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Cross charge and GST implications

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To recapitulate, different units of a same entity functioning in different States are treated as “distinct persons” under the GST law and supply of goods or services or both between such “distinct persons”, even if made without consideration are treated as supply, as per Schedule I of the CGST Act.

This deeming fiction was created, so that the Input Tax Credit chain is maintained in tact. One of the major disadvantage of the earlier VAT regime was the restriction of ITC on inter-state supplies, which led to proliferation of Depots, only to circumvent payment of CST and consequent litigation and one of the objective of such GST is to remove such regional tax barriers. If supply against consideration alone are treated as supplies, goods stock transferred from one unit to another unit (in a different State) would not amount to supply and the input tax chain would be cut off at that stage and that is why even supply of goods from one unit of an entity to another unit of the same entity in a different State or supplies between related persons are also declared as supply, though made without any consideration. This purpose would have been well achieved if only supply of goods without consideration alone are thus deemed to be supply, but knowingly or unknowingly, supply of services without consideration are also deemed to be supplies, which has led to insurmountable difficulties to the trade.

One major problem would be valuation of such supplies. As per second proviso under Rule 28 of the CGST Rules, 2017, if the recipient is entitled for full Input Tax Credit, then whatever value is declared in the invoice, even a nominal value could be adopted. But many of the recipient units may be involved in making exempt supplies also, in which case, as per Rule 42 of the CGST Rules, 2017, they would be entitled only for proportionate ITC and hence the benefit of the second proviso under Rule 28 cannot be claimed in the matter of valuation. Determination of open market value, value of services of like kind and quality are highly subjective and subject to interpretation / disputes.

The issue can be discussed as under.

Employees of Corporate office / registered office, etc.

Every entity may have a registered office / Corporate office / Head office / Marketing office, etc. (hereainafter referred to commonly as HO) which would cater to all units of the entity, situated in different States. Thus, the employees working in HO are working for all units of the entity. Once the said HO on the one hand and other units of the same entity in different States are deemed as "distinct persons", the question arises as to whether the HO is supplying the services of its employees to its other units, warranting payment of GST for such deemed supply.

In this connection, it is also relevant to note that as per Schedule III of the CGST Act, "Services by an employee to the employer in the course of or in relation to his employment" is not at all treated as a supply. In this context, the Authority for Advance Ruling (AAR) has held in the case of Columbia Asia Hospitals Pvt Ltd – 2018-TIOL-113-AAR-GST, since the HO and other Units in a different State of an entity are distinct persons, the employees of HO are not employees of the Unit in different States and hence, the transaction is covered by Schedule I of the Act, and GST is payable. Assuming that an entity is having 4 units in 4 different States and a Corporate office. If the employee cost has to be shared among the four units, by raising a GST invoice, in what proportion the employee cost can be shared among the units for the purpose of GST valuation? There are no guidelines in this regard in the statutory provisions.

In this connection, it is felt that the legal fiction of treating different units of the same entity situated in different States as distinct persons, as per Section 25 (4) of the Act. To quote,

Sec. 25 (4) A person who has obtained or is required to obtain more than one registration, whether in one State or Union territory or more than one State or Union territory shall, in respect of each such registration, be treated as distinct persons for the purposes of this Act.

It may be noted that any legal fiction created by a Statute is for a specific purpose and the above deeming fiction is only "for the purposes of this Act". Otherwise, the fact remains that different units of an entity situated in different States are part of the same entity and hence constitute a single person only.

In order to decide whether the employees working in HO are also employees of the units of the entity in different States or not, there is no need to refer to any of the provisions of the CGST Act. Employment is a contract between the employer and employee and is governed by the Contract Act as well as by any other special enactments relating to such employment. By all means the employees of an entity are employees of the entity as a whole as the entity is a single entity. So, when the employees of HO are catering to the works of all units, they do such works only in their capacity as employees of the entity as a whole and the fact that different units of such entity are treated as distinct persons under GST law, cannot alter the fact that they are employees of the same entity.

Hence, in the author's view, albeit the decision of the AAR, there is no requirement to charge any GST in respect of the employee cost pertaining to HO, though the same may invite litigation.

Other common services received by HO from various service providers.

The HO would be receiving various services from various service providers. For example, when the HO pays rent for its premises, can it be said that in turn that similar service is provided by HO to its units in different States? When HO pays to its statutory auditor, can it be said that HO is providing such services to its units in different States? There is host of common services received by HO, the benefit of which is attributable to all units. The question now is as to whether the HO is said to be procuring such common services for the benefit of all its Units, which activity by itself can be considered as a supply, by virtue of S.No.2 of Schedule I. If so, HO should avail ITC of GST charged by all such service providers and in turn raise GST invoices on its units in different States.

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But it may be noted that a separate mechanism called "input service distributor" is available under the statute, and the term is defined in Section 2 (61) of the Act, as

"Input Service Distributor" means an office of the supplier of goods or services or both which receives tax invoices issued under section 31 towards the receipt of input services and issues a prescribed document for the purposes of distributing the credit of central tax, State tax, integrated tax or Union territory tax paid on the said services to a supplier of taxable goods or services or both having the same Permanent Account Number as that of the said office.

The manner of distribution of such ITC by the input service distributor is laid down in Section 20 of the Act.

If the deeming fiction of treating activities between distinct persons as per S.No. 2 of Schedule II of the CGST Act, 2017 is applied in respect of all services received by HO, then the concept of input service distributor itself would be rendered redundant. While interpreting the statutory provisions, no part of the statute could be rendered redundant and harmonious construction has to be adopted.

Thus it can be concluded, in respect of various services received by HO, there is no presumption that the HO is in turn supplying similar services to its Units in different states, requiring payment of GST and it is sufficient if proportionate ITC is distributed through input service distributor.

Based on the above, the following two options are available for all assesses to follow.

(i) Do not pay any GST for any such interunit supply of services and litigate the issue.
(ii) In order to avoid litigation, pay GST for such cases and avail ITC at the recipient end.

If option (ii) above is chosen, the following factors have to be kept in mind.

If the receiving unit is entitled to avail full ITC (receiving unit not making any exempt supply and hence Rule 42 of CGST Rules, 2017 is not at all applicable), then valuation of the deemed supply of various services by HO to its units is not at all an issue and a consolidated, nominal value can be assigned for all services provided by HO to its units, as per second proviso to Rule 28 of the CGST Rules, 2018.

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.

But, if the receiving unit is not entitled for full ITC (receiving unit making certain exempt supply and hence Rule 42 of CGST Rules, 2017 is applicable), then valuation has to be done, as per Rule 28, based on open market value or value of services of like kind and quality. But ascertaining such values would be a nightmare. It is better to adopt cost plus 10 % under Rule 30. To put it simply, all cost incurred by HO may be shared among all units based on some objective criteria (turnover or any other relevant criteria) and then the value for GST may be considered as 110 % of such allocated cost.