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Analysis of certain Indirect Tax proposals in Union Budget 2018-19

February 6, 2018

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Budget proposals impacting levy of import duties on ‘In-bond sales’

Proposed changes with regard to 'In-bond sales'

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- Amendment to section 3(7) of the Customs Tariff Act so as to include reference to the proposed new sub-section (8A), for the purposes of computation of import duties in case of supply of goods warehoused under the Customs Act.

- Amendment to Section 3(9) of the CTA - To include reference to the proposed new sub-section (10A), for the purposes of computation of the import duties in case of supply of goods warehoused under the Customs Act.

- **Method of Computation**: additional import duties to be paid on **higher of the 'transaction value'** (under Section 14 of Customs Act) **or the value determined** under new sub-section (8) - in case of multiple transactions, value of last transaction to be taken as the transaction value

  Illustration: If A imports goods valued at Rs. 100 and subsequently sells the same at Rs. 300 to B while the goods are still lying in the custom bonded warehouse, then additional import duty under Customs Tariff Act, as per the newly introduced sub-section shall be payable on Rs 300 while filing of the ex-bond bill of entry by B.

Proposed changes with regard to 'In-bond sales' - Comparison with Circular No. 46/ 2017 - Customs

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- Explanation provided in Circular No. 46/2017-Customs dated 24.11.2017 (Circular) regarding applicability of additional import duty on goods transferred/ sold while being deposited in a custom bonded warehouse

  "4…The value of such supply shall be determined in terms of section 15 of the CGST Act read with section 20 of the IGST Act and the rules made thereunder, without prejudice to the fact that customs duty (which includes BCD and applicable IGST payable under the Customs Tariff Act) will be levied and collected at the ex-bond stage."

- **Proposed Section 3(8A) of CTA is a departure from the prescribed valuation mechanism under the Circular**

- **Fate of the circular and the additional Import duty already levied basis the valuation mechanism prescribed in the circular already undertaken? No provision of valuation present earlier – thus non-taxable?**

- **Issue of Double Taxation unresolved -** As per the explanation provided in the Circular, there are two instances when duty would have to be paid if the goods kept in the custom bonded warehouse is sold prior to filing of the ex-bond bill of entry by the importer/ supplier - in accordance with illustration provided in the next slide

Proposed changes with regard to 'In-bond sales' - Comparison with Circular No. 46/ 2017 - Customs

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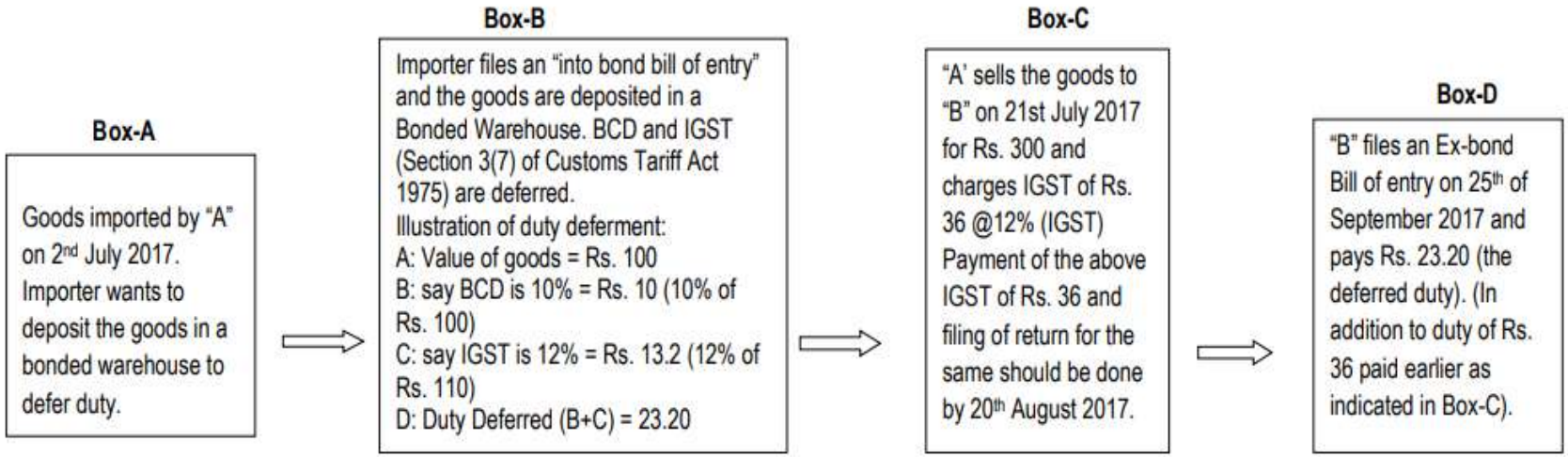
As per the Illustration in the Circular: If A imports goods valued at Rs. 100 and subsequently sells the same at Rs. 300 to B while the goods are still lying in the custom bonded warehouse, then additional import duty of Rs. 36 has to be paid on the sale transaction between A and B calculated @12 % on the total value of Rs. 300 and another additional duty of customs has to be paid while filing of the ex-bond bill of entry by B of Rs. 13.20 as deferred duty of customs in accordance with section 5 of the IGST Act read with relevant

Sale of goods in a Bonded Warehouse and clearance thereof:

ILLUSTRATION



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Budget proposals pertaining to service tax on ‘profit oil’/ ‘cost oil’ and larger implications thereof

Understanding Cost Oil and Profit Oil

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CP

Cost Petroleum
portion of the oil acquired by the operator for setting-off the contract cost (i.e. exploration costs, production costs and development costs)

PP

Profit Petroleum
the extra quantity of the oil extracted – i.e. total extracted oil – cost oil = **profit oil**

Exemption from Service Tax on Profit Petroleum

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- Section 105 of the Finance Bill, 2018 (**"Bill"**) proposes to introduce a special provision for **retrospective exemption from service tax** on Government's share of profit petroleum

"*105. (1) Notwithstanding anything contained in section 66B of Chapter V of the Finance Act, 1994, as it stood prior to its omission vide section 173 of the Central Goods and Services Tax Act, 2017 (hereinafter referred to as the said Chapter),* ***no service tax, leviable on the consideration paid to the Government in the form of Government's share of profit petroleum****, as defined in the contract entered into by the Government in this behalf, shall be levied or collected in respect of taxable services provided or agreed to be provided by the Government by way of grant of license or lease to explore or mine petroleum crude or natural gas or both,* ***during the period commencing from the 1st day of April, 2016 and ending with the 30th day of June, 2017*** *(both days inclusive).*

(2) Refund shall be made of all such service tax which has been collected, but which would not have been so collected, had sub-section (1) been in force at all material times: Provided that an application for the claim of refund of service tax shall be made within a period of six months from the date on which the Finance Bill, 2018 receives the assent of the President.

(3) Notwithstanding the omission of the said Chapter, the provisions of the said Chapter shall apply for refund under this section retrospectively as if the said Chapter had been in force at all material times."

Service tax exemption in line with GST exemptions recommended by GST Council in January 2018

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- Vide Notification No. 5/2018 – Integrated tax (Rate) dated 25.01.2018 (and corresponding CGST/SGST notifications): **exemption from GST as is leviable on the consideration paid to the Central Government in the form of Central Government's share of profit petroleum** as defined in the contract entered into by the Central Government in this behalf, for supply of services by way of grant of license or lease to explore or mine petroleum crude or natural gas or both.
- GST Council also decided to - "….*clarify that* ***cost petroleum*** *is not taxable per se*"

- ✓ **Does the Government recognize "profit petroleum" as consideration towards a service by Government but not "cost petroleum"?**
- ✓ **If cost petroleum is not taxable *per se* under GST, can service tax be demanded on the same at all?**
- ✓ **What happens to 'profit petroleum' earned by the Government between 1.7.17 to 24.1.18? Are the GST exemptions retrospective?**
- ✓ **Can there be an element of service between parties to a arrangement like the Production Sharing Contract which is like a 'joint venture'?**

Specific Transactions – Taxability of Cost Oil/ Profit Oil

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CP

Cost Petroleum
portion of the oil acquired by the operator for setting-off the contract cost (i.e. exploration costs, production costs and development costs)

Whether recovery of CP and PP a 'consideration' for assessees for supply of services of exploration & production of Crude Oil/ Gas to GOI?
**** SCNs issued basis above***

PP

Profit Petroleum
the extra quantity of the oil extracted – i.e. total extracted oil – cost oil = **profit oil**

Whether recovery of CP and PP by GOI a 'consideration' received by the GOI from 'Contractor' for the supply of service of grant of license for exploration & production of Crude Oil/ Gas?

Specific Transactions – Taxability of Cost Oil/ Profit Oil

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The PSCs under NELP are based on the principle of 'profit sharing'. Also held in **Commissioner of Income Tax v. Enron Oil and Gas India Limited [Civil Appeal No. 5433 of 2008]**

1

ARGUMENT IN FAVOUR OF NON-LEVY

The Contractor*(s) and the Government act like Partners/Joint Venturers, and there is no supply of service by one person for another.*

There is no element of quid pro quo consideration envisaged under the PSC between the GOI and the Contractor

2

ARGUMENTS IN FAVOR OF LEVY

Supply of services specified in Schedule I even sans consideration shall be liable to GST when the same is between related persons, or between distinct persons, when made in the course of furtherance of business.

The parties to the PSC are likely to qualify as "related parties" and the supplies made between them even if sans consideration are likely to be liable to GST

Key arguments against taxability

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- As per the 'production sharing contract' all consortium members work independently and bear the cost of the extraction of oil/gas in proportion of their participating interest **– hence, no services are supplied and no service tax/GST is leviable**
  - In a PSC the parties to the contract have a stake in the oil exploration, effectively making the operator and the Government - **'partners'/ 'joint venturers'**
- It may also be argued that oil companies pay the royalty charges as per the Oil Fields (Development & Regulation) Act, 1948 – hence, 'cost oil' and 'profit oil' cannot be considered to be a consideration towards the grant or assignment for using the natural resource **– a transaction cannot have two separate considerations**
- The fact that Government of India and the Contractor are engaged in profit sharing itself militates against any contention of there being a Service Provider – Service Recipient relationship
- Recovery of cost petroleum by the parties is not a consideration towards 'any service' in as much as there is no '*quid pro quo*'. 'Cost Petroleum' is nothing but value realized from sales of Crude Oil and Natural Gas towards recovery of 'Contract Costs' and is not a consideration/ return for any identifiable services.

Mormugao Port Trust v. CCE, Goa; TS-432-CESTAT-2016-ST

Judgment (in the context of service tax) of CESTAT holding that activities undertaken by a partner/ co-venturer for mutual benefit of the partnership/ joint venture cannot be regarded as a service rendered by one person to another for consideration and therefore cannot be taxed.

Applying the 'joint venturer' argument in a real estate context

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Revenue Sharing contracts

Where land owner(s) contribute development right and the developer(s) contribute construction expertise and capital and they share in the sale proceeds in proportion to their contribution.

Cost sharing contracts

Where multiple land-owners come together, pool their land parcels, proportionately bear cost of construction by appointing a construction contractor and share in the sale proceeds/built-up real estate in proportion to their contribution.

- ✓ *These arrangements should qualify as scenarios where the element of 'rendering service' of any kind is absent – in such cases, it is possible to argue that there is no quid pro quo between the parties and the same is purely is a cost/revenue sharing mechanism entered into between the parties. The* ***returns in the form of share of sale proceeds, it can be argued, are simply a recovery on the investments made by the companies who are partners/co-venturers in this venture and not consideration for 'supply'****.*

- ✓ **Caveat**: Such arguments are heavily dependent upon how the underlying contracts are worded – not a general legal conclusion

Applying the 'joint venturer' argument in a real estate context – case law

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CST, DELHI v. M/s OMAXE LIMITED – 2018-VIL-22-CESTAT-DEL-ST

The respondent–assessee was engaged in the business of real estate development. They entered into an agreement with M/s R.P.S. Associates on 13.03.2004. The agreement envisaged the usage of expertise of the respondent-assessee with reference to the project developed by M/s RPS Associates. Both the parties had responsibilities and obligations in terms of the said agreement.

In pursuance of the agreement a joint account was also opened in which all the proceeds for the project development and installed to various customers were credited. The assessee received their consideration, which is 8% of the gross amount credited in the said joint account.

CESTAT held that the Respondent –assessee had not provided any advice or consultancy with reference to organisation of M/s RPS Associates or business of M/s RPS Associates - No such role can be inferred from the agreement.

The agreement is essentially a joint business arrangement in which the amount is shared based on the gross receipt. Accordingly, no service tax could have been levied.

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