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Indirect Tax Alert

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Ruling under GST era

M/s. Fraunhofer-Gesellschaft Zur Forderung Der Angewwandten Forschung – Appellate Authority for Advance Ruling, Karnataka[1]

Issues for Consideration

- Can the activities undertaken by a liaison office, in line with the conditions specified by the Reserve Bank of India ("RBI"), be regarded as supply of service under GST?
- If yes, is the liaison office required to be registered under GST and liable to pay GST?

Discussion

- M/s. Fraunhofer-Gesellschaft ZurForderung der Angewandten Forschung e.V ("Head Office / HO") is incorporated in Germany and undertakes the business of promoting applied research. The HO has set up a liaison office in Bangalore ("the Appellant / LO") to act as its extended arm and carries out the activities as permitted by the RBI.
- As per the RBI permission, a liaison office cannot generate any income in India and cannot engage in any trade or commercial activity.
- The Appellant had approached the Authority for Advance Ruling ("the Authority") to determine whether the activities of a liaison office amount to supply of service or not. The Authority vide its order[2], held that the activities undertaken by the Appellant amounted to supply under GST and they are required to be registered under GST.
- Being aggrieved by said order, the Appellant filed an appeal before the Appellate Authority for Advance Ruling ("the Appellate Authority") on the following grounds:
  - The Authority has not taken into consideration the condition prescribed by the RBI that the LO cannot generate any income in India and cannot engage in any trade or commercial activity. It can perform only the permitted activities such as representing the parent company in India, acting as a communication channel between parent company and Indian companies, etc.
  - The LO is not a separate or independent entity but a geographical extension of the parent company with the same legal identity as the parent company.

[1] 2021-VIL-11-AAAR
[2] 2020-VIL-295-AAR

- There is no supply of goods / services between the LO and the HO. The LO is not engaged in any activity with any person in India in the course or furtherance of business. The LO is acting as a communication channel between the HO and the businesses in India by employing its own personnel and therefore, there is no supply of service.
- The amount received by the LO from its HO is towards salary, rent, security, electricity, travelling, etc., as the LO does not have any other source of income. Mere reimbursement of expenses cannot be termed as consideration.
- The Authority has erred by treating the activities of the LO as being covered under section 2(17)(b) of the CGST Act, 2017. Further, the LO and the HO cannot be regarded as two distinct persons as they are not associated in the business of one another. The LO is working as employee of HO and the activities of LO are not covered under the definition of supply.
- As per the Companies Act, 2013, there is no separate registration required for the LO and the Appellant is registered in the name of the HO, which clearly shows that the LO does not have an independent existence of its own.
- The LO cannot be regarded as an intermediary as it has already produced a Chartered Accountant certificate to confirm that it has not carried out any business, trade or commerce.

- The Appellate Authority after considering the facts of the case observed as follows:
  - Establishment of a liaison office in India is regulated by section 6(6) of the Foreign Exchange Management Act, 1999 ("FEMA"). The Appellant has obtained permission from the RBI to act as a LO of its HO and needs to adhere to the various conditions / restrictions as imposed by the RBI for its functioning as a LO.
  - For an activity to be termed as a 'supply', the activity must be done by (i) a person; (ii) for a consideration; and (iii) it should be in the course or furtherance of business.
  - The inward remittances received by the LO from its HO for maintaining the office in India cannot be regarded as consideration for the liaison activity. This removes the liaison office activities from the scope of 'supply' under section 7(1)(a) of the CGST Act, 2017.
  - The LO is not recognised as a separate legal entity in India. Under the Companies Act, 2013, every foreign entity establishing its place of business in India by way of a liaison office shall be treated as a foreign company as defined under section 2(42) of the Companies Act, 2013. The liaison office is registered with the Registrar of Companies in the same name as the parent foreign company.
  - The concept of 'related person' arises only when there are two 'persons' in existence as per law. In the present case, there is only one legal entity, i.e. the company in Germany and the liaison office in India is **only an extension of the foreign company having no separate identity in India**. The liaison office is not a 'person' recognised as per law and thus the question of it being a related person does not arise.
  - LO cannot be regarded as 'artificial juridical person' as they are not natural persons but separate entities under law, which the LO is not. Accordingly, the finding of the Authority that the HO and LO are deemed to be related persons in not correct.
  - As the LO and HO cannot be treated as separate persons but one legal entity, the liaison activity performed by the LO for HO is in the nature of the service rendered to self which does not come within the purview of 'supply'.

Ruling

The activities undertaken by the Appellant (liaison office) does not amount to supply under GST and accordingly, there being no taxable supply no registration is required under GST.

Dhruva Comments:

The ruling categorising the liaison office as an extension of HO falls in line with the regulatory framework within which RBI permits the LO to undertake limited / restricted activities for HO. Being an extended arm, the activities / services performed are rendered to self and outside the purview of 'supply'. The ruling would be welcomed by similarly placed liaison offices and should put the controversy to rest.

Judgment under pre-GST era

The State of Tamil Nadu v. *TVL. Parasakthi & Co., Theni, TVL. Eswar Finance Corporation, Theni, The Secretary, Tamil Nadu Sales Tax Appellate Tribunal (AB), Madurai*[3]

Issue for Consideration

Whether purchasing coffee seeds, processing them and exporting instant coffee is entitled to the benefit of section 5(3)[4] of the Central Sales Tax Act, 1956 ("CST Act, 1956")?

Discussion

- The Respondents purchased coffee seeds and exported instant coffee, soluble coffee, Indian spray coffee and Indian soluble coffee (collectively referred to as "instant coffee"). The Respondent claimed the benefit of section 5(3) of the CST Act, 1956 for the said exports.
- The Petitioner, however, alleged that the Respondents were not entitled to the benefit of section 5(3) of the CST Act, 1956.
- The matter reached before the Tamil Nadu Sales Tax Appellate Tribunal ("Tribunal") wherein the Tribunal held that the dealers were entitled to exemption under section 5(3) of the CST Act, 1956 as the coffee seeds supplied by the dealer were roasted, ground, extracted and spray dried, which did not alter the character of the goods supplied by the dealers.
- Aggrieved, the Petitioner filed the present Writ Petitions before the Hon'ble High Court of Madras on the following contentions:
  - The Respondents are not entitled to the benefit of section 5(3) of the CST Act, 1956 as the goods exported are not the same as the goods purchased.
  - Both the coffee seeds and instant coffee are commercial commodities and said coffee seeds underwent a process, due to which the same goods that was purchased were not exported.
  - Reliance was placed on the judgment of the Hon'ble division Bench of Madras in the case of *State of Tamil Nadu rep. by the Deputy Commissioner, Madurai Division, Madurai* v. *M/s Vijayalashmi Leather Industries P. Ltd.*[5] in support of their contention.
- After considering the facts of the case and the contentions of the parties, the Hon'ble High Court observed as follows:
  - The judgment of *M/s Vijayalashmi Leather Industries P. Ltd* (*supra*) was based on entirely different facts.
  - The transactions in the present case between dealers, the exporter and foreign buyer are inextricably connected and hence in terms of judgment of the Hon'ble Supreme Court in the case of *State of Karnataka* v. *M/s Azad Coach Builders (P) Ltd.*[6] the "same goods" theory is not applicable in the present case.
  - The Hon'ble Tribunal has already examined the *'same goods'* theory and has rightly relied on the decision of this Court in the case of *Ram*

[3] 2021 (2) TMI 802
[4] Section 5(3) of the CST Act, 1956: "Notwithstanding anything contained in sub-section (1), the last sale or purchase of any goods preceding the sale or purchase occasioning the export of those goods out of the territory of India shall also be deemed to be in the course of such export, if such last sale or purchase took place after, and was for the purpose of complying with, the agreement or order for or in relation to such export."
[5] Writ Petition nos. 3987, 3997 and 3721 of 2003 dated February 11, 2020
[6] (2010) 36 VST 1

Bahadur Takkur Takkur (P) Ltd. v. *Coffee Board, Bangalore*[7].

Judgment

The Hon'ble High Court upheld the order of the Tribunal and dismissed the Writ Petitions.

Dhruva Comments:

The judgment has clarified that exemption under section 5(3) of the CST Act, 1956 would be available on purchase of goods even if the said goods are exported after processing which did not alter the character of the goods and provided the same is inextricably connected with the export of goods. The burden to establish the link between the export and penultimate sale lies on the assessee and thus documentation would play a crucial role in establishing the bonafides of the transaction.

[7] (1991) 80 STC 99

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