The TAX POST

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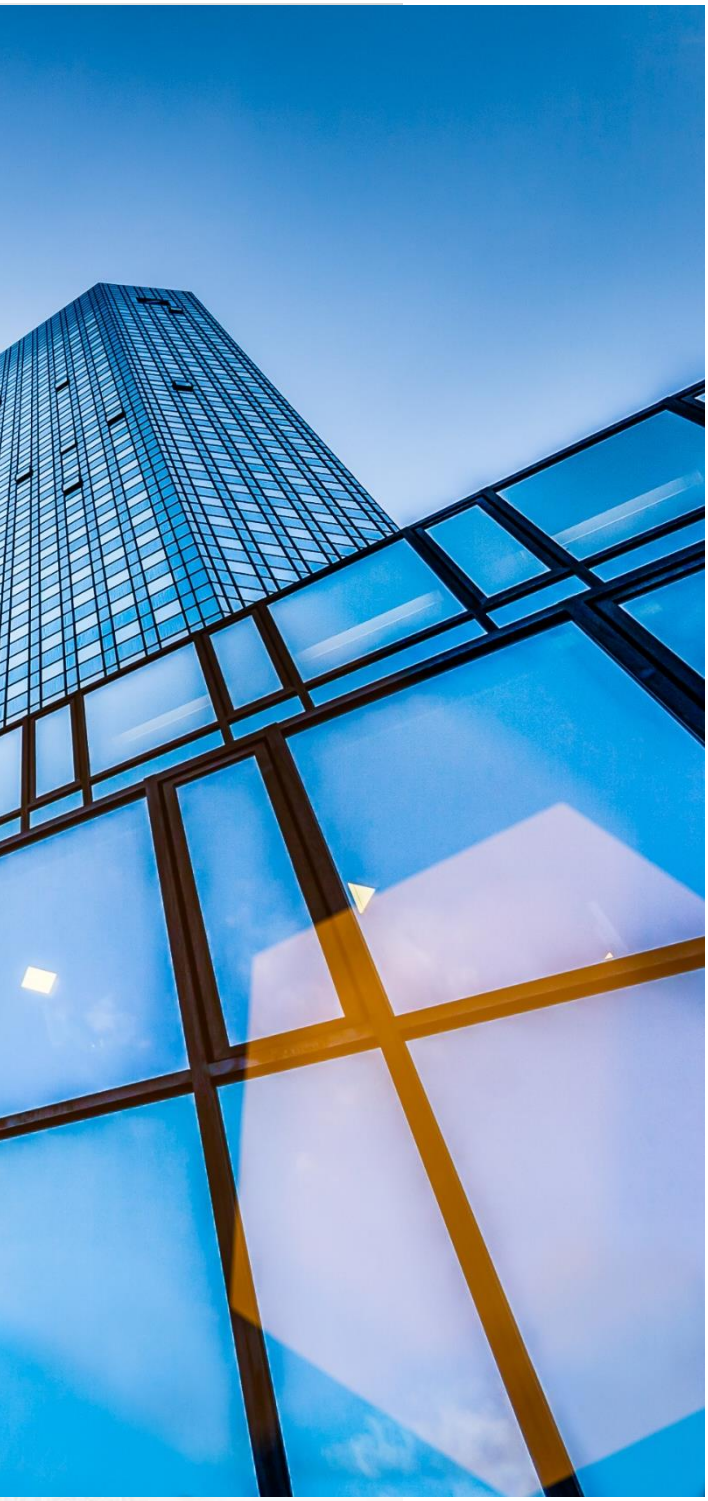

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PREFACE

The World Economic Outlook (WEO) report of April 2022 of the International Monetary Fund (IMF) projects that global economic prospects have worsened significantly since the forecast in January 2022. It was projected that the global recovery would strengthen from the second quarter of the current year after a short-lived impact of the Omicron variant. Since then, the outlook has deteriorated, causing a humanitarian crisis and sanctions because of the Russia – Ukraine war. This crisis unfolds while the global economy was on a mending path but had not yet fully recovered from the COVID-19 pandemic, with a significant divergence between the economic recoveries of advanced economies and emerging markets and developing ones.

Frequent and wider-ranging lockdowns in China, a manufacturing powerhouse, have also slowed business activity and could cause new bottlenecks in global supply chains. Yet, as per the IMF report, China is projected to grow around 5.1%, as against India's 6.9% (lower than 8.2% in 2022). It thus becomes important for India to make inroads into the export market and cater to the demands caused by existing geopolitical situations. India's focus on 'Make in India' and 'Ease of Doing Business' can drive growth during these periods, coupled with the promotional efforts, which can spur the exports from the domestic market.

Exercise for alignment of domestic product classification with HS-2022, the seventh edition of Harmonised System of Nomenclature (HSN) which has come into force from 1 January 2022, is thus a step in the right direction to aid in the trade negotiations, customs process areas of controls and procedures, risk assessment, IT compliances, administration of Rules of Origin, collection of international trade statistics, etc. Classification of goods while is an area of specialisation, a right mix of appropriate technology and human intelligence can aid the transition. The 'Cover Story' of this edition of 'The Tax Post' discusses the intricacies associated with this.

Special Economic Zones (SEZ) have been a vital link in India's drive to cater to the global market, even though the trend of export statistics from SEZs during the last few years vis-à-vis the actual plan has not been too encouraging. Thus, the Union Finance Minister's announcement during the Union Budget 2022-23 of the proposed, new SEZ legislation needs to be seen in this context. The future of the SEZ format is expected to change so that India can gather a larger chunk of the global demand. This edition of 'The Tax Post' discusses the proposed revamp of the SEZ policy and policy considerations, which would be in the mind of the government.

In a recent judgement, which is a blessing for real estate developers and property buyers, the Gujarat High Court has held that ad hoc one-third deduction towards land value in computing a taxable value for GST levy on the purchase of under construction property, is ultra vires the provisions of the CGST Act and unconstitutional. The section 'Decoded' of this edition discusses this judgment.

The 'Expert Speak' section of this edition discusses certain issues relating to the GST law, where the concept of 'Place of Supply of Service', which is an important criterion for proper treatment of export and import, has caused uncertainties. We continue to bring news from other jurisdictions in the section 'Global Updates'.

We trust this edition would be a good read for you.

COVER STORY

Harmonized System of Nomenclature and Customs Tariff of India – Need of Blending Technology and Human Intelligence

Indian Customs Tariff

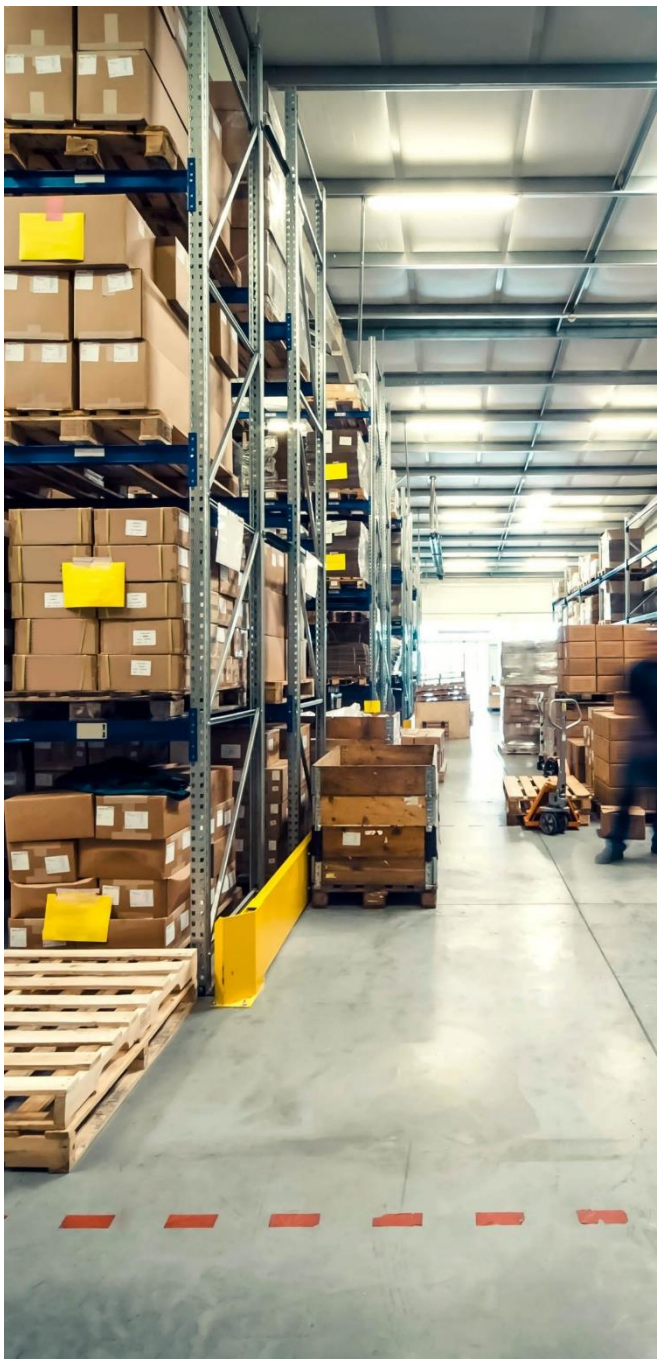
Accurate classification of goods under the Custom law (and GST law) assumes profound importance. Incorrect classification leads to dreadful consequences. Section 17 of the Customs Act, 1962 read with the Customs Tariff Act, 1975 (CTA) is of utmost importance to determine (a) Customs duty rate (b) applicability of import controls/restrictions (c) Levy of anti-dumping/safeguard duty and (d) the duty exemptions. The first Schedule of CTA specifies the nomenclature of imported goods based on the International Convention on the Harmonized Commodity Description and Coding System or "Harmonized System of Nomenclature" (HSN or HS), which is amended every five years and the latest amendment becoming effective on 1 January 2022.

CTA has 21 Sections that contain a total of 98 Chapters; while Chapters 1 to 97 are aligned to the HSN, Chapter 98 applies to goods imported for projects or as baggage, postal goods, laboratory chemicals, ship stores, etc. A Section codifies a particular class of goods and Section Notes explain the scope of Chapters/headings, etc. therein. A Chapter consists of Chapter Notes, a brief description of commodities arranged at 4-digit levels. 'Headings' are arranged at 6-digit levels and 'sub-headings' (or tariff items) at 8-digit levels.

For legal purposes for determining the classification of an item, the text of Section Notes, Chapter Notes, Sub-heading Notes, Supplementary Notes, Headings, Sub-headings and the General Rules for Interpretation of Import Tariff (GIR) are relevant. The general principle of classification is to match the correct and complete description of goods with that in the CTA. When this is not possible, such as when goods are imported under a trading name or goods appear classifiable under different Customs Tariff Chapters / Headings, then the classification may be determined by ascertaining the correct description of goods in terms of Customs Tariff Heading (CTH) read with GIR.

Need for Harmonization of Commodity Description

HSN developed by the World Customs Organization (WCO) entered into force on 1 January 1988. After its implementation, the use of the HSN quickly spread and there are now more than 200 economies and Customs or Economic Unions currently using the HSN as a basis for their national Customs tariffs.



While it is used for Customs tariffs it was found that HS can be used for other purposes such as –

- Basis for collection of international trade statistics
- Administration of Rules of Origin (RoO) under Free Trade Agreements (FTA)
- Collection of internal taxes
- Trade negotiations (e.g., the WTO schedules of tariff concessions and FTAs)
- Transport tariffs and statistics
- Monitoring of controlled goods (e.g., wastes, narcotics, chemical weapons, etc)
- Customs process areas of controls and procedures, risk assessment, IT compliances.

India's adoption of HSN for Tax administration

India adopted the internationally accepted HSN, in the formulation of which all considerations, technical and legal have been considered, to reduce disputes on tariff classification. As tariff would be on the lines of HS, it would bring about considerable alignment between the customs and GST tariffs (and Central Excise) and thus facilitate charging of additional customs duty on imports equivalent to GST. Indian Courts have consistently held that any dispute relating to tariff classification must, as far as possible, be resolved concerning the nomenclature indicated by the HSN, unless there is an expressly different intention indicated by Indian law.

HS-2022

The new (seventh) edition of HS (HS-2022) has come into force from 1 January 2022. This edition has introduced some significant changes to the Harmonized System with a total of 351 amendments at the six-digit level, covering a wide range of goods moving across borders.

Adaption to current trade through the recognition of new product streams and addressing environmental and social issues of global concern are the major features of the HS 2022 amendments. Visibility is brought about to several high-profile product streams in the 2022 Edition to recognise the changing trade patterns. Electrical and electronic waste, commonly referred to as e-waste, is one example of a product class that presents significant policy concerns as well as a high value in trade, hence HS 2022 includes specific provisions for its classification to assist countries in their work under the Basel Convention.

New provisions for novel tobacco and nicotine-based products resulted from the difficulties of the classification of these products, lack of visibility in trade statistics and the very high monetary value of this trade. Unmanned aerial vehicles (UAVs), commonly referred to as 'drones', also gain their specific provisions to simplify the classification of these aircraft. Smartphones will gain their subheading and note, which will also clarify and confirm the current heading classification of these multifunctional devices.

Another area of focus has been for the future, is the classification of multi-purpose intermediate assemblies. The recognition of the dangers of delays in the deployment of tools for the rapid diagnosis of infectious diseases in outbreaks has led to changes to the provisions for such diagnostic kits to simplify classification. New provisions for placebos and clinical trial kits for medical research to enable classification without information on the ingredients in a placebo will assist in facilitating cross-border medical research. Cell cultures and cell therapy are among the product classes that have gained new and specific provisions.

On a human security level, several new provisions provide for various dual use items. Protection of society and the fight against terrorism are increasingly important roles for Customs. Many new subheadings have been created for dual use goods that could be diverted for unauthorised use, such as radioactive materials and biological safety cabinets, as well as for items required for the construction of improvised explosive devices, such as detonators. The HS 2022 introduces new subheadings for specific chemicals controlled under the Chemical Weapons Convention (CWC), for certain hazardous chemicals controlled under the Rotterdam Convention and for certain persistent organic pollutants (POPs) controlled under the Stockholm Convention.

The changes are not confined to creating new specific provisions for various goods. The amendments also include clarification of texts to ensure uniform application of the nomenclature. Given the wide scope of the changes, it becomes inevitable that trade familiarise itself with these changes and adoption in the domestic customs/GST tariff.

Complexities of HSN based classification

In the WCO Conference on the Future Direction of the Harmonized System (HS) 2019, one of the main topics of discussion was HSN complexity. Concern was expressed around the difficulty in the adoption of HS classification, especially for small and medium-sized enterprises that are being granted the opportunity to participate in the global economy, but don't necessarily possess the tools needed to do so.

HS classification (and thus the customs/GST tariff adoption) remains largely a manual process requiring significant expertise in the legal texts and product knowledge. This difficulty manifests itself in the numerous instances of classification error. While WCO offers large volume of literatures and utilities to address this challenge, for the average trader or other stake holders, who may be challenged with classifying numerous commodities in a timely manner, these resources may not be as helpful. The WCO tools are essentially repositories of information which are of limited use to the vast majority of individuals whose HS literacy and experience is either nominal or non-existent.

Regarding training, which is considered to be an antidote for lack of expertise, very few organisations are able to devote and support in the conduct of appropriate and adequate training programmes in terms of the content and depth, despite allocation of sizable resources.

Then the moot question that crops up is even if rich resources and extensive training do not offer practical solutions to the classification errors and efficiencies, can appropriate technology be developed to address these needs? The answer may be difficult! It requires a hybrid model – an appropriate mix of technology and the subject matter expertise can help address the issue with much lesser effort/time but with accuracy. However, the effectiveness will depend on the kind of technology adopted and the level of expertise of the person carrying out the classification exercise.

Aid of Technology in Classification

Different types of technologies are currently in use to aid inappropriate classification of goods. Search engines using keywords, technology tools sculptured by experts and machine learning algorithms are the important ones. Each of them comes with its benefits and demerits.

The most common technology used to power classification assistance tools use keyword search operators. This is used in one form or another in most Customs management systems, electronic single windows and trade information portals. Keyword search tools work by trying to match the words or phrases that users submit with those in the target document. If the user does not enter a word or phrase that is explicitly used in the nomenclature, the engine will offer incorrect or no results.

A search for 'computer' in the Indian Customs Portal would throw up results covering various goods falling under Chapter-85 [viz. 85437041 (Computerised editing systems), 96121010 (Computer printer ribbon)]. Thus, it becomes important for the user to know the tariff description of the item, which in this case is 'Automatic data processing machines' to receive an appropriate classification (and duty rate) as 847130. Keyword engines can hardly be relied upon as classification assistance tools, as they have not been designed for the specific purpose of HS classification. They do not consider or apply the General Interpretive Rules (GIRs) or Legal Notes.

Expert systems are a branch of applied Artificial Intelligence (AI) that have been built specifically to address challenges associated with HS classification. Typical challenges confronted by these customised tools include matching commonly used commercial goods descriptions to HS terminology, handling complex searches like parts and sets/kits, application of HS GIRs and Section/Chapter Notes. Unlike the keyword engines, these tools employ specific domain knowledge and rules of thumb and use reasoning tools to drive the commodity classification process intelligently and intuitively to a single code.

Expert system-based classification assistance tools have successfully demonstrated the ability to make consistent and more accurate recommendations. The process of classification has been automated to a fair degree; however, it is still completely within the control of the declarant. The tool makes inferences and assumptions and responds to user specified input, ultimately providing a recommendation that has been generated through the consideration and application of GIRs and HS Legal Notes.

The latest application of advanced technology in the Customs compliance sphere is machine learning (ML). ML is a form of artificial intelligence that makes predictions from data. The power of ML is that it uses algorithms and statistical models to learn and adapt without the need for explicit programming instructions. ML's critical success factor is the data used to train the system. For an ML algorithm to be reliable, the data must be sufficient, representative and reliably labelled.

While the old adage 'garbage-in, garbage-out' has plagued analytics and decision making for generations, it carries a special warning for machine learning. The quality demands of ML are steep, and bad data can rear its ugly head in the historical data used to train the predictive model and again in the new data used by that model to make future decisions.

Human Intervention

Of the three main technologies discussed above in the aid of HS classification, expert systems appear to hold an edge over the others as it best meets the oft-conflicting objectives of trade facilitation and customs compliance. Facilitation is achieved through a more satisfying user experience – users may be able to describe their goods in everyday commercial language; the tools are relatively more intelligent and user-friendly; tools attempt to converge to a single HS code, while it leaves the ultimate control of classification in the hands of the user. Compliance is attained consistently and deterministically through the automatic consideration and application of complex rules and legal notes.

Tools of any kind, including but not limited to artificial intelligence-enabled tools, are merely tools. They are designed to assist classification and not to perform classification. So, it stands to reason that the results they produce will only be as good as the people who design as well as who use them for performing the classification function.

While the legislation, processors and controls continue to emerge factoring in the needs of the time, the technology will continue to perform the 'catch-up' act to address the demands of the time. The law also continues to evolve basis judicial pronouncements and interpretation, which tools may not be able to recognise and adapt on a real-time basis, prospectively or retrospectively.

Human abilities, however, are more expansive. Contrary to AI abilities that are only responsive to the data available, humans can imagine, anticipate, feel, and judge changing situations, which allows them to shift from short-term to long-term concerns. These abilities are unique to humans and do not require a steady flow of externally provided data to work, as is the case with AI. In this way, humans represent authentic intelligence.

Authentic intelligence is needed when open systems are in place. In an open management system, the team or organisation is interacting with the external environment and therefore has to deal with influences from outside. Such work setting requires the ability to anticipate and work with, for example, sudden changes and distorted information exchange, while at the same time being creative in distilling a vision and future strategy. In open systems, transformation efforts are continuously at work and effective management of that process requires authentic intelligence.

The right blend of appropriate technology tools, coupled with human expertise could be the prescription to drive away from the ghosts of classification and any adverse outcomes. The new edition of HSN which came into effect on 1 January 2022 and the consequential changes in the customs classification provide the perfect setting to revisit the positions taken, taxes paid and identify gaps that needs to be weeded out.

THE EXPERT SPEAK

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PLACE OF SUPPLY FOR SERVICES - A VITAL LINK IN THE GST SUPPLY CHAIN

Goods & Service Tax Law (GST) in India was implemented post the 101st amendment of the Constitution by the legislatures. GST subsumed several Indirect Taxes and replaced the taxable events like 'manufacture', 'sale' or the provision of service, with the taxable event 'supply' of goods or service or both.

GST is a destination-based consumption tax wherein the Goods and Services are taxed and revenue flows to the State where they are consumed and not at the 'origin', unlike erstwhile Indirect Tax laws where the originating state had the right to levy and collect taxes. Under GST law, the state where the goods/services are consumed will receive the revenue.

The 'Place of Supply' (PoS) provision under the GST law helps determine the place where the goods and services are consumed, and this provision is extremely critical since most of the other provisions of the GST law are interlinked to PoS. The PoS provision is not only crucial from the perspective of domestic transactions but also becomes relevant to determine the consumption of goods and services in cross border transactions i.e., while determining the export and import of goods and services.

The PoS for the domestic supply of goods is provided under section 10 and for cross border supply of goods in section 11 of the Integrated Goods and Services Tax Act, 2017 (IGST Act). For the domestic supply of service, the determination of PoS is as provided in Section 12 and for international transactions section 13 must be adhered to. In the case of a supply of goods, PoS is generally the location where the delivery of the goods terminates. While in the case of supply of services the general PoS is the location of recipient of services.

However, certain exceptions are carved-out for the determination of the PoS of services; for e.g. in a certain type of services, the PoS is the location where service is performed, for services relating to immovable properties PoS is the location where the immovable property is situated, for the 'intermediary' services it is the location of service provider, for services about an event, the location where such events take place and so on.

However, there are ambiguities concerning PoS for certain situations. A few of these ambiguities were resolved as the GST Law matured, however, there are still a few areas that require clarity and will have to be addressed expeditiously.

For example, there has been a long-drawn debate as to whether the PoS for services provided by the Clinical Research Organisation would be the location of recipient of such service or would the location where the services are performed be the location. This issue has been deliberated not only under the GST regime but also under the service tax law. Also, contrary judicial pronouncements have been issued on this subject under the erstwhile regime. However, the Government through a notification dated 30 September 2019 has clarified that the PoS for the services under consideration will be the location of recipient. Though this has been clarified now, the notification cannot be made applicable retrospectively and dispute for the historical period continues!

Further, PoS for Broadcasting services was also not clear when the GST law got implemented. Though section 12(11) of the IGST Act seeks to cover PoS provision applicable for Broadcasting services, the fine print of the section does not specify PoS for such a service. However, it was later clarified by the Government that PoS for broadcasting services shall be the address of the recipient of service which is available as per the record of the supplier and if no such location is available it shall be the location of the supplier of services.

As the GST law progressed, a few issues that surfaced in the context of the PoS provisions were addressed and resolved. There are a few more issues that need attention so that the same does not leave any uncertainty.

One such example is determination of PoS in case of online events, which takes place on virtual platforms. In case of such events, either the supplier of service or receiver of service is likely located outside India. However, section 13(5) which pertains to PoS for events in case of cross border transactions, categorically states that the POS for services of admission to and other specified services related to events shall be the place where the event is held. However, it does not specifically cover online events, which do not have physicality. Hence, the moot question that needs to be answered here is whether in case of online events the PoS will have to be determined as per section 13(5) of the IGST Act or the general (residual) PoS of location of service recipient will be applicable.

Another example in this regard is the determination of PoS of services by way of transportation of goods, including by mail or courier. As per Section 12(8) of the IGST Act, the PoS for such services when supplied to a registered person, shall be the location of such person. The section further provides where the transportation of goods is to a place outside India, the place of supply shall be the place of destination of such goods. This causes the service provider to levy IGST to a recipient in the same state and ITC of such IGST if availed is likely to be denied by the authorities since the PoS is outside India.

Also, in case of hotel accommodation services, the PoS is the location of immovable property. This adds to cost of production, for e.g., where the hotel or accommodation is located in a state and for a production house which does not have a GST registration. By way of example, if a recipient is located and registered in Maharashtra and the shooting location i.e., location of the hotel/ accommodation is Kerala, in the absence of GST registration in Kerela, the ITC of the hotel accommodation services will be a cost.

It's been nearly half a decade since the introduction of GST in India. The Government, industry bodies as well as the GST Council have worked together and taken significant steps to iron-out the issues and practical challenges faced by the businesses, through periodic representations, issues of notifications and clarifications from time to time. However, several issues persist even after 5 years, and the industry is hopeful that as in the past, the pending issues especially from a PoS perspective will be resolved soon, as this provision is the backbone of the smooth collection of and devolution of GST revenue entitled to various states in the country.

IN-TALES

REVAMP OF THE SEZ SCHEME – A STEP IN THE RIGHT DIRECTION TO PROPEL INDIA TO A USD 5BN ECONOMY

Presenting her 4th Union Budget on 1 February 2022, the Union Finance Minister Ms. Nirmala Sitharaman announced a plan to replace the Special Economic Zones (SEZ) Act with a new legislation that will enable the States to become partners in the development of enterprise and service hubs leading to growth of the economy through export promotion. The current SEZ legislation is just 16 years old and was framed under a different economic situation and a lot has changed since then. Framing an SEZ policy that is World Trade Organization (WTO) compliant, while providing necessary impetus, is the need of the hour.

SEZ is an area in a country that is subject to different economic regulations than other regions within the same country. The economic regulations of SEZs tend to be conducive to and attract foreign direct investment (FDI). SEZs are typically created to facilitate rapid economic growth by leveraging tax incentives to attract foreign investment and spark technological advancement. SEZs in India can import goods into the country without payment of customs duty for manufacture and export the resultant product. Supplies to SEZs from the domestic market afforded the treatment as 'export' with attendant benefits. SEZs were eligible for exemption from Income tax on export income until it was phased out with effect from FY 2020-21.

Currently, over 260 SEZs are operational in the country, with over 5600 units. Investments in SEZs soared from INR 40bn (in 2006) to INR 6400bn as of May 2022[1] and the employment generation showed significant growth from 135,000 in (2006) to 26,16,000 in May 2022. The exports from SEZ also soared from a mere USD 5bn (in 2005-06) to USD 128bn (in 2021-22). However, this does not include sales effected by SEZs into the domestic market, which have been showing increasing trend in the last few years (25% of production in 2021-22).

Although many countries experimented with the Economic Zone concept, through various models of development, only a few have been successful in leveraging the concept to drive manufacturing and export growth. China's experience with this model is one of the most successful ones, which started with just four zones at the initial stage to experiment with market-oriented economic reforms and eventually rolled-out more with relevant reforms and zone programmes across the country. Indonesia also tested the water with a few zones and increased the numbers steadily to first showcase the tangible results and attract further investments into existing zones, which resulted in increased economic activity and economies of scale. Vietnam adopted a framework where incentives were given based on the nature of the manufacturing activity and choice of location irrespective of for export or domestic consumption.

Around 4900 (around 60%) of India's SEZ Units are in the IT/ITeS sector. From a performance evaluation perspective, SEZs in India have contributed to employment generation, investments and exports; but the performance did not meet the expectation or projections. The Government projected employment of 100mn by year 2022 while the actual stays at 2.6mn. Investment of INR 6400bn achieved by India, though is sizeable, the comparative figures of China, Vietnam and Indonesia are far more attractive. One of the major reasons is the low participation of the manufacturing sector in the SEZs. Notably, in the service sector, it was primarily the IT and ITeS sector that contributed to the export, while a focus on other value-added services was missing despite the regulation allowing a host of other services, which could have been part of the landscape.

Several other reasons and challenges are attributed to this limited performance of SEZs in India in comparison to the global contenders. Some of the important limitations include:

- Process inefficiencies such as lack of robust single window mechanisms

[1] http://sezindia.nic.in/upload/627b8b429cd71fact%20sheet%20on%2010.05.2022.pdf

- Multiple government interfaces and delays in 'entry' and 'exit' from zone
- Regulatory challenges – non-processing areas, mandatory Net Foreign Exchange Earnings, increased duty incidence on supplies to DTA, etc.
- Withdrawal of Income tax benefits (MAT and DDA exemption and phase-out of IT exemption
- Minimum land requirement
- Large quantum of unused land
- Internal infrastructure failing to meet international demands
- Land cost (or rent) not commensurate with facilities

Taking cognisance of the evolving aspirations of the world and with an eye on furthering India's push towards a global manufacturing hub under the 'Make in India' programme, The Government of India constituted an expert committee under the Chairmanship of Mr. Baba Kalyani, Chairman & MD of M/s. Bharat Forge Ltd. to study and recommend suitable changes in the existing SEZ format to help meet the overall objective, grab the global opportunity and define a format which is consistent with WTO mandate. The committee submitted its report in November 2018 with many recommendations to revitalise SEZs in India.

Key recommendations of the committee are –

- Framework shift from export growth to broad-based Employment and Economic Enclaves -3Es
- Formulation of separate rules and procedures for manufacturing and service SEZs
- Shift from supply driven to demand driven approach for 3Es development for efficiency and current level of existing inventory in the region
- Enabling framework for Ease of Doing Business (EoDB) in 3Es in sync with State EoDB initiatives.
- Integrated online portal for new investments, operational requirements and exits related matters.
- Enhance competitiveness by enabling the ecosystem by funding high speed multi modal connectivity, business services and utility infrastructure. Support to create high quality infrastructure either within or linked to the zones
- Promote integrated industrial and urban development - walk to work zones, States and centre to coordinate on the framework development to bring linkages between all initiatives
- Procedural relaxations for developers and tenants to improve operational and exit issues
- Extension of Sunset Clause and retaining tax or duty benefits
- Broad-banding definition of services/allowing multiple services to come together
- Extension of benefit under Services Export incentives scheme.
- Allowing alternate sectors to invest in sector specific SEZs/ 3Es
- Flexibility of long-term lease for developers and tenants
- Facility of sub-contracting for customers outside 3Es/SEZs without cap
- Specified domestic supplies supporting 'Make in India' to be considered in NFE computation
- No Export duty on goods supplied to developers and used in the manufacture of goods exported
- Flexibility in usage of non-processing areas
- Infrastructure status to improve access to finance and enable long term borrowing
- Promote MSME participation to enable manufacture-enabling service players to locate in 3E
- Dispute resolution through arbitration and commercial courts

The Union Government had reviewed the recommendations made by the Committee and examined the need to revamp the current policy with a view to address the challenges faced by SEZs in global trade. A discussion was also held to find ways to implement the recommendations made by the committee and facilitate 'Ease of Doing Business'. If India is on the path to become a USD 5tn economy by 2025 then the present environment of manufacturing competitiveness and services have to undergo a basic paradigm shift. The success seen in services sectors like IT and ITeS have to be replicated in other services sectors like health care, financial services, legal, repair and design services.

The Union Finance Minister's statement in the Parliament has come at a critical juncture as the SEZ programme is facing disinterest among investors and a gap in overall policy achievement. Thus, a scheme change may well be on the card. While recommendations cover the whole gamut of the challenges experienced by the sector, it would be very interesting to see how the Government proposes to incorporate the same in the final document.

Some of the fiscal concessions recommended by the Committee may be extremely difficult to cobble-up as a policy initiative. The World Trade Organisation (WTO) in a dispute settlement resolution in October 2019 ruled against the nature of prohibited subsidies that the SEZs were providing, violating the provisions of the Agreement on Subsidies and Countervailing Measures.

Similarly, the Service Export Incentive which is sought to be discontinued by the Union Government may not receive a favourable consideration from the Government. Co-ordination in the implementation of initiatives between the Union and State governments though may augur well, may be difficult to actualise.

While the revamp of the existing structure is extremely critical for the sector to not just survive but contribute significantly to realise the country's dream of becoming a USD 5tn economy by 2025, integration of SEZs with the domestic market, easing of NFE norms, effective single-widow clearance mechanism, creation of internal infrastructure, reducing delay in regulatory clearances, relaxation in land use norms, etc. can reignite the sector and propel the country to a higher growth trajectory.

DECODED

Ad-hoc one third deduction for land value for GST levy on 'under construction' property is ultra vires the GST law and unconstitutional – Gujrat High Court

Facts:

In a judgement[2] which is a blessing for real estate developers and property buyers, the Gujarat High Court has held that ad hoc one third deduction towards land value in computing taxable value for GST levy on purchase of under construction property, is ultra vires the provisions of the CGST Act and unconstitutional.

Notification no:11/2017-Central Tax (Rate) dated 28 June 2017 grants a flat deduction of one third amount towards the cost of land, from the total amount paid for under construction property, for levy of GST. The total amount paid includes the consideration for construction plus the amount paid for acquiring land/undivided share in land. In this case, the land price as well as the price for the cost of construction, was mentioned separately in the agreement. However, relying on the specific provisions in the notification, the GST was levied on the total agreement value (i.e., value of land plus construction) after allowing deduction for one third of the value towards land, despite the actual price of the land as reflected in the agreement being far over one third of the total agreement value.

This resulted in overall GST liability being higher than the GST liability computed only on the construction cost, which is the actual taxable service. The buyer of property, who had borne the additional tax burden, filed a Writ petition before the Gujarat High Court to declare the mandatory ad hoc deduction of one third value of contract towards land cost as unconstitutional and arbitrary and prayed for a direction to refund the excess tax.

Contentions of the property buyer:

In this case, the excess GST suffered was claimed as a refund by the property buyer. On behalf of the property buyer it was argued that such ad hoc deduction is arbitrary and ultra vires the provisions of the GST law on the following grounds:

Section 140 of the CGST Act read with Rule-117 of CGST Rules, lays basis for carry forward of CENVAT balance under the legacy laws, by filing a claim in form GST Tran-1

- Since the agreement indicates actual consideration towards the price of land and construction cost, the entire amount towards land price should be outside the purview of GST. However, due to deeming fiction to exclude only one third of the total agreement value towards land value, the tax liability far exceeded the liability by the statute. Such calculation of liability by way of deeming fiction is ultra-vires the provisions of the GST Acts.

- Deeming fictions can be resorted to only in cases where the actual value cannot be ascertained and if the actual value can be ascertained, fictional values cannot be taken into consideration. Section 15 (1) of the CGST Act stipulates that the actual price paid or payable for the transaction, for the valuation of taxable service and only when the actual price cannot be ascertained, resort to valuation rules can be taken to determine the value.
- Referring to the legislative history of taxability of works contracts (and citing landmark decisions in the cases of Gannon Dunkerley[3] and Larson and Toubro[4]), it was submitted that sale of any land, whether developed or undeveloped would not be eligible to tax under GST laws and accordingly, the entire consideration charged towards land should be excluded. The legislative history of the works contract indicates that the intention is to only impose tax on construction undertaken for a buyer from the stage when the contract is executed between the developer and buyer. Any activity carried out by the developer before execution of contract with the

[2] Munjaal Manishbhai Bhatt Vs. Commissioner of CGST & Central Excise (2022 – TIOL – 663 – Guj)
[3] State of Madras Vs Ganon Dunkerley and Co (Madras) Ltd. (1958) 9 STC 353 (SC) and Gannon Dunkerley and Co. Vs State of Rajasthan (1993) 1 SCC 364 (SC)
[4] Larson and Toubro Ltd. Vs State of Karnataka (2014) 1 SCC 708 (SC)

prospective buyer cannot be 'supply' and therefore cannot be made liable to GST.

- In the service tax regime, the levy of service tax on services of construction of a complex, where the land was also getting transferred, was struck down by the Delhi High Court, in case of Suresh Kumar Bansal[4] , as being unconstitutional on the ground that the service tax law did not include any provision to compute service tax in case of a transaction involving transfer of land. Since in the GST law also, only a fixed percentage of deduction is granted for land, the provisions are contrary to the judgment of the Delhi High Court and should be struck down
- Deeming fiction is discriminatory since a person getting a bungalow constructed on 15-20% of the purchased land will get the same deduction as a buyer of a flat in a multi storied building
- Reliance was also placed on the Supreme Court judgment in the case of Wipro Ltd[6], where the rule prescribing a 1% addition of FOB value towards loading, unloading, etc. was held to be ultra-vires, especially when the cost of these activities is available on actuals. Reliance was also placed on the judgment of Acer India Ltd[7] where the Supreme Court held that tax could not be levied on software (which was exempt from excise duty) by including its value in the value of computers
- Tax cannot be imposed on a value unconnected with the subject matter of tax. The impugned notification leads to a consequence whereby tax is imposed on land which is never sought to be taxed by the statute

Contentions of the Tax Authority:

Justifying the legality of the deeming fiction, it was argued on behalf of the tax authority that:

- The Government has express powers to fix the deemed value of such supply, on the recommendation of the GST Council. Since the deemed value has been ascertained and prescribed in exercise of such powers, even though the actual value is available, it does not become ultra vires section 15 of CGST Act. Deeming fiction is used only to ascertain the value of supply to be taxed and to consider the land portion in the supply, the GST council recommended the method under dispute to arrive at such calculation of value of supply.
- The Government has exercised its powers to make law and section 15(5) of the CGST Act allows the value of such supplies as may be notified by the Government on recommendations of the GST Council.
- The Government is empowered to decide the rate with conditions as applicable in public interest based on recommendations of the GST Council and the GST Council is well within its power to recommend such reductions with restrictions as applicable. The Government enjoys wide latitude in classification for taxation and is allowed to pick and choose rates of taxation. Since the subject notification is issued in pursuance of recommendation by GST Council, the question of such entry in notification being ultra vires the CGST Act and article 14 and 246A of the Constitution does not arise.
- None of the components of the transaction, such as purchase of land, construction of bungalow and development of various amenities, etc. can be separated and are an integral part of the transaction.
- The transaction is not for sale of plain land but is for a developed plot of land, which is subject to various conditions, limitations, etc. unlike a transaction of sale of land. The land component in the present case also consists of various benefits that are exclusively available to the property buyer by being under the plotting scheme. Hence, land includes these developments also and value of development cannot be ascertained as the same are to be enjoyed with all the occupants of the scheme. The Supreme Court in the case of Narne Construction Private Ltd.[8] had held that the sale of a developed plot is not sale of land only and it is a different transaction than a mere sale of land
- If value of land is taken as per the agreement, it may be prone to misuse by artificially inflating the value of the land to escape levy of tax

Judgment:

The Gujarat High Court's key observations are summarised below:

- The activity of supply initiates only after the agreement is entered into between the supplier and the recipient, for consideration. The legislative intent is to impose tax only on construction activity undertaken by a supplier pursuant to a contract with the recipient.
- The legislative intent is to impose tax on the construction activity undertaken by a supplier at the behest of or pursuant to contract with the recipient. There is no intention to impose tax on the supply of land in any form and it is for this reason that it is provided in the Schedule III to the GST Acts that the supply of land will be neither supply of goods nor supply of services.
- If a tripartite agreement (between landowner, developer and buyer) is entered into after the land is developed, then such development activity was not undertaken for the prospective buyer and therefore there is no question of imposition of GST on the developed land.
- The deduction for the value of land is also available for sale of developed as well as undeveloped land.
- The Application of such a mandatory uniform rate of deduction even though the actual value of land is ascertainable, is discriminatory, arbitrary, and violative of Article 14 of the Constitution of India. The deeming fiction of one-third of agreement value towards deduction for land also leads to a situation where the measure of tax imposed has no nexus with the charge of tax which is only on the supply of construction services.
- Section 15(1) of the CGST Act requires that the valuation is by the 'actual price paid and payable' for the service and where such actual price is available, tax has to be imposed on such actual value. Deeming fiction can be applied only where actual value is not ascertainable.
- The contention of the Government that section 15(5) gives power to the Government to prescribe such deemed value was rejected as such prescription of deemed value must be prescribed under rules and not under a notification. Also, when delegated legislation is

[5] Suresh Kumar Bansal Vs Union of India (2016) 92 VST 330 (Del. HC)
[6] Wipro Ltd. Vs Assistant Collector of Customs and Others (2015) 14 SCC 161 (SC)
[7] CCEx Pondicherry Vs Acer India Ltd. (2004) 8 SCC 173 (SC)
[8] Narne Construction P. Ltd. and Ors vs Union of India (UOI) and Ors (2012) 5 SCC 359 (SC)

- challenged as being ultra vires, it cannot be defended on the ground that the Government had competence to issue such delegated piece of legislation.
- Even in the service tax regime, such abatement of one third amount from consideration was held to be unconstitutional by Delhi High Court in case of Suresh Kumar Bansal, as the valuation provisions did not provide for deduction for land value.
- The reliance on Narne Construction's case is misplaced as it was in the context of Consumer Protection Act, 1986 and is as such inapplicable while interpreting a taxing statute.
- The High Court directed the concerned GST authority to refund the excess amount of tax collected and deposited with the treasury along with the interest at the rate of 6% per annum, calculated from the date of excess payment of tax till the date of refund to the property buyer, within 12 weeks from the date of receipt of this order.

Comments:

The Judgement has effectively reduced the overall GST burden, especially relating to properties in the large cities, where the land cost can be significantly higher than one third of the agreement value. It will help the property buyers as the effective acquisition cost of the property may be reduced and aid the real estate industry to spur demand.

The judgment has addressed the inherent anomaly in grant of flat one third deduction towards value of land, disregarding the location, size or type of property involved (e.g., flat vs. a villa or land in metro city or other towns, etc.) and decided the issue in favour of the taxpayers. The observation of the Court, particularly relating to calculation of construction service value on a cost-plus basis or the comments for taxability of the plot development would need to be studied closely on a case-to-case basis. Another interesting observation of the High Court is about imposition of tax on the supply made only after the agreement for provision of services is signed. While such observation is backed by past Supreme Court cases, the question revolving around its application remains.

It is quite likely that the Government may file an appeal against the order in the Supreme Court and/ or amend the GST Act to address the fall-out of this judgment. Before making any changes to the applicable tax rates or giving refunds to the customers for the excess tax collected in past, the industry would need to consider this aspect.

GLOBAL TRENDS

VAT/GST News:

International:

China to exempt 3% Value Added Tax (VAT) levied on some small firms

China will exempt 3% VAT levied on some small firms, the country's main source of jobs to help shore up the world's second-largest economy.

To shore up economic stability, China has pledged around 1.5 trillion Yuan (USD 235.47 Bn) of VAT rebates to cushion the financial pressure on small firms.

(Source:

https://www.reuters.com/world/china/china-says-exempt-3-vat-levied-some-small-firms-2022-03-24/)

Indonesia to impose VAT, income tax on crypto assets from May

Indonesia plans to charge VAT on crypto asset transactions and an income tax on capital gains from such investments at 0.1% each, starting from 1 May 2022, amid a boom in digital asset trading.

Last year's total crypto asset transactions in commodity futures markets reached 859.4 trillion Rupiah (USD 59.8 Bn), up more than 10 times from 2020's transaction value, as per the data from the Commodity Futures Trading Regulatory Agency.

(Source:

https://www.reuters.com/business/finance/indonesia-impose-vat-income-tax-crypto-assets-may-2022-04-01/)

Moldova: Government approves proposal to amend VAT refund regulations for exported services

The Ministry of Finance Moldova approved a proposed amendment to the VAT refund regulation which allows economic operators who render exported services to use bank statements as evidence to prove entitlement for a VAT refund claim in the absence of payment documents (payment order).

(Source:

Moldova: Amendment for VAT refund regulations for exported services (globalvatcompliance.com))

Bulgaria: Government accepts bill to increase VAT registration thresholds starting 1 January 2023

The Bulgarian national assembly is taking into consideration raising the VAT registration thresholds. This is the first in a series of measures that will be introduced as part of economic measures to combat soaring prices.

(Source:

Bulgaria: Increase of VAT registration thresholds starting January 1, 2023 (globalvatcompliance.com))

Moving towards a common e-invoicing standard in Europe

More and more countries globally are implementing mandatory e-invoicing or digital reporting requirements. The requirements differ significantly between countries, with different standards and formats, diverse data fields required, as well as different processes relating to how the invoice and its data are shared with tax authorities and received by customers.

In the European Union (EU), the first country that mandated e-invoicing for B2B transactions was Italy in 2019. However, the majority of EU countries are now moving forward with implementing mandatory e-invoicing, either for B2G or for B2B supplies, with some launching pilot programs and others bringing in new legislation to bring in e-invoicing in the next 12-24 months.

(Source:

Moving towards a common e-invoicing standard in Europe (avalara.com))

UK is making VAT digital - Making Tax Digital (MTD) reaches its next milestone

According to the order, a 0% VAT rate would be applied to free-of-charge delivery of goods or supply of services targeted at assisting victims of Ukraine's armed conflict made between 24 February 24 to 30 June 2022.

(Source:

The UK is making VAT digital - MTD reaches its next milestone (avalara.com))

India

GST collections touch record high at INR 1.68 Tn in April, says Centre

As per the Ministry of Finance, the gross GST revenue collected in April is INR 1.68tn. Out of this, the central GST collected amounts to INR 331.59bn, state GST worth INR 17.93bn, integrated GST is INR 819.39bn which also includes INR 367.05 Bn collected on import of goods and the cess is INR 106.49Bn. The cess includes INR 8.57Mn collected on the import of goods.

(Source: https://www.hindustantimes.com/business/gst-collections-touch-record-high-at-rs-1-68-lakh-crore-in-april-says-centre-101651398867706.html)

Maharashtra Budget 2022: State cuts tax on Compressed Natural Gas (CNG), Piped Natural Gas (PNG); GST amnesty scheme proposed

In a piece of good news for the public battered by inflation, the Maharashtra state government has decided to significantly reduce the tax on CNG and PNG. The tax cut on CNG will benefit a significant number of vehicle owners, including cab drivers, while that on PNG will lead to lower bills for households in Mumbai and other cities.

(Source: https://www.hindustantimes.com/cities/mumbai-news/maha-budget-2022-state-cuts-tax-on-cng-png-gst-amnesty-scheme-proposed-101647015726892.html)

No proposal of 28% GST on crypto services

Multiple media sources reported recently that the GST council is considering a 28% tax on cryptocurrency, like the present GST on online gaming, casinos, betting, and lottery. Contrary to those reports, the Finance Ministry has clarified that the GST council is not going to impose 28% GST on crypto services.

(Source: https://www.businesstoday.in/crypto/story/exclusive-no-proposal-of-28-gst-on-crypto-services-sources-say-333144-2022-05-11)

GST On 143 Items may Increase: handbags, deodorant, chocolate prices to see hike next month?

The GST Council is reported to have sought the views of states for increasing rates on 143 items. The products on which GST rates might be increased include handbags, perfumes/deodorants, chocolates, chewing gums, apparel & clothing accessories of leather, and walnuts, among others.

Of the total 143 items, 92% is proposed to be shifted from the 18% tax slab to the top 28% slab.

(Source: https://www.news18.com/news/business/tax/gst-on-143-items-may-increase-handbags-deo-chocolate-prices-to-see-hike-next-month-5047573.html)

Customs News:

International:

World Customs Organisation (WCO) supports the Zambia Revenue Authority (ZRA) in its ambition to establish a full-fledged AEO programme

Under the framework of the United Kingdom's HMRC trade facilitation capacity building programme, the WCO delivered in-country support to the ZRA to establish an AEO programme that would be aligned with the SAFE Framework of Standards and Article 7.7 of the WTO's Trade Facilitation Agreement.

(Source: World Customs Organization (wcoomd.org))

India

Govt exempts all customs duties on cotton imports till 30 Sept

Import of cotton has been fully exempted from customs duties till 30 September 2022, a move which will benefit the textile industry and lower prices for consumers, said the Ministry of Finance in a notification.

This notification came into effect on 14 April 2022 and will remain in force up to and inclusive of 30 September 2022.

(Source: https://www.businesstoday.in/latest/policy/story/govt-exempts-all-customs-duties-on-cotton-imports-till-30-sept-329789-2022-04-13)

Decoding India-UAE CEPA: Can it provide the roadmap for USD 100bn in trade over the next 5 years

The Comprehensive Economic Partnership Agreement (CEPA) with UAE was inked on 18 February 2022 and is India's first complete free trade agreement to be signed with any country in a decade. The negotiations between India and UAE were concluded in a record span of 88 days, and the CEPA was operationalised on 1 May 2022.

(Source: https://economictimes.indiatimes.com/small-biz/trade/exports/insights/decoding-india-uae-cepa-can-it-provide-the-roadmap-for-100-billion-in-trade-over-the-next-5-years/articleshow/91249354.cms)

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