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EY Tax Alert

HC upholds constitutional validity of place of supply provision relating to intermediary services

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Executive summary

This Tax Alert summarizes a recent ruling[1] of the Gujarat High Court (HC) dealing with constitutional validity of section 13(8)(b) of the Integrated Goods and Services Tax Act, 2017 (IGST Act).

As per section 13(8)(b), place of supply of intermediary services, where either the supplier or recipient is outside India, shall be the location of the supplier.

One of the conditions to qualify as export of service under the Goods and Services Tax (GST) is that the place of supply should be outside India. Hence, intermediary services provided to a person outside India do not qualify as export.

The key observations of the HC are:

- Parliament has exclusive powers under Article 246A of the Constitution to frame laws for inter-state supply of goods or services.
- Only because the invoices are raised on the person outside India and foreign exchange is received in India, it would not qualify to be export of services, more particularly when the legislature has thought it fit to consider the place of supply as location of service provider in India.
- There is no deeming provision, but a clear stipulation in the Act legislated by the Parliament to consider location of intermediary as the place of supply.
- A similar situation also existed in service tax regime. Therefore, it is a consistent stand of the government to tax services provided by intermediaries in India.

Thus, the HC held that section 13(8)(b) read with section 2(13) of the IGST Act cannot be considered as ultra-vires or unconstitutional.

[1] 2020-TIOL-1274-HC-AHM-GST

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Background

- Petitioner is an association of recycling industry.
- The members of the petitioner facilitate in India the sale of recycled goods by companies located outside India (foreign principal).
- They receive commission in convertible foreign exchange upon receipt of sale proceeds by the foreign principal.
- As per section 2(6) of the Integrated Goods and Services Tax Act, 2017 (IGST Act), one of the conditions for a supply to qualify as export of service is that the place of supply of such service is outside India.
- Section 13(8)(b) of IGST Act provides that in case of intermediary services, where either the supplier or the recipient of service is located outside India, the place of supply shall be the location of the supplier.
- As per section 8 of IGST Act, where the location of supplier and place of supply are in the same state, it will be treated as an intra-state supply.
- Accordingly, the services provided by members of petitioner to the foreign principal is not export of services and they have to pay central tax (CGST) and state tax (SGST) on the transaction.
- Aggrieved, petitioner filed a writ petition before Gujarat High Court (HC) challenging the constitutional validity of section 13(8)(b) of the IGST Act.

Petitioner's Contentions

- As per Article 286(1) of the Constitution of India, a state has no jurisdiction to impose tax when supply takes place outside the state or in the course of import/ export.
- Article 286 of the Constitution authorizes Parliament to formulate principles for determining when a supply is deemed to have been undertaken outside the territory of the state or in the course of import/ export.

  Power vested with Parliament is confined to this and it is not authorized to legislate and artificially assign place of supply to be within India when clearly, services are being exported out of India.
- Section 13(8)(b) read with section 8 of the IGST Act is violative of Article 286(1) of the Constitution as the service provider would be liable to charge CGST and SGST on the commission received from foreign principal.
- Further, section 13(8)(b) is violative of Article 14 of the Constitution as it renders differential treatment when services are supplied within and outside the territory of India.

  If supplier and recipient of intermediary services are in India, then as per section 12(2) of the IGST Act, place of supply shall be the location of recipient. However, for the same services, if either the supplier or recipient is outside India, the place of supply is the location of supplier.
- It is a settled law that test prescribed by Article 14 has to be satisfied by any class of legislation to survive. There should be intelligible differentia and the same should have a nexus with the object sought to be achieved.
- The nature of intermediary services when compared with service provided by management consultants, lawyers or portfolio managers substantially remain the same.

  Therefore, there seems to be no reason to treat intermediary services differently from other advisory services.
- Further, there appears to be no explanation as to how the differential treatment accorded to the intermediary services can help achieve the object of taxing services which are rendered within India and to exclude those that are clearly exported.
- Definition of intermediary in section 2(13) of the IGST Act is vague.

  The definition excludes services provided on own account, however what is construed as 'own account' requires a clear explanation in order to determine what is specifically included within the domain of an intermediary.
- Relying on decisions of Supreme Court (SC)[2], it was contended that section (13)(8)(b) of the IGST Act suffers from incurable defect of vagueness and is liable to be struck down.
- GST is a destination-based tax system whereas the impugned provision is a deviation.
- Intermediary services would be subject to tax in the country where the recipient is located as it would be an import of service for such recipient.

  Therefore, section 13(8)(b) contributes to double taxation which also affects the margin earned by members of the petitioner.
- Section 13(8)(b) of the IGST Act suffers from the defect of unreasonableness as it creates a deeming fiction by which a transaction involving a resident supplier providing advisory like services to a non-resident, which is a clear export of service, is deemed to have place of supply in India. This is contrary to the object of GST.
- Exemption[3] provided to intermediary service, where location of both the supplier and recipient of goods is outside India, results in distinction between intermediary services rendered with respect to goods and services.

  Also, by granting exemption, the service providers cannot avail credit and claim refund which would have been the case if such services are treated as export.

[2] Kartar Singh v. State of Punjab [(1994) 3 SCC 569]; Shreya Singhal v. Union of India [2015-TIOL-27-SC-MISC]

[3] Vide Notification No. 20/2019-IGST (Rate) dated 30 September 2019

- In view of the impugned provision, there is a possibility that intermediaries could shift base to a location outside India to escape the tax implication or would term their services as management consultancy services so as to get out of the rigors of said provision.
- It would be in larger interest that section 13(8)(b) of IGST Act be declared as ultra vires and unconstitutional.

Revenue's contentions

- Going by strict interpretation of section 13(8)(b) of IGST Act, supply of services by intermediaries to the recipients outside India are not export of services irrespective of mode of payment.
- Since service provided by members of petitioners is not an export, the question of violation of Articles 265[4] and 286 of the Constitution does not arise.
- Keeping the place of provision of intermediary service as the location of service provider is purposeful and considered policy decision of the government.
- The existing provisions in GST are in consonance with Service tax provisions.
- Parliament has got wide amplitude to create deeming fictions under taxation matters.
- Article 246A of the Constitution gives Parliament exclusive power to make laws with respect to goods and services tax, where the supply takes place in course of inter-state trade or commerce.
- Benefits accruing to exporters of services are meant for those who actually export services and not to every other entity which is directly or indirectly associated with exporter.
- Contention of the petitioner that differential treatment accorded to intermediary services is violative of Article 14 is not tenable because one service cannot be compared with other so as to justify such claim of violation.
- It is very much within the powers of the government to categorize goods and services for the purpose of taxation in such manner as suits its policies and objectives.
- Providing exception to the default provision (recipient's location as place of supply) is governed by revenue considerations and is within legislative competence.
- Legislature is free to pick and choose the supply that it intends to tax and the manner in which it is to be taxed. There is no violation of Article 14 of the Constitution.
- Reason for prescribing distinct treatment for intermediary is that an intermediary is a go-between two persons, i.e. main supplier and the recipient, though the contractual agreement may be with only one of them.

  Hence, it is not feasible to prescribe one person as the recipient of intermediary service and thus, general rule cannot be applied.
- Further, intermediary acts as an agent of the principal and in that sense, place of effective use and enjoyment of such service is in the territory where the agent is representing the principal.
- The Organization for Economic Cooperation and Development (OECD) also recommends distinct approach for taxation of intermediary services.
- SC, in the case of Delhi Development Authority[5], has held that a policy decision is subject to judicial review on following grounds:
  - If it is unconstitutional;
  - It dehors the provisions of the Act and regulations;
  - The delegate has acted beyond its powers of delegations; or
  - Executive policy is contrary to the statutory or a larger policy.

  In the facts of the present case, none of the above grounds are applicable.

High Court Ruling

- Parliament has exclusive powers under Article 246A of the Constitution to frame laws for inter-state supply of goods or services.
- There is no distinction between the intermediary services provided by a person in India or outside India. Only because the invoices are raised on the person outside India and foreign exchange is received in India, it would not qualify to be export of services, more particularly when the legislature has thought it fit to consider the place of supply as location of service provider in India.
- Therefore, there is no deeming provision as canvassed by the petitioner, but a clear stipulation in the Act legislated by the Parliament to consider location of intermediary (i.e. service provider) as the place of supply.
- Similar situation also existed in Service tax regime. Thus, it is a consistent stand of government to tax services provided by intermediary in India.
- The contention of the petitioner regarding double taxation is not tenable because intermediary services provided by the members would not be taxable in the hands of recipient.

  If the service provided by intermediary is not taxed in India, then provision of such service will go untaxed.
- Thus, HC held that section 13(8)(b) read with section 2(13) of the IGST Act cannot be considered as ultra-vires or unconstitutional in any manner.

[4] Article 265 of Constitution provides that no tax shall be levied or collected except by the authority of law.

[5] [2008 (2) SCC 672]

- However, it would be open for Revenue to consider representation made by petitioner so as redress the grievance in suitable manner and in consonance with the provisions of CGST and IGST Act.

Comments

a. With the High Court confirming that intermediary services do not qualify as export, taxpayers may review the contractual terms and exact nature of service to be provided in case of cross-border transactions.

b. Providing more clarity on the scope of intermediary services could help in avoiding unwarranted litigation. It is relevant to note that the circular on intermediary services issued earlier under GST, was withdrawn ab-initio.

   As per minutes of the meeting of the GST Council, the revised circular has been approved, however the same is yet to be issued by the Central Board of Indirect Taxes and Customs (CBIC).

c. The ruling seems to settle the dispute regarding the nature of tax to be charged by the intermediary while supplying services outside India. Earlier, some advance ruling authorities (AARs) have held that the intermediary should charge integrated tax in such cases.

d. Though the Court has observed that the transaction would not be taxed in the hands of recipient, it may not hold good if the import of intermediary services in the recipient's country is taxed basis the location of recipient.

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