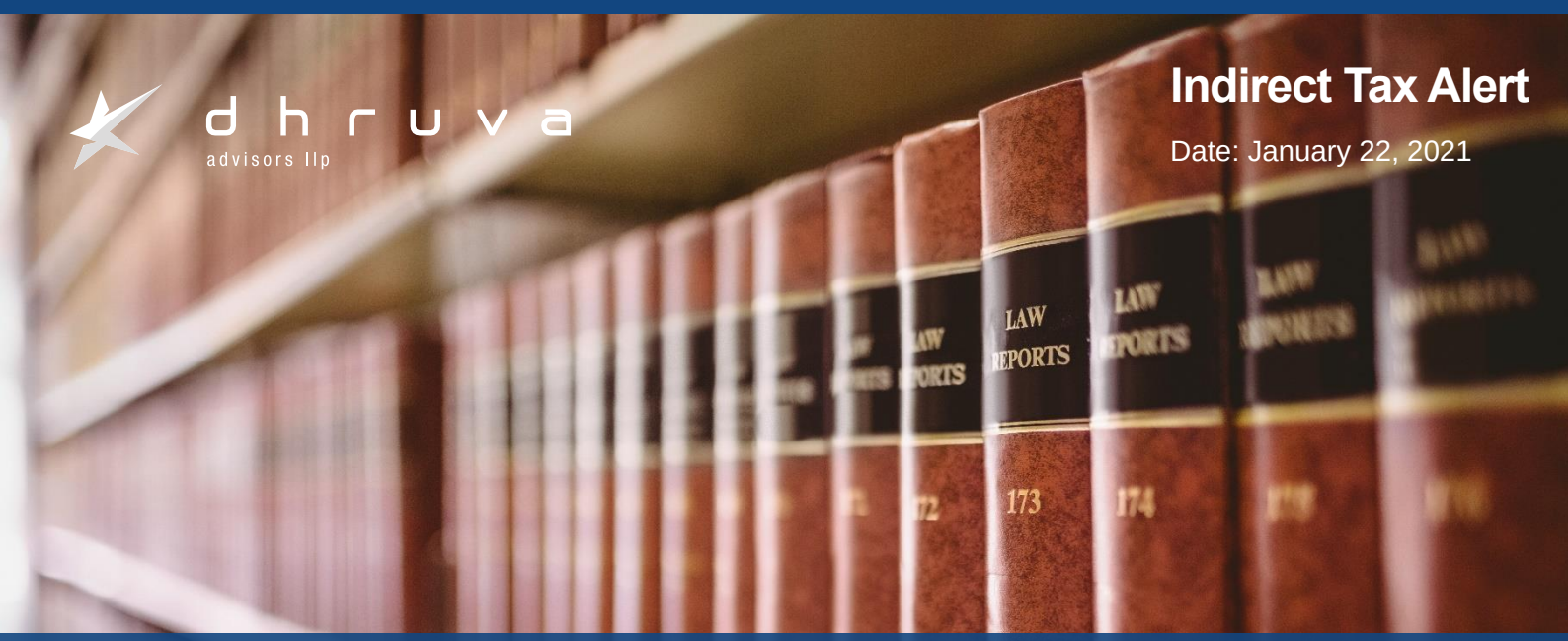

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Indirect Tax Alert

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Judgment under pre-GST era

M/s Vellanki Frame Works v. *The Commercial Tax Officer, Visakhapatnam*[1]

Issue for Consideration

Whether sale can be said to have taken place in the high seas in the course of import, and be construed as exempted under section 5(2) of the Central Sales Tax Act, 1956 ("CST Act, 1956") when the bill of entry ("BOE") is filed and the Customs duty is paid by the seller and not the end buyer?

Discussion

- The Petitioner, engaged in the business of selling and purchasing logs, timber and wooden batons, had imported timber from other countries.
- The assessments were undertaken for FY 2005-06 and 2006-07, wherein the assessment orders disallowed the exemption claimed by the Petitioner in respect of sales effected by transfer of title documents before the goods had crossed the customs frontiers of India under section 5(2) of the CST Act, 1956, i.e. High Seas Sale ("HSS").
- Thereafter, a Writ Petition was filed by the Petitioner before the Hon'ble High Court of Andhra Pradesh against the assessment orders. After considering the facts of the case and the contentions of both parties, the Hon'ble High Court passed its judgment,[2] holding the impugned sale as an inter-state sale liable to CST mainly on the following grounds:
  - The expanded definition of "importer" cannot be used to usurp the identity of an importer from the person who has filed the bill of entry.
  - If the appellant had sold the goods on HSS to the ultimate buyer, only the buyer would be the importer and not the appellant, and the very fact that the name of the buyer was not reflected as the importer in the BOE for home consumption belies the contention of the appellant about HSS to the buyer.
  - There was no material on record to show that either the Import General Manifest ("IGM") contained the name of the ultimate buyer as the importer/consignee, or that it was subsequently amended in terms of section 30(3) of the Customs Act, 1962.
- Aggrieved, the Petitioner filed a Special Leave Petition challenging the order of the High Court

[1] 2021-VIL-04-SC
[2] 2015-VIL-14-AP

supra before the Hon'ble Supreme Court on the following contentions:

- Reference was made to the quadripartite agreement between WBT (foreign supplier), Indus (first high seas seller), the Petitioner and Radha Industries (ultimate buyer / Radha) stipulating that Indus would purchase the goods from WBT and during the course of transit of goods (in the high seas) would sell the goods to the Petitioner. Indus would then transfer the document of title to goods in favour of the Petitioner and the Petitioner would further transfer the said documents in favour of Radha before the goods crossed the customs frontier of India.
- As per the agreement, the Petitioner would act as an agent of Radha and would clear the goods from the customs authorities where the delivery of goods would be completed once the Petitioner issued the delivery note to Radha. The responsibility of carriage of goods, after clearance, from the port to the factory premises in the state of Uttar Pradesh was of Radha.
- Endorsement of the bill of lading in favour of Radha was made on December 12, 2005 when the goods were on high seas and had not yet reached the customs frontiers of India, and the BOE was filed on December 28, 2005. Therefore, the title to goods was transferred in favour of Radha before the goods crossed the customs frontiers of India and hence the impugned sale is in the course of import.
- The Respondent's reliance on the debit note raised by the Petitioner on Radha and the conclusion that the sale took place after the goods crossed the customs frontiers of India are not relevant as endorsement of the bill of lading and its date are the **only factors** relevant for determining whether or not the sale is covered by section 5(2) of the CST Act, 1956 and all other factors are irrelevant in determining the core issue regarding the point of sale.
- The definition of 'importer' in the Customs Act, 1962 only indicates the person who is in possession of goods at the time of filing the BOE but does not indicate the title to the goods.
- Reliance was placed on various judgments to support their contentions.

- The Respondents contended as under:
  - The agency agreement between the Petitioner and Radha was a sham and nominal document, drawn only for the purpose of evasion of tax liability under the CST Act, 1956.
  - The agency agreement played no role at all in the import transaction and it was the appellant alone who was the real importer.
  - Basis the agreements entered into and the real intent behind them, as well as the filing of BOE, the conclusions of the High Court are correct.
  - The import was complete by and through the Petitioner and until such completion Radha was not in the picture. The monetary transactions between the Petitioner and Radha are proof that the transaction of sale between them was after the goods had crossed the customs frontiers of India.

- After hearing the contentions of the Petitioner and the Respondent, the Hon'ble Supreme Court observed as follows:
  - A sale becomes part and parcel of import if it either occasions such import **or** if it occurs by way of a transfer of document of title to the goods before the goods cross the customs frontiers of India.
  - The Court analysed the judgments relied upon by the Petitioner in support of its contention and observed that the said judgments are not applicable to the facts of the present case.
  - Upon analysing various provisions of the Customs law, it was observed that the net result of the expanded definition of "importer" is that while any person who imports goods into India would be an importer, the owner of the goods or a person holding himself to be an importer would also be regarded as an importer during

the period between the importation of goods and their clearance for home consumption. This crucial period would generally be that period when the goods are warehoused after importation and are then cleared from the warehouse by a person other than the person who actually imported the goods.

- Since the name of Radha (and other end-buyers) was not mentioned in the IGM as the importer / consignee, nor the relevant IGM was amended, the suggestion about second HSS in favour of Radha (and other end-buyers) is only a self-serving suggestion of the Petitioner, with no corroboration on record. In fact, the official records totally contradict the suggestion of the Petitioner.
- If the Petitioner was merely acting as an agent, then the BOE would have reflected the name of the end-buyer as the importer who would have been assessed for customs duty and the Petitioner as an agent of the importer.
- Upon the BOE being recorded in the Petitioner's name as importer and being assessed to customs duty, the second HSS agreement never came into operation.
- Reliance was placed on the judgment of the Hon'ble Supreme Court in the case of *K. Gopinathan Nair and Ors*. v. *State of Kerala*[3] to observe that the contention of the Petitioner concerning the inter-linked nature of transactions under the quadripartite agreements and the suggestion that the impugned sales occasioned import stand effectively repelled. The **two alternative parts** of sub-section (2) of section 5 **cannot ordinarily go together**.
- The Petitioner had raised debit notes on the end-buyers but only after having cleared the goods by filing the BOE for home consumption. Once the suggestion about the second HSS is not accepted and it is found that the Petitioner was the importer of goods and cleared the goods for home consumption, the natural consequence of raising such debit notes on the end-buyers situated in different States and movement of goods to such end-buyers would be to consider these transactions as inter-State sales liable to CST as per section 3(a) of the CST Act, 1956.
- After the Petitioner got the goods released by filing the BOE for home consumption, the goods were ultimately received by Radha in the State of Uttar Pradesh (as well as other end-buyers in different States). These facts are sufficient to establish that the movement of goods inside the country from one State to another had been on account of the sale by the Petitioner to the end-buyers; and such sales took place only after the Petitioner obtained the goods from the bonded warehouse for home consumption.
- The overall dealings indicate that the attempt of the Petitioner was only to distort the facts and, by alleging multiple transactions, to somehow avoid the operation of law relating to CST. Such attempt has rightly been met with disapproval at the hands of the Respondent and the High Court.

Judgment

The Hon'ble Supreme Court upheld the judgment of the High Court denying the exemption under section 5(2) of the CST Act, 1956 to the sale made by the Petitioner.

Dhruva Comments:

The judgment lays emphasis on one of the key elements in carrying out the HSS transaction whereby the clearance under customs should be in the name of the ultimate buyer who should be the importer on record. Further, a given transaction can either be a sale occasioning import or effected by the transfer of documents of title to the goods before the goods cross the customs frontiers of India. Both cannot simultaneously ordinarily subsist.

Sale in the course of import or HSS are routinely executed transactions and documentation in this regard

[3] 1997-VIL-03-SC

plays a key role in establishing the intent between the contracting parties.

Rulings under GST era

M/s Fastrack Deal Comm Pvt. Ltd. – Authority for Advance Ruling, Gujarat[4]

Issue for Consideration

Whether amount forfeited due to breach of terms and conditions of a contract for sale of land would be liable to GST?

Discussion

- The Applicant entered into a contract with the purchaser for sale of its factory land, for which he received 20% of the contract value as an advance. One condition in the contract stipulated that the amount paid by the purchaser would be treated as forfeited, if the purchaser fails to pay the remaining amount on or before December 31, 2019 along with interest at the rate of 18% p.a.
- The Applicant approached the Authority for Advance Ruling ("the Authority"), contending that since the sale of land is not liable to GST, the forfeited amount should also not be liable to GST. Accordingly, the Applicant sought advance ruling for the following questions:
  - Whether the amount forfeited by the Applicant could be liable to GST?
  - Who would be considered as service receiver and service provider?
  - Whether forfeiture of the advance amount could be liable to GST, when sale of land is not treated as supply under the GST law?
- After taking into account the terms and conditions of the contract for sale of land, the Authority made the following observations:
  - The activity of forfeiture nowhere involves sale of land. The Applicant has received the money not on account of sale of land but on account of non-fulfilment of conditions of the contract for sale of land.
  - Para 5(e) of Schedule II to the CGST Act, 2017 provides that '*agreeing to the obligation to refrain from an act, or to tolerate an act or a situation, or to do an act*' shall be treated as supply of service. Hence, one should be 'agreeing to the obligation' either to refrain from an act, or to tolerate an act or situation, or to do an act.
  - While entering into the contact, the purchaser was well aware that the amount given as an advance would be forfeited in the event of non-fulfilment of conditions of payment.
  - The purpose of payment is an act of tolerance in the sense that when there is a breach of contract, the Applicant is put to certain hardships, which he tolerates in return of the payment received as an advance, being forfeited. Thus, the Applicant has refrained from taking subsequent action / has tolerated an act of the purchaser for which the consideration has been received by him.
  - Therefore, the Applicant's transaction of agreeing to the obligation to refrain or tolerate or to do an act (exiting from the contract) will be covered under para 5(e) of the Schedule II to the CGST Act, 2017.

Ruling

The Authority held as under:

- The amount forfeited by the Applicant would be liable to GST.
- The Applicant is the service provider and the purchaser is the service receiver.
- The forfeited amount is covered under supply of service as per para 5(e) of Schedule II to the CGST Act, 2017.

[4] 2021-VIL-19-AAR

Dhruva Comments:

In another recent advance ruling in the case of *M/s State Warehousing Corporation*[5], the Authority for Advance Ruling, Haryana, examined taxability over interest charged on rice millers in the case of delay in delivery of milled rice and held that the same would be a supply of service under para 5(e) of the Schedule II to the CGST Act, 2017.

On the contrary, the Hon'ble CESTAT[6], New Delhi recently held that the compensation / penalty / liquidated damages received for breach of terms of a contract would not be liable to Service tax.

The issue of taxability over receipt of such liquidated damages / compensation seems to be far from being settled until concluded by the Apex Court.

M/s Tea Post Private Ltd[7]

Issues for Consideration

- What will be the HSN classification and rate of GST applicable to the franchise fees and royalty received under the franchise agreement?
- Whether transfer of an operational outlet (along with all the assets and liabilities) can be considered as transfer of a going concern and exempt from GST?
- Whether input tax credit ("ITC") can be claimed on supplies received for developing the outlet?

Discussion

- The Applicant is a tea house chain selling non-alcoholic beverages, snacks and merchandise items either directly or through outlets owned by them or by third parties under "franchise agreement".
- The Applicant enters into a franchise agreement with third parties wherein it receives a lump sum franchise fees for use of its trademark, brand name and Intellectual property. The Applicant also receives a monthly royalty at a pre-determined rate on gross sales revenue or a fixed pre-determined amount, *whichever is higher* from the franchisee.
- The Applicant is also in the business of developing an outlet by renting the premises, purchasing and installing required equipment and operating the outlet for a certain period till the time they find a purchaser to carry forward the outlet's operations. In such a case, the Applicant enters into two different agreements namely "purchase agreement" and "franchise agreement".
- Under the "purchase agreement", an operating outlet is sold to the purchaser along with all its assets necessary for continuing the outlet's operations with regularity and permanency and liabilities towards employees, creditors and government authorities.
- The Applicant approached the Authority for Advance Ruling ("AAR") of Gujarat for seeking clarification on the following issues:
  - Classification of franchisee fees and royalty received under franchisee agreement;
  - Eligibility to claim exemption under GST on transfer of an operational unit as a going concern;
  - If negative, then, availability of ITC on the purchase of equipment, etc. of an operational unit.
- The Applicant's contentions are as under:
  - Franchisee fees and royalty falls under HSN code 9973 and would get covered under sl. no. 17(i)[8] of notification no. 11/2017-Central Tax (Rate) dated June 28, 2017 attracting 12% GST rate.
  - Royalty collected is in the nature of Licensing services taken on regular basis for the right to use trademarks and franchises and should fall under HSN code 997336 and not 998396.

[5] 2021-VIL-56-AAR
[6] *M/s. South Eastern Coalfields Ltd.* v. *Commissioner of Central Excise and Service Tax* [Order no.51651/2020 dated December 22, 2020]
[7] 2021-VIL-17-AAR
[8] Temporary or permanent transfer or permitting the use or enjoyment of Intellectual Property (IP) right in respect of goods other than Information Technology software

- The transfer of an operational outlet should be treated as a "transfer of a going concern" and exempt from GST.
- If the transfer of an operational unit is not treated as an exempt transaction, then the Applicant should be eligible to claim the ITC on inward supplies received at the time of developing the outlet including installation of equipment, furniture etc.

- After hearing the Applicant's contention, the AAR observed as follows:
  - The HSN code 997336 covers *"Licensing services for the right to use trademarks and franchises"*. However, the heading 9973 does not cover the "*Franchise services*" provided by the Applicant to the franchisee under the Franchise Agreement.
  - There is a difference between "licencing" and "franchising" as under:

Licensing	**Franchising**
An arrangement where the licensee acquires the right to use products where the ownership of goods remains with the licensor.	The franchisee enjoys the ownership of a business on behalf of the franchiser for a fee where the processes are closely controlled by franchisor.
One party sells another party the right to use its intellectual property or manufacture the licensor's products in exchange of royalty.	One party permits another to use its brand name or business model for a fee to conduct the business as an independent branch of the franchisor.
Deals with goods like software, patented technologies etc.	Deals with service businesses like food chains, service centres of automobiles etc
Licensor has no autonomy over the business of the licensee.	Franchisor exercises enormous control over the business of the franchisee in terms of quality of service provided etc
The licensor sells the right to use intellectual property, or produce a company's product to the licensee, for a negotiated fee.	The franchisor permits the franchisee to use business model, brand name or process for a fee, to conduct business, as an independent branch of the parent company.
Governed by a licensing agreement, which involves a one-time transfer of property or rights for a fee. There is no technical support or assistance provided by the licensor in most cases.	Governed by an elaborate agreement specifying the responsibilities & duties of the parties involved. The franchisor assists in setting up the service provider with adequate skill and knowledge to emanate its brand to the customers
Registration is not required.	Registration is required.
Absence of training and support by the licensor to the licensee.	Complete training and support provided by the franchisor to franchisee
Licensor has control on the use of intellectual property by the licensee but has no control over	Franchisor exerts considerable control over franchisee's business and process.

Licensing	Franchising
the licensee's business.	

- Basis the above, the AAR concluded that the present agreement is a Franchise agreement and not a License agreement.
- The services in the present case are "Franchising services" and hence, falls under HSN code 998396 related to “trademarks and franchises” and attracts 18% GST as per sl. no. 21 of notification no. 11/2017-Central Tax (Rate) dated June 28, 2017.
- Coming to Question no. 2, the AAR observed that the present case is of selling of the equipment/ infrastructure as the land and building is not rented out and is not owned by the Applicant. Therefore, the question of sale of land and building is ruled out. Hence, selling the operating equipment / infrastructure for running the outlet is nothing but a sale of goods by the Applicant in the form of equipment/ infrastructure for operating the outlet. Hence, the activity clearly falls under the ambit of supply under section 7 of the CGST Act, 2017.
- The business assets are not supplied for a purpose other than business. Also, the Applicant does not cease to be a taxable person. Hence, such transfer of assets would not be covered under para no. 4(b) or 4(c) of Schedule II to the CGST Act, 2017.
- The transaction would get covered under para no. 4(a) of the Schedule II to the CGST Act, 2017 and hence taking over the assets and liabilities of the Applicant by the purchaser i.e. transfer of business assets amounts to “supply of goods” liable to GST.
- The transfer of business assets implies that a part of the assets is transferred and not the whole business. In the present case, only one outlet is being transferred / sold to the recipient. Thus, it is not a case of transfer of an ongoing concern in whole and hence the transaction is not covered under the clause ‘transfer of a going concern as an independent part thereof’.
- Independent part of a firm would be a distinct business vertical and not the same vertical of which only a certain portion has been transferred to other entity.
- A branch of the same business vertical can by no stretch of imagination be considered as an independent part of the concern.
- The transfer of business assets is covered under the category of 'supply of goods' and not covered by the clause 'transfer of a going concern, as a whole or an independent part thereof'. Thus, the transaction becomes taxable under GST.
- Since the transaction is in the nature of ‘supply of goods’ and not ‘supply of services’, the exemption from GST under the aforesaid entry would not be applicable.
- Regarding the availability of ITC pertaining to the equipment / infrastructure for the operational outlet, the AAR observed that the operational outlet is sold to the recipient as a part of the business activity and would be covered under section 16(1) of the CGST Act, 2017 and hence, the Applicant would be eligible for ITC subject to fulfilment of the prescribed conditions.

Ruling

The AAR held as under:

- "Franchisee Fees" and "Royalty" received by the Applicant are classified under HSN 998396 and attracts 18% GST.
- Transfer of an operational outlet does not amount to "Services by way of transfer of a going concern, as a whole or an independent part thereof".
- Transfer of an operational outlet is not exempt from GST under exemption notification.
- ITC of supplies received at the time of developing the outlet are available subject to fulfilment of prescribed conditions.

Dhruva Comments:

Transfer of business on a going concern basis has always been a contentious issue and subject matter of judicial interpretation. The authority in the instant case has narrowly interpreted the phrase 'independent part thereof' under the exemption entry 'Services by way of transfer of a going concern, as a whole or *an independent part thereof*' to mean that an independent part of a firm would be a distinct business vertical and not the same vertical of which a certain portion has been transferred to other entity.

It has been observed that a branch of the same business vertical can by no stretch of imagination be considered as an independent part of the concern. The fact that such part of the business would function independently has not been considered. It needs to be seen how the judiciary would interpret the said exemption entry considering the facts of each transaction.

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