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Indirect Tax Alert

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Ruling under GST era

M/s. Fraunhofer-Gesellschaft Zur Forderung Der Angewwandten Forschung – 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 services under GST?
- If yes, is the liaison office required to be registered under GST and liable to pay GST?

Discussion

- M/s. Fraunhofer-Gesellschaft Zur Forderung 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 Applicant") to act as its extended arm and carries out the activities as permitted by the RBI.
- As per the RBI, the liaison office cannot generate any income in India and cannot engage in any trade or commercial activity. Furthermore, the liaison office can perform the following functions:
  - Representing the parent company in India;
  - Promoting export / import from / to India;
  - Promoting technical / financial collaborations between parent / group companies and companies in India;
  - Acting as a communication channel between the parent Company and Indian Companies.
- The expenses incurred by the liaison office would be met from the funds received from the HO.
- The Applicant approached the Authority for Advance Ruling ("the Authority") and contended that there is no supply of services by the liaison office to its HO on the following grounds:
  - The liaison office is merely acting as an extended arm of the HO and is not engaged in any business activity of its own, not charging or collecting any fee or consideration. The liaison office does not account any income in the financials and the only income is the remittance from the HO purely to meet the working of the office. Accordingly, the activity undertaken by

[1] 2020 (10) TMI 809

the liaison office does not amount to supply under section 7(1)(a) of the CGST Act, 2017 as there is no supply of goods / services for a consideration and no business activity is being undertaken.

- As per section 25 of the CGST Act, 2017, to be regarded as distinct person, there should be two or more establishments, but in the present case, the liaison office is mere extension of the HO, and no separate identity can be established. Furthermore, they are not related persons as there is only one legal entity and no relationship can be established. Accordingly, the transaction does not fall within paragraph 2[2] of the Schedule I to the CGST Act, 2017 (i.e. Activities to be treated as supply even if made without consideration).
- The Authority for Advance Ruling in other states have passed favourable rulings[3] by upholding that the activities undertaken by a liaison office do not amount to supply of services.

- On the basis of the facts of the case, the Authority held that the moot question to be decided was whether the activity amounts to supply or not and the remaining questions would be dependent on this core issue. The Authority observed as follows:
  - The term 'liaison office' is not defined under the CGST Act, 2017 but defined under the FEMA Regulations, 2016[4] and as per which, **primarily it is a place of business**.
  - The definition of 'person' under section 2(84) of the CGST Act, 2017 is very wide and covers every artificial judicial person not covered within the definition. A judicial person is a non-human legal entity recognized by law with duties and rights. The RBI has recognized the Applicant and conferred upon them certain duties and placed certain restrictions. Therefore, the Applicant is covered within the definition of 'person'.
  - The liaising activities undertaken by the Applicant fall within the definition of business under clause 2(17)(b) of the CGST Act, 2017 as the activities being undertaken are ancillary to the activities mentioned in clause (a) of section 2(17)[5]. Furthermore, the definition of 'business' is to be derived from CGST Act, 2017 and RBI's injunction on the business for the Applicant cannot decide the scope of business for the purpose of GST law.
  - In terms of clause (c) to the explanation to section 15[6] of the CGST Act, 2017, the Applicant and the HO shall be deemed to be related since the Applicant has itself admitted that they are involved in promoting the business of HO in India and they act on behalf of HO for its customers in India.
  - Accordingly, the activities performed by the Applicant should fall within the scope of supply under section 7 of the CGST Act, 2017 as it is in relation to furtherance of business. Furthermore, the activities are also covered within section 7(1)(c) (i.e. paragraph 2 of the Schedule I to the CGST Act, 2017) even in the absence of a consideration.
  - In terms of the explanation 1 and 2 to section 8 of the IGST Act, 2017, the Applicant and the HO shall be treated as an establishment of distinct persons. Therefore, the Applicant and HO are distinct persons and the activities performed by them cannot be regarded as export of services as the condition prescribed under section 2(6)(v) of the IGST Act, 2017 is not satisfied.
  - The Applicant is facilitating the supply between the HO and the Indian customers. They have a

[2] Paragraph 2 of Schedule I reads as - Supply of goods or services or both between related persons or between distinct persons as specified in section 25, when made in the course or furtherance of business
[3] *Habufa Meubelen B.V.* [2018 (7) TMI 883] and *Takko Holding GmbH* [2018 (10) TMI 1315]
[4] Foreign Exchange Management (Establishment in India of a branch office or a liaison office or a project office or any other place of business) Regulations, 2016
[5] Section 2(17)(a) reads as business includes (a) any trade, commerce, manufacture, profession, vocation, adventure, wager or any other similar activity, whether or not it is for a pecuniary benefit
[6] Clause (c) of explanation to section 15 reads as persons who are associated in the business of one another in that one is the sole agent or sole distributor or sole concessionaire, howsoever described, of the other, shall be deemed to be related

mandate from the RBI for this purpose. Furthermore, they are not making any supply on their own, which is a restriction placed upon them. Accordingly, they are covered within the definition of intermediary as per section 2(13) of the IGST Act, 2017.

– The supply of services by the Applicant amounts to inter-state supply in terms of section 7(5) of the IGST Act, 2017 and a person making an inter-state supply is mandatorily required to take registration in terms of section 24 of the CGST Act, 2017.

Ruling

- The activities undertaken by the Applicant (liaison office) amounts to supply under GST and is required to registered under GST.
- GST is to be paid if the place of supply of services is in India.

Dhruva Comments:

The RBI grants permission for setting up of a liaison office and expressly restricts from generating any income and engaging in any trade / commercial activity. It needs to be deliberated upon as to whether such an establishment can be construed to be undertaking a 'supply' in the course or furtherance of business, for the purposes of GST when it is completely barred by the RBI.

Interestingly, the Authority has not taken into account the similar rulings passed by the other State Authorities.

Furthermore, there appears to be an error by the Authority to regard the supplies as an inter-state supply when it has held that the Applicant is an intermediary.

Judgment under GST era

Assistant Commissioner of CGST and Central Excise Guindy Division, Chennai & Ors. v. Sutherland Global Services Pvt. Ltd.[7]

Issue for Consideration

Is the carry forward and utilisation of accumulated credit pertaining to Education Cess ("EC"), Secondary and Higher Education Cess ("SHEC") and Krishi Kalyan Cess ("KKC") allowed after the introduction of GST on July 1, 2017 ("the appointed date")?

Discussion

- The Division Bench of the Hon'ble Madras High Court ("the Bench") has overturned the judgment[8] of the Single Judge and has held that the taxpayer is not entitled to transition the accumulated balance pertaining to EC, SHEC and KKC as input tax credit ("ITC") under the GST regime and adjust it against any output GST liability. After perusing the provisions under the GST law and the history of the introduction of the Cesses, the Bench observed as follows:
  - There is no intendment nor equity about taxation and both the charging provisions as well as the exemption provisions under the taxing statutes must be strictly construed. Moreover, the Golden Rule of Interpretation (i.e. plain language should be interpreted according to its plain meaning) should be the cardinal principle applicable to the taxing statutes.
  - Cess, being specially collected, is slightly different in nature from a tax or duty even though it might be imposed and collected in the manner of a tax or duty and loosely termed as such. Despite this, the collection of Cess remains distinct due to the dedicated purpose for its imposition. Furthermore, the purpose of the facility of taking credit of the Cess on input goods and services was to avoid a cascading

[7] 2020-VIL-500-MAD
[8] 2019-VIL-536-MAD

effect rather than to alter the character of the imposition of Cess.

- Explanation 1 to section 140 of the CGST Act, 2017 (“the Act”) restricts the meaning of the expression "eligible duties" to seven specified duties. Consequently, only these seven specified duties as they pertain to inputs, semi-finished goods or finished goods held in stock on the appointed date shall be eligible to be carried forward and adjusted against the output GST liability in accordance with the aforementioned explanation. Furthermore, the absence of EC, SHEC and KKC from the list of seven specified duties means that these Cesses cannot be inserted into the said explanation for the purpose of being carried forward.
- A closer examination of explanation 1 and 2 to the section 140 of the Act indicates that the seven duties have been merely repeated under “eligible duties and taxes” with an addition of Service tax in respect of inputs and input services under the explanation 2. Furthermore, the addition of the words "and taxes" with the expression "eligible duties" under explanation 2 appears only to be on account of addition of "Service tax".
- Placing reliance on section 140(5) of the Act to which explanation 2 is applicable, the Bench observed that the provision clearly specifies and permits credit of Service tax paid on input services before the appointed date within a specified period. Thus, neither “eligible duties” nor “eligible duties and taxes” can be construed to encompass the Cesses with reference to explanation 1 and 2, respectively.
- Explanation 3 to section 140 of the Act clarifies that the expression “eligible duties and taxes” will exclude any Cess that has not been specified in explanations 1 and 2. The Bench also observed that although the National Calamity Contingent Duty (“NCCD”) imposed under section 136 of the Finance Act, 2001, was named as a duty within this Act, it was in fact a Cess. Furthermore, it was created to meet expenditure to manage any national calamity. However, its set-off has been specifically permitted possibly because the levy imposed under the Finance Act, 2001 continued even after the appointed day.
- The Bench observed that the exclusion of Cesses for the purpose of section 140 of the Act makes the intention of the Legislature very clear and the departmental circular[9] rightly clarified the position with reference to explanation 3 to section 140 of the Act. Furthermore, taking the credit of Cesses in the Electronic Credit Ledger shall not entitle a utilisation due to the fact that after the termination of the EC and SHEC in 2015, such credit cannot be called an input Cenvat credit. Consequently, a **mere accounting entry will not provide any vested right for transition and utilisation of such credit against Output GST liability**.
- The various sub-sections of section 140 of the Act do not operate in isolation and after careful comparison one can see that while all other sub-sections use the expression "entitled to take credit", sub-section (8) uses the expression "allowed to take". The utilisation of such credit, even if taken in the Electronic Ledger and notified in Form TRAN-1, does not guarantee any right of utilisation independent of other provisions contained in section 140 of the Act that specially ignore explanation 3.
- Cess of any kind except NCCD was not eligible for being carried forward.
- The credit of EC and SHEC became a dead claim in the year 2015 and consequently there was no question of allowing it to be carried forward and set-off after a gap of two years against Output GST liability.
- The Bench placed reliance on the Hon’ble Supreme Court’s judgment in the case of

[9] Dated January 2, 2019

Unicorn Industries v. *Union of India*[10] and *Union of India* v. *Modi Rubber Limited*[11] in support of its observations.

- In the case of Eicher Motors, the Hon'ble Supreme Court observed that "*the right accrued would be continued until the facility available thereto gets worked out"*. Since Cess could not be adjusted even against normal Excise duty in the pre-GST era, the question of applying said ratio does not arise.
- The Bench relied on judgments[12] to state that Cenvat credit or ITC under the GST regime is a **concession and a facility, and not a vested right**. However, even if the right to Cenvat credit is placed on the pedestal of a statutory right, it can be curtailed and regulated by formulating conditions for availing such a right.
- The carry forward or set-off of such credit cannot be claimed by any implied intention or vested right theory.
- The transition of unutilised ITC could be allowed only in respect of taxes and duties that were subsumed under the GST Law. The Bench observed that the EC, SHEC and KKC were not subsumed, neither by the Parliament nor by the States. Hence, the question of transitioning them into the GST Regime and their utilisation against Output GST liability cannot arise.

Judgment

The Bench allowed the Writ Appeal by setting aside the order of the Learned Single Judge and held that EC, SHEC and KKC cannot be transitioned and adjusted against Output GST liability under the GST regime.

Dhruva Comments:

This judgment could cause major ripples since the departmental authorities would initiate recovery proceedings for such disputed credits and notices to follow in other cases.

The ruling negates the notion that the transition of credits is a vested right and makes no reference to the savings provisions under the GST law. In addition, the retrospective insertion of explanation 3 into section 140 of the Act and its constitutional validity needs to be assessed. Furthermore, whether or not this amounts to a violation of the *doctrine of promissory estoppel* needs to be considered.

Considering the technicalities involved with the disputed subject, the matter is likely to reach the Hon'ble Supreme Court for its final resolution.

[10] 2019-VIL-42-SC-CE
[11] 1986-VIL-09-SC-CE
[12] *Union of India* v. *Uttam Steel Limited* [2015-VIL-53-SC-CE] and *Jayam and Co.* v. *Assistant Commissioner and Others* [2016-VIL-45-SC]

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