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AGENCY AND BEYOND .....

When agent wears the hat of a 'Supplier on his own account'

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- A brief note on recent decision of UK Upper Tribunal dated 30.07.202 in All Answers Limited Vs. The Commissioner for Her Majesty's Revenue and Customs.

- A note on scope of Agency Transactions under Schedule I of Central Goods and Service tax Act, 2017.

The concept of 'Agency' is one of the thoroughly exploited arrangements in commercial world. Though the Contract Acts of different jurisdictions exhaustively deal with the rights and obligations and limitations of agent in an agency relationship, in the world of taxation, the concept of agency has much more ramifications than what is captured under general Contract Act. A 'contract of agency' can conveniently be used by interested parties and interpreted by tax authorities as a tool for tax avoidance in various ways. There is a popular belief in commercial world that the agency is established , if the terms of contract could point to existence of one.

The recent decision of the UK Upper Tribunal in ALL ANSWERS LIMITED VS. THE COMMISSIONERS FOR HER MAJESTY'S REVENUE& CUSTOMS dated 30.07.2020, after a thorough examination of terms of contract of agency between the parties, has come to a conclusion that the terms of contract when read harmoniously with the commercial and economic reality of the transaction, results in a scenario where the 'agent' is shedding his cloak of 'agency' and is stepping in to the shoes of a 'supplier'

Facts in brief:

The appellant (All Answers Limited), operates an online portal https://www.allanswers.co.uk/ ,through which it offers academic services as essay writing service, dissertation writing service, assignment writing service etc to their customers. A customer, who requires the service, would place an order in the online portal. The appellant is conveying the terms of contract to customer through an online agreement, which is called customer agreement. The portal would execute the service either through own employees or through pool of freelance writers who are associated with the appellant for contributing the academic work.

The appellant has entered in to, what they call, a 'contract of agency' with writers, which provides that the writers are engaging the appellant as agent for reaching their work to customers.

The appellant has structured their pricing mechanism in such a manner that the customer is required to make payment, which is usually fifty percent of the total fee for work at the time of placing order and remaining at the time of delivery. Two third of the fee is retained by the appellant and one third is passed on to the writer.

Dispute arose, when the appellant was not willing to pay VAT in respect of amounts (one third of fee received) shared with the writers.

The appellant was of view that the amount passed on to the writers are treated as consideration for supply made by the writers to customer and hence the appellant, who is only an agent, is not liable to pay VAT on such portion of consideration passed on to writers. The appellant is liable to pay VAT only in respect of commission retained by them and not on entire amount collected.

HMRC objected and raised demand on appellant in respect of whole consideration received from the customer. HMRC contend that the entire consideration is for single supply, which is made by the appellant.

The First Tier Tribunal had decided the matter in favor of HMRC. The First Tier Tribunal had held that the agreements were smokescreen arrangement. The economic and commercial reality of the situation pointed to a conclusion that the appellant is a supplier to customers and is hence liable for paying VAT on gross amount. Aggrieved by the order of First Tier Tribunal, the appellant approached the Upper Tribunal. The issue for consideration was whether the academic work was supplied by the appellant to customers or by writers to customers. If the appellant is an agent, they are liable to pay VAT only in respect of amount retained by them.

If the appellant is the actual supplier, they are liable to pay VAT on entire amount collected from buyer. In such a scenario the services procured from the writers would be inward supply, which is used for providing outward supply to customers.

The Upper Tribunal held that the appellant is the direct supplier of academic work to customers. The writers are not directly supplying the academic work to customers in spite of some terms of the contract binding the writer directly to customers.

The following principles and facts were relied on while holding the appellant as a supplier and not an agent of writer.

Principle of Reciprocal Performance :

The entire case was decided around the concept of 'reciprocal performance' described in Tolsma v Inspecteur der Omzetbelasting Leeuwarden [1994] STC 509, case.

The Upper Tribunal examined the question whether for supply of academic work, the legal obligation of contract was between the writer and customer or between appellant and customer. To identify this aspect, the terms of contract and economic reality of transaction was analysed.

Principle of Economic and Commercial Reality :

Contractual position normally reflects the economic and commercial reality of transactions and therefore to satisfy requirement of legal certainty such contractual terms are to be considered. But some times when contractual terms do not reflect the economic and commercial reality of transactions, such contractual terms constitutes artificial arrangement which does not correspond with economic and commercial reality. It is interesting to note that, in present case, the tribunal had taken great efforts to harmoniously read terms of 'customer contract' and commercial reality of transaction.

Agreement between the Writers and Appellant and conclusion :

The Upper Tribunal noticed that as per agreement, the writer is authorizing the appellant (i) to act as their agent, (ii) authorize to set pricing, and commission, (iii) to enter in to contract on behalf with customers, (iv) authorize to collect payment, (v) deduct commission and (vi) pay balance amount. The agreement also provided that the IPR to work submitted belongs to the Appellant. As per terms the appellant was authorized by the writer to act on his behalf and enter in to contract with the third party.

A specific clause mentions that if the writer is submitting a plagiarized work, he is directly liable to customer for payment of compensation. The Upper Tribunal relied on the principle that the agency is a fiduciary relationship where principal manifest assent to another to act on his behalf and agent manifest assent to act on behalf of principal. The Writers gave consent to the appellant to act as their agents and appellant exercised such authority in entering in to contracts. But it is interesting to note that, in spite of above, the Upper Tribunal concluded that the agent is rendering service to customer.

This is mainly on an interpretation of terms of contract between the appellant and customer and the aspect of Commercial and economic reality of the transactions.

Agreement between Appellant and Customer and conclusion:

The Upper Tribunal relied on following terms of agreements (i) the appellant act as agent for qualified experts to sell their original work to customers; (ii) the Customer appoints appellant to search for experts, (iii) customer is not to make direct contact with the writer, (iv) appellant undertakes to exercise reasonable skill and judgment in allocating expert, (v) customeris given only a

license to use the work and not copyright of work delivered. On a detailed perusal of above terms, it has been held that the agreement contains terms which binds the appellant personally liable to customer. The Upper Tribunal also gave great importance to the arrangement that the though writer transferred entire copyright on work to appellant, the customer was given only a limited license by the appellant. This showed that having divested itself of copyright, the writer is not in a position to provide license to use work to the customer. The appellant provided customer only limited right to use the work. This was different from the right of copyright that appellant got.

The tribunal on arriving at conclusion, held that the contract with customer is consistent with commercial and economic reality, pointing to conclusion that the appellant is not an 'agent' but 'actual supplier'.

AGENCY TRANSACTIONS UNDER GST

- The order of the Upper Tribunal discussed above, has extended the status of agent as a supplier on an analysis of the terms of contract and commercial reality of transactions. Even Indian tax system, whether sales tax, VAT or Service Tax were not free from litigation on agency transactions. History of sales tax is abundant with

cases where 'Contract of agency' has been categorized by Tax Department as 'Contract of sale'. The Hon'ble Supreme Court has carved out the principle that the essence of a contract of sale is the transfer of title to the goods for a price paid or promised to be paid. The essence of agency to sell is the delivery of the goods to a person who is to sell them, not as his own property but as the property of the principal who continues to be the owner of the goods and will therefore be liable to account for the sale proceeds. While interpreting the terms of an agreement, the Court has to look to the substance rather than the form of the agreement.

- Use of words like "agent" or "agency", "buyer" and "seller" is not sufficient to lead to the inference that the parties did in fact intend that the saidstatus would be conferred. (Bhopal Sugar Industries Ltd vs Sales Tax Officer 1977 AIR 1275).

Under Service Tax, the levy of service tax on Agency transactions commenced in 1997 when Service Tax was levied on CHAs, steamer agents and C& F agents. The issue whether agent is acting as independent service provider or is just an agent has aggravated after the shift to negative list regime, when a definition was brought in for 'intermediary'.

The definition of 'intermediary' though covered all facilitation services, it consciously excluded transactions undertaken on one's own account. The history of litigations that followed has brought out the following broad parameters to classify a taxable person as an intermediary or independent service provider:

- Intermediary cannot alter nature of service;
- Intermediary cannot alter the value of service, (though he can bargain for better price for principal)
- The value of service of intermediary is to be distinctly identifiable from the supply he is arranging ;
- The nature of supply effected by intermediary on behalf of principal is clearly identifiable;
- Under GST, for a transaction to qualify as 'supply', it should be made by a person, for consideration, in the course or furtherance of business. The commission earned by an 'agent' for performing his duties under contract of agency is therefore liable for GST as it is a supply covered with in scope of supply.
- In addition to the above, the Principal – Agency transactions have been given a distinct status under Schedule I of CGST Act. Schedule I, deals with activities deemed as supply, though same does not involve any consideration.

- Paragraph No. 3 of said schedule, treats the following as supply:

supply of goods by a principal to his agent, where, agent undertakes to supply such goods on behalf of principal or

supply of goods by an agent to his principal where the agent undertakes to receive such goods on behalf of principal

The general meaning conveyed by above clauses appears to be this :

- Supply of goods by principal to agent, though made without any consideration, is deemed as a supply, in cases where, the agent undertakes to supply such goods on behalf of principal.

- Similarly, Supply of goods by an agent to his principal, though made without any consideration, is deemed as a supply, in cases where, the agent undertakes to receive such goods on behalf of principal.

- A plain reading of the above gives an impression that in case of all types of Principal-Agency transactions, the deeming fiction of supply as prescribed under Sl. No. 3 of Schedule I would apply. But, Circular No. 57/31/2018-GST dated 04.09.2018

provides clarification which restricts the applicability of above serial number to types of transactions explained therein. The Circular highlights the following :

- *all the activities between the principal and the agent and vice versa do not fall within the scope of the said entry.*

- *The supply of services between the principal and the agent and vice versa is outside the ambit of the said entry, and would therefore require "consideration" to consider it as supply and thus, be liable to GST.*

- *an agent can be appointed for performing any act on behalf of the principal which may or may not have the potential for representation on behalf of the principal. So, the crucial element here is the representative character of the agent which enables him to* carry out activities on behalf of the principal.

- It may be noted that the crucial factor is how to determine whether the agent is wearing the representative hat and is supplying or receiving goods on behalf of the principal. The key ingredient for determining relationship under GST would be whether the invoice

for the further supply of goods on behalf of the principal is being issued by the agent or not. Where the invoice for further supply is being issued by the agent in his name then, any provision of goods from the principal to the agent would fall within the fold of the said entry. However, it may be noted that in cases where the invoice is issued by the agent to the customer in the name of the principal, such agent shall not fall within the ambit of Schedule I of the CGST Act.

Sample scenarios where Para 3, Schedule I applies

- An auctioneer, selling paintings of an artist in auction and raising invoice in his own name. The agent, auctioneer is having authority to transfer title of goods to end buyer in this case.

- C&F agent or commission agent takes possession of the goods from the principal and issues the invoice in his own name. The disclosure or non-disclosure of the name of the principal is immaterial in such situations.

Sample scenarios where Para 3, Schedule 1 is not applicable

A procurement agent sourcing goods and invoice issued directly on principal;

- Auctioneer identifying buyers and finalizing auction where banker is raising invoice directly on buyer.

Therefore, under GST, not all transactions between Principal and Agent are deemed as supply liable for GST.

However, if and when, there arises a question, in a tripartite transaction, involving principal, agent and customer, whether the transaction is effected by agent as a supplier in own capacity or as a representative of the principal. The terms of contract and form and substance of transactions between the parties would definitely be the determining factor in such situations.

The fiction under schedule will come into play when the agent acts in a representative capacity and not when he acts independently, in which case there is actually a supply and there's no need to deem it as a supply.