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INDIRECT TAX

GST on intermediary – Constitutional validity of IGST Section 13(8)(b) – Split verdict by Bombay High Court

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The Division Bench of the Bombay High Court has rendered a split verdict on whether Section 13(8)(b) and Section 8(2) of the Integrated Goods and Services Tax Act, 2017 (**'IGST Act'**) are *ultra vires* Articles 14, 19, 245, 246, 246A, 269A and 286 of the Constitution of India and Section 9 of the Central Goods and Services Tax Act, 2017 (**'CGST Act'**).

FACTS AND ISSUES

The Petitioner was engaged in providing marketing and promotion services to customers located outside India (**'principal'**) and received consideration towards such services in foreign currency. The customers located in India directly placed purchase order on the principal. Upon receipt of payment from the customer, the principal paid commission to the Petitioner. The Petitioner was an 'intermediary' of the principal as per Section 2(13) of the IGST Act.

As per Section 13(8)(b) of the IGST Act, when the principal (recipient of the service) is located outside India, the place of supply shall be the location of supplier of services, i.e. India. Consequently, when the location of the Petitioner and the place of supply are within the same State, the transaction qualifies to be an intra-state supply as per Section 8(2) of the IGST Act and the Petitioner was liable to pay Central Goods and Services Tax (CGST) and State Goods and Services Tax (SGST).

In this background, the Petitioner challenged the validity of Section 13(8)(b) and Section 8(2) of the IGST Act on various grounds.

RELEVANT ARGUMENTS ON BEHALF OF THE PETITIONER

- Levy of tax on export of service is *ultra vires* Article 246A read with Article 269A and Article 286 of the Constitution of India. A parliamentary law cannot have extra-territorial operation.
- Section 8(2) and Section 13(8)(b) of the IGST Act are *ultra vires* the charging section in Section 5 of the IGST Act as also Section 9 of the CGST Act.
- GST is a destination-based tax on consumption. Therefore, services provided by a service provider in India to a service receiver located outside India which is treated as export of service, cannot be taxed.
- Other similarly placed services are all treated as an export of service. Therefore, Section 13(8)(b) is violative of Article 14.
- The right of the petitioner to carry on trade and business under Article 19(1)(g) of the Constitution of India is jeopardized inasmuch as it incentivizes the principal to set up liaison office in India at the cost of intermediaries like the Petitioner.

- An indirect tax must be capable of being passed on to the end receiver of the service. Therefore, it is trite that an agent cannot be burdened with GST.

- Levy of GST on an 'intermediary services' would lead to double taxation on the same service by imposition of IGST on commission received by the Petitioner and simultaneous taxation of the same in the hands of the principal in the importing country.

- Globally, intermediary services are treated as export of services and are not taxed.

RELEVANT ARGUMENTS ON BEHALF OF THE DEPARTMENT

- Even under the pre-GST regime, the place of supply in case of 'intermediary services', has been the location of the intermediary.

- The services are actually performed and enjoyed at the place where the intermediary is located. Therefore, Section 13(8)(b) is constitutionally valid.

- If place of supply for all intermediary services were to be the location of the recipient, such supplies would go outside the tax net.

- Taxing services provided by intermediaries would incentivize FDI, and hence, such taxation is in consonance with Make in India programme.

- Intermediary services are not export of services within the meaning of Section 2(6) of the IGST Act as all the five conditions are not satisfied.

- The principal would be eligible to claim deduction in respect of services received from the Petitioner. Hence, there is no question of double taxation.

- An identical challenge was decided by the Gujarat High Court in *Material Recycling Association of India* v. *Union of India* [2020-VIL-341-GUJ]. The same should be uniformly followed throughout the territory of India.

FINDINGS OF THE BOMBAY HIGH COURT

The matter was to be decided by a Division Bench of the Court. In view of divergence in opinion between the two judges. The findings contained in each of these opinions are captured hereinafter:

Section 13(8)(b) is ultra vires the Constitution: Per Justice Ujjal Bhuyan

- The Constitution does not empower imposition of tax on export of services out of territory of India by treating the same as a local supply. (*para 47*)

- A law may have extra-territorial operation to subserve an object which is related to something in India. It is inconceivable that a law should be made by Parliament in India which has no relationship with anything in India. (*para 53.2*)

- By artificially creating a deeming fiction in the form of Section 13(8)(b) of the IGST Act, the place of supply has been treated as the location of the supplier in India. This runs contrary to the scheme of the CGST Act as well as the IGST Act besides going beyond the charging sections of both the Acts. (*para 54*)

- The extra-territorial effect given by way of Section 13(8)(b) has no real connection or nexus with the taxing regime in India. It runs completely counter to the very fundamental principle on which GST is based i.e., it is a destination-based consumption tax as against the principle of origin-based taxation. (*para 56*)

- Insofar as the decision of the Gujarat High Court in *Material Recycling Association of India* which decided an identical challenge, judgment of one High Court is not a binding precedent on other High Courts. (*para 59*)

- Not challenging the Place of Provision of Service Rules, 2012 can be no valid ground for non-suiting the Petitioner from instituting the present challenge. (*para 62*)

- The submissions that levy of IGST on supply of services by intermediaries to foreign customers would strengthen the *Make in India* program can be no answer to challenge to constitutionality of a parliamentary statute. Besides, such a statement has been made *de-hors* any supporting statistics and analysis. (*para 63*)

Section 13(8)(b) is intra vires the Constitution: Per Justice Abhay Ahuja

Challenge to validity vis-à-vis Article 246A, 269A and 286 of the Constitution of India:

- The legislature has enacted a specific provision defining 'intermediary' in Section 2(13) and to govern intermediary services in Section 13(8)(b). The question of application of general provision of Section 2(6) of export of services would not arise. (*para 99*)

- A conjoint reading of Article 269A(1) with Article 269A(5) and Article 246A exclusively empowers the Parliament to make law on what is inter-state supply and what is not. The power to enact provisions determining the nature of supplies whether inter-state or intra-state or determining the place of supply originates from these Articles. (*para 103*)

- Once the Parliament has in its wisdom stipulated the place of supply in case of intermediary services, no fault can be found with the provision by artificially attempting to link it with another provision to demonstrate constitutional or legislative infraction. (*para 105*)

- All that Section 13(8)(b) does is to provide for place of supply in respect of intermediary services where the service recipient is outside India (as in the case of the Petitioner), to be the location of the supplier of services. Therefore, there is no question of extra territorial legislation here. (*para 107.4*)

Challenge to validity vis-à-vis Article 14 and 19(1)(g) of the Constitution of India:

- In taxing statutes, legislature holds the power to frame laws to plug in specific revenue leakages. (*para 110.8*)

- Petitioner who is providing intermediary service to a recipient outside India is on a different footing. There is a reasonable classification founded on intelligible differentia which has a rational relation / nexus to the object sought to be achieved. (*para 110.9 and 110.10*)

- Whether a foreign exporter would set up a liaison office in India is a matter which is in the individual freedom of such an exporter. It has no bearing on deciding the constitutionality of Section 13(8)(b). (*para 111.4*)

Challenge to validity vis-à-vis the respective charging sections under CGST Act:

- When the Constitution has empowered the Parliament to formulate principles determining the place of supply, Section 13(8)(b) cannot be said to be ultra vires the charging section. (*para 113.3*)

- Section 13(8)(b) and the respective charging sections operate in different fields. (*para 114.4*)

Challenge to validity vis-à-vis double taxation:

- The two taxes which are separate and distinct imposts on two different transactions / supplies is permissible as in law, there is no overlapping. (*para 115.2*)

- The commission paid by the recipient would generally be entitled to deduction in the foreign country and therefore, it would not be a case of double taxation. (*para 115.3*)

Implications and comments:

- Owing to divergence in opinion, the Registry has been directed to place the matter before the Chief Justice of the Bombay High Court for determining further course of action.

- The constitutionality of Section 13(8)(b) was earlier upheld by the Gujarat High Court decision in *Material Recycling Association of India.*

- This decision has also kept open the scope for considering representations made by the Petitioner to redress their grievance on this aspect (*para 116.4 of the judgment rendered by Justice Abhay Ahuja*). This is a reiteration of what was already stated by the Gujarat High Court in *Material Recycling case.*

[*Dharmendra M. Jani* v. *Union of India & Ors.* – Judgment dated 9 June 2021 by Justice Ujjal Bhuyan and Judgment dated 16 June 2021 by Justice Abhay Ahuja, in Writ Petition No. 2031 of 2018, Bombay High Court]

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