

Bona Fide Purchasers and Input Tax Credit: Supreme Court Upholds Fairness under DVAT and Implications for GST in case Dealer got cancel post purchase transaction.



Introduction

On 9 October 2025, the Supreme Court of India, in “Commissioner of Trade and Tax, Delhi v. M/s Shanti Kiran India (P) Ltd. (2025-TIOL-77-SC-VAT)”, delivered a landmark pronouncement reaffirming a core principle of fiscal fairness under the **Delhi Value Added Tax Act, 2004 (DVAT Act)**. The Bench comprising **Justices Manoj Misra and N.K. Singh** upheld that a bona fide purchasing dealer who has paid tax in good faith to a registered selling dealer cannot be denied **Input Tax Credit (ITC)** merely because the seller subsequently defaults in depositing that tax with the Government.

While issued in the form of an order, the ruling carries binding legal significance, bringing closure to a protracted line of litigation under **Section 9(2)(g)** of the DVAT Act—a provision that had long unsettled Delhi’s VAT regime by allowing reversal of ITC in cases where the selling dealer failed to remit the collected tax.

The judgment thus reinforces judicial protection for genuine business transactions and strengthens the broader principle of fairness in indirect taxation.

Background of the Dispute

The dispute in “Commissioner of Trade and Tax, Delhi v. M/s Shanti Kiran India (P) Ltd.” arose from a recurring issue under the **Delhi Value Added Tax Act, 2004 (DVAT Act)** whether a **purchasing dealer**, who had entered into transactions with a **seller duly registered** under the Act and had paid **Value Added Tax (VAT)** in good faith at the time of purchase, could subsequently be denied **Input Tax Credit (ITC)** merely because the selling dealer defaulted in depositing that tax with the Government.

In the present case, the respondents, “M/s Shanti Kiran India (P) Ltd.” and other purchasing dealers, had procured goods from dealers registered with the **Department of Trade and Taxes, Government of NCT of Delhi**. Each transaction was duly supported by valid tax invoices, and VAT had been properly charged and paid to the selling dealers.

However, following these transactions, the registrations of certain selling dealers were **cancelled**, and they failed to **remit the collected tax** to the Government treasury.

Relying on Section 9(2)(g) of the DVAT Act, the Department took the position that since the selling dealers had not deposited the tax, the corresponding ITC claimed by the purchasers was **inadmissible**. The respondents challenged this action before the **Delhi High Court**, which held in their favour, ruling that bona fide purchasers who have acted in good faith and paid due tax cannot be penalised for the seller’s default. The Department then **appealed to the Supreme Court**, resulting in the landmark judgment that has now settled this long-standing controversy.

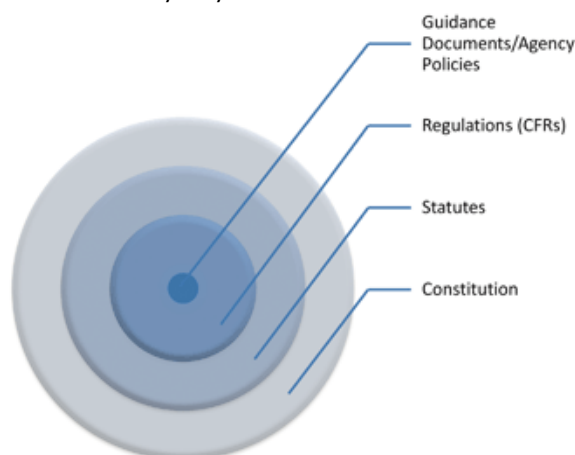
Statutory Framework

The controversy arose in the context of Section 9 of the Delhi Value Added Tax Act, 2004 (DVAT Act), which governs a dealer’s entitlement to Input Tax Credit (ITC). Under Section 9(1), a registered dealer is entitled to claim ITC on purchases made during a tax period, provided that such goods are used for making taxable sales.

However, Section 9(2) enumerates specific circumstances under which ITC shall not be allowed.

The present dispute turned on clause (g) of sub-section (2), which provides 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 clause was frequently invoked by the tax authorities to disallow ITC to purchasing dealers whenever the selling dealer defaulted in remitting the tax—regardless of whether the purchaser had acted in good faith or had any means of verifying the seller’s subsequent compliance. This interpretation caused considerable hardship for genuine traders who had duly paid VAT to registered sellers against valid tax invoices but were later penalised for defaults entirely beyond their control.





Delhi High Court verdict in similar case

A similar issue was considered by the **Delhi High Court** in “On Quest Merchandising India Pvt. Ltd. v. Government of NCT of Delhi and Ors., 2017” SCC Online Delhi 13037, in the context of **Section 9(2)(g)** of the **Delhi Value Added Tax Act, 2004 (DVAT Act)**.

Section 9(1) permits a registered dealer to claim **Input Tax Credit (ITC)** for purchases made during a tax period, provided the purchases arise in the course of the dealer’s business and the goods are used, directly or indirectly, for making taxable sales under **Section 7. Sub-section (2)** specifies the conditions under which ITC shall not be allowed. Specifically, **clause (g)** provides that ITC is available to a purchasing dealer only if the tax paid by the selling dealer has been deposited with the Government, lawfully adjusted against output tax liability, and correctly reflected in the relevant returns.

In *On Quest Merchandising India*, the Delhi High Court “read down” clause (g) to protect bona fide purchasers. The Court held:

“The expression ‘dealer or class of dealers’ occurring in Section 9(2)(g) of the DVAT Act should be interpreted as not including a purchasing dealer who has bona fide entered into purchase transactions with validly registered selling dealers who have issued tax invoices in accordance with Section 50 of the Act where there is no mismatch of the transactions in Annexures 2A and 2B. Unless the expression ‘dealer or class of dealers’ in Section 9(2)(g) is read down in this manner, the entire provision would have to be held violative of Article 14 of the Constitution.”

The Court further clarified that:

“As a result, the Department is precluded from invoking Section 9(2)(g) to deny ITC to a bona fide purchasing dealer. If the selling dealer fails to deposit the collected tax, the proper remedy lies against the defaulting selling dealer, and not the purchasing dealer. Only where the Department can demonstrate collusion between the purchasing and selling dealers can action be taken under Section 40A of the DVAT Act.”

This decision reinforced the principle that **genuine purchasers acting in good faith cannot be penalised** for defaults committed by selling dealers beyond their control, ensuring fairness and protecting the rights of compliant taxpayers.

Supreme Court Order

In view of the above, the Court observed that

- 1.) There was no dispute regarding the registration status of the selling dealer on the date of the transactions,
- 2.) There were no transactions or the tax invoices under question challenged for their authenticity,
- 3.) Department doesn’t made allege any element of collusion between the selling and purchasing dealers.

On this basis, the Supreme Court found **no reason to interfere** with the High Court’s order granting the purchasing dealers the benefit of ITC after due verification of the invoices.

Concluding that the appeals “**lack merit**,” the Supreme Court dismissed them, simultaneously disposing of all pending applications, and reinforced the principle that **genuine dealers acting in good faith are entitled to claim ITC**.

Impact of Supreme Court Order

Although the ruling arose in a **VAT context**, its implications clearly extend to the **GST regime**. Under GST, authorities have occasionally denied ITC for supplier-side non-compliance such as mismatches between **GSTR-2A and 2B** even when the purchaser bears no fault. The Supreme Court’s reasoning now provides a **constitutional lens**, emphasizing that ITC denial must be **proportionate** and founded on **demonstrable involvement in evasion**, rather than mere procedural lapses by another party. This precedent is likely to influence **litigation strategies, departmental guidance, and circulars**, promoting a more evidence-based approach before any credit reversal is attempted.





The Supreme Court's decision in "Commissioner of Trade and Tax, Delhi v. M/s Shanti Kiran India (P) Ltd." marks a significant reaffirmation of taxpayer protection and the principle of fairness in indirect taxation. By upholding the entitlement of bona fide purchasers to claim ITC despite the selling dealer's default in remitting tax, the Court has clarified the proper scope of Section 9(2)(g) of the DVAT Act and reinforced the constitutional safeguards against arbitrary denial of credit.

Beyond the VAT regime, the ruling provides important guidance for GST compliance and administration, emphasizing that ITC denial must be based on actual wrongdoing or collusion, rather than mere procedural non-compliance by the supplier. For taxpayers and authorities alike, this judgment encourages a principled, evidence-based approach to ITC claims and reversals, protecting the rights of genuine businesses while ensuring that remedies for default remain directed at the responsible parties. Ultimately, the decision strengthens legal certainty, promotes business confidence, and underscores the judiciary's commitment to equitable taxation.



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