

GST in India The Road Ahead



THE ASSOCIATED CHAMBERS OF COMMERCE AND INDUSTRY OF INDIA

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FOREWORD

“Any change, even a change for the better, is always accompanied by discomforts”. Just like the evolution of GST.

No doubt, businesses and the Government have faced their respective set of challenges to adapt to the GST regime. Greater compliance, increased transparency and the simplicity of one single tax law balance out the negatives. Tax never being a dull topic - through this book we have tried to address the most recent and topical tax issues that are currently being faced by businesses in India. This compendium of articles is a response to real time taxation queries of India Inc today.

The book addresses GST related issues including anti – profiteering, incongruities between GST and income tax laws and the need for alignment between GST and customs laws. Current trends such as amnesty laws and the need for a more comprehensive tax regulatory regime for the digital medium have also been covered. Additionally, we have also included topics on the core of the constitutional provisions of GST, the status of advance rulings, GST implications on transactions in securities and the never ending debate on GST credit.

Finally, no book on tax can be complete without addressing the elephant in the room – tax litigation.

We do hope this makes for some interesting reading. We enjoy every reader’s opinion and welcome your feedback on taxation@assocham.com and insights@elp-in.com.

Regards

ASSOCHAM & Economic Laws Practice (ELP)

A blurred, high-speed photograph of a road stretching into the distance, with a yellow border.

5 YEARS OF GST AND THE ROAD AHEAD

‘GST is the taxation system of New India, of the Digital India. It is not merely Ease of doing Business. It is demonstrating Way of doing business. GST is not just a tax reform, but it is a landmark step towards economic reforms. Beyond the taxation revamp, it is also paving the way towards social reforms. It is a vouchment for corruption free taxation system. In legal parlance GST may be known as Goods and Services Tax. But the benefits of GST will positively ensure it to be "Good and Simple Tax" for the citizens of India. Good because it liberates us from layers of taxation, Simple because it is uniformly implemented pan India. There will be "one nation, one tax" and tax system shall be executed in a standard manner in all the states. I am sure that we all will be able to take it forward in a unified manner.’

Hon’ble Prime Minister at the GST launch event

Introduction of GST is clearly a landmark reform for India. It has merged multiple erstwhile laws into one single law, thereby saving businesses the hassle of dealing with multiple provisions and filings. The earlier system of multiple indirect taxes at different levels of the value chain had started to plague the entire system and clearly GST was a panacea to the same. One of the biggest benefits to business on introduction of GST has been fungibility of credit across goods and services. Also, with entry tax, octroi and similar levies getting subsumed into GST and removal of check-posts, we have clearly achieved a free and fast flow of goods across the country.

GST has been conceptualized as ‘one nation, one tax’, a tax which was also para-phrased as ‘Good and simple tax’. The intent was to achieve a standard, corruption free, and simple taxation system across the country, to be implemented in a unified manner. We have until now seen cooperative federalism at its best in play, where the Central and the State Governments have been taking decisions with consensus.

The moot point - have we achieved the objectives as articulated by our Hon’ble Prime Minister when we look at the journey of GST over the last five years.

“Simplicity is not a simple thing” – Charlie Chaplin

Is GST Law truly a ‘Good and Simple tax’? The answer somewhere lies in the middle.

GST Law encapsulates a standard set of provisions that are applicable across the country. To this extent, we do not have to go through multiple Central or State-level provisions, each specifying a different criterion on taxability (including eligibility to take credit), nor do we have to deal with separate tax authorities administering those laws or for that matter get audit or assessments completed under each of those laws.

While there are innumerable benefits, like any other tax law, there are multiple issues as well, and understandably so. And the heart of those issues is the design of the law keeping in mind India’s federal structure. The laws are administered by both the Central as well as the State Governments. This translates to separate return filings (i.e., transaction level reporting) for each State. Each State will administer levy and collection of GST leading to a State-wise determination of payment of tax, audit, and assessments. Since revenues of States are based on consumption (being a destination-based consumption tax), the determination of correct Place of Supply (**POS**) becomes important and is an area of focus for the State GST authorities’ attention. While there are rules to determine POS, the answer is not simple, specifically qua services.

A derivative of this concept is the distinct entity concept where each branch of a company in a State is treated as a separate distinct entity. A deeming fiction created under the law requires each branch to charge GST for supplies that it may have made to its other branch, so that the GST revenue accrues to the right State. This concept by itself has created multiple complexities and has generated a debate on what is required/not needed to be cross charged (e.g., employee cost, third party cost etc.), and at

what value. The concept of attribution of taxes also existed in the pre-GST regime viz. under VAT laws for goods, and under Service tax laws by way of Input service distributor mechanism, for services. However, GST provisions have stretched this concept beyond distribution of GST on third party costs to even internal costs (such as the employee cost) which was not called for. The fact that there is no GST in an employer – employee relationship is being casually brushed aside defeating the concepts of Contract Law, to deem a contract between the employee and a branch of an employer, rather than the legal entity. Also, considering the specific provisions of deemed open market value (where full credit is available), the entire exercise is revenue neutral and is futile. Rather, it creates working capital issues for the industry.

There is an urgent need to re-look at the entire concept of cross-charge between branches, more specifically in the context of services, to avoid protracted litigation in the coming days. A parallel issue that also needs clarification is distribution of credit through an Input service distributor mechanism *versus* Cross charge. The allegations raised against one versus another is per se fallacious considering that the objectives of distribution are met in either case.

Another aspect of the design is separate administration by each State, leading to multiplicity of notices from different States, including duplicity in proceedings. In many cases parallel investigations are being initiated, by Central tax evasion authorities across India even though the jurisdictional GST audits may be on-going or scrutiny notices on the same subject matter has been issued across various States. Responding to a multiplicity of notices, each asking for voluminous amount of data/information is a daunting task. It is a matter of experience that all investigations/audits are not pleasant, thereby, creating an environment of concern amongst industries. We have seen stringent actions such as arrests, blocking of credit, cancellation of registrations, forceful recovery of alleged amounts (calling it as voluntary payments), initiation of garnishee proceedings, attachment of bank accounts etc. being taken, and in some cases, without following the due process of law.

Prior to the introduction of GST, there existed a concept of Large Taxpayer Units (LTU's). This was a single window clearance point for all matters relating to central excise, income tax/corporate tax and service tax. Can a similar concept be conceptualized under the GST regime where taxpayers are assessed in one State e.g., where they have the highest turnover or highest tax payment or any other intelligible criteria? In this manner, each State will have the authority to assess a few LTU's and taxpayers will be spared the agony of dealing with multiple States. The outcome can then be shared with respective Jurisdictional States to initiate further action.

Where there is a law, there will be litigation. GST being a new law, we have witnessed Writ petitions

“ I’m only responsible for what I say, not for what you understand’ – John Wayne

getting filed on various issues of technicality and interpretation of provisions. There cannot be a debate on the fact that the Government's intent is to avoid/reduce litigation. However, it is also a fact that litigation is unavoidable. We have already seen several administrative and legal issues been raised before judicial forums. Multiple negative/divergent Advance Rulings have further added to the woes of the industry.

What is critical is to have a right dispute resolution mechanism in place. The first step in the direction is to try and avoid a dispute. To this end, the Government could look at reviving the sectoral committees with appropriate representation from both Centre and the States, with which industries could have a meaningful dialogue on issues of policy, interpretation, and administration.

Setting up the GST Appellate tribunal with the right constitution of members in the earliest possible time frame is critical. There is already a pendency that has got created over the last five years. On one end, the taxpayers are saddled with the burden of pre-deposit, while on the other, Government revenues are locked up in litigation. In addition, the precedence that would get created could help address and settle similar issues across India. Interestingly, as we release this document, the GST

Council has in its 47th meeting held on June 28th and 29th 2022¹ has proposed to constitute a Group of Ministers to address various concerns raised by the States in relation to constitution of GST Appellate Tribunal and make recommendations for appropriate amendments in CGST Act

It is interesting to see several clarifications issued in the 47th meeting, many of which are in the right spirit of law, and it is therefore important that issues of substantial concern are immediately taken up by the GST Council and a timely amendment is recommended/ clarification issued before the same becomes a subject matter of protracted litigation.

“ When you think everything is someone else’s fault, you will suffer a lot” – Dalai Lama

Can a genuine and bonafide buyer for value be penalized for the fault of his supplier. The answer is unfortunately a ‘yes’ and this is what the provisions provide for. To be fair, both sides have valid viewpoints. On the one hand, while the Government has not been able to collect those taxes on the flip side, the recipient taxpayer is made to bear the burden for any non-compliances by the supplier. Is it his burden to bear? That is the classic debate that has been going on since the pre-GST regime and continues under the GST regime. We have already seen some positive jurisprudence under the VAT regime allowing credit to a bonafide buyer for value.

With the further tightening of the Input tax credit provisions², it is only imperative that taxpayers become vigilant. Most taxpayers are gearing to the change and are focusing on establishing a robust mechanism to ensure that they do not lose credit because of mismatch issues. There is, however, an element of vagueness qua proposed Section 38 of the CGST Act dealing with GSTR-2B statement.

While there will be no immediate answers on this issue, however, there could be an attempt to strike a balance where taxpayers are not prejudiced for no fault of theirs. For the pre-amendment period - where there is a debate on the validity of the provisions per se or for the period when there was no mechanism to verify tax payment by supplier - should the Government not offer relaxations by way of let go of the recovery of taxes from the recipient? Albeit the right to recover the GST with interest and penalty from the supplier remains. Also, on a going forward basis, innovative measures can be thought of, e.g., a recipient may be given an option to pay GST on Suo-moto basis and take credit say in a situation where the supplier is a continuous defaulter for two months. This will only enhance the Government’s revenue and save cost of litigation. In addition, a proper flow of information where credit is disallowed, however, taxes are subsequently recovered from the supplier, is in line with principles of equity. Another relief that could be considered is a lower rate of interest for the recipient in genuine cases, as sometimes the interest component itself exceeds the base amount leaving no other option for the recipient but to litigate or a settlement scheme waiving say 50% of reversals and the entirety of interest for the past periods upon voluntary reversal of credit. Let both parties share the burden.

“ The next road is always ahead” – Oprah Winfrey

GST Law is still in its evolution stage. The GST Council in its 47th meeting has made series of recommendations on rate rationalization – to remove inverted duty structure, has suggested amendments for ease of compliances, clarifications on issues of dispute, resolving the formula on the inverted duty structure and clarifying certain issues with respect to eligibility of refunds in case of lower rate on account of concessional rate etc., detailing of some of which are awaited etc. Taxpayers need to gear up to the various changes and prepare themselves for their impact.

¹ Information based on Press release and media reports

² Introduction of Clause (aa) under Section 16 and newly substituted Section 38 for GSTR -2B

One of the key aspects is the continuity of cooperative federalism and a unified decision-making approach. The Supreme Court³, highlighting the importance of “cooperative federalism” for the well-being of democracy, held that Union and State legislatures have “equal, simultaneous and unique powers” to make laws on GST and the recommendations of the GST Council are not binding on them. This observation has led to debate on whether the unified approach followed by the Centre and States will continue going forward or will States formulate divergent provisions ignoring the GST Council recommendations. While this seems quite unlikely (as also seen from the outcome of the 47th meeting which was held post the Supreme Court discussion), , only time will unfold this debated issue. Interestingly, the compensation cess extension issue did not get resolved and the discussions have got postponed to the next meeting.

On rate rationalization, we have noticed the Government tilting towards enhancing rates for certain products and even proposing to tax certain so called ‘sin’ products at 28%. This would be a ‘U’ turn from the earlier view that 28% slab should have least number of goods /services. There may also be a merging of slabs which may automatically enhance GST rates for certain goods/services. This would bring simplicity, address some of the interpretation issues on classification and to some extent address the inverted duty structure issue. We have already seen a proposed rate hike on several products in the 47th meeting to resolve the inverted duty structure issues. Pruning of some of the existing exemptions is also likely.

The Government should also introduce a mechanism which could enable taxpayers to liquidate their accumulated input credit – whether it be for goods or services, and to this end, need to re-think on refund for GST on input services in a claim for refund under the inverted duty structure provisions. One of the key philosophies of the GST law is complete fungibility of credits and its use, and that should not be diluted. Also, if such refund is allowed for goods, there is no rationale to discriminate qua services.

Last but not the least, taxpayers will see enhanced State-level activity on account of GST audits/Assessment and scrutiny. Businesses need to gear up for such audits/ scrutiny notices. There are open industry issues for which currently there may not be any answers, and companies should be prepared for demand notices and pre-deposit. Another aspect that companies need to be vigilant of is investigation by anti-evasion authorities, and the rights and obligations of the company during this investigation. Any position taken should be looked at holistically (from various tax and regulatory laws perspective) and not in isolation. Genuine issues which could have a significant impact should be proactively taken up and pursued through associations and industry bodies.

Last but not the least, focusing on automation is the key to handling compliances smoothly (including avoiding tax loss or tax errors on account of mismatch). At the moment, Government is technologically better geared up than the industry (as is evident from the system-based notices).

³ Union of India & Anr. v. M/s Mohit Minerals Pvt. Ltd. [Civil Appeal No. 1390 of 2022]

An aerial photograph of a large container ship sailing on a deep blue ocean. The ship is viewed from above, showing its bow at the top and its long deck filled with stacks of colorful shipping containers. The containers are in various colors including white, red, blue, and orange. The ship's wake is visible in the water. The entire image is framed by a thin yellow border.

SUPREME COURT DECISION ON OCEAN FREIGHT

**DECODING THE CONSTITUTIONAL
PROVISIONS**

‘The constitutional scheme therefore envisages a two-step process. At the first level of the GST Council, Article 279A(6) envisages cooperative federalism and in the absence of either a non obstante clause in Article 279A or a ‘subject to’ clause in Article 246A, the need or requirement is that both the Union and the States should be supportive of this cooperative federalism through the process of collaborative federalism...

The deletion of Article 279B and the inclusion of Article 279(1) by the Constitution Amendment Act 2016 indicates that the Parliament intended for the recommendations of the GST Council to only have a persuasive value, particularly when interpreted along with the objective of the GST regime to foster cooperative federalism and harmony between the constituent units....Neither does Article 279A begin with a non-obstante clause nor does Article 246A state that it is subject to the provisions of Article 279A. The Parliament and the State legislatures possess simultaneous power to legislate on GST. Article 246A does not envisage a repugnancy provision to resolve the inconsistencies between the Central and the State laws on GST. The ‘recommendations’ of the GST Council are the product of a collaborative dialogue involving the Union and States. They are recommendatory in nature’.

Union of India & Anr. v. M/s Mohit Minerals Pvt. Ltd⁴

Undisputedly, the core recognition of the 101st Amendment is associated with the introduction of GST which resulted in subsuming of a number of indirect taxes into a unified GST, levied by the Union Government and the State Governments. Adoption of GST undoubtedly revolutionized the concept of One Nation – One Tax – One Aspiration and seeks to play a pivotal role in catapulting the economic growth of the nation to its fullest potential in the years to come. The GST system has certainly resulted in a much simpler tax eco system as was in vogue earlier. In summation this phase of Fiscal Unification was indeed historical.

It is in-fact the tectonic shift in "cooperative federalism" which was at the heart of the 101st amendment. The amendment was a compact yet comprehensive Act of 20 sections primarily resulting in insertion, repealing and amending of Articles in the Constitution of India marking a new era of simultaneous but harmonious exercise of power by the Union and the States on a subject.

Since its origin, the Constitution contained a three-fold distribution of legislative power. Under Article 246, the subjects of legislation enumerated in the Union List of the Seventh Schedule were assigned to Parliament, those in the State List were assigned exclusively to the States and those in the Concurrent List were assigned both to Parliament and the States with precedence to Parliament under the provisions of Article 254. This position stood completely altered qua GST, with the 101st amendment which introduced article 246A.

Article 246A (1) provided for a unique source of power exercisable concurrently by the Parliament and the Legislature of a State. It expressly overrides Article 246 and 254 and accordingly represents the exclusive source of power to legislate on GST. Within the scheme of 246A, a further exclusivity of power is conferred on the Parliament to make law with respect to GST where the supply of goods, or of services, or both takes place in the course of inter-State trade or commerce. It is for the first time that an article seeks to embody a constitutional principle of simultaneous levy as distinct from the principle of concurrence. It is in this light that there has been a paradigm shift in creating a unique repository of source of power for the simultaneous legislation on a defined subject by both the Union as well as the State.

Consequential changes in the definitions contained in article 366 as also the changes made in the respective entries of List I and II were also made which in terms aligned the spirit of these substantive amendments in the respective articles.

The next vital article which took birth as a consequence of the 101st amendment was Article 269A dealing with the framework for the Levy and Collection of GST in the course of inter-state supplies.

⁴ C.A No. 1390 of 2022

While, as per the scheme of Article 246A and 269A, power to levy and collect GST on such inter-state sales is with the Government of India but the same is subject to the spirit of due apportionment of the collected tax between the Union and the States, in accordance with the law enacted by the Parliament in this regard on the recommendation of the GST Council. While the first part of article 269A (1) read with article 246A (2) highlights the exclusivity enjoyed by the Union Government on the subject of 'levy' and 'collection' of the GST on the supplies in the course of inter-state trade, the latter part of the article expressly caveats such an exercise by providing for the manner in which the fruits of the said collection are to be split between the two stakeholders.

Article 279A is a unique provision. It provides for the creation of GST Council as a Constitutional Body and envisages it as a virtual torch bearer for GST issues. The nature of the constitution of GST Council is again reflective of the joint and cooperative spirit of GST framework which seems to be implicitly embedded across all the insertions brought in by the 101st amendment.

In summary, this spirit of cooperative Federalism being the soul of the GST framework needs constant nurturing and preservation. It is the inherent spirit of just sharing that will hold the key to the concept of co-operative Federalism in the coming times. In the event of any disruptions in this line of harmony, the entire framework of GST could come into debate. There are very few legislations which affect businesses so fundamentally as this Amendment has and it is therefore imperative that each stakeholder plays a constructive part in ensuring its continued success.



GST CREDIT SAGA

Matching of Input Tax Credit (ITC) under GST became more complex and burdensome for the taxpayers with the recent amendments made by the Government which come into effect on January 1, 2022. A crucial amendment has been introduced under Section 16 of the Central Goods and Services Tax Act, 2017 (**CGST Act**) which mandates filing of return by the supplier and communication thereof of such filing to the recipient to avail the credit.

While this sounds simple enough, in absence of a proper credit matching facility on the GST portal in the past, the recipient taxpayer has been made to suffer nightmares to faultlessly perform the matching exercise. The draft GST Law when introduced proposed automatic matching of credit on the portal and successful communication to the recipient, which remained on the paper and never got implemented. On the contrary, the Government introduced a series of amendments in the law to ensure that the reconciliation which the portal failed to do, is done by taxpayer himself, using whatever tools they have at their disposal.

Among these amendments, a crucial one which compelled the taxpayers to start matching the credit manually/technologically was the introduction of Rule 36(4) Central Goods and Services Tax Rules, 2017 (**CGST Rules**) which restricted ITC in respect of unmatched invoices to a specified percentage of matched invoices. On one hand, due to possible negative consequences such as denial of credit and the interest and penalties that follow, practically most taxpayers have been following Rule 36(4). On the other hand, writ courts have been dealing with the constitutional validity of this Rule considering that it is not backed by a substantive provision.

During this tussle on whether to match credit, the Government introduced a new Form called GSTR-2B on the GST portal containing details of ITC based on the invoices reported by the suppliers in their outward supply statement in GSTR-1. This was introduced as a static statement to be available a day after the due date of furnishing GSTR-1. The Government also added a detailed advisory on how to match the credit using GSTR-2B while keeping the option of GSTR-2A (which is the dynamic statement) intact on the portal. Post introduction of GSTR-2B, taxpayers have been receiving demand notices for ITC taken in GSTR-3B that exceeds the amount in GSTR-2B.

The amendment made in Section 16 bridges the gap that raised questions on the constitutional validity of Rule 36(4), and about which Form (GSTR-2A or GSTR-2B) is to be used for the matching exercise. The amended provision will now be a powerful tool for the tax authorities to deny ITC if invoice is not reported by the supplier in its GSTR-1. Rule 36(4) is also amended to allow only the matched credit to the recipient and the earlier provision which allows certain percentage of unmatched credit also stands removed.

Consequences for the taxpayers

The following points are critical to note:

- With effect from January 1, 2022, unless the respective supplier has filed his/its returns on time, recipient has no ability to take ITC.
- GSTR-2B is a static document which is generated one day after the due date of filing of GSTR-1⁵. Hence, a taxpayer's eligible credit gets decided and locked on the 12th while the actual credit availment and the consequent tax payment is required to be made on the 20th which is the due date of filing GSTR-3B. Hence, any late filing by the supplier between 13th and 20th will not reflect in GSTR-2B to the taxpayer in that month but it will go to the subsequent month's GSTR-2B. This will have far reaching implication on the cash flows of the taxpayer who will not be able to avail genuine credits where the only defect is that the supplier has filed his return late.

⁵ On the 12th of every month

- Even if taxpayers can match GSTR-3B with GSTR-2B for the month, there is still a possibility that the supplier may end up not paying GST. There is no mechanism for a recipient to ascertain whether the tax has been paid by the supplier and to this end, the substituted Section 38 is in vague. This could result in a scenario where the department chases the unsuspecting recipient for recovery of tax who in turns chases after the actual tax evader, i.e., the supplier.
- In case the department denies the credit to the recipient and recovers unpaid tax from the supplier, there is no mechanism for the recipient to know and avail credit of such tax paid, defeating the principles of equity.
- The rampant blockage of ITC by the tax authorities because of mismatch issues will only see an increase. It is also sometimes seen that the ITC blocked amount is higher than the mismatched amount. This is also leading to cash flow issues where taxpayers are forced to pay GST in cash despite having ITC. Unblocking is not done Suo-moto even after one year as stipulated by the provisions. Writ petitions get filed unnecessarily, which by provisions can only contain a direction to unblock the credit in accordance with the provisions of law.
- The tax authorities have already been rejecting export refunds of ITC which has remained mismatched. This amendment will not give more teeth to such rejections.

Under the earlier VAT laws, we have seen Courts⁶, on occasion, take a lenient view in favour of a bonafide buyer on disallowance of credit by the department due to non-payment by the supplier. However, GST is a different law, and the ever-changing provisions of GST are yet to go through the grinds of legal scrutiny which may take some time. Noteworthy is that a similar view has also been taken by the Calcutta High Court⁷ in the GST regime.

Way Forward

We will see litigation on this aspect for the past period and loss of credit on a going forward basis. In the meanwhile, the question is how do taxpayers safeguard themselves from the denial of credit, interest, and penal consequences?

Apart from the legal battle which taxpayers will have to fight, there is a need for extensive technology intervention whereby such reconciliations are automated, and errors are reduced. Steps such as not paying GST till reflected in GSTR-2B, immediate action against defaulting suppliers, contractual changes to recover GST amount at a later stage, maintaining a vendor rating through automation etc. are some of the key steps that taxpayers need to start thinking about.

⁶ Arise India Ltd. Vs. Commissioner of Trade and Taxes [TS-314-HC-2017(Del)-VAT]

⁷ Sanchita Kundu Vs. Assistant Commissioner of Sales Tax [W.P.A 7231 of 2022]



LITIGATION : A PERCEIVED RESOLUTION

‘Litigation’, said Ambrose Bierce, ‘is a machine which you go into as a pig and come out of as a sausage’.

The Indirect Taxes in India included levy of Central Excise and Service Tax. The Hon’ble Finance Minister (**FM**) while presenting the Budget for the Fiscal year 2019-20 in her speech mentioned that currently INR 3.75 lakh crores is blocked in litigations in service tax and excise. The quantum of litigation that is pending in various appellate fora for excise and service tax could be imagined with the above statistic.

To allow the businesses to unload this baggage and be free from legacy litigations the FM introduced the ‘Sabka Vikas (**Legacy Dispute Resolution**) Scheme, 2019’ for excise and service tax matters. The scheme was opted for by many taxpayers, and we have also seen Writ petitions being filed on eligibility to the Scheme. The objective of the scheme is dispute settlement, which clearly merits a liberal approach.

Given the increasing indirect tax woes being faced by industry, the Government of India introduced GST in the year 2017. Key objectives for the introduction of GST were to remove the cascading effect of taxes, and to allow seamless credit of the taxed paid.

Another aim to be achieved with the introduction of GST was to reduce litigation. For businesses to flourish, it is imperative for the tax environment to be conducive. One of the fears that haunts business entities doing business in/with India is the rampant litigation and the amount of time taken for litigation to conclude. GST as it is being perceived by industry, is falling short of success on a core parameter for judging tax reforms i.e., reduced litigation. And we are yet to see the Elephant in the room.

In this backdrop, it may be interesting to look at some of the recent rulings of the Hon’ble Supreme Court and High Court giving us an indication that a closure/finality as perceived by a taxpayer is actually a new beginning of another battle to come.

Levy of IGST on ocean freight

The Hon’ble Supreme Court has finally decided the controversy around levy of IGST on the ocean freight component in a CIF contract for import.

The Supreme Court has held that *“the ‘recommendations’ of the GST Council are the product of a collaborative dialogue involving the Union and States. They are recommendatory in nature”*. The Supreme Court dismissed assesses contentions regarding excessive delegation while issuing the Impugned Notifications⁸ and held that the said notifications were issued in accordance with the provisions of the CGST Act and the Government has the power to specify categories of supply of goods or services on which the tax will be paid on reverse charge basis. With respect to ‘recipient’ of the services provided by the foreign shipping company, it was observed that provisions governing the place of supply in the case of ocean freight service deems it to be the destination of goods. While departing from the rule of strict interpretation, the term “recipient” was contextually interpreted to include importer of the goods. Accordingly, it was noted that since the goods are coming to India, the IGST Act is wide enough to cover a taxable event which bears a nexus to India.

The Hon’ble Apex Court has however finally concluded that supply of ocean freight services qualifies as a composite supply wherein the principal supply is that of goods and duty under Customs Act has been paid on the value of goods which is inclusive of the value of freight services. Hence, no GST can be levied again considering the same transaction as services.

The judgement is perceived to be a success for the taxpayers. However, while resolving one issue, the Judgement has opened several other issues. The concept of deemed / beneficial recipient could open a Pandora’s box. Also, the fate of Writ petitions filed under service tax regime will have to be now

⁸ Notification no. 8/2017- IGST (Rate) dated 28.06.2017 and notification no. 10/2017 - IGST (Rate) dated 28.06.07

watched closely to see whether the concept of composite supply under the GST laws also apply to the service tax laws. The finding that the decisions of Council are not binding, but recommendatory could impact the very tenants of the GST Law if States start taking a divergent view, though that seems far stretched at the moment. However, when it comes to tax laws, nothing is 'I-M-POSSIBLE'.

Secondment or manpower supply

Another landmark judgement delivered by the Hon'ble Supreme Court is on the amounts paid for seconded employees to a foreign group company. The Indian company and its foreign group company entered into an arrangement where an employee of the foreign group company, having the required skill set and qualifications, is sent to India for a given period. The seconded employee enters into an employment contract with the Indian Company and is entitled to perks and benefits as per the contract.

The Hon'ble Supreme Court held that to determine taxability, the real employer of the seconded employee needs to be ascertained, and doctrine of substance over form needs to be observed. To this end, the following questions were formulated for deliberation:

- Whether on cessation of employment with Indian company, the seconded employee will be repatriated to foreign group company?
- Whether the secondment agreement read with the employment contract of an employee is a contract of service or a contract for service?
- Whether there is an employer-employee relationship between Indian entity and the seconded employee?

Answering all of the aforesaid questions, it was concluded that the arrangement for seconded employee was nothing but an arrangement of manpower services by the foreign group company in light of the peculiar overall arrangement between the Indian company and the foreign group company. It was observed that the Indian entity is ultimately rendering services to their foreign group company and executing the orders provided by the parent company. Therefore, the benefit of the services rendered by the seconded employees accrues to the foreign group company. It was further observed that to take advantage of the globalized economy and locational advantage, the seconded employees are deployed for a duration to accomplish a specific task post which they are to be repatriated back. Also, their salaries are paid abroad in foreign currency, and they remain as employees of the foreign company for social security benefits. The plea of revenue neutrality was also rejected.

There is an existing controversy under Income tax on the subject matter, wherein, the assesses are defending allegations of existence of PE and attribution of profits or withholding of taxes on fee for technical services in deputation contracts. Needless to mention that a Supreme Court order being law of the land, could have a direct impact on the issues being contested under Income tax. An ostensible argument though available is that the provisions under both the laws are different and hence, the findings ought not to apply, however could be a difficult contention unless a differentiation in facts is also drawn out. We will also see demands being raised on similar secondment arrangements without having any regard to the facts of the particular facts and consequent GST and interest liability. Where credit is available, businesses could think of paying the tax and contest interest. The negative finding on revenue neutrality will also be used by the tax authorities to deny this plea in multiple other litigations.

Actual value or 1/3rd abatement towards value of land under construction contracts

A writ was filed before the Hon'ble High Court of Gujarat challenging the vires of the entry of Rate Notification⁹ along with notes appended to the said notification which prescribes that in case of

⁹ Entry 3(if) of Notification No. 11/2017- Central Tax (Rate) dated June 28, 2017

construction contracts involving transfer of land, the value of land is equal to one third of the total amount charged for such supply. The primary contention of the petitioner was that imposition of GST on consideration received towards the sale of land by virtue of delegated legislation was ultra vires the provisions of the CGST/SGST Act. While reading down paragraph 2 of the notes appended to the Rate Notification, it was held that deeming fiction with regards to the value of land in construction contracts will not apply where actual value of land is ascertainable. However, such deeming fiction will be applicable when the actual value of land or undivided share in land is not available or where the taxpayer so chooses ignoring the actual value.

The Court observed that the expression 'sale of land' mentioned in Schedule III of the CGST/SGST Act would include land in any form, and therefore, it would be outside the scope of levy of GST. Further, it was observed that there could be imposition of tax on goods and services used in the course of development of plots.

This ruling provides relief to the taxpayers in projects involving development of bungalows, villas and low-rise apartments in metro cities like Mumbai where value of land is quite higher and such value may exceed deemed 1/3rd of the total consideration charged from the customers.

The litigation is clearly far from over on the subject matter. It is likely that the ruling will get challenged before the Supreme Court by the tax department. Also, other Jurisdictional high courts may also differ in their view point.

Refund for Inverted Duty Structure

Amongst all other matters discussed above, this is the one issue that has achieved final closure, albeit in the negative, though some fundamental questions have been left open.

While refund provisions under the GST Law permitted the refund of unutilized input tax credit in case of inverted duty structure, retrospective amendment of Rule 89(5) of the CGST Rules explicitly restricted the refund of credit on input services. The Government also made its intention clear vide Circular 79/53/2018-GST dated December 31, 2018, by stating that both the law and the related rules clearly prevent the refund of tax paid on input services and capital goods as part of refund of Input tax credit accumulated on account of inverted duty structure.

Aggrieved by the said interpretation of the Government, writ petitions were filed before various Writ Courts inter alia challenging the retrospective amendment of the rule restricting the refund of input services and capital goods. In this backdrop, the Hon'ble Gujarat High Court in the case of VKC Footsteps¹⁰ held that the Explanation (a) to Rule 89(5) which denies the refund of 'unutilized input tax' paid on 'input services' as part of 'Input tax credit' accumulated on account of inverted duty structure is ultra vires the provisions governing refund under the CGST Act. The decision was a breath of fresh air to the aggrieved sectors which became hopeful that the refund on account of inverted duty structure with respect to input services would ultimately be allowed. However, the Hon'ble Madras High Court gave a contradictory ruling¹¹ and held that strict and contextual interpretation of the provisions governing the refund would suggest that refund of unutilized credit from input goods is only permitted and not of services. Further, it was noted by the Hon'ble High Court of Madras that the term 'input' and 'input services' are defined for the purpose of GST Laws and accordingly the restriction prescribed under the rules regarding refund of unutilized credit is valid.

The Hon'ble Supreme Court¹¹ has upheld the judgement delivered by Madras High Court and set aside the decision of Gujarat High Court. The Hon'ble Supreme Court concluded that refund can only be allowed under two scenarios envisaged under clauses (i) and (ii) of the first proviso. The expression 'other than' used in the said proviso operates as a limitation or restriction on claiming refund. Further,

¹⁰ VKC Footsteps India Private Limited vs. Union of India & Others [TS-585-HC-2020(GUJ)-NT]

¹¹ Transtonnelstroy Afcons Joint Venture vs. Union of India [TS-800-HC-2020(MAD)-NT]

¹¹ Union of India & Ors v. VKC Footsteps India Private Limited

Hon'ble Supreme Court noted that on a plain reading of clause(ii) to the said proviso clearly covers refund of unutilized ITC which has accumulated on account of rate of tax of inputs being higher than the rate of tax on output supplies.

Taking cue from other factors which could lead to accumulation of unutilized ITC and the provisions introduced under the erstwhile State VAT laws to overcome the disruption caused due to such accumulation, Hon'ble Supreme Court held that Parliament has consciously restricted the refund of ITC only in cases where the credit has accumulated on account of rate of tax on inputs being higher than the rate of tax on output supplies.

With respect to the formula prescribed under Rule 89(5), Hon'ble Supreme Court held that once the principle behind section 54(3) is upheld, the formula under rule 89 rightly gives effect to this and hence cannot be struck down. However, it was observed that the formula does result in certain imbalances that are unfavourable to the taxpayer and urged the GST council to reconsider the formula prescribed for computation of the refund amount. It is in line with this observation that the GST council has in its 47th meeting proposed for a change in formula for calculation of refund under rule 89(5) to consider utilization of ITC on account of inputs and input services for payment of output tax on inverted rated supplies in the same ratio in which ITC has been availed on inputs and input services during the said tax period. Details of such change are awaited.

While the Supreme Court has laid down the law of the land on the issue, the refund of input services is per se one of the most foremost demands of the Industry from the Government. There is no sound logic for creating this discrimination between goods and services insofar as refund provisions are concerned. It is however a consolation that at least the formula issue is proposed to be resolved.

Arrest under GST

Under GST, the officers have been granted the power to arrest a person in case he has a '**reason to believe**' that the said person has committed any of the four types of offences listed below and the amount of tax evaded or input tax credit wrongly availed exceeds INR 5 crores (Imprisonment for 5 years with fine) or INR 2 crores (Imprisonment for 3 years with fine) viz.

- Supply of goods or services without issuance of invoice
- Issue of invoice or bill without the supply of goods or services leading to wrongful availment or utilization of credit
- Availment of input tax credit basis (ii)
- Collecting the tax but not paying to the Government

A lot of questions concerning the provision has already come up for debate before the High Courts and the Supreme Court of India, including the Constitutional validity of the provision, and different High Courts have taken conflicting views. The Supreme Court on 27.05.2019¹² dismissed the SLP against the judgment of the Telangana High Court¹³ upholding the Commissioner's power to order an arrest if a specified offence has been committed. The court has held that there was no need for a FIR to be filed and also denied pre-arrest bail to the taxpayer. After the decision, the Hon'ble Supreme Court¹⁴, pursuant to a challenge against the Bombay High Court order where a conflicting view was taken, has directed that all the matters be listed before a three-judge Bench of the Supreme Court. The Gujarat High Court¹⁵ has also subsequently upheld the powers granted to the tax officers under the GST laws including no requirement of adjudication and no obligation to register FIR. The Hon'ble High Court did stress that the Commissioners "reason to believe" must be backed by material proof

¹² P.V. Ramana Reddy vs UOI [SLP (CRL) 4430/2019]

¹³ P.V. Ramana Reddy vs UOI [WP No.4764 of 2019]

¹⁴ UOI vs. Sapna Jain [SLP (CRL) 4322-4324/2019]

¹⁵ Vimal Yashwantgiri Goswami v. State of Gujarat [R/SPECIAL CIVIL APPLICATION NO. 13679 of 2019]

and credible information and must not be based on an allegation of such offence and that the constitutional safeguards as laid out by the Supreme Court in Dr. D.K. Basu's case¹⁶ with respect to arrest and procedure to be followed therein will equally apply to the Act.

However, considering the current trend of rulings, the three-bench decision of the Supreme Court is eagerly awaited. Until then, we could see rampant use of the powers across the country.

.... And the saga continues

Considering the size of Indian economy and the complex business models, disputes between the taxpayers and the tax authorities is inevitable. This saga of tax litigation seems to be continuing in the GST era too. While there is a shift in the model of levy of indirect taxation in India, whether that shift can be aligned in the way the Revenue thinks while administering the law, is the moot question. It would be interesting to see, given the rulings from various High Courts and Supreme Court, how the GST laws will shape up and if the government and the judiciary will be able to address the challenges in a time-bound manner. Also, one of the most critical factors is constituting the GST Tribunal at the earliest possible. At least a positive step is being taken in the direction by the 47th GST council meeting.

¹⁶ (1997) 1 SCC 416



THE DEMISE OF ADVANCE RULINGS

In 1991, when the Indian economy opened, it was applauded as a new dawn. A breakaway from the infamous license-raj, it promised a liberalized, transparent, and investor-friendly India. Amongst the slew of measures taken by the government to boost investor confidence, a remarkable one was notifying the Authority for Advance Ruling (**AAR**) under income-tax law in 1993: a quasi-judicial forum through which prospective investors could obtain a tax ruling on future transactions.

The AAR was conceived as a body which would provide binding decrees – preventing inadvertent defaults of tax and thereby years of litigation. Inherent to the AAR was its impartiality, signified best by the fact that it was presided by a retired Supreme Court judge. The AAR was, suffice to say, successful in serving its intended purpose. Non-resident investors actively approached the Authority with difficult questions of fact and law, reassured that their submissions would be heard and considered impartially. Encouraged by this success, advance rulings were thereafter introduced for customs and excise matters in 1999. This was further extended to service tax matters in 2003. Notably, the structure of the income-tax AAR was retained – with a retired judge of the Supreme Court as the Chairman. Both AARs are responsible for various landmark rulings through the years. Over the years, they helped bridge the gap between the conflicting interests of the taxpayer and the revenue in an amicable, non-litigative manner – a relief for the already overburdened courts and tribunals. In all of this, the AARs also emerged as bodies specially geared towards addressing the tax implications of increasingly complex transactions.

Naturally, one would expect that these tools, which had helped build investor trust, provided taxpayer certainty, and eventually contributed to growth would come to be expanded and evolved. The last few years, however, have had a different story to tell.

The first change in policy was showcased by the new advance ruling authority as constituted under GST. This AAR altogether did away with the requirement of a presiding retired judge or even an independent judicial member. Instead, it came to be comprised only of senior jurisdictional officers. Soon enough, this regression was taken over to other regimes – starting with the replacement of the AAR for customs with a Commissioner/Principal Commissioner (as a ruling member) in 2018. The option of appeal from the same was also removed in 2021 as part of “rationalization of Tribunals”. The AAR for income-tax was also made defunct and replaced with the “Board of Advance Rulings” (BAR), which consists only of revenue officers. The ostensible reason given for this change was the non-availability of eligible persons (retired judges of the Supreme Court, Chief Justices of High Courts and other judges of High Courts who have served for seven years or more).

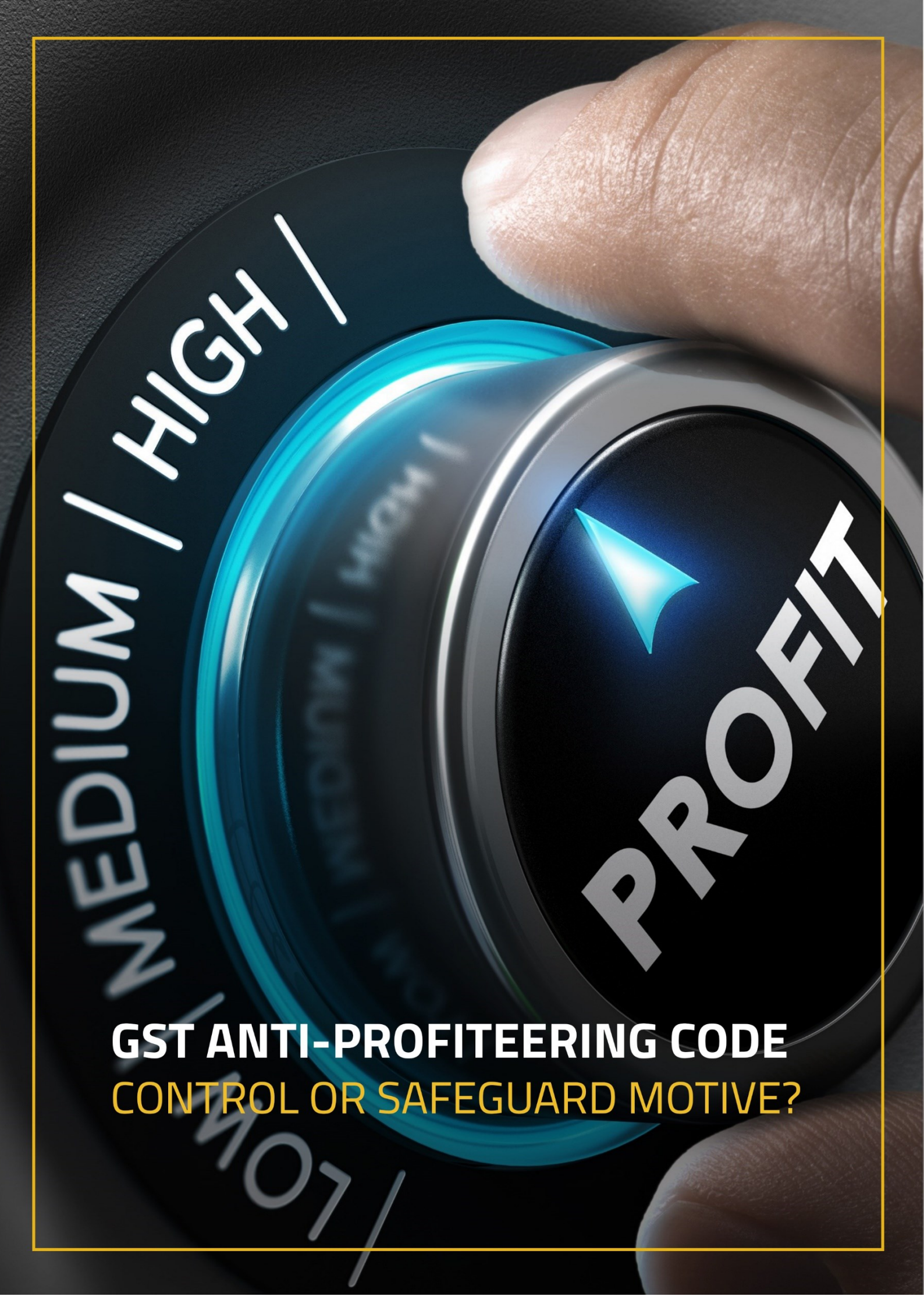
Notwithstanding the intent behind these changes, it has struck a devastating blow to the primary goals of advance rulings, *i.e.*, providing confidence in the fairness of the system and bringing certainty to taxpayers, especially to the ones outside India. The perception of AARs as a neutral forum is now compromised with advance rulings left entirely in the hands of revenue officials. Contrary to the very purpose of advance rulings, this only opens more avenues for litigation. Time and again, the Supreme Court, especially in the context of tribunals, has reiterated the importance of neutral judges who are independent from executive control and trained to judicial thinking. We have already seen one such debate in the context of constitution of GST Tribunal. This also extends to AARs, which were endowed with judicial functions and more important, the taxpayers’ trust.

In addition to structural changes, there has also been a move towards making the rulings non-binding. Rulings of the new BAR under income-tax for example, are not binding on either the taxpayer or the revenue. A similar amendment has now been made for the Customs AAR¹⁷, by which the validity of its rulings will be limited to three years only – too small a time frame to offset the costs and risks of

¹⁷ vide Finance Act, 2022

obtaining the advance ruling. Also, the logic of the amendment lacks clarity considering that any change in facts will anyways make the AAR not applicable. However, when there is no change either in facts or in law, the entire effort becomes futile. These provisions reduce the function of the AAR to a merely advisory body and take away any hopes the taxpayer might have towards certainty.

The instances point towards a gradual (and steady) weakening of the structure of advance ruling authority and a dilution of its independence. As they stand today, the AARs do not appear to inspire any confidence of the taxpayer. A similar fate has arisen for AAR's under GST which has created more issues that it has resolved. A negative ruling (however absurd it may be) though not binding on other Applicants is being used for issuing notices to other taxpayers, thereby, enhancing litigation rather than reducing it. Ironically enough, these changes which undermine the AARs have come after the WTO Agreement on Trade Facilitation signed at Bali (to which India is a signatory), which specifically mandates a system of advance ruling as part of a modern and efficient tax procedure. Our approach seems to be otherwise though.



GST ANTI-PROFITEERING CODE
CONTROL OR SAFEGUARD MOTIVE?

The National Anti-Profiteering Authority (**NAA**), apex body to assess profiteering, has time and gain assured business that it is not a price regulator and neither does it have legislative intent. Though the body was established post GST roll out, the prospects of its establishment were enough to ensure businesses did not abuse the downward revision of GST rates and/or upward revision of Input Tax Credit (**ITC**) allowances.

It is interesting to note that the advent of GST also marked the implementation of formal anti-profiteering provisions for the very first time in India, to ensure that the implementation of the new law does not disrupt the economy & markets. Malaysia and Australia were amongst regions from where experiences were borrowed for the same. These jurisdictions, however, employed a strategy of determining unreasonably high rates in the transitional phase and permitted those business decisions, which did not involve manipulation of prices. India, however, implemented profiteering provisions far more seriously and stringently. This article seeks to understand the real times issues being faced by industry on anti – profiteering.

What is Profiteering?

Profiteering has been defined in various ways in dictionaries – be it the act of making an unreasonable profit not justified by the corresponding assumption of risk, excessive or unfair profit or a word synonymous with exploitation. CBIC FAQ provides that, *‘In terms of Section 171 of the CGST Act, 2017, the suppliers of goods and services should pass on the benefit of any reduction in the rate of tax or the benefit of input tax credit to the recipients by way of commensurate reduction in prices. The willful action of not passing on the above benefits to the recipients in the manner prescribed is known as profiteering’*. All references indicate that, there is one common theme which strongly comes forth - *profiteering is all about deriving opportunistic gains*.

However, five years on, the anti – profiteering tirade is so prevalent that industry is questioning whether the provisions are merely intended towards safeguarding interests against opportunistic gains or also aimed at controlling prices.

The dilemma

It is a given, that the provisions were introduced to contain profiteering impact of any favorable change in the rate of tax or allowance of input tax credits (i.e., GST paid on procurements or ITC) or conversely put, to push businesses into passing on GST benefits, if any. Given this, it would merit perceiving the impact of these provisions only on such commercial contracts (for buying and selling of goods/services), which existed and were not completed at the time of change in the rate of tax and/or ITC allowance.

However, can the law define or contain pricing methodology in cases, where the contracts are entered into and serviced only post the above changes have taken effect? Alternately speaking, if the contracts did not exist on the change or transition date, how can there be any transition impact leave alone any benefit or loss?

As an illustration, A placed an order with B for the supply of 10,000 units of product ‘X’ say on January 1, 2019 (at INR 118, per unit, inclusive of tax), when the product was liable to 18% GST. Up to January 31, 2019 ~6,000 units were supplied; however, from February 1, 2019 the GST rate on the product was reduced to 12%. It was only logical that B demanded A to reduce the tax impact on the supply price (of pending quantity) to which A obliged. The tax outgo, for B, was accordingly reduced as A was now charging only INR 112 per unit (as the tax inclusive price). Notably, the contract transitioned a rate change scenario and therefore, even if A and B contractually did not provide for a reduction in prices, the operation of law was clear, and the prices were required to be reduced irrespective for the serviced or balance portion of the contract.

The question, at this juncture, is assuming A reorders a supply of 10,000 units from B on March 1, 2019, is B legally obliged to offer the supply at INR 112 per unit or less? Following follow-on queries surface in this regard:

- If the price that B could offer had to be INR 112 or less in the above illustration, would it not tantamount to controlling prices in case of a newly negotiated commercial contract (that did not transition the relevant event of change in rate of tax). Would this approach not defy general logic as well as the rights bestowed upon a business by the Constitution of India i.e., free pricing?
- Assuming, for mere sake of argument, that the prices had to be kept down (i.e., a precise price control action) – For what length of time should this approach be maintained? When can the prices be next revised upwards and what quantum of upward revision would not trigger profiteering as seen under provisions of GST laws?

These are pertinent issues in view of the legal and commercial aspects that are involved or may be triggered. Even more so, when one views this from an overarching perspective of India's economic growth.

The debate of 'Fair' versus 'Forced'

Fair: In context of GST profiteering, we find that when two parties commercially negotiate the prices of supply, it involves an offer (including terms/assumptions about GST) and a consequent acceptance. Now that a *post facto* event changes the assumptions (about GST rate & ITC allowance) that the parties must have factored into their decision, it is only equitable to seek a restatement of prices by adjusting for such change. It is necessary to do so, as the change in relevant factor(s)/ assumption(s), that occurs *post facto* was not known and beyond control of either party.

Forced: In another case, if all facts are clear and then commercially negotiated to a certain price, without any further changes in law, it cannot be argued that one party made opportunistic gains as all factors were known/disclosed and parties still chose to transact, at a given price, at their own will. If the legislation argues profiteering in such a contract, in any manner, then it is nothing but forced as these contracts did not witness any change in law.

Given this context, when one considers the previous illustration – both logic and legal understanding are defied – why can the prices not be pegged higher than INR 112 (say INR 115/ 118/ 120) if the parties mutually agree? This is mere economics of demand/ supply & other market factors and strictly not covered by the intention of the anti – profiteering provisions, which are currently being implemented (in a manner) to control prices.

At this juncture, it is also pertinent to mention that article 19(1)(g) of the Constitution of India, allows imposition of such restrictions on business (read pricing control) that may be necessary to do so in public interest, but by effecting a law on the subject. However, the ground reality remains that the laws have been made only in cases of few/identified commodities under the Essential Commodities Act, 1955. If not covered by this enactment or similar, any other law cannot (in any manner) regulate the prices.

The NAA has on previous occasions opined that these provisions are sensitive to natural business outcomes and has appreciated that several factors contribute to pricing decisions such as supply and demand, supplier's cost and taxes, etc. How much of this is being implemented in word and spirit is an open book debate with data & information (for deliberation) available in the public domain.

Even assuming that the law intended that profiteering provisions should be applied to cases of subsequent contracts/transactions, unsold inventory, etc., it is important to codify/clarify the duration for which these provisions can apply. Economic factors being extremely volatile, this form of suppression could have a significant impact on business. Industry would benefit if the law clarified that prices or passing of benefits would be reviewed for a short window immediately following the changes, at best say for a month or so.

Last but not the least, the system at present lacks a prescribed methodology, which is sector or business specific. Current procedures, without a debate on their respective merits, are sector agnostic. It is commonly understood that a FMCG sector and say real estate sector cannot be

compared, likewise a dine-in restaurant and food & beverage counter in a multiplex are incomparable – hence, a straight jacketed approach to profiteering would automatically be unwarranted. Thus, unless a business and a case specific approach is deployed, a one size fits all approach leads to a distorted result insofar as determination of profiteering is concerned.

Business and regulation are inextricably linked. Industry will no doubt welcome norms, which correctly identify manipulators and differentiate between business/moral profit & tax profiteering. The administration needs to focus on two significant factors – governance and safeguarding the interests of business. Businesses have to make money as that's the only way to survive.

Also, it is relevant to note that the NAA is likely to merge with the Competition Commission of India (CCI). This clarifies that anti-profteering provisions are here to stay.

The background is a dark blue gradient with a network of glowing white lines and dots. On the right side, there is a large, 3D geometric structure made of dark blue and white beams, with several glowing yellow-orange light bars integrated into its frame. The overall aesthetic is futuristic and digital.

TAXATION OF THE DIGITAL ECONOMY

THE INDIAN APPROACH

With the first generation of the web mostly being a passive “read-only” web (based on information) and Web 2.0, being a “read-write” web (based on social networks, wikis and blogs), a major shift in tax policies to cater to a digital world was not directly warranted. The essential reason for their introduction was the underlying activity of grant/right to use of licenses (of data, information, software, algorithms, etc.); which most tax policies viewed as a service. With the online data/information business growing manifold, the Indian indirect tax laws were maneuvered to include these transactions in the fiscal revenue realm through prescription of specific provisions for “online information and database access or retrieval services”. Most global B2C online licensing transactions purchased in India were brought under the indirect tax laws. Also, for the first time, foreign suppliers were asked to register and pay Indirect taxes in India, thereby, also bringing them within the administrative/ adjudication framework of the Indian tax authorities. The extra-territoriality of the provisions is a debate for another day.

With the advent of new digital products and services and a sudden spur in digital transactions, more specifically post Covid-19, a re-look at the taxation framework for digital transactions becomes imperative. However, before that, let us look at the current framework.

Taxability in the current framework

As regards digital transactions and of transactions through digital mode, the current framework stipulates specific provisions for taxability of transactions executed through e-commerce operators and OIDAR services. These were introduced with the primary intent to tax those digital transactions (domestic and global) which could have escaped the GST net merely because of non-identification (through e-commerce platform) and non-availability (located outside India) of the supplier, supplying goods/services.

A summary of the current taxability schema under GST is provided below:

Concept prescribed under the GST laws	Brief of the concept	Taxability
Electronic Commerce Operator ('E-Com Operator')	An E-Com operator has been defined to mean a person who owns, operates or manages digital or electronic facility or platform for e-commerce	<ul style="list-style-type: none"> E-Com operator to collect tax @1% on taxable supplies made through their platform by other suppliers For certain specified services, responsibility to discharge GST has been cast on the e-com operator including a e-com operator not located in the taxable territory Mandatory registration for persons making taxable supplies of goods through e-com operators; even where turnover is below threshold limit
OIDAR	“Online information and database access or retrieval services” means services whose delivery is mediated by information technology over the internet or an electronic network and the nature of which renders their supply essentially automated and involving minimal human intervention and impossible to	<ul style="list-style-type: none"> Non-resident suppliers required to discharge GST on OIDAR services supplied to non-taxable online recipients

<p>ensure in the absence of information technology and includes electronic services such as,-</p> <ul style="list-style-type: none"> (i) advertising on the internet; (ii) providing cloud services; (iii) provision of e-books, movie, music, software and other intangibles through telecommunication networks or internet; (iv) providing data or information, retrievable or otherwise, to any person in electronic form through a computer network; (v) online supplies of digital content (movies, television shows, music and the like); (vi) digital data storage; and (vii) online gaming 	
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The evolving scenario

A re-look at the provisions for taxing digital transactions become imperative with the next generation of world wide web – Web 3.0 or Metaverse. Although the metaverse proper isn't here yet, technological foundations like blockchain and crypto assets are steadily being developed, setting the stage for the next round of revolution in the digital space. For example, in the metaverse era, nonfungible tokens (**NFT**) can be owned and swapped. NFTs operate like cryptographic tokens, but unlike crypto currencies are not mutually interchangeable. Each NFT may represent a different underlying asset and thus have a different value. In summary, one would be able to purchase physical-world items in the metaverse and “hold”/“own” 3D models of what they've shopped for, own piece of art or music, to which no one else could claim ownership of.

Currently, most intangibles are taxed as services on the assumption that there is a temporary transfer of a right. The law is however obscure regarding cross-border taxability of intangibles (such as IPR, copyright etc.) where there is a permanent transfer of property involved. With the technology maturing and shift from temporary transfer to ownership of digital goods (permanent transfer), a question arises on taxability of such supplies when made from outside India to an Indian recipient. To illustrate, say, a 3D digital car is purchased by an Indian customer from someone in New Jersey, U.S. In the current framework, it may be difficult to tax such transactions in India as there would be no physical movement of goods, there exists no mechanism¹⁸ for levy/ collection of duty under the Customs Act. The current framework of the GST law primarily contemplates “goods” as tangible property, though the schedule for levy of GST on goods also covers certain intangible transactions. As goods could be both tangible/ intangible¹⁹, such transactions may remain untaxed under the GST law as they are transactions of import of goods (to be administered under the Customs Act) and no physical imports are involved. Also, where the above transaction is executed within Indian borders, there could arise a multitude of issues such as taxability of these transactions as goods/ services, rate of tax, administration of such supplies, etc.

Another example to the above conundrum is taxability of events. Currently, GST on global events is taxed basis the place where the event is actually held. Events held outside India do not trigger a GST

¹⁸ Position in law upheld by the Apex Court in the case of Commissioner Vs Oracle India Pvt Ltd [2016 (342) ELT A40]

¹⁹ Tata Consultancy Services Vs State of Andhra Pradesh (2004) 24 PHT 581 (SC)(FB)

levy; with neither the supplier nor the recipient being liable to discharge GST. With the digital revolution unfolding and anticipations of virtual reality becoming the preferred choice, more and more of entertainment, artistic, musical, and similar events are expected to be held virtually. Unless explicitly clarified, determination of location of such events will currently be a debate including possibilities like location being determined basis hosting location, key performer's location (which could also be multiple locations for a large sized event), etc. The issue of determination of location of such events would also be relevant in the context of local events as here again the place of supply of such services has been manifested to be the place where the event is held. Given the federal structure of the Indian economy, location of supplier of service and place of supply become pivotal to determining the correct taxability of the transactions.

The above quandary is anticipated in a wide range of similar such virtual supplies, say training services where the place of supply is determined basis the location of performance of service. For virtual trainings, where location of the trainer is not relevant, and the services could be provided from across the world, it would become difficult to determine the location of supplier and sometimes even the place of supply (where say the address on record of the customer is different from the place of access). Similarly, augmented reality is being deployed to give buyers a virtual interface to physical products located across the country or to attend virtual conferences, so to say in person. Where goods are involved, one may contend that the taxability can be determined basis the 'situs' of goods (a concept more relevant to the erstwhile VAT laws), however where services are concerned (say entry into an event or attending a meeting / conference), the taxability parameters could be debatable.

The increasing volume of such transactions and inclination of the millennials/ Gen Z to better and faster adapt to a virtual world would engender relook at conventional definitions and provisions of indirect tax laws.



INCOME

TAX

**THE INCONGRUITY BETWEEN
INCOME TAX AND GST LAWS**

The claim of deduction of business expenditure under Income Tax Act, 1961 (**Income Tax Act**) and ITC under the GST Laws are governed by a common underlying principle, that such expenditure should be for business purposes. However, irrespective of the commonality between the two Acts, there are differences between restrictions imposed on availing the claim of deduction and claiming credit.

The provisions under Section 30 to 36 of the Income Tax Act deal with deductions of business expenditure for computing profits and gains of business or profession and prescribe certain conditions to avail such deductions. The fundamental basis for claiming deductions under the Income Tax Act is that the expenditure incurred should be for carrying on the business. It is a settled position of law that the assessee should incur the expenditure in his capacity as a person carrying on the business/commercial expediency.²⁰

Given the above context, it is also important to examine the provisions relating to availment of ITC of business expenditure under the GST regime. Section 16 of the CGST Act allows a registered person to avail ITC on the tax paid on the inward supply of goods and/or services, which is used by the person in course and furtherance of its business.

While both the legislations are based on the same principle of the expenses being considered as business expenses, there is a degree of non-alignment between the provisions of deductions allowed under the Income Tax Act, and ITC available under the GST Act. To be clear, ITC of tax paid on inward supplies, being a business expenditure, may not be available to an entity – this, however, would be allowed as a deduction under the Income Tax Act.

Under the GST Regime (vide Section 17(5) of the CGST Act), the Government has provided for a *non-obstante* clause, by way of which it denies availment of ITC towards certain supplies. By virtue of this provision, even if the inward supply of goods/services mentioned therein is used in the course and furtherance of business, the ITC would not be available. A few instances, are mentioned below:

■ **Rent free accommodation**

Income Tax Act: In terms of the provisions of Income Tax Act, the expenditure incurred for rent-free accommodation would be considered as business expenditure.

CGST Act: As per the provisions of the CGST Act, ITC is not available for the same. In a recent Advance Ruling²¹ the issue raised was whether ITC was admissible in respect of GST paid for a hotel stay in case of rent-free residential accommodation provided to key personnel of the company. It was observed that even though expenditures for rent-free accommodation was part of the salary of key personnel, and allowed as business expenditure, ITC on the same was not available.

■ **Business expenditure for the welfare of the company's employees such as cost incurred on maintenance of township, security, residential colony, hospitals**

Income Tax Act: These expenditures are allowed as business expenditure under the provisions of Income Tax Act.

CGST Act: In terms of the provisions of the CGST Act, ITC of the same would not be available. The Appellate Authority of Advance Ruling in Orissa²² has held that the said inward supplies were not integral to the business activity of the assessee and would therefore not be eligible to credit under the GST Law.

■ **Expenditure incurred by rent-a-cab services for transportation of employees**

Income Tax Act: This would be considered as business expenditure

²⁰ S A Builders Ltd. v. CIT [2007] 288 ITR 1/158 Taxman 74 (SC)

²¹ POSCO India Pune Processing Center Pvt. Ltd., 2019 (21) G.S.T.L. 351 (A.A.R. - GST)

²² National Aluminum Company Ltd., 2019 (2) TMI 1527 – AAAR Odisha

CGST Act: Credit on the inward supply of rent-a-cab services is not available, unless the same is mandated by the Government under any law or the assessee receiving such a service is also engaged in provision of the same outward supply of rent-a-cab services.

This non-alignment was also present in the pre-GST Regime, where a service or good, though eligible for deduction as a business expenditure, was not eligible for claiming Cenvat credit under the provisions of the Cenvat Credit Rules, 2004. In this context, the Hon'ble Bombay High Court²³ has held that the repair and maintenance services used in a residential colony of an assessee's employees, was a welfare activity and not an activity relating to business and hence the same was not covered under the definition of Input Service, even though such expenditure incurred was allowable as a deduction under Income Tax Act. The said anomaly continues in the GST regime as well.

It is, therefore, indeed evident that two different treatments appear to apply for the very same nature of expenditure – under the Income Tax Act and the GST Act. It would be prudent for the Government to consider the position adopted under the Income Tax Act, ensuring that the expenses on receipt of goods/services which are used by an assessee for its business purposes, would be available as credit even under the GST regime. This would be in line with the government's intent on creating an easier business environment for corporate India.

Provisions for valuation between related parties under the Income Tax Act and GST

The transactions between related parties have always been suspected as a tool to shift profits and therefore reduce the overall tax liability of a company or a group operating from multiple global locations with different tax laws. In terms of Section 92 of the Income Tax Act, any international transaction or specified domestic transaction between associated enterprises, shall be based on an arm's length price. Under the GST Regime, the transaction between related persons is deemed to be a supply, even when they are made without consideration. The valuation of such supplies ought to be determined as per Rule 28 of the Central Goods and Services Tax Rules, 2017 (**CGST Rules**).

While the objective of both the Acts is to establish whether or not the price at which the transaction has been entered into has been influenced by the relationship between the parties and whether the tax payable has been understated or not, the provisions under the CGST Act and Rules do not accept the valuation as per the methodology prescribed under the Income Tax Law, for transactions between related persons, and vice-versa. This may lead to a situation of any assesses arriving at different values qua the same transaction.

The key variation between the GST valuation and transfer pricing regulations have been outlined below:

Transfer pricing provisions under Income Tax	Valuation rules under CGST rules
Threshold limit	
It is only made applicable towards specified domestic transactions till the extent that the aggregate of such transactions entered between the parties are less than a sum of INR 20 crores in the previous year	There is no similar threshold limit prescribed for the applicability of valuation methods prescribed
Specific applicability of the valuation methods in specific circumstances	
It is applicable only to the specified domestic transactions between associated enterprises,	The valuation methods prescribed for supplies made between related persons, is applicable in

²³ CCE, Nagpur v. Manikgarh Cement, [2010 (20) S.T.R. 456 (Bom.)]

wherein the recipient is enjoying certain tax benefits, for example, companies operating as industrial undertaking or enterprises engaged in infrastructure development	all cases, and no specific exclusion is carved out, for the same
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Order of applicability of valuation methods

Arm's length price can be determined by following any of the prescribed methods of computation. The most appropriate method being that which gives regard to the nature of the transaction or the class of associated persons or the functions performed by such persons	It prescribes a sequential order of determination of the value, wherein, the primary method is based on the Open Market Value (OMV) of the supply of goods/services, followed by other methods, in case the OMV is not determinable
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Deeming fiction for determination of value for related party transactions

No deeming fiction provision. Hence, the assessee would be required to determine the arm's length price in all cases, subject to the conditions and restrictions prescribed	In a case, where the recipient is eligible for ITC for any supply made by a related person, the value declared in the invoice would be deemed to be the OMV for such supply
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Comparable prices for transactions with respect to previous years

It permits use of multi-year data of comparable uncontrolled transactions which could have an influence on the determination of transfer prices, or where the data for the current year is unavailable	It does not specify the determination of value of the supply of goods/services between related parties, based on prices of the goods/services of like kind and quality for the previous years
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The divergence between the GST valuation method for related party transaction and the transfer pricing provisions under Income Tax Law, is yet to be settled and further clarification and guidance is awaited. Industry till then is managing in an ambiguous environment.

Anti-Abuse provisions & cross implications under either law

The income-tax withholding provisions have, overtime, been sharpened to nail down certain transactions, which probably went unreported from a tax standpoint. However, a discovery of these transactions has a corresponding GST consequence too, which is enabled and tracked through sharing of information between two tax offices.

With new digital age boom there has been unprecedented growth in the e-commerce transactions, so much so that several sellers (big and small alike) are able to access e-commerce marketplace platforms for selling their products. In view of the cannon of efficient detection of taxable transactions and collection of taxes, withholding provisions under Section 194-O of the Income Tax Act were introduced vide Finance Act, 2020. Under the said provision an e-commerce operator is liable to withhold 1% tax on the gross amount of sales or services effectuated through the marketplace platform. A similar such concept in GST is deduction of TCS on e-commerce transactions, whereby a 1% TCS is liable to be deducted and paid on e-commerce transactions. Albeit targeted towards the same purpose, i.e., efficient detection and taxation of e-commerce transactions, the provisions are quite different. While there is an alignment on the definitions of e-commerce operator and e-commerce, however, the definition of e-commerce participant under the Income tax provisions is quite extensive and covers every transaction done through an e-commerce platform. Whereas, under GST TCS applies only on transactions made 'through' an e-commerce platform (as an intermediary platform provided by a third

party) and do not apply in situations where products are supplied through companies own website. Also, there are logical exclusions under GST qua agents, for situations where cash is not collected by the e-commerce platform or where two e-commerce websites are involved, and TCS is deducted only by one of them. In view of the above, all e-commerce transactions as per GST provisions are likely to get subjected to TDS, however, the same may not be true vice-versa.

Another spade that has been added to the armory of withholding provisions is Section 194R of the Income Tax Act. This new section requires deduction of tax at source @ 10%, by listed persons when providing any benefit or perquisite, whether convertible into money or not, to a resident recipient arising in course of their business of profession. While this contentious provision is effective July 2022, it may leave the recipient taxpayer perplexed in terms of finalizing both income-tax withholding and GST implications on the transaction that would be subjected to this withholding. The deliberations commence from decoding what constitutes 'benefit' or 'perquisite' as the terms have not been defined under the IT law. The provision, thus, turns out to be of wide amplitude. From a GST standpoint once it is established that a benefit or perquisite has been allowed by one person to another in course or furtherance of business, there could be potential GST implication in hands of both the provider as well as the recipient. These GST implications may range from issues connected with barter transactions such as taxability, valuation, etc. as well as input tax credit reversals/ restrictions – with all implication being probable for either side. The question that would in many instances arise for debate is if 194R becomes applicable, does it mean that the transaction also becomes liable to GST by automatic implication. A view could have been taken in the past under the GST Laws that either there is no rendition of service (as what is being offered is a discount) or that such incentives are not for rendition of any service.

Also, the application of these provisions can prove to be a double-edged sword for business decision making. Illustratively, let's say two products liable to different GST rate are bundled together for a singular price – depending upon whether (a) the offering is purported to be a combo at a singular price; or (b) the offering is based on premise of buy 'x' to get 'y' free. Scenario (a) would of course be out of reins of 194R but would trigger debate of composite and mixed supply classification from a GST standpoint dubbing, which rate of tax to apply to the whole price. Similarly, in (b) 194R would trigger and likewise say some argumentative GST credit reversals in hands of supplier, while straight forward but the quantum of trade schemes in circulation and Income Tax TDS/ ITC reversal implications thereupon would wreck a havoc by sheer quantum of working capital requirement & costs involved due to this proposition. Also, could there be a proposition that the person receiving the goods for free is liable to pay GST, as a supplier of a promotion / marketing service merely because 194R TDS has been deducted, and the benefit / perquisite is nothing but a quid-pro quo towards such services. Net Net the businesses will have to strive to survive.

Incongruity & Inter-relationship

Turnover /tax paid under Income tax vs. Turnover and purchases reported in GST returns

Fake GST credit vs. disallowance of expenditure under Income tax

GST credit vs. Allowable expenditure under Income Tax

Fixed place PE vs. Fixed Establishment

26 AS vs. GST under Reverse charge mechanism /

TCS and TDS on Ecommerce transactions – varied criteria

Valuation – Open Market value vs. Arms length price

Intermediary under GST vs. Agency PE

Equalization levy vs. OIDAR

Characterisation of transaction vs. Applicability / Withholding of tax (e.g. Secondment arrangement)

Exemption under Income tax vs. GST (low-income housing)

194R vs. Applicability of GST



GST IMPLICATIONS ON TRANSACTION IN SECURITIES

Background

‘Securities’ (shares, scrips, stocks, bonds, derivative instruments, etc.) have been explicitly excluded from the purview of GST, by virtue of their exclusion from the definition of ‘goods’ and ‘services’, as per Section 2(52) and Section 2(102) of the CGST Act respectively. However, even while not being a taxable transaction itself, a transaction in securities has several other implications in terms of GST law. This arises pursuant to treating such transactions as ‘exempted’ supplies for the purpose of determination of admissible input tax credit for the entity.

Do GST provisions explicitly require reversal of input tax credit?

Cognizant of the fact that several businesses engage in transactions in securities even while it is not part of their core business – usually such transactions are undertaken for efficient deployment of unused funds or for hedging commodity prices and currency exposures – the GST law has sought to ensure that ITC attributable to such activities undergoes reversal. There could also be strategic stake buy or sell transactions in securities of group companies or of promoters, either generally or in the course of an Initial Public Offering.

Section 17(2) and Section 17(3) of the CGST Act read with Explanation 2(a) to Chapter V of the CGST Rules, seek to achieve this. Relevant provisions are given below:

Provision	Relevant extract
Section 17(2)	Where the goods or services or both are used by the registered person partly for effecting taxable supplies including zero-rated supplies under this Act or under the Integrated Goods and Services Tax Act and partly for effecting exempt supplies under the said Acts, the amount of credit shall be restricted to so much of the input tax as is attributable to the said taxable supplies including zero-rated supplies
Section 17(3)	The value of exempt supply under sub-section (2) shall be such as may be prescribed, and shall include supplies on which the recipient is liable to pay tax on reverse charge basis, transactions in securities, sale of land and, subject to clause (b) of paragraph 5 of Schedule II, sale of building
Explanation 2(a) to Chapter V of the CGST Rules	For the purposes of this Chapter, (2) for determining the value of an exempt supply as referred to in sub-section (3) of section 17-... (b) the value of security shall be taken as one per cent. of the sale value of such security.

‘Securities’ whether exempt?

While the intention of the Government is clearly reflected in the given provisions, the application needs to be examined. It is noted that Section 17(2) of the CGST Act casts a restriction on availing ITC to the extent it is attributable to an ‘exempt supply’. As per Section 2(47) of the CGST Act, the term ‘exempt supply’ means supply of goods or services which are exempted, or which attract nil rate of GST and includes non-taxable supply. Non-taxable supply is further defined under Section 2(78) to ‘mean such supply on which no tax is leviable’. Therefore, to constitute an exempt supply/non-taxable supply of goods or services, the pre-requisite test of being a supply of either has to be met. Since ‘securities’ find an exclusion from the ambit of ‘goods’ and ‘services’ itself, the question of it qualifying as an exempt or a non-taxable supply would not arise, more so when the said terms are exhaustively defined.

The question which arises is whether Section 17(3) does enough to overcome the limitation placed under Section 17(2), so as to achieve the legislative intent. Unfortunately, a plain reading of the

provision suggests that it fails to get the job done. As evident, the said provision is merely assigned the task of determining 'value of exempt supply' under sub-section (2). It, however, exceeds such authority and attempts placing therein 'transactions in securities', even when the same does not constitute a supply in the first place. A 'notwithstanding clause' or a deeming fiction stretching/expanding the scope of the term 'exempt supply' to include within its ambit 'transactions in securities' could have unequivocally empowered the legislature to neutralize ITC attributable to the said activity.

Quite clearly, there is an ambiguity as to whether the law, as drafted, requires ITC reversal for transactions in securities. It may, therefore, be relevant to refer to the findings of the Constitution Bench of the Hon'ble Supreme Court in the case of *Commissioner of Cus. (Import), Mumbai vs. Dilip Kumar & Company*²⁴, wherein it was held that while interpreting a taxing statute, there is no room for intendment or presumption and that it has to be interpreted only on the basis of language employed, and any ambiguity in taxing provisions has to be interpreted in favor of the assessee.

However, an interpretation that there is no requirement for reversing ITC attributable to transactions in securities would render the applicable extract of Section 17(3) redundant and would be contrary to the settled law, inter alia, in terms of the decision of the Hon'ble Supreme Court²⁵, that an interpretation which ignores words, or which renders words superfluous, cannot be taken.

To conclude, there is a visible gap between the intent and the letter of law under the present GST law, which may inevitably lead to litigation. This could mean that possibly another retrospective amendment may be on the anvil.

Is the quantum of ITC reversal sought commensurate with the quantum of ITC usage?

Assuming that transactions in securities necessitate reversal of ITC, it needs to be seen whether the mechanism currently prescribed, achieves a reasonable and realistic reversal, commensurate to the extent of common services consumed in the course of the subject activity.

It is noteworthy that only a miniscule quantum of common infrastructure is directly consumed in such activity, primarily pertaining to employee costs, which are not within the ambit of GST, and certain other costs such as IT infrastructure, internet services etc. However, in terms of Rule 42 of the CGST Rules, the moment an activity qualifies as an exempt supply, all common input services, which may not be exclusively attributable to taxable/exempt operations, will have to undergo reversal. To this extent, various services – whose procurement is not determinant on conduct of the subject transactions e.g., office rent, legal and audit, security etc. – will suffer the brunt of ITC reversal. To this extent, the reversal mechanism appears to be arbitrary and unreasonable. On the contrary, it would be more logical if ITC reversal could have been restricted only to such inputs and input services, which are directly connected to transactions in securities.

Do hedging transactions merit ITC reversal?

Many entities which deal in commodities where prices are exchange determined (such as industrial metals, precious metals, etc.) often enter into commodity derivative transactions with the sole objective of hedging their future procurements or supplies from any adverse price movements. Similarly, entities which make procurements or supplies which require cross border settlement may enter into currency derivative transactions solely for securing foreign currency exposure.

It may be pertinent to note that any gain or loss arising out of such derivative transactions is proportionately linked to the corresponding variation in price at which the taxable supply is eventually made. In effect, no gain or loss independently arises on account of the derivative contract.

²⁴ Commissioner of Cus. (Import), Mumbai vs. Dilip Kumar & Company, [2018 (361) E.L.T. 577 (S.C.)]

²⁵ Calcutta vs. Hindustan Petroleum Corpn. Ltd., [2005 (189) E.L.T. 258 (S.C.)]

For better understanding, consider this illustration. Mr. X, a trader in certain commercial metals, intends to supply a certain quantity of the same after a month. Mr. X apprehends that one month hence, the price of such commodity may fluctuate. To hedge the pricing risk, he enters into a forward sell contract in such commercial metals with a month's maturity at a strike price of USD 20,000. Assuming that at maturity the market price is (a) USD 15,000, or (b) USD 25,000, the following alternative scenarios would emerge:

Particulars	Market price (USD 15,000)	Market price (USD 20,000)
1. Strike price of forward sell contract	USD 20,000	USD 20,000
2. Market price at the time of maturity*	USD 15,000	USD 25,000
3. Profit (loss) on forward sell contract [1-2]	USD 5,000	(USD 5,000)
4. Net effective consideration received, owing to the hedging transaction [2+3]#	USD 20,000	USD 20,000

**Note: -To offset his position, Mr. X will generally enter into a forward buy contract of equal denomination, price of which will be near equivalent to the market price*

#Price received on supply of goods (market price at maturity) + profit (loss) on the forward derivative contract

As evident, under either scenario, Mr. X is guarded from any price fluctuation, by virtue of the derivative contract and receives an identical overall consideration in respect of its taxable supplies. Thus, the only objective of entering into such derivative contracts is to secure the price of taxable supplies, which is equivalent to the strike price of the derivative contract. However, as already enumerated, derivative contracts qualify as 'securities' and any transaction therein, notwithstanding whether it is for trading or for hedging purposes, would necessitate ITC reversal. Therefore, seeking ITC reversal for transactions which are carried out as a part of the taxable business and for securing the price of taxable supplies being made under GST appear to be onerous, inappropriate, and unreasonable.

In this regard, it is also relevant to note that jurisprudence under the Income Tax laws clearly recognizes such hedging transactions as forming part of normal business operations rather than speculative business operations. These hedging transactions cannot be construed as transactions independent of such business. This issue perhaps merits an active dialogue with the Government. It is no doubt beneficial for industry to seek exclusion for the activity of hedging from the ambit of 'transactions in securities.'



INTERPLAY OF GST LAWS VIS-À-VIS CUSTOMS

There is no doubt, the introduction of GST has allowed its effects to be felt in other Laws, *including* the Customs Law. This article highlights, via illustrations, the strong interplay of GST and Customs in relation to international trade transactions.

Levy of IGST on Imports

Section 5(1) of the IGST Act authorises the levy of an integrated tax on all inter-state supplies of goods and services or both. The integrated tax can also be levied on goods imported into India on the value determined under Section 3 of the Customs Tariff Act 1975¹¹ at the point when customs duties are levied on the goods under Section 12 of the Customs Act 1962.

One of the issues that had arisen in the past was levy of dual GST, one on supplies made by Export Oriented Units to a company in the Domestic Tariff Area (DTA) or supplies made by bonded warehouses before the goods are cleared into DTA, and another one on clearance into DTA as part of value of imports. This led to the amendment in Schedule III and the following transactions by virtue thereof were neither treated as supply of goods nor supply of services:

“8. (a) Supply of warehoused goods to any person before clearance for home consumption;

(b) Supply of goods by the consignee to any other person, by endorsement of documents of title to the goods, after the goods have been dispatched from the port of origin located outside India but before clearance for home consumption.

Explanation 2 - For the purposes of paragraph 8, the expression “warehoused goods” shall have the same meaning as assigned to it in the Customs Act, 1962”

As regards SEZ is concerned (which are not warehoused goods as per the Customs Act, 1962), a view is being taken that such supplies are IGST supplies by virtue of the IGST Act, and the point of taxation gets shifted to imports and paid by the importer by virtue of the said Act.

Valuation

As per the provisions of Section 14 of the Customs Act, 1962 (**Customs Act**) read with Customs Valuation (Determination of Value of Imported Goods) Rules, 2007 (**Customs Valuation Rules**), the value of the imported goods is the transaction value of such goods where the buyer and seller of the goods are not related, and price is the sole consideration for the sale. Specific additions to the transaction value are prescribed under Rule 10 of the Customs Valuation Rules. Given that value of certain services is included in the transaction value of imported goods, there is double taxation *per se* in respect of those services wherein there is no exemption of IGST on the services which already form part of the transaction value of the imported goods.

Under the GST regime, certain instances of transactions where there is an element of double taxation are given below:

▪ Levy of IGST on Ocean Freight

One of the most contentious issues under the GST regime, affecting almost all importers across industries, was whether the importers are liable to pay IGST under Reverse Charge Mechanism (RCM) on ocean freight paid for services of transportation of goods up to customs station of clearance in India, provided by a person located in a non-taxable territory. This is, even if such freight is a part of CIF value of imported goods on which the applicable Customs duty along with IGST (as a component of Customs duty) is already paid. The issue now stands resolved by the Hon’ble Supreme Court²⁶ as far as GST is concerned, however, is still unresolved for Writs filed under the Service tax regime. Also, duality of taxes stays insofar as FOB suppliers are concerned.

²⁶Union of India & Anr. v. M/s Mohit Minerals Pvt. Ltd. [Civil Appeal No. 1390 of 2022]

■ Double taxation of service imports in certain other cases

Valuation provisions under Customs require adding value of certain services on to the transaction value of imported goods for the purpose of payment of Customs duty. In line with the same, exemption from payment of IGST under RCM has been granted to royalty and license fee to the extent that the same is included in the value of goods imported on which IGST (as a component of Customs duty) is paid²⁷. However, no such exemption is currently available qua other services (such as commissions and brokerage, engineering, design work) which form a part of transaction value and wherein Customs duty and IGST (as a component of Customs duty) are already paid. This results in double taxation in respect of such services. Double taxation goes against the fundamental principle of GST which is to curb cascading effect of taxes.

It is important to note that the ruling of the Supreme Court in Mohit Minerals³¹ case clearly offers a very strong argument to contend that GST should not be paid for amounts added to the value of goods and should be used specifically in situations where either credit is not available either wholly or in part or there is accumulation.

Scope and ambit of 'export' in the context of Duty-Free Shops (DFS)

Under the erstwhile Value Added Tax and Central Sales Tax laws, the Hon'ble Supreme Court of India²⁸ had held that sale of goods by duty free shops at International Airports, which are undisputedly beyond the Customs frontier of India, cannot be subjected to the levy of Sales Tax.

Under the GST regime, the controversy started with an Advance Ruling pronounced by the Delhi AAR²⁹ wherein a view contrary to that of the Apex Court was taken thereby holding that supplies made by a DFS to outbound passengers is amenable to GST as export under GST takes place only when goods cross territorial waters/airspace of India and not merely on crossing customs barriers. A similar view was also adopted by the Bombay High Court³⁰ and Madhya Pradesh High Court³¹. However, a similar issue also came up for consideration before the Allahabad High Court³² wherein it was held that sales made by DFS constitute as exports as the goods are taken outside India and will not attract GST.

Given the conflicting judgements, the Government of India granted exemption³³ to any supply of goods by a retail outlet established in the departure area of an international airport, beyond the immigration counters, to an outgoing international tourist, from IGST. Interestingly, the exemption from payment of IGST indicates that the Government considers the supply to be otherwise, amenable to GST. This fact has also been categorically mentioned in a Circular³⁴. Further, the exemption has only been granted to supplies that take place from the departure area and that too to 'outgoing international tourists'.

The term 'outgoing international tourist' has been defined to mean a person not normally resident in India who enters India for a stay of not more than 6 months for legitimate non-immigrant purposes. A natural conclusion to this would be that no exemption will be available to an Indian resident purchasing goods from such retail outlets. This is for the simple reason that they cannot be called as persons who are not normally residents.

The limited exemption is expected to bring added responsibility on the DFS since they will now be required to maintain a separate record of sales to 'outgoing international tourists' and also cast a responsibility upon DFS to scrutinize if the passenger qualifies for an exemption or not.

²⁷ Notification No. 6/2018-Integrated Tax (Rate) dated January 25, 2018

²⁸ Hotel Ashoka v. Assistant Commissioner of Commercial Taxes — 2012 (276) E.L.T. 433 (S.C.)

²⁹ IN RE: Rod Retail Pvt. Ltd. [2018 (12) GSTL 206 (AAR – GST)]

³⁰ A-1 Cuisines Pvt. Ltd. vs. Union of India [2019 (22) GSTL 326 (Bom.)]

³¹ Vasu Consulting Pvt. Ltd. vs. Union of India [2019 (22) GSTL 163 (MP)].

³² Atin Krishna vs. Union of India [2019 (25) GSTL 390 (All.)]

³³ Notification No. 11/2019 – Integrated Tax (Rate) dated June 29, 2019

³⁴ No.106/25/2019-GST dated June 29, 2019

Classification

In any indirect tax, classification of goods is very vital. The same has wide implications particularly in the case of a multi rate tax structure like GST. Customs adopt the global classification of goods, based on the Harmonised System of Nomenclature (**HSN**) read along with General Rules of Interpretation. The rate Notification of goods under GST regime also adopts the classification, rules of interpretation, section notes and chapter notes as specified under the Customs Tariff Act, 1975. However, certain anomalies in classification are seen with respect to 'goods' and 'services'. For example – any Intellectual Property Right (temporary transfer) imported into India over a physical medium is considered as goods for the purposes of Customs while under the GST, by virtue of Entry 5(c) of Schedule II of the Central GST Act, 2017 the same is classified as service. This may lead to issues in future if there is a difference in the IGST rate, double taxation³⁵, availment of any exemption benefit restricted to goods etc.

Also it is important to align GST and Customs classification specifically where two different rates could become applicable under the GST Laws qua contradicting classifications.

³⁵ There is no double taxation with effect from January 25, 2018 in light of the specific exemption granted vide Notification No. 06/2018-I.T. (Rate) from payment of IGST under RCM for royalty and license fee - to the extent the same is included in the value of imported goods on which IGST (as a component of Customs duty) is paid. For the period prior to January 25, 2018, the issue of double taxation persists.

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