'Global IDT Chronicles': VAT Treatment of Employee Recoveries: An Insight into Global Scenario – Part I

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'Employee rewards and perks' has always been a contentious issue, irrespective of pre-GST era or during! Recently, the Maharashtra Authority of Advance Ruling ('AAR'), has rendered a ruling in case of **Tata Motors Ltd. [TS-745-AAR-2020-NT]** on employee recoveries, which is a welcome one for the assessees. In this write-up, our Global IDT Chronicles contributor **Sindhu Mangat (Advocate, Swamy Associates)** takes a deep dive into the VAT provisions governing employer–employee supplies across the globe.

Deliberating on the all-encompassing definition of 'service', the author highlights that all jurisdictions while implementing VAT had kept the services by employee to employer as falling outside the taxable scope of supply of goods or services. Nonetheless, employers rendering canteen, transportation facility, gifts, uniforms, medical insurance etc. had to face the litmus test of whether such 'supplies' would be liable to VAT/GST in the hands of the employer.' Plunging into the quagmire of nuances in this respect, the author outlines two scenarios, viz. (a) Salary Sacrifice or reduction in Salary scheme and (b) Salary Deduction schemes while discussing the VAT implications flowing from such arrangements in certain foreign jurisdictions with reference to important case laws on the subject. Further, Ms. Mangat takes us through UK VAT Tribunal's decision in the case of **Co-operative Insurance Society [1992] (VTD 109)** wherein HMRC had attempted to tax the supplies under Salary Sacrifice agreements but the Tribunal had held that no VAT was due on the value of the service supplied, which position was reversed by the landmark European Court of Justice (ECJ) judgment in **AstraZeneca UK Ltd v HMRC Case C-40/09 EC J**. In this context, author glides through the concepts discussed in the judgment and HMRC's consolidated stand on employee recovery, following the ECJ judgment.

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The Maharashtra Advance Ruling authority, In re Tata Motors Limited [1] has recently given a ruling to the effect that there is no GST applicable on recovery of nominal transportation fee by employer from its employees. The ruling favors non applicability of GST referring to Sl. No. 1 of Schedule III to the CGST Act, 2017. As per said entry the *services by an employee to the employer in the course of or in relation to his employment* is kept outside the levy of GST by classifying same as neither supply of goods nor supply of services.

The ruling, though has favored assesee, raises few important questions. The first and foremost is that while determining the GST applicability of an amount in the hands of employer, how far reliance can be placed on Sl. No of Schedule III, which is intended to exclude services of employee from clutches of GST levy. On a plain reading, an activity of service by an employee in course of employment is out of scope of GST levy and hence the natural consequence is that any consideration attributable to payment for such service is not to be subject to tax. The consideration for such service, under terms of employment, may be expressed in terms of money or be in form of non monetary benefits. The question therefore is, whether the blanket test is to address the issue from the point of employee and classify transactions as falling within or out of consideration attributable to employment Or whether the transaction is to be analysed from an angle whether the activity constitutes a taxable supply in course of business or commerce of employer.

A look at the vat provisions governing employer –employee supplies across globe points to a conclusion that there is a point from which the privileged exclusion of consideration attributable to contract of employment is delinked and supplies effected by employer to employee are made accountable for VAT. The legislative and judicial approach on the issue has tilted either ways - treating supplies by employer as consideration in kind in return for services of employee Or the supplies constituting a taxable activity in the hands of employer irrespective consideration being attributable to be part of salary or wages of employee.

Before plunging to the quagmire of nuances, one should, for the sake of basic awareness, understand that the all encompassing definition of 'service' as *anything other than goods*, necessitated reclassification of several activities not having a strictly commercial angle as either made liable for tax, exempted from tax or excluded from scope of tax (out of scope supplies). Though activities performed by an employee under a contract of employment fell within the definition of 'service', an attempt to subject same to tax, would run contrary to the concept of taxing only transactions amounting to business (economic activity). An employee engaged in an activity amounting to service for earning livelihood cannot be classified as a business or economic activity. Therefore all jurisdictions while implementing VAT had kept the services by employee to employer as falling outside the taxable scope of supply of goods or services.

But unfortunately, on the flip side, the employer, while effecting various supplies to employees, in lieu of salary or by making deductions from salary , had to face the issue whether such 'supplies' would also qualify as 'supplies' made by a taxable person in course of his business or economic activity. For example the supply of canteen facility, transportation facilities, uniforms, medical insurance, vouchers , other perks and gifts to employees had to face the litmus test of whether constituting 'supply liable for VAT/GST in the hands of the employer.

On basis of commonly recognized arrangements, the situations where employers effect supplies to their employees arise in following two scenarios:

- ***'Salary Sacrifice or reduction in Salary scheme' ; and (b) Salary Deduction schemes***

In a Salary Sacrifice arrangement an employee opts to receive optional non cash benefits provided by the employer and forgoes part of their salary in return. Example - cars, Redeemable retail vouchers as sodexo etc. This arrangement is characterized by the fact that the employment contract will specifically mention about such salary sacrifice arrangements. The employee in return for the benefit is agreeing for a reduced 'take-home' salary. In other words the salary is divided in to cash and non cash components.

The second mode of arrangement is through deduction from salary. In this arrangement an amount is deducted from an employee's pay in return for a supply of goods or services by the employer. Example: Canteen facility, gym membership etc. Such deductions are not conspicuously mentioned in terms of employment.

The present discussion addresses, VAT implications flowing from above arrangements in certain foreign jurisdictions with reference to some important caselaws on the subject.

A perusal of VAT treatment of employer supplies under UK VAT would show that though HMRC had attempted to tax the supplies under Salary Sacrifice agreements, decision of VAT Tribunal in the case of *Co-operative Insurance Society [1992] (VTD 109)* held that where an employee negotiated their salary to include certain services (use of a car) but then received a reduced salary (a salary sacrifice) , this was part of their employment contract and no VAT was due on the value of the service supplied.

This position was reversed after a period of 19 years, by the landmark Judgment of European Court of Justice (ECJ) in the matter of *AstraZeneca UK Ltd v HMRC Case C-40/09 ECJ*[2] . The VAT treatment of supplies by employers in UK can now be classified with reference to this case , as period before 'Astra Zeneca' and 'after Astra Zeneca. The Judgment dealt with VAT applicability of redeemable retail vouchers received by employees under 'Salary Sacrifice arrangements'.

Astra Zeneca , a pharmaceutical company, as part of its salary package, offered its employees, the option of receiving a portion of salary as retail vouchers which could be redeemed at retail outlets. The appellant, initially, did not charge VAT on supply of such vouchers, neither took input tax credit of VAT suffered on purchase of such vouchers. Subsequently they had proceeded with claims for recovery of VAT incurred on purchase on ground that same constitutes a business expense. The revenue had proceeded with assessment on ground that appellant is required to pay VAT on supply of vouchers.

ECJ, while holding that the employer has effected a taxable supply of vouchers to employees, has applied the following principles to the factual scenario:

-A company when it provides vouchers to its employees in exchange for them giving up part of their cash remuneration carries out an economic activity. The scope of the term economic activities is very wide, and that the term is ***objective*** *in character, in the sense that the activity is considered per se and without regard to its purpose or results.*

- the transaction can be classified as supply of services, since classification as supply of goods is ruled out because the do not immediately transfer right to dispose of any property.

-The element of 'consideration' has been held as satisfied as there was a direct link between the service provided and the consideration received. The direct link is established when the employees give up part of their cash remuneration in return for retail vouchers.

The above Judgment, therefore, applied the core concepts of supply, service and consideration to receipt of non cash benefit by the employee. Following the Judgment, HMRC has consolidated their stand on employee recovery as follows[3]:

- *Where deductions are made from salary for goods or services provided by an employer to their employees they are liable for VAT irrespective of whether deduction is under a salary deduction or*

salary sacrifice arrangement;

- *The remuneration an employee forgoes is consideration for the taxable benefits provided and output VAT will be due from and input VAT recoverable by the employer in accordance with the normal rules;*
- *Where the true value is not reflected, the value should be based on the cost to the employer;*
- *Where the supplies are given free to employees, there is no liability for VAT. Therefore, if food etc are supplied free to employees, there is no liability on part of employer to pay GST.*

But, inspite of above, it is interesting to note that the UK Upper tribunal has taken a different view and held salary sacrifice arrangements as not attracting VAT in the matter of The Commissioner for Her Majesty's *Revenue and Customs Vs. Pertemps Limited****[4]****.*

(..to be continued in Part 2)

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[1] https://www.mahagst.gov.in/sites/default/files/ddq/GST%20ARA%20ORDER%20-%20TATA%20MOTORS%20LIMITED_0.pdf

[2] https://assets.publishing.service.gov.uk/media/5d4adf1340f0b65a08207306/HMRC_v_Pertemps_Ltd.pdf?_ga=2.87313688.1460321607.1566897120-1076255770.1549463974

[3] https://www.gov.uk/hmrc-internal-manuals/vat-supply-and-consideration/vatsc05880

[4] https://assets.publishing.service.gov.uk/media/5d4adf1340f0b65a08207306/HMRC_v_Pertemps_Ltd.pdf