



A Monthly Journal of
**The Chamber of
Tax Consultants**

THE CHAMBER'S JOURNAL

Your Monthly Companion on Tax & Allied Subjects

Vol. XII | No. 12 | September 2024

GST LANDSCAPE - ISSUES & CHALLENGES



Log on to The Chamber's website for
Online payment for programmes

www.ctconline.org

GST on Related Party Transactions: A Comprehensive Analysis



Kumar Visalaksh
Advocate



CA Ashish Garg

Overview

In the GST Regime related party transactions has emerged as one of the key issues of dispute. The challenge has been particularly compounded by the underlying law which treats related party transactions as supply regardless of presence of consideration. This article delves into complexities surrounding GST implications on such transactions, focusing on chargeability, valuation, and the key open issues. We also examine judicial precedents and recent clarifications issued by Central Board of Indirect Taxes and Customs (CBIC), which are shaping the interpretation qua GST implication in this context.

Inevitably in the course of any investigation/audit carried out by the GST department, related party transactions invariably attract closer scrutiny. Gathering from our experience in last seven years, few prominent issues analysed in this article are - (a) Corporate guarantees, (b) Right to use of brand name, trademarks, and other intellectual property by related entities, and (c) Secondment of employees by overseas group entity.

The introduction of Goods and Services Tax (GST) in India in July 2017 was a pivotal moment in the country's tax reform journey, streamlining various indirect taxes into a single, unified system. While GST has significantly contributed to improving ease of doing business by simplifying the indirect tax structure, it has also brought to the forefront several contentious issues that persisted under the previous indirect tax regime as well. Among these, the treatment of related party transactions particularly remains susceptible to disputes sparking debates regarding both - the applicability of tax and the mechanism for valuing such transactions.

This article delves into complexities surrounding GST implications on related

party transactions, focusing on chargeability, valuation, and the key open issues. We also examine judicial precedents and recent clarifications issued by Central Board of Indirect Taxes and Customs (CBIC), which are shaping the interpretation qua GST implications in this context.

I. Overview of Relevant Provisions

Definition of Related Persons

Under the Central Goods and Services Tax Act, 2017 ('CGST Act'), the term "related person" is broadly defined under the explanation to Section 15. This definition includes, among others, legally recognized business partners, employer-employee relationships, any person

who directly or indirectly owns/controls 25% of the equity, entities under common control, and members of the same family.

Owing to the broad definition - determining whether the entities are related or not become crucial, as it directly influences the valuation and chargeability of GST on transactions between them.

Chargeability of GST on Related Party Transactions

The chargeability of GST is primarily governed by Section 7 of the CGST Act, which defines the scope of the term "supply". According to Section 7, supply includes all forms of transactions such as sale, transfer, license, rental, exchange, etc., provided they are made or agreed to be made for consideration by a person in the course or furtherance of business.

However, transactions specified in Schedule I of the CGST Act are treated as supplies even if they are made without consideration. Schedule I notably includes transactions between related persons within its scope. This provision enables the levy of GST on related party transactions, regardless of presence of monetary consideration. Introduction of related party transaction in Schedule – I signifies a substantial shift in the tax position qua levy and valuation from the service tax regime.

Valuation of Related Party Transactions

The valuation of supply under GST is governed by Section 15 of the CGST Act. For standard transactions, Section 15(1) stipulates that the value of supply shall be the "transaction value", which refers to the price actually paid or payable, provided the parties are not related and the price is the sole consideration. However, when the value cannot be determined under Section 15(1), the valuation is to be made in accordance

with manner as prescribed under the Central Goods and Services Tax Rules, 2017 ('CGST Rules'). Accordingly, for valuation of related party transactions – evaluation of valuation rules become imperative.

Rule 28 of the CGST Rules sets forth the mechanism for valuing supplies between related entities. The rule prescribes a hierarchical approach to valuation: first, by determining the Open Market Value (OMV); if the OMV cannot be ascertained, then by applying the value of goods/services of like kind and quality; if neither of these methods is feasible, the cost-plus method (Rule 30) or the residual method (Rule 31) can be applied.

Notably, the terms "OMV" and "supply like kind and quality" are further clarified in the explanations to the valuation rules. OMV refers to the full value in money, excluding GST, payable by a person in a transaction, where supplier and recipient are not related and price is the sole consideration, to obtain such supply at the same time when the supply being valued is made. "Supply of like kind and quality" means any other supply of goods/services made under similar circumstances, which in respect of the characteristics, quality, quantity, functional components, materials, reputation, etc. is same or closely resembles that supply of goods/services.

Additionally, Qua OMV, the second proviso to Rule 28 is particularly noteworthy. It states that if the recipient of the supply is eligible for full input tax credit (ITC), the value declared on the invoice shall be deemed to be the OMV. This provision aims to reduce disputes over valuation in cases where the recipient is entitled to full ITC.

The complexities inherent in these provisions render the valuation of related party transactions one of the most intricate aspects of GST law.

II. Key Open Issues

Inevitably in the course of any investigation/audit carried out by the GST department, related party transactions invariably attract closer scrutiny. Gathering from our experience in last seven years, few prominent issues are - (a) Corporate guarantees, (b) Right to use of brand name, trademarks, and other intellectual property by related entities, and (c) Secondment of employees by overseas group entity.

A. Corporate Guarantee

Corporate guarantee between group companies has emerged as one of the key issues in recent times. The core issue in these arrangements is whether such guarantees constitute a supply of services under GST law.

"Corporate Guarantee" is a common practice in the corporate world, often provided by a holding company for its subsidiary. These guarantees are typically issued when a subsidiary seeks to secure a loan, such as a term loan or working capital loan, from a financial institution. Such guarantees are generally provided without any charge or consideration, with the main objective being to enable the subsidiary to quickly access funds from lenders.

In 2023, insertion of sub rule (2) to Rule 28 actually compounded the complexity of the issue. Sub rule (2) for the first time prescribed a value of 1% of the amount of such guarantee offered, or the actual consideration, whichever is higher - as the value of supply of service by way of providing corporate guarantee to any banking company or financial institution by a person who is a related and located in India.

In this context, CBIC vide **Circular No. 204/16/2023-GST dated 27.10.2023** ('Circular No. 204/2023') *inter-alia* stated that in all such cases of supply of services by a holding

company to a subsidiary company in the form of providing corporate guarantee to a bank/financial institution, the taxable value will henceforth be determined as per the provisions of Rule 28(2), irrespective of whether full ITC is available to the recipient of services or not.

The effect of Rule 28(2) and CBIC circular is that providing a corporate guarantee on behalf of a subsidiary (to a bank or financial institution) is presumed to be taxable supply of services, with a prescribed value of 1% of the guaranteed amount without any timeline or prescription of payment.

Recently, Rule 28(2) has been retrospectively amended (w.e.f. 26.10.2023) by **Notification No. 12/2024 - Central Tax dated 10.07.2024** and a proviso is inserted to provided that where the recipient is eligible for full ITC, the value declared on the invoice shall be deemed to be the value of said supply of services. It also provided that value of 1% shall be calculated on amount of such guarantee offered per annum.

Additionally, CBIC vide **Circular No. 225/19/2024-GST dated 11.07.2024**, *qua* valuation of corporate guarantee *inter-alia* clarified that - **(a)** For corporate guarantees issued or renewed before 26.10.2023, the valuation would be determined based on Rule 28 as it existed at that time, **(b)** In cases where full ITC is available to the recipient, the value declared on the invoice shall be deemed to be the value of supply of the said service.

This retrospective amendment and circular offer some relief, particularly in cases where the subsidiary (recipient of supply) is eligible for full ITC, as it is clarified that the deeming provisions under Rule 28(2) mandatorily will not apply. Moreover, in such cases any value declared on the invoice should be considered as the OMV.

Despite this, the underlying issue that whether the provision of corporate guarantee constitute a supply of services on merits still persist. Rule 28(2) presumes that providing a corporate guarantee on behalf of a subsidiary constitutes a taxable supply of services under the CGST Act. However, basis the following grounds it can be contended that the said activity should not be considered a supply of services:

- a) These guarantees are issued by the holding Company to protect its own investments, by enabling the subsidiary to source funding and improving its creditworthiness. The subsidiaries may not have the appropriate financial bandwidth to borrow money from financial institutions without a guarantee.
- b) Providing a corporate guarantee can be seen as a quasi-capital or "shareholder activity". For this reason, even under the erstwhile Service Tax regime, the same was not taxed a service to the subsidiary and is also not treated as a "provision of services" under the Transfer Pricing provisions of the Income-tax Act.
- c) Rule 28(2) as far as the same provides for a deemed valuation is manifestly arbitrary, beyond the provisions of the CGST Act, and results in an excessive and confiscatory levy.

Therefore, the assessee may consider challenging the legality of Rule 28(2) and the Circular No. 204/2023 by approaching the jurisdictional High Court or the appellate authority as the case may be. High Courts have already admitted writ petitions on this issue, and in a case, the effect and operation of Circular No. 204/2023 have been stayed.

B. Use of Brand Name, Trademarks, and Other Intellectual Property by Related Entities

Another arrangement between related entities - which is susceptible to dispute - under GST law is qua the grant of right to use of intellectual property, such as brand names, trademarks, and logos, by one group entity to the other. The primary issue centres on whether the grant of such right to use constitutes a taxable supply of services, and if so, how such a supply should be valued.

Recent media reports suggest that GST authorities have issued notices to large conglomerates and banking entities qua these arrangements. The department's stance is that the grant of the right to use a brand name to a related entity, even without consideration, constitutes a supply of service.

Whether these arrangements qualify as a separate supply or not depends on various underlying factors, such as the commercial relation between entities, purposes of granting the right to use, etc. However, given the broad definition of supply under GST, particularly for related party transactions, the right to use a brand name by a related party may in general qualify as a "supply" even in the absence of monetary consideration. However, the valuation of such transactions remains a complex issue.

As discussed above, the valuation of related party transaction is to be made at OMV. A perusal of the definition of OMV suggests that same is the price at which supply of services is made when the supplier and recipient are not related, and the price is the sole consideration. Essentially, OMV is the full monetary value of services payable by an unrelated person for "such supply" at the same time when the supply being valued is made.

Qua these transactions, the biggest challenge is to arrive at a OMV as not only each brand is unique but it is unlikely that same trademark simultaneously also offered to an unrelated entity. Additionally, as grant of the right to use a trademark is intangible in nature, factors like quantity, functionality, and materials are not applicable. Moreover, the reputation and quality associated with a particular brand are unique characteristics that cannot be easily compared to another brand. Hence, determining the OMV of such supplies, or even the value of a supply of like kind and quality, may not be feasible task.

In absence of availability of OMV and value of supply of like kind and quality, for the purposes of valuation one may go further down in the hierarchy prescribed under Rule 28, which states that value can be determined as per Rule 31 (residual method). Under the residual method, while no specific methodology is prescribed, the overall principle which emerges is that the value adopted should be at arm's length.

The assessee may, therefore - as one of the alternatives - identify companies engaged in similar activities and attempt to draw a comparison with the consideration or royalty charged or paid by those companies for the use of a brand name. This comparison may require adjustments to account for differences specific to the comparable entities and factors unique to the assessee.

To arrive at the arm's length price, the assessee may also consider conducting a study and preparing a report outlining the methodology used to select comparable companies, the value attributed to the use of the brand name, and various transfer pricing principles, including those relating to arm's length pricing. However, this exercise is not a easy one. Although, it is noteworthy that by virtue of second proviso to Rule 28 - in cases

where full ITC is available, the value declared on the invoice should ideally not be subject to litigation by the department.

C. *Secondment of Employees*

The issue of employee secondment, where employees of a parent company are seconded to a subsidiary or associate company is also one of the contentious matter under GST. The key question revolves around whether such secondment constitutes a supply of manpower services and consequently attracts GST.

Typically, in a secondment arrangement, expatriates from a foreign parent company are deputed to an Indian subsidiary. The foreign and Indian entities enter into a secondment agreement that governs the terms of the arrangement. This is often accompanied by a separate employment agreement between the secondee and the Indian entity, specifying the terms of employment such as tenure, place of work, salary, and termination.

Under the GST regime, similar to the erstwhile service tax regime, services provided by an employer to its employee are excluded from the scope of supply. Various Tribunal orders in the service tax regime have held that secondees work under the control and supervision of the Indian entity as employees, with no direct or indirect consideration paid by the Indian entity to the foreign entity. Therefore, these transactions would not qualify as manpower supply services.

However, the Judgment of Hon'ble Supreme Court in the case of ***CCE & ST Bangalore (Adjudication) vs. Northern Operating Systems Private Limited [2022 SCC Online SC 658]***, unsettled the said legal position which had been previously followed by the Tribunals in a catena of judicial precedents. The Court, applying the "substance over form" principle, held that the secondment of

employees from an overseas group company to an Indian company would attract service tax under reverse charge.

It is crucial to note that the decision in Northern Operating was based on the specific facts of that case. There was a "service agreement" between the group companies for back-office support services, where the Indian entity received a 15% markup on the overall expenses. Given these particular circumstances, the Supreme Court observed that the overseas group company's business required highly skilled personnel to fulfill its contracts. The Indian entity's role was to execute specific tasks assigned by the overseas company. As part of this agreement, employees of the overseas company were seconded to the Indian entity for the required duration to complete the tasks. The salaries of these seconded employees were paid by the overseas entity and subsequently reimbursed by the Indian entity. On these facts, the Court concluded that "the overseas employer, in relation to its business, deploys them to the assessee on secondment".

Despite the Northern Operating judgment being fact-specific, it has triggered widespread investigations and notices by tax authorities. Given the similarities between the provisions under GST and Service Tax regime qua applicability of tax on import of services, the issue has also surfaced under GST, with the department scrutinizing secondment arrangements and attempting to levy GST under RCM based on this judgment.

To address these challenges and contest the tax demand on its merits, it become crucial to distinguish the facts of one's case from the Northern Operating. Accordingly, it is advisable to carefully analyse the existing secondment agreements, focusing on whether the arrangement constitutes an employer-employee relationship or a supply of

manpower services. Key factors to consider include the control and supervision of the employees, the method of salary payment, and whether the Indian entity has the right to accept or reject specific secondees. Depending on the specifics of each case, taxpayers can advance their arguments to establish that arrangement should not be treated as a supply of manpower services. In fact, on similar lines, the writ petition preferred by the taxpayers are pending before various high courts and certain cases the stay has also been granted on the recovery proceedings.

Additionally, in case where full ITC is available, a contention can be made that the valuation of such services ought to be determined in accordance with the second proviso to Rule 28(2) of the CGST Rules. Further, in this regard reference can be made to **Circular No.210/4/2024-GST dated 26.06.2024 ('Circular No. 210/2024')** wherein it is clarified that where the foreign affiliate is providing certain services to the related domestic entity, and full ITC is available the value declared on the self-invoice may be deemed as OMV. Further, if the self-invoice is not issued - the value of such services may be deemed to be declared as 'Nil'.

Accordingly, as the parties in a secondment arrangement are related, taxpayers (if full ITC is available) basis the Circular No.210/2024 can contest the GST demand under RCM by applying Rule 28 and valuing the secondment services at NIL, resulting in no GST liability.

Further, for future transactions, it is essential to clearly set out the secondment agreements in a manner that clearly establishes the existence of an employer-employee relationship. Key factors which can be considered while drafting such agreement are – **(a)** the entities having operational and functional control on the employee, **(b)** period

of secondment, and (c) manner or remitting salary.

These factors will be crucial in establishing whether the arrangement constitutes an employer-employee relationship or a supply of manpower services subject to the levy of GST.

III. Conclusion

GST on related party transactions remains one of the most complex and evolving areas of GST law. The wide scope of the term “supply”, coupled with the detailed valuation rules, in certain transactions presents a unique set of challenges in evaluating related party dealings.

Recent CBIC clarifications vide Circulars have provided some relief in cases involving full ITC, however, the interpretation of "full

ITC" in itself remains a potential point of contention. On one hand, it could be argued that full ITC eligibility should be assessed with respect to the specific transaction for which the valuation is being made. Conversely, department may argue that eligibility should be assessed at the entity level. This ambiguity can lead to differing interpretations, making this aspect of valuation particularly susceptible to disputes.

Thus, Companies must be vigilant while formulating the agreements with related entities. In many cases, prior to finalisation of such agreements - it may be prudent to conduct detailed examination from the GST perspective. Ultimately, the key to navigating these challenges lies in a proactive approach— careful planning.

Comments from Tax Head



Mr. Rajesh Gosain, Head of Tax, Ericsson India.

“Related party transactions under GST present significant challenges and frequently attract heightened scrutiny from GST authorities. The broad definition of "related persons" under the GST Law, combined with the provision that such transactions are deemed taxable supplies even in the absence of consideration, adds substantial complexity to GST compliances.

Valuation of these transactions remains a particular concern, especially for services. For instance, determining the OMV for intangible assets like IPR often proves difficult, particularly when no comparable transactions are available. Although recent CBIC clarifications have provided some relief, further advisory guidance on best practices for valuing related party transactions would be beneficial.

Further, introducing a standardized approach to defining "full ITC" eligibility will aid in bring more consistency and reducing the likelihood of litigations. By implementing these measures, the government can support businesses in navigating GST compliances in relation to related party transactions more effectively. This article deals with burning issues surrounding the controversy and is a good read.”

