

**Dear Professional Colleague,**

**Post sale discounts shall not form part of the turnover**

We are sharing with you an important judgment of the Hon'ble Supreme Court of India in the case of ***Southern Motors Vs. State of Karnataka*** **{[2017] 77 taxmann.com 251 (SC)}** on the following issue:

**Issue:**

Whether the post sale discounts granted by the assessee by issuing credit notes are eligible for deduction from total turnover to quantify their taxable turnover?

**Facts & Background:**

M/s Southern Motors ("**the Appellant**" or "**the Company**") is a dealer in motor vehicles and registered under the Karnataka Value Added Tax Act, 2003 ("**The KVAT Act**"). The Appellant raised the tax invoices on the purchasers as per the policy of manufacturers of vehicles to maintain uniformity in the price thereof. After the sales were completed, credit notes were issued to the customers granting discounts, in order to meet the competition in the market and for allied reasons. Consequentially, the Company has received only the net amount that is the amount shown in the invoice less the sum of discount disclosed in the credit note. Accordingly, the net amount, so received was reflected in his books of account and returns were filed under the Income Tax Act, 1961.

However, the Department disallowed the claim of deduction towards discounts from the total turnover in terms of Rule 3(2)(c) of the Karnataka Value Added Tax Rules, 2005 ("**the KVAT Rules**") on the ground that the same were not revealed at the time of issuance of tax invoices, though credit notes were issued subsequently.

Thus, after an unsuccessful challenge before the High Court, the Appellant preferred an appeal before the Hon'ble Supreme Court.

**Appellant's view:**

Section 30 of the KVAT Act read with Rule 31 of the KVAT Rules (dealing with 'credit and debit notes') clearly states that the assessee is entitled to claim deduction of the discount allowed to their customers by credit notes, from the total turnover to quantify their taxable turnover. As some discounts, especially those linked to targets to be achieved in a particular period are not comprehensible at the time of sale, these logically cannot be reflected in the tax invoices. Further, in no view of the matter, Rule 3(2)(c) of the KVAT Rules can be conceded a primacy to curtail or abrogate Section 30 of the KVAT Act or Rule 31 of the KVAT Rules, lest the latter provisions are rendered otiose.

Further, it is no longer *res integra* that trade discount is not constituent to sale price and therefore not taxable. Moreover, it has been insistently pleaded that a post sale discount

through credit notes is revenue neutral in terms of Section 30(3) of the KVAT Act, as a consequence whereof the selling and the purchasing dealers accordingly remodel their returns and pay taxes as due.

**Revenue's view:**

A discount to qualify for deduction to compute the total and eventual taxable turnover, as contemplated in Rule 3(2)(c) of the KVAT Rules has to be essentially reflected in the tax invoice or the bill of sale issued in respect of the sales. According to them, Section 30 of the KVAT Act and Rule 31 of the KVAT Rules deal with a situation where after a tax invoice is issued, it transpires that the tax charged has either exceeded or has fallen short of the tax payable for which a credit/debit note, as the case may be, would be issued. As these two provisions do not regulate the computation of a taxable turnover, there is no correlation thereof with Rule 3(2)(c) of the KVAT Rules which has been assigned an independent role to determine the tax liability. In absence of any specific provision in the parent statute granting tax exemption based on deduction founded on post sale trade discount, Section 30 of the KVAT Act and Rule 31 of the KVAT Rules are of no avail to the assesses. It is maintained that in any view of the matter, a taxing statute has to be construed strictly and any exemption is permissible only if the legislation permits the same.

**Held:**

The Hon'ble Supreme Court after observing the various legal pronouncements has held that the requirement of reference of the discount in the tax invoice or bill of sale to qualify it for deduction has to be in relation to the final sale/purchase price and not limited to the original sale without the trade discount. However, the transactions allowing discount have to be proved on the basis of contemporaneous records and the final sale price after subtracting the trade discount must mandatorily be reflected in the accounts as stipulated under Rule 3(2)(c) of the KVAT Rules. The sale/purchase price has to be adjudged on a combined consideration of the tax invoice or bill of sale as the case may be along with the accounts reflecting the trade discount and the actual price paid. Further, the first proviso to Rule 3(2)(c) of the KVAT Rules has to be so read down, to be in consonance with the true intendment of the legislature and to achieve as well the avowed objective of correct determination of the taxable turnover. The contrary interpretation accorded by the High Court being in defiance of logic and the established axioms of interpretation of statutes is thus unacceptable and is negated.

**Treatment of post supply discounts in the GST Regime – Our Comment:**

As per Section 15(3)(b) of the Model CGST/SGST Act, 2016, the value of supply shall not include any discount that is given after the supply has been effected provided that:

- 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.

- Also Input tax credit has been reversed by the recipient of the supply as is attributable to the discount on the basis of document issued by the supplier.

Such post supply discounts will always be under challenge. Further, it would be a complex procedure to determine if the receiver of the discount has reduced his claim of input tax also.

Hence, this provision should be duly amended keeping in mind of existing legal jurisprudence as held in the above decision of the Hon'ble Supreme Court wherein it was held that the sale/purchase price has to be adjudged on a combined consideration of the tax invoice or bill of sale as the case may be along with the accounts reflecting the trade discount and the actual price paid.

Thus, the provision in respect of discount should be made in the context of the decision of the Hon'ble Supreme Court as generally, post sale discounts are linked to targets to be achieved in a particular period which is not comprehensible at the time of sale and accordingly, this discount is logically cannot be linked with the tax invoices.

*Hope the information will assist you in your Professional endeavours. In case of any query/information, please do not hesitate to write back to us.*

Thanks & Best Regards,

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