



A DOLTISH WAY OF TAX EVASION: LEGALITY REVOLVING AROUND ISSUE OF FAKE INVOICE FOR INPUT TAX CREDIT (ITC)

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**A DOLTISH WAY OF TAX
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TAX CREDIT (ITC)**

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Introduction

On 29th March, 2017 Parliament of India passed the Goods and Services Act, 2017 which came into effect on 1st July, 2017. GST can be said to be a single, unified taxation system on every addition of value starting from manufacturing to the sale or consumption of goods/ services. The Legacy of Excise duty, CST (Inter-State Sale), VAT (Intra-State Sale), and service tax was subsumed into a single taxation system. With the advent of GST, the Indian Taxation regime went through a paradigm

shift from source based to destination based tax system.

This new system of taxation has attempted to avoid the cascading effect of taxation by incorporation of the Input Tax Credit (ITC), which is considered as the cornerstone of GST. Input Tax Credit basically means that the amount of tax paid on the inputs is available as a set off against the amount of tax payable on the outward supply or sale. The Central Goods and Services Act, 2017 provides provisions for utilization, restrictions and conditions for ITC.

Section 2(62) of the CGST Act defines Input Tax as any central tax, state tax, integrated tax, or union territory tax charged by the registered person for the supply of goods or services or both made to him. The section also provides an exhaustive list of taxes which fall under the category of the input tax. Section 2(63) of the Act defines input tax credit as the credit of input tax¹.

¹ The Central Goods and Services Act, 2017, No. 12 Acts of Parliament, 2017

In the recent times, especially from the month of November, 2020 as a result of special drive started by Directorate General of GST Council of India, there are various reported instances of claim of ITC fraudulently². In this article the legal aspects related to ITC are analyzed in the light of current GST Frauds.

Conditions for taking Input Tax Credit

The Act provides for 4 conditions required to be fulfilled by the registered person to avail or obtain ITC³:

- 1) One must have possession of tax invoice or debit note or such other tax paying document as may be prescribed. Further as per Rule 36(4) of the CGST Rules, 2017 invoice and debit notes issued should be in compliance with the provisions of section 31 and 34 respectively⁴.
- 2) One must have received the good or services or both. If the goods were to be supplied in installments, the ITC can be

made available only after the receipt of the last installment.

- 3) The availability of ITC is also subjected to the payment of taxes by the supplier.

FOR EXAMPLE: Mr. Ram received goods from Mr. Shyam and he has paid for the value of goods along with the taxes. Mr. Ram here is not eligible for receiving ITC but ITC will be made available to him only after Mr. Shyam has paid the taxes collected by him from to the Government.

- 4) Payment of Taxes and Filing of return under section 39 of the Act is essential for claiming ITC. However, ITC can be availed on provisional basis under section 41 of the Act⁵.

It is thus, imperative to know that in a financial year, the return for September is to be filed by 20th October⁶.

The Credit of CGST can be utilized for the payment of CGST and then for IGST. Similarly, the credit of SGST can be utilized for the payment of SGST and then for the IGST. However, the credits of CGST and SGST cannot be used to set off

² Fake ITC: Officials arrest 25, book 350 cases in nationwide crackdown, Economic Time, https://economictimes.indiatimes.com/news/politics-and-nation/nationwide-drive-against-gst-fake-invoices-fraud25arrestedinlast4days/articleshow/79233142.cms?utm_source=contentofinterest&utm_medium=ext&utm_campaign=cppst (Last visited on 24th November, 2020)

³ The Central Goods and Services Act, 2017, § 16, No. 12 Acts of Parliament, 2017

⁴ The Central Goods and Services Act, 2017, No. 12 Acts of Parliament, 2017

⁵ The Central Goods and Services Act, 2017, No. 12 Acts of Parliament, 2017

⁶ The Central Goods and Services Act, 2017, § 39, No. 12 Acts of Parliament, 2017

each other. Only the credit availed from IGST can be used for the payment of IGST and then followed by CGST or SGST.

Fake Invoice

Huge number of GST misrepresentation or fraud cases including the utilization of fake invoice for availment of ITC, which is additionally used to pay GST on outward supply have been recognized since the rollout of GST by the Central GST authorities just as State GST authorities. Though the mens rea for the utilization of such invoices shows up to be deceitful availment/encashment of ITC credit, the corrupt elements locked in this additionally swindle other authorities, for example, Banks by blowing up turnovers, money laundering and so on.

The fake invoices are generally those wherein GST invoices are raised or issued without delivery of goods or services or payment of GST. There are three ways in which the fake invoices can be misused in the GST regime⁷.

1. When the invoice is issued to the entity without any actual delivery of goods or services. This makes the ITC available to

the entity even when the issuer hasn't paid the taxes thus, it leads to actual loss of revenue.

2. When the invoices are issued to one person and the goods or services are directed to another person. Thus, the person who receives or purchases the invoices can utilize the credits during outward supply thus, resulting in the loss of revenue.
3. When the invoices are routed from shell and dummy companies in a circular fashion to transfer the ITC from one company to another in order to increase the turnover. In these cases there is no actual delivery of goods or services thus, using the credits from such routing or transfer of invoices result in loss of revenue?

In India, people always tend to mend ways to find a way out of tax liabilities. Thus, it is peremptory to analyze the present legal system so as to create a rock solid wall or blockage against such practices.

Investigation of cases involving the fake invoices for GST Fraud

The first and very important step in the investigation is the identification of fraudster or the people involved. It is noted that people have a tendency to operate through impersonation using dummy

⁷ GST Council,
<http://gstcouncil.gov.in/sites/default/files/SOP-for->

[Tackling-Fake-Invoice.pdf](#) (Last visited on 23rd November, 2020)

names who don't have any assent thus, making it impossible to recover the amount. In the present time, a large number of fake firms have been created for tax evasion or availment of ITC. These fake firms are involved only in sale and purchase of fake invoices so as to pass on the ITC without actual business. This can be achieved by analyzing several risk parameters such as multiple GSTIN registration for a given address or for a given PAN, common email, address, promoters, authorized signatories for multiple GSTIN, use of sensitive commodities by the tax payers and alike.

The power to investigate such cases involving use of fake invoice to receive, use or avail ITC is vested upon officers not below the rank of joint commissioner to either inspect themselves or assign a proper officer to do the inspection followed by search and seizure as mentioned under section 67 of the Act⁸. The prime focus of inspection or investigation should be to establish that there was no actual supply of goods or services to prove that the fake invoice was issued.

Fake Invoice and Availment of ITC from such invoices is an offence

1. CGST Act

The offence of issue of fake invoice and availment of ITC through such fake invoice without actual supply of goods or services is declared as offences under section 122(1) (ii) & (vii) of the CGST Act, 2017 respectively. This section also provides for the penalty of Rs.10,000 or an amount equivalent to the tax evaded or ITC availed of or passed on or distributed irregularly, or the refund claimed fraudulently, whichever is higher⁹.

Further Section 132 of the Act via clause (b) and (c) of subsection 1 declares both parties as offenders; one who issued such invoice and the one who used such invoice to avail fabricated ITC¹⁰. This section provides that the person committing such offences shall be punishable as below in cases where the amount of tax evaded or the amount of input tax credit wrongly availed or utilised or the amount of refund wrongly taken:

- i.* If the amount exceeds Rs. 5 Crore- imprisonment for a term which may extend to 5 years and fine;

⁸ The Central Goods and Services Act, 2017, No. 12 Acts of Parliament, 2017

⁹ The Central Goods and Services Act, 2017, No. 12 Acts of Parliament, 2017

¹⁰ The Finance Bills, 2020, No. 26 of 2020

- ii. If the amount exceeds Rs.2 Crore but does not exceed Rs. 5 Crore- imprisonment for a term which may extend to 3 years and fine;
- iii. If the amount exceeds Rs.1 Crore but does not exceed Rs. 2 Crore- imprisonment for a term which may extend to one year and fine¹¹.

Gujarat¹², held that the power to arrest is vested upon the appropriate officer only if he has reasons to believe that the offense of such nature as mentioned in clauses (a), (b), (c), and (d) of subsection 1 of section 132 have been committed, without there being any adjudication for assessment. The Court also held that the arresting officer is required to record his reasons for such

<i>Amount of tax evaded or ITC availed</i>	<i>Penalty</i>
1 crore < amount < 2 crore	1 year
2 crore < amount < 5 crore	3 years
amount > 5 crore	5 years

2. **Income Tax Act**

Section 271AAD of the Income Tax Act, provides that if the books of account of any person are found have a (i) false entry; or (ii) any relevant entry is omitted so as to evade tax liability; under any proceeding in this statute, such person shall be liable to pay the penalty of sum of false or omitted entry¹³.

In this section books of account include ledgers, day-books, cash books, account books and other books, whether written or printed from any electro-magnetic data storage device¹⁴. The burden of proving that false entry or omitted entry was intended to evade tax liability and not a mere mistake is on the department.

This section further requires that the imprisonment shall not be less than 6 months in the absence of special and adequate reasons to the contrary to be recorded in the judgment and the Offence of usage of fake invoice for tax evasion or wrongful availment of ITC is cognizable and non-bailable under the GST Act. For the purpose of offences committed under this section, an officer is empowered to arrest the offenders under section 69. The Gujarat High Court in the case of Vimal Yashwantgiri Goswami v. State of

¹¹ The Central Goods and Services Act, 2017, No. 12 Acts of Parliament, 2017

¹² Special Civil Application No. 13679 of 2019

¹³ The Income Tax Act, 1961, No. 43 Acts of Parliament, 1961

¹⁴ The Income Tax Act, 1961, § 2(12A), No. 43 Acts of Parliament, 1961

If any person issues any fake invoice or takes or avails ITC upon such invoice without actual receipt of goods or services in contravention of the provisions of the relevant statute or law, the assessing officer under section 271AAD might consider such transaction to be false entry and thus, penalise for the same.

3. Indian Penal Code

Section 415 of the IPC defines Cheating to include an act of deceiving **any person to deliver any property or consent that any person shall retain any property, or intentionally induces such person to do or omit certain act.** Further the explanation of this section provides that dishonest concealment of any fact is cheating¹⁵. Section 418 states that whoever **cheats with the knowledge of wrongful loss to any person**, who has interest in the transaction shall be punished with imprisonment up to 3 years or fine or both¹⁶. Thereby, when fake invoice is issued and/or ITC is availed or utilised without receiving any goods or services it amounts to cheating under section 415, 417¹⁷ and 418.

Section 420 of the IPC states that when a person dishonestly induces another person to deliver any property, **or to make, alter or destroy any part of valuable security, or anything which is signed, sealed, and is capable of being converted into valuable security**, he shall be liable to the punishment of imprisonment up to 7 years and fine¹⁸. Thus, when a fake invoice is issued or used to take/avail/utilize ITC, it can be termed as cheating under the Indian Penal Code. Further depending upon the situation section 416 and 419 of IPC which deals with cheating by impersonation may also be applicable because in majority of cases people employ fake identities or dummy companies which don't own any assets.

Forgery has been defined under section 463 of the IPC as **making of false document with the intention of causing damage or injury to the public or any person, or supporting any claim or title**, or causing any person to part with property, **or entering into any express or implied contract**, or with intention of committing fraud¹⁹. Section 468 provides punishment

¹⁵ Indian Penal Code, 1860, No. 45, Acts of Parliament, 1860

¹⁶ Indian Penal Code, 1860, No. 45, Acts of Parliament, 1860

¹⁷ Indian Penal Code, 1860, § 417 (Punishment for cheating), No. 45, Acts of Parliament, 1860

¹⁸ Indian Penal Code, 1860, No. 45, Acts of Parliament, 1860

¹⁹ Indian Penal Code, 1860, No. 45, Acts of Parliament, 1860

for Forgery for the purpose of cheating as imprisonment up to 7 years and also fine²⁰. Further section 467 of the IPC deals with the offence of forgery of documents which purports to be a valuable security **or which purports to give authority to any person to make or transfer any valuable security**, or to receive the principal, interest or dividends thereon, or **to receive or deliver any money, movable property, or valuable security, or any document purporting to be an acquittance or receipt acknowledging the payment of money**, or an acquittance or receipt for the delivery of any movable property or valuable security. This section provides for the punishment of life imprisonment or imprisonment which extends up to 10 years and fine. On analysing the definition of Forgery along with provisions of section 467 and 468, it can be ascertained that fake invoice is clearly a forged document.

4. Money Laundering Act

Section 3 of the Prevention of Money Laundering Act defines it as a criminal act wherein a party is directly or indirectly part

of, assisting or involved in any activity connected with the proceeds of crime and projecting it as an untainted property²¹. In the definition proceeds of crime is the genesis of the offence of money laundering²². Proceeds of crime is basically any property directly or indirectly, derived or obtained in relation to scheduled offenses or value of any such property²³. The fake invoice and the availment of ITC from these invoices amounts to money laundering as there is no actual movement of goods or services but only trading of fake invoices and on the basis of these fake invoices, ITC is availed and passed on. The purpose is only to evade Tax liabilities. Section 4 of the Act provides for punishment of imprisonment of 3 years which may extend up to 7 years and fine. Further the offense under section 467 of IPC is mentioned under part B of the scheduled offenses under the Act. Thus, the cases involving amount more than Rs. 1 crore will fall under this category²⁴.

²⁰ Indian Penal Code, 1860, No. 45, Acts of Parliament, 1860

²¹ The Prevention of Money Laundering Act, 2002, No. 15 Acts of Parliament, 2003

²² Ahsan Ahmad Mirza and Ors. V. Enforcement Directorate and Anr, WP(C) No.2780/2019 CM No. 5528/2019

²³ The Prevention of Money Laundering Act, 2002, § 2(1) (u), No. 15 Acts of Parliament, 2003

²⁴ The Prevention of Money Laundering Act, 2002, § 2(1) (y), No. 15 Acts of Parliament, 2003

5. Conservation of Foreign Exchange and Prevention of Smuggling Activities Act

It was noted in various news articles that Government has been attempting to try the cases involving fake invoices under this Act²⁵. The objective of this Act is to provide for preventive detention for the purpose of conservation and augmentation of foreign exchange and prevention of smuggling activities.

Smuggling as defined under Customs Act with respect to goods means any act or omission which renders such goods liable for confiscation under the provisions of this Act²⁶. In a simpler sense smuggling refers to those crimes where-in goods are transported into or outside one jurisdiction or country, which are prohibited by law or upon which custom duties are not paid.

In India there are several hubs wherein branded goods are imported without proper payment of duties and sold at cheaper rates. It may be the situation wherein goods are imported from or exported to some other party illegally and to cover such act fake invoices are issued and used for availment of ITC. In such situations the people

involved may be detained under section 3 and 4 of the COFEPSA Act²⁷.

Conclusion and Suggestion

It can be concluded that with such a strong penal legal system against fake invoice frauds there has been sheer failure of technology to act as a deterrent against evasion, the authorities lacked oversight and diligence in the initial stages which paved way for such notorious actions. GST regime was intended to create a seamless chain of transactions wherein all the transactions are documented and backed by invoices to prevent evasion. People have adopted diversified modus operandi to evade taxation. The system of ITC was designed to excavate cascading effect but ended up paving way for fraudulent activities for evasion of tax through ITC. There are various non-identifiable entities which are registered under GST using PAN of some random people so as to claim ITC by issuing fake invoices.

In order to curb these activities the following actions might be adopted:

1. Use of biometrics in registration under GST regime.

²⁵ *Supra* 2

²⁶ The Customs Act, 1962, § 2(39), No. 52 Acts of Parliament, 1962

²⁷ The Conservation Of Foreign Exchange and Prevention of Smuggling Activities Act, 1974, No. 52 Acts of Parliament, 1974

2. Business Intelligence and Fraud Analytical tools must be applied for identification of riskier dealers based on the riskier input supply chain and outward supply chain, abnormal taxpayer behaviour in terms of ITC availment.
3. Appropriate measures should be adopted to ensure the delivery of goods or services before the ITC is availed.
4. Provisions of attachment of property should be invoked once such cases are reported. Offence database should be created in the application module so as to flag the GSTIN of fraudulent entities and to enable identification of buyers of such entities.