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THE BHANDARI SCRAP JUDGMENT: A CONSTITUTIONAL VICTORY, BUT A COMPLIANCE CONUNDRUM

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The Supreme Court's decision in ***Bhandari Scrap Traders v. Union of India SLP(C) No. 23931/2026*** marks a significant development in the jurisprudence surrounding Input Tax Credit ("**ITC**") under the Goods & Service Tax ("**GST**") regime. By upholding the **constitutional validity of Section 16(2)(c)** of the Central Goods and Services Tax Act, 2017 ("**CGST Act**"), the Court has reaffirmed that entitlement to ITC is subject to the statutory condition that the tax charged in respect of the supply has actually been paid to the Government.

While the judgment conclusively addresses the constitutional challenge to Section 16(2)(c), it simultaneously brings into sharp focus a significant practical concern, the vulnerability of a *bona fide* recipient to the compliance failures of its supplier, on whom such an assessee has no control whatsoever. Thus, although the provision has survived constitutional scrutiny, the practical implications of its enforcement continue to raise important questions regarding fairness, compliance and the allocation of risk under the GST framework. In our view, an innocent recipient ought not to be made to suffer for the supplier's non-payment of GST to the Government, even after having paid the supplier the full invoice value, including GST. It is the defaulting supplier who should be proceeded against for recovery and prosecuted where fraud is established rather than foisting the loss onto the recipient of such supplies.

The Core Tension: Statutory Validity versus Practical Hardship

The difficulty arises in cases involving a genuine recipient who has received the goods or services, paid the consideration along with the applicable GST, obtained a valid tax invoice, and complied with all statutory obligations that are within its knowledge and control. Despite this, such a recipient may be denied ITC solely because the supplier has failed to discharge the corresponding tax liability to the Government.

This effectively places the consequences of the supplier's default on the recipient, even where the recipient may have had no practical means of verifying whether the supplier ultimately discharged its tax liability. While such an outcome may follow from the express language of Section 16(2)(c), it creates a genuine hardship for an innocent purchaser who has acted in good faith and has otherwise complied with the requirements of the law.

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The Gujarat High Court, whose decision was affirmed by the Supreme Court, had itself recognised the difficulties faced by *bona fide* purchasers and observed that the issue may require legislative intervention through more robust and technology-driven compliance mechanisms. The Supreme Court, while agreeing with the High Court's conclusion that there was no basis to declare the provision unconstitutional or to read it down, has effectively left the resolution of these practical concerns to the legislature and the tax administration.

Divergent Judicial Approaches and the Resulting Uncertainty

The *Bhandari Scrap* decision must also be viewed against the backdrop of judicial decisions that have sought to protect genuine purchasers from the consequences of a supplier's default. In certain cases, High Courts have adopted a more equitable approach, holding that ITC should not be denied to a purchaser who has entered into a genuine transaction with a registered supplier and has acted *bona fide*, particularly in the absence of fraud, collusion or any allegation that the transaction itself is fictitious.

For instance, the Tripura High Court in ***Sahil Enterprises v. Union of India M/s Sahil Enterprises v. Union of India, WP(C) No. 688 of 2022*** adopted an approach that sought to protect *bona fide* purchasing dealers and distinguished cases involving genuine transactions from those involving fraud or collusion. Similarly, the Karnataka High Court has, in appropriate cases, recognised the importance of examining the genuineness of the recipient's transaction and the recipient's conduct before fastening the consequences of the supplier's default upon the purchaser.

These decisions reflect an underlying judicial concern that a statutory condition should not operate in a manner that requires a taxpayer to perform something beyond its practical ability or control. Earlier decisions, including ***Commissioner, Trade & Taxes v. Shanti Kiran India Pvt. Ltd. and On Quest Merchandising 2025-TIOL-77-SC-VAT***, have similarly emphasised the need to protect genuine purchasers where transactions are bona fide and there is no allegation of collusion or fraud.

The *Bhandari Scrap* decision, however, gives authoritative weight to the validity of the statutory condition itself. The precise manner in which earlier equitable principles will operate alongside the strict requirement of Section 16(2)(c), particularly in fact-specific cases involving genuine recipients, may therefore continue to be tested in future litigation.

Reshaping Compliance: The Unanswered Questions

The decision is likely to have significant implications for the manner in which businesses approach GST compliance and vendor management. Several issues may continue to arise in future disputes.

First, the question of recovery from the supplier remains important. Should the tax authorities be required, as a matter of fairness, to first take reasonable steps to recover the tax from the defaulting supplier before proceeding against a genuine recipient? Section 16(2)(c), as upheld in *Bhandari Scrap*, does not expressly impose such a requirement. Nevertheless, this issue may continue to arise in cases where the supplier is identifiable, operational and capable of being proceeded against.

Secondly, cases involving retrospective cancellation of registration and fraudulent suppliers require careful consideration. Where a supplier was registered at the time of the transaction and the recipient has

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acted on the basis of valid documentation, the subsequent cancellation of the supplier's registration should not, by itself, automatically establish that the recipient was complicit in any wrongdoing. The principles reflected in decisions such as *Shanti Kiran* may continue to be relevant in determining whether the transaction was genuine and whether the recipient had acted *bona fide*.

Thirdly, it bears emphasis that a supplier who collects tax as part of the consideration charged to a recipient, and then deliberately withholds that amount from the Government, is not merely in civil default, such conduct amounts to the appropriation of what is, in substance, public money collected on the State's behalf. Section 132(1)(d) of the CGST Act itself makes it a specific criminal offence to collect tax and fail to remit it to the Government beyond three months, attracting imprisonment and, at higher thresholds, cognizable and non-bailable status. The concern is not new to GST either: Section 11D of the Central Excise Act, 1944 similarly obliged a person who had collected any amount representing excise duty to deposit it with the Central Government, and Section 89(1)(d) of the Finance Act, 1994 made the non-deposit of collected service tax a distinct criminal offence. The legislature has therefore already recognised, across successive indirect tax regimes, that such conduct warrants independent penal consequence in the hands of the defaulting supplier. The more pointed question raised by Bhandari Scrap is why this existing machinery is so rarely invoked against the defaulting supplier in practice, while the bona fide recipient bears the consequence through denial of ITC. A robust and consistent recourse to Section 132(1)(d) against errant suppliers, rather than reliance on the recipient to absorb the loss, may go some way toward restoring the balance this judgment leaves unresolved.

Finally, the judgment highlights the need for meaningful safeguards for genuine taxpayers. If the availability of ITC depends upon the supplier's actual payment of tax, the compliance framework should ideally provide the recipient with a reliable and timely mechanism to verify the fulfilment of that condition. Without such visibility, the recipient is exposed to a risk that may be impossible to fully mitigate through ordinary commercial diligence.

The Need for a Balanced Approach

The *Bhandari Scrap* judgment undoubtedly reinforces the legislative framework embodied in Section 16(2)(c) of the CGST Act. However, constitutional validity and practical fairness are not necessarily the same question. The fact that Parliament is constitutionally entitled to make ITC conditional upon payment of tax by the supplier does not eliminate the commercial hardship that may arise when a genuine recipient loses credit because of another person's default.

A balanced framework must therefore seek to protect revenue without unduly prejudicing *bona fide* businesses. This could be achieved through stronger technological safeguards, greater transparency regarding supplier compliance, targeted enforcement against defaulting suppliers, or a statutory mechanism that protects recipients who can demonstrate that they have acted diligently and without collusion.

Conclusion

The *Bhandari Scrap* judgment settles an important constitutional question in favour of the validity of Section 16(2)(c), but it does not bring an end to the broader debate surrounding the protection of *bona fide* purchasers

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under the GST regime. The decision confirms the legal validity of making ITC dependent upon the supplier's payment of tax, however, it also exposes the practical difficulty of imposing the consequences of a supplier's non-compliance upon a recipient who may have done everything reasonably expected of it.

The manner in which future courts address cases involving genuine transactions, retrospective cancellation of registration, fraudulent suppliers and the availability of remedies against defaulting suppliers will therefore remain significant. Ultimately, the long-term solution may need to come from legislative or administrative reform that reconciles the legitimate objective of revenue protection with the equally important need to provide certainty and fairness to genuine taxpayers.

Until such safeguards are introduced, businesses will need to adopt increasingly rigorous vendor due diligence and compliance monitoring mechanisms, as their entitlement to ITC may remain vulnerable to the compliance failures of their supplier, a position that may be legally sustainable under the present framework, but remains commercially challenging in practice.

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