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# EY Tax Alert

## Supreme court upholds validity of pre-import condition under Advance Authorisation scheme

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## Executive summary

This tax alert summarizes a recent ruling[1] of the Supreme Court (SC). The question involved was whether the pre-import condition for claiming exemption of integrated tax and compensation cess on import of goods against Advance Authorisation (AA) is arbitrary and unreasonable.

Gujarat High Court (HC)[2] had struck down the pre-import condition contained in para 4.14 of Foreign Trade Policy 2015-2020 (FTP). Aggrieved, Revenue preferred an appeal before the SC.

SC upheld the validity of pre-import condition under Advance Authorization (AA) scheme on the following grounds:

- Upon introduction of GST, exporters, through trade notices, were made aware that AA and its utilization would not continue in the same manner as the AA scheme operating earlier.
- Para 4.13 of FTP gave powers to the Directorate General of Foreign Trade (DGFT) to impose pre-import condition. Also, para 4.27 of Handbook of Procedure (HBP) was amended to provide that duty free authorization cannot be issued for inputs which are subject to pre-import condition.
- The exporter's argument that there is no rationale for differential treatment of Basic custom duty (BCD) and IGST under AA scheme is without merit. There is justification for a separate treatment of the two levies as BCD is a customs levy at the point of import with no question of credit. On the other hand, IGST is levied at multiple points (including at the stage of import) and input credit is available.
- Undue hardship to the taxpayer cannot be a sufficient ground to hold the insertion of pre-import condition as arbitrary.

[1] 2023-VIL-47-SC
[2] 2019-VIL-80-GUJ

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# Background

- The taxpayer is an Advance Authorisation (AA) license holder.
- Notification No. 18/2015-Customs dated 1 April 2015 exempted payment of BCD, additional duty, special additional duty, safeguard duty and anti-dumping duty on inputs imported against valid AA.
- After the introduction GST, the above notification was amended w.e.f. 13 October 2017 granting IGST and compensation cess exemption subject to the fulfillment of the following two condition:
  - Export obligation should be fulfilled by physical exports only
  - Fulfillment of pre-import condition
- At the same time, Notification No. 33/2015-2020 was issued, amending various provisions of the FTP, whereby 'pre-import condition' was incorporated in para 4.14 thereof with effect from 13 October 2017.
- Subsequently, vide Notification no. 1/2019-Customs dated 10 January 2019, this condition was omitted.
- By virtue of para 4.27 of Handbook of Procedures (HBP), exports in anticipation of authorization are permitted, with a clarification that exports made from the date of generation of file number for an Advance Authorisation may be accepted towards discharge of export obligation.
- Writ petition was filed before Gujarat HC wherein the taxpayer claimed that it is unaware about this condition, and continued exports in anticipation of grant of AA, and consequently expected exemption from all custom duty levies, including IGST and compensation cess.
- HC observed that the pre-import condition was subsequently omitted as the Union found it to be in the public interest not to continue with the said condition.

  Also, considering the interpretation of the condition of physical export and pre-import put forth by the DRI, it is more or less impossible to make any exports under an AA without violating the condition of pre-import. In effect and substance, what is given by one hand is taken away by the other.
- HC held the condition of pre-import militates against AA scheme and therefore, pre-import condition in case of imports under AA for exemption from integrated tax and GST compensation cess, do not meet with the test of reasonableness.
- Aggrieved, the Revenue preferred an appeal before the Supreme Court (SC).

# Revenue's contentions

- Para 4.03 of FTP specifically required physical incorporation of imported materials in exported goods which was possible only if imports were made prior to export. The said para had an inbuilt pre-imported condition which had to be followed.
- Para 4.27 allowed exports in anticipation of an authorization. This was an exception to meet requirement in case of exigencies. Exporters were availing the benefit of this provision without exception. Further, para 4.27(d) of the HBP barred benefit of export in anticipation of authorization for inputs where pre-import condition was imposed.
- There is no conflict between para 4.03 of FTP and that of 4.27(a) of the HBP. The scope and field of operation of individual para were completely different.
- Further, para 4.13 of FTP gives powers to the policy makers to impose pre import condition on any inputs imported under this chapter.
- The taxpayer has only argued that the pre import condition was burdensome and not challenged the power to impose the levies. The condition and the manner in which such levies are collected is within the domain of the legislature if the power to levy was undisputed.

# Taxpayer's contentions

- There is no rationale or justification in imposing the "pre-import condition" only for a limited period from 13 October 2017 to 9 January 2019, to a scheme operating successfully without any such condition.
- Further, there is no reason or justification for subjecting only IGST and compensation cess to the 'pre-import condition' and not imposing the said condition to other import duties.
- It would be impossible for a manufacturer exporter to execute export orders within a short period of time if the pre-import condition is satisfied.
- Regular exporters import raw materials against several authorizations and utilize such goods for manufacturing final products for exports with reference to those authorization. Consequently, there could be no 'one to one' correlation between import of a consignment of inputs against one particular authorization and utilization of such inputs for manufacturing final products for export against those particular authorizations.
- When the levy of IGST on imported goods was treated like the levy of BCD, there was no reason why the unconditional exemption of BCD granted under the scheme could not be extended to IGST exemption. There was no intelligible difference between the two. Thus, Article 14 of the Constitution was violated as there was no rationale behind different classification of IGST and

BCD exemption. Reliance was placed on various SC rulings in this regard.[2]

- Further, Article 19(1) g of the Constitution was also violated as the pre import condition had no nexus with the object sought to be achieved by the AA scheme.

## SC ruling

- The exporters were made aware of the changes brought due to the introduction of GST through a trade notice[3]. The notice clearly mentioned that AA and its utilization would not continue in the same manner as the AA scheme was operating earlier.

- Para 4.27 of HBP was amended to include 4.27(d) which stated that duty free authorization for inputs subject to pre-import condition could not be issued.

- Para 4.13 of FTP gave powers to the DGFT to impose pre-import condition for any inputs under this chapter. HC is wrong in assuming that only specified goods were subject to pre-import condition.

- Introduction of pre-import condition may have resulted in hardship to the exporters and would have forced the exporters to discontinue with their former business practices. However, this cannot be a ground to hold the insertion of pre-import condition as arbitrary.

  In case of Mysore SEB vs. Bangalore Woolen Cotton & Silk Mills Ltd.[4] a Constitution Bench of SC held that inconvenience is not a decisive factor to be considered while interpreting the statute.

- The allegation of discrimination is without merit as para 4.13 itself empowered the DGFT to impose pre-import condition on any inputs which are not specifically included in Appendix -4J. The existence of this discretion meant there is flexibility to the policymakers to treat different AA holders differently.

- Further, there could not be a blanket right to claim exemption and such exemption is dependent on the assessment of the state, tax administrators and the economy. The old levies are completely different from the new levies as in case of new levies, payment is insisted as a part of unified system of levy, assessment, collection, payment and refund.

- When a reform of new legislation is introduced, the doctrine of classification cannot be applied strictly. The same was emphasized in case of State of Gujrat vs. Shri Ambica Mills and Ajoy Kumar Banerjee vs. Union of India[5].

- There is no constitutional compulsion that whilst framing a new law, or policies under a new legislation particularly with a different set of fiscal norms which overhauls the taxation structure, concessions granted or given earlier should continue in the same fashion as they were in the past. The object of the new law was to create a new rights and obligation with new attendant conditions.

- The argument that there is no rationale for differential treatment of BCD and IGST under AA scheme is without merit. There is a justification for separate treatment of the two levies as IGST is levied at multiple points and input tax credit is available till the point of end user. BCD is a custom levy at the point of import and there is no question of credit.

- The taxpayer's contention that subsequent withdrawal of pre-import condition meant that the Union itself recognized its unworkable and unfeasible nature and consequently the condition should not be insisted upon for the period it existed, is faulty.

  The Foreign Trade (Development and Regulation) Act, 1992 has no powers to frame retrospective regulations[6]. To give retrospective effect, to the notification of 10 January 2019 through interpretation, would be to achieve what is impermissible in law.

- Various commentators and economist have spoken about how introduction of GST was one of the most significant tax reforms undertaken by India. Inevitably, this transformation is bound to lead to some disruption. In the present case, the disruption is in the form of exporters needing to import inputs, pay the two duties, and claim refunds. These inconveniences are insufficient to conclude that such change is unreasonable and arbitrary.

- Accordingly, SC set aside the judgment passed by HC. However, since the taxpayers were enjoying interim orders, till the impugned judgments were delivered, the Revenue is directed to permit them to claim refund or input credit (whichever applicable and/or wherever customs duty was paid).

  For doing so, the taxpayers shall approach the jurisdictional commissioner and apply with documentary evidence within six weeks from the date of this judgment. The claim for refund/credit, shall be examined on their merits, on a case-by-case basis. For the sake of convenience, the revenue shall direct the appropriate procedure to be followed, conveniently, through a circular, in this regard.

[2] Laxmi Khandsari vs. State of Uttar Pradesh [1981 (3) SCR 92]; State of Haryana vs. Jai Singh [2003 (9) SCC 114]; Welfare Association ARP vs. Ranjit P. Gohil [2003 (9) SCC 358]
[3] Trade Notice 11/2017 dated 30 June 2017
[4] AIR 1963 SC 1128
[5] [1974 (3) SCR 760] and [1984 (3) SCR 252]
[6] SC ruling in case of Director General of Foreign Trade vs. Kanak Exports [2015-VIL-174-SC-CU]

## Comments

a. Importers may need to examine the applicability of SC ruling in their case and identify non-fulfilment of pre-import condition while responding to notices received in this regard.

b. Earlier, the Madras HC in case of Vedanta Ltd.[2018-VIL-490-MAD] had upheld the pre-import condition imposed under AA scheme.

c. Further, it would be relevant to determine whether the recovery of integrated tax and compensation cess should be made under the Customs law or GST law since it may impact the powers of officer who can initiate the recovery and invoke the limitation period.

d. In case the tax dues are paid through TR-6 challan, its credit eligibility will need to be analyzed under the GST law.

# Our offices

Ahmedabad
22nd Floor, B Wing, Privilon
Ambli BRT Road, Behind Iskcon
Temple, Off SG Highway
Ahmedabad - 380 059
Tel: + 91 79 6608 3800

Bengaluru
12th & 13th floor
"UB City", Canberra Block
No. 24, Vittal Mallya Road
Bengaluru - 560 001
Tel: + 91 80 6727 5000

Ground Floor, 'A' wing
Divyasree Chambers
# 11, O'Shaughnessy Road
Langford Gardens
Bengaluru - 560 025
Tel: + 91 80 6727 5000

Chandigarh
Elante offices, Unit No. B-613 & 614
6th Floor, Plot No- 178-178A
Industrial & Business Park, Phase-I
Chandigarh - 160 002
Tel: + 91 172 6717800

Chennai
Tidel Park, 6th & 7th Floor
A Block, No.4, Rajiv Gandhi Salai
Taramani, Chennai - 600 113
Tel: + 91 44 6654 8100

Delhi NCR
Golf View Corporate Tower B
Sector 42, Sector Road
Gurugram - 122 002
Tel: + 91 124 443 4000

3rd & 6th Floor, Worldmark-1
IGI Airport Hospitality District
Aerocity, New Delhi - 110 037
Tel: + 91 11 4731 8000

4th & 5th Floor, Plot No 2B
Tower 2, Sector 126
Gautam Budh Nagar, U.P.
Noida - 201 304
Tel: + 91 120 671 7000

Hyderabad
THE SKYVIEW 10
18th Floor, "SOUTH LOBBY"
Survey No 83/1, Raidurgam
Hyderabad - 500 032
Tel: + 91 40 6736 2000

Jamshedpur
1st Floor, Shantiniketan Building,
Holding No. 1
SB Shop Area, Bistupur
Jamshedpur – 831 001
Tel: + 91 657 663 1000

Kochi
9th Floor, ABAD Nucleus
NH-49, Maradu PO
Kochi - 682 304
Tel: + 91 484 433 4000

Kolkata
22 Camac Street
3rd Floor, Block 'C'
Kolkata - 700 016
Tel: + 91 33 6615 3400

Mumbai
14th Floor, The Ruby
29 Senapati Bapat Marg
Dadar (W), Mumbai - 400 028
Tel: + 91 22 6192 0000

5th Floor, Block B-2
Nirlon Knowledge Park
Off. Western Express Highway
Goregaon (E)
Mumbai - 400 063
Tel: + 91 22 6192 0000

Pune
C-401, 4th floor
Panchshil Tech Park, Yerwada
(Near Don Bosco School)
Pune - 411 006
Tel: + 91 20 4912 6000

Ernst & Young LLP

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