R

IN THE HIGH COURT OF KARNATAKA AT BENGALURU

DATED THIS THE 17TH DAY OF JUNE, 2019

BEFORE

THE HON'BLE MRS.JUSTICE S.SUJATHA

WRIT PETITION Nos.17989 & 23971/2018 (T – RES)

BETWEEN:

M/s ONYX DESIGNS
A PROPRIETORSHIP CONCERN
HAVING ITS OFFICE AT
NO.17G/46-3 & 17G/46-3-1,
1ST FLOOR, INDUSTRIAL SUBURB,
2ND STAGE, YESHWANTPUR
BANGALORE - 560 022
REP. BY ITS PROPRIETOR
SHRI ANSHUL JINDAL. ... PETITIONER

[BY SRI RAJESH CHANDER KUMAR, ADV.]

AND:

1. THE ASSISTANT COMMISSIONER
OF COMMERCIAL TAXES
(AUDIT) - 6.1, DVO-0,
3KD FLOOR, 2ND BLOCK,
KIADB BUILDING, 14TH CROSS,
4TH PHASE, PEENYA 2ND STAGE
BANGALORE - 560 058.

2. THE STATE OF KARNATAKA
DEPARTMENT OF FINANCE
REP BY ITS SECRETARY
VIDHANA SOUDHA,
BANGALORE-560001. ...RESPONDENTS

[BY SRI T.K.VEDAMURTHY, AGA.]

THESE WRIT PETITIONS ARE FILED UNDER ARTICLES 226 & 227 OF THE CONSTITUTION OF INDIA, PRAYING TO QUASH THE IMPUGNED RE-ASSESSMENT ORDERS IN CAS NO. 262460945 ALONG WITH THE CONSEQUENT DEMAND NOTICE, DATED 07.04.2018 AND IN CAS NO. 214460966 ALONG WITH THE CONSEQUENT DEMAND NOTICE DATED 07.04.2018 VIDE ANNEXURES-A AND B AND ANNEXURES-C AND D ISSUED FOR THE PERIOD 2011-2012 AND 2012-2013 RESPECTIVELY BY THE R-1 AS BEING IN ABUSE OF JURISDICTION, WHOLLY ARBITRARY, ILLEGAL AND UNTENABLE IN LAW.

THESE PETITIONS HAVING BEEN HEARD AND RESERVED ON 13.06.2019, COMING ON FOR PRONOUNCEMENT OF ORDER THIS DAY, ***S.SUJATHA J.,*** PASSED THE FOLLOWING:

O R D E R

The petitioner has challenged the re-assessment orders along with the consequent demand notices issued by respondent No.1 relating to the tax periods 2011-12 and 2012-13.

2. The petitioner is a dealer registered under the provisions of the Karnataka Value Added Tax Act, 2003 ('KVAT Act' for short) dealing in the business of trading in bags and gift items. The petitioner availed the credit of input tax paid on the purchases made from the dealers registered in the State of Karnataka in accordance with the provisions of Section 10(2) of the

KVAT Act and after deducting the same from the output tax payable, discharged the net tax liability as per Section 10(3) of the KVAT Act. Returns were filed relating to the tax periods 2011-12 and 2012-13 accordingly. Respondent No.1 (prescribed authority) passed the re-assessment orders and issued consequent demand notices. Being aggrieved, the petitioner is before this Court.

3. Learned counsel Sri. Rajesh Chander Kumar appearing for the petitioner would submit that the proposition notice dated 23.03.2018 for the tax periods in question came to be issued by respondent No.1 under Section 39(1) read with Sections 36(1) and 72(2) of the KVAT Act. It was alleged that the dealers with whom the petitioner had transacted, had either been de-registered and not filed VAT returns and paid taxes, or they were registered, but not declared sales made to the petitioner or had declared less sales and not paid taxes

collected on the sales made to the petitioner. The said notice being ex-facie incorrect with the factual aspects, the petitioner filed its reply contending that the cancellation or registration can only have the prospective effect and not the retrospective effect and thus the purchases being prior to the date of de-registration, the input tax claimed thereof cannot be disallowed. It was further argued that there is no restriction to give input tax credit, if a selling dealer has failed to remit the input tax collected from the purchasing dealer. The learned counsel inviting the attention of this Court to the re-assessment order submitted that despite accepting that the dealer has effected purchases from the dealers who have been registered under the provisions of KVAT Act, while some of them have been subsequently de-registered, others were still filing returns during the assessment years, prescribed authority disallowed the input credit contrary to the provisions of the KVAT Act. Indeed, the

prescribed authority has observed that there is no provision in the KVAT Act which restricts the input credit on purchases effected from defaulting dealers. if the input is not restricted, it would lead to loss of revenue to the State. It is the finding of the prescribed authority that when an amount collected by way of tax which is due to the State is not remitted, it leads to loss of revenue to the State's exchequer if input credit is allowed. The prescribed authority exceeded the jurisdiction in arriving at such a finding.

4. Learned counsel further argued that the degree of burden of proof contemplated under Section 70 of the KVAT Act cannot be enlarged beyond the scope of the said Section. The finding given by the prescribed authority in disallowing the input credit would scuttle the charging Section 3 of the KVAT Act and would frustrate the whole purpose and object of the KVAT Act. The ex-parte re-assessment orders impugned passed

without providing sufficient opportunity of being heard are perverse, arbitrary and illegal.

Learned counsel in support of his contention relied on the following judgments:-

1. *The State of Karnataka vs. Rajesh Jain in STRP Nos.171 and 313-316/2016 (D.D. 07.12.2016);*
2. *Mukand Limited vs. The State of Karnataka in STRP No.100006/2016 (D.D. 22.01.2018);*
3. *Arise India Limited and Ors. vs. Commissioner of Trade and Taxes, Delhi and Ors. (D.D.26.10.2017);*
4. *State of Maharashtra vs. Suresh Trading Company reported in (1997) 11 SCC 378.*

5. Learned Additional Government Advocate Sri. T.K. Vedamurthy appearing for the revenue raised objections regarding the maintainability of the writ petitions in challenging the re-assessment orders directly before this Court invoking the writ jurisdiction without exhausting the alternative and efficacious

remedy available under the KVAT Act. Learned Additional Government Advocate justifying the impugned orders submitted that Sections 10(2) and 10(3) of the KVAT Act provides for allowing input tax credit subject to the selling dealer depositing the tax from the purchasing dealer as per the invoice raised. It was argued that the petitioner has not provided sufficient proof in claim of input tax on purchases i.e., original copies of purchase invoices, proof of physical movement of goods and details of goods taken inwards (like gate pass) after purchase. In the absence of sufficient proof, the input tax credit claim has been disallowed as per the provisions of Section 70 of the KVAT Act. Remitting of the tax by the selling dealer/s collected from the purchasing dealer/s is the condition precedent for allowing the input tax credit. Admittedly, the selling dealers have not remitted the tax collected from the petitioner in the transaction wherein the input tax credit has been claimed. Thus, the order impugned

is passed in accordance with law and deserves to be confirmed by this Court.

In support of his contentions the learned counsel placed reliance on the following judgments:-

1. *M/s. Bhavani Enterprises vs. The Addl. Commissioner of Commercial Taxes in STA No.71/2013 (D.D. 13.06.2018);*
2. *Microqual Techno Private Limited vs. Additional Commissioner of Commercial Taxes in STA No.1/2010 (D.D.06.08.2010).*

6. I have carefully considered the submissions of the learned counsel appearing for the parties and perused the material on record. In the circumstances, there is no absolute bar to exercise the writ jurisdiction by this Court.

7. The only point that arises for consideration of this Court is:

> *"Whether remitting of tax by registered selling dealer is a condition precedent in claiming input tax credit by the purchasing dealer against a valid invoice with the tax component paid?"*

8. To answer the aforesaid point, it is apt to refer to relevant provisions of the KVAT Act.

Section 10(2) and 10(3), 11(a)(9) of the KVAT Act reads thus:-

> ***"10. Output tax, input tax and net tax:***
>
> *(1) xxxxxxx*
>
> *(2) Subject to input tax restrictions specified in Sections 11, 12, 14, [17 and 18], input tax in relation to any registered dealer means the tax collected or payable under this Act on the sale to him of any goods for use in the course of his business, and includes the tax on the sale of goods to his agent who purchases such goods on his behalf subject to the manner as may be prescribed to claim input tax in such cases.*
>
> (3) *Subject to input tax restriction specified in Sections 11, 12, 14, 17, 18 and 19, the net tax payable by a registered dealer in respect of each tax period shall be the amount of output tax payable by him in that period less the input tax deductible by him as may be prescribed in that period and relatable to goods purchased during the period immediately preceding five tax periods of such tax period, if input tax of such*

goods is not claimed in any of such five preceding tax periods and shall be accounted for in accordance with the provisions of this Act.

11. Input tax restrictions:-

(a) Input tax shall not be deducted in calculating the net tax payable, in respect of.-

(1) xxxxxx

(2) xxxxxx

(3) xxxxxx

(4) xxxxxx

(5) xxxxxx

(6) xxxxxx

(7) xxxxxx

(8) xxxxxx

(9) tax paid on goods purchased by a dealer who is required to be registered under the Act, but has failed to register."

9. Sections 10[2]and [3] of the KVAT Act contemplates what is input tax in relation to any registered dealer and the net tax payable by a registered dealer in respect of each tax period. Section 11[a] [1] to [9] deals with input tax restrictions. Section 11[a][9]

would be relevant for the purposes of the present case which spells out about the input tax restrictions inasmuch as the tax paid on goods purchased by a dealer who is required to be registered under the Act, but has failed to register. It is also admitted by the prescribed authority that there is no provision in KVAT Act which restricts input credit on purchases effected from defaulting dealers.

10. The division bench of this Court in the case of ***Rajesh Jain*** supra, has observed thus:

> *"7. The aforesaid shows that the finding of fact ahs been recorded by the Tribunal that the assessee has fully discharged the burden of proof to claim the deduction of input tax as per the tax invoices. The aforesaid finding, in view of the evidence produced and referred to hereinabove by the Tribunal, cannot be said to be perverse. Hence, the question needs to be answered in favour of the assessee. Even if such question arises on the aspects of re-appreciation of the evidence such would result into question of fact. Hence, we do not find that any question of law would arise for consideration, as sought to be canvassed.*
>
> *8. Mr.T.K.Vedamurthy, learned AGA attempted to contend that if the selling dealer*

has not deposited the amount of VAT with the Government, then the purchaser dealer would not be entitled to claim the benefit of entry tax credit and the said aspect is not examined by the Tribunal.

9. We do not find that the matter can be stretched to that extent as sought to be canvassed. Once the purchaser dealer-assesee satisfactorily demonstrates that while purchasing goods, he has paid the amount of VAT to the selling dealer, the matter should end so far as his entitlement to the claim input tax credit. If the selling dealer has not deposited the amount in full or a part thereof, it would be for the Revenue to proceed against the selling dealer. But thereby the benefit of input tax credit cannot be deprived to the purchaser dealer."

11. In the case of ***Mukand Limited*** supra, the Division Bench of this Court has observed thus:

"10. The limited ground on which we have to examine the issue on hand is, whether the respondent was justified in denying input tax credit benefits to the assessee, on the ground that the VAT-100 returns filed by the selling dealers are not traceable under EFS. It is trite that the revenue can be at a loss in allowing the input tax credit to a dealer, who deals with a bogus transaction, for example, a selling dealer who is not in existence or a de-registered dealer, in such

circumstances, it is not in doubt that unless the purchasing dealer establishes the genuineness of the invoices issued by the selling dealer, no input tax credit can be allowed but that is not the case in the present set of facts. The Assessing Officer while passing reassessment order has categorically observed that the invoices are genuine and in view of the material placed before this Court with respect to the selling dealer No.7, the matter requires reconsideration by the Assessing Officer. Even as regards the selling dealer Nos.4 to 6, no reasons are assigned by the respondent for denying the input tax credit. It is also trite that no input tax credit can be disallowed on the premise that the selling dealer is de-registered subsequent to the relevant tax periods. The cause shown for disallowance with respect to selling dealer No.7 is that the said concern has been de-registered in 2007, returns are not traced and input tax credit claim is not allowable. The same is contrary to the returns now made available before this Court. The tax period involved in the present case is relating to 2005-06, if any de-registration is made subsequently, the same would not disentitle the purchasing dealer to claim input tax credit for the tax period of 2005-06."

12. From the aforesaid rulings, it is clear that the benefit of input tax cannot be deprived to the purchaser dealer, if the purchaser dealer satisfactorily demonstrates that while purchasing goods, he has paid the amount of tax to the selling dealer. If the selling dealer has not deposited the amount in full or a part thereof, it would be for the revenue to proceed against the selling dealer.

13. It is beneficial to refer to the judgment of the Hon'ble High Court of Delhi in the case of ***Arise India Limited and Others*** supra, wherein the validity of Section 9[2][g] of the Delhi Value Added Tax Act, 2004 ['DVAT Act' for short] fell for consideration. Section 9[2][g] of the DVAT Act reads as under:

> *"[g] to the dealers or class of dealers unless the tax paid by the purchasing dealer has actually been deposited by the selling dealer with the Government or has been lawfully adjusted against output tax liability*

and correctly reflected in the return filed for the respective tax period."

14. The findings are recorded by the Hon'ble Court at paragraphs 39, 40 and 41 as under:

"39. Applying the law explained in the above decisions, it can be safely concluded in the present case that there is a singular failure by the legislature to make a distinction between purchasing dealers who have bona fide transacted with the selling dealer by taking all precautions as required by the DVAT Act and those that have not. Therefore, there was need to restrict the denial of ITC only to the selling dealers who had failed to deposit the tax collected by them and not punish bona fide purchasing dealers. The latter cannot be expected to do the impossible. It is trite that a law that is not capable of honest compliance will fail in achieving its objective. If it seeks to visit disobedience with disproportionate consequences to a bona fide purchasing dealer, it will become vulnerable to invalidation on the touchstone of Article 14 of the Constitution.

40. The need for the law to distinguish between honest and dishonest dealers was

acknowledged by the Punjab and Haryana High Court in Gheru Lal Bal Chand v. State of Haryana (supra) where the constitutional validity of a similar Section 8 of the Haryana DVAT Act, 2003 („HVAT Act') was being considered. It was held that:

> *"In legal jurisprudence, the liability can be fastened on a person who either acts fraudulently or has been a party to the collusion or connivance with the offender. However, law nowhere envisages imposing any penalty either directly or vicariously where a person is not connected with any such event or an act. Law cannot envisage an almost impossible eventuality. The onus upon the assessee gets discharged on production of Form VAT C-4 which is required to be genuine and not thereafter to substantiate its truthfulness by running from pillar to post to collect the material for its authenticity. In the absence of any malafide intention, connivance or wrongful association of the assessee with the selling dealer or any dealer earlier thereto, no liability can be imposed on the principle of vicarious liability. Law cannot put such onerous responsibility on the assessee*

otherwise, it would be difficult to hold the law to be valid on the touchstone of Articles 14 and 19 of the Constitution of India. The rule of interpretation requires that such meaning should be assigned to the provision which would make the provision of the Act effective and advance the purpose of the Act. This should be done wherever possible without doing any violence to the language of the provision. A statute has to be read in such a manner so as to do justice to the parties. If it is held that the person who does not deposit or is required to deposit the tax would be put in an advantageous position and whereas the person who has paid the tax would be worse, the interpretation would give result to an absurdity. Such a construction has to be avoided.

In other words, the genuineness of the certificate and declaration may be examined by the taxing authority, but onus cannot be put on the assessee to establish the correctness or the truthfulness of the statements recorded therein. The authorities can examine whether the Form VAT C-4 was bogus and was procured by

the dealer in collusion with the selling dealer. The department is required to allow the claim once proper declaration is furnished and in the event of its falsity, the department can proceed against the defaulter when the genuineness of the declaration is not in question. However, an exception is carved out in. The event where fraud, collusion or connivance is established between the registered purchasing dealers or the immediate preceding selling registered dealer or any of the predecessors selling registered dealer, the benefit contained in Form VAT C-4 would not be available to the registered purchasing dealer. The aforesaid interpretation would result in achieving the purpose of the rule which is to make the object of the provisions of the Act workable, i.e., realization of tax by the revenue by legitimate methods."

41. The Court respectfully concurs with the above analysis and holds that in the present case, the purchasing dealer is being asked to do the impossible, i.e. to anticipate the selling dealer who will not deposit with the Government the tax

collected by him from those purchasing dealer and therefore avoid transacting with such selling dealers. Alternatively, what Section 9 (2) (g) of the DVAT Act requires the purchasing dealer to do is that after transacting with the selling dealer, somehow ensure that the selling dealer does in fact deposit the tax collected from the purchasing dealer and if the selling dealer fails to do so, undergo the risk of being denied the ITC. Indeed Section 9 (2) (g) of the DVAT Act places an onerous burden on a bonafide purchasing dealer."

15. The Hon'ble Delhi High Court read down the said Section 9(2)(g) to the effect that the expression "dealer or class of dealers" should be interpreted as not including a purchasing dealer who has bonafide entered into purchase transactions with validly registered selling dealers who have issued tax invoices in accordance with the Act where there is no mismatch of the transactions. It was observed that unless the expression "dealer or class of dealers" in Section 9[2][g] "read down" in the above manner, the entire provision has to be held to be

violative of Article 14 of the Constitution. It is also significant to note that the said judgment has been confirmed by the Hon'ble Apex Court.

16. The reasonings of the prescribed authority for disallowing the input tax credit recorded in the Assessment order are quoted hereunder:-

> *"The reply filed by the assessee was studied in detail.* ***It is true that the dealer has effected purchases from the dealers who have been registered under the provisions of KVAT Act, 2003.*** *While some of them have been subsequently de-registered, others were still filing returns during the assessment year. However, in all the cases where input credit is proposed to be disallowed,* ***it is very much true that those dealers have not remitted the taxes collected from the assessee. this would lead to substantial loss of revenue to the State.*** *Since the amount collected by the assessee is not remitted to the Government, input credit on these purchases cannot be given to the assessee.*
>
> *Further, it is advised in the reply that the department should initiate recovery actions from the defaulting dealers in terms of Part V – Rule 55 to 130-B of KVAT Rules, 2003. However, the undersigned officer is very limited in resources and powers to*

initiate action against all such defaulters. An assessing officer has power to verify books of accounts and issue notices to only those dealers for whom assignment note is issued by the Hon'ble Commissioner of Commercial Taxes, Karnataka. What is more, the defaulting dealers in the instant case [assessee's sellers] are very few; however, they may run into thousands in some other case. Given the limited resource and man-power, it is nearly impossible for the department to initiate action against all defaulting dealers, where multiple re-assessments have to be done and it becomes difficult to keep track of all the defaulters.

Hence, xxxxx

In view of the above discussions, it is clear that the assessee has the knowledge that the taxes paid by him on purchases made from defaulting dealers has not been remitted to the Government. ***Though there is no provision in KVAT Act, 2003 which restricts input credit on purchases effected from defaulting dealers,*** *if the input is not restricted, it would lead to loss of revenue to the State. State is not a profit – making body but a system which is involved in providing amenities and protection to the citizen. For these activities, it needs money, and taxes collected by people forms major source of its income. Hence, when an amount collected by way of tax which is due to the State is not remitted, it leads to loss of revenue to the state's exchequer. If input credit is allowed even on the purchases*

where the tax due to the Government was not paid, it leads to a bad trend and to substantial loss of revenue to the State."
(Emphasis supplied)

17. The reasons assigned by the Assessing officer establishes that the petitioner-assessee has fully discharged the burden of proof to claim the deduction of input tax as per the tax invoices but the selling dealer has failed to remit the said collected taxes. The purchaser dealer having paid the amount of VAT to the registered selling dealer, his entitlement to claim input tax credit need not be tagged with the registered selling dealer depositing the said collected tax amount in full or a part thereof. The charging provision of Section 3 provides that the tax shall be levied on every sale of goods in the State by a registered dealer or a dealer liable to be registered in accordance with the provisions of the Act. Further, the tax shall also to be levied, and paid by every registered dealer or dealer liable to be registered on the sale of taxable goods to him for use in

the course of his business, by a person who is not registered under this Act. Indisputably, the petitioner has purchased the goods from a registered dealer not from an unregistered dealer. Section 9 of the KVAT Act provides collection of tax by registered dealers. If there is any default on the part of such registered dealers in not remitting the tax, so collected into the Government treasury or any designated bank and furnish monthly returns as specified under Section 35 to the prescribed authority, the proceedings are required to be initiated against such registered selling dealers in accordance with the provisions of the KVAT Act.

18. The Division Bench of this Court in the case of ***M/s. Bhavani Enterprises*** supra, was dealing with the penalty imposed by the prescribed authority under Section 70[2] of the KVAT Act wherein, the input tax credit availed by the assessee was held to be on the basis of fake and false invoices of the selling dealers

who actually did not exist and upon investigation and query, being found that those dealers did not exist and therefore the input tax credit could not be allowed in the hands of the purchasing dealer. In that context, it is held that the burden of proving that input tax claim is correct lies upon the dealer claiming such input tax credit.

19. In the case of ***Microqual Techno Private Limited*** supra, the Revisional Authority exercising the suo motu power of revision against the order of the First Appellate Authority which set aside the penalty imposed had recorded a finding that the invoices produced were not genuine as the same were procured through a mediator which was well within the knowledge of the assessee. In such circumstances, it was observed that in order to claim the benefit of refund of input tax, the assessee has produced fake invoices which did not reflect the genuine transaction. It is not a bona fide act

of the assessee. Accordingly, the penalty levied under Section 70 of the Act was confirmed.

20. In view of admission of the genuine transaction as well as bonafide claim and in the absence of any other allegations made against the purchasing dealer in the assessment orders, merely for the reason that selling dealers have not deposited the collected tax amount or some of the selling dealers have been subsequently deregistered cannot be a ground to deny the input tax credit.

21. It is the contention of the petitioner that respondent No.1 – prescribed authority has mis-stated the dates of de-registration of certain selling dealers. These factual aspects requires to be re-considered by the respondent No.1 – prescribed authority. It is needless to observe that in the event of purchases made by the assessee relates to the period subsequent to de-

registration of the selling dealer, no input tax credit can be allowed.

22. For the reasons aforesaid, the re-assessment orders and the demand notices at Annexures – A, B, C and D are set aside. The proceedings are restored to the file of the respondent No.1 – prescribed authority for re-consideration. Respondent No.1 – prescribed authority shall re-consider the matter in accordance with law keeping in mind the observations made hereinabove and after providing an opportunity of hearing to the petitioner shall conclude the re-assessments in an expedite manner.

Writ petitions stand disposed of in terms of the above.

Sd/-
JUDGE

PMR/NC.