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GST Compendium

A monthly guide

May 2023

Editor's Note

The Director General of Foreign Trade (DGFT) has announced the procedure related to applying for the amnesty scheme with regard to Export Promotion Capital Goods scheme and Advance Authorisation announced last month, with the last date of the application being 30 June 2023. The DGFT has further clarified that no interest would be payable on the portion of additional customs duty and special additional customs duty. Furthermore, the amount of interest payable shall not exceed 100% of the basic customs duties exempted in proportion to the unfulfilled export obligation.

On the judicial front, the Supreme Court (SC) has ruled that sans consideration, service tax is not leviable on the corporate guarantee provided by the assessee to its group companies. This is a welcome ruling under the Services Tax regime; however, its implications need to be further evaluated under the GST regime where related party transactions are treated as deemed supplies, liable to GST, even without consideration.

On another issue, the SC has held that the import of engineering designs and drawings is liable to service tax under the reverse charge, even though they are considered goods under customs laws. The SC has reiterated that the same activity can be taxed as 'goods and services,' provided the contract is indivisible. Further, it is important to consider the intent of the parties to the contract while deciding whether a transaction involves the sale of goods or the provision of service.

In another important ruling, the Bombay High Court (HC) has upheld the validity of the provisions related to the place of supply in the case of the intermediary under the GST law. The HC has held that the services rendered by Indian intermediaries to the recipient outside India would be liable to Integrated GST. Therefore, the state cannot impose central and state GST on such transactions.

In this edition, we have shared the subject matter expert views on the impact of changes in the tax rate on royalty/fees for technical services on foreign companies.

On the direct tax front, the Central Board of Direct Taxes (CBDT) has extended the timeline for linking PAN with Aadhaar and extended the relaxation provided to certain non-residents from e-filing Form No. 10F. The CBDT has also provided clarifications for employers regarding withholding tax under the new tax regime.

I hope you will find this edition an interesting read.

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01 Important amendments/updates

A. Key updates under the GST and erstwhile indirect tax laws

GSTN issues advisory regarding the time limit to report invoices on the e-invoice IRP portals

- The government has decided to set a deadline for reporting old invoices on the e-invoice IRP portals for taxpayers having AATO more than or equal to INR 100 crores.
- These taxpayers will not be allowed to report invoices older than seven days on the date of reporting.
- The restriction will apply to all document types (invoice, credit note and debit note) for which IRN is to be generated.
- As of now, there is no such reporting restriction on taxpayers having AATO less than INR 100 crores.
- In order to provide sufficient time for taxpayers to comply with this requirement and make the system enabled, this restriction was proposed to be implemented from 1 May 2023 onwards. However, this has been decided to be deferred as of now.
- The next date of implementation will be shared with you in due course of time.
- It indicates the intention of the government to gradually move towards real time uploading of the e-invoices on the IRP portal.

(https://www.gst.gov.in/newsandupdates/read/582 and https://www.gst.gov.in/newsandupdates/read/578)

GSTN issues advisory on bank account validation

- The GSTN has informed that the functionality for bank account validation has been integrated with the GST system to ensure that the bank accounts provided by the taxpayer are correct.
- The bank account validation status can be seen under the 'Dashboard → My Profile → Bank Account Status' tab on the portal. Taxpayers will also receive bank account status details on their registered emails and mobile numbers immediately after the validation of their reported bank accounts is completed.
- Post the validation, any bank account number in the database would have one status out of the four status types, i.e., success, failure, success with remark, pending for validation.

Status	Further details	Action by taxpayer
Failure	• The entered PAN number is invalid. • PAN number is not available in the concerned bank account. • The PAN number registered under GSTIN and the PAN maintained in the bank account are not the same. • The IFSC code entered for the bank account details is invalid.	The taxpayer is expected to ensure that the correct bank details have been entered and the KYC for the bank account is completed by the bank.
Success with remark	The account cannot be validated since the bank is not integrated with the NPCI for online bank account validation.	To speed further online processes, the taxpayer should provide an alternate bank account number for revalidation.
Pending for validation		The taxpayer needs to wait, as the account will be validated by the NPCI.

- Further, taxpayers can add/delete bank account details at any time, and new account details will be validated.

(https://www.gst.gov.in/newsandupdates/read/579)

GSTN provides new facility to verify document reference number mentioned on offline communications issued by state GST authorities

- A new facility has been made available on the GST portal to verify document RFN mentioned on offline communications issued by the state GST authorities.
- Presently, most of the documents generated on the GST portal, such as notices/ orders, etc., have a system-generated unique identifier DIN/RFN. These documents are already traceable on the taxpayer's dashboard. In addition to this, the GSTN will shortly provide a new facility to verify such documents through auto-generated RFN.
- Further, in order to check whether the STO issued the offline communications or the not system-generated communications, a new facility for RFN generation by the STO and verification by the taxpayer has been provided. Under this facility, the STO can generate a RFN for the physically generated correspondence, which can be validated by the taxpayer. The navigation for this facility is **Services > User Services > Verify RFN option** and provide the RFN to be verified. In case of pre-login, limited details will be provided for verification. However, when the taxpayer logs in and verifies the RFN mentioned in an offline communication, greater details will be provided to the taxpayer.

(https://www.gst.gov.in/newsandupdates/read/580)

B. Key updates under the Customs/FTP/SEZ laws

CBIC waives interest on duty payable in respect of goods where duty is not paid due to technical inability

The CBIC recently enabled the ECL functionality in phases from 1 April 2023. Pursuant to this, the trade faced difficulty due to unanticipated technical problems on the common portal and with the authorised banks, resulting in interest payable u/s 47(2) of the Customs Act.

To address these concerns, the CBIC issued two orders, waiving off the interest for the period from 1 April 2023 to 13 April 2023. However, in view of technical difficulties persisting for certain BoE , the CBIC has issued the Customs [(Waiver of Interest) Third Order, 2023 (Order No. 3/2023-Customs (N.T.) dated 17 April 2023)].

Vide the said order, the whole of interest payable u/s 47(2) of the Customs Act for the period from 14 April 2023 till the date of the removal of the system inability, and thereafter up to three days (including holidays), has been waived off. This waiver is in respect of such goods relating to those BoE on which the duty payment was initiated without depositing in the ECL on or before 13 April 2023 but was not successful due to technical issues and was further not possible to be re-initiated from the ECL.

The waiver shall be subject to the fulfilment of the following conditions:

- The duty and interest shall be paid within three days (including holidays) from the date of removal of such system inability at the common portal and certified by the DG Systems;
- The importer undertakes not to pass on the incidence of such interest paid; and
- Consequential refund of such interest paid shall be subject to Section 27 of the Customs Act.

(Order No. 3/2023-Customs (N.T.) dated 17 April 2023)

CBIC waives interest on duty payable in respect of goods where payment is to be made from ECL for the period 11 April to 13 April 2023

The CBIC recently enabled the ECL functionality in phases from 1 April 2023. Pursuant to this, the trade faced difficulty due to unanticipated technical problems on the common portal and with the authorised banks, resulting in interest payable u/s 47(2) of the Customs Act.

To address these concerns, the CBIC had issued the Customs (Waiver of Interest) Order, 2023 (Order No. 1/2023-Customs (N.T.) dated 6 April 2023). Vide the said order, the whole of interest payable u/s 47(2) of the Customs Act for the period from 1 April 2023 up to and including 10 April 2023, in respect of such goods where the payment of import duty is to be made from the amount available in the ECL, has been waived on the common portal.

The errors are still occurring in the system, affecting the timely completion by users of sequential procedures whereby the accounting is made in the duty payment process, resulting in the accumulation of interest. Therefore, the CBIC has issued the Customs (Waiver of Interest) Second Order, 2023 (Order No. 2/2023-Customs (N.T.) dated 11 April 2023). Vide the said order, the whole of interest payable u/s 47(2) of the Customs Act for the period from 11 April 2023 up to and including 13 April 2023, in respect of such goods where the payment of import duty is to be made from the amount available in the ECL, has been waived on the common portal.

(Order No. 2/2023-Customs (N.T.) dated 11 April 2023)

CBIC waives interest on duty payable in respect of goods where payment is to be made from ECL from 1 April to 10 April 2023

The ECL functionality envisaged in Section 51A of the Customs Act provides that the importer, exporter, or any person liable to pay the duty, fees, etc., under the Customs Act, has to make a non-interest-bearing deposit with the government for the purpose of payment effective from 1 June 2022. The CBIC recently enabled the ECL in phases from 1 April 2023.

Pursuant to the above, the trade faced difficulty due to unanticipated technical problems on the common portal and with the authorised banks, resulting in interest payable u/s 47(2) of the Customs Act. To address these concerns, the CBIC has issued the Customs (Waiver of Interest) Order, 2023.

Vide the said order, the whole of interest payable u/s 47(2) of the Customs Act for the period from 1 April 2023 up to and including 10 April 2023, in respect of such goods where the payment of import duty is to be made from the amount available in the ECL, has been waived on the common portal.

Further, in respect of the BoE for which the import duty payment has already been made and integrated with the ICES during the said period, the refund claim for interest shall be subject to the provisions of Section 27 of the Customs Act.

(Order No. 1/2023-Customs (N.T.) dated 6 April 2023)

DGFT notifies procedure for applying for one-time settlement of default in EO under the amnesty scheme for Advance Authorisation and EPCG license holders

Pursuant to an announcement made by the government, the DGFT had notified the amnesty scheme for one-time settlement of default in the EO under the AA and EPCG scheme.

In this regard, the DGFT has issued a policy circular outlining the procedure to be followed for applying for one-time settlement under the amnesty scheme. The process has been summarised below:

- The authorisation holders (applicants) need to log on to the DGFT portal and navigate to the Services tab > AA/DFIA or EPCG > Closure of AA or Closure of EPCG and select the checkbox for 'amnesty scheme' for one-time settlement of default in the EO.
- The applicants need to indicate the duty and interest values to be paid (as per the applicant's calculations) under the 'Redemption Matrix' tab and submit the application online.
- The RA shall examine the application and confirm the shortfall to the applicant through an online letter.
- The applicants are required to deposit customs duty, along with interest, with the concerned jurisdictional customs authorities, along with proof thereof, to the RA.
- The RA may examine the payment evidence and consider granting the EODC online.
- The RA shall process the applications within three working days.

(Policy Circular No.1/2023-24 dated 17 April 2023)

DFGT issues clarification for amnesty scheme for one-time settlement of EO default

Pursuant to the amnesty scheme for the one-time settlement of default in the EO on 1 April 2023, the DGFT has clarified that all pending cases of default in meeting the EO can be regularised by the authorisation holder on payment of all customs duties that were exempted in proportion to the unfulfilled EO, with the amount of interest payable being limited to a maximum of 100% of such exempted duties on which interest is due.

Furthermore, no interest is payable on the portion of additional customs duty and special additional customs duty.

(Public Notice no. 07/2023 dated 18 April 2023)

DGFT notifies mandatory submission of UIN linked bank account for availing benefit under the interest equalisation scheme

Effective from 1 April 2022, the eligible interest equalisation beneficiaries were required to submit an acknowledgement consisting of a UIN to the concerned bank to avail the interest subvention under this scheme.

The DGFT has now directed that w.e.f. 1 May 2023, exporters seeking the benefit under the said scheme are required to submit an acknowledgement with their UIN linked to a specific bank for a one-time disbursement. The beneficiaries of the scheme are required to provide a new UIN for each disbursement to the concerned bank and the same is applicable where the credit is rolled over. Further, a new UIN shall be generated by the exporter for each rollover.

However, considering the operational challenges faced by the beneficiaries of the scheme and the banks, the DGFT has clarified that an acknowledgement consisting of a UIN, valid for a FY, shall be unique to a specific bank. If a scheme beneficiary desires to take advantage of the benefits of the scheme from multiple banks, a new UIN must be provided for each bank.

(Trade Notice No. 03/2023-2024 dated 20 April 2023 and 04/2023-2024 dated 21 April 2023)

DGFT amends the procedure for application for TRQ under India-UAE CEPA for FY 2023-24

The DGFT has amended the procedure for application for TRQ under the tariff head 7108 under the India-UAE CEPA for FY 2023-24 as under:

- New applications for TRQ under the tariff head 7108 for FY 2023-24 are invited up to 7 May 2023.
- Applications for TRQ under the India-UAE CEPA for the tariff head 7108 for FY 2023-24 are invited online through the DGFT website (https://dgft.gov.in) –> Import Management System –>TRQ.
- New applications that may be received pursuant to this public notice shall be considered together with the earlier applications already received for TRQ allocation of a total of 140 MTs under the tariff head 7108 for FY 2023-24.
- The minimum lot size of allocation shall be 5 kgs ordinarily and shall be subject to a downward revision in case the number of eligible applicants is higher. Allocation shall be made in multiples of the minimum lot size and shall be less than or equal to the quantity as requested by the applicant.
- The said TRQ allocation shall be subject to a six-monthly review. In cases where the TRQ utilisation is found to be 25% or less in the said review process, 50% of the balance TRQ quantities shall be deemed to be considered as surrendered and shall be considered for re-allocation to other TRQ allottees.

(Public Notice No. 12/2023 dated 28 April 2023)

DGFT extends validity of ad-hoc norms

For ease of business and reducing transaction cost, the DGFT has amended the HBP to extend the validity of ad-hoc norms already ratified by the norms committee for self-declared authorisation obtained towards the same export and import products. Accordingly, the validity of ratified norms has been extended from 31 March 2023 till **31 March 2026.**

(Public Notice No.09/2023 dated 25 April 2023)

02 Key judicial pronouncements

A. Key rulings under the GST and erstwhile indirect tax laws

Corporate guarantee provided by parent company to its subsidiaries without consideration not leviable to service tax - SC

Summary

In a landmark judgement, the SC has held that service tax is not leviable on the corporate guarantee provided by the assessee to its group companies without consideration. The SC stated that consideration is a must for levying service tax on a corporate guarantee, and thereby, upheld the CESTAT's order of not levying tax.

Facts of the case

- M/s Edelweiss Financial Services Limited (the assessee) issued a corporate guarantee on the behalf of its group company located within and outside India without any consideration.
- The Revenue contended that the assessee has not discharged the service tax liability on corporate guarantee as the provider of 'banking and other financial services' for the period prior to and after 30 June 2012, and issued a SCN.
- The adjudicating authority had concluded that the receipt of commission from overseas companies, being consideration for the export of services, was not taxable, and that, insofar as domestic facilitation was concerned, the definition provided in Section 65(12) of the Finance Act, did not extend to a 'corporate guarantee', which, unlike a 'bank guarantee', finds no specific enumeration as 'other financial services' therein till 20 June 2012. For the period thereafter, the absence of 'consideration' for facilitating a 'corporate guarantee' excluded such activity from coverage within the definition of 'service' in Section 65B(44) of the Finance Act.
- The CESTAT ruled that any activity shall indicate a 'provider' as well as the flow of 'consideration' for the purpose of taxability under the Finance Act. In the absence of any of these two elements, taxability under Section 66B of the Finance Act will not arise. Thus, there is no consideration insofar as a 'corporate guarantee' issued by the assessee on behalf of its subsidiary companies is concerned. Therefore, the CESTAT dismissed the Revenue's appeal due to the absence of consideration.
- Aggrieved by the CESTAT's decision, the Revenue has filed a civil appeal before the SC.

SC observations and ruling (Civil Appeal Diary No(s).5258/2023, Order dated 17 March 2023)

- **No evidence to demonstrate taxability**: The SC observed that this was a case where the assessee had not received any consideration while providing a corporate guarantee to its group companies. Further, no effort was made on behalf of the Revenue to assail the above-mentioned finding or to demonstrate that the issuance of a corporate guarantee to group companies without consideration would be a taxable service.
- **Consideration is must for levying service tax:** Since there was no consideration flowing to the assessee, the SC held that in the absence of consideration, no service tax liability emerges.
- **No reason to admit the appeal:** In view of the conclusive finding by the CESTAT and the Commissioner, the SC found no reason to admit this case on the ground that it should be tagged with other pending civil appeal in the case of DLF Cyber City Developers Ltd., as it has not been demonstrated that the factual matrix of both cases is identical.

Our comments

This is a significant ruling that will set a precedence in similar matters and help resolve long-drawn litigations on the issue under the erstwhile service tax regime. Under the GST regime, related party transactions, even without consideration, are treated as deemed supplies and are leviable for GST. In this regard, it is pertinent to note that while the SC has ruled that consideration is a must to levy tax on a corporate guarantee, this may create problems for the businesses under the GST regime. Therefore, the decision is likely to open the Pandora's box in cases of corporate guarantees provided by or to related parties, intercompany, or directors, as more assessees are likely to come under the Revenue's scanner.

Duty-free shops are outside the customs frontiers of India, therefore cannot be burdened with any indirect taxes – SC

Summary

The SC has affirmed the CESTAT's order and held that service tax or any other indirect tax cannot be imposed on the DFS situated in either the arrival or departure terminal of international airports. The SC has stated that the DFS are outside the customs frontiers of the territory of India and therefore cannot be burdened with any indirect taxes. Therefore, any tax levied on the DFS cannot be retained and the DFS would be entitled for refund of the tax without raising any technical objection, including that of limitation.

Facts of the case

- M/s Flemingo Travel Retail Limited (the appellant) is engaged in the business of running the DFS at the arrival and departure terminals of the Mumbai and Delhi international airports.
- Vide Notification No. 41/2012-ST dated 29 June 2012, a rebate of service tax paid on taxable services used for the export of goods was granted by way of a refund to such exporter of goods.
- The appellant filed a refund application in consonance with the above-mentioned notification for claiming the refund of service tax paid on rent paid to the Mumbai International Airport.
- The refund claim was rejected in the first instance by the original adjudicating authority on the ground that 'renting of immoveable property' was exigible to service tax and is not liable to be refunded as per the provisions of the Finance Act.
- The Commissioner (Appeals), the first appellate authority, confirming the rejection order, dismissed the appeal. Aggrieved by the arbitrary dismissal of the genuine refund claim, the appellant approached the Mumbai CESTAT.
- The CESTAT allowed the appeal, concluding that the DFS situated and operating at the international airports, being a global market, are competing among themselves in a tax-exempt environment, and accordingly, the levy of service tax shall be bereft of lawful authority.
- Aggrieved by the CESTAT's decision, the Revenue had filed the present appeal before the SC.

SC observations and ruling [Civil Appeal Nos.11400-11401/2018, Order dated 10 April 2023]

- **DFS are outside customs frontiers of India:** Referring to its earlier judgements and Article 286 of the Constitution, the SC stated that the DFS, whether situated in arrival or departure terminals, are outside the customs frontiers of India. Hence, they cannot be saddled with any indirect tax burden, and any such levy would be unconstitutional.
- **DFS entitled for refund:** If any tax is levied on the DFS, the same cannot be retained and the DFS would be entitled for refund of the same without raising any technical objections, including that of limitation.
- **Appeal dismissed:** The SC refused to entertain the prior pending appeals and left it at the discretion of the CBIC to take appropriate action on such pending appeals basis this judgement.

Our comments

This is a significant and welcome ruling by the SC, considering that the taxability of supplies to and supplies by the DFS have been an issue of extensive litigation in the pre-GST regime and even under the GST regime. It is important to note that the SC has held that the DFS is entitled to refund of service tax paid even if the claim is not filed within the timelines as prescribed.

Though the judgement has been delivered in the context of service tax laws, it will have widespread ramifications on similar transactions even under the GST regime. In this regard, it is pertinent to note that pursuant to the SC ruling, in the case of Aarish Altaf Tinwala, the supply of goods from the DFS was considered a zero-rated supply under, and such DFS was also eligible for a refund of the ITC. However, from 1 February 2019, the sale of goods by the DFS was no longer considered a supply of goods or services pursuant to it being covered under Para 8(a) of Schedule III to the CGST Act. Despite this, the DFS could still claim the ITC on inward supplies because there is no requirement of ITC reversal on transactions that are not considered as a supply.

To overcome the above, recently, in the Union Budget 2023, it was proposed to include transactions covered under Para 8(a) of the Schedule III, i.e., the supply of warehoused goods before clearance for home consumption within the value of exempt supply. Thus, it appears that the intention of the government is to not provide a refund of the ITC on inputs and input services to the DFS.

However, there arises an ambiguity as to whether the government has the power to restrict the ITC on zero-rated supplies, as Section 16(2) of the IGST Act specifically provides that the ITC shall be available in the case of zero-rated supplies, even if they are exempt supplies.

Import of engineering design and drawings liable to service tax even if considered as goods under customs – SC

Summary

The SC has quashed the CESTAT's order and held that the EDD of various models imported by the assessee for the purpose of manufacturing a WTG are leviable to service tax under the category of 'design services'. The SC stated that merely because the EDD prepared and supplied by the sister company were shown as 'goods' under the Customs Act and in the BoE, that by itself cannot be a ground to take such services out of the definition of 'design services'. The SC has found that the CESTAT's finding - that the assessee is not liable to pay the service tax under 'design services' as the custom authority considered the same as 'goods' - is erroneous.

Facts of the case

- MS Suzlon Energy Limited (the assessee) is engaged in the manufacturing of WTGs. It entered into an agreement with its sister concern outside India for the purchase of EDD to be used exclusively for the manufacture of a WTG in India.
- While importing, the assessee classified the imported designs under 'paper' in the BoE filed with the custom authorities and claimed benefit of nil rate of duty.
- The Revenue issued a SCN, raising the demand of service tax on the value of 'design services' imported by the assessee. The said demand was subsequently confirmed vide an OIO.
- Aggrieved by the OIO passed by the Commissioner, confirming the demands of service tax and also levying the interest and penalty, the respondent filed appeals before the CESTAT.
- The CESTAT observed that the 'design and drawings' are classified as 'goods' under customs and the taxation of goods and services are mutually and explicitly conceived levies. Therefore, the same activity cannot be taxed as both. Consequently, the CESTAT set aside the OIO on the ground that 'drawing and design' are to be treated as goods, and therefore, it cannot be treated as service.
- Aggrieved by the decision of the CESTAT, the Revenue has filed an appeal before the SC.
- The issue before the SC is whether the activity of import of 'EDD' from the sister concern companies is classifiable under the taxable category of 'design services' under the service tax law.

SC observations and ruling [Civil Appeal Nos.11400-11401/2018, Order dated 10 April 2023]

- **Designs are customised for the assessee:** The SC noted that designs are exclusively made for and used by the assessee. The SC stated that in terms of Circular No. 15/2011-Customs dated 18 March 2011, the imported designs are akin to packaged software and would therefore be subjected to service tax. Despite the above, the BoE was presented, treating the same as 'paper' for which the duty payable was 'nil'. Therefore, neither any custom duty, nor any service tax was paid on the said transaction.
- **Same activity can be taxed as goods and services:** The SC noted that the definition of 'design services' is wide and conclusive under the service tax law. Merely because the EDD are prepared and supplied by the sister concern company were shown as 'goods' under the customs law, the same by itself cannot be a ground to take it out of the definition of 'design services'. As per the settled position of law, the same activity can be taxed as 'goods' and 'services', provided the contract is indivisible.
- **Intention of the parties:** The SC emphasised that the distinction between the sale of goods and contract for service depends upon the fact that whether the contracting parties intend to transfer goods and services separately or in indivisible manner. Basis this and the present factual matrix, the SC held that in the present case, the activity of import of engineering design and drawings is classifiable under 'design service'. Accordingly, the SC has allowed the present appeal in favour of the Revenue.
- **Remitted matter back:** The matter was remitted back to the CESTAT to consider other grounds raised by the assessee, viz., whether the services (if any) rendered by a foreign entity will fall within the purview of 'design services' and whether the department was justified in invoking the extended period of limitation.

Our comments

In the case of BSNL, the SC has held that in any event, different aspects of a given transaction can fall within the legislative competence of two legislatures and both would have the power to tax that aspect. Even in the present case, the SC has reiterated that the same activity can be taxed as 'goods' and 'services', provided the contract is indivisible. Also, the intent of the contracting parties is crucial for determining whether the transaction is of the sale of goods or provision of service.

In light of the SC's ruling, the levy and valuation aspects may have to be evaluated in case of transactions of royalty, as the same shall be added in the assessable value of goods and leviable to service tax as well.

Central and state GST not applicable on intermediary services provided to an overseas recipient; upholds validity of intermediary-related provisions under the IGST Act – Bombay HC

Summary

The Bombay HC has upheld the validity of provisions about the PoS in the case of the intermediary under the IGST Act. Accordingly, it has held that the state cannot impose GST (central and state GST) on services rendered by Indian intermediaries to the recipient outside India. The transaction would be liable to IGST.

Facts of the case

- Dharmendra M Jani (the petitioner) is engaged in providing marketing and promotion services to his customers located outside India. To provide such services, the petitioner enters into an agreement with his overseas customers. Under such an agreement, the petitioner provides services to enable his foreign principal to get purchasers for its goods in India.
- The petitioner has treated the said services as export of services, as the same are consumed outside India and are outside the purview of the CGST Act, whereas the department considered it under intermediary services.
- The petitioner contended that the levy of tax on export of services by way of treating it as intermediary services is *ultra vires* of Article 246A read with Article 269 and Article 286 of the Constitution, as the Constitution only grants power to the parliament to frame laws for interstate trade or commerce.
- The petitioner alleged that the parliament is not empowered to enact laws in respect of extraterritorial transactions. Therefore, levy is *ultra vires* of Article 286(1) of the Constitution.
- The petitioner has also contended that Section 13(8) (b) of the IGST Act is *ultra vires* of the charging section of the CGST Act, as a provision of Section 13(8)(b) cannot be read/utilised under the provision of the CGST/MGST Act.
- The issue before the HC is whether a transaction in the instant case is a transaction of 'export of services', falling within the meaning of Section 2(6) of the IGST Act, and it is being treated as an 'intrastate trade or commerce' under the CGST Act and the MGST Act.

Bombay HC observations and ruling [Writ Petition No. 2031 of 2018, Order dated 18 April 2023]

- **The inter-state supply of services cannot be treated as intra-state supply:** The HC observed that one of the key principles of GST is that as a general rule, the place of taxation of goods and services is based on the destination principle. However, in the instant matter, merely by the virtue of friction of law, the character of a transaction from export of services is being altered into a transaction of intra-state supply of services. Therefore, the friction, which is created by Section 13(8)(b) of the IGST Act, would be required to be confined only to the provisions of the IGST Act, as there is no scope for the friction travelling beyond the provisions of the IGST Act to the CGST and the MGST Acts, as neither the constitution would permit taxing of an export of service under the said enactments, nor these legislations would accept taxing such a transaction.
- **State does not have jurisdictional power to levy tax on inter-state supply of services:** The HC held that by virtue of Article 286 of the Constituition, the state cannot impose tax in case the supply takes place outside the state or in case of import or export. Therefore, the transaction of marketing and promotion services being undertaken by the petitioner cannot amount to an intra-state trade. Thus, the petitioner cannot be taxed under the CGST Act and MGST Act. The HC has emphasised on the report by the 'Department-related Parliamentary Standing Committee on Commerce', wherein the committee has recommended an amendment to Section 13(8) of the IGST Act. The committee has deliberated that intermediary services should be made subjected to the default Section 13(2) of the IGST Act, so as to extend the benefit of export to the intermediaries.
- **Double taxation:** If an analogy is derived from the cumulative reading of Section 13(8)(b) r/w Section 8(2) of the IGST Act, so as to be read and applied under the provisions of the CGST Act and the MGST Act, it would lead not only to a consequence of double taxation but also to an implausible and illogical effect, in recognising two independent transactions to be one transaction for the purpose of the levy of CGST and MGST as intra-state trade and commerce.

- **Provisions of IGST should not be read under into the provision of CGST/MGST:** The HC noted that the transaction of export of services as that of the petitioners on the one hand is treated as inter-state supply by virtue of Section 7(5) the IGST Act and is subsequently treated as an intra-state supply by virtue of Section 13(8)(b) of the IGST Act. The cumulative effect of the provisions of Section 13(8)(b), read with Section 8(2) and Section 12 of the IGST Act, can neither be read nor can be said to be of any relevance for the purpose of the CGST and MGST Acts when it comes to any levy of GST under the said acts on intermediary services, of the nature of export of services falling within the meaning of Section 2(6) of the IGST Act.
- **Validity of Section 13(8)(b) and Section 8(2) of the IGST Act upheld:** The HC held that the provisions of Section 13(8)(b) and Section 8(2) of the IGST Act are legal, valid and constitutional. Further, these are confined in their operation to the provisions of the IGST Act only and the same cannot be made applicable for the levy of tax on services under the CGST and MGST Acts.

Our comments

This is an important judgement by the Bombay HC wherein it has held that the services provided by intermediaries to persons abroad will not attract central GST and state GST. However, it has upheld the legality of the provisions related to an intermediary under the IGST Act.

On a similar issue earlier, even the Gujarat HC, in the case of the Material Recycling Association, had held that the provision of Section 13(8)(b), read with Section 2(13) of the IGST Act, is not *ultra vires* or unconstitutional in any manner.

Karnataka HC quashes amendment to Rule 89(4)(c) as being *ultra vires* to GST law and Constitution

Summary

Amendment to Rule 89(4)(c) of the CGST Rules, restricting the amount of export turnover towards the calculation of refund amount, has been held as *ultra vires* to the GST law and the Constitution. The Karnataka HC further held that the rule fails to prescribe the refund computation in cases where no similar goods are supplied in the domestic market and the value of like goods provided by other suppliers is unavailable.

Facts of the case

- M/s Tonbo Imaging India Pvt Ltd (the petitioner) is engaged in developing innovative designs in micro-optics, lower-power electronics and real-time vision processing systems in a customised manner for its customers.
- The petitioner had filed refund claims of unutilised ITC on account of exports made under the LUT during the period May 2018 to March 2019 under Section 54(3)(i) of the CGST Act, read with Rule 89 of the CGST rules.
- In view of the amendment made in Rule 89(4)(c) vide Notification No.16/2020-CT effective from 23 March 2020, the authorities issued three SCNs on the grounds that the petitioner has not submitted the proofs to substantiate that the value of the export turnover mentioned in the instant claim is 1.5 times of ‘like goods’ as required to be computed under Rule 89(4)(c) of the CGST rules.
- In response to the SCNs, the petitioner contended that the amended rule (supra) would not be applicable in the instant case, as the period for which the refund was claimed (i.e., May 2018 to March 2019) is much prior to the amendment of Rule 89(4)(c) of the CGST Rules. Further, the petitioner submitted that they are engaged in the export of customised goods, and hence, furnishing the proof of like or similar goods supplied domestically in India is not possible.
- The authorities rejected the submission of the petitioner and issued an order disallowing the refund claims.
- Aggrieved by the order of the authorities, the petitioner filed a writ petition before the HC.

SC observations and ruling (SLP Civil Appeal Diary No. 4928/2023, Order dated 27 February 2023)

- **Amended rule is violative of Article 14 and Article 19(4) of the Constitution:** The HC noted that Rule 89(4)(c) only restricts the refund quantum where the exports are made under LUT as opposed to the refund claimed where goods are exported after the payment of tax. Therefore, the said rule seeks to create discrimination between two classes of exporters, and therefore, is violative of Article 14 and Article 19(1)(g) of the Constitution.
- **Rule 89(4)(c) defeats the purpose of Section 16 of the IGST Act and Section 54 of the CGST Act:** The HC opined that Section 16 of the IGST Act aims to make the exports tax-free by ‘zero-rating’ them. However, Rule 89(4)(c) attempts to restrict the same by including domestic turnover in the definition of zero-rated supplies for the computation of the refund claim, which should only cover export turnover.

- **Prejudicial to exporters:** The HC observed that placing unreasonable restrictions on refund claims would ultimately discourage the exporters who account for the export incentives while quoting prices to foreign customers. The HC further emphasised that taking away or restricting the benefit of unutilised ITC would also adversely affect the availability of the rotation of funds, which is essential for the business to thrive.
- **Amended Rule 89(4)(c) is unreasonable and arbitrary:** The HC has stated that Rule 89(4)(c) prescribes undertaking the value of 'like goods' domestically supplied by the exporter or similar supplier. In this regard, the HC opined that the use of terminology such as 'like' or 'similar' indicates vagueness in the aforesaid rule. Furthermore, referring to the facts of the instant case, the HC also noted that the rule fails to prescribe the refund computation in cases where no similar goods are supplied in the domestic market and the value of like goods provided by other suppliers is not available.
- **Rule 89(4)(c) is *ultra vires* of Section 16 and Section 54 of the CGST Act:** The HC has held that Rule 89(4)(c) attempts to take away the right of the exporter to obtain a refund, which is entrusted vide Section 16 of the IGST Act and Section 54 of the CGST Act. Thus, the said rule is *ultra vires* to the said sections and liable to be quashed. In view of the same, the HC has allowed the refund claims of the petitioner.

Our comments

The amendment restricted the turnover of zero-rated supply of goods to 1.5 times the value of like goods domestically supplied by the same or similarly placed supplier to compute the refund of the ITC. This affected the exporters' working capital, especially where the exporters already had accumulated credit.

Thus, this is a significant and welcome judgement by the Karnataka HC. As a result, the taxpayers whose refund claims were rejected or who claimed lower refunds, may evaluate the possibility of claiming the differential refund.

In this regard, it is pertinent to note that on a similar issue earlier, the apex court, in the case of VKC Footsteps Pvt. Ltd, had held that while recognising an entitlement to a refund, it is open to the legislature to define the circumstances in which a refund can be claimed.

ITC to recipient not to be available on account of non-payment by supplier to the government – Madras HC

Summary

The Madras HC has held that under the GST laws, the ITC is admissible in respect of a supply only when the tax charged for such supply is paid to the government. Further, the HC stated that to ensure that the interests of the Revenue are protected, the GST laws provide for a mandate that the tax liability is defrayed/met either at the hands of the supplier or the purchaser. The substantive or primary liability is of the supplier, and the ITC reversal of the buyer can be a protective measure to ensure the Revenue's interest. Furthermore, the HC stated that the Revenue should ensure a mechanism to restore/refund the tax paid by the buyer if the recovery is made from the supplier.

Facts of the case

- M/s Pinstar Automotive Private Limited (the petitioner) received a pre-assessment notice wherein the Revenue denied the ITC to the petitioner on certain supplies where suppliers had not paid GST to the government.
- The petitioner contented that it has complied with eligibility requirements of Section 16 of the CGST Act and paid the consideration, along with GST, to the supplier within 180 days, and therefore, they are eligible for the ITC.
- The stand was rejected by the respondent who passed an OIO confirming the demand proposed in the SCN. Inter alia, the assessing authority has confirmed the addition proposed under the SCN.
- Placing reliance on the HC's decisions of erstwhile law, the petitioner has filed an appeal before the Madras HC, contending that the ITC should not be denied to them due to the supplier's default.
- Further, the petitioner has chosen to seek rectification of the OIO for rectification of errors apparent on the face of the record under Section 161 of the CGST Act.

Madras HC observations and ruling [Writ Petition No. 8686 of 2023, Order dated 20 March 2023]

- **Mandatory requirements for availing ITC:** Section 16(2) of the CGST Act provides certain mandatory contingencies for continuity of the ITC to a registered person. Inter alia, one of the conditions is that the tax charged in respect of such supply has been actually paid to the government in cash or through utilisation of the ITC, admissible in respect of the said supply. Thus, there is a mandate cast upon the petitioner/claimant to the ITC to ensure compliance with the provisions, as in the alternative and as a natural consequence of Section 16(2)(c) of the CGST Act, it would be entitled to the ITC.
- **Provisions of Section 16 of the CGST Act should be complied:** The HC held that the conditions of Section 16 are to be read strictly and that there cannot be any jeopardy to the interest of the Revenue. The said section ensures that the interests of the Revenue are protected by providing for a mandate that the tax liability is defrayed/met either at the hands of the supplier or the purchaser, the petitioner in this case. Thus, no fault can be attributed to the Revenue in this regard.

- **Recovery from the petitioner is a protective measure:** The HC observed that the provisions of Section 16 ensure that the tax liabilities should either be met by the supplier or the recipient. The HC has stated that the substantive or primary liability is of the supplier and the ITC reversal of the buyer can be a protective measure to ensure the Revenue's interest.

- **Appropriate mechanism to prevent unjust enrichment by way of double benefit to the government**: The HC has directed the Revenue to devise a mechanism for refund or re-availment of the ITC to the petitioner towards the amount recovered from them as and when the recoveries are made from the defaulting suppliers. This is so because the government cannot take double benefit from the recipient as well as the supplier.

- **Writ petition allowed:** The HC stated that it had no intention to intervene in the conclusion of the assessing authority on the reversal of the ITC. However, the HC stated that no opportunity has been granted to the petitioner before the passing of the impugned order, and this is a fatal flaw. This procedure followed by the authority is clearly contrary to the third proviso to Section 16 of the CGST Act that necessitates that where the authority proposes to take a view adverse to the applicant, due process must be followed. Thus, the HC directed that the petitioner shall be heard by the issue of notice and orders passed on the Section 161 application within a period of four weeks.

Our comments

Contrary to the present ruling, earlier in the case of M/s D.Y.Beathel Enterprises, the Madras HC held that the purchaser/buyer cannot be asked to reverse the ITC availed when there is a default on the part of the seller to discharge its tax liability to the government. The HC stated that strict action should have been taken against the seller, and the Revenue should initiate recovery proceedings before asking the purchaser to reverse the ITC.

The SC, in the case of Arise India Limited, had earlier dismissed the SLP filed by the Revenue and refused to interfere with the order of the Delhi HC, which had held that the relevant provisions under the VAT law are violative to the extent that they disallow the ITC to the purchaser due to the default of the selling dealer in depositing tax.

Even the Karnataka HC, in the case of Simplex Infrastructures Ltd., had held that the ITC could not be denied in the hands of the purchasing dealer merely because the selling dealer had not discharged its VAT liability.

It may be noted that w.e.f. 1 October 2022, Section 41(2) of the CGST Act has been amended to provide that the ITC shall be reversed, along with applicable interest, wherein the supplier has not paid the tax to the government.

SC lists the matter of constitutional validity of GST exigibility on leasing/renting of immovable property

Myrayash Hotels Pvt. Ltd. had filed a petition before the Bombay HC, challenging the constitutional validity of Para 2 and Para 5(a) of the Schedule II to the CGST Act. The petitioner contended that under Article 246A of the Constitution, GST can be levied only on 'goods and services'. In the case of a lease/rent agreement, there is no 'service' provided by the lessor/landlord to the lessee/tenant. Thus, there can be no levy of GST on the same. Only the state legislatures have the power to tax transactions relating to the immovable property under Entry 49 List II of the seventh schedule of the Constitution. Thus, GST cannot be levied under Article 246A on such a lease/rent transaction.

The petitioner submitted that when a lease is given by the lessor/landlord to the lessee/tenant by way of a lease, all rights and enjoyment over that immoveable property is denounced from the lessor/landlord to the lessee/tenant for the lease/rent period. In the instant matter, the Bombay HC rejected the contention of petitioner and followed its decision given in the Retailers Association of India (RAI), stating that the judgement pronounced in the case of the RAI was rendered to the context of service tax. However, the principle laid down therein is also applicable under GST.

Earlier, the Bombay HC, in the case of the RAI, had held that the Parliament has wide powers under the residuary power of legislation, and since service tax was enacted under the residuary power of legislation, one cannot challenge the assumption of the Parliament that there is a service element in the leasing of land, if the tax does not come within List II of the seventh schedule of the Constitution.

The SC has granted a leave to the appeal filed by the petitioner and has tagged it with the connected Civil Appeal No. 4487 of 2010 and other allied appeal for hearing. The SC has further clarified that there is no stay against the recovery, and it will be open for the Revenue to recover the tax in accordance with the law and on its own merits.

B. Key updates under the Customs/FTP/SEZ laws

SC upholds the validity of mandatory fulfilment of pre-import condition for imports under advance authorisations

Summary

The SC has upheld the requirement of the 'pre-import condition' incorporated in the FTP and HBP to claim exemption of IGST and Compensation Cess on inputs imported for the manufacture of export goods, on the basis of AA scheme. The SC noted that the inconvenience caused to exporters by paying two duties and claiming refund could not be a ground to hold the 'pre-import' condition as arbitrary. Further, the SC observed that the FTP itself empowered the DGFT to impose 'pre-import conditions' on articles other than those specified that the Gujarat HC had failed to consider and had erroneously proceeded on the assumption that only the goods specified were subject to the 'pre-import condition'. Therefore, the SC has set aside the Gujarat HC judgement and held that the pre-import condition under the AA scheme for availing benefit of exemption is not arbitrary or unreasonable.

However, the SC has directed the Revenue to permit the exporters who were enjoying interim orders till the impugned judgements were delivered, to claim refund or ITC, and they shall approach the Jurisdictional Commissioner and apply with documentary evidence within six weeks from the date of the judgement.

Facts of the case

- The Gujarat HC had struck down the 'pre-import condition' under the AA scheme in the FTP for being unconstitutional, arbitrary and unreasonable.
- Initially, the payment of BCD, CVD and SAD, Safeguard Duty and Anti-Dumping Duty on inputs imported against the AA, was exempted. After the introduction of GST, the CVD and SAD were subsumed, while the IGST and Compensation Cess were introduced. However, the same benefit of exemption was not extended to the IGST and Compensation Cess, leading to the exporters having to avail subsequent ITC or take refund of such duties. This further led to the concomitant blocking of working capital.
- The DGFT extended the benefit of exemption to the IGST and Compensation Cess from 13 October 2017, subject to conditions, namely the 'pre-import condition' and 'physical exports'.
- Cosmos Films Limited (petitioner) herein claimed that they were unaware about this condition, and continued exports in anticipation of the grant of AA, and consequently expected exemption from all custom duty levies, including the IGST and Compensation Cess.
- The HC noted that the department had interpreted a 'pre-import condition' to mean that 'goods had to be imported first, and then the final product manufactured with such imported goods were to be exported'. The condition stood satisfied when inputs imported against a particular AA license were used to manufacture finished goods exported for the fulfilment of EO of that specific AA license. The HC stated that such interpretation is unfeasible and leads to impossibility.
- The HC noted that the department denied exemption by treating the permissible imports as 'replenishment imports'. Merely because the exports were carried out first, followed by duty-free import against authorisation, exemption cannot be denied. Such 'sudden treatment' of inputs when the HBP permitted exports in anticipation of authorisation was held to be incomprehensible and unreasonable. The HC further emphasised that the condition was subsequently withdrawn w.e.f. 10.01.2019 Para. 4.13 of the FTP Para 4.27(a) of the HBP.

SC observations and judgement [CA No. 290 of 2023, Order dated 28 April 2023]:

- **Inconvenience or hardship cannot be a ground to interpret plain language of statute differently:** The SC noted that the amendment brought inconvenience to exporters who first paid the import duties and subsequently claimed refunds, subject to fulfilment of the condition. However, such hardship cannot be grounds to implicate that the pre-import condition was arbitrary. The SC expounded that 'hardship' is not relevant in pronouncing on the constitutional validity of a fiscal statute or economic law'.
- **All AA holders were never treated alike:** Drawing reference from Para. 4.13(i) of the FTP, it observed that the DGFT retained power to impose a pre-import condition on articles other than those mentioned in Appendix-4J and rebuffed the interpretation that only articles mentioned in Appendix-4J could be subjected to the pre-import condition. The existence of this discretion means that there is flexibility in regard to the nature of policies to be adopted, having regard to the state of export trade, and concessions to be extended in the trade and tax regime. The SC opined that all AA holders were never treated alike.
- **No blanket right to claim exemption:** There cannot be a blanket right to claim exemption, and that such a relief is dependent on the assessment of the state and tax administrators, and mechanism for its administration. The exemption from the requirement of pre-import conditions continues in respect of the old levies, which are, even as on date, not part of the GST regime. That clearly sets them apart from the new levies, the payment of which is insisted (after which refund can be sought) as a part of a unified system of levy, assessment, collection, payment, and refund.

- **Doctrine of classification cannot be applied strictly on new legislation:** When reform by way of a new legislation is introduced, the doctrine of classification cannot be applied strictly, and some allowance for experimentation, to observe the effect of the law, is available to the executive or legislature.
- **No constitutional compulsion to continue concessions granted in past:** There is no constitutional compulsion that while framing a new law, or policies under a new legislation – particularly when an entirely different set of fiscal norms are created, overhauling the taxation structure, concessions hitherto granted or given should necessarily be continued in the same fashion as they were in the past.
- **Pre-import condition cannot be arbitrary or unreasonable:** The object of the new law is the creation of new rights and obligations, with new attendant conditions. This process is bound to lead to some disruption. In this case, the disruption is in the form of requirement to pay the two duties and claim refunds. Therefore, the exclusion of benefit of imports in anticipation of AAs and requiring payment of duties with the 'pre-import condition', cannot be characterised as arbitrary or unreasonable.
- **HC judgement not sustainable:** Construing the later notification of 10 January 2019 as being effective from 13 October 2017 would be giving effect to it from a date prior to the date of its existence. In other words, the court would impart retrospectivity. To give a retrospective effect to the said notification through interpretation would be to achieve what is impermissible in law. What applies to refunds (the right to which can be curtailed legitimately), applies equally to exemptions. Therefore, the impugned judgement of the Gujarat HC need to be set aside.

Our comments

Contrary to the Gujarat HC's decisions, earlier, the Madras HC, in the Vedanta Limited case, had also upheld the validity of the pre-import condition. The HC observed that the import is in the nature of replenishment of inputs used in already exported goods.

The SC has struck down the Gujarat HC's ruling, and thus, the exemption from levy of the IGST under Section 3 (7) and Compensation Cess leviable under Section 3 (9) of Customs Tariff Act, 1975, shall be subject to the conditions that the EO shall be fulfilled by physical exports only and the 'pre-import condition' during the period 13 October 2017 till 10 January 2019.

The present ruling is likely to cause hardship to the exporters, as the authorities will issue notices and they will be required to pay duty, along with interest, for the disputed period.

03

Decoding advance rulings under GST

Services by branch to head office exigible to GST – Tamil Nadu AAR

Summary

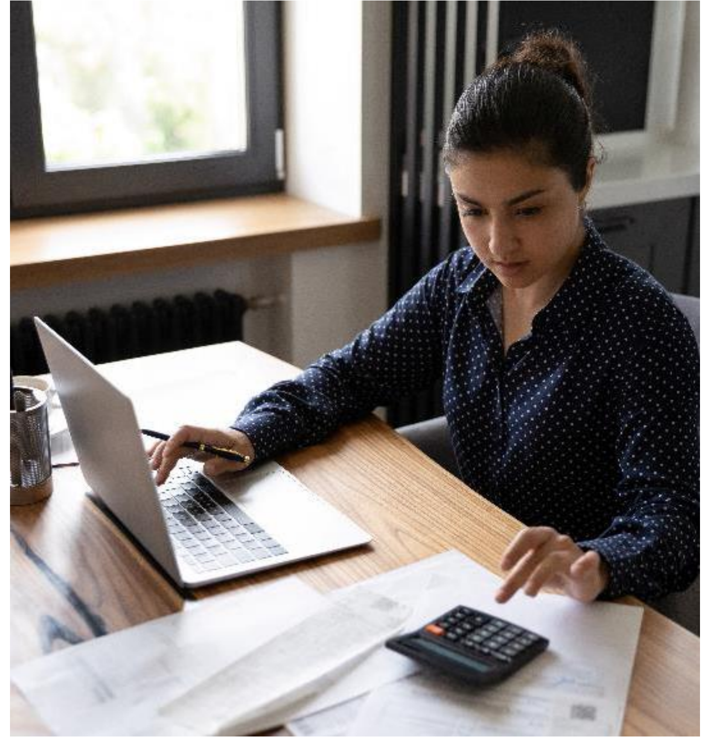
The Tamil Nadu AAR has ruled that GST shall be levied on services, including the services of common employees of a person, provided by a branch office to head office and vice versa, each having separate GST registration. According to the AAR, services supplied directly to the head office by an employee deployed in a branch of an entity will be in his representative capacity as an employee of the branch. The AAR has referred to provisions dealing with supply between related or distinct persons and held that any supply of service between two registrations of the same person in the same or different states will be subject to GST.

Facts of the case

- The branch office of Profisolutions Private Limited (the applicant) registered in the state of Tamil Nadu provides accounting services and various technical services to its head office registered in Karnataka.
- The applicant submitted that employees are appointed and working for the company as a whole and not specifically for the head office or branch office. Furthermore, the salary and benefits paid to the employees are in relation to employment, being outside the purview of supply. Therefore, the applicant has neither issued any invoice nor charged GST for the provision of such services.
- The applicant sought an advance ruling to determine whether the services provided by the branch office in one state to the head office in another state through common employees constitute as supply of services in terms of Section 7 of the CGST Act and exigible to GST.

Tamil Nadu AAR observations and ruling [Advance Ruling No. 07/ARA/2023 dated 31 March 2023]

- **Services by the branch employee to head office is in his representative capacity:** The AAR noted the applicant's view that employees are appointed and working for the company as a whole and such head office and branch are a distinct person under GST. In this respect, the AAR stated that the service provided by a branch employee flows only through the branch to the head office or customer. Furthermore, services provided directly to the head office by an employee deployed in a branch of an entity will be in his representative capacity as an employee of the branch.
- **Services by branch office to head office exigible to GST:** The AAR referred to the relevant provisions related to the supply between related persons or distinct persons under the GST law. Basis that, the AAR stated that any supply of services between two registrations in the same or different states attracts such provisions. Further, since the employees are related persons, even the services of employees deployed at one registered place of business to another registered premises of the same person attracts such provisions. Therefore, the AAR held that the services provided by the branch office to head office and vice versa, each having separate GST registration, will attract GST.



Our comments

The matter that whether any supply of services from the head office to the branch office and vice versa is chargeable to GST or not has been a contentious issue since the introduction of GST.

Earlier, the Karnataka AAAR upheld the AAR decision in the case of M/s. Columbia Asia Hospitals Private Limited, wherein it had been held that activities such as accounting, administrative work, etc. with the use of services of employees sitting at the corporate office for other offices, shall be treated as taxable supply of service and liable to GST. However, this ruling is under challenge before the Karnataka HC.

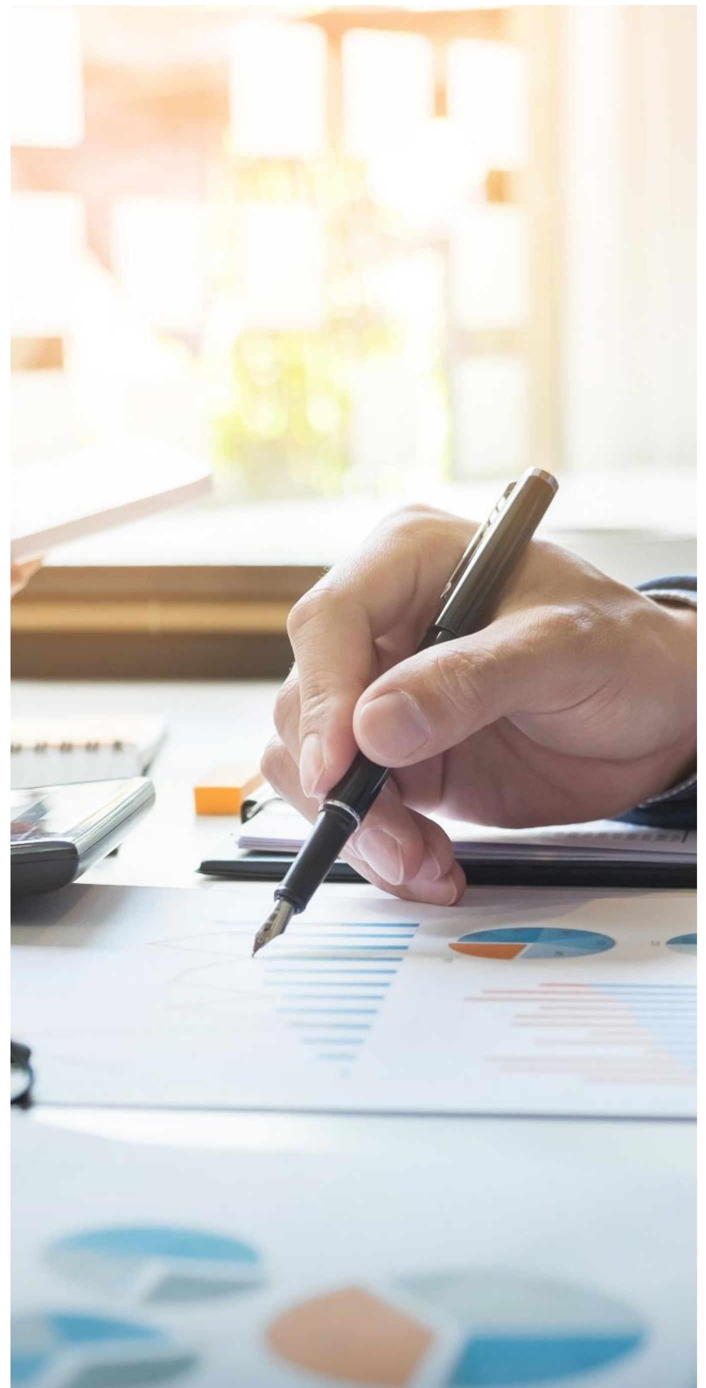
Similarly, in the case of Cummins India Limited, the Maharashtra AAAR upheld the AAR decision wherein it had been held that where the head office is using all its human resources to facilitate the operational requirements of the branch offices/units, in that case, allocation and recovery of any amount, including the employee's salary cost by the head office from its branch offices/units, will be subject to GST. Further, the AAAR affirmed the open market value of the services for the valuation purpose.

Even the Haryana AAR, in the case of Tupperware India Private Limited, had held that the services supplied by the head office to other units by way of performing activities shall be leviable under the GST regime.

The present ruling is in congruence with the above rulings. However, the AAR has not discussed the valuation methodology of such services. Cross charging employee cost is a tricky topic and may have significant tax repercussions for the taxpayers having exempt supply. This decision may lead to more litigation, and the taxpayers may receive frequent notices in this respect. Therefore, the government should clarify this issue to avoid unnecessary squabbles.

04 Expert's column

In this edition, Sujay Paul, Chartered Accountant, Noida, responds to the impact of changes in the tax rate on royalty/fees for technical services on foreign companies.



Change in tax rate on royalty/fees for technical services - Impact on foreign companies

What is the change introduced in the taxability of royalties and FTS?

- The Finance Act, 2023, has amended the tax rate applicable on royalties and FTS earned by foreign companies under the Indian IT Act.
- Royalties are payments made to the owner for the use of an asset or property, such as patents, copyrights, intellectual property rights, among others. Furthermore, FTS refers to payments made for the rendering of any managerial, technical or consultancy services.
- The erstwhile tax rate of 10% under Section 115A of the IT Act has been increased to 20% in case of royalty or FTS earned by non-residents, including foreign companies.
- Pursuant to this amendment, royalty and FTS will now be taxed under the domestic tax law at the same tax rate as applicable to dividend and interest (except for certain categories where the interest is taxed at concessional rates).

When is this change effective from?

- The new tax rate of 20% stated above is applicable in respect of royalties/FTS earned on or after 1 April 2023 (i.e., from FY 2023-24 onwards).
- The change in tax rate also results in a change in the rate at which taxes are required to be withheld by a payer while making payment of such royalty/FTS to non-residents and foreign companies. Accordingly, taxes need to be withheld at the revised rate on royalties/ FTS earned on or after 1 April 2023.

What will be the impact of this change on the applicable tax rate of royalty and FTS under the provisions of the DTAA (or tax treaty) entered by India with other countries?

- The recent increase in the tax rate on royalty and FTS from 10% to 20% under the Indian domestic tax law will not impact the rate of tax under the respective DTAAs entered into by India with other countries.
- The applicable tax rate for royalty and FTS under the DTAA will continue to be governed by the respective agreements with other countries.
- A non-resident taxpayer (including foreign companies) have the option to choose between the provisions of the domestic tax law and the applicable tax treaty, whichever is more beneficial to them. In light of the increase in tax rates under domestic tax law, it would be relevant to check whether the applicable DTAA provides for any relief in terms of lower tax rates applicable to FTS and royalty.
- It is important to note that most of the DTAAs that India has entered into usually provide a lower tax rate on royalty and FTS as compared to 20% under the domestic tax law. For instance, tax treaties with countries such as Singapore, the UK, and Germany typically provide for a 10% tax rate on royalty and FTS, while under the India-US treaty, the rate is usually 15%. Therefore, while there is no change in tax rates under the DTAA for royalty and FTS, this amendment is likely to result in more taxpayers choosing to be governed by the respective DTAAs rather than the domestic tax law wherever the DTAAs provide for a beneficial tax rate.
- Further, the increase in tax rates on royalties and FTS under Indian domestic tax law would not per se impact the positions adopted by foreign companies that are already availing treaty benefits by virtue of a lower tax rate under the relevant tax treaty or treating the income as exempt due to the narrow definition of royalty or FTS provided under the treaty.

What are the applicable compliances/documents to be furnished if a company claims benefit under the DTAA?

- With an increase in tax rates on royalty and FTS under the domestic tax law, it is more likely that the non-resident entities will take recourse to the tax treaty wherein a lower/ beneficial rate has been provided. This will result in greater compliance obligations for the non-resident recipient. In order to claim the beneficial provisions under a DTAA, a foreign company must have the following documents:
  - A Tax Residency Certificate issued by the tax authority of the foreign country (the country of residence of the foreign company);
  - Electronically filed Form 10F; and
  - No permanent establishment declaration.
- Form 10F must be electronically filed by an authorised signatory of the foreign entity. Furthermore, the foreign entity will have to apply for tax registration in India (i.e., obtain PAN) and create its account on the income tax portal for filing Form 10F online.

Are foreign entities earning only royalty/FTS exempt to file their ITRs (annually) in India?

- As per the domestic tax provisions, foreign companies earning royalty or FTS are not required to file tax returns in India, on which the taxes are withheld not lower than the tax stated in the specified provision, i.e., Section 115A of the IT Act.
- Now, with an increase in the domestic tax rate to 20%, foreign companies are likely to take recourse or avail the lower tax rates prescribed in the tax treaties. This will result in an obligation on such taxpayers to file tax returns in India.
- Further, if non-resident entities have taxes deducted at a higher rate than the rate prescribed under the relevant tax treaty, they may still be able to claim treaty benefits while filing their ITRs. However, this is subject to conditions/ documentation requirements.

05 Issues on your mind

What is an AEO and an AEO programme?

An AEO is a business entity involved in the international movement of goods requiring compliance with provisions of the national customs law and is approved by or on behalf of the national administration in compliance with the WCO or equivalent supply chain security standards. The security standards are detailed in the WCO SAFE FoS, which is the basis of the Indian AEO programme.

The AEO programme enables the Customs administration to identify the safe and compliant business entity to provide them a higher degree of assured facilitation. This segmentation approach enables the Customs resources to focus on less or non-compliant or risky businesses for control. Thus, the aim of the AEO programme is to secure the international supply chain by granting recognition to reliable operators and encouraging best practices at all levels in the international supply chain.

Through this programme, the Customs shares its responsibility with the businesses, while at the same time rewarding them with several additional benefits.

What is the structure of the Indian AEO programme and its validity?

There is a three-tier programme for importers and exporters, i.e., AEO-T1, AEO-T2 and AEO-T3, in the increasing degree of benefits accorded and compliance requirements. Furthermore, there is a single tier AEO programme for logistics providers, custodians or terminal operators, customs brokers and warehouse operators that are granted the AEO-LO certificate.

The validity of the AEO certificate is three years for AEO-T1 and AEO-T2, and five years for AEO-T3 and AEO-LO.

What are the due dates for filing AEO and AEO-LO applications?

Till 30 April 2023, the AEO-LO applicants would be allowed to physically file an AEO application without registering on the AEO portal as a transitional measure. However, from 1 May 2023, it will be mandatory for AEO-LO applicants to register on the portal for AEO certification. The updated version of the website - www.aeoindia.gov.in - is accessible from 11 April 2023.

What is MRA?

MRA are bilateral understandings between two Customs administrations that allow one business partnership programme to recognise the AEO validations of the other country's programme and extend reciprocal benefits to each other's AEO. The benefits are generally in the nature of enhanced system-based facilitation and reduced interdiction, lower risk score for an Indian exporter's consignments at a foreign port.

06 Important developments under direct taxes

CBDT extends last date to link PAN with Aadhaar

The CBDT had earlier specified 31 March 2023 as the last date to link PAN with Aadhaar. However, it has recently extended this date to **30 June 2023.**

Further, the CBDT has also specified the following consequences of failure to link PAN with Aadhaar [applicable from **1 July 2023**]:

- The PAN will become inoperative;
- No refund would be granted to such taxers;
- No interest on refund would be payable during the period the PAN was inoperative; and
- A higher rate of TDS and TCS will be levied as per Section 206AA and 206CC of the IT Act, respectively.

However, the PAN can be made operative again in 30 days upon intimation of the Aadhaar to the prescribed authority, along with fees of INR 1,000.

[CBDT press release dated 28 March 2023, Notification no. 15 of 2023 dated 28 March 2023 and Order dated 1 April 2023]

Certain non-residents exempted from e-filing of Form No. 10F

The DGIT (Systems) had earlier exempted certain non-residents not having PAN and who were not required to obtain PAN (under the IT Act) from filing Form No. 10F electronically. However, this exemption was provided only up to 31 March 2023.

Recently, the CBDT has further extended the aforesaid relaxation up to **30 September 2023.** Accordingly, such non-residents may undertake statutory compliance of filing Form No. 10F till **30 September 2023** in the manual form.

[CBDT order dated 28 March 2023]

Procedure for filing and disposal of application for no tax deduction on specified income (Form No. 15C and 15D)

Section 195(3) of the IT Act provides that a banking company or insurer or any other person who carries on a business / profession in India through a branch can apply for a certificate to receive interest or other income without deduction of TDS. Such an application is to be filed with the AO in Form No. 15C or Form No. 15D.

In this regard, the DGIT (Systems) has specified the procedure for filling an application in Form No. 15C or Form No. 15D as under [applicable w.e.f. 1 April 2023]:

- Unregistered taxpayers are required to be registered on the TRACES website using the PAN;
- Application to be made electronically through the TRACES website with respect to interest income and other sums;
- Form No. 15C or 15D, along with supporting documents, shall be submitted using DS / EVC / mobile OTP;
- Taxpayers accessing the website from outside India can login at the TRACES website and submit Form No. 15C / Form No.15D, along with supporting documents using DS only; and
- Status of the application can be tracked on the website under the ‘Statements / Forms’ tab.

Further, the DGIT (Systems) also prescribed the procedure for the following:

- Assignment of application to the TDS AOs in the international taxation charges;
- Processing the application by the TDS AO, range head and commissioners of income tax; and
- Issuance of certificate on the TRACES website.

[Notification no. 1 of 2023 dated 29 March 2023]

Clarification regarding employer’s obligation to withhold tax under the default tax regime

As per the Finance Act, 2023, the new tax regime would be the default tax regime. However, taxpayers not having income from a business or profession may exercise an option whether to be governed by this regime or not on a yearly basis before the due date of filing the ITR.

Accordingly, employers sought clarity regarding the manner in which TDS under Section 192 of the IT Act is to be computed. In order to reduce ambiguity and hardship to employers, the CBDT has notified that:

- The employer will seek information from each employee regarding the intended tax regime (i.e., whether the employee wants to opt out of the default tax regime);
- Based on the information, TDS shall be deducted as per the option exercised; and
- If the employee fails to intimate the aforesaid information, in such case, TDS should be deducted as per the default tax regime.

However, the aforesaid intimation by the employee would not amount to exercising the option as per Section 115BAC(6) of the IT Act, which is to be exercised at the time of filing the original return of income.

[Circular No. 4 of 2023 dated 5 April 2023]

07 Glossary

AA	Advance Authorisation
AAR	Authority for Advance Ruling
AAAR	Appellate Authority for Advance Ruling
AATO	Annual Aggregate Turnover
AEO	Authorised Economic Operator
AEO-LO	Authorised Economic Operator-Logistics Service Providers
AO	Assessing Officer
BCD	Basic Customs Duty
BoE	Bill of Entry
CBIC	Central Board of Indirect Taxes and Customs
CBDT	Central Board of Direct Taxes
CESTAT	Customs Excise and Services Tax Appellate CESTAT
CEPA	Comprehensive Economic Partnership Agreement
CGST	Central Goods and Service Tax
CGST Act	Central Goods and Service Tax Act, 2017
CGST Rules	Central Goods and Service Tax Rules, 2017
CPCB	Central Pollution Control Board
Customs Act	The Customs Act, 1962
CVD	Countervailing duty
DFIA	Duty Free Import Authorisation
DFS	Duty Free Shops
DGFT	Directorate General of Foreign Trade
DGIT(System)	Director General of Income-tax (Systems)
DIN	Document Identification Number
DS	Digital Signature
DTAA	Double Taxation Avoidance Agreement
ECL	Electronic Cash Ledger
EDD	Engineering Design & Drawings
EO	Export Obligation
EODC	Export Obligation Discharge Certificate
EPCG	Export Promotion Capital Goods
EVC	Electronic Verification Code
Finance Act	The Finance Act, 1994
FTP	Foreign Trade Policy
FTS	Fees for Technical Services
FY	Financial Year
GST	Goods and Services Tax
GSTN	GST network
HBP	Handbook of Procedures
HC	High Court
IFSC	Indian Financial System Code
IGST	Integrated Goods and Services Tax
IGST Act	The Integrated Goods and Services Tax Act, 2017
INR	Indian Rupee
ITC	Input Tax Credit
IT Act	The Income Tax Act, 1961
ITR	Income-Tax return
IRN	Invoice Reference Number
IRP	Invoice Registration Portal
KYC	Know Your Customer
LUT	Letter of Undertaking
MGST	Maharashtra Goods and Services Tax Act, 2017
MRA	Mutual Recognition Agreement/Arrangement
NPCI	National Payment Corporation of India
OIO	Order-in-Original
OTP	One-time password
PAN	Permanent Account Number
PoS	Place of Supply
RA	Regional Authority
RFN	Reference Number
SAD	Special Additional Duty
SC	Supreme Court
SCN	Show Cause Notice
STO	State GST tax officer
SLP	Special Leave Petition
TRACES	TDS Reconciliation Analysis and Correction Enabling System
TRQ	Tariff Rate Quota
TDS	Tax Deducted at Source
TCS	Tax Collected at Source
UAE	United Arab Emirates
UIN	Unique Identification Number
WTG	Wind Turbine Generator
WCO	World Customs Organisation
WCO SAFE FoS	World Customs Organisation Safe framework of standards

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