

Whether Expense Reimbursement Liable to GST or Reversal of Proportionate ITC?

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Karthik Mani

Associate Partner, Indirect Tax, BDO India LLP

The GST law has been successful in removing most of the questions on taxability of goods or services, compared to erstwhile Indirect tax laws. The disputes pertaining to classification of goods or services are substantially lowered under GST, compared to the legacy Central excise, VAT or Service tax law. However, certain concepts pertaining to valuation has been borrowed from the erstwhile Indirect tax law and one such concept is the concept of 'pure agent' to determine whether reimbursement of expenses would form part of the taxable value or not.

It is an indispensable part of every business to incur several expenditures while supplying goods or services to a recipient and mostly the supplier is required to incur expenditures to effectively supply goods or services or incur expenses on behalf of the recipient to ease the transaction flow. In these transactions, one dilemma that every supplier faces are, whether the expenses incurred by him should form part of the taxable value or not and if not included, whether the value would amount to exempt supply requiring proportionate ITC reversal.

The above dilemma can be addressed by answering the following questions -

1. Whether the expenses qualify as that of a 'pure agent'?

The scope of the term 'supply' is covered in Section 7 of CGST Act, 2017 and the term 'supply' is wide enough to cover all forms of supply of goods or services or both when made for a consideration by a person in the course or furtherance of business. When supplier incurs expenditure to procure goods or services on behalf of the recipient, it is important to ascertain whether the goods or services procured by the supplier is meant for supply to the recipient and the transaction would qualify as 'Supply'.

Further, Section 15 (2) (c) of CGST Act, 2017 states that value of supply shall include the following for levying GST -

Incidental expenses, including commission and packing, charged by the supplier to the recipient of a supply and any amount charged for anything done by the supplier in respect of the supply of goods or services or both at the time of, or before delivery of goods or supply of services.

The above provision makes it clear that the incidental expenses incurred by a supplier and any amount charged by the supplier in respect of the supply of goods or services, or both shall form part of the taxable value for levying GST. However, the above provision does not answer the question of whether expenses incurred by the supplier on behalf of the recipient needs to be included as part of the taxable value.

The answer to the above can be found in Rule 33 of CGST Rules, 2017, which provides following conditions to determine the nature of expenditure incurred by the supplier would amount to expenses incurred in the capacity of 'pure agent' and will get excluded from the taxable value.

1. The supplier is authorised by the recipient to act as pure agent while making payment to third party supplier.
2. The supplier mentions the amount paid by him to the third party supplier in the capacity of pure agent, as a separate line item in the tax invoice issued by him to the recipient
3. The supplier is rendering some other primary supplies to the recipient on his own account, and he additionally acts in the capacity of pure agent to procure supplies from a third party.
4. Satisfies the below condition to qualify as "pure agent" [Explanation to Rule 33] –
 - *enters into a contractual agreement with the recipient of supply to act as his pure agent to incur expenditure or costs in the course of supply of goods or services or both;*
 - *neither intends to hold nor holds any title to the goods or services or both so procured or supplied as pure agent of the recipient of supply;*
 - *does not use for his own interest such goods or services so procured; and*
 - *receives only the actual amount incurred to procure such goods or services in addition to the amount received for supply he provides on his own account.*

It is important to note that all the above conditions needs to be satisfied by a supplier to qualify as 'pure agent' and the act of incurring the expenditure on behalf of the recipient shall be through an contractual arrangement and the pure agent should not receive the goods or services with invoices addressed to him (will amount to holding title over the goods or services) and should ensure that he recovers exactly the same amount he incurred for procuring the goods or services from third party, without having any margin.

From the above, the taxpayers can adopt a view that, any expenses which the supplier incurs on behalf of the recipient and is not part of his obligation to incur, and those expenditures that satisfy all the conditions set out in Rule 33 above shall be treated as 'pure agent' expenses and disclosed separately in the tax invoice without subjecting such costs to GST.

Further, if the supplier incurs any incidental expenses which are essential for him to incur while rendering services to the recipient and are not meeting all the conditions forming part of Rule 33, such expenses shall be included as part of the taxable value for GST levy.

2. Whether Input tax Credit (ITC) is eligible on expenditure incurred in the capacity of pure agent

Considering the fact that GST law seeks to facilitate seamless flow of ITC, transactions such as 'pure agent' transactions, which are very common in the business should not create any barrier for free flow ITC. It would be reasonable to assume that, when a transaction qualifies as pure agent transaction in terms of Rule 33 of CGST Rules, 2017 and the pure agent is acting only on behalf of the ultimate recipient of the supply, any taxable supplies rendered by the original supplier to the ultimate recipient should result in availability of ITC to the ultimate recipient subject to fulfilment of conditions provided in Section 16 and 17 of CGST Act, 2017.

The pure agent would be receiving the supplies only on behalf of the ultimate recipient and will not be incurring the expenditures for providing any further supply of taxable goods or services or both, hence even in circumstances where the original supplier erroneously issues the invoices in the name of the pure agent, the pure agent will not be eligible to avail ITC on such invoices.

3. Whether consideration towards pure agent transactions would amount to exempt supplies requiring ITC reversal

The term 'exempt supply' is defined in Section 2(47) and the definition considers supplies with 'Nil rate' of tax, or wholly exempt supplies, and non-taxable supplies as exempt supplies. Further Section 2(79) defines the term non-taxable supplies and considers all supply of goods or services which are not leviable to GST.

From the above, an argument can be made that the definition of non-taxable supplies is wide enough to include even a 'pure agent' transaction. The supplier incurring expenses as 'pure agent' shall have to rule-out possibility of these expenses being considered as 'exempt supplies' to escape the onus of ITC

reversal under Section 17(2) of CGST Act, 2017. Debate such as what constitute 'Supply', 'Exempt supply', 'Service' 'Nil rate of tax', 'Wholly exempt' and 'non-taxable supply', etc. are extremely relevant while taking any position. However, it is critical to note that the pure agent collects the amount from recipient of supply only through contractual arrangement, agree to incur the expenses on behalf of the recipient and not for rendering any taxable or exempt supply.

Further, as specified in para 2 above and in terms of Section 17(1) of CGST Act, 2017, the 'pure agent' is restricted to avail ITC on the supplies received on behalf of the ultimate recipient of supply, hence the ITC restriction on the pure agent is already covered in Section 17(1) of CGST Act, 2017

It can also be argued that if the transaction of 'pure agent' is considered as supply, the same may be given a status of taxable supply (and not exempt supply), since there is no explicit exemption provided towards 'pure agent' supplies. The requirement to exclude the pure agent supplies originate from the valuation provisions, hence a view can be adopted that the transaction is taxable and only the value is excluded for levy of taxes. Similar views are adopted for sectors where deemed valuation is provided in Rule 32 of CGST Rules, 2017, namely, money exchange, air ticket booking, and life insurance services, where partial value is not taxed due to valuation requirement and such partial value not taxed is not considered as exempt supply for reversal of ITC.

Any levy of taxes or demand for reversal of ITC towards expenses incurred in the capacity of 'pure agent' would be having direct impact on the operations of the supplier and hence suppliers intending to act in the capacity of 'pure agent' should take appropriate measures to meet all the conditions to qualify as 'Pure agent'. Further, the Government, considering its aim to ease business operations, should create clarity in the law for differentiating 'Pure agent' from transaction where incidental expenses are incurred for rendering primary supply.