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APPELLATE AUTHORITY CONFIRMS THAT ACTIVITIES CARRIED OUT BY AN EMPLOYEE FOR AN OFFICE LOCATED IN ANOTHER STATE WOULD BE A TAXABLE SUPPLY

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The Karnataka Appellate Authority for Advance Rulings (AAAR) has upheld the ruling of the Karnataka Authority for Advance Rulings (AAR) in the application filed by Columbia Asia Hospitals Pvt. Ltd. (Applicant). The AAR had ruled that the activities carried out by employees of the Corporate office (CO) of the Applicant for the Applicant's branch offices would be taxable as supplies between distinct persons.

Facts of the case

The Applicant is a healthcare group operating a chain of hospitals across six states. Each hospital is a separate profit centre. The CO, located in the state of Karnataka, handled operations such as accounting, administrative work and information technology systems maintenance for all hospitals. The operational costs, pro-rated on the basis of turnover, were invoiced by the CO to the respective hospitals charging applicable goods and services tax (GST). However, the salary of the CO employees was cross-charged to the other hospitals without GST.

Before the AAR, the Applicant contended that "services by an employee to the employer in the course of or in relation to his employment" is "neither a supply of goods nor a supply of services" under Entry 1 of Schedule III of the Central Goods and Services Tax Act, 2017 (CGST Act). The Applicant therefore sought a ruling that cross-charging of employee's salary cost by the CO to the other hospitals should not be eligible to GST. However, the AAR ruled that:

- the employee-employer relationship exists only in the CO;
- the CO and the other hospitals registered in other states are distinct persons as per Section 25(4) of the CGST Act;
- the CO employees have no employee-employer relationship with the other distinct persons i.e. the other hospitals.

Accordingly, the employee's salary cost cross-charged to hospitals by the CO would be eligible to GST under Entry 2 of Schedule I of the CGST Act.

Contentions before AAAR

Before the AAAR, the Applicant contended that Entry 2 of Schedule I of the CGST Act has to be read in conjunction with Entry 1 of Schedule III of the CGST Act. The Applicant

argued that the employer-employee relationship existed between the employee and the company and not between the employee and the distinct person.

AAAR Ruling

The AAAR ruled that:

- A transaction between distinct persons even without consideration is termed as a supply under Entry 2 of Schedule I of the said Act read with Section 7(1)(c) of the CGST Act;
- The employees stationed at the location of a particular establishment of a distinct person are deemed to be rendering their services only to that establishment of a distinct person and not to any other distinct person even though all distinct persons are of the same business entity. Such services of employees, when rendered in the course of their employment are not considered as a 'supply of service' in terms of Entry 1 to Schedule III;
- The employee-employer relationship is to be viewed separately for every registered unit of the business entity;
- Input Service Distributor (ISD) allows distribution of input tax credit on input services attributable to other distinct persons without any element of service being provided by ISD;
- Certain expenses like rent and housekeeping incurred by the CO can be allocated only by way of cross-charge and not under the ISD mechanism.
- Activities such as accounting, administrative work, etc. with the use of the services of the personnel working in the CO for the benefit of all hospitals is to be treated as a taxable supply in terms of the Entry 2 of Schedule I read with Section 7 of the CGST Act.

Accordingly, the AAAR upheld the AAR ruling that the CO of the Applicant is providing a taxable service to its other hospitals.

Comment:

The AAAR ruling may be subject to criticism as it does not take into account the nature of the employer-employee relationship and adopts a marginal view that such a relationship will be restricted by the location out of which such employee is based. Albeit the advance ruling is only binding on the Applicant, it has far-reaching consequences for sectors which are GST exempt like investment, education, health care or sectors for which the availment of input tax credit is restricted like banking and finance companies and restaurant business. A few crucial points for consideration emanating from this decision are discussed below:

- A corporate office/ head office would be seen as providing taxable services to branch offices located in other states;
- Employees of branch offices doing work for corporate office/ head office/ other branch offices would be seen as providing taxable services to such offices;
- Cross-charging and recovery of employee cost/establishment cost from profit centres would be subject to valuation norms and may require to be valued at cost plus 10% basis;

- Even if there is no cross-charge, GST would still be payable if a person has establishment in more than one state with common personnel or infrastructure;

This ruling will impact every business with presence in more than one state as they would be required to undertake additional paper work and also re-assess the costs as the incremental tax may or may not be fully recoverable.

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