

Reversal of Input tax credit: Navigating Financial and Commercial Credit notes

Section 15 of the GST Act lays down the principle in which value of supply is determined. In other words, Credit note(s) can be issued as a commercial transaction between the two contracting parties. Secondary discounts shall not be excluded while determining the value of supply as such discounts are not known at the time of supply and the conditions laid down in clause (b) of sub-section (3) of section 15 of the said Act are not satisfied.

In this regard, attention is invited to Section 2(62) which deals with input tax credit uses the words 'tax charged' whereas Section 2(82) which deals with output tax liability uses the words 'tax chargeable'. This itself reflects the fact that the recipient of the goods or services is only concerned with tax charged by the supplier for the claim of input tax credit and need not to go on the compliances/chargeability issues of the supplier.

Further, in case of incentive related benefits such as cash discount which are extended by supplier to recipient of the supply, there cannot be any service by the recipient to the supplier. There is no service which is rendered by the recipient in this case. There is no quid pro quo or agreement or intention for the rendering of any services by recipient to the supplier.

Also, we would like to throw the light on clause (aa) sub-section (2) of section 16 of CGST Act, 2017 and sub-rule (4) of rule 36 of CGST Rules, 2017, wherein it is mentioned that registered person can avail ITC only if the invoice/debit note reflects in GSTR-2B/GSTR-2A. Since, in our case the supplier has issued financial credit note and accordingly the same is not reflected in GSTR-2B/GSTR-2A. As such there is no liability on us to reverse the Input Tax Credit.

It is further relevant to note that Section 34(1) of the CGST Act, 2017 allows the issuance of the GST credit note only for the reduction of the taxable value or tax charged which is not the present case. Even if it does qualify the requirements of Section 34(1), issuance of the such credit note is discretionary on the part of the supplier. It is relevant to note that Section 34(1) states that '*..... may issue to the recipient.....*' *unlike Section 34(3) which deals with the issuance of debit notes and states that '..... shall issue to the recipient.....'*

Nonetheless, in the present facts of the case, no credit note reducing GST liability has been issued and accordingly there is no requirement on us to reduce the corresponding input tax credit which is availed in due compliance with Section 16. This aspect is unequivocally clarified by circular no. 92/11/2019-GSTas reproduced above which is issued by CBIC in the exercise of the powers conferred by Section 168.

Further guidance can be taken from the ruling of AAR, Andhra Pradesh, in the matter of Vedmutha Electricals India Pvt. Ltd. [Advance Ruling no. 05/AP/GST/2023 dated May 26,2023].

Facts:

M/s. Vedmutha Electricals India Private Limited (“the Applicant”) are engaged in the business of supply various electronic items.

The Applicant purchased various electronic items from M/s. Gold Medal Electricals Private Limited (“the Supplier”). The supplier issued tax invoice as per Rule 46 of the Central Goods and Services Tax Rules, 2017 (“the CGST Rules”), and charge GST on taxable as per section 15 of the Central Goods and Services Tax Act, 2017 (“the CGST Act”).

The supplier provided number of incentives in the form of “discounts,” including Turnover Discounts, Quantity Discounts, Cash Discounts, Additional Scheme Discounts, 3 Months Regular Scheme Discounts, etc., year by year from the time of registration to the present. All of the aforementioned discounts are post sale discounts. The supplier raised financial/commercial Credit notes for the above-mentioned discounts. The applicant has properly accounted for these financial credit notes and the distributors have disclosed them in their Income Tax Returns. The supplier does not reduce its output tax liability concerning these financial/commercial credit notes as stated in Section 15 which does not make it subject to exclude “Post Supply Discounts” from the transaction value. Additionally, the supplier has submitted an affidavit stating the non-reduction of GST liability due to these credit notes.

The Applicant further asserts that in case of post supply discounts, the discount is specified in an agreement made at or before the time of the supply and the Input tax credit (“ITC”) attributable to the discount is not to be reversed by the Applicant.

Issues:

Whether the Applicant is liable to reverse the ITC proportionately to the extent of financial/commercial Credit note issued by the supplier?

Held:

The AAR, Andhra Pradesh, in Advance Ruling no. 05/AP/GST/2023 held as under:

- Observed that, the provisions of section 15(3)(b) of the CGST Act can only be applicable if there was a prior agreement and a link is established between the relevant invoices and the discounts provided. In this case, no such correlation was found between the Credit notes issued by the supplier and the Applicant. As a result, the benefit of reducing the value of the discount from the transaction value, as per the provisions of section 15(3)(b), was not allowed.
- Noted that, the financial credit note should not be used as a means of fraudulently transferring ITC by inflating an invoice.
- Held that, the post-supply discount received by the Applicant from the supplier did not impact the transaction value between the parties. Therefore, the Applicant is

eligible to take full credit of the GST charged in the tax invoice and was not required to reverse the ITC to the extent of the financial or commercial Credit notes issued by the supplier.

Similar to the above ruling In MRF Ltd. AAAR Tamil Nadu (TN/AAAR/04/2019(AR) dated 24.06.2019) dated 24.06.2019. Ruled that, '*appellant (recipient) can avail the Input Tax Credit of the full GST charged on the undiscounted supply invoice of goods/ services by their suppliers. A proportionate reversal of the credit is not required to be done by them in case of a post purchase discount given by the supplier to them through the C2FO platform (commercial credit note)*'

Representations have been received from the trade and industry that whether credit notes(s) under sub-section (1) of section 34 of the said Act can be issued in such cases even if the conditions laid down in clause (b) of sub-section (3) of section 15 of the said Act are not satisfied. It is hereby clarified that financial/commercial credit note(s) can be issued by the supplier even if the conditions mentioned in clause (b) of sub-section (3) of section 15 of the said Act are not satisfied. In other words, credit note(s) can be issued as a commercial transaction between the two contracting parties.

Conclusion-

The question of whether a reversal of Input tax credit is required in the case of financial or commercial Credit notes is a complex issue. It depends on the purpose and nature of the Credit note. To navigate this area effectively, businesses should maintain transparent and accurate records of all transactions. Understanding the nuances of ITC and Credit notes is essential for businesses seeking to operate within the bounds of tax compliance while optimizing their financial processes.