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Treatment of Common Services from Head Office

Under GST Law each registered branch is treated as a 'distinct' and related person. Further, GST law treats as 'supply' provision of goods/services/both to a related person even when made without consideration.

In this context an important question arises on treatment of common services (IT, HR, Tax, Finance, etc.) by a company's head office to branches registered in other States. At the outset, should such common services be considered as 'supply' at all? Should such services be supported by invoices and then should GST be charged? If yes, then what should be the valuation of such services?

Presented below are two different schools of thought on the above aspect:

Approach I – No Valuation of Common Services is Required

One view which finds support from jurisprudence under erstwhile regime is that branches merely reimburse the proportionate share – there being no element of service or 'supply' and hence no Service Tax/GST levy.

Similar stand was taken in erstwhile regime by the Hon'ble CESTAT, Mumbai which held as follows[1]:

"*Having considered the rival submissions and contentions,* ***we are of the view that in respect of reimbursement of common expenses in the nature of electricity and other expenses incurred commonly by the appellant, no service can be stated to have been rendered and accordingly, the same not liable to Service Tax****. …We set aside the levy of Service Tax on the reimbursement of common expenses such as electricity charges, common office expenses, etc."*

In case of ***Franco Indian Pharmaceutical (P) Ltd.***, the Mumbai bench of Hon'ble CESTAT held[2]:

"*Even otherwise, by its very nature, a situation where employer-companies have a pre-existing agreement to hire employees on joint basis and agree to share the cost of employment on actual by dividing it amongst themselves in such a manner that each employer bears only his part of the cost indicates that there was no intention amongst the employer-companies to render any service to each other. It indeed the intention of the parties would have been otherwise, the employer-company which takes the trouble of hiring an employee in its own rolls would have insisted on some mark-up or margin being given to it, over and above the actual cost.* ***In the absence of such a mark-up/margin, the payments received against debit notes by one employer-company upon the other employer-companies, will not partake the character***

[1] JM Financial Services Vs. Commissioner of Service Tax, Mumbai – CESTAT
[2] Franco Indian Pharmaceutical (P) Ltd. Vs. Commissioner of Service Tax, Mumbai – CESTAT

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of consideration for any service, but will merely represent reimbursement of shared costs."

Tax Neutrality Argument

Moreover, the entire exercise of valuation of common services is revenue neutral as Input tax credits (ITCs) shall be available even if Service Tax is discharged by registered persons. This aspect was examined by Gujarat High Court. It was held[3]:

"*The grievance was that the aspect of undervaluation has not been considered by the Tribunal at all.* ***Grievance would have merited acceptance if the ultimate exercise would have benefited the Revenue by collection of duty in the coffers of the exchequer. In the facts of the present case, admittedly no such benefit accrues to the exchequer. In the circumstances, if the Tribunal has chosen not to determine an academic issue, it is not possible to state that any legal infirmity exists in the impugned order of the Tribunal***."

This was further reiterated by Ahmedabad bench of CESTAT where it was held as follows[4]:

"***Even if any additional duty was payable the same was also available as credit to the recipient of goods. It is an exercise entirely covered by the concept of revenue neutrality****, as per the case laws relied upon by the respondent. Secondly,* ***in the event of credit being admissible to the recipient of the same group of companies it cannot be held that there could be any intention on the part of the respondent to evade payment of duty*** *and accordingly extended period is not attracted in the present demands*."

In view of above Rulings, perhaps one could argue that common expenses incurred by HO for the branches should not be considered as 'supply'.

Alternative Approach II: Valuation of Common Services

GST law prescribes that where the supplier and recipient are not related, the value of 'supply' shall be the transaction value. However, supplies between HO and its branches are supplies between related/ 'distinct' persons and the transaction value cannot be relied upon. In such cases, the value of supply as per Rule 28 of CGST rules shall be (in this order):

(i) Open Market Value (OMV); or
(ii) Value of Supply of 'like kind and quality'; or
(iii) Value determined under Rule 30 or Rule 31 (Rule 30 prescribes a 10% mark-up on cost and Rule 31 is the residual method)

The proviso to this rule is of significance which provides that where recipients are entitled to full input tax credit, the value declared in the invoice is deemed to be OMV. In other words, in a case of supply between related parties or distinct persons – the supplier is free to determine the price on its own, as the transaction is revenue neutral. At the same time, the transaction between branches shall not have any impact on the overall GST liability of the company. However, GST law mandates that invoice at some value should still be issued and GST should also be paid on the invoice value.

Way Forward

There are no judicial precedents on valuation of common services under GST and the decisions under Service tax may have little persuasive value. Service Tax was a centrally administrated law wherein revenue accrued to the Centre alone whereas under GST, tax has to be shared between Centre and States equally which raises questions peculiar to GST regime. For

[3] Commissioner of CCEx and Customs Vs. Indeos ABS Limited – Gujarat High Court
[4] Commissioner of CCEx Vs. Reclamation Welding Limited – CESTAT

example, can revenue neutrality argument be applied when branches are spread across different States – each being a separate tax jurisdiction under GST law?

While it could be argued that common expenses incurred by HO should not be considered as 'supply', it may be an aggressive view subject to dispute, especially at lower levels of tax administration. Further, one should not lose sight of the fact that the GST law prescribes penalties for providing services without raising invoice and collecting GST. It is imperative that corporate management takes an informed decision taking into account multiple factors such as risk appetite, quantum of common expenses and possible penal consequences.

The information contained in this newsletter is solely intended to provide general guidance on matters of interest. Nothing herein constitutes professional or legal advice, nor does any information herein constitute a comprehensive or complete statement of the issues discussed. It is recommended that you seek a professional advice to confirm your understanding on the issues dealt above.