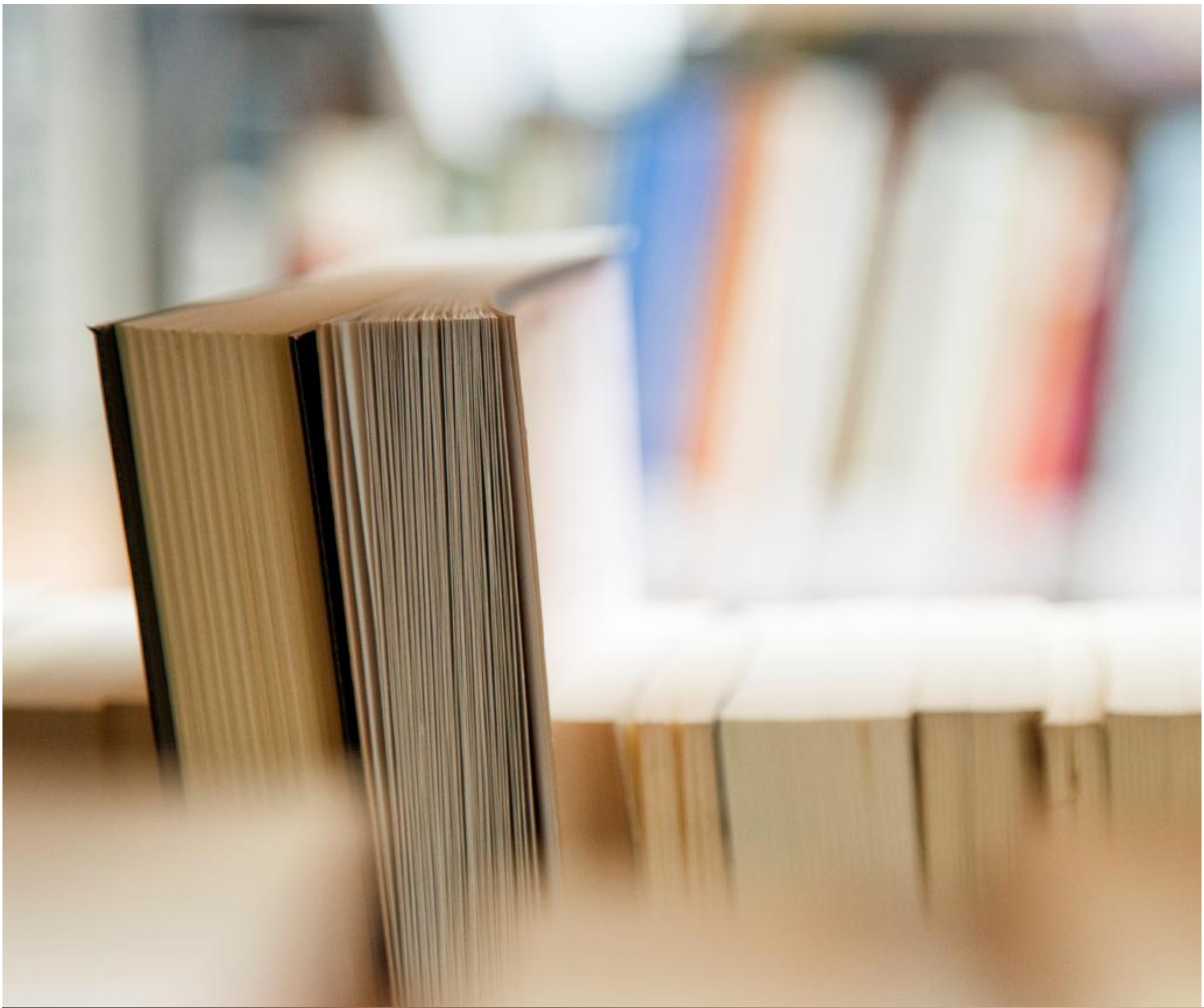

Securities - An Analysis under GST

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Securities – an analysis under GST

There have been widespread confusions regarding the instruments lying within the ambit of securities and their taxability under the GST regime. Further, the coverage of securities within the GST laws and the admissibility of these as input tax credit is a pertinent area of discussion.

Taxability of transaction in securities

At the outset, one needs to analyse the definition of goods and services as per the CGST Act 2017 to determine the coverage of transaction in securities:

"2(52) "goods" means every kind of movable property other than money and securities but includes actionable claim, growing crops, grass and things attached to or forming part of the land which are agreed to be severed before supply or under a contract of supply

2(102) "services" means anything other than goods, money and securities but includes activities relating to the use of money or its conversion by cash or by any other mode, from one form, currency or denomination, to another form, currency or denomination for which a separate consideration is charged;"

The definition of both goods and services exclude securities from their scope. This means that securities cannot be regarded as either goods or services. Upon carefully observing the definition of supply as per Section 7 of the CGST Act, it can be found that supply can only be in respect of goods and/or services. Anything which is not goods and / or services should not be considered as a supply altogether within the terms of Section 7 of the CGST Act 2017. Further, it is already known that Section 9 of the CGST Act and Section 5 of the IGST Act which are chargeability sections under the GST law presupposes that tax is leviable on supplies. Any activity failing the test of supply will escape the taxability under GST law. Thereby, it can be gathered that securities are outside the bounds of GST as regards the definition of supply.

Meaning of securities

Now, it should be determined as to what are the items that should be considered as securities. The definition of securities as per Section 2(101) of the CGST Act straightaway requires one to draw parallel from the definition of securities given under Section 2(h) of the Securities Contracts (Regulation) Act 1956. The definition of securities given under the said provision is as below:

"securities" include—

(i) shares, scrips, stocks, bonds, debentures, debenture stock or other marketable securities of a like nature in or of any incorporated company or other body corporate;

(ia) derivative;

(ib) units or any other instrument issued by any collective investment scheme to the investors in such schemes;

(ic) security receipt as defined in clause (zg) of section 2 of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (54 of 2002);

(id) units or any other such instrument issued to the investors under any mutual fund scheme;

(ie) any certificate or instrument (by whatever name called), issued to an investor by any issuer being a special purpose distinct entity which possesses any debt or receivable, including mortgage debt, assigned to such entity, and acknowledging beneficial interest of such investor in such debt or receivable including mortgage debt, as the case may be;

(ii) Government securities;

(iia) such other instruments as may be declared by the Central Government to be securities; and

(iii) rights or interests in securities;"

Any consideration earned from transaction in the abovementioned securities will be outside the levy of GST.

a. **Shares, debentures, bonds and mutual funds**

Shares, debentures and mutual funds are all part of the definition of securities given above. As already stated above, transaction in securities cannot be considered as supplies altogether. So, the following common items of the financial statements will not be considered as supplies altogether:

a) Dividend from mutual fund and shares
b) Capital gain from sale of shares and mutual funds
c) Interest on bonds and debentures

Some other innovative transactions with regard to shares, debentures and mutual funds viz. bonus stripping, dividend stripping, consolidation of shares, splitting of shares, obtaining shares due to various corporate actions (like amalgamation, demerger, sale of undertaking etc.), buyback of shares, allotment of shares etc. will all be outside the ambit of supply altogether.

b. Loans, advances or deposits

Though interest on debentures cannot be regarded as a supply, the same cannot be necessarily held with regard to interest on loans, advances or deposits. What is particularly excluded from the definition of both goods and services is securities. With the comprehensive definition of services, almost everything other than goods is purported to be covered. Only money and securities are envisaged to be left out. Clearly from the definition of securities depicted above, loans, advances and deposits cannot be categorized as securities under the Securities Contracts Regulation Act, 1956. So, even advancing of loans and deposits are said to be included within the spectacular definition of services. In fact, entry no. 27 of the Notification no. 12/2017-Central Tax (rate) dated 28th June 2017 states the following to be an exempt supply:

"Services by way of extending deposits, loans or advances in so far as the consideration is represented by way of interest or discount"

c. Futures, forwards, options and swaps

Derivatives are an integral part of the definition of securities. Derivatives have been defined in section 2(ac) of the Securities Contracts Regulation Act as follows:

"derivative" includes—

(A) a security derived from a debt instrument, share, loan, whether secured or unsecured, risk instrument or contract for differences or any other form of security;
(B) a contract which derives its value from the prices, or index of prices, of underlying securities;"

The common factor between all the financial instruments enlisted here viz. Futures, forwards, options and swaps derive their own value on the basis of another underlying asset. This asset may be in the form of equity, debt etc. With the change in the pricing of the underlying asset, the price of the derivatives too. So, all these instruments irrespective of being exchange traded or over the counter will be considered as derivatives falling within the definition of securities. Any consideration earned from dealing in these derivatives will be outside the ambit of GST.

d. Mortgaged backed and Asset backed securities

These are instruments which can be created by a company through a special purpose entity. The debt, loans and receivables realizable by the company are transferred by the company to this special purpose entity. In order to monetize these realizable assets at an earlier date, the entity issues securities against such assets. The consideration of these securities is financed vide the amount realized from the underlying assets. In turn, the investor of these securities gets a beneficial interest in the underlying realizable debt or receivables. This squarely falls within clause (ie) of the definition of securities. So, they will be outside the ambit of GST.

e. Sweat Equity

Against settlement of the liability, this amount is paid in the form of equity to a vendor against supply of goods, employee against employment contract, consultant against his professional charges etc. Since, equity falls within the definition of securities, they will not be considered as a supply. However, this is not to exclude from the scope of the taxation the underlying transaction i.e supply of goods, consultancy charges, salary payments etc. These transactions will draw their guidance from the definition of supply or the deemed exclusions from this definition of supply as per Schedule III.

f. Employee Stock Option Plan

Employee Stock option plan are usually part of the employees' remuneration for work done in the company. The employees are provided with option to buy the stocks of the company at a lower than market price. This option is provided at no or negligible cost and remain in the ESOP trust fund until (or unless) the option is exercised by the employee.

Upon studying the definition of securities, even right or interest in securities will be covered. An option to exercise the right to buy the securities should ideally fall within this scope. Thereby, the granting of options as part of the employee stock option plan and the vesting of such right in the securities will be considered as part of the definition of securities and outside the ambit of supply under GST.

g. Security Receipt

As per Section 2(zg) of the SARFAESI Act:

"security receipt" means a receipt or other security, issued by a securitisation company or reconstruction company to any qualified institutional buyer pursuant to a scheme, evidencing the purchase or acquisition by the holder thereof, of an undivided right, title or interest in the financial asset involved in securitisation

A company may raise money through securitization of any financial asset. Against this, they issue a security receipt to the buyer. Such buyer holds the title, undivided right or interest in the said financial asset involved in the securitization. Such security receipts may be traded in the market. The transaction involving such security receipts will be treated as transaction in securities and will be outside the ambit of GST.

h. Duty credit scrips

A duty credit scrip is issued by the Director General of Foreign Trade and can be used to pay various duties and taxes to the Government. These are issued under various schemes of the Foreign Trade policy to the exporter of goods and services. These duty credit scrips are tradeable in the market.

These scrips are not mentioned in the definition of securities described above. So, they are not covered by the definition of securities. As regards the classification of the said scrips under goods or services, the Government has expressly mentioned duty credit scrips under HSN Code 4907. These are however stated to be exempt. Thereby, these scrips will be considered as exempt goods in nature.

i. Chit Fund

According to Section 2(b) of the Chit Funds Act, 1982:

"Chit means a transaction whether called chit, chit fund, chitty, kuree or by any other name by or under which a person enters into an agreement with a specified number of persons that every one of them shall subscribe a certain sum of money (or a certain quantity of grain instead) by way of periodical instalments over a definite period and that each such subscriber shall, in his turn, as determined by lot or by auction or by tender or in such other manner as may be specified in the chit agreement, be entitled to the prize amount".

The Kerala High Court had upheld the levy of service tax on chit funds. Even under GST, this will continue to be taxable as they do not lie within the definition of securities given under the GST law. In fact, services provided by a foreman of a chit fund in relation to chit has been expressly held to be liable to be tax at the rate of 12% under the HSN code 9971 as per the Notification no. 11/2018-Central tax(rate) dated 28th June 2017 and the corresponding notifications under the IGST and SGST laws.

Reversal of Input tax credit

Availment of input tax credit under the GST law is only allowed to the extent the outward supplies are taxable in nature. Input tax credit cannot be entitled to the extent the same is used for provision for exempt supply. As already mentioned above, securities does not get covered within the definition of supply itself. So, the question that comes up is whether input tax credit should be reversed if the activity is on account of transaction in securities. For the purpose of reversal of credit, the law expands the coverage of exempt supply as per Section 17(3) of the CGST Act 2017. Such expanded coverage has been deemed to include transaction in securities. So, transaction in securities even though is outside the ambit of the definition of supply, the same is included in the calculation of exempt supply only for the purpose of reversal of input tax credit.

Conclusion

It is apropos that the meaning of the term securities should be delicately handled. This is one of the very few activities or transactions to have been excluded from the definition of supply and leviability to GST. An attempt has been made to illustrate a few financial products and their taxability under the GST vis a vis the definition of securities as per the GST law. There are innumerable financial instruments which are used in the financial services industry and it is recommended that they should be put through the rigours of definition of securities to form an opinion on their taxability under GST. The article purports to serve as a guide when applying the definition of securities to all such practical situations that one may have to confront. Ofcourse, it must be kept in mind that even though one may escape the levy of GST if they fall within the definition of securities but the input tax credit against the said activity of transaction in securities needs to be reversed.

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