



THE CONUNDRUM OF INTERMEDIARY SERVICES

CMA Amit Kumar Sarker
Senior Director
Deloitte Haskins & Sells, LLP



Shri Aniket Singh
Manager
Deloitte Haskins & Sells, LLP

Value Added Tax (VAT) on goods and services has been implemented in many countries around the world with certain commonalities across jurisdictions. One core feature of VAT across countries is the fact that the tax is based on the destination principle. This means that exports are tax free along with provision for refund of input taxes (that is, free of VAT) and imports are taxed on the same basis and with the same rates as local supplies.

While the Indian GST including the erstwhile indirect tax regime, is based on the destination principle for cross border services, taxation of intermediary services has been a thorny exception to the rule. The location of the supplier takes precedence in determining the place of supply and the benefit of export is denied. It therefore becomes critical for businesses to carefully evaluate their cross border contracts which involve customer/vendor interactions, support services, etc. and then determine the tax position accordingly.

The GST law defines an intermediary¹ as a broker, an agent or any other person, who arranges or facilitates the supply of goods or services or both, between two or more persons, but does not include a person who supplies such goods or services or both on his own account. This definition is a near replica of the one in the erstwhile Service Tax regime. An illustrative case could be in case of a marketing/sales support contract, which includes within its scope of services, aspects such as identification of potential customers, liaising with them for purchase orders, providing information about the overseas supplier's products to the customers/potential customers and similar pre-sales activities. The Hon'ble Mumbai CESTAT in the decision of Lubrizol Advanced Materials² relied upon, inter alia, the fact that since the consideration received for providing such services is based upon cost plus mark-up and is nowhere connected with the main supply of goods, the company is not engaged in facilitating supply between the overseas entity and its Indian customers, and is therefore not an intermediary.

On the other hand, if one refers to the ruling of Maharashtra Appellate Authority for Advance Rulings for Goods and Services Tax (AAAR) in the case of Asahi Kasei India Pvt. Ltd.³, such contracts and the activities mentioned therein have been held as falling within the domain of intermediary services. In fact, most of the Advance Rulings in GST on such contracts have rendered a similar decision. Should the method of defining the consideration in such contracts be a factor or should businesses look at the scope of services exclusively, and if such scope includes interactions with third parties on behalf of the overseas entity, should the service be classified as an intermediary service? Would the decision in the Lubrizol Advanced Materials change with a change in the method of defining consideration from cost plus to commission (percentage of sales) with the scope of service remaining unaltered? This question appears to have been answered by the Hon'ble Mumbai

¹ Section 2(13) of the IGST Act, 2017

² 2019-VIL-38-CESTAT-MUM-ST

³ TS-561-AAAR-2019

CESTAT in a recent decision in the case of Chevron Phillips⁴, wherein even though the remuneration for the sales promotion activities was being derived as a percentage of net sales of the overseas entity to their customers in India, the activities were held to be outside the scope of intermediary services. The Hon'ble Tribunal held that since the service provider played no role in price fixation nor did they negotiate in any manner on behalf of the overseas company and its customers/potential customers, they could not be regarded as intermediary.

With the expansion in the ambit of intermediary services in October 2014, entities traditionally engaged in indenting services have had to resort charging Service tax/GST on their service fees (commission) even to their overseas customers or group companies. However, marketing support services, business development services, brand promotion, business support or outsourcing services, etc. provided from India to overseas customers, have also been challenged by tax authorities as intermediary services. This has resulted in an uncertainty for these types of service providers with a potential levy of GST sought to be imposed by tax authorities leading to a question of commercial viability for these service providers. The decision in the case of Chevron Philips is a welcome decision. However, it remains to be seen whether the same would attain finality or be litigated further.

Recently, the government had introduced a circular⁵ on intermediary services in the context of IT/ITES sector clarifying various scenarios and activities, which would be considered as intermediary services. By leaving the discretion of determination of the nature of services in certain cases, in the hands of the tax authorities, the circular resulted in creating confusion and uncertainty for service exporters in these sectors. With representations from the industry, the circular was eventually withdrawn bringing in much needed relief, albeit temporarily, for the service exporters.

To make matters more complex, the Hon'ble Mumbai CESTAT in the case of Arcelor Mittal Projects India Pvt⁶ has referred the decision pertaining to export position of a Marketing/Brand promotion contract to a larger bench, where the period of dispute is even before the negative list regime.

Certainty and simplicity have to be a cornerstone for any tax policy. Tax rules should be clear and simple to understand so that businesses can anticipate the tax consequences of a transaction, including knowing when, where, how and if the tax is to be accounted. While clarifying the position on intermediary services in the near future, the government could look at the recommendations made in the 139th Parliamentary Standing Committee Report on Commerce which had recommended to extend the benefit of export of services to intermediary services. This will significantly reduce the cost of doing business in India for the world, leading to a potential increase in investments as well as foreign exchange, which could be one of that much-needed impetus to navigate the present challenges being faced by the economy due to COVID-19 imposed disruptions.

⁴ 2019-VIL-763-CESTAT-MUM-ST

⁵ Circular No. 107/26/2019-GST dated 18th July, 2019

⁶ 2019 (10) TMI 327 Cestat Mumbai