

SUPREME COURT UPHOLDS SECTION 16(2)(C) OF THE CGST ACT: ITC REMAINS CONDITIONAL ON THE SUPPLIER'S ACTUAL PAYMENT OF TAX

Bhandari Scrap Traders read together with the Refusal of SC to interfere with Allahabad High Court's Safecon Lifescience ruling: what recipients can, and cannot, expect from the current state of ITC jurisprudence

Bhandari Scrap Traders v. Union of India & Ors.

Supreme Court of India dated 24 July 2026

Affirming: Maruti Enterprise v. Union of India & Ors.,
Gujarat High Court, judgment dated 1 May 2026



KEY TAKEAWAYS

- The Supreme Court has upheld the constitutional validity of Section 16(2)(c) of the CGST Act, confirming that Input Tax Credit ("ITC") remains conditional upon the supplier's actual payment of tax to the Government.
- The decision significantly narrows the scope for constitutional challenges against ITC denial arising from supplier defaults.
- At the same time, the Supreme Court's earlier refusal to interfere in Safecon Lifescience continues to reinforce judicial protection against arbitrary invocation of Section 74 where recipients have maintained a complete documentary trail.
- Businesses should immediately strengthen supplier due diligence, contractual safeguards and ongoing vendor compliance monitoring to mitigate future ITC exposure.

IN BRIEF

The Supreme Court has dismissed a batch of Special Leave Petitions in **Bhandari Scrap Traders v. Union of India & Ors.**, affirming the Gujarat High Court's decision in **Maruti Enterprise v. Union of India & Ors.** The Supreme Court held that Section 16(2)(c) of the CGST Act, 2017 — which conditions a recipient's entitlement to input tax credit on actual payment of tax by the supplier to the Government — is neither unconstitutional nor liable to be read down. The Court recorded its complete agreement with the Gujarat High Court's reasoning and affirmed the judgment under challenge.



The ruling settles, at least for the present, one of the most contested compliance questions under GST: whether ITC can be denied to a recipient purely because its supplier has defaulted on depositing tax, even where the recipient has otherwise done everything right. Read alongside the Allahabad High Court's recent ruling in **Additional Commissioner Grade 2 & Anr. v. M/s Safecon Lifescience Private Limited**, which the Supreme Court also declined to disturb, the two decisions together mark out the current boundaries of ITC litigation: the condition in Section 16(2)(c) is constitutionally sound, but the manner in which the Revenue invokes it against a documented, bona fide transaction remains very much open to challenge.

BACKGROUND

Section 16(2) of the CGST Act sets out the conditions a registered person must satisfy before claiming ITC – a valid tax invoice, receipt of goods or services, furnishing of the relevant return and, under clause (c), actual payment of the tax charged on the supply to the Government, whether in cash or through utilisation of admissible credit. This condition has long troubled recipients, since it makes their credit dependent on a compliance failure by the supplier that the recipient typically has no way of detecting or controlling – the supplier's Form GSTR-3B not being visible to the buyer.

The fairness of such a condition has been tested before. Under the erstwhile Delhi VAT regime, the Delhi High Court in **On Quest Merchandising India (P) Ltd. v. Government of NCT of Delhi** read down the pari materia Section 9(2)(g) of the Delhi VAT Act, 2004 to spare bona fide purchasing dealers from being penalised for a selling dealer's default – a position the Supreme Court subsequently affirmed in **Commissioner of Trade & Tax, Delhi v. Arise India Ltd. and again in Commissioner Trade & Tax, Delhi v. Shanti Kiran India (P) Ltd.** Under GST, this reasoning found favour with the Gauhati High Court in **National Plasto Moulding v. State of Assam** and, more recently, with the Tripura High Court in **Sahil Enterprises v. Union of India & Ors.**, which read down Section 16(2)(c) so that it would apply only to transactions that were not bona fide, or were collusive or fraudulent.

Running the other way, the Kerala High Court in **M. Trade Links v. Union of India and Nahasshukoor v. Assistant Commissioner**, the Andhra Pradesh High Court in **Thirumalakonda Plywoods v. Assistant Commissioner**, and the Patna High Court in **Astha Enterprises v. State of Bihar** have all upheld the strict, unqualified operation of the condition, treating ITC as a statutory concession available only on fulfilment of every prescribed condition. The Supreme Court itself, in **State of Karnataka v. Ecom Gill Coffee Trading Pvt. Ltd.**, had earlier held that the burden of proving the genuineness of a transaction and actual payment of tax rests on the dealer claiming the credit, and that invoices or proof of payment by cheque, without more, do not discharge that burden.

It is against this divided body of case law that the Gujarat High Court's judgment in **Maruti Enterprise** – and now the Supreme Court's affirmation of it in **Bhandari Scrap Traders** – assumes significance.

FACTS OF THE CASE

The petitioners, M/s. Bhandari Scrap Traders, had been denied ITC solely on the ground that their suppliers had not deposited the corresponding tax with the Government. Before the Gujarat High Court, they challenged Section 16(2)(c) as arbitrary and ultra vires Articles 14, 19(1)(g), 265 and 300A of the Constitution, arguing that the genuineness of their purchases already stood established through clauses (a), (aa), (b) and (ba) of Section 16(2), and that clause (c) effectively made their credit dependent on something entirely outside their knowledge or control – the supplier's own tax filings.

They invoked the maxim *lex non cogit ad impossibilia* (the law does not compel the impossible) and relied heavily on the On Quest Merchandising line of authority (Delhi VAT Ruling), including its affirmance in Arise India (Delhi VAT Ruling) and Shanti Kiran (Delhi VAT Ruling), as well as on the Tripura High Court's decision in Sahil Enterprises (GST Ruling). Alternatively, they prayed that the provision be read down to apply only where the transaction itself was found to be fraudulent, collusive, or involved connivance between the purchasing dealer and the supplier, so as to exclude bona fide purchasers from its rigour.

The Revenue's position was that ITC is a concession granted by statute and not a vested right, and that Section 16(2)(c) cannot be read in isolation. It must be read with Section 41(2), Section 53 and Section 155 of the CGST Act, together with Rule 37A of the CGST Rules, 2017 – provisions under which a recipient must reverse credit, with interest, where the supplier defaults, but is equally entitled to re-avail that credit once the supplier eventually pays the tax. On this basis, the Revenue argued, the analogy to the Delhi VAT scheme did not hold, since the Delhi VAT Act contained no comparable re-availing mechanism.

By its judgment dated 1 May 2026, the Gujarat High Court sided with the Revenue. It held that ITC is a statutory concession rather than a constitutional or vested right, and that where the statute itself provides for reversal and re-availing of credit, the resulting sequence cannot be characterised as double taxation so as to invalidate the provision. The Court also rejected the argument that the absence of a specific mechanism for the purchasing dealer to recover its loss directly from the defaulting supplier renders the provision unconstitutional, noting that the purchasing dealer may pursue its own remedies against the supplier while the Government separately retains the authority to recover the unpaid tax. On this reasoning, the High Court upheld the constitutional validity of Section 16(2)(c), declined to read it down, and expressly parted ways with the Tripura High Court's view in Sahil Enterprises. The petitioners carried the matter to the Supreme Court by way of Special Leave Petitions.



ISSUE FOR CONSIDERATION

Whether Section 16(2)(c) of the CGST Act — which denies ITC to a recipient wherever the supplier has failed to actually pay the corresponding tax to the Government — is ultra vires Articles 14, 19(1)(g), 265 and 300A of the Constitution, or ought at least to be read down to protect bona fide purchasing dealers.



DECISION

Dismissing the batch of Special Leave Petitions, the Supreme Court held that:

- while a separate SLP arising from the Tripura High Court's ruling in Sahil Enterprises remains pending, that court had not undertaken an analysis comparable to the detailed exercise carried out by the Gujarat High Court in the judgment under challenge;
- the Gujarat High Court had correctly distinguished the scheme of the CGST Act from that of the Delhi VAT Act, and the differences it identified make it impossible to place a purchasing dealer under GST on the same footing as a bona fide purchasing dealer under the Delhi VAT regime;
- the Gujarat High Court was right to anchor its reasoning in Sections 41, 73 and 74 of the CGST Act, which entitle a purchasing dealer to re-avail reversed credit once the supplier is made to discharge the tax liability;
- no case had been made out for striking down Section 16(2)(c) as unconstitutional or for reading it down; the Court expressed itself in complete and respectful agreement with the Gujarat High Court's reasoning in Maruti Enterprise, and affirmed and upheld the judgment; and
- the Special Leave Petitions were accordingly dismissed.

The Gujarat High Court, in the judgment so affirmed, did not leave recipients entirely without a remedy. It urged the Government to re-evaluate the difficulties faced by honest purchasers and to consider a robust, technology-driven mechanism for real-time verification of invoice-wise tax payments by suppliers, coupled with prompt recovery action against defaulting sellers — observing, in substance, that legislative amendment or clarification within the GST framework may be needed to ease the burden currently falling on genuine buyers. The Supreme Court's dismissal leaves this reform suggestion undisturbed, even as it affirms the constitutional position underlying it.



READING BHANDARI WITH SAFECON: TWO SIDES OF THE SAME COIN

A fair reading of the current landscape requires Bhandari Scrap Traders to be set alongside the Supreme Court's equally recent refusal to interfere with the Allahabad High Court's ruling in *Additional Commissioner Grade 2 & Anr. v. M/s Safecon Lifescience Private Limited* [SLP (C) No. 23993 of 2026, dated 17 July 2026]. The two rulings are not in tension; they operate at different stages of the same enquiry.

In **Safecon**, the taxpayer had purchased medicines from a validly registered, drug-licensed supplier in April 2021, supported by an e-way bill, transport documentation and banking proof of payment, with both parties' GSTR-3B returns reconciling. Years later, on unverified intelligence, the Department issued a Section 74 notice asserting that the supplier's registration had since been cancelled and, when that ground did not hold, that the supplier had itself purchased from tainted firms a month before the transaction in question. The Allahabad High Court held that Section 74 proceedings cannot survive once a recipient has placed a complete, undisputed documentary trail on record, and that the provision applies only where fraud, wilful misstatement, or suppression of facts can actually be shown — not merely inferred from a supplier's subsequent misconduct or deregistration. The Supreme Court declined to interfere, observing that it found no good ground to entertain the Revenue's petition.

Taken together, the two decisions draw a workable line. **Bhandari Scrap Traders** confirms that Section 16(2)(c) is a valid, operative condition: a recipient cannot claim ITC merely because it held a valid invoice and paid its supplier, if that supplier never deposited the corresponding tax. **Safecon**, by contrast, confirms that the Revenue cannot invoke Section 74 — a provision confined to fraud, wilful misstatement or suppression — as a shortcut around that framework, particularly where the supplier's default or disqualification surfaces only after the transaction and the recipient's own compliance is not in dispute. Put differently, what a recipient must show to keep its credit is unaffected by *Safecon*; how the Department may go about denying or clawing back that credit is what *Safecon* constrains.

A technical caveat applies to both dismissals. As the Supreme Court itself clarified in **Kunhayammed v. State of Kerala**, a Special Leave Petition dismissed without a reasoned order does not amount to a declaration of law under Article 141 of the Constitution, and the doctrine of merger does not apply. **Bhandari Scrap Traders** is a reasoned dismissal on the merits of the constitutional challenge and therefore stands on a different footing — it is a considered affirmation of the Gujarat High Court's view. The **Safecon** dismissal, by contrast, appears to have been made without a speaking order, so the operative precedent there remains the Allahabad High Court's reasoning, reinforced rather than replaced by the Supreme Court's refusal to interfere.

It is also worth flagging what neither ruling decides. The Supreme Court's order in **Prime Metals v. Central Board of Indirect Taxes and Customs & Ors.**, at times read as bearing on Section 16(2)(c), did not touch the constitutional question at all — the Court there simply declined to interfere with the Rajasthan High Court's dismissal of a writ petition on the ground of an available statutory appellate remedy, expressly leaving the validity question open. **Bhandari Scrap Traders** is, for now, the more authoritative word on that specific constitutional question.

OUR COMMENTS

The decision in **Bhandari Scrap Traders** restores clarity to a provision that practitioners have long flagged as harsh in operation. Section 16(2)(c), read with Section 41, makes actual payment of tax by the supplier — not merely possession of a valid invoice or proof of payment to the supplier — a precondition for ITC. Section 41(2), as substituted by the Finance Act, 2022, obliges the recipient to reverse such credit, with interest, where the supplier defaults, and its proviso allows re-availment once the supplier pays up, with the mechanics set out in Rule 37A. Section 155 places the burden of proving eligibility on the claimant, and Section 53's requirement to transfer funds to the destination State on inter-State supplies explains why credit cannot be allowed to sit alongside unpaid tax without disturbing the fiscal architecture GST is built on.

The Tripura High Court's contrary approach in **Sahil Enterprises** — reading down Section 16(2)(c) to exempt bona fide transactions from its rigour, on facts where the Department itself did not dispute the recipient's payment of over ₹1.11 crore to its supplier — remains under challenge before the Supreme Court in a separate, still-pending SLP. That challenge stands considerably weakened by the Court's affirmation of the contrary view in **Bhandari Scrap Traders**.

At the same time, Safecon — and the broader line of cases it joins, including Suncraft Energy, Solvi Enterprises and R.T. Infotech from the Calcutta and Allahabad High Courts — is a reminder that constitutional validity and administrative overreach are separate questions. A recipient with a complete documentary trail (tax invoice, e-way bill, transport record, banking payment, and a return that reconciles with the supplier's own filing) retains a genuinely strong case where the Department attempts to invoke Section 74 on the strength of a supplier's later fall from grace, rather than any deficiency in the recipient's own compliance at the time of the transaction. The Supreme Court's ruling in **State of Karnataka v. Ecom Gill Coffee Trading Pvt. Ltd.** remains the operative caution on the other side: invoices and banking proof, without more, will not discharge a recipient's burden where the genuineness of the underlying transaction is itself in question.



WAY FORWARD

For businesses, the practical position following Bhandari Scrap Traders is now reasonably settled:

- ITC remains conditional on the supplier actually depositing the corresponding tax, and a constitutional challenge to Section 16(2)(c) is no longer a viable line of defence against a demand founded on that condition;
- a recipient's remedy where the supplier defaults lies in reversing the credit and re-availing it later under Section 41(2) read with Rule 37A, rather than in resisting the reversal on constitutional grounds;
- where a demand instead invokes Section 74 on the strength of the supplier's subsequent registration cancellation, insolvency, or unrelated defaults, the Safecon line of authority remains available, provided the recipient's own documentary trail at the time of the transaction is complete and undisputed;
- strengthen vendor onboarding and ongoing due diligence, particularly for high-value or new suppliers;
- reconcile GSTR-2B against purchase records on a regular basis to identify supplier defaults early, and preserve e-way bills, transport records and banking proof as a matter of course;
- build indemnity and tax-withholding clauses into supply contracts, so that the commercial risk of a supplier's default does not fall on the recipient by default; and
- track the pending Supreme Court appeal in **Sahil Enterprises**, since it may yet refine the treatment of genuinely bona fide transactions, and note that fraud-based proceedings under Section 74 apply only up to FY 2023-24, with Section 74A bringing a common limitation period from FY 2024-25 onward regardless of intent.

DISCLAIMER

This alert is intended for general informational purposes and reflects the legal position as reported as of the date below. It is not, and should not be treated as, a substitute for professional advice on the facts of any specific case. Readers are advised to consult their tax advisor before acting, or refraining from acting, on the basis of this note.

