GST ITC w.r.t IPO Expenses

KIRTANE & PANDIT

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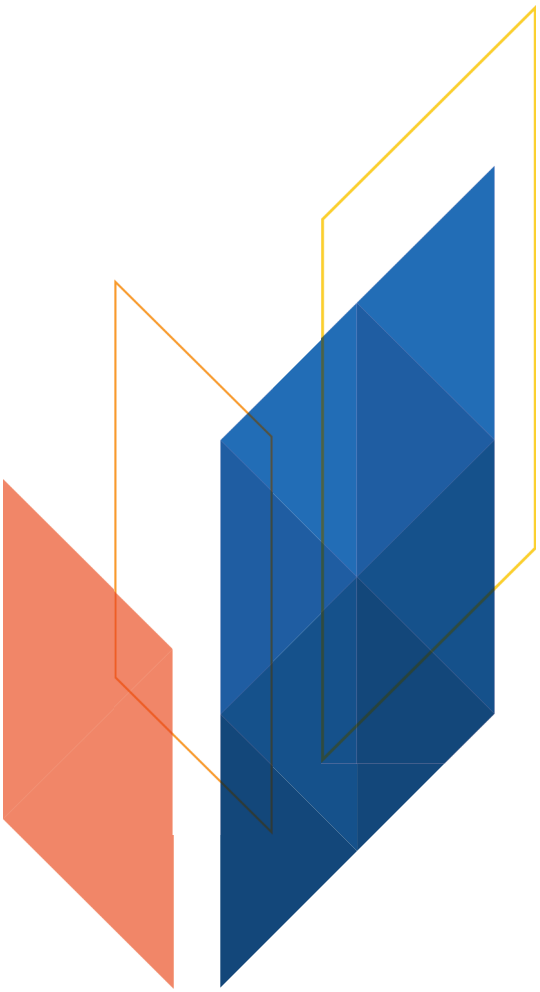

Introduction

The Capital market represents the “Primary Market” and the “Secondary Market”. The capital market has two interdependent and inseparable segments, the new issuers (the primary market) and stock (secondary) market. The primary market is used by issuers for raising fresh capital from the investors by making initial public offers (IPO) or rights issues or offers for sale of equity or debt. An active secondary market promotes the growth of the primary market and capital formation, since the investors in the primary market are assured of a continuous market where they have an option to liquidate their investments.

A corporate may raise capital in the primary market by way of an initial public offer (IPO), rights issue or private placement. An Initial Public Offer (IPO) is the selling of securities to the public in the primary market. It is the largest source of funds with long or indefinite maturity for the company.

An IPO is an important step in the growth of a business. It provides a company access to funds through the public capital market. An IPO also greatly increases the credibility and publicity that a business receives.

Looking at the whole IPO process from the angle of GST, there seems to be an ambiguity in terms of availability of Input tax credit (ITC) in relation to the expenses incurred during this process by a company.

This article attempts to provide an understanding of the issues involved in relation to the availability of ITC in case of an IPO.

Today's Scenario

According to the published reports the Indian stock exchanges, including the Bombay Stock Exchange (BSE) and the National Stock Exchange (NSE), have emerged as global leaders in IPOs for the year 2023.

In a notable development, the primary markets, comprising BSE and NSE, recorded 31 IPOs (including one InvIT) in the fourth quarter of 2023, marking a significant up-tick compared to the same period in 2022 and the third quarter of 2023. This represents a remarkable 72% increase over Q4 2022 and a substantial 41% increase over Q3 2023.

Similarly, the Small and Medium Enterprises (SME) markets showcased remarkable growth, witnessing 61 IPOs in Q4 2023, as compared to 34 and 47 IPOs in Q4 2022and Q3 2023, respectively. This demonstrates a robust 79% and 30% increase compared to Q4 2022 and Q3 2023, respectively.

Understanding an IPO

Pursuant to Section 2(1)(w) of Securities Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2018, the term initial public offer (IPO) is defined as follows:

> *"Initial public offer" means an offer of specified securities by an unlisted issuer to the public for subscription and includes an offer for sale of specified securities to the public by any existing holders of such specified securities in an unlisted issuer"*

The issue of IPO can be categorized into below mentioned scenarios:

Fresh issue of shares

- Company issues new shares that are offered to the public for the first time
- The proceeds from the sale of these shares go directly to the company, and they are typically used for expansion, debt reduction, or other corporate purposes

Offer for sale

- Existing shareholders, such as promoters, venture capitalists, or other investors, sell their shares to the public
- The company does not receive any proceeds from this type of offering; instead, the selling shareholders benefit from the sale

Combined Offer

- Combination of fresh issue of shares and an offer for sale
- Company issues new shares to raise capital, and existing shareholders also sell some of their shares.

Pursuant to the regulation of Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2018 an Initial Public offer is said to be successful only when minimum subscription is at least 90% of the offer through the offer document except in case of an offer of sale through specified securities. An extract of the same is reproduced as under:

> *"45. (1) The minimum subscription to be received in the issue shall be at least ninety per cent. of the offer through the offer document, except in case of an offer for sale of specified securities: Provided that the minimum subscription to be received shall be subject to the allotment of minimum number of specified securities, as prescribed under the Securities Contracts (Regulation) Rules, 1957."*

If the minimum subscription amount is received then the said IPO is said to be successful and post that, allotment of shares is done.

Questions to Ponder

In view of the above-mentioned understanding and facts, the Indian Primary Market has become a growth hub for the companies issuing IPOs showing a consistent increase in the number of IPOs in recent times.

Considering the number of IPOs as well as the amount of capital raised by the companies, the expenses incurred for the purpose of IPOs are also sizeable.

An illustrative list of types of expenses which are incurred during an IPO is given below for reference:

IPO Expenses	
• SEBI Filing Fees	• Stock Exchange Fees
• ROC Filing Fees	• Merchant Bankers fee
• Legal Advisors fee	• Auditors fee
• Registrars to the Issue fee	• Advertising and Marketing expenses
• Prospectus Printing charges	• Distribution Costs
• Publicity Costs	• Stationery cost
• Underwriting Fees	• Brokerage Fees

The GST Input Tax Credit (ITC) involved in case of above expenditure is a considerable amount which is the matter of litigation across the industry players.

The important questions which need to be answered are:

- Whether issue of shares / securities can be considered as transactions in securities and thus an exempt supply?

- Whether the expenditure incurred in case of IPO is in relation to the business activity?

Basis this, the eligibility of ITC may be determined.

Relevant Provisions

1. Definition of Goods as per Section 2(52) of CGST Act, 2017:

"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. Definition of Securities as per Section 2(101) of CGST Act, 2017:

"securities" shall have the same meaning as assigned to it in clause (h) of section 2 of the Securities Contracts (Regulation) Act, 1956

3. Definition of Services as per Section 2(102) of CGST Act, 2017:

"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

[Explanation.––For the removal of doubts, it is hereby clarified that the expression "services" includes facilitating or arranging transactions in securities;]

4. Section 16(1) of CGST Act, 2017:

Every registered person shall, subject to such conditions and restrictions as may be prescribed and in the manner specified in section 49, be entitled to take credit of input tax charged on any supply of goods or services or both to him which are used or intended to be used in the course or furtherance of his business and the said amount shall be credited to the electronic credit ledger of such person.

5. Section 17 sub-section (1) to (3) of CGST Act, 2017:

(1) Where the goods or services or both are used by the registered person partly for the purpose of any business and partly for other purposes, the amount of credit shall be restricted to so much of the input tax as is attributable to the purposes of his business.

(2) Where the goods or services or both are used by the registered person partly for effecting taxable supplies including zero-rated supplies under this Act or under the Integrated Goods and Services Tax Act and partly for effecting exempt supplies under the said Acts, the amount of credit shall be restricted to so much of the input tax as is attributable to the said taxable supplies including zero-rated supplies.

(3) The value of exempt supply under sub-section (2) shall be such as may be prescribed, and shall include supplies on which the recipient is liable to pay tax on reverse charge basis, transactions in securities, sale of land and, subject to clause (b) of paragraph 5 of Schedule II, sale of building.

[Explanation.— For the purposes of this sub-section, the expression ''value of exempt supply'' shall not include the value of activities or transactions specified in Schedule III, except those specified in paragraph 5 of the said Schedule

6. Section 2(h) of Securities Contracts (Regulation) Act, 1956:

"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

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

(ii) Government securities

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

(iii) rights or interest in securities

Let us analyse the first question:

Q.1 Whether issue of shares / securities can be considered as transactions in securities and thus an exempt supply?

Transaction in Shares and Allotment / Issue of Shares:

Before addressing the eligibility of the expenses incurred for an IPO, clarity is required in relation to whether the terms "Transaction in Shares" and "Allotment / Issue of Shares" are same or different from each other.

A. Allotment / Issue of Shares:

The term allotment / issue of shares has not been defined under Companies Act, SEBI Act, and rules there in.

The Honourable Supreme Court has explained the difference between allotment / issue shares and transaction of shares as follows:

- As per the Company law 'allotment' means the appropriation out of the previously unappropriated capital of a company, of a certain number of shares to a person. Till such allotment the shares do not exist as such. It is on allotment in this sense that the shares come into existence.
- A share is a chose in action. A chose in action implies existence of some person entitled to the rights in action in contradistinction from rights in possession.
- There is a difference between issue of a share to a subscriber and the purchase of a share from an existing shareholder. The first case is that of creation whereas the second case is that of transfer of chose in action.
- Case laws referred: *M/s Sri Gopal Jalan & Company India Ltd. v. Calcutta Stock Exchange Association Ltd. AIR 1964 Cal. 250, 1964 SCR (3) 698) & Khoday Distilleries Ltd. v. CIT[2009] 176 Taxman 142/[2008] 307 ITR 312 (SC)*

Basis above, we can derive the meaning of allotment / issue of shares as creating the share by appropriation of the unappropriated share capital of the company.

Hence, the allotment / issue process is the first step where the share comes into existence.

B. Transaction in Shares:

Under the provisions of GST Act, as per Section 17, ITC is restricted in case of transactions in securities since it is treated as an exempt supply.

Further, as per Explanation provided to Rule 42 of CGST Rules, 2017, the value of security shall be taken as one per cent of the sale value of such security.

On a conjoint reading of the above provisions, the ITC restriction would be applicable in transaction involving sale of securities.

Based on above distinction, we can conclude that the scenario of allotment / issue of shares during an IPO does not amount to transaction in shares since the shares do not have prior existence before allotment / issue process.

Q.2 Whether the expenditure incurred in case of an IPO is in relation to the business activity?

View 1: The expenditure incurred in case of an IPO is not related to the business activity:

1. Referring to Section 16 (1) of CGST Act, 2017 a registered person can avail input tax charged on supply of goods and / or services to him

2. As per the definition of goods and services as per the CGST Act, 2017, the shares / securities do not fall within the meaning of goods and services. Hence, shares / securities cannot be termed as goods or services under GST

3. Since shares / securities are neither goods nor services, a view may be taken as the input tax charged in relation to issue of such shares / securities may not be termed as input tax available to the recipient within the provision of Section 16 (1) of CGST Act, 2017

4. Further, by issue of new shares / securities, the company is raising capital for expansion. A view may be taken by the Department officials that there is no direct nexus between the IPO activity undertaken and the ongoing business of the company.

5. Hence, such IPO activity is not in relation to the business and ITC for such activity cannot be claimed

View 2: The expenditure incurred in case of an IPO is related to the business activity:

1. Even though shares / securities are neither considered as goods nor services, the services received by the company during an IPO are for the purpose of issue of new shares / securities.

2. During the IPO activity, the shares / securities are not in existence. After allotment / issue of shares, the shares / securities come into existence. This position is in line with the views expressed by the Honourable Supreme Court (Discussed in Question 1 above). Hence, the services availed for an IPO cannot be said to be directly related to trading or transactions in shares / securities.

3. Basis this the input tax charged on such services is squarely covered by the provisions of Section 16 (1) of CGST Act, 2017

4. The activity of raising capital for expansion through an IPO is a business activity only. Any business has an inherent characteristic to expand its operations after a certain period. It cannot be considered as an extraordinary activity which is different from the day-to-day business operations

5. The above view is also supported by the decisions passed by the Hon'ble Bombay High Court's judgment in the case of *Commissioner of C. Ex., Nagpur v. Ultratech Cement Ltd. [2010 (20) S.T.R. 577 (Bom.) = 2010 (260) E.L.T. 369 (Bom.)]* and the Hon'ble Karnataka High Court's judgment in the case of *Commissioner of C. Ex., Bangalore-III v. Stanzen Toyotetsu India (P) Ltd. [2011 (23) S.T.R. 444 (Kar.)]*

6. The main intent of an IPO is to raise capital and use the same for subsequent business activities, hence IPO process can be considered as a business activity conducted in course or furtherance of business and ITC in relation to such activity can be considered as eligible.

7. Further, in case of a business raising the funds by taking loans from banks or financial institutions, the expenditure incurred in case of processing fees / documentation fees etc. is in relation to the furtherance of business and ITC relating to the same is eligible. Comparing this scenario with raising of funds through an IPO, the ITC on expenditure incurred for an IPO should be considered as eligible.

GST Implications

Fresh Issue of Shares:

As discussed previously, the IPO process does not amount to transaction in securities and hence it cannot be treated as an exempt supply.

As per Section 16 of CGST Act, 2017 ITC in case of goods or services used or intended to be used in the course or furtherance of business can be availed.

The objective and purpose of an IPO is to raise funds for a company, which enables the company to expand their business on a larger scale and achieve operational growth.

Considering this objective, the IPO process is in direct nexus with the course or furtherance of business and hence the expenses incurred for an IPO are also for the furtherance of business only.

Hence, ITC for such expenses incurred for an IPO can be considered as eligible and can be availed subject to fulfilment of other prescribed conditions.

Offer for Sale:

In this scenario, the company is not receiving any funds from sale of shares by promoters, venture capitalists, or other investors. Hence, it may not be considered as an activity which is for furtherance of business and ITC on related expenses may not be considered as eligible.

Combined Offer:

In this case, to the extent of issue of fresh shares to the public by the company, ITC on expenses incurred may be considered as eligible since it is for furtherance of business.

Legacy Position:

The issue of eligibility of IPO expenses for credit was addressed in the legacy period. In the case of **CESTAT, Bangalore Bench in M/s Kernex Microsystems (India) Ltd. v. CCE, Cus. & ST [2016] (42) STR 533 (Tri. - Bang.)** wherein the IPO was arranged by the company for expansion of its activities. The Tribunal held that CENVAT Credit on input services like advertisement, used for collecting capital through IPO by the appellant could not be denied. Definition of 'input services 'under rule 2(l) of Cenvat Credit Rules, 2004 is wide enough to cover such services.

Position taken by Ex-chequer:

Tax authorities have started issuing notices to the companies which have issued shares through an IPO.

The authorities are taking the view that the listing of shares is equivalent to trading of securities, which is an exempted supply as per the GST provisions, hence the ITC claimed by the companies should be reversed.

Conclusion

As enumerated in this article, the IPO process brings the shares / securities in existence for the first time. It is distinct from transactions or trading in shares / securities hence it cannot be treated as an exempt supply under GST.

The objective of an IPO being raising of capital for expansion of business itself proves that the entire process is for the furtherance of business and ITC on expenses incurred for the IPO process can be considered as eligible subject to fulfilment of other prescribed conditions.

The GST implications can be summarised as follows:

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