap Traders*, the validity of Section 16(2)(c) of the CGST Act is no longer open to challenge and the Hon'ble High Court has rightly not attempted to read it down. At the same time, it has shifted the debate from validity to the manner of application. The Revenue must now show application of mind, disclose the material, examine the genuineness of the specific supply and record what has been done against the defaulting supplier before reversing the credit of the buyer. It is also significant that the Court has recognised three distinct phases of law (prior to October 01, 2022, from October 01, 2022 and from December 26, 2022), which is a strong ground for disputes pertaining to the earlier years where no mechanism for re-avilment existed.

For taxpayers, the ruling does not grant immunity. The burden under Section 155 of the CGST Act continues to rest on the recipient and ITC will still be lost where the transaction is found to be collusive or the goods were never received. Recipients should therefore maintain a

A2Z Taxcorp LLP

complete documentary trail (tax invoice, e-way bill, transport receipt, weighbridge slip, stock and consumption records and bank payment proof) and should specifically call upon the proper officer to disclose the action taken against the supplier. The guidelines are binding on the Central and State authorities in Punjab, Haryana and Chandigarh, and would carry persuasive value before authorities and Courts elsewhere. It is also worth recalling that the GST Council, in its press release dated May 04, 2018, had itself stated that there shall be no automatic reversal of credit from the buyer on non-payment of tax by the seller, except in exceptional situations such as a missing dealer or closure of business by the supplier.

[CLICK HERE FOR OFFICIAL JUDGMENT COPY](#)

(Author can be reached at info@a2ztaxcorp.com)

DISCLAIMER: The views expressed are strictly of the author and A2Z Taxcorp LLP. The contents of this article are solely for informational purpose and for the reader's personal non-commercial use. It does not constitute professional advice or recommendation of firm. Neither the author nor firm and its affiliates accepts any liabilities for any loss or damage of any kind arising out of any information in this article nor for any actions taken in reliance thereon. Further, no portion of our article or newsletter should be used for any purpose(s) unless authorized in writing and we reserve a legal right for any infringement on usage of our article or newsletter without prior permission.