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Indirect Tax Alert

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Rulings under GST era

Tokyo Electric Power Company, Holding Inc. – Authority for Advance Ruling, Odisha[1]

Issue for Consideration

Can the location of a supplier, being a foreign company, be a project site in India for rendering consultancy services and thereby, required to obtain registration under GST?

Discussion

- M/s Tokyo Electric Power Company Service Ltd., Japan in association with Tokyo Electric Power Company, Holding Inc., Japan ("the Applicant") (collectively referred as consultants) have entered into an agreement with Odisha Power Transmission Corporation Ltd. ("OPTCL") to provide consultancy services in relation to a Project being undertaken in India.
- As per the agreement the Applicant, through their experts, would provide and transfer technical knowledge in relation to outdoor equipment to OPTCL's engineer and staff through actual consulting activities during the designing and implementation stage of the Project. The experts would be staying in India for considerable duration of time.
- The Applicant approached the Authority for Advance Ruling ("the Authority") to contend that they were not required to obtain registration under GST since as per the definition of 'location of supplier of services' under section 2(71) of the CGST Act, 2017, it had no fixed establishment in India and its usual place of business was also not India.
- The Authority after taking into account the facts of the case observed as follows:
  - The services would be provided through the Applicant's expert, support staff and sub-station engineer. Furthermore, as per the contract document, OPTCL has provided an office to the consultant and the office operation and maintenance charge would be borne by OPTCL.
  - As per the definition of 'location of supplier of service', the location of the supplier is usually the place from where supply is made, a place mentioned as principal place of business in the GST registration certificate. But in the present case, the place of supply and the location of the

[1] 2020-VIL-606-ALH

supplier is at the project site which is different from the place of business.

- The agreement entered into is a long-term project spanning over 46 months. The Applicant would depute the staff at the project site of OPTCL and OPTCL shall provide the staff access to project site for rendition of their services.
- The experts maintain suitable structures in terms of human and technical resources at the site of OPTCL. This indicates a sufficient degree of permanence to the human and technical resources employed at the site. The Applicant, therefore, through its experts, supplies the services at the site from a fixed establishment as defined under section 2(7) of the IGST Act, 2017[2]. Therefore, the location of the Applicant should be in India.
- Furthermore, the contention that the said service amounts to import of service and that, accordingly, OPTCL is liable to pay tax under reverse charge mechanism, is not correct.

Ruling

The Applicant is required to obtain registration under GST for the consultancy services.

Dhruva Comments:

GST law requires a supplier to obtain registration in the state from where taxable supplies are executed. Determining the place **from where** supplies are made and whether registration is required in a state where contract is being executed has been a subject matter of debate and there have been contrary rulings on the same. It will have to be ascertained on a case-to-case basis whether there persists a sufficient degree of permanence so as to qualify as a fixed establishment or otherwise.

M/s Page Industries Limited[3]

Issue for Consideration

Whether GST paid on promotional / marketing products used for promoting the brand and marketing the product can be availed as input tax credit ("ITC") under GST?

Discussion

- The Applicant is engaged in the manufacture, marketing and distribution of garments, swimwear, and swimming equipment under various brand names.
- The Applicant sells their products through their own outlets and through franchisees / distributors and retailers.
- For promoting its brand and to market the products, the Applicant avails services of advertising agencies for ads in print media, electronic media etc. The Applicant also procures promotional / marketing materials for displaying their products at the point of purchase ("POP") i.e. their own showrooms or the showrooms of distributors / retailers. The Applicant is paying GST on such services and materials. The Applicant procures various types of promotional / marketing products on which ITC is being claimed namely: display items, display boards, uniforms, posters, gifts, outdoor hoardings, carry bags, etc.
- The Applicant, without transferring the title of the said goods, shifts them to their showrooms and to the showrooms of their distributors/dealers for use in displaying their products, and in some cases, they are directly transferred from the supplier's premises to the POP.
- The Applicant also exports the promotional / marketing material to their overseas distributors / retailers free of cost under RBI guidelines to promote their brand and market the products in overseas countries.
- The Applicant approached the Authority for Advance Ruling ("the Authority") to contend that ITC

[2] "fixed establishment" means a place (other than the registered place of business) which is characterised by a sufficient degree of permanence and suitable structure in terms of human and technical resources to supply services or to receive and use services for its own needs.
[3] 2020-VIL-332-AAR

on such promotional / marketing items is eligible as 'inputs' on the following grounds:

- The promotional / marketing materials are for promoting the brands and for marketing their products, thereby forming an integral part of their business and hence amounts to use of such goods in the course or furtherance of business and hence ITC should be available as per section 16 of the CGST Act, 2017.
- The phase "used in the course or furtherance of business" has a very wide meaning and should include not only goods or services procured in relation to their "output" but also goods and services used in the course or furtherance of business.
- Reliance was also placed on various judgments of the Hon'ble Supreme Court and High Court to support their contention that promotion of brands and marketing of products forms an integral part of business and hence should qualify as an input and hence ITC on the same should be available.
- The Applicant is not merely distributing the products free of cost to the POPs but is distributing with an obligation to use it for promotional / marketing purposes and hence such products cannot be construed as "gifts" as per section 17(5)(h) of the CGST Act, 2017.
- The ownership of promotional / marketing products is not transferred to the distributors / retailers and they will not use the products for their personal use, hence such products cannot be said to be gifts.
- As per the agency / dealership agreements entered into between the Applicant and their dealers, there is an obligation on the part of dealers to promote the brands of the Applicant.
- In the event of promotional / marketing items being sent to their own showrooms, there is neither a supply nor a gift and hence the question of applicability of section 17(5)(h) of the CGST Act, 2017 does not arise.

- After hearing the Applicant's contentions, the Authority observed as follows:
  - Basis the type of promotional / marketing items procured and their use, there are two types of goods involved:
    - **Non-distributable goods:** Those delivered to distributors, franchisees and retailers for use in their premises, but ownership lies with the Applicant.
    - **Distributable goods:** Those delivered free of cost to distributors, franchisees and retailers for distribution to their employees and customers.
  - In case of non-distributable goods, the goods are capitalised by the Applicant and are returnable items. In the absence of any proof being made available as to whether these are returned back to the Applicant and are disposed of later at the end of their use, the following scenarios emerge: (i) the goods are returned back to the Applicant and are used further or are destroyed as they same are not usable; or (ii) the goods are not returned at all and are written off.
  - Since these non-distributable goods are capitalised by the Applicant, they cannot be treated as inputs, but qualify as capital goods.
  - In all the aforementioned scenarios, the Applicant uses the goods in the course or furtherance of business and hence the Applicant is entitled to avail ITC as per section 16 of the CGST Act, 2017.
  - However, after the end of the usage period, assuming that the goods are written off, destroyed or lost, then as per section 17(5)(g) of the CGST Act, 2017, the ITC claimed on the said goods shall be required to be reversed in accordance with rule 43 of the CGST Rules, 2017.
  - In case of distributable goods, they are procured by the Applicant for sales promotion and are distributed free of cost i.e. without any consideration to franchisees and other distributors / retailers. After distribution, such goods do not form part of the accounts of the Applicant.

- The franchisees of the Applicant qualify as related persons in terms of section 15(5)(c) of the CGST Act, 2017 as they are associated in the business of one another. Thus, the distribution of goods by way of gifts and free supplies to the franchisees is to be treated as deemed supply in terms of sl. no. 2 of Schedule I of the CGST Act, 2017. Accordingly, the Applicant needs to discharge GST on such supplies and is entitled to avail ITC on the said goods.
- In case of distributable goods distributed to other distributors / retailers who do not qualify as related persons, such distribution of goods to these retailers would be treated as gifts as per circular no. 92/11/2019-GST dated March 7, 2019. Hence, the transaction is not a supply and ITC on the same is not eligible to the Applicant.

Ruling

- ITC on procurement of distributable goods for distribution free of cost to franchisees is eligible as the distribution qualifies as a supply exigible to GST. However, ITC on goods meant for distribution to retailers is not allowed as per section 17(5) of the CGST Act, 2017.
- ITC on procurement of non-distributable goods is eligible, being capital goods in nature. However, if such goods are disposed of by way of writing off, destruction or are lost, the ITC claimed needs to be reversed in terms of rule 43 of the CGST Rules, 2017.

Dhruva Comments:

While the ruling has extensively dealt with the type of goods being categorised as distributable and non-distributable, it needs to be critically examined as to which expense would be classified as sales promotion, free supplies / samples and gifts. A far deeper analysis should be undertaken on these expenses / arrangements considering the provisions pertaining to supply amongst related parties and input tax credit.

Judgment under Pre-GST era

M/s. GGS Infrastructure Private Limited v. Commissioner of CGST & Central Excise[4]

Issues for Consideration

Whether a resolution plan for revival of a Company which is approved by the Committee of Creditors ("CoC") and sanctioned by the National Company Law Tribunal ("NCLT") is binding on the Service tax authorities?

Discussion

- The Petitioner is engaged in providing cranes on a lease / hire basis to infrastructure companies. The Petitioner underwent a period of great financial stress which resulted in failure to repay its dues to its creditors. One of the unsecured creditors filed a Petition under section 7 of the Insolvency and Bankruptcy Code, 2016 ("the IBC") before the NCLT.
- The Petition was admitted, and an interim resolution professional ("IRP") was appointed to initiate the insolvency process on the corporate debtor i.e. the Petitioner. Creditors of the Petitioner were called upon to submit proof of their claims to the IRP. One of the creditors ("the Applicant") submitted a resolution plan seeking to take over the Petitioner. In the interim, a new resolution professional ("RP") was appointed with a direction for immediate completion of the corporate insolvency resolution proceedings.
- Thereafter, the CoC approved the plan submitted by the Applicant. The resolution plan provided for settlement of dues of the operational creditors at 5% of the principal amount only with a waiver of interest, penal interest and penalty.
- The NCLT passed an order allowing the miscellaneous application filed by the RP for

[4] 2020 (12) TMI 914

sanction of the resolution plan. The NCLT in its order noted that the claim raised on account of Service tax dues fell under the definition of operational creditors and held that the dues should be settled at a par with other operational creditors thereby crystalising the claim, if any, by the department at 5% of the amount of principal dues with a waiver of interest, penal interest and penalty.

- However, the Respondents had already recovered a part of their Service tax due from the bankers and debtors of the Petitioner and passed an order confirming the tax liability without considering the order passed by the NCLT i.e. settling the dues at 5% of the principal amount along with a waiver of interest, penal interest and penalty.
- After perusing the facts of the present case, the Hon'ble High Court made the following observations:
  - The focus of the IBC is on resolution of insolvency and bankruptcy i.e. revival of corporate persons, partnership firms and individuals facing insolvency and bankruptcy rather than liquidation. In this regard, reliance was placed upon the judgment pronounced by the Hon'ble Supreme Court in the case of *Swiss Ribbons Pvt. Ltd.* v. *Union of India*[5].
  - After perusing various provisions of the IBC, the Court noted that once a resolution plan is approved, it shall be binding on the corporate debtor and its employees, members, creditors including the Central / State Government or any local authority, and other stakeholders involved in the resolution plan. Moreover, the provisions of the IBC have an overriding effect over other laws in accordance with section 31(1) read with section 238 of the IBC.
  - After careful examination of the chronology of the issue of the show cause notices and the initiation of the recovery proceeding by the Respondents, the Court observed that section 87(b)(i) of the Finance Act, 1994 was invoked much before the issue of first show cause cum demand notice to the Petitioner. The Court also noted that although the recoveries made were highly questionable, it was not necessary to examine its legality or illegality considering the fact that the resolution plan was approved by the CoC and sanctioned by the NCLT.
  - The Court held that a resolution plan approved by the CoC and sanctioned by the NCLT is binding on all the stakeholders including the operational creditors by relying upon the judgments[6] pronounced by the Hon'ble Supreme Court. The plan provides for settlement of Service tax dues at 5% of the amount of principal dues that would be crystallized upon "adjudication" along with, waiver of interest, penal interest and penalty. Furthermore, the plan uses the term "adjudicated" and not "adjusted" as sought to be read and applied by the Respondent and therefore the Petitioner would be required to pay only 5% of the dues adjudicated without adjusting it with the amounts recovered from the bankers or the debtors.
  - The Court also observed that the Respondent would be duty bound to refund the balance amount to the Petitioner which will not only be in terms of the resolution plan and thus, in accordance with law, but will also be a step in the right direction for revival of the Petitioner which is the key objective of the IBC.

Judgment

The Hon'ble High Court allowed the Writ Petition and directed the Respondents to refund the amount appropriated which was already recovered from the bankers and debtors after retaining 5% of the dues crystalised / adjudicated.

Dhruva Comments:

[5] (2019) 4 SCC 17
[6] *Committee of Creditors of Essar Steel India Limited* v. *Satish Kumar Gupta* [2019 SCC Online SC 1478] and *K. Sashidhar* v. *Indian Overseas Bank* [2019 SCC Online SC 257]

The judgment deciphers the intent of the legislation to provide another opportunity for revival of sick industries / undertakings under the IBC. The judgment clearly places an importance on the 'revival' of industries through the IBC. Furthermore, it lays emphasis on the fact that a resolution plan once approved, the commercial wisdom of the CoC should be accepted, unless there are reasons to doubt the same, and any judicial intervention has been avoided for ensuring prompt / punctual completion under the IBC. It will be interesting to see whether or not the current matter goes for another round of litigation.

M/s. South Eastern Coalfields Ltd. v. Commissioner of Central Excise and Service Tax[7]

Issue for Consideration

Whether compensation / penalty / liquidated damages received for breach of terms of contract be liable to Service tax?

Discussion

- The Appellant is primarily engaged in the business of mining and sale of coal.
- In the Appellant's commercial contracts, certain clauses were provided for charging compensation / penalty / liquidated damages for non-observance / breach of certain terms of the contract.
- A Show Cause Notice ("SCN") was issued alleging that the following amounts collected towards compensation / penalty / liquidated damages for breach of terms and conditions of the contract is a declared service as per section 66E(e) of the Finance Act, 1994 and hence, liable to Service tax:
  - Compensation / penalty from buyers on the short-lifted / un-lifted quantity of coal;
  - Compensation / penalty from service providers for breach of the terms of the contract; and
  - Liquidated damages from the suppliers of materials for breach of the terms of the contract.
- Despite the Appellant's submission that the said amounts were not collected towards toleration of an act, an order was passed confirming the aforesaid demand.
- Being aggrieved, the Appellant filed the present appeal before the Hon'ble CESTAT.
- The Hon'ble CESTAT heard the contentions of both the parties and made the following observations:
  - Explanation to section 67(1) of the Finance Act, 1994 clearly provides that only an amount that is payable for taxable service will be considered as 'consideration'.
  - As per the decisions of the Hon'ble Supreme Court[8] and the Larger Bench of the Tribunal[9], any amount charged which has no nexus with the taxable service and is not consideration for the service provided does not become part of the taxable value. There is a marked distinction between 'conditions to a contract' and 'considerations for a contract'.
  - For levy of Service tax under section 66E(e) of the Finance Act, 1994, there must be flow of consideration from one person to another when one person agrees to the obligation to refrain from an act, or to tolerate an act, etc.
  - An agreement must be read as a whole to gather the intention of the parties. In the present case, the intention of the parties was supply of coal, goods and various types of services. The consideration was contemplated for such supply of coal, goods etc. The intention of the parties was certainly not to flout terms of the agreement so that the penal clauses are attracted.
  - The penal clauses are provided to safeguard the commercial interest of the Appellant and cannot, by any stretch of imagination, be said that invocation of penalty clauses is the reason

[7] Order no.51651/2020 dated December 22, 2020
[8] *Commissioner of Service Tax* v. *M/s Bhayana Builders* [2018 (2) TMI 1325]; *Union of India* v. *Intercontinental Consultants and Technocrats* [2018 (10) GSTL 401 (SC)]
[9] *Bhayana Builders (P) Ltd* v. *Commissioner of Service Tax* [2013 (32) STR 49 (Tri.-LB)]

for execution of the contract for an agreed consideration.

- As per another decision by the Hon'ble Supreme Court[10], if a party promises to abstain from doing something, it can be regarded as a consideration, but such abstinence has to be specifically mentioned in the agreement. In the present case, the agreements do not specify what precise obligation has been cast upon the Appellant to refrain from an act or tolerate an act or a situation.
- There has to be a direct link between a service rendered and the consideration received[11].
- The Division Bench of the Tribunal[12] held that ex-gratia charges received by a manufacturer from a customer for not fully utilising its capacity did not emanate from any obligation on the parties to tolerate an act or a situation and cannot be considered to be towards payment for any services.
- Accordingly, it is not possible to sustain the view that penalty, forfeiture of earnest money deposit and liquidated damages have been received by the Appellant towards 'consideration' for 'tolerating an act' leviable to Service tax.

Judgment

The Hon'ble CESTAT allowed the appeal, by setting aside the order confirming the aforesaid demand.

Dhruva Comments:

Taxability of liquidated damages has been a contentious issue traversing through erstwhile Service tax and now GST regime. The decision has quite elaborately discussed several facets of the contract and provided clarity over various aspects involving compensation / penalty / liquidated damages pursuant to breach of terms and conditions of a contract. The subject issue is unlikely to achieve finality until concluded by the Apex Court. There have been contrary AARs on the disputed subject under GST and this decision would equally be relevant under the GST era.

[10] *Food Corporation of India* v. *Surana Commercial Co. and others* [(2003) 8 SCC 636]
[11] Judgement of European Court of Justice (First Chamber) Case C-277/2005, in *Societe Thermale d'Eugenic-les-Bains* v. *Ministere de l'Economie, des Finances et de l'Industrie*
[12] *M/s K.N. Food Industries Pvt. Ltd.* v. *Commissioner of CGST and Central Excise Kanpur* [2019-TIOL-3651-CESTAT-ALL]

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