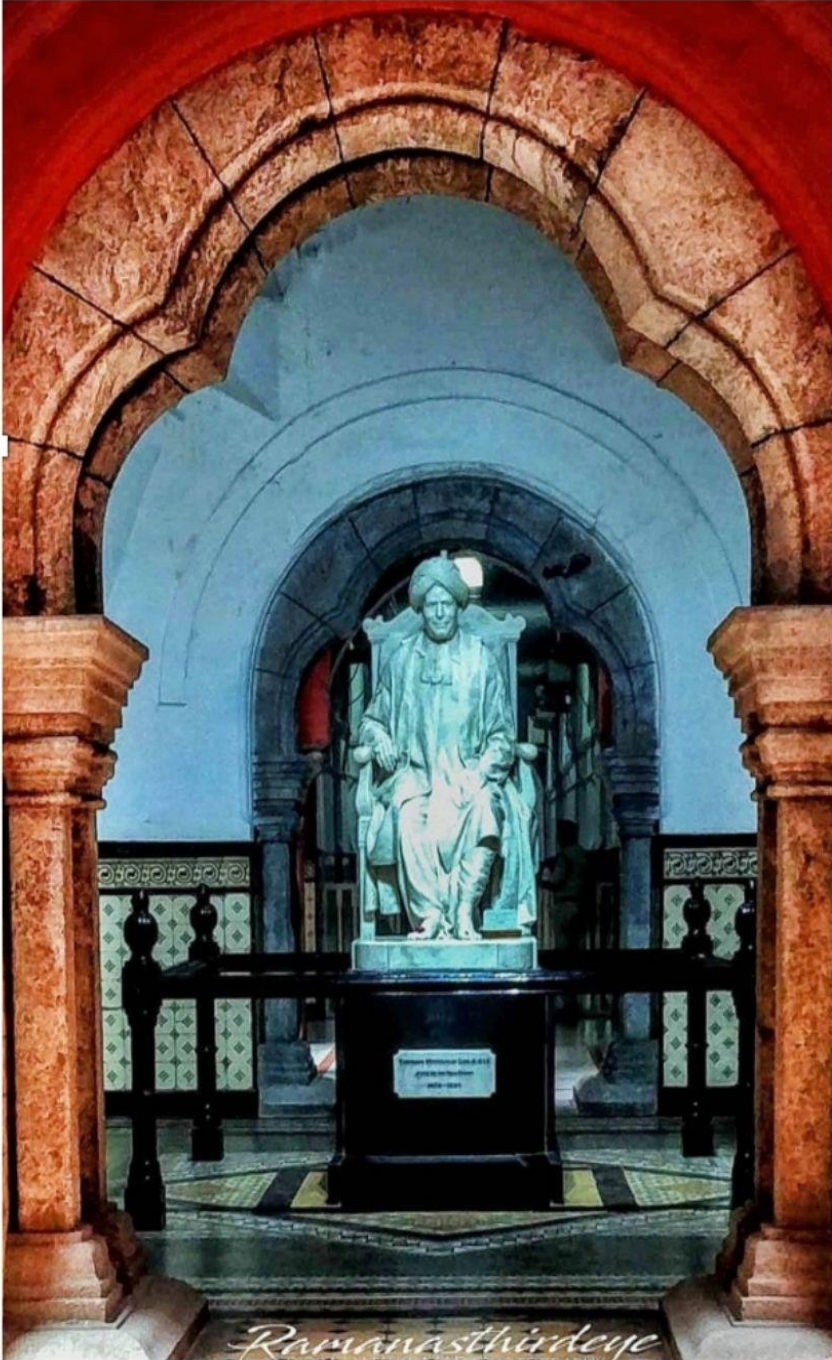


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Virtue will confer heaven and wealth; what greater
source of happiness can man possess ?

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INPUT TAX CREDIT ON IPO EXPENSES



**Adv. B Maragatha Nithya, Senior
Associate, Swamy Associates**

India's IPO (Initial Public Offer) market has become one of the busiest avenues for corporate fundraising. Every public issue brings with it substantial GST-bearing expenditure on merchant bankers, legal advisors, registrars, advertising agencies, printers, underwriters and other professionals. The amounts involved are significant, and so is the input tax credit at stake.

The controversy is deceptively simple: Can a company claim ITC on GST paid for raising capital through an IPO or must that credit be reversed because the issue of shares is treated as a "transaction in securities" under Section 17(3) of the CGST Act?

The answer depends on a question GST law has never squarely addressed: Is issuing a share the same as transacting in a security?

What is an IPO

An IPO is the process through which an unlisted company raises fresh capital from the public by issuing specified securities under the Regulations, 2018¹. Unlike a secondary sale, an IPO creates new securities and introduces them into the market.

Where Does the CGST Act Stand?

Section 16(1) of the CGST Act, 2017 grants ITC on goods and services used in the course or furtherance of business. Capital raising is undeniably a business activity. However, Sections 17(1) and 17(2) require proportionate reversal where common inputs are used for taxable and exempt supplies. The real controversy arises from Section 17(3), which expands the concept of exempt supply to include transactions in securities for the limited purpose of ITC apportionment. Rule 42 of the CGST Rules, 2017 provides mechanism for reversal of ITC.

Analysis of the phrase "Transaction in securities"

The phrase "transaction in securities" deserves closer scrutiny. Securities themselves are excluded from the definitions of both goods and services. Yet, with effect from 1 February 2019, an

¹ Regulation 2(1)(w) of the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2018

Explanation to Section 2(102) clarified that services include facilitating or arranging transactions in securities.

The legislative history explains why. The 28th GST Council Agenda Note records that the amendment was introduced to tax brokerage, documentation charges and other facilitation services in relation to transaction in securities are consideration for services and chargeable to GST. This is adopted from the pre-GST regime². Read in context, the target was not the issuer's own act of bringing a new security into existence.

Does Section 17(3) Cover Creation or Only Transfer?

Section 17(3) is where “transaction in securities” does its substantive work, listing it alongside “sale of land” and “sale of building” for the purpose of computing the value of exempt supply. Both “sale of land” and “sale of building” describe the transfer of an asset that already exists i.e. a plot, a structure held by one person and conveyed to another. By the interpretive principle of *noscitur a sociis*, “transaction in securities” should be read in the same vein: dealing in a security that already exists, not the creation of one. Read in context, Section 17(3) is concerned with the movement of existing assets from one person to another. An IPO does neither. It brings a security into existence for the first time.

Rule 45 and the Deeming Valuation of Securities

The Explanation 2(b) to Rule 45 of the CGST Rules which specifies that the value of security shall be taken as one percent of the sale value of such security, strengthens the above interpretation. The deeming fiction presupposes a sale or transfer of an existing security. It has no natural application where securities come into existence through allotment.

Private-Law Vocabulary: Sale, Transfer, Contract

The distinction is deeply embedded in Indian private law. Under the Contract Act³, allotment is the company's “acceptance” of a fresh “proposal”, forming a new agreement that brings the share into existence rather than transferring any pre-existing property. The Sale of Goods Act⁴ and the

² Para 2.6.8 of CBEC's 2012 Taxation of Services: An Education Guide

³ Sections 2(a) and 2(b) define proposal and acceptance, which together form an agreement enforceable by law under Section 2(h).

⁴ Section 4 defines a contract of sale as one where property in goods is transferred for a price. Section 2(7) includes “stock and shares” within “goods.”

Transfer of Property Act⁵ also govern the pre-existing property. Company law also distinguishes between allotment⁶ and “transfer.

The Apex Court⁷ although in the context of Gift Tax recognised the same distinction while holding that issuing shares creates property, whereas purchasing shares transfers existing property.

Board Clarifications

The CBIC’s own Circular⁸ clarifies that the activity of lending of securities is not a transaction in securities as it does not involve disposal of securities. This disposal test further supports the aforesaid observation that IPO services are not a transaction in securities.

Comparative Perspective

Indian GST borrows several VAT concepts, making European jurisprudence persuasive where statutory language is comparable. The European Court of Justice⁹ held that while a share issue itself falls outside VAT, related professional costs are deductible as general overheads. The principle is that a transaction outside the scope of tax is not automatically an exempt supply requiring apportionment. Though not binding in India, this precedent is persuasive and reinforces the conclusion reached independently above.

Pre-GST & GST case laws

Even before GST, tax authorities denied CENVAT credit on expenses related to IPOs. However, the Appellate Authorities allowed such credit, considering these expenses as directly or indirectly related to a company's business.¹⁰

Under GST, the Haryana AAAR¹¹ upheld ITC for a fresh-issue transaction (QIP), permitting credit on merchant-banker and professional fees tied to proceeds used for debt repayment, but disallowing credit where proceeds were invested in a wholly-owned subsidiary. QIP stands for Qualified Institutions Placement- a fundraising route under SEBI's ICDR Regulations that lets an already-

5 Section 5 defines “transfer of property” as an act by which a living person conveys property already held

6 (Companies Act, 2013-Sections 23, 39, 42, 62)

7 Khoday Distilleries Ltd- [2009] 176 Taxman 142 (SC)

8 Circular No. 119/38/2019-GST, dated 11-10-2019

9 Kretztechnik AG v. Finanzamt Linz (ECJ, 2005)

10 Kernex Microsystems (India) Ltd- 2015 (12) TMI 1106 - CESTAT BANGALORE; SEZAL GLASS LTD- 2014 (8) TMI 17 - CESTAT AHMEDABAD

11 RHI Magnesita India Limited- 2026 (6) TMI 939

listed Indian company raise fresh capital quickly by issuing new shares (or other specified securities) directly to Qualified Institutional Buyers.

However, in none of the above cases, the forum dealt with specific statutory exclusion from the ambit of input tax credit.

Conclusion

The real question is not whether securities are outside GST, the statute already answers that. The question is whether raising capital is synonymous with transacting in securities. Section 17(3), Rule 45, company law and legislative history all point towards the latter being confined to sale of existing securities rather than the creation of new ones.

Until the Government throws light on the legal position, IPO-related ITC will remain a fertile area for litigation. If the revenue biased interpretation ultimately prevails, GST becomes a direct cost of raising capital, a result difficult to reconcile with the principle that ITC should ordinarily flow for expenditure incurred in the course or furtherance of business.

