The TAX POST

A bimonthly bulletin on the world of Indirect Taxes

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PREFACE

It is appropriate to quote Nelson Mandela, who remarked that “Remember to celebrate milestones as you prepare for the road ahead”, as we commemorate the 5th anniversary of the Goods & Service Tax (GST) in India. These five years have been path-breaking in the context of the Indian taxation horizon and the achievements thus far have exceeded the challenges, hiccups and processual hurdles. Times do not remain static nor do the challenges of time, economic needs or policy priorities.

Businesses have started clamoring for GST recalibration to iron-out rough edges. The expectation for the next five years includes removal of all cascading taxes such as Excise duty and VAT/CST on petro-products, phase-out of Compensation Cess and broad-base of Input Tax Credit regime, convergence of rate slabs into 2 (or 3) nearer to Revenue Neutral Rate, etc.

While there is a palpable resonance in the demand for the inclusion of petro-products within the amplitude of GST, the trajectory of the global order draws a different picture necessitating a well-envisioned policy prioritisation. The Cover Story of this edition of ‘The Tax Post’ discusses the compulsion that the country faces as we move towards encompassing key fossil fuels into the GST fold, especially the environmental concerns and the country’s committed to global platforms.

This edition's ‘Expert Speak’ discusses the historic Comprehensive Economic Partnership Agreement (CEPA) between India and the United Arab Emirates (UAE) which was signed in February 2022. The article deals with the possibilities that opens-up to both countries, especially the economic benefits, access to quality education, liberalisation of customs tariffs, etc.

The section ‘In Tales’ bisects the Aviation industry and India’s position in the global arena including some of the key hurdles the industry faces. In an important ruling of the Supreme Court, it has been held that reimbursement of salary cost of a seconded employee by an Indian company to an overseas group company is liable to Service tax under ‘Reverse Charge’, which will have ramifications under GST as well. In the section ‘Decoded’ we are deliberating on the implication of this important judgment.

We continue to bring updates on key developments under VAT/GST from other parts of the world in our section ‘Global Updates’.

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

GUNJAN PRABHAKARAN
Partner & Leader
Indirect Tax

COVER STORY

TAXING OF FOSSIL FUEL FOR SUSTAINABLE GROWTH

GST on Petroleum Products:

In July 2022, India celebrated the completion of five years of GST. These five years have been path-breaking in the context of its taxation horizon. The achievements thus far have exceeded the challenges, hiccups and processual hurdles.

Businesses have already started the clamour for GST recalibration to iron-out rough edges to realise the true potential of a pan-India unified taxation system with a zero-tax cost on businesses. The general expectation for the next five years includes the removal of all cascading taxes such as Excise duty and VAT/CST on petroproducts (Petroleum Crude, Diesel, Aviation Turbine Fuel, Natural gas, and Crude Oil) and the Compensation Cess, progressively. Bringing petroproducts under GST has been a longstanding demand of the industry and trade[1] and the voice has gained wider acceptance[2] including from some of the State[3] and the Union[4] governments.

While there is a palpable resonance in the demand for the inclusion of petroproducts within the amplitude of GST to contain tax costs, the trajectory of the global order draws a different picture requiring a well-envisioned policy prioritisation. There have been global concerns and high decibel debates on the environmental aspect of increased use of fossil fuels in the short, medium, and long term. Thus, the inclusion of petroproducts in the GST chain cannot be seen as a standalone fiscal policy measure, but it coincides with the environmental angle having an international audience.

Fossil Fuel and Environmental Aspects:

Whenever fossil fuels are burnt, carbon emissions cannot be completely eliminated. Unlike other pollutants, Carbon Dioxide (CO2) cannot be effectively filtered before being emitted into the atmosphere – at least not with current technologies. The only way to generate zero emissions is by using non-fossil fuel sources (such as wind, solar, geothermal, etc.) or reducing activities that are energy intensive such as Cement, Steel, and Pulp production.

The long-term stability of the climate depends on the earth's radiation balance. Radiation comes from the sun and is reflected by the Earth by emitting outgoing longwave radiation. Greenhouse gases act as insulators to longwave radiation coming from the surface. This is the natural greenhouse effect and is the reason the Earth's surface is warm enough to sustain life. Natural emissions are kept balanced because of processes that generate emissions of CO2 (such as respiration of humans/animals, decomposition, etc.), photosynthesis, and emissions absorbed by the ocean.

[1] https://www.business-standard.com/article/economy-policy/tax-on-fuel-cii-asks-to-include-petrol-diesel-natural-gas-under-gst-118011600475_1.html
[2] https://www.thehindu.com/news/national/gst-council-may-consider-bringing-petrol-diesel-under-gst/article36452717.ece
[3] https://www.business-standard.com/article/pti-stories/bring-petroleum-products-under-gst-punjab-finance-minister-118091300906_1.html
[4] https://economictimes.indiatimes.com/industry/energy/oil-gas/bringing-petroleum-products-under-gst-to-cut-taxes-on-petrol-diesel-nitin-gadkari/articleshow/87632247.cms?from=mdr

Besides natural processes, CO2 can also be produced by human activities, most notably the burning of fossil fuels. Since the industrial revolution, human activities have caused a dramatic increase in carbon emissions in the atmosphere which has disrupted the Earth's natural balance. Carbon emissions concentrate in the earth's atmosphere, exacerbating the natural greenhouse effect by trapping heat. This phenomenon, known as global warming, is causing the Earth to warm faster than normal.

The Earth has already experienced an increase in temperature of around 1 degree Celsius since the industrial revolution. This is caused directly by carbon emissions at higher-than-natural concentrations, which the Earth would take a long time to rebalance. Therefore, even if we stop all emissions today, it will still take up to 200 years for the last artificially emitted CO2 particle to leave the atmosphere. In a recent report[5] of the Intergovernmental Panel on Climate Change (IPCC), scientists estimated that an increase of 1.5 degrees Celsius concerning pre-industrial levels (0.5 more than today) would cause the climate to change with severe consequences to natural and human systems. With an increase of 2 degrees Celsius, the Earth may reach a tipping point, where it is no longer possible to reverse global warming.

UN Handbook on 'Carbon Taxation' for Developing Countries:

Key findings and recommendations:

The United Nations Handbook on Carbon Taxation for Developing Countries (October 2021) is a new publication developed through the work of the United Nations Committee of Experts on International Cooperation in Tax Matters and its Subcommittee on Environmental Taxation Issues. This handbook responds to country demands for clearer practical guidance on policy and administrative aspects of designing and implementing suitable taxation to lower/discourage the use of fossil fuel. The Handbook outlines some of the common reasons why countries might want to introduce a Carbon tax and provides options for policy design and administration that might cater to the different needs and priorities of countries. Critical recommendations and the guidance provided in the handbook are extremely relevant for the developing economies, which forms the basis for this cover story.

Carbon Pricing Initiatives (CPI) are policy instruments that use prices to provide incentives for economic agents to support climate mitigation. Today, they are considered fundamental to support environmental policy and climate mitigation, and their use has increased across the world. Economic agents, such as firms and households, do not usually have an incentive to adopt technologies that lower carbon emissions derived from their polluting activities. It is often cheaper to just continue emitting, regardless of the effect this has on the environment. Therefore, policy intervention is needed to reduce emissions and in the case of climate policy, mitigate climate change and achieve the pledges under the Paris Agreement.

In the context of climate mitigation, CPI is generally understood to have two principal instruments, Carbon Tax and Emission Trading Systems (ETS). Carbon taxation is a policy instrument where a government sets the price of carbon and lets the market determine the total emissions. An ETS is a pricing instrument where the government sets a maximum limit on emissions and lets the market determine the price of carbon emissions and emission abatement efforts through a mechanism that allocates and trades emission permits (or allowances) across firms. It is also important to note that there are several other instruments that a country may introduce, or already have in place, which in practice set a price on carbon, for example, taxes on energy, excise taxes on fossil fuels and resource taxes, among others.

ETS is generally considered to be more complex than a Carbon tax because it requires a specialised institutional system to establish the rules for the transaction of emission allowances. This is difficult and costly and has been implemented effectively only in developed countries. There are many obvious advantages in implementing a Carbon tax instead of an ETS. It is simple, it does not require complex monitoring, reporting and a verification system, and it can be implemented through the existing tax instruments like Excise taxes and Duties.

[5] IPCC, 2018

Carbon Tax – Features, Impact, Advantage and Short-comings:

A Carbon tax is defined as a compulsory payment to the government with no recompense levied on carbon corresponding to carbon-based (equivalent) emissions in the atmosphere and is thus characterised as having both environmental purpose and effect.

Many countries (among developing countries Argentina, Chile, Colombia, Mexico, and South Africa) have already introduced Carbon taxes at a domestic level. However, other countries have introduced taxes which may be called 'Carbon tax' but should not be considered so from a technical perspective. For example, some countries have taxes in place that are commonly referred to as Carbon taxes but are in fact Ad-valorem taxes on fuels or taxes on motor vehicles. Another example is that a Carbon tax allows different pricing between a traditional diesel and 'cleaner' diesel (i.e., lower fossil content, achieved by blending with biofuels), while this would be more difficult with an Ad-valorem tax.

Carbon taxes are considered cost-effective to incentivise the reduction of Green House Gas emissions by encouraging low-carbon emission behaviour including the abatement of emissions through investment in technology. Over time, continued investment in technologies for emission reduction will result in technological progress and reduce the cost of clean energy by providing an accelerating mechanism for the reduction of carbon emissions. By levy of this tax, emitters are confronted with the environmental cost of their actions and forced to manage their carbon emissions.

When introducing a Carbon tax, policymakers may want to apply four core principles, viz.

- Polluter-pays principle (internalisation of environmental costs rather than shifting them to the community)
- Principle of prevention (state responsibility to ensure that activities in their jurisdiction do not cause damage to other states)
- The precautionary principle (preventative measures should be put in place when there is a risk of future long-term harm)
- Principle of common but differentiated responsibilities (all countries are to share the responsibility).

Carbon tax ensures cost certainty as the price is determined by the tax rate and whatever the incidence of the tax irrespective if it can be passed on to consumers or not, the cost cannot rise above a particular price. An ETS, on the other hand, suffers from inherent cost uncertainty. While allowances may be initially distributed for free, businesses will eventually have to pay for them. And since the price is determined by the demand and supply of emission permits or allowances, businesses will face price uncertainty.

A Carbon tax offers stable and predictable carbon prices. Economic agents are aware that they will have to pay a certain price when they emit above a certain level. This enables businesses to plan their investments in low-carbon technologies. Therefore, a Carbon tax provides certainty on the cost that the polluter will have to consider when making decisions. To ensure the continued reduction of emissions, policymakers may have to review the tax rate periodically and check whether the rate is still suitable to achieve the desired emission target. In the absence of a global agreement, some countries or regions have unilaterally adopted a carbon price. A carbon price, whether in the form of a Carbon tax or another instrument, forces domestic producers to partially internalise the cost of environmental damage and therefore can raise their cost of production.

Dealing with competitive disadvantage and potential carbon leakage is important for the government to gain industry acceptance of climate policy, including carbon pricing. Moreover, some governments are exploring carbon border adjustment mechanisms as a tool to deal with carbon leakage and competitiveness.

India Outlook:

Addressing the world leaders at United Nations COP 26 at Glasgow, Prime Minister Mr. Narendra Modi listed out five commitments of India to combat climate change with a bold announcement placing climate change at the centre of its environmental policies addressing the world leaders. India asserted that it would deliver in 'letter and spirit' the commitments under the Paris Agreement. The five commitments[6] are:

- Achieving the target of net zero emissions by the year 2070
- Achieving 500-gigawatt non-fossil energy capacity by 2030
- Fulfilling 50 percent of its energy requirements from renewable energy sources by 2030
- Reduction of total projected carbon emissions by one billion tonnes from now to 2030
- Reduction of the carbon intensity of the economy by 45% by 2030, over 2005 levels

The 2030 Agenda contains 17 Sustainable Development Goals and 169 targets to advance the three dimensions of sustainable development - economic, social and environmental. 9 of the 17 goals contain pledges related to environmental protection, based on the consideration that environmental protection is inextricably linked to sustainable and equitable development and that countries should aim to decouple economic growth from environmental degradation. If India's commitment to the global forum on emission reduction and environmental protection were to be actualised, it is compelled to initiate stringent measures to contain its carbon footprint.

[6] https://economictimes.indiatimes.com/news/india/india-put-climate-change-at-the-centre-of-its-environmental-policies-in-2021/articleshow/88542444.cms

Increasing forest cover, switching over to non-polluting transport fuel, blending fossil fuels with biofuel (Ethanol, Biodiesel, etc.), reducing dependency on coal as fuel, investing in technology, containing the usage of plastic, monitoring air/water quality, discouraging the use of fossil fuel, etc. could aid in achieving India's commitment. Taxation could be one of the avenues to make undesirable goods expensive that the rational consumers would be forced to contain (or give up) their usage. Revenue gained from making companies producing these products pay higher taxes, can be used to fund other programmes. In the Indian context too, petroleum products have been traditionally subjected to a higher rate of tax (Excise duty, VAT, CST, etc.) for welfare programs.

Thus, it would be far-fetched to anticipate that convergence of petroleum products into the GST framework would reduce the tax costs, when it is viewed from the perspective of environmental aspects and India's commitment to the global forum. Nevertheless, it is hoped that eventually if the country, out of compulsion, decides to continue to heavily tax fossil fuels, the government may not treat it as another avenue for revenue generation for its routine needs, but exclusively to create infrastructure and augment the technology for sustainable growth. After all, clean air and water are the basic necessities for living in a healthy world.

It reminds the remarks of Benjamin Tucker - "To force a man to pay for the violation of his own liberty is indeed an addition of insult to injury".

THE EXPERT SPEAK

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UNLOCKING THE INDO-UAE COMPREHENSIVE ECONOMIC PARTNERSHIP AGREEMENT (CEPA)

The historic CEPA between India and United Arab Emirates (UAE) was signed on 18 February 2022 in a record span of 88 days and came into effect on 01 May 2022. It was imperative in the trade relations between the two countries and the first comprehensive strategic partnership with any government of the UAE, besides it being the first complete Free Trade Agreement (FTA) to be signed by India in a decade.

The CEPA has been executed with numerous objectives and initiatives. One of the primary objectives is to increase bilateral, non-oil trade to USD 100bn in the next five years. Indo-UAE CEPA is a comprehensive agreement that covers cooperation in several sectors. The CEPA includes Trade in Goods and Services, Sanitary and Phytosanitary (SPS) measures, defence and security, education, health, telecom, dispute settlement, customs procedures, pharmaceutical products, government procurement, Intellectual Property Rights (IPR), investment, and digital trade.

The CEPA between India and the UAE covers almost all the tariff lines dealt in by India (11908 tariff lines) and the UAE (7581 tariff lines), respectively. India is expected to benefit from preferential market access provided by the UAE, covering over 97% of its tariff lines, which account for 99% of Indian exports to the UAE. India will also offer preferential access to the UAE on over 90% of its tariff lines, including lines of export interest.

As regards trade in services, CEPA contains legal provisions to regulate cross-border trade in services and offers service providers an open and non-discriminatory environment for cross-border trade. Service providers in the UAE have offered market access in around 100 sub-sectors of the UAE, while Indian service providers will have access to about 111 of the UAE sub-sectors.

Since the CEPA is more exhaustive than other FTAs, this covers different aspects of businesses between these two countries which include:

- Providing SPS Measures - Aims to protect human, animal and plant life or health in both the contracting countries to strengthen communication, consultation and cooperation between the parties' competent authorities
- Prevent unjustified trade barriers, enhance transparency, encourage the development and adoption of science-based international standards, guidelines & recommendations and promote their implementation by the parties
- Focus on digital trade - To encourage paperless trading, both parties shall try to provide and accept trade administration documents in digital/electronic form. It establishes a framework to promote consumer confidence in digital trade and foster an environment conducive to advancing digital marketing, including e-commerce and the digital transformation of the global economy
- Clear rules on audit, certification and import checks have been established to ensure that standards, technical regulations and conformity assessment procedures do not create unnecessary barriers to trade between the two nations and specific provisions to increase efficiency in customs procedures affecting the movement in the cross-border trade
- Issuing customs rulings before import, facilitating cross-border clearance for economic operators and adopting international best customs management techniques
- Focus on technical regulations, standards, conformity assessment procedures, marketing authorisations, notification procedures and inspections relating to Good Clinical Practices (GCPs) and Good Manufacturing Practices (GMPs) of manufacturers of pharmaceutical products carried out in the territories of the parties that may affect trade in pharmaceutical products
- The tariff has been eliminated with immediate effect on finished pharmaceutical products and other items such as waste pharmaceuticals, enzymes for pharmaceutical use other than streptokinase and pharmaceutical glassware

Determination of 'Origin of Goods' provides for origin criteria to be met for claiming preferential treatment under India-UAE CEPA. Stringent 'Rules of Origin' (RoO) have been put in place for strict monitoring of trade flows between the two nations to prevent the circumvention of products from other countries. RoO criteria are a way to curb the misuse of FTAs. A good is deemed to be originated in a country if it is wholly obtained or produced in its territory or has undergone sufficient working or production per the Product Specific Rules (PSR).

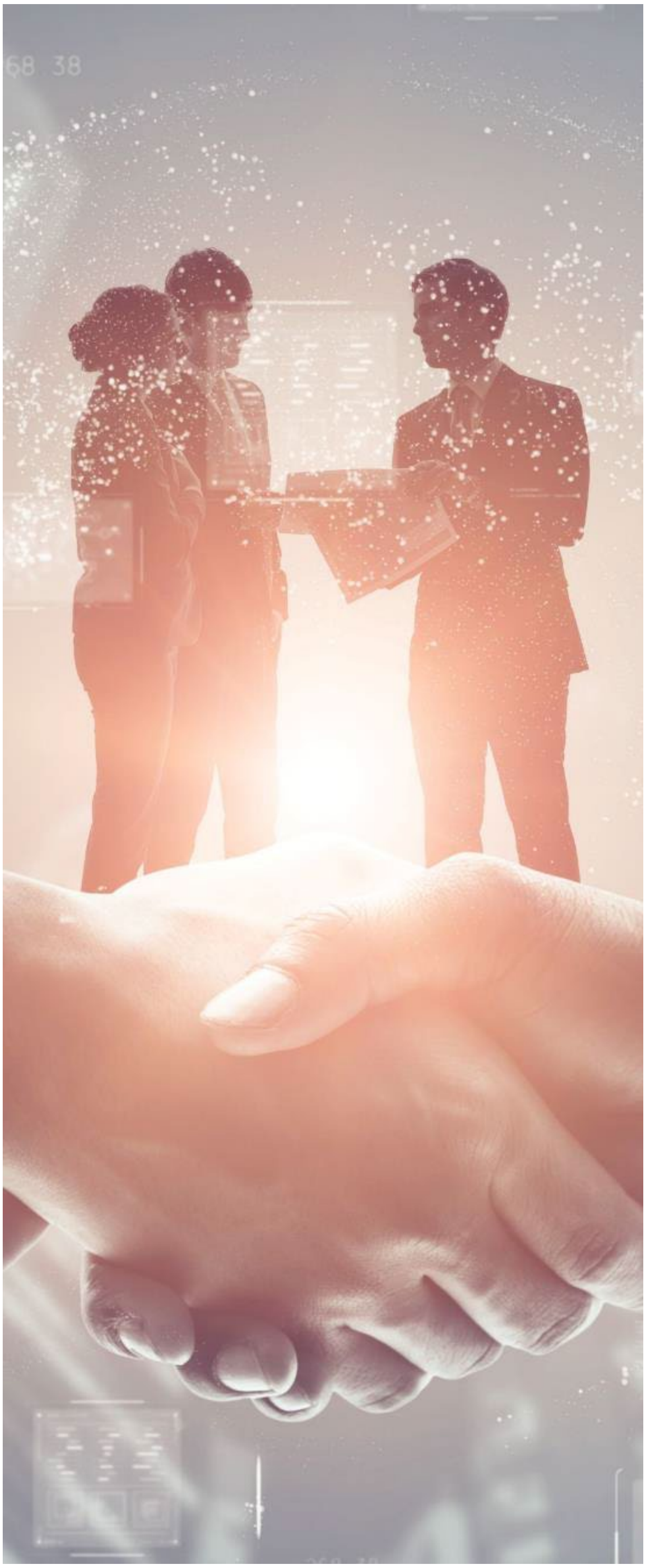
The agreed rules are based on compound criteria of Change in Tariff Classification (CTC) of the good plus a minimum percentage value-added.

‘Wholly Obtained Products’ are a list of products that shall be considered entirely obtained or produced in the territory of the exporting country. De Minis provides for situations where non-originating material, even if not meeting the criteria of change in tariff classification, shall be considered originating.

Minimum required information like HS Code, description and quantity of the products, name of the consignee, exporter or manufacturer and origin criteria. It is set out in Annex 3A and PSR in Annex 3B. Value Addition of 40%, 7% and 3.5% is mandated in some of the products falling under PSR, as mentioned in Annex 3B. Issuing authorities of India and UAE are mentioned in Annex 3C and Annex 3D, respectively.

A Certificate of Origin (CoO) is the most valid proof of fulfilling the requirements laid down under the RoO. A CoO must be issued before, at or within five working days of the date of exportation as per the format in Annex 3E of the Agreement. There's a provision in the Agreement to issue a CoO retrospectively. CoO shall be valid for twelve months from the date of issue in the exporting party.

India-UAE CEPA is a landmark trade pact that will propel the economic ties between the countries, which have a history of completing each other’s vision toward economic prosperity. Through this, both countries are projected to achieve significant economic benefits in access to quality education, liberalisation of customs tariffs, ease of facilitating access to respective markets and ease of movement of skilled labour to support these economic initiatives. There is a need to have more coordination among all the agencies involved in foreign trade to take maximum benefit out of CEPA.



IN-TALES

THE AVIATION SECTOR - REBOUND AFTER A COVID-INDUCED LULL

Until a few years back, travel by air was considered a luxury and remained an aspiration for a large section of the middle class in India. With the reduction in fares to affordable levels (at times as low as an airconditioned train fare) and improvement in the earning capacity of the local population, it no longer remains an impossible aspiration. This has resulted in the growth of the airline sector and the entry of new airlines.

Recently, the aviation sector has been in news, be it the privatisation of the Indian flag carrier, an old airline getting back its flying permission after a turbulent period or the newly launched airline getting its flying permission.

India has now become the third largest domestic aviation market in the world and is expected to overtake the United Kingdom to become the third largest air passenger market by 2024 globally. The growth of the aviation sector has been aided by supportive government policies such as NCAP 2016 (leading to various initiatives like RCP-UDAN, etc), Krishi Udan 2.0, NABH, etc. as well as the advent of low-cost carriers making air travel affordable and the willingness of the passengers to opt for air travel over other modes of travel.

The overall growth of the sector can be gauged from the fact that the capacity available in domestic flights increased from 98bn KM (approximately) in FY16 to 155bn KM in FY19 (the last full year before the Covid-19 pandemic impacted the operations) and despite close to 60% increase in capacity, the capacity utilisation increased from 83% (approximately) of original capacity in FY16 to 88% of the increased capacity in FY19, clearly highlighting the growth of the sector[7].

While the pandemic impacted the airlines in a major way initially bringing the operations to a complete halt, it was followed by a phased restart with the removal of restrictions and a claw back to close to pre-pandemic levels. This can be seen from the statistics that the passengers carried by domestic airlines during January 2022 - May 2022 were 48mn as against 31mn in the corresponding period in the previous year[8]. The growth path of the aviation sector in India can be gauged from the fact that the Indian carriers are set to double their fleet capacity to around 1100 aircrafts by 2027. The pandemic also saw the growth in chartered plane operations due to people preferring to travel with limited co-passengers. Along with the growth of the airlines, the overall aviation ecosystem is becoming favourable in India.

The Government of India, as well as the Airports Authority of India have already announced the set-up of new airports as well as expansion of airports/terminals of various airports, with major investment outlays.

With the set-up of new airports/expansion of the existing airports, the growth story of the aviation sector is set to grow further. The recent focus of the Government on the privatisation of airports is expected to increase efficiency and encourage additional capital expenditure.

The various tax and regulatory incentives offered by the Government in the International Financial Services Centre (presently only in GIFT City in the State of Gujarat) for aircraft leasing is attracting leasing companies to India and further assisting in augmenting the overall ecosystem for the airlines in India. In addition, the growth of the airlines is also attracting Maintenance, Repairs and Overhauling (MRO) operations in India; recently a large French company announced its decision to set up its largest MRO facility in India.

[7] Data as per an IBEF presentation on aviation sector
[8] Monthly summary issued by MoCA

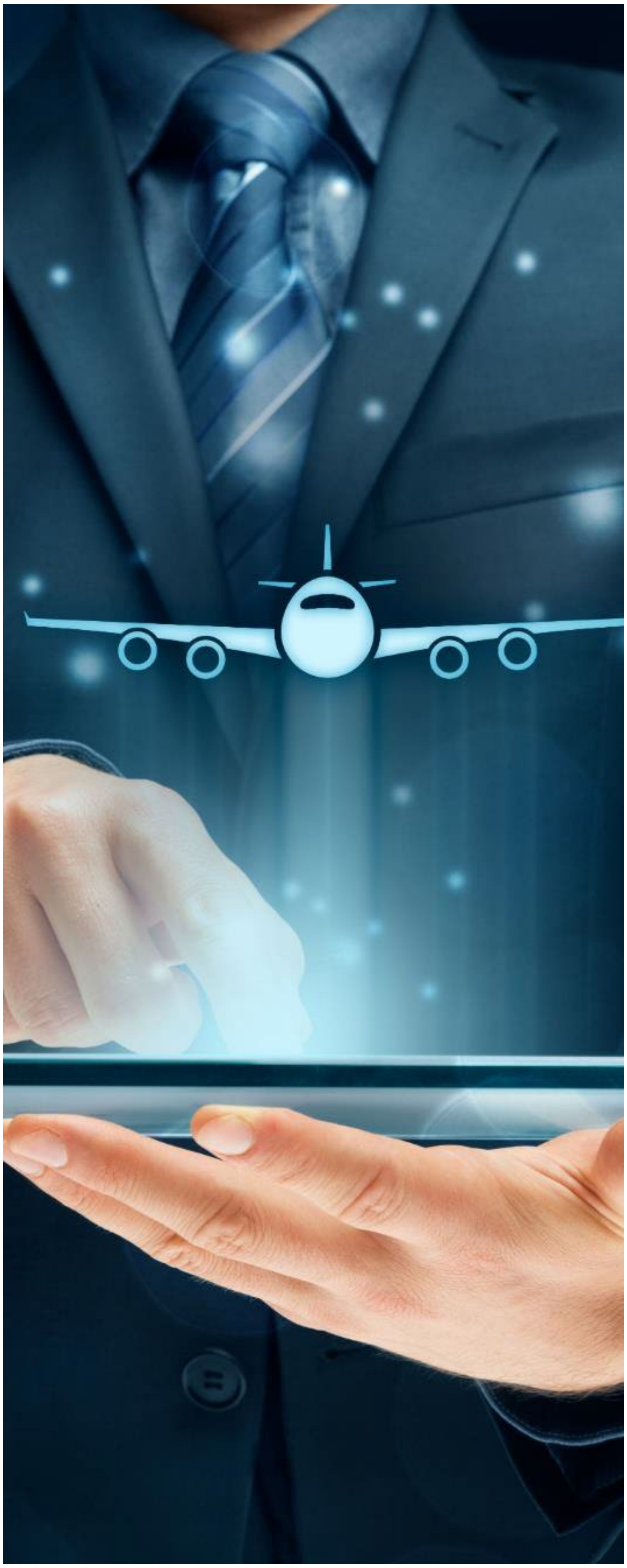
When it comes to indirect taxation, one of the biggest issues for the airlines is the high tax rates on Aviation Turbine Fuel (ATF). With the ATF costs accounts for around 35%-40% of the total costs especially if the high, non-creditable tax component is reckoned, it becomes a major burden on the industry. As ATF is outside the GST structure, it also results in breaking the chain of an input tax credit, resulting in high effective costs. The sector is clamouring for the inclusion of ATF within the GST structure so that the credit chain remains unbroken and effective cost comes down. However, there does not seem to be any immediate proposal to introduce GST on ATF, which the industry hopes, would change soon.

Some of the other typical indirect tax issues, which the sector grapples with are -

- Dispute on input tax credits claimed on the procurement of food for in-flight servicing and expenses incurred for a layover of the crew like hotel stay, etc.
- Taxability of ancillary services and linking it with the class of travel to determine the appropriate rate of tax
- Valuation of reward tickets given to customers and travel agents
- Applicable tax rates for charter flights
- Credit on capex by airport operators
- Taxability of the free/concessional rate tickets issued to employees in line with company policies
- Challenges in interfacing with tax authorities in multiple jurisdictions by the tax team based in the central office
- Reliance on multiple sources of data from CRS agencies for compliances by airlines

Lastly, for international outbound cargo shipments, GST has been exempted, resulting in the requirement of reversal of tax credits by the airlines. Since the intention of the Government is not to tax exports, it would be preferable to 'zero rate' these transactions to mitigate cost escalation and derive competitive advantage. A similar objective can be achieved if the revenue from international outbound cargo shipments is excluded to calculate the reversal of credits.

The aviation sector in India is poised for significant growth, as can be seen from the growth plans of various airlines and allied sectors. As it would be important to support this sector to facilitate growth; it would be equally important to support related infrastructure/businesses, such as airports, MROs, and aircraft manufacturers (including supporting manufacturers) to allow the sector to flourish.



DECODED

Apex Court re-opens the debate about Service tax on employee secondments

Facts:

In a judgment of wide ramification, the Supreme Court of India has held that reimbursement of salary cost of a seconded employee by an Indian company to an overseas group company is liable to service tax under 'Reverse Charge'[9].

It is a common practice in multinational organisations to 'second' employees of one entity to another in a different country for a specified period. During this period, seconded employees work in the transferee entity under the control and direction of the transferee. However, the employee continues the employment contract with the transferor to not disturb social security, retiral benefits, etc. In such cases, for administrative convenience, the salary of the seconded employees is reimbursed by the transferee, on actuals.

There have been multiple disputes as regards whether such an arrangement is tantamount to a rendition of Manpower Supply Service, obligating the Indian transferee to discharge Service tax liability under reverse charge. The key facts of the present case are as under:

- The transferee company had entered into agreements with the group company in India to provide certain specified services
- When required, the Indian company requested the group companies to second managerial and provided technical personnel which was entertained by the group company. The transferee issued a letter of understanding to the seconded employees
- The employees worked under the instructions and directions of the transferee while the employee continued to remain on the payroll of the overseas group company
- The employee received salary and other payments from the transferor company. The transferor would raise a Debit Note on the transferee without any markup
- Income tax under Indian law was deducted from the salary of the seconded employees and remitted to the authorities in India. Also, other statutory benefits such as Provident Fund, etc. were also applicable in India for the seconded employees
- The tax authorities considered such reimbursement as consideration for the provision of Manpower Supply Services and demanded Service tax from the transferee under reverse charge. The transferee resisted and the Tribunal decided in favour of the transferee company, which was challenged by the Tax Authority before the Supreme Court

[9] [Commissioner of C, CE & ST - Bangalore (Adj), etc Vs Northern Operating Systems P. Ltd. in Civil Appeal No. 2289-2293 Of 2021]

Rival Contentions:

Tax authorities

- The overseas transfer company offers the service of supply of seconded employees to perform services to be executed by the transferee to the foreign group companies
- The secondment was a limited duration assignment, and the employee had a right to terminate the assignment
- Upon completion of the assignment, seconded employees reverted to the original position in the foreign companies or were deployed elsewhere in terms of global policy
- The overseas group company provided certain services to transferees using its employees
- The temporary control over seconded employees did not take away the fact that the real employer was the transferor company
- The secondment was necessary for the skill sets and expertise of the seconded employees to deliver the services to be provided by the Indian company to the overseas group company
- Control of transferee over seconded employees is for a limited duration and was not permitted to impose sanctions in case of non-performance but could only ask for a return of the seconded employee

Taxpayer

- The Manpower supply service merely seeks to cover cases where manpower so supplied comes under the direction and control of the recipient without contractual employment, however, the seconded employees were contractually hired as the transferee's employees
- The seconded employees work under the direction of the transferee and report to the offices of the transferee. They were answerable to the transferee and their remuneration is also fixed by the transferee
- The manner of disbursal of salary was solely for the sake of convenience and continuation of the social security benefits in the seconded employee's home country
- On similar facts, the Supreme Court dismissed the appeal filed by the tax authorities in the case of Nissin Brake India (P) Ltd. [2019 (24) GSTL J171 (SC)]
- The amounts paid to the transferor are only reimbursement of expenses, which is not subject to Service tax
- There was no intention to evade tax by the transferee and the demand, if any, should be restricted only to a normal period of limitation
- The taxes paid, if any, would have been claimed as a refund by the transferee

Supreme Court decision:

After hearing rival contentions, the Supreme Court of India decided the matter in favour of the tax authorities. The important observations of the Supreme Court are as under:

- The main question to address is who is the employer of the seconded employee? If the transferee is to be treated as an employer, the payment made to the transferor would be a reimbursement. If the transferor is treated as an employer, the arrangement would be treated as a rendition of service by the transferor to the transferee and would be subjected to Service tax
- The nomenclature of any contract or document is not decisive of its nature. An overall reading of all the documents and their effect is required to be seen by the Courts
- There is not one single determinative factor to which the Courts give primacy while deciding whether an arrangement is a contract of service (as claimed by the transferee) or a contract for service. What is relevant is multiple tests, taken on the totality of the fact and situations in a given case and depending on the facts of each case, all the factors may not be relevant, or if relevant, may not be given the same weight to conclude. The Supreme Court has consistently applied the test of 'substance over form', requiring a close look at the terms of the contract or the agreements, to decide the issue
- The Court observed that the agreements entered into by the transferee point to the fact that the transferor has a pool of highly skilled employees, who are entitled to a certain salary structure as well as social security benefits. These employees, having regard to their expertise and specialisation, are seconded to the concerned countries (in this case, India) for the use of their skills. Upon the cessation of the term of secondment, they return to their overseas employer or are deployed on some other secondment
- The secondment is a part of the global policy where the group company loans the services of employees temporarily and on completion of the secondment, the employees are repatriated following the global repatriation policy. The letter of understanding between the transferee and the seconded employee nowhere states that the seconded employee would be treated as the transferee's employee after the secondment period
- While the control over the employees and the right to ask the seconded employees to return, if their functioning is not as desired, is with the transferee; the transferor, in relation to its business, deploys such employees to the transferee on a secondment basis. The terms of employment of such employees are in line with the transferor, who is their employer
- The salary package with allowances, etc. are all expressed in foreign currency
- The remittance to the transferor is a consideration for the services
- The argument that the demand would be revenue neutral since the transferee would have been able to claim a refund of tax, had it been paid, was not considered since the Supreme Court was only adjudicating about the nature of the transaction and the Service tax levy
- Certain decisions of the CESTAT[10] in favour of various taxpayers, which were affirmed by the Supreme Court earlier, are unreasoned and thus have no precedential value

BDO comments:

There are multiple judgments favouring taxpayers on the issue including that of the Supreme Court which dismissed appeals filed by the tax authorities and the issue stood settled for a while. This judgment has reopened the controversy. The Supreme Court has relied on specific agreements and proceeded to determine the issue emphasising 'substance over form'.

[10] Commissioner v. Volkswagen India (Pvt.) Ltd. - 2016 (42) STR J145 (SC) and Computer Sciences Corporation India Pvt. Ltd. v. CST (2014-TIOL-434-CESTAT DEL).

The Supreme Court observed that there is no one single factor to determine this issue - the factors, which seem to have influenced the decision may be (a) the seconded employees executing the work outsourced by the group companies to the transferee company under a service contract (b) continuation of employment with the original employer.

It is important to note here that though the Supreme Court had taken cognisance of remittance of income tax in India by the seconded employee and coverage under Provident Fund which would further the argument that there exists an employer-employee relationship between the seconded employees and the transferee, it did not sway the conclusion of the Supreme Court.

The CBIC had issued a “draft” circular in 2012 on the taxability of the joint employment arrangements, where it was clarified that where one entity pays the salary and other expenses of the staff on behalf of other joint employers, which are recovered from other employers on an agreed basis on actuals, it would only be a case of cost reimbursement and will not be liable to service tax. This circular appears to cover the situation in the present case. Even though it is a draft circular, it might have had a persuasive value to contend that the Government also accepted ‘joint employment’ as an accepted practice and considered a view that reimbursement of salary costs in such cases between companies does not tantamount to a service transaction.

While this judgment is rendered under legacy Service tax law, the ratio of this judgment may have relevance under GST law also. The companies having secondment arrangements may be required to revisit the stands taken by them, considering the observations contained in this judgment under the specific facts in their case.

GLOBAL TRENDS

VAT/GST News:

International:

Taiwan: Government explains non-deductibility of Input Value Added Tax (VAT) for shareholder gift expenses

The Taiwanese Ministry of Finance clarified the deduction disallowance for input VAT on costs expended on shareholder presents. The explanation states that corporations that give souvenirs to shareholders during shareholder meetings are not allowed to deduct the input tax paid on the presents since they are not business costs.

(Source:

https://www.globalvatcompliance.com/globalvatnews/taiwan-vat-gift/)

Albania: Council presents draft Bill on VAT measures in science-technology parks

Council Ministers of Albania accepted the draft tax measures bill on Science-Technology Park and designed the provisions. The bill supports VAT exemption for goods and services, and even instruments for park use, VAT exemption for impacts from infrastructure, VAT exemption for 10 years for real estate construction projects for parks and VAT exemption for revenue generated from park activities for 15 years.

(Source:
https://www.globalvatcompliance.com/globalvatnews/albania-tech-park/)

Guatemala: The General VAT Regime now requires mandatory electronic invoicing

The Superintendent of Tax Administration informed that as of 1 July 2022, taxpayers who are registered in the General VAT Regime must only issue Online Electronic Invoices (FEL). Paper invoices (pre-printed) will no longer be accepted and cannot be used for tax credit transactions. The taxpayer must follow the necessary procedures to issue FEL.

(Source:

https://www.globalvatcompliance.com/globalvatnews/guatemala-electronic-invoicing/)

India

Goods and Service Tax (GST) strong at INR 1.4bn; PMI, Auto sales steady

GST collection in the month of May stayed above the INR 1.4bn mark for the third consecutive month. Experts saw it as a reflection of the Indian economy's stability and consistency amid global headwinds. At INR 1.40bn, the May GST collection was 44% higher than the May 2021 figure although it was significantly lower than the all-time high of INR 1.67bn recorded in April.

(Source: https://www.hindustantimes.com/india-news/gst-strong-at-1-4l-cr-pmi-auto-sales-steady-101654109234395.html)

GST registration exemption for sellers with low turnover to boost e-commerce

The GST Council has decided to ease the process for intra-state supplies made through e-commerce portals. Suppliers will not have to obtain GST registrations, if their turnover is lower than INR 4mn and INR 2mn for goods and services, respectively. This would come into effect from 1 January 2023.

(Source: https://www.hindustantimes.com/business/gst-registration-exemption-for-sellers-with-low-turnover-to-boost-ecommerce-101656558543888.html)

GST's half-a-decade journey: Tech usage to plug revenue leaks, INR 1.3bn monthly tax 'new normal'

India's biggest tax reform, the GST, completes its half-a-decade journey on 30 June 2022 with many hits and some misses, and brought about a paradigm shift in the use of technology to bring about tax compliance and making over INR 1bn revenue collection every month 'a new normal'.

(Source: https://economictimes.indiatimes.com/small-biz/gst/gsts-half-a-decade-journey-tech-usage-to-plug-revenue-leaks-rs-1-3-lakh-cr-monthly-tax-new-normal/articleshow/92566377.cms)

Customs News:

International:

The Swiss State Secretariat for Economic Affairs (SECO) World Customs Organization (WCO) Global Trade Facilitation Programme kicks off in Jordan

On 16 May 2022, Jordan welcomed the SECO-WCO Global Trade Facilitation Programme (GTFP), a WCO flagship programme funded by SECO, aimed at fostering, and facilitating international trade, through the implementation and application of international standards and best practices.

Within the framework of the GTFP's light touch intervention in Jordan, the WCO will support the Jordan Customs Department in developing a procedure allowing for expedited release of goods entered through air cargo facilities, thus aligning with the WTO TFA Article 7.8 on expedited shipments.

(Source: http://www.wcoomd.org/en/media/newsroom/2022/may/the-seco-wco-global-trade-facilitation-programme-kicks-off-in-jordan.aspx)

WCO signs Cooperation Agreement with Universal Postal Union (UPU)

The new cooperation agreement intends to replace the existing Memorandum of Understanding (MoU) originally signed by the WCO and the UPU in 1994 and amended in 2007, to reflect the recent regulatory and technology developments and adequately respond to the rapid growth of international mail volumes stemming from E-Commerce.

(*Source: http://www.wcoomd.org/en/media/newsroom/2022/may/wco-signs-cooperation-agreement-with-upu.aspx*)

India:

Levy of Customs duty on E-commerce is key to end big tech's monopoly, rent-seeking behaviour: India

Group of 20 economies (G20) and Organisation for Economic Co-operation and Development (OECD) like pact on levying customs duties on e-transmissions should be considered to end the monopolistic, rent-seeking, and anti-competitive practices of big tech companies and allow developing countries to share a small portion of the super profits and huge benefits they enjoy.

(Source: https://economictimes.indiatimes.com/news/economy/policy/ecommerce-customs-duty-key-to-end-big-techs-monopoly-rent-seeking-behavior-india/articleshow/92236872.cms)

Centre cuts Excise duty on Petrol and Diesel to curb inflation

With the clear aim of reining in the inflation, the Central Government lowered Central Excise Duty on petrol by INR 8 per litre and on diesel by INR 6 per litre. It also decided to cut customs duty on raw materials for plastic, iron, and steel.

(*Source: https://www.thehindubusinessline.com/news/govt-cuts-excise-duty-on-petrol-diesel-to-curb-inflation/article65443012.ece*)

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