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Concept of 'Supply' under GST: International Perspectives and Learnings for India

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February 10, 2018



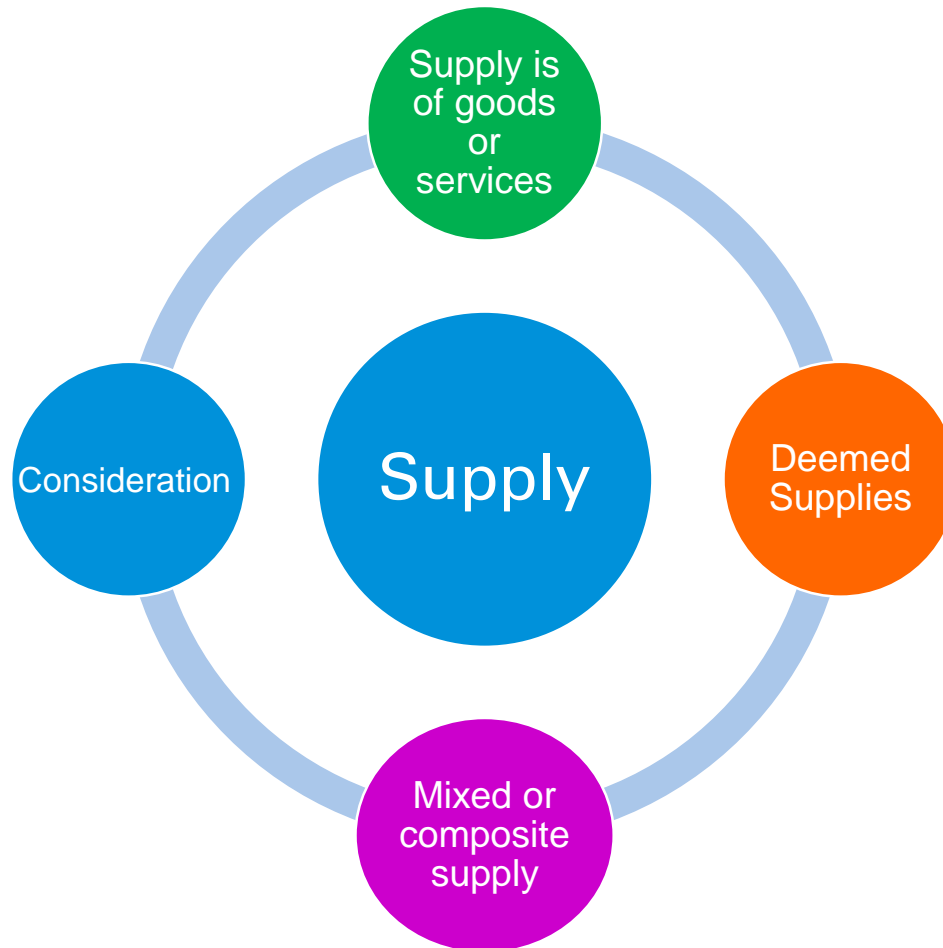


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International jurisprudence around GST



Fundamental concepts under GST



- ❖ **The concepts of 'supply' and 'consideration' are common across the GST/VAT legislations applicable in various jurisdictions**
- ❖ *In the next few slides we have discussed the jurisprudence on these concepts*

Definition of 'supply' across jurisdictions

India	Malaysian GST	New Zealand	EU VAT	Australia GST
<p>7. (1) For the purposes of this Act, the expression “supply” includes – (a) all forms of supply of goods or services or both such as sale, transfer, barter, exchange, licence, rental, lease or disposal <u>made or agreed to be made for a consideration</u> by a person in the course or furtherance of business;....</p>	<p>4. (1) subject to subsections (2) and (3), “supply” means all forms of supply, including supply of imported services, done for a consideration and anything which is not a supply of goods but is done for a consideration is a supply of services.</p>	<p>5. Meaning of term supply (1) For the purposes of this Act, the term supply includes all forms of supply. </p>	<p>Article 14 - supply of goods 1. ‘Supply of goods’ shall mean the transfer of the right to dispose of tangible property as owner.....</p> <p>Article 24 - Supply of services 1. ‘Supply of services’ shall mean any transaction which does not constitute a supply of goods.....</p>	<p>You make a taxable supply if: (a) <u>you make the supply for consideration</u>; and (b) the supply is made in the course or furtherance of an *enterprise that you carry on; and....</p>

Definition of 'supply' across jurisdictions

- ❖ **'Supply' has been defined differently in different jurisdictions** – EU and Malaysia have a restrictive definition, whereas, India and New Zealand have expansive definition
- ❖ However, concept of 'supply' is not infinite even if an 'inclusive' definition is used – even under New Zealand GST It was held in **Databank Systems Ltd v Commissioner of Inland Revenue (NZ)** (1987) 9 NZTC 6213 that **"supply" means "to furnish or provide"** – a voluntary act of provision is necessary
- ❖ Relying upon the Databank case above, under Australian GST, in **Shaw v. Director of Housing and State of Tasmania (No. 2)**, [2001] TASSC 2, the Court stipulated that the term 'supply' requires a voluntary act by the supplier –
 - **Facts involved in this case** – The plaintiff was entitled to recover damages from the defendants for negligent misstatement.
 - **Issue involved** – Whether tax liability arose in consequence of payment of the judgement sum? In other words, when the Court finally assesses the damages and makes an order, will there be any supply (*supply includes a release from an obligation*) leviable to tax?
 - **Held** – **The Court noted that the obligation of a judgment debtor to pay a judgment sum, extinguished by the act of payment, did not constitute a supply because it did not depend upon any voluntary action on the part of the judgment creditor.** Thus, there cannot be a supply constituted by a release of an obligation that occurs independently of the act of the releaser.

Definition of 'supply' across jurisdictions

- Relevant excerpt from the judgement -

“..... When the judgment is satisfied the debt created by the judgment is thereby extinguished and does not depend on the surrender of any rights or the release of the judgment debtor.”..19. It is true that in some circumstances, a release occurs by operation of law....However, the Act, s 9-5 opens with the words, “You **make** a taxable supply if...”**The verb “make” indicates a legislative intention to impose the tax only on voluntary supplies, not upon those supplies that occur without an act of the releasor.....** Application of that proposition to the word “supply” as enacted in the Act, s 9-10 reinforces the concept that there is a legislative intention not to include in the word “supply” the release of an obligation that occurs independently of the act of the releasor...”

- ❖ **GSTR 2006/9 issued by Australian Tax Office – Compulsory Acquisitions by Operation of Law**
 - In cases where land vests in the authority as a result of the authority seeking to acquire the land, and **initiating the compulsory acquisition process pursuant to its statutory right, then the owner does not make a supply.**
 - **This is because the owner does not provide anything to the authority. It takes no action to cause its legal interest to be transferred or surrendered to the authority.** It has no obligation to do anything, to refrain from doing something or to tolerate an act or situation.
- ❖ **Learning for India:** an activity would qualify as a **‘supply’ only if a voluntary act is undertaken by the supplier**

Definition of 'supply' across jurisdictions

- In contrast to compulsory acquisitions by government, where an owner initiates the acquisition by writing to the appropriate authority, such acquisition shall be regarded as supply.
- ***Hornsby Shire Council v Commissioner of Taxation [2008] AATA 1060***
 - **Facts involved in this case** – CSR Ltd owned a quarry in Hornsby which was zoned “Open Space A”. As per the enactment, land zoned as “Open Space A” must be acquired if the landowner makes a formal request in writing. In March 2001, CSR made such a request and subsequently acquisition took place. The acquirer subsequently wanted to claim input tax credit.
 - **Issue involved** – whether in respect of the compulsory acquisition of the quarry from CSR, there was a "supply" within s 9-10 of A New Tax System (Goods and Services Tax) Act 1999?
Section 9-10(2)(d) - supply includes a grant, assignment or surrender of real property
 - The Court held that When CSR gave notice, in terms of the LEP it did indeed incur legal obligations, and moreover did so in respect of subsequent actions leading up to the acquisition of the quarry. **Hence, there was a supply within s 9-10(2)(g) of the GST Act. There was, moreover, a surrender within s 9-10(2)(d).**
- Thus, Australian GST makes a distinction between extinguishment of an owner's interest by statute and doing of a thing that is compelled by statute. The former when, initiated at the request of the owner, shall be supply and the latter being compulsory acquisition shall not be regarded as supply.

Learning for India: an activity would qualify as a **'supply' only if a voluntary act is undertaken by the supplier**

'Supply' is 'made' only if there is identifiable 'consumption' - lessons from EU VAT

❖ Case C-215/94: Jurgen Mohr's case

- Mr Mohr was the owner of an agricultural holding on which he kept dairy cattle. He made an application to the Federal Office for Food and Forestry for a grant for receiving compensation for the definitive discontinuation of milk production. In his application he undertook definitively to discontinue milk production and not to make any claim for a milk reference quantity under the common organization of the market. The office upheld his application and granted him a single payment and subsequently, Mr Mohr sold his cattle thus ceasing all milk production.
- **Issue - Whether an undertaking to discontinue milk production given by a farmer constitutes a supply of services so that the compensation received for that purpose is subject to turnover tax.**
- Article 6(1) of the Directive provides “Supply of services” shall mean any transaction which does not constitute a supply of goods within the meaning of Article 5. Further, such transactions may include inter aim....— **obligations to refrain from an act or to tolerate an act or situation,..**

'Supply' is 'made' only if there is identifiable 'consumption' - lessons from EU VAT

❖ Case C-215/94: Jurgen Mohr's case

Revenue's contentions	European Court of Justice ("ECJ") ruling
Compensation and milk production are mutually dependant – clear link between consideration and service of discontinuation (refraining from an act)	VAT – a tax on consumption of services Local authority, by compensating for milk production, is not acquiring services for its own use but for community's good – they are not the consumers. Hence, the same is not a supply

- ❖ **Learning for India:** an activity would qualify as a 'supply' only if a voluntary act is undertaken by the supplier **AND there is an identifiable consumer for such activity**

Intention to create legal relationship - concept

Intent to create legal relationship – Balfour v Balfour [1919] 2 KB 571

- Mr. Balfour agreed to pay his wife a sum of money for maintenance while he was posted to Ceylon. After they separated, Mrs. Balfour took action to hold him to his payments. The action failed because there was no indication that the arrangement was intended to be a contract
- Important because Mrs. Balfour was suing Mr. Balfour under contract – not because he married her, but, because he **promised** her
- **Lord Atkin** – “*..there are agreements between parties which do not result in contracts within the meaning of that term in our law. The ordinary example is where two parties agree to take a walk together, or where there is an offer and an acceptance of hospitality.... To my mind those agreements, or many of them, do not result in contracts at all, and they do not result in contracts even though there may be what as between other parties would constitute consideration for the agreement. The consideration, as we know, may consist either in some right, interest, profit or benefit accruing to one party, or some forbearance, detriment, loss or responsibility given, suffered or undertaken by the other. That is a well-known definition, and it constantly happens, I think, that such arrangements made between husband and wife are arrangements in which there are mutual promises, or in which there is consideration in form within the definition that I have mentioned. **Nevertheless they are not contracts, and they are not contracts because the parties did not intend that they should be attended by legal consequences**”*

'Supply' - intention to create legal relationship

❖ Case C-16/93: Tolsma's case

- Mr Tolsma played a barrel organ on the public highway in the Netherlands. During his musical performance he offered passers-by a collecting tin for their donations; he also sometimes knocked on the door of houses and shops to ask for donations, but without being able to claim any remuneration by right.
- **Issue** - A service which consists of playing music on the public highway, for which no payment is stipulated but payment is nevertheless received, be regarded as supply of services for consideration and hence, liable to turnover tax.

Revenue's contentions	European Court of Justice ("ECJ") ruling
<p>Direct link between payments by passers-by and service of musical performance by Tolsma</p> <p>Doesn't matter if payments received were not a matter of right for Tolsma</p>	<p>'supply of services' is effected 'for consideration', and hence is taxable, only if there is a legal relationship between the provider of the service and the recipient pursuant to which there is</p> <ul style="list-style-type: none">- reciprocal performance,-the <u>remuneration received</u> by the provider of the service <u>constituting the value actually given in return for the service supplied to the recipient</u> <p>Upheld Tolsma's claim - "no agreement between parties"</p>

'Supply' - intention to create legal relationship

❖ Case C-16/93: Tolsma's case

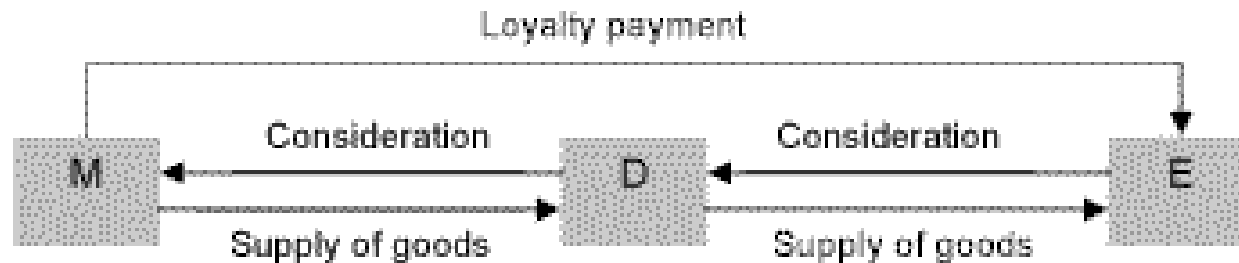
- The Court noted that a supply of services is effected 'for consideration' within the meaning of Article 2 (1) of the Sixth Directive, and hence is taxable, **only if there is a legal relationship between the provider of the service and the recipient pursuant to which there is reciprocal performance. Thus, it was held that if a musician who performs on the public highway receives donations from passers-by, those receipts cannot be regarded as the consideration for a service supplied to them.** Further, where a person's activity consisted exclusively in providing services for no direct consideration, there was no basis of assessment and the services were therefore not subject to VAT.

❖ Illustration under Australian GST Law which **contradict** the principles of the Tolsma case: **voluntary payments for restaurant supplies** - *A restaurant run by a sole trader accepts tips from its customers which are not passed to the restaurant's employees. Such tips are unsolicited and are in addition to the price stipulated by the restaurant.*

- It was held that tips are voluntary payments made in connection with the restaurant supplies made by the sole trader to its customers and thus form part of the consideration charged for such supplies. **Although there is no obligation on the customers to make these payments, the tips form part of the consideration for the restaurant supplies by the sole trader to its customers.** On the other hand, if the sole trader passes the tips on to the restaurant's employees then such tips constitute income of the restaurant employees and such payments are not subject to GST as the employees are not carrying on an enterprise for GST purposes.

'Supply' - intention to create legal relationship

- ❖ **GSTR 2006/9 (Australia) - Illustration – Loyalty payments with no supply of goods/ services**
 - *M is a manufacturer of goods and supplies goods to authorized dealer (D). D further supplies goods to end users (E) and makes a standing offer to E that if E's purchases from D reach a certain level, M will pay E a 'loyalty payment'.*



- **Whether supply** - E is not under any binding obligation to M to purchase goods through D and does not make a supply to M simply by making acquisitions from D. Thus, the loyalty payment made by M to E cannot be consideration for a supply from E to M because E does not make a supply to M.

'Obligation to refrain from an act' - Case study vis-à-vis Liquidated Damages

- ❖ **Having established the fact that 'supply' requires a positive act from the supplier – whether liquidated damages would qualify as a 'supply'?**
- ❖ It is pertinent to note that the taxability of 'liquidated damages' was unclear even under the erstwhile taxation regime
 - **In Service tax law, Section 66E(e) categorized** – “*agreeing to the obligation to refrain from an act, or to tolerate an act or a situation, or to do an act;*” – as a 'declared service'
 - **Similarly under CGST Act – Clause 5(e) of Schedule II expressly categorizes** – '*tolerating an act or situation*' as a 'supply of service'
 - Even under EU VAT, as per article 25 of the VAT Directive - '*A supply of services may consist, inter alia, in one of the following transactions: (b) **the obligation to refrain from an act, or to tolerate an act or situation***
- ❖ *In this regard, we have discussed the tax implication on liquidated damages – in the subsequent slide*

'Obligation to refrain from an act' - Case study vis-à-vis Liquidated Damages

- ECJ in **Landboden-Agrardienste vs. Finanzamt Calau [Case C-384/95]** – held, compensation received by a farmer under the national compensation scheme, pursuant to a declaration given by him that he would not harvest at least 20% of his potato crop – **is not taxable under EU VAT**
 - **Facts involved in this case** – Landboden-Agrardienste gave an undertaking for reduction in potato production pursuant to the order by Food, Agriculture and Forestry Office of the local authority promoting the extensification of agricultural production. The undertaking was accepted and compensation was granted in return for a 20% reduction in annual potato production.
 - **Issue involved** – Whether an undertaking given by a farmer under a national compensation scheme not to harvest at least 20% of his potato crop constitutes an obligation to refrain from an act or tolerate an act/ situation and is thus a supply of services under Article 6 (1) of the 6th Directive?
 - The Court noted that for –

*“24. Since the **undertaking given by a farmer to reduce production does not entail either for the competent national authorities or for other identifiable persons any benefit which would enable them to be considered to be consumers of a service, it cannot be classified as a supply of services within the meaning of Article 6(1) of the Sixth Directive”***

'Obligation to refrain from an act' - Case study vis-à-vis Liquidated Damages

- **Liquidated damages are agreed pre-estimated sums to be paid in the event of a breach of contract by one of the parties and should not qualify as 'benefit' to the other party**
- **Liquidated damages are a pre-agreed consequence of breach – there is no 'tolerance'**
 - ✓ **UK VAT Instruction Manual VATSC35600** – “Liquidated damages:They are not consideration for supplies and are outside the scope of VAT.”
 - ✓ **Entry 22.3 of the VAT Notice 708 issued by HM Revenue and Customs, UK provides -** “Liquidated damages are agreed pre-estimated sums to be paid in the event of a breach of contract by one of the parties. The amount is either a set figure or determined by a formula.. If you receive liquidated damages, you are not receiving payment for a supply by you and no VAT is due on that amount.”
- It is important to note Section 73 read with Section 74 of the Indian contract Act:

“73. Compensation of loss or damage caused by breach of contract

When a contract has been broken, the party who suffers by such breach is entitled to receive, from the party who has broken the contract, compensation for any loss or damage caused to him thereby, which naturally arose in the usual course of things from such breach, or which the parties knew, when they made the contract, to be likely to result from the breach of it...”

'Obligation to refrain from an act' - Case study vis-à-vis Liquidated Damages

“74. Compensation for breach of contract where penalty stipulated for

When a contract has been broken, if a sum is named in the contract as the amount to be paid in case of such breach, or if the contract contains any other stipulation by way of penalty, the party complaining of the breach is entitled, whether or not actual damage or loss is proved to have been caused thereby, to receive from the party who has broken the contract reasonable compensation not exceeding the amount so named or, as the case may be, the penalty stipulated for.”

- Section 74 dispenses with the requirement of proving actual damage once breach of contract is established, the Court is enabled to award the “reasonable compensation” not exceeding the amount specified in the contract or the amounts which can be arrived at on application of the formulae or method prescribed in the contract.
- Hon’ble the Madras High Court in the case of **Sri Sri Sri Palahari Mahant Raja Ram Doss Bavaji Vs. Sri Sri Sri Gajapathi Krishna Chendra Deo Garu [AIR 1933 Mad 729]** noted that “liquidated damages” is a term that is not used in the Contract Act but employed to denote a sum named in the contract as the amount to be paid in case of a breach.

Obligation to refrain from act – When ‘Supply’

- ❖ **As discussed earlier, ‘Supply’ = a positive act of doing something requiring **consumption by the recipient** ?**

- ❖ It is pertinent to look at instances where obligation to refrain from an act or tolerance of an act is treated as a supply:
 - **Under service tax law** – ‘Non compete clauses’ in contracts furnish an example of when ‘obligation to refrain from an act’ constitutes a supply

 - **Under Australian GST** - As per GSTR 2006/9, *an entity may be said to be making a supply by refraining from doing something or tolerating some act or situation if the entity was subject to an obligation to do so and then performed accordingly.*
 - **MBI Properties Pty Ltd.** - MBI Properties Pty Ltd (MBI) acquired three apartments in a hotel complex, each of which was subject to a lease entered into between the vendor, South Steyne Hotel Pty Ltd (South Steyne), and the operator of the hotel, Mirvac Management Ltd (MML). MBI, on acquiring the rights of the lessor, became the recipient of a "supply of a going concern" and assumed the lessor's rights and obligations with respect to the aforesaid lease.

 - **Issue – Whether the continuing observance of lessor's obligations by MBI constitute a supply?**

Obligation to refrain from act – When ‘Supply’

- The High Court noted that a transaction which involves a supplier entering into and performing an executory contract will in general involve the **supplier making at least two supplies**. The first being creation of contractual rights and obligations and secondly, a supply by means of contractual performance of the obligation.
- The High Court recognised that providing continuing use and enjoyment of premises by observing an express or implied covenant of quiet enjoyment under a lease, *the supplier was providing something, albeit by means of refraining from doing something or tolerating some act or situation*

Concept of 'consideration' across jurisdictions

India (definition under Finance Act, 1994)	India (definition under CGST Act)	EU VAT
<p>67. Valuation of taxable services for charging service tax. —</p> <p>(1) Subject to the provisions of this Chapter, where service tax is chargeable on any taxable service with reference to its value, then such value shall, —</p> <p>(i) in a case where the provision of service is for a consideration in money, be the gross amount charged by the service provider for such service provided or to be provided by him;</p> <p>(ii) in a case where the provision of service is for a consideration not wholly or partly consisting of money, be such amount in money as, with the addition of service tax charged, is equivalent to the consideration;....</p> <p>The term 'consideration' has been defined to include any amount that is payable <u>for</u> the taxable services provided or to be provided.</p>	<p>(31) "consideration" in relation to the supply of goods or services or both includes—</p> <p>(a) any payment made or to be made, whether in money or otherwise, in respect of, in response to, or for the inducement of, the supply of goods or services or both, whether by the recipient or by any other person but shall not include any subsidy given by the Central Government or a State Government;</p> <p>(b) the monetary value of any act or forbearance, in respect of, in response to, or for the inducement of, the supply of goods or services or both, whether by the recipient or by any other person but shall not include any subsidy given by the Central Government or a State Government:....</p>	<p>In respect of the supply of goods or services, other than as referred to in Articles 74 to 77, the taxable amount shall include everything which constitutes consideration obtained or to be obtained by the supplier, <u>in return for the supply</u>, from the customer or a third party, including subsidies directly linked to the price of the supply.</p>

The nexus required between the 'service' and what is purported to be 'consideration' appears to have been more direct under erstwhile service tax law and also in the EU VAT – **whereas under GST 'consideration' could also be "in respect of" or "for the inducement of" the service in question**

Concept of 'consideration' in other jurisdictions

- ❖ **Definition of 'consideration' under CGST Act is akin to the definition provided under Australian GST –**
 - “(a) any payment, or any act or forbearance, in connection with a supply of anything; and
 - (b) any payment, or any act or forbearance, in response to or for the inducement of a supply of anything.
 - (2) It does not matter whether the payment, act or forbearance was voluntary, or whether it was by the recipient of the supply.
 - (2A) It does not matter:
 - (a) whether the payment, act or forbearance was in compliance with an order of a court, or of a tribunal or other body that has the power to make orders; or
 - (b) whether the payment, act or forbearance was in compliance with a settlement relating to proceedings before a court, or before a tribunal or other body that has the power to make orders.
 - (2B)”

- ❖ In this regard reference may be made to **Goods and Service Tax Ruling 2001/6 issued by the Australian tax Office** [which is a public ruling under Division 358 of Schedule 1 to the Taxation Administration Act, 1953] –
 - The ruling laid down the general legal principles in relation to ‘consideration’ *and the key learnings from the said decision have been discussed in the subsequent slide*

Key learnings from Australian GST

❖ The term ‘consideration’ includes payments by persons other than recipient

“49. Consideration is defined in section 195-1 to mean ‘any consideration, within the meaning given by sections 9-15 and 9-17, in connection with the supply’. The meaning given to consideration in section 9-15 extends beyond payments to include such things as acts and forbearances. It may include payments made voluntarily, and payments made by persons other than the recipient of a supply”

❖ Consideration should have ‘sufficient’ nexus with the supply made

“50. Section 9-15 further provides that a payment will be consideration for a supply if the payment is ‘in connection with’, ‘in response to’ or ‘for the inducement’ of a supply. Thus, there must be a sufficient nexus between a particular payment and a particular supply for the payment to be consideration for that supply.

51. It follows that there are two elements to the definition of consideration. The first is the payment by one entity to another. The second element is the nexus that must be established between the payment and a supply.

56. It will not be sufficient for there to be a supply and a payment. GST is not payable on a supply unless it is made for consideration, and the other tests in section 9-5 are satisfied. There must be a sufficient nexus between the supply and the payment.”

Key learnings from Australian GST (contd...)

❖ Importance of establishing nexus under other jurisdictions –

- **New Zealand** – The nexus requirement was further emphasized in the **Chatham Islands Enterprise Trust v. Commissioner of Inland Revenue (1999) 19 NZTC 15,075** decision of the New Zealand Court of Appeal.

Facts - The Chatham Islands Enterprise Trust came into existence after concern over a number of decades regarding the responsibility and financial liability for essential services required by Chatham Islands residents. At the heart of the plan was the injection of money which would ensure the infrastructure was retained and that the commercial operations could be developed from that point forward. The Government agreed to pay \$8 million in two instalments and the transfer the Crown assets.

Issue - whether an amount settled on a trust by the New Zealand Government could be construed as consideration for a supply of services made by the trustee to either the settlor or the beneficiaries.

63. Tipping J,commented at page 15,081: ‘I therefore have difficulty in seeing how it can be said that the payments made by the Crown were in respect of or for the inducement of any services. Clearly the payments were not in response to the supply of services.’”

Key learnings from Australian GST (contd...)

❖ Nexus – the ‘substance’ test

“71. In determining whether a sufficient nexus exists between supply and consideration, regard needs to be had to the true character of the transaction. **An arrangement between parties will be characterised not merely by the description that parties give to the arrangement, but by looking at all of the transactions entered into and the circumstances in which the transactions are made.**”

❖ Illustrations explaining as to what constitutes ‘consideration’ –

▪ Importance should be given to the transaction that occurs –

*“If tenant does not agree to keep the leased premises in good repair, it is likely that the landlord would require the tenant to make higher lease payments. **However, if the tenant agrees to maintain the property, then, it is not consideration for the supply of the premises**”*

Key learnings from Australian GST (contd...)

- ❖ Illustrations explaining as to what constitutes ‘consideration’ –
 - **Things used in making the supply: ‘consideration’ versus ‘condition of contract’ –**
 - Engineer agrees to supply services to a Company at a rate of Rs. 100 per hour. Services are to be performed at Company's premises in Mumbai. Company provides the Engineer with the computer facilities, etc. to perform the services. Company also bears travelling and accommodation charges. The provision of the use of computer facilities, etc. are not part of the price paid for the services, **they are rather conditions of the contract** that go to defining the supply made by the Engineer. They do not provide economic value to Engineer in return for his supply. **The provision of these things in these circumstances is not consideration in connection with the supply by the Engineer.** The only consideration is the agreed hourly rate received by the Engineer.
 - **Case Study 1:** ‘Allowed loss’ in LNG regasification contracts – typically during this process of regasification, there is a loss of some miniscule amount of LNG. The same is specifically provided for in the contracts for regasification as ‘allowed losses’ and such ‘allowed losses’ are not treated as a deficiency in the regasification services. **Whether such allowed loss is ‘condition of contract’ or and ‘additional consideration’ for the regasification service provider?**

Key learnings from Australian GST (contd...)

- **Case Study 2**: In cases where a lower price is offered by processor manufacturers to bulk purchasers like laptop/desktop manufacturers - where processor manufacturers' tagline is mentioned on the final product ie, the laptop/desktop computer (like "Intel inside" or "powered by Intel"), **does it mean the tagline is additional consideration received from computer/tablet manufacturer?**
- ❖ **Further, any goods/service made available as a condition of contract need not necessarily qualify as a 'consideration'** (whether monetary or non-monetary)

- ❖ **Whether GST is payable on incentive payments made by a supplier to its vendors?**
- ❖ **The Federal Court in the case of AP Group Ltd. Vs. Commissioner of Taxation- 2013 FCAFC 105 –**
 - **Facts involved in this case** – The taxpayer was a motor vehicle dealer that acquired motor vehicles from various motor vehicle manufacturers/distributors (manufacturers), through an interposed finance company, under a bailment arrangement. Immediately before the supply of the motor vehicle by the dealer to the customer, the finance company transferred title of the motor vehicle to the dealer, enabling the dealer to sell the motor vehicle to the customer. **The manufacturer paid certain incentive payments to the dealer (taxpayer).**
 - **Issue involved** – Whether the incentive payments were consideration for taxable supplies under paragraph 9-5(a) of the A New Tax System (Goods and Services Tax) Act 1999 (GST Act)?
9-5(a) - “*you make a taxable supply if you make the supply for consideration”*
 - The Court held

“53. On analysis, the so-called supplies for consideration identified by the Commissioner are nothing more than the encouragement of an overall business relationship between the manufacturer and the dealer to the mutual benefit of both. The relationship involves a whole raft of obligations from one to the other all, presumably, with the ultimate objective of maximising their respective commercial positions.”

Continued on next slide

- ❖ **Whether GST is payable on incentive payments made by a supplier to its vendors?**
- ❖ **The Federal Court in the case of AP Group Ltd. Vs. Commissioner of Taxation- 2013 FCAFC 105 –**

.....The fact that the dealer receives a payment as an incentive when certain thresholds associated with running the business in this way does not mean that the dealer is supplying a service to the manufacturer for consideration. If the incentive payment were not available there is no basis to infer that the dealer would not behave in the same way for free. For these reasons there cannot be said to be any supply for consideration in these arrangements.”

- ❖ **Now, applying the above reasoning in the below factual situation:**
 - A manufacturer has depots in a state which are run by its agents – *agents are not customers of the manufacturer.* The agent is responsible for (a) proper maintenance and storage of the stocks received from outside the State, (b) their dispatch to the customers and (c) ensure seamless dispatches as and when permits are generated.
 - As part of the agreement, the manufacturer offers incentives payments apart from the service fees to the agent. This incentive is subject to the total volume of products that the agent is able to move from depot to ultimate customers.
 - **Question to decide** – Are such incentive payments leviable to GST?

Continued...

- It is important to note that the incentive payments made by the manufacturer have a direct linkage to the performance of the agent in discharging its main service obligation. Where the performance of the agent is better, the payments are due from manufacturer.
- In other words, payment of incentives form part of a single contractual arrangement and thus inextricably linked to the procurement of the main services in view of the contractual commitment to pay the incentive, should there be an enhanced performance level as per specifications under the contractual arrangement
- Thus, the additional payments in form of incentives can be contended as being relatable to the supply of the main services, and is dependent on the efficiency of such services
- **Lessons for India:** Incentive payments may not qualify as ‘consideration’ for a supply, depending on facts

Treatment of 'subsidy' *vis-à-vis* 'consideration'

- **Office des produits wallons ASBL (OPW) and Belgian State Case C – 184/00 dated 22.11.2001 –**
- **Facts involved in this case** – The OPW is a private non-profit-making association which carries out the advertising and sale of Walloon agricultural and horticultural products and agricultural foodstuffs, an activity in respect of which it is subject to VAT. It enjoys an annual subsidy from the Walloon Region for four types of activity, namely the publication of a catalogue, the publication of a magazine entitled Wallonie nouvelle, the running of local offices and participation in local events.
- **Issue involved** – What interpretation should be given to the term 'subsidies directly linked to the price' within the meaning of Article 11A(1)(a) of the Sixth Directive and, in particular, whether an operating subsidy, such must be included in the taxable amount?
- The Court noted that for the subsidy to be directly linked to the price of such supplies, within the meaning of Article 11A of the Sixth Directive, it is also necessary, that it be paid specifically to the subsidised body to enable it to provide particular goods or services. Only in that case can the subsidy be regarded as consideration for the supply of goods or services, and therefore be taxable a supply of services.

Treatment of 'subsidy' *vis-à-vis* 'consideration'

- ECJ in this decision interpreted the phrase '*subsidies directly linked to the price*' – **held:-**

“Article 11A of the Sixth Directive deals with situations where three parties are involved: the authority which grants the subsidy, the body which benefits from it and the purchaser of the goods or services delivered or supplied by the subsidised body. Thus, transactions covered by Article 11A of the Sixth Directive are not those carried out for the benefit of the authority granting the subsidy.....

However, the mere fact that a subsidy may affect the price of the goods or services supplied by the subsidised body is not enough to make that subsidy taxable. **For the subsidy to be directly linked to the price of such supplies....it is also necessary....that it be paid specifically to the subsidised body to enable it to provide particular goods or services.** Only in that case can the subsidy be regarded as consideration for the supply of goods or services, and therefore be taxable.....The price payable by the purchaser must be fixed in such a way that it diminishes in proportion to the subsidy granted to the seller or supplier of the goods or services, which therefore constitutes an element in determining the price demanded by the latter.....”

- **Under the erstwhile taxation regime in India**, the settled principles in the context of 'subsidies' was mostly surrounding the 'subsidies' provided by the government through administrative orders. **Under GST**, albeit 'subsidies' are includible in the 'transaction value', the 'subsidies' provided by the Central or State Government is expressly kept outside. **What is includible in the 'transaction value' is only 'subsidies directly linked to the price', when not given by the Central or State Government.**

Treatment of 'subsidy' *vis-à-vis* 'consideration'

- In **Indian Potash Vs. State of Kerala [W.P.C 8444 of 2011]**:
- **Issue involved** – Whether amount received by the assessee by way of 'subsidy' from the Central Government on the sale of fertilizers effected by them, can be included in the taxable turnover?
- The Court held that sale is a bilateral transaction which stems out of a contract between the seller and the purchaser. An essential ingredient of a sale is "price". Fixation of the price is a matter of agreement between the parties. **The sale is not conditional on the Central Government paying any amount by way of subsidy. The essential contract between the parties, namely, the seller and the purchaser of fertilizers, is only for payment of the price subject to the maximum fixed by the Central Government and not for any other. This being the contract, any other sum received by me seller-petitioners for a different purpose and not as consideration for the sale.**
- **Learning for India:** The clarification on 'direct linkage' of subsidy would be useful

Treatment of activities undertaken by partner/co-venturer for mutual benefit

- In case of **Production Sharing Contracts for oil and gas exploration** between **consortiums of private companies and the Government**, various parties come together and act for mutual benefit of each other.
- Such models are used in other sectors too, for eg:
 - **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.
 - **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.
- **Treatment of cost/sharing of revenue and activities undertaken by partners/co-venturers**
 - **Reimbursement of cost/sharing of revenue does not qualify as ‘consideration’**
 - **Mormugao Port Trust v. CCE, Goa; TS-432-CESTAT-2016-ST – CESTAT:** With a view to expand its cargo handling capacity at Mormugao, M/s. Mormugao Port Trust floated a tender for the construction and operation of two new multi-purpose bulk cargo handling berths and accordingly it entered into an agreement under the Public Private Participation (‘PPP’) model with M/s. South West Port Ltd (“SWPL”) vide which it leased out parcels of land and water front situated in the harbor to SWPL. On such leased parcels of land, SWPL constructed a jetty for the loading and unloading of cargo. Mormugao received amounts from SWPL in the form of license fee and royalty.

Treatment of activities undertaken by partner/co-venturer for mutual benefit

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

“The question that arises for consideration is whether the activity undertaken by a co-venture (partner) for the furtherance of the joint venture (partnership) can be said to be a service rendered by such co-venturer (partner) to the Joint Venture (Partnership). In our view, the answer to this question has to be in the negative inasmuch as **whatever the partner does for the furtherance of the business of the partnership, he does so only for advancing his own interest as he has a stake in the success of the venture. There is neither an intention to render a service to the other partners nor is there any consideration fixed as a quid pro quo for any particular service of a partner. All the resources and contribution of a partner enter into a common pool of resource required for running the joint enterprise and if such an enterprise is successful the partners become entitled to profits as a reward for the risks taken by them for investing their resources in the venture...**”

- **The CESTAT held** 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 under GST.

Deemed Supply - learnings from EU/UK

- **Deemed Supply** - Certain transactions are treated as supplies of goods and services where they otherwise may not have been, for example, where no consideration is received. **UK (VATA 1994 ss 1(1)(a), 56(6) and Sch 4: “where goods forming part of the assets of a business are transferred or disposed of by or under the directions of the person carrying on the business so as no longer to form part of those assets.....”**
- **Schedule I of the CGST Act** provides for activities that shall be deemed to be supply even if made without consideration:

“1. Permanent transfer or disposal of business assets where input tax credit has been availed on such assets.

2. Supply of goods or services or both between related persons or between distinct persons as specified in section 25, when made in the course or furtherance of business: Provided that gifts not exceeding fifty thousand rupees in value in a financial year by an employer to an employee shall not be treated as supply of goods or services or both.

3. Supply of goods—

(a) by a principal to his agent where the agent undertakes to supply such goods on behalf of the principal; or

(b) by an agent to his principal where the agent undertakes to receive such goods on behalf of the principal.

.....”

Deemed Supply – learnings from EU/UK

- **Trade only plant sales limited v. The Commissioner of Customs and Excise LON/03/593 (VTD 18847)**
 - ❑ **Facts involved in this case** – In 1998 Vales Press purchased a commercial property. In January 2000 Vales Press transferred its business to an associated company as a going concern. Vales Press retained the property, and ceased to be registered.
 - ❑ **Issue involved** – whether there was a deemed supply of the commercial property to the transferor when Vales Press ceased to be a taxable person.
 - ❑ The Court noted: *“Paragraph 8(1) provides that, where a person ceases to be a taxable person, any goods (or land) then forming part of the assets of the business carried on by him shall be deemed to be supplied by him in the course or furtherance of his business immediately before he ceases to be a taxable person unless the business is transferred as a going concern to another taxable person”*

The Court held that when Vale Press ceased to be registered, it made a deemed supply of purchased property immediately before it ceased to be registered

Mixed/ Composite Supply under Indian GST

- Section 2(30) of the CGST Act reproduced below defines composite supply:
“**composite supply**” means a supply made by a taxable person to a recipient consisting of two or more taxable supplies of goods or services or both, or any combination thereof, which are naturally bundled and supplied in conjunction with each other in the ordinary course of business, one of which is a principal supply;

Illustration.— Where goods are packed and transported with insurance, the supply of goods, packing materials, transport and insurance is a composite supply and supply of goods is a principal supply;

- Further section 2(74) of the CGST Act defines mixed supply as below:

“**mixed supply**” means two or more individual supplies of goods or services, or any combination thereof, made in conjunction with each other by a taxable person for a single price where such supply does not constitute a composite supply.

Illustration.— A supply of a package consisting of canned foods, sweets, chocolates, cakes, dry fruits, aerated drinks and fruit juices when supplied for a single price is a mixed supply. Each of these items can be supplied separately and is not dependent on any other. It shall not be a mixed supply if these items are supplied separately;

- Section 8 provides for the determination of tax liability on composite and mixed supplies as below:
 - **A composite supply comprising two or more supplies, one of which is a principal supply, shall be treated as a supply of such principal supply;**
 - **A mixed supply comprising two or more supplies shall be treated as a supply of that particular supply which attracts the highest rate of tax.**

Mixed/ Composite Supply- learnings from Australia and EU

- **GSTR 2006/9 (Australia) - *A supply that contains a dominant part, but also includes something that is integral, ancillary or incidental to that part is a 'composite supply', being the supply of a single thing.***

- ***Card Protection Plan Ltd. v. Commissioners of Custom and Excise (Case C -349/96)***
 - ❑ **Facts involved in this case** – CPP offered holders of credit cards, on payment of a certain sum, a plan intended to protect them against financial loss and inconvenience resulting from the loss or theft of their cards or of certain other items such as car keys, passports and insurance documents.

 - ❑ **Issue involved** – What is the proper test to be applied in deciding whether a transaction consists for VAT purposes of a single composite supply or of two or more independent supplies?

 - ❑ The Court noted that there is a single supply in particular in cases where one or more elements are to be regarded as constituting the principal service, whilst one or more elements are to be regarded, by contrast, as ancillary services which share the tax treatment of the principal service. A service must be regarded as ancillary to a principal service if it does not constitute for customers an aim in itself, but a means of better enjoying the principal service supplied.

Mixed/ Composite Supply- learnings from Australia and EU

- **GSTR 2001/8** - *“one can determine whether the transaction is a **mixed supply** because it has separately identifiable parts that the GST Act treats as taxable and non-taxable, or whether it is a composite supply because one part of the supply should be regarded as being the dominant part, with the other parts being integral, ancillary or incidental to that dominant part.”*

The distinction between parts that are separately identifiable and things that are integral, ancillary or incidental, is a question of fact and degree. In deciding whether a supply consists of more than one part we take the view that you adopt a commonsense approach.”

'Ancillary' or 'Incidental' supplies

- ❖ **'Ancillary' or 'Incidental' supply akin to 'closely related supplies' under EU VAT**
- ❖ **Decision of ECJ in the case of Commissioners for Her Majesty's Revenue and Customs v. Brockenhurst College (C-699 /15)** – provided an interpretation to the term 'closely related supplies' – which is not defined under the EU VAT
 - **Facts involved in this case** – A college offering courses in catering and hospitality had a restaurant in the premises which, was run by the students under the supervision of tutors, for enhancing their skills and giving them a real time experience
 - **Issue involved** – College was exempted from VAT as it was engaged in providing education, whether the said exemption was available to the services supplied by restaurant?
 - **Held** – Court took a deep dive into the factual matrix and observed that restaurant services were entirely supplied by students to a limited number of third parties (who are registered on the database) – the restaurant was not run for earning profits, hence, 'principle of fiscal neutrality' was not violated – **thus, the restaurant services qualified as a 'closely related supply'; hence, exemption available**
- ❖ **ECJ in its decision propounded three fundamental conditions /parameters to determine as to whether a supply is a 'closely related supply'**

'Ancillary' or 'Incidental' supplies

- ❖ These parameters can be pragmatically in the Indian context used to decipher 'incidental' or 'ancillary' supplies
- ❖ **The three fundamental conditions /parameters are – a supply is incidental or auxiliary if**
 - **It "relates to" and is "closely linked" with the main supply;**
 - **It is actually supplied as ancillary to the main supply; and**
 - **If it does not constitute an end in itself, but a means of better enjoying the main supply**
- ❖ These factors may also be used in ascertaining '**composite supplies**' under **Section 2(30) of the CGST Act** or **scope of various GST exemptions/concessions**



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