CASE STUDY 3

FST Limited is engaged in the business of manufacturing and export of ready- made garments like T-shirts, skirts, tops and similar casual wear. CA T is statutory auditor of the company and also provides tax consultancy services. He also handles matters pertaining to direct and indirect taxes of the company. On a Monday morning, he had gone to the company's office located in NOIDA for participating in a pre-arranged meeting with certain key directors of the company on some matters. The said location also houses company's manufacturing facilities.

Barely had the meeting started, a team of three officers from Income Tax department descended upon the company's premises to conduct TDS survey under Income Tax Act, 1961. After completing the necessary formalities, they asked for financial statements for last three years and evidence of TDS returns filed during those periods. Thereafter, they took control of the systems of the company containing its books of accounts. Meanwhile, directors of the company requested CA T to stay there and help them out in this situation.

After perusing company's accounts books, documentary evidence including bills for few hours, the team summarized following points/ purported lapses by the company in the matter of TDS deduction and incidental issues: -

(i) It was pointed out that company has made payments during these years to Bharat Container Corporation Limited (BCCL), a government owned PSU. The said company operates container cargo services and its terminal is linked with rail lines to various gateway ports including one at JNPT, Nhava Sheva, Mumbai.

FST Limited sends its export bound cargo utilizing above PSU's services. On going through bills raised by BCCL on FST Limited, it was observed that these pertained to charges levied by BCCL for handling containers, road transportation charges and railway freight. The team has pointed out that tax has been short-deducted for above payments made to BCCL.

(ii) FST Limited has made payments during these years to certain companies providing clearing and forwarding services for carriage of goods. The team has pointed out that tax has been deducted on these payments at inappropriate rates leading to short-deduction of tax. The team insists that these payments are in the nature of brokerage and warrant tax deduction rate of 5%.

(iii) FST Limited had also recently participated in a fair in Mumbai in 2023-24 and had paid charges of Rs.5.00 lacs towards makeshift stall and use of furniture in an exhibition centre

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owned by a company. The team had pointed out non-deduction of tax at source by FST Limited on the same.

(iv) During the survey, team also stumbled upon service bills of few clearing and forwarding agents. These agents were acting as shipping agents of non-resident ship owners. FST Limited had paid ocean freight to these shipping agents of non-resident shipping lines. The team had pointed out that tax has not been deducted on ocean freight paid to these shipping agents.

Before leaving, the team raised show-cause notice (SCN) relating to above issues.

Just when he was working on preparing a reply to above SCN after few days in his office, CA T received copy of a notice forwarded by the company. The said notice issued by Superintendent (Anti-Evasion), CGST Division informed that exporter company has been flagged as a "risky exporter" on the basis of risk analysis by DGARM (Directorate General of Analytics & Risk Management). The said notice contained a long list of documents to be submitted by the company including copies of GSTR-9, GSTR-3B, GSTR-1, reconciliations with ITC reflecting on portal, reconciliation of e-way bills issued with GSTR-1, financial statements of past years. The company is exporting goods on payment of IGST. Its export bound shipments attract GST @ 5%. Subsequently, a departmental team also visited premises of the company.

On going through documents submitted by the company and after conducting necessary verifications, team raised the following issues: -

(A) The team pointed out that fabric which is main raw material for manufacturing of garments having taxable value of Rs.50.00 lacs attracting GST rate of 5% was destroyed in a fire in premises of the company during month of April 2023. The company had availed ITC of Rs.2.50 lacs in the month of April 2023.

(B) The company has been availing services of a security service agency for providing it with security manpower. The company has paid amount of Rs.10.00 lacs to one such security service agency (a proprietorship concern) during year 2023-24 up to date of team's visit. It is insisted that company was required to pay GST on such services under reverse charge mechanism.

(C) It has been pointed out that company has received duty credit scrips under foreign trade policy of the government by virtue of being in export trade. These duty credit scrips, in turn, have been sold by the company to third parties. Supply of such duty credit scrips are exempt from GST under notification no.35/2017-Central tax (Rate). The team points out that company is required to reverse ITC on common input services relating to such exempt supplies.

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Assume that Income Tax Law for financial year 2023-24 (AY 2024-25) is applicable in situations involving past years. Ignore surcharges.

I. Multiple Choice Questions

1. Considering matter stated at [i] relating to short-deduction of tax from payments made to BCCL by survey team in their show-cause notice, which of the following statements is most appropriate in this regard?

   (a) Tax was required to be deducted on handling charges and railway freight. However, no tax was required to be deducted on road transportation charges under relevant provisions of law.

   (b) Tax was required to be deducted on road transportation charges and railway freight. However, no tax was required to be deducted on handling charges under relevant provisions of law.

   (c) Tax was required to be deducted on handling charges, road transportation charges and railway freight. The issue raised in SCN is correct and company has short deducted tax from payments made to BCCL.

   (d) Tax was required to be deducted on handling charges and road transportation charges. However, no tax was required to be deducted on railway freight under relevant provisions of law.

2. The survey team has raised the issue of application of inappropriate rate while deducting tax from payments made to certain companies providing clearing and forwarding services at JNPT, Nhava Sheva, Mumbai. Which of following statements is likely to be correct in this regard?

   (a) Tax was required to be deducted @ 5%. FST Limited has deducted tax from payments made to companies providing clearing and forwarding services @ 1%. Hence, there is short deduction of tax @ 4% from payments made to these companies.

   (b) Tax was required to be deducted @ 5%. FST Limited has deducted tax from payments made to companies providing clearing and forwarding services @ 2%. Hence, there is short deduction of tax @ 3% from payments made to these companies.

   (c) Tax was required to be deducted @ 2% and not @ 5% as pointed out by team. The issue raised in SCN is not in accordance with law.

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(d) Tax was required to be deducted @ 5%. FST Limited has deducted tax from payments made to companies providing clearing and forwarding services @ 0.5%. Hence, there is short deduction of tax @ 4.5% from payments made to these companies.

3. It was pointed out in the SCN that FST Limited has failed to deduct tax at source on payment made to a company owning exhibition centre in Mumbai for a makeshift stall and use of furniture. Which of following statements is in accordance with law in this regard?

(a) Tax was required to be deducted at source on payment made to the company owning exhibition centre. Such type of payment necessitates deduction of tax at source @ 2%.

(b) Tax was required to be deducted at source on payment made to the company owning exhibition centre. Such type of payment necessitates deduction of tax at source @ 10%.

(c) Tax was required to be deducted only for charges for use of makeshift stall @ 2% and for use of furniture @ 10%.

(d) Tax was not required to be deducted on the type of payment discussed above. Therefore, issued raised in SCN is not in accordance with law.

4. As regards destruction of stock of raw material in a fire in the month of April 2023 is concerned, which statement is most appropriate?

(a) Reversal of ITC of Rs.2.50 lacs by the company

(b) Reducing output liability by Rs.2.50 lacs by the company

(c) Increasing output liability by Rs.2.50 lacs by the company

(d) The issue raised by the team is not in accordance with law.

5. The team has raised the issue of non-payment of GST on availing services of a security agency described in case study under reverse charge mechanism. Which of the following is true in this regard?

(a) GST of Rs.0.50 lac was required to be paid under reverse charge and ITC of Rs.0.50 lac was required to be taken by the company in its monthly GSTR-3B.

(b) GST of Rs.1.80 lac was required to be paid under reverse charge and ITC of Rs.1.80 lac was required to be taken by the company in its monthly GSTR-3B.

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(c) GST of Rs.0.50 lac was required to be paid under reverse charge but no credit of the same was required to be taken by the company in its monthly GSTR-3B.

(d) GST of Rs.1.80 lac was required to be paid under reverse charge but no credit of the same was required to be taken by the company in its monthly GSTR-3B.

II. Descriptive Questions

6. The survey team has raised the matter regarding non-deduction of tax at source on ocean freight paid to shipping agents of non-resident foreign shipping companies in its show-cause notice. How can CA T defend the company while preparing reply to show cause notice as far as this issue is concerned? Quote relevant provisions of law (including notifications/circulars) on this subject matter.

7. The GST team has pointed out that the company is required to reverse the ITC on common input services relating to exempt supplies of duty credit scrips. What is your opinion on this issue considering relevant provisions of law?

ANSWERS TO THE CASE STUDY 3

I. Answers to the Multiple Choice Questions

1. (d) Under provisions of section 194C of Income Tax Act, 1961, tax is required to be deducted at source in accordance with provisions of this section for carrying out any work. Explanation to Section 194C explains that work shall include carriage of goods or passengers by any mode of transport other than by railways. Therefore, transport charges by railways does not require deduction of tax at source. Handling charges are in nature of service contracts and require deduction of tax at source under section 194C.

2. (c) The team has pointed out that tax has been deducted on payments made to certain companies providing clearing and forwarding services at inappropriate rates leading to short-deduction of tax. The team insists that these payments are in nature of brokerage and warrant tax deduction rate of 5%. However, team's view point is not in accordance with law. The expenses incurred are not in nature of brokerage. Explanation to section 194H provides that "commission or brokerage" includes any payment received or receivable, directly or indirectly, by a person acting on behalf of another person for services rendered (not being professional services) or for any services in the course of buying or selling of

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goods or in relation to any transaction relating to any asset, valuable article or thing, not being securities.

However, in the given situation, services are being rendered by companies as forwarders and for facilitating their movement and carriage from port to the country of destination. Brokerage is normally associated with payment in nature of buying or selling of goods or in relation to any transaction relating to any asset. Further, circular no.715 dated 8.8.1995 issued by CBDT states that "*as regards payment to clearing and forwarding agent for carriage of goods, the same shall be subject to tax deduction at source under section 194C of Income Tax Act.*

3. (b) Under provisions of section 194- I of Income Tax Act, 1961, any person, not being an individual or a Hindu undivided family, who is responsible for paying to a resident any income by way of rent, shall, at the time of credit of such income to the account of the payee or at the time of payment thereof in cash or by the issue of a cheque or draft or by any other mode, whichever is earlier, deduct income-tax thereon at the rate of—

(i) two per cent for the use of any machinery or plant or equipment; and

(ii) ten per cent for the use of any land or building (including factory building) or land appurtenant to a building (including factory building) or furniture or fittings

Provided that no deduction shall be made under this section where the amount of such income or, as the case may be, the aggregate of the amounts of such income credited or paid or likely to be credited or paid during the financial year by the aforesaid person to the account of, or to, the payee, does not exceed two hundred and forty thousand rupees.

The company has made payment of Rs.5.00 lacs for use of building and furniture which is more than threshold limit of section 194- I. It attracts TDS @ 10% as provided for under section 194- I.

4. (a) Section 17(5)(h) of CGST Act, 2017 states that input tax credit shall not be available in respect of goods lost, stolen, destroyed, written off or disposed of by way of gift or free samples. Since raw material having taxable value of Rs.50.00 lac has been destroyed in fire, ITC on same amounting to Rs.2.50 lac needs to be reversed by the company.

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5. **(b)** Security services provided by a person other than a body corporate to a registered person located in taxable territory are liable to GST under reverse charge mechanism under notification number 29/2018 -Central Tax (Rate) dated 31.12.2018. Since FST Limited has availed services provided by way of supply of security personnel from a proprietary firm, it has to pay GST under reverse charge mechanism.

Further, GST rate for services i.e. 18% is applicable to such services under reverse charge mechanism and company needs to take ITC in respect of same.

II. Answers to the Descriptive Questions

6. In the given situation, FST Limited has made payment of ocean freight to agents of non-resident foreign shipping companies.

Section 194C states that any person responsible for paying any sum to any resident for carrying out any work (including supply of labour for carrying out any work) in pursuance of a contract between the contractor and a specified person shall, at the time of credit of such sum to the account of the contractor or at the time of payment thereof in cash or by issue of a cheque or draft or by any other mode, whichever is earlier, deduct tax at source at specified rates. In accordance with provisions of section 194 C, work also includes carriage of goods and passengers by any mode of transport other than railways.

However, Board has issued circular no.723 dated 19.9.1995 in this regard relating to shipping business of non-residents. It states that section 172 deals with shipping business of non-residents. Section 172(1) provides that the mode of the levy and recovery of tax in the case of any ship, belonging to or chartered by a non-resident, which carries passengers, livestock, mail or goods shipped at a port in India. An analysis of the provisions of section 172 would show that these provisions have to be applied to every journey a ship, belonging to or chartered by a non-resident, undertakes from any port in India. Section 172 is a self-contained code for the levy and recovery of the tax, ship-wise, and journey wise, and requires the filing of the return within a maximum time of thirty days from the date of departure of the ship.

The provisions of section 172 are to apply, notwithstanding anything contained in other provisions of the Act. Therefore, in such cases, the provisions of sections 194C and 195 relating to tax deduction at source are not applicable. The recovery of tax is to be regulated, for a voyage undertaken from any port in India by a ship under the provisions of section 172.

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Section 194C deals with work contracts including carriage of goods and passengers by any mode of transport other than railways. This section applies to payments made by a person to any "resident" (termed as contractor). It is clear from the section that the area of operation of TDS is confined to payments made to any "resident". On the other hand, section 172 operates in the area of computation of profits from shipping business of non-residents. Thus, there is no overlapping in the areas of operation of these sections.

It further states that there would, however, be cases where payments are made to shipping agents of non-resident ship-owners or charterers for carriage of passengers etc., shipped at a port in India. *Since, the agent acts on behalf of the non-resident ship-owner or charterer, he steps into the shoes of the principal. Accordingly, provisions of section 172 shall apply and those of sections 194C and 195 will not apply.*

Therefore, it is very much clear from above analysis that FST Limited was not required to deduct tax at source from payments on account of ocean freight to shipping agents of non-resident ship owners. CA T can defend the company by preparing reply to SCN on these lines.

7. Section 17(2) of CGST Act, 2017 states that where the goods or services or both are used by the registered person partly for effecting taxable supplies including zero-rated supplies under this Act or under the Integrated Goods and Services Tax Act and partly for effecting exempt supplies under the said Acts, the amount of credit shall be restricted to so much of the input tax as is attributable to the said taxable supplies including zero-rated supplies.

Further, section 17 (3) states that the value of exempt supply under sub-section (2) shall be such as may be prescribed, and shall include supplies on which the recipient is liable to pay tax on reverse charge basis, transactions in securities, sale of land and, subject to clause (b) of paragraph 5 of Schedule II, sale of building.

[**Explanation.**- For the purposes of this sub-section, the expression "value of exempt supply" shall not include the value of activities or transactions specified in Schedule III, except those specified in paragraph 5 of the said Schedule]

In this regard, Rule 42 of CGST Rules, 2017 prescribes manner of determination of input tax credit in respect of inputs and input services and reversal thereof where input or input services have been partly used for effecting taxable supplies including zero rated supplies and partly for effecting exempt supplies.

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Further, Rule 43(1) of CGST Rules, 2017 prescribes manner of determination of input tax credit in respect of capital goods and reversal thereof in certain cases including where such ITC is partly used for effecting taxable supplies including zero rated supplies and partly for effecting exempt supplies.

Explanation 1 under this clause states that for the purposes of rule 42 and rule 43, aggregate value of exempt supplies shall **exclude:** -

- the value of services by way of accepting deposits, extending loans or advances in so far as the consideration is represented by way of interest or discount, except in case of a banking company or a financial institution including a non-banking financial company, engaged in supplying services by way of accepting deposits, extending loans or advances and
- the value of supply of services by way of transportation of goods by a vessel from the customs station of clearance in India to a place outside India.
- the value of supply of Duty Credit Scrips specified in the notification of the Government of India, Ministry of Finance, Department of Revenue **No. 35/2017-Central Tax (Rate)**, dated 13.10.2017.

Therefore, value of supply of duty credit scrips is excluded from aggregate value of exempt supplies determined under Rule 42 of CGST Rules, 2017. Since value of such supply is excluded while determining value of exempt supplies under Rule 42, no ITC is required to be reversed in respect of such exempt supply.

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