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**DIRECT
TAXES**



**INDIRECT
TAXES**



**ALLIED
LAWS**



**CONSTITUTION
OF INDIA**



**ACCOUNTING &
AUDIT**

DIRECT TAXES

- PAN Application and Amendment: Understanding the New Regime Effective 1st April 2026
- AS 22: A Critical Analysis of Deferred Tax Accounting in India
- The Sunset Clause the Revenue Forgot: Section 151A(2)

INDIRECT TAXES

- GST on Leasehold Rights – Opening A Pandora's Box
- Supplier's default in payment of GST, recipient bears the cost
- Issues and Concerns in Dealing with Digital Evidences in Gst Proceedings

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- Home Buyers' Rights under Rera versus Secured Creditors under Sarfaesi

SPECIAL LEAVE PETITION (SLP)

- On Direct Taxes

CONSTITUTION OF INDIA

- Article 141 of The Constitution of India – Doctrine of per Curiam as also per Incuriam

WITH DUE RESPECT - NO CONTEMPT

- When Proceedings u/s 74 of GST justified. Analysis of Supreme Court decision in case of G. R. Infra Projects Ltd. Ratlam vs. The State of Madhya Pradesh & Ors.

ACCOUNTING & AUDIT

- Forensic accounting tool for detecting revenue manipulation under IND AS 115: An Empirical study
- Interplay Between Different Audit and Assurance Functions: Statutory Audit, Tax Audit, GST Verification, FEMA and Other Regulatory Compliance
- ICAI Peer Review - A Comprehensive Compliance Guide for Chartered Accountants Practice Unit

Contents

From the Editor	Ajay R. Singh.....	5
President's Communique	S. Venkataramani.....	8
DIRECT TAXES		
• PAN Application and Amendment: Understanding the New Regime Effective 1st April 2026 – CA. Divya B. Jokhakar, Mumbai		13-15
• AS 22: A Critical Analysis of Deferred Tax Accounting in India – CA. Charmi Shah, Mumbai		16-21
• The Sunset Clause the Revenue Forgot: Section 151A(2) – Piyush Baid, FCCA MCSI, Kolkata		22-28
INDIRECT TAXES		
• GST on Leasehold Rights – Opening A Pandora's Box – CA Kush Vora, Mumbai		29-32
• Supplier's default in payment of GST, recipient bears the cost – Mr. Rishab J., Ms. Gayathri, Ms. Saindhavi Sridhar, Advocates, Palakkad		33-37
• Issues and Concerns in Dealing with Digital Evidences in Gst Proceedings – M. A. Maniyar, Deputy Commissioner of Commercial Taxes (Retd)		38-47
ALLIED LAWS		
• Home Buyers' Rights under RERA versus Secured Creditors under SARFAESI – CA. Ramesha Prabhu, Mumbai		48-52
SPECIAL LEAVE PETITION (SLP)		
• On Direct Taxes – Neelam Jadhav, Advocate, Mumbai		53-54
CONSTITUTION OF INDIA		
• Article 141 of The Constitution of India – Doctrine of per Curiam as also per Incuriam – Dr. M.V.K. Moorthy, Supreme Court Advocate, Hyderabad		55-59
WITH DUE RESPECT – NO CONTEMPT		
• When Proceedings u/s 74 of GST justified. Analysis of Supreme Court decision in case of G. R. Infra Projects Ltd. Ratlam vs. The State of Madhya Pradesh & Ors. – C. B. Thakar, Advocate, Mumbai		60-62
ACCOUNTING & AUDIT		
• Forensic accounting tool for detecting revenue manipulation under IND AS 115: An Empirical study – CA. Ashita Shah, Mumbai		63-68
• Interplay Between Different Audit and Assurance Functions: Statutory Audit, Tax Audit, GST Verification, FEMA and Other Regulatory Compliance – CA Rahul V. Shah, Mumbai		69-77
• ICAI Peer Review - A Comprehensive Compliance Guide for Chartered Accountants Practice Unit – CA. Ram Sahni, New Delhi		78-81
NUT CRACKERS		
• Question & Answer – Direct Taxes – CA. H. N. Motiwalla, Mumbai		82-83
• Question & Answer – Indirect Taxes – Ratan Samal & Manohar Samal, Advocates, Mumbai		84-85



Supplier's default in payment of GST, recipient bears the cost

Mr. Rishab J., Ms. Gayathri,
Ms. Saindhavi Sridhar, Advocates

Introduction:

The price of a product reflects the cost incurred at various stages of its production and supply. This includes the cost of raw materials, components, goods and services procured by the manufacturer or supplier, along with the taxes paid on such procurements. Where the tax paid on these inputs is not available as a credit, it becomes part of the cost of the product and is effectively borne again when tax is imposed on the outward supply. This results in a cascading effect of taxes, commonly referred to as “tax on tax”. The concept of Input tax credit (“ITC”) addresses this issue by allowing the tax paid on inputs and input services to be set off against the tax payable on the corresponding outward supply.

Under the erstwhile indirect tax regime, the availability of such credit was fragmented across the Central and State tax systems, since the credit of Central taxes could not generally be utilised against State taxes and vice versa, preventing a seamless flow of credit through the supply chain.

The introduction of the Goods and Services Tax (“GST”) sought to address this issue by bringing several Central and State indirect taxes within a common framework and establishing a system of credit that could move through the supply chain. However, the entitlement to ITC is subject to the conditions prescribed

under the Central Goods and Services Tax Act, 2017 (“CGST Act”). Section 16 of the CGST Act governs the eligibility and conditions for availment of ITC, with Section 16(2)(c) specifically requiring actual payment of tax to the Government by the supplier as one of the pre-conditions to avail ITC. This condition assumes significance where a recipient has received the goods or services, paid the supplier the consideration along with the applicable tax and otherwise acted in good faith, but the supplier has failed to discharge the corresponding tax liability to the Government. The question that consequently arises is whether the recipient can be denied ITC for a default that is attributable to the supplier and beyond the recipient's control.

The validity of such a draconian condition was considered by the Gujarat High Court in *Maruti Enterprise V. Union of India* (2026) 42 Centax 256 Guj., which upheld the constitutional validity of Section 16(2)(c) of the CGST Act and declined to read an additional requirement of fraud or collusion into it. The Supreme Court subsequently considered the matter in *Bhandari Scrap Traders V. Union of India* (2026) 44 Centax 356 (S.C.) (“*Bhandari Scrap Traders*”) and declined to interfere with the view taken by the Gujarat High Court.

This article examines the reasoning adopted by the Courts and its implications for businesses

navigating supplier side non-compliance under the GST regime.

Maruti Enterprise - Why the Gujarat High Court upheld Section 16(2)(c)

ITC as a statutory entitlement subject to conditions

The Court proceeded on the basis that ITC is a statutory benefit or concession and not an unconditional or vested right. While Section 16(1) enables a registered person to claim credit of input tax, such entitlement is expressly made subject to the conditions and restrictions prescribed under the CGST Act. Accordingly, the fact that a transaction is genuine, the goods or services have been received, and the recipient has paid the supplier the consideration including GST does not, by itself, exhaust the statutory conditions imposed for availment of ITC. Section 16(2)(c) contains a further and independent requirement that the tax charged in respect of the supply has actually been paid to the Government. The Court therefore distinguished between the supplier's liability to discharge tax and the recipient's eligibility to claim ITC. The supplier remains liable for the tax payable on the supply, but the recipient's corresponding credit remains subject to fulfilment of the statutory conditions governing ITC.

Section 16(2)(c) as part of the broader GST credit mechanism

The Court did not, however, read Section 16(2)(c) in isolation. A significant part of its reasoning was founded on the manner in which the provision operates within the wider GST framework. In particular, the Court considered Section 41(2) of the CGST Act and Rule 37A of the CGST Rules, which contemplate reversal of ITC where the supplier has not discharged the corresponding tax liability and subsequent re-availment upon payment of such tax. The Court also considered Sections 53, 73, 74 and 155 of the CGST Act as forming part of the statutory framework governing the movement, recovery and verification of tax and credit.

The Court thereafter rejected the argument that Section 16(2)(c) necessarily results in a permanent loss of ITC to the recipient. According to the Court, the statutory scheme contemplates a contingent denial or reversal of ITC where the corresponding tax has not been paid, coupled with a mechanism for recovery from the defaulting supplier and subsequent re-availment by the recipient once the statutory condition is satisfied. The Court consequently considered the burden imposed by Section 16(2)(c) to be part of a deliberate legislative allocation of risk within the GST credit chain rather than an unconstitutional transfer of the supplier's tax liability to the recipient.

The significance of Ecom Gill and the burden of establishing ITC eligibility

The Court further relied upon the Supreme Court's decision in *State of Karnataka v. Ecom Gill Coffee Trading Pvt. Ltd.*, MANU/SC/0224/2023 ("*Ecom Gill*"), to reinforce the proposition that the burden of establishing entitlement to ITC lies upon the person claiming such credit. In *Ecom Gill*, the Supreme Court had held, in the context of the Karnataka VAT legislation, that mere production of invoices or proof of payment through cheque would not, by itself, establish the genuineness of the underlying transaction. The purchasing dealer was required to establish the relevant facts necessary to substantiate its claim to ITC. The Gujarat High Court considered this principle relevant to the statutory burden under Section 155 of the CGST Act, which places the burden of proving eligibility for ITC on the person claiming such credit. In its view, the recipient claiming ITC cannot treat the production of an invoice or payment of consideration to the supplier as conclusively establishing its entitlement to credit. The recipient bears the statutory burden of establishing that the conditions for availment of ITC have been satisfied. The Court consequently relied upon *Ecom Gill* to reject the proposition that the burden of establishing ITC eligibility could, merely on the basis of the

recipient's bona fides, be shifted entirely to the Revenue.

Distinguishing On Quest Merchandising and the subsequent pro-recipient decisions

The Petitioners had relied substantially upon the line of authorities beginning with the Delhi High Court's decision in *On Quest Merchandising India Pvt. Ltd. v. Government of NCT of Delhi*, 2018 (10) G.S.T.L. 182 (Del.), ("*On Quest Merchandising*") where the Delhi High Court had read down the corresponding provision under the Delhi VAT Act so as to protect a bona fide purchasing dealer from denial of credit on account of the selling dealer's default. The petitioners also relied upon subsequent decisions of the Tripura, Karnataka and Gauhati High Courts which had adopted a similar approach in the context of input tax credit under GST.

The Gujarat High Court declined to apply these decisions to the GST regime. The Court noted that *On Quest Merchandising* concerned Section 9(2)(g) of the Delhi VAT Act, which permitted denial of input tax credit to a purchasing dealer where the selling dealer had failed to deposit the tax collected from the purchasing dealer with the Government, and therefore arose under a statutory framework materially different from the CGST Act. In particular, the Gujarat High Court considered the statutory architecture of the GST regime, including Sections 41 and 53 and Rule 37A, to be materially relevant to the question whether denial of ITC following supplier default resulted in an irreversible or disproportionate consequence. The Court therefore held that the reasoning adopted under the VAT regime could not simply be transplanted into the GST regime without examining the distinct statutory framework governing GST credit.

Bona Fide recipients and the limits of Section 16(2)(c)

The petitioners sought to read into Section 16(2)(c) an exception for recipients who had acted bona fide and had not participated in any fraud,

collusion or connivance.

The Court declined to introduce such a qualification into the provision. It noted that Section 16(2)(c) of the CGST Act, on its plain terms, does not make the recipient's knowledge, participation or involvement in the supplier's default relevant to the operation of the condition. Reading such a requirement into the provision would therefore amount, in the Court's view, to adding words to the statute rather than interpreting the provision as enacted.

It also referred to the principles governing reading down, observing that the doctrine may be employed to preserve constitutionality where the language admits of such an interpretation, but cannot be used to rewrite an unambiguous legislative provision.

Bhandari Scrap Traders - What does the Supreme Court decision establish?

The challenge to Section 16(2)(c) of the CGST Act subsequently came before the Supreme Court in *Bhandari Scrap Traders*. The petitioners challenged the Gujarat High Court's judgment in *Maruti Enterprise*, which had upheld the constitutional validity of Section 16(2)(c) of the CGST Act and declined to read down the provision to protect bona fide recipients from supplier-side tax default. The Supreme Court dismissed the Special Leave Petitions and expressly held that the Gujarat High Court was justified in finding no ground to declare Section 16(2)(c) of the CGST Act unconstitutional or to read down its provisions.

Practical compliance implications for the Business

The decision in *Bhandari Scrap Traders* has an immediate practical implication for recipients. The supplier-side GST non-compliance becomes a material ITC risk for the recipient, even though the underlying tax liability continues to rest with the supplier. *Bhandari Scrap Traders* does not prescribe any particular due-diligence standard that a recipient must satisfy to

establish its entitlement to credit. Thus, although the constitutional challenge has been settled, the more relevant question for businesses is how the risk of supplier-side non-compliance should be identified, managed and commercially allocated.

The Court also referred to the decision of the Court of Justice of the European Union ("CJEU") in *Axel Kittel v. Belgian State (Joined Cases C-439/04 and C-440/04)*, which applied a knowledge-based standard in the context of VAT fraud. The CJEU held that where a taxable person did not and could not know that the transaction was connected with fraud committed by the seller, the right to deduct input tax could not be denied merely on that account. Conversely, where, having regard to objective factors, the taxable person knew or ought to have known that the transaction was connected with fraudulent evasion of VAT, the entitlement to deduct could be refused.

The Gujarat High Court referred to this principle while considering the position of a bona fide recipient under the GST framework. The Court observed that a recipient who has acted bona fide and has taken reasonable precautions to guard against supplier default may mitigate the risk of supplier default through appropriate contractual arrangements, including indemnity clauses with its suppliers.

A further concern arises from the Gujarat High Court's reliance on the recipient's ability to pursue the defaulting supplier for recovery of the resulting loss. While such a remedy may provide a means of enforcing the recipient's contractual or commercial rights against the supplier, it does not necessarily address the immediate ITC consequence under the GST framework. The recipient may have paid the supplier the full consideration, including the GST component, and complied with the conditions within its control, yet may still be required to bear the economic consequence of the supplier's subsequent default. A civil or contractual remedy against the supplier may

therefore not be equivalent to restoration of the recipient's ITC and may, in practical terms, involve substantial delay and uncertainty.

The position is particularly significant because the GST framework does not provide the recipient with an option to discharge the supplier's outstanding tax liability directly to the Government in order to preserve its own ITC. Proviso to Section 16(2)(d), on the other hand, requires the recipient to pay the value of the supply together with the tax payable thereon to the supplier within 180 days. The recipient is therefore placed in a position where it is required to complete its payment obligations to the supplier, while the satisfaction of Section 16(2)(c) remains dependent upon a subsequent act of the supplier over which the recipient may have no effective control.

A further question concerns the extent of the tax actually remaining unpaid within the supply chain. GST is structured as a value-added tax, with eligible input tax credit available at successive stages of the supply chain. Accordingly, the supplier's net tax liability may, in appropriate circumstances, be reduced by credit attributable to taxes already discharged at earlier stages. Where tax has already been collected and paid at preceding stages of the supply chain, it may be questioned whether denial of the recipient's entire corresponding ITC, solely because of the supplier's subsequent failure to discharge its net liability, produces a consequence disproportionate to the actual revenue shortfall. This does not, as a matter of statutory interpretation, displace the express requirement under Section 16(2)(c), but it raises a legitimate policy and proportionality question concerning the manner in which supplier default should affect downstream credit.

These considerations make effective supplier-side recovery particularly important. If the availability of the recipient's credit is linked to actual payment of tax by the supplier, the effectiveness and timeliness of recovery

proceedings against the supplier become critical to ensuring that the recipient does not bear the economic consequences of such default indefinitely.

In practice, this may include appropriate supplier due diligence, verification of GST registration details, invoice-level reconciliation with GSTR-2B, monitoring of supplier reporting and filing patterns, and timely identification of mismatches. Businesses may also consider strengthening contractual arrangements to address supplier-side non-compliance through provisions dealing with timely payment of GST, cooperation in reconciliation and departmental proceedings, indemnification for loss of ITC, and commercially feasible withholding or recovery mechanisms.

However, the long-term resolution of this issue may require a pragmatic policy response. The GST Council may consider the practical difficulties faced by bona fide recipients and examine whether the existing mechanisms for

recovery of tax from defaulting suppliers can be strengthened and made more effective. A more robust supplier-side recovery mechanism, supported by appropriate technological safeguards and procedural measures, could ensure that the tax is recovered from the person legally responsible for discharging it, while reducing the extent to which supplier default translates into an immediate economic burden for the recipient. Such an approach would preserve the integrity of the ITC chain while seeking to ensure that the operation of Section 16(2)(c) does not disproportionately prejudice recipients who have otherwise acted in compliance with the law. While Section 76 of the CGST Act enables the Government to initiate proceedings where a supplier, after collecting tax, defaults in payment to the Government, a more stringent implementation of this provision can strengthen supplier-side recovery and, in turn, help mitigate the economic consequences of such default for bona fide recipients.



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