

Taxability of Employee Reimbursements/Entitlements

Companies in normal course of business have profiled employee expense reimbursement policies. These policies are made up on pure business considerations and operational exigencies. In light of the levy of GST under Reverse Charge vide section 9 (4) of the CGST Act, 2017 some questions have arisen with respect to taxability of such reimbursements made by companies to its employees for various reasons. We have analysed a few examples of such expenses and have come up with a mechanism as an aid to decide the taxability of each expense type individually. We call this matrix as the “Four Box theory”. In this mechanism we have developed 4 boxes of logic and defined taxability of each such box. Every time you come across an expense, one will have to analyse the same and put it in one of the box and thereby derive its taxability. Ministry of Finance has also issued a press release dated 10.07.2017 wherein they have clarified the issues involved. Before we define the theory, we shall discuss the law part:

1. Registration

Every person providing taxable supplies is required to register under GST. Only persons whose turnover is below 20 lacs per year are not required to register. This 20 lacs limit has to be derived by including all taxable as well as non-taxable incomes of a financial year. As per section 24, certain persons are required to register mandatorily even if their total turnover is below 20 lacs.

2. What is Reverse Charge Mechanism:

In normal case, a supplier of goods or services is required to pay GST on the supplies made by him, but when the Government chooses it levies a tax in the reverse manner whereby the recipient of those goods or services is mandated by law to pay the tax, this is popularly known as Reverse Charge Mechanism (RCM).

Under GST there are 2 subsets of supplies which fall under RCM:

a. Notified goods and services

GST on any purchase of notified goods or services (as per our RCM alert dated 6.07.2017) shall be payable on RCM basis.

In case of supply of RCM notified goods and services, even if both the supplier as well as recipient are registered, the recipient will have to pay the tax.

b. Purchases from Unregistered Persons

Under GST law, as reproduced below, mandates payment of tax under RCM in certain situations:

Section 9 (4) of the CGST and SGST Act, reads as under:

*The **central tax / State Tax** in respect of the supply of taxable goods or services or both by a **supplier, who is not registered**, to a **registered person** shall be paid by such person on reverse charge basis as the **recipient** and all the provisions of this Act shall apply to such recipient as if he is the person liable for paying the tax in relation to the supply of such goods or services or both.*

Section 5 (4) of the IGST Act, reads as under:

*The **integrated tax** in respect of the supply of taxable goods or services or both by a **supplier, who is not registered**, to a **registered person** shall be paid by such person on reverse charge basis as the **recipient** and all the provisions of this Act shall apply to such recipient as if he is the person liable for paying the tax in relation to the supply of such goods or services or both.*

As can be witnessed from the provisions above, in case of services supplied by an Unregistered Person to a Registered Person, **Recipient** is required to pay the tax under RCM

Term “Recipient” is defined in section 2 (93) of the CGST act as under:

(93) “recipient” of supply of goods or services or both, means—

(a) where a consideration is payable for the supply of goods or services or both, the person who is liable to pay that consideration;

(b) where no consideration is payable for the supply of goods, the person to whom the goods are delivered or made available, or to whom possession or use of the goods is given or made available; and

(c) where no consideration is payable for the supply of a service, the person to whom the service is rendered,

and any reference to a person to whom a supply is made shall be construed as a reference to the recipient of the supply and shall include an agent acting as such on behalf of the recipient in relation to the goods or services or both supplied;

In reference to reimbursements being made by the company to the employee, person liable to pay the consideration is the company and not the employee. Employee merely incurs the expense on behalf of the company, hence the recipient is the company.

3. Concept of Supply

In relation to reimbursements / entitlements given to employees it is important to weigh such transactions in the light of the concept of supply.

Based on the same, it would further be important to understand whether the employee has independently supplied the underlying services to the company or he has acted merely as a conduit for receiving such goods or services on behalf of the company.

Sr. No.	Law Reference	Provisions of the Law	Conditions Satisfied	
			Entitlements given to employee subject to actual performance of work	Paid to an employee on submission of invoice of expense
1	Section 7 of CGST Act	all forms of supply of goods or services	No <i>(See note 1)</i>	Yes <i>(See note 2)</i>
		or both such as sale, transfer, barter, exchange, licence, rental, lease or disposal made or agreed to be made		
		for a consideration		
		by a person in the course or furtherance of business		
2	Section 7 (1) (c) of the CGST Act read with Schedule I	Supply of goods or services	No <i>(See note 1)</i>	Not applicable since it a supply as per point above
		or both between related persons or between distinct persons as specified in section 25,	Yes	
		when made in the course or furtherance of business	No	
3	Section 7 (2) (a) of the CGST Act read with Schedule III	Services by an employee to the employer	Yes	Not applicable since it a supply as per point above
		in the course of or in relation to his employment.	Yes <i>(See note 1)</i>	

Note 1

Services provided by an employee in course or in relation to his employment are neither goods nor services as per section 7 (2) (a) of the CGST Act r.w. Schedule III clause 1.

Hence entitlements given to employees on performance of underlying work shall clearly fall under the above exception, hence shall not be a supply at all, accordingly such entitlements will not be taxable under GST as they fall under **Box 2** as explained below.

However, there can be instances wherein such entitlements are paid on adhoc basis not specifically requiring execution of actual work. Such instances in our opinion shall get covered as a part of salary forming part of Form 16. Accordingly, such adhoc entitlements will also not be taxable under GST as they fall under **Box 1** as explained below.

Note 2

Certain reimbursements/entitlements are reimbursed to an employee upon presentation of invoice of underlying expense. Such expenses need to be evaluated in terms of their classification either under **Box 2 or Box 3 or Box 4** of our 'Four box theory' as explained below. Accordingly their tax treatment need to be followed. Employee in such cases would act as a conduit for receiving such goods or services on behalf of the company and it would be deemed that the company is the actual recipient.

4. Taxability of Reimbursements/Entitlements given to employees under RCM

In normal course of business, employees of a company are required to incur certain expenses for performing various functions entrusted to them, in turn companies pay for such expenses to the employees on reimbursement basis as well as on fixed basis. For example, marketing executives are required to go in the field for marketing works wherein they may incur conveyance, food and beverage and hotel accommodation expenses which are then reimbursed by the company, basis the invoices/vouchers submitted.

Sometimes companies provide monthly fixed payments in lieu of entitlements, like telephone, conveyance, medical which the employee gets irrespective of the fact that those expenses are incurred or not.

Four Box Theory

Taxability reimbursements and entitlements will be as under:

1. Box Number 1 – Salary

Any reimbursement or entitlement provided by the employer to the employee in terms of the contract of employment and which forms part of the salary shall not be subjected to GST under RCM.

2. Box Number 2 – Exempt Supplies

If the Goods or services procured by the employee or the company are exempt from levy of GST, then the same will not be taxable under RCM, irrespective of the fact whether it is a reimbursement or an entitlement.

3. Box number 3 – Supplies received from Registered persons

Goods or services though procured by the employees, but if these are procured from registered persons then the same will not be taxable under RCM even though the invoice is not in the name of the company, as the underlying expense has suffered tax once and there is no value addition that is done by the employee in it. Secondly as explained, company is the ultimate recipient of the underlying services, therefore the supplier as well as the recipient are registered, question of RCM wont arise.

4. Box number 4 – Supplies received from Unregistered Person

If the goods or services being procured by the employees are supplied by an Unregistered person then the company shall have to pay GST under RCM at the rates applicable to such goods or service, expense of which is being reimbursed.

Common thread going through the above theory is that, one needs to analyse the taxability and the status of supplier of the underlying expense being reimbursed, if the same is taxable and supplier is unregistered than the company ought to pay GST. If the expense being reimbursed forms part of the salary of the employee than question of leviability of GST thereon doesn't arise.

Based on the above theory, some sample expenses which are routinely reimbursed are analysed:

Reimbursements paid to employees (covered under employment contract – forming part of Cost to Company package)

Sr.	Nature of Reimbursements or facilities given to employees	Box	GST Levy
1	Uniform Allowance / reimbursements	1	No
2	Travel/Petrol/Fuel charges whether fixed or per km (forms part of Salary)	1	No
3	Travel Petrol/Fuel charges whether fixed or per km (Does not form part of Salary)	2	No
4	Telephone/Mobile Allowance or Reimbursement	2	No
5	Employee Telephone charges paid directly to telephone company	3	No
6	Residential accommodation given to employee	2	No
7	Cab charges given to employee	2	No
8	Public Transport, Metered cab or auto rickshaw charges	2	No
9	Food allowance / Food reimbursements	2	No
10	Employee Medical / Personal Accident insurance	2	No
11	Health Check-up	2	No
12	Reimbursement of expenses incurred by employees for pursuing education	2	No
13	Office laptops / Vehicle / mobile handset provided by company to employees (for office work)	2	No
14	Knowledge updation and Professional Pursuit allowance	2	No
15	Other Allowances not linked to actual expense and which do not form part of Salary (See Note below)	2*	No

* As per schedule III to the CGST Act, 2017, services by an employee to the employer, in the course of or in relation to his employment are neither goods nor service, hence any allowance that qualifies to be a service from an employee to an employer and which is in relations to his employment, shall not be taxable under GST. However, this is a grey area and any decision on this needs to be taken on case to case basis

Taxability of Procurements of underlying goods or services being reimbursed

Sr.	Purchase / procurement of: (If procured by an employee from Registered Vendor then RCM will not apply in any case)	Box	GST Levy
1	Uniform	4	Yes
2	Petrol / Fuel	2	No
3	Telephone/Mobile charges	3	NA
4	Residential accommodation given to employee	2	No
5	Rent a Cab	4	Yes
6	Public Transport, Metered cab or auto rickshaw charges	2	No
7	Food bill of restaurant or outdoor caterer	4	Yes
8	Employee Medical / Personal Accident Insurance	3	NA
9	Health Check-up	2	No
10	Employee education charges paid to college	2	No
11	Office laptops / Vehicle / mobile handset purchased	4	Yes
12	Gifts given to employees in excess of Rs. 50,000/- per employee per annum	Supply	Yes

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