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CHARTERED ACCOUNTANTS

Gifts, Discounts, Credits & Impact Thereof

- Contributed by CA Sri Harsha

Section 17(5) of Central Goods & Services Tax Act, 17 (for brevity CT Act) deals with blocked credits. The said section starts with non-obstinate clause overriding the general provisions of Section 16 of CT Act which deals with credit entitlements. In other words, despite of the fact that a particular goods or input services is used for furtherance of business, the credit of tax paid on such items shall not be entitled if such item is mentioned vide Section 17(5). In this article, we try to analyse, the sub-section (h) of Section 17(5) with the help of certain recent advance rulings.

Section 17(5)(h) states that input tax credit shall not be available with respect to goods lost, stolen, destroyed, written off or disposed by way of gift or free samples. That is to say, if a supplier who has purchased certain goods and disposed the same by way of gift or free samples, the supplier is not entitled to take credit despite of the fact such gifts or free samples would yield additional business to the supplier. With the above basics in place, let us proceed to examine certain advance rulings to better understand the ambit of Section 17(5)(h).

We have picked up four rulings of Authority for Advance Rulings (AAR) for the purpose of this write up. Among four rulings, three emanate from Maharashtra AAR and the one is from Kerala AAR.

Biostadt India Limited's Ruling – Maharashtra AAR
(20 Dec 18)

The applicant is engaged in business of developing, manufacturing and distributing crop protection chemicals and hybrid seeds. In order to achieve sales and marketing objectives, the applicant has launched various target based – sales incentive schemes for their distributors and retailers. The said schemes help the customers to be motivated to achieve a specified target and in turn helps the applicant to achieve their sales targets. Basis above, the applicant has announced two schemes, wherein the distributors or retailers would be entitled to gold coins depending upon the quantity of the products they lift from applicant and the time period in which they make payments for such products to applicant.

Applicants are purchasing gold coins from registered vendors and paying applicable tax on said purchases. The question before the AAR was whether the said tax paid on purchase of gold coins which is used to reward the distributor or retailers is entitled for availment of credit? The applicant believes that said credit of tax paid on gold coins can be availed as credit since the same is used for furtherance of his business. Further, applicant believes that said gold coins cannot be called as 'gifts' to fall under the blocked credits vide Section 17(5)(h), for the reason that 'gift' is a gratuitous payment and does not involve any consideration. Once a consideration is attached to a transaction, then it cannot be called as 'gift'. The applicant further states that gold coins are not gifted just like that to the retailers. Only if the retailer or distributor satisfies certain conditions, then he is entitled for gold coins, otherwise he would not. Hence, the applicant believes that gold coins are not 'gifts' and accordingly not covered vide Section 17(5)(h) and hence credit of taxes paid can be availed.

The contention of the jurisdictional officer was that since the gold coins are not given in furtherance of business, the said are nothing but pure gifts and accordingly the credit of taxes paid cannot be availed as credit by the applicant. The concerned officer has designed a three question set to decide when a transaction can be called as in course or furtherance of business and applied such questions to the applicant's case and decided that applicant has failed to satisfy such questions and accordingly the transaction of purchase of gold coins is not an activity in course or furtherance of business. Further the concerned officer has also stated that if the gold coins are given as discounts and recorded as a contractual obligation in the invoice/documents, then the credit of taxes paid on purchase of gold coins can be availed as it does not amounts to gifts in such case (more about this later).

The AAR after hearing both the views has stated that the intention under GST laws is non-granting/denial of setoff is envisaged in situations where there is no tax on output supply. The AAR held that in cases where the goods are procured with levy of input tax and are supplied without tax being paid on such output supplies, the scheme of GST act provides no input tax credit, except export.

The AAR further held that the applicant's contention that they have contractual arrangement with the retailer wherein if the distributor purchases certain amount of company's product or makes payment, then he shall be entitled to a gold coin. This can be inferred as if the distributor of the applicant is providing services of increased sale for which consideration is in the form of gold coin and applicant has failed to prove that he has paid tax on such output supply[1] and hence the gold coins are nothing but gifts and accordingly credit of taxes paid cannot be availed by applicant.

Polycab Wires Private Limited's Ruling – Kerala AAR
(02 March 19)

The applicant is a dealer in electrical goods, cables of all kinds including wires, pipes etc. The applicant has supplied electrical items to Kerala State Electricity Board (KSEB) through their distributors spread across the state in connection with reinstating connectivity in the flood ridden areas as part of the 'mission reconnect'. The materials are supplied free of cost as a part of Corporate Social Responsibility (CSR) activity. The applicant states that the distributors raised bills on applicant in relation to the materials supplies free of cost to KSEB. The distributors issued tax invoices to KSEB showing sale value, GST and total amount with 100% discount. The GST liability on such invoices was paid to government. The applicant believes that since the tax liability is paid to the government, the distributors are eligible to take the credit on such items at the time of purchase. The applicant reimbursed the total amounts to the distributors and accounted the same as donation in kind towards CSR expenses for Kerala Flood Relief, 2018.

The AAR has held that since the distributors valued the goods and shown such value as discount and paid tax on values (prior to the discount) and distributor claiming the total amounts which is offered as discount from the applicant, the distributor is entitled to claim input tax credit on the goods cleared to KSEB. Further, AAR also held that applicant's another activity, where in certain electrical items like switches, fans, cables etc to flood affected people under CSR expenses on free basis without collecting any money, the applicant is not entitled to avail credit, since such free supplies fall under the ambit of Section 17(5)(h).

Sanofi India Limited's Ruling – Kerala AAR

[1] The view of AAR is that since applicant is receiving consideration from distributor not wholly in money because the distributor is also providing certain services to applicant, the applicant would have paid tax on such non-monetary consideration (services provided by distributor) while discharging tax on his outward supplies in accordance with rules for valuation. Since applicant has not paid such tax, the credit of gold coins cannot be availed.

(24 April 19)

The applicant is engaged in business of sale of pharmaceutical goods and services through group entities during the course of which they incur various marketing and distribution expenses, with a view to promote their brand/products and to enhance their sales under various schemes. The applicant distributes different types of products among its trade channels as promotional items or brand remainders. Applicant inter-alia, runs two promotional schemes namely 'Shubh Labh Trade Loyalty Program' and 'Brand Reminders Products'. The applicant states that vide 'Shubh Labh Trade Loyalty Program', the distributors based on their sales volume will be awarded reward points. Based on their reward points, distributors can redeem either goods or services. Once the distributor intimates his intention to applicant, the applicant purchases such goods or services and gives them to the distributors. For example, if the distributor is eligible for a watch based on his reward points, the distributor places a request that he wishes to redeem his reward points against the watch. The applicant then buys such watch and gives them to the distributor. Vide the 'Brand Reminders Products', the applicant distributes products like pens, notepad, key chains to distributors or doctors with their name embossed on it to promote brand and sales. The applicant states that he purchases all the products by paying appropriate taxes and the question before AAR is whether such taxes paid can be availed as credit.

The applicant believes that all such products which are given as part of marketing and promotional activity vide the two schemes are for the furtherance of business and hence the same are eligible for credit. Applicant states that the said items are not hit by the provisions of Section 17(5)(h) since they are not in the nature of 'gifts'. Since these items are not distributed on the voluntary basis and only out of contractual obligation, such items cannot be held as 'gifts' and accordingly credit is eligible on such items.

The jurisdictional officer states that such products are given as free supplies and since there is no consideration the same would not be supply in terms of Section 9 of CT Act. Further, the officer states that such supplies merit classification of 'exempt supply' and accordingly credit pertaining to exempt supplies in terms of Section 17(2) cannot be availed. The officer also states that in light of provisions of Section 17(5)(h), credit is restricted in terms of goods disposed by way of gifts, credit cannot be availed. The officer also states that the applicant is not signing any contract with the customers so that to call such distribution as arising out of contractual obligation.

The AAR after hearing both the views has held similar to its earlier ruling in the matter of Biostadt India Limited (supra). The AAR also has considered the submission made by applicant in light of the Circular 92/11/2019-GST dated 7th March 19, wherein it was clarified that supplier would be eligible for credits even in the case of post supply/volume discounts, if the other conditions mentioned in section 15(3) are satisfied. AAR has held that the circular deals with instances of discounts, which is not the facts in the applicant's case.

Golden Tobacco Limited's Ruling –Maharashtra AAR
(04 May 19)

The applicant is seller of cigarettes. The applicant was planning to introduce a promotional scheme, wherein if a distributor buys 100 packs of cigarettes, he will be entitled for additional 10 packs of cigarettes without any further cost. The distributor will pay for 100 packs and will receive 110 packs. The applicant makes two individual supplies, 100 packs and 10 packs at a price of 100 packs. The applicant also states that there will be also instances of staggered discounts, like, if a distributor buys

1000 packs of cigarettes, they would be entitled, say 150 packs of instead of regular 100 packs. Here also the distributor pays for 1000 packs but gets 1150 packs. The applicant proposes to pay tax only on 100 packs or 1000 packs and not on the additional cigarettes. The applicant believes that there is no requirement to reverse the credit pertaining to the additional cigarettes which were given to distributors even though there is no separate consideration for the same. The applicant believes that the additional pack of cigarettes which is being given to distributors was in the nature of discount and since the same is shown on the face of invoice, there is neither obligation to pay tax on the same or reverse the credit to the extent of such additional packs.

The jurisdictional officer believes that the benefit of reduction of discount from the invoice value is available for the recipient of supply and not for the supplier and put forwards his contention by quoting an illustration. He states if the supplier is making a supply of Rs 1,000/- on which 15% additional goods are being given as discount, then the supplier is required to pay tax on Rs 1,150/- and not on Rs 1,000/-. Then he proceeds to state that the recipient of supply would be entitled to take credit of full tax paid by him to supplier that is Rs 115/- (assuming rate of tax is 10%) and then reverse the credit of Rs 15/- is the same is attributable to the discount portion of Rs 150/-.

The AAR after hearing both the views, has stated that the contentions of applicant are found to be in accordance with the Circular 92/11/2019-GST, wherein it was clarified that the additional packs would not be an individual supply of free goods but a case of two or more individual supplies where a single price is being charged for the entire supply. It can be best treated as supplying two goods for the price of one. In such a case, the taxability of such supply will be dependent upon as to whether the supply is composite or mixed supply. The AAR therefore held that there is no requirement to pay tax on additional packs and the additional packs will not be considered as exempt supplies or free samples and accordingly the credit need not be reversed in terms of either Section 17(2) or Section 17(5)(h).

Circular 92 and Circular 105:

The Central Board of Indirect Taxes & Customs (CBIC) has issued two circulars on the subject issue.

Vide Circular 92, it is clarified that if goods are given as free samples or gifts, the same would not be treated as supply in terms of Section 7, in absence of consideration. Further, in terms of Section 17(5)(h), the credit pertaining to such free samples and gifts cannot be availed.

Circular 92 also clarified that in cases of 'buy one get one free', 'buy more save more', there is no individual supply of free goods and it is two or more individual supplies at a single price. It can at best be treated as supplying two goods for the price of one. If such two supplies for a price of one is a composite supply, then the principal supply would be taxable and if it is a mixed supply, the supply will be charged with item having highest tax rate. Further, the Circular also clarified that if the conditions mentioned in Section 15(3) are satisfied, then such value of goods can be reduced from the value of supply and supplier is not under obligation to reverse any credit.

Vide Circular 105, it is clarified that if the discount given by the supplier of goods to the dealer/distributor is for the post sale incentive requiring the dealer to do some act like undertaking special sales drive, advertisement campaign, exhibition etc., then such transaction would be a separate transaction and the additional discount will be the consideration for undertaking such activity and therefore would be in relation to supply of services by dealer/distributor to the supplier of goods and tax has to be paid on such supply. However, if the discount is extended to dealer/distributor without any further obligation or action required from the dealer/distributor's end, then the post discount given by the supplier of goods will be excluded from the value of supply subject to satisfaction of other conditions mentioned in Section 15(3).

Conclusion:

From the reading of all rulings and circulars issued in this connection, the taxpayer should have in place robust documentation to prove the bonafides of the benefits extended to the dealer/distributor. If the tax authorities categorise them as gifts to the dealers/distributors [as in matter of Biostadt India Limited (supra)], the taxpayer cannot avail the credit on such items. However, if the taxpayer can impress the tax authorities that such items are not gifts, but are given as contractual obligation with the dealer/distributor, then the value of such items will be reduced from the value of supply and also the taxpayer is not under an obligation to reverse the credit pertaining to such items. At the same time, the taxpayer has to make sure that if such items/gifts/discounts are given to dealer/distributor for additional services, then he has to appraise the dealer/distributor about the potential tax liability in the hands of the later. All said and done, the documentation is what saves the taxpayer from potential tax liability or reversal of credit.

CBIC should also clarify in situation where the discounts/incentives are offered by supplier of goods to dealers/distributors for receiving certain post sales activity, whether the supplier of goods is also liable to pay tax on such additional services received by him in terms of valuation rules, since the supplier of goods is receiving consideration not wholly in money but also non-monetary consideration in form of services from the dealer/distributor and the dealer/distributor takes such tax paid as credit and raises another invoice on the supplier of goods as contemplated by Circular 105 (in similar lines to builder and landowner transactions under joint development model). This assumes importance because the Maharashtra AAR in couples of rulings (supra) has brought this issue while deciding the eligibility of credit of gifts and other items.