



# TREATMENT OF DISCOUNTS FROM THE PERSPECTIVE OF RECIPIENT AND ANALYSIS OF SECTION 15(2)(E) OF CGST ACT, 2017-PART I

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There has been a lack of clarity in terms how discounts would be treated by the recipient wherein either tax has not been reversed by the supplier or wherein tax has been reversed by the supplier. This series of article seeks to analyse treatment of discount from the perspective of the recipient in different situations.

The analysis and interpretation of Section 15(2)(e) of the CGST Act, 2017 holds one of the keys in unlocking and analyzing the impact of discount on the valuation of taxable supply from the perspective of the recipient. Let's refer Section 15(2)(e) of CGST Act, 2017 which is as follows:

*(2) The value of supply shall include---*

*(e) **subsidies directly linked to the price** excluding subsidies provided by the Central Government and State Governments.*

*Explanation.--For the purposes of this sub-section, the amount of subsidy shall be included in the value of supply of the supplier who receives the subsidy.*

### 1. **Meaning of the word Subsidy:**

The term subsidy has not been defined under the CGST Act, 2017. The term has been defined under the Cambridge Dictionary as

*"money given as part of the cost of something, to help or encourage it to happen"*

Hon'ble Rajasthan High Court in the matter of **M/s Panwar Trading Corporation Vs. State of Rajasthan & Ors. in the judgement dated 12<sup>th</sup> November 2014, discussed the meaning of subsidize as follows:**

*We do not agree with the contention advanced by learned counsel appearing for the petitioner that the word 'subsidize' would mean the price to be subsidized by the government, under any scheme. The word 'subsidize', in sub-section (3A) of Section 18, has not been used in a sense, in which the goods are sold on any concession, exemption, or subsidy, given by the State Government under any scheme. The word 'subsidize' has been defined in 'The New Shorter Oxford English Dictionary', as follows:-*

*"subsidize.- 1. Pay money to secure the services of (mercenary or foreign troops); provide (a country or leader) with a subsidy to secure military assistance or neutrality. 2. Support (an organization, activity, person, etc.) by grants of money. Also, reduce the cost of (a commodity or service) by subsidy."*

38. In 'Concise Oxford English Dictionary', the word 'subsidize' has been defined as follows:-

*"subsidize or subsidise. v. support (an organization or activity) financially.> pay part of the cost of producing (something) to reduce its price."*

Thus, subsidy can be summarized as an amount which goes on to reduce the cost of the goods or services. It is in the nature of assistance or support to pay the part of the cost of the goods or services. Therefore, it would be wrong to restrict the meaning of subsidy to amount received from central government or state government and any amount received under any nomenclature i.e. discount, reimbursement, concession, rebate etc which goes on to reduce the cost of the product would fall in the purview of subsidy.

## 2. Scope of the word "Price"

Now question is what is the scope of the word "price" referred in section 15(2)(e). The word price referred to in section 15(2)(e) of CGST Act, 2017 takes colour from the provisions of Section 15(1) of CGST Act, 2017 which provides as follows:

- *The value of a supply of goods or services or both shall be the transaction value, which is the **price actually paid or payable for the said supply** of goods or services or both...*

Section 15(1) refers to price actually paid or payable for the purpose of value of supply and 15(2) provides that value of supply as referred to in 15(1) shall include the subsidies which are linked to the "price". Therefore, price which has been referred to in section 15(2)(e) would be the price at which the goods are being supplied.

## 3. Meaning of the Word "link"

The word "link" has been defined in Cambridge dictionary as *"to make a connection between two or more people, things, or ideas"*. Dictionary.com defines it as *"Anything serving to connect one part or thing with another; a bond or tie:"*.

Thus anything which establishes a tie or connect two different things or one part of the thing to another has been defined as a link. Scope of the word "link" include both direct connection i.e. anything which is close or integrally connected to another and also indirectly connected i.e. anything which has an association but which does not have an immediate cause and effect relationship.

## 4. "Directly linked to Price"-Impact of the use of word "Directly"

The provision uses the words "directly linked to". The issue arises that what is the scope of the words "linked to" and "directly linked to". Does it make any difference if the word "directly" has been attached to the words "linked to price".

The difference between the two phrases can at best be understood with the example of difference between the words "in relation to" and "directly in relation to". How the narrative changes with the word "directly" being attached to the words "in relation to".

### **a) Meaning of the Words "in relation to"**

Hon'ble Apex Court in the matter of ***Doypack Systems Pvt Ltd v. Union of India: AIR 1988 SC 782***, observed meaning of expressions "in relation to" as under:-

*"49. The expression "in relation to" (so also "pertaining to"), is a very broad expression which presupposes another subject matter. These are words of comprehensiveness which might both have a direct significance as well as an indirect significance depending on the context..." "...*

*In this connection reference may be made to 76 Corpus Juris Secundum at pages 620 and 621 where it is stated that the term "relate" is also defined as meaning to bring into association or connection with. It has been clearly mentioned that "relating to" has been held to be equivalent to or synonymous with as to "concerning with" and "pertaining to". The expression "pertaining to" is an expression of expansion and not of contraction." (emphasis supplied)*

Thus, Hon'ble Apex Court has observed that the words "in relation to" have both direct as well as indirect significance. It is a very broad expression and the wordings have to be given meaning of expansion rather than contraction.

### **b) Meaning of the Words "Directly in relation to"**

Educational Guide issued by CBEC in the month of June 2012 in para 5.5.2 highlighted the meaning of the words ***"directly in relation to the immovable property"*** and provided that

*"There must be more than a mere indirect or incidental connection between a service provided in relation to an immovable property, and the underlying immovable property. For example, a legal firm's general opinion with respect to the capital gains tax liability arising from the sale of a commercial property in India is basically advice on taxation legislation in general even though it relates to the subject of an immovable property. This will not be treated as a service in respect of the immovable property."*

Thus, what this education guide provided that although the services of a legal counsel with respect to the capital gain tax liability arising out of sale of commercial property in India relates to the subject of an immovable property but it does not have a direct or an incidental connection.

It further goes on to provide that

*“The place of provision of services rule applies only to services which relate directly to specific sites of land or property. In other words, the immovable property must be clearly identifiable to be the one from where, or in respect of which, a service is being provided. Thus, there needs to be a very close link or association between the service and the immovable property. Needless to say, this rule does not apply if a provision of service has only an indirect connection with the immovable property, or if the service is only an incidental component of a more comprehensive supply of services.”*

CBEC Educational Guide itself provides that indirect relation to the immovable property would not be sufficient for the application of the specific rule and therefore, there must be a direct or a proximate relation to the immovable property. Another example given in the educational guide is as follows:

*For example, the services of an architect contracted to design the landscaping of a particular resort hotel in Goa would be land-related. However, if an interior decorator is engaged by a retail chain to design a common décor for all its stores in India, this service would not be land related. The default rule i.e. Rule 3 will apply in this case.*

Thus, with the use of word “directly”, merely an indirect link to the price would not be sufficient for an amount to be included in the value of supply. The ensuing paragraph details out the factors which would constitute an amount received as subsidy “directly linked to price”.

### **c) Necessary Factors to constitute amount received as subsidy “Directly linked to price”:**

- Expression “Directly Linked to Price” does not have an independent meaning but aims to narrow the scope of the provision in the sense that it contemplates that there should be a very close, clear and obvious link or association between the subsidy and its impact on the price thereof. This very close, clear and obvious link or association is considered to exist only when the impact of the subsidy is clearly identifiable.
- There must be more than a mere indirect or incidental link between the subsidy and its impact on the price of the product. The impact of the subsidy must be clearly identifiable to be the one which has directly impacted the price of the product. The link of subsidy with price must be at the heart and must have predominant impact over the price of the supply.

For example, Distributor “A Ltd.” has announced a scheme wherein “B Ltd.” has to sale the goods at a

discount of Rs 500/- during a month and "A Ltd" would reimburse the discount of Rs 500/- to "B Ltd.". Therefore, Rs 500/- received by "B Ltd." from "A Ltd." would be termed as an amount directly linked to selling price.

**d) Example of "Directly linked to Selling price"- Section 7 of Kerala VAT Act serves as a great example:**

Just to give an example of what can constitute an amount which can be termed as "directly linked to selling price, it would be apt to quote *Explanation VII* to the definition of turnover under Section 2(lii) of the KVAT Act as an example.

I have refrained from giving any further examples, as my further series of articles would be covering them in detail and impact of Section 15(3) cannot be ignored before assessing the taxability of such amount. Therefore, reading of example given needs to be restricted only to understand what can be termed as "directly linked to price.

***Explanation VII:*** *Where a dealer sells any goods purchased by him at a price lower than that at which it was purchased and subsequently receives any amount from any person towards reimbursement of the balance of the price, the amount so received shall be deemed to be turnover in respect of such goods.*

**"Emphasis Supplied"**

Although the provision consists of a rider that the dealer should have sold the goods purchased by him at a price lower than that at which it was purchased. However, there is no such condition attached to Section 15(2)(e) of CGST Act, 2017. Therefore, one needs to ignore this condition while interpreting the words highlighted above in Explanation VII and it's only for reference that what can constitute an amount "directly linked to price".

**The rationale of the above provision has been explained in the matter of *State of Kerala v. Syed Muhammed* Hon'ble Kerala High Court stated the relevant law as under:**

*It is obvious from the above that the purpose of the Explanation is to levy tax on the actual sale price irrespective of whether it is received by the dealer at the time of sale of goods or from the purchaser itself. In other words, any amount received by a dealer by way of consideration for sale of goods whether it is received from the purchaser or not is assessable as turnover in respect of the goods sold.*

Hon'ble Kerala High Court in the matter of **Vettathil Agencies v. Commercial Tax Officer, Cherthala 81 taxmann.com 56 (Kerala)** referred to the Judgement of Single Judge in Writ Petition No. 27088/14 as follows:-

*An incidental question had also arisen for consideration as to whether the amount offered by way of discount*

*through credit notes issued by the supplier of the goods at a point in time subsequent to the sale of goods to the petitioners can be added as sales turnover of the petitioners by invoking provisions of Explanation VII to the definition of turnover under Section 2(lii) of the KVAT Act. In Para 10 of the Judgement, it was held that*

10. *Secondly, if the discount amounts received by the petitioners from their suppliers, can be demonstrated to be amounts received by them towards balance of the sale price of the goods, then the sales turnover of the petitioners can be enhanced to that extent alone and the output tax payable by the petitioner computed accordingly. Against this output tax found to be payable by the petitioners, the input tax availed by them would have to be set off to the extent possible. In this event, the assessing authorities would be acting in accordance with Explanation VII to Section 2 (lii) to determine the output tax payable by the petitioner on the enhanced sales turn over.*

#### **5. Subsidy provided by Central Government and State Government excluded from the purview value of Taxable Supply:**

Subsidies which are granted by the Central Government or the State Government would be out of the purview of Section 15(2)(e) of CGST Act, 2017. Therefore, even though such subsidies might be directly linked to price but would be outside the purview of the provision.

#### **6. Value of subsidy to be included in the value of supply of the person who receives the subsidy:**

Explanation to Section 15(2) provides that once it is ascertained that value of a subsidy received has to be included for the purpose of arriving at the value of taxable supply, amount of subsidy would be included in the value of supply made by the supplier who receives the subsidy.

For example, Distributor "A Ltd." has announced a scheme wherein "B Ltd." has to sale goods at a discount of Rs 500/- during a month and discount of Rs 500/- given to customer would be reimbursed to "B Ltd." by "A Ltd.". "B Limited" in the above scenario would be receiving Rs 5500 i.e. Rs 5000/- from "C" and Rs 500 from "A Limited".

"B Limited" sold the goods to "C" at Rs 5000/- after giving discount of Rs 500. "In the given scenario, value of supply for "B Ltd" to "C" would be Rs 5500 as Subsidy received by "B Ltd" from "A Ltd" is a price linked subsidy and **assuming that other conditions are satisfied for the purpose of including such subsidy in the value of supply**, "B Ltd" would have to levy and collect tax from "C" on Rs 5500 and once tax is collected at Rs 5500/-, "B Ltd" can thereafter allow discount of Rs 500 to "C".

The next series of article would analyse when different nature of discounts like discount on offtake, retail, cash discount, trade discount, special discount etc. would be included in the value of supply and therefore

supplier would be liable to include such amount in the value of supply and charge tax thereof and when such amounts received would be outside the purview of value of supply. Further, whether an incentive received on retail price can be termed as a subsidy as it goes on to reduce the cost of the product or whether it's a supply in terms of provision of CGST Act, 2017.