

Taxability of Liaison Office under GST

Liaison office is a viable option for the foreign company proposing to enter the Indian market for the first time to undertake exploratory activities and analyze the growth potential and connect with prospective customers/ vendors without undertaking any commercial activity as such with cost of maintaining such liaison office, being met out of funds repatriated by Head Office. From GST perspective, challenges exist with regard to taxability of liaison office This article attempts to present an in-depth analysis of the governing provisions for liaison office and to address issues. Read more...



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Goods and Services Tax Act ('GST'), a very big reform is at present in fourth year of implementation. The act which aimed to simplify the taxation process has evolved over time to address the footraces in its path by rationalizing the rate structure, further simplification of compliance norms, ease of doing business and addressing the anomalies in the provisions by issuing requisite notifications / circulars as and when required. However, still there are numerous issues that need to be elucidated to avoid issues among the taxpayers. This article attempts to explain one such uncertainty pertaining to taxability of liaison office under GST.

A foreign company may initiate business in India by setting up a liaison office to explore Indian market for their potential opportunities to invest and establish business presence in India. Establishment of liaison office in India by foreign entities is governed by Reserve Bank of India under Foreign Exchange Management (Establishment in India of a branch office or a liaison office or a project office or any other place of business) Regulations, 2016. These regulations define 'liaison office' as:

"a place of business which act as a communication channel between the principal place of business or



Head Office located outside India and entities in India

Under the RBI guidelines, liaison offices cannot undertake any commercial /trading/ industrial activity, directly or indirectly, and must maintain itself out of inward remittances received from abroad through normal banking channel.

Activities which can be undertaken by liaison office are specified in Schedule II of the regulations, which are listed under:

- i. Representing the parent company / group companies in India.
- ii. Promoting export / import from / to India.
- iii. Promoting technical/ financial collaborations between parent / group companies and companies in India.
- iv. Acting as a communication channel between the parent company and Indian companies.

Therefore, entire administrative expenses like rent, security, electricity etc. including salary expenses of Indian liaison office are met by foreign parent entity. It merely acts an executing arm of the head office and do not have resources to carry on the business activity.

Taxability in GST

In order to understand GST taxability on above transaction, let us first analyse whether the liaison office has the capabilities to carryout activities of the nature that would constitute 'supply' liable to GST. Section 7 of the Central Goods and Services Tax Act, 2017 defines the term supply, which reads as under: -

7. (1) For the purposes of this Act, the expression "supply" includes-

- (a) *all forms of supply of goods or services or both such as sale, transfer, barter, exchange, licence, rental, lease or disposal made or agreed to be made for a consideration by a person in the course or furtherance of business;*
- (b) *import of services for a consideration whether or not in the course or furtherance of business and;*
- (c) *the activities specified in Schedule I, made or agreed to be made without a consideration*

It may be worthwhile to mention that 'place of business' under the GST law includes

- (a) *a place from where the business is ordinarily carried on, and includes a warehouse, a godown or any other place where a taxable person stores his goods, supplies or receives goods or services or both; or*
- (b) *a place where a taxable person maintains his books of account; or*
- (c) *a place where a taxable person is engaged in business through an agent, by whatever name called.*

Further, Section 2(50) defines "fixed establishment" as a place (other than the registered place of business) which is characterised by a sufficient degree of permanence and suitable structure in terms of human and technical resources to supply services, or to receive and use services for its own needs.

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In the given scenario, liaison office is not undertaking any activity per se on its own. It cannot generate any income in India as per the RBI guidelines. In the absence of consideration, it cannot be termed as supply under Section 7(1)(a). Therefore, reference would now be drawn to Schedule I which list down certain activities which would constitute supply even if there is no component of consideration.

Entry 2 of Schedule I of the CGST Act, 2017 specifies supply of services between related parties or distinct persons as specified under Section 25, even without consideration, constitute a supply, when made in the course or furtherance of business.

Now the term related parties are defined under explanation to Section 15 of the CGST Act which specifies as under:

- “(a) persons shall be deemed to be ‘related persons’ if—
- (i) such persons are officers or directors of one another’s businesses;
 - (ii) such persons are legally recognised partners in business;
 - (iii) such persons are employer and employee;
 - (iv) any person directly or indirectly owns, controls or holds twenty-five per cent. or more of the outstanding voting stock or shares of both of them;
 - (v) one of them directly or indirectly controls the other;
 - (vi) both of them are directly or indirectly controlled by a third person;
 - (vii) together they directly or indirectly control a third person; or
 - (viii) they are members of the same family;
- (c) persons who are associated in the business of one another in that one is the sole agent or sole distributor or sole concessionaire, howsoever described, of the other, shall be deemed to be related.”

Further, relevant extract of distinct persons as specified under Section 25 is enumerated below:

“(4) A person who has obtained or is required to obtain more than one registration, whether in one State or Union territory or more than one State or Union territory shall, in respect of each such registration, be treated as distinct persons for the purposes of this Act.

(5) Where a person who has obtained or is required to obtain registration in a State or Union territory in respect of an establishment, has an establishment in another State or Union territory, then such establishments shall be treated as establishments of distinct persons for the purposes of this Act.”

Given above legal provisions, careful analysis would be required to determine whether liaison office and foreign entity would be treated as related parties or distinct person to attract GST applicability. This is one of the gray area which needs to be addressed under GST.

There are two school of thoughts in this regard, first being the liaison office is nothing more than an extended arm of the Head office and performs no separate functions other than those specified and approved by the RBI. It has been established for the ease of communication between Indian counterparts and the foreign entity, accordingly the liaison office is neither related nor distinct persons as it is only one legal entity and no relationship can be established. There cannot be a flow of services inter se the liaison office and head office as it amounts to ‘no supply’ and therefore, the reimbursement of expenses made by the foreign head office cannot be treated as a consideration towards any service.

However, another view is that liaison office and head office related in terms of explanation (c) to Section 15 of the CGST Act and scope of business, as defined in Section 2(17) of CGST Act is wide enough to include the activities or transactions which are incidental to the main activity of trade, commerce, manufacture, profession etc. And since the

liaison office is involved in promoting the business of foreign entity in India, it would constitute ‘SUPPLY’ under GST.

Once supply gets attracted, one need to analyse the requirement of getting registered under GST which is governed under Section 22 of the CGST Act, 2017. In case the aggregate turnover in a financial year exceeds the prescribed threshold limit, registration provisions gets attracted.

Survey of AARs

There are divergent advance rulings under GST regime which are pronounced by Authority for Advance Ruling to determine taxability of GST on transactions by liaison office. Some of the advance rulings are listed below for ease of reference:

1. M/S Habufa Meubelen B.V. 2018 (7) TMI 883 – Authority for Advance Ruling – Rajasthan

Issue placed before Rajasthan Advance ruling authority was whether the reimbursement of expenses and salary paid by foreign Head Office (HO) to the liaison office established in India is liable to GST as supply of service, when no consideration for any



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services is charged/ paid and whether the registration requirement would get attracted.

It was decided that in the given case, the applicant does not have any other source of income and it is solely dependent on the HO for all its expenses which are subsequently reimbursed by the HO. Therefore, HO and liaison office cannot be treated as separate persons as there cannot be any flow of services between them as one cannot provide service to self and the reimbursement of expenses made by the HO cannot be treated as a consideration towards any service.

Further, as there are no taxable supplies made



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by the liaison office, they are not required to get registered.

2. M/S. Takko Holding GMBH 2018 (10) TMI 1315 – Authority For Advance Ruling – Tamil Nadu

On similar issue relating to discharge of GST by liaison office, Tamil Nadu authority for advance ruling held that the applicant is acting as an extension of the German Office in its procurement activities from suppliers in India as has been spelt out in the RBI permission letter. Hence, they are neither related nor distinct persons, but are in fact working as employees of the foreign office. Accordingly, none of the liaison activities of the applicant is covered under the definition of supply, no GST leviable.

3. M/S. Wilhelm Fricke Se 2021 (1) TMI 690 - Authority For Advance Ruling, Haryana

Issued place before the advance ruling authority was whether the reimbursement of expenses and salary paid by Wilhelm Fricke SE, Germany to the liaison office established in India is considered as supply of services as per Section (7) of the CGST Act, 2017 or under Schedule I of CGST Act, 2017, especially when no consideration is charged/ paid.

It was decided that since there is no commission/ fees being charged or any other remuneration being received/ income being earned by the office in India for the liaison activities/ services rendered by it, the HO and Liaison Office cannot be treated as separate persons. The amount received from HO are the funds for payment of salary, reimbursement of expenses like rent, security, electricity, travelling, etc. No consideration is being charged by the applicant from the HO for such services.

4. M/S. Fraunhofer-Gesellschaft Zur Forderung Der Angewandten Forschung 2021 (1) TMI 690 - Authority For Advance Ruling, Haryana

It was held that Section 2 (17) (a) of the CGST Act 2017 stipulates that “*business*” includes any trade, commerce, manufacture, profession, vocation, adventure, wager or any other similar activity, whether or not it is for a pecuniary benefit. Further “*business*” also includes any activity or transaction in connection with or incidental or ancillary to sub-clause (a), in terms of Section 2(17) (b) of the CGST Act 2017. Accordingly, liaison activity falls within the ambit of business.

Further, applicant and head office are deemed to be related in terms of explanation (c) of Section 15 of the CGST Act as they act on behalf of its head office for its customers in India. Thus, the activities of the applicant squarely fit to be treated as supply in terms of Section 7(1)(c) of the of CGST Act 2017, even in the absence of consideration.

The supply of services by the applicant amount to inter-state supply of services in terms of Section 7(5) of the IGST Act 2017. Further persons making any inter-state taxable supply shall be required to be registered compulsorily in terms of Section 24 of the CGST Act 2017.

It is pertinent to note that Karnataka Appellate AAR has set aside the order of AAR stating that liaison office is a place of business to act as a communication channel between the head office and does not generate any income / commission / remuneration. A service rendered to self cannot come within the purview of supply under GST.



Reasons and Reconciliation of Rulings

Given the above contrary pronouncements by Authority for Advance ruling, it is quite evident that such decisions add to unwarranted litigation and sows the seeds of doubt among taxpayers.

The conflict is not something that can be admitted as a disharmony which will sort itself out in due course to pay GST on the repatriation of cost of maintenance of GST while still maintaining the assertion about the nature of activity to be compliant with extant regulation under FEMA. Income-tax will likely step in to expect that this 'underlying activity' being admitted, albeit for GST purposes, to be in the nature of business, would be liable to foreign corporations' tax and be compliant with transfer pricing regulations. All these compliances render the undertaking given to FEMA void. As such, Applicants must review their presentation of facts and make amends to the nature of activities undertake so as squeeze out any semblance of business in India so that repatriation (of cost of maintenance of liaison offices) steers clear of 'supply'. And when a transaction is not supply, flow of money will not be consideration.

Conclusion

Extant regulations in FEMA is a policy statement of the Government to welcome foreign capital to undertake exploratory



Extant regulations in FEMA is a policy statement of the Government to welcome foreign capital to undertake exploratory and non-commercial activities before they make a decision to invest and set-up commercial activities in India.

and non-commercial activities before they make a decision to invest and set-up commercial activities in India. Business is, therefore, understood not as expenditure in a foreign jurisdiction but an enterprise with its own 'income generating capacity' that is created in such jurisdiction.

It appears that a liaison office that pays GST on the repatriation (of cost of its maintenance) and even pays Income-tax on an arm's length price would stand of forfeit its status as liaison office and become a branch office or other form of permanent establishment. And the definition of fixed establishment and distinct persons in GST would be a cause of concern for 'liaison offices'.

To conclude, a clarification from the government on this issue will surely be helpful in preventing cognizance of these rulings and will aim to bring more clarity. ■■■