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Fraud by Supplier And ITC Eligibility

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UNDER Central Excise and Service Tax regime, recipient of goods or services was not entitled to CENVAT Credit of duty / tax, in the circumstances where the differential duty became payable by reasons such as fraud or a wilful mis-statement or suppression of facts, etc. with intent to evade tax. Such provisions were envisaged under Rule 9(1)(b) and (bb) of the CENVAT Rules applicable to CENVAT Credit of Excise Duty and Service Tax, respectively.

Such situation arises when a supplier indulging into fraud to evade payment of tax is caught by the tax authorities. Such supplier may choose to pay differential tax and raise an invoice on the recipient. Such invoices were called supplementary invoices, in the earlier tax regime. Under GST, Debit Notes can be issued.

Rule 9(1)(b)/(bb) of the CENVAT Rules barred a recipient from availing credit on supplementary invoices where additional amount of tax became recoverable from supplier on account of non-levy or non-payment by reasons such as fraud.

A provision, though not identical, but, dealing with a similar situation, can be found in Rule 36(3) of the CGST Rules, which is reproduced:

36(3) No input tax credit shall be availed by a registered person in respect of any tax that has been paid in pursuance of any order where any demand has been confirmed on account of any fraud, wilful misstatement or suppression of facts. (Emphasis Supplied)

A careful reading of Rule 36(3) will show how it is different from the provisions of CENVAT Rules. In the CENVAT Rules, recipient was barred from availing Credit on Supplementary Invoices where additional amount

of tax became recoverable from the supplier on account of non-payment of tax by reasons such as fraud. It, thankfully, does not appear to be so in GST where the disqualification is confirmation of demand on account of fraud.

Let us analyse this situation, in terms of Rule 36(3), with an example.

X Ltd. supplied goods to Y Ltd. during the financial year 2017-18, by charging GST @ 18%. GST officials objected to the classification of goods and according to the classification done by the GST Officials appropriate rate of GST would be 28%. Therefore, there is an additional tax liability to the tune of 10%.

A demand is raised on X Ltd. for the differential tax liability under Section 74 of the CGST Act, by alleging that there is suppression of facts, etc.

Consequently, X Ltd. paid the differential tax liability, and issued Debit Notes under Section 34(3) of CGST Act to Y Ltd.

The question that arises is whether Y Ltd. will be barred from claiming ITC under Rule 36(3) of the CGST Rules.

On plain reading of Rule 36(3) of the CGST Rules, there appears to be no difficulty. A question that needs to be addressed first is as to when was the differential tax paid? If the differential tax was paid prior to issuance of Order confirming the demand then there appears to be no threat to the claim of credit.

A lot hinges on use of words *"tax that has been paid in pursuance of any order"*. The term *"in pursuance of"* means *"something that is done in consequence of"* or *"in accordance with"* or *"in fulfilment of"*.

The Hon'ble Supreme Court while deciding Aircraft Employees' Housing Coop. Society Ltd. v. Secy., Rural Development and Panchayat Raj, Govt. of Karnataka, (1996) 11 SCC 475 at page 478 held in paragraph 4:

"In pursuance of" would mean under the authority of or by virtue of or in the course of carrying out in accordance with the scheme or plan or direction or order or anything in consequence or conformable to or according to; act of pursuing, carrying out and performance, prosecution..."
(Emphasis Supplied)

Tax paid prior to issue of an order **cannot** be said to be *"tax paid in pursuance of such order"*. For tax to be termed as *"paid in pursuance of any order"*, payment of tax after receipt of such an order, is *sine qua non*

ITC can be claimed even if an order is passed confirming the demand of tax on account of fraud, if tax is paid prior to receipt of order.

In the instant example, tax paid by X Ltd. will be tax paid in pursuance of a "Notice" under Section 74(1) and not in pursuance of an "Order" issued under Section 74(9), and, therefore, bar on eligibility to ITC under Rule 36(3) will not apply.

It is only when differential tax is paid in **pursuance** of an order (i.e. after receipt of an order) where demand of tax is confirmed on account of fraud, etc., ITC cannot be claimed by the recipient.

Now let us take another example:

X Ltd. participates in adjudication and pays tax after an Order under Section 74(9) is received confirming demand of tax and holding *inter alia* that there was fraud/suppression of facts. Consequently, X issues debit notes to Y Ltd.

Nonetheless, an appeal is filed against the aforesaid Order.

The Appellate Authority holds that there was no fraud/suppression of facts and accordingly allows the appeal.

The question is whether Y Ltd. is entitled to avail ITC on the basis of debit notes issued by X Ltd.?

As the Adjudication Order has been set aside, payment of tax in pursuance of Adjudication Order is no more tainted with fraud, etc. and even the Adjudication Order has merged in Order of Appellate Authority and thus has ceased to exist. Once the original findings of fraud/suppression of facts is purged, eligibility to ITC should be restored. Therefore, strictly speaking, Y Ltd. should be entitled to claim ITC on the basis of debit notes.

However, Revenue is most likely to take a view that the day/date on which tax was paid, the tax payment was in pursuance of an Order where demand was confirmed on account of fraud, suppression etc. That alone is the primary consideration and what happens to that Order subsequently is of no consequence.

Another point that requires consideration is on the aspect of limitation to take ITC prescribed under Section 16(4). By the time the Order is passed by Appellate Authority, limitation to claim ITC may have lapsed. Either side may take the litigation to higher forums and up to the Supreme Court and if it is finally held that there was no suppression, then, in all fairness, the time spent in litigation should not come in the way of claiming ITC.

[The views expressed are strictly personal.]

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