Unlocking Litigation Strategies: Fighting Penalties for Late Supplier Payments under GST Law

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The issue of challenging penalties on Input Tax Credit (ITC) availed but not reversed by the recipient of supply, in case he has made belated payments of the value of the supply along with tax thereon to the supplier after 180 days of invoice issuance is a contentious one under the GST law. Show Cause Notices (SCNs) under Section 74(1) of the CGST Act, 2017 in respect of F.Y.(s) up to 2023-24 and under Section 74A of the CGST Act, 2017 in respect of F.Y.(s) 2024-25 and onwards are often issued demanding the reversal of such ITC along with payment of applicable interest and penalty on the allegations of fraudulent ITC usage and on the basis of violation of Second Proviso to Section 16(2) of the CGST Act read with Rule 37 of the CGST Rules. This article discusses several grounds of defence, supported with significant court precedents, that may be relied upon in challenging such penalty notices.

Introduction

One of the burning issues which is often litigated in the GST law since its inception is challenging the levy of penalty on the amount of Input Tax Credit (ITC) availed earlier but neither paid nor reversed in case of belated payment by the recipient of the supply to the supplier towards the value of the supply along with tax thereon made after a period of 180 days from the date of issue of invoice by the supplier.

Usually, a Show Cause Notice (SCN) u/s 74(1) of the CGST Act, 2017 in respect of F.Y.(s) up to 2023-24 and u/s 74A of the CGST Act, 2017 in respect of F.Y.(s) 2024-25 and onwards is issued demanding such penalty, alleging wrongful availment of ITC and wrongfully utilizing the same for payment of GST by reasons of fraud, wilful misstatement of facts, and suppression of material facts with an intention to evade GST payment. The above-mentioned SCN is issued as a result of an audit finding in the Audit Observations Report and in the Audit Report in Form GST ADT-02.

Grounds of Defence

Being a litigated issue, it becomes important to understand the grounds of defence that may be taken when replying to such SCNs. Following court decisions and other points may be referred while drafting such grounds of defence:

(1) Any shortcomings noticed during the course of Departmental Audit u/s 65 of the CGST Act itself cannot

***Source**: Self*

be reasoned that the deficiency was due to mala fide intention on the part of the assessee.

In case the SCN does not discuss the facts and circumstances which were suppressed or mis-declared or mis-stated by the taxpayer and how the taxpayer had availed the said admissible ITC with mala fide intention, except observing that had the audit not pointed out the impugned ITC, the amount would not have been recovered from the taxpayer. This reasoning, standing alone, cannot be accepted as a ground for confirming suppression, mis-statement or mis-declaration of facts by the taxpayer.

The very objective of conducting the audit of records of an assessee is to ascertain the correctness of the payment of tax, availment of ITC, etc. Any shortcomings noticed during the course of audit itself cannot be reasoned that the deficiency was due to mala fide intention on part of the assessee.

Furthermore, in case the SCN is based only on the audit para and there is no iota of evidence to prove either suppression or mis-declaration of facts or contravention of provisions with intention to evade the payment of tax, the SCN may be liable to be quashed.

In this regard, reliance may be placed on the following judgments:

- M/s. Nexteer Automotive India Pvt. Ltd. versus the Commissioner of Central Excise and Service Tax (2023) - CESTAT Bangalore
- The Hon'ble Karnataka High Court in the case of Commissioner of Central Excise and Service Tax Bangalore-I versus Geneva Fine Punch Enclosures Ltd. [2011 (1) TMI 746 - Karnataka High Court]
- M/s. LANDIS + GYR LTD. versus Commissioner of Central Excise, Kolkata-V 2013 (290) E.L.T. 447 (Tri. - Kolkata), 2017 (49) S.T.R. 637 (Tri. - Kolkata) CESTAT Kolkata

(2) It is only in cases where tax is determined coupled with the fact that the tax is evaded by a reason of fraud, collusion or any wilful mis-statement or suppression of facts or contravention of any of the provisions of this Act or the rules made thereunder with intent to evade payment of tax, the liability to pay penalty arises.

It is worthwhile to refer to Section 74(1) of the CGST Act, 2017 in respect of F.Y.(s) up to 2023-24 and Section 74A of the CGST Act, 2017 in respect of F.Y.(s) 2024-25 and onwards, wherein it is mentioned that the taxpayer is required to *"show cause as to why he should not pay the amount specified in the notice along with interest payable thereon under section 50 and a penalty equivalent to the tax specified in the notice."* Therefore, it is to be noted that Section 74(1) of the CGST Act, 2017 in respect of F.Y.(s) up to 2023-24 and Section 74A of the CGST Act, 2017 in respect of F.Y.(s) 2024-25 and onwards specify that the amount of penalty should be equivalent to the tax specified in the notice.

Secondly, there would exist no case for imposing penalty when the aforesaid requirement of mentioning the cause of evasion of tax is not provided in the SCN. Furthermore, there would exist no case for imposing penalty, when the entire tax along with the value of supply has been already paid, albeit belatedly after 180 days from the date of issue of the invoice by the supplier, but before the issue of the SCN u/s 74(1) of the CGST Act, 2017 in respect of F.Y.(s) up to 2023-24 and u/s 74A of the CGST Act, 2017 in respect of F.Y.(s) 2024-25 and onwards and when the recovery of interest as required u/s 16(2) of the CGST Act, 2017 read with Rule 37 of the CGST Rules, 2017 and computed u/s 50(1) of the CGST Act, 2017 has been done by voluntary payment by the assessee on being pointed out by the audit or adjudication team. Therefore, it may be inferred that when the taxpayer fails to reverse the Input Tax Credit as per Rule 37 of the CGST Rules 2017, it would amount to erroneous utilisation of credit and not otherwise.

In this regard, reliance may be placed on the following judgments:

- The Hon'ble Karnataka High Court in the case of Commissioner of Central Excise and Service Tax Bangalore-I versus Geneva Fine Punch Enclosures Ltd. [2011 (1) TMI 746 - Karnataka High Court]
- M/s. LANDIS + GYR LTD. versus Commissioner of Central Excise, Kolkata-V 2013 (290) E.L.T. 447 (Tri. - Kolkata), 2017 (49) S.T.R. 637 (Tri. - Kolkata) CESTAT Kolkata

Furthermore, reliance may be placed on ***Para 3.3 of Instruction No. 05/2023-GST dated the 13th December 2023***, which states that the extended period of limitation, as prescribed under Section 74 of the CGST Act, 2017 in respect of F.Y.(s) up to 2023-24 and under Section 74A of the CGST Act, 2017 in respect of F.Y.(s) 2024-25 and onwards cannot be invoked in the absence of any material evidence of fraud or wilful misstatement or suppression of facts to evade tax. Accordingly, the evidence for the invocation of the extended period shall form part of the show cause notice. Furthermore, reliance may be placed on the Hon'ble Madras High Court judgement in the case of ***Hind Aluminium Vs Assistant Commissioner 2023 (2) TMI 90,*** **wherein it was stated that an order passed on the basis of a Show Cause Notice** which is bald and cryptic and which has simply extracted the ingredients of Section 74 of the CGST Act, 2017 in respect of F.Y.(s) up to 2023-24 and Section 74A of the CGST Act, 2017 in respect of F.Y.(s) 2024-25 and onwards and does not disclose the exact details of the violations committed by the taxpayer, is liable to be quashed and set aside.

(3) There is no suppression of fact, non-declaration or wilful mis-representation in case the entire amount of impugned ITC availed and utilized were duly accounted for in the Electronic Credit Ledger (ECL) and the aforementioned ITC was duly reflected in the monthly returns filed in GSTR-3B with the department and had been correctly reported in the audited financial statements.

Furthermore, there is no suppression of fact when all payments, albeit belatedly after 180 days from the date of issue of the invoice by the supplier, have been carried out through banking channels towards the value of the supply along with tax thereon and all such banking payments have been adequately reported in the audited books of accounts and financial statements of the relevant financial years.

In this regard, reliance may be placed on the following judgments:

- Wild Craft India Private Limited versus Commissioner of Central Tax, Mysuru Commissionerate 2019 (7) TMI 902 - CESTAT Bangalore and in Tata Global Beverages Limited Versus Commissioner of Central Tax, Bangalore North, 2019 (2) TMI 586 – CESTAT Bangalore
- M/s. Landis + Gyr Ltd. versus Commissioner of Central Excise, Kolkata-V 2013 (290) E.L.T. 447 (Tri. - Kolkata), 2017 (49) S.T.R. 637 (Tri. - Kolkata) CESTAT Kolkata

- M/s. Jwalla Security Force versus Commissioner of Service Tax Cell, Nagpur [2015 (11) TMI 524 – CESTAT Mumbai]

(4) When the situation is **revenue-neutral, then no mala fide intention could be discerned. The burden of proving mala fide intention or suppression is on the revenue, since it is the cardinal principle of law that the burden of proof lies on the shoulder of the person alleging it.** Moreover, **a mechanical reproduction of the language used in the statute would not per se justify the mala fide intentions.**

In case the amount of output tax was paid by the supplier in full to the Government Exchequer, for which an undertaking can be acquired from the supplier or a CA, there can be said to be no loss of tax to the Government and this is a case of a revenue neutral situation.

Furthermore, in case of belated payment of value of supply along with tax thereon to the supplier after 180 days from the date of issue of invoice by the supplier, there exists no tax liability or no requirement of reversal of ITC by the recipient of supply as per the Second proviso to Section 16(2) of the CGST Act read with Rule 37 of the CGST Rules.

Moreover, **Section 16(2)(c) of the CGST Act mandates the eligibility of ITC only in case the tax charged in respect of the supply has been paid to the Government Exchequer**. Thus, the Government is not losing any revenue due to such an exercise and the only benefit accruing to the Government due to such exercise is the interest u/s 50(1) of the CGST Act.

It is to be noted that when there is a revenue neutral situation, there cannot be a question of any fraud, suppression of facts, wilful misstatement etc. and penalty cannot be levied and the same has been held in a plethora of cases decided under the Central Excise and Service Tax law. It is to be noted that when the entire exercise is revenue neutral, the assessee could not have achieved any purpose to evade the tax.

In this regard, reliance may be placed on the following judgments:

- Essilor India Pvt. Ltd. versus Commissioner of Central Tax, Bangalore North Karnataka, 2018 (11) TMI 826 - CESTAT Bangalore
- Nirlon Ltd. versus CCEx – 2015 (320) ELT 22 (SC)
- CCEx versus Tenneco RC India Pvt. Ltd. – 2015 (323) E.L.T. 299 (Mad.)

M/s. Uniworth Textiles Ltd. versus Commissioner of Central Excise. Raipur 2013 (1) TMI 616 – (SC)

Conclusion

Therefore, in the above-mentioned scenario of belated payment in full of value of supply along with tax thereon to the supplier, a SCN issued u/s 74(1) of the CGST Act, 2017 in respect of F.Y.(s) up to 2023-24 and issued u/s 74A of the CGST Act, 2017 in respect of F.Y.(s) 2024-25 and onwards is in principle a mere demand notice for the recovery of applicable interest as required u/s 16(2) of the CGST Act, 2017 read with Rule 37 of the CGST Rules, 2017 and Section 50(1) of the CGST Act, 2017 and the imposition of penalty can be challenged on the basis of the above-mentioned grounds of defence since neither is there any determination of tax liability payable, nor is there any tax liability due on part of the recipient of the supply and there has been no incidence or intention of any tax evasion by a reason of fraud, collusion or any wilful mis-statement or suppression of facts or contravention of any of the provisions of this Act or the rules made thereunder.

Reference

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