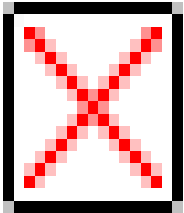


Post supply discount and ITC reversal - why this kerfuffle

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A Case Study

Let's describe a scenario where there are two layers in a transaction where post supply discounts are allowed by the supplier.

1. Manufacturer to dealer and
2. Dealer to customers
3. Vendor to Manufacturer

subject to Sec 15(3) (a)/(b) /Proviso to Sec 16 of the CGST Act.

1. Take the case of a Manufacturer to dealer transaction first

Suppose a manufacturer does not seek reduction in tax liability in an instance, either because of his helplessness or that of his dealer, to ensure that the burden of tax has not been passed on.

The Law is very strict in terms of Sec 33 read with Rule 46 of the rules requiring the Supplier to indicate prominently in the Invoice the tax amount forming part of the Price at which supply is made.

As a corollary to the above, as per Sec 49(9), every person who has paid tax unless the contrary is proved by him, be deemed to have passed on the full burden of tax to the recipient of the said transaction.

Thus the Manufacturer if unable to comply with the proviso to Sec 34(2), then he compensates the dealer by a price-off by issuing a commercial credit note, which would be outside the purview of GST. Then the original tax paid by the manufacturer and the ITC availed by the dealer, remain undisturbed.

But a question arises about taxability when there's a reverse supply visualized there, in the form of a service from the dealer if any, identifiable for the price-off benefit given to the dealer by the Manufacturer.

The original transaction is always linked to their relationship as Manufacturer-Dealer. So, there is one school of thought that says re-characterization of this relationship, from time to time to hive off new reverse supplies, on special occasions like sales drives/campaigns, and treat the amount parted from price by credit notes as consideration for a separate taxable activity, is the height of fiction.

It's not that such fiction was not tried out by the Department but had to be given up by withdrawing the practice recommended earlier by Circular No. [105/24/2019-GST](#) Dated the 28th June, 2019 by a subsequent Circular No. [112/31/2019-GST](#) dated 3rd October, 2019 by CBIC, as unworkable and litigious.

The said circular Supra, first figured out a reverse supply by the dealer in the form of a service for the discount given post sales by the Manufacturer.

It suggested use of the tax credit earned by the dealer at the time of original supply for squaring off his contrived tax liability on such reverse supply.

It recommended the price off given by the Manufacturer itself to be treated as consideration, to satisfy the requirement Rule 34(1) read with Proviso 2 to 16(2) to enable him to hold on to the tax reduction claimed consequent to the PSD allowed by him.

This proved to be absurd as you can't create this fictional reverse liability for all post supply discounts and hence the Advisory issued was withdrawn and the confusion whitewashed. But basic issues were left as it is to the tax payers to fend if not mend for themselves.

2. Coming to the next leg of the transaction i.e the dealer to the customer.

Here due to competition, the dealer is not allowed to sell below a certain price, so it's not possible to invoice below the market price.

Therefore, for the price-off given by the dealer to his customers, the dealers are shown special concessions by the Manufacturer like junkets and so on.

Hence it's a collective arrangement between the Manufacturer and the dealers, not to let the Prices slide below a certain level bench marked beforehand.

The customers at the dealer's end could be B2B or B2C. Credit would have been taken by the former to the extent shown in the Invoice and doesn't arise in the case of the latter namely B2C.

Financial credit notes have been widely accepted as a panacea for this problem. Hence discount to the dealers is passed on through private financial credit notes or junkets and the like.

The sub-point here is, whether manufacturer can avail credit on these junkets by way of air tickets and other expenses bulk booked by him for the dealers. The answer would be yes and No, depending upon the fact, in whose name it is billed. Be that as it may.

How to deal with the second leg of credit availed by B2B customers, if discount is passed on by GST credit notes by the manufacturer to the dealer. If dealers/final customers are not reversing credit, the manufacturers are targeted for action by the Department.

The scheme of discount is as per prior arrangement in writing and reflected at Invoice level as mandated under Sec 15(3)(b) (i) &(ii) and most importantly when the GSTR-1,2 & 3 are not in place.

If the GSTR-2 &3 were to be operative already, it would have ensured automatic reversal of credit in the hands of dealers/customers once credit note was issued and liability Ledger was deflated at the Manufacturer's end.

In the above backdrop, Zeroing in on the Manufacturer.to account for the non-reversal of ITC by the dealers/customers by the Department is clearly premature and acting out of jurisdiction.

Given the time, the reversals will always be accounted for by both the Manufacturer. and the dealer. So why this great hurry in breathing down the Manufacturers. is not appreciated by the Industry.

The B2C customer of the dealer is a one-time customer, so the dealer reserves his right to show him some Price -off by way of off-the-record concessions, which are hard to bring under the radar or can be accused of anti-profiteering as customer has not received any price reduction linked to Invoice or dealer claimed any reduction in tax liability.

But the B2B Customer of the dealer is not a one-time customer, so the dealer can't reserve his right to show him some Price-off by way of any off-the-record concessions but will have to give him a proper discount in his Invoice.

Since he has got a discount from the Manufacturer and therefore he is bound to pass on the same to the B2B customer, by way of issuing another GST Credit note like the one he got from the Manufacturer.

If the end customer of the dealer or the dealer himself doesn't reverse the credit for the discount, the Manufacturer can't be held responsible for the re-credit on the basis of the credit note he issued to the dealer.

Manufacturer. has to wait for the full cycle of reversal up to the end customer of dealer reversing the credit to have his reduction of tax liability claimed, is a point that makes no sense but being raised by the Department all the same and agitated by the Manufacturers.

The provision in the new GST Law about treatment of discounts though is clear and uniform across the country, the execution of the provision by the Department makes it more complicated than it already is to understand if not unclear by itself.

Mainly here, the supplier's benefit is completely dependent on an action or inaction, with regard to reversal of ITC, by the buyer. A supplier cannot have any control over the buyer's action on the treatment of discount in his books.

3. Last but not the least is the case of PSD from Vendor to Manufacturer.

The manufacturing firm is offered certain discount by its vendors in lieu of early payments. This is a post-supply discount which does not have any impact on the tax liability of the supplier, and manufacturing firm pays discounted price to vendors together with full GST to be charged on original price.

M/s MRF Ltd have preferred an application seeking Advance Ruling on Whether they can avail the ITC of the full GST charged on the supply of invoice or a proportionate reversal of the same is required in case of post purchase discount offered by their Vendors of the goods or services.

Tamil Nadu AAR holds vide its Order - [2019-TIOL-87-AAR-GST](#)

that applicant can avail ITC only to the extent of invoice value raised by suppliers less post purchase/invoice discount availed through C2FO model [an interactive automated data exchange which can be installed for data interaction relating to sale & purchase of goods and services between a Buyer (the Applicant-MRF) and a Supplier (Any supplier of goods or input services of the Applicant) in compliance to various ethical, accounting and business standards. Both the Supplier and Recipient of goods or services should register on the platform provided by C2FO model]

The AAR Observed that C2FO platform is a marketplace model where both applicant/recipient and his suppliers are registered but discounts offered are not mentioned in supply contract, though discounts are specifically linked to relevant invoices;

Accordingly, Section 15(3)(b) does not apply, therefore the value of supply in such transactions remains as 'full undiscounted value' mentioned in the invoice;

Referring proviso to Section 16, remarks that recipient is entitled to avail credit of ITC on payment made by him alone and if any amount is not paid and recipient has availed full credit, same would be added to his output tax liability;

Consequently, observes that if applicant "has availed input tax credit on the full amount, he should reverse the difference amount equal to the discount, to avoid adding to his output liability.

The above order was set aside in appeal by the AAAR - [2019-TIOL-61-AAAR-GST](#) as follows;

Considering the facts and circumstances of the appeal, the appellant M/s MRF Ltd can avail the Input Tax Credit of the full GST charged on the undiscounted supply invoice of goods/ services by their suppliers.

A proportionate reversal of the credit is not required to be done by them in case of a post purchase discount given by the supplier to them **through the C2FO platform, in the circumstances mentioned by them and discussed above.**

This is subject to their fulfilling the other conditions stipulated by law and that the GST paid by them for the said goods/ service is not reversed or reimbursed/ re-credited etc to them in any manner by the supplier or on his behalf, after the credit has been availed by M/s MRF.

The ruling is limited to cases where a post purchase discount is extended by the supplier of the goods or services to the appellant on account of their registering in the interactive automated data exchange arrangement setup by C2FO India LLP, which is the subject matter of this Advance Ruling.

The above decision viewed the C2F0 platform is a marketplace model where both applicant/recipient and his suppliers are registered but discounts offered are not mentioned in supply contract, in the event of discounts being specifically linked to relevant invoices are as good as mentioned in the supply contract, which the AAR failed to appreciate.

But if the above transaction was not coming under an electronic platform where suppliers and recipients of goods are not linked in such a manner, it would not suffice to let the Recipients take the ITC on the full undiscounted value.

But, to the contrary it would require proportionate reversal of ITC, involved on the Post supply discount offered through commercial Credit note route with no mention of it in the purchase Order or lacks Invoice level linking of the Post supply discount.

END NOTE

Solution for dealing with this situation could be that all transactions are recorded through originally planned GSTR-1, 2, 3 in the GSTN portal or by early introduction of a Simple comprehensive 3-in 1 return.

A mechanism that could possibly find a solution for the GST credit note issue and reversal of ITC on account of discount uploaded by the supplier would automatically reduce the ITC of the buyer.

To extend discounts after the supply has been made, various companies currently issue a commercial credit note (a credit note without adjustment of GST) for price adjustments in scenarios like post-supply discounts. The buyer pays GST on the full value of supply and doesn't usually claim a reduction of GST of the amount relating to the reduction in value.

Why all this kerfuffle by the Department in changing its stand back and forth issuing circulars; one in March [92/11/2019-GST](#) Dated the 7 March, 2019, clarifying a part of it in June by Circular No. [105/24/2019-GST](#) Dated the 28 June, 2019 and withdrawing it by the October Circular No. [112/31/2019-GST](#) dated 3rd October, 2019 and not explaining what it means by the remaining part of it left to linger, on the subject of the Post supply discounts and ITC reversals.

Most businesses have taken a stand on the above scenario to claim ITC of the entire GST paid by the supplier. The government should consider issuing an explicit clarification on the said issue also to avoid any unwarranted and prolonged litigation on this aspect.

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