



Credit eligibility on goods given under incentive schemes

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Introduction:

One of the major expenditures incurred in some of the industries is business promotion. This being a typical and a critical expenditure for many industries (i.e. even a small trader in such industry would have to incur such expense), innovation is the stress whereby business promotion schemes could take form of free goods being given or reward points being given or free trips being offered, etc. In the recent ruling given by the Karnataka Authority for Advance Ruling (AAR) in the case of Surfa Coats (India) Private Limited dated 12.09.2019 [2019 (10) TMI 568] it was ruled that free goods and services would not be eligible for input tax credit (ITC), being restricted u/s 17(5) of the CGST Act, 2017. Let us have a look at the said ruling and analyse in the light of the provisions and the business practices.

Facts:

1. The applicant is into the business of manufacturing **decorative paints** meant for interiors as well as on exterior surface. Applicant frames many incentive schemes like Painters Schemes, Dealers Incentive Schemes, Gold Schemes, Foreign and Local Trip Schemes etc. to survive in the existing market conditions in the industry and which motivate dealers to lift their products.
2. The incentives are given subject to fulfillment of terms laid down in each such scheme. The incentive once computed is mostly given in kind. The applicant purchases TVs, refrigerators, washing machines, mixers, wet grinders, watches, mobiles, gold coins, bed sheets etc., for distribution to painters and dealers in connection with the above said incentive schemes. Also, at times applicant offers foreign and local trips as incentives, for which they procure various tax suffered services. Further in the Gold scheme, the applicant gives gold to dealers once the actual sales are achieved by the dealers in terms of targets fixed.

Applicant's submission and query:

1. Such painter schemes are given by most of the paint companies to market their products and make their presence in the industry and the gold incentive scheme is given to the dealers based on the achievement of target sales which is moreover for sales promotion.



2. Therefore applicant states that these items are used in the course of furtherance of business only and not for sale and thus desires to have a ruling whether input tax credit (hereinafter referred to as 'ITC') is admissible on these incentive items bought and given in terms of schemes to promote company's product only.

Authority's observation and analysis:

3. The goods and services so procured and distributed as incentives or gifts are disposed **without any consideration** from dealers or painters and hence do not qualify to be a 'supply' in terms of Section 7 of the CGST Act, 2017 (hereinafter referred to as 'Act'). Further no GST is being paid on disposal of the said gift items.
4. Moreover, in terms of section 17(5) (h) of the Act, ITC is not allowed on any goods disposed of by way of free samples or gifts **whether or not in the course or furtherance of business.**
5. The free travel services provided are also without any consideration and hence do not qualify to be a "supply" in terms of section 7 of the CGST Act 2017 and Schedule 1 to the Act.
6. It is further clarified in para (A)(ii) of circular No.92/11/2019-GST dated 07.03.2019, that *"input tax credit shall not be available to the supplier on the inputs, input services and capital goods to the extent they are used in relation to the gifts or free samples distributed without any consideration"*

Ruling:

7. In the view of above facts and observations of Authority, it was ruled that the **applicant is not eligible to avail ITC** on the inward supplies of goods and services **which are attributable to the incentives** provided in the **form of gifts of goods and services to the painters and dealers** and other persons under the CGST / SGST / IGST Act.

Comments

The transaction between the applicant and its dealers is on principal to principal basis wherein the goods are sold to the dealers on an invoice, which are then sold by the dealer to its customers. In such a case, it is to be understood that any incentive or discount given would not partake the character of a separate supply or service as was always being held under the earlier laws, like in the case of Commissioner v. AIA Engineering Ltd. - 2016 (41) S.T.R. J262 (S.C.), Commissioner Of Service Tax, Mumbai-I



Versus Sai Service Station Ltd. 2014 (35) S.T.R. 625 (Tri. - Mumbai) and a host of other decisions.

Further, these incentives, discounts can be given either in monetary terms or in kind. In the instant case, the following are the incentives offered:

- a. Free gifts being goods,
- b. Gold coin given as per the terms of the agreement between the dealer and the applicant on reaching the target volumes, and
- c. Free trips being given, which are in the nature of free services.

The relevant provision under section 17(5) *ibid* restricting credit reads as below:

..... input tax credit shall not be available in respect of the following, namely:-.....(h) goods lost, stolen, destroyed, written off or disposed of by way of gift or free samples;

From the above, it is clear that for the credit to be restricted

- a. There should be a gift given, and
- b. Such gift should be that of goods.

Another aspect to be noted is that such goods are to be DISPOSED OF by way of gifts. What is the relevance of use the phrase 'disposed of'? The said phrase means getting rid of something that you no longer want or need. Can the said interpretation be taken whereby, unless anything useless is gifted (i.e. something no longer required), the restriction under section 17(5) *ibid* will not apply? Further, can it be said that the so called free goods are given in place of a monetary discount, in which case there can be no credit restriction as these discounts are not for any separate activity or given free, but are in relation to the supply already made by the Applicant (the original supply of goods by the Applicant to the dealer) which has suffered tax?

Another aspect to be considered is whether giving the goods free can be treated to be a barter transaction? No, for the reason that the said goods are not given for anything in return from the recipient, but it is in continuation of the sale transaction already made by the Applicant to the dealer. Hence, may not satisfy to be a barter also. These are extreme views which will have to be judicially tested.

Coming to the present case, following can be noted to enable credit w.r.t. the incentives given:

- a. Gold coins: Given as part of the agreement which cannot be considered as a gift as there is an obligation on part of the Applicant to give such gold coins on



fulfilment of the conditions stated. In this regard, important to note the press release dated 10.07.2017 wherein it was mentioned

*“Gift has not been defined in the GST law. In common parlance, gift is made without consideration, is voluntary in nature and is made occasionally. **It cannot be demanded as a matter of right** by the employee and the employee cannot move a court of law for obtaining a gift”*

On this count it can be stated that the credit relating to the gold coins given, which is an obligation on the Applicant, would be eligible as it does not partake the nature of a gift.

- b. Other free goods: If it cannot be shown that the other free goods given are an obligation, credit may not be eligible.
- c. Free trips: These are not goods and the restriction under section 17(5) *ibid* being only for the goods, credit will be eligible on the count that the said services are used in the course or furtherance of business. ‘Business’ is a very wide term as was held in a host of decisions under the earlier laws for the CENVAT eligibility before 01.04.2011. The free trips given could fall under the ambit of usage for business as it leads to increase in sales and thereby credit being eligible.

Further the circular referred to in the ruling does not mention credit will not be available on free goods and services but only mentions that the ITC of the goods and services used in relation to the gifts i.e. goods being given as gifts, as contained in section 17(5) *ibid*, would not be eligible. Thereby, reliance on the said circular is also not correct.

“input tax credit shall not be available to the supplier on the inputs, input services and capital goods to the extent they are used in relation to the gifts or free samples distributed without any consideration”

Further, as far as the mention in the ruling that since the free goods are given without consideration and there is no supply, credit is not eligible, it can be said that when the inputs and input services satisfy the condition of being used for business (being in relation to taxable supplies), it does not matter whether their transfer per-se is a supply or not.

Assuming that the mention in the ruling regarding liability under Schedule I to the Act is correct, in such case can the Applicant consider the free goods procured directly as an expense without taking it into stock whereby it would not be a business asset and thereby no liability to pay tax?



GST being a new law, there are a lot of areas where the trade and industry have moved ahead by taking conservative views. Further, the advance rulings give confirmation to such views (which in the view of the paper writers should not be taken too seriously to take business decisions). However, it is advised in case of huge stakes that before it is too late, a professional can be consulted to identify possible value additions considering the risks involved to take informed decisions.

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