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# Fake GST Invoices: Challenges within Current Legal Framework and Proposed Solutions

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RAGHAV GIRDHAR<sup>1</sup> AND MR. HIMANSHU VARSHNEY<sup>2</sup>

## ABSTRACT

*The Goods and Services Tax (GST) was implemented in India in July 2017 as a comprehensive tax system aimed at abolishing cascading taxes, simplifying compliance, and improving transparency throughout the economy. However, a major issue facing GST is the rise of counterfeit invoices, where businesses create false invoices without any actual supply of goods or services. These deceptive practices are primarily intended to illegally obtain or transfer Input Tax Credit (ITC), leading to significant revenue losses for the government. The extent and intricacy of these frauds have revealed serious weaknesses in the existing legal and regulatory framework. This paper seeks to analyse the operational processes behind fraudulent GST invoicing, identify the shortcomings within the legal and enforcement systems, and offer practical policy and technological solutions to address this escalating issue. Additionally, the research examines judicial decisions and assesses the importance of inter-agency collaboration and the use of emerging technologies, such as artificial intelligence, in preventing and reducing such tax evasion methods. The introduction of the Goods and Services Tax (GST) in India was celebrated as a transformative reform aimed at optimizing the country's indirect tax structure, facilitating business operations, and expanding the tax base. Nevertheless, the rise of fraudulent GST invoices—tax documents created without any genuine transfer of goods or services—has surfaced as a significant obstacle to achieving the goals of the GST system. These counterfeit invoices are mainly utilized to unlawfully claim or transfer Input Tax Credit (ITC), resulting in substantial revenue losses for the government and disrupting fair market practices. This study examines the inherent structural vulnerabilities within India's Goods and Services Tax (GST) framework that facilitate the proliferation of fraudulent activities. It identifies deficiencies in real-time verification, data analytics, and legal enforcement mechanisms. The analysis includes a review of recent judicial decisions, administrative practices, and enforcement results, providing a comprehensive critique of the existing legal structure. Furthermore, it suggests a series of effective, technology-driven legislative measures to mitigate these fraudulent activities, such as the adoption of real-time invoice*

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<sup>1</sup> Author is a student at Amity Law School, Noida, India.

<sup>2</sup> Author is an Assistant Professor at Amity law School, Noida, India.

*reconciliation, AI-enhanced monitoring systems, and improved coordination among various agencies. The research underscores the pressing necessity for focused reforms to safeguard fiscal integrity and maintain the transparency that the GST system aims to deliver.*

**Keywords:** *Fake GST invoices: challenges within current Legal Framework and proposed solutions Conclusion And footnotes.*

## I. INTRODUCTION

The Legal Framework Regulating GST Invoices The GST legislation, primarily governed by the Central Goods and Services Tax Act of 2017 (CGST Act), requires the issuance of invoices as stipulated in Section 31. The CGST Rules of 2017, particularly Rule 36 and Rule 37, outline the eligibility criteria and conditions for claiming Input Tax Credit (ITC). 1. Mechanism of Fraudulent GST Invoicing Entities engaged in GST fraud often utilize shell companies or fictitious firms to generate invoices without any actual supply of goods or services. These invoices are then employed to claim ITC or to transfer it to another entity, creating a paper trail devoid of legitimate transactions. The Goods and Services Tax (GST), which was implemented on July 1, 2017, marked a significant advancement in simplifying India's complex indirect tax system. By consolidating various state and central taxes into a single, cohesive tax, GST sought to eliminate tax cascading, improve transparency, and enhance overall compliance. Ideally, this framework was intended to promote greater accountability through the tracking of taxes at each stage of the supply chain. However, the system's susceptibility to exploitation has emerged as one of its most significant administrative hurdles, particularly in the context of fraudulent GST invoicing. Fraudulent GST invoicing involves the fabrication and distribution of invoices for transactions that do not exist. These invoices allow individuals or entities to illegitimately claim or transfer ITC, thereby reducing their tax obligations or artificially boosting their profitability. Such fraudulent activities not only deplete the public treasury but also disrupt market equilibrium, providing unfair advantages to unscrupulous players over compliant taxpayers. Frequently, shell companies and transient operators are established solely for the purpose of generating and distributing these fraudulent invoices. Despite the strict regulations outlined in the CGST Act, including Sections 122 (penalties for specific offenses) and 132 (punishments for tax evasion), enforcement has been insufficient due to the intricate nature of financial fraud, low rates of conviction, and delays in procedures. Furthermore, the isolated operations of regulatory agencies, insufficient verification processes, and limited technological integration have worsened the situation. This research seeks to pinpoint the significant weaknesses in the existing legal framework and suggest viable solutions based on legislative, administrative, and

technological reforms to effectively combat the issue of fraudulent invoices.<sup>3</sup>

## II. CHALLENGES IN THE CURRENT LEGAL FRAMEWORK

- **Lack of Robust Verification Mechanisms** There is no real-time verification system to confirm the movement of goods or the genuineness of supply.
- **Inadequate Data Integration** The absence of seamless data sharing between GSTN, banks, and other regulatory bodies hampers the detection of fraud.<sup>4</sup>
- **Low Conviction Rates** Despite numerous arrests and investigations, actual convictions under Sections 132 and 122 of the CGST Act remain low, indicating enforcement gaps.
- **Difficulty in Tracing Beneficiaries** Due to complex layering and use of dummy firms, identifying the end beneficiaries of fake ITC becomes challenging.

## III. JUDICIAL PERSPECTIVE

Courts have generally taken a stern view of fake invoicing practices. In *State of Gujarat v. Mohit Minerals Pvt. Ltd.* (2020), the Gujarat High Court emphasized the need for strict scrutiny of ITC claims. However, issues related to procedural lapses and fundamental rights have also led to the granting of bail in some cases.

## IV. PROPOSED SOLUTIONS

- **Introduction of Real-time Invoice Matching System** Implementing a real-time matching mechanism between invoices uploaded by suppliers and recipients can drastically reduce fraud.
- **Enhanced Inter-agency Coordination** Establishing stronger links between GSTN, Financial Intelligence Unit (FIU), banks, and Income Tax Department can facilitate better fraud detection.
- **Use of Artificial Intelligence and Data Analytics** AI-based tools can be used to identify patterns of fake invoicing and red-flag suspicious transactions.<sup>5</sup>
- **Stricter Penalties and Fast-track Courts** Amending the CGST Act to include harsher penalties and setting up special courts for speedy adjudication can enhance deterrence.

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<sup>3</sup> “The CGST Rules of 2017, particularly Rule 36 and Rule 372, outline the eligibility criteria and conditions for claiming Input Tax Credit (ITC)”

<sup>4</sup> “banks, and other regulatory bodies hampers the detection of fraud”

<sup>5</sup> “can be used to identify patterns of fake invoicing and red-flag suspicious transactions”

- **Mandatory E-Way Bills and RFID Integration** Wider implementation of e-way bills and linking them with RFID technology can ensure the physical movement of goods corresponds with invoicing.<sup>6</sup>

## V. CONCLUSION

Combating the issue of fraudulent GST invoices necessitates a comprehensive strategy that includes legislative changes, technological advancements, and vigilant administration. It is essential to enhance the legal framework and foster inter-agency collaboration to uphold the integrity of the GST system. The rise of counterfeit GST invoices significantly threatens the credibility of India's indirect tax system, jeopardizing the fundamental objectives of transparency and revenue generation that GST aims to fulfill. The fraudulent misuse of Input Tax Credit through paper transactions leads to substantial financial losses for the government and damages the reputation of the tax system, placing compliant businesses at a disadvantage. This document has identified critical weaknesses in the existing legal framework, including inadequate invoice verification processes, disjointed data systems, low conviction rates, and judicial leniency in certain instances. Although statutory provisions exist under the CGST Act, the enforcement mechanisms are still outpaced by the creativity of economic offenders who exploit technological and procedural gaps. To tackle these challenges, a layered approach is essential. Legal reforms should be complemented by the implementation of sophisticated data analytics and AI-based monitoring systems. Real-time invoice reconciliation, the integration of financial databases, and improved collaboration among regulatory agencies are crucial for the prevention and detection of fraudulent activities. Additionally, accelerating judicial proceedings through specialized courts and enforcing stricter penalties will act as a necessary deterrent.

In conclusion, addressing the issue of fraudulent GST invoicing is not exclusively the duty of tax authorities. It requires a collaborative approach involving policymakers, enforcement bodies, industry participants, and the judicial system. By closing legal gaps and adopting technological advancements, India can ensure the fiscal integrity needed to maintain its ambitious GST framework and promote a fairer economic landscape.

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<sup>6</sup> "and linking them with RFID technology can ensure the physical movement of goods corresponds with invoicing"

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