

Intermediary vs Marketing Support Services

- Contributed by CA Sri Harsha & CA Manindar

The thin line of difference between the intermediary and marketing support services is fading as time progresses in the goods & services taxes era. In this write up, we analyse the line of difference between the intermediary and marketing support services (MSS) and conclude the safe way to proceed further and also give an heads up about the impact under income tax laws.

Before proceeding further, let us step back and understand the concept of 'intermediary' under the goods & services tax laws (GST laws) and then compare with MSS and decide upon the taxability of both the said items.

Let us set the context for you to make it lively. AB Inc is a company incorporated in United States of America and engaged in manufacture of certain items. AB India is a subsidiary company incorporated in India, which is engaged in manufacture of certain items.

Now, AB Inc and AB India contemplates to enter an agreement. Both the companies sat across the table and has finalised two options.

Option 1 – Comprehensive Role to AB India:

Under this option, AB Inc contemplates to give comprehensive role to AB India for representing AB Inc in India. Vide this option, AB India will be authorised to scout for customers, make presentations to the customers, follow up on orders, negotiate the contracts, see that orders are placed on AB Inc, co-ordinate the delivery of such goods to customers, prepare invoices for AB Inc, follow up on payment for AB Inc with the customers.

The consideration for the services provided by AB India to AB Inc are settled by arriving certain percentage on the sales made by AB India on behalf of AB Inc.

Option 2 – Limited Role to AB India:

Under this option, AB Inc contemplates to give a limited role to AB India for representing AB Inc in India. The role allows AB India to promote the brand of AB Inc in India, participate in trade fairs representing AB Inc, directing any active leads to AB Inc, preparation of market survey reports and any incidental activities. AB India is not allowed/obliged to meet any customers.

The consideration for the services provided by AB India to AB Inc are settled by arriving cost plus certain mark up. The cost incurred by AB India is identified and a certain percentage is added as margin and charged to AB Inc.

Now, let us proceed to understand the concepts of intermediary and MSS and then decide the taxability of Option 1 and Option 2. Before proceeding further to understand the said concepts, we have to have in place what if a service is classified as Intermediary instead of MSS. How would the taxation differ? For this, we have to identify the place of supply and lets proceed with that.

Determination of Place of Supply:

The State in which goods or services are supplied (place of supply) as well as the state or territory in which the supplier is located (location of supplier) will form the basis to determine whether a transaction of supply of goods or services is an inter-state supply or intra- state supply. These two parameters will be decided as per the provisions of IT Act.

If the place of supply and location of supplier are in two different states/union territories, the said transaction shall be categorised as inter-state. Otherwise, the supply shall be treated as intra-state. However, there are certain exceptions to the above statements and certain supplies are mandatorily treated as inter-state supplies.

To determine the place of supply for a transaction, the Integrated Goods & Services Tax Act (IGST Act) lays two sections namely Section 12 and Section 13. Section 12 will apply in situations where the location of supplier and recipient is in India. Section 13 will apply in situations where the location of supplier or location of recipient is outside India.

Hence, we have to examine whether location of supplier (AB India) and location of recipient (AB Inc) is within India or outside India to decide on to which section has to be used for determination of place of supply.

Since AB India is located in India and AB Inc is located outside India, the appropriate section that is relevant to determine the place of supply is Section 13 of IGST Act. Section 13 has 13 sub-sections. Vide sub-section (2), the general rule for determining the place of supply is laid. If the supply does not fall in any of the sub-sections (3) to (13) [notified supplies], the place of supply shall be the location of recipient of services. If a supply falls in any of notified supplies, then place of supply of such supply shall be determined as per the relevant sub-section in which supply stands classified.

In precise terms, if the supply falls under the ambit of notified supplies, then place of supply should be determined by such sub-section. If a supply does not fall under the notified supplies, then place of supply shall be the location of recipient of services.

The place of supply for 'intermediary' is laid down vide Section 13(8)(b) which states that the location of intermediary is the place of supply. Hence, if AB India is held to be intermediary, the service shall be deemed to be consumed in India and accordingly AB India is required to pay tax on such services.

The place of supply for 'MSS' is not among the notified supplies. Hence, the place of supply shall be the location of recipient as per Section 13(2), which is outside India. Since the place of supply is outside India, the said services are treated as export of services, subject to satisfaction of other conditions.

Hence, if AB India is held as intermediary, the place of supply is in India and tax has to be paid by AB India for the services provided to AB Inc. However, if AB India is held as providing MSS or falls under the exclusion to the definition of intermediary, then place of supply is outside India and accordingly services provided by AB India are treated as export of services and not tax is required to be paid. The tax impact is 18%.

With this tax impact in background, now let us proceed to understand the concepts of 'intermediary'.

Intermediary:

Vide Section 13(8), the place of supply of certain services is fixed as the location of supplier. One of the said services is 'intermediary services'. Section 2(13) of IT Act defines the phrase 'intermediary' as ***'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'***.

From the above, it is evident any person who arranges or facilitates supply of goods between two or more persons are covered under the definition of 'intermediary'. Since AB India is arranging or facilitating supply of goods between AB Inc and customers under Option - 1, AB India can be called as 'intermediary'.

The definition of 'intermediary' excludes a person who supplies goods or services or both on his own account. The phrase 'on his own account' has neither been defined in IGST or Central Goods & Services Tax (CGST) Acts. Hence, it has to be understood from the judgments in this connection or based on the circulars or press releases issued by Central Board of Indirect Taxes and Customs (CBIC) from time to time.

CBIC Circular:

CBIC at the time of introduction of taxation based on negative list in the year 2012, has released a book by name 'Taxation of Services : An Education Guide'. Vide Para 5.9.6 the Education Guide has tried to lay down the scope of phrase 'on his own account' by referring to an example of freight forwarder. The Education Guide states that if the freight forwarder enters a contract with customer wherein, he buys and sells freight transport as a principal, then the freight forwarder would be stated that he is acting in his own account. However, if the freight forwarder arranges the facility of freight without actually entering a contract with the customer, then the freight forwarder is called as an 'intermediary'.

GoDaddy's case:

The interpretation of 'intermediary' has also come up in the matter of GoDaddy India Web Services Private Limited v Commissioner of Service Tax, Delhi - IV¹ before the Authority for Advance Rulings. The facts of the said case are GoDaddy Inc is contemplating to enter an agreement with GoDaddy India, whereby GoDaddy India is to provide support services in an integrated manner to assist GoDaddy Inc to develop its brand in India, carry on its operations efficiently and serve customers in India. GoDaddy India has to provide marketing and promotion services, supervision of quality of third-party customer care centre services and payment processing services.

The tax authorities have opined such services provided by GoDaddy India to GoDaddy Inc are in the nature of 'intermediary' services and hence taxable in India. The Authorities after examining the proposed agreement between GoDaddy Inc and GoDaddy India stated that GoDaddy India is engaged in providing business support services to GoDaddy Inc and there is no contract between GoDaddy India and customers of GoDaddy Inc in India. GoDaddy provides services directly to GoDaddy Inc and not to its customers. Further, the payments were received from GoDaddy Inc and not from its customers and hence the Authority has held that services provided by GoDaddy India are not in the nature of 'intermediary'.

Global Transportation Services Private Limited's case:

The said concept 'on his own account' is well explained in the matter of Global Transportation Services Private Limited v Commissioner of Service Tax Mumbai² by the Authority for Advance Rulings. In the facts of the said matter, the applicant is providing various services to its customers by entering individual contracts with various vendors. The applicant independently contracts with various vendors and provide such services to its Client. If there is a damage, the applicant will have right to sue the vendor and the Client will have right to sue the applicant. In such circumstance, the tax authorities argued that the applicant is an 'intermediary' because he is facilitating or arranging the services between his client and vendors. The applicant stated that he is excluded from the definition of 'intermediary' since he is supplying the services on his own account.

¹ 2016 (3) TMI 355 – AAR

² 2016 (9) TMI – AAR

The Authority of Advance Ruling after making reference to the terms of the contract has stated that the applicant is acting on his own account and it cannot be said that applicant is acting as an intermediary for the only reason that the price which is to be paid by the Client is negotiated by the applicant with vendor and hence for this reason alone, the applicant cannot be said that he is facilitating or arranging the services between the Client and vendor. Accordingly, it was held that applicant is engaged on his own account and not as an 'intermediary'.

In light of the above, we have to understand the phrase 'on his own account'. In other words, if the activities of the person are in the nature of principal to principal, then it can be said that such person is providing services or goods on his own account. However, under Option -1, AB India facilitates or arranges the supply of goods from AB Inc to customers in India. Hence, it cannot be said that the AB India is acting on principal to principal basis. There is an agency relationship between AB India and AB Inc for the reason that one of the primary objects of AB India is also to procure orders from AB Inc.

Sabre Travel Network India Private Limited's case:

We also gather support from the recent judgment in the matter of Sabre Travel Network India Private Limited (Sabre India) passed by Authority for Advance Ruling, Maharashtra³, wherein it was held that applicant' services of scouting for customers for parent company cannot be called providing services on his own account. The relevant paras from the said judgement are reproduced hereunder for ready reference:

*From the facts before us we find that the applicant is covered by the said definition of an intermediary because **they are definitely acting as a broker/ agent, etc and facilitating the process for sale of CRS Software belonging to their foreign parent company, to the Indian subscribers because they identify such subscribers on their own in India. It is the sales team of the Applicant which approaches potential subscribers in India to whom they explain the features of the CRS Software and the flexibility of said software to integrate with the potential subscriber's system for smooth functioning. Once the applicant gets a positive response from the subscriber, they scan the credentials and the business potential of the subscriber to whom it is proposed to market the CRS Software.....***

Thus from the above we find that first and foremost it is the job of the applicant to scout for subscribers in India. It is nowhere mentioned that the subscribers come on their own to the applicant. Thus the applicant explains and educates the subscriber about the software. Hence it is clear that the subscriber becomes aware of the software only after the applicant approaches them. It is also mentioned that the software does not belong to the applicant. Thus we find that the applicant actually acts as an Intermediary between the potential subscriber and Sabre APAC. The applicant is not providing services on their own.

Mrs Vishakhar Prashant Bhawe, Micro Instruments case:

³ 2018 (12) TMI – AAR, Maharashtra

In the matter of Mrs Vishakhar Prashant Bhawe, Micro Instruments⁴, it was held that the applicant is acting in capacity of broker and facilitating the process for sale of materials by their foreign principals to Indian parties for the reason they locate the customer, negotiate the prices and probably ensure the sale, they also provide for discounts to the said customers, out of the commissions received by them and hence the services provided by the applicant are in the nature of 'intermediary'.

Vserveglobal Private Limited's case:

In addition to the above, in the matter of Vserveglobal Private Limited⁵, the Authority for Advance Ruling has held that applicant who is engaged in provision of back office administrative and accounting support and co-ordination with buyers, sellers and other necessary parties for execution of purchase and sale contracts entered by their clients and other incidental services are in the nature of 'intermediary' services.

Asahi Kasei India Private Limited's case:

In the matter of Asahi Kasei India Private Limited⁶, the Authority for Advance Ruling has held that applicant who is engaged in provision of marketing support services to its holding company are not to be considered as 'intermediary' services. The authority has also held that relationship between the parties is that of independent contractors and the agreement does not intend to create a principal and agent relationship. The applicant shall not represent itself to be agent and vice versa. On the contrary, the applicant would provide services on own account to its holding company so that the latter can improve the functioning of holding company and further augment its business vis-à-vis sale of all products manufactured or sold.

The authority further held that the applicant no way carries out activities such as conclusion of contracts, acceptance of sale orders, invoicing, determination of sale prices and like services. Hence, the said services provided by applicant to its holding company are not in the nature of 'intermediary' services since they are provided on his own account.

Conclusion:

From the above, it is evident that if AB Inc enters an agreement as mentioned in Option – 1, the said services will be called as 'intermediary' and accordingly taxable in India in the hands of AB India. Option – 1 provides a comprehensive role to AB India and it creates an agency relationship with AB Inc and undoubtedly falls under the definition of 'intermediary'.

However, if AB India enters agreement in Option – 2, whereby assumes a limited role, then it can be said that AB India does not fit into the definition of 'intermediary'.

Hence, from the above discussion, it is evident that there is only a thin line of difference between 'intermediary' and 'marketing support services' and certain AAR's stumbled to arrive at right conclusions. We suggest drafting the agreements detailing the exact scope of services in clear way to avoid any future litigations. It is also important to note that tax paid on intermediary services would not be eligible as credit as such service is under forward charge and not under reverse charge.

⁴ 2018 (12) TMI 227 – AAR Maharashtra

⁵ 2018 (11) TMI 959 – AAR Maharashtra

⁶ 2019 (1) TMI 1091 – AAR Maharashtra

Passing Remarks – Income Tax laws:

The agreement entered between AB India and AB Inc will also have implications under income tax laws. If the agreement entered is under Option -1, there is every possibility that AB Inc having a permanent establishment (PE) in India in form of agency through AB India. If agreement entered is under Option -2, the said services might not constitute PE in India. What constitutes a PE in India or not depends upon the Double Taxation Avoidance Agreement that India has with such other country. The above is based on general understanding of the treaties with majority of the countries and need not represent the final view.