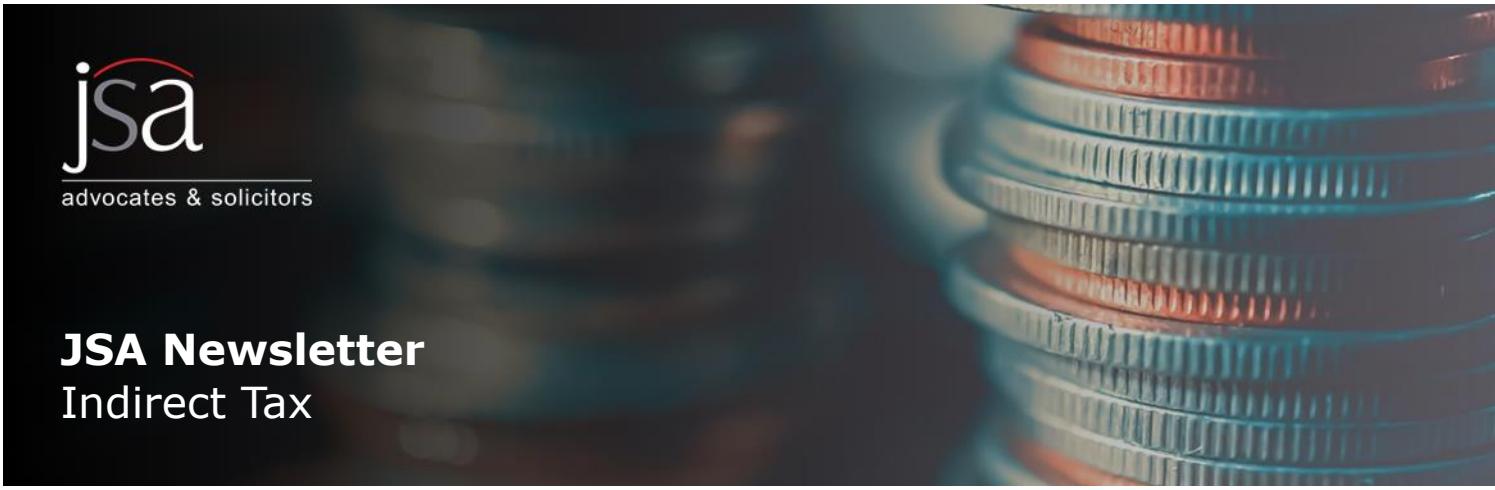

June 2022 Edition

Recent Rulings by Courts and Authorities

Supreme Court

Secondment of employees by overseas group companies to Indian subsidiary held to be a taxable service – emphasising on the principle of 'substance over form'

In the case of ***CC, CE & ST – Bangalore (Adjudication) etc. vs. Northern Operating Systems Private Limited***[1], the Hon'ble Supreme Court of India ("**Supreme Court**") recently ruled on the taxability of payments/ reimbursement of salaries and other social benefits made to the overseas group companies, for employees seconded to the Indian subsidiaries/ affiliates.

In the given case, the Indian subsidiary was responsible for providing back-office support services to the foreign group company and received consideration on cost-plus markup basis. During the secondment period, the seconded employees worked under direct supervision and control of the Indian subsidiary. The seconded employees were on the payroll of the Indian subsidiary and accordingly, compliances pertaining to provident fund and TDS under the Income Tax Act, 1961 were undertaken for such employees in India. However, the seconded employees also continued to be on the payroll of the foreign group company, for the purpose of continuation of social security, retirement and health benefits (which was reimbursed to the foreign group company by the Indian subsidiary). On completion of the secondment period, such employees returned to their country of origin or to another host country.

The Supreme Court, while deciding upon taxability of reimbursements made by the Indian subsidiary of costs pertaining to the seconded employees incurred by the foreign group company, observed the following:

1. One of the cardinal principles of interpretation of documents is that the nomenclature of any contract, or document, is not decisive of its nature. An overall reading of the document, and its effect, is to be considered.
2. The true nature of the relationship between the seconded employees and the respondent should be based on overall reading of the materials, considering the essence of the contracts. Therefore, based on the facts of the case, the seconded employees were only under practical control of the Indian subsidiary and in effect continued to be employees of the foreign group company.
3. The employees were seconded to avail their expertise and specialization for the economic benefit of the Indian subsidiary, thereby, being a *quid pro quo* under the secondment arrangements.
4. The Supreme Court considered the essence of the overall arrangement and relied on the principle of 'substance over form' and held that secondment of employees by foreign group company to Indian subsidiary/ affiliate was subject to service tax under the category of 'manpower recruitment and supply agency services' under RCM[2].

[1] 2022 (5) TMI 967 – Supreme Court
[2] Reverse Charge Mechanism

5. However, the Supreme Court observed that the extended period of limitation should not be invoked in the present case as the matter involves a significant question of law and interpretation.

JSA Comments: Taxability of transactions involving cross-border secondment of employees to India has been a contentious matter under the Service tax as well as the GST regime. There were earlier judgements of Tribunals/ High Courts, wherein secondment of employees under dual employment structure was held to be not leviable to Service tax. This ruling has unsettled the largely accepted position and businesses will have to revisit their tax position on such transactions.

Supreme Court rules in favour of the assessee, holds that IGST[3] is not payable on ocean freight under reverse charge mechanism

The Supreme Court in the case of ***Union of India v. Mohit Minerals Private Limited***[4] has held that the importer of goods in India (on CIF basis) is not liable to pay IGST on the ocean freight under RCM. Please refer to our JSA Prism of May 21, 2022 for detailed analysis of the ruling.

High Court

Mandatory application of deeming fiction ascribing 1/3rd deduction towards value of land or undivided share of land in construction contracts held *ultra-vires*

In the case of ***Munjaal Manishbhai Bhatt vs. Union of India***[5], the Hon'ble High Court of Gujarat ("**Gujarat High Court**") decided on the issue of whether a delegated legislation (notification) providing 1/3rd deduction for value of land or undivided share of land involved in construction contracts by way of a deeming fiction was *ultra-vires* the provisions of the GST law and violative of article 14 of the Constitution of India.

The petitioner entered into an agreement with a developer for purchase of a plot of land and construction of bungalow thereupon, with separate considerations agreed for each component i.e., land as well as construction of bungalow. Considering that supply of land was outside the ambit of GST (basis Schedule III of the CGST Act[6]), the petitioner believed that GST is payable only on the consideration for the supply of construction services. However, the developer sought GST at the rate of 18% on the entire consideration payable under the agreement after deducting 1/3rd of the total value as abatement towards value of land[7].

The High Court, while deciding the issue, observed the below:

1. Relying on several judicial precedents[8], the High Court observed that the intention of the legislature was never to levy tax on supply of land in any form and for the same reason, 'sale of land' was provided in Schedule III of the CGST Act (equally for both developed and undeveloped land).
2. The statutory provision requires levy of tax on actual price payable for the construction service and where such actual price is available, tax should be levied on such actual value. Delegated legislation cannot provide for a deemed deduction for value of land. Deeming fiction can be applied only where actual value is not ascertainable. Therefore, mandatory deemed deduction for value of land is *ultra-vires* the statutory provisions.
3. The deeming fiction is applied uniformly irrespective of the size of the plot of land and construction therein. Further, no distinction is made between a supply of undivided share of land involved in supply of a flat and supply of a parcel of land involved in supply of a bungalow. The deeming fiction to this extent is arbitrary.

Basis the above, the High Court held that application of such mandatory deemed deduction for value of land, in all cases, is discriminatory and arbitrary. Therefore, the said deduction was held to be *ultra vires* the GST law and violative

[3] Integrated goods and service tax
[4] 2022 (5) TMI 968 - Supreme Court
[5] 2022 (5) TMI 397 - Gujarat High Court
[6] Central Goods and Services Act, 2017
[7] Entry no. 3(if) read with paragraph 2 of Notification No. 11/2017 – Central Tax (Rate) dated June 28, 2017
[8] Gannon Dunkerley vs. State of Rajasthan, (1993) 1 SCC 364 and Larsen and Toubro Limited vs. State of Karnataka, (2014) 1 SCC 708

of article 14 of the Constitution of India. The deeming fiction cannot be mandatory in nature and will only be applicable at the option of the taxable person, in cases where actual value of land or undivided share in land is not ascertainable.

JSA Comments: This ruling has clarified a significant principle of valuation and has implications for various sectors, one of them being renewable energy sector for setting up solar power projects etc.

Levy of GST on mining royalty payable to the State Government stayed

The Hon'ble High Court of Allahabad ("**Allahabad High Court**") in the case of *Jitendra Singh vs. Union of India*[9] has stayed the GST demand on payment of royalty on mining transactions.

In a writ petition filed before the Allahabad High Court to contest the demand of GST raised against the petitioner on mining royalty paid to the State government, the petitioner submitted that royalty payment made to the State government for granting mining rights is in the nature of tax and not consideration for supply of goods or services and hence, no GST liability could arise on such payments. Reliance was placed in this regard on the interim order passed by the High Court in another matter of *A.D. Agro Foods Private Limited vs. Union of India*[10].

Relying on several judicial precedents[11] passed by the Supreme Court and the above interim order (*supra*)and the reliance placed therein upon Apex Court's decision in the matter of, the Allahabad High Court held that the matter requires consideration both on the issue of liability to pay royalty and GST thereupon, and hence, stayed the demand of GST and payment of royalty until further orders.

CESTAT

Compensation received for cancellation of coal blocks pursuant to a Court order is not 'consideration' for tolerating the act of cancellation, hence not taxable

In the case of ***Jindal Steel and Power Limited vs. Principal Commissioner of CGST & CX, Ranchi***[12]**,** the appellant was allocated a coal block at Jharkhand. However, the said allocation was cancelled *vide* the Supreme Court's order. Subsequently, special coal mine provisions were passed, per which the coal block allocated to the appellant, among others, was re-allocated to successful new bidder(s) upon payment of compensation to the appellant (prior allottee) for transfer of right, title and interest in the land and coal mine infrastructure.

The tax authorities sought to recover service tax on the said compensation received, as being 'consideration' received for tolerating the act of cancellation of coal blocks.

The CESTAT observed that tolerating something and receiving a compensation for such tolerance pre-supposes the following:

1. the person had a choice to tolerate or not;
2. the person chose to tolerate;
3. such tolerance was for a consideration as per an agreement (written or otherwise) to tolerate;
4. the tolerance was a taxable service.

The CESTAT noted that none of the above elements were present in the instant case. As the cancellation of the coal block was in terms of the Supreme Court's order and not as a result of a contract to tolerate cancellation, the appellant had no choice other than tolerating the cancellation. There was no consideration for tolerating the cancellation, only a statutory compensation provided for investment made by the appellant.

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9 J2022 (5) TMI 533 - Allahabad High Court.
10 Writ Tax No. 475 of 2021.
11 India Cement Limited and Others vs. State of Tamil Nadu and Others, 1990) 1 SCC 12 and Lakhwinder Singh vs. Union of India and Others, Writ Petition (Civil) No. 1076 of 2021
12 2022 (5) TMI 254 - CESTAT Kolkata

Therefore, it was held that such compensation is not consideration towards the taxable service of tolerating a situation and accordingly, no Service tax can be levied on the same.

Similarly, in the case of ***Krishnapatnam Port Company Limited vs. Commissioner Of Central Excise & Service Tax, Guntur***[13]**,** the CESTAT ruled upon the core issue of whether liquidated damages/ compensation charges received by the appellant towards breach and non-compliance of importing minimum guaranteed tonnage ("**MGT**") by the other party to the contract could be considered as 'consideration' for 'declared service' as provided under Section 66E(e) of the Finance Act[14], thereby, subject to Service tax.

The CESTAT observed that the penalty clause was provided to safeguard the commercial interest of the appellant in case of a financial injury and to discourage the other party from repeatedly breaching the terms and conditions of the agreement. This penal clause did not emanate from any obligation on the part of the appellant to 'tolerate an act or a situation' of the defaulting party. This penalty had no nexus with any taxable service provided under the Finance Act but was merely towards fulfillment of 'conditions of the agreement'.

Basis the above and various judicial precedents, the CESTAT held that recovery of liquidated damages/ compensation charges/ penalty from the defaulting party is not to be considered towards provision of service, as the appellant did not carry or assume to carry any activity to receive the 'compensation charge' and hence, no service tax is to be levied.

4G telecommunication towers do not constitute 'immovable property', CENVAT credit allowed

In the case of ***Reliance Jio Infocomm Limited vs. Assistant Commissioner of CGST and Central Excise, Belapur-IV Division***[15]*,* the CESTAT decided on whether 4G telecommunication towers constituted 'immovable property' or 'movable property' for the purposes of availing CENVAT credit.

The appellant was engaged in the business of offering long term evolution-fourth generation wireless telecommunication services. For providing such services, the appellant set up towers, transmission/ reception equipment, electrical utility items, and other ancillary items (collectively referred to as "**4G Towers**"), for which CENVAT credit was availed. However, the authorities denied CENVAT credit on such 4G towers treating the same to be 'immovable property'. The appellant reversed the said credit under protest and subsequently, filed for a refund thereof, which was also rejected by the authorities. Therefore, the appellant filed an appeal before the CESTAT.

The CESTAT observed that 4G Towers are architecturally different from conventional 2G/ 3G towers in as much as these are specifically designed by the engineers by reducing height, weight and dimensions to enable quick and smooth removal/ relocation thereof as and when required, without causing any damage. Traditional 2G/ 3G towers were partly embedded in the earth and any relocation thereof used to result in partial damage to its portions embedded in the earth. However, 4G Towers are neither land nor benefits arising out of land nor are attached to the earth or permanently fastened to anything attached to the earth. These are in fact, merely fastened on a foundation above the ground using nuts and bolts in a manner that these could be easily unfastened and relocated from one location to another without damage.

Basis the above, the CESTAT held that 4G Towers were not 'immovable property'. Therefore, CENVAT credit claimed by the appellant was allowed and refund granted.

Appellate Authority for Advance Ruling ("AAAR") and Authority for Advance Ruling ("AAR")

Healthcare services provided independent of resort business held to be a part of composite supply, with principal supply that of 'accommodation services'

[13] 2022 (5) TMI 253 - CESTAT Hyderabad.
[14] Chapter V of the Finance Act, 1994
[15] 2022 (4) TMI 1361

In the matter of ***Corbett Nature Reserve***[16], the applicant was engaged in the business of running a resort and an independent healthcare centre, wherein healthcare services were provided to not only in-house customers of the resort but was open to general public as well. The centre was registered as a "Naturopathy Centre" under the Clinical Establishment Act, 2010 to provide naturopathy services.

The applicant contended that 'health care services' provided by them at their Naturopathy Centre were exempt from GST as per the Exemption Notification[17]. The AAR, however, held that these services were provided as part of a composite supply, of which 'accommodation services' was a principal supply and hence, was taxable at the rate applicable to supply of 'accommodation services'.

Aggrieved by the AAR, the applicant approached the AAAR, wherein it was observed that the applicant advertised and marketed their 'accommodation service' as their main service and 'naturopathy' as an additional service. Further, observing that all such ancillary/ additional activities had a proximal nexus with 'accommodation services', the AAAR upheld the ruling of the AAR, that accommodation services and other services including naturopathy services rendered during the course of said service were 'composite supply', with the principal supply of 'accommodation service'. Therefore, naturopathy services, being a part of a composite supply, were held to be taxable at the rate applicable to supply of 'accommodation services'.

Instruction

CBIC[18] instructs no 'recovery' of tax dues could be necessarily made during the course of search/ inspection/ investigation proceedings

Instruction No. 01/2022-23 (GST-Investigation) dated May 25, 2022

With an aim to eliminate the use of force or coercion by officers, the CBIC has clarified that there may not be any circumstances necessitating 'recovery' of tax dues by the officers during the course of search or inspection or investigation proceedings. However, this would not bar the taxpayers for making voluntarily tax payments through Form DRC-03.

JSA Comments: CBIC's instruction comes as a relief to the assesses undergoing investigation proceedings, as in many instances assesses are forced to pay tax during the course of such investigations. This instruction should keep a check on abuse of powers by the officers. It remains to be seen how this instruction to be implemented.

For more details, please contact km@jsalaw.com

[16] 2022 (5) TMI 182 - Appellate Authority for Advance Rulings, Uttarakhand.
[17] Entry no. 74 of Notification No. 12/2017 - Central Tax (Rate) dated June 28, 2017
[18] Central Board of Indirect Taxes and Customs (GST-Investigation Wing)

