

Landmark Ruling on GST Input Tax Credit under Section 16(2)(c)

Supplier Default May Trigger Inquiry, but ITC Cannot Be Denied Automatically

Shaurya Alloys Pvt. Ltd. v. State of Punjab & Another and connected matters (P&H High Court, 01.10.2026)

Introduction

One of the most persistent grievances of GST-registered businesses has been the denial or reversal of Input Tax Credit (ITC) on genuine purchases, only because the supplier failed to deposit the tax, filed nil or short returns, or had its registration cancelled, sometimes with retrospective effect. The honest purchaser, having paid the full invoice value including GST, was left to bear the consequences of a default it had no means to control.

In a significant judgment pronounced on 01 October 2026, the Hon'ble High Court of Punjab & Haryana, deciding a batch of 424 writ petitions, has upheld the constitutional validity of Section 16(2)(c) read with Section 155 of the CGST Act, 2017, while laying down detailed safeguards that tax authorities must follow before denying ITC. In this update, Rajput Jain & Associates explains the ruling, its guiding principles and what businesses should do now.

Case Snapshot

Case Title	Shaurya Alloys Pvt. Ltd. v. State of Punjab & Another and connected matters
Court	High Court of Punjab & Haryana at Chandigarh
Lead Case	CWP-34296-2024 (O&M)
Batch	424 writ petitions
Bench	Hon'ble Ashwani Kumar Mishra, C.J. and Hon'ble Rohit Kapoor, J.
Pronounced on	01.10.2026
Provision	Section 16(2)(c) read with Section 155 of the CGST Act, 2017
Core Issue	Whether Input Tax Credit (ITC) can be denied to a purchaser merely because the supplier failed to deposit the tax collected

1. Facts and Background

- The Court examined a batch of 424 writ petitions concerning denial or reversal of ITC under Section 16(2)(c) of the CGST Act, 2017.
- The common grievance was that purchasing dealers had paid GST to their suppliers, yet ITC was denied because the suppliers allegedly failed to deposit the tax, filed nil or short returns, or had their registrations cancelled (in some cases retrospectively).
- The petitioners challenged Section 16(2)(c) read with Section 155, contending that a buyer cannot be compelled to perform the impossible act of ensuring actual payment of tax by the supplier.
- The Court clarified that it was not deciding each petition individually; instead, it laid down guiding principles to govern all such cases.

2. Issues Before the Court

1. Whether Section 16(2)(c), read with Section 155, is unconstitutional?
2. Whether ITC can be denied mechanically to a purchasing dealer due to supplier default?
3. Whether retrospective cancellation of supplier registration, nil/short returns or alerts are by themselves enough to reverse ITC?
4. What procedural safeguards must apply before invoking Section 16(2)(c)?

3. Held / Ratio

- **Constitutional challenge rejected:** Section 16(2)(c) read with Section 155 was upheld.
- **No mechanical application:** The provision cannot be applied in isolation or in a routine, mechanical manner.
- **Supplier default is not enough:** A mere default by the supplier does not automatically justify denial of ITC to the purchaser.
- **Holistic examination:** The proper officer must examine the genuineness of the transaction, the circumstances of the supplier's default, the evidence produced by the purchaser and the statutory recovery mechanism available against the supplier.
- **Where denial is valid:** Where there is collusion, fraud, bogus transactions or no actual receipt of goods or services, ITC may validly be denied.

4. Key Principles and Guidelines Laid Down

The Court laid down the following principles, which will now govern proceedings under Section 16(2)(c):

1. **No routine invocation:** Section 16(2)(c) cannot be invoked in a routine or mechanical manner.
2. **Triggers are not conclusions:** Retrospective cancellation of the supplier's registration, nil/short returns, an alert, intimation or complaint may trigger an inquiry, but cannot by themselves be the sole ground for denying ITC.
3. **Recorded satisfaction before SCN:** Before issuing a show cause notice, the proper officer must record satisfaction regarding supplier details, invoices, tax periods, the ITC amount, the precise nature of the default and the proceedings taken against the supplier.
4. **Direct link required:** The investigation must establish some direct link between the purchaser and the supplier to show a violation of Section 16(2).
5. **Full disclosure:** The SCN must disclose all material relied upon, with supporting documents such as alerts, inspection reports, panchamas, statements, e-way bill, vehicle, toll and banking data.
6. **Foundational facts for Section 74/74A:** Where Section 74 or 74A is invoked, the SCN itself must contain foundational facts showing fraud, wilful misstatement or suppression attributable to the purchaser.
7. **No automatic attribution of fraud:** A supplier's fraud cannot automatically be attributed to the purchasing dealer without connecting facts.
8. **Discharging the Section 155 burden:** The burden lies on the purchaser, but it may be discharged through invoices, proof of receipt of goods/services, e-way bills, transport receipts, weighbridge slips, stock and consumption records, etc.

9. **Examining retrospective cancellation:** Where denial is based on retrospective cancellation of the supplier's registration, the officer must examine the reason and effective date of cancellation and whether it affects the genuineness of the particular supply.
10. **Action against the supplier:** The Department must consider proceedings and recovery against the supplier; the statutory remedy against the supplier cannot be rendered toothless.
11. **No double recovery:** If tax on the same supply has already been recovered from or deposited by the supplier, that fact must be considered, and permissible re-availment under the proviso to Section 41(2) and Rule 37A must be allowed as applicable.
12. **Law of the relevant period:** The proper officer must apply the law relevant to the tax period; later amendments cannot be applied retrospectively.
13. **Purchaser's registration protected:** The purchaser's registration cannot be cancelled merely because purchases were made from a supplier whose registration was later cancelled, unless independent grounds under Section 29(2) exist.
14. **Hearing and cross-examination:** A personal hearing under Section 75(4) is required; where third-party statements are relied upon and cross-examination is sought, the request must be decided by a reasoned order.
15. **Speaking order:** The final order must be a speaking order dealing with the reply, the documents and each disputed condition of Section 16(2).
16. **DRC-03 does not cure defects:** A DRC-03 deposit made during investigation does not cure the absence of a proper SCN.
17. **Applicability:** These guidelines apply to pending and future proceedings.

5. Operative Directions

- **At the SCN stage:** Petitioners may file a reply or supplementary reply with evidence within 8 weeks.
- If the SCN lacks particulars or relied-upon material, the officer must supply the same.
- If a supplementary notice or corrigendum introduces a new ground, the taxpayer may object, and the objection must be decided.
- Where adjudication orders have already been passed, the proper officer must re-visit the matter, grant a hearing and pass a fresh reasoned order in light of the judgment.
- Existing impugned orders were not formally set aside, but will abide by the fresh decision.
- Amounts already deposited, recovered or reversed will abide by the fresh decision and may be adjusted or refunded with interest, wherever warranted.
- No fresh coercive recovery action will be taken until the fresh decision is made.
- The Department remains free to proceed against defaulting suppliers.

6. Practical Way Forward for Taxpayers

- **Preserve the complete transaction trail:** tax invoices, GSTR-2A/2B reflection, e-way bills, transport documents, weighbridge slips, stock records, proof of payment and consumption records.
- **Challenge mechanical SCNs and orders** that are based only on supplier default or retrospective cancellation.

- **Demand relied-upon documents and seek cross-examination** where third-party statements form the foundation of the case.
- **Argue specifically against double recovery** and highlight any action or recovery already initiated against the supplier.
- **In Section 74 cases**, check whether the SCN itself contains foundational facts linking the purchaser to the alleged fraud.
- **Review past orders:** Businesses whose ITC was reversed through orders already passed should assess whether a fresh hearing, adjustment or refund with interest can now be pursued.

Bottom Line

Supplier default may trigger an inquiry, but ITC cannot be denied automatically. The Department must investigate the transaction, disclose the material relied upon, follow due process and pass a reasoned order before reversing ITC.

How Rajput Jain & Associates Can Help

Our GST litigation and advisory team assists businesses at every stage of ITC disputes, including:

- Review of SCNs, intimations (DRC-01A) and adjudication orders on ITC denial against the principles laid down in this judgment.
- Preparation of replies, supplementary replies and evidence compilation to discharge the burden under Section 155.
- Representation in personal hearings, requests for cross-examination and filing of appeals before the Appellate Authority, GSTAT and the High Court.
- Vendor due-diligence and ITC reconciliation (GSTR-2A/2B vs books) to prevent future disputes.
- Claims for adjustment or refund with interest of amounts already deposited or reversed.

For assistance, contact us at info@carajput.com or call **+91-98-11-322-785 / +011-43-52-0194**. Visit www.carajput.com for more GST updates.

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