

EY Tax Alert

AAR holds goods distributed under target-based schemes as supply while confirming ITC eligibility

Executive summary

EY Alerts cover significant tax news, developments and changes in legislation that affect Indian businesses. They act as technical summaries to keep you on top of the latest tax issues. For more information, please contact your EY advisor.

This Tax Alert summarizes a recent ruling¹ of the Karnataka Authority for Advance Ruling (AAR) pertaining to Goods and Services Tax (GST) implication on goods distributed to dealers as part of target-based incentive schemes.

Applicant in the given case is engaged in the business of manufacture of cement. In order to achieve sales and marketing objectives, it launched various target-based promotional schemes wherein it would distribute gold coins and other white goods to its dealers, free of cost, on achieving specified targets laid down in the schemes. Accordingly, it sought advance ruling in respect of ITC admissibility and taxability on goods so distributed.

The AAR ruled that:

- ▶ The goods are issued to dealers subject to fulfilment of pre-agreed conditions and stipulations. Gift is something which is given without any conditions or stipulations and hence, the above transaction cannot be covered under the scope of "goods disposed of by way of gift". Accordingly, ITC on the same is not restricted under Section 17(5)(h) of the Central Goods and Services Tax Act, 2017 (CGST Act).
- ▶ Achievement of marketing targets set by the applicant is a non-monetary consideration paid by the dealers for the issuance of incentives. Since, such transfer is made for a consideration, the same is covered in the definition of supply as per Section 7 of the CGST Act and hence, taxable.
- ▶ Even if the above transaction is not treated to involve consideration, the same will get covered under Entry 1 of Schedule I to the CGST Act (*i.e.*, permanent transfer or disposal of business asset on which ITC has been availed) and hence, will be treated as supply as per Section 7(1)(c) of the CGST Act.

¹ TS-424-AAR(KAR)-2023-GST

Background

- ▶ The applicant is engaged in the business of manufacturing different kinds of cement and incurs various marketing and distribution expenses to promote its brand and enhance sales.
- ▶ Accordingly, it launched various target-based promotional schemes wherein it would distribute gold coins and other white goods to its dealers, free of cost, on achieving specified targets laid down in the schemes.
- ▶ Applicant approached Karnataka Authority for Advance Ruling (AAR) to seek ruling on whether the obligation to issue gold coins and white goods to dealer upon achieving the stipulated targets during the scheme period would be regarded as:
 - ▶ "goods disposed of by way of gift" and thereby, input tax credit (ITC) on the same would be restricted under Section 17(5)(h) of the Central Goods and Services Tax Act, 2017 (CGST Act)?
 - ▶ permanent transfer or disposal of business asset on which ITC has been availed and thereby, getting covered under Entry 1 of Schedule I to the CGST Act?
 - ▶ supply under Section 7 of the CGST Act?

Applicant's contentions

- ▶ The restriction laid down in section 17(5)(h) is applicable only in respect of goods disposed of by way of gifts.

Gifts as per Gift Tax Act, 1958 has been defined to mean transfer by one person to another of any existing movable or immovable property voluntarily and without any consideration in money or money's worth.

The gold coins and white goods distributed to the dealers cannot be regarded as gifts as the dealer is eligible for the aforesaid goods only on the satisfaction of the terms and condition laid down under the scheme.
- ▶ Distribution of gold coins and white goods cannot be regarded as permanent transfer or disposal of business assets.

The said restriction is only applicable to those assets which are capitalized in the books of account and not in respect of revenue expenditure.
- ▶ Schedule II to the CGST Act provides list of activities to be treated as supply of goods or supply of services. Entry 4(a) of the said Schedule provides that where goods forming part of the assets of a business are transferred or disposed of, such transfer or disposal is a supply of goods.

The term business asset used in Schedule I has to be read with Entry 4(a) of Schedule II. Therefore, the said entry is applicable only in cases where goods which are part of balance sheet are permanently transferred.

- ▶ If the intention of legislature was to tax all types of goods, including capital goods under Entry 1, then the legislature would have used the term "goods" akin to Entry 2 and 3. However, it intentionally used the term "business asset" to restrict the scope of the said entry to assets which are an item of balance sheet.
- ▶ A transaction can be said to be a "supply" only if the same has been made or agreed to be made for a consideration. Therefore, in the absence of consideration, supply cannot be said to have been made.

In the instant case, there is no consideration received from the dealers for the goods distributed to them. Therefore, the gold coins and white goods issued as part of incentive schemes cannot be regarded as supply under Section 7 of the CGST Act.

AAR Ruling

- ▶ The applicant is issuing goods to dealers as per the agreement reached between them. It is only issued subject to the fulfilment of specified conditions and stipulations.

Gift is something which is given without any conditions or stipulations and hence, the above transaction cannot be covered under the scope of "gift" and accordingly, ITC is not restricted on the same.

Further, achievement of marketing targets set by the applicant is a non-monetary consideration paid by the dealers for the issuance of gold coins and white goods by the applicant. Since, such transfer is made for a consideration, the same is covered in the definition of supply.
- ▶ Even if the above transaction is not considered to involve consideration, transfer of goods to dealers on which ITC has been availed will get covered under Entry 1 of Schedule I.

The term asset would include inventory and since the goods are procured in the course of business, it would be covered under the scope of business asset. Nowhere in the said Schedule it is stated that these business assets should be capitalized.

Accordingly, Entry 1 of Schedule I will cover the activity of distribution of white goods or gold coins as incentives and hence, would be treated as supply of such goods as per Section 7(1)(c) of the CGST Act.

Comments

- a. In the past, various AARs have treated goods distributed free of cost under promotional schemes as "gift" and hence, disallowed ITC on the same.
- b. AAR's observation that achievement of marketing targets by the distributor becomes consideration for supply of in-kind incentives by the supplier needs to be legally evaluated.
- c. Although the AAR has held that transfer of goods under incentive schemes will be covered under Entry 1 of Schedule I, it is silent on the valuation mechanism to be adopted for such transactions.
- d. Even from distributor's perspective, under the erstwhile service tax regime, there are various judgements to hold that target-based incentive (in the form of rebates, discounts etc.) cannot be treated as consideration for provision of any service by the distributor.

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