The Curious Case of Advance Rulings on Recovery from Employees

The recent ruling pronounced by the GST Authority for Advance Rulings, Kerala on the taxability of recoveries made from employees by the employer will have an enormous rippling effect across the industry. It will trigger aspects of employer-employee relationship which, till now, seemed innocuous and outside the purview of GST.

The Ruling

The ruling essentially covers only the recovery made by the employer for food provided in the canteen run by it. Taking into account the facts that such canteen is mandatorily required to be provided under the Factories Act, 1948 and that the recovery is made purely at cost and there is no profit mark-up element involved, the ruling has considered this service as a taxable service under GST. Simple enough ? Or so it seems.

What the Ruling did not cover

As the Authorities tend to attend to jurisprudence of the matter, this ruling also merely examines the issue put before it and does not cover within its ambit as to what will be the position of law if the recovery made is only partial and the balance is subsidized by the employer, or what happens if no recovery is made at all ? Surely, these, and many more questions are puzzling the legal minds grappling with finding solutions to such ambiguities.

The Law

The GST law specifically covers services by an employee to the employer in the course or in relation to his employment as an activity that will be not be considered as a supply of either goods or services and consequently, any consideration flowing from the employer to the employee in this regard will not be taxed under GST. *[Schedule III to CGST Act, 2017]*. At the same time, the law also defines "related persons" to cover employer and employee and goes on to lay down taxability of the transactions of supply between related persons even if done without consideration, if made in the course or furtherance of business. *[Schedule I to CGST Act, 2017]*. It further lays down the principles of valuation when transactions are undertaken between related persons, with or without consideration. *[Section 15 of CGST Act, 2017 read with Rule 28 of CGST Rules, 2017]*.

The Ripples

The clarification given by the authorities in its press release dated July 10, 2017 must be kept in mind which stated that supply by the employer to the employee in terms of contractual agreement entered into between the employer and the employee, will not be subjected to GST.
Now, with the ruling, the entire set of activities between the employer and employee have been put to the test of taxability, whether or not forming part of the employment contract. Though the ruling

is silent as to whether such a recovery was part of the employment contract or not, would the ruling have been any different if it had been so ?

And the ripples do not stop here. What will be the value attributed to any activity for the purposes of taxation will also be questioned due to coverage of this transaction as a transaction between "related persons". The law lays down arm's length or market price of similar goods or services. So where full recovery is not made, taxability of a higher amount seems to be the order of the day, raising the cost of employment for the employers, especially in cases where the input tax credit is not permissible by law viz. in case of providing club and health and fitness services. Though it has been clarified in the press release by Government that such services for which credit is blocked in the hands of employer will not attract GST liability if the same has been provided to all employees *"free of cost",* but this also has open threads as to what will be the impact if employer recovers actual or subsidized cost from the employees for such facilities.

There is also the issue of activities which extend beyond the employee viz. medical insurance of family of the employee. Would the premium attributable towards the insurance of family be treated as a taxable supply by the employer to the employee ? Or say, the usage of the car provided by the employer to the employee for employment use, but also used by the family ? Would such transactions be considered as supplies provided to persons other than the employee and taxed ? Troublesome times ahead for sure!

To take the analogy of the ruling forward, how will the taxman consider supply of laptop, working station and other amenities in the office to the employee ? Surely these are in the course of the employment, but like an unwritten rule. Absurd to even consider it ? Maybe yes, but then, as in the case of the ruling given and under discussion here, even providing food in a canteen is a statutory responsibility of the employer. So if the Authority for Advance Rulings (AAR) can take a view for this, then what stops the parallel being drawn on other issues ? As it is, AAR is a quasi-judicial process and can only be questioned in a court of law. It would be quite interesting to see AAR of another State giving a contrary ruling, more in line with the settled position of erstwhile laws.

Conclusion

It is extremely challenging to determine the element of supply in the day-to-day activities between employer and employee. It will require the careful attention and microscopic scrutiny of every activity vis-à-vis the employee to ensure due compliance of law. It would augur well for this new law, the government and the business community if the issue is dealt with swiftly and suitable clarifications provided, before more productive time is diverted to such non-productive deliberations.

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