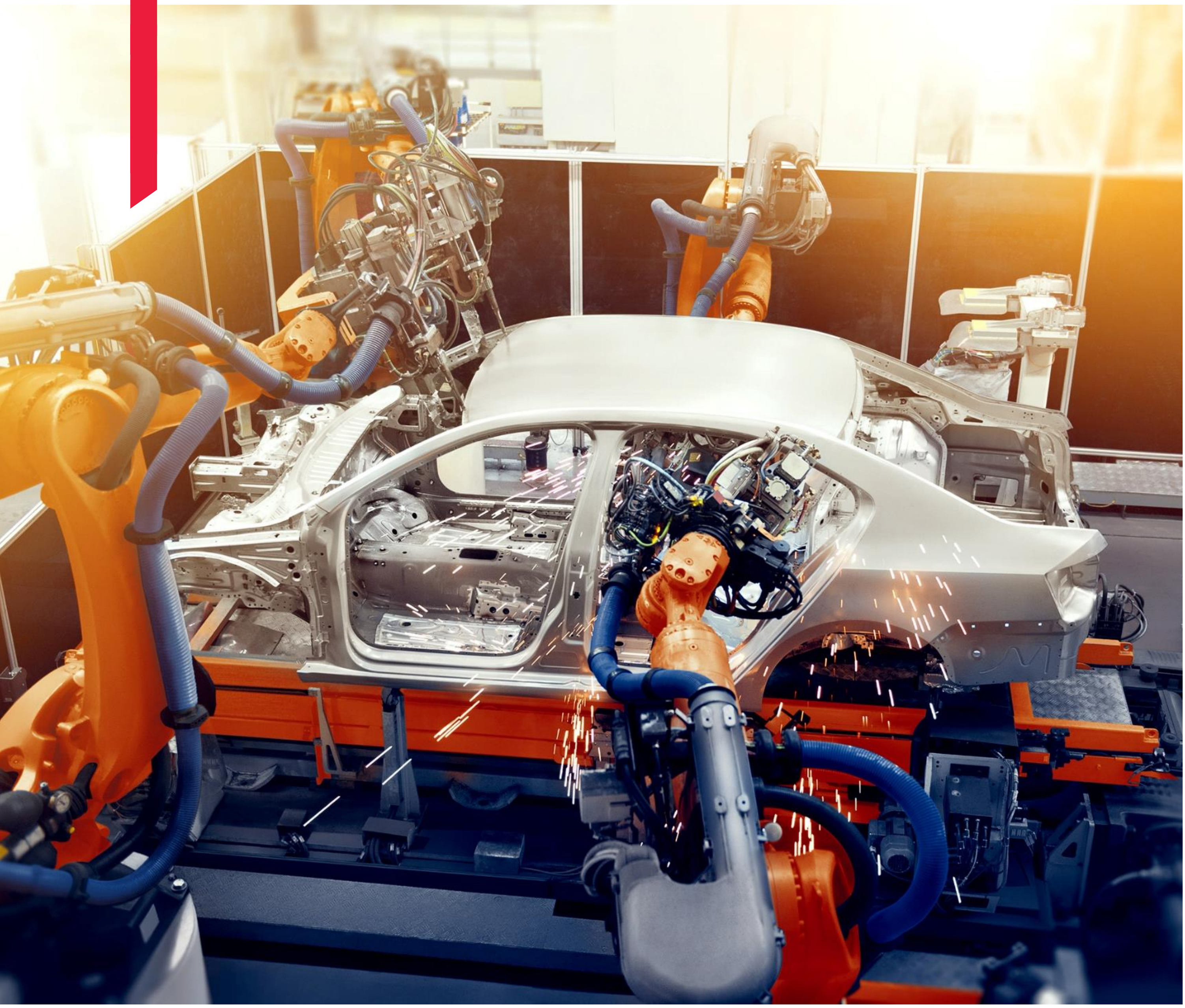
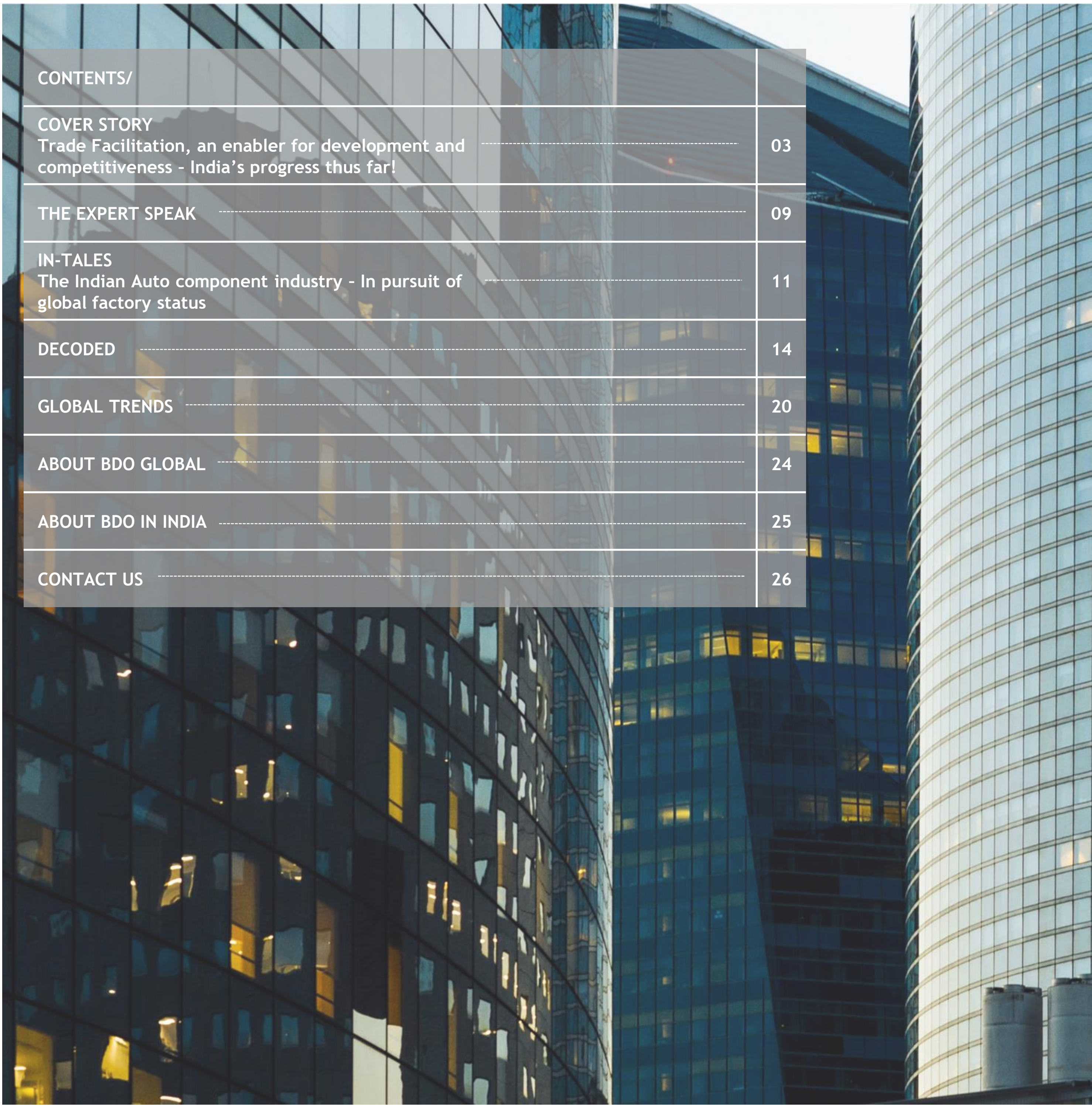


# The TAX POST

## A bimonthly bulletin on the world of Indirect Taxes

Edition 8 - September 2021

Presented by BDO in India



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# PREFACE

Trade Facilitation (TF) is a key enabler of a country's pursuit for economic development and improving national competitiveness. The new world order underscores the importance of novel ways in which global trade is required to be transacted and felt the need of re-imagining initiatives to aid smooth flow of goods and services across national boundaries, especially essential supplies to areas where they are most needed. This discussion gathered momentum over the last 18 months in the wake of the pandemic, which has changed the landscape of the global economy.

TF has been a longstanding priority for Governments worldwide. The Government of India also wanted to proactively improve the country's regulatory climate as part of the 'Make in India' and 'Atmanirbhar Bharat' initiatives and has taken several steps to provide a conducive eco-system for business to trade across the globe and neutralise certain inherent adversities associated with trading from India.

This edition of the Cover Story discusses the progress of the 'Trade Facilitation' measures undertaken by India and what lies ahead in the coming months.

The success of the trade facilitation measures is certainly going to affect Indian industries and their competitiveness in the global market. One key sector, which has tremendous export potential is the auto component industry, which has received significant focus in India especially in the last 2 decades. The section 'In Tales' discusses the outlook of this sector in India.

The Indian Government has been devising novel schemes to incentivise the Indian industry and the 'Production Linked Incentive' (PLI) scheme has been one of the latest schemes on the list. The 'Expert Speak section' features one of our Partners, as he discusses the PLI scheme in the context of the Pharma industry.

A recent, landmark ruling of the Supreme Court is likely to cause flutters to the industry, especially for those facing 'inverted duty structure' under the GST law, where the output tax rate is lower than input tax rate leading to the accumulation tax credit. This decision would deny the taxpayer refund of 'input service' credits and considering the importance of this judgment, the section 'Decoded' discusses this ruling in detail.

Our regular section 'Global trends' brings news on VAT/GST across the globe.

We hope you find this edition of 'The Tax Post' an interesting read.

**GUNJAN PRABHAKARAN**
Partner & Leader
Indirect Tax

# COVER STORY

## Trade Facilitation, an enabler for development and competitiveness – India's progress thus far!

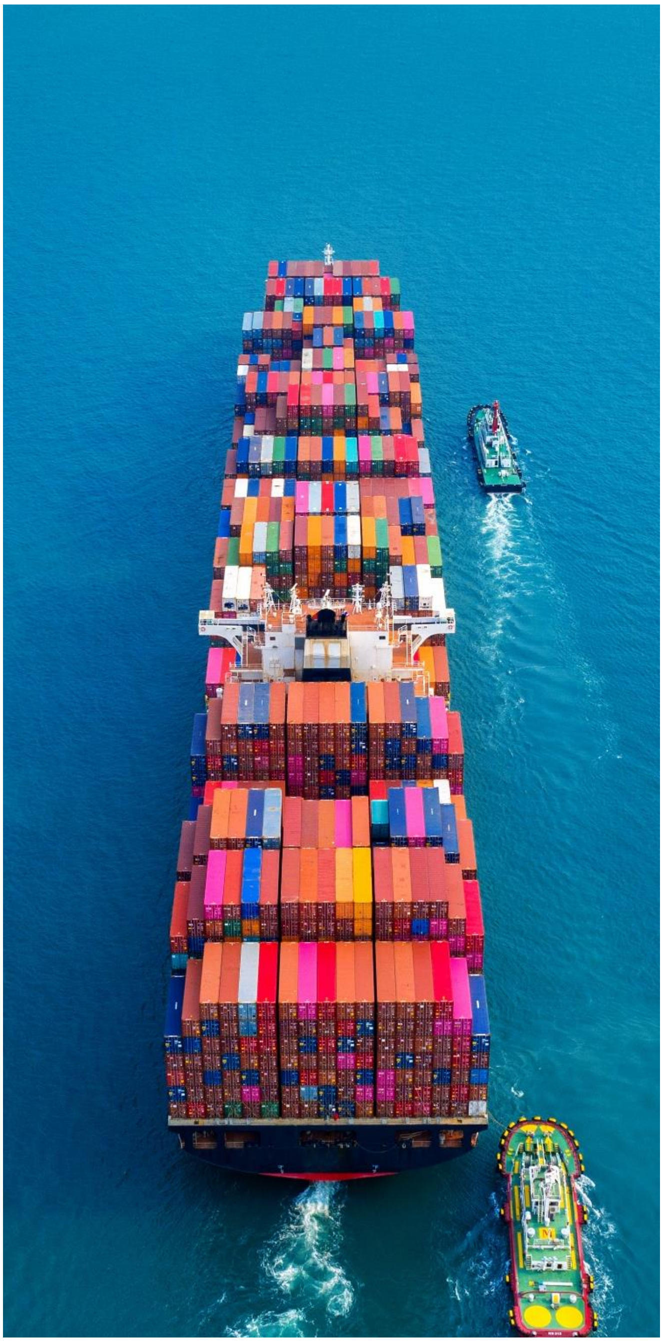
### Background:

Trade Facilitation (TF) is a key enabler of a country's pursuit for economic development and improving national competitiveness. TF has been a longstanding priority for Governments across the world. Bureaucratic delays and 'red tape' pose a burden for moving goods across borders for traders. TF - simplification, modernisation and harmonisation of export and import processes, has therefore emerged as an important issue for the world trading system.

WTO members concluded negotiations at the Bali Ministerial Conference in 2013 on the landmark Trade Facilitation Agreement (TFA) which entered into force on 22 February 2017 following its ratification by two-thirds of the WTO membership. The WTO agreement on TFA covers various aspects, such as –

- *Member's obligation to publish information on procedure/duty-rates/fees on import/export,*
- *Giving opportunity to comment before implementation of new procedure/processes*
- *Robust advance ruling mechanism*
- *Procedure for appeal/review*
- *Measure to enhance impartiality/non-discrimination/transparency*
- *Discipline on fee and charges on import/export*
- *Release & clearance of goods*
- *Border agency co-operation*
- *Movement of goods intended for import under customs control*
- *Formalities connected with importation, exportation, and transit*
- *Freedom of transit*
- *Customs co-operation*
- *Special treatment for developing country and least developed countries*
- *Formation of committee on trade facilitation and participation by members*

The Government of India (GoI) wanted to proactively improve its business regulatory climate as part of its 'Make in India' initiative. India ratified the WTO Trade Facilitation Agreement on 22 April 2016, which came into force from 22 February 2017.



## India's pursuit in Trade Facilitation:

- ***National Trade Facilitation Action Plan 2017-20 (NTFAP-2017)***

  The formulation of the 'National Trade Facilitation Action Plan 2017-20' (NTFAP-2017) was the first initiative of the GoI as an active facilitator of cross border trade. NTFAP 2017 envisions transformation of the eco-system through efficient, transparent, risk-based, coordinated, digital, seamless and technology-driven procedures which are supported by state-of-the art seaport, airports, land border crossings, rail, road and other logistics infrastructure. It targeted to bring-down the overall cargo release time for imports within 48 hours for Sea-Cargo, Inland Container Depots (ICD) and Land Custom Stations (LCS) and 24 hours for Air Cargo; for exports the release time was set as within 24 hours for Sea Cargo, ICD and LCS and 12 hours for Air Cargo.

  The underlying principle behind India's TF initiative is to create a business climate conducive for legitimate trade. Various ministries of the GoI are engaged in programmes that focus on TF. An umbrella vision document that encompasses the entire gamut of TF measures were provided for a unified approach, concerted action plan and to prevent redundancy.

  A new mindset had to be created among the government bodies to transform themselves from a perceived regulatory mind-set to a facilitator role. Meaningful engagement with the private sector, a structured and comprehensive approach to TF also came to be part of the NTFAP-2017.

  The four key pillars of NTFAP 2017 emanated from the following:

  - ***Transparency*** *– Improved access to accurate and complete information*
  - ***Technology*** *– Develop and use digital detection technologies to ease-out trade bottlenecks and improve efficiency*
  - ***Simplified Procedures and Risk-based assessments*** *- Simplified, uniform and harmonised procedure with increased adoption of risk-based management approach*
  - ***Infrastructure Augmentation*** *– Enhancement of road/rail facilities leading to port and infrastructure within Ports, ICDs LCS, etc.*

  The key measure of TF enhancement i.e., 'Ease of Doing Business' ranking was targeted to be within the top 50 within 3-5 years. This was aimed to align with the 'Make in India' programme, which targeted the increase of the contribution of the manufacturing sector in the country's GDP, from 16% to 25% by year 2020.

The transaction cost (15% of the cost of goods) in India was considered significantly high, compared to many other countries with cost of transport and logistics sector at over 14% of the GDP. It was estimated that reduction in this cost by even 10%, would lead to increase in export. Reduction in cargo release time together with 40% increase in Direct Port Delivery (DPD) could significantly improve the current status. It also promised to meet other goals of improving efficiency, creating professional work ethos, and reducing costs in the long term and integrating other regulatory agencies through the online environment.

NTFAC 2017 also envisioned improving the investment climate through better infrastructure. According to UNCTAD World Investment Report 2016 India acquired the 10th slot in the top-10 FDI destinations globally in 2015. Consistent growth in FDI would help fund infrastructure growth in important sectors like highways, ports and airways, which would directly lead to enhancement in TF measures, as poor infrastructure has been one of the key bottlenecks that the industry is facing, particularly textiles, pharma, electronics and auto components, agricultural and marine produce, etc. The TF measures identified in the NTFAC 2017 broadly aligned with the OECD TF Measures as well as the World Bank's Trading Across Borders report.

NTFAC 2017 laid-down 'Action Plans' which listed-out the activities that will enable achievement of the vision and objectives and the indicative timelines to prioritise the activities in to short-, medium- and long-term plans. Categorisation of activities as per A and B gave indication of available timeframes to implement the activities. As infrastructure and technology augmentation are prime enablers for TF, especially in the Indian context, the action plan covered many activities in these areas. As they go beyond TF per se, they were defined as TFA Plus Category they being pivotal for TF.

With the establishment of and the working of the National Committee on Trade Facilitation (NCTF) since October 2016, a formal kick off TFA took place. Development and approval of the action plan, recommendations of working groups on legislative changes, time release studies, infrastructure augmentation and outreach programmes along with suggestions 1from the private sector were incorporated as inputs to the action plan.

Lead agencies for the action plan were identified, which included Customs, DGFT, FSSAI and CDCSO, Animal and Plant Quarantine, Bureau of Standards, Textile Committee, WPC, Wildlife Crime Control Bureau, Ministries of Shipping, Civil Aviation, Railways, Roads & Highways, Commerce, Finance and Home Affairs, etc. The action plan covered the following:

| Category-A | Category B | TFA Plus |
|---|---|---|
| Host and update regulatory information on inter-net | Creation of enquiry points including webchat and call centres | RFID based gate automation of ports |
| Security measures for livestock imports | Legally binding consultations mechanism prior to new laws | Installation of weighbridge or weighment cranes in ports |
| Monitor detentions and communication to stake holders | Legislative changes in Advance ruling, adopting international best practices | Shipping lines issue e-delivery. Reduce port dwell time for export shipments. |
| Allow re-test at the request of importer | Legislative changes in Customs law in the pre-arrival process | Inter-terminal truck movement in JNPT. Widening of approach roads at ports |
| Publication of fees/charges (on cost) basis on a single window website | Integrated risk management and fast-track clearance for low-risk cargo. Conversation of 22 non-EDI ports to EDI system | Establishment of labs in all seaports |
| Rationalise penalty and imposition only on responsible person and written communications | Co-operation with neighbouring countries to align working days/hours | Increase non-intrusive inspection and detention technologies. |
| Strengthen Post Clearance Audit (PCA) and intimation of completion of PCA | Creation of central document repository for access by all regulatory agencies. | Sector specific facilities at Ports and increase DPD and Direct Port Entry (DPE) |
| Conduct 'Time Release Study' in all Ports/ICD/LCS to reduce down dwell time to plan | Single window for exports to integrate with all regulatory agencies | Roll-out additional vessel movement, container movement, cargo details, etc. in integration with ICEGATE |
| Increase number of AEO accreditations | Streamline process of reimport for outward and inward processes under duty exemption | Provide average clearance time to exporters and importers |
| Streamline e-commerce documentation process | | Activities to be carried-out by Ministries of Civil Aviation, Home affairs, Railways, Road transport and highways, Commerce and other agencies like DGFT, CBIC, etc. |
| Augmentation of infrastructure and creation of process/SoP for expeditious release of perishable cargo | | |
| Review of documentation requirements for uniformity, simplification and transition to electronic documentation | | |
| Issue of circulars for uniformity in procedure for rejected goods | | |
| Streamlining procedures for transit documentation | | |
| Increased connectivity and co-operation with other customs administrations | | |

Adoption of an integrated TF action plan with active participation at the highest-level reflects the Government's commitment to enhance its TF approach. While some processes are continuous, some could be implemented immediately, leading to fulfilment of the objective and vision and making India's trade facilitation reforms a success story.

- **National Trade Facilitation Action Plan 2020-23 (NTFAP-2020)**

  NTFAP 2017 was an early measure by GoI to be an active facilitator of trade, which contained 96 specific measures assigned to stake holders with indicative timelines and contained two distinct set of measures. The first set being Category A for improvement and Category B for compliance. Second set (TFA Plus) related to infrastructure and technology adoption as an overarching TF strategy.

  **Current Status:**

  As a result of consistent TF measures over successive years, India marked steady improvement across each of the measures in the last few years.

  'Doing Business Report', a flagship publication of World Bank measures regulations that enhance or constrain business activities across 10 indicators in 190 countries. In particular the 'Trading Across Borders' indicator measures the time and cost associated with the logistics of exports and imports covering documentary compliances, border compliance and domestic transport in the EXIM process. Supported by TF initiatives, India improved its rank on the indicator from 143 (in 2016) to 68 in 2019. This enabled the overall country ranking to improve from 130 (in 2013) to 63 in 2019. The goal now is to further improve and break into the top 50 economies shortly.

  A global survey on Digital and Sustainable Trade Facilitation organised by United Nations, covers nearly 130 economies, and 53 measures are related to TF as well as paperless trade initiatives. In the last report, India improved its overall TF implementation score from 69% to 80% and became a front-runner in APAC and South and Southwest Asia region.

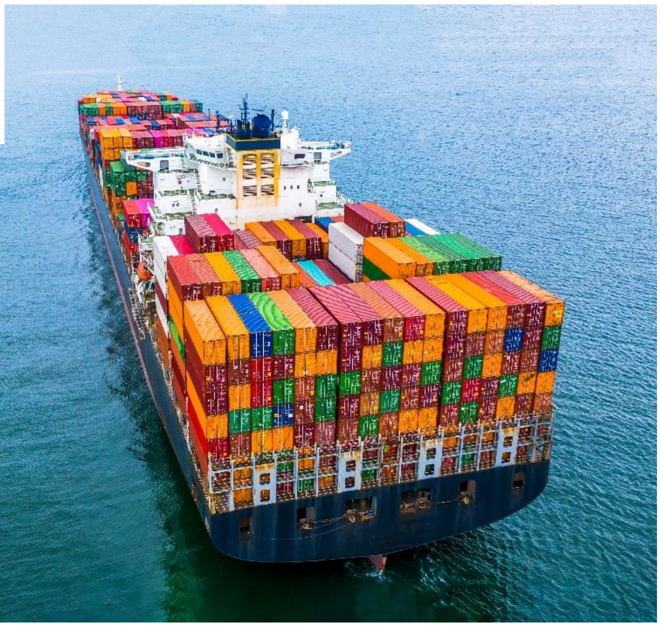
Logistic Performance Index (LPI) an interactive bench marking tool developed by the World Bank to assist countries to identify opportunities of improvement in trade logistics and it is carried out twice a year. Between 2014 to 2018, India's LPI score evidenced significant improvement primarily on account of customs reforms and tracking and trading facilities. As per OECD's Trade Facilitation Indicator, which ranks economies on a scale of 2, India witnessed improvement in the overall average score from 1.30 in 2017 to 1.50 in 2019.

At the time of implementation, India notified 72% of TFA provisions as Category-A obligations i.e., which had already been implemented. 28% has been under Category-B, which were due to implemented by February 2022. With 6% implementation of TF measures under NTFAP 2017, the remaining are expected to be completed by February 2022.

**Road Ahead:**

NTFAP details specific activities to be continued to ensure compliance to FTA and decided visions, goals and objectives. Each activity identifies relevant stake holders and performance indicators associated with implementation timelines. The activities are a combination of Category-B and TFA Plus action items. While Category-B items carry a deadline of February 2022, TFA Plus items go beyond the ambit of TFA. The actionable have also been bucketed under short-term (within 6 months), medium-term (6 to 18 months) and long-term (18 to 36 months).

The following table captures pending actionables under short, medium and long term, with corresponding indicators as Category B or TFA Plus.



| Short-term (within 6 months) | Medium-term (6 - 18 months) | Long-term (18 - 36 months) |
|---|---|---|
| **Category - B** | **Category-B** | **Category-B** |
| Provide opportunity and time to comment on proposed introduction or amendment laws and regulations | Notification of URLs of websites where customs procedures, applied duty rates, fees, trade restrictions/ prohibitions, penalty, appeal provisions, tariff quota, FTAs, etc. will be hosted. | Enhance customs co-operation on cross-border trade at land ports. |
| Provide trade opportunity to acquaint with legislations before implementation | Amendment of Advance Ruling Rules to reflect decentralised architecture of authority for advance ruling and broaden its scope | Alignment of working days/hours, mutual recognition of standards and SPS, one stop border control |
| Participating Government Agencies (PGA) to limit application of Sanitary & Phyto Sanitary Measures (SPM) to relevant point of entries. | Insert statutory provision for encouraging voluntary disclosure to mitigate penalty | |
| Expedited clearance of perishable commodities. | Process for Customs appeal/review including for courier import/exports, customs broking license, etc. | |
| Streamline reimport provisions for outward/inward processing with exemption on duty | Delink of release of goods from duty payment | |
| | Restrict new regulations on pre-shipment inspection | |
| | Allow re-export of goods non-compliant with SPS or technical regulation | |
| TFA Plus | TFA Plus | TFA Plus |
| Curtail price irregularities in shipping by encouraging transparent charges by shipping-lines, laydown mechanism for feedback and check unfair trade practices by lines/freight-forwarders, etc. | Integrate risk management system of Customs and PGAs to reduce interdiction to 10% for imports | Finalise MoU, Passenger and cargo protocols, facilitate cross-border trade and joint development of border trade infrastructure under Bangladesh, Bhutan, India and Nepal Agreement |
| Increase outreach measures for TF and action points under NTFAP 2020 | Increase AEO Acceptance, uptake of AEO (especially MSME), Message exchange between PGAs to indicate AEO status, Preferential treatment of AEOs, MRA with export markets | Implementation of National Single Phase II for digital Certificate of Origin and Shipping Bill in integration with DGFT |
| Prior intimation of non-tariff measures by PGA by supplying list of prohibitions/restrictions and no new prohibitions | Creation sector specific centres of excellence to serve as a data repository on taxation and industry trends | Use of Chatbot for trade facilitation |
| Enable digital form of procedures, documents, applied duty rates, fee, rules for classification/valuation/ rule of origin, import/ export/ transit restrictions and penal provision | Develop National Customs Targeting Centre for precise targeting and better facilitation | Adoption of intelligent non-intrusive technology for customs examinations |

| | | |
|---|---|---|
| Establish standardised enquiry points by all regulatory and logistics agencies | Security declarations in ACC Export Processes to discard paper documentation and encourage e-CSD form | Electronic processing of customs clearances across custom stations. |
| Enable e-sign in customs environment | Uniform application of NTM through digital publication; digitise BL and create common platform for banks, liners, traders, CHAs to reflect the status. | Design and implement Land Port Community System to integrate various stake holders with 24x7 availability |
| Use of handheld security equipment like metal detectors, door frame metal detectors, barrier and rotary mirrors | Establish DPE and DPD nominated place at ICDs | Electronic issuance of CoO and other authorizations |
| | Define and publish service level specification for activities on cargo requiring PGA clearances. | Development of National Logistics Portal (Marine) to provide end to end trade facilitation |
| | Promote gender inclusiveness | Deploy smart gates at Ports to facilitate faster movement |
| | Simplification of Customs Tariff notifications | Establish centralised parking plazas in ports |
| | Digital integration of PGAs. Technology solution for management of Bond/Sureties. | Rail and Road gate efficiency in ports to address connectivity issues |
| | Enhanced customs clearance system under Turant Customs. | Promote integration ICDs with freight corridors and augment rail infrastructure to decrease turnaround time |
| | Integration of GST Form INV 1 reference number with SB to eliminate data entry errors | Conduct gap analysis on infrastructure to resolve issues |
| | Common Customs system for seamless clearance | Enhance/upgrade cross border trade infrastructure at land borders |
| | Expeditious development of National Air Cargo Community system. | Development of Roads to improve last mile connectivity |
| | Enhancement of DGFT portal for ease of online transactions | Increase share of DPD/DPE by rail |
| | API based interface to integrate Sarathi, Vahan, Fastag with PCS and NACCS | Management of freight into Ports via dedicated midnight freight corridors |
| | Conduct National Time Release Study annually and enable live/real time study | Infrastructural and operational improvements at Kolkata port |
| | Improve infrastructure in Integrated Check Posts and improve cargo handling efficiencies | Establishment of Air Freight Stations near prominent export oriented industrial clusters |
| | Establishment of common integrated labs where PGA may perform test procedures | Infrastructure to reduce wagon placement and removal time at major seaports. |
| | Standardised sampling solution across all customs zones | Roll-on, roll-off services at ICPs |

# THE EXPERT SPEAK

**ABHINAV SRIVASTAVA**
Partner / Indirect Tax
Hyderabad

## Incentives for the Pharmaceutical sector and practical issues

### Background

India enjoys an important position in the global pharmaceuticals sector and has dominant presence in the field of generic drugs. The Indian pharmaceutical sector supplies over 50% of global demand for various vaccines, 40% of generic demand in the US and 25% of all medicine in the UK. Presently, over 80% of the antiretroviral drugs used globally to combat AIDS (Acquired Immune Deficiency Syndrome) are supplied by Indian pharmaceutical firms[1].

The Indian pharma industry is the 3rd largest in the world by volume and presently it is valued at USD 41bn[2]. It is expected that the sector will grow to USD 65bn by 2024 and to USD 120-130bn by 2030[3].

The pharma sector is one of the key contributors to India's exports and is the 3rd largest exported commodity. However, a substantial portion of Active Pharmaceutical Ingredients (API) is being imported, mainly from China.

### Need for the incentive scheme:

During the outbreak of COVID-19, there was shortage of cross border transportation facilities and raw materials. Consequently, there were price fluctuations as well. This was a trigger for the thought that there needs to be a greater resilience to external shocks. The Government wants to create an environment where capacity enhancement for domestic production for critical and high value drugs can happen. Further, this policy is in sync with the Atmanirbhar Bharat initiative of the Government.

### Incentive schemes:

The following schemes were launched for the pharma sector:

- Production Linked Incentive Scheme (PLI) 1.0 – PLI Scheme for bulk drugs (53 products)
- PLI 2.0 – PLI scheme for specified product segments
- Bulk drug parks

**PLI Scheme 1.0 & 2.0 overview:**

| Particulars | PLI 1.0 | PLI 2.0 |
|---|---|---|
| Eligible products | 53 API, Key Starting Materials "KSM" and Drug intermediates "DI" | Specific products presently not manufactured in India / complex generic drugs, in-vitro diagnostic devices etc. |
| Eligibility criteria | Committed investment and annual production capacity | Various criteria such as Gross manufacturing revenue, R&D expenditure etc. |
| Incentive | 5-20% based on year and product | 3-10% based on year and category |
| Tenure (FY) | 2020-21 to 2029-30 | 2022-23 to 2027-28 |
| Incentive outlay (INR) | 69.40bn | 150bn |

### Bulk drug park scheme

- This scheme has been launched to promote set-up and fund creation of common infrastructural facilities for 3 bulk drug parks in India with an incentive outlay of INR 30bn
- Proposer for the scheme will be the state government
- Bulk drug park shall be for production of preferred products
- Grant-in-aid will be capped to INR 10bn for each bulk drug park
- The scheme is valid for a tenure of FY 2020-21 to FY 2024-25.

### Scheme implementation:

- As per media reports[4], 47 approvals were issued (as on 13 April 2021) under PLI scheme 1.0. Also, for few products, the scheme was re-introduced for fresh applications.

1 Source https://www.ibef.org/industry/pharmaceutical-india.aspx
2 https://www.investindia.gov.in/schemes-for-pharmaceuticals-manufacturing
3 https://www.indiabudget.gov.in/economicsurvey/ebook_es2021/files/basic-html/page471.html
4 https://pib.gov.in/PressReleasePage.aspx?PRID=1711482

- Applications for all the 3 categories were received for PLI 2.0 and designated authorities are currently evaluating the applications.
- The Companies who will get the approvals under PLI Scheme shall be required to submit periodic performance reports and submit claim for incentive based on the prescribed guidelines.

## Issues with PLI Schemes

**Price fluctuations:**

- Incentives in the schemes are linked to sales price/incremental sales and investment. Unlike other sectors, the pharma sector is subject to heavy price fluctuation. Prices of some of the products tend to significantly decrease over time. This would mean that even if the Company has made the committed investment and also achieved sales in terms of volume terms, it may still face challenges in in-cashing the benefit since the sales value (turnover of the eligible drugs / APIs) may have remained stagnant or gone down.

**Price Control Regulations:**

- In certain cases, products will be brought under price control regulations and prices may be required to be reduced based on the same. Here also, challenges as discussed for price fluctuation scenario may arise.
- Both the schemes had limited slots for respective product/product category/segment.
- Given the kind of response received for PLI Schemes so far, it needs to be seen whether the Government introduces PLI 3.0 also to accommodate more Companies especially the ones who might have missed-out on the two rounds so far.
- Alternatively, in a scenario where the existing applicants (who are eventually shortlisted) decide to opt-out of the scheme at a later point of time, the Government may explore the option allowing other Companies to enroll for this scheme.

**Cap on number of applicants:**

- Guidelines of the scheme were complex considering the same were subjected to frequent amendments and several clarifications were issued. Some of the clarifications went on to the extent of modifying the original guidelines requiring re-submission of applications.
- For certain categories of applicants, the evaluation criteria were partly based on cumulative investments made in the last 10 years. This indirectly meant that older companies had a better probability of getting approval under this scheme instead of newer ones. This again was a matter of debate and representation.

To summarise, the introduction of the PLI schemes is a step in the right direction; it provides the much-needed boost for increasing investment and production capacities (and consequently employment generation) for pharma products, which are presently not manufactured in India or there is heavy dependence on imports. This also needs to be seen in the context of an overall policy push (Atmanirbhar Bharat) by the Government to introduce PLI Schemes for other select sectors also.
What also needs to be seen is the way the Scheme is implemented eventually and whether disbursals happen seamlessly.

# IN-TALES

## The Indian Auto component industry – In pursuit of global factory status

The Indian auto-components industry has experienced healthy growth over the last few years. The auto-components industry expanded by a CAGR of 6% over FY2016 to FY2020 to reach USD 49.3bn in FY2020. The industry is expected to reach USD 200bn by FY2026.

The auto-components industry accounts for 2.3% of India's GDP and employs over 1.5mn people directly and indirectly. A stable government framework, increased purchasing power, large domestic market, and an ever-increasing development in infrastructure has made India a favourable destination for investments.

While the organised sector caters to original equipment manufacturers (OEMs) of high-value precision instruments, the unorganised sector largely fulfils the needs of the aftermarket category.

The auto-component industry's revenue stood at USD 49.3bn in FY2020, up from USD 39.05bn. in FY16 and is expected to reach USD 200bn by FY2026. Export of auto components grew at a CAGR of 7.6% to reach INR 1026bn (USD 14.5bn) during the same time. As per Automobile Component Manufacturers Association (ACMA), automobile components export from India is expected to reach USD 80bn by 2026. The Indian auto components industry is expected to reach USD 200bn in revenue by FY2026.

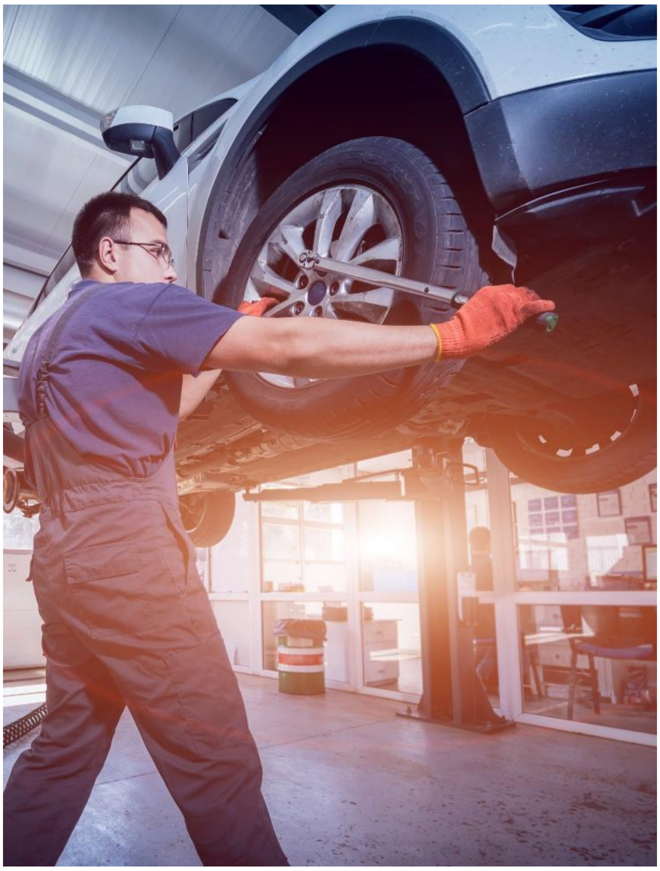
The Foreign Direct Investment (FDI) inflow into Indian automotive (including auto components) industry during the period April 2000-March 2021 stood at USD 25.85bn as per the data released by the Department for Promotion of Industry and Internal Trade.

The Indian auto-components industry is set to become the 3rd largest in the world by 2025 and the domestic auto-component manufactures are well positioned to benefit from the globalisation of the sector as export potential could be increased by up to USD 30bn by 2021.

**Key Growth Drivers:**

Drivers for the growth of the sector in India, includes the following:

- Growing working population, expanding middle class, larger house-hold disposable income
- Urbanisation and daily commutation needs
- Upward moving, middle class aspirations
- Flexible financing options
- Shift towards a cleaner environment and demand for electric and hybrid cars



- Favourable government policies and conducive eco-system
- Significant cost advantage up to 23%, in comparison to western markets
- Availability of skill sets and focus on R&D
- Export opportunities
- Significant FDI
- Large two-wheeler market
- National vehicle scrappage policy to spur demand

Rapid globalisation is opening newer opportunities for the transportation industry, especially while it makes a shift towards electric, electronic and hybrid cars, which are deemed more efficient, safe, and reliable mode of transportation. Over the next decade, this will lead to newer verticals and opportunities for auto-component manufacturers, who would need to adapt to change via systematic R&D.

**Government Policies:**

Various policy initiatives taken by the successive government has augured well for the organised growth of the sector. Some of the key policy frame works are the following:

- **Automotive Mission Plans (AMP)**

  Close on heels of the expiry of AMP 2006-16, the GoI has announced AMP 2016-2026, which is a collective vision of GoI and the Indian Automotive Industry as to where the auto/auto-component/tractor industry should reach over the next 10 years. AMP 2006-16 achieved some of its main objectives, be it employment creation, investments and FDI, increase in volume/capacities, transforming the potential of converting country into an auto-hub, creating export demand, etc. The successor document envisions that by 2026, the Indian automotive industry will be among the top three of the world in engineering, manufacture and export of vehicles and auto components, and will encompass safe, efficient and environment friendly conditions for affordable mobility of people and transportation of goods in India comparable with global standards.

  The interventions under AMP 2016 cover the entire gamut of measures such as Fuel Emission Norms, Safety Standards, Inspection & Certification Regime, End of life Policy, Trade policy (Customs duty rationalization, Free Trade Agreements, Foreign Trade Policy), Fiscal and Taxation initiatives, Skill Development, Automotive specific infrastructure, accelerated establishment of physical infrastructure and improving Business Climate.

- **FAME India**

  The Department of Heavy Industry had launched a scheme, namely 'Faster Adoption and Manufacturing of Hybrid & Electric Vehicles in India' (FAME India), for the promotion of electric and hybrid vehicles with an outlay of around INR 9bn, in 2015. Based on outcome and experience gained during this phase as well as with inputs from stakeholders, the scope and scale of the scheme was significantly revamped and extended for another 3 year-period from April 2019. The outlay under the scheme was increased to INR 100bn.

  A 'demand incentive' of INR 85bn was earmarked to compensate manufactures, who in term of the policy are required to offer reduced price to consumers under the scheme, to spur demand. The scheme also envisages creation of charging stations, ample publicity and other administrative expenses.

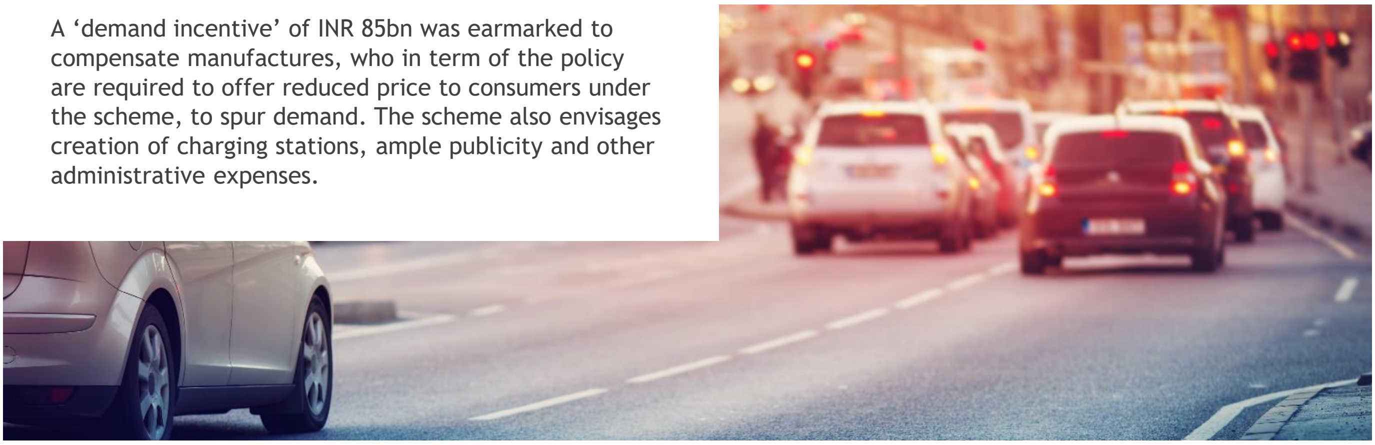
- **PLI Scheme**

  With an aim to help the automobile industry overcome the cost disabilities faced by them for the manufacture of advanced automotive technology and in turn make India a global champion, the GoI introduced a PLI scheme for the auto and drone industry with an outlay of INR 260bn over a period of 5 years. When compared to PLIs for other industries, this scheme extends incentives to new investors besides existing players. The scheme is available for Battery Electric Vehicles, Hydrogen Fuel Cell Vehicles of all sectors, Advanced Automotive Technology components of vehicles, Completely Knocked Down (CKD)/ Semi Knocked Down (SKD) kits, Vehicle aggregates of 2-Wheelers, 3-Wheelers, passenger vehicles, commercial vehicles, tractors etc.

  The scheme expects i) Fresh investment over INR 425bn ii) Incremental production over INR 2.3tn, and iii) Additional employment for 750,000 people. The already existing PLI scheme for Advanced Chemistry Cell (ACC) (INR 181bn) would promote production of auto components using advanced technologies and increase the adoption of clean mobility solutions and boost localisation of new technologies.

- **Taxation Reforms:**

  The introduction of GST, in place of archaic, multiple indirect taxes at the Central and State level, has been another step to invigorate the auto/auto-component sector, which has been reeling under the onslaught of various non-creditable indirect taxes. GST has transformed the country into a single common market with uniform tax rates and procedures. The process of phase-out of Cesses levied under the legacy indirect taxes has been kicked-off under GST and it is expected that significantly high Cesses levied on mid/high-end variant automobile would be phased-out soon to reap the benefits of introduction of GST in the country and spur demand.



- **Automobile Scrappage Policy:**

  The vehicle scrappage policy is a government-funded programme to replace old vehicles from Indian roads. The policy is expected to reduce pollution, create job opportunities, and boost demand for new vehicles. Several countries including the US, Germany, Canada and China have introduced vehicle scrappage policies to boost their respective automotive industries and check vehicular pollution.

  The new policy seeks to extent the following benefits:

  - 5% discount on new vehicles against a scrapped vehicle
  - Zero new registration fee
  - Scrap value equivalent of 4-6% of ex-showroom price of new vehicles
  - States can give up to 25% and 15% rebate on road tax for personal and commercial vehicles, respectively
  - Reduced maintenance cost and increased savings from fuel
  - Availability of steel scrap and recycling to reduce price

  According to the Ministry of Road Transport and Highways, there are nearly 17mn medium and heavy commercial vehicles that are older than 15 years without any valid fitness certificate, 5mn light motor vehicles older than 20 years and 3.4mn light motor vehicles older than 15 years. Also, the average age of commercial vehicles is over 10 years, and the private vehicles is 10-15 years. Therefore, the proposed policy is also likely to boost sales of heavy and medium commercial vehicles that had been in the contraction zone since 2018.

**Challenges from Indirect Tax Angle:**

The automotive value chain faced significant disruptions in FY 2021 with operations being adversely impacted by the first and second wave of COVID-19. Despite such a volatile environment, the industry displayed great resilience to stand-up to the crisis. Several economies and the industry supply chain across the globe experienced severe disruptions.

While the overall future outlook appears to be promising, government intervention in the fiscal and taxation arena would help the sector to tap the opportunity. Few specific concern areas are listed below:

- GST rate rationalisation of automobiles, especially levy of Cesses which takes the overall tax on the automobiles as high as 50%.
- Inclusion of petroleum products under GST to reduce vehicle running cost
- Customs duty rationalisation
- Challenges associated with refund of accumulated input service credit, especially in inverted duty structure situation (e.g., Electric vehicle, tractors, etc.)
- Suitable mechanism to incentive exports, in the wake of removal of MEIS
- The Supreme Court in a recent judgment (2021(3) TMI 291) has held that 'Relays' used solely as part of railway signaling equipment will be classified under Chapter 8608 as per their 'predominant use or principal use'. This decision has a major impact on auto/auto-component manufacturers, who are being asked to cough-up significantly higher GST on their supplies. It is expected that the Government would suitably address the concerns of the industry.
- Impact of the above judgment on imported goods
- Other issues with respect to stabilisation of GST law and procedures continues to pause challenges, be it uncertainty on Input Service Distribution model viz a viz. cost recharge, increased compliance burden in credit matching, e-way bill, e-invoice, etc., stringent timeline in goods return including the procedures, inefficiencies in Advance Ruling where the authorities are inclined to take positions favouring the revenue, etc.
- The proposed amendment to the CST Act to restrict the benefit of concessional CST against Form-C to petroleum products is expected to increase the price on account of tax, which is runs counter to the object and purpose of GST

## Conclusion

The pandemic inflicted Indian economy which has been passing through sluggishness, had to also counter the cyclical downturn in several segments. It is expected that the current situation would soon blow over and the sector will see better days  to cater to the pent-up, post-pandemic demand.

# DECODED

## No Room for Refund of Input 'Service' Credits, under 'Inverted Duty' situations, says Apex Court

**The Context:**

In a landmark ruling[5] on 13 September 2021 while disposing off a batch of petitions, the Supreme of Court of India concluded that refund of input 'service' credit under the 'inverted duty structure' route in terms of Section 54(3) of CGST Act, 2017 (the Act) read with Rule-89(5) of CGST Rules, 2017 (the Rules) is impermissible. With this, a finality has reached on the vexed issue of eligibility to refund of input 'service' credit and the Apex Court concluded that the taxpayer is eligible to claim refund of ITC on input 'goods' alone.

The Supreme Court had to step-in to break the stalemate caused by conflicting judgments of the Gujrat High Court[6] and the Madras Court[7] on the very same issue. While the Gujrat High Court upheld the contention of the taxpayer that Rule-89(5) which limits the refund of input 'service' credit is ultra vires section 54(3) of the Act thereby the claimant become entitled to refund of ITC of input 'service' also along with ITC on input 'goods', the Madras High Court took a contrarian view.

**The Controversy:**

When the GST law was introduced in July 2017, lawmakers thought it fit to introduce specific provisions (Section-54(3) of the Act and Rule-89(5) of the Rules) to allow refund of accumulated ITC arisen on account of GST on input being higher than GST on output supplies, a situation commonly referred to as 'inverted duty structure'.

Neither section 54(3) of the Act uttered any fetters on claim of refund of input 'services', nor the Rule-89(5) as it existed up to 17 April 2018. In fact, rule-89(5), which notified the formula to stipulate maximum refund, specifically included refund of ITC on input 'services', at the percentage of turnover of the inverted rated supply of goods. While the legacy indirect tax laws sought to address the 'inverted duty' situations by rationalising tax rates on finished goods, GST sought to adopt a cash refund route to provide relief. However, this beneficial piece of legislation did not remain in its original form in the statute books!

Many eyebrows were raised when rule 89(5) was amended with effect from 18 April 2018 prospectively, to deny refund of ITC on 'services'. This meant that the supplier of


goods falling in the inverted duty structure situation would be eligible for refund of the accumulated ITC on account of input 'goods' alone, but not input 'services' prospectively from 18 April 2018. This was soon followed by another retrospective amendment to rule-89(5), to make it effective from the very inception of the GST law in July 2017.

These amendments led to a severe cash crunch for many industries, who were left with significant ITC build-up on account of input 'services', which are invariably subjected to higher GST of 18%, while the output suffered lower GST of 5%. This led to a spate of litigations.

5 UoI & Ors Vs VKC Footsteps India Private Ltd (Civil Appeal no:4810 of 2021)
6 VKC Footsteps India Private Limited Vs UoI (2020 (43) GSTL 336 Guj)
7 Tvl. Transtonnelstroy Afcons Joint Venture Vs. UoI (2020 (43) 433 Mad)

**High Court Orders:**

While disposing-off a petition, the Gujrat High Court observed that prescribing the formula in rule 89(5) to exclude refund of tax paid on "input service" as part of the refund of un-utilised input tax credit, is contrary to the provisions of section 54 (3) which provides for claim of refund of "any un-utilized input tax credit". Input goods and input service are both part of the 'input tax' and 'input tax credit'. Therefore, as per provision of section 54 (3), the legislature has provided that registered persons may claim refund of 'any un-utilised input tax', therefore, by way of Rule 89(5) of the Rules such claim of the refund cannot be restricted only to 'input'. The Tax-authority was directed to allow refund of the unutilized ITC on account of 'service' also.

In a contrarian judgment, the Madras High Court had held that refund is a statutory right and extension of the benefit of refund only to the un-utilised credit that accumulates on account of rate of tax on input 'goods' being higher than the rate of tax on output supplies by excluding un-utilized ITC that accumulated on account of input 'services' is a valid exercise of legislative power. Section 54(3)(ii) qualifies the enacting clause by limiting the entitlement of refund to credit that accumulates as a result of the rate of tax on input 'goods' being higher than the rate of tax on output supplies. Accordingly, amended Rule 89(5) which provides for refund only on un-utilised ITC accumulated on account of input 'goods', is in conformity with the statute, whereas the unamended Rule 89(5) ibid exceeded the scope of Section 54(3)(ii) by extending the benefit of refund to the credit that accumulates both on account of the rate of tax on 'inputs' and input 'services'. Consequently, Rule 89(5) ibid, as amended, is intra vires both the general rule making power and Section 54(3) of the Act.

The conflicting views of the High Courts were challenged by the aggrieved parties in Supreme Court, leading to the latest, conclusive, 140-page judgment of the Apex Court.

**Issue before the Supreme Court:**

The taxpayer sought to defend the claim of refund on the following broad grounds:

- Rule 89(5), to the extent it denies refund of ITC relatable to input services, is ultra vires Section 54; GST a destination based, value-added and multistage tax should not stick to the intermediaries but only on final consumer thus ensuring neutrality in value chain.
- The purpose of the 101st Constitutional Amendment was to replace legacy indirect taxes to provide a common nation market and to obviate the cascading effect of tax; the statement of object and reasons accompanying the CGST bill introduction emphasised that there is seamless transfer of ITC in each stage of supply, which stands reaffirmed by OECD guidelines
- The situations where input tax rate exceed output tax rate is an anomaly, aberration and distortion and conflicts with the fundamental principles of GST
- The Government in public interest imposes lower tax rates on products such as fertilizers, tractors and lower-price footwear. The objective is frustrated if inputs for making the final products are taxed at a higher rate and no refund of unutilised credit is allowed
- Refund of unutilised ITC seeks to achieve the objective of value-added consumption-based taxation in its true sense
- A near perfect GST legislation provides for refund of ITC in a situation involving inverted duty structure. The refund ensures that anomalies in tax rates do not result in distortions to the fundamental features of GST.
- Section 54(3) has been enacted to achieve the objective of removing the cascading effect of unutilized ITC and thus provides for refund of 'any unutilised input tax credit' but the refund is available in only two situations namely, (a) zero rated supplies; and (b) inverted duty structure.
- The proviso only provides for 'cases' in which the refund under the main provisions of section 54(3) will be available. Once the requirement of inverted duty structure in proviso (ii) is fulfilled, the entire unutilised ITC has to be refunded.
- Circular no:79/53/2018-GST states that refund will be granted on all inputs, including input services, which attract a lower rate of tax than on output supply
- Proviso (ii) to section 54(3) does not define the quantum of refund. The quantum of refund is provided in the main segment to section 54(3). The expression 'any' unutilised ITC means all unutilised ITC. Definitions of 'input tax credit' under Section 2(63) and 'input tax' in Section 2(62) would indicate that both input 'goods' and input 'services' are included;
- Use of expression 'credit' and 'accumulated' in clause (ii) of section 54 signifies one particular sum and attempt to bifurcate it into 'goods' and 'services' will produce anomalous results.
- Clause (ii) of the proviso uses the words 'on account of' which means by reason of or because of. By stipulating that the proviso provides for the quantum of refunds, the Revenue is attempting to substitute the words 'on account of' with 'to the extent of'.
- Though the Act makes a distinction between 'inputs' and 'input services', this is only relevant at the stage prior to the availment of credit; after the credit has been availed, it goes in a common pool from which the credit is utilised for making payment for output tax.
- In respect of refund of unutilised ITC, the refund will be granted as provided under sub-section (3). The explanation does not restrict the refund only to credit availed on input 'goods'.

- The general rule making power under section 164(1) cannot save offending provisions of the Explanation to rule 89(5).
- Rule 89(5) in the garb of fixing a formula has restricted the refund of ITC to input goods by denying it on input services. Such a rule cannot be treated as one for carrying-out the purpose of the Act.
- A delegated legislation can be struck down as ultra vires of a principal statute. The laying of delegated legislation before Parliament does not confer any validity on ultra vires provisions.
- A rule made on the recommendation of the GST Council must be in consonance with the relevant legislation, failing which it would be ultra vires.
- The purpose of the provision is to give effect to the doctrine of equivalence or neutrality, which is the basic objective of the GST and this is sought to be achieved by granting seamless credit through section 16.
- The proviso to section 54(3) merely prescribes the condition and does not deal with the quantum of refund since the quantum is prescribed by the substantive provision. Main provisions of section 54(3) confers an entitlement to the refund of the entire unutilised ITC and the proviso only seeks to provide the condition and not to obliterate the main provision.
- All registered persons demanding refund on account of inverted duty structure for input 'goods' and input 'services' form a part of the same class and seek equality of privileges in terms of Article 14 of the Constitution
- After treating tax on input 'goods' and input 'services' in an identical fashion by granting credit (to achieve neutrality) and making the entire credit as a part of homogeneous basket, granting refund to input 'goods' and not to input 'services' (from that basket) is a colourable device to set at naught the doctrine of neutrality.
- In the formula prescribed under rule 89(5), while reducing the 'tax payable on such inverted rated supply of goods or services' the taxpayer should be allowed to first utilise the ITC accumulated on account of input services, which is otherwise not eligible for refund
- Rule 89(5) while providing a procedure for computing refund under section 54(3) imposes an artificial restriction which has not been prescribed in the main statute and is patently arbitrary and illegal.

On behalf of the Union of India, it was argued that –

- Goods and services are distinct at a Constitutional level. Article 366(12) of the Constitution defines 'goods', while Article 366(26A) defines 'services'. Hence, 'goods', 'services', 'inputs' and 'input services' have distinct definitions under the GST law.
- Though goods and services are brought to tax under a common code, both the Constitution and the statute have maintained a distinction between 'goods' and 'services'. They remain distinct for prescription, treatment and interpretation.
- The provisos to section 54(3) should be construed as 'restrictions' as –
  - The expression employed in the main clause of section 54(3) is 'claim' whereas the provisos restrict this ambit by the use of the expression 'allowed'. The expression 'allowed' appears in all the three provisos;
  - The main clause of section 54(3) uses the expression 'any unutilised ITC'. On the other hand, the expression 'any' is conspicuous by its absence in all the provisos.
  - The main clause of section 54(3) uses the expression 'a registered person may claim refund' while on the other hand, the three provisos have employed a restrictive expression or a negative expression, that is, 'no refund of unutilised ITC shall be allowed'.
  - When the main clause used the expression 'any', this is expressly restricted by the use of the expression 'no refund of unutilised ITC shall be allowed in cases other than…'.
  - In view of the above, the provisos under section 54(3) have to be read and interpreted as 'restrictions' and not as 'qualifications'.
- The two situations are contemplated in the first proviso, which deal with contrasting situations with stark differences; while the first situation which deals with exports on which no tax is leviable, complete refund of ITC on goods and services are allowed. However, sub-clause (ii) of the first proviso deals with domestic supplies which are taxable outward supplies, in respect of which Parliament has chosen to allow refund of unutilised ITC only to the extent of the 'credit accumulated on account of rate of tax on inputs'.
- The first proviso cannot be read as a mere 'qualification' or 'eligibility' for the grant of refund on the entire unutilised ITC comprising input 'goods' and input 'services' for the following reasons:
  - The expression used is 'the credit' and the accumulation is restricted only on account of 'inputs'.
  - The proviso limits the grant of refund only to two circumstances and hence the limitation has to be read as it is without extending it to input 'services' and capital goods, specifically since the legislature has not included them

.

- If the intention was to allow refund of unutilised ITC on account of input 'services' and capital goods, in addition to input goods, such an intent would have been conveyed through statutory language, which is missing.
- The expression 'credit' has to be read along with 'inputs' and cannot be read as to extend a refund to input 'services' and capital goods also, which are expressly not referred to in the proviso.

- The reason why Parliament has adopted the expression 'unutilised ITC' in the main part of section 54(3) and the first proviso, but has chosen to employ only the expression 'inputs' is as follows:
  - The expression 'any' in the main section is absent in the first proviso with the further limitation that refund of 'unutilised ITC' is limited only to two circumstances specified in the proviso.
  - The first situation deals with refund on account of zero-rated supplies which are exports where refund is granted on all the taxes paid on input goods, input services including taxes paid on export supplies.
  - When it comes to an inverted duty tax structure, the refund is limited to only one category namely, 'credit accumulated on account of rate of tax on inputs';
  - The expression 'unutilized ITC' could comprise of taxes paid both on input goods and input services, and the first proviso and the main section necessarily have to employ the expression 'unutilised ITC' to take care of zero-rated supplies which are exports under the first category.
  - When it comes to an inverted tax structure, it is limited only to 'inputs'.
  - The Parliament has rightly used the expression 'unutilised' ITC both in the main clause and in the first proviso to deal with zero rated supplies and restricted refund to those arising out of 'inputs' when it comes to an inverted structure.
  - Parliament could not have used the expression 'inputs' in the main clause and first proviso as this would act as a disability to zero rated supplies where Parliament intended to grant a refund arising out of both input 'goods' and input 'services'.
  - The Parliament has therefore appropriately employed the expression 'unutilised ITC' in the main clause and the first proviso and has used the limited expression 'inputs' in sub-clause (ii) to the first proviso in the inverted structure.
- If the intent of Parliament was to grant a refund on input goods and input services even in the case of inverted tax structure, it would have defined refund in Explanation-I to section 54(14) at par with zero rated supplies and there was no need to limit it only on account of 'inputs'.
- The purpose of Article 279A (6) of the Constitution is to ensure that the GST Council, while discharging its function, is guided by the need for a harmonised structure. Thus, the term 'harmonised' or, harmony in this context would mean uniformity, consistency, shared values and responsibilities between the Union Government and State Governments. The essence of Article 279(A)(6) is promotion of cooperative federalism.
- Registered assessees having unutilised ITC do not form distinct and separate class. Unutilized ITC can be accumulated for multiple reasons. Thus, although registered assessees accumulating unutilised ITC constitute one category, it has numerous species. Parliament is entitled to choose the species out of the category and grant concessions or benefits. This would amount to treating equals equally, and unequal unequally.
- The doctrines of equivalence, neutrality or secondary stage cascading effect are inapplicable and should not be used to read-in grant of refund for unutilised ITC on input services.
- Although the stated goal of the doctrines may be convergence of a destination-based tax, policy issues as to how to achieve the stated goal must be left to the discretion of the Union Government and the State Governments. The level, type, and time frame to achieve a complete convergence is a policy issue, which cannot be subject to judicial review

**Supreme Court Finding:**

**The crux of the dispute in the present case pertains to how sub-section (3) to section 54 and rule-89(5) have to be read harmoniously. The Supreme Court discussed the circumstances leading to the introduction of GST legislation, the object and purpose of the switch-over to the GST, evaluation of the101st Constitutional amendment and the Statutory provisions and decided the case in favour of Union of India, on the following grounds:**

- While enacting clause (ii) of the first proviso to section 54(3) of the Act, Parliament, took notice of the eventuality 'where the credit has accumulated on account of the rate of tax on inputs being higher than the rate of tax on output supplies'. The Parliament is cognizant of the fact that ITC may accumulate for a variety of reasons, of which inverted duty structure is one situation. Parliament was legislating to provide for a refund and therefore restricted it to the two situations spelt-out in clauses (i) and (ii) of the first proviso. The opening words of the substantive part of section 54(3) contemplate a claim of refund of 'any unutilised input tax credit'. But the impact of the first proviso, as its opening words indicate, is that –
  - 'No refund' of unutilized ITC 'shall be allowed' 'in cases other than' (i) and (ii);
  - The expression 'in cases other than' is a clear indicator that clauses (i) and (ii) are restrictive and not conditions of eligibility. A refund, in other words, can be allowed in the two contingencies spelt out in clauses (i) and (ii) of the first proviso;

- There is a clear distinction between clause (i) and clause (ii) of the first proviso: (a) in the case of exports, the contingency is zero-rated supplies without any distinction between input goods or input services; (b) clause (ii) relates to the accumulation of credit on account of 'inverted duty structure'
- The legislative draftsperson has made a clear distinction between clause (i) and clause (ii) of the first proviso and it was in this context that the opening words of section 54(3) have used the expression 'may claim refund of any unutilised ITC';
- Explanation 1 to section 54 (14), while defining the expression 'refund' adopts an inclusive definition covering (a) refund of tax paid on zero rated supplies of goods or services or both; (b) refund of tax paid on input goods or inputs services used in making such zero-rated supplies; (c) refund of tax on supply of goods regarded as deemed exports; and (d) refund of unutilized ITC 'as provided under sub-section (3) of Section 54';
- Explanation 1, supra, indicates that with reference to exports, the legislature has brought within its fold ITC on input goods and input services. In contrast, in the case of domestic supplies it has contemplated refund of unutilized ITC 'as provided under sub-section (3)'. The Explanation is a clear indicator that in respect of domestic supplies, it is only unutilised credit which has accumulated on the rate of tax on input goods being higher than the rate of output supplies of which a refund can be allowed. Clause (ii) of the first proviso in other words is a restriction and not a mere condition of eligibility.
- The issue before the Court, however, is whether a priori equivalence between goods and services for the purpose of bringing both within a composite tax regime must result in the conclusion that a refund of unutilised ITC must be made available to both - input goods as well as input services, disregarding the provision which has been inserted by the legislature in the present case in the form of section 54(3). The answer to this is clear. The Court while interpreting the provisions of section 54(3) must give effect to its plain terms. The Court cannot redraw legislative boundaries based on an ideal which the law was intended to pursue.
- The jurisprudential basis furnishes a depiction of an ideal state of existence of GST legislation within the purview of a modern economy, as a destination-based tax. But there can be no gain saying the fact that fiscal legislation around the world, India being no exception, makes complex balances founded on socio-economic complexities and diversities which permeate each society. The form which a GST legislation in a unitary State may take will vary considerably from its avatar in a nation such as India where a dual system of GST law operates within the context of a federal structure.
- An abstract doctrine cannot be a ground for the Court to undertake the task of redrawing the text or context of a statutory provision. This is clearly an area of law where judicial interpretation cannot be ahead of policy making. Fiscal policy ought not be dictated through the judgments of the High Courts or this Court. For it is not the function of the Court in the fiscal arena to compel Parliament to go further and to do more by, for instance, expanding the coverage of the legislation or to bring in uniformity of rates. This would constitute an impermissible judicial encroachment on legislative power.
- Likewise, when the first proviso to section 54(3) has provided for a restriction on the entitlement to refund, it would be impermissible for the Court to redraw the boundaries or to expand the provision for refund beyond what the legislature has provided.
- There are multiple situations where the accumulation of ITC can result such as high discount price, predatory price, business loss, below value price, etc. which are indicators that a class covers a bundle of species as opposed to one, unique or homogenous specie. Once it is recognised, it is necessary to allow the legislature the latitude to distinguish between credit arising out of 'goods' stream and 'service' stream,
- Thus, to construe 'inputs' so as to include both input 'goods' and input 'services' would do violence to the provisions of section 54(3) and would run contrary to the terms of Explanation-I. Consequently, it is not open to the Court to accept the argument of the taxpayer that in the process of construing section 54(3) contextually, the Court should broaden the expression 'inputs' to cover both 'goods' and 'services'.
- The intent of Parliament is evident by the use of a double-negative format by employing the expression 'no refund' as well as the expression 'in cases other than'. In other words, a refund is contemplated in the situations provided in clauses (i) and (ii) and no other.
- Parliament was within its legislative authority in determining whether refunds should be allowed of unutilised ITC tracing its origin both to input 'goods' and input 'services' or, as it has legislated, input goods alone. By its clear stipulation that a refund would be admissible only where the

- unutilised ITC has accumulated on account of the rate of tax on inputs being higher than the rate of tax on output supplies, Parliament has confined the refund in the manner which is described above. While recognising an entitlement to refund, it is open to the legislature to define the circumstances in which a refund can be claimed.
- It is not possible to accept the premise that the guiding principles which impart a measure of flexibility to the legislature in designing appropriate classifications for the purpose of a fiscal regime should be confined only to the revenue harvesting measures of a statute. The precedents of the Apex Court provide abundant justification for the fundamental principle that a discriminatory provision under tax legislation is not per se invalid.
- The Parliament is entitled to make policy choices and adopt appropriate classifications, given the latitude which our constitutional jurisprudence allows it in matters involving tax legislation and to provide for exemptions, concessions, and benefits on terms, as it considers appropriate.
- A claim to refund is governed by the statute. There is no constitutional entitlement to seek a refund.
- Section 164(1) confers power on the Government to make rules for carrying out the provisions of the Act on the recommendations of the GST Council. It is open to the rule making authority to frame rules, so long as they are consistent with the provisions of the parent enactment. Absence of the words 'as may be prescribed' in section 54(3) does not deprive the rule making authority to make rules for carrying out the provisions of the Act.
- The purpose of the formula in Rule 89(5) is to give effect to section 54(3)(ii) which makes a distinction between input 'goods' and input 'services' for grant of refund. Once the principle behind section 54(3)(ii) of the CGST Act is upheld, the formula cannot be struck down merely for giving effect to the same.
- Further, an anomaly per se cannot result in the invalidation of a fiscal rule which has been framed in exercise of the power of a delegated legislation. The Court should not allow itself to become a one-time arbiter of any and every anomaly of a fiscal regime.
- The reading down of the formula by prescribing an order of utilisation, as canvassed by the taxpayer, would take this Court down the path of recrafting the formula and walk into the shoes of the executive or the legislature, which is impermissible.
- However, given the anomalies pointed out by the assessees, the Court urged the GST Council to reconsider the formula and take a policy decision regarding the same to prescribe proportion and/or order of utilisation of input service credit.

**Conclusion:**

The industry and trade have been waiting with bated breath for the out-come of this tax controversy. Many taxpayers, especially those supplying finished goods (such as fertilizers, tractors, low priced foot ware, etc.) subjected to lower GST rates, factoring strategic importance of these products consumed by farmers or lower income groups. Denial of cash refund of input 'service' tax will result in accumulation of ITC with no visibility or feasibility of monetisation of this 'book' credits.

The decision of the Supreme Court may prompt many companies to revisit pricing strategies to factor non-monetisable credit as a 'cost' leading to price rise on products (and defeating the policy objective), unless the GST Council and Government choose to recraft the framework.

The lone ray of hope now is the response of the GST Council and the Government, with regard to the adjustment of input 'goods' credit and input 'service' credit in proportion to its utilisation in payment of the output tax, as urged by the Apex Court. Will there be recrafting of the refund formula, to factor the utilisation of input 'service' credit in the payment of output tax in the coming times? Will there be a legislative change in order to align the policy intention of containing price of strategically important products by way of suitable refund mechanism?

When the dust of court room battle on this hotly contested matter is settled, would pragmatism and policy vision prevail over revenue consideration?

# GLOBAL TRENDS

**VAT/GST News:**

**International:**

### Mandatory digital payment for VAT returns

An electronic payment system for indirect tax payments has been in place since July 2020 and an automated invoicing system since October 2020. The National Board of Revenue (NBR) in Bangladesh is now looking to make electronic payments mandatory for VAT payments. This will be a gradual process beginning from invoices above Tk 10 Mn. NBR plans to slowly reduce this limit up to the point where e-payment will become compulsory for all VAT payments.
*Source:*
*https://www.globalvatcompliance.com/bangladesh-mandatory-digital-payment-for-vat-returns/*

### Ukraine: Formation of a tax credit in VAT reporting at the expense of customs declarations

The Main Department of the State Tax Service in Kyiv issued a formal notice reminding businesses and taxable individuals that the tax credit does not include the amount of tax paid in connection with the purchase of goods & services that is not confirmed by the Unified Register of tax invoices or by customs declarations. Therefore, this amount cannot be included in the tax credit in their customs declarations.
In the case of importation of goods into the customs territory of Ukraine, the document certifying the right to include VAT amounts in the tax credit is a customs declaration issued in accordance with the law confirming payment of the tax (paragraph 201.12 of Article 201 of the TCU).
Therefore, if the VAT payer pays the amount of tax when importing goods into the customs territory of Ukraine and such payment is confirmed by all necessary customs declarations, only then the taxpayer has the right to include this VAT in the tax credit of the reporting period.

*Source: https://www.globalvatcompliance.com/ukraine-tax-credit-vat-reporting-customs/*

### Belgium: Tighter guarantee rules for VAT registrations of foreign taxpayers

Changes in guaranteed rules for VAT registrations with fiscal representation are set to take place this October in Belgium. This amendment to the current decree has been set to be implemented on 01 October 2021, and it will change the guaranteed rules to include heavier obligations for all foreign companies who want to register for VAT via a fiscal representative in Belgium.

The new legislation sets the guarantee as a necessary obligation and sets the amount at 10% of the VAT due for a 12-month period.

The guaranteed amounts are set with a minimum of EUR 7.500 and a maximum of EUR 1 million.

Under these new rules, it seems that a minimum of EUR 7.500 will always be required when registering VAT with a fiscal representative in Belgium.
*Source: https://www.globalvatcompliance.com/belgium-guarantee-vat-registrations/*

### Food delivery subject to VAT in Egypt

Egypt's tax authorities say that food sold online is now subject to VAT. Restaurant food deliveries are themselves also subject to VAT, the head of Egypt's tax service said.

Any food business selling online is obliged to register for VAT if their annual turnover exceeds EGP 500 000. VAT applies at the standard rate of 14%.

Authorities say that VAT on online food sales and food delivery will create an even playing field across the industry.
*Source: https://www.vatglobal.com/food-delivery-subject-to-vat-in-egypt/*

### UK hospitality sector VAT rate changes on 1 October

The UK hospitality sector VAT rate will increase on 1 October 2021. Currently, the VAT rate on food, accommodation and admission to certain events is set at a reduced rate of 5%. However, while the rate will increase at the end of September, it will not yet return to the full 20% rate.

Government always initiated the VAT cuts as temporary measures but extended the cuts more than once. Despite some resistance to extending the cuts beyond March 2021, the UK government ultimately extended the 5% rate until 30 September 2021.

Source: https://www.vatglobal.com/uk-hospitality-sector-vat-rate-changes-on-1-october/

### Non-resident electronic service providers with an income above 1.8 million THB subjected to VAT from 1 September 2021

Earlier this year, Thailand enacted a legislation to introduce an obligation on non-resident electronic services providers to register for, charge, and remit VAT. The implementation date of the new regime is 1 September 2021.

The new legislation mainly stipulates that business-to-consumer supplies of e-services will be subjected to VAT from 1 September 2021, if the supplier's annual turnover is above 1.8 million THB (47,000 EUR or 55,500 USD). Such a supplier shall register for VAT, file VAT returns, and pay VAT by calculating output tax without deducting input tax starting from 1 September 2021. The electronic service providers and electronic platforms are not required to issue a tax invoice or keep an input tax report.

Source: https://www.globalvatcompliance.com/thailand-digital-services-subjected-to-vat-1september2021/

### Israel - Digital services VAT for foreign companies

Government has published a proposal to introduce digital services VAT. The new VAT would apply to foreign businesses that supply online services to customers in Israel. The proposal is part of a broader memorandum detailing numerous policy proposals issued by the Israeli finance ministry.

Source: **https://www.vatglobal.com/israel-plans-digital-services-vat-for-foreign-companies/**

### Netherlands introducing new customs declaration system

The Netherlands is switching to a new customs declaration system, replacing its current AGS system. The Netherlands' new Declaration Management System aims to align Dutch protocols more closely with EU standards.

However, industry insiders are concerned that the DMS introduces additional complexity to the customs process. Specifically, shippers need to ensure they have software in place by the deadline. Shippers need technology that meets the requirements of the new multi-step customs declaration procedure.

Source: https://www.vatglobal.com/netherlands-introducing-new-customs-declaration-system/

## India

### GST Suvidha Kendra brings digital business opportunities for 0.1 Mn entrepreneur

During the recent Union Budget, the finance minister shared the government's objective to focus on easy GST & digital payments. The Union budget has earmarked INR 15 BN for a scheme to incentivize digital payments, which took off significantly in India following the coronavirus pandemic.

The fintech company, GST Suvidha Kendra by Prologic Web Solutions, offers GST compliance solutions for enormous endeavours, MSMEs and SMEs, and has the total set-up of GST-related arrangements going from e-invoicing, creating, and accommodating e-way bills, documenting GST returns, and performing point by point purchase reconciliation.

Source: https://www.hindustantimes.com/brand-post/gst-suvidha-kendra-brings-digital-business-opportunities-for-1-lakh-entrepreneur-101629722900527.html

### Govt to consider bringing petrol, diesel under GST: Report

An Indian ministerial panel on the GST will consider taxing petroleum products under a single national rate, according to people familiar with the matter, opening the door for a potential major change in consumer prices and government revenue.

The panel, headed by Finance Minister Nirmala Sitharaman, will examine the proposal at its meeting Friday after an Indian Court asked for the matter to be taken up, the people said, requesting not to be identified as the agenda of the meeting isn't public.

Source: https://www.livemint.com/politics/policy/govt-to-consider-bringing-petrol-diesel-into-gst-report-11631605822924.html

### Gradual Aadhaar authentication for 8 Mn existing GST firms on the cards

The GST Council will next week consider a road map to gradually make Aadhaar-based GST authentication mandatory for about 8 Mn existing firms after it already made it compulsory for new registrations last year.

The matter will be deliberated at the 45th meeting of the Council, which will be held in Lucknow on September 17.

Source:

https://www.hindustantimes.com/business/gradual-aadhaar-authentication-for-8-million-existing-gst-firms-on-the-cards-101631518347445.html

### Council to decide on GST aid for states beyond June 2022

GST Council will meet in Lucknow on September 17 to sort out the vexatious issue of whether and how to compensate states for any 'revenue shortfall' beyond June 2022, when the current such mechanism is designed to end.

The sources said the Council will likely debate on the 'streamlining' of GST rates correcting and inverted duty structures. Tightening of anti-evasion measures is also on the agenda as such initiatives, including the steps taken to bust the rackets cornering undue tax credits, have indeed borne fruit (despite the economic turmoil, GST revenues crossed the INR 1000 Bn mark for several months in a row till August 2021 (except in June).

Source:
https://www.financialexpress.com/economy/september-17-meeting-council-to-decide-on-gst-aid-for-states-beyond-june-2022/2323015/

## Customs News

**International:**

### WCO Secretary General addresses the Fifth Meeting of the UN Counter-Terrorism Coordination Compact Committee

The Fifth Meeting of the UN Global Counter-Terrorism Coordination Compact Committee took place as a virtual meeting on 28 August 2020. Members of the Global Compact, including the WCO Secretary General, Dr. Kunio Mikuriya, were asked to exchange views on how they had delivered their priorities and continued to support their members throughout the recent COVID-19 pandemic.

The Secretary General highlighted that the international community had to recognize that the COVID-19 situation could be exploited by organized crime and terrorist groups to gain illegal profits; to address this threat, the WCO has organized "Operation STOP" as an emergency response targeting the illicit trade in critical medical supplies and counterfeit medicines in close cooperation with INTERPOL and a number of other Global Counter-Terrorism Compact partners. He announced that the outcome of the seizures following this operation and an analysis of emerging illicit trade would be published shortly.

Source:
http://www.wcoomd.org/en/media/newsroom/2020/august/wco-sg-addresses-the-fifth-meeting-of-the-un-counter-terrorism-coordination-compact-committee.aspx

### Customs in Madagascar boosts its Risk Management capacities

The WCO Secretariat conducted a virtual fact-finding Workshop on Risk Management for Malagasy Customs. In the framework of the implementation of the Administration's 2021-2023 Strategic Plan, this Workshop was aimed at identifying the key functions to be addressed in Risk Management. This event was made possible. thanks to funding from Her Majesty's Revenue and Customs (HMRC).

Malagasy Customs' Director of Risk Management, together with the Heads of Enforcement, Seaport operations, Airport operations and the Human Resource department, welcomed this activity, which provided them with an opportunity to identify weaknesses in terms of bridging any gaps in the system. All participants were unanimous in agreeing that Risk Management is key to their modernization, reform and WTO TFA implementation efforts.

Source:
http://www.wcoomd.org/en/media/newsroom/2021/september/customs-in-madagascar-boosts-its-risk-management-capacities.aspx

## India

### Govt cuts Customs duties on edible oil to ease retail prices

The government has slashed base Customs duties on palm oil, soy oil and sunflower oil to ease elevated level of edible oil prices, according to the Finance Ministry.

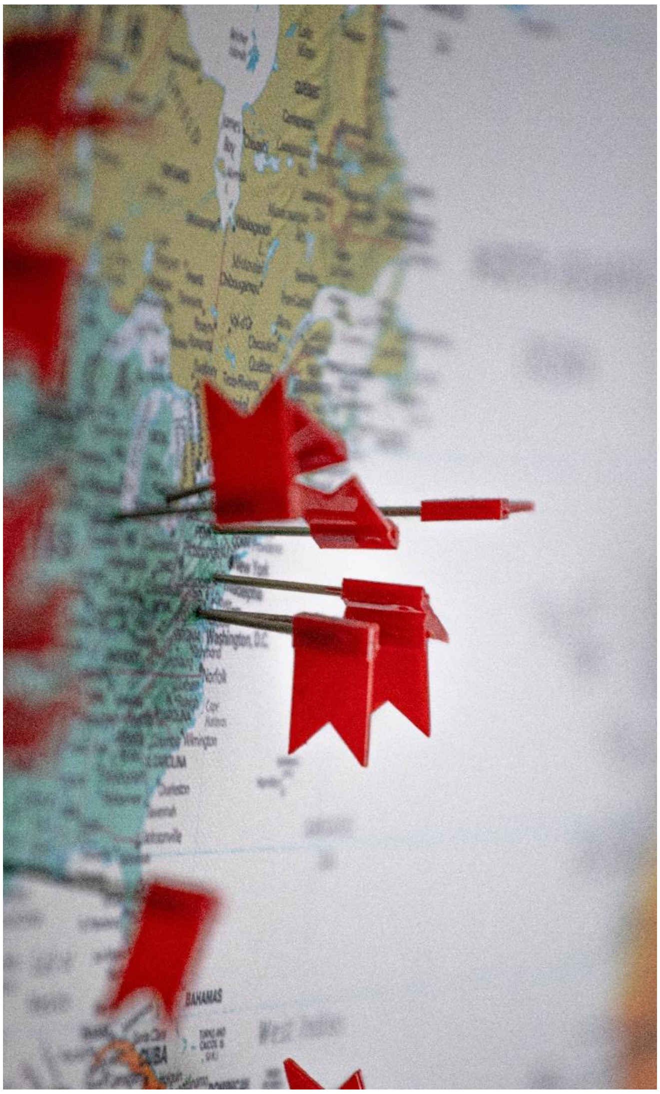
The base import tax on crude palm oil has been reduced to 2.5 per cent from 10 per cent, while the tax on crude soy oil and crude sunflower oil has been reduced to 2.5 per cent from 7.5 per cent, the Finance Ministry said in a notification issued late on Friday.

Source: https://indianexpress.com/article/business/economy/govt-cuts-customs-duties-on-edible-oil-to-ease-retail-prices-7503383/

### Customs Commissionerate not to issue reports interpreting law: CBIC

In an instruction to all Principal Chief Commissioners of Customs, the Central Board of Indirect Taxes and Customs (CBIC) said in order to establish a standard practice on all matters of classification of goods, with respect to levy of duty and for the implementation of any other provision of the Customs Act, 1962, Directorates/Commissionerate/Audit will not issue any circulars which are in the nature of clarification or interpretation.

Source: https://economictimes.indiatimes.com/news/economy/policy/customs-commissionerates-not-to-issue-reports-interpreting-law-cbic/articleshow/85533299.cms



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## Contact Us

For any content related queries, you may write in to taxadvisory@bdo.in or get in touch with,


**GUNJAN PRABHAKARAN**
Partner & Leader
Indirect Tax
D: +91 44 6131 0203
gunjanprabhakaran@bdo.in



**DINESH KUMAR**
Associate Partner
Indirect Tax
D: +91 9840 3100 39
dineshkumar@bdo.in


For any other queries or feedback, kindly write to us at marketing@bdo.in

## BDO in India

**Ahmedabad**
The First, Block C – 907 & 908
Behind ITC Narmada, Keshavbaug
Vastrapur, Ahmedabad 380015, INDIA
Tel: +91 98 2564 0046

**Bengaluru**
SV Tower, No. 27, Floor 4
80 Feet Road, 6th Block, Koramangala
Bengaluru 560095, INDIA
Tel: +91 80 6811 1600

**Chennai**
No. 443 & 445, Floor 5, Main Building
Guna Complex, Anna Salai, Teynampet
Chennai 600018, INDIA
Tel: +91 44 6131 0200

**Delhi NCR - Office 1**
The Palm Springs Plaza
Office No. 1501-10, Sector-54
Golf Course Road
Gurugram 122001, INDIA
Tel: +91 124 281 9000

**Delhi NCR - Office 2**
Windsor IT Park
Plot No: A-1, Floor 2
Tower-B, Sector-125
Noida 201301, INDIA
Tel: +91 120 684 8000

**Goa**
701, Kamat Towers
9, EDC Complex, Patto
Panaji, Goa 403001, INDIA
Tel: +91 832 674 1600

**Hyderabad**
1101/B, Manjeera Trinity Corporate
JNTU-Hitech City Road, Kukatpally
Hyderabad 500072, INDIA
Tel: +91 40 6814 2999

**Kochi**
XL/215 A, Krishna Kripa
Layam Road, Ernakulam
Kochi 682011, INDIA
Tel: +91 484 675 1600

**Kolkata**
Floor 4, Duckback House
41, Shakespeare Sarani
Kolkata 700017, INDIA
Tel: +91 33 6766 1600

**Mumbai - Office 1**
The Ruby, Level 9, North West Wing
Senapati Bapat Marg, Dadar (W)
Mumbai 400028, INDIA
Tel: +91 22 6277 1600

**Mumbai - Office 2**
Floor 6, Raheja Titanium
Western Express Highway
Geetanjali Railway Colony, Ram Nagar
Goregaon (E), Mumbai 400063, INDIA
+91 22 6831 1600

**Pune - Office 1**
Floor 6, Building # 1
Cerebrum IT Park, Kalyani Nagar
Pune 411014, INDIA
Tel: +91 20 6763 3400

**Pune - Office 2**
Floor 2 & 4, Mantri Sterling, Deep
Bunglow Chowk, Model Colony,
Shivaji Nagar, Pune 411016, INDIA
Tel: +91 20 6723 3800