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GST Judicial Decisions

Constitutional validity of Section 13(8)(b) imposing GST on intermediary services provided to recipients outside India challenged

Dharmendra M. Jani [2021] 127 taxmann.com 730 (High Court – Bombay)
(Matter referred to the Hon'ble Chief Justice)

Relevant Facts

The petitioner is engaged in providing marketing and promotional services, by way of soliciting purchase orders, to overseas customers engaged in manufacture and/or sale of goods. The Indian purchaser directly places the purchase order on the overseas customer of the petitioner for supply of the goods which are then shipped by the overseas customer to the Indian purchaser. Such goods are cleared by the Indian purchaser from the customs. The overseas customer raises sale invoice in the name of the Indian purchaser who directly remits the sale proceeds to the overseas customer. Upon receipt of such payment, the overseas customer pays commission to the petitioner against invoice issued by the petitioner. The entire payment is received by the petitioner in India in convertible foreign exchange.

The transaction entered into by the petitioner with the foreign customers is one of export of service from India earning valuable convertible foreign exchange for the country. It is an "export of service" within the meaning of Section 2(6) of the IGST Act. Petitioner is also an "intermediary" within the meaning of Section 2(13) of the IGST Act. So, it is an export of service by an intermediary. However, by virtue of Section 13(8)(b) of the IGST Act, the place of provision of intermediary services, where the supplier or recipient is outside India, is the location of supplier and therefore the transaction is brought in the tax net though it is export of services.

The writ petition filed challenges the constitutional validity Section 13(8)(b) of the IGST Act read with Section 8(2) of the said Act on the following grounds:

- Levy of tax on export of service is ultra vires Article 269A of the Constitution of India.
- Section 8(2) and Section 13(8)(b) of the IGST Act are ultra vires Section 9 (Charging Section) of the CGST Act.
- GST is a destination-based tax consumption tax. For taxability, consumption is the determining criteria irrespective of performance. Once the services are consumed outside India, Parliament has no jurisdiction to levy tax on such services.
- Levy of GST on an intermediary is violative of Article 14 and Article 19(1)(g) of the Constitution of India.
- The cardinal rule of indirect taxation is that it must be capable of being passed on to the end receiver of the service. Therefore, an agent cannot be burdened with GST.
- Levy of GST on an intermediary like the petitioner providing services to an overseas customer would lead to double taxation.

The two-member Bench of the Hon'ble High Court have dissenting views as detailed below:

Ujjal Bhuyan, J.

The extra-territorial effect given by way of Section 13(8)(b) of the IGST Act has no real connection or nexus with the taxing regime in India introduced by the GST system; rather it runs completely counter to the very fundamental principle on which GST is based i.e., it is a destination-based consumption tax as against the principle of origin-based taxation. Section 13(8)(b) of the IGST Act not only falls foul of the overall scheme of the CGST Act and the IGST Act but also overrides Articles 245, 246A, 269A and 286(1) (b) of the Constitution.

Levy of IGST on supply of services by intermediaries to foreign customers would strengthen the Make in India program by encouraging foreign investment can be no answer to challenge to constitutionality of a parliamentary statute. Besides such a statement has been made de-hors any supporting statistics and analysis. Section 13(8)(b) of the IGST Act is ultra vires besides being unconstitutional as an artificial device is created to overcome a constitutional embargo.

Abhay Ahuja, J.

Neither Section 13(8)(b) nor Section 8(2) of the IGST Act are unconstitutional or ultra vires the Act. Section 13(8)(b) is also not ultra vires Section 9 of CGST Act. Once the Parliament has in its wisdom stipulated the place of supply of intermediary services to be the location of supplier, no fault can be found with the provision by artificially attempting to link it with another provision to demonstrate constitutional or legislative infraction.

Article 286 restricts the right of the State to impose taxes on import or export of goods or services. The said restriction is not applicable to the Parliament. Article 269A(5) empowers the Parliament to formulate laws to determine inter-State trade or commerce. The supply by intermediary will be treated as an inter-state supply of services.

CNK Comments

The constitutional validity of levy of GST on intermediary services has been questioned in the Bombay as well as Gujarat High Court. Whilst the Gujarat High Court upheld the constitutional validity in the case of Material Recycling Association of India [2020] 118 taxmann.com 75 (High Court - Gujarat), the current case has been placed before the Hon'ble Chief Justice for further administration. While the final order is awaited, a detailed analysis of enactments having extra-territorial operation is on the cards.

No reversal of Input Tax Credit required under Section 17(5)(h) in case of manufacturing losses

ARS Steels & Alloy International (P.) Ltd. [2021] 127 taxmann.com 787 (High Court – Madras).

(In favor of the assessee)

Relevant Facts

The petitioners are engaged in the manufacture of MS Billets and Ingots. MS scrap is an input in the manufacture of MS Billets and the latter, in turn, constitutes an input for manufacture of TMT/CTD Bars. There is a loss of a small portion of the inputs, inherent to the manufacturing process.

The impugned orders seek to reverse a portion of the input tax credit **(ITC)** claimed by the petitioners, proportionate to the loss of the input, referring to the provisions of Section 17(5)(h) of the GST Act which warrant reversal of ITC in case goods are lost, stolen, destroyed, written off or disposed of by way of gift or free samples.

Held

- Some amount of consumption of the input was inevitable in the manufacturing process.
- To say that what is contained in finished product is only a quantity of all the inputs of the same weight as that of the finished product would presuppose that all manufacturing processes would never have an inherent loss in the process of manufacture. The expression 'inputs of such finished product', 'contained in finished products' cannot be looked at theoretically with its semantics. It has to be understood in the context of what constitutes a manufacturing process.
- If there is no dispute about the fact that every manufacturing process would automatically result in some kind of a loss such as evaporation, creation of by-products, etc., the total quantity of inputs that went into the making of the finished product represents the inputs of such products in entirety.
- Accordingly, the reversal of ITC involving Section 17(5)(h) by the revenue, in cases of loss by consumption of input which is inherent to manufacturing loss is misconceived, as such loss is not contemplated or covered by the situations adumbrated under Section 17(5)(h).

CNK Comments

It is a welcome judgement wherein the settled position under the erstwhile law is upheld under the GST era. Losses of inputs are inherent in the manufacturing process itself and the same do not warrant reversal of ITC.

The term "Contract" interpreted for applicability of TDS

Udupi Nirmiti Kendra, In re [2021] 127 taxmann.com 734 (AAR - Karnataka).

(Partly in favor of the applicant)

Relevant Facts

The applicant is a registered society under the Karnataka Societies Registration Act, 1960, which procures goods/services on need basis and does not have explicit contracts with any supplier. They also do not have any fixed terms of rate/credit period/discount/ support services.

The applicant sought the advance ruling to interpret the term "Contract" for tax deducted at source **(TDS)** applicability under Section 51 of the CGST Act in absence of explicit contract. Section 51 requires TDS to be deducted @1% from the payment made/credited to the supplier where total value of supply exceeds INR 2.5 lakhs.

The applicant sought ruling on the applicability of TDS under the following scenarios:

- Goods and services procured on need basis without any contract. Value of supply under single invoice is more than the threshold limit of INR 2.5 lakhs
- Goods and services procured on need basis without any contract. Value of supply under single invoice does not exceed the threshold limit of INR 2.5 lakhs. However, total purchases in a year exceed the limit.
- Goods and services procured on call off basis under continuous supply agreement and where value of single invoice as well as value of total supply is less than the threshold of INR 2.5 lakhs
- Goods and services procured on call off basis under continuous supply agreement and where value of single invoice is less than the threshold of INR 2.5 lakhs, but the annual supply is more than the threshold limit of INR 2.5 lakhs.

The applicant submitted that the term "contract" is not defined in the GST Act. On combined reading of GST Act, Contract Act and Sale of Goods Act, the applicant contends that in absence of a contract, i.e., absence of commitment for past, present and future period between the parties, every supply is subject to the respective purchase order, and therefore, the tax invoice itself shall be considered as a contract to determine the applicability of TDS under Section 51.

The Authority pronounced the ruling as under:

- Section 51 requires TDS to be deducted when the supply under a contact exceeds the threshold limit. The criteria is "supply under a contract" and not "invoice".
- Supply under a contract can be executed between a supplier and recipient who are distinct persons. A written agreement is not a pre-condition and the same is governed by Contract Act, 1872.
- Sale of goods is only a subset of supply and hence all contracts covered under Sale of Goods Act, 1930 are contracts under GST Act.
- Tax invoice is a commercial document which represents a transaction, and it could cover the contract or a part of the contract.
- The agreement between the supplier and recipient is of prime consideration and if it is for a continuous supply to be made in installments, then the contact would include all the part supplies made and covered under separate invoices.

Held

- 1st scenario – TDS is applicable as value of single invoice exceeds the threshold limit.
- 2nd scenario – Value of supply under a single invoice does not exceed INR 2.5 lakhs and assuming that it is a single transaction as per the purchase order, TDS is not applicable on that single transaction/invoice. However, if it is a part supply of a continuous supply contract as per the purchase order, and the total value of supply as per the purchase order exceeds INR 2.5 lakhs, then TDS is applicable.
- 3rd scenario and 4th scenario – Agreement of continuous supply is a contact and if the amount involved in the contract exceeds INR 2.5 lakhs, TDS is applicable.

CNK Comments

The interpretation of term "Contract" is crucial in determining TDS implications and it is rightly interpreted to ensure that the implications are based on the contract.

No reversal of ITC by recipient for failure of supplier to deposit tax paid by recipient without examining supplier and initiating recovery proceeds against seller

D.Y. Beathel Enterprises [2021] 127 taxmann.com 80 (High Court – Madras)
(In favor of the assessee)

Relevant Facts

The petitioner is engaged in trading of raw rubber sheets and procured goods from registered suppliers. The petitioner paid consideration (including tax) through banking channels to the supplier. The petitioner claimed ITC based on the returns filed by the supplier. At the time of inspection, the Department found that the supplier had not paid tax to the Government.

The department issued a show-cause notice on the petitioner for recovery of liability. The petitioner submitted that the consideration payable (including tax) was already paid by them to the supplier and the supplier should be confronted during the enquiry. However, the order passed by the Department levied the entire liability on the petitioner. Aggrieved by the Order, the petitioner filed a writ petition before the Hon'ble High Court.

Held

- The proposition that the Authority does not have the jurisdiction to reverse ITC availed by the assessee on the ground that the seller has not paid the tax as held in the case of Sri Vinayaga Agencies pertained to the previous tax regime and may not be straight-away applicable to the current tax regime.
- The press release issued on 04.05.2018 mentioned that there shall not be any automatic reversal of ITC from the buyer on non-payment of tax by the seller. In case of default in payment of tax by the seller, recovery shall be made from the seller. However, reversal of credit from buyer shall also be an option available with the revenue authorities to address exceptional situations like missing dealer, closure of business by the supplier or the supplier not having adequate assets etc.
- Section 16 of the CGST Act prescribes that ITC shall be available when the buyer receives the goods and tax charged in respect of the said supply is paid to the Government. Therefore, if the tax had not reached the kitty of the Government, then the liability may have to be eventually borne by one party, either the seller or the buyer. However, in the present case, the Department did not initiate any recovery action against the seller.
- Since the respondent has claimed that there is no movement of goods, examination of supplier is all the more necessary and imperative. The impugned order suffered fundamental flaws and was quashed for non-examination of supplier in the enquiry and non-intimation of recovery from the supplier in the first place.

CNK Comments

A key judgement which brings much needed relief for tax-payers where suppliers have defaulted in the payment of tax. The Court has held that first action of recovery has to be taken against the seller. However, in cases where the recipient has paid tax to the supplier and the supplier has defaulted owing to closure of business or similar reasons, it seems recovery can still be made from the recipient of goods or services.

KEY TAKE AWAY

- Extra-territorial enactment caused by deeming fiction of place of supply in case of intermediary services has been challenged. The final judgement will have far fetched implications on taxability thereof.
- Manufacturing losses do not warrant reversal under Section 17(5).
- "Contract" is pre-dominant for determining TDS implications.
- For default on the part of the supplier for non-payment of tax collected from recipients, primarily recovery to be done from the supplier and without such proceedings, recipient not liable to reverse input tax credit.

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