Tax alert: Supreme Court upholds Gujarat High Court decision that ITC not eligible if supplier fails to deposit GST with Government

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The Supreme Court has upheld the Gujarat High Court judgement that input tax credit (ITC) would be denied to recipients where supplier fails to deposit GST. While the Hon'ble Tripura High Court decision had read down the provision and allowed ITC in bonafide cases, it has been distinguished by the Hon'ble Supreme Court on the ground that evaluation of legal framework of GST law was not carried out in that case. The Supreme Court also held that purchasing dealer, under VAT regime, cannot be treated at par with purchasing dealer under GST laws for availment of ITC. Also, under GST, ITC is reversed in case of non-payment by the supplier but can be re-availed after supplier discharges the GST liability.

In a nutshell

The Supreme Court has affirmed the Gujarat High Court's decision that had upheld the constitutional validity of section 16(2)(c) and declined to read it down thereby rejecting taxpayer's contentions that bona fide purchasers should be protected for supplier defaults beyond their control.

The distinguishment of judgments under VAT regime compared with the GST law, done by the Gujarat High Court has been upheld. It has been affirmed that the GST framework operates under a materially different statutory scheme.

The Supreme Court reiterated the GST provisions as per which a recipient is entitled to re-avail credit once the supplier discharges the tax liability at a later stage.

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Background

- The issue for consideration was whether ITC can be denied to the recipient where supplier has failed to remit the tax collected from the recipient, as mandated under Section 16(2)(c) of the CGST Act.
- In the past, the Gujarat High Court had dealt with a batch of writ petitions challenging the constitutional validity of Section 16(2)(c) of the CGST Act, wherein the petitioners sought either (i) striking down the provision as unconstitutional, or (ii) reading it down so that it would apply only in cases involving fraud, collusion, or connivance, thereby excluding bona fide purchasers from its scope.
- However, the Gujarat High Court upheld the constitutional validity of Section 16(2)(c) and declined to read down the provision in favour of bona fide recipients. Aggrieved by the Gujarat High Court decision[1], the petitioner filed a special leave petition (SLP) before the Supreme Court of India.

Supreme Court judgement[2]

- The Supreme Court held that the Tripura High Court's case[3] which read down Section 16(2)(c) and restricted ITC only in cases of fraudulent or collusive transactions, had not undertaken the exercise of detailed examination of GST framework as done in the impugned Gujarat High Court judgement.
- The Supreme Court held that no parity could be drawn between the provisions of Delhi Value Added Tax Act, 2004 ("Delhi VAT Act") and GST Laws so as to place a purchasing dealer under the CGST Act on the same footing as a purported bona fide purchasing dealer under the Delhi VAT Act where the supplier fails to discharge the requisite tax liability.
- The Court accepted the Gujarat High Court's reasoning that under GST regime a purchasing dealer who has reversed ITC due to supplier's default, would be entitled to re-avail such credit once the supplier subsequently discharges the outstanding tax liability.
- Accordingly, the Supreme Court concurred with the findings of the Gujarat High Court that had (i) declared Section 16(2)(c) as constitutional and (ii) declined to read it down. Thus, the SLP was dismissed.

Deloitte comments

The Supreme Court's decision confirms that if a supplier defaults to deposit the tax collected from the recipient with the Government, the recipient will not be entitled to ITC even in bona fide scenarios. It has thus brought finality to the issue under the GST regime. Businesses need to strengthen vendor due diligence processes, continuously monitor supplier GST compliances viz. deposit of tax to the Government, its due reporting in its GSTR-1 and auto population in recipient's GSTR-2B and incorporate robust contractual safeguards and indemnity clauses to mitigate potential tax exposure arising in case of supplier defaults.

From a direct tax perspective, the deductibility on denial of GST input tax credit, due to a supplier's default in depositing tax with the Government, would need to be examined under the relevant provisions of the Income-tax Act.

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[1] *Bhandari Scrap Traders vs. UOI & Ors, (Special Civil Application No. 749/2025) (Maruti Enterprise v. UOI 2026-VIL-432-Guj)*

[2] *Bhandari Scrap Traders vs. UOI & Ors, 2026-VIL-69-SC*

[3] M/s Sahil Enterprises Vs. UOI and Ors, 2026-VIL-15-TRI

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