

Recent important developments in direct and indirect taxes impacting the Oil and Gas sector

August 2022

EY

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Changes in Customs and GST notification for O&G Operations

- ▶ Amendment in List of specified goods and procedural aspects
- ▶ Increase in GST from 5% to 12% for import / local supplies of O&G items
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Changes in Customs and GST notification for O&G Operations





Changes in Customs and GST notifications for O&G Operations

Amendment in list of specified goods, procedural aspects and increase in GST rates

Particulars	Prior to amendments [Pre amendment conditions for import / local supply of goods for O&G operations]	Amendment under Custom Notification 50/2017 [Amendment in List 33 and conditions w.e.f. 2 Feb 2022; and GST rate increased from 5% to 12% (w.e.f. 18 July 2022)]	Amendment under GST Notification 3/2017 [GST rate increased from 5% to 12% (w.e.f. 18 July 2022)]
Tax rate on specified goods for O&G operations	Customs: Imports - BCD exempt + IGST at 5% GST: Local Supply - GST at 5%	Imports - BCD exempt + IGST at 5% (IGST increased to 12% w.e.f. 18 July 2022)	Local Supply - GST at 5% (increased to 12% w.e.f. 18 July 2022)
Applicability (List 33 of customs / List 1 of GST)	Customs: Goods specified in List 33 GST: Goods specified in List 1	Goods falling under column (3) of List 33 (truncated) plus description linked to HSN codes ▶ Column 3 of List 33 = Description of goods	No amendment
Condition to obtain Essentiality Certificate ('EC') from Directorate General Hydrocarbons ('DGH')	EC required to claim this concessional duty	Condition to obtain EC omitted, instead, letter from Operator required for use in O&G operations	No amendment
Disposal of goods	<ul style="list-style-type: none"> ▶ In serviceable form - Customs / GST payable on depreciated value. ▶ In unserviceable / scrap - <ul style="list-style-type: none"> ▶ Custom duty: option to pay at 7.5% of transaction value ▶ GST: option to pay at 18% of transaction value 	Amended condition has omitted concept of depreciated value altogether - condition only refers to disposal of unserviceable / scrap (duty payable at 7.5% of transaction value)	No amendment

Changes in Customs and GST notifications for O&G Operations

Key impact areas for the O&G industry



Key tax aspects

Relevant to look at “change in law” clause in contract

Charging correct GST rate on local supplies, for EC obtained at old GST rate of 5% (12% w.e.f. 18 July 2022)
Rate to be determined basis Time of Supply provisions under GST

Possible credit blockage due to increased GST rates - may need to look at inverted duty refunds and options to mitigate GST on imports



Key operational aspects

Operation / logistic teams to put correct HSN in shipping documents and invoices
Linkage of concessional customs duty to HSN classification wef 2 Feb 22

Maintain documentary evidence to substantiate that goods fall under amended List 33
For instance - actual use certificate, User Manual, Chartered Engineer’s certificate



Key watch out areas / clarification awaited

Condition in Customs is letter from operator while in GST, it is letter from DGH
For imported goods, whether Letter from operator suffice?

Mismatch of goods as per description vs HSN under Customs

Customs duty on block transfer of goods w.e.f. 2 Feb 2022 (qualifying for list prior to 2 Feb 22) but not under amended list 33

Customs duty on sale of serviceable goods - 7.5% (as applicable on disposal of unserviceable / scrap items) vs applicable tariff rate

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Recent GST updates
including input credit,
interest and return
formats



Recent GST updates

Key Changes in GST law and procedures

Interest payable under various scenarios

Scenario	Interest payable on
Delayed payment - Transactions reported in same tax period	Net cash liability paid through Electronic Cash Ledger (inserted rule 88B with effect from 1 July 2017)
Above transactions reported in subsequent tax period	Gross liability (Cash + Credit ledger)
Wrongfully availed ITC utilized for GST payment	Payable from date of utilization of wrongly availed ITC till date of payment

Change in inverted duty refund formula

- Refinement in formula for claiming refund of ITC in case of Inverted Duty Structure - amendment introduced to correct anomalies in old formula following SC's ruling in VKC Footsteps

Other changes

Relevant changes in GST returns formats

- FORM GSTR 9 - Mandatory reporting of certain details which were optional earlier (For instance HSN for outward supplies)
- FORM GSTR 3B
 - ITC has to match with 2B
 - Rules amended in reporting and reversal of ineligible/blocked Input Tax Credit in Table 4 - *changes in Table 4 yet to become effective*

Time period from 01.03.2020 to 28.02.2022 excluded while computing limitation period of 2 years for claiming GST refund

Allowed transfer of balance in electronic cash ledger to 'distinct person' (GSTIN within same PAN)

2 months window to be opened up (from 1 Sept 2022 to 31 Oct 2022) for claiming transitional credit in view of Apex Court ruling [M/s Filco Trade Centre Pvt Ltd]

Recent GST updates

Clarification issued on various GST issues

Welcome clarifications issued by CBIC

Liquidated Damages

- ▶ It is a mere flow of money from defaulting party (who causes breach) to other party (who suffers loss / damage)
- ▶ No agreement by aggrieved party receiving liquidated damages, to refrain from / tolerate act / do anything for party paying LD
- ▶ Payment not a "consideration" for "a supply" hence not liable to GST

Note: Refund option can be explored for GST paid on LD factoring unjust enrichment

Employee Related

- ▶ ITC on goods or services which are obligatory for an employer to provide to its employees - **applicable to the whole clause (b) of section 17(5)**
- ▶ **Perquisites to employee** in terms of contractual employment agreement - **No GST** since same is in lieu of services provided in relation to employment
- ▶ **Forfeiture of salary** not a "consideration" for tolerating act of such premature quitting of employment but as penalties to discourage and deter such a situation - **not liable to GST**

Powers to summons and arrest

- ▶ Summons to mention the person as accused or as a witness. GST officers to not summon top management at the first instance.
- ▶ Arrest for offences amount exceeding Rs 2 crore - the tax officials to have reason to believe that the accused can tamper evidence, intent to evade tax or claim undue benefits is evident and mens rea is palpable.
- ▶ Arrest should not be resorted to in cases based on the difference in the interpretation of the law

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Supreme Court rulings





Supreme Court ruling on ocean freight in the case of Mohit Minerals



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Key Supreme Court Ruling - Mohit Minerals

Impact areas

- ▶ Held - Freight under CIF contract towards import is a singular composite supply and cannot be dissected - RCM on ocean freight separately as service is not tenable in view of provisions of composite supply.
- ▶ Impact - Open Questions
 - ▶ Whether taxpayer should discontinue payment of GST under RCM or wait for amendment by way of Notification/ clarification from department?
 - ▶ Whether GST paid under RCM and availed as ITC for past periods can be disputed by department?
 - ▶ Does this ruling hold true for non-CIF imports (eg FOB)
- ▶ Aftermath - Refund of IGST paid on ocean freight under RCM allowed to M/s Louis Dreyfus Company Pvt. Ltd by the Hon'ble Gujarat High Court



Secondment post Supreme
Court ruling in the case of
Northern Operating Systems





Supreme Court ruling - Northern Operating Systems

Overview of the case

Facts of the case

- ▶ The Indian entity providing back office and operational support to foreign group company(s), periodically requested for secondment of employees
- ▶ Employment continued on payroll of the foreign company for social security purposes
- ▶ Salary component paid overseas was reimbursed by the Indian entity without any markup
- ▶ Revenue allegation - Secondment is liable to service tax as "manpower recruitment or supply agency service"
- ▶ Period covered under the ruling pertains to pre-negative list as well as negative list era

Key issues before the Supreme Court

- ▶ Whether secondment of expatriate employees qualifies as "manpower supply service" taxable in hands of Indian Entity (under reverse charge mechanism)
- ▶ Whether employer-employee relationship exists between Indian entity and seconded employee (and hence service tax should not apply)



Supreme Court ruling - Northern Operating Systems

Overview of the case

“Substance over form” applied by Supreme Court to conclude existence of a service

- ▶ The overseas employer, in relation to its business, deploys personnel (on secondment) to the Indian entity
- ▶ While control over expatriate employee is transferred to the Indian Entity (for limited period), overseas employer still pays salaries along with social security measures
- ▶ Expatriate employees repatriate back to home location upon cessation of secondment period (as per global policy)
- ▶ The Indian entity derives economic benefit from the secondment as it secures specific jobs or assignments, from the overseas group companies
- ▶ Secondment is essentially “loaning of employee’s service on a temporary basis” by overseas employer

Ruling

- ▶ Foreign entity continues to qualify as employer of such expat employees - Arrangement is in the nature of ‘manpower recruitment or supply agency services’ provided by the foreign entity to the Indian entity
- ▶ Indian entity is liable to pay service tax under reverse charge mechanism

> Impact of the Supreme Court ruling

Impact - Indirect taxes

- ▶ Ongoing or settled service tax litigations - whether same should be further litigated, interest cost and credit / refund eligibility
- ▶ Position to be taken for GST - for past transactions and ongoing
- ▶ What types of arrangements will now qualify as "employment" for no GST

Impact - Direct taxes

View 1 - F Co is the employer of seconded employees

- ▶ SC ruling in NOS case lays down criteria for determining employment relationship which is of general application
- ▶ In absence of any special rules or definition of employment in income tax law or treaties, the ratio of NOS may be applied even for interpretation of income tax law or DTAA

View 2 - I Co is the employer of seconded employees

- ▶ SC ruling is limited to determination of a manpower supply service rendered by F Co to I Co
- ▶ SC ruling does not conclusively determine who was the real/economic employer during the secondment period
- ▶ The said ruling may not be regarded as laying down the principles of determination of employer-employee relationship during the secondment period for the purposes of the Act or DTAA

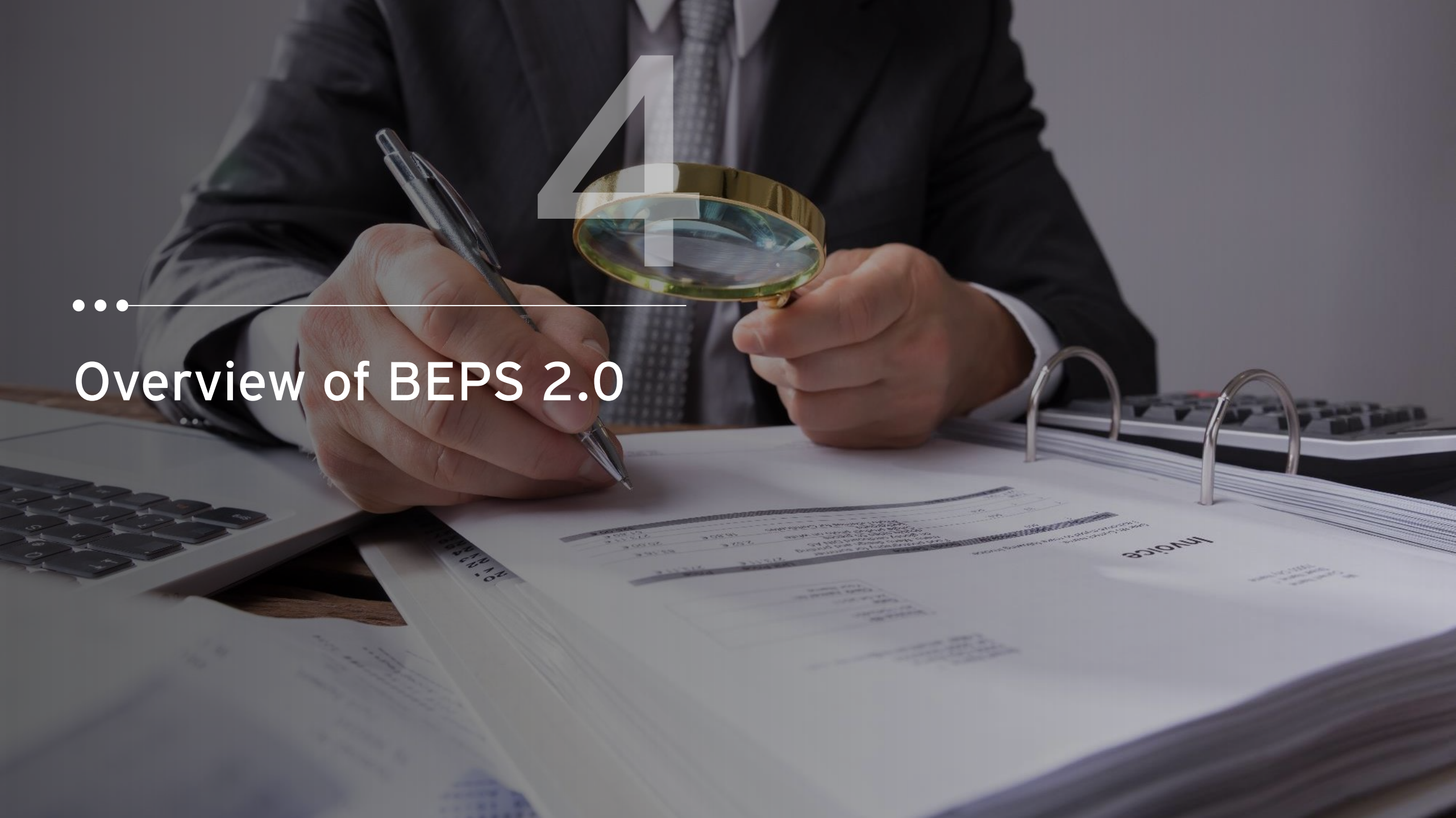
Given the above, one may need a thorough examination of the following facts to conclude who is the employer:

- ▶ Where is the payroll located, which entity makes the payment and which entity bears the cost?
- ▶ Role and powers of F Co post seconding the employee to India
- ▶ Role, responsibilities and powers of I Co against the seconded employee
- ▶ Control and supervision of the seconded employee
- ▶ Work done by the seconded employees in India

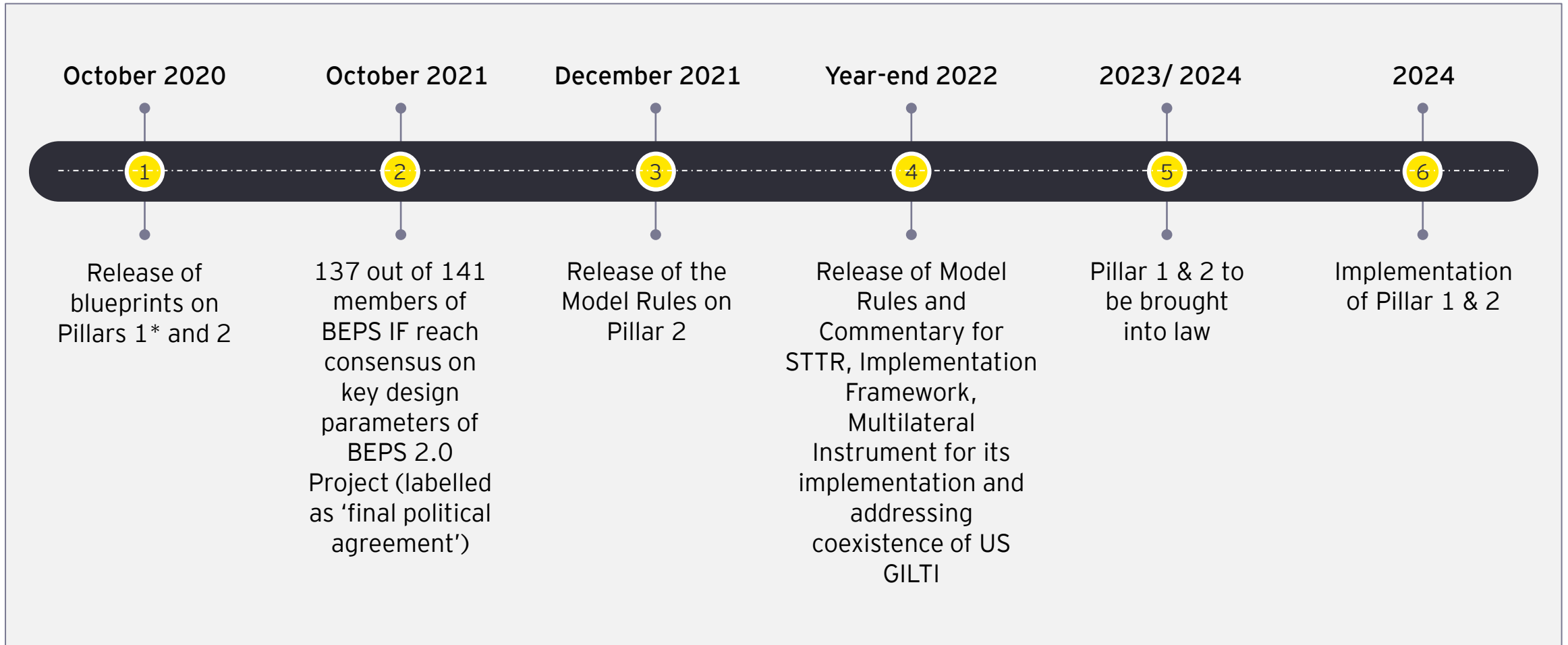
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Overview of BEPS 2.0



> Timeline of BEPS 2.0



**Draft Rules on Pillar 1 are expected by early 2023*

> Key Highlights of Pillar One

Pillar One of BEPS 2.0 project proposes to develop new nexus rules and modify existing profit allocation rules to re-allocate portion of profits of large and profitable MNE groups to market jurisdictions

Applicability

Pillar One is applicable to MNE groups with global turnover > EUR 20 billion and profitability > 10%

Allocation required

MNEs are required to re-allocate 25% of residual profits in excess of 10% of profit to market jurisdictions

Unilateral taxes

All unilateral Digital Service Tax (DST) and other similar measures will need to be withdrawn once Pillar One is effective

Impact of Pillar One:

- ▶ OECD estimates that taxing rights on USD 125 billion+ profits may be re-allocated to market jurisdictions each year
- ▶ Various MNEs operating in India in a remote manner (ie through online sale of products, equipment, goods, etc) may get impacted once Pillar One becomes effective
- ▶ Large Indian MNEs would also be impacted as they would be required to work out their taxes in foreign countries as per amended tax rules

> Key Highlights of Pillar Two

Pillar Two seeks to bridge the gap of ETRs of different jurisdictions by ensuring minimum tax in each jurisdiction and giving right to other jurisdictions to collect taxes in case minimum tax is not paid in any jurisdiction

Applicability

Pillar Two is applicable to MNE groups with global annual revenue > EUR 750 million in two out of four previous years

STTR

Denial of treaty benefits for covered payments if not subject to a nominal tax rate of > 9% (standalone treaty provision). This would be entered as an agreement between countries, similar to MLI

GloBE rules

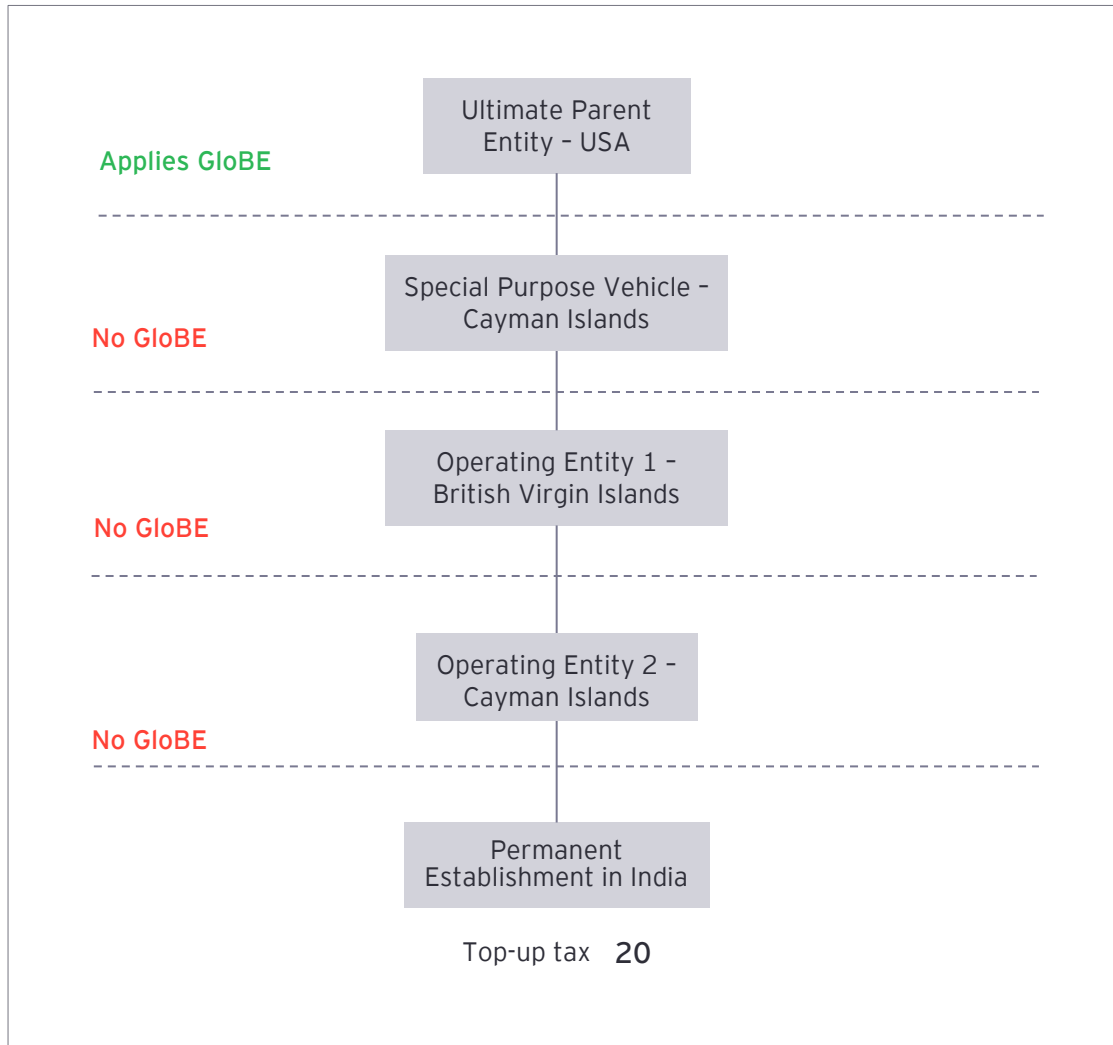
Minimum tax rate of 15% prescribed. If ETR is below 15%, the home jurisdiction has a right to levy a differential top-up tax and if not, other countries where the group operates can levy such taxes

Impact of Pillar Two:

- ▶ Determine if Pillar Two would result into an increase in Group ETR due to presence in low tax jurisdictions or payment of tax on deemed basis
- ▶ Impact on supply chain due to increase in input costs
- ▶ Compliance and reporting requirements in different countries in which MNE groups operate

**Based on Draft Rules*

➤ Case study on Globe Rules r.w.s 44BB of the Income Tax Act, 1961



- ▶ Ultimate Parent Entity is a resident of USA and implements GloBE Rules
- ▶ Operating Entity 1 is resident of British Virgin Islands and does not implement GloBE Rules
- ▶ Operating Entity 2 is a resident of Cayman Islands and does not implement GloBE Rules
- ▶ Operating Entity has a Permanent Establishment in India which offers its income to tax under section 44BB

Sr No	Particulars	Amount
(a)	Gross revenue of PE in India	1,000
(b)	Book Profit of PE in India	400
(c)	Tax cost @4 % of gross revenue under section 44BB (presumptive basis) (gross revenue*10%*40%)	40
(d)	Effective Tax Rate (tax cost/book profit*100)	10%
(e)	Top-up Tax % (TUT) (minimum tax rate - ETR)	5%
(f)	TUT amount (book profit x TUT%)	20

> Way forward to be adopted for BEPS 2.0

Is Pillar One/ Two applicable?

- ▶ Review threshold and expected impact of the rules

What would be the potential ETR impact?

- ▶ ETR modelling and initial operational impact assessment (data, process)
- ▶ What will it cost me, peers/competitors?
- ▶ Impact on M&A, integrations and divestments

Monitoring Tax Policy

- ▶ What will be the implementation timeline in my key countries?
- ▶ Influence on implementation in my home country
- ▶ Stakeholder reporting
- ▶ How will my key countries respond on Pillar Two / incentives?

How do I report in my Group accounts?

- ▶ Consider the impact of deferred tax, transfer pricing, intergroup transactions and transition rules
- ▶ What does it mean for public tax reporting?

Do I need to change my Tax Control Framework?

- ▶ Audit trail of data, data collected once and used in multiple filings, who reviews?
- ▶ Who signs off?
- ▶ One source of truth

What is our technology and data approach?

- ▶ Consider technology, data and broader compliance synergies to build a business case for Pillar Two reporting including Globe Information Return (GIR) and Country-by-Country Reporting Directive

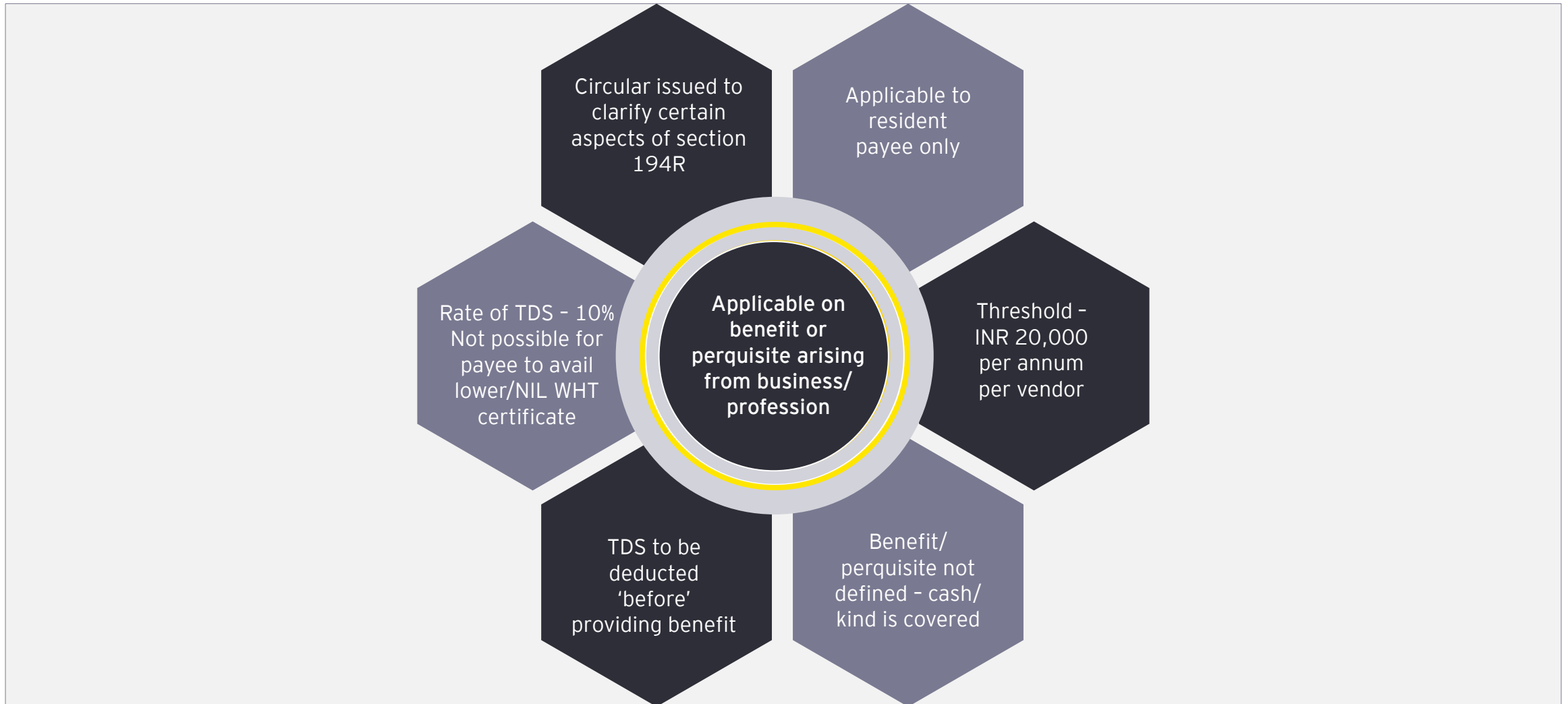
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TDS under Section 194R - Provisions effective from 1 July 2022



> TDS under Section 194R - provisions effective from 1 July 2022



> Circular No 12 of 2022 - Ultra vires?

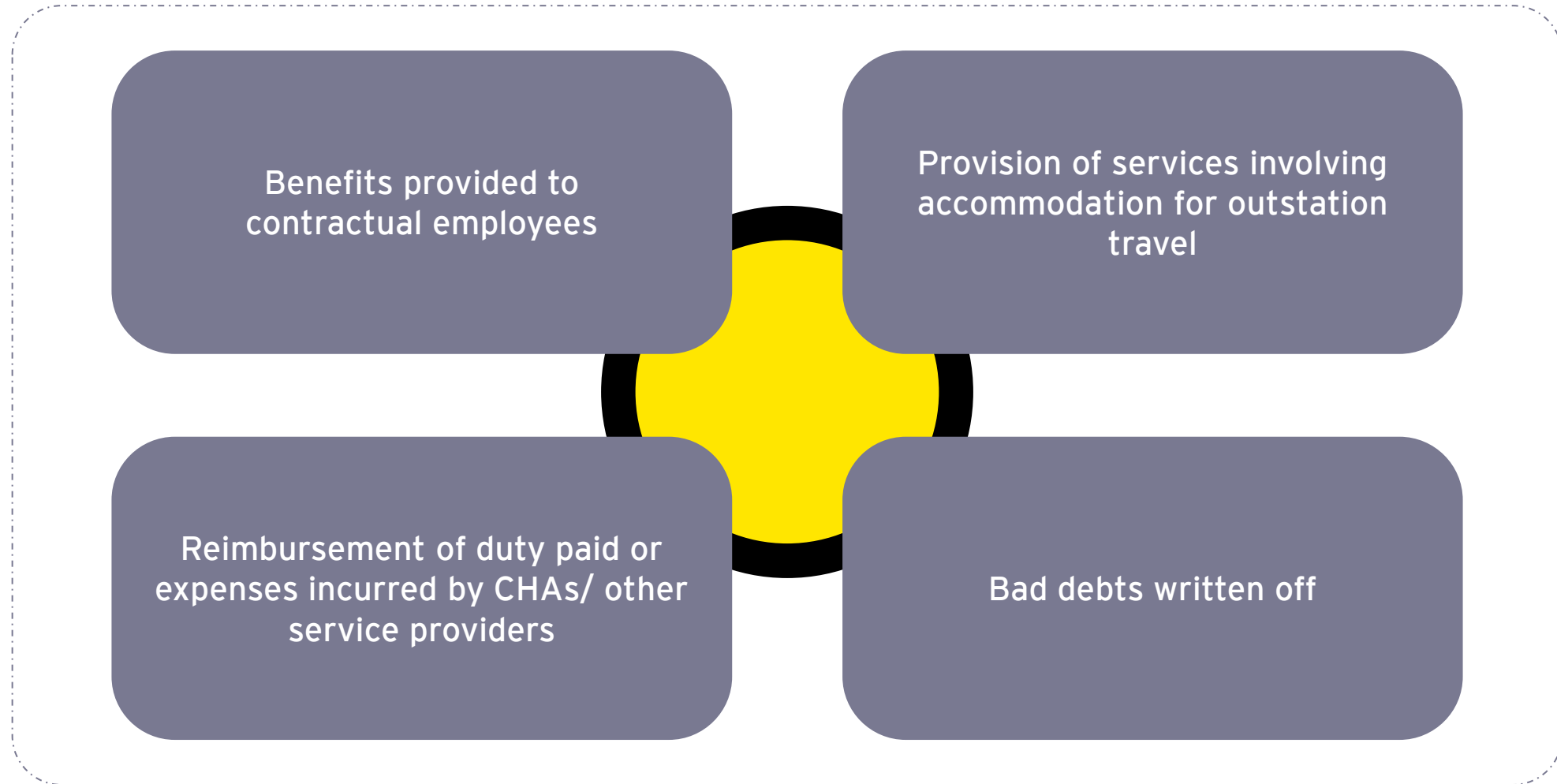
Will the guidelines issued vide the circular increase the litigation?

Tax deduction will apply irrespective of whether the benefit/ perquisite is taxable or not

Tax is required to be deducted even when the benefit or perquisite is in the form of capital asset

Pure reimbursement will also attract tax deduction

> Scenarios for evaluation



> Abbreviations

BCD	Basic Customs Duty
BEPS	Base Erosion & Profit Sharing
CGST	Central Goods and Services Tax
DGH	Director General Hydrocarbons
EC	Essentiality Certificate
ETR	Estimated Tax Rate
HSN	Harmonized System of Nomenclature
GST	Goods and Service Tax
GSTN	Goods and Services Tax Network
ITC	Input Tax Credit
ISD	Input Service Distributor
IGST	Integrated Goods and Services Tax
SC	Supreme Court
SGST	State Goods and Service Tax
STTR	Subject to tax Rule
TDS	Tax deducted at source



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Questions



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