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By

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Dear Readers,

Greetings for the season!

In this edition, we bring you to quite a few interesting articles.

The article on 'Mohit Minerals – Recipient of Service – To be Revisited?' deals with the decision of recent Honourable High Court of Gujarat in the matter of Mohit Minerals, where in the Honourable High Court has struck the levy of tax under reverse charge on importer stating that he could not be called as recipient of service. However, seen from a different perspective, we believe that the importer can be called as recipient of service and accordingly be subjected to reverse charge obligation. We have articulated our understanding and observations in the said article.

The article on 'Taxation of Receipts – Extinction of Profit Earning Apparatus' deals with the taxation of receipts which are in the nature of extinction of source of income. The question whether such receipt is capital or revenue has been discussed in such article and hope you will have a good read of the same.

The article 'SOFTEX for Non-STPI Units – A Mandatory Requirement – FEMA' is to alert all clients in the DTA units which are engaged in provision of software services to get registered with STPI as Non-STPI to comply with FEMA regulations and accordingly save themselves from penalty and compounding.

I hope that you will have good time reading this edition and please do share your feedback. I will also urge clients to mail us topics or issues on which you want us to deliberate in our future editions, so that we can contribute to the same.

Thanking You,

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DIRECT TAXATION

TAXATION OF RECEIPTS - EXTINCTION OF PROFIT EARNING APPARTUS

Contributed by CA Suresh Babu S & CA Sri Harsha

The taxation of a receipt under the Income Tax Act becomes challenging when the said receipt is in the nature of capital as pleaded by tax payer as against revenue by tax authorities. Needless to state, that under the Income Tax Act, 1961 (for brevity 'ITA'), all revenue receipts are taxable unless specifically stated not taxable and all capital receipts are not taxable unless specifically stated to be taxable. This is one of the cardinal principals embodied in ITA. However, whether a receipt is in the nature of capital or revenue is always hard to find and the courts had always framed various tests to determine the nature of the receipt and consequently the taxability.

In this article, we are dealing with determination of nature of one such receipt, which is received on extinction of profit apparatus or sterilisation of profits. Let us understand the nature of receipt by taking an example.

Case Study:

Say, ABC Limited has entered an agreement with PQR Limited. Vide such contract, ABC Limited is allowed to occupy the land owned by PQR Limited and construct a hotel and manage the same and the revenues earned from such hotel are agreed to be shared among ABC Limited and PQR Limited in a proportion.

After ABC Limited spending certain resources and mobilising the work force for development of land into proposed hotel, differences arose between ABC Limited and PQR Limited which stalled the hotel project. Since no land was made available by PQR Limited despite repeated reminders, ABC Limited is constrained to invoke the arbitration clause in the contract. Accordingly, the matter has reached the arbitral tribunal.

Before the Arbitral Tribunal, both ABC Limited and PQR Limited has submitted various claims along with evidences in their support. ABC Limited has made claims based on loss of profits because the project could not take place. The Arbitral Tribunal after perusing the entire documents and claims has held that PQR Limited is liable to pay certain amounts to ABC Limited and ordered the same.

Accordingly PQR Limited has paid amounts as stated in arbitral award and the same were received by ABC Limited. Now, the question which arose is, what would be the nature of receipt in the hands of ABC Limited? If the response is Capital, then the same would not be coming into the purview of definition of 'income' as per ITA. If the response is Revenue, the same would be falling under the ambit of definition of 'income' and be subjected to tax. Keeping the above question in mind, let us proceed to examine the taxability of such a receipt in the hands of ABC Limited.

As stated earlier, the characterisation of receipt as 'revenue' or 'capital' is not codified in the law and there is no straight jacketed formula. Hence, we have to place reliance on the existing jurisprudence on the said subject to decide the nature of such receipt. The Honourable Income Tax Appellate Tribunal (for brevity 'ITAT') of Pune had an occasion to deal with the taxation of similar receipts in the matter of Aquapharm Chemical Company Limited (for brevity 'Aquapharm').

Aquapharm matter – ITAT Pune:

The facts in Aquapharm were that they have entered an agreement with AIK-Germany, for supply of technical knowhow for manufacture of fire-retardant chemicals. Aquapharm was incorporated in 1974 and has two plants located in India. In order to diversify its business, Aquapharm has contemplated to start a new division which manufactures the fire-retardant chemicals. Since Aquapharm does not have enough experience and competence, they have entered agreement with AIK-Germany for supply of knowhow. Aquapharm obtained requisite approvals for project expansion for start of new manufacturing facility and also paid the first instalment of knowhow fee to AIK-Germany for the knowhow. Consequent to such payment, Aquapharm has received certain technical information and drawings from AIK-Germany. The information received was not good enough to start the manufacturing activities of fire-retardant chemicals. Despite repeated requests from Aquapharm, AIK-Germany has not shared any further information stating that all the information required to start the said manufacturing activities was already shared by the later. However, Aquapharm was of the belief that there was still certain information, which was required and in absence of such information, the manufacturing facility could not kick in. In light of the above deadlock, Aquapharm was forced to invoke the arbitration clause in the contract. The arbitral tribunal after hearing the said matter, has ordered AIK-Germany to pay an amount of INR 4.53 Crores as compensation for the settlement of dispute.

The said amount was claimed by Aquapharm as capital receipt and accordingly the same was not offered to tax. While processing the return under Section 143(1)(a) of ITA, prima-facie adjustment of INR 4.53 Crores as revenue receipt. Aquapharm has filed a rectification application under Section 154 but could not succeed. Aquapharm could not succeed even in the appeal proceedings as the appellate authority was of the belief that the receipt was revenue in nature. The said matter has reached the Honourable ITAT. Before the Honourable ITAT, Aquapharm has argued that the compensation received was for lost profit due to non-supply of knowhow and not on loss of profit. Since the information was not received and the manufacturing activity could not take place, the entire works which were required to start the said facility has gone waste and accordinglyAquapharm pleaded that the compensation received was for the lost of profit due to disturbance to the profit-making apparatus (the manufacturing facility) and just for not loss of profit. Since the compensation was for the purposes of disturbance of profit-making apparatus, Aquapharm pleaded that the said receipt was in the nature of capital and hence not taxable and placed reliance on number of judgments including the Apex Court in the matter of Bombay Burmah Trading Corporation[2] .

Revenue agreed that the amounts received as compensation for giving up rights in profit making apparatus would be in the nature of capital receipt, however, the venture is only for the purposes of carrying on existing business by taking the help of another, then the compensation is in the nature of revenue. Since in the facts of Aquapharm, it was an existing business, the compensation received from AIK would be in the nature of revenue and accordingly subjected to tax. The Revenue has relied on the decision of Delhi High Court in the matter of CIT vs Manoranchan Picture Corporation[3] . The other arguments which were put forth by the Revenue are as under:

[1]2012 (2) TMI 594 – ITAT Pune
[2]161 ITR 386 (SC)
[3]1977 228 ITR 202 (Del)

- The compensation is not for suffering injury to the profit-making apparatus. The apparatus of the assessee was the existing set up and the proposed making of fire-retardantchemical was merely an expansion of the existing business.
- The compensation received was in normal course of business carried on by the assessee.
- The injury if any was not inflicted of any capital asset of the assesse. The agreement was to use the knowhow as a license for a limited period.
- The failure to supply full details of knowhow did not affect the basic intention of the business of the assessee.
- The compensation for the loss suffered by assessee was incidental to business and it did not amount to be received for loss of an enduring asset.
- The assessee had mainly acquired the right to use the technology and the expenditure incurred has also been claimed as a revenue expenditure, therefore any receipt in view of such expenditure cannot be termed as capital receipt.
- The arbitration award there categorically states that the amount of compensation received by the assessee is in lieu of profits and not because the assessee's profits earning apparatus was affected, hence the expenses on arbitration has been claimed as revenue expenditure and
- The loss of extinction of source of income which the assessee contends never came into the effect. The arbitration award is only in lieu of profits.

The Honourable ITAT after pursuing all the above objections have examined each objection in detail. Let us proceed to understand the rationale delivered by the Honourable ITAT for each of the above objection.

The compensation is not for suffering injury to the profit-making apparatus. The apparatus of the assessee was the existing set up and the proposed making of fire-retardant chemical was merely an expansion of the existing business:

The Honourable ITAT has held that the new division of Aquapharm cannot be called as an extension to an existing set-up. The new manufacturing facility as contemplated by Aquapharm was not in any way connected with the existing facility and accordingly the ITAT held that the manufacturing facility is profit earning source and non-facilitation of technical knowhow made Aquapharm deprived from such profit earning source. The ITAT placing reliance on the decision of Honourable Bombay High Court in the matter of J. Vajantizies & Others[4] held that where the Voyantizies was prevented from commencement of business and the damages for compensation received were worked out on the basis of loss of profit which the J. Vajantizies would have earned if he had carried on business would be only a capital receipt and held that the amount received by Aquapharm was capital in nature.

The compensation received was in normal course of business carried on by the assessee:

The Honourable ITAT stated that as held earlier that the above compensation was not received in normal course of business since the business qua manufacturing facility has not kicked off to say that the compensation was received in normal course of business. The ITAT took support from Honourable Andhra Pradesh High Court in the matter of Barium Chemicals Limited [5], wherein the High Court held that in order to decide whether a payment is in the nature of revenue or not, its true nature and substance has to be found out. If the payment is received in the normal course of business for loss of stock in trade, the

[4] 91 ITR 345 (Bom)
[5] 168 ITR 164 (AP)

same can be held as revenue receipt. On the other hand, the High Court continued to state that if a payment is towards compensation received for extinction or sterilisation partly or fully of a profit earning source, such receipt not being in the ordinary course of business would be a capital receipt. The ITAT held that since in the facts of Aquapharm, there was no loss of stock or any other loss after starting of its business (qua manufacturing of fire retardant chemical) and the compensation was received since the knowhow was not good enough to start the manufacturing activity, the compensation would be very well called for extinction of profit earning source and accordingly the nature of such receipt would be in the nature of capital.

The ITAT further stated that the reliance of the Revenue on the decisions in the matter of Ansal Properties & Industries Limited[6] would not help since the fact patterns in such case was different from facts of Aquapharm. The ITAT has held that the decision of Ansal Properties& Industries Limited can be distinguished from the facts of Aquapharm matter, since in the former case, the facts were that the company was carrying on business within the existing framework of business and as per the needs of business, contracts with existing agencies were terminated and the fresh agencies were entered. The compensation was granted for loss of future profits which were held as revenue receipts. Since the compensation was received during the normal course of business, the court therein held that such receipt was in the nature of revenue. However, the facts in Aquapharm are completely different and the reliance on Ansal Properties & Industries Limited would not help the Revenue.

The injury if any was not inflicted of any capital asset of the assesse. The agreement was to use the knowhow as a license for a limited period:

The Honourable ITAT then proceeded to take up the next objection. The Revenue contended that the compensation received by Aquapharm did not inflict any capital asset and accordingly the compensation received was revenue in nature. The Revenue further placed reliance on decision of Honourable High Court of Delhi in the matter of Manornajan Corporation[7] and pleaded that the compensation received should be held as revenue in nature. The ITAT stated that the decision of Manornajan Corporation would help the cause of Aquapharm and not of Revenue. The ITAT has stated that in the facts of Manornajan Corporation, the amounts were received as compensation for existing business and there was no damage to the profit earning apparatus. Hence, the Honourable Delhi High Court in such fact pattern, held that the receipts were revenue in nature. However, the Honourable Delhi High Court stated that if the compensation is received for giving up its right was itself the profit earning apparatus and such an action would disrespect the entire profit earning structure, the said compensation should be treated as capital in nature. The ITAT has held that the ratio delivered by Honourable High Court squarely applies to the facts of Aquapharm and accordingly the receipt should be treated in the nature of capital.

The failure to supply full details of knowhow did not affect the basic intention of the business of the assessee:

The Honourable ITAT has held that there was no evidence to show that the Aquapharm could continue the business as usual in absence of knowhow. In absence of such evidence and treating the manufacturing plant of fire-retardant chemical as a distinct unit, the ITAT could not uphold the submission made by Revenue on this count.

[6](2008) 19 SOT 391 (Del)
[7](1997) 223 ITR 32 (Gau)

The compensation for the loss suffered by assessee was incidental to business and it did not amount to be received for loss of an enduring asset:

The Honourable ITAT has brushed away this allegation of Revenue by referring to the observations made in the preceding paras. Accordingly, ITAT held that the compensation cannot be treated as receipt incidental to business.

The assessee had mainly acquired the right to use the technology and the expenditure incurred has also been claimed as a revenue expenditure, therefore any receipt in view of such expenditure cannot be termed as capital receipt:

The Revenue pleaded that since Aquapharm has claimed the payments made to AIK-Germany were charged off to profit and loss account, any receipt thereof should also be credited to profit and loss account and accordingly be subjected to tax. The Honourable ITAT has held that whether a receipt is revenue or capital has to be decided based on the complete facts available and circumstances in which such compensation was ordered. The ITAT held that the loss was compensated by the award by the arbitrator keeping in mind that the Aquapharm could not start the manufacturing and earn the profit therefrom due to non-supply of technical knowhow. Hence, the plea of authorities that expenditure incurred to acquire the right to use of technology was claimed as revenue expenditure, therefore any receipt in lieu of such expenditure cannot be claimed as capital receipt has no substance.

The loss of extinction of source of income which the assessee contends never came into the effect. The arbitration award is only in lieu of profits:

The Revenue further placed arguments stating that the arbitral award categorically records that amount of compensation received by Aquapharm was in lieu of profits and not because the Aquapharm 's profit earning apparatus was effected. The Revenue further placed reliance on the decision of Apex court in the matter of Raghuwansi Mills Limited[8] and Travancore Rubber & Tea Co. Limited[9] to argue that the receipts were in the nature of revenue. The Honourable ITAT has held that in light of the undisputed fact that the compensation was awarded for the loss suffered by Aquapharm which was attributed to extinction of profit earning apparatus, the receipt was capital in nature. Further, the ITAT has held that the decisions relied by Revenue cannot be applied to the present set of facts because, the facts involved in relied upon matters was receipts in case of tax payers who were already in business. The ITAT further placed reliance on the decision of Apex court in the matter of Senairam Doongarwell [10], where in it was held that just because compensation was determined with reference to the lost profits, it would not amount to revenue receipt. The basic question would be whether the proposed business is sterilised or could not take off.

Conclusion in Aquapharm 's matter:

The Honourable ITAT accordingly held that the compensation which is received for extinction of profit-making apparatus or sterilisation of profits would be in the nature of capital and accordingly brushed away all the grounds put forth by Revenue.

[8] 22 ITR 484 (SC)
[9] 243 ITR 158 (SC)
[10] 42 ITR 392 (SC)

Aerens Developers matter – ITAT Delhi:

The Honourable ITAT of Delhi had an occasion to decide upon the nature of receipt in the matter of Aerens Developers and Engineers Limited[11] (for brevity Aerens Developers). The facts in the matter of Aerens Developers were, that the assessee has entered a consortium agreement amongst its associates defining their roles, rights and responsibilities along with respective share in consortium. All the consortium companies through their lead company, entered an agreement with JMA Buildcom (P) Limited to purchase 10 acres of land for a consideration of INR 15 Crores. Since JMA Buildcom could not purchase the said lands despite many reminders, the consortium companies has settled the dispute invoking arbitration clause. Accordingly, one of the consortium company being Aerens Developers has received INR 1 Crores as compensation. Aerens Developers has claimed that the said amount as a capital receipt and has not offered tax on the reasons that there is a disturbance to the profit earning apparatus and accordingly the receipt is capital in nature. The Revenue has stated that no tangible asset has not been lost to treat the compensation as capital loss and accordingly pleaded that the compensation was to be treated as revenue.

The Honourable ITAT after referring to the decision of Honourable ITAT Pune in the matter of Aquapharm (supra), has held that the injury was caused to the profit-making apparatus as the land which was profit making apparatus for consortium was not supplied by JMA Buildcom (P) Limited and hold that the compensation received was for lost profit due to non-supply of land and not on loss of profit and accordingly the receipt of INR 1 Crore was held to be capital in nature.

Conclusion to Case Study:

In the facts of our case study, ABC Limited has received compensation since PQR Limited could not make available the land which is required to start the project. Since land being the most important aspect for the project and absence of which could disturb the entire profit-making apparatus of ABC Limited, the compensation seen from the perspective of the above judgments would be treated as capital.The Honourable Supreme Court's observation in the matter of Senairam Doongramall (supra), which states that just because the damages were worked on loss of profits, the receipt could not be coloured as revenue is quite an essential one and important too.

However, as everyone is aware there is no one size fits all answer to the question which deals with determination of nature of receipt. Every receipt has to be judged in the context which it arises and surrounding facts should be taken into consideration before concluding on the nature of receipt and consequently its taxability.

[11] 2016 (9) TMI 948 – ITAT Delhi

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GST

MOHIT MINERALS - RECIPIENT OF SERVICE - TO BE REVISITED

Contributed by CA Sri Harsha & CA Manindar

Introduction:

In our 45th Volume (April 2018 edition) of our wiki, we have authored an article titled "GST on Shipping Services— the unwarranted turmoil" on GST implications over the services by way of transport of goods by vessel. It has been explained by us that the ocean freight and air cargo freight were not subject to tax for the reason that the tax is collected in the form of customs duties by including these costs in the value of goods. However, levy of service tax on services by way of transport of goods by vessel has been brought in with effect from 01.06.2016 in order to provide level playing field to Indian shippers compared to foreign shippers.

It was explained therein that the Indian importers are bearing the input tax burden on various goods and services received by them for providing their services and as a result of this, their cost of services has been increased compared to foreign suppliers. Accordingly, the levy was brought on these services so that they can collect tax from the customers and adjust the input taxes while paying the output tax.

It was also explained therein that upon introduction of service tax on services of domestic shipping lines, many of the Indian importers tried to reduce the incidence of service tax by converting FOB contracts into CIF contracts requiring the foreign suppliers to arrange for transportation as well by using the services of foreign shipping lines. In order to overcome this, service tax was introduced on services o foreign shipping lines also under reverse charge requiring the Indian importer to pay tax under reverse charge. Taxing of these services also continued under the GST regime as well.

The said article has explained the grounds on which the levy can be challenged which includes the double taxation aspect and reverse charge obligation on importer of goods. It was also explained therein that how the objective of level playing field between Indian and foreign shipping lines can be achieved without taxing these services.

Recently, the Gujarat High Court has struck down the levy of GST on ocean freight with respect to imports undertaken on CIF basis. In light of this judgment, let us have a look at the reasons on which the levy was struck down by the Gujarat High Court, the possible reasons on which the position laid down in the above decision can be overturned and the way forward for the Government to achieve level playing field between the services of domestic and foreign shipping lines.

Challenge on the vires of the levy in case of CIF Imports:

Under the GST regime, the imposition of tax under reverse charge on the importer of goods on CIF basis has been challenged before the Gujarat High Court in the case of Mohit Minerals Private Limited vs. UOI, 2020(1)TMI 974, Gujarat High Court. The relevant extracts are reproduced as under:

*144. In the present case, **the writ-applicant is importing goods on the CIF basis, i.e. the contract is for supply of goods delivered at the Indian port. Thus, the transportation of goods in a vessel is the obligation of the foreign exporter. The foreign exporter enters into contract with the shipping line for availing the services of transportation of goods in a vessel. The obligation to pay consideration is also of the foreign exporter. The writ-applicant is not at all concerned with how the foreign exporter delivers the goods at the Indian port or whether the consideration of the shipping line has been paid by the foreign exporter or not.** Even in a case of non-payment of the consideration of the freight by the foreign exporter, the shipping line cannot recover the consideration from the writ-applicant.*

145. Thus, the writ-applicant could be said to have neither availed the services of transportation of goods in a vessel nor he is liable to pay the consideration of such service. Hence, the writ-applicant is not the 'recipient' of the transportation of goods in a vessel service as per Section 2(93) of the CGST Act.

146. We are construing the provisions of taxing statute and that too the charging section of a taxing statute. It is a settled principle of construction of tax laws that there is no room for any intendment or presumption in tax statutes and one has to look only at the language used.

*147. **The principle of construction in tax statutes is that if the person sought to be taxed comes within the letter of the law he must be taxed. In a taxing Act one has to merely look at what is clearly said. There is no room for any intendment. There is no equity about a tax. There is no presumption as to tax. Nothing is to be read in, nothing is to be implied. One can only look fairly at the language used.***

*148. **In our opinion, the writ-applicant cannot be made liable to pay tax on some supposed theory that the importer is directly or indirectly recipient of the service. The term 'recipient' has to be read in the sense in which it has been defined under the Act. There is no room for any interference or logic in the tax laws.***

*254. **In view of the aforesaid discussion, we have reached to the conclusion that no tax is leviable under the Integrated Goods and Services Tax Act, 2007, on the ocean freight for the services provided by a person located in a non-taxable territory by way of transportation of goods by a vessel from a place outside India upto the customs station of clearance in India and the levy and collection of tax of such ocean freight under the impugned Notifications is not permissible in law.***

Thus, the levy of GST under reverse charge on the importer towards the services by way of transportation of goods by vessel has been struck down by the Gujrat High Court and held that the notifications requiring the importer to pay tax under reverse charge are ultra vires.

Observations in Mohit Minerals on the aspect of Double Taxation:

With respect to the imported goods, in terms of the proviso to section 5(1) of the Integrated Goods and Services Tax Act, 2017 (for brevity 'IT Act') read with section 3(7)of the Customs Tariff Act, 1975, the imported goods are subject to IGST at the time of clearance of goods when Basic Customs Duty (BCD)is levied under section 12 of the Customs Act, 1962.

Further, for levy of IGST on the imported article, in terms of section 3(8) of the Customs Tariff Act, 1975, the value of the imported article shall be the value as determined under section 14 of the Customs Act, 1962 or the tariff value of such article fixed at sub-section (2) of said section 14 and BCD chargeable under section 12 of the Customs Act, 1962.In terms of section 14 of the Customs Act, 1962, BCD shall be levied on the CIF value of the imported goods i.e. on the value of the goods including the cost of transportation, insurance, loading, unloading and handling charges for bringing the imported goods to the place of importation.

Thus, in the case of imported goods, the value of freight is included in the value of imported goods and the importer is paying BCD and IT. In addition to this, the Indian shipping line or the importer under reverse charge in a case where the imports are on a CIF basis are required to pay GST separately on these services. Thus, double taxation is evident and is not backed by GST laws anywhere. It is on the aspect of double taxation, the services of transportation of goods by vessel are exempted for the period prior to 01.06.2016.

Though the petitions in the above case approached the Gujarat High Court challenging the levy under reverse charge on the importer, the following observations made by the Gujarat High Court on the aspect of double taxation would equally apply to the case of direct charge on the services undertaken by the Indian shipping lines. The relevant extracts are reproduced as under:

213. It is a fundamental principle of construction of tax statutes that ***if the words of the Act on one construction results into double taxation of the same transaction, that result will be avoided by adopting another construction which may reasonably be open. Further, double taxation, by way of delegated legislation, when the statute does not expressly provide, is not permissible.***

214. In the case of United Shippers Ltd. v. CCE, 2015(37) STR 1043(T), the Tribunal held that there can be no levy of service tax on barge charges and the handling charges which is part of the import transaction into India and form an integral part of the transaction value on which the customs duty is leviable. The judgment of the Tribunal has been affirmed by the Supreme Court in the case of CCE v.United Shippers, 2015(39) STR J369 (SC).

215. Thus, having paid the ***IGST on the amount of freight which is included in the value of the imported goods, the impugned notifications levying tax again as a supply of service, without any express sanctionby the statute, are illegal and liable to be struck down.***

Thus, in the opinion of the paper writers, the above extracts of the judgement would equally apply to cases of direct charge by Indian shipping lines and the vires of such tax levy could also be questioned.

Suggested Way forward:

As discussed above, the objective of taxing the services by way of transportation of goods by vessel is to provide the level playing field to Indian shipping lines compared to foreign shipping lines by reducing the input taxes involved in the cost of transportation. Further, the services by way of transportation of goods by air continued to be exempt. By following the said practice, the problem of input tax cost burden is also prevalent on-air cargo operators as well.

In the opinion of the paper writers, Government have other options to achieve this objective of reducing the input tax cost. They need have to resort to taxing of output service. The Governments can declare all the international shipping or transportation services as zero-rated supplies under section 16 of the IT Act, 2017. As a result of this, these operators can claim a refund of the accumulated input tax. As a result of this, their cost of transportation is not burdened by input tax cost and they can continue to be competitive with foreign shipping lines. The Gujarat High Court in the above-referred decision has recommended for this.

Let us hope that the GST council and the Governments respond prudently in this regard and provide that extra boost to the Indian shipping lines and air cargo operators. This is very much required because of the current slowdown of the global economy.

Does Mohit Minerals require re-consideration?

In our opinion, an alternate perspective to the conclusions arrived in Mohit Minerals is also possible. With due respects, the Honourable High Court has not considered the core aspect in detail, which being the definition of 'recipient of supply of goods or services or both'. It appears that the discussion on the said aspect was carried on with a presumption that the levy does not exist and even existed, it would be ultra-vires. The reasoning as to why we have arrived at that conclusion is as under.

Importer as Recipient:

In our opinion, the definition of 'recipient of supply of goods or services or both' as laid down in Section 2(93) of Central Goods & Services Tax Act, 2017 (for brevity 'CT Act') is wide enough to cover the 'importer' as recipient for the purposes of payment of tax under reverse charge. The said definition can be split into three compartments for better understanding.

2(93)	Covers	Instance	Recipient
(a)	Supply of goods or services or both	Where consideration is payable	person who is liable to pay consideration
(b)	Supply of goods	Where no consideration is payable	person to whom goods are delivered or made available or to whom possession or use of goods is given or made available
(c)	***Supply of services***	***Where no consideration is payable***	***the person to whom the service is rendered***

and any reference to a person to whom a supply is made shall be construed as a reference to the recipient of supply and shall include an agent acting as such on behalf of the recipient in relation to the goods or services or both supplied

The judgment in Para 144 states that a person who is importing goods on CIF basis, the contract is for supply of goods delivered at the Indian Port and the transportation of goods is an obligation of the foreign exporter. It continues to state that importer is not at all concerned with how the foreign exporter delivers the goods at the Indian Port or whether the consideration of the shipping line has been paid by the foreign exporter or not and holds that even in case of non-payment of consideration of freight by the foreign exporter, the shipping line cannot recover the consideration from importer. Accordingly, in Para 145 it was held that importer could be said to have neither availed the services of transportation of goods in a vessel nor he is liable to pay the consideration of such service and hence not a 'recipient'.

Now, we would like to raise few questions for which we elicit responses from the readers. The questions are as under:

- Is the shipping line does not know as to whom the delivery of consignment is being made?
- Will shipping line delivers goods to any person or only to an importer?
- When would be the obligation of shipping line terminates qua his contract with foreign shipper?
- Is shipping line allowed to dump the goods at the port without assigning them to a specific agent or importer?
- What would be shipping line state about importer in Import General Manifest which is to be filed by him?

An underlying response to all the above questions state that there exists a knowledge about the importer with the shipping line. In other words, even though the contract is entered between the foreign shipping line and foreign exporter, the shipping line is actually aware about the importer. Only out of this awareness, the goods are being delivered to him and the only exception to the normal rule of trade is, the freight is not paid by the importer but the foreign exporter. Except for this commercial term, for all other purposes, the importer and foreign exporter will be the recipient of services of shipping line.

The definition of 'recipient of supply of goods or services or both' has sub-clause (c), essentially to cover these instances. In cases of supply of services, where no consideration is payable, the person to whom the service is rendered is called as 'recipient'. The judgment only by reason that the contract is not negotiated by importer or consideration is not being paid by importer cannot rule out the possibility of importer as 'recipient', especially in view of the existence of sub-section (c) in the statue book.

The sub-section (c) can also be more understood in great detail when we read with sub-section (b). The sub-section (b) states that in case of supply of goods, where there is no consideration payable, the recipient would be **the persons to whom goods are delivered or made available, or to whom the possession or use of the goods is given or made available. If the same analogy is applied for the services also, the importer may be called as 'recipient' since the services of ocean freight are delivered or made available to him or use of such services is given or made available to him.**

Without this sort of a discussion or a perspective, the judgment went on more hypothetical basis and held that importer cannot be called as 'recipient'. In Para 149 of the judgment, it was stated that if the definition of 'recipient' is overlooked or ignored, then the importer would become recipient of all goods which goes into manufacture/production of goods and all the services which have been availed by the foreign exporter for such purposes and held that such reasoning leads to harsh and arbitrary result which has to be avoided.

In our opinion, the definition of 'recipient of goods or services or both' is to be understood based on the appropriate context. The said definition is in the statute book only for limited purposes, of which, paying tax under revere charge is one of them. The said definition has to be examined in the context of reverse charge which was not attempted by the Honourable High Court.

The legislature is well aware that there would be certain instances where consideration is not payable and still a person can be called as 'recipient' and accordingly inserted sub-section (b) and (c) in the above definition. If at all a person who pays consideration alone is to be called as 'recipient', then there would not be any necessity to come up with sub-section (b) and (c). Hence, in our opinion, the importer fits under sub-section (c), since he is said to receive the ocean freight services and he is not obliged to pay any consideration. Since, he satisfies all the conditions of sub-section (c), the importer squarely fits within the letter of law for being taxed under reverse charge and then the reverse charge is not based on supposed theory as envisaged by the Honourable High Court.

The above aspect is vital and judgment should have spent more time on to the reasons why the importer does not fit in sub-section (c). This being the foundation for the rest of the judgement, we opine that a proper reasoning has been done on this aspect which makes it fit for a re-consideration. All aspects like double taxation and others will fall in place if this vital aspect is seen from the above perspective.

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FEMA

SOFTEX FOR NON-STPI UNITS - A MANDATORY REQUIREMENT

Contributed by CA Suresh Babu S & CA Sri Harsha

Introduction:

The typical model of majority of the IT companies which are engaged in provision of software services to parent/group companies is 'cost plus mark-up'. Under this model, the Indian companies would agree to provide a host of services to the parent/group companies and bill them on periodical basis on cost plus agreed mark-up. An agreed and transfer-pricing friendly margin/mark-up would ensure that Indian companies are always left with good enough reserves and not to worry of working capital requirements. This would ensure that Indian companies would never get into losses and concentrate on development of software and provision of other ancillary services. IT companies can start their operations in India either as SEZ or STPI or simple DTA unit[1] . Each of them have specific set of regulations and host of compliances to be adhered. The selection of the unit (SEZ/STPI/DTA) is purely the decision of promoter taking into the advantages and limitations which each set-up would provide.

The advent of MAT and phase out of Section 10A benefit under the Income Tax laws made choice of setting up a software company as SEZ unit, no longer a favorable option. The same is the case with STPI. Thereby all the companies now prefer starting the company as a DTA unit, since there are no specific pre-requisite conditions that are to be satisfied unlike SEZs and STPIs, which make the entire process of setup of DTA unit easy and hassle-free.

Problem:

However, one of the biggest procedural set-back in setting up a software company in DTA is the certification of proof of export of software. For a unit located in SEZ, it is granted by Development Commissioner and for a unit located in STPI, it is granted by Commissioner of STPI. However, for DTA unit, there is no exclusive/specific/nodalauthority for monitoring/grant of certification as to whether export of services has actually and genuinely taken place.

This places a huge challenge on the software exporters to prove that there is an actual export of software which has taken place. This is also escalated by the fact that the software cannot be seen like goods and raises a serious doubt in the minds of the authorities regarding the genuineness of the exports. With money laundering activities and shell-companies is talked all over world on day-to-day basis, the governmental authorities, tend to look a closer look at the activities of certain software companies, which poses a significant threat to the genuine companies. This is majorly because there is noexclusive/specific/nodal authority which authenticates/certifies services provided by DTA units.

[1]For the purposes of simplicity, let us assume that DTA unit does not include STPI unit.

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Amidst of the above suspicion, while these companies apply for refunds under indirect taxation, absence of certification of invoices by any of the nodal/specified agency, would present number of issues before the indirect taxation authorities. Further, the current FEMA laws would require software companies to file certain forms as declaration for proof of export of software services. The DTA units are not generally

allowed to file said declaration unless they take a separate registration with STPI by paying an annual fee depending upon the turnover of the unit. If the said forms are not filed, then it would lead to a non-compliance under FEMA laws.

Solution:

Keeping all of the above in view, we advise to each of the DTA unit, which is engaged in provision of software services, to obtain registration as Non-STPI unit with STPI authorities and obtain the authentication of invoice and also enable the DTA unit to file declarations under FEMA laws to avoid non-compliance thereof.

In the below write-up, we discuss in detail the law position under the FEMA regulations which make it necessary for the DTA units to register as Non-STPI units and also the procedure for obtaining registration as Non-STPI and other connected matters.

Obligation under FEMA:

Section 7 of FEMA deals with export of goods and services. Vide Section 7(3), every exporter of services shall furnish to RBI or to such authorities a declaration in such form and in such manner as may be specified, containing the true and correct material particulars in relation to payment for such services. Accordingly, to provide the manner and details to be contained the Foreign Exchange Management (Export of Goods and Services) Regulations, 2015 have been framed.

In terms of Regulation 3 ibid, the exporters of goods and services are required to declare the value of exports to the specified authority viz. Commissioner of Customs in case of goods and Director of STPI/Commissioner of SEZ in case of software. RBI requires the certification of the value of exports by the specified authority in order to monitor their realization and the specified authority is made responsible for this certification.

EDF is the prescribed form to declare the value of exported goods while SOFTEX is the prescribed form to declare the software exports. In case of export of goods, the declaration of the value of exported goods and its certification takes place during the time of export while in case of export of software, the declaration of the value of exported software and its certification is a post facto exercise which would be undertaken after export performance.

Regulation 3(3) ibid has clarified that in situations where there are no prescribed declarations are specified to be made for any services, the exporter may export such services without furnishing any declaration, but shall be liable to realize the amount of foreign exchange which becomes due or accrues on account of such export and repatriate in accordance with FEMA regulations. The above is applicable only when the regulations do not prescribe any declaration for the services which are exported. However, as stated earlier, for export of software a declaration in the manner of SOFTEX has to be filed. Hence,

[2]Master Direction No. 16/2015-16 dated 01.01.2016(https://www.rbi.org.in/scripts/NotificationUser.aspx?Id=10395&fn=5&Mode=0

every exporter of software is obliged to file a declaration in SOFTEX. Now, let us proceed to understand the expression 'software' for the purposes of FEMA regulations.

Meaning and Scope of 'Software':

Regulation 2(viii) of the Foreign Exchange Management (Export of Goods and Services) Regulations, 2015 defines the term 'software' to mean any compute programme, database, drawing, design, audio/video signals, any information by whatever name called in or any medium other than in or on any physical medium.

The definition given is exhaustive and includes all kinds of software that may be shared in any medium other than in physical medium. The software in physical medium is treated as goods and declarations applicable for goods will equally applicable for software in physical medium. Apart from the above definition, Regulation 6(B) ibid specifies that SOFTEX form should also be filed for audio/video/television software.

Hence, on a combined reading of the definition of 'software' and Regulation 6(B), it is evident that SOFTEX form should be filed for computer software including audio/video/television software.

Declaration in SOFTEX:

Regulation 6 of the Foreign Exchange Management (Export of Goods and Services) Regulations, 2015 provides for declaration of software exports before the designated official of STPI or SEZs. The said official is under obligation to certify the value of the software exports.

The procedure related to filing of export declaration in SOFTEX form and its certification has been provided under Master Circular No. 14/2013-14 dated 01.07.2013 read with Master Direction on Export of Goods and Services[2] .

Accordingly, the exporter of software is required to make a declaration in SOFTEX Form in duplicate not later than 30 days from the date of invoice or date of last invoice raised in a month. The data submitted through SOFTEX forms shall be transmitted electronically from STPI/SEZs to RBI. The data received by RBI will be made available in EDPMS portal through which the bankers can access the said information to match the inward remittance of export proceeds.

A unique number for each of the SOFTEX form submitted shall be generated electronically through the facility extended by RBI. One of the copies of the SOFTEX form shall be retained by STPI/SEZs for their records purpose and the other copy shall be handed over to the exporter after due certification from STPI/SEZ.

The certification of the value of exports by the designated authority of STPI/SEZ will be undertaken after examining the required documents in this regard. The documents sought by the said authority are required to be made available by the exporter within a period of 30 days. The certification process will be smooth and generally the values declared in the invoices issued towards software exports will be

accepted and certified. Rejections are only in cases where there exists a doubt on genuineness of the export transaction undertaken.

The copy of SOFTEX form duly certified by the designated authority of STPI/SEZ shall be submitted to the banker for the purpose of realization of export proceeds.

Obligation on DTA Units:

As stated earlier, the units located in SEZs and undertaking software exports can declare their value of exports in SOFTEX forms before the designated authority of SEZs. The units registered under STPI scheme of Foreign Trade Policy can also declare the value of exports in SOFTEX forms before the designated authority of STPIs and accordingly obtain the required certification. The declarations and compliances prescribed under SEZ and STPI scheme are sufficient and they will take care of the requirements related to SOFTEX forms also.

With respect to units operating otherwise than as STPI or SEZ units that is DTA units, RBI has notified STPI as the authority to receive declarations in SOFTEX forms and to certify the value of exports. In order to accept SOFTEX forms and to certify the values from these units, STPI has required these units to register with them and undertake the necessary compliances as notified from time to time.

Consequences of Non-Filing of SOFTEX:

S No	Export Turnover for the Year	Annual Services Charges (INR)
1	Upto 12.5 lakhs	INR 4,000
2	Above 12.5 lakhs to 25 lakhs	INR 8,000
3	Above 25 lakhs to 50 lakhs	INR 16,000
4	Above 50 lakhs to 3 Cr	INR 55,000
5	Above 3 Cr to 10 Cr	INR 1,10,000
6	Above 10 Cr to 25 Cr	INR 2,25,000
7	Above 25 Cr to 50 Cr	INR 2,50,000
8	Above 50 Cr to 100 Cr	INR 3,50,000
9	Above 100 Cr to 500 Cr	INR 5,75,000
10	Above 500 Cr to 1000 Cr	INR 6,00,000
11	Above 1000 Cr	INR 6,50,000

[3]BRCs are to be issued by Bank for realization of export proceeds as required under para 1.12 of FTP 2015-20

[4]Amounts mentioned are excluding GST amount. GST will be charged at 18% on the mentioned charge.

Compliances & Other Aspects as Non-STPI Units:

The DTA unitsare required to obtain a registration before STPI. This is called registration as Non-STPI unit. The unit seeking to obtain the said registration is required to file an application in prescribed form[5] with required supporting documents before the Director, STPI. The application shall be accompanied by a prescribed fee of Rs. 1,000 plus GST. The Director, STPI will verify the application along with supporting documents and grant the registration[6] as a Non-STPI unit. The registration granted is valid for a period of three years. It is required to be renewed before its expiry by approaching the Director, STPI during the last three months prior to the expiry of registration.

All the contracts entered by the Non-STPI unit to undertake software exports are required to be registered with STPI by making necessary application[7] in this regard. Further, a copy of said contracts are also required to be enclosed. The registration of contracts shallbe undertaken prior to declaration of software exports under the said contracts.

The Non-STPI unit registered with STPI is required to submit quarterly and annual performance reports in the prescribed forms[8].

Glossary

Acronym	Detailed Description
STPI	Software Technology Park of India
SEZ	Special Economic Zone
DTA	Domestic Tariff Unit
RBI	Reserve Bank of India
EDF	Export Declaration Forms
SOFTEX	Software Exports
FEMA	Foreign Exchange Management Act, 1999
GST	Goods & Services Tax
BRC	Bank Realisation Certificate
QPR	Quarterly Performance Report
APR	Annual Performance Report

[5]Prescribed form to apply for Non-STPI Registration by Hyderabad STPI is Annexure-I
[6]Registration Certificate will be given in the form Annexure-II by Hyderabad STPI. This is also called as LoP (Letter of Permission)
[7]Application for Registration of Contracts shall be made in form Annexure-V by Hyderabad STPI
[8]QPR shall be filed in Form Annexure-III while APR shall be filed in Form Annexure-IV

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