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Services Provided through Third Parties

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This document contains a brief on services provided through or by third party companies

Many services contracted to be provided by 'A' to 'B' are actually delivered by a third party 'C'.A telephonic helpline is typically one such service. Logistics services are so commonly outsourced that an abbreviated term "3PL" is used to denote a third-party provider of logistics services. Later in this piece we shall look at a typical situation of 3PL.

Ambiguities in service tax on third party services:

The tripartite structure of subcontracted services generates complexity and sometimes bewilderment in service tax in by the interplay of different sets of rules and statutory provisions. This has become accentuated by the Place of Provision Rules 2012 (hereinafter "PoP Rules"). The legal provisions yield no clear answer to the fundamental question of who is to be considered as providing service to whom in a tripartite situation. This impacts the question of import and export of services and attendant liabilities / benefits.

Classification of third party services before July 2012:

Prior to July 2012, third party services were mostly covered in the category 'business auxiliary services', defined in Section 65(19) of the Finance Act 1994 (hereinafter, "the Act") as follows (relevant extract):

- Promotion or marketing or sale of goods produced or provided or belonging to the client
- Promotion or marketing of service provided by the client
- Any customer care service provided on behalf of the client
- Procurement of goods or services, which are inputs for the client; or [Explanation -…]
- Production or processing of goods for, or on behalf of, the client
- A service incidental or auxiliary to any activity specified in sub-clauses (i) to (vi), such as billing, issue or collection or recovery of cheques, payments, maintenance of accounts and remittance, inventory management, evaluation or development of prospective customer or vendor, public relation services, management or supervision, […]

All these services involved dealing with a third party on behalf of the client.

From July 2012: "intermediary services"?

From July 2012 the list of taxable services was scrapped, and all services became taxable, except for those in the negative list. However this has not removed the need to describe a service correctly, because descriptions of specific services are relevant in several contexts. Thus, the PoP Rules, while stipulating that the place of provision of service is generally in the location of the recipient, also provides exceptions in the form of differential treatment for specified services. Among these is 'intermediary services', which are taxable at the location of the intermediary.

Rule 9 of the PoP Rules says:

9. The place of provision of following services shall be the location of the service provider:

(a) …
(b) …
(c) Intermediary services;
(d) …

'Intermediary service' is defined in the Rules as they stand today, as follows:

2(f) "intermediary" means a broker, an agent or any other person, by whatever name called, who arranges or facilitates a provision of a service (hereinafter called the 'main' service) between two or more persons, but does not include a person who provides the main service on his account.;

This definition is modified with effect from 1 October 2014, under the Place of Provision of Services (Amendment) Rules 2014, issued under notification 14/2014-ST dated 11 July 2014, to read as follows:

2(f) "intermediary" means a broker, an agent or any other person, by whatever name called, who arranges or facilitates a provision 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;

It can be seen from the definition that that intermediary facilitates or arranges the provision of the main service but does not provide the main service on his own account. The meaning of the phrase "on his own account" is not explained. However, upon reflection, it can be perceived that if a person provided a service independently, and not under agency of a third party, he would never come within the penumbra of 'intermediary' or need to be excluded from it. The meaning therefore becomes clear, that an intermediary is one who arranges or facilitates a service but does not himself provide it. In the third party transactions that we are discussing here, like 3PL, the third parties provide the main service and are not merely intermediaries.

Thus the categorization of third party services post July 2012 is a marked departure from their categorization prior to that. In the earlier period, as can be seen from the definition in section 65(19) of the Act, undisclosed agents were treated similarly to disclosed agents. Now, while there is a large overlap, there are categories that were covered earlier in 'business auxiliary service' but are not 'intermediaries'. For example, a subcontractor who processed some goods, perhaps unbeknown to the person who placed the order with the principal, had been taxable under 'business auxiliary service'. Now he will not be covered by the definition of 'intermediary', as he does not facilitate or arrange a service between two entities.

The treatment of third party services, even to the extent that there is common ground between 'business auxiliary service' and 'intermediary', is also different from July 2012. This is discussed in the next section.

Export and import of services:

Two sets of rules were deleted with effect from 1 July 2012:

- Export of Services Rules 2005, and
- Taxability of Services (Provided from Outside India and Received in India) Rules 2006

These were replaced by the PoP Rules 2012.

Export / import of third party service prior to July 2012

For business auxiliary service, which earlier covered third party services, the main criterion for export under the erstwhile Export of Services Rules 2005 was that the service be provided to a recipient located outside India [Rule 3(iii)]. In addition the Rules stipulated that the service should be provided from India and used outside India, and the payment should be in convertible foreign exchange. Conversely for import, the service was treated as imported if received by a recipient located in India.

Import / export of services from July 2012

From July 2012 the process for determining whether a service is taxable /non-taxable by virtue of import / export is more complicated, involving correlating and interpreting provisions in the Act and in two sets of rules. The process goes as follows.

Service tax is levied under section 66B of the Act, which lays down that –

(66B) There shall be levied a tax (hereinafter referred to as the service tax) at the rate of twelve per cent on the value of all services, other than those services specified in the negative list, provided or agreed to be provided in the taxable territory by one person to another and collected in such manner as may be prescribed.

Thus service tax is levied on services provided "in the taxable territory".

Whether a service is provided in the taxable territory is not a common sense determination. Section 66C empowers the central government to make rules to determine, with regard to the nature and description of various services, the place in which they are provided or deemed to be provided. The PoP Rules have been notified under this section of the Act.

The PoP Rules first give us a default determination of the place of provision of service, in Rule 3: "The place of provision of a service shall be the location of the recipient of service". After this, various kinds of services are listed as exceptions to the default treatment. Among these, two are of particular interest in the present discussion. These are Rule 4 and Rule 9.

Rule 9. The place of provision of following services shall be the location of the service provider:
(a) …
(b) …
(c) Intermediary services;
(d) …

Thus, intermediary services are one of the specified services for which the location of the service provider is regarded as the place of provision of services. If the intermediary is outside India, then the service is taken as provided outside India and is not taxable; if the intermediary is in India then the service is taxable, even if the client is outside India and pays in foreign exchange.

Rule 4. The place of provision of following services shall be the location where the services are actually performed, namely:

(a) services provided in respect of goods that are required to be made physically available by the recipient of service to the provider of service, or to a person acting on behalf of the provider of service, in order to provide the service: […]

According to this rule, the services requiring physical availability of goods will be taxed in the location where they are actually performed. The services of handling goods require the goods to be physically available to the service provider; hence the services of 3PLs are required to be taxed in the location where they are performed.

Example of ambiguity in service tax: 3PL services:

A foreign multinational company with operations in India enters into agreement with a logistics service provider based outside India for provision of packing, unpacking, loading, unloading and shipping services in India. The logistics service provider has no presence in India, and executes the work through agents in India (3PLs), to whom payment is made in foreign exchange. Query: What is the liability of service tax in this transaction?

As we have seen above, the default position as laid down in Rule 3 of the PoP Rules is that service is provided at the location of the recipient of service. In the example, the Indian arm of the multinational company receives the service in terms of its agreement with the logistics service provider; hence the service is taxable in India. Further, under the definition of 'person liable to pay service tax' in rule 2 of the Service Tax Rules 1994, the recipient of service from outside India is the person liable to pay service tax on it. To identify the person from whom the multinational receives services we may be guided by the case of Paul Merchants Limited.

In the case of Paul Merchants Limited and others versus Commissioner of Central Excise, Chandigarh, reported as 2013 (29) STR 257 (Trib), the CESTAT held that service of paying out money remitted from outside India was to be considered as provided by the agents in India to the foreign money transfer company, and observed that,

"It is the person who requested for the service and is liable to make payment for the same who has to be treated as recipient of the service, not the person or persons affected by the performance of the service."

It appears from this that the multinational company receives service from the Foreign Service provider and would be liable to pay service tax on the logistics services in India.

However, under Rule 9 of the Place of Provision of Services Rules, the location of the intermediary is the place where the service of an intermediary is performed and is taxable. The service of the intermediary is the very service that is received by the multinational. Even if we do not treat the 3PL as an intermediary because he provides the main service, we come up against Rule 4, in terms of which the service in respect of goods is taxable in the location where it is performed. If the service is taxable in India and the performed by a person available in India, then that person is liable to pay the service tax.

So is the 3PL to pay tax on its performance, or is the multinational to pay tax on it in terms of its privity of contract with the Foreign Service provider; or will this be a strange case of double taxation?

In this particular case the answer lies in the agency agreement under which the 3PL performs its services. The Indian arm of the multinational receives its services from the Foreign Service provider, but through the 3PL in India. Thus the multinational does not receive the services from outside India and is not the 'person liable to pay service tax' under Rule 2 of the Service Tax Rules. The 3PL receives its payment from outside India but performs the service in India and pays service tax accordingly.

However, when the service tax department's audit discovers payments made to the Foreign Service provider by the Indian arm of the multinational, it will not be easy to convince the department of this reasoning without a protracted process of adjudication and appeal.

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