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IN THE HIGH COURT OF KERALA AT ERNAKULAM

PRESENT

THE HONOURABLE MR. JUSTICE DEVAN RAMACHANDRAN

&

THE HONOURABLE MR. JUSTICE GOPINATH P.

&

THE HONOURABLE MR.JUSTICE MOHAMMED NIAS C.P.

Tuesday, the 15th day of July 2025 / 24th Ashadha, 1947

ICR (OT.REV) NO. 3 OF 2025

ARISING FROM OT (REV) NO.64/2020

PETITIONER:

S.P.FAIZAL

S.P.M.CHICKEN STALL, SHOP NO.2,

CENTRAL MARKET, CALICUT

THE HIGH COURT OF KERALA सत्यमेव जयते

BY ADVS.R.JAIKRISHNA and C.S.ARUN SHANKAR

Advocates for petitioner

RESPONDENT:

STATE OF KERALA REPRESENTED BY ITS SECRETARY TO

GOVERNMENT, TAX DEPARTMENT, GOVERNMENT SECRETARIAT,

THIRUVANANTHAPURAM G.P.O., THIRUVANANTHAPURAM 695 001

BY GOVERNMENT PLEADER

THIS ICR (OTHER TAX REVISION (VAT)) NO.3/2025 ALONG WITH CONNECTED CASES HAVING COME UP FOR ORDERS AGAIN ON 15.07.2025, UPON PERUSING THIS COURT'S COMMON ORDER DATED 08.04.2025 THE COURT ON THE SAME DAY PASSED THE FOLLOWING:

ICR(OT.REV).3/2025 & CON.CASES :1:

"C.R."

DEVAN RAMACHANDRAN, GOPINATH P. & MOHAMMED NIAS C.P., JJ.

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ICR (OT.Rev) No.3 of 2025 in OT. Rev. No. 64 of 2020,
W.P.(C) No. 6733 of 2019, OT. Rev. No. 64 of 2020,
W.P.(C) No. 3524 of 2020 and OT. Rev. No.36 of 2021

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Dated this the 15th day of July, 2025

O R D E R

Mohammed Nias C.P., J

The substantial question of law referred to the Full Bench is whether a purchasing dealer, who has otherwise complied with all statutory requirements, can legitimately be denied the benefit of input tax credit solely on the ground that the selling dealer failed to remit the tax collected.

2. W.P(C) No.6733/2019 was filed against the assessment order of the Sales Tax Officer denying ITC to the petitioner on the ground that the seller had not remitted the requisite tax as under the *Kerala Value Added Tax Act, 2003 (hereinafter referred to as "KVAT").* A learned Single judge, after considering the view of the Division Bench of this Court in **C.P. Rasheed v. State of Kerala [OT Rev. No. 104/2015, decided on 10.08.2018]**, found that the same runs contrary to the view of the Division Bench of the Delhi High Court in **On Quest Merchandising India Pvt. Ltd. v. Government of**

NCT of Delhi (W.P.(C) 6093/2017), and directed that the matter be placed before a Division Bench to consider whether the matter needs to be placed before a Full bench.

3. The registered dealers under the provisions of the KVAT Act, had approached this court by way of writ petitions challenging the denial of input tax credit on certain purchases made from registered selling dealers who, though having issued proper tax invoices and collected the tax component from the petitioner, subsequently failed to deposit the said tax amounts with the government treasury.

4. The Division Bench before whom the matters were placed noted that the bench in **C.P. Rasheed** (*Supra*) did not consider "tax paid or payable" in the definition of Input Tax Credit under S.2(xxiii). Moreover, the recovery methods available to the state under S. 31 and S.35 of the KVAT Act were also overlooked by the Bench in **C.P. Rasheed** (*Supra*). *Accordingly*, the Division Bench referred the matter to the Full Bench with the following question:

> *"Whether the credit of input tax can be availed by the purchasing dealer if the selling dealer had failed to remit the tax due at the earlier instance under the provisions of the Kerala Value Added Tax Act, 2003."*

5. The learned Senior Counsel Sri. A Kumar, R. Jaikrishna, and Sri. Joju Kynady, appearing for the petitioners, advanced arguments in support of the petitioners' claim for input tax credit. It is argued that the definition of "input tax" under Section 2(xxiii) of the KVAT Act as tax "paid or payable" by a registered dealer indicates two distinct and independent bases for credit entitlement. The deliberate use of the disjunctive "or" in this statutory definition, according to the petitioner, clearly indicates the legislative intent to recognise that credit arises either from actual payment of tax or from the legal obligation to pay tax created by a valid commercial transaction, without making such credit contingent upon the selling dealer's subsequent remittance of the tax to the government exchequer. This interpretation, the petitioner argues, finds strong support in the comprehensive scheme for input tax credit laid out in Section 11 of the Act, which meticulously outlines the conditions for availing of credit without making any reference whatsoever to the selling dealer's tax payment status.

6. The petitioner further emphasizes that the limited and specific grounds for denial of input tax credit enumerated in Section 11(5)(m) relate exclusively to issues of documentary compliance - particularly the absence of valid tax invoices or evidence of fraudulent issuance of such invoices -

rather than to any subsequent actions or inactions on the part of the selling dealer concerning tax remittance. The petitioner's case is that denying input tax credit to compliant purchasing dealers due to selling dealers' subsequent defaults would subvert the VAT system's objective of preventing cascading taxation. Such denial would effectively impose double taxation by making purchasers bear tax burdens already paid to defaulting sellers, contrary to the basic principles of value-added taxation, while placing an unreasonable compliance burden on dealers. Practically, it would require purchasers to continuously monitor suppliers' tax remittances - an impossible obligation that disrupts normal commercial practices and contradicts the Act's careful allocation of responsibilities between dealers and revenue authorities.

7. The petitioner strongly relies on the decision in ***On Quest Merchandising (Supra),*** which held that bona fide purchasers with valid invoices should not be penalised for sellers' defaults, as the revenue department's proper remedy lies in pursuing recovery against defaulters rather than denying legitimate credits to compliant dealers. Heavy reliance is placed on the judgment of the Delhi High Court in ***Arise India Ltd. v. Commissioner of Trade and Taxes*** [TS-314-HC-2017-Del-VAT], which

interpreted Section 9(2)(g) of the DVAT Act and held that the Department would be precluded from denying ITC to a purchasing dealer who has bona fide entered into a purchase transaction with a registered selling dealer and has produced a tax invoice reflecting the TIN number. The Court further held that the remedy of the Department is to proceed against the defaulting selling dealer to recover such tax and not to deny the purchasing dealer the input tax credit. Support is also drawn from the Madras High Court's judgment in **Sri Vinayaga Agencies v. Assistant Commissioner (CT) [2013 (60) VST 283]**, which found that the buyer cannot be mulcted with the tax liability on the ground that the seller had not paid the tax to the Government. Once it is established that the seller is a registered dealer and the buyer has paid the amount as reflected in the invoice, it is for the Department to proceed against the seller.

8. It is also contended that **C.P. Rasheed** (supra) inadvertently creates an arbitrary and unjustified classification among purchasers: one category being bona fide purchasers who have paid tax based on valid invoices issued by registered dealers, and another consisting of fraudulent purchasers who collude with sellers to falsely claim credit, despite the availability of statutory mechanisms under Sections 25 and 67(1)(e) to

detect and penalise fraudulent transactions. The petitioners submit that permitting the State to deny ITC despite the dealer having paid tax to the seller results in unjust enrichment and a double recovery of tax, once from the purchaser and again from the seller, without offering the purchaser either credit or refund. Such an outcome, it is urged, is neither equitable nor within the contemplation of a value-added tax framework.

9. The State, represented by the learned Special Government Pleader (Taxes), Sri. Mohammed Rafiq based his arguments primarily on considerations of revenue protection and fiscal responsibility. The respondent's primary contention is that input tax credit constitutes a statutory concession granted by the legislature rather than an absolute or indefeasible right and that such credit can only be legitimately granted when the corresponding tax amount has actually been received into the government treasury. The respondent argues that allowing input tax credit without actual tax remittance would create what they characterise as a "vacuum" or shortfall in revenue collection, which the KVAT Act cannot reasonably be interpreted as permitting or countenancing. The respondent further emphasises that the provisions of Section 6 regarding output tax liability create an independent obligation on purchasing dealers that cannot

be discharged or offset by credits for tax amounts that were never actually received by the government. They maintain that the system of matching returns between purchasing and selling dealers serves as a vital safeguard against potential revenue leakage and that the absence of such matching due to selling dealers' defaults provides legitimate and sufficient grounds for denial of input tax credit.

10. The respondent seeks to distinguish the Delhi High Court's decision in ***On Quest Merchandising*** *(Supra)* as pertaining to a different statutory regime under the Delhi VAT Act, arguing that Kerala's unique revenue realities, administrative challenges, and fiscal requirements justify and necessitate adopting a stricter and more circumspect approach to input tax credit availability.

11. Heard the arguments advanced by learned counsel for both sides, perused the records and examined the statutory scheme.

12. The relevant provisions in the KVAT are extracted hereunder:

> "***Section 2 (xxiii):*** "*Input Tax*" *means the tax paid or payable under this Act by a registered dealer to another registered dealer onthe purchase of goods in the course of business and includes the tax paid on the purchase of materials for the research and development in relation to any goods.*

> ***Section 6:*** *Levy of tax on sale or purchase of goods.- (1) Every dealer whose total turnover for a year is not less than ten lakhs rupees and every importer or casual trader or agent of a non-resident dealer, or dealer in jewellery of gold, silver and platinum group metals or silver articles or contractor or any State Government, Central Government or Government of any Union Territory or any department thereof or any local authority or any autonomous body whatever be his total turnover for the year, shall be liable to pay tax on his sales or purchases of goods as provided in this Act. The liability to pay tax shall be on the taxable turnover, -*
>
> ***Section 11(1):*** *Input Tax Credit : - (1) Subject to the other provisions of this section, any registered dealer, liable to tax under sub- section (1) of section 6, shall be eligible for input tax credit.*
>
> ***Section 11(5)m:*** *No input tax credit shall be allowed for the purchases of goods where tax invoice in the prescribed form is not available with the dealer or there is evidence that the same has not been issued by the selling dealer;*
>
> ***Section 11(9):*** *Any dealer who claims input tax credit under this section in respect of any purchase shall keep the original tax invoice for such purchase (duly filled in and signed and issued by the selling dealer) wherein the input tax has been separately charged, and produce for verification as and when required by any authority empowered under this Act."*

13. Section 2(xxiii) of the KVAT Act provides the foundational definition of "input tax" as tax "paid or payable" by a registered dealer on

purchases made in the course of business. This definition assumes particular significance in the present context as it employs the disjunctive "or," thereby creating two alternative and independent bases for credit entitlement, clarifying that ITC arises from either the actual payment of tax or the legal obligation to pay, irrespective of whether the seller later remits the tax to the government. Section 6 of the Act establishes the liability for payment of tax on taxable turnover, while Section 11(1) grants ITC eligibility to registered dealers liable to tax under Section 6. Section 11(5)(m) specifies that denial of ITC is limited to cases where the purchaser lacks proper documentation, such as a valid tax invoice, or where there is evidence that such invoice was not properly issued by the selling dealer. Section 11(9) imposes the obligation on dealers to retain original tax invoices, but notably does not cast an impossible task upon them to verify or ensure the selling dealers' tax remittances.

14. The comprehensive credit mechanism established in Section 11 contains no requirement, either express or implied, linking credit eligibility to the selling dealer's tax remittance, with the exclusive and exhaustive grounds for denial being confined solely to the purchasing dealer's documentary compliance rather than to the selling dealer's subsequent

actions or omissions. Thus, a reading of the provisions in the Kerala Value Added Tax Act, 2003, justifies the conclusion that input tax credit (ITC) should be available to purchasing dealers even if the selling dealer fails to remit the tax.

15. The legislative intent is clear that the VAT system is designed to avoid cascading taxation by ensuring uninterrupted credit flow, with enforcement mechanisms under Sections 31 and 35, providing the revenue department with comprehensive and effective tools for recovering taxes from defaulting dealers, thereby creating a complete and self-contained system for addressing seller non-compliance without penalising compliant purchasing dealers. This interpretation, we feel gives full effect to the statutory language while maintaining the integrity of the VAT system, protects bona fide commercial transactions without compromising the government's enforcement powers, avoids the economic distortions caused by cascading taxation, and promotes the much-needed certainty and predictability in commercial dealings that are essential for a healthy business environment. Our view is reinforced by the Delhi High Court's decision in ***On Quest Merchandising*** (Supra), which held that bona fide purchasers with valid invoices cannot be denied ITC due to seller defaults.

We note that the Special leave petition filed against the same was dismissed.

16. The contention on behalf of the government that ITC is contingent on the seller's actual tax remittance is unacceptable for multiple reasons. In interpreting the phrase "paid or payable" in Section 2(xxiii), the respondent argues for a construction that requires actual payment into the treasury as a precondition for credit availability, rather than recognising mere transactional liability or obligation to pay. This interpretation, however, renders the word "payable" redundant and fails to give effect to the plain language of the statute. This distinction is unpersuasive as the relevant provisions of the KVAT Act are materially similar to those considered in the Delhi case. It also introduces an extra-statutory condition not found in the KVAT Act. Denying ITC results in unjust enrichment for the State, as it effectively collects tax twice, once from the purchaser (through disallowed credit) and again from the seller (via recovery proceedings). It also imposes an impractical burden on purchasers to monitor their sellers' tax compliance, which is neither legally required nor feasible in normal business operations. The government's stance contradicts the fundamental principles of VAT, which aim to tax only value addition and prevent

economic distortions caused by double taxation. The contentions of the respondents overlook the fundamental nature of input tax credit as an integral component of the VAT system's architecture rather than a mere privilege.

17. Profitable reference can be made to the decision of the Hon'ble Supreme Court in **Corporation Bank v. Saraswati Abharanasala [(2009) 19 VST 84 (SC)],** which reads as follows:

> "*25. The statute should be considered in such a manner so as to hold that it serves to seek a reasonable result. The statute would not be considered in such a manner so as to encourage defaulters and discourage those who abide by the law.*
> *26. The statute furthermore, it is trite, should be read in the manner so as to do justice to the parties. If it is to be held, without there being any statutory provision that those who have deposited the amount in time would be put to a disadvantageous position and those who were defaulters would be better placed, the same would give rise to an absurdity. Construction of the statute which leads to confusion must be avoided.*"

18. The decision in **C.P. Rasheed** (supra) cannot be sustained as it ignored the statutory definition of "input tax", which speaks of "paid or payable," erroneously linking ITC eligibility to the seller's remittance. The

judgment also failed to consider the enforcement mechanisms available under Sections 31 and 35 of the KVAT Act, which allow the State to recover unpaid taxes directly from defaulting sellers. Additionally, **C.P. Rasheed** (supra) conflicts with the Delhi High Court's more reasoned approach in On Quest Merchandising, which recognised that penalising purchasers for sellers' defaults violates principles of equity and commercial fairness. Accepting the view taken in **C.P. Rasheed** (supra) would have several negative consequences. First, it would lead to cascading taxation, as purchasers would effectively pay tax twice, once to the seller and again through disallowed ITC, defeating the purpose of the VAT system. Second, it would disrupt normal business operations by forcing purchasers to verify sellers' tax compliance, an unreasonable and unworkable requirement. Third, it would unfairly burden bona fide purchasers who have complied with all statutory requirements, such as retaining valid tax invoices, while letting defaulting sellers escape scrutiny. Finally, it would encourage the State to prioritise recovering taxes from compliant purchasers rather than pursuing defaulting sellers, undermining enforcement accountability in tax administration, besides being against the object of the Credit Scheme under the KVAT Act, where a seamless and smooth availment of credit by a

purchasing dealer is contemplated.

19. **C.P. Rasheed** (supra) also creates two sub-classes: one being bona fide purchasers who have remitted tax based on valid invoices, and another comprising fraudulent purchasers colluding with sellers to falsely claim input tax credit and cause loss to the revenue. The purchasers who are identically situated are treated differently only on an arbitrary basis, i.e. on the basis of whether the seller has remitted the tax or not. Yet, under **C.P.Rasheed** (supra), even a bona fide purchaser, who has paid tax against genuine transactions, is denied input tax credit merely because the seller has defaulted in payment, which violates Article 14 of the Constitution. Despite both purchasers having complied with statutory obligations, only the latter is denied credit. Such a distinction is not based on any rational or intelligible differentia and imposes an impossible burden on purchasers to monitor the compliance behaviour of their sellers.

20. In light of the foregoing analysis and after careful consideration of all aspects of the matter, we answer the reference as under:

i. The input tax credit can be legitimately availed by the purchasing dealer under the Kerala Value Added Tax Act, 2003, even in cases where the selling dealer failed to remit the tax due to the government, provided that the

purchasing dealer has strictly complied with all statutory requirements including possession of genuine tax invoices as required under the statute.

ii. The responsibility for recovering unpaid tax lies properly and primarily with the tax authorities, who must proceed against the defaulting seller, rather than against the innocent purchasing dealer who has fulfilled all obligations imposed by the Act.

iii. Given the above, we hold that the view expressed in **C.P. Rasheed** (supra) is incorrect and, resultantly, overrule the said judgment.

The Reference is answered as above.

Sd/-
DEVAN RAMACHANDRAN
JUDGE

Sd/-
GOPINATH P.
JUDGE

Sd/-
MOHAMMED NIAS C.P.
JUDGE

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