UPDATES

Indirect Tax Updates

January-February 2022

This update covers:

1 Customs ____ 1

2 Service Tax ____ 2

3 Goods and Services Tax ____ 3

1 Customs

This update covers key judicial developments and important notifications relating to customs, service tax and GST in the months of January and February 2022.

No Social Welfare Surcharge payable on goods exempted from basic and other customs duties

The Department of Revenue (Tax Research Unit) has issued a clarification on the applicability of Social Welfare Surcharge (**SWS**) on goods exempted from basic customs duty or other customs duties/ cesses.

The SWS is collected by the Central Government on imported goods under Section 110 of the Finance Act, 2018. It is levied and collected as a duty of customs and is calculated at the rate of 10% on the aggregate of the customs duties, taxes and cesses.

As the SWS is calculated on the aggregate of customs duty payable on the import of goods and not on the value of the imported goods, it has been clarified that the SWS would be 'Nil' in cases where the aggregate of customs duty is zero even though SWS has not been specifically exempted.

This clarification helps to settle the uncertainty on applicability of SWS where customs duty had been exempted. Certain field formations had been taking a view that even where the customs duty was exempted, SWS was payable on notional customs duty determined at the tariff rate.

Country of Origin Certificates cannot be undone without following due process laid down under the Treaty

The Customs, Excise and Service Tax Appellate Tribunal (**CESTAT**), Ahmedabad has set aside the confirmation of differential duty demand by the Customs department on the ground of Country of Origin (**COO**) Certificate being invalid.

CESTAT concurred with the importer's submission that the Rules framed under India's Treaty with South-East Asian countries (**Rules**) provide for an elaborate procedure for verification of COO Certificates. As per the Rules, the COO Certificate is to be referred to the competent authority abroad, which may be followed by checks and verification visits. However, in the present case, the Customs department, without getting any confirmation on the authenticity of COO Certificates from the competent governmental authority abroad, denied the exemption benefit and confirmed duty demand. Accordingly, the CESTAT set aside the confirmation of demand but kept it open for the Customs department to conduct the verification procedure in terms of the Rules.

This decision will help importers against arbitrary denial of exemption benefits by the Customs department without following the procedure for verification of COO certificates provided under various treaties.

2 Service Tax

Service tax not leviable on notice pay

The Customs, Excise and Service Tax Appellate Tribunal (**CESTAT**), New Delhi has held that no service tax is leviable on notice pay received by an employer from its employee for premature resignation and failure to serve the entire notice period.

The tax department had contended that the amounts received by an employer from its employee for resigning from service without giving the requisite notice constitute consideration towards the service of 'agreeing to tolerate an act'. However, the CESTAT held that such amounts received by the employer are not in the nature of consideration but compensation under the employment contract and therefore, service tax was not payable.

Previously, the Madras High Court had also ruled against the levy of service tax on notice pay. The decision of CESTAT has now reinforced this position.

No service tax on 'cost petroleum' and 'profit petroleum' under profit sharing contracts

CESTAT, Mumbai, in *B.G. Exploration & Production India Ltd. v Commissioner of CGST & Central Excise*, has held that 'cost petroleum' and 'profit petroleum' under a Production Sharing Contract cannot be treated as consideration for rendering any mining service to the Government of India.

The Appellant Company had entered into a Joint Operating Agreement for the exploration, development and production of petroleum. As per this agreement, if the exploration is successful, the mineral is extracted and is first shared among the Joint Venture (**JV**) companies to recover the costs. This is termed as 'cost petroleum'. Thereafter, the surplus is shared between the JV Companies and the Government, which is termed as 'profit petroleum'. The tax department accordingly sought to levy service tax on entitlement towards cost and profit petroleum as consideration for rendering mining services to the Government.

The CESTAT, relying upon its earlier decisions, observed that the activities of the JV did not amount to service. It agreed with the Appellant's contention that cost and profit petroleum are an inherent and embedded part of the production sharing contract which cannot be treated as consideration for any services. Accordingly, it held that no service tax can be fastened upon the Appellant as the JV carried out the exploration and production of petroleum for itself and not as a service to the Government.

Transactions are taxable irrespective of their legality and tax benefits as well as tax reliefs are equally available to such transactions

CESTAT, Chennai, in *V.V. Minerals v Commissioner of GST and C. Excise*, has held that the charging sections of tax laws apply to illegal acts just as they apply to legal activities. However, taxing the illegal businesses does not absolve them of their illegality.

In the present case, the tax department had rejected refund claims against the exports made by the assessee on the ground that the supplier of goods had violated the local laws. However, the CESTAT noted that merely because the supplier of goods had violated the local laws, the assessee/ exporter cannot be denied the tax benefits available to it in terms of the statutory provisions. The CESTAT further observed that the assessee/ exporter was also not issued any show cause notice whereby wrongful conduct on its part or abetment with the supplier was alleged. Thus, denying the refund to the assessee/ exporter would be directing the assessee/ exporter to suffer the tax burden.

Accordingly, CESTAT held that taxability cannot be based on the legality or illegality of an act and so long as the acts fall under the taxing statute, the tax must be paid. Further, as tax is leviable on illegal activity, tax benefits or tax reliefs are equally available to illegal businesses.

This decision is important as many a times *bona fide* recipients, without any fault on their part, have to bear the brunt of the illegal actions of their suppliers.

3 Goods and Services Tax

Benefit of Input Tax Credit to be given to recipients in case of genuine purchase transactions

The Calcutta High Court, in *LGW Industries Ltd. v Union of India*, has directed the Goods and Services Tax (**GST**) Department to grant the benefit of Input Tax Credit (**ITC**) to the recipient where the purchases are found to be genuine.

The tax department had sought to deny ITC to the recipient on the ground that the suppliers were non-existent and that the recipient had failed to verify the genuineness and identity of such suppliers. On the other hand, the recipient contended that during the relevant period, the suppliers had been reflected as registered taxable persons on the GST portal and even the invoice-wise details of the disputed purchases were made available to the recipient in FORM GSTR-2A (auto populated form containing details of inward supplies). The recipient accordingly argued that it cannot be penalised if the suppliers were found to be fake and bogus after the transactions were over.

While the Calcutta High Court remanded the matter back to the tax department to consider the recipient's entitlement to ITC afresh, the High Court directed that the recipient would be granted the benefit of ITC if all the purchases and transactions in question were found to be genuine and supported by valid documents and if such transactions were made before the cancellation of registration of the suppliers.

The denial of ITC to the recipient on account of irregularities at the supplier's end has been a primordial controversy in GST enforcement. This decision will help the recipients in securing ITC which may be denied owing to mischief/ oversight on part of the suppliers.

Instructions on procedure for conducting search operations and issuing show cause notices under Goods and Services Tax

The Central Board of Indirect Taxes and Customs (**Board**) has issued specific guidelines/ instructions for carrying out search proceedings under the GST law.

The guidelines provide that the authorising officer should have justifiable reasons for authorising a search. Further, a search ought to be conducted under valid warrant and should be made in the presence of two or more independent witnesses. Upon conducting search proceedings, a *Panchnama* ought to be drawn containing a truthful account of the proceedings and a list of the documents/ goods recovered during the search. These guidelines also allow the person from whose custody any document is seized to make copies thereof and require every recorded statement to be signed by the person making the statement.

These instructions have been issued to prevent the department's case from weakening/failing to pass muster under judicial scrutiny due to procedural lapses such as non-adherence of the due process for conducting searches.

Instructions have also been issued to the tax department for timely completion of investigations and issuance of show cause notices under Sections 73 and 74 of the Central Goods and Services Tax Act, 2017 (**CGST Act**) (which pertain to determination of tax in case of non-fraud/ fraud cases). These instructions have been issued as Section 73(10) and 74(10) of the CGST Act provide for issuance of orders adjudicating show cause notices within three and five years, respectively, from the due date for furnishing annual returns.

Given that the due date for filing the annual returns for the periods 2017-18, 2018-19 and 2019-20 have already passed, the time limit of three/ five years for issuance of orders under Section 73 and 74 of the CGST Act has already kicked in. Accordingly, these instructions have been issued to avoid situations where the tax department is unable to pass orders within the prescribed time period or where the quality of adjudication suffers owing to paucity of time.

Changes effective 1 January 2022 under GST regime

A host of changes in substantive provisions, procedural rules and tax rates to the GST regime have been brought into effect from 1 January 2022. These changes come against the backdrop of the decisions of the GST Council as well as the Finance Act, 2021 which made certain amendments to the Central Goods and Services Tax Act, 2017 (CGST Act). A few important changes have been highlighted below.

Retrospective expansion of meaning of 'supply'

The scope of supply has been expanded by inserting Section 7(1)(aa) to the CGST Act retrospectively from 1 July 2017. This amendment, introduced through the Finance Act, 2021, provides that activities or transactions between clubs and associations and their members for consideration will constitute *'supply'* as they are deemed to be two separate persons and therefore taxable.

This amendment was brought in to overcome the effect of the judgment of the Supreme Court in *State of West Bengal & Ors. v Calcutta Club Ltd.* which held that sales tax could not be levied on a sale between an unincorporated club and its members. The judgment had clarified the position in relation to the 46th amendment to the Constitution of India which inserted Article 366(29A) in the definition clause defining 'deemed sale'. This insertion created a legal fiction to construe a supply of goods by any unincorporated association or body of persons to a member thereof for cash, deferred payment or other valuable consideration as a deemed sale, and therefore liable to tax. In this judgment, it was held that the doctrine of mutuality continued to apply to transactions of deemed sales of goods between clubs and their members and even with the amendment to the Constitution of India, sales tax could not be levied on a transaction of sale between unincorporated clubs and their members.

With the insertion of Section 7(1)(aa) to the CGST Act, transactions between clubs and their members will constitute a taxable supply, retrospectively, and pose a GST burden on the clubs for supplies made to their members. In most cases, such clubs will not have collected GST from the recipient, leading to significant tax liability on the supplier and consequent potential litigation. This provision may also impact the *inter-se* supply between members of unincorporated joint ventures.

Restriction on availing Input Tax Credit

Under the GST regime, a controversial issue is that if a supplier does not pay GST, then ITC is denied to the recipient. This is problematic for recipients as failure by suppliers to pay GST affects their ability to claim ITC.

The issue has been further complicated by the insertion of Section 16(2)(aa) to the CGST Act by the Finance Act, 2021, to be implemented from 1 January 2022. As per Section 16(2)(aa), ITC will be allowed only when the details of the invoice or debit note have been furnished by the supplier in its return for outward supplies (in Form GSTR- 1) and such details of invoice or debit note have been communicated to the recipient (in Form GSTR 2B). A corresponding amendment to Rule 36(4) of the Central Goods and Services Tax Rules, 2017 (**CGST Rules**) has also been made to implement Section 16(2)(aa) such that ITC cannot be claimed by the recipient if the supplier has not furnished the details of such supply in its outward returns. The compliance with this additional conditionality to claim ITC is likely to be burdensome for the assessees in cases where even though they receive goods and services and pay GST thereon, the supplier fails to reflect the details of such supplies in its outward returns.

Thus, this issue under GST regime will likely plague assessees. ITC genuinely claimed should not be disturbed merely because the supplier did not reflect the invoices in its returns. In such cases, it would be beneficial if an enquiry is conducted at the supplier's side and recipient's credit remains unaffected.

Recovery proceedings in case of self-assessed tax returns

Prior to 1 January 2022, if there was a mismatch between the monthly return for outward supply (Form GSTR-1) and the monthly consolidated return (Form GSTR-3B) of a supplier, the tax department could initiate proceedings for determination of tax amount under Section 73 or 74 of the CGST Act. However, this position has been altered from 1 January 2022. An Explanation has been inserted in Section 75(12) of the CGST Act, such that recovery of self-assessed tax can be made by the tax department under Section 79 if there is a mismatch between the GST returns, i.e., Form GSTR-1 and GSTR-3B. Consequently, in a situation where details of supplies are reflected in Form GSTR-1 of the supplier but not captured under Form GSTR-3B, recovery under Section 79 (by detaining or selling goods, deducting the amount payable from the money owed to the person, etc.) can be made without following the rigours of Section 73 or Section 74 of the CGST Act such as issuing show cause notices and adjudication thereof.

There may be genuine cases of discrepancy between Form GSTR-1 and Form GSTR-3B of the supplier. Even in such cases, recovery proceedings can be initiated without following the adjudication procedure, which may adversely impact the assessee. Therefore, it becomes important for businesses to be cautious while filing Forms GSTR-1 and GSTR-3B.

Electronic Commerce Operators

From 1 January 2022, the services of transportation of passengers by non-air-conditioned carriages, metered cabs, motorcycles and autorickshaws when supplied through Electronic Commerce Operators (**ECOs**) have been made taxable and GST is required to be paid by ECOs.

Even services of transportation of passengers by autorickshaws when provided through ECOs have been brought under the tax net and now the liability to discharge GST will be on the aggregators. This may result in some variance in the fare of autorickshaws plying on roads from those booked through apps.

Further, ECOs will be liable for payment of GST on restaurant services supplied through them. Though the tax burden would remain the same, the point of collection of tax will change from restaurants to ECOs ensuring greater compliance and thereby plugging leakages.

Inverted duty correction

Pursuant to the decision taken in the 45th GST Council Meeting, the GST rate on footwear not under Rs.1000 per pair has been increased from 5% to 12% from 1 January 2022. This move aims to resolve the issue of inverted duty structure (i.e., where ITC has accumulated on account of tax rate on inputs being higher than tax rate on output supplies). However, a similar hike in the rates for textiles has been deferred. The decision to continue with the existing rates was announced in the 46th GST council meeting on 31 December 2021. This was due to opposition from various State Governments against such a hike on textile products.

Works contract services to Governmental Authorities and Governmental Entities

GST rate for composite supplies of works contract services/pure services of various descriptions to Governmental authorities or Governmental entities has been increased to 18% from 1 January 2022. These were earlier exempt or taxable at a concessional rate of 12%.

This is likely to pose an issue for companies that have long-term contracts with Governmental authorities and Governmental entities. Contracts entered into on the strength of exemption/concessional rates will have to be revisited in view of this change in tax. Change-in-law clauses will have to be reviewed so that the increase in tax rate does not result in increased costs to business.

Developments related to detention, seizure and release of goods and vehicles in transit

Sections 73 and 74 of the CGST Act deal with the determination of tax liability. Clause (ii) to Explanation 1 of Section 74, which also extends to Section 73 of the CGST Act, provides that where proceedings for determination of tax against the main person have concluded, the proceedings against all persons liable to pay penalty under the specified sections will also be deemed to be concluded.

The Finance Act, 2021 amended this clause such that the proceedings under Section 129 (pertaining to detention, seizure and release of goods and vehicles in transit) and Section 130 (pertaining to confiscation of goods or vehicles and levy of penalty) of the CGST Act have been kept independent of proceedings under Sections 73 and 74. Accordingly, even though the proceedings under Section 73 or 74 may have concluded, proceedings under Section 129 and 130 for detention and confiscation of goods and vehicles can still go on.

Further, an appeal can now be filed against the order for penalty in respect of detention or seizure of goods or vehicles upon payment of 25% of the penalty amount. The penalty amounts in case of detention or seizure of goods under Section 129 have also been revised.

The provision for release of goods or vehicles on a provisional basis upon furnishing a bond and security has been omitted. However, vehicles can be released on payment by the transporter of the penalty amount or one lakh rupees, whichever is less.

Where the person transporting goods or owner of goods fails to pay the penalty within fifteen days, the detained goods or vehicles can be sold or disposed of. To recover penalty by sale of detained or seized goods or vehicles, a new Rule 114A has now been inserted in the CGST Rules.

These amendments have been implemented from 1 January 2022. Businesses should exercise greater caution while effecting transportation of goods in vehicles since minor omissions or oversight can prove to be onerous.

The intent behind introducing these changes seems to be to plug revenue leakages and ensure greater compliance with the GST laws. At the same time, it is equally important to safeguard the interest of *bona fide* taxpayers. For true success of the GST legislation, ease of doing business is as important as the need for securing the interests of the tax department and genuine taxpayers should not be penalised for minor lapses.