

Revenue Neutrality – Concept and Impact on Indian GST



CA. Ramya C

ramya@hnaindia.com

The term 'Revenue Neutral' implies a situation where changes in the application of tax laws in different countries or States (where there exist State and Centre) does not result in a transaction escaping tax or missing being taxed at both ends, by change in the total amount of revenue coming into the Government's treasury. In other words, a State where the Government does not gain or lose any revenue. This concept is most prevalent in indirect taxes. The principal of revenue neutrality has not been prescribed in law. The doctrine is formed through evolved jurisprudence and certain internationally accepted guidelines,

OECD Guidelines for Indirect Taxation:

The OECD (Organisation for Economic Co-operation and Development) conducted surveys of governments and businesses between 2007 and 2009, based on which revenue neutrality guidelines were issued. These guidelines were to be followed by countries while creating tax policies.

The guidelines are as follows:

Guideline 1: The burden of value added taxes themselves should not lie on taxable businesses except where explicitly provided for in legislation.

Guideline 2: Businesses in similar situations carrying out similar transactions should be subject to similar levels of taxation.

Guideline 3: VAT rules should be framed in such a way that they are not the primary influence on business decisions.

Guideline 4: With respect to the level of taxation, foreign businesses should not be disadvantaged nor advantaged compared to domestic businesses in the jurisdiction where the tax may be due or paid.

Guideline 5: To ensure foreign businesses do not incur irrecoverable VAT, governments may choose from a number of approaches.

Guideline 6: Where specific administrative requirements for foreign businesses are deemed necessary, they should not create a disproportionate or inappropriate compliance burden for the businesses.

In creating a revenue neutral tax regime, these OECD guidelines have been adopted in taxation laws by various countries (including India). Canada and New Zealand relies on zero rating to provide relief to foreign businesses when appropriate (Guideline 4). Canada allows non-resident businesses to register in its country (Guideline 2), or to require a third party to register on their behalf to offset the input GST or be responsible when GST is not paid (Guideline 3). The said principal was affirmed under European Union law in the case **50/87 Commission of the European Communities Vs the French Republic of 21 September, 1988**.

(The OECD Guidelines may be accessed here:

<https://www.oecd.org/ctp/consumption/guidelinesneutrality2011.pdf>)

Implications of Revenue Neutrality in India:

Revenue Neutrality is not a new concept in Indian indirect tax system. It has been quoted in various jurisprudence in the pre-GST and post-GST as well. Depending on the facts and circumstances of the case, there were instances when the doctrine of revenue neutrality was accepted and also when the doctrine was rejected or held as irrelevant. Following are significant judgements under erstwhile laws:

Where Doctrine of Revenue Neutrality was accepted:

- 1. V.E. Commercial Vehicles Ltd Vs. CCE & ST [2018 (15) G.S.T.L. 291 (Tri. - Del.)] affirmed by the Supreme Court in [2019 (31) G.S.T.L. J96 (S.C.)]:** The demand of short-payment of duty along with interest and penalties was set aside since as revenue neutral since such duty paid would inevitably be available as rebate since goods are exported.
- 2. Mahindra & Mahindra Ltd Vs CCE [2019 (368) E.L.T. 105 (Tri. - Mumbai)] affirmed by the Supreme Court in [2019 (368) E.L.T. A41 (S.C.)]:** In this case, for clearances to sister unit, admin expenses, R&D expenses and royalty was demanded to be included for discharge of duty. The Supreme Court accepted the contention of revenue neutrality and set aside the demand since the receiving sister entity would be anyhow eligible for CENVAT Credit.
- 3. Jet Airways (I) Ltd Vs Commissioner of Service Tax [2016 (44) S.T.R. 465 (Tri. - Mumbai)] affirmed by the Supreme Court in 2017 (7) G.S.T.L. J35 (S.C.):** The case was with respect to demand of service tax under RCM on online information and database access or retrieval services. It was observed that service tax payable under RCM, being available as credit for discharging tax on its output service, the entire issue is revenue neutral and the demand, interest and penalty is not sustainable.

4. **CCE Vs Coca-Cola India Pvt Ltd [2007 (213) E.L.T. 490 (S.C.)]**: The Supreme Court accepted the stand taken by the Assessee that the duty payable in respect of beverage basis/concentrates is modvatable. Since the duty payable by the Respondent is modvatable, there is no revenue implication. The issue of classification is, therefore, academic. No purpose would be served by entertaining the present appeal.

5. **Commissioner of C.EX.& CUS., Vadodara Vs Narmada Chematur Pharmaceuticals Ltd [2005 (179) E.L.T. 276 (S.C.)]**: The Supreme Court held that where an optional exemption is not availed to enable availment of Cenvat/Modvat credit and when such Cenvat/Modvat credit amount claimed to be wrongly availed is exactly equivalent to the amount of excise duty paid by not availing the exemption, the consequence is revenue neutral, hence demand for such wrong availment of credit rightly quashed by Tribunal.

6. **Jay Yushin Ltd Vs CCE [2000 (119) E.L.T. 718 (Tri.-LB)]**: Wherein extended period of limitation was held invalid due to revenue neutrality. It further observed:

“(a) Revenue neutrality being a question of fact, the same is to be established in the facts of each case and not merely by showing the availability of an alternate scheme;...

*...(c) With particular reference to Modvat scheme (which has occasioned this reference) it has to be shown that the **Revenue neutral situation comes about in relation to the credit available to the assessee himself and not by way of availability of credit to the buyer of the assessee’s manufactured goods;**”*

Where Doctrine of Revenue Neutrality was NOT accepted:

1. **Jemcon Industries Vs CCE [2018 (17) G.S.T.L. 264 (Tri. - Mumbai)] affirmed by the Supreme Court in 2018 (17) G.S.T.L. J50 (S.C.)**: It was held that value of free goods supplied by the buyer to seller is required to be added to the assessable value. The assessee contended that it is a revenue neutral situation since the customer would be eligible for credit on such free goods. The Court held that:

“We find that the Cenvat credit was not taken by the appellant, rather it was not available to them whereas the Cenvat credit was admittedly taken by the buyer. Secondly, the appellant, due to crossing the exemption limit of Rs. 1 crore are required to pay duty on other goods also. Therefore, the revenue neutrality does not apply in the facts of the present case.”

2. **Commissioner of ST Vs Melange Developers Private Limited [2020 (33) G.S.T.L. 116 (Tri. - LB)]**: Wherein it was held as under:

*“The submission of the Learned Counsel for the Respondent regarding ‘revenue neutrality’ **cannot also be accepted in view of the specific provisions of Section 66 and 68 of the Act. A sub-***

contractor has to discharge the Service Tax liability when he renders taxable service. The contractor can, as noticed above, take credit in the manner provided for in the Cenvat Credit Rules of 2004”.

Here, it is important to note that the favourable case of Coca-Cola discussed above has been distinguished multiple times including in Lahari Impex Pvt Ltd Vs CC (Seaport-Import), Chennai [2020 (374) E.L.T. 716 (Mad.)], which was affirmed by the Supreme Court and also the recent Supreme Court decision in C.C., C.E. & S.T., Bangalore (Adjudication) Vs Northern Operating Systems Pvt Ltd [2022 (61) G.S.T.L. 129 (S.C.)].

In the former case of Lahari Impex, with respect to non-fulfillment of condition for duty drawback, it was held that merely because Assessee could claim duty drawback later on, and same may result in revenue neutral situation, period of one year prescribed in said Notification cannot be said to be without any meaning. In the latter case of Northern Operating Systems, it was observed as follows: *“As regards the question of revenue neutrality is concerned, the assessee’s principal contention was that assuming it is liable, on reverse charge basis, nevertheless, it would be entitled to refund; **it is noticeable that the two orders relied on by it (in SRF and Coca Cola) by this Court, merely affirmed the rulings of the CESTAT, without any independent reasoning. Their precedential value is of a limited nature. This Court has been, in the present case, called upon to adjudicate about the nature of the transaction, and whether the incidence of service tax arises by virtue of provision of secondment services. That a particular rate of tax - or no tax, is payable, or that if and when liability arises, the assessee, can through a certain existing arrangement, claim the whole or part of the duty as refund, is an irrelevant detail. The incidence of taxation, is entirely removed from whether, when and to what extent, Parliament chooses to recover the amount.”***

From the above, it can be seen that there is no hard-and-fast rule for application of revenue neutrality. However, its application can be summarised as below:

- a) Revenue neutrality may be used to render demand unsustainable (for instance, when it relates to transfer between sister concerns, especially when the recipient is eligible for credit)
- b) The Doctrine may be used to render demand unsustainable when any benefits of an equal value accrue from the Govt (such as refund)
- c) Revenue neutrality may be used to argue against extended period of limitation
- d) The doctrine may also not be applicable in case of classification issues leading to differential tax payment, irrespective of whether the recipient is eligible for credit.
- e) It could be used where a transaction gets taxed in both countries by the taxpayer or exempted in both countries by revenue in litigation.

Doctrine of Revenue Neutrality in GST Regime:

GST is a destination-based tax. The purpose of principle of revenue neutrality is that the burden of tax should be borne by the final consumer and such taxes should not constitute the business entity's or the supplier's cost. If such neutrality is not maintained, i.e., seamless flow of credit, which is the very intent of GST would be disrupted.

In case of forward charge, the taxes being remitted at a time subsequent to supply, the same would interfere with revenue neutrality due to the time lag in deposit of taxes to the Government and availment of credit of such taxes by the recipient. However, in case of reverse charge mechanism, wherein the recipient of goods/service is required to remit the taxes, revenue neutrality is maintained at all times since the tax remitted to the government is parallelly availed as input tax credit.

Based on the OECD Guidelines and jurisprudence, instances of where Revenue Neutrality would apply and would not apply is summarized below.

Cases under GST where Revenue Neutrality would apply:

- a) Demand for payment of GST under RCM (in cases of RCM for import of services, Guideline No. 5 is being followed, to ensure foreign suppliers do not incur irrecoverable GST)
- b) Valuation w.r.t supplies between distinct persons having same PAN and between related entities (this also satisfies Guideline 2 wherein Businesses in similar situations carrying out similar transactions should be subject to similar levels of taxation)
- c) CGST & SGST instead of IGST and vice versa.
- d) Mis-classification but there is no additional tax payable (ex: both 18%)
- e) With respect to demand above, doctrine of revenue neutrality may be considered for arguing against interest and penalty
- f) Valuation of goods given free of cost by the buyer to seller for the purpose of a supply. Under GST, it is a revenue neutral situation since it does not become includible in the taxable value for discharging GST.
- g) It could be used where a transaction gets taxed in both countries by the taxpayer or exempted in both countries by revenue in litigation.

Cases under GST where Revenue Neutrality may NOT apply:

- a) Misclassification of goods/services resulting in short-payment of tax
- b) Demand for addition to existing taxable value, resulting in short-payment of tax, irrespective of whether the recipient is eligible for ITC or not.
- c) When ITC is claimed after the period allowed in law (i.e., after 30th November of subsequent FY) – due to OECD Guideline 1 & Supreme Court in the case of Lahari Impex.

- d) Arguing against principle behind restricted ITC. For instance, argument that restricting ITC related to immovable property, motor vehicles etc., is not revenue neutral since GST paid to vendor is becoming a cost to the recipient. This is an instance of OECD Guideline 1.

It may also be noted that the observations of the Supreme Court, in the case of Northern Operating Systems does not deem the concept of revenue neutrality relevant to the facts, even as the tax payable under RCM would be eligible as refund. The Court did not outrightly reject revenue neutrality also. However, given that it has been settled by various courts that RCM is a revenue neutral situation, it needs to be seen how this judgement would fare under GST.

How will it help taxpayers in litigation?

Understanding the concept of revenue neutrality and its implications to the facts of the case would prove to be very useful to taxpayers who are under litigation. It can be helpful in following cases:

- a) To render demand unsustainable
- b) To render interest and penalty unsustainable
- c) To argue against extended period of limitation
- d) To argue on double taxation

Conclusion:

Revenue Neutrality forms the foundation of indirect taxation, as laid out in the OECD Guidelines. The doctrine may be used to defend against demand of GST under reverse charge mechanism, extended period of limitation etc., as spelt out in the earlier paragraphs. However, before adopting revenue neutrality argument, it is pertinent to understand the facts involved to determine its applicability and for utilization of the right jurisprudence for the proceedings.

Acknowledgements: Thank you to Kavyashree V for her help in drafting this article. Immense gratitude to CA. Madhukar N Hiregange, Adv. Naveen Kumar KS and CA. Anil Kumar Bezawada for their valuable inputs.

Disclaimer:

The views and opinions expressed in this article are those of the authors only. Analysis of examples performed within this article are only for educational purposes. They should not be utilized in real-world analytic products as they are based only on limited and dated open-source information. In case of any questions in understanding of this article, the author may be contacted on ramya@hnaindia.com