

## Reimbursement of additional discounts liable to GST?

### *In Re. Santhosh Distributors*<sup>1</sup>

The issue before the Appellate Authority for Advance Ruling, Kerala ('AAAR') was the taxability of discounts reimbursed by Castrol India Limited to its authorised dealer (i.e., 'the Appellant'), against supplies made by the Appellant at discounted price to its customers.

#### **Facts of the case:**

- M/s Santhosh Distributors ('Appellant') an authorised dealer of Castrol India Limited ('Principal'), is engaged in the supply of Castrol-brand industrial and automotive lubricants.
- To augment sales volume, the Appellant supplied goods to its customers, at reduced prices ('SKU discounts'), in accordance with the scheme approved by the Principal. The Principal reimbursed the Appellant for such SKU discounts, through issuance of commercial credit notes.
- The Appellant filed an application with the Kerala Authority for Advance Ruling ('AAR') on the following questions:
  - a) Whether the SKU discounts offered by the Principal to the customers (via the Appellant) were taxable under GST;

b) Whether the Appellant was liable to reverse Input Tax Credit ('ITC') against the commercial credit notes issued by the Principal.

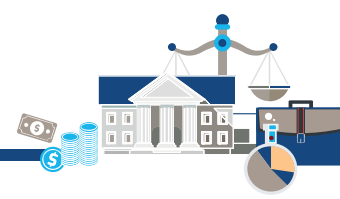
- Observing that SKU discounts offered by the Principal through the Appellant were intended to augment the sales volumes, the AAR held that these discounts were to be treated as an additional consideration flowing from the Principal. Hence, these amounts were liable to be added to the taxable value of supplies made by the Appellant to its customers. It was also observed that the Appellant was eligible to avail full ITC without undertaking any reversals.
- Aggrieved by the advance ruling, the Appellant filed an appeal before the AAAR.

#### **Judgement of the AAAR:**

Upholding the decision of the AAR, the AAAR held that in the present case, the additional discount (SKU discounts) given by the Principal to the customers through the Appellant attracted GST. The AAAR addressed the following questions (as part of the appeal):

- a) Whether the discount provided by the Principal to the customers through the Appellant attracted GST;

<sup>1</sup> TS-346-AAAR(Ker.)-2021-GST



- b) Whether the amount shown in the commercial credit notes issued to the Appellant attracted proportionate ITC reversals;
- c) Whether there was any GST liability on the Appellant for the reimbursements of SKU discounts provided by the Principal to the Appellant.

The appellate ruling was made on the following basis:

- The AAAR noted that the dispute in the instant case was regarding the taxability of post-sale SKU discounts, wherein the amount of discount was not agreed between the parties at the time of supply of goods.
- Referring to Section 15(3) of the Central Goods and Services Tax Act, 2017 ('CGST Act'), the AAAR observed that reduction in the 'taxable value' was allowed only on satisfaction of the following conditions:
  - a) The discount was established under an agreement entered before the time of supply and linked to relevant invoices; and
  - b) ITC attributable to the discount was reversed by the recipient.
- Further, it was elucidated that the quantum of 'post-sale' discounts offered by the supplier had to be pre-determined according to the agreement terms. In other words, the same could not be open ended or based on any criteria at the supplier's discretion. The AAAR observed that the SKU discounts being reimbursed by the Principal, after supply of goods, did not fulfil the twin requirements of Section 15(3) of the CGST Act. Hence, such reimbursements could not be considered as discount for the purposes of arriving at 'transaction value' under Section 15 of the CGST Act.
- It was held that commercial credit notes issued by the Principal would not be relevant for reducing the tax liability of the Principal. At the same time, the Appellant was not required to undertake ITC reversals in such a case.
- Importantly, the AAAR observed that additional discounts given by the Appellant and then

reimbursed by the Principal, are to be treated as a 'consideration' in terms of Section 2(31) of the CGST Act, since it is paid to offer the reduced price and augment the sales.

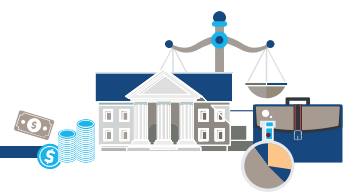
- The Appellant in this case had no discretion to decide the discount being offered to the customer and was offering the discount as specified by the Principal. Since the Principal decided upon such SKU discounts and then reimbursed the amount to the Appellant, the AAAR held that that it is an (additional) consideration paid by the Principal to the Appellants for making such supply and is liable to be taxed. Consequently, such discounts were liable to be added to the consideration for arriving at the taxable value of goods supplied to customers.
- It emerges that the customer would not be eligible to claim ITC of differential GST payable on such SKU discounts, since the appellate order states that ITC is available only to the extent of tax paid by the customer.

#### **Dhruva Comments:**

The Appellant was selling goods to its customers at prices pre-fixed by the Principal. Such pre-determined price was the sole 'consideration' which accrued to the Appellant against these sales-supplies, thus only such amount should be brought to tax.

Reimbursements offered against the SKU discounts are of the nature and character of discounts. Receipt from the Principal (by way of credit notes) does not deserve to be treated as an additional 'consideration' for a supply. The amounts depicted in credit notes are, in effect, an adjustment of the sale price between the Appellant and the Principal.

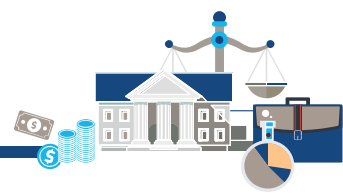
The AAAR has not appreciated that discounts of the kind referred to in this case are, effectively, a reduction in consideration for the supply made by the manufacturer-supplier. Commercially, the goods are supplied at a price lower than the price originally agreed between the parties. Favourable jurisprudence under the *erstwhile* indirect taxes regime is available, wherein the Courts, relying on common trade practice and the accounting policies adopted by assessee-companies, have held that such post-sale discounts are merely



price adjustments and the same cannot be treated as an 'additional consideration' against the original supply of goods.

Trade and industry will have to find a mechanism to pay appropriate tax considering the true nature of each arrangement, whilst administering discounting or incentive schemes, which are a standard feature of the commercial world.

Interestingly, the Central Government has identified this very issue (reimbursement of discounts by companies in the FMCG, consumer durables sectors) as being something that requires immediate attention.





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