

EY Tax Alert

Gujarat HC quashes CBIC Circular and extends GST exemption to DISCOM's ancillary services

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Executive summary

This Tax Alert summarizes a recent ruling of Gujarat High Court (HC)^[1], which strikes down paragraph 4(1) of Circular No. 34/8/2018-GST dated 1 March 2018 as being ultra vires the provisions of CGST Act and exemption notification^[2].

The circular clarified that various charges collected by the power distribution companies like rental charges for metering equipment, charges for duplicate bill, application fee for releasing connection of electricity, etc. are taxable.

The key observations of HC are as follows:

- ▶ Services which were included within the ambit of transmission and distribution of electricity during the pre-negative list regime cannot now be sought to be excluded by merely issuing a clarificatory circular, that too, with retrospective effect.
- ▶ Such services would stand covered by the exemption granted to transmission and distribution of electricity.
- ▶ The services provided by the petitioner are in the nature of composite supply and therefore the tax liability has to be determined by treating the same as a supply of transmission and distribution of electricity (which is the principal supply).

^[1] Torrent Power Ltd. v. Union of India [2019-VIL-18-GUJ]

^[2] Notification No. 12/2017-Central tax (Rate), dated 28 June 2017

Background

- ▶ The petitioner is engaged in the business of generation, transmission and distribution of electricity in the state of Gujarat.
- ▶ The Gujarat Electricity Regulatory Commission (GERC) Regulations empower the petitioners to recover the charges for various kinds of activities which are part of the electricity distribution process such as registration, testing charges, disconnection charges, meter rent, etc.
- ▶ Notification Nos. 11/2010-ST dated 27 February 2010 and 32/2010-ST dated 22 June 2010, were issued exempting services of transmission and distribution of electricity from levy of Service tax.
- ▶ Vide Circular No. 131/13/2010-ST dated 7 December 2010, it was clarified that supply of electricity meters on hire to the consumers was an essential activity having direct and close nexus with the transmission and distribution of electricity and was, therefore, covered by the above exemption notifications.
- ▶ Transmission of electricity by an electricity transmission or distribution utility was subsequently included in the negative list of services and was thus not taxable.
- ▶ Petitioner did not pay tax on various charges collected in connection with transmission of electricity post 2012.
- ▶ Under GST, transmission or distribution of electricity by an electricity transmission or distribution utility is exempt.¹
- ▶ On 1 March 2018, CBIC issued Circular No. 34/8/2018-GST. Paragraph 4(1) of the circular clarify that following charges recovered by DISCOMS (Distribution Companies) from consumers are taxable:
 - ▶ Application fee for releasing connection of electricity
 - ▶ Rental Charges against metering equipment
 - ▶ Testing fee for meters/ transformers, capacitors etc.
 - ▶ Labour charges from customers for shifting of meters or shifting of service lines
 - ▶ Charges for duplicate bill
- ▶ Subsequently, the Directorate General of Goods and Service Tax Intelligence (DGGI), issued summons to the petitioner requiring them to submit details relating to charges as mentioned in the impugned circular for all years commencing 2012-13.
- ▶ Service tax and GST was proposed to be levied on such charges.
- ▶ Aggrieved, the petitioner filed Writ Petition before the Gujarat High Court (HC).

Petitioner's Contentions

- ▶ Entry 25 of the exemption notification (under GST) exempts from tax, the service of transmission or

distribution of electricity.

- ▶ Such notification would cover all activities that are directly and closely connected to the distribution or transmission of electricity.
- ▶ The charges such as meter rent and other similar charges are specifically included in the charges for electricity as per the provisions of the Electricity Act.
- ▶ Even other miscellaneous charges relating to the activity of transmission or distribution are required to be collected in accordance with the provisions of the Electricity Act and the GERC Regulations.
- ▶ Such activities are mandatorily required to be carried out for the purpose of supply of electricity. It is not possible to supply electricity without undertaking such activities.
- ▶ All the charges such as application fee, meter rent, testing fee, etc. are towards transmission and distribution of electricity and, therefore, exempt by virtue of the inclusion of transmission and distribution of electricity in the negative list and exemption notifications issued under GST.
- ▶ The clarification to the effect that they would not be covered by entry relating to exemption of transmission or distribution of electricity is contrary to express words as well as intent of the exemption notification and, therefore, bad and illegal.
- ▶ Alternatively, if the services relating to transmission and distribution of electricity are per-se not covered by exemption notifications, then such services would form part of composite supply with principal supply being transmission and distribution of electricity and be taxed accordingly.²
- ▶ The services are part of main service of transmission and distribution and cannot be segregated for the purpose of GST. The fact that these services are being regulated by the GERC shows that they are composite.
- ▶ When the notification under the parent Act exempts the principal supply, a circular cannot impinge upon the notification and seek to hold the composite supply taxable.
- ▶ Circular cannot run contrary to the notification, and hence, the impugned clarification deserved to be set aside.
- ▶ Once the impugned circular is set aside, the rigours of the summons, whereby the petitioner is called upon to furnish details with regard to the services in question would also be required to be set aside.
- ▶ In any case, the impugned circular cannot be given retrospective effect as was sought to be done in the given case. Reliance was placed upon the decision of the Supreme Court in the cases of *Suchitra Components Limited v. Commissioner of Central Excise*³ and *Commissioner of Central Excise, Bangalore v. Mysore Electricals Industries Ltd.*⁴
- ▶ Insofar as the period of the negative list regime was

¹ As per entry 25 of Notification No. 12/2017-Central tax (Rate) dated 28 June 2017.

² As per Sections 2(30) and 8(a) of the CGST Act, 2017.

³ 2007-VIL-62-SC-CE

⁴ 2006-VIL-57-SC-CE

concerned, such services would fall within the ambit of bundled services as contemplated under Section 66F(3) of Finance Act, 1994. and thus exempt even under the negative list regime.

Revenue's Contentions

- ▶ Preliminary objection was raised to the maintainability of the petition on the ground that the petition was directed against a summons issued by the Revenue.
- ▶ As Revenue has powers to issue summons, it is not illegal and consequently, cannot be subject matter of challenge in a writ petition. Reliance was placed upon the decision of the Madras HC in case of *K. Elumalai v. Commissioner of Customs, Chennai*⁵.
- ▶ Previous exemption notifications⁶ had been issued prior to the year 2012 and came to be rescinded by the Notification dated 20 June 2012. Hence, clarificatory Circular dated 7 December 2010, which had been issued in the context of the earlier exemption notifications would not survive.
- ▶ Reference was made to sub-section (1) of section 66F of the Finance Act, as amended in 2012, which provides that unless otherwise specified, reference to a service (main service) shall not include reference to a service which is used for providing main service.
- ▶ Section 66F clarifies the intention of widening the tax net and, accordingly, with effect from 1 July 2012, the Legislature consciously discontinued the additional exemption provided to related/ancillary services by the Circular dated 7 December 2010.
- ▶ Only the services of transmission and distribution of electricity are exempt and, hence, the related/ancillary services would not fall within the purview of the exemption notifications.
- ▶ Section 66F of the Finance Act cannot be read to expand the exemption provision and that merely because some services may be naturally bundled with exempted services, would not make such services exempt from tax.
- ▶ While the purpose of the Electricity Act is to govern the supply and distribution of a commodity, its taxability would be governed by the taxing statute. Merely because supply and distribution is governed by a statute, the same would not expand the scope of the exemption notification.
- ▶ It is settled law that exemption provisions are required to be interpreted strictly and in case of doubt the benefit goes to the State. Reliance was placed on the decision of the Supreme Court in the cases of *Commissioner of Customs v. Dilipkumar and Company*⁷ and *Novopan India Limited v. Collector of Central Excise and Customs, Hyderabad*⁸.
- ▶ Further, Section 66F(3) of the Finance Act (provision relating to bundled services), operates only qua services which are chargeable to tax under section 66B. Hence,

Section 66F(3) would not apply to services falling in the negative list. Therefore, benefit of bundling would not be available in the given case.

- ▶ Under GST, when tax is leviable on one service and the other service is exempt, Section 8 of the CGST Act (provision taxing composite supply in same way as principle supply) would not apply.
- ▶ Further, as per the definition of 'composite supply', its constituent supplies should be so integrated with each other that one is not supplied in the ordinary course of business without or independent of the other.
- ▶ In the given case, subject services may not necessarily be supplied so as to provide services of transmission and distribution of electricity.
- ▶ Reliance was placed upon the decision of Rajasthan Authority for Advance Ruling (AAR) in the case of *TP Ajmer Distribution Ltd*⁹. Relying on the impugned circular, the AAR had held that various services including meter renting services are chargeable under GST.
- ▶ Further, the circular simply clarifies the existing position as well as the position which existed earlier, and thus does not amount to levy of fresh tax with retrospective effect. The cases of *Katira Construction Ltd. v. Union of India*¹⁰ and *Commissioner of Income Tax, Ahmedabad, v. Gold Coin Health Food Pvt. Ltd.*¹¹ were referred.

High Court Ruling

- ▶ In view of fact that the impugned summons was based upon the clarificatory circular, which was subject matter of challenge in the given petition, HC dismissed Revenue's contention that the petition challenging the summons was not maintainable.
- ▶ It was not the summons per se which was subject matter of challenge, but the basis thereof, viz. the clarificatory Circular dated 1 March 2018, which was also subject matter of challenge.
- ▶ Challenge to the impugned summons was only an ancillary relief sought in connection therewith.
- ▶ Referring to the Circular dated 7 December 2010 issued under Service tax, the HC observed that the reason for saying that supply of electricity meters for hire to consumers was covered by the exemption notification was that such service was an essential activity having direct and close nexus with transmission and distribution of electricity.
- ▶ The circular only provides an interpretation of when a service would stand included in another service, that is, when such service is an essential activity having direct and close nexus with the exempted activity.
- ▶ Therefore, the fact that the exemption notifications came to be rescinded would have no bearing in as much as the circular only clarifies what according to the

⁵ 2017 (355) ELT 241 (Madras)

⁶ Notification Nos. 11/2010-ST dated 27 February 2010 and 32/2010-ST dated 22 June 2010

⁷ 2018-VIL-23-SC-CU-CB

⁸ 1994-VIL-05-SC-CE

⁹ 2018-VIL-80-AAR

¹⁰ (2013) 352 ITR 513 (Gujarat)

¹¹ (2008) 304 ITR 308 (SC)

Government would stand included in another service. Such interpretation would not change merely because the exemption is now granted under some other provision.

- ▶ The meaning of 'transmission and distribution of electricity' does not change either for the negative list regime or the GST regime.
- ▶ If that be so, the services which stood included within the ambit of transmission and distribution of electricity during the pre-negative list regime cannot now be sought to be excluded by merely issuing a clarificatory circular, that too, with retrospective effect.
- ▶ By the circular, Revenue seeks to give a different interpretation of the very same services as against the clarification issued in the pre-negative list regime.
- ▶ From the very manner in which the Revenue has treated the services related to transmission and distribution of electricity during the pre-negative list regime, such services would stand covered by the exemption granted to transmission and distribution of electricity by virtue of inclusion of such services in the negative list of services under Service tax as well as by exemption notification issued under GST.
- ▶ A perusal of the GERC Regulations indicates that the services which are sought to be taxed are the services, which the petitioner is required to mandatorily provide at the rate prescribed by GERC, a statutory authority constituted under the provisions of the Electricity Act.
- ▶ All these services are essential activities which have a direct and close nexus with transmission and distribution of electricity.
- ▶ Dismissing Revenue's contention, the HC observed that there was nothing in the language employed in sub-section (3) of section 66F to read into it a requirement that the bundled service should not be exempt from tax.
- ▶ All that the sub-section provides is that taxability of bundled services shall be determined in the manner provided therein.
- ▶ The term taxability means liability to taxation. The term taxability would take within its sweep not being taxable also.
- ▶ Accordingly, where the services are naturally bundled in the ordinary course of business and the single service which gives such bundle its essential character is exempt from tax, the entire bundle will have to be treated as provision of such single service (and thus will be exempt).
- ▶ Section 8 read with Section 2(30) of CGST Act are more or less akin to section 66F(3)(a) of the Finance Act. Both require that to fall within the ambit, the services should be naturally bundled in the ordinary course of business.
- ▶ HC dismissed Revenue's contention that clause (a) of Section 8 of the CGST Act would not be applicable where the principal supply is exempt from levy of tax. It observed that there was nothing in section 8 of the Act to read any such construction.
- ▶ What the Section says is that the tax liability of a composite or a mixed supply shall be determined in the manner provided thereunder. In a given case, the tax liability may be nil, but that would not take such service

out of the purview of section 8, notwithstanding that the end result may be nil tax liability.

- ▶ In the given case, the related supplies cannot be supplied separately. They are dependent on the principal supply of transmission and distribution of electricity and vice versa.
- ▶ Transmission and distribution of electricity cannot be done without the help of electric line, electric plant and electric meter, nor can the related services be used for any purpose other than for transmission and distribution of electricity.
- ▶ The principal supply and the related/ ancillary services go hand in hand and one cannot be provided independent of the other.
- ▶ The services provided by the petitioner are in the nature of composite supply and therefore the tax liability thereof has to be determined by treating the same as a supply of transmission and distribution of electricity (which is the principle supply).
- ▶ Consequently, if the principal supply of transmission and distribution of electricity is exempt, the tax liability of the related services shall also be determined accordingly.
- ▶ The HC, thus, struck down paragraph 4(1) of the impugned Circular No.34/8/2018-GST dated 1 March 2018 as being ultra vires the provisions of section 8 of the CGST Act, 2017 as well as serial No.25 of Notification No.12/2017- CT (Rate).
- ▶ The impugned summons by the Revenue were also set aside.
- ▶ HC declined Revenue's request to stay the operation of the judgment for eight weeks so as to enable them to approach the higher forum.

Comments

Although the circular issued by CBIC is not binding on the taxpayers, the ruling of Gujarat HC has cleared the ambiguity that had arisen due to conflicting view in the circular issued under GST and is likely to benefit not only the power distributing entities but also the end consumers.

The ruling confirms the position that a composite supply could include an exempt supply also. However, there are media reports that GST Council is considering to unbundle supplies which consist of both taxable and exempt supplies.

Reference is invited to EY Tax Alert of 8 March 2018 wherein a view had been expressed that clarification on tax treatment in respect of incidental supplies by DISCOMS was required to be revisited and that such supplies may be treated as composite supply.

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