DISCOUNT AND TREATMENT IN INDIRECT TAX

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In today's business environment, discount is the sharpest weapon for promoting a product or brand. Even a school going kid knows the concept of "Buy one get one" or "Get up to 70% discount" type marketing taglines. Interestingly, even today our tax laws (including GST laws) do not have a definition of the term "Discount". This has resulted in litigations in the past, which in my view did not add any value to any of the stake holders. This article will try to discuss the legal position on discount based on judicial precedence and provision of Law.

Why discount: Dictionary meaning of discount is "*a reduction in the usual price*"**.** Main purpose of discount is to increase the sale. However, discount alone cannot increase the sale but it can surely influence customer behaviour assuming that the other factors such as quality, customer perception about the product or brand value are all on an equal footing. Discount varies industry wise, sector wise or even some cases region wise. Some of the smartly designed discount schemes could ignite the customers' desire for a particular product or a brand which otherwise are given a pass on account of various reasons.

Following are some common objectives of any discount scheme:

- **Increased Traffic resulting to increased sales:** It is mostly followed in retail sector. Offering such discounts increase the foot fall in the store and ultimately could be converted into increased sales.

- **Attracting new customers without a large marketing campaign**: Attracting new customer, who is loyal to a different brand, is a challenge today. A good discount scheme not only attract new customers into the business but encourage existing customers to bring in new customers for the same business catapulting the growth in sales to new heights.

- **Monetize Inventory**: Converting stock into cash is ultimate aim of any business. Discounting allows the business to dispose of ageing inventory. For various strategic reasons, businesses may be interested to discontinue some of its existing products. Discount schemes targeted for products is perhaps the most convenient way to achieve such an objective.

- **Meeting Sales Targets:** Most businesses have monthly sales targets. Given the seasonal fluctuations in consumer buying behaviour, discount schemes help businesses to achieve their sales targets.

Treatment of discount created lot of confusion in the past, especially from Indirect Tax perspective. Plethora of judgements have led to multiple interpretations and have thus made the term "Discount" an interesting and misty topic for tax professionals. Let us discuss some of controversies and judicial precedents in relation to Discount.

Pattern of discount ordinarily can be divided into two types

i. General discount: It is given for a short period and available to all types of customers. e.g. a festival discount (Diwali Dhamaka), packaged discount (buy one get one), stock clearance sale etc. Such discounts are known to customers at the time of purchase of goods and disbursement of such discounts are prompt.

ii. Performance based discount: It is given mostly to loyal customers. This type of discount are dependent on the intake by the customers. The details of such a scheme are known to the customer at the time of purchase but quantification of the discount may not be possible at the time of purchase. Examples of such schemes could be quantity / volume based discount, discount on promptness of payment etc.

In these types of discounts, disbursement is generally at a later date through various modes such as credit note, redemption of loyalty points, etc.

Types of discounts:

Let us understand some of the common types of discount which are prevalent in the Indian market:

Cash discount: This discount is allowed when the purchaser makes payment promptly or within the period of agreed credit period.

Trade discount: Trade discount is understood differently in different markets. Let us understand this *term based on common commercial parlance:*

- **Special discount:** Depending upon the market conditions and company's strategy, some companies launch this type of discount for a limited period. This discount are generally focussed for a particular product / area / season. Generally this discount could be influenced by competitor's price.

- **Loyalty scheme:** It is generally a point based discount scheme. These schemes are launched to motivate customers to remain loyal to a particular company / brand. Points are earned by the customers on various parameters Each points have some value attached to it and such accumulated points can be redeemed by the customers on periodical basis against products of the same company or products of other companies as well.

- **Periodical Incentive:** Retaining satisfied customers not only increases sale but it also motivates them to bring more second or third level customers for the business. This discount is normally decided after the end of a period (quarter/ half year / yearly) and depends on the volume intake of the customer.

Disbursements of discounts:

The genesis of tax related controversies is disbursement of discount. It depends on various factors which could include the following:

(a) Marketing strategy of a company
(b) Industry practice
(b) Class of customers,
(c) Financial planning etc.

In case of retail industry, discounts are disbursed mostly at the time of sale. However, organised retail sector has also introduced loyalty point based incentive schemes, which defers the disbursement. In case of other industries, especially for B2B transactions discount could be disbursed in phased manner. Following four methods are commonly used for disbursement of discounts:

(1) Reduction of price on the invoice;
(2) Grant cash back scheme;
(3) Credit notes which could be adjusted for settlement of the amount due from the buyer;
(4) Gift items equivalent to the value of the discount etc.

Tax treatment of Discounts:

Tax treatment of discount is the most critical area of the discount saga. Most preferred and litigation free way of showing discounts is to show the same on the invoice. However, due to commercial reasons, it may not be possible to show all discounts on the invoice itself and the problem actually starts there.

Tax authorities are generally reluctant to reduce the discount from taxable value, if the same is not shown on the invoice. Tax Department's common argument in such cases is that if the discount is known at the time of sale then it can be easily depicted on the invoice. Any discount post the event of supply or sale is an afterthought and hence should not be deducted from the taxable value.

The Apex Court and different High Courts have consistently held that showing discount on the face of the invoice cannot be the only mechanism for passing on discounts and also for the purpose of deriving the taxable value of any sale or supply.

Let us understand some of the landmark judgments in this regard:

- **Southern Motors Vs State of Karnataka and Others (Civil Appeal Nos.10955-10971 of 2016:**

  The Honourable Supreme Court opined that In today's competitive market, trade discounts not only are dependent on variable factors but also might be strategically not disclosable at the time of the original sale. The actual quantification of the trade discount, depending on the nature of the trade and the related stipulations, may be deferred till the happening of a contemplated event, so much so that the benefit thereof is extended at a point of time subsequent to that of the original sale. However, the transactions allowing discount have to be proved on the basis of contemporaneous records and the final sale price after deducting the trade discount must mandatorily be reflected in the accounts. The Apex Court has clarified that the intention of the legislature could not have been to deny the benefit of deduction of trade discount by insisting on the reflection of such trade discount on the invoice itself.

- Union of India & others Vs Bombay Tyres International Pvt Ltd [1984(17) ELT 329 (SC)]

  In this case, the Apex court clearly opined that because of the terms of sale or by established practice the allowance and nature of the trade discount is known prior to the removal of goods the deductions on such discount cannot be disallowed merely because they are not payable at the time of each invoice or deducted from the invoice price.

- CCE Madras Vs Addison & Co Ltd [2016-TIOL-146-SC-CX-LB] :

  The Apex Court set aside a plea that the turnover discount is not an admissible abatement on the ground that the quantum of discount is not known prior to the removal of goods. If the discount is known to the customer prior to the removal of goods then the same is deductable.

The author would not want to burden the reader with many other similar and consistent decisions passed by the Supreme Court and different High Courts. To summarise the consistent view, Courts have held that if the discount is known to the customer before the event of sale /supply, then the same would be deductible from the taxable value. Although above cases are pertain to the earlier tax regime, however, the ratio of the decisions is relevant even for transactions in the GST regime.

Before discussing about the tax treatment of discount in the GST regime, let us first refer to the relevant provision of the CGST Act. Section 15 of the CGST Act deals with the provision of discount, which states as under:

"The *value of the supply shall not include any discount which is given* –

(a) before or at the time of the supply if such discount has been duly recorded in the invoice issued in respect of such supply; ***and***

(b) after the supply has been effected, if -

(i) such discount is established in terms of an agreement entered into at or before the time of such supply and specifically linked to relevant invoices; and

(ii) input tax credit as is attributable to the discount on the basis of document issued by the supplier has been reversed by the recipient of the supply."

A plain reading of the Section leads us to the following logical inference:

a. Discount, if mentioned on the face of the invoice, can be reduced from the taxable value of the supply of goods.

b. Discount, even if not mentioned on the face of the invoice can be reduced from the taxable value, if following conditions are satisfied :

   i) Discount is established in terms of an agreement before supply. In simple words, both supplier and recipient are aware and have agreed about the discount before the supply.
   ii) Discount is linked to a specific supply invoice.
   iii) Input Tax credit attributable to the discount is required to be reversed by the buyer or recipient of the supply.

From the above provision it is clear that the legislature has principally accepted Court's view even in GST regime. This is a welcome provision in the new tax regime, which made the intent of the legislation clear and uniform across the country. However, the operating part of the provision makes the issue complicated. This is because the supplier's benefit is completely dependent on an action or inaction, with regard to reversal of Input Tax Credit, of the buyer. A supplier does not have any control over the buyer's actions on the treatment of discount in his books.

In the GST regime all transactions are recorded through GSTN portal. Accordingly, a mechanism which could possibly be explored in order to effectuate post supply discount is a process wherein the credit note (on account of discount) uploaded by the supplier would automatically reduce the Input Tax credit of the buyer.

Conclusion:

From the above discussion, we could come to a rationale conclusion that the nomenclature or method of disbursement of discount would not have any impact of such discount for computation of tax liability of the supplier. The intent or commercial arrangement between the supplier and recipient would decide whether the discount in relation to any supply could reduce the GST liability of the supplier to the extent of such discount.

GST liability of the supplier would be reduced if both supplier and receiver of the goods / services are aware of the discount before supply. Further, the impact of the mode of disbursement of discount could be summarised as under from a GST perspective:

- If the discount is disbursed at the time of supply then the same should be shown on the invoice and GST would be computed on the value net of discount.

- If discount is disbursed at a later date, then credit note should be issued and the same credit note should be linked to the supply invoice and the recipient of should reverse the Input Tax Credit attributable to such discount.

It is important to note that with the current legislative structure, other modes of disbursement of discount, such as redeeming loyalty points or giving freebees could create operational challenges if the supplier desires to consider such discount for computing his GST liability.