



Place of Supply outside India - A Taxability conundrum



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TAXABILITY CONUNDRUM

Article 246 of the Constitution of India provides the authority to levy taxes by allocation between the Centre and States. Apart from giving the authority to levy taxes, an important restriction has been given under Article 265 of the Constitution of India which states that “No tax shall be levied or collected except by authority of law”. This implies that though the power to make laws has been given by the Constitution to the Parliament and the Legislature of a State as the case may be, such tax law cannot encroach the boundaries set by the Constitution of India. Any provision which moves beyond the powers allowed by the Constitution of India may result in it being declared as ultra vires by the judicial authorities.

For interpretation of any indirect tax law, the most important aspect is a diligent study of the chargeability section under it. It identifies the taxable event on which the tax to be levied. The basic intent of the taxability and objective of the tax act can be identified through this chargeability section. As regards the application of this principle, GST law is no different. The chargeability section i.e. Section 5 of the IGST Act states the following:

“(1) Subject to the provisions of sub-section (2), there shall be levied a tax called the integrated goods and services tax on all inter-state supplies of goods or services or both; except on the supply of alcoholic liquor for human consumption, on the value determined under section 15 of the Central Goods and Services Tax Act and at such rates not exceeding forty percent as may be notified by the Government on the

recommendations of the Council and collected in such manner as may be prescribed and shall be paid by the taxable person

Provided that the integrated tax on goods imported into India shall be levied and collected in accordance with the provisions of section 3 of the Customs Tariff Act, 1975 on the value as determined under the said Act at the point when duties of customs are levied on the said goods under section 12 of the Customs Act

(2) The integrated tax on the supply of petroleum crude, high speed diesel, motor spirit (commonly known as petrol), natural gas and aviation turbine fuel shall be levied with effect from such date as may be notified by the Government on the recommendations of the Council”

From the above, it can be inferred that IGST Act, 2017 purports to tax inter-state supplies of goods or services except alcoholic liquor for human consumption and petroleum products. An exception that has been carved out is power given to the Government to grant exemption for certain goods or services as per Section 6 of the IGST Act. The taxability for import of goods and point of taxation is said to be driven by the Customs Act, 1962 which states that all taxes at the time of importation will be collected when the import declarations are filed before the customs authorities for customs clearance. Apart from the above, it has been stated that certain supplies will be taxed as zero rated supplies under the law as per Section 16 of the IGST Act, 2017. Though these supplies are supposed to be taxable but the same will be subjected to 0% tax. As per Section 16(1) of the IGST Act:

“zero rated supply means any of the following supplies of goods or services or both, namely:

(a) Export of goods or services or both;

(b) Supply of goods or services or both to a Special Economic Zone developer or Special Economic Zone Unit”

In order to be subjected to zero rate of tax, one should satisfy the definition of export of goods or services or fall within supply to SEZ developer/unit. As per Section 2 of the IGST Act, export of goods and export of services have been defined as the following:

“Export of goods with its grammatical variations and cognate expressions, means taking goods out of India to a place outside India”

“Export of services means the supply of any service when –

- (i) The supplier of service is located in India*
- (ii) The recipient of service is located outside India*
- (iii) The place of supply of service is outside India*
- (iv) The payment for such service has been received by the supplier of service in convertible foreign exchange and*
- (v) The supplier of service and the recipient of service are not merely establishments of a distinct person in accordance with Explanation 1 in Section 8”*

Hence, one should be able to satisfy the definition of export of goods or services to fall within the ambit of zero rated supply. If the conditions laid down in the definition are not satisfied, one should not consider them as part of zero rated supply. For instance, if there is an export of service wherein the consideration is not received in convertible foreign exchange, it will not be considered as a zero rated supply. Now, the question that arises is if one does not fall within the ambit of zero rated supply, should tax be payable in India even if the place of supply is outside India?

Here it is pertinent to refer Section 7 of the IGST Act, 2017 which covers inter state supplies. Section 7(5)(a) states the following:

“Supply of goods or services or both when the supplier is located in India and the place of supply is outside India shall be treated to be a supply of goods or services or both in the course of inter-state trade or commerce”

Hence, even if the place of supply is outside India and it does not fall within the definition of export of goods/services, it will be deemed as inter-state supply. The chargeability section of the IGST Act, 2017 purports to tax all inter-state supplies and it may seem here that tax needs to be paid on such supplies wherein the place of supply is outside India but doesn't get covered within the ambit of export of goods or services.

Here, a parallel may be drawn with import of goods for which Section 7(2) of the IGST Act states the following:

“Supply of goods imported into the territory of India till they cross the customs frontiers of India, shall be treated to be a supply of goods in the course of inter-state trade or commerce”.

Here, high sea sales i.e. supply in the course of import before crossing of customs frontiers is deemed to be an inter state supply. However, it is not leviable to GST because the proviso to the chargeability section states that IGST shall be levied at the point when customs duties are levied i.e the filing of import declarations. Hence, there is no cause for confusion in respect of chargeability for import of goods. Only when bill of entry is filed, GST will be levied. Any supplies before filing of such bill of entry will not be taxable.

Such a parallel provision to exempt supplies wherein the place of supply is outside India has not been made in respect of supplies which are not zero rated. So as per the IGST Act, such supplies which are in the course of inter-state trade or commerce may be leviable to GST even if they do not fall within the definition of zero rated supply.

This has raised a dark cloud over certain supplies which are prevalent commonly:

- 1) Merchant trade transactions i.e. when the supplier instructs movement of goods from one country to the other wherein such goods do not cross the customs frontier of India
- 2) Services which are exported but the consideration is not received in convertible foreign exchange
- 3) Services which are exported but supplier and recipient are merely establishments of a distinct person

The first point above is not considered to be export of goods because it does not involve taking the goods out of India. The goods are transferred from one country to the other on instructions of a supplier in India.

The second point is not export of services within the GST law as export of services requires receipt of consideration in convertible foreign exchange.

The third point above is also not export of services within the GST law as the supplier and recipient should not be establishments of a distinct person for coverage under export of services.

Since, all the three supplies above have been covered within the ambit of inter-state supplies and are not zero rated supplies, they may be considered to be taxable as per the IGST Act, 2017. However, before jumping to any conclusion, one should refer to the Constitution of India. Article 269A of the Constitution of India inserted after the enactment of the 101st Constitutional Amendment Act, 2016 has been extracted below:

“(1) Goods and services tax on supplies in the course of inter state trade or commerce should be levied and collected by the Government of India and such tax shall be apportioned between the Union and States in the manner as may be provided by Parliament by law on recommendations of the GST Council.

(5) Parliament may, by law, formulate principles for determining the place of supply, and when a supply of goods or services takes place in the course of inter state trade or commerce.”

So, the powers for determining inter state supplies leviable to GST have been given to the Parliament which have been exercised by deeming the same in IGST Act, 2017 as discussed above.

In spite of the above powers, one of the major restrictions for imposition of GST has been provided in the amended Article 286 of the Constitution of India:

“(1) No law of a State shall impose, or authorise the imposition of, a tax on the supply of goods or services both, where such supply takes place—

(a) outside the State; or

(b) in the course of the import of the goods or services or both into, or export of the goods or services or both out of, the territory of India.

(2) Parliament may by law formulate principles for determining when a supply of goods or services or both in any of the ways mentioned in clause (1).”

On a careful reading of (b) above, it can be inferred that no law can allow taxing of supplies wherein supply is in the course of import of goods or services into India or where the goods are exported out of India. IGST Act, 2017 perfectly covers such situations and does not levy taxes on the same. For supply in the course of import, no tax is levied unless the import declarations are filed for clearance from the customs frontiers. Also, for transaction which are covered within export of goods or services have been zero rated under the IGST Act, 2017. So, point (b) above as prescribed in the Constitution of India has been complied through the IGST Act, 2017.

But, with regard to situation covered in (a) above, where place of supply is outside India, no tax should be levied as per the Constitution of India. The three examples given above which are commonly prevalent but do not fall within export of goods or services as defined above should be examined here. In all the three examples, the place of supply is outside India even though they do satisfy the definition of export of goods or services. As per the chargeability section 5 of the IGST Act which levies taxes on all inter state supplies, even the supplies covered in the three examples above seem to be taxable. However, the Constitution of India restricts any law to charge taxes which takes place or wherein the place of supply is outside India. Hence, there is a disparity between the IGST Act and the Constitution of India in cases wherein the place of supply is outside India. If the authorities desire to tax such transactions as per the IGST Act, 2017, in all likelihood a writ petition against the said provision will be filed for declaration of the said provision as ultra vires the Constitution of India.

From the above, it can be concluded that though the Parliament has been allowed the power to make laws with regard to determination of place of supply, the restrictions have also been provided in the Constitution of India. Any provision in the law should be kept in line with the restriction imposed by the Constitution of India. In situations where the place of supply is outside India but they do not get covered within the definition of export of goods or services, there is a divergence in the law as regards the Constitution of India. The Constitution of India does not allow leviability of GST on it whereas the IGST Act seems to levy taxes on such supplies. These transactions are very common and are carried out by businesses in large scale. It is suggested here that the Government should pay attention to this anomaly and amend the same to avoid any mass scale litigation on the said provision.

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