



Bangalore Branch of ICAI – Study Circle Meet

GST implications of employer employee and other specified group company transactions

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Agenda

Employer Employee Transactions

1. Out of the frying pan and into the fire
2. History of taxability
3. Legal provisions under GST
4. Notice pay recovery
5. Employers providing various benefits to employees
 - a) Canteen Recovery
 - b) Recovery for loss of assets
 - c) Insurance Recovery
 - d) Transport Recovery
 - e) Recovery for car lease premium
 - f) Rewards for exemplary service
 - g) Credit card Reimbursement
6. ITC on covid related measures for employees
7. Perquisites under Income Tax Act

Specified group company transactions

1. Valuation provisions for related party transactions
2. Cross charge of costs between states
3. Branch and Liaison Offices
4. Supplier's credit period extension
5. Treatment of subvention payments including interest subvention payments
6. Corporate Guarantee
7. Parent allowing subsidiary to use brand, logo, etc
8. Group Company Transactions – Income tax and regulatory considerations



Goods and service tax – Out of the frying pan and into the fire

GST framework throws a wide net for taxability - high probability of litigation for related party transactions

Deemed supply

Due to specific provisions mandating certain transactions to be "supply", scope of coverage is extensive



Consideration not relevant

Unlike under service tax regime, consideration not mandatory under GST



Intra-company transactions

Due to the scope of "related party transactions", even intra-company transactions across states are within GST net



Legal remedies

With largely unfavorable advance rulings and no GST Appellate Tribunal, settling technical positions is difficult



GST

Evaluating tax positions for related party transactions

GST provisions has been subject to constant and multiple amendments since introduction – getting tax positions right is no more an easy task.

Positions adopted under the previous regime may not hold good and warrant re-evaluation

History – Taxing employer and employee transactions

History of employer-employee transactions

Service Tax - Finance Act, 1994

Section 65B clause (44) "Service means any activity carried out by a person for another for consideration, and includes a declared service, but shall not include -

(a) (...)

(b) a provision of service by an employee to the employer in the course of or in relation to his employment;

(c) (...)

Section 66E – The following shall constitute declared services, namely:

(a) (...)

(b) Agreeing to the obligation to refrain from an act or to tolerate an act or a situation, or to do an act;

(c) (,,)

Circular issued by DGCEI – Directed Revenue Officers to collect service tax on notice pay or other recoveries of similar nature by the employer from employees.

Circular stated that said services are being provided by employers to its employees and consideration in terms of forfeiture of security deposit or other payments being received by employers in lieu of their services

VAT - Karnataka Value Added Tax Act, 2004

Section 2, clause (6) 'Business' includes:

(a) Any trade, consumer, manufacture or any adventure or concern in the nature of trade, commerce or manufacture, whether or not such trade, commerce, manufacture, adventure or concern is carried on in furtherance of gains or profit and whether or not any gain or profit accrues therefrom; and

(a) Any transaction in connection with or incidental to, such trade, commerce, manufacture, adventure or concern.

TVS Motors Co Ltd vs State of Karnataka - STA Nos 49/ 2011 and 26-28/2012 – Transaction of supply of food and non-alcoholic beverages to employees and guests on subsidized rates constituted 'sale' and was held liable to be tax

While the erstwhile regime also carries some dispute in relation to employer-employee, GST regime has further convoluted the matter by deeming employer and employee as related parties

GST – Relevant legal provisions

Scope of Supply and meaning of "Related Parties"

Section 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; and
- (c) the activities specified in Schedule I, made or agreed to be made without a consideration**

(1A) where certain activities or transactions constitute a supply in accordance with the provisions of sub-section (1), they shall be treated either as supply of goods or supply of services as referred to in Schedule II.

(2) Notwithstanding anything contained in sub-section (1),-

- (a) **activities or transactions specified in Schedule III;** or
- (b) (...)

Schedule I – ACTIVITIES TO BE TREATED AS SUPPLY EVEN IF MADE WITHOUT CONSIDERATION

(a) (...)

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

Explanation to section 15 of the CGST Act, 2017 – For the purposes of this Act, -

(a) Persons shall be deemed to be "related parties" if –

(i) (...)

(iii) Such persons are employer and employee:

GST – Relevant legal provisions

Input Tax Credit and Press Release

Section 17 (5) (b) of the CGST Act, 2017 – Restrictions on input tax credit

(i) **food and beverages**, outdoor catering, beauty treatment, health services, cosmetic and plastic surgery, leasing, renting or hiring of motor vehicles, vessels or aircraft referred to in clause (a) or clause (aa) except when used for the purposes specified therein, life insurance and health insurance:

Provided that the input tax credit in respect of such goods or services or both shall be available where an inward supply of such goods or services or both is used by a registered person for making an outward taxable supply of the same category of goods or services or both or as an element of a taxable composite or mixed supply;

(ii) membership of a club, health and fitness centre; and

(iii) travel benefits extended to employees on vacation such as leave or home travel concession:

Provided that the input tax credit in respect of such goods or services or both shall be available, where it is obligatory for an employer to provide the same to its employees under any law for the time being in force.

Section 17(5) (g) of the CGST Act, 2017

(g) goods or services or both used for personal consumption

Press release issued by CBIC dated July 10, 2017

- Taxability of gift
 - Gifts up to a value of INR 50k is not taxable and beyond INR 50k made without consideration is liable to GST when made in the course of furtherance of business
- Taxability of perquisites
 - Supply by the employer to the employee in terms of the contractual agreement entered into between the employer and the employee will not be subject to GST
 - Since ITC is not allowed on club membership, health and fitness centre etc., such services when provided for free to all the employees shall not be liable to GST

Notice Pay Recovery

In a scenario where an employee is required to serve a stipulated time under notice of leave, employer offers an option to employee to pay a certain amount to be released earlier from employment contract

Recovery is on account of employment contract between employer and employee. Condition of notice pay recovery included in employment contract mainly to cover losses incurred by company due to disruption in services caused by an early exit of employee without adequate opportunity to obtain replacement. This condition is typically installed in contract to deter employees from seeking early release from employment and not with a view to earn notice pay recovery.



Taxmen's view

- Services are liable to be taxed under the entry agreeing to obligation to refrain from an act or to tolerate an act or a situation, or to do an act
- Services are deemed to be supply of services
- Payments specifically towards tolerating early release and is in nature of forfeiture
- Outside contract of employment as payment is to rescind contract of employment prematurely
- Gujarat AAR – M/s Amneal Pharmaceuticals (GUJ/ GAAR/ R/ 51/ 2020)

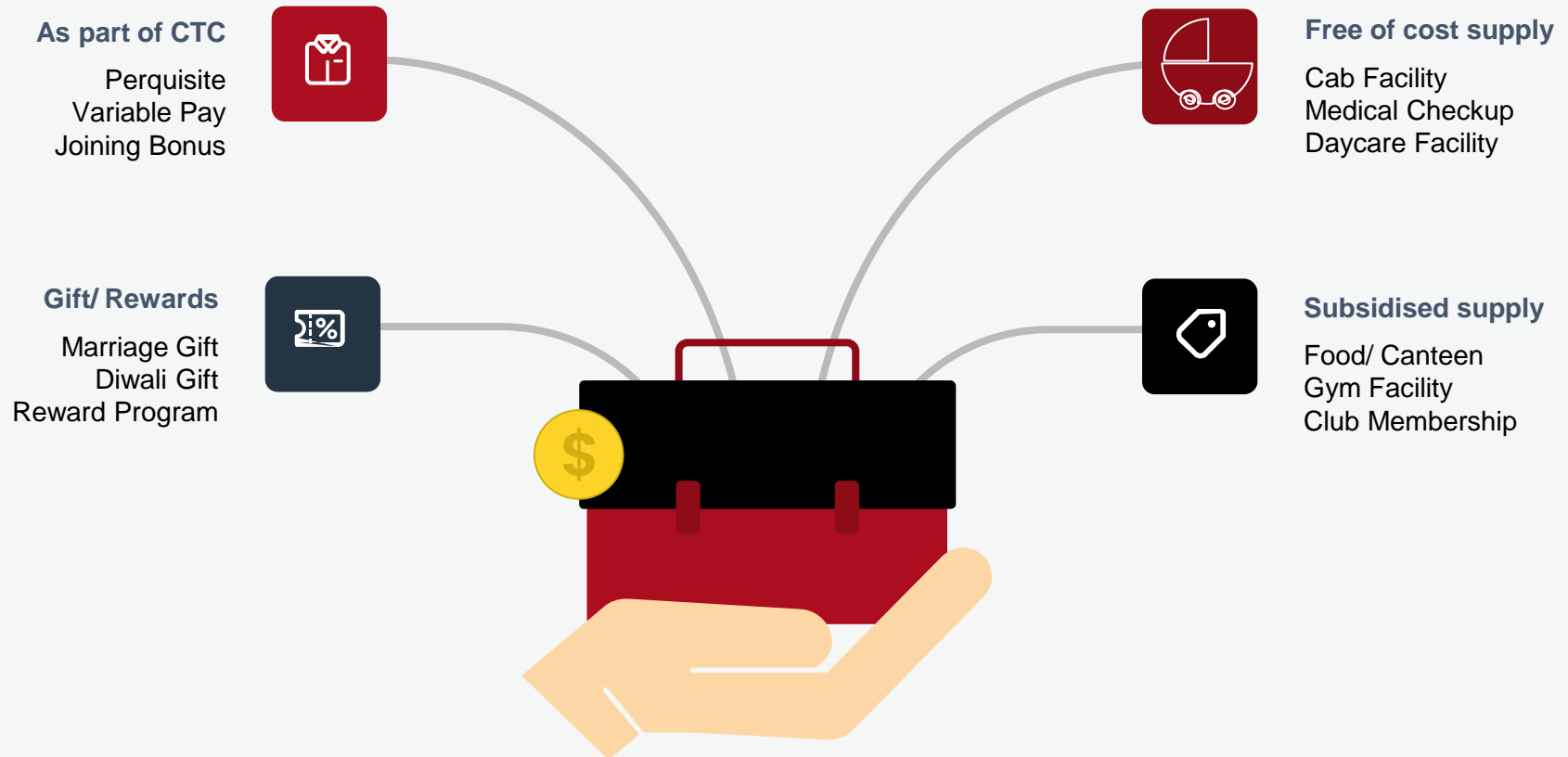
Taxpayers' view

- Post amendment in 2018, ingredient of “supply” is mandatory to establish taxability which in current case is missing
- Payment not towards tolerating any act in absence of agreement
- Payments in lieu of employee's salary and accordingly any payment made is within the confines of employment agreement making it outside the purview of taxation
- Amount recovered is from salary of employee and hence part of employment contract - HCL Learning Limited – ST Appeal No 70580 of 2018 (CESTAT – Allahabad)

'Test of supply' mandatory for Schedule II 5(e) entry - agreeing to obligation to refrain from an act, or to tolerate an act or a situation, or to do an act – in view of amended definition of supply under Section 7

Issue remains highly litigative under GST regime as well. However a 'no tax' position could be defended at higher forums of appeal given the favourable rulings under the service tax regime

Bouquet of benefits to employees



Canteen Recovery

Businesses commonly allow employees to avail lunch facility at premises at a subsidised or on free of cost basis



Recovery towards subsidised canteen services typically in a format where a third party vendor is invited into the premises of employer and offer food at subsidised rates, employer pays third party in full and recovers a portion of supply from its employees

Taxmen's view

- Liable to be taxed as supply of food and beverage services at other than specified premises – at 5% without ITC
- Since employer and employee are related parties, even if no recovery is made, GST liable to be paid on open market value of supply
- M/s Caltech Polymers Pvt Ltd [Order No CT/ 7726/ 2018 - C3, dated September 25, 2018]

Taxpayers' view

- Company merely collecting a portion of bill of third party and not carrying out any supply by itself
- Company is a pass through for payments to third party
- No 'supply' as Company is not providing food and beverages in the course of furtherance of its business
- Even if recovery is liable to be paid, input tax credit should be allowed making transaction revenue neutral and hence charging tax would be futile

Multiple advance rulings such as Dakshina Kannada, Tata Motors, Dishman Carbogen Amics have ruled in favour of applicants. However, the position is not yet settled and hence remains litigative.

Canteen Recovery

Whether input tax credit is available if GST rate charged is 5%?

- Section 17(5) allows input tax credit of food and beverages and outdoor catering services in a scenario where such inputs are used for further supply of the same category
- Section 17(5) prefaces a *non-obstante* clause and overrides Section 16(1)
- Section 16(1) entitles a person to avail ITC subject to certain conditions prescribed
- Notification 11/ 2017 CT (Rate) is one such notification that prescribes for rate of tax subject to conditions prescribed
- Accordingly, a position is possible that as Section 17(5) has an overriding effect on Section 16(1), the restriction provided through Notification 11/2017 CT (Rate) should be applicable to Section 17(5), which specifically allows for credit of supply of food and beverages
- Statutory provisions have primacy over delegated provision
 - Corporation Bank vs Saraswati Abharansala (SC)
 - Amritsar paper vs CCE Ludhiana (SC)
 - Travelite India vs Union of India (SC)

Accordingly, a view is possible that in a scenario where GST @ 5% is charged, input tax credit could be availed even though specifically restricted under the rate notification. However, the position is not free from doubt and hence could be litigated

Other Recoveries

Loss of asset

If employees damage any asset belonging to the company or lose any asset designated to them, the company charges an amount to make good such loss incurred on account of the employee

Insurance Premium Recovery

Employees are usually extended the option to add family members to the corporate insurance policy and appropriate premium amount is recovered from the employee – AAR Maharashtra – No tax on recovery - Jotun India - 2019-VIL-25-AAR

Transport Recovery

Company offers bus transport facility to employees at a subsidised rate to facilitate easier commute. AAR Maharashtra – No tax on recovery – Tata Motors - GST-ARA- 23/2019-20/B-46

Car Lease Premium

Company provides car to employee and pays car lease premium. Company also provides an option to employee to buy car at end of employment contract or lease period

An argument is possible that the above recoveries are mere liquidated damages (for loss of asset) or facilitation of payment to third parties (other recoveries) and is merely a transaction in money. Hence, no GST is liable to be paid.

For facilities provided to employees, it is pertinent to review the employment contract and review the same at a transaction level before concluding on the final technical position regarding applicability of GST

Rewards for exemplary service

Whether payments made to employees under rewards and recognition program are liable to GST?

Payments in the form of gold coins, free holiday package vouchers etc

Lucky dip at a town hall event

Kudos award, long service award, gift vouchers etc

- Gifts provided to employees above the value of INR 50,000 per annum is liable to GST
- What constitutes a gift? Not been defined under GST law
- In common parlance, gift is without consideration and voluntary in nature
- It cannot be demanded as a matter of right by employee
- Employee cannot move a court of law for obtaining a gift
- *Ex-gratia* payments outside ambit of employment contract could be gifts
- If an amount is to be paid as part of company policy to all employees, such amount should not fall within purview of gifts
- Rewards for exemplary service as part of company policy can be argued to be outside the ambit of 'gift'

What happens if only certain employees are eligible to rewards as part of company policy?

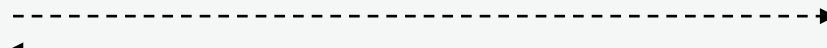
What is the scope of the term "all employees" as mentioned in the press release

Credit card expense reimbursement – ICU medical case¹

Applicant - Indian company



Services under a MSA – Development services and expenses incurred for providing such services



Foreign Holding Company



Issues credit card to employees and issues commercial invoice for bills settled



- GST is to be paid on reimbursement amounts at the time as determined under Section 13 of the Act, as it represents a part of the consideration which is received in advance by appellant from its recipient
- Applicable GST rate on such expenses sought to be reimbursed is the same rate at which appellant charges for software development charges as expenses borne are part of taxable value of such services
- Fact of reimbursement does not result in any transaction on its own. CGST Rules specifically require addition of such expenses to value of principal service

1. Order-in-Appeal No. AAAR/10/2021(AR), dated March 10, 2021

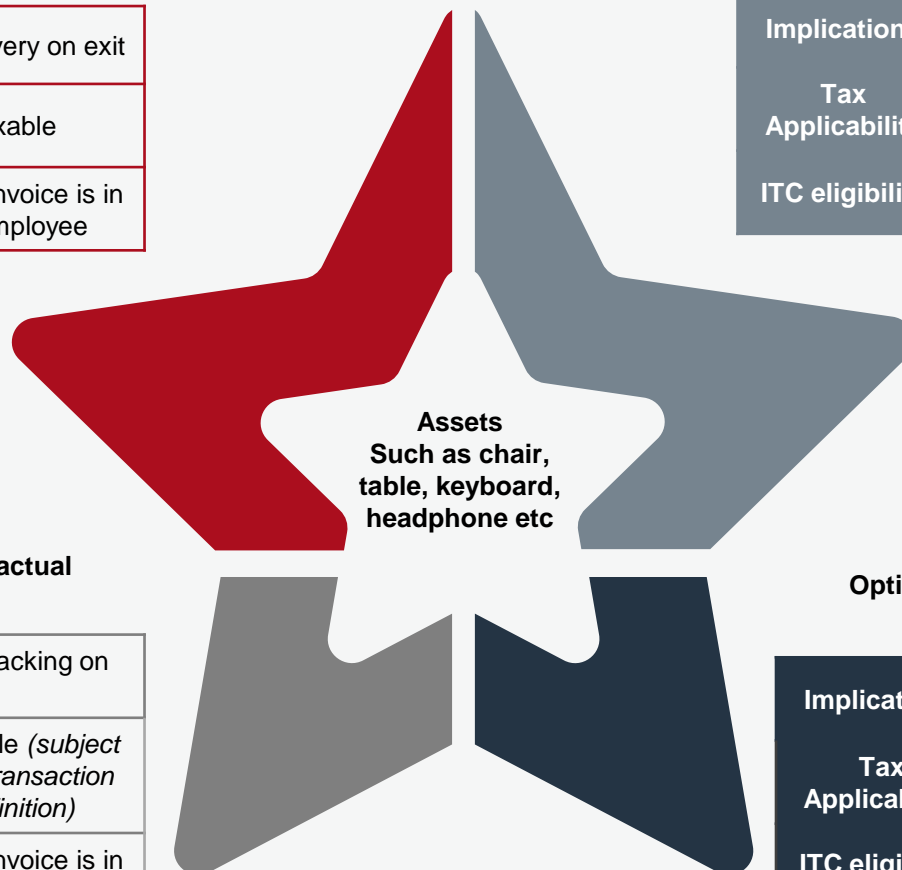
ITC on covid related measures for employees

Option 1: One-time cash allowance

Implications	No tracking, recovery on exit
Tax Applicability	Could be taxable
ITC eligibility	Not available as invoice is in the name of employee

Option 2: Negotiated rate and one-time allowance

Implications	No tracking, recovery on exit
Tax Applicability	Could be taxable
ITC eligibility	Not available as invoice is in the name of employee



Option 4: Reimbursement of actual costs

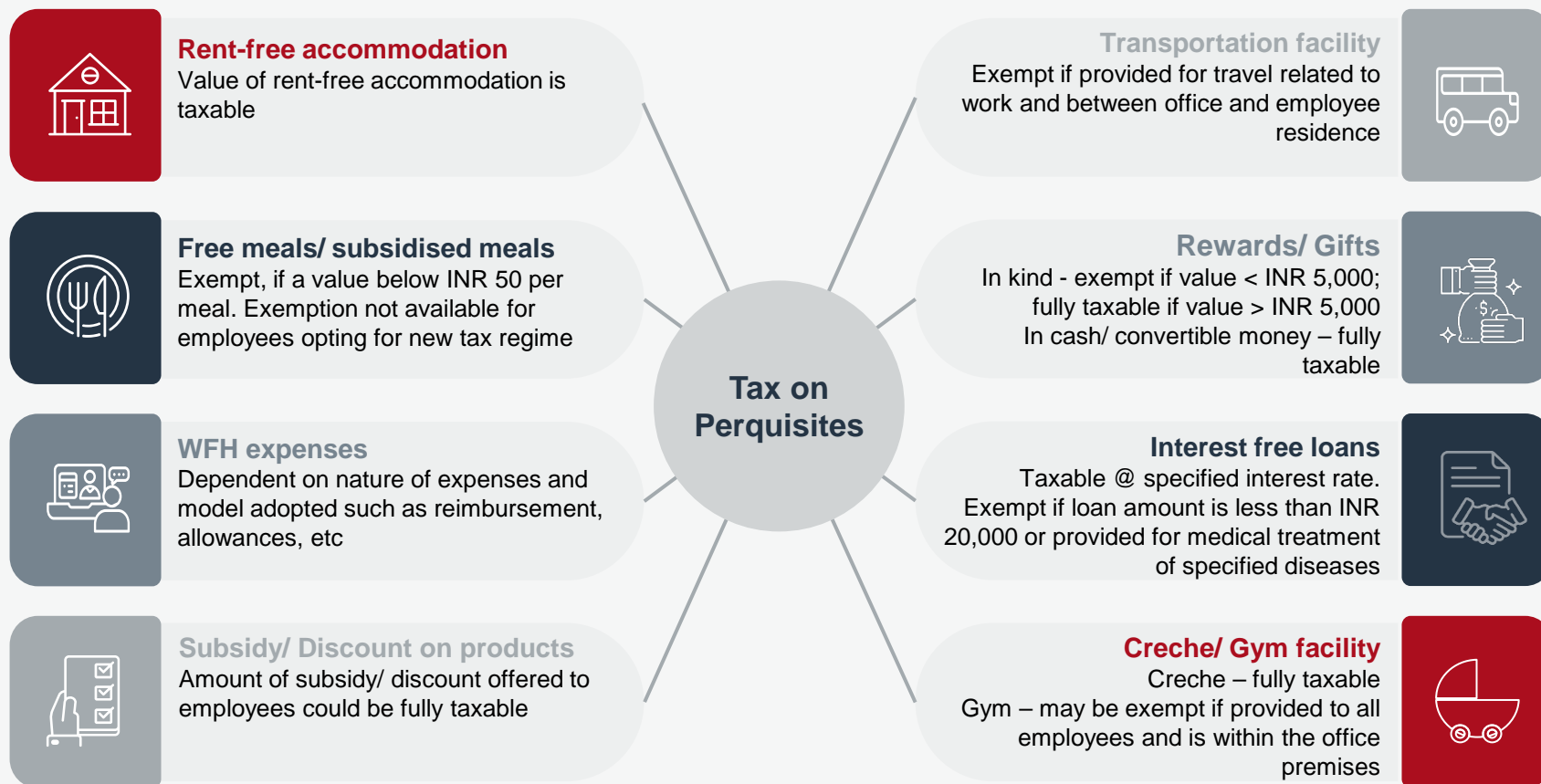
Implications	Capitalization, tracking on exit
Tax Applicability	May not be taxable (<i>subject to fulfillment of 'transaction in money' definition</i>)
ITC eligibility	Not available as invoice is in the name of employee

Option 3: Central procurement and distribution by employer

Implications	Delivery, capitalization, tracking on exit
Tax Applicability	Not taxable as asset owned by company
ITC eligibility	Should be eligible

Perquisites

Section 17(2) of the Income-tax Act, 1961 (IT Act) read with Rule 3 and 3A of Income-tax Rules, 1962 deals with perquisite taxation. Inclusive definition of perquisites under IT Act. Therefore, benefits and facilities provided to employees, unless specifically exempt/ excluded could be taxed as perquisites



Taxability of certain facilities commonly provided such as broadband connection, electronic gadgets, etc remains unclear and may therefore be seen as taxable perquisites



Specified group company transactions

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Valuation provisions for related party transactions

Valuation provisions for related party transactions

Rule 28 - Value of supply of goods or services or both between distinct or related persons, other than through an agent

Value of supply of goods or services or both between distinct persons as specified in sub-section (4) and (5) of Section 25 or where the supplier and recipient are related, other than where the supply is made through an agent, shall -

- (a) be the **open market value** of such supply
- (b) if the open market value is not available, be the value of supply of goods or services of **like kind and quality**
- (c) if the value is not determinable under clause (a) or (b), be the value as determined by the application of rule 30 or rule 31, in that order:

Provided that where the goods are intended for further supply as such by the recipient, the value shall, at the option of the supplier, be an amount equivalent to ninety percent of the price charged for the supply of goods of like kind and quality by the recipient to his customer not being a related person:

Provided further that where the recipient is **eligible for full input tax credit**, the value declared in the invoice shall be deemed to be the open market value of the goods or services

What constitutes Open Market Value?

What is the scope of like kind and quality?

What is the scope of full input tax credit?

Cross charge vs ISD



GST Provisions

- Section 25 state that each registrations of same legal entity shall be treated as establishments of distinct persons ie, separate person for GST
- As per Schedule I, transactions between distinct persons, in furtherance of business, even without consideration shall be treated as supply



Typical cost inclusions

- Common costs incurred by branches and Head Office such as audit fee
- Stock transfers, asset transfer, costs exclusively mapped to 1 registration
- Common functions undertaken by Head Office: Accounting, Tax, Finance, Legal and HR



Open issues

- How to arrive at value for charging GST on support services? Whether salary of employees to be considered?
- Whether cross charge is required for all the third party/common services?
- ISD registration increases compliance burden, limits ability to transfer credit to within the financial year
- Cross charge to replace ISD wherever feasible?

Branch and Liaison Office under GST

Treatment of Branch and Liaison office under GST?

- Branch or Liaison Office (LO) in India and its Head Office outside India qualify as '**distinct persons**' under GST - Accordingly, any activity undertaken by Branch or LO in India for foreign HO, **with or without consideration liable to GST**
- Any services provided by head office in India to overseas branch not be treated as 'export of services' by virtue of Section-2(6) of IGST Act, 2017
- While supplies by an Indian LO or Branch liable to GST, specific exemption has been provided in this regard

As per Notification 15/2018 dated July 26, 2018

Services supplied by an establishment of a person in India to any establishment of that person outside India, which are treated as establishments of distinct persons in accordance with Explanation-1 of Section-8 of IGST Act, 2017 would be exempted from GST provided that the place of supply of the service is outside India in accordance with section 13 of IGST Act, 2017

Due to the exemption, the Branch or the LO must reverse any input tax credit availed in India as per the provisions of rule 42 under the CGST Rules, 2017

The Hon'ble AAR in the case of *World Economic Forum*¹ held that LO of World Economic Forum not liable to GST on services received from HO on the grounds that since an LO by design cannot carry on any business in India, so long as services imported by LO from its HO are not used in course of furtherance of business, LO not liable to pay GST on such transactions. Contrary view in the case of *Dubai Chamber of Commerce*², where it was held that LO is liable to pay GST on receipts from HO

¹ [TS-438-AAR(MAH)-2021-GST]

² Advance Ruling NO.GST-ARA-35/2019-20/B-14

Supplier's credit period extension

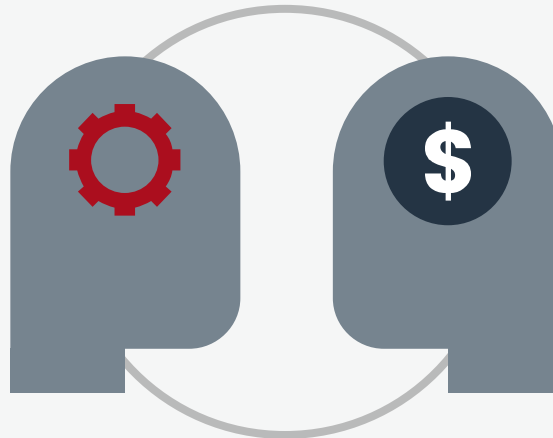
In a scenario where the supplier of goods allows extension of credit period to its related party, would penal interest as applicable to other third parties be liable to be included in the value of supply?

Taxmen's view

Given that the company is providing preferential treatment to its related party, the same can be considered as an tolerating an act and hence liable to GST

Amount of penal interest as that would be charged to a third party customer should be included in the value of supply and subjected to tax

Since penal interest is liable to be included in value of supply, it shall form part of value of principle supply and not as a separately identifiable supply



Taxpayer's view

Penal interest is liable to included in value of supply, however the time of supply of such penal interest is only upon receipt of such penal interest (Section 12(6) or 13(6), as the case may be, of CGST Act, 2017

Since penal interest will never be received, the time of supply fails and accordingly the levy fails

Above penal interest different from interest charged by way of extending a loan to a company which is exempt vide Notification 12/ 2017 dated June 28, 2017. Circular 102/ 21/ 2019 - GST clarifies that only in a scenario where the supplier proposes to charge penal interest for late payment for supply of goods, the same shall be liable to be included in value of supply

Subvention Payments

What is subvention fee?

Meaning

- Reference could be made to Income Tax Act, 1962, Section 2(24) (xviii) - Assistance in the form of a subsidy or grant or cash incentive or duty drawback or waiver or concession or reimbursement (by whatever name called) by the Central Government or a State Government or any authority or body or agency in cash or kind to the assessee
- As per oxford dictionary – A grant of money, especially from a government

Commercial Parlance

- In commercial parlance, it refers to an amount paid by a company to another company to maintain a certain profit margin or to make good a loss or to subsidise an asset or a project

Coverage under GST law

- Such payments can be covered within the provisions of Schedule II - deemed supply of service - agreeing to the obligation to refrain from an act, or to tolerate an act or a situation, or to do an act

Thoughts on taxability of subvention payments under GST?

Subvention Payments

Questions to ask

- What is nature of relationship between companies?
- What triggered payment of subvention fee?
- What is financial condition of company(s)? Loss making or profit making?
- Whether payment mandated by an agreement at occurrence of an event?
- Whether money so received can be freely used for any purpose?
- Whether the recipient has no obligation to pay money back after receipt?

Taxable under GST if

- Company is profit making
- Payment mandatory to recipient under an agreement
- Money paid could be used freely by recipient
- Recorded as an income and not as a capital receipt

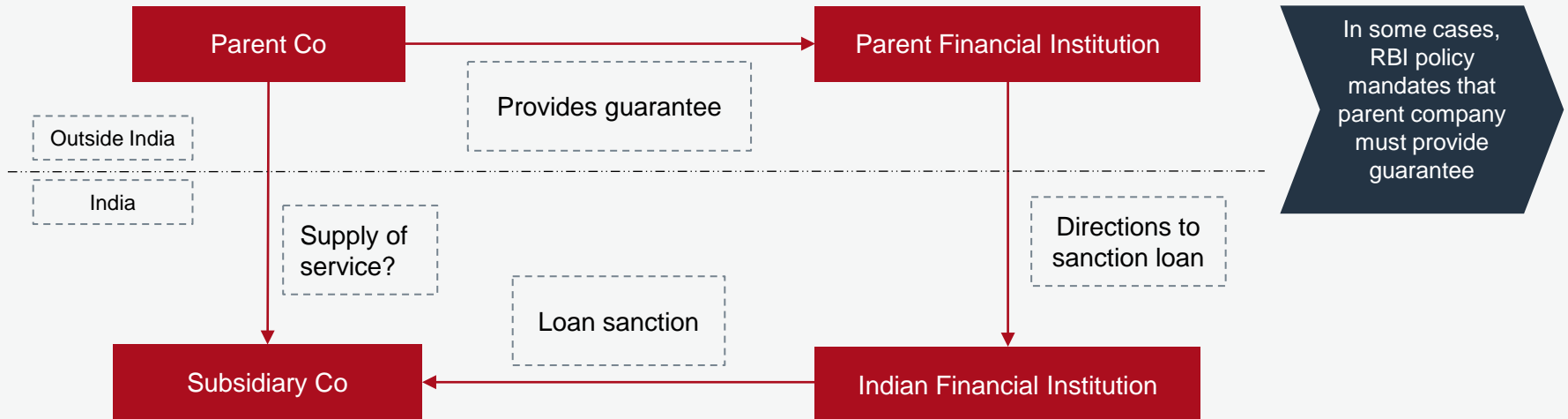
Could be not taxable under GST if

- Loss making company
- Related parties involved
- Subvention payment not mandatory
- Not covered by an agreement
- Money paid not to be returned by recipient
- Amount paid is to be used towards specific asset/ project

Various forms of subvention payments exist such as interest subvention, limited risk distributor, subsidiary companies requiring bailout packages etc. Fact specific analysis required to conclude on the technical position of GST applicability

Corporate Guarantee

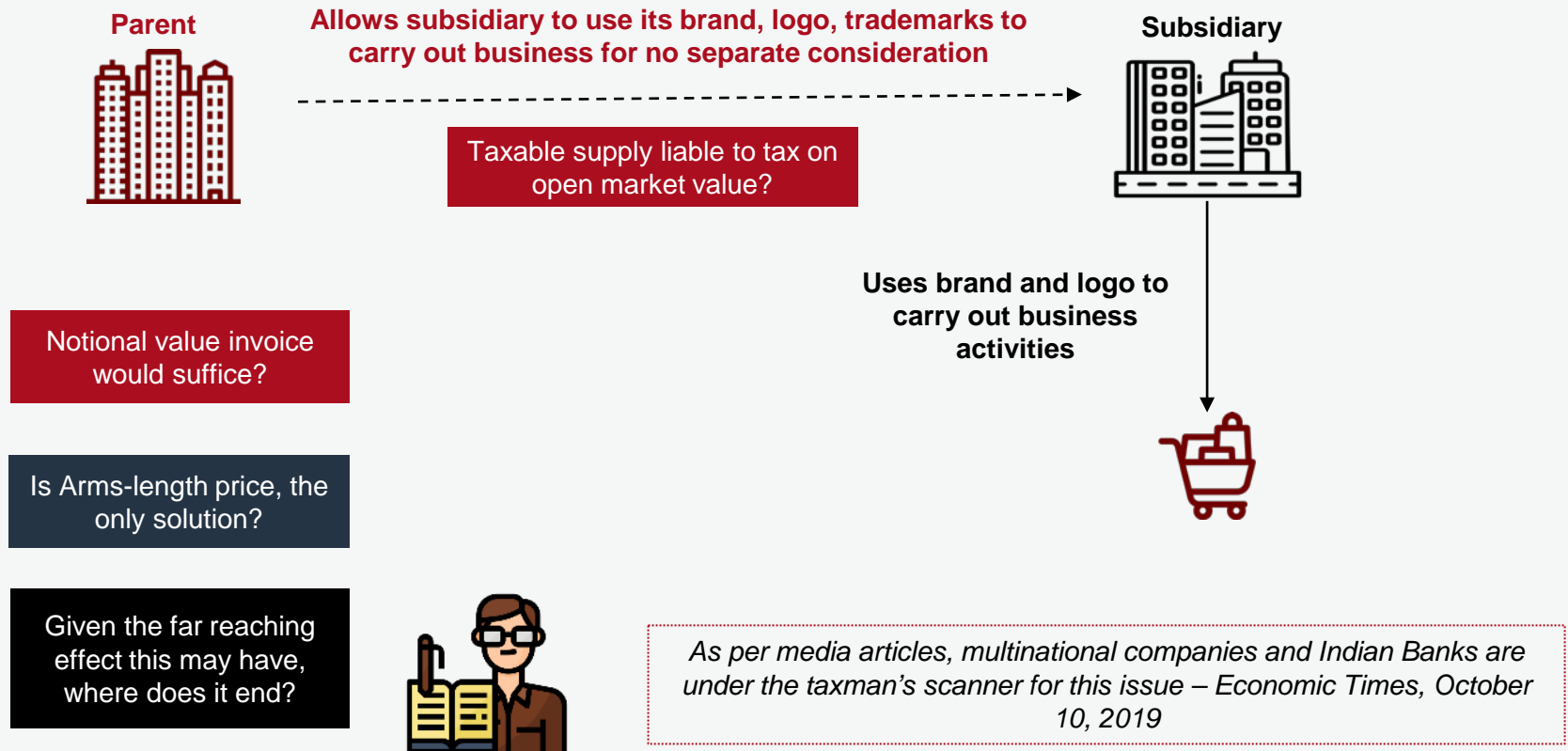
Questions to ask



Whether the above act of providing corporate guarantee is liable to GST? Valuation? Detection risk?

In situations where without the parent company's guarantee, subsidiary would not have been sanctioned the loan, an argument can be made that such supply is liable to GST

Parent allowing subsidiary to use brand, logo, etc



Group Company Transactions

Income tax and Regulatory Considerations

Key considerations under other regulations

Extension of credit period

Divergent judicial precedents exist on characterisation of receipts towards extension of credit period. View 1 is such income is in same nature of underlying transaction (sale of goods/ provision of services). View 2 is receipt is in nature of interest income. Analysis is based on facts of each case and becomes more crucial in case payment is made to foreign parties

Credit extended by foreign parties would be subject to Trade Credit Framework under exchange control regulations

Subvention payments

Characterisation of subvention income as capital receipts vs revenue receipt has been matter of litigation. Supreme Court³ held that subvention received from parent company to make good losses is capital receipt as it is to protect investment of parent company

Use of brand name, logo etc

Usage of brand name, logo, trademarks, etc by group companies should be at arm's length and against payment of royalty for such usage

Related party transactions

Transactions with related parties should be arm's length. Where Assessing Officer is of an opinion that any expenses/ payments made to specified related parties is excessive or unreasonable, the excessive payment could be disallowed under Section 40A(2) of IT Act

Separate approvals may be required under Section 188 of Companies Act, 2013 and SEBI Regulations (*refer Annexure 1*)

Corporate Guarantee

Corporate guarantee provided by associated enterprise would be deemed debt issued by such associated enterprise and be subject to thin capitalisation rules under Section 94B of IT Act

Indian company may extend guarantee on behalf of its foreign joint venture/ wholly owned subsidiary within permissible limits under exchange control regulations



Where the above are international transactions between associated enterprises, Transfer Pricing regulations may also apply

³ Siemens Public Communications Networks Ltd vs CIT TS-651-SC-2016

Summing it up – Where do we go from here?



Scope of related party transactions are vast

Professionals and businesses to review each related party agreement with a fresh perspective to proactively take necessary actions, wherever required. Position master to be maintained to ensure clarity in thought at the time of audit

Consideration not relevant

Given that consideration is not relevant for GST for related party transactions, a review of various roles and responsibilities of related parties to be analysed to identify any transaction at risk of GST

Advance rulings have a persuasive value

As advance rulings, whether in favour or not, are binding only on the applicant, positions supported by advance rulings may not be free from litigation. Companies should seek professional views on material transactions.

Open market value

Where a transaction is decided to be taxed, companies should seek corroborative evidence to support their valuation in case open market value is adopted for transactions

Sync with other laws (Transfer Pricing, Company Law, Income Tax, FEMA etc)

Given the sweeping amount of data available with various Departments (Exchange of information agreements), it is critical to ensure that positions adopted under GST law are calibrated with positions adopted under other laws or a cogent reason is documented for any disparity between positions under various laws

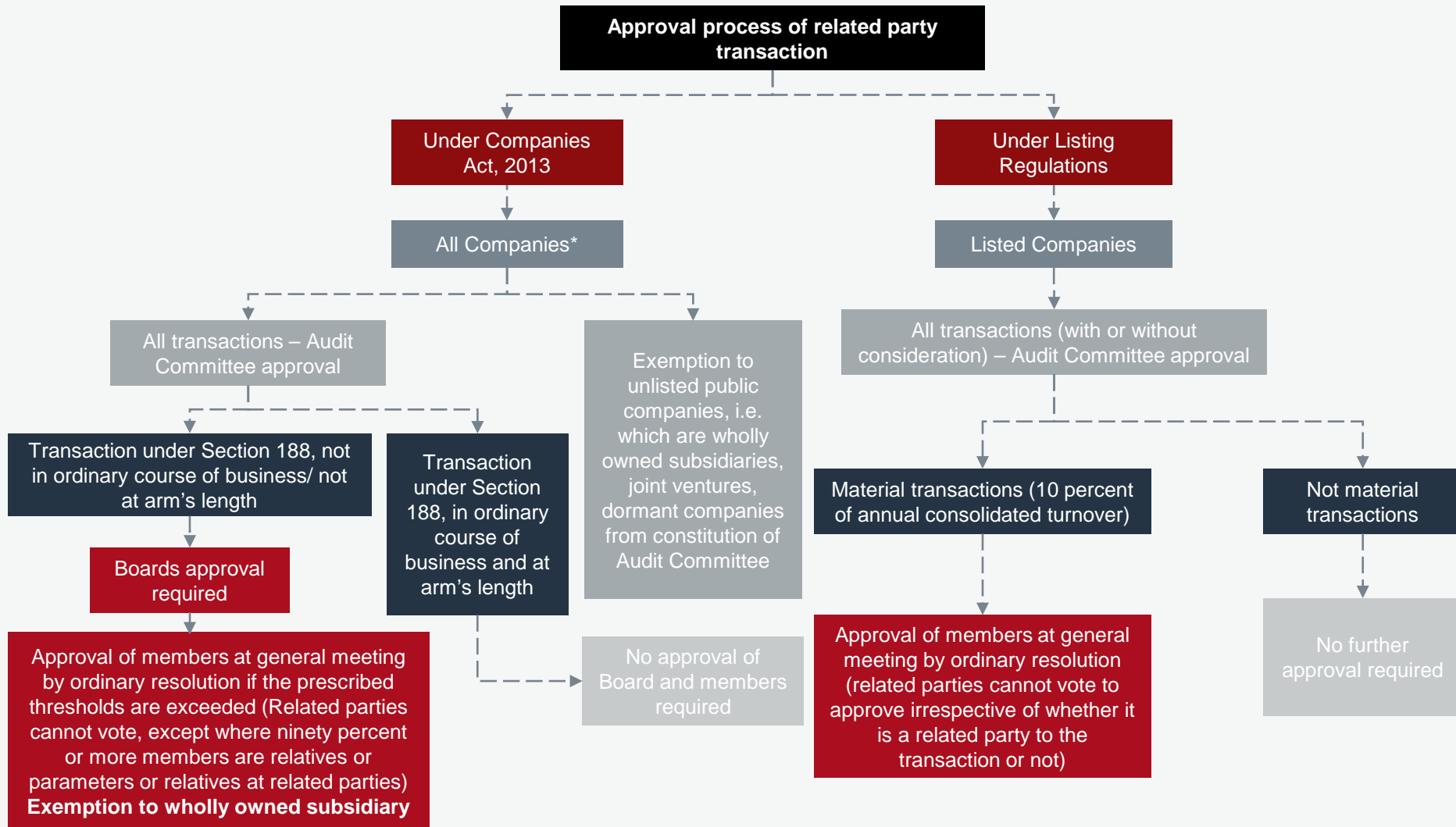


Annexures

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Annexure 1 – Approvals for related party transactions



* Except for transactions between the holding company and its wholly owned subsidiary



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