Newsletter

Sharp View

April 2023

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APRIL 2023

April marks the beginning of summer in India and the temperatures begin to rise initially for the southern and western states. It marks the end of spring and the best time to watch the trees blooming with fruits and flowers. India has a rich geographical and climate diversity for growing fruits, vegetables, flowers and other horticultural plants and April is an ideal month for many of them.

Indian horticulture industry holds huge potential and the government has taken various measures to boost the horticulture sector (being an allied sector of agriculture.)

Measures taken by the Indian government to promote Indian horticulture:

- Atmanirbhar Clean Plant Program to boost the availability of disease-free, quality planting material for high-value horticultural crops at an outlay of INR 2,200 crore.
- The Ministry of Agriculture and Farmers Welfare, Government of India, has launched the Cluster Development Programme (CDP), to enable holistic growth and development of identified horticulture clusters to make them globally competitive and entrench them into national and global value chains.
- Provision of INR 459 crore to make natural farming a mass movement.
- Centres of excellence (CoEs) are set up and the CoEs undertake training in the latest technologies in the field of horticulture. The CoEs also serve as a source of planting material for fruits and vegetable seedlings for protected cultivation and the transfer of technology and know-how in diverse areas like post-harvest management, irrigation, plant protection, etc.

Things to watch out for in FY 2023-24

Recently, there was an amendment to the Finance bill outside the budget proposals relating to the taxability of long term capital gains arising out of the sale of market-linked debentures. Accordingly from assessment year (AY) 2024-25 (i.e. sale/transfers done from 1-4-2023), the gains on the transfer/sale of:

- market-linked debentures (including those classified or regulated by SEBI as market-linked debentures)
- any security which has an underlying principal component in the form of debt security and its returns are linked to the market returns on other underlying securities or indices (i.e. units of a debt-oriented fund) will become taxable as short term capital gains (STCG) attracting tax at the slab rates/prevailing rates and
- there will be no indexation benefit on STCG resulting in an increase in the effective tax rate for the assessees.

Impact

Due to this amendment, the units of debt-oriented mutual funds and similar instruments may become less attractive in the long run and investors may now shift to conventional investment options like fixed deposits, time deposits, etc. To make their FDs more attractive, banks have already started offering higher interest rates in the new financial year. We may also witness more investments in corporate bonds/debentures shortly.

Assurance

Overview of housing finance sector in India

NBFCs including HFCs have proven to be parallel funding options to banks in respect of financial services to the crucial economic sectors. Post pandemic, the sector has strongly rebounded as evidenced by many positive indicators. Mr. Arjun M.K., Rathna Kiran Potnuru (Bengaluru office) and Ms. Aarti Joshi (Vadodara office) take an overview of the HFC sector explaining its legal framework, accounting and auditing aspects and the way the auditors overcome the challenges associated with the reporting function.

Assurance

Overview of housing finance sector in India

Over the years, the Non-Banking Financial Companies (NBFCs) and Housing Finance Companies (HFCs) sectors in India have evolved in terms of size, operations, and technological sophistication with entry into new areas of financial services and products. NBFCs and HFCs have proven to be a parallel funding option to banks in respect of financial services to the crucial economic sectors. Several NBFCs and HFCs have also successfully adopted digital modes to support their financial products and services to a wide spectrum of customers. Today NBFCs and HFCs are the largest net borrowers of funds from the financial system and have become systemically important to the country's financial system. This article focuses on housing finance sector though many of the aspects covered here are relevant and applicable to NBFCs in general.

NBFC

9600+
Total NBFCs spread across products, customer segments, and geographies

Having assets worth more than
INR 54 trillion

25%
Equivalent to about the asset size of banking sector

Source – RBI data (As on 31 March 2021)

HFC

Assets under management (AUM) more than
INR 15 trillion

HDFC & LIC dominated the housing finance sector in India with a market share of **60%** coverage of an AUM of **INR 9 trillion**

The year 2022 had seen the housing finance companies scaling up their performance with a significant rise in their AUM and consolidation of entities.

Source – NHB data (As on 31 March 2022)

Last few years

The Covid years were disturbing for banking, NBFC and HFC sector, due to the decline in the demand in real estate sector, negative trends in India's GDP, loss of jobs, shortfall in the take-away income of various economic groups and inability to repay loans increasing the value of the non-performing assets.

However, the sector started recovering from the year 2022, after removal of COVID restrictions and opening up of physical access to the banks and their branches. Most of the HFCs showcased growth in their AUM and business due to growth in affordable housing segment and the appreciable nature of the collateral, i.e., real estate / house property.

Post pandemic, the shift from 'work-from-office' to work-from-anywhere' model also made it viable especially for the first-time home buyers to purchase or construct houses in tier II and tier III cities.

Assurance

Overview of housing finance sector in India

> *The Covid-19 crisis significantly impacted the residential real estate market. Health concerns and stay-at-home orders led to fewer buyers looking for homes during the initial phase of the pandemic in April-June, 2020. Subsequently, India's real estate industry gained momentum from September 2020 onwards and peaked in the quarter ending in March 2021. The second wave of the pandemic affected the real estate sector yet again when home buyers delayed purchases due to mounting uncertainty and restricted movement. However, timely policy intervention by the government coupled with low home loan interest rates propped up demand and attracted buyers more readily in the affordable segment in FY23. The overall increase in composite HPI assessment and HPI market prices indicates a revival in the housing finance sector. A stable to moderate increase in HPI also offers confidence to homeowners and home loan financiers in terms of the retained value of the asset.*

Source – Economic survey 2022-23 on housing finance sector

Budget 2023 highlights the following points that prove the strong rebound of NBFC sector:

- The capital position of NBFCs remained robust, with CRAR of 27.4% as at end-September 2022.
- The gross non-performing assets (GNPA) ratio of NBFCs eased from the peak of 7.2 % recorded during the second wave of pandemic to reach 5.9 % in September 2022, close to the pre-pandemic level.
- Cleaner balance sheets led to enhanced lending by financial institutions. Credit disbursed by NBFCs has also been on the rise.
- With improved and healthier balance sheets of the banking, non-banking and corporate sectors, a fresh credit cycle has begun, evident from the double-digit growth in bank credit over the past months.
- An overall increase in composite Housing Price Indices (HPI) assessment and HPI market prices indicates a revival in the housing finance sector. A stable to moderate increase in HPI also offers confidence to homeowners and home loan financiers in terms of the retained value of the asset.

Assurance

Overview of housing finance sector in India

Legal framework and recent regulatory changes

RBI has been adding and standardising the norms covering HFCs according to their risk, size and exposures to bring them at par with banks.

1. **Co-regulated by RBI and NHB:** Presently, the HFC sector is regulated by the National Housing Bank (NHB) and the Reserve Bank of India (RBI). Therefore, HFCs are required to comply with both NHB and RBI directives, as applicable.

2. **Scale based regulations:** Over the past couple of years, RBI has introduced certain regulations for NBFCs similar to banks in a phased manner. The scale based regulations classify NBFCs into 4 layers, based on their size, activity and perceived risks. In a recent RBI study (September 2022), wherein 16 upper layer NBFCs were identified, the year-on-year credit growth rate was recorded at 17.2% with a better GNPA ratio of 4.2%.

3. **RBI clarifications on IRACP norms:** The RBI had issued a circular dated 12 November 2021 clarifying on aspects such as standardisation of asset classification under days past due (DPD) approach, process change to identify NPAs on a day-end basis and upgradation of accounts classified as NPAs to standard assets upon full collection. These clarifications resulted in identification of more NPAs and increase in overall provision for expected credit loss in certain cases.

4. **RBI mandated IS audit** where the scope shall include IT general controls, user access management, IT infrastructure controls review, application security review, vulnerability assessment and penetration testing.

5. RBI also introduced restrictions on loans and advances, limits of taking exposures, and additional disclosures in financial statements from the financial year 2022-23.

Overview of housing finance sector in India

Industry specific accounting and auditing aspects:

1.1 Impairment of financial assets

Indian GAAP read with NHB/RBI guidelines provided for impairment of financial assets based on incurred loss approach. This approach required lesser management judgements and estimates, and placed more reliance on historical data. On the other hand, Ind AS follows expected loss approach which covers the incurred loss, plus expected losses due to defaults and delays in the cashflows.

The provisioning under expected credit loss method involves significant judgments and estimates by the management such as:

- Model for determining the probability of default (PD).
- Criteria for assessing if there has been a significant increase in credit risk.
- Development of ECL models, including the various formulae and the choice of inputs.
- Determination of associations between macroeconomic scenarios and, economic inputs, and the effect on PD, exposure at default (EAD) and loss given default (LGD).
- Selection of forward-looking macroeconomic scenarios and their probability weightings, to derive the economic inputs into the ECL models.

Considering the implications of such judgement and estimates on the financial reporting, the impairment of financial assets is generally identified as a risk of material misstatement and a key audit matter in the audit of financial statements.

1.2 IT systems and controls

NBFCs including HFCs rely heavily on IT systems for various aspects ranging from day-to-day operations to financial reporting. Such aspects include

Capturing of the data: These include capturing customers' data, processing, sanction, disbursements and collection of loans.

Processing of information: These include interest computation on loans, calculation of DPD, daily NPA identification etc.

Report generation: Generation of appropriate reports used for external and regulatory reporting.

The auditor of such HFCs is required to design and perform the audit procedures of such IT systems which may include

- Obtaining an understanding of the company's IT-related control environments including amendments/ changes to such systems i.e., IT applications, databases, and operating systems that are relevant to the audit.
- Testing IT general controls and IT application controls including program development, access requests to systems, and controls around the periodic review of access rights.
- Testing the design and operating effectiveness of the significant accounts-related automated controls such as computation of interest income, DPD, NPA identification, and consistency of data transmission between applications.
- Testing the logic of system-generated reports relevant to the audit mainly the loan registers, interest income reports etc. for evaluating completeness and accuracy.

Assurance

Overview of housing finance sector in India

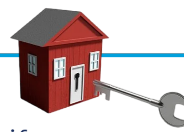
Auditors generally consider this as a key audit matter because of the reliance of key financial accounting and reporting processes on the IT systems, pervasive nature and complexity of the IT environment and possibility of gaps in the IT control environment which may result in misstatement in the financial accounting and reporting records

1.3 Risk factors in relation to fake/non-existent borrowers:

The risk of creation of fake/non-existent borrowers and lending money to them through virtual branches needs to be adequately mitigated, which may otherwise lead to money-laundering transactions. Similarly, the risk of inappropriate reporting due to evergreening of loans needs to be assessed including the reasoning for further lending to the same borrowers.

1.4 Other aspects

There are other aspects that could be relevant in the financial reporting and the audit of financial statements of HFCs such as:



- Securitization of loan receivables
- Direct assignment of loan and recognition of servicing asset/liability and excess interest spread, if any
- Transfer to impairment reserve where Ind AS impairment allowance is lower than IRACP provisioning
- Recognition of income on non-performing assets
- Identification and accounting for transaction costs incurred / processing fees paid / collected as period cost / income or its adjustment under effective interest rate method
- Accounting for gain / loss on modification of loans and derecognition of loans
- Expected credit loss accounting and disclosure for undrawn loan commitments
- Evaluation of business model and fair valuation of assets held for sale
- Maintaining crucial ratios such as capital-to-risk weighted assets ratio, Tier I CRAR, Tier II CRAR, liquidity coverage ratio and principal business criteria for HFCs
- Creation of statutory reserve under NHB Act and transfer to special reserve under Income Tax Act.
- Physical visit of at least the top 20 branches / top 20% of the branches and conducting house property visits and collateral inspections. Discussions with the branch management to develop preliminary understanding of the internal controls at the branch level
- Usage of data analytics and machine learning in maintaining robust internal financial control systems.

Concluding notes

NBFCs including HFCs have proven to be a parallel funding option to banks in respect of financial services to the crucial economic sectors. The largest quantum of credit from NBFC's balance sheets go to the industrial sector, followed by retail, services, and agriculture. Several NBFCs including HFCs have also successfully adopted digital modes to support their financial products and services to a wide spectrum of customers. Adoption of digital technology and India's galloping pace of fintech adaption makes the sector more accountable and robust.

GRC

Beneficial interest: Overview of sections 89 and 90 of the Companies Act, 2013

Sections 89 and 90 of the Companies Act, 2013 deal with the provisions of beneficial interest in a company. The beneficial owners and registered owners are required to make the necessary declarations to the company. Similarly, the company is obliged to maintain a register of beneficial interest and declarations. Ms. Abhilasha Rai (Vadodara office) explains in detail the compliance requirements under these sections.

Beneficial interest: Overview of sections 89 and 90 of the Companies Act, 2013

A beneficial interest refers to the entitlement to receive advantages from assets, property, or securities that are owned by someone else. This term is typically associated with trusts, which involve an author who establishes the trust, a trustee who holds the trust assets, and a beneficiary for whom the trust is created. In a trust, the beneficiary does not directly own the property but has the right to receive all the benefits arising from it, as specified in the trust deed.

The Companies Act, 2013 ('the Act') and its associated rules also acknowledge beneficial interest in relation to shares, where a person's name is listed in the register of members, but they do not actually own the shares. Sections 89 and 90 of the Act provide for the identification, recognition, and registration of these beneficial interests and their holders.

Definitions [Rule-2 of Companies (Significant Beneficial Owners) Rules, 2018]

A beneficial interest in a share refers to the right or entitlement of a person, either alone or together with others, to exercise any or all of the rights attached to the share, or to receive any dividend or other distribution related to that share, directly or indirectly through a contract or arrangement. A reporting company is a company incorporated under the Act or any previous company law that must comply with the requirements of section 90 of the Act.

A significant beneficial owner, in relation to a reporting company, refers to an individual who possesses any of the following rights or entitlements in that company, either alone or through one or more persons or trusts:

- Holds an indirect/any other form of holdings not less than 10% of the company's shares.
- Holds an indirect/any direct form of holdings not less than 10% of the company's voting rights.
- Has the right to receive a dividend or participate in other distributions in a financial year ('FY') not less than 10% of the total dividend or distribution.
- Has the right to exercise significant influence or control over the company in any way other than through direct holdings.

1. **Direct entitlement/rights (of an individual) in the reporting company:**
   - The shares must be held in the name of the individual.
   - The individual must hold and acquire a beneficial interest in the reporting company and make a declaration to that effect.

2. **Indirect entitlement/rights (of an individual) in the reporting company:**
   - The individual holds majority stake in a member of the reporting entity.
   - The individual holds a majority stake in the ultimate holding company of the said member (whether incorporated or registered in India or abroad).
   - Hindu Undivided Family ('HUF') through its Karta is a member of the reporting company.
   - A partnership entity, either through itself or a partner (being an individual), holds a majority stake in the body corporate which is a partner of the partnership entity or holds a majority stake in the ultimate holding company of the body corporate which is a partner of the partnership entity.
   - A Trust, where the individual is a trustee in the case of a discretionary or charitable trust, a beneficiary in the case of a specific trust, or the author or settler in the case of a revocable trust.
   - A pooled investment vehicle or an entity controlled by the pooled investment vehicle

based in a member state of the Financial Action Task Force on Money Laundering, and the regulator of the securities market in such member state is a member of the International Organization of Securities Commissions. The individual, in relation to the pooled investment vehicle, is a general partner, an investment manager, or a Chief Executive Officer where the investment manager of such pooled vehicle is a body corporate or a partnership entity.

Declaration under section 89

By registered owner – Where the name of a person is entered in the register of members as the holder of shares in that company but who does not hold the beneficial interest in such shares, such person shall file with the company a declaration in form MGT-4 within 30 days from the date on which his name entered into the registered of members. Where any change occurs in the beneficial interest in such shares, the registered owner shall file a declaration in form MGT-4 within 30 days from the date of such change.

Declaration by a beneficial owner – Every person who holds or acquires a beneficial interest in a share of a company shall make a declaration to the company in form MGT-5 within 30 days from the date of acquisition of such interest in the company's shares. In case of any change occurs in the beneficial interest the beneficial owner shall file a declaration with the company in form MGT-5 within 30 days from the date of such change.

Declaration by a company – Where any declaration under section 89 is received by the company, it shall make a note of such declaration in the register of members [MGT-1] and shall file, within 30 days from the date of receipt of declaration by it, a return in Form MGT-6 with the ROC.

Contravention and penalty

Failure by any person to make the required declarations as required above, will result into a penalty of INR 50,000 and in case of continuing failure, a further penalty of INR 200 for each day after the first day during which such failure continues, subject to a maximum of INR 5,00,000.

- No right in relation to any share shall be enforceable by him or by any person claiming through him where the required declaration is not made by the beneficial owner.
- If a company fails to file the return within the specified time, the company shall be liable to a penalty of INR 1,000 for each day during which such failure continues, subject to a maximum of INR 5,00,000. For officer in default, the penalty is INR 2,00,000.

However, a company can pay dividends to its members irrespective of the default of the members/company/individual defaulting in filing of declarations mentioned above.

Beneficial interest: Overview of sections 89 and 90 of the Companies Act, 2013

Summary of section 89 of the Act

E-Form	Purpose of Form	Time Period	By Whom	To Whom
Form MGT-4	Declaration of ownership	Within 30 days	Registered owner	Company
Form MGT-4	Change of beneficial interest	Within 30 days	Registered owner	Company
Form MGT-5	Declaration of ownership	Within 30 days	Beneficial owner	Company
Form MGT-5	Change of beneficial interest	Within 30 days	Beneficial owner	Company
Form MGT-6	Return of declaration provided by RO and BO by Company to ROC	After the receipt of declaration form RO and BO	Company	ROC

Register of beneficial interest and declaration under section 90

Every individual, who acting alone or together, or through one or more persons or trust, and persons resident outside India, holds beneficial interests, of not less than 25%, in shares of a company or the right to exercise significant influence or control over the company, shall make a declaration to the company in Form BEN-1 specifying the nature of his interest and other particulars, and within 30 days of acquisition of the beneficial interest or rights and any change thereof.

Every company shall take necessary steps to identify an individual who is a significant beneficial owner in relation to the company and require him to comply with the provisions of this section. Where the company receives declaration in Form BEN-1 it shall maintain a register of the interest declared by individuals and changes therein in Form BEN-2, which shall be open for inspection in working hours by payment of prescribed fees. Further, the company shall file a return of significant beneficial owners of the company and changes therein with the ROC in Form BEN-2 within 30 days from the receipt of a declaration.

Duty of company under section 90

A company shall give notice in Form BEN-2 to any person (whether or not a member of the company) whom the company knows or has reasonable cause to believe—

- to be a significant beneficial owner of the company;
- to be having knowledge of the identity of a significant beneficial owner or another person likely to have such knowledge; or
- to have been a significant beneficial owner of the company at any time during the 3 years immediately preceding the date on which the notice is issued, and who is not registered as a significant beneficial owner with the company as required under section 90.

The information required by the notice shall be given by the concerned person within a period of maximum 30 days from the date of the notice. Failure/unsatisfactory provision of such information to the company gives a right to the company to approach the Tribunal for initiating an order directing that the shares in question be subject to restrictions with regard to the transfer of interest, suspension of all rights attached to the shares and other prescribed matters.

Section 90 prescribes the procedures of the Tribunal including certain relaxations given to the defaulting persons. However, in case of further defaults under section 90, the shares in question shall be transferred, without any restrictions, to the authority constituted under sub-section (5) of section 125 to administer the Investor Education and Protection Fund.

Contravention and penalty

If any person fails to make a declaration as required, he shall be liable to a penalty of INR 50,000 and in case of continuing failure, with a further penalty of INR 1,000 for each day after the first day during which such failure continues, subject to a maximum of INR 2,00,000. If a company, required to maintain a register and file the information with the ROC or required to take necessary steps, fails to do so, or denies inspection as provided therein, the company shall be liable to a penalty of INR 1,00,000 and in case of continuing failure, with a further penalty of INR 500 for each day, after the first day during which such failure continues, subject to a maximum of INR 5,00,000 and every officer of the company who is in default shall be liable to a penalty of INR 25,000 and in case of continuing failure, with a further penalty of INR 200 for each day, after the first during which such failure continues, subject to a maximum of INR 1,00,000. If any person wilfully furnishes any false or incorrect information or suppresses any material information of which he is aware in the declaration made under this section, he shall be liable to action under section 447.

Summary of section 90 of the Companies Act,2013

E-Form	Purpose of Form	Time Period	By Whom	To Whom
Form BEN-1	Declaration by Individual	Within 30 days after the receipt of notice	Disclosure of Interest by SBO	Company
Form BEN-2	Declaration by Company	Within 30 days	Return filled by company	Registrar
Form BEN-3	Registers of SBO		Company to maintain registers of SBO	
Form BEN-4	Notice for extraction of information	Within 30 days	Company	Individuals

TAXATION

Supreme Court judgement: No ITC to the buyer without evidence of physical movement of goods

Recently, the honourable Supreme Court of India held that the onus of claiming the correct input tax rebate/credit under the earlier VAT Acts will lie on the assessee buyer. A mere claim to be a bonafide purchaser is not enough and physical movement of goods and other evidence to prove payment of tax by the seller (as required under the Karnataka VAT Act) must be proved. Mr. Shouvik Roy (Mumbai office) explains the case law as this ratio decidendi is equally important in the present GST regime.

Supreme Court judgement: No ITC to the buyer without evidence of physical movement of goods

Synopsis

The Honourable Supreme Court (SC) in the ***State of Karnataka v. M/s. Ecom Gill Coffee Trading Pvt. Ltd. [Civil Appeal No 230 of 2023 dated March 13, 2023]*** has quashed and set aside the order passed by the Honourable Karnataka High Court with the *ratio decidendi* that until and unless the purchasing dealer (buyer) fully discharges the burden of proof under section 70 of the Karnataka Value Added Tax Act, 2003 ('the KVAT Act'), and proves the genuineness of the transaction/purchase and sale by producing the relevant documents and evidences, such as:

a. name and address of the selling dealer,
b. details of the vehicle which has delivered the goods,
c. payment of freight charges,
d. acknowledgement of taking delivery of goods,
e. tax invoices and payment particulars etc.,

such buyer shall not be entitled to claim the Input Tax Credit ('ITC'). The SC then restored the order passed by the Revenue Department, which was against the assessee buyer.

Facts

- M/s. **Ecom Gill Coffee Trading Pvt Ltd**. ('the respondent') is a purchasing dealer. The respondent has purchased green coffee beans from other dealers for the purposes of further sale in exports and in the domestic market.
- The Revenue Department ('the appellant') issued a notice to the assessee buyer under section 39 of the KVAT Act upon finding irregularities in Input Tax Rebate claimed for Assessment Year ('AY') 2010-2011.
- Subsequently, upon re-assessment, it was found that the respondent had claimed ITC from 27 sellers, out of which 6 were de-registered, 3 had not filed taxes despite selling to the dealer, and 6 had denied turnover and not paid taxes.
- Consequentially ITC worth INR 10.52 lakh was disallowed by the department.
- The respondent buyer preferred an appeal, but it was rejected by the first appellate authority.
- However, the second appellate authority (Karnataka VAT Tribunal) allowed the appeal on the grounds that the respondent purchased the coffee from the registered dealer under genuine tax invoices and consequently allowed the ITC claimed vide its judgment ('the impugned judgement').
- The Honourable Karnataka High Court ('HC') also dismissed the revision application filed by the Department against the order of the appellate authority vide its order.
- Being aggrieved by the HC order and the order of the appellate authority, the Department filed this Civil Appeal to the SC.

Grounds argued by the Department

- The appellant (department) contended that the HC has materially erred in dismissing the revision application as it did not consider that the burden of proof for claiming ITC is on the purchasing dealers.
- It was argued by department that the buyers must prove the authenticity of the transactions and actual movement of goods as per section 70 of the KVAT Act.
- Further, the department contended that the respondent buyer is entitled to ITC only if it (buyer) can prove the actual payment of tax and transfer of goods as the Department cannot hunt down and recover from sellers who are not registered or have filed 'NIL' returns.

Grounds argued by the assessee buyer

The respondent buyer contended that:

- It had discharged the burden of proof cast under section 70 of the KVAT Act.
- Once the dealer has discharged the burden of proof cast under section 70 of the KVAT Act, the

purchasing dealer is entitled to the ITC and if at all it is indeed found that the tax is indeed not paid by the seller, the same can be recovered from the seller.

- Further, the assessee contended that, neither any other document nor any other obligation, is statutorily required for establishing the claim for seeking refund towards ITC are provided in the KVAT Act and Rule 27 & Rule 29 of the KVAT Rules, 2005. Hence, the department had acted beyond the KVAT Act and the KVAT Rules.

The SC Judgement, its key observations and ratio decidendi

The Honourable Supreme Court in Civil Appeal No 230 of 2023 held as under:

- SC analysed section 70 of the KVAT Act and noted that the burden of proving that the ITC is correctly claimed lies on the purchasing dealer and merely claiming to be a bona-fide purchaser is not enough to discharge this burden. The dealer must provide additional evidence and proof of the actual physical movement of goods.
- SC observed that in this case concerned purchasing dealers failed to discharge the burden cast upon them as per section 70 of the KVAT Act.
- Held that, until the purchasing dealer discharges the burden cast under section 70 of the KVAT Act and proves the genuineness of the transaction/purchase and sale by producing the relevant materials, such purchasing dealer shall not be entitled to ITC.
- Further held that, the second appellate authority and the HC have upset the concurrent findings given by the appellant as well as the first appellate authority, on irrelevant considerations that producing invoices or payments through cheques are sufficient to claim ITC which, is erroneous.
- Stated that, the reliance on Rule 27 and Rule 29 of the KVAT Rules by purchasing dealers is insufficient to prove the actual physical movement of goods, which is required to discharge the burden of proving the genuineness of transactions as per section 70 of the KVAT Act.
- Further stated that, in the absence of any cogent material like furnishing the name and address of the selling dealer, details of the vehicle which has delivered the goods, payment of freight charges, acknowledgement of taking delivery of goods, tax invoices and payment particulars etc., the department was justified in denying the ITC.
- Held that, the Tribunal as well as the High Court have materially erred in allowing the ITC despite the concerned purchasing dealers failing to prove the genuineness of the transactions and failing to discharge the burden of proof as per section 70 of the KVAT Act.
- Quashed and set aside the impugned judgment and the impugned order.
- Restored the order passed by the department.

Implications

This judgement has implications for the GST regime also, as the ITC provisions of the GST Act are largely similar to provisions of the erstwhile VAT Acts. Already, the amended sections 16(ba) (c) and (d) along with section 41 of the Central GST Act (CGST Act), have placed the entire onus on the purchasing buyer (claiming ITC), for correct tax payment by the seller on the relevant invoices. This judgement by the apex court will further strengthen the hands of the department in scrutiny and proceedings by the department on transactions of ITC. The purchasing buyers will have to maintain even greater vigil on selection of their vendors and documentation provided by the vendors as evidence of their tax payment. They will also have to ensure that the purchase contracts are robust, to allow them to recover loss of ITC caused due to defaults by the sellers/vendors.

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