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Recent Rulings by Courts and Authorities

High Court Rulings

No reversal of ITC[1] required in relation to loss arising from manufacturing process

In the case of ***ARS Steels & Alloy International Private Limited vs. State Tax Officer, Group– I, Inspection, Intelligence – I, Chennai, [2021 (6) TMI 957- Madras High Court]***, the petitioner was engaged in the manufacture of MS billets and ingots, with an inherent loss of inputs in the manufacturing process. An assessment order was passed against the petitioner seeking reversal of ITC on account of inputs lost in the manufacturing process in terms of Section 17(5)(h) of the CGST Act[2], which specifically disallows ITC on "goods lost, stolen, destroyed, written off or disposed of by way of gift or free samples".

The Hon'ble High Court observed that the aforesaid provision contemplates a loss which is quantifiable and involves external factors/ compulsions. Loss occasioned by consumption during the process of manufacture is inherent to the process itself and cannot be equated with the loss of inputs requiring proportionate reversal of ITC. Therefore, the Hon'ble High Court set aside the impugned assessment order, observing that the finished product cannot contain exactly the same quantity of inputs used in the manufacturing process.

CESTAT[3] Rulings

Carried interest retained by certain class of investors is a performance fee, exigible to service tax

In the case of ***ICICI Econet Internet and Technology Fund vs. Commissioner of Central Tax, Bangalore North, [TS-290-CESTAT-2021 (Bang)***], the appellant was a VCF[4] set up as a trust under the Trusts Act[5] and registered with the SEBI[6]. The Fund was being managed and represented by a trustee (in lieu of trusteeship fees) and the contributions made by the investors were held in the trust (for return on investment). An AMC[7] was appointed for managing the investment. The investors/ contributors are classified in Class A, B and C. Class A and B contributors are LIC, ICICI Bank, PNB, etc. whereas Class C contributors are the AMC and other ICICI trust funds. A demand of service tax was raised on the expenses incurred by the VCF, carried

1 Input tax credit
2 Central Goods and Services Tax Act, 2017
3 Customs Excise and Service Tax Appellate Tribunal
4 Venture Capital Fund
5 Indian Trusts Act, 1882
6 Securities and Exchange Board of India
7 Asset Management Company

interest paid to Class C investors and on the provision for loss and impairment of investments disclosed in the financials of the VCF. The demands were confirmed, and an appeal was filed against the same before the CESTAT. The CESTAT, based on the arguments put forth by both the parties, held as follows:

i) Doctrine of Mutuality does not apply - Funds and contributors are distinct person: The appellants contended that there is no distinction between the trust and the contributors, a trust is not recognized as a "person" in law and a trust cannot be proceeded against. The appellants also relied upon the concept of 'doctrine of mutuality' and on the provisions of the Income Tax Act, Trusts Act, outlining the said principle. However, the CESTAT held that the activities of VCFs of distributing dividends and other amounts to the respective unit holders were clearly mentioned in the private placement memorandum and other scheme documents, which evidenced the profit motive of the VCF. Given VCF's involvement in commercial activities, CESTAT held that doctrine of mutuality did not exist in this situation.

ii) Carried interest is in the nature of performance fee: The appellants contended that the mere fact that the AMC is a contributor, cannot be confused to equate carried interest (return on investment made by the AMC) to be performance/ management fee. They further clarified that the AMC wore two hats, i.e. (a) of an investment manager, for which it received management/ performance fee and (b) of a contributor/ investor for which it received carried interest. However, it was argued by the Service tax authorities that Class A unit holders were paid a return which is 2.86 times the investment, whereas Class C unit holders (AMC and the nominees) were paid a return of 1,356 times the investment. Based on this argument, CESTAT held that the trust used discretionary powers to benefit a certain class of investors. Therefore, as far as the distribution of dividends/ profit is concerned, the VCFs made provisions to act in a manner that is beyond the interest of the investors/ contributors. CESTAT also held that the carried interest is neither interest nor return on investment, instead, is a portion of the consideration retained by the VCFs for the services rendered by them to the investors and passed on, in disguise of return on investments, to class C unit holders, i.e., the AMC.

Accordingly, it was held that the entire structure was a façade, devised by the appellant in such a manner that the AMC and/ or its nominees receive huge sums of money in the guise of carried interest, with the twin motives of benefitting the AMC and/ or its nominees at the expense of the subscribers and avoiding taxes.

In light of the above, the demand of service tax was upheld on the carried interest paid to Class C investors, being in the nature of performance fee. The matter has been remanded for re-calculation after considering the availability of CENVAT credit, cum duty benefit and to determine the gross value of taxable services (taking into account the various heads of expenses wrongly considered by the authorities such as loss on sale of investment, loss on revaluation of assets, etc.).

JSA Comments: The ruling deals with the implications on a VCF under the pre-negative list service tax regime. However, the ruling has raised questions on various settled industry practices of (i) non-taxability of carried interest for various investment pooling vehicle structures (including VCFs, mutual funds, alternate investments funds, etc.), (ii) trusts not carrying out commercial activities, thereby not requiring registration under the indirect tax laws (i.e., service tax as well as GST).

The ruling has also blurred the difference between "transaction in money" vis-à-vis "consideration for services of transaction in money", adding to ambiguity for valuing services. The ruling will also have an impact on the taxability of such/ similar transactions under the negative list regime of Service tax as well as GST. It is likely that the issues involved in the matter will finally get settled at higher levels of adjudication.

Compensation paid towards breach of contract is for safeguarding a loss and cannot be subjected to tax as consideration for "tolerating an act"

In the case of ***Ruchi Soya Industries Limited vs. Commissioner of Customs, CGST & CE, Indore***, [***2021 (7) TMI 415 - CESTAT New Delhi***], the appellant had set up a project for generating electricity through Wind Turbine Generators, for which they entered into a contract for procuring operation and maintenance services. As per one of the clauses in the said contract, if the machine availability was short of the desired requirement levels, the service provider was liable to compensate the appellant for losses incurred on account of non-availability of the machine. The Service tax authorities confirmed a demand of service tax on the payment received by the appellant towards such compensation, classifying it as consideration towards declared service of "agreeing to the obligation to tolerate an act".

An appeal was filed against the said order before the CESTAT, which observed that, in order to levy service tax, an amount should necessarily be consideration towards a taxable service. In the present case, the service tax authorities alleged that the amount received by the appellant was consideration for services of obligation to tolerate an act. However, the CESTAT noted that the machine availability clause of the service agreement contemplating payment of compensation was only to ensure that defaulting act is not undertaken/ repeated. Accordingly, it was held that said clause cannot be construed as agreeing to tolerate an act, and therefore, the compensation received by the appellant to safeguard the losses incurred due to deficiency in services cannot be subjected to service tax.

Similarly, in another case of ***Steel Authority of India Limited vs. Commissioner of GST and Central Excise, Salem [2021 (7) TMI 1092 - CESTAT Chennai]***, the appellant was a manufacturer of various steel products. Demand of service tax was raised against the appellant in respect of amounts received towards breach of contractual obligations by suppliers and customers, treating the same as consideration towards act of *tolerating the contractual default of suppliers/ customers*. Such amounts included liquidated damages on account of failure to deliver consignments within the delivery schedule, forfeiture of earnest money deposit on failure of the bidders to make full payment within prescribed time and ground rent recovered for extension of due date to pay full sale value.

The CESTAT observed that the issue of levy of service tax on liquidated damages is settled in the favor of assessee in ***South Eastern Coalfields Limited vs. Commissioner of Central Excise and Service Tax [TS1120-CESTAT- 2020 (Del.)]***, wherein it was held that there is a distinction between 'condition to a contract' and 'consideration for the contract' and the penal damages provided for in the agreement is a condition to the contract. Further, it was observed that the recovery of liquidated damages/ penalty from other party cannot be said to be towards any service *per se* including toleration of an act, since neither party intends to pay/ receive compensation for breach of contract and the purpose of imposing penalty is to ensure that the defaulting act is not undertaken or repeated. Accordingly, the demand of service tax was set aside.

JSA Comments: The above decisions further strengthen the view adopted by the assessees, that any amount paid towards breach of conditions of a contract cannot be equated with consideration for discharge of a service and therefore should not be subjected to tax.

Authority for Advance Ruling ('AAR')/Appellate Authority for Advance Ruling ('AAAR')

Services supplied by an Indian branch to foreign customers of an overseas holding company does not qualify as an export

In the case of ***Sutherland Mortgage Service Inc. [2021 (7) TMI 477- AAR Kerala]***, the applicant is a branch office of Sutherland Mortgage Service Inc. ("**SMSI USA**") established as per guidelines of RBI[8] to undertake service activities. The applicant entered into an inter-company agreement with SMSI USA for providing services such as mortgage orientation, cash management, analytics and reporting etc. to customers of SMSI USA located outside India. As per the agreement between SMSI USA and its customers, services were being provided from USA as well as India branch. The applicant directly raised an invoice for the cost incurred in supplying such services to the customers of SMSI USA located outside India along with mark-up which is received by the applicant in convertible foreign exchange. The applicant sought an advance ruling on whether the services supplied by them qualify as an export of service.

As per the applicant, the agreement between SMSI USA and the customers clearly contemplated that the services will be provided from Indian branch, and actual flow of service is also from India to the customers located outside India, therefore recipient of service in the present case was the customers and not SMSI USA. The applicant further argued that all the conditions for export were satisfied by them, and therefore the services supplied by them should qualify as an export of service.

The AAR observed that as per the agreement between the applicant and SMSI USA, the person liable to pay consideration was SMSI USA even though the services were actually rendered to the customers located outside India. Accordingly, it was held that, considering that the applicant and SMSI USA qualify as establishments of distinct person (being a branch of a foreign holding company), the conditions for qualifying as export of service were not satisfied in the present case. However, GST was held not to be payable in the present case, since there is a specific exemption for services supplied by an establishment in India to an establishment located outside India which qualify as establishments of distinct person for the purpose of GST Law.

Business support services to parent company located outside India taxable as intermediary services

In the case of ***Airbus Group India Private Limited, 2021 (7) TMI 263- AAR Karnataka,*** the applicant was operating as a subsidiary of Airbus Invest SAS, France and Airbus SE Netherlands (hereinafter referred to as "**parent company**"). The applicant had entered into an agreement with its parent company to provide support services in relation to its global procurement/ sourcing strategy, *inter-alia* including:

- Procurement operations involving review of Indian supplier landscape, providing updates on supplier operations, conducting onsite assessment of supplier's facility, promoting awareness about Airbus's ethics/ compliance guidelines, and sharing of market and/ or product information etc.,
- Procurement transformation and central services function in relation to procurement ethics and compliance, procurement process and key project management.

[8] Reserve Bank of India

The applicant was providing services to its parent company on principal-to-principal basis and had no role in finalizing a supplier or entering into a contract for procurement etc. The final selection of a supplier, issuance of purchase order and finalizing the terms and conditions of the procurement contract was done by the parent company. In this regard, the applicant sought an advance ruling on correct classification of their services.

As per the applicant, the services supplied by them under the service agreement were classifiable under SAC[9] 9983 which covers "Other professional, technical and business services". The AAR relied upon the scheme of classification of services and observed that services supplied by the applicant does not fit in any of the service description under the heading 998399, which only includes *specialty design services including interior design, design originals, scientific and technical consulting services, original compilation of facts/ information services, translation services, trademark services and drafting services*.

Further, the applicant submitted that the services provided by them would not be covered under the ambit of intermediary services, since they are neither a broker/ agent, nor they are facilitating any supply of goods or services between their parent company and Indian suppliers. Their role was limited to providing necessary information, review & advise from quality perspective and final decision was made by the parent company.

AAR noted that an intermediary is different from a broker/agent in as much as they need not undertake an activity on another's behalf. Therefore, principal-to-principal relationship or acting as an independent contractor as contemplated under the service agreement is not relevant for the purpose of determining whether the services supplied by the applicant are intermediary services. It was therefore observed that the appellant was facilitating the supply of goods by the Indian vendors/ suppliers to their parent company, and accordingly, the services supplied by them qualify as intermediary services.

Post-sale discount reimbursed by way of credit notes are taxable as consideration in cases where exact quantum of discount not discernible from the agreement

In the case of ***Santhosh Distributors*** [***2021 (7) TMI 789- AAAR Kerala***], the appellant was an authorized distributor of Castrol India Limited ("**Castrol**") and had entered into an agreement for distribution of products of Castrol on a principal-to-principal basis. As per the said agreement, the price of the products sold to the dealers by the appellant were determined by Castrol. Castrol also operated various discount schemes for its distributors to augment sales volume which *inter- alia* included SKU discount wherein Castrol reimbursed the discounts extended by the distributors to their dealers by way of issuance of a credit note.

The present appeal was filed against the order of AAR which held that that credit note issued by Castrol is a commercial credit note and GST already paid for sale between Castrol and appellant ("**Transaction 1**") cannot be reduced and accordingly there was no requirement of reversal of ITC by the appellant. Further, it was held that post-sale discount offered by Castrol through its distributors (which is reimbursed to the distributors by Castrol) qualifies as consideration towards sale between appellant and dealers ("**Transaction 2**") and therefore, liable to be added to the transaction value for sale between appellant and dealers.

The appellant has challenged the decision of AAR on the following grounds:

- Amount reimbursed by way of credit notes are nothing but a post-sale discount pertaining to transaction value of Transaction 1, on which GST has already been paid.

[9] Service accounting code

- Post-sale discount offered by Castrol is for securing lower prices for its customers and therefore actual price realized in both Transaction 1 and 2 are actually lesser than the transaction value on which GST has already been paid.
- Impugned order is a non-speaking one and the decision is concurrent with the circular issued by CBIC[10] clarifying the treatment of post-sale discount, which has already been rescinded.

In the above backdrop, AAAR observed that as per valuation provision under CGST Act, the post-sale discount must emanate from the terms of an agreement which should clearly spell out the criteria for arriving at the quantum of such discount and secondly, the recipient of supply should reverse the ITC proportionate to such discount. It was noted that post-sale discount contemplated under the present agreement is open ended and without any stipulated criteria for ascertaining the exact quantum of discount. The "rate difference" or "special discount" offered to appellants are totally dependent upon the discretion of Castrol and cannot be quantified at or before the time of supply, therefore the conditions prescribed under the CGST Act for qualifying as a post-sale discount eligible for deduction from the transaction value is not satisfied.

The AAAR further observed that as per proviso to section 34(2) of the CGST Act, no adjustment in output liability is permitted in cases where incidence of tax has been passed on to any other person and considering that the tax incidence in present case for Transaction 1 has already been passed on to the appellant, the credit note issued by Castrol will not be eligible for reduction of the tax liability. Accordingly, the reimbursement of discount by Castrol over and above the invoice value of Transaction 2 qualifies as consideration towards said transaction between appellant and the dealers, and the applicable GST will be payable on the same.

[10] Central Board of Indirect Taxes and Customs

Notifications/Circulars/Instructions/Public Notices

General penalty[11] for non-compliance with requirement of dynamic QR[12] code waived

Notification no. 28/2021- Central Tax dated June 30, 2021

Government has announced waiver of general penalty prescribed under the CGST Act which may extend up to INR 25,000 in case of non-compliance with the requirement of having dynamic QR code on B2C[13] invoices issued by a taxpayer whose aggregate turnover exceeded 500 crores. This requirement was made mandatory with effect from December 1, 2020, and waiver of aforesaid penalty has been provided only for a period up to September 30, 2021.

Amendments to the CGST Act w.r.t. the requirement of audit of annual accounts and filing of reconciliation statement notified

Notification no. 29 and 30/2021- Central Tax dated July 30, 2021

The amendments to CGST Act proposed vide Finance Act, 2021, omitting the requirement of getting the accounts audited by a chartered accountant or a cost account which was mandatorily required to be submitted along with reconciliation statement in Form GSTR 9C, with effect from August 1, 2021. Further, suitable amendment to section 44 of the CGST Act has also been made effective from August 1, 2021, which now provides that the reconciliation statement can now be self-certified by a taxpayer and will form part of the annual return to be furnished in Form GSTR 9.

In order to facilitate the said changes, suitable amendment has also been made to Rule 80 of CGST Rules[14] and instructions contained under Form GSTR 9. Taxpayers having aggregate turnover exceeding five crores in a F.Y.[15] will still be required to file reconciliation statement in Form GSTR 9C, however on self-certification basis.

Exemption from filing the annual return for F.Y. 2020-21

Notification no. 31/2021- Central Tax dated July 30, 2021

A registered person whose aggregate turnover in the F.Y. 2020-21 does not exceed INR 2 crores, will not be required to file the annual return in Form GSTR 9.

Amendments clarifying levy of IGST[16] and compensation cess on re-import of goods sent out of India for repairs

Notification no. 36 and 37/ 2021- Customs and Circular No. 16/ 2021-Customs dated July 19, 2021

CBIC has made amendments to Notification no. 45 and 46 of 2017- Customs dated June 30, 2017 ("**Notifications**"), which *inter-alia* exempted customs duty on value of "goods sent out of India for repairs"

11 Section 125 of CGST Act
12 Quick Response Code
13 Business to Consumer
14 Central Goods ad Services Tax Rules, 2017
15 Financial Year
16 Integrated Goods and Services Tax Act

and "cut and polished precious and semi-precious stone exported for repairs/ treatment abroad" and limited the customs duty levy only on the fair cost of repair, freight and insurance etc. incurred on these goods at the time of re-import. Now, the term "duty of customs" used in the Notifications has been substituted with the words "said duty, tax and cess" and an explanation has been added to clarify that IGST and compensation cess will also be payable on repair, freight and insurance cost incurred at the time of re-import.

Further, a circular has been issued in this regard to clarify that such exemptions were also available under the pre-GST regime and same have been continued vide aforesaid Notifications, whereby additional duties of customs have now been replaced with IGST and compensation cess payable on value of repair, freight and insurance incurred on the re-imported goods. It is further clarified that that the levy of IGST and cess on the value of repair, freight and insurance was disputed in the case of ***Interglobe Aviation Limited vs. Commissioner of Customs [2020 (43) G.S.T.L. 410 (Tri. - Del.)***], and while interpreting the Notifications, Hon'ble CESTAT held that intention of legislature was to impose only basic customs duty ("**BCD**") on fair cost of repair, freight and insurance and not IGST and cess. The department has filed an appeal against the said decision before Hon'ble Supreme Court. Therefore, the amendments and clarification have been issued pursuant to 43rd GST Council meeting to clarify the intent of the government.

Clarification regarding extension of limitation under GST Law

Circular No. 157/13/2021-GST dated July 20, 2021

The Hon'ble Supreme Court had, vide its order dated April 27, 2021, extended the period of limitation under any general and special laws in respect of any judicial or quasi-judicial proceedings till further orders. In this regard, CBIC upon examination of the matter has clarified that:

- Quasi-judicial proceedings by tax authorities such as disposal of application for refund, application for revocation of cancellation of registration, adjudication proceedings of demand notices, etc. will be governed by the extensions of time granted by the statutes or notification issued thereunder.
- Appeals against quasi-judicial orders by an assessee/ tax authority will be covered by the order of Supreme Court and time limit will be deemed to be extended till further orders.
- Proceedings and compliances required to be initiated/ undertaken by an assessee will be governed as per the statutory scheme and not covered under the extension granted by Hon'ble Supreme Court.

New web-portal for online AEO[17] application

Circular No. 13/2021-Customs dated July 1, 2021

Online facility for filing of application for AEO Tier 1 was made effective in December 2018. Now, an updated version of the existing facility has been launched for on-boarding of AEO Tier 2 and Tier 3 categories. As per the circular, an assessee applying for AEO Tier 2 and Tier 3 category will now be required to file an online application along with physical submission of documents. before office of jurisdictional principal chief commissioner/ chief commissioner.

The new website offers seamless, real time monitoring of status of application and for timely compliances. As a transition measure till July 31, 2021, physical application filing would be allowed for AEO Tier 2 and Tier 3 category. Online registration on the new portal will become mandatory with effect from August 1, 2021.

[17] Authorized Economic Operator

New AATO[18] functionality enabled on GSTN[19] portal

Advisory on AATO Functionality dated July 28, 2021

GSTN has introduced a new feature which enables the taxpayers to update their AATO on the portal in case the auto-populated turnover based on the returns filed by them during previous F.Y. does not match with their actual AATO. A taxpayer can use this facility to amend their turnover twice within a month from the date on which this feature is enabled. Once the AATO has been updated by a taxpayer, it will be sent to the jurisdictional tax officer for review and the tax officer can further amend the AATO in case of any discrepancy. In case, no such action is taken by the tax officer, the AATO will be deemed to be final. Additionally, the method adopted for computation of AATO based on returns filed by a taxpayer has also been prescribed on the portal. This functionality will enable the tax authorities to keep a check on the compliances to be undertaken based on AATO.

For more details, please contact km@jsalaw.com

18 Annual Aggregate Turnover
19 Goods and Services Tax Network