



Impact of GST Valuation on sharing of Cost between Group Companies



S KHAITAN & ASSOCIATES

SHUBHAM KHAITAN

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SHARING OF COST BETWEEN GROUP

COMPANIES

One of the major areas of dispute during the Service tax regime has been the valuation of the goods and services which are commonly used by group companies. The impact and allocation of GST for these group companies will also be a major aspect under the current regime. The approach to be followed here depends on whether the goods/services have been outsourced from third party or have been provided internally.

Valuation of goods and services which are outsourced from third party

Various goods and services are procured by group companies from third parties. To analyse the valuation of these goods and services, there can be two approaches which can be evaluated here.

The first approach is that the expenses may be incurred by any of the companies. However, upon following the basis of factor costing for the relevant cost, such cost may be divided among the two companies. There may be internal adjustments of the payments periodically for the differential between the amount incurred and the amount apportioned based on the factor cost. In this cost sharing method, the reimbursement will be on actual expenditure basis and there is no profit element involved. However, this approach is not free from litigation. There have been innumerable judicial cases under Service tax which have arisen under this approach. This will be because the invoice may be in the name of one of the companies and the Input tax credit has to be availed by that company as well. However, the expenditure may have to be recognized in another company's books because of the apportionment using factor costing. Reconciliation statement between the audited

financial statements and the returns as per the GST regime to be filed for every financial year under the GST regime may also not depict the right picture. This can result in raising of questions by the Department.

The second approach is that the expenses should be incurred by only one company and it should avail the complete input tax credit. In turn, that company should raise an invoice on the other company for the portion of services that has been received by that other company. To find the basis of such service, the factor costing technique should be used once again. For each nature of expense, the basis of apportionment should be found out. Once this basis is known, the actual cost that has been incurred can be known using the books of accounts. Thereafter, using the basis of apportionment, the actual cost to be apportioned to the other company can be found out. Then, the company which has incurred that cost can raise an invoice for the cost apportionable to the other company. Taxes charged by one company in the invoice will be availed by the other. So, the matter will be profit neutral for the group as a whole. At the same time, it will lower chances of litigation as one company is paying taxes for the services provided to the other. So, this is the recommended approach that should be followed for dividing of cost between two companies.

For the purpose of exact valuation as per the GST law, one should also refer to Section 15 of the CGST Act, 2017. As per the said section, the value of supply of goods or services has been stated to be the transaction value i.e. the price actually paid or payable for the said supply where supplier and recipient are not related and the price is the sole consideration. Group companies will always be considered as related persons as per the explanation to Section 15. In the case of related persons, one may need to refer to Rule 28 of the CGST Rules, 2017. As per the said rule:

“The value of the supply of goods or services or both between distinct persons as specified in sub-section (4) and (5) of section 25 or where the supplier and recipient are related, other than where the supply is made through an agent, shall-

(a) be the open market value of such supply;

(b) if the open market value is not available, be the value of supply of goods or

services of like kind and quality;

(c) if the value is not determinable under clause (a) or (b), be the value as determined by the application of rule 30 or rule 31, in that order:

Provided that where the goods are intended for further supply as such by the recipient, the value shall, at the option of the supplier, be an amount equivalent to ninety percent of the price charged for the supply of goods of like kind and quality by the recipient to his customer not being a related person:

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.”

As per the provisions given above, open market value should be given the first priority if the recipient and supplier are related. Open market value has been defined to be the following:

“open market value” of a supply of goods or services or both means the full value in money, excluding the integrated tax, central tax, State tax, Union territory tax and the cess payable by a person in a transaction, where the supplier and the recipient of the supply are not related and the price is the sole consideration, to obtain such supply at the same time when the supply being valued is made;”

Hence, OMV basically refers to the supply of such services in a situation where the supplier and recipient are not related and price is the sole consideration.

However, as per the proviso to Rule 28 of the CGST Rules, 2017, it should be mentioned here that the value mentioned as per the invoice will be deemed to be the open market value. Once, the open market value is determinable, one need not refer to the other provisions of the rules for determining the taxable value.

When the cost is incurred by one company by procuring services from third party, the value charged can be considered as the open market value. This is because the transaction occurs between the supplier and the recipient wherein both are not related and price is the sole consideration. One should find the proportion to be allocated to the other company depending on the nature of cost using factor costing.

Then this proportion so arrived should be used to apportion the cost using the value adopted in the transaction with the third party. To further secure the matter, the law allows any value as adopted in the invoice to be the taxable value when the recipient is eligible for full input tax credit in a related party transaction.

Valuation of goods and services provided internally

Various facilities owned by one company can be used by the other for running its operations. For the expenses incurred regularly, the apportionment of cost has already been discussed above. However, for the usage of the facilities, a separate charge should be levied by one company to the other. It is pertinent that a suitable value should be adopted for the usage of these facilities for the purpose of charging GST.

As per Section 15 of the CGST Act, 2017, the value of supply of goods or services has been stated to be the transaction value i.e. the price actually paid or payable for the said supply where supplier and recipient are not related and the price is the sole consideration. Group companies will always be considered as related persons as per the explanation to Section 15. In the case of related persons, one may need to refer to Rule 28 of the CGST Rules, 2017. As per the said rule:

“The value of the supply of goods or services or both between distinct persons as specified in sub-section (4) and (5) of section 25 or where the supplier and recipient are related, other than where the supply is made through an agent, shall-

(a) be the open market value of such supply;

(b) if the open market value is not available, be the value of supply of goods or services of like kind and quality;

(c) if the value is not determinable under clause (a) or (b), be the value as determined by the application of rule 30 or rule 31, in that order:

Provided that where the goods are intended for further supply as such by the recipient, the value shall, at the option of the supplier, be an amount equivalent to ninety percent of the price charged for the supply of goods of like kind and quality by the recipient to his customer not being a related person:

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.”

As per the provisions given above, open market value should be given the first priority if the recipient and supplier are related. Open market value has been defined to be the following:

“open market value” of a supply of goods or services or both means the full value in money, excluding the integrated tax, central tax, State tax, Union territory tax and the cess payable by a person in a transaction, where the supplier and the recipient of the supply are not related and the price is the sole consideration, to obtain such supply at the same time when the supply being valued is made;”

Hence, OMV basically refers to the supply of such services in a situation where the supplier and recipient are not related and price is the sole consideration.

If OMV is not available, then the supply of goods or services or both of like kind and quality should be taken. It may be extremely difficult to find the value of similar goods or services in the given case as the erected plant and machinery being transferred may not be an openly tradable good.

One should refer to Rule 30 if the valuation cannot be arrived on the basis of the open market value and value of supply of goods or services of like kind and quality. Rule 30 mentions that the value taken should be 110% of the cost of production or manufacture or the cost of acquisition of goods or cost of provision of services.

If the value cannot be determined by Rule 30 either, one can determine the valuation on the basis of reasonable means consistent with the principles and the general provisions of section 15 and the rules. The supplier of services has an option to avail this rule avoiding Rule 30 completely.

However, as per the proviso to Rule 28 of the CGST Rules, 2017, it should be mentioned here that the value mentioned as per the invoice will be deemed to be the open market value. Once, the open market value is determinable, one need not refer to other provisions of the rules for determining the taxable value.

Conclusion

It may be emphasized that the valuation mentioned in all the above cases have been opined based on the provisions of the GST law. As far as practicable, the methods to be adopted for finding the correct market value has been recommended. However, the decision relating to the arm's length prices should only be taken after complying with the relevant provisions of transfer pricing.

Shubham Khaitan

B.Com(Hons), ACA, ACS, CFA(US), DISA(ICAI)

Partner, Tax & Regulatory

S. Khaitan & Associates | Chartered Accountants

T: +91 33 4068 7062 | M: +91 9831912725

E: shubham@cakhaitan.com

A: Mookerjee House, 2nd Floor

17, Brabourne Road, Kolkata 700 001

W: www.cakhaitan.com



REGD OFFICE : 24/25, RUPCHAND ROY STREET,
3RD FLOOR,
KOLKATA – 700007

ADMIN OFFICE : MOOKERJEE HOUSE,
17, BRABOURNE ROAD, 2NDFLOOR
KOLKATA - 700001

PHONE NO : 03340687062, +919831912725

EMAIL ID : info@cakhaitan.com
shubham@cakhaitan.com

WEBSITE : www.cakhaitan.com