Service Tax /GST on dealer Credits - An incredible attempt to Tax!

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"The oldest, shortest words – 'yes' and 'no' are those which require the most thought"- Pythagoras

The aforementioned thoughts of Pythagoras can be said to be taken most seriously by the tax authorities in India. While the industry is still to recover from the muddle of principles of taxation of passive actions[1]; the taxation of active actions is the new talk of the town[2] It is not an overstatement to term the tax authorities as the best cooks of a legal delicacy. The emerging controversy related to service tax / Goods and Services Tax ('GST') liability on post sales discounts is the most recent example.

Authorities have begun investigations against several corporates in the fast-moving consumer goods ('FMCG') industries on the point that post-sales discounts received in the hands of the dealers are liable to service tax. The authorities are viewing such post-sales credits given to dealers / distributors (by way of discounts, incentives etc.) as a separate transaction distinct from original sale. Per them, such credits are to be taxed as a service since the same qualify as consideration for an activity / set of activities undertaken by the dealers / distributors. In reference to the erstwhile regime the authorities seek to treat such transactions as a declared service of agreeing to do an act[3]. With a similar entry present in the GST laws as well[4], the authorities are also eying at fastening GST liability on such credits post July 1, 2017.

In day to day businesses various discounts (such as trade discount, quantity based discounts etc.) are provided by manufacturers by issuing credit note to dealers. From an accounting perspective, manufacturers adjust their sale turnover with the amount of credit note while the dealers park the value of credit note as an adjustment to the purchase. Sometimes the dealers also book such credits as miscellaneous income. At present, no service tax is paid on such discount received by the dealers. The above practice is also in line with the jurisprudence developed over time which treat such discounts event connected the sales and not as a separate transaction.

Treatment of discounts: A jurisprudential analysis

Historically speaking, the legal issues vis-à-vis discount had been limited to its deductibility from the sales turnover for the purposes of levy of sales tax / value added tax ('VAT'). Post the introduction of service tax laws, a new controversy as to whether such discounts would constitute a 'consideration' for service or not has been added to the list of legal issues. The latter issue is expected to arise in the GST regime as well. In order to recognize the intricacies of the issue, it is imperative to deep dive into the erstwhile jurisprudence for a better understanding.

The Indian courts have been of the view that concession in price shown by way of an additional incentive with a view to promote one's own trade qualifies for deduction from sales turnover as a trade discount for computing the sales tax thereon.[5] Thus, such trade discount is not charge for a service.

Under the erstwhile sales tax / VAT laws trade discounts were deductible from taxable turnover if issued in regular trade practice or is in accordance with the terms of contract or agreement. Important to note that the accounting treatment of post-sales discounts to establish its relationship to a sale also needs to be taken into consideration in such cases. A similar view has been given by the courts as well.[6]

The issue has cropped up in the erstwhile service tax regime as well where target / quantity-based incentives were being treated as a 'business auxiliary service' by the revenue. The Courts have answered the question in negative and held the same to be in the nature of trade discounts on which no service tax can be levied.[7] Even logically speaking, discounts are issued to promote one's own sale and is not a service of marketing or promotion of goods of the principal.

In this regard, jurisprudence under income tax also gains importance wherein the relationship between manufacturer (original seller) and dealer has been held to be on a principal to principal basis and not that of an agent and principal.[8] The context of such jurisprudence was to establish that no liability to deduct tax at source under Section 194H of the Income Tax Act, 1961 arises on suppliers towards discounts extended to dealers / distributors. Although, there are adverse jurisprudence on the same issue, but in the authors' view no TDS liability should arise on dealer credits given on account of post-sale discounts.

Analysis and Conclusion

Looking at the nature of allegations put forward by tax authorities in recent times, it is not far-fetched to state that the intention of the authorities is to stretch the legal interpretations as far as possible and bring every transaction under the purview of tax. However, the authors beg to differ on such allegations.

Legally and logically, discount is a part and parcel of transaction of transfer of title in goods and cannot be said to be an independent transaction in itself. Important to note that it is a settled principle of law that VAT and service tax are mutually exclusive.[9] A transaction cannot be subject to levy of both VAT and service tax. Thus, once VAT has been levied on the same transaction, no service tax can be levied separately on the same transaction.

The charging provision under Finance Act[10] does not include an activity which constitutes merely a transfer of title in goods by way of sale. Further, it also excludes trading of goods from its purview under the negative list.[11] A recent circular[12] issued by the Government on scope of declared service clarifies that one cannot apply the concept of 'declared service' to remove a service from the Negative List and make it a taxable service.

As discussed, a manufacturer and a dealer do not have an agency relationship and act on principal to principal basis. Consequently, a post sales discount offered to a dealer is not in the form of commission and no charge under service tax can be created for the instant transaction. The above view is in sync with the treatment of discounts from an accounting perspective as well. As per the Indian Accounting Standards, revenue is measured taking into account the amount of any trade discounts or volume rebates given by an entity.[13] From the buyers' end such discounts are deductible in determining the costs of purchase[14]. Therefore, a post-sales discount is a part of the original sale and the amount of the discount is deducted from the original consideration.

A similar view can be taken under GST regime as well as per which it can be said that the discount is a part of the original supply of goods and would not form a separate supply of service on which GST can be levied. From a different perspective, it can also be said that the authorities are in fact artificially splitting a single transaction of supply of goods into two and demanding tax on the post-sales discount as supply of service. It is trite law that it is not legally permissible to artificially split a transaction for taxation purposes unless the legislature provides for such a provision in the law itself.[15]

Although, as of now, the taxability issues have arisen in the FMCG companies, the issue holds relevance for all industries operating under the post-sales discount model. The issue being scalable needs to be handled appropriately by the taxpayers. Divergent positions, if adopted by taxpayers from indirect tax, income tax, accounting and documentation perspectives, can add to the complexity of the matter. The issue gains much more significance as any service tax demand by the revenue would not be available as credit and would become a cost to the system. The same would also hold true for credit of past GST period for which the last due date of taking credit has already lapsed.

Looking at the nature of demands that the revenue authorities have sought in recent times, a taxpayer unknowingly has invited itself to a flood of litigations just by saying a 'yes' or 'no' to a transaction in the past. It seems that even saying a 'yes' / 'no' is not tenable because as per the revenue a simple 'yes' or 'no' is a taxable transaction in itself. Tax is indeed inevitable!

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[1] https://www.taxscan.in/gst-dept-directs-tata-sons-pay-rs-1524-crore/35549/.

[2]https://economictimes.indiatimes.com/industry/cons-products/fmcg/fmcg-distributors-face-gst-scrutiny-for-post-sale-discounts/articleshow/69260412.cms.

[3] Section 663(e), Finance Act, 1994.

[4] Schedule II, Central Goods and Services Tax Act, 2017.

[5] Deputy Commissioner of Sales Tax (Law) vs Motor Industries Company [1983 53 STC 48 (SC)].

[6] Maya Appliances (P) Ltd. v. CCT, (2018) 2 SCC 756 and Southern Motors v. State of Karnataka, (2017) 3 SCC 467.

[7] CST vs Sai Service Station Ltd [2013 (10) TMI 1155 - CESTAT MUMBAI] and 2018 (6) TMI 1430 - CESTAT MUMBAI – TMI.

[8] DCIT v. M/s Creative Technotex Private Limited, ITA No.2035/KOL/2016 decided on July 27, 2018.

[9] Imagic Creative (P.) Ltd. v. Commissioner of Commercial Taxes, (2008) 2 SCC 614.

[10] Section 65B(44), Finance Act, 1994.

[11] Section 65D(e), Finance Act, 1994.

[12] Circular 212/2/2019-Service Tax dated May 21, 2019.

[13] Indian Accounting Standard 18.

[14] Indian Accounting Standard 2.

[15] State of Madras v. Gannon Dunkerley, AIR 1958 SC 560.