CROSS BORDER TRANSACTIONS WITH IMPLICATIONS OF RELATED PARTIES:

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Introduction:

Cross-border transactions are basically any transfer of goods or services, or both, between two individuals or business entities in two different jurisdictions. Due to different jurisdictions being involved, many issues arise with regard to the tax considerations. It not only requires looking into tax laws on two different countries but also checking the tax treaties between the said countries.

Cross-border transactions and the role of GST on the same has always been a confusing topic. With the advent of globalization, cross border transactions between the nations have increased multi-fold. With such an increase, the ambiguities regarding GST implications on such transactions have also increased. The industry has always struggled with litigation for such transactions, as the GST Law has not precisely defined provisions.

Issues have also been observed in cases where foreign entity opens a branch in India under the same Trade Name as that of the parent. Two common transactions that occur in this scenario is that the parent allocates cost to the branch which is booked as an expense in branch's books and the second being any remittance of amount from the branch to the parent. In both these transactions, there remains a confusion as to whether to consider it as a supply.

In this article, we have tried to understand and simplify some such cross-border transactions and understand the issues in case related parties are involved:

1. Export of Goods:

- As defined u/s 2(5) of the IGST Act, 2017, "**Export of Goods** with its grammatical variations and cognate expressions, means taking goods out of India to a place outside India."
- Under the GST Law, export of goods and services is treated as a Zero rated supply. Zero rated supply does not mean that the transactions is exempted from GST but that the exporter will pay tax on such a supply at "0%" rate. However the issue arises as to the GST Input Tax that the exporter has to pay to its supplier in order to procure the inputs and/or input services pertaining to export. Since, effectively there is no GST liability on exports, credit of taxes paid on inputs/input services cannot be offset. Thus, in this regard the GST Law provides two options for exporter to claim refund of such Input Tax:
    - A registered person can export goods without the payment (EXPWOP) of GST, only after obtaining a Bond or Letter of Undertaking (LUT), by filing Form GST RFD-11 with the jurisdictional commissioner. If the exporter chooses to export through this option, he has to apply for a refund of the Input Tax so paid on inputs and/or input services after submitting the relevant documents with the GST Department.
    - However, in case the Exporter opts to export goods with payment of GST (out of his own pocket), the refund of same is auto populated on the ICE Gate portal on filing of relevant details in GSTR-1. (Shipping Bill No., Port Code, Shipping Bill date).

2. Export of Services:

- **Export of Services"** has been defined u/s 2(6) of the IGST Act, 2017. A supply of service can be said to be an Export of Service transaction if:

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 4[or in Indian rupees wherever permitted by the Reserve Bank of India]; 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, if all the above 5 conditions are met supply will be considered as an Export of Services which is a Zero rated supply.

- Additionally, for pt. v an exception has been provided by way of a clarification (vide. cbic-gst-circular-161-17-2021) that supply between parent and subsidiary will be allowed to qualify as an Export of Services transaction even though it is a mere establishment of distinct persons.

- Similar to export of goods, under export of services, the exporter can claim a refund for Input Tax paid, either by applying for a LUT or on payment of taxes, by applying with the GST Department.

3. Import of Goods (IMPG):

- Article 269A of the GST regime states that the supply of commodities or services or both, if imported into India, will be considered as supply under inter-state commerce or trade and will attract integrated tax.

- The importer of goods shall pay the requisite custom duties and IGST on the assessable value as per the Customs Act, to clear the goods from customs. The input tax so paid on IMPG is allowed to be claimed as Input Tax Credit. The same is auto-populated in GSTR-2B only after filing the Bill of Entry.

4. Import of Services (IMPS):

- The import of services is defined as the supply of a service by a supplier who is based outside the country, but the recipient of the services is based in India, and the place at which the service is supplied is also within the geographical boundaries of the country.

- As per Notification 13/2017 –CT (Rates) and 10/2017 –IT (Rates) dated 28-06-2017, GST on Import of Services has to be paid on Reverse Charge Basis.

5. Issues regarding taxation due to involvement of related parties:

- First let us understand what a related party is under the GST Law:

  "Related party has been defined u/s 2(84) of the CGST Act, 2017." A person shall be deemed to be a related party if it falls into any of the below categories:

  - Officer or director of one business is the officer/ director of another business
  - Businesses legally recognized as partners

- An employer and employee
- Any person who holds at least 25% shares in another company, either directly or indirectly
- One of them controls another directly or indirectly
- They're under common control or management
- The entities together control another entity
- The promoters or managerial persons are members of the same family.

Thus, if the parties involved in the transaction of export fall into any one of the categories, they will be treated as a related party.

- In both the above transactions of export, there arises an ambiguity about the valuation of the transaction, in case the same is done with a related party. Due to the relationship of the two entities, value of the consideration for any exports may be influenced. This in turn would result in lesser tax being paid to the government, as GST is charged as a percentage of the transaction value. Hence, to ensure that the tax is being paid correctly at arm's length price, GST Law has prescribed certain rules regarding valuation.
- **Valuation of transactions:** Taxability of transactions between related parties is also covered under Schedule I wherein transactions without consideration shall also be deemed to be a supply under GST. For this purpose, value of supply shall be considered to be the open market value in accordance with valuation rules.
- **Rule 27 of the GST valuation rules** explains that in case the transaction is not valued at arm's length price then the following methods needs to be adopted:
  - **Open Market Value** of such supply – Open Market value is the value of a similar transaction done between two unrelated parties. For e.g. X sells goods to Y (Related party) for 1,000 and to Z (Unrelated party) for 1,500. Hence, the Open Market Value will be 1,500 and B will have to pay tax on 1,500.
  - In case Open Market Value is not determinable, then value of **like and similar goods** needs to be considered. For e.g. If in the above example X does not sell to any unrelated parties then Open Market Value is not determinable. Hence, in such a scenario, the transaction should be valued by considering the value considered by another dealer dealing in such similar goods.
  - If it is not possible to value the transaction by any of the above methods, value can be determined by taking the **cost of production** of such goods as a basis.
- The above valuations rules have not clearly been structured leaving it open-ended and wide to interpretation. Terms like similar transactions, similar goods etc. don't clearly indicate what method is to be followed which leaves the valuation open to interpretation. This creates ambiguity and consequently, litigation.
- In case the two parties involved in the transaction of Import of Goods are related parties, the assessable value is determined as per Rule 3 of the Customs Valuation rules. Rule 3 explains that the in case if the two parties in the transactions are related parties, the assessable value will be investigated by a special branch under the Customs called as Special Valuation Branch (SVB).
- If the SVB determines that the assessable value is not genuine, the assessable value will not be acceptable and will be determined in one of the following methods (in the following order) :

- Value of Identical/ Similar Goods (As per rule 4 & 5)
- Deductive Value Method (Rule 7)
- Computed Value Method (Rule 8)
- Best Judgement Method (Rule 9) – Residuary Method

- Schedule I of the CGST Act, 2017, states that if Services are imported from a related party in the course of furtherance of business even without consideration would still be treated as supply. Hence, tax would still be paid on reverse charge.

With globalization, borders have really lost significance in terms of business expansion. However, tax laws have not really globalized at the same pace which creates ambiguity and litigation. GST law is at a very nascent stage and has failed to envisage complexities involved in online supply of service s/ goods, VDAs, digital assets, business structuring for global presence. Thus, the road to taxability of cross border transactions especially when related parties are involved is a challenge, the solution for which is yet awaited even after 6 years of GST.
