GST Alert **07/2018-19**
Date **17.08.2018**

Critical Analysis of Advance Ruling on Taxability of Employee costs in companies having Multi State businesses

After the onset of GST, one topic which was discussed at all professional congregations albeit in a jocular manner was whether one was required to pay GST on its centrally located staff providing virtual services to its branches in other states.

Answer to this question has now been given under an Advance Ruling issued by the Karnataka AAR in the case of Columbia Asia Hospitals Pvt Ltd. (applicant). As per this order, authority has affirmed the view that head office will have to pay GST and raise invoices to its branches as the same are a 'Supply' as per section 7 read with Schedule I of the CGST Act, 2017

It is important to point out here that this order is binding only on the applicant and the Karnataka GST department and no one else, still it has generated much heat and questions are being raised from all corners of trade and business. Impact of the law interpreted in this order by the AAR is far reaching and shall impact many layers of business.

This alert analysis interpretational logic espoused by the said AAR order and the relevant law to understand and advice whether one needs to pay GST on centrally incurred administration costs for a multi-state business

1. Transactional Facts of Columbia Case

To understand the nuances of this matter, lets go through what this advance ruling is all about

Columbia Hospital has its Head office (HO) in Karnataka (registered in GST) and also has some branches in other states which are also registered under GST. Activities for all the branches with respect to accounting, administration and maintenance of IT system are carried out by the employees from the HO.

HO receives certain services at its Karnataka HO such as renting of office space, travel expenses, consultancy services, communication expenses etc., credit of GST paid thereon was

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availed by the HO in the state of Karnataka and subsequently, it cross charged these costs to its various registered branches in other states and paid IGST on them.

2. Question raised for Advance Ruling

Whether the activities performed by the employees at the Head office in the course of employment such as accounting, other administrative and IT system maintenance for the units located in the other states as well i.e. distinct persons as per Section 25(4) of the Central Goods and Services Tax Act, 2017 (CGST Act) shall be treated as supply as per Entry 2 of Schedule I of the CGST Act or it shall not be treated as supply of services as per Entry 1 of Schedule III of the CGST Act?

3. Grounds on which said Order is based

After analysis all the facts given by Columbia, AAR has said that the activities performed by the employees at the head office in the course of or in relation to employment such as accounting, other administrative and IT system maintenance for the units located in the other states shall be treated as supply as per Entry 2 of Schedule I of the CGST Act.

This order is based on the following 2 grounds:

a. Services provided to the HO (employer) by the persons employed by it are in the nature of the employee-employer relationship. Since the HO and the branches are distinct persons under the Act, there is no such relationship between the employees of one distinct entity with another distinct entity, at least as per the GST Acts, even if they are belonging to the same legal entity.

b. Activities done between the related persons are treated as supplies and the valuation includes all costs, the employee cost also needs to be taken into consideration at the time of valuation of goods or services provided by one distinct entity to the other distinct entities.

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4. Legal Analysis

Facts discussed above is a normal way of working of almost all multi-state firms and companies, common human resources required to the run the business including top management are invariably located centrally at the head office and operational staff is only placed at the branch level. Centrally located employees are staffed in the wings like management, finance, accounts, Information technology, Human Resource etc, these employees work for all branches irrespective of states as the business processes are singular and not branch specific in majority of the cases.

A. Said Transaction is not a 'Supply' as defined in GST law

i. As per section 7 of the GST acts, any goods or service are taxable only if they are supplied by one person to another. It also taxes supply of goods or services between 2 registered entities of one legal entity even if there is no consideration.

ii. There is no dispute that the head office and its registered branches will be deemed to be distinct persons for the purposes of GST law.

iii. Section 7 reads as under:

> *7. (1) For the purposes of this Act, the expression "supply" includes—*
> *(a) all forms of supply of goods or services 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;*
> *(b) import of services for a consideration whether or not in the course or furtherance of business;*
> ***(c) the activities specified in Schedule I, made or agreed to be made without a consideration; and***
> *(d) the activities to be treated as supply of goods or supply of services as referred to in Schedule II.*
>
> *SCHEDULE I*
> *[See section 7]*
> *ACTIVITIES TO BE TREATED AS SUPPLY EVEN IF MADE WITHOUT CONSIDERATION*
>
> *2. Supply of goods or services or both between related persons or between distinct persons as specified in section 25, when made in the course or furtherance of business:*
>
> *Provided that gifts not exceeding fifty thousand rupees in value in a financial year by*

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an employer to an employee shall not be treated as supply of goods or services or both.

iv. Section 7 as well as entry 2 of Schedule I presupposes that there has to be a supply of services from one to another even if between HO and branch.

v. Section 7 (1) (c) as reproduced above uses the phrase "activities specified in Schedule I" whereas entry 2 of schedule I doesn't specify any specific act, rather it says that in case there is any kind of supply between 2 distinct persons without consideration then that would also be a supply. In other words, there has to be a Supply of goods or service in order to invoke entry 2 of schedule I, in absence of a tangible supply said entry cannot be invoked in our view.

vi. HO is the main management wing of the company and as per the policy of the company, it chooses to house certain functions at this premises for purely business reasons. There is no active agreement between HO and its branch to render a service, for a Supply to germinate a contractual (may be oral) calling of services by the recipient is a must without which there can be no Supply.

vii. In case of multi state businesses, HO houses management functions and handles the business chores as are required for one legal entity, it cannot by any stretch of imagination or law be said that the branch has called for rendering of services of accounting or finance or management from its HO.

viii. None of the words chosen by the parliament in section 7 (1) (a) of the CGST Act viz. "sale, transfer, barter, exchange, licence, rental, lease or disposal", cover the functions executed by the HO for its branches. For that matter, none of these words even cover supply of service.

ix. If the interpretation given in Advance ruling is accepted, gifts given below Rs. 50000/- from HO to an employee at its branch shall also become taxable in the hands of HO, which shall make the proviso redundant

x. In the discussion part (para 8.2) of the order, authority has said that the HO and branch are related persons as defined in section 15 of the Act because HO controls the Branch. This

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interpretation is flawed for the simple reason that the statute uses the words *"one of them directly or indirectly controls the other"* which envisages 2 legal entities and it is not meant for branches of the same legal entity. However, in ruling part, authority veers towards saying that the HO and Branch are distinct persons, having said so, this wouldn't make any difference to the overall ruling.

xi. **In view of the above discussion, in our view said transaction is not a 'Supply' at all and hence cannot be taxed.**

B. Said Transaction falls into the exclusion of Employer-Employee

i. As per section 7 of the GST laws, activities falling under Schedule III shall neither be goods nor services and therefore not taxable under GST.

ii. Entry 1 of this schedule prescribes that services by an employee to an employer in or in course of his employment shall not be termed as a supply of goods or services and therefore will not be taxed under GST.

iii. Schedule III entry 1 reads as under:

> *SCHEDULE III*
> *[See section 7]*
> *ACTIVITIES OR TRANSACTIONS WHICH SHALL BE TREATED NEITHER AS A SUPPLY OF GOODS NOR A SUPPLY OF SERVICES*
>
> *1. Services by an employee to the employer in the course of or in relation to his employment.*

iv. Terms 'employer' as well as 'employee' have not been defined in the GST law, however definitions given under some other Indian law can be taken to understand them:

The Employees Provident Funds and Miscellaneous Provisions Act, 1952 defines these terms as under:

> ***2 (e) "employer"*** *means-*
> *(i) in relation to an establishment which is a factory, the owner or occupier of the factory, including the agent of such owner or occupier, the legal representative of a deceased owner or occupier and, where a person has been named as a manager of the factory under*

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(ii) in relation to any other establishment, the person who, or the authority which, has the ultimate control over the affairs of the establishment, and where the said affairs are entrusted to a manager, managing director or managing agent, such manager, managing director or managing agent;

***2 (f) "employee"** means any person who is employed for wages in any kind of work, manual or otherwise, in or in connection with the work of an establishment and who gets his wages directly or indirectly from the employer, and includes any person,- (i) employed by or through a contractor in or in connection with the work of the establishment; (ii) engaged as an apprentice, not being an apprentice engaged under the Apprentices Act, 1961 (52 of 1961) or under the standing orders of the establishment;*

Blacks Law dictionary defines these 2 terms as under:

***Employer** means one who employs the services of others; one for whom employees work and who pays their wages or salaries.*

*An **employee** is a person who works in the service of another under express or implied contract for hire, under which the employer has the right to control details of work performance*

v. Schedule III or for that matter any part of the GST law doesn't restrict the meaning of these terms into geographical boundaries. An employee placed at the branch is as much an employee who is placed at the HO. Company as a whole is the employer for all or any of the employees of the company.

vi. Further, Section 7 mandates that transactions falling under schedule III shall neither be a Supply of goods nor a supply of service, hence question of going to Schedule I in such transactions shall not arise.

vii. **In view of the above discussion, even if the same is termed as a Supply of Service, Entry 1 of Schedule III shall cover employee services rendered to its employer located anywhere in India, one cannot dissect an employer employee relationship in geographical terms, hence employee services rendered in relation to accounting, other administrative and IT system maintenance to the branches located in the other states would be covered in entry 1 of schedule III and therefore would not be Supply of Services at all.**

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Conclusion

The very premises on which this Advance ruling is based is flawed in view of the discussion above, hence in our view services rendered by employees to its company, irrespective of the location where the employee sits and where the branches of the company are, will not be taxable under GST.

In May 2018, this very bench of Authority for Advance Ruling of Karnataka had issued a ruling in case of M/s. Gogte Infrastructure Development Corporation Ltd. wherein it said that Hotel accommodation services rendered by a Hotel to SEZ units would be intra state supply and would therefore be liable to pay CGST + SGST. This was in total disregard of the extant provisions of the IGST Act which say that any supply of goods or service to an SEZ unit would be an inter-state supply and further section 16 of IGST act renders supplies made to SEZ as zero rated. Central Board of Indirect Taxes had to step in and issue a circular negating this Advance Ruling vide circular no. 48/22/2018-GST dated 14.06.2018.

Such Advance Rulings are going against the very tenet of GST, One Nation One Tax, if we start taxing such innocuous transactions it will lead us nowhere.

We earnestly hope that the board and council steps in (again) and issues necessary clarification on this very vital issue and not let it fester. If this goes unchecked, litigations will rule the roost. Secondly looking at overall quality of the orders coming in this short span of 1 year, we request the GST Council to centralise this vital function in the medium to long term and build in checks and balances to maintain quality.

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