

Tax alert: ITC on goods or services procured for giving incentives to dealers not allowed - Karnataka AAR

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Summary

The Karnataka Advance Ruling Authority (AAR) in a recent case held that the Applicant is not eligible to avail Input Tax Credit (ITC) on the inward supplies of goods and services given as incentives in the form of gifts of goods and services to dealers. Further, the AAR observed that free travel services provided to dealers without consideration would not qualify as 'supply'. Accordingly, it held that the ITC on services procured for offering free trips is not available as it is in the nature of gift.

Facts of the case

- The Applicant¹ is a manufacturer of decorative paints. The manufactured paints are marketed through its dealers spread across south and west India.
- The Applicant offers various incentive schemes to its dealers in order to motivate them and increase sales. The Applicant procures various goods or services in order to give as incentive to its dealers and painters.
- It sought an advance ruling on whether ITC would be allowed on goods/services procured by it for giving as incentives.

Karnataka AAR observations and ruling

- **Nature of gifts:** The goods or services distributed to dealers or painters are in the nature of gifts/incentives. GST law does not allow credit on any goods disposed by way of gift or free samples, whether or not in the course or furtherance of business².
- **Does not qualify as supply:** Such gifts/incentives are given without receipt of any consideration. Hence, such activity does not qualify as a supply³.
- **ITC not available:** Therefore, the AAR held that the Applicant is not eligible to avail ITC in respect of goods or services procured for giving incentives to its dealers.

- **Free foreign or local trips:** The free trips as provided to dealers are without any consideration, and hence they do not qualify supply⁴. Therefore, ITC in respect of services procured by the Applicant to offer free foreign or local trips to its dealers shall not be available⁵.

Our comments

Earlier, the Maharashtra AAR had provided a similar ruling wherein ITC was disallowed on expenses incurred towards promotional schemes of loyalty programme and goods given as brand reminders. The Central Board of Indirect Taxes and Customs (CBIC) had issued a clarification in relation to treatment of sales promotion schemes vide Circular No. 92/11/2019-GST dated 7 March 2019, wherein it was clarified that ITC shall not be available to the extent used in relation to goods or services provided as free samples/gifts. However, the said circular was withdrawn by the CBIC citing numerous representations received expressing apprehensions on the legality of the said Circular. It should be kept in mind that giving incentives to dealers in lieu of achieving a defined sales target could still be argued as being directly linked to business promotion, the cost of which has already been included in the original value of supply. Thus, where GST is discharged on the original value, ITC on free of charge supply should be allowed. The governments must consider this anomaly and provide necessary clarification in this regard.

¹ Surfa Coats India Pvt. Ltd.

² Section 17(5)(h) of the CGST Act, 2017

³ U/s 7 of the CGST Act, 2017

⁴ In terms of Section 7(a)(1) of the CGST Act, 2017 and Schedule I of the CGST Act, 2017

⁵ Circular No. 92/11/2019-GST dated 7 March 2019

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