

Legacy issues under Indirect tax law

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Issues for discussion

1. Scope of Intermediary services
2. Taxability of notice pay recovery from employees
3. Foreign bank charges – person liable to pay tax
4. DICGC insurance credit eligibility to banks
5. Transfer of right to use goods – ‘Sale’ *vis-a-vis* ‘Service’

Scope of Intermediary services

- **Service tax regime** - *“Intermediary means a broker, an agent or any other person, by whatever name called, who arranges or facilitates a provisions of a service (**hereinafter called the “main” service**) or a supply of goods, between two or more persons, but does not include a person who **provides the main service** or supplies the goods on his account”*
- **GST regime** - *“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*
- Place of provision/place of supply for intermediary is “location of intermediary” while for other services e.g BSS, BAS it is “location of service recipient”
- Classification of service is of paramount significance as it impacts taxability of service

Scope of Intermediary services

- Moot question is “main service” or “facilitation of main service”
 - **Sunrise immigration consultants (CESTAT Chandigarh 2018)**
 - Provision of referral services to colleges and banks is in nature of promoting or marketing of business of colleges and banks which is BAS and not main service of education or loans as provided by college or bank respectively
 - **GoDaddy India web services [Delhi AAR 2016]**
 - Various services of marketing, branding, offline marketing, oversight of quality of third party customer care center and payment processing provided as single service of BSS is not an intermediary service
 - Sole intention was to promote GoDaddy US business and not to facilitate the service
- CBEC Guide has illustrated travel agent, tour operator, commission agent, recovery agent as intermediaries whereas call centre who provide services on their own account are not classified as intermediary

Scope of Intermediary services

- Guiding principle for not qualifying as “intermediary’ the services could be that such services should have no connection with the provision of main service but largely could be pre and post the provision of main service.

e.g. Referring customers to overseas company is not an intermediary services but assistance in ensuring that goods reach the customers (e.g clearance from customs and delivery to customers) or negotiating the price for goods/services could be construed as intermediary service

- Determination of whether a service qualifies as an export is also dependent on whether service is intermediary
- In absence of clear guidelines under the law the ambiguity is likely to continue
- Provision of taxing intermediary located in India has been criticized as mockery of “Make in India”

Notice pay recovery from employees

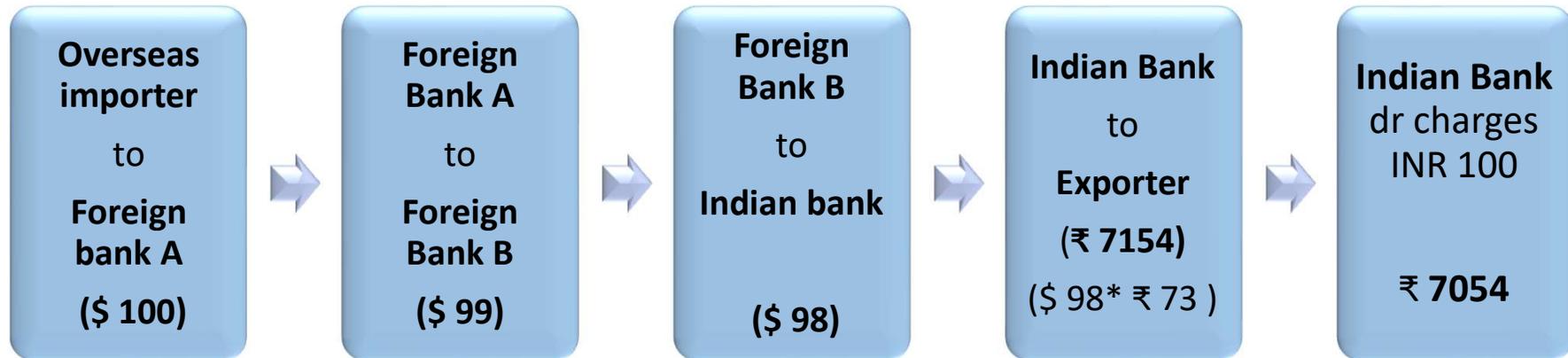
- Services provided by employee to employer in the course of employment specifically exempted from scope of “service” under service tax regime also excluded under GST regime under Schedule III
- Employment contract generally provides for the notice period on resignation and also that employee can pay certain amount in lieu of notice period (notice pay)
- Under service tax regime section 66 E(e) and under GST regime Schedule II entry 5(e) covers - 'agreeing to the obligation to refrain from an act, or to tolerate an act or a situation, or to do an act'
- Department view is that notice pay recovery is taxable under aforesaid entry earlier under service tax and now GST
- No judicial precedents yet to address the controversy

Notice pay recovery from employees

- **Conservative view** – taxable as it is consideration for agreeing to the obligation to refrain from an act, or to tolerate an act or a situation
- ***Alternate view***
 - Notice pay is a sum mutually agreed by the parties for breach of contract and is a consideration flowing from the employment contract itself
 - Employer can only sue for recovery of such amount but cannot enforce mandatory serving of the notice period
 - Hence, once notice pay is done, there can be no toleration or refrainment from the act of not suing for serving mandatory notice period
 - Notice pay recovery deduction from the salary payable to the resigning employee, not a separate consideration flowing from any independent service
 - Income tax judicial precedents allow deduction of notice pay as salary adjustment
- There should be specific clarification on non taxability of notice pay to avoid frivolous litigations

Foreign Bank charges – who is service recipient?

Transaction flow



- Dispute on service tax payment on charges levied by Foreign Bank A and Foreign Bank B (USD 2) in above illustration
- Trade Notice No 20/13-14- ST-I dated 10 February 2014 was issued by Commissionerate that the Indian banks would be regarded as the service recipient
- SCNs issued to Banks to pay service tax under reverse charge on foreign bank charges
- In some cases exporters were also issued notices- shows ambiguity in minds of Revenue

Foreign Bank charges – who is service recipient?

- Arguments in favour of Banks
 - Banks are not service recipients but mere pass through entity in transfer of money, statutorily required to act as a pass through agent for receiving foreign remittances into India
 - Banks do not receive services neither pay any consideration, charges are borne by the exporters against export proceeds
 - Charges not booked in the books of the Bank but that of exporter
 - Banks paid service tax on foreign bank charges when services received and used for its own purpose
- Recent banking sector FAQ under GST clarified that transaction involves two services, one from bank in India to the importer/exporter and one from the overseas correspondent banks to the bank in India and liability to be determined accordingly
- The aforesaid FAQ could create more litigation in the existing environment and is likely to be challenged

DICGC insurance : Credit eligibility to Banks

- Deposit insurance is compulsory for all banks in the country and is a measure to protect bank depositors and promote financial stability
- DICGC is a RBI subsidiary which insures all bank deposits upto a maximum of INR 1 lakh
- DICGC charged service tax on the insurance premium and banks availed credit of same
- Kochi Regional Unit of DGCEI initiated investigation on the basis of intelligence gathered that banks availed credit on DICGC premium
- SCNs issued with allegation that :
 - DICGC premium is not an input service as it is not used to provide any output services
 - No fees is charged by bank for taking deposit hence DICGC premium not input service
 - Used exclusively for the exempted service of extending deposits loans advances and hence no credit is available

DICGC insurance : Credit eligibility to Banks

- Favourable order by Mumbai CESTAT in the case of DCB Bank and Delhi CESTAT in the case of Punjab National bank, however order being challenged by Dept
- Recently matter argued by six other banks before Mumbai CESTAT, order reserved by CESTAT, major grounds as follows:
 - Insurance service is common input service for the bank and DICGC insurance service qualifies as 'input service'
 - Fees is charged from maintenance of ledger folio, issuance of passbooks, issuance of cheque books, issuance of ATM cards, issue of statements of accounts etc - all activities together form "operation of bank a/c"
 - Composite service should not be broken into separate service
 - DICGC insurance is a statutory requirement
 - On harmonious reading of the Rule 2(l), 2(p) and Rule 6(3B) of the CENVAT Credit Rules, credit on DICGC would be available
 - DICGC services are covered under both the main part and inclusive part of the definition of input service
- Unless suitable clarification is issued, litigations likely to be continued under GST regime

Transfer of right to use : Sale or Service?

- Article 366(29A) (d) of the Constitution (46th amendment) defined tax on sale of goods to include 'transfer of right to use goods' hence empowered states to levy tax
- Finance Act 1994 empowers Centre to levy service tax on supply of tangible goods, on temporary transfer of IPR
- Disputes on whether a transaction is transfer of right to use under VAT or service of Supply of tangible goods, franchise, IPR service
- What constitutes transfer of right to use as per judicial precedents?
 - Apex Court in **BSNL** laid down attributes of "transfer of right to use" with emphasis on transfer being to exclusion of transferor, same right cannot be again transferred to other
 - Apex Court is **Rashtriya Ispat** - transfer of effective control and possession of goods to be with transferee, there should be no restriction on usage
 - AP High court in **GS Lamba** – full control on the method, manner and time of using the goods to be decided by transferee

Transfer of right to use : Sale or Service?

- Hyderabad CESTAT in **PowerMak Industries** held that standard clauses in agreement for maintaining the leased goods do not hamper the transfer of right to use
- In case of intangibles **Bombay High Court** held:
 - in case of **Mahyco Monsanto** it held that transfer of technology on medium of seeds was transfer of right to use goods as the seeds were in complete possession and control of transferee and hence subject to VAT whereas;
 - in case of **Subway Systems** it held that transfer of trademark that it was a case of permissive use of IPR since any breach would require return of IPR rights and hence service tax will apply
- Although GST law has deemed transfer of right to use goods as service , the taxable event, still the definition of 'tax on deemed sale of goods' exists since the Article 366(29A) of the Constitution has not been deleted
- Whether a transaction is a transfer of the right to use the goods or a service is essentially a question of fact based on terms of the contract

THANK YOU

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