GST: A good & simple tax – Controversial issues and possible solutions

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Brief introduction to GST

The legal framework of Goods and Services Tax("**GST**") was conceptualised at the beginning of a new millennium i.e in the year 2000, by the Kelkar Task Force on Indirect Taxes. This phenomenon was followed by the release of the First Discussion Paper in 2009 on GST by the Empowered Committee of State Finance Ministers. After much deliberation and negotiation between the Central Government and State Governments, the Constitution (122nd Amendment) Bill, 2014 was introduced in Parliament. This Amendment Bill was passed by the Lok Sabha in May, 2015 and pursuant to certain amendments, was finally passed in the Rajya Sabha and thereafter again by the Lok Sabha in August, 2016. The Bill has been ratified by the required number of States, and received the assent of the President on 8th September, 2016 and has been enacted as the 101st Constitution Amendment Act, 2016("**Amendment Act**")[1]. Subsequently, the Central Goods and Services Tax Act, 2017("**CGST Act**"), State Goods and Services Tax Act, 2017("**SGST Act**")/Union Territory Goods and Services Tax Act, 2017("**UTGST Act**") and the Integrated Goods and Services Tax Act, 2017("**IGST Act**") were brought into force by Parliament and the respective Legislatures of the States.

Important controversial issues under GST law and some possible solutions are dealt with below.

Controversial Issue #1: Input Tax Credit- Mismatches, availability etc.

One of the most fundamental concepts under GST law is input tax credit("**ITC**"), which although is not a vested right[2], is essential for the

[1] https://gstcouncil.gov.in/brief-history-gst#:~:text=The%20idea%20of%20a%20nationwide,cascading%2C%20and%20promote%20economic%20integration.
[2] ALD Automotive Private Limited vs. CTO (2019) 13 SCC 225

growth and sustainability of every business. The underlying principle is that taxes paid on inputs are allowed to be adjusted against taxes pay on outputs in the course or furtherance of business. ITC is credited in the Electronic Credit Ledger of a taxable person. Since the introduction of GST, there are several issues that have cropped up pertaining to ITC. These issues are dealt with below:

1. *If the supplier has not discharged the output tax liability can the purchaser still claim ITC upon payment of input tax when the said transaction is evidenced by legitimate invoices or otherwise?*

   The Hon'ble Patna High Court has ruled[3] that if the supplier has not made payment of output tax, then the purchaser is disentitled from claiming ITC in its electronic credit ledger pursuant to payment of input tax even though the transaction is evidenced by invoices and the claim is otherwise legitimate. The Court relied upon Section 16(2)(c) of the Bihar Goods and Services Tax Act, 2017 which states that ITC cannot be claimed by the purchaser, if the 'supplier' does not deposit the output tax (either through the electronic cash ledger or through utilisation of ITC) with the Government. The Court ruled that in such circumstances, the purchaser may proceed to recover the tax from the supplier, or may seek for a refund in the event the government is successful in recovering the tax from the supplier. The Court noted that the argument on double taxation was not impressive since double taxation would arise only when the seller fails to remit the tax to the government.

   A Single Judge of the Calcutta High Court has taken a contrary view[4] and on an identical question of law has remanded the matter to the GST authorities to decide whether the tax had been paid by the purchaser, whether the transaction was genuine and whether the cancellation of the

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[3] M/s. Aastha Enterprises vs. State of Bihar & Anr. Civil Writ Jurisdiction Case No. 10395 of 2023 decided on 18.8.2023(Pat.)(HC)

[4] Sanchita Kundu & Anr. vs. Assistant Commissioner of State Tax W.P.A. 7231 of 2022 decided on 5.5.2022(Cal.)(HC)

registration of the suppliers was carried out after the transaction in question. The Court has directed ITC to be allowed to the petitioner/purchaser if all of the above are answered in the affirmative. This ruling is at odds with the ruling of the Hon'ble Patna High Court which has disentitled the purchaser to avail ITC at the threshold itself on the basis that the supplier must mandatorily deposit the tax with the government failing which ITC cannot be availed. On the contrary, in *Sanchita Kundu*, the Hon'ble Calcutta High Court has directed the allowance of ITC depending pursuant to examination of the facts and circumstances of the case.

On account of the above dichotomy, it becomes imperative to analyse the repercussions for the taxpayer.

Possible Solutions

In my view, the judgment of the Hon'ble Patna High Court(supra) is erroneous for several reasons. Section 16(2)(c) of the Bihar Goods and Services Tax Act, 2017 refers to payment of tax by the purchaser and not the supplier; it is impossible to contend that Section 16(2)(c) adverts to the supplier when such a situation was not envisaged by the legislature at all and is a situation dependent entirely upon the facts and circumstances of a particular case i.e whether or not the supplier has made payment of the output tax. Also, availment of ITC and payment of output tax exist in two separate compartments. In my view, the legislature has envisaged only payment of ITC by the purchaser as per Section 16(2)(c) to claim ITC otherwise in every case where payment of tax has not been made by the supplier the purchaser will be disentitled to claim ITC by virtue of the said provision, and therefore such a hard and fast and blanket rule without leaving any scope for the examination of the merits of the case cannot be the intent of the legislature. The reason I say 'blanket rule' is because in every case no matter the facts, unless the supplier deposits the tax collected, ITC cannot be availed, if such an interpretation is accepted. There may be a situation where there is an error on the part of the GST authorities in confirming the payment of tax even though the tax has been

paid by the supplier, yet there can be no availment of ITC. Hence, the provision amounts to a blanket rule and cannot apply to deny ITC if the supplier fails to make payment of the tax and this cannot be a valid basis for denial of ITC to the purchaser. Also, the question of double taxation in the hands of the purchaser does arise in the event the supplier does not make payment of the output tax and then ITC is denied, and this is the view of the Patna High Court as well. However, the Patna High Court states that it is only in such a situation that there is a case of double taxation and not otherwise. In my view, such a situation cannot be brushed aside and ignored easily.

At this stage it is relevant to note a recent judgment of the Hon'ble Supreme Court in *State of Karnataka vs. M/s Ecom Gill Coffee Trading Private Limited*[5]. The Court was considering Section 70 of the Karnataka Value Added Tax Act, 2003. The Court held that unless the purchasing dealer shows the genuineness of the transaction by showing actual movement of the goods, identity of the sellers etc. mere production of invoices will not suffice and ITC cannot be availed only on the basis of the invoices and other documents. The Court eventually upheld the claim of denial of ITC.

Although the decision of the Hon'ble Supreme Court does not directly deal with the issue at hand i.e it does not deal with a situation where the tax has not been paid by the selling dealer/supplier, it is nevertheless an aid to understanding the controversy at hand. Businesses cannot be scuttled, and the entire supply chain may be affected due to the non-payment of tax by the selling dealer. In such a case, the purchasing dealer in his capacity as selling dealer also will not deposit the tax on the basis that he was not allowed to claim ITC. Otherwise, it would be a case of double taxation for the selling dealer(erstwhile purchasing dealer). In any event, if the view of the Patna High Court is upheld, that the purchasing dealer can apply for a refund once the State collects the tax through recovery mechanisms, that

[5] State of Karnataka vs. M/s. Ecom Gill Coffee Trading Private Limited (2023) SCC OnLine SC 248

would amount to disrupting the supply chain since the purchaser has not availed ITC and will in all probability also not pay the output tax qua when he is a selling dealer. Not paying the output tax in the next leg of the transaction would be cost effective since the purchasing dealer will earn interest when the refund becomes due, and will pay a similar interest when he pays the output tax to the government. However, the supply chain will surely be disrupted due to the gaps in payment. Hence, an appropriate remedy/possible solution would be to allow the purchaser to avail ITC subject to the genuineness of the transaction and other circumstances, while the government recovers the output tax from the selling dealer. As such, in my view, the Single Judge of the Hon'ble Calcutta High Court in *Sanchita Kundu*(supra) proceeded correctly.

2. *Can ITC be denied by the GST authorities on the basis that there is a mismatch between FORM GSTR-2A and the claim of the assessee in FORM GSTR-3B?*

   The Hon'ble High Court of Kerela in a recent decision[6] has upheld the claim of ITC of the taxpayer on account of mismatches in FORM GSTR-2A with the exact amount of ITC claimed by the taxpayer in FORM GSTR-3B. The Court relied on CBIC's Press Release dated 18.10.2018 that '*furnishing of outward details in Form GSTR-1 by the corresponding supplier and the facility to view the same in Form GSTR-2A by the recipient is in the nature of taxpayer facilitation and does not impact the ability of the tax payer to avail ITC on self-assessment basis in consonance with the provisions of Section 16 of the Act'.* The Court also referred to the decision of the Hon'ble Supreme Court in *UOI vs. Bharti Airtel Ltd. & Ors.*[7], wherein it was opined that FORM GSTR-2A is '*only a facilitator for taking a confirm(sic: confirmed) decision while making the self-assessment.'* The Court held that the purchaser cannot be held responsible

[6] Diya Agencies vs. State Tax Officer WP(C) No. 29769 Of 2023 decided on 12.9.2023(Ker.)(HC)

[7] (2022) 4 SCC 328

for the seller's inability to remit the tax deposited with it. Finally, the matter was remanded to the assessing officer to verify the claim of the petitioner. Similarly, in another case[8], the Calcutta High Court directed the GST authorities to take action against the selling dealer before any ITC is reversed in the hands of the purchasing dealer. The CBIC has also released a Circular[9] dealing with the issue of mismatch between ITC availed in GSTR-3B and GSTR-2A.

Possible Solutions

If the Department does appeal to the Supreme Court, in my view, the Supreme Court ought not to entertain the SLP's since the said decisions are based on sound reasoning. Taking into account the judgment of the Supreme Court in *Bharti Airtel* and the Press Release of the CBIC, it may safely be concluded that GSTR-2A being merely a facilitator, no adverse inferences can be drawn against the purchaser for mismatches between the said Form GSTR-2A and FORM GSTR-3B. Moreover, in the absence of control of the taxpayer over FORM GSTR-2A it becomes difficult to restrict the claim of ITC to that appearing in FORM GSTR-2A in genuine cases where the auto-population is erroneous. (It is pertinent to note that the Madras High Court in a recent decision[10] has observed that the auto-population in GSTR-2A is fool proof and that there is no scope for any confusion). Hence, in my view, the Court may consider the additional claim and if the same if found genuine, the same has to be accepted by the GST authorities.

Controversial Issue #2- GST on gambling in casinos, online money gaming, horse racing, betting and lottery

[8] Suncraft Energy Private Limited And Another vs. Assistant Commissioner [MAT 1218 OF 2023] decided on 2.8.2023(Cal.)(HC)

[9] Circular No. 183/15/2022-GST dated 27th December, 2022

[10] M/s.Progressive Stone Works vs. Joint Commissioner & Ors. W.P.Nos.17109 & 17111 of 2021 decided on 16.6.2022(Mad.)(HC)

A major controversy surrounds the dubiously introduced GST on gambling in casinos, online gaming, and horse racing etc. It is pertinent to note that the online money gaming sector in India alone amounted to about Rs. 135 billion in 2022. The 50th GST Council meeting held on 11th July 2023 discussed important issues in the gambling sector and some crucial decisions were made for the online gaming industry, casinos and the horse racing businesses. The GST Council made recommendations on the imposition of GST on such activities and also sought to put an end to the debate over the taxability of games of skill vs. games of chance. It recommended a uniform rate of 28% GST on the full face value of purchase of chips in the casinos, value of bets placed during horse racing, and face value of bets placed during online gaming. The GST 51st Council meeting was held on 3rd August, 2023 whereat the proposed amendments were approved in the CGST Act, 2017 and IGST Act, 2017.

Pursuant to the aforementioned Council meetings, the CGST (Amendment) Bill, 2023 and IGST (Amendment) Bill, 2023 were introduced on 11th August, 2023 in the Lok Sabha. The Bills have received the assent of the President and are published in the Official Gazette on 18th August, 2023 and are now Acts of Parliament. On 29th September, 2023, the CBIC notified[11] [12] 1st October, 2023 when the said Acts of Parliament will come into force. The CGST Amendment Act provides for definitions of online gaming(Section 2(80A)), online money gaming (Section 2 (80B)), specified actionable claim(Section 2 (102A)) and virtual digital asset (Section 2 (117A)). The definition of supplier in Section 2(105) is amended by insertion of a proviso to provide clarity on who is a supplier in case of supplies pertaining to specified actionable claims. Section 24 of the CGST Act is sought to be amended by insertion of clause (xia) which provides for mandatory registration of a person supplying online money gaming from a place outside India to a person in India. In Schedule III, 'lottery, betting and gambling', stands substituted by 'specified actionable claims' thereby omitting all

[11] Notification No. 48/2023- Central Tax dated 29th September, 2023

12 Notification No. 02/2023-Integrated Tax dated 29th September, 2023

actionable claims except specified actionable claims defined in Section 2(102A) which relate to betting, lottery, gambling etc., from the purview of GST. Hence, GST is now leviable on specified actionable claims being actionable claims related to betting, gambling, lottery, horse racing, online money gaming, or casinos.

Under the IGST Amendment Act, 2023, Section 2(17)(vii) is amended which now excludes online money gaming from the definition of Online Information and Data Access or Retrieval (OIDAR) services.

On 29th September, 2023, the CBIC also released two Rate notifications[13] [14] imposing CGST and IGST @28% on specified actionable claims.

It is pertinent to note that never before has such serious attention been given to the gambling sector which was aptly described as *res extra commercium* by the Hon'ble Supreme Court in a famous case[15]. The phrase is defined as 'a thing outside commerce'[16]'. This essentially means that gambling is outside the ordinary and cannot be termed as a 'business'. Now suddenly, States such as Goa which heavily rely on gambling as a source of revenue, will be suddenly and adversely affected.

The said amendments have also raised considerable controversy on two issues viz. (i) the value of the taxable supply, will GST be chargeable on the face value of the bets or on the deposits or any other mode? and (ii) in which cases would the GST @28% be applicable, would GST @28% be applicable even in cases where the game is a game of skill or predominantly of skill? Although, the amendments have streamlined GST on gambling by making specific references to various activities and defining them but the amendments are still draconian inasmuch it seems that several activities

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[13] Notification No. 11/2023-Central Tax (Rate) dated 29th September, 2023

[14] Notification No. 14/2023-Integrated Tax (Rate) dated September 29, 2023

[15] State of Bombay vs. R.M. D. Chamarbaugwala AIR 1957 SC 699

[16] https://en.wikipedia.org/wiki/Res_extra_commercium

regardless of whether they are games of skill or games of chance would attract 28% GST. By tightening the law on GST on gambling by providing an inclusive definition of 'specified actionable claims' the liability extends to all forms of gambling activity irrespective whether the activity is a game of skill or game of chance and the liability to be imposed on suppliers of such services, is at a highly unexpected and exorbitant rate of 28%. Not only has the Government discouraged gambling activity, it undertakes to make it impossible for any casino or online platform or any other person to attract customers, who otherwise freely indulged in the said activities. Moreover, every single activity is covered under the amendments, ranging from lottery, horse racing, online gaming etc. By including every single activity within the purview of GST, it virtually amounts to banning any form of gambling be it a game of skill or game of chance since there is no provision whatsoever distinguishing the two concepts, and it is entirely left open to judicial interpretation. Hence, while the amendments have streamlined the levy of GST by introducing an inclusive definition of 'specified actionable claims' which include lottery, betting and all other forms of gambling, in the absence of any statutory provision differentiating between games of skill and games of chance, the arbitrariness of applying a uniform rate of 28 % on every form of activity of gambling regardless of its nature is draconian.

At this stage it is relevant to note the judgment of the Hon'ble Supreme Court in *Skill Lotto Solutions Pvt. Ltd. vs. UOI & Ors.*[17] wherein the Supreme Court upheld the levy of GST on lotteries, betting, and gambling as mentioned in the exclusion under paragraph 6 of Schedule III to the CGST Act, but did not adjudicate whether the rate of 28% is arbitrary or not. The said issue was left open to be agitated in appropriate proceedings. The Hon'ble Supreme Court noted that lottery(which was under consideration) is a form of gambling and the legislature has appropriately excluded it from the ambit of Schedule III(Supplies which are to be treated as neither a supply of goods or services) and thereby upheld the levy of GST on such activity. The Hon'ble Karnataka High Court in *Gameskraft Technologies Private Limited vs. Directorate*

[17] (2021) 15 SCC 667 : (2020) SCC OnLine SC 990

General of Goods and Services Tax Intelligence & Ors.[18] also dealt with taxation of Rummy and other forms of gambling. In the said case, the Hon'ble Karnataka High Court quashed a Rs. 21,000 crore notice issued under Section 74(1) and an intimation issued under Section 74(5) of the CGST Act. The Karnataka High Court was considering whether games of skill such as Rummy fall under betting and gambling under paragraph 6 to Schedule III of the CGST Act. The Court pointed out the distinction between games of skill and games of chance and held that games involving betting and gambling are not the same as games of skill and they are only games of chance, which are subjected to tax. Hence, Rummy or any other game being predominantly games of skill are outside the purview of GST. The said judgment is under consideration by the Hon'ble Supreme Court. The Supreme Court has stayed the judgment of the Hon'ble Karnataka High Court pending further consideration.[19]

Possible Solutions

The said decision of the Hon'ble Karnataka High Court is a welcome ruling which although rendered under the pre-amendment regime, casts a heavy doubt on the introduction of GST at a flat rate of 28% on 'specified actionable claims' which in my view is without any basis for two fundamental reasons viz. that games of skill cannot attract such a high rate of GST and secondly, even assuming the games played are games of chance, leisure activities may be taxed appropriately but do not come at such a heavy price! This question of the arbitrary rate of 28% GST was not adjudicated by the Supreme Court in *Skill Lotto*(supra) hence we are yet to see some finality on the issue. In my view, GST @28% is too high even if the game is a game of chance and a rate of 18% would be a relief to the gaming industry considering all forms of gaming are now included within the purview of GST. It would also be appropriate for the Hon'ble Supreme Court in *Gameskraft Technologies*(supra) to uphold the decision of the Hon'ble Karnataka High

[18] 2023 SCC OnLine Kar 18 : (2023) 116 GSTR 53

[19] Directorate General of Goods And Services Tax Intelligence & Ors Vs. Gameskraft Technologies Private Limited & Ors.(SLP(C)/ 19366-19369/2023)

Court to the extent that games of skill cannot possibly attract GST @28% while on the other hand, activities involving games of skill are not completely absolved from GST and there would be some GST payable. They cannot be treated as neither a supply of goods nor services as held by the Hon'ble Karnataka High Court. Also, games involving both skill and chance if predominantly games of skill cannot attract GST @28%.

Moreover, if ultimately GST @28% is to be levied, the GST must be levied on the deposits the customers make with the casino, or online platform in the cases of online money gaming platforms failing which the levy would be arbitrary(this has already been implemented[20]). Conversely, in cases of horse racing, GST can only be levied on the value of the face value of the bets placed. In cases of lottery tickets, GST is to be levied on the face value of the lottery ticket only.

Controversial Issue #3: Constitution of the GST Appellate Tribunal for adjudicating second appeals

Pendency and backlog of cases is inevitable if there are no judicial fora to adjudicate such cases. This became a stark reality; the GST Appellate Tribunal envisaged under Section 109[21] of the CGST Act was kept in abeyance for several years, infact from the very inception of the CGST Act by the Central Government, and was never notified. This created havoc amongst the tax Bar since there was no second appellate authority constituted to hear appeals and the High Courts across the country were flooded with Writ Petitions filed under Article 226 of the Constitution of India challenging the decisions of the first appellate authorities.

Sub-section 2 of Section 109 states that the powers of the Appellate Tribunal are exercisable by the National Benches, Regional Benches, State Benches and Area Benches. Sub-section 4 provides for constitution of State Benches

[20] Notification 51/2023- Central Tax dated 29th September, 2023

[21] Enforceable w.e.f 1-7-2017 vide Noti. No. 9/2017-Central Tax, dt. 28-6-2017

by the Government. Sub-section 5 provides for adjudication of appeals by the State Bench and Principal Bench against the orders passed by the Appellate authority or the Revisional Authority.

The Central Government, on the recommendations of the GST Council, had issued the Central Goods and Services Tax (Ninth Removal of Difficulties) Order, 2019, dated 3rd December, 2019, in terms of which an appeal to the Appellate Tribunal could be made within three months (six months in case of appeals by the Department) from the date of communication of order, or the date on which the President or the State President, as the case may be, of the Appellate Tribunal enters office, whichever is later. This was an ad hoc measure adopted by the Central Government to reduce pendency of cases but was meaningless in effect and hence did not augur well with the taxpayers.

It was only on 14th September, 2023 that the Ministry of Finance, Department of Revenue published a Notification constituting 31 State Benches of the GST Appellate Tribunal across India. However, the Principal Bench is yet to be notified.

Possible Solutions

The Government has not notified the Principal Bench of the Appellate Tribunal at New Delhi which shall consist of a President, a Judicial Member, a Technical Member(Centre), and a Technical Member(State). The constitution of the Principal Bench is imperative to further reduce pendency. Proviso to sub-section 5 of Section 109 states that the cases in which any one of the issues involved relates to the place of supply, shall be heard only by the Principal Bench. Hence, all such cases are still languishing and remain pending in the High Courts. It would be desirable and in the best interests of taxpayers to see the notification of the constitution of the Principal Bench as well.

Controversial Issue #4: Taxation of Intermediaries defined under Section 2(13) of the IGST Act

Taxation of intermediaries has now acquired a definite place in the list of controversial subjects under GST law owing to the manifest difficulty in providing a uniform and correct judicial interpretation to the various provisions under the GST enactments. In mid-2021 there was a split verdict by a Division Bench of the Bombay High Court[22] on account of divergence of opinion regarding the constitutional validity of Sections 13(8)(b) and Section 8(2) of the IGST Act where one of the Judges on the Bench(Justice Abhay Ahuja) upheld the validity of the said provisions while the other companion Judge(Justice Ujjal Bhuyan) ruled that they ought to be struck down.

The matter was referred to a Third referee Judge(Justice G.S. Kulkarni) under the law of Letters Patent who ultimately passed a judgment[23] upon thoroughly examining the issues involved in an exposition of over 100 pages.

The facts of the case in brief are that the petitioner was providing marketing and promotion services to its customers located outside India who were engaged in the manufacture and sale of goods. The Petitioner was engaged in locating customers/importers in India for these overseas manufacturers. It entered into an agreement with the foreign customers for the said purpose. The income of the Petitioner was essentially a percentage of the consideration(commission) received by the foreign customers pursuant to sale of goods to the Indian importer/customer. The Petitioner's income from the said activity was receivable only in convertible foreign exchange.

The Petitioner contended that his business was nothing but an export of service defined under Section 2(6) of the IGST Act. The reason why Section 13(8)(b) of the IGST Act was challenged as *ultra vires* was because the place of supply of intermediary services was deemed to be the location of the supplier, which in the present case was India. Hence, the condition (iii) of Section 2(6) which states that the place of supply should be outside India to qualify as an export of service was not satisfied and hence the Petitioner's

[22] 2021 SCC OnLine Bom 839

[23] 2023 SCC OnLine Bom 852 : (2023) 113 GSTR 281

activity could not qualify as an export of service and instead it had to bear CGST and SGST liability.

The Third referee Judge held that though there is some substance in the contention of the Petitioner's that the transaction is an export of service, it is only safe to assume that the constitutional validity of the provisions are upheld unless it is shown that there is some manifest arbitrariness, or the legislature lacks legislative competence. At the same time, the dilemma of recognising the impugned transaction undertaken by the intermediaries as an intra-state supply or inter state supply, or as an export of service was well noticed by the learned Judge. The learned Judge ultimately concluded that the although the recipient of the service is located outside India and GST is a destination based/consumption based tax, by a legal fiction, the place of supply is located in India i.e location of the intermediary. That, on a cumulative effect of Section 13(8)(b), Section 8(2) and Section 12(2)(b)(ii), the supplies of intermediaries are nothing but intra-state supplies.

Possible Solutions- the way forward

In my view, with respect, the learned referee judge has laid too much emphasis on the doctrine of presumption of constitutional validity of a statute. It is well settled, that the law may in its myriad ways be harsh and oppressive, but it is only the underlying practical realm of things which need to be carefully observed, and this is true especially in cases of challenges to constitutional validity. Upholding the constitutional validity of the provisions even though the conclusion drawn is that the activities carried out by intermediaries is an export of service, is in my view, erroneous. The Petitioner is bound by the rule of law but if the law works to his detriment, and he is prevented from carrying on business, certainly it is open to him to assail the provisions which are the cause of his misery. In the present case, the Petitioner provided, vide an agreement, marketing and promotion services to a foreign customer, and he was totally unconnected with the Indian importer financially and only to the extent of facilitating business with the foreign manufacturer. Now, in cases where the importer is also located in a foreign country, it would amount to an export of service, but in cases where the importer is in India, the

transaction would be taxable. Such an interpretation of taxing the intermediary service when the importer is located in India defeats logic and if the Petitioner is unconnected to the importer, it can hardly be said that the transaction of the Petitioner supplying services to a foreign manufacturer is taxable when there is no nexus between the Petitioner and the importer. Thus, as rightly concluded by the learned Third referee Judge, the transaction would amount to an export of service and if that is the case, the Petitioner ought to have been entitled to refund of input taxes instead of having to bear the liability to pay taxes.

Controversial Issue #5: GST on Construction of Immoveable Property and Works Contract

Relevant provisions under the CGST/SGST Acts

Section 2(119) of the CGST Act defines works contract as the building, repair, renovation, maintenance etc. of immoveable property, when transfer of goods is involved in the execution of the contract. Para 6(a) of Schedule II of the CGST Act treats works contract services as a composite supply which shall be a supply of services. Para 5(b) of Schedule II of the CGST Act treats construction of a complex, building etc. as a supply of service except where the sale consideration is received after the issuance of a completion certificate by the competent authority or after its first occupation, whichever is earlier. Para 5 of Schedule III of the CGST Act provides that sale of land, and subject to clause (b) of paragraph 5 of Schedule II, sale of building is neither to be treated as a supply of goods or services.

Brief background of taxation of works contracts

In *State of Madras vs. Gannon Dunkerley and Co. (Madras) Ltd.*[24], a Constitution Bench of the Hon'ble Supreme Court held that in a works contract/building contract, there was no sale of goods pursuant to an agreement being executed between the developer with the landowner for

[24] AIR 1958 SC 560 : (1959) SCR 379.

construction of a building, for consideration as specified therein, and since there was no sale of goods under the contract as aforesaid, there could be no sales tax collected by the States under the sales tax laws of the States.

Subsequently, the Law Commission of India in its 61st report examined the situation viz. whether the States ought to have the power to levy tax as aforesaid. This led to the insertion vide the Constitution(Forty-sixth Amendment) Act, 1962 of Article 366(29-A) in the Constitution of India, 1950 making a tax on the transfer of property in goods involved in the execution of works contract equivalent to a tax on the sale or purchase of goods.

In *Gannon Dunkerley and Co. vs. State of Rajasthan[Gannon Dunkerley – II]*[25], a Constitution Bench of the Supreme Court examined the effect of the above amendment and *inter alia* concluded that there is a deemed sale of goods in the execution of a works contract by virtue of the legal fiction under Article 366(29-A), and that the value of goods may be determined by excluding the value of the charges towards labour and services.

Pursuant to the above amendment and ratio in Ganon Dunkerley – II, most States amended their sales tax statutes to include a levy on deemed sale of goods in works contracts. The validity of the provisions as inserted by the respective States to levy the tax on sale of goods was challenged and a Constitution Bench of the Supreme Court in *Builders Association of India vs. Union of India*[26]. The Constitution Bench reiterated that in a works contract there is a deemed sale. However, the restrictions under Articles 286 and 269 of the Constitution of India, 1950 would apply.

In *Larsen and Toubro Limited and Another vs. State of Karnataka & Anr.*[27], the scope of works contracts was further examined and it was held that a contract for work/service is distinguishable from a contract for sale. In the former there is the person providing the work or service no property in the

[25] 1993 (1) SCC 364
[26] (1989) 2 SCC 645
[27] [(2014) (1) SCC 708]

thing produced as a whole, notwithstanding a part of the property/materials may be his own. In the case of a contract for sale, the thing produced as a whole is solely owned by the party who transfers under a contract and transfers it for a price. It was held that three conditions must be fulfilled to sustain the levy of tax on the goods deemed to have been sold in execution of the works contract viz.:

(i) there must be a works contract,

(ii) The goods must be involved in the execution of the works contract and

(iii) The property in those goods must be transferred to a third party either as goods or in some other form.

It was held that a contract of sale is distinguishable from a works contract where in the latter there is mix of a service element and a deemed sale of goods.

In *Total Environment Building Systems Pvt. Ltd vs. Deputy Commissioner of Commercial Taxes and Others*[28], the Hon'ble Supreme Court held that service tax is not leviable on works contracts prior to the amendment by the Finance Act, 2007 and only with effect from 1-4-2007.

Issues

I

An issue arises on the claim of ITC in works contracts since there is no ITC available due to the exclusion provided in Section 17(5)(c) of the CGST Act. The said provision states that ITC will not be available if works contract services are supplied for construction of immovable property, except where it is an input service for further supply of works contract service. Hence, the contractors cannot claim ITC on inputs unless and until a sub-contractor providing services is engaged.

II

[28] (2022) SCC OnLine SC 953

A secondary issue arises whether tax can be levied at all, if the consideration is received by the developer after the completion certificate, or time of first occupation whichever is earlier. By virtue of paragraph 5 of Schedule III of the CGST/SGST Acts, sale of land, and subject to clause (b) of paragraph 5 of Schedule II sale of a building, are not taxable they being treated as neither a supply of goods or supply of services. Hence, if the consideration is received after completion certificate/first occupation is issued, the supply is not to be taxed as a supply of a service by virtue of paragraph 5(b) of Schedule II. Once it is not to be treated as a supply of service, whether paragraph 5 of Schedule III kicks in such that the sale of a building goes untaxed? Or does it qualify as a composite supply of a works contract service under paragraph 6 of Schedule II?

III

A third issue arises whether paragraph 6 of Schedule II treating supply under a works contract as a composite supply where the principal supply is supply of service is valid? The legislature has vide paragraph 6 treated supplies of works contract services as a composite supply where the principal supply is a supply of service. This is notwithstanding that Constitution Benches of the Supreme Court as noted above, have laid down that there is a deemed sale of goods in cases of works contracts and the States have the power to levy sales tax(now CGST/SGST) in cases of works contracts. Hence, what exactly is the rationale for treating works contracts services as supplies of services only and completely excluding the supply of goods as a taxable supply?

Possible Solutions

I

In a recent judgment, the Hon'ble High Court of Tripura[29] allowed ITC on works contracts services for construction of a hotel as the same was

[29] M/S SR Constructions vs. The Union of India & Ors. decided on 4.4.2023(Tri)(HC)

immoveable property and the said service did not fall under Section 17(5)(c) of the CGST Act. This was on the basis that the contractor had validly engaged a sub-contractor and paid ITC on the taxable supply and hence there was no reason to deny ITC. This is welcome ruling for taxpayers who do not have to face arbitrary demands from the GST authorities when ITC has been validly claimed based on input tax paid towards receipt of services from sub-contractors towards further supply of works contract service.

II

Whether tax can be levied at all if the consideration is received after the issue of completion certificate or first occupation, in view of paragraph 5(b) of Schedule III of the CGST Act, is a vexed question. One school of thought is that once the supply cannot be treated as a supply of service, since the consideration has been received after the completion certificate/first occupation, can it be said that the supply is taxable at all? Or taxable as a works contract service when supplies of works contracts are deemed to be supplies of services? One cannot argue that the supply is a supply of service due to the exclusion in the said paragraph 5(b) and hence it cannot possibly be contended that the supply is a supply of works contract service since the said supply of works contract services is deemed to be a supply of services. In the absence of the activity being a supply of works contracts services, only paragraph 5 of Schedule III will apply and the supply is to be treated neither as a supply of goods or supply of services. Therefore, no tax can be levied in such cases. This view is supported by a recent ruling of the Authority for Advance Ruling, Karnataka[30] where the applicant entered into a development agreement such that 40% of the undivided right, title, and interest in the land proportionate to super built up area and 40% of car parking spaces would be his entitlement and the entire consideration i.e the above car parking spaces and flats having being received after occupancy certificate/completion certificate, whether any GST would be payable on the same? The applicant contended that he had entered into agreements for sale of flats with

[30] Advance Ruling No. KAR ADRG 55/2020 decided on 7.11.2020 (Applicant: Sri. B.R Sridhar)

prospective buyers after the completion certificate was issued hence there was no GST payable. Upholding this argument of the applicant, the AAR held that the applicant is not liable to pay GST since the consideration (as above) has been received after completion/occupancy certificate and is hit by clause 5 of Schedule III of the CGST/SGST Acts. The AAR also held that the time of supply would be after the flats are handed over to the applicant which is after completion/occupancy certificate has been received.

Another school of thought is that such supplies are taxable as a works contract service in view of the various judgments of the Hon'ble Supreme Court as laid down from time to time. In the case of *Larsen and Toubro Limited v. State of Karnataka*[31], it was held in paragraph 115 that "*It may, however, be clarified that activity of construction undertaken by the developer would be works contract only from the stage the developer enters into a contract with the flat purchaser. The value addition made to the goods transferred after the agreement is entered into with the flat purchaser can only be made chargeable to tax by the State Government."*

The Court upheld tripartite agreements entered into between developer, landowner, and flat purchasers as works contracts even though there was sale of immoveable property involved. This was on the basis that, according to the Court, definition of works contract contained an inclusive definition and sales tax would be payable on the value addition of the goods/moveables utilised in execution of the works contract.

In *Total Environment Building Systems*(supra), it was held that service tax is leviable on works contracts after introduction of the Finance Act, 2007 w.e.f 1.4.2007. Hence, this school of thought advocates that even if consideration is received after completion certificate is issued, the said service will be taxable as a supply of works contract service under the CGST/SGST Acts inasmuch as the construction of building by a developer under a tripartite agreement attracts service tax and it is immaterial if the consideration is received after completion certificate/occupancy certificate is issued since it is

[31] (2014) 1 SCC 708

a works contracts service. Hence, paragraph 5 of Schedule III is not applicable.

III

It seems largely incoherent that the lawmakers have purported to treat supplies under works contracts as a composite supply with the principal supply being a supply of services when Constitution Bench decisions of the Hon'ble Supreme Court have treated the supply as a composite contract where there is a deemed sale of goods and there is a supply of service as well. This has caused much confusion, since even under Article 366(29-A)(b) of the Constitution of India, 1950, tax on the sale or purchase of goods includes a tax on the transfer of property in goods involved in the execution of a works contract. Hence, for the legislature to suddenly treat the aforesaid supplies a supply of services only remains totally unfounded.

However, under the Maharashtra Goods and Services Tax Act, 2017 as well, supply under a works contract is treated as a composite supply and a supply of services, hence the rationale seems to be to impose GST on the value of the services only and not of the goods even by the State Governments. This would however amount to an approach different from the express provisions of the Constitution of India, 1950 and of the decisions of Constitution Benches of the Hon'ble Supreme Court.

Parting Comments

From the above, it can be gleaned, that GST is a far cry from being labelled a good and simple tax. Its complexity has stretched the brightest of minds, it continues to do so, and its application to novel as well as existing concepts confounds one too many. One interesting feature of GST is its nexus to the Constitution of India, 1950 described as the holy grail of India. GST has a very strong nexus to different provisions of the Constitution of India, 1950 and in fact many a time leading counsels need to rely on such Articles/provisions to buttress their arguments. This is seen as above with taxation of intermediaries and works contracts, where different provisions of

the Constitution of India, 1950 have been applied and worked out to address the situation.

Issues in ITC are ever evolving and mismatches in ITC between different Forms/Returns, whether the ITC has been correctly claimed due to error in auto-population etc. are all issues which will continue to exist. To make things worse, many a time there is non-application of mind on the part of the GST authorities which results in filing of writ petitions and the matters are remanded to the authorities for fresh decisions. In some cases, despite the availability of remand, the High Courts impose costs and grant the relief straightaway without remanding the matter due to the utter disregard of the provisions under GST law. These are all issues which ought to be addressed at some point of time.

GST on gambling was the need of the hour since loss of Revenue to the Centre and States was mounting owing to the exponential size of the online gaming and gambling industry. However, as pointed out above, GST @28% cannot possibly be countenanced and as a safety measure, even if the Hon'ble Supreme Court does hold various forms of gambling as games of chance, there is always a room for error where such games of chance are infact games of skill, but the repercussions on the entertainment industry till the judgment is overruled will be calamitous in view of the arbitrary GST rate. Hence, in my view, it is not feasible to put a 28% GST on all forms of gambling irrespective whether the games are games of skill or chance. As pointed out, even if the Supreme Court does hold games of skill cannot attract GST @28% but erroneously holds that some games are games of chance, it will automatically attract GST @28% even if the Supreme court has errored. Hence, the potential risk to legitimate businesses is grave.

As far as taxation of intermediaries and works contracts is concerned, in my view these concepts are at a nascent stage, but do require quick redressal. Taxation of activities of intermediaries has already been met with a divergence of opinion of two High Court Judges and in my view ought to be decided by a Constitution Bench of the Supreme Court in view of the applicability of the provisions of the Constitution of India, 1950. Taxation of

supplies under works contracts has always been a vexed issue with an ever evolving landscape of burning issues and queries to be addressed by the Courts based on the facts and circumstances of each case.

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