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Indirect Tax Alert

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Judgment under Pre-GST era

Steel Authority of India Ltd. v. *Commissioner of GST and Central Excise, Salem*[1]

Issue for Consideration

Whether liquidated damages recovered from vendors for breach of contract would be classified as consideration for 'tolerating an act' and therefore be liable to Service tax?

Discussion

- The Appellant is a Public Sector Undertaking engaged in the manufacture of carbon steel, coin blanks and alloy steel. It has recovered various amounts such as liquidated damages, forfeiture of Earnest money deposit ('EMD') and ground rent from its vendors due to their failure to deliver the consignments as per the agreed timelines as well as from buyers for breach of certain contractual obligations.
- The Respondent has passed an order ('impugned order') to tax the above amounts recovered as they form the consideration for the declared service of 'tolerating an act or a situation' as per section 66E(e) of the Finance Act, 1994.
- The impugned order has been upheld by the Appellate authority and hence the Appellants have challenged the order before the Hon'ble CESTAT, Chennai and contended as follows:
  - The Appellants place their reliance on the CESTAT judgment in the case of *South Eastern Coalfields Ltd.* v. *Commissioner of Central Excise and Service Tax, Raipur*[2] wherein it was held that no service tax shall be levied on liquidated damages recovered by the company.
  - They also relied on the CESTAT judgment in the case of *M.P. Poorva Kshetra Vidyut Vitran Co. Ltd.* v. *Principal Commissioner CGST and Central Excise, Bhopal*[3] wherein the Tribunal held that service tax was not leviable on the penalty amounts recovered for non-compliance of the terms of the contracts.
- The Hon'ble Tribunal held that:
  - The CESTAT judgment in the case of *South Eastern Coalfields (supra)* had held in favour of the Appellants on a similar issue. In the above

[1] 2021 (7) TMI 591
[2] 2020 (12) TMI 912
[3] 2021 (2) TMI 821

case, the Tribunal rejected the Revenue's contentions that the penalty amount, forfeiture of EMD and liquidated damages collected by the Appellants amounted to consideration for the declared service of 'tolerating an act' and thus service tax was not leviable.

- An agreement must be read in its entirety in order to derive the intention of the parties involved. In the present case, the intention of the parties was to ensure the continuous and timely supply of goods and for availing various other services. The intention was not to breach the terms of the contract in order to attract the penalty provisions.
- The penal clauses in the contract were merely to safeguard the commercial interests of the Appellant and thus it could not be held that recovering the penalty amounts by entering into a contract was the intention of the parties.
- The recovery of liquidated damages / penalties from other parties is not a consideration for any service *per se*, since neither the appellant is carrying on any activity in order to receive compensation nor is there any intention of the other party to breach or violate the terms of the contract and suffer a loss.
- The penal clauses are necessary to ensure that the defaulting act is not undertaken or repeated and the same cannot be said to be towards tolerating a breach of agreement by the defaulting party.
- The activities mentioned under section 66E(e) of Finance Act, 1994 would apply when the agreement specifically refers to an activity of tolerating an act or refraining from an act and the consideration flows in respect of such activity.
- The ratio of the judgment in the case of *South Eastern Coalfields* is squarely applicable to the present case and thus the view taken by the Respondent in the impugned order cannot be sustained.

Judgment

In view of the judicial precedents, the Hon'ble CESTAT allowed the appeal and set aside the impugned order pronounced by the Respondent.

Dhruva Comments:

Clause 5(e) of Schedule II of the CGST Act, 2017 states that the activity of 'tolerating an act or a situation' or 'agreeing to the obligation to refrain from an act' is a supply of service. The language employed is similar to that of section 66E(e) of the Finance Act, 1994 which classified such services as 'declared service' under the erstwhile Service tax law.

Various advance rulings have been passed under GST that classify the penalties recovered from breach of contract as a 'supply' under GST and thus liable to tax. It will be interesting to see how this matter unfolds before the courts under GST as the ratio of these judgments could equally apply under GST.

Ruling under GST era

M/s. Chep India Private Limited – Authority for Advance Ruling, Karnataka[4]

Issue for Consideration

Whether leasing of goods between distinct persons constitutes 'supply of services' and is exigible to GST?

Discussion

- The Applicant i.e. Chep India Private Limited ('CIPL') is engaged in renting of re-usable unit load pallets, crates and containers ('goods') for shared use by multiple participants within the Industrial and retail sector throughout the supply chain under a "pooling" business model. The ownership of the goods rests with the Applicant at all times.
- The Applicant is proposing to change its business model wherein the broad business mechanics would work as follows:

[4] TS-359-AAR(KAR)-2021-GST

- The Applicant would be consolidating the ownership of all goods at its Karnataka location ('CIPL, Karnataka').
- Thereafter, CIPL Karnataka would be leasing the goods either to its customers or to other CIPL locations in other states ('CIPL branches') under a delivery challan and it would be raising periodic invoices for collecting lease charges.
- CIPL branches would in turn issue the equipment to their customers. CIPL branches would be collecting lease charges from their customers.
- There may also be cases where another location of CIPL (e.g. CIPL, Tamil Nadu) requires certain equipment, which is not available at CIPL, Karnataka but is available at some other CIPL location (e.g. CIPL, Kerala). In such a case, CIPL, Kerala would transfer the equipment to CIPL, Tamil Nadu on the basis of the instructions from CIPL, Karnataka. In such a case, CIPL, Karnataka would stop collecting lease charge from CIPL, Kerala and it would start collecting them from CIPL, Tamil Nadu instead. Furthermore, CIPL, Kerala would charge CIPL, Karnataka for the facilitation / arrangement of movement of equipment to CIPL, Tamil Nadu.

- The Applicant filed the present advance ruling before the Karnataka Authority for Advance Ruling ('the Authority') seeking clarity on GST implications on various aspects of the proposed business model.

- After considering the facts of the case, the Authority observed the following:
  - The Applicant is an incorporated entity under the Companies Act, 2013 and is covered under the definition of "person" under GST.
  - One branch of the same Company cannot enter into a lease/rental transaction with another branch of same Company as per the Companies Act, 2013 or under the Income Tax Act, 1961 as these cannot be considered as transactions and no revenue can be recognised in such transactions. The assets are held in common by all branches.
  - However, GST requires state specific registration and is a tax within the state. Therefore, all stock transfers from one state to another are treated as supplies.
  - Transactions between two entities of the same concern would be treated as deemed supplies between deemed distinct persons as per section 25(4) of the CGST Act.
  - Hence, all transactions between CIPL, Karnataka to CIPL branches would be covered under the scope of supply under section 7(1) of the CGST Act.
  - Since the equipment is being purchased on account of CIPL, Karnataka, the goods are held as owned assets by CIPL, Karnataka and as leased assets by CIPL branches for which CIPL branches are liable to pay consideration for such lease.
  - Since CIPL, Karnataka and CIPL branches are distinct persons and since a transfer of goods is effected from CIPL, Karnataka to CIPL branches, without a transfer of ownership, the same amounts to supply of service of lease as per sl.no. 1(b) of Schedule II of the CGST Act,[5] but only for the purpose of GST.
  - With regards to the value of the supply as per the GST law, since the CIPL branches are eligible for full input tax credit, the value that is declared on the invoice should be treated as the value of such supply as per second proviso to rule 28 of the CGST Rules.
  - With regards to the documents that are to be carried for the movement of goods from CIPL, Karnataka to CIPL branches, the Authority observed that since the transaction involves supply of service, a tax invoice is required to be issued as per section 31(2) of the CGST Act, read with rule 47 of the CGST Rules.
  - The Applicant is supplying services involving movement of goods and hence as per rule 55

[5] Schedule II: 1*(b) any transfer of right in goods or of undivided share in goods without the transfer of title thereof, is a supply of services;*

read with rule 138 of the CGST Rules, the Applicant is liable to issue a delivery challan at the time of removal of such goods for the purpose of lease and also to issue an e-way bill on which the value shall be the market value of such goods and not the value of supply of services involved.

- With regards to the situation in which one location of CIPL (e.g. CIPL, Kerala) transports equipment to another location of CIPL (e.g. Tamil Nadu) on the instructions of CIPL, Karnataka, the Authority observed as follows:
  - Although CIPL, Kerala is in possession of the goods, CIPL, Karnataka is the owner of the goods. CIPL, Kerala is only a lessee of the goods and is therefore required to give the goods back on termination of lease contract. Such movement should be accompanied by an e-way bill generated by CIPL, Kerala.
  - If CIPL, Karnataka instructs CIPL, Kerala to transport the goods to CIPL, Tamil Nadu, the lease contract between CIPL, Karnataka and CIPL, Kerala ends there and CIPL, Kerala holds the goods as a bailee. In such a case, CIPL, Karnataka should enter into a lease transaction with CIPL, Tamil Nadu and raise a delivery challan and an e-way bill with the 'ship from address as "CIPL, Kerala" and ship to address as "CIPL, Tamil Nadu". The transaction would be akin to CIPL, Karnataka picking up the goods and sending them to CIPL, Tamil Nadu.
  - Hence the movement of goods should be treated as a supply of goods on lease by CIPL, Karnataka to CIPL, Tamil Nadu which is liable to tax in the hands of CIPL, Karnataka.
  - Furthermore, the services provided by CIPL, Kerala to CIPL, Karnataka in facilitating the transportation of the goods to CIPL, Tamil Nadu are also exigible to GST.
  - Alternatively, if CIPL, Kerala sub leases the goods to CIPL, Tamil Nadu, then CIPL, Kerala would be required to generate an e-way bill and delivery challan for the movement of goods from CIPL, Kerala to CIPL, Tamil Nadu. Also, the lease contract between CIPL, Karnataka and CIPL, Kerala would continue and hence CIPL, Kerala would be liable to pay lease rentals to CIPL, Karnataka.

Ruling

The Authority passed the following ruling:

- The equipment leased by CIPL, Karnataka to CIPL branches would be considered as lease transaction exigible to GST.
- The value of lease declared on the invoice would be the value for GST purposes since full input tax credit is available.
- The document to be carried for movement of goods from CIPL, Karnataka to CIPL, Kerala would be a delivery challan and an e-way bill for the entire value of the goods that are transported.
- If the movement of goods between CIPL, Kerala and CIPL, Tamil Nadu occurs under the instructions of CIPL, Karnataka, this would result in a separate transaction of supply by CIPL, Karnataka to CIPL, Tamil Nadu. However, if the agreement is between CIPL, Kerala and CIPL, Tamil Nadu which causes movement, then it would be a supply by CIPL, Kerala. The documents to be carried are a delivery challan and an e-way bill as issued by either CIPL, Karnataka or CIPL, Kerala if the supply is by CIPL, Karnataka or by CIPL, Kerala respectively.

Dhruva Comments:

The Authority has clarified various practical issues arising in relation to lease transactions between distinct persons and documentation for the movement of goods, valuation of goods etc. The supply of goods between two inter-state branches is well recognised. Whilst the law covers services as well, the question could be whether it will cover supplies which are covered by a

'specific contract' or 'arrangement' or could it be implied i.e. even if there is no 'specific contract'?

Circular

Clarification on applicability of IGST on repair cost, insurance and freight, on goods re-imported after being exported for repairs

The Government has issued circular no. 16/2021-Customs dated July 19, 2021 which clarifies the applicability of IGST on repair cost, insurance and freight, on goods re-imported after being exported for repairs. The clarification is summarised below:

- Notification no. 45/2017-Customs and 46/2017-Customs dated June 30, 2017 prescribed levy of duties or taxes (including Basic Custom Duty, IGST, etc.) on re-import of goods exported for repair outside India to be payable at the applicable rates only on the value of repairs, insurance and freight and not on the entire value of goods re-imported.
- A similar concession was granted in the pre-GST period vide notification no. 94/96-Customs in respect of BCD, Additional duty of customs etc. The GST council, at the time of rollout of GST via consequential amendment, replaced additional duties of customs with IGST and compensation cess.
- Furthermore, GST Council, in its 37th meeting, affirmed both its decision to make available input tax credit paid on aircraft engines and parts exported for repairs and later re-imported and the leviability of IGST on such re-imports. It also re-affirmed the GST rate on maintenance, repair and overhauling (MRO) services in respect of aircraft, aircraft engines and other components and parts and the leviability of IGST on re-imports.
- Recently, CESTAT in the matter of *M/s Interglobe Aviation Limited* v. *Commissioner of Customs*[6] on analysis of notification no. 45/2017-customs interpreted that only BCD is applicable on the value of repairs, insurance and freight of re-imported goods and that consequently IGST and compensation cess would be wholly exempt. In this regard, an appeal has been preferred by the department before the Hon'ble Supreme Court.
- In view of the above, on recommendation of the GST Council in its 43rd meeting, clarificatory amendments have been made vide notifications no. 36/2021-Customs and 37/2021-Customs dated July 19, 2021 for levy of IGST on the value of repairs, insurance and freight of re-imported goods.

Dhruva Comments:

In the case of *M/s Interglobe Aviation Limited (supra),* the CESTAT was of the view that 'duty of customs' would mean 'BCD'. Non-mentioning of IGST and compensation cess specifically in the exemption notification would mean that only BCD would be levied on the cost of repairs, insurance and freight whereas IGST and compensation cess would not be leviable. Now the notifications have been amended vide notification no. 36/2021-Customs and 37/2021-Customs dated July 19, 2021 for levy of IGST and cess on the value of repairs, insurance and freight of re-imported goods by inserting the words "duty, tax and applicable cesses".

It will be interesting to see how the judiciary unfolds on this issue and whether duty of customs could be interpreted to include IGST and cess.

Notifications

Changes with respect to Annual return in form GSTR-9 and self-certified reconciliation statement in form GSTR-9C for FY 2020-21[7]

- Section 110 and section 111 of the Finance Act, 2021 have been notified to be effective from August 1, 2021. Accordingly, section 35(5) of the CGST

[6] 2020 (43) G.S.T.L. 410 (Tri. – Del)
[7] Notification no. 29/2021-Central Tax dated July 30, 2021, notification no. 30/2021-Central Tax dated July 30, 2021 and notification no. 31/2021-Central Tax dated July 30, 2021

Act, requiring the filing of a Chartered Accountant certified reconciliation statement has been omitted and section 44 of the CGST Act has been substituted to provide for filing of annual return and a **self-certified reconciliation statement**.

- Furthermore, rule 80 of the CGST Rules has also been suitably substituted (w.e.f. August 1, 2021) to keep it in line with the changes made under section 35 and 44 of the CGST Act. The rule also states that the self-certified reconciliation statement would only be required to be submitted for specified taxpayers whose aggregate turnover during a financial year exceeds ₹ 5 crores.
- Furthermore, the requirement of filing an annual return for FY 2020-21 in Form GSTR-9 has been exempted for taxpayers whose aggregate turnover in FY 2020-21 is upto ₹ 2 crores.
- The Government has notified the amendments in the Form GSTR-9 and GSTR 9C for FY 2020-21.

Dhruva Comments:

While the requirement of certification by CA stands replaced with self-certification, the activity of reconciliation of books of accounts with GST return needs to be meticulously undertaken and appropriate disclosures along with notes should be provided in the reconciliation statement. It is imperative to note that the format of annual return and reconciliation statement remains unchanged.

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