

## **GST on Intermediary services-An Analysis**

The term intermediary has been defined in sub-section (13) of section 2 of the IGST as under–

*“intermediary” means a broker, an agent or any other person, by whatever name called, who arranges or facilitates the supply of goods or services or both, or securities, between two or more persons, but does not include a person who supplies such goods or services or both or securities on his own account.*

The words ‘arranges or facilitates’ the supply of goods of services or both between two or more persons’ is the crux of the definition of the term ‘intermediary’. Does the term ‘arrange’ or ‘facilitate’ has to be construed strictly so as to mean that till the time the services of an intermediary do not actually result in the supply of goods or services by the principal to the customer, the services so rendered do not fall in the category of an ‘intermediary’? Alternatively, will even rendering support or marketing service which may or may not lead to eventual supply of goods or services by the principal to the customer would result in services being classified as that of an ‘intermediary’.

The said phrase ‘arranges or facilitates the supply of goods of services between two or more persons’ was the subject matter of discussion in the case of Toshniwal Brothers wherein the AAR on the facts of the case held that the tax-payer was an intermediary. The said Ruling has also been confirmed by the Hon’ble AAAR and is reported in [2019]102 Taxmann.com37.

The facts of the case were that the appellant was a supplier of services to overseas clients and was engaged in the business of marketing, sales promotion and post sale support services. As part of the above activities the AAR/AAAR noted that the applicant was carrying out the following activities:

- a) The appellant had been accorded exclusive agency in the territory of India and Bangladesh with respect to all measuring and test instruments produced by Brabender GmbH & Co. KG for the food industry business.
- b) The appellant had been appointed as an agent to negotiate business transactions on behalf of the Principal (Brabender, Germany) with prospective customers in the assigned territory.
- c) It was the duty of the Appellant as an agent to visit the customers and prospective customers and inform the Principal when he learns of any demand.
- d) As part of negotiating business transactions on behalf of the Principal, the appellant promotes and markets the products of the Principal in India which includes advertising the details of the goods, demonstration of the products to the prospective customers, communicating with the prospective customers about the goods, informing the Principal about the queries and comments of the prospective customers and reviewing the credit rating of the prospective customers.
- e) Once the order is finalized between the Principal and the customer and the goods are imported by the customer, the appellant provides support services by way of installation, initial start-up of the products and demonstration of its satisfactory performance.

Basis the above activities the AAR & the AAAR held that:

*“The entire gamut of the above activities viz. the act of identifying the prospective customers in India, promoting the products of the Principal to the prospective customers, addressing the queries of the prospective customers with regard to the Principal’s products, communicating with the Principal about the comments and queries of the prospective customers and reviewing the credit rating of the prospective customers are all part and parcel of facilitating the supply of products by Brabender, Germany to the customers in India.”*

The AAAR also held that *“A general understanding of the term ‘arranging’ or ‘facilitation’ would cover a very wide range of activities ranging from marketing or sales promotion of the goods or services of the client, locating prospective buyers for the client’s products or locating sources of supply of the goods or services required by the client, price negotiation with the prospective buyer/prospective supplier, procuring sales orders in respect of the goods or services of the client and like activities”.*

The question that arises is whether the service of identification of customers and other back office support would in itself result in a service provider being classified as an intermediary or only when the service provider in addition to identification of the customer does other services as were being done by the appellant in the aforesaid case, would the service provider become an ‘intermediary’.

Let us look at the view expressed by the Government in the education guide which was issued in 2012 when the service tax regime was overhauled. The Guide provides as under:

*In order to determine whether a person is acting as an intermediary or not, the following factors need to be considered:-*

*Nature and value: An intermediary cannot alter the nature or value of the service, the supply of which he facilitates on behalf of his principal, although the principal may authorize the intermediary to negotiate a different price. Also, the principal must know the exact value at which the service is supplied (or obtained) on his behalf, and any discounts that the intermediary obtains must be passed back to the principal.*

*Separation of value: The value of an intermediary’s service is invariably identifiable from the main supply of service that he is arranging. It can be based on an agreed percentage of the sale or purchase price. Generally, the amount charged by an agent from his principal is referred to as “commission”.*

*Identity and title: The service provided by the intermediary on behalf of the principal is clearly identifiable.*

A careful reading of the explanation more so the words *‘The service provided by the intermediary on behalf of the principal is clearly identifiable’* hereinabove suggests that services being performed by the service provider which do not result in any customer interface should not be classified as an intermediary. This means that where a service provider renders pure back office support to an overseas principal be it market research or sales promotion etc. the services should not be classified as an Intermediary. On the other hand, if the services result in dealing with the prospective customer as was the case in Toshniwal Brothers then there is a likelihood that the services so rendered would result in being classified as intermediary services.

Another issue which requires consideration is that the phrase “arranging or facilitating” precedes the words “supply of goods or services”. Therefore, only when the activity of arranging or facilitating results in actual supply of goods or services or both would it result in a person rendering that supply being called as an intermediary. The term supply has not been defined in the GST Law. However, Section 7 of the CGST Act defines the term “Scope of Supply”. Section 7(1)(a) provides as under:

***“All forms of supply of goods or services or both such as sale, transfer, barter, exchange, licence, rental, lease or disposal made or agreed to be made for a consideration by a person in the course or furtherance of business”.***

A bare reading of the Scope of Supply indicates that these are all activities which involve actual sale of goods or rendition of service. None of the terms used in the above meaning of ‘supply’ convey that the words refer to an activity before the eventual ‘supply’. It follows therefrom that even in a case where there is a customer interface but there is no actual supply of goods or services, it should be possible to argue that the services being rendered would not be classified as intermediary services.

Besides the issue of customer interface resulting in the service provider being classified as an intermediary or not, another point which needs consideration is the ‘basis of charge’ by the service provider to the principal. Would the manner of compensation of the person in India be relevant to decide whether the person is an intermediary? In other words, where cost plus methodology is being adopted as against a commission model of compensation, would this be a deciding factor by itself in concluding whether services are in the nature of an ‘intermediary’ or not.

Generally, a cost-plus model is followed when there is no customer interface and a combination of cost plus and a commission-based model is followed when the services being rendered result in a customer interface which thereafter results in an actual supply. A cost-plus model would therefore be indicative of the fact that the services being rendered by the service provider in India are purely of a back-office support and accordingly do not result in the services being classified as an intermediary. Whereas a commission-based remuneration structure would indicate that the activities are more than mere back office support. Thus, the method of charge of compensation is not determinative in itself of whether the services would be that of an intermediary or not but on the other hand provides sufficient evidence to the fact that the service provider is ‘arranging or facilitating the supply’ and therefore the services so provided should be subject to GST.

These are early days in the evolution of the GST law. One will have to wait and watch how the term ‘intermediary’ is finally interpreted by the Courts. Till that time the tax-payers should be careful of how the contract is drafted and should also be mindful of the implications under the income tax law.