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Supreme Court stays Allahabad High Court ruling that Section 61 scrutiny is not a pre-condition for a Section 74A SCN

The Hon'ble Supreme Court in ***M/s Neelkanth Entrepreneurs Private Limited v. State of U.P. & Anr. [SLP (C) No. 34742 of 2026 dated October 06, 2026]*** issued notice, **returnable on November 20, 2026**, in the Special Leave Petition filed against the judgment of the Hon'ble Allahabad High Court (Lucknow Bench) in ***M/s Neelkanth Entrepreneurs Private Limited v. State of U.P. & Anr. [Writ Tax No. 1024 of 2026 dated September 09, 2026]*** and directed that, in the meantime, there shall be a **stay of operation of the impugned judgment of the High Court**.

The Hon'ble Allahabad High Court had dismissed the writ petition filed against a Show Cause Notice dated July 09, 2026 issued under Section 74A(1) of the Central Goods and Services Tax Act, 2017 **("the CGST Act")**, holding that scrutiny of returns under Section 61 of the CGST Act read with Rule 99 of the Central Goods and Services Tax Rules, 2017 **("the CGST Rules")** is not an invariable pre-condition for issuance of a Show Cause Notice under Section 74A where the notice rests on independent verification, that the notice alleging bogus and non-existent sub-contractors validly invokes Section 74A(5)(ii), and that no interference under Article 226 of the Constitution of India was warranted at the show cause stage. The High Court, however, granted the petitioner liberty to file a detailed reply within four weeks, to be considered by the adjudicating authority on its own merits, uninfluenced by the Court's observations and after affording adequate opportunity of hearing.

Facts:

M/s Neelkanth Entrepreneurs Private Limited **("the Petitioner")** is a GST-registered company supplying works-contract services. It executes sub-contract works for NCC Limited in Bihar, Jharkhand, Uttar Pradesh and Maharashtra. For FY 2025-26, it sub-contracted portions of these works on a back-to-back basis to eighteen registered sub-contractors.

The Petitioner's record includes work orders, tax invoices, measurement sheets, bank statements showing payments through banking channels, GSTR-2A/B2B invoice summaries, registration-status documents of the sub-contractors, and signed undertakings from the sub-contractors confirming execution of the works and filing of returns with payment of tax.

The Respondents issued the SCN dated July 09, 2026 under Section 74A(1) of the CGST Act proposing to deny the ITC availed together with tax, interest and penalty, on the allegation that the works sub-contracted to the firms appeared bogus and non-existent. The Petitioner did not file a reply to the SCN. It filed a writ petition before the Allahabad High Court seeking (i) quashing of the SCN and (ii) a declaration that Section 16(2)(c) of the CGST/UPGST Acts is ultra vires. It contended that the SCN bypassed the mandatory scrutiny mechanism under Section 61 of the CGST Act read with Rule 99 of the CGST Rules, that Section 74A(5)(ii) was wrongly invoked in the absence of any allegation of fraud, wilful misstatement or suppression, that no physical verification of the sub-contractors was conducted or confronted to it, and that, relying on ***Suncraft Energy Pvt. Ltd. v. Assistant Commissioner, State Tax*** **[(2023) 117 GSTR 78 (Cal.)]**, ITC could not be denied to a bona fide recipient without first proceeding against the defaulting supplier. The Respondents submitted that the Petitioner's returns were never picked up for scrutiny, that the SCN arose from independent verification revealing that the eighteen sub-contractors were bogus and non-existent, that the Petitioner's precedents were all cases where scrutiny had admittedly been undertaken, and that the matter was only at the SCN stage where all grounds could be raised in reply.

The High Court dismissed the writ petition on September 09, 2026. Aggrieved, the Petitioner filed the present Special Leave Petition before the Hon'ble Supreme Court, which, by order dated October 06, 2026, issued notice **returnable on November 20, 2026** and stayed the operation of the impugned judgment.

Issues

- Whether scrutiny of returns under Section 61 of the CGST Act read with Rule 99 of the CGST Rules is a mandatory pre-condition for issuance of a Show Cause Notice under Section 74A of the CGST Act where the notice rests on independent verification?

- Whether the invocation of Section 74A(5)(ii) of the CGST Act is without jurisdiction for want of the ingredients of fraud, wilful misstatement or suppression of facts, where the notice alleges that the sub-contractors are bogus and non-existent?

- Whether the High Court ought to exercise its writ jurisdiction under Article 226 of the Constitution of India to interdict a Show Cause Notice at the threshold, where the noticee has not filed any reply?

Held:

The Hon'ble Allahabad High Court in ***Writ Tax No. 1024 of 2026*** held as under:

- **Noted that,** the challenge to the constitutional validity of Section 16(2)(c) of the CGST Act was not pressed by the Petitioner in view of the dismissal by the Hon'ble Supreme Court of the SLP in ***Bhandari Scrap Traders v. Union of India & Ors.*** **[2026 SCC OnLine SC 1570, order dated July 24, 2026]**, affirming the Gujarat High Court's judgment in ***Maruti Enterprises v. Union of India & Ors.***, which confirms that ITC is a conditional statutory benefit and not a vested right, available only where the supplier has actually paid the tax to the Government.

- **Observed that,** Section 61 of the CGST Act is a pre-adjudicatory and verificatory mechanism confined to scrutiny of returns already filed, whereas Sections 73 and 74A operate independently and are triggered whenever tax is short-paid or ITC is wrongly availed, which fact may come to the notice of the proper officer through scrutiny, audit, special audit, inspection, search and seizure or, as in the present case, independent verification of the antecedents of the sub-contractors. Section 74A(1) opens with the

words “where it appears to the proper officer”, which is not tethered to any single source of information, and Section 61 is therefore not the sole gateway to Section 74A.

- **Noted that,** the mandatory word “shall” in Rule 99(1) of the CGST Rules comes into play only where scrutiny under Section 61 has in fact been initiated; the Respondents’ uncontroverted stand was that the Petitioner’s returns were never picked up for scrutiny. The decisions relied upon by the Petitioner in ***Goverdhandham Estate***, ***Pepsico India Holdings***, ***Ramhari & Brothers***, ***Qualicum Solutions***, ***Amex Services and Suncraft Energy*** were all rendered where scrutiny under Section 61 had admittedly been undertaken and are distinguishable, while ***Nagarjuna Agro Chemicals***, ***Devi Traders and Mandarina Apartment Owners Welfare Assn.*** support the view that scrutiny is not a condition precedent.

- **Held that,** Section 61 is not, as a matter of law, an invariable jurisdictional pre-condition to every notice under Section 74A; however, where the proper officer possesses only return-based discrepancy material and no independent source of information, compliance with Section 61 and Rule 99 may be a mandatory procedural safeguard, non-compliance of which may expose the resultant proceedings to challenge.

- **Held that,** the SCN, which specifically alleges that the eighteen sub-contractors were bogus and non-existent and that ITC was availed on fake invoices without actual supply, discloses on its face the foundational facts to attract Section 74A(5)(ii), following ***Tvl. K. Ezhil Arasan v. Joint Commissioner (ST) Intelligence, Salem*** **[2026:MHC:2274 dated June 08, 2026]**; whether those allegations are true is a matter of evidence for the adjudicating authority and not for determination under Article 226.

- **Held that,** ordinarily no writ lies against a mere Show Cause Notice unless it is wholly without jurisdiction **(*Union of India v. Kunisetty Satyanarayana* [(2006) 12 SCC 28])**; none of the exceptions carved out in ***Whirlpool Corporation v. Registrar of Trade Marks*** **[(1998) 8 SCC 1]** was attracted, the Petitioner had admittedly not replied to the SCN, and the

grounds urged were essentially factual. ***Suncraft Energy***, which proceeds on the footing of a genuine but defaulting supplier, does not deal with a case where the very existence of the supplier is doubted, and its applicability is left open for the adjudicating authority.

- **Directed that,** the dismissal of the writ petition shall not preclude the Petitioner from filing a detailed reply to the SCN within four weeks, raising all factual and legal contentions, which the adjudicating authority shall consider on its own merits, in accordance with law, uninfluenced by the Court's observations and after affording adequate opportunity of hearing, including an opportunity to place on record the documents relied upon. All rights and contentions on the merits of the SCN were kept open.

Our Comments:

A bare perusal of Section 61 of the CGST Act shows that it empowers the proper officer to scrutinise a return and related particulars to verify their correctness and if a discrepancy is noticed, the proper officer informs the taxpayer in Form GST ASMT-10 under Rule 99 and asks for an explanation in Form ASMT-11. If the explanation is found acceptable, or the taxpayer accepts the discrepancy and pays the tax in Form GST DRC-03 within thirty days, the scrutiny is closed by an order in Form GST ASMT-12. If not, the proper officer may proceed further, including determining tax under Section 73 or 74 or Section 74A. It is a pre-adjudicatory and verificatory exercise as no demand can be confirmed or recovered on the strength of an ASMT-10 notice or an ASMT-12 order alone. Where no satisfactory explanation is furnished within thirty days, or corrective measures are not taken, the proper officer may initiate audit (Section 65), special audit (Section 66), inspection, search and seizure (Section 67) or proceed to determine the tax and other dues under Section 73, 74 or 74A.

The question before the Hon'ble High Court was whether the department must go through Section 61 scrutiny and Rule 99 before issuing a Section 74A SCN.

Section 74A of the CGST Act does not require that a scrutiny under Section 61 must precede the notice. Section 74A(1) opens with the words "where it appears to the proper officer", which are not tethered to any single source of information, be it scrutiny, audit, inspection or independent verification. A similar view was taken by the Andhra Pradesh High Court in ***Devi Traders v. State of Andhra Pradesh*** **[2023 SCC OnLine AP 1886]**, holding that scrutiny under Section 61 is not a sine qua non for proceedings under Section 74. However, once scrutiny under Section 61 is actually initiated and discrepancies are noticed, Rule 99 of the CGST Rules makes the issuance of Form GST ASMT-10 mandatory.

This procedural step ensures that the taxpayer is given a fair chance to address the discrepancies, thereby upholding the principles of natural justice. Failure to issue Form GST ASMT-10 when discrepancies are found during scrutiny is a procedural lapse under Section 61 and Rule 99, even though it may not directly contravene Section 73. The Calcutta High Court in ***Amex Services & Anr. v. Deputy Commissioner, State Tax, Asansol Charge & Ors.*** **[WPA 9391 of 2024 dated May 22, 2024, reported in (2024) 129 GSTR 482]** held that where scrutiny has been undertaken, the proper officer must issue Form GST ASMT-10 before proceeding to issue an SCN, as non-issuance deprives the taxpayer of the opportunity to explain the discrepancy and violates the principles of natural justice. The Orissa High Court in ***M/s Qualicum Solutions Pvt. Ltd. v. Chief Commissioner of CT & GST*** **[W.P.(C) No. 27986 of 2024 dated November 14, 2024]** took the same view.

The Telangana High Court in ***MR Steels v. Deputy Commissioner of State Tax*** **[W.P. No. 34743 of 2025]** held that when show cause notices are issued following search and seizure operations during an investigation, prior return scrutiny under Section 61 is not a mandatory prerequisite, and challenges regarding procedural non-compliance or lack of opportunity should be raised before the adjudicating authority.

Further, the Gauhati High Court in ***M/s Pepsico India Holdings Pvt. Ltd. v. Union of India*** **[W.P. (C) No. 6960 of 2023 dated September 19, 2025, reported in (2026) 159 GSTR 404]** held that

where the proposed demand is based solely on discrepancies found in the taxpayer's own returns, the procedural requirement of Section 61 read with Rule 99 acts as a condition precedent which cannot be bypassed before issuing an SCN under Section 73. Similarly, the Rajasthan High Court in ***Goverdhandham Estate Pvt. Ltd. v. State of Rajasthan & Ors.*** **[D.B. Civil Writ Petition No. 16702/2023 dated January 17, 2024, reported in (2025) 147 GSTR 239]**, against which the Department's SLP stands dismissed by the Hon'ble Supreme Court, held that where the statute prescribes a specific procedure to rectify discrepancies before recovery, the Department is bound to follow it. The Rajasthan High Court reiterated this in ***Ramhari & Brothers v. Joint Commissioner (State Tax), Bharatpur*** **[D.B. Civil Writ Petition No. 20189 of 2025 dated July 16, 2026, reported in (2026) 44 Centax 327 (Raj.)]**.

Per contra, the Allahabad High Court in the present case distinguished all of these decisions on the ground that in each of them the Department had admittedly initiated scrutiny under Section 61, whereas here the returns were never picked up for scrutiny at all. The Court did not, however, render Section 61 irrelevant: it clarified that where the officer has only return-based discrepancy material and no independent source of information, compliance with Section 61 and Rule 99 may be a mandatory safeguard. The Section 61 argument therefore turns on what material the Department actually relied upon. In the present case, the SCN was founded not merely on the Petitioner's returns but on independent verification of the eighteen sub-contractors, which allegedly revealed them to be bogus and non-existent.

Likewise, the Madras High Court in ***Mandarina Apartment Owners Welfare Assn. v. Commercial Tax Officer/State Tax Officer*** **[2024 SCC OnLine Mad 3501 dated July 16, 2024]** held that upon fulfilment of two conditions, i.e., selection of returns for scrutiny and discovery of discrepancies on such scrutiny, there is a mandatory obligation to issue Form GST ASMT-10 to enable the registered person to furnish an explanation; however, Sections 61 and 73 operate as distinct and independent proceedings, and scrutiny of returns is not a condition precedent to adjudication under Chapter XV, since the SCN is the culmination of an investigation which the proper officer is free to conduct on material gathered from any source.

Similarly, a co-ordinate Bench of the Allahabad High Court in ***M/s Nagarjuna Agro Chemicals (P) Ltd. v. State of U.P.*** **[2023 SCC OnLine All 5339 dated May 15, 2023]** held that the scrutiny proceedings of return as well as proceedings under section 74 are two separate and distinct exigencies and issuance of notice under section 61(3), therefore, cannot be construed as a condition precedent for initiation of action under section 74 of the Act.

Thus, it can be concluded that Section 61 is not the sole gateway to an SCN. Where no return has been filed, there is nothing to scrutinise, and the proper officer has to rely on other routes such as audit, inspection, search and seizure, or an SCN under Section 73, 74 or 74A. In short, Sections 73, 74 and 74A do not themselves require ASMT-10 before an SCN. Section 61 and Rule 99 come into play when discrepancies are found during scrutiny of returns, and the Allahabad High Court has clarified that compliance may also be a mandatory safeguard where the notice rests only on return-based discrepancies. Proper officers should therefore issue ASMT-10 before an SCN in such cases. This keeps the process fair, follows the statutory scheme and upholds the principles of natural justice. Where the department has independent material, as in the present case, where the sub-contractors were verified independently, an SCN under Section 74A can be issued without prior scrutiny. The judgment is, however, under challenge before the Hon'ble Supreme Court in **SLP (C) No. 34742 of 2026, which has stayed its operation by order dated October 06, 2026, with notice returnable on November 20, 2026**. Until the Supreme Court decides the issue, taxpayers facing an SCN under Section 73, 74 or 74A should examine whether the notice is founded only on their own returns (in which case the absence of Form GST ASMT-10 remains a strong ground) or on independent material gathered by the Department.

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