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Supreme Court Reaffirms Protection to Bona Fide Purchasers in VAT Transactions: Commissioner, Trade & Tax.

AUTHOR Ayush Shukla

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Introduction

In a significant reaffirmation of taxpayer protection under the Delhi Value Added Tax Act, 2004 (DVAT Act), the Supreme Court of India in The Commissioner, Trade and Tax, Delhi v. M/s Shanti Kiran India (P) Ltd.[1] dismissed the Department's appeals and upheld the Delhi High Court's view that bona fide purchasing dealers cannot be denied Input Tax Credit (ITC) merely because the selling dealer, despite being registered at the time of transaction, subsequently defaulted in depositing the collected tax with the government. Although the ruling is delivered in the form of an order, it carries binding legal significance, as it reinforces an established interpretation of Section 9(2)(g) of the DVAT Act and affirms judicial protection for genuine business transactions undertaken in good faith.

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Background of the Case

The dispute revolved around whether a purchasing dealer, who had entered transactions with a seller validly registered under the DVAT Act and had paid VAT on such purchases, could be denied ITC on the ground that the selling dealer later failed to deposit the tax with the government treasury. The respondents, M/s Shanti Kiran India (P) Ltd. and other purchasing dealers, had purchased goods from dealers registered with the Department of Trade and Taxes, Government of NCT of Delhi. The purchases were duly supported by tax invoices, and VAT was paid to the seller dealers at the time of transaction. However, following these transactions, the seller dealers' registrations were cancelled, and they defaulted in remitting the VAT collected to the government. The Department took the position that since the selling dealers had not deposited the tax, the corresponding ITC claimed by the purchasing dealers was inadmissible. The respondents challenged this action before the Delhi High Court, which held in their favour, declaring bona fide purchasers entitled to ITC. The Department appealed the decision to the Supreme Court.

Legal Framework

The relevant provision under the DVAT Act is Section 9, which governs entitlement to Input Tax Credit.

- Section 9(1) allows a registered dealer to claim ITC on purchases made during a tax period, provided such goods are used for making taxable sales.
- Section 9(2) lists exceptions where ITC shall not be allowed.

The dispute specifically concerned clause (g) of sub-section (2), which states that ITC shall not be allowed where the tax payable by the selling dealer has not actually been deposited with the government or lawfully adjusted. In practice, this provision had often been invoked by the tax authorities to deny ITC to purchasing dealers, even when the sellers' defaults occurred without the buyers' knowledge or control. This led to hardship for honest traders who had acted in good faith and possessed valid invoices from registered sellers.

Delhi High Court's View

The Delhi High Court, while deciding in favour of the purchasing dealers, had relied on its earlier ruling in On Quest Merchandising India Pvt. Ltd. v. Government of NCT of Delhi and Ors.[2] the High Court had "read down" Section 9(2)(g) to hold that the phrase "dealer or class of dealers" should not include bona fide purchasing dealers who have transacted with validly registered sellers, received proper tax invoices, and where there is no evidence of collusion or fraud. The Court held that a contrary interpretation would render the provision arbitrary and violative of Article 14 of the Constitution of India. It was further

observed that if a seller fails to deposit the tax collected, the remedy for the Department lies against the defaulting seller, not against the innocent purchaser. Only in cases where collusion or fraudulent intent is established can ITC be denied under Section 40A of the DVAT Act. Applying this rationale, the Delhi High Court in Shanti Kiran India (P) Limited held that the respondents were bona fide purchasers entitled to the ITC benefit after verification of their invoices and tax records.

Supreme Court's Order

The Supreme Court dismissed the appeals, finding no reason to interfere with the Delhi High Court's judgment.

The Court observed that:

- The selling dealers were registered on the date of the transaction.
- The purchases were made against valid tax invoices.
- The Department had not disputed the genuineness of the transactions or alleged any collusion between the sellers and purchasers.

In such circumstances, denying ITC to bona fide purchasers would be unjustified. The Court noted that the issue was already settled by its earlier order dismissing the Special Leave Petition thereby confirming the correctness of the Delhi High Court's reasoning. The Supreme Court concluded that the appeals "lack merit" and accordingly dismissed them, thereby upholding the right of bona fide dealers to claim ITC. All pending applications were also disposed of.

Legal and Practical Significance

This order, though concise, holds substantial jurisprudential value. It consolidates the protection available to honest taxpayers under the value-added tax framework and clarifies the scope of Section 9(2)(g) of the DVAT Act.

The ruling ensures that:

1. Genuine business transactions are not penalized for administrative lapses or fraud committed by unrelated sellers.
2. Tax credit mechanisms remain fair and predictable, encouraging compliance and trust in the tax system.
3. Tax authorities must pursue defaulters, the selling dealers who collected tax but failed to remit it rather than shifting the burden onto compliant purchasers.

This principle also aligns with the "buyer protection" approach now embedded in the Goods and Services Tax (GST) regime, where similar issues regarding mismatched invoices and supplier defaults have arisen. The judgment strengthens the continuity of judicial thought favouring equity and proportionality in indirect taxation.

Conclusion

The Supreme Court's order in Commissioner, Trade and Tax, Delhi v. Shanti Kiran India (P) Ltd. reinforces an important aspect of tax justice: a bona fide purchaser should not be made to suffer for the wrongdoing or default of another. By affirming the Delhi High Court's reasoning and reiterating the principle established in On Quest Merchandising, the Court has ensured that the law remains fair and constitutionally compliant. The decision upholds the foundational tenet that tax administration must balance enforcement with equity, ensuring that compliance obligations are not extended beyond what is reasonable and just.

For businesses and tax practitioners, the order provides clarity and reassurance that transactions conducted with registered dealers, accompanied by valid invoices and genuine payments, will not be retrospectively disallowed for ITC solely due to subsequent defaults by counterparties. This order thus is a critical reaffirmation of good-faith protection, constitutional fairness, and sound tax governance under the DVAT framework principles that continue to resonate within the broader landscape of Indian indirect tax law.

For more details, write to us at: contact@indialaw.in

[1] CIVIL APPEAL NO(S).2042-2047/2015

[2] 2017 SCC OnLine Delhi 13037

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