L&S UPDATE

An e-update to clients from Lakshmikumaran & Sridharan

9 JULY 2022

INDIRECT TAX

Fake invoices – Applicability of demand and penalty

UPDATE NO. 34 OF 2022

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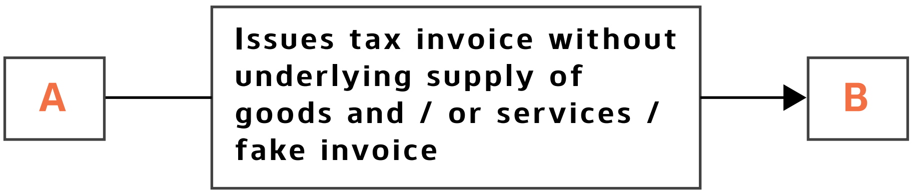
exceeding expectations
SINCE 1985

CIRCULAR NO. 171/03/2022-GST, DATED 6 JULY 2022

Clarification on issues relating to applicability of demand and penalty provisions in respect of transactions involving fake invoices

The CBIC has laid down certain principles while clarifying various issues relating to the applicability of demand and penalty under the provisions of the CGST Act in respect of transactions where tax invoices are issued without any corresponding supply of goods and/or services (**'fake invoices'**), in order to allow the recipients of the fake invoices to avail and utilise input tax credit (**'ITC'**) fraudulently, on the basis of such invoices.

Issue 1:

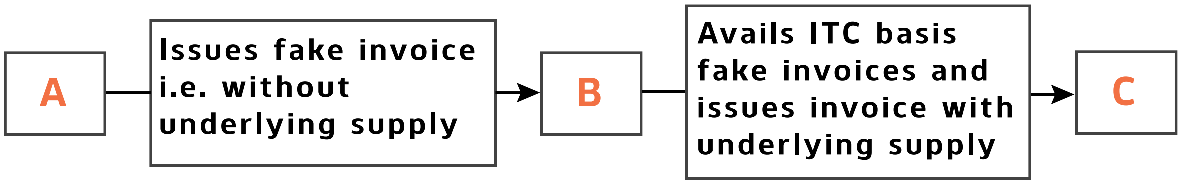


Clarification:

Implications in the hands of 'A'
Where a registered person 'A' has provided another registered person 'B' with fake invoices, there is no 'supply' in terms of Section 7 of the CGST Act, since there is no actual underlying supply of goods and/or services taking place for consideration. Thus, no tax liability arises on 'A', and they will not be subject to any demand and recovery proceedings or penal action under Section 73/74 of the CGST Act.

However, 'A' will be liable to pay penalty under Section 122(1)(ii) of the CGST Act for the issuance of tax invoices without the actual supply of goods and / or services.

Issue 2:



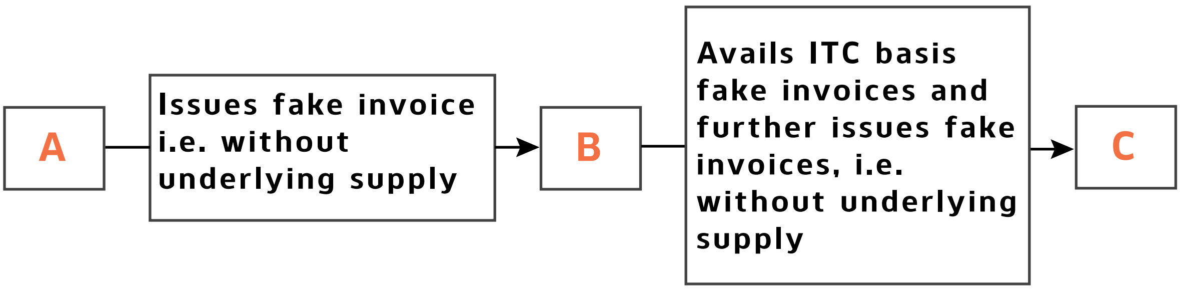
Clarification:

Demand, recovery and penal actions against 'B'

Since the registered person 'B' has availed and utilized fraudulent ITC on the basis of the said fake invoice, without receiving the goods or services or both, in contravention of the provisions of section 16(2)(b) of CGST Act, he shall be liable for the demand and recovery of the said ITC, along with penal action, under the provisions of Section 74 of the CGST Act, along with applicable interest under the provisions of Section 50 of the said Act.

Further, if penal action for the fraudulent availment and/or utilisation of ITC has been taken against B under Section 74, no penalty for the same fraudulent availment / utilisation of ITC can be imposed on B under any other provision of the CGST Act (as per Section 75(13) of the CGST Act).

Issue 3:



Clarification:

Demand, recovery and penal actions against 'B'

Where the registered person B avails the ITC in respect of the fake invoices issued by A and issues further fake invoices to C for passing on the benefit of the ITC to C, the ITC so availed by B in their electronic credit ledger will be ineligible under Section 16(2)(b) of the CGST Act. Further, applying the above principle, since there is no actual supply of goods and/or services taking place from B to C, no tax liability arises on B, and they will not be subject to any demand and recovery proceedings or penal action under Section 73/74 of the CGST Act.

However, B will be liable for penal action under Section 122(1)(ii) and 122(1)(vii) of the CGST Act for issuing invoices without any actual supply of goods and /or services, and for availing / utilising ITC without the actual receipt of goods and /or services.

The CBIC has further clarified as under:
- The actual action to be taken against a person will depend upon the specific facts and circumstances of the case which may involve complex mixture of above scenarios, or even may not be covered by any of the above scenarios.

- Also, these clarifications do not preclude the invocation of criminal proceedings under Section 132 of the CGST Act in respect of such transactions. Further, penal action will be applicable on the persons at whose instance such transactions take place, and who retain the benefits from the same under Section 122(1A) of the CGST Act.

L&S comments:

- The Circular clarifies what implications can ensue in terms of the demand and recovery proceedings and penal action for the issuer of fake invoices, and the recipient of such fake invoices.

- It appears from the Circular that in case of an issuer of fake invoices, such as 'A', the penalty can be imposed only under Section 122(1)(ii) of the CGST Act for the issuance of invoices without any actual supply of goods and / or services, and such penalty will be INR 20,000 (INR 10,000 under the CGST Act + INR 10,000 under the relevant SGST Act, or INR 20,000 in case of inter-State transactions).

- Thus, the Circular suggests that such demand and recovery provisions will be attracted in respect of the person in the chain of transaction, who fraudulently avails and utilises such ITC against the actual outward supplies by issuing tax invoices. This can be in addition to other criminal proceedings against such person.

- However, other persons involved in the above chain of facilitating fraudulent ITC can be subjected to penal action under Section 122 of the CGST Act, and / or criminal proceedings under Section 132.

- Further, a recipient of fake invoices, who avails and utilises fraudulent ITC on the basis of such invoices, and who further issues fake invoices to pass on such ITC to another person, such as B in Issue 3 discussed above, will be liable to penalty under Section 122(1)(ii) and (vii) of the CGST Act, which can extend up to the total amount of ITC availed of or passed on.

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