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A Deep Dive into the Place of Supply of Scientific Research, Testing and Analysis Services

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Introduction:

Ever since the introduction of negative based taxation effective from 01.07.2012 under the pre-GST era, the cross-border services by way of scientific research, technical testing or analysis services have undergone huge litigation as to whether these services are to be considered as exported services or not. The issue remained status quo even under the GST regime. Amid this ambiguity, certain scientific research, testing, and analysis services related to Pharma Sector got relief with specific notification notifying their place of supply as that of the location of the recipient of the supply. In this backdrop, let us do a deep dive into this issue by analyzing the position under Service Tax and GST laws.

Statutory Background under Service Tax and GST:

Under the service tax regime, in terms of Rule 6A of the Rules[1], a service is said to be exported if the service is undertaken by a service provider located in India, the service recipient located is outside India, if the place of provision of said service is outside India and the consideration has been received in convertible foreign exchange. The place of provision of the service shall be required to be determined in terms of Place of Provision of Service Rules, 2012.

Coming to GST regime, the term 'export of services' is defined in an identical manner as that under Rule 6A of the Rules (supra) under Section 2(6) of IT Act[2]. Accordingly, a service is exported if the supplier is in India, the recipient is located outside India, the place of supply of the service is also outside India and the consideration for the service has been received in convertible foreign exchange. The place of provision of service undertaken with respect to those services where either the supplier or the recipient is located outside India shall be determined in terms of Section 13 of IT Act.

In view of the understanding of the concept of export of service under Service Tax and GST, it is clear that place of supply/place of provision is one of the important aspects which determines whether a service is exported or not. Under the Place of Provision of Service Rules, 2012, Rule 3 is the general rule which provides for determination of place of provision of service in case of services not covered by any of the other rules. Accordingly, the place of provision of services not covered by other rules is the location of the recipient of service.

Rule 4 provides for determination of the place of provision of service with respect to performance-based services. sub-clause (a) provides that the place of provision of service in respect of the goods that are required to be physically made available by the service receiver to the service provider or to any person acting on behalf of the service provider to provide the service shall be the location where the services are actually performed. Of course, there are certain exceptions provided in case of services provided using electronic means and in situations where goods are temporarily imported for repairs etc. and are subsequently exported without being used in India.

Coming to GST, Section 13(2) of the IT Act, provides for place of supply in general. It is akin to Rule 3 (supra). Accordingly, the place of supply for all services except those covered under sub-section (3) to (12) shall be the location of the recipient

[1] Service Tax Rules, 1994
[2] Integrated Goods and Services Tax Act, 2017

of service. Section 13(3)(a) provides for place of supply of services in respect of goods. The wordings of this provision are identical to Rule 4 supra. The comparative provisions of Rule 4(a) and section 13(3)(a) are reproduced as under for perusal.

Rule 4(a) of Place of Provision of Services Rules, 2012	**Section 13(3)(a) of IT Act, 2017**
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: Provided that when such services are provided from a remote location by way of electronic means the place of provision shall be the location where goods are situated at the time of provision of service: Provided further that this clause shall not apply in the case of a service provided in respect of goods that are temporarily imported into India for repairs and are exported after the repairs without being put to any use in the taxable territory, other than that which is required for such repair	The place of supply of the following services shall be the location where the services are actually performed, namely: (a) services supplied *in respect of goods* which are required to be made physically available by the recipient of services to the supplier of services, or to a person acting on behalf of the supplier of services in order to provide the services: Provided that when such services are provided from a remote location by way of electronic means, the place of supply shall be the location where goods are situated at the time of supply of services: Provided further that nothing contained in this clause shall apply in the case of services supplied in respect of goods which are temporarily imported into India for repairs ***or for any other treatment or process*** and are exported after such repairs or treatment or process without being put to any use in India, other than that which is required for such repairs or treatment or process;

In view of the above-reproduced provisions of Rule 4(a)/section 13(3)(a), it provides that services provided in respect of goods are covered under this rule. In view of the language used, a view can be taken that the said Rule 4(a)/section 13(3)(a) covers only those services which are performed on the goods in order to give value addition to the goods concerned and not in case of research, testing or analysis services undertaken on goods which get consumed or lose their commercial value in such process of research or testing. Accordingly, it can be said that scientific research, testing and analysis services are not covered by these provisions and are covered by the general rule. Consequently, it can be argued that the place of supply/place of provision for these services can be said to be the location of the recipient of service i.e. outside India and not the place where such goods are located. Assuming all other conditions required for export are satisfied, since the place of supply/place of provision is outside India, the services provided would be qualified as 'export'.

On the other hand, it is equally possible to argue that the language of Rule 4(a)/section 13(3)(a) is wide enough to cover all kinds of services which require the goods from the recipient and services performed on them despite of the fact that such services are not value additive qua such goods. Accordingly, it can be argued that the place of supply/place of provision of scientific research, testing and analysis services is the location where the services are actually performed i.e. India and not the location of recipient. Since place of supply/place of provision is in India, this implies that the services would not be covered as exported service even though consideration has been received in convertible foreign exchange and on top of this, the service would be reckoned as taxable service and the Indian entity is required to collect service tax/GST from his foreign client and accordingly remit the tax amount to Government.

In view of the interpretational issue, the matter reached courts/tribunals which are examined in the subsequent paras.

Jurisprudence evolved under the Service Tax:

The e-guide issued by CBIC[3] with respect to negative list-based tax of services effective from 01.07.2012 clarifies the scope and ambit of Rule 4 as under:

5.4 Rule 4- Performance based Services

5.4.1 What are the services that are provided "in respect of goods that are made physically available, by the receiver to the service provider, in order to provide the service"?- sub-rule (1):

Services that are related to goods, and which require such goods to be made available to the service provider or a person acting on behalf of the service provider so that the service can be rendered, are covered here. ***The essential characteristic of a service to be covered under this rule is that the goods temporarily come into the physical possession or control of the service provider, and without this happening, the service cannot be rendered.*** *Thus, the service involves movable objects or things that can be touched, felt or possessed.* ***Examples of such services are repair, reconditioning, or any other work on goods (not amounting to manufacture), storage and warehousing, courier service, cargo handling service (loading, unloading, packing or unpacking of cargo), technical testing/inspection/certification/ analysis of goods, dry cleaning etc. It will not cover services where the supply of goods by the receiver is not material to the rendering of the service e.g. where a consultancy report commissioned by a person is given on a pen drive belonging to the customer. Similarly, provision of a market research service to a manufacturing firm for a consumer product (say, a new detergent) will not fall in this category, even if the market research firm is given say, 1000 nos. of 1 kilogram packets of the product by the manufacturer, to carry for door-to-door surveys.***

In view of the above-extracted para of e-guide, CBIC has clarified that the intent of Rule 4 stating that the said rule is applicable only to those cases where it is impossible to carry out the services unless the goods are made available by the recipient of the service. The examples cited to describe the nature of services covered under Rule 4 includes technical testing, inspection, certification or analysis of goods.

Further, it has clarified that it will not cover services where the supply of goods by the receiver of service is not material to the rendering of service. The examples cited for this are giving pen drive by the recipient of service to obtain consultancy report, the conduct of market research for products of service receiver by doing door-to-door using the samples given by the service receiver.

Thus e-guide clarified that services of the nature of technical testing, inspection, certification or analysis of goods come within the ambit of Rule 4. However, in the case of CCE vs. Sai Life Sciences Ltd[4], the Honourable two-member bench of CESTAT Mumbai has considered the issue related to applicability of Rule 4 for the research and development services in pharmaceutical products. In the said case, the First Appellate Authority, while acknowledging that some chemicals required

[3] Central Board of Excise and Customs (CBEC) was the administrative body for implementation of Indirect Taxes in the Country. This is currently known as CBIC (Central Board of Indirect Taxes and Customs) and continues to be head organization for implementation of Indirect Taxes.

[4] 2016 (2) TMI 724 – CESTAT Mumbai

for research and development are provided by the clients, held that the services are not in respect of those materials. Accordingly held that Rule 4 is not applicable. The relevant extracts of the First Appellate Authority order are as under:

> ***The 'deliverables' by the Appellants are neither supplied or owned by the service receiver nor the Appellants are providing any service in respect of the deliverables***. ***Synthesis of a new compound using various chemicals, solvents, reagents, compounds cannot be called as service in respect of the said chemicals, solvents, compounds.*** *Further, the Appellants are formulating the process of the manufacture of the new compounds and the process is being sent to their clients/service receiver. It is seen from the detail service agreement that the Appellants are engaged into converting compound 120 into compound 129.*

When the above matter was appealed before the Honourable Bench of CESTAT, Mumbai upheld the order of the First Appellate Authority by holding that if the benefit of service is accrued outside India, then by no stretch of imagination it can be said that there is no export of service. Thus, the Honourable bench of CESTAT, Mumbai held that with respect to technical testing and analysis services, Rule 4 is not applicable and is covered by Rule 3.

In view of the ratio laid down in the above case, in case of technical testing and analysis services as the deliverable involved is technical testing and analysis of the goods involved and its communication by way of a report, it can be said that the service involved is not in respect of the goods and accordingly, Rule 4 is not applicable.

Subsequently, in the case of Principal Commissioner of Central Excise Vs. Advinus Therapeutics Ltd[5], the Honourable two-member bench of CESTAT Mumbai has again considered this issue and it was held as under:

> *15. Accordingly, we can infer that the location of performance of service in respect of goods is not an abstract, absolute expression for fastening tax liability on services that involve goods in some way; for that, Rule 3 would have sufficed.* ***A contingency that is not amenable to Rule 3 has been foreseen and remedied by Rule 4 and in the process, the sovereign jurisdiction to tax is asserted. It is, therefore, not by the specific word or phrase in Rule 4(1) of Place of Provision of Services Rules, 2012 that the taxability is to be determined but from the mischief effect intended to be plugged. It is obviously not intended to tax any activity rendered on goods as to alter its form because that would be covered by excise on manufacture or be afforded privileges available to merchandise trade. The provision itself excludes goods imported temporarily for repairs but that does not, ipso facto, exempt goods imported temporarily for repairs from taxability which would, by default, be predicated by the intent in Rule 3.*** *Consequently, a recipient in India would be liable to tax on such temporary imports for repairs while service to a recipient located abroad would not be taxable. This is in consonance with the privilege of exemption afforded to export of services. The special and distinct role of Rule 4 becomes clearer.*
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> *16. Not intended to tax the activity of altering goods supplied by the recipient of service or for repairs on goods, Rule 4(1) of Place of Provision of Services Rules, 2012 would appear, by elimination of possibilities, to relate to goods that require some activity to be performed without altering its form.* ***The exemplification in the Education Guide referred supra renders it pellucid. Certification is an important facet of trade and such certification, if undertaken in India, will not be able to escape tax by reference to location of the entity which entrusted the activity to the service provider in India. This is merely one situation but it should suffice for us to enunciate that Rule 4(1) is intended to resorted when services are rendered on goods without altering its form that in which it was made available to the service provider. This is***

[5] 2017 (51) S.T.R. 298 (Tri. - Mumbai)

the harmonious construct that can be placed on the applicability of Rule 4 in the context of tax on services and the general principle that taxes are not exported with services or goods.

17.The goods supplied to the respondent, minor though the proportion may be, are subject to alteration in the course of research. It is not asserted anywhere that these goods, in its altered or unaltered form, are sent back to the service recipient; if it were, the provisions of Customs Act, 1962 would be invoked to eliminate tax burden. ***If the goods cease to exist in the form in which it has been supplied, it cannot be said that services have been provided in respect of goods even if it cannot be denied that services have been rendered on the goods. Consequently, the provisions of Rule 4 (1) are not attracted and, in terms of Rule 6A of Service Tax Rules, 1994, the definition of export of services is applicable thus entitling the appellant to eligibility under Rule 5 of Cenvat Credit Rules, 2004.***

In view of the above excerpts of the decision of Honourable CESTAT in the above-referred case, the purpose and intent of Rule 4 [now, Section 13(3)(a)] has been laid down as under:

a. The intent of Rule 4(a) is to remedy out some specific situations that would otherwise have enabled escapement from tax where Rule 3 may not serve to confer jurisdiction.
b. The intent of Rule 4(a) is not to tax any activity of altering the goods supplied by the recipient because it would be covered by an excise on manufacture or be afforded privileges available to merchandise trade.
c. Rule 4(a) itself excludes the cases where repair services are undertaken by importing the goods temporarily and are exported after such repairs. This exception has been made in consonance with the privilege given to exporter of services.
d. If the goods cease to exist in the form in which it has been supplied, it cannot be said that services have been provided in respect of goods even if it cannot be denied that services have been rendered on the goods.
e. Alteration of goods takes place in the process of research.

In view of the above proposition laid down in the case of Advinus Therapeutics (supra), though service is rendered on the goods, it cannot be said that the service is said to be undertaken in respect of the goods to come under the ambit of Rule 4 if the goods cease to exist in the form in which it has been supplied. In the case of technical testing and analysis services, the goods get altered in the process undertaken and remain of the goods are generally discarded. Therefore, going by the principle laid down in this case, technical testing and analysis cases are not covered by Rule 4 of Place of Provision of Service Rules, 2012 or under section 13(3)(a) of IT Act.

Thus, by placing reliance in the above-discussed matters of Sai Life Science (supra) and Advinus Therapeutics (supra), a view can be adopted that technical testing and analysis services are not of the nature covered under section 13(3)(a) of the IT Act and are covered by section 13(2) itself for the purpose of determining the place of supply. Accordingly, the place of supply can be said to be the location service recipient which is outside India. As the place of supply of service is outside India, the service involved qualify as export of service (zero-rated) and is not taxable.

However, very recently, the Honourable two-member bench of Mumbai CESTAT, in the case of Sai Life Sciences Ltd vs. CCE[6] has distinguished their own above decisions and concluded that technical testing and analysis services that are undertaken on goods supplied by the recipient are covered under Rule 4 of the Place of Provision of Service Rules, 2012. The relevant extracts of the said decision under para 5.10 are reproduced as under:

[6] 2019 (6) TMI 572 - CESTAT Mumbai

From the facts of the present case we find that appellant have conducted DMPK Studies in respect of the NCE's provided to them by the overseas client. ***Rule 4 do not put any conditions in respect of alteration or alternation of the goods provided by the service recipient. Reading anything beyond what has been provided in the rules/ statue cannot be proper interpretation put to rules. Both the decisions in case of Sai Life Sciences and Advinus Therapeutic have proceeded mainly on the principle that taxes should not be exported. The taxes are to be determined as per the taxing statue and it is for legislator and tax policy makers to determine as to what should be taxed and what should not be taxed. High sounding phrases as this cannot restrict or expand the scope of taxing statue. In case something falls within the scheme of taxation the same cannot be exempted till specifically exempted by a proper notification.*** *In the present case, we find that the activities undertaken by the appellants in terms of DMPK studies squarely fall within the scheme of Rule 4 of POPS Rules, and hence the location of service provider shall be place of provision of service which is in India and hence cannot be treated as export of service in terms of Rule 6A of Service Tax Rules, 1994.*

In view of the above-reproduced para of the recent decision, the Honourable two-member bench of CESTAT has taken a contrary view by distinguishing their own decisions as discussed above. Accordingly held that Rule 4 does not put any conditions in respect of alteration or alternation of the goods provided by the service recipient and reading such condition cannot be a proper interpretation of rules. Accordingly, it was held that technical testing and analysis services are covered under Rule 4 and the place of provision shall be determined to be the place where services are performed.

Legal Proposition under GST law:

Under the GST regime, the issue has been referred to Authority for Advance Ruling of various states and in most of the cases, the applications are disposed of without considering the said question on the reasoning that the issue involves the determination of place of supply and no jurisdiction has been conferred on them in terms of section 97(2) of the CT Act, 2017.

However, in several cases, the issue has been considered and as usual, the issue has been determined in favour of Revenue, without appreciating the submissions of the applicant taxpayer. For reference, please refer In Re: M/s Cliantha Research Limited[7] and In Re: M/s Syngenta Bioscience Private Limited[8]

Representations from Pharma Sector and the Notification to shift the Place of Supply:

In view of the ambiguity on the place of supply, the pharma companies into research, technical testing and analysis services were left in doldrums as they are opened to the exposure to pay tax on the value of services provided to the overseas client and at the same time, there would be a possibility that the laws of the country of their client consider these services as imported services requiring the client to pay their respective tax. Thus, the costs associated with their services shoot up and eventually rendering them incompetent in the global market. In view of this reason, representations were made on this issue to Governments and GST Council.

In terms of section 13(13) of the IT Act, on the grounds of double taxation or non-taxation of the supply of service, Government is given the power to notify any description of services or circumstances in which the place of supply shall be the place of effective use and enjoyment of a service.

[7] 2019 (6) TMI 1307 - AAR, Maharashtra
[8] 2019 (10) TMI 751 - AAR, Goa

By exercising this power, Government has issued Notification No. 04/2019-IT (Rate) dated 30.09.2019 (effective from 01.10.2019) to notify the place of supply for various kinds of research, technical testing and analysis services as that of the location of the recipient of service. In view of this notification, the pharma sector has obtained relief from this issue and accordingly, their research, technical testing and analysis services would be considered as supplied outside India and are exported.

However, the question remained with respect to services provided by this sector for the period up to 30.09.2019. Whether the notification can be given retrospective effect to treat the said services as exported even for the period up to 30.09.2019. Further, recently the said notification is amended[9] with effect from 01.04.2020 to shift the place of supply to the location of the recipient of service with respect to maintenance, repair or overhaul service in respect of aircrafts, aircraft engines and other aircraft components or parts supplied to a person for use in the course or furtherance of business.

In view of this discussion, the place of supply has been shifted for scientific research, technical testing and analysis services of the pharma sector alone. However, these kinds of services are undertaken in other sectors as well. Questions remain on the applicability of the provisions of section 13(3)(a) or general rule under section 13(2) with respect to the determination of place of supply for these services. Further, the important question that may arise for legal consideration is whether the swift in place of supply for the research, technical testing and analysis services of pharma sector alone would be arbitrary and discriminative without any reasonable basis and may be challenged since it violates Article 14 of the Indian Constitution. This would be so, when all kinds of research, technical testing or analysis services would be benefit or value addition to the business of customer located outside India.

Conclusion:

In light of the above discussion, the determination of the place of supply for services of the nature of scientific research, technical testing or analysis services is subject to interpretation and different stands are taken by judiciary. Further, the practice adopted by Central Government in issuing specific notifications to shift the place of supply for services involved in certain sectors would not be considered as appropriate solution to rest the ambiguity and to make the services of Indian Companies competitive in global market. Further, such practice will lead to further legal complications such as retrospective applicability of the benefit given under these notifications and the arbitrary nature of such notifications. In view of this reason, it would be advisable for the Government to take a uniform stand on this issue across all sectors and put the issue at rest.

[9] Amendment inserted vide Notification No. 02/2020-Integrtaed Tax (Rate) dated 26.03.2020