dhruva advisors llp

GST Alert
August 8th, 2022

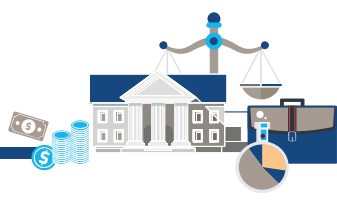
Clarifications on certain GST issues

In accordance with the recommendations made by the GST Council at the 47th Council Meeting, the Central Board of Indirect Taxes and Customs ('CBIC') issued multiple Circulars[1] on August 3rd , 2022 clarifying issues on GST rates/exemptions on both goods and services. The CBIC also issued a significant yet detailed Circular on applicability of GST on liquidated damages, compensation and penalty arising out of breach/break of a contract. The key clarifications are explained in detail here.

1. Clarifications regarding applicable GST rates and exemptions on certain services[2]

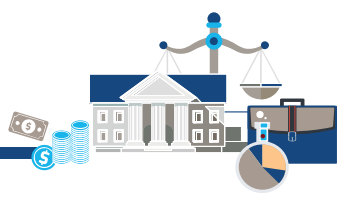
Issue	Clarification
Exemption to services associated with transit cargo both to and from Nepal and Bhutan	• The supply of services associated with transit cargo to Nepal and Bhutan are exempted by entry 9B of Notification No. 12/2017-Central Tax (Rate) dated 28 June 2017 ("Exemption Notification"). • The basis of the recommendations in the 20th GST Council meeting have since been clarified with the intention of ensuring that the provision of exemption under the above entry was available for services in relation to transit cargo for both to and from Nepal and Bhutan. • It has been now clarified that the exemption (under said entry) is equally available for the movement of empty containers from Nepal and Bhutan after delivery of goods in the said countries as such services are associated with transit cargo. The Circular elaborates that whether the containers are the same as the ones used to carry and deliver the goods to the said countries is verifiable through the process set up under the Transshipment of Cargo to Nepal under Electronic Cargo Tracking System Regulations, 2019.

[1] *Circular 177, 178 and 179 dated August 3, 2022*
[2] *Circular No. 177/09/2022-TRU dated August 3, 2022*



Issue	Clarification
Exemption on services by way of storage and warehousing of cotton in baled or ginned form up to 17 July 2022	• As per entry 24B of the Exemption Notification, services by way of storage and warehousing of, *inter alia*, raw vegetable fibers, such as cotton, flax, jute, etc., are exempted from GST up to 17 July 2022. • It has been clarified that as per the Cotton Fiber glossary issued by barnhardtcotton.net, 'cotton fiber' is defined as cotton staple, virgin cotton or raw cotton that are removed from the cotton seed by the gin. The CESTAT in the case of *R.K.& Sons vs. CCE, Rohtak*[3] observed that cotton fiber obtained by ginning cotton plucked from cotton plants is nothing but raw cotton fiber because there cannot be a more raw form of cotton fiber obtained from cotton-with-seeds. • The Circular hence states that cotton fiber, whether in ginned or baled form, is classified under raw vegetable fibers and the service of storage and warehousing such cotton is eligible for exemption under entry 24B of the Exemption Notification up to 17 July 2022. • It is noteworthy that the exemption on such storage and warehousing of raw vegetable fibers, such as cotton, flax, jute, etc., has been withdrawn *vide* Notification No. 04/2022 -Central Tax (Rate), dated 13 July 2022 w.e.f. 18 July 2022, issued on the recommendations of the GST Council.
Location charges or preferential location charges (PLC) collected in addition to the lease premium for long-term lease of land	• Entry 41 of the Exemption Notification exempts upfront amount (referred to as premium, salami, cost, price, development charges or by any other name) payable in respect of service by way of the granting of a long-term lease (of 30 years, or more) of industrial plots or plots for development of infrastructure for financial business, provided by the State Government Industrial Development Corporations or Undertakings or by any other entity having 20 per cent or more ownership of Central Government, State Government, Union territory to the industrial units or the developers in any industrial or financial business area. • It is clarified that allowing choice of location of land is fundamental to the supply of a long-term lease of land and therefore, the location charges or PLC would form part of the consideration charged for said long-term lease of land. Given this, such charges would be eligible for exemption from GST, in terms of the above-mentioned entry.
Additional toll fees collected in the form of higher toll charges from vehicles not having fastag	• It has been clarified that the additional amount collected from road users (plying a vehicle) not having a fastag is akin to toll charges and would merit exemption under entry 23 of the Exemption Notification (services by way of access to a road or a bridge on payment of toll charges). • A parallel has been drawn with the earlier Circular no. 164/20/2021-GST, dated 6 October 2021, wherein it was clarified that the overloading charges collected at toll plazas were effectively higher toll charges and thus, would have the same treatment as given to toll charges. Similarly, the additional toll fees collected would be viewed as toll for allowing access to roads or bridges.

[3] *2016 (42) STR 314 (Tri. - Del.)*

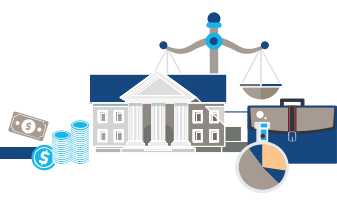


Issue	Clarification
Taxability on sale of land after levelling, laying down of drainage lines, etc.	• Sr. No. 5 of Schedule III of the CGST Act provides that 'sale of land' is neither a supply of goods nor a supply of services and hence, GST is not applicable. • The Circular clarifies that the land may be sold either as it is or after development, such as levelling, laying down of drainage lines, water lines, electricity lines, etc. The sale of said developed land would be treated as a sale/transfer of land only and thus, would not be chargeable to GST. • Additionally, it is clarified that for any service provided (to the developers) for the development of said land like levelling or laying of drainage lines, GST is liable to be discharged at the applicable tax rates.

Situations in which GST is liable to be paid under reverse charge by a body corporate on renting of motor vehicles designed to carry passengers	• As per entry 15 of Notification No. 13/2017- Central Tax (Rate), dated 28 June 2017, services provided by any person other than a body corporate to a body corporate, by way of renting any motor vehicle designed to carry passengers (where the cost of fuel is included in the consideration) and where the supplier does not issue an invoice charging central tax at the rate of six per cent, is liable to GST under the reverse charge mechanism (RCM) by such receiving body corporate.
	• An ambiguity as to whether RCM is applicable on the service of transportation of passengers under HSN 9964 or on the renting of a motor vehicle designed to carry passengers under HSN 9966 arose.
	• HSN 9966 covers the service of renting of motor vehicles designed for the transport of passengers for a period of time where the person renting the motor vehicle defines how and when the vehicle will be operated, determining schedules, routes and other operational considerations. On the contrary, passenger transport services over pre-determined routes on pre-determined schedules are classified under HSN 9964.
	• It is clarified that:
	  ○ RCM shall be applicable for services falling under HSN 9966 where a body corporate hires a motor vehicle for a particular period of time, during which time the renter retains operational control over the vehicle, and the service provider (non-body corporate) does not charge GST at the rate of 12% on the invoice.
	  ○ RCM shall not apply where the body corporate avails passenger transport services falling under HSN 9964 which are for specific journeys or voyages over pre-determined routes.
	
	Dhruva Comments: *The Circular reads both entries (HSN 9964 and 9966) following respective definition and creates a distinction between their coverage. The classification shall help to reduce dispute around the classification of renting services vis-à-vis passenger transport arrangements. This clarification shall enable clearer position since it supports the position on input tax credit eligibility, which is ineligible on certain services such as the renting or hiring of motor vehicles.*

Issue	Clarification
Exemption on hiring of vehicles by firms for transportation of their employees to and from work by a non-airconditioned contract carriage	• Entry 15(b) of the Exemption Notification exempts the following services: 'non-airconditioned contract carriages, other than radio taxi, for the transportation of passengers, excluding for tourism, conducted tours, charter or hire'. • It is clarified that the exemption entry covering services of transportation of passengers, with or without accompanied belongings, by non-airconditioned contract carriages is only available to services under HSN 9964, where transportation takes place over pre-determined routes on a pre-determined schedule. • The exemption shall not apply to services involving the renting of vehicles covered under HSN 9966. ***Dhruva Comments:*** *Taxability of bus transportation services (in a non-airconditioned contract carriage), when availed by a body corporate for its employees, has been a contentious issue. The Circular brings clarity on the issue and stipulates that GST shall not be applicable when the services involve passenger transportation. However, in the case of renting motor vehicles, wherein the vehicle is taken on charger or hire, GST shall continue to be applicable.*
Taxability of transport services of minerals from mining pit head to railway siding, beneficiation plant, etc. by vehicles deployed with a driver for a specific duration of time	• Entry 18 of the Exemption Notification exempts services by way of the transport of goods by road, other than by a Goods Transport Agency (GTA). • There are situations wherein vehicles, such as tippers, dumpers, loaders, trucks, etc., are given on hire to the mining lease operator, along with a vehicle operator, wherein the expenses for fuel are generally borne by the recipient and such transport vehicles are at the disposal of the mining lease operator for the transport of minerals as per their requirement during the contract. • It has been clarified that such renting arrangements are classifiable under HSN 9966 and liable to GST at the rate of 18% up to 17 July 2022 (and 12% w.e.f. 18 July 2022). The exemption under entry 18 of the Exemption Notification is not available as the service of giving the vehicles on rent with an operator on hire is not a supply of service by way of the transport of goods. ***Dhruva Comments:*** *The clarification seeks to end the dispute around the categorisation of service arrangements, wherein the vehicle is rented / hired with transporters and thus is classed as GTA service. Under the service tax regime, the CESTAT, on several occasions, had held such arrangements as GTA[4] services. With the present clarification, service providers ought to charge GST on such hiring / renting arrangements.*

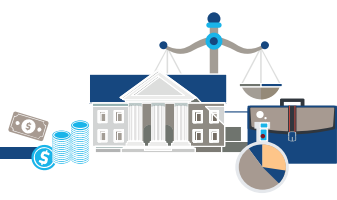
[4] *Mahanadi Coalfields Ltd. vs. CCE & ST, BBSR-I, 2022 (57) GSTL 242 (Tri. - Kolkata); Northern Coalfield Ltd. vs. CCE, Allahabad, 2018 (10) GSTL 245 (Tri. - All.)*



2. Clarifications regarding applicable GST rates and classification of certain goods[5]

Issue	Clarification
Electric vehicles, whether or not they are fitted with a battery pack	• There were uncertainties around the applicable rate of GST on electrically operated vehicles (e-vehicle) without batteries fitted compounded by divergent advance rulings on GST rate applicability on e-vehicles sold without batteries. West Bengal AAR, in the case of ***Hooghly Motors Pvt. Ltd.***[6], had ruled that e-vehicles without pre-fitted batteries should be classifiable under HSN 8706 with GST rate 28%, while the Odisha AAR in the case of ***Anjali Enterprises***[7] had ruled that e-vehicles are designed to run only on electrical energy and should be classifiable under HSN 8703 with GST rate 5%. • In this context, it has been clarified that the fitting of batteries cannot be considered as a concomitant factor for defining a vehicle as an (electrically operated) e-vehicle. Reference has been made to HSN Explanatory Notes, which has not considered batteries to be a component of e-vehicles, and the absence of which changes the essential character of an incomplete, unfinished or unassembled vehicle. Hence, it is clarified that e-vehicles shall be classified under HSN 8703, even if a battery is not fitted to such vehicle at the time of supply, and thereby, attracting a 5% GST.
Taxability of treated sewage water	• Water, falling under HSN 2201, with certain exclusions, is exempt from GST *vide* entry 99 of Notification No. 2/2017-Central Tax (Rate), dated 28 June 2017. • It has been clarified that treated sewage water was not equivalent to purified water for the purpose of the levy of GST. Hence, such water will fall under HSN 2201 and shall be exempt *vide* the above entry. • To further consolidate this position, *vide* Notification No. 7/2022-Central Tax (Rate), dated 13 July 2022, the word 'purified' has been removed from the above exemption entry.

[5] *Circular No. 179/11/2022-GST, dated August 03, 2022*
[6] *2020-VIL-235-AAR*
[7] *2021-VIL-280-AAR*

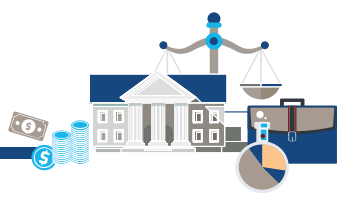


3. Clarification on applicability of GST on liquidated damages, compensation and penalty arising out of breach of contract or other provisions of law[8]

Issue	Clarification
Scope of entry 5(e) of Scheule II - "Agreeing to the obligation to refrain from an act or to tolerate an act or a situation, or to do an act"	**The interpretation and coverage of the Sr. No. 5(e) of Schedule II of CGST Act, 2017 has always been contentious and has seen varied views including from various judicial authorities under the erstwhile regime. In this circular, the CBIC has explained the concept of and purport of *"Agreeing to the obligation to refrain from an act or to tolerate an act or a situation, or to do an act"* with illustrations and stipulates guiding principles, along with a detailed explanation, to determine the taxability of various transactions. It should first be recalled that an action should first qualify as "supply" and thereafter may be classified as "service" should it fall within the scope of Sr. No. 5(e) of Schedule II.** • Reference is drawn to the clarification provided under service tax in the **"**Taxation of Service: An Education Guide**"** relating to the concept of 'activity for a consideration' which involves an element of a contractual relationship, wherein the person doing an activity does so at the desire of the person for whom the activity is done in exchange for a consideration. • The act of (i) refraining from an act; (ii) tolerating an act or situation; or (iii) to do an act can be considered as a 'supply' only if there is a contractual relationship (i.e., agreement) between two parties. There must be a necessary and sufficient nexus between the supply (i.e., agreement to do or to abstain from doing) and consideration. • An activity done without such a relationship**,** i.e., without the express or implied contractual reciprocity of a consideration, would not be an 'activity for consideration', even though such an activity may lead to the accrual of gains to the person carrying out the activity. All flow of money cannot be taxable by regarding this entry as an omnibus entry. • Payments such as liquidated damages for breach of contract, penalties under the mining act, forfeiture of salary, penalty for cheque dishonor**,** etc. are not a consideration for tolerating an act or situation. These are but events in a contractual situation.
Liquidated Damages ('LD')	• The essence of LD / damages for deficient supply is essentially retributive and compensatory in nature in the case of breach of contract. The Circular relies on the Black's Law dictionary meaning of LD which reads as *"as cash compensation agreed to by a signed, written contract for breach of contract, payable to the aggrieved party"* and takes the backing of the provisions under the Indian Contract Act, 1972, wherein: ○ Section 73 of the Act provides for compensation for loss or damage caused by breach of contract**;** and ○ Section 74 of the Act stipulates compensation for breach of contract where penalty is stipulated. • It has been clarified that LD cannot be said to be a consideration received for tolerating the breach or non-performance of contract. The contract is entered into for execution and its specific performance and not for its breach (or tolerating such breach). LD is not the desired outcome of the contract. Such payments do not constitute consideration for a

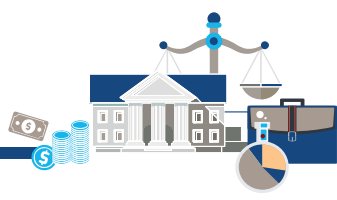
[8] *Circular No. 179/10/2022-GST, August 3, 2022*

Issue	Clarification
	supply and therefore, are not taxable. Examples of such cases are damages resulting from damage to property, negligence, piracy, unauthorised use of trade name, penalty for delayed construction of houses, etc. • It has also been clarified that if payment is merely an event in the course of the performance of the agreement and it does not represent 'the object', as such, of the contract then it cannot be considered a 'consideration'. There is in such cases no contract to the effect of tolerating an act. • However, certain payments, such as acceptance of late fee, early termination fee, pre-payment penalty or cancellation charges, which are referred to as 'fine or penalty', are consideration for supply. These supplies are ancillary to the principal supply and shall be assessed depending upon the nature and taxability of the principal supply.
Cancellation of coal blocks	• It has been clarified that the compensation given for such cancellation is not under a contract between the allottees and the Government but, under provision of the statute and in pursuance of Supreme Court orders. Therefore, the compensation paid was not classed as a service to the Government by way of the tolerating of an act of cancellation of previously made allocations. Hence, such compensation is not taxable.
Cheque dishonour fine / penalty	• The fine or penalty that the banker imposes for dishonour of a cheque is a penalty. It is charged to act as a deterrent and discourage such an act or further default. Therefore, a fine and/or penalty charged for a cheque dishonour is not a consideration for any service and therefore, are not taxable.
Penalty imposed for violation of laws	• Penalties imposed for violation of laws, such as traffic violations or violations of pollution norms, cannot be regarded as consideration charged by the Government or a Local Authority for tolerating violation of laws. Laws are not framed for tolerating their violation and there is no contractual arrangement in this behalf. Therefore, these amounts are not leviable to GST.
Notice pay recovery from an exiting employee prior to the agreed period	• Notice pay is recovered, not as a consideration for tolerating acts of premature quitting before the agreed / bond period, but as penalties for dissuading non-serious employees from taking up employment. The employee does not get anything in return from the employer. Hence, such amounts recovered by the employer are not taxable as consideration for the service of agreeing to tolerate an act or a situation.
Late payment surcharge or fee	• The facility of accepting late payments with interest or a late payment fee, fine or penalty is a facility granted by supplier (and recorded in the contract) naturally bundled with the main supply. Since it is ancillary to and naturally bundled with the principal supply, such as for electricity, water, insurance, etc. is liable for GST but, it should be assessed at the same rate as the principal supply.
Fixed capacity charges for power	• Both the components of the price, the minimum fixed charges/capacity charges and the variable/energy charges, are charged for sale of electricity and thus, are not taxable as electricity is exempt from GST.
Cancellation charges	• Allowing cancellation of an intended supply against the payment of a cancellation fee or retention or forfeiture of a part or whole of the consideration or security deposit is to be assessed as the principal supply. For instance, the cancellation of a travel ticket / hotel



Issue	Clarification
	accommodation, forfeiture of a non-refundable ticket, acceptance of a late fee payment, etc. • However, forfeiture of earnest money by a seller in the case of a breach by the buyer or forfeiture by the Government / Local Authority in the event of a successful bidder failing to act after winning the bid is mere flow of money and not a consideration for tolerating the breach of contract and hence, not taxable. ***Dhruva Comments:*** *There have been several advance rulings on matters such as LD and notice pay recovery. Under the GST regime, several AARs[9] held that LD are to be treated as consideration for an act of tolerance of non-performance and thus, the value of LD is subject to GST. There are several other advance rulings along similar lines and dealing with varied aspects of arrangement between parties. In the landmark case of* ***Bai Mamubai Trust v. Suchitra WD/O. Sadhu Koraga Shetty***[10]***,*** *the High Court held that GST is not applicable on damages / compensation (royalty) paid to the aggrieved party for a legal injury. Similarly, on notice pay recovery, the Madras High Court in* ***GE T&D India Limited***[11] *held that such amounts cannot be subjected to service tax in the absence of an underlying service by the employer to the employee. Tax authorities on the other hand and since the inception of the declared service category (under the service tax regime), have continued to challenge and demand tax on these recoveries. Owing to this practice taxpayers across India, depending on their ability to recover these taxes, have adopted varied practices. In this background the above clarifications are welcome and the Circular has made an adequate attempt to set out the scope of the declared service category of "Agreeing to the obligation to refrain from an act or to tolerate an act or a situation, or to do an act" and cover as many transactions and eventualities to properly explain the intent of law. The taxpayers would need to use the clarification as a basis to determine the taxability of other similar transactions which may not be specific mentioned in the Circular.*

[9] *Dholera Industrial City Development Project Limited, 2019(8) TMI 1217; Maharashtra State Power Generation Company Limited 2018 (5) TMI 1332*
[10] *2019-VIL-454-BOM*
[11] *2020 (35) GSTL 89 (Mad.)*



ADDRESSES

Mumbai
1101, One World Centre,
11th floor, Tower 2B, 841,
Senapati Bapat Marg,
Elphinstone Road (West),
Mumbai 400013
Tel: +91 22 6108 1000 / 1900

Ahmedabad
B3, 3rd Floor, Safal Profitaire,
Near Auda Garden,
Prahladnagar, Corporate Road,
Ahmedabad 380015
Tel: +91-79-6134 3434

Bengaluru
Prestige Terraces, 2nd Floor
Union Street, Infantry Road,
Bengaluru 560001
Tel: +91-80-4660 2500

Delhi / NCR
101 & 102, 1st Floor, Tower 4B
DLF Corporate Park
M G Road, Gurgaon
Haryana 122002
Tel: +91-124-668 7000

Pune
305, Pride Gateway, Near D-Mart, Baner,
Pune 411045
Tel: +91-20-6730 1000

Kolkata
4th Floor, Unit No 403, Camac Square,
24 Camac Street, Kolkata
West Bengal 700016
Tel: +91-33-6637 1000

Singapore
Dhruva Advisors (Singapore) Pte. Ltd.
20 Collyer Quay, #11-05
Singapore 049319
Tel: +65 9105 3645

Dubai
WTS Dhruva Consultants
Emaar Square Building 4, 2nd Floor,
Office 207, Downtown,
Dubai, UAE
Tel: + 971 56 900 5849

KEY CONTACTS

Dinesh Kanabar
Chief Executive Officer
dinesh.kanabar@dhruvaadvisors.com

Niraj Bagri
niraj.bagri@dhruvaadvisors.com

Ranjeet Mahtani
ranjeet.mahtani@dhruvaadvisors.com

Dhruva Advisors has been consistently recognised as the **"India Tax Firm of the Year"** at the ITR Asia Tax Awards in 2017, 2018, 2019, 2020 and 2021.

Dhruva Advisors has also been recognised as the **"India Disputes and Litigation Firm of the Year"** at the ITR Asia Tax Awards 2018 and 2020.

WTS Dhruva Consultants has been recognised as the **"Best Newcomer Firm of the Year"** at the ITR European Tax Awards 2020.

Dhruva Advisors has been recognised as the **"Best Newcomer Firm of the Year"** at the ITR Asia Tax Awards 2016.

Dhruva Advisors has been consistently recognised as a **Tier 1 Firm in India for General Corporate Tax** by the International Tax Review's in its World Tax Guide.

Dhruva Advisors has also been consistently recognised as a **Tier 1 Firm in India for its Transfer Pricing** practice ranking table in ITR's World Transfer Pricing guide

Dhruva Advisors has been consistently recognised as a **Tier 1 Firm in India for Indirect Taxes** in International Tax Review's Indirect Tax Guide.