

Eye Share : The impurities in the pure agency provisions under the GST regime!

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The includability of reimbursable expenses in valuation of taxable services has been an area of immense debate and confusion ever since the service tax era. Under the erstwhile regime, definition of 'pure agent' covered a person who entered into a contractual agreement with recipient of service to act as his pure agent to incur expenditure in the course of providing taxable service.

Ms. Poonam Harjani (Partner, Nitya Tax Associates) along with **Ms. Kritika Poddar (Associate)** state that under GST, the Government has relaxed and simplified the conditions of pure agency. Since the condition carving liability on recipient of service to make payment to third party has been done away with, authors elucidate that under GST, privity of contract between third party and recipient of service is no longer a condition to exclude reimbursable expenses from taxable supply value.

Article



The concept of pure agency under service tax regime - the inherent contradiction that existed back then

The includability of reimbursable expenses in valuation of taxable services has been an area of immense debate and confusion ever since the service tax era. A statutory structure for exclusion of such expenses was attempted to be provided within the framework of service tax laws by way of introduction of the concept of pure agent under the valuation rules w.e.f. April 19, 2006. However, the law prevalent then, borrowed from the UK VAT Directives, contained onerous conditions, rendering the benefit of the concept being available to very limited situations.

In the erstwhile regime, the definition of pure agent *inter alia* covered a person who entered into a contractual agreement with the recipient of service to act as his pure agent to incur expenditure in the course of providing taxable service. This meant that two things were necessary to qualify as a pure agent: (i) existence of a contract between supplier of service and recipient of service by which former would act as pure agent of the latter in respect of the reimbursable expenditure (ii) the pure agent would incur some reimbursable expenses while providing the main service.

It is important to understand the meaning of the term incur to understand the afore-mentioned provisions better. The term incur has been defined in the Black's Law Dictionary as '*to suffer or bring on oneself (a liability or expense)*'. This means suffering of the expense by service provider and not mere payment to third party was essential to qualify the definition of pure agent.

Further, certain conditions were prescribed for a service provider to qualify as pure agent of recipient of service under the service tax regime. One such condition relevant in the present context has been reiterated below:

‘The recipient of service is liable to make payment to the third party’.

The above-mentioned condition casted liability of payment on recipient of service. This condition implied existence of a contract between recipient and third party. On close scrutiny of the above-mentioned provisions, it is evident that there existed a contradiction in the definition and conditions of pure agent under service tax law. The definition required the service provider to incur the expense in its own capacity and eventually claim it from recipient while the conditions required the service provider to be mere conduit of payment.

The provisions under the Goods and Services Tax (‘GST’) regime

Under GST, the Government has relaxed and simplified the conditions of pure agency. The earlier applicable condition which imposed liability on recipient of service to make payment to the third party has been done away with. This leads to the inevitable inference that privity of contract between third party and recipient of service is no longer a condition under GST to exclude value of reimbursable expenses from the value of taxable supply.

Nevertheless, the definition remains the same. This means it is necessary for supplier of service to incur expense as pure agent. Ostensibly this change seems pro-tax payers. However, if applied in this way, in reference to regular business to business transactions, the concept of pure agency will not work. This is for the reason that if the supplier needs to have a privity of contract with the third-party vendor towards reimbursable expenses which are not included for discharge of GST liability on main supply, it would lead to blockage of input tax credits in respect of reimbursable expenses. Such an interpretation of the pure agency provisions will necessitate major restructuring in the business models of many industries which have historically worked on cost plus reimbursement models including the customs house agents, media agencies, travel agents, etc.

Is claiming as reimbursement of expenses – an alternative?

Sometimes, supplier of service while providing main service, incurs certain expenses which are beyond the scope of work of the supplier. Such expenses are recovered by supplier on actual basis from recipient of service. For example, a mandap keeper supplying mandap keeper services may incur certain catering expenses on request from recipient of service. Mandap keeper will recover these expenses on a cost to cost basis from recipient.

The mandap keeper in this case will qualify as pure agent only if all the conditions of pure agency as prescribed in GST law are met.

As discussed above, with the advent of GST, there is no requirement of privity of contract between caterer and recipient of service. As such, the recipient will not be eligible to claim input tax credit of catering services since he has not received the services. This makes pure agency arrangement non-workable for regular B2B transactions where credit is entitled to the recipient. This leads us to the question whether in this case, the plea of the catering expense being a reimbursable expenditure and hence, to that extent a mere transaction in money can be taken, in the alternative under the GST regime? In the authors’ considered view, yes, it can be.

This view is also supported in the case of ***Sri Bhagavathy Traders v. Commissioner of Central Excise, Cochin [2011 (24) STR 290 (Tr-Bang)]*** wherein the Tribunal held that only when service recipient is legally obliged to pay to third party and this amount is paid by service provider on behalf of service recipient, then it will qualify as reimbursable expense not leviable to service tax.

Implications on cross charge of common expenses

Reimbursement / re-bill model is being routinely followed by many business groups wherein one of the companies of the group incurs common expenses on behalf of their group companies and subsequently recovers it on a cost-to-cost or cost-plus-mark-up basis from them. In these cases, typically there is no other supply made by the company cross charging the common costs. For example, a company named XYZ, Australia incurs IT expenses on behalf of its group company ABC, India. XYZ, Australia recovers only IT expense from ABC, India on a cost to cost basis.

One of the essential conditions of pure agent is that the supplier must incur the reimbursable expense in addition to the amount recovered for main service. This condition to qualify as pure agent will not be satisfied in the above-mentioned example as XYZ, Australia, is not providing any main service to its group companies. Hence, the amount recovered for IT expense will be leviable to GST unless there is a contract between recipient and third party, which will then qualify as mere transaction in money and will not be leviable to GST.

Further, if the recovery is on cost-plus- markup basis, GST will be leviable on the whole amount (and not just the markup) of transaction.

Reimbursement of expenses – a comparative of treatment under the service tax vis-à-vis the GST regime

The below table provides for a comparative of implications on reimbursable expenditure for various scenarios under the service tax vis-à-vis GST regime through an illustration where A is supplier of main service, B is recipient of service and C is the third party vendor:

Nature	Privity of contract	Implications under erstwhile service tax regime	Implications under GST regime
Expense reimbursement	A & C	Not excludible from value of taxable services. A entitled to avail CENVAT credit on reimbursable expenditure	Excludible from value of taxable supply as pure agent. Credit of GST incurred on reimbursable expenditure, however, not admissible to recipient
		Excludible from value of taxable supply as pure agent. B entitled to avail	Excludible from value of taxable supply being

together with main supply	B & C	CENVAT credit on reimbursable expenditure. <i>(Notwithstanding the inherent position in the pure agent provisions discussed above, this position was accepted by Department.</i>	transaction in money. B entitled to avail input tax credit on reimbursable expenditure provided invoice towards such expenditure issued by C with B's relevant GSTIN
Rebilling of only costs (without markup)	A & C	Not excludible from value of taxable services. A entitled to avail CENVAT credit on reimbursable expenditure	Not excludible from value of taxable services. A entitled to avail input tax credit credit on reimbursable expenditure
	B & C	Due to absence of main supply from A to B, the pure agency concept cannot be invoked. Excludible from value of taxable supply being transaction in money. B entitled to avail input tax credit on reimbursable expenditure provided invoice towards such expenditure issued by C to B.	Due to absence of main supply from A to B, the pure agency concept cannot be invoked. Excludible from value of taxable supply being transaction in money. B entitled to avail input tax credit on reimbursable expenditure provided invoice towards such expenditure issued by C with B's relevant GSTIN
Recovery on cost plus markup basis	A & C	Service tax leviable on reimbursable expenditure. A entitled to avail CENVAT credit on reimbursable expenditure	GST leviable on reimbursable expenditure. A entitled to avail input tax credit on reimbursable expenditure, provided invoice towards such expenditure issued by C with A's relevant GSTIN

Conclusion

Hence, the attempt to simplify the provisions of pure agency under GST has not been successful due to inefficiency on the part of recipient to avail credits. Supplier may consider receiving the services from third party on principal to principal basis and including it in the value of main supply of services while billing to recipient for main service. This will be mere pass through of credits where the recipient will be eligible to claim credit of taxes paid.



However, this option is not available in cases where the liability to pay is inherent on recipient only. Eligibility of these expenses as pure reimbursable expenses will continue to be major concern in industry under GST regime. For instance, the liability to pay customs duty is the statutory obligation of the importer only. In terms of the GST provisions, if the customs house agent pays customs duty on behalf of the importer, it cannot exclude the amount of such customs duty treating itself as a pure agent.

For such situations, taking the plea that the payout of the customs duties on behalf of the importer is a transaction in money, is the only way to exclude the amount of such duties from the value of taxable supplies made by the customs house agent!!