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India

INSIGHT: India to Clarify Definition of “Intermediary” under GST Regime



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The Authority for Advance Rulings, India, ruled that certain services provided to a foreign company by its Indian service provider are taxable intermediary services instead of tax-exempt exports.

In our view, the facts of the case do not warrant the relevant service provider to be considered as an intermediary.

AAR Ruling An Indian company (the “Applicant”), provides back-end support services to its foreign client engaged in trading and distribution of goods. The Applicant had approached the Authority for Advance Rulings (“AAR”) to determine whether the services would qualify as exports as they were under the former service tax regime and therefore be exempt from goods and services tax (“GST”) as well.

The services in question included typical business process outsourcing (“BPO”) activities such as generating order numbers, creating purchase orders/sales con-

tracts, liaising with suppliers and inspection authorities, communicating with customers of the foreign client, facilitating payments from customers to the Applicant and from the Applicant to suppliers, troubleshooting, maintaining records of the foreign client’s employees, etc. The AAR held that the Applicant arranged or facilitated the supply of goods or services or both between its foreign client and its customers.

Accordingly, the Applicant fell squarely within the definition of “intermediary” under the GST regime and was subject to tax at the rate of 18 percent. Without discussing in further detail, the AAR rejected the Applicant’s argument that it was providing such services on its own account and on a principal-to-principal basis with its foreign client. Despite the fact that the definition of intermediary under the service tax and GST regimes are similar, the AAR’s decision to treat BPO services as intermediary services instead of exports was a departure from well-established precedent under the service tax regime.

In fact, under the former regime, only those taxpayers who provided services to both its clients and client’s end-customers were treated as intermediaries. Interaction with end-customers as a result of the primary service being provided to their foreign clients was treated as export of service to the foreign client. The end-customers were merely beneficiaries of the service provided to the foreign client.

Impact of the AAR Ruling The one-sided decision opened the floodgates of tax department notices to Indian BPO companies providing services to foreign cli-

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ents where such services involve interactions with the foreign client's end-customer. Cross-border services agreements are often executed between an Indian service provider and a foreign service recipient, where the ultimate benefit of services provided flows to customers of the foreign recipient. In fact, the foreign service recipient often engages the Indian service provider specifically because it is located in the jurisdiction of its end-customers and is thereby better suited to provide the required services.

It is also relevant to note that the majority of the BPO/outsourcing industry is structured in a manner where there is a service arrangement on a principal-to-principal basis with the overseas service recipient/parent. There may or may not be a third-party beneficiary/end-customer. In some cases, the nature/business model of outsourcing services itself involves helpline services being provided to the end-customer.

Further, such services are usually provided from Special Economic Zones ("SEZ")/Software Technology Parks of India ("STPI") zones and the nature of such services has been treated as exports—exempt for service tax/GST. Post the AAR ruling now if tax authorities treat BPOs as intermediaries, it would not only jeopardize the overall structure and functioning of the BPO industry but would also question the existence of SEZ/STPI zones. Such treatment would also add ambiguity and increase the cost of doing business for BPOs and their foreign clients, as transactions that were always considered tax-free exports of business support services, would suddenly appear to be taxable as "intermediary services" under the GST regime.

In the context, it is crucial for the government to clarify the definition of intermediary and provide relief to those service providers, including BPOs, which may interact with end-customers, but only in order to provide a primary service to their foreign clients on a principal-to-principal basis. The correct interpretation and application of this distinction will preempt a surge in litigation and rise in cost of doing business in India which is likely to follow if the distinction is lost.

Strategic Planning Points While the government still contemplates how to clarify the law, tax authorities have already issued notices to BPOs based on the principles laid down in several AAR decisions where export of services has been classified as intermediary activities.

As such, it becomes important to ensure that service contracts are carefully drafted to make clear that the services provided are on a principal to principal basis and on the service provider's own account. To this extent the following considerations should be kept in mind when drafting the service contract:

- Carefully identify the foreign client as the principal service recipient;
- Ensure that when enumerating the description of services, it is clear that such services are being rendered to the foreign client and any benefit provided to the end-customer is only on behalf of the foreign client;
- There should not be any payment flowing from end-customer to the service provider;
- There should not be any element of control exercised by the end-customer directly on the service provider in relation to the services rendered; and
- Ensure that fees paid for the services provided are not based on the number of end-customers or revenue earned from them. This becomes important as payments received as a percentage of revenue received by the foreign client from its end-customers or based on the number of foreign customers may be seen as a commission received as an intermediary.

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