



# *Impact of GST*

## FMCG and Retail

September 2018



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# *FMCG and Retail Sector in India*





# ***FMCG and Retail Sector in India***

Fast moving consumer goods (FMCG) is the 4th largest sector in the Indian economy. There are three main segments in the sector – food and beverages, healthcare and household and personal care which accounts for almost half of the sector.

FMCG Companies are looking to invest in energy efficient plants to benefit the society and lower costs in the long term. Growing awareness, easier access, and changing lifestyles are the key growth drivers for the consumer market. The focus on agriculture, MSMEs, education, healthcare, infrastructure and employment policies by the Government also have an impact on the growth of this sector.

Since different products are taxed at different rates under GST, on a macro level, the average tax and the final prices that the end customer ends up paying have averaged out post implementation of GST, with some products becoming more expensive (aerated beverages, shampoos etc.) and others becoming cheaper (toothpaste, soaps etc.).

As the retail sector witnesses unprecedented growth, India has emerged among the most desirable retail destinations in the world. Even though modern trade is growing at 15 to 20% per annum, it has a low organised retail penetration of just 8%. Further, various infrastructural challenges remain.

India's economic growth and its demographic profile make the country a compelling business case for global retailers planning an international foray. The strong economic growth is attributed to high disposable incomes, growing middle-class influence, increasing individual wealth and the country's large young population. The untapped rural sector and the lesser developed Tier II and Tier III cities provide ample opportunities for growth. The liberalisation of FDI in single-brand retail and the expected opening-up of FDI in multi-brand retail have generated significant interest among multinational retailers.

## ***The GST implementation – Teething issues and current state of play***

One of the biggest challenges in the GST implementation was the technology infrastructure and experience of compliance given that since Day zero; there were bugs, the portal had a slow response rate and performance related issues. The Government constituted a committee to address the issues and it is working on improving the tax payer experience and various steps at simplification of process are being introduced.

The implementation of the E-way bill also brought with it operational as well as technology challenges for which the Government took additional time to get the framework up and running. The portal was revamped and was introduced in February 2018 and is completely functional since April 2018 on a pan India basis. The automation of E-waybill system is a welcome relief from the previous practice of manual checking of way bill information at check posts in different States which led to different interpretations and maintenance of different types of documentation/ records based on State VAT law provisions.

Multiple tax rates (5%, 12%, 18% and 28%) is another aspect which complicates the taxation system and leads to unwarranted classification disputes which has plagued the FMCG sector. The GST law also prescribes for a levy of compensation cess on some specific goods. Further, the applicable rate also depends upon value-based classification (footwear, apparel etc), Specification based classification and based on status of buyers. The Government has indicated that it will continue to work on rationalization of rates and try to move towards a simplified tax rate structure.

An important aspect of the implementation of a new law is to have a quick and robust dispute prevention and restitution mechanism. Acknowledging the need for suitable clarifications, the Authority for Advance Ruling (AAR) has been set up in multiple jurisdictions across India. The AAR has been fairly proactive in disposing off advance ruling applications, especially in Karnataka, Maharashtra, Kerala and Gujarat. However, given that the AAR has been constituted at a State level, there is a possibility of contrary rulings by two different AARs. This indicates a need for a central management team. Further, the appellate process for challenging such advance rulings is not completely robust as yet. These factors are placing the efficacy of the advance ruling mechanism in doubt in the minds of the tax paying community.

Transition from one regime to another is always a difficult process and it was no different in the present case. The Government did allow for transition of all input tax credits in the books of accounts to the new regime, subject to fulfillment of prescribed conditions. This step taken by the Government was appreciated by the industry. However, the nuances for interpreting the conditionals of availing such credit were not appropriately



addressed. For eg. While the Krishi Kalyan Cess ('KKC') was available as input credit under the previous regime, there was no clarity on transitioning it to GST, while a recent proposed amendment seeks to deny the credit altogether. Further, subsequently, it was clarified in an Advance Ruling<sup>1</sup> that this was ineligible for transition. The legality of such clarification is likely to be tested before the courts. Moreover, due to revenue collection challenges in the initial months, the Government also issued numerous notices disputing eligibility of transitional credit, thereby imposing more rigorous documentation/ compliance requirements on players already reeling under transition challenges. Further, in some cases, there was a technology challenge i.e. eligible transitional credit did not reflect on the GST portal or dealers were unable to file the prescribed forms online. It is expected that the Government will address these concerns soon and give relief to taxpayers.

Further, even after one year of GST go-live, there is deferment of implementation of provisions relating to advances and purchases from unregistered vendors, Tax Collection at Source for e-Commerce players and Tax Deducted at Source for works contractors which leads to an atmosphere of ambiguity for existing businesses as well as those looking to set up new ventures. One of the focus areas for India Inc is the **matching concept**, wherein a buyer is required to reconcile its tax payments with the tax collections, deposited and reported by the supplier on the Government portal. Any incorrect or unmatched transaction would lead to denial of credit to the buyer. However, due to IT glitches, this concept was not implementable and the system is deferred till necessary technological framework is put in place by the Government.

Given that employer and employees are defined as related parties under the GST law and supplies to related parties even without consideration is now a taxable supply, all transactions between employers-employee need to be analyzed *qua* the said provision. Supplies from employee to employer of Gifts upto INR 50,000 per employee are exempted from GST. Free benefits such as free food, health check-up, gym, crèche etc. are common facilities provided to all employees and benefits that form part of employment policy should be akin to standardized consideration to the employee in course of employment and thus, should not be liable to GST. However, wherein there are supplies for which part or full value recovered from employees (such as subsidized food), the same to be considered as supply and valued at the open market value. Kerala AAR in a recent advance ruling<sup>2</sup>, held recovery of canteen food expenses as taxable supplies

Tax payers also under various contracts have clauses pertaining to liquidated damages from their vendors i.e. contractors etc. for delay in delivery, performance issues, etc. Such damages may also get adjusted from the invoice, thus resulting in net billing/payment. Taxability of liquidated damages/ cancellation charges have been matter of litigation even under the erstwhile indirect tax regime. Given the wide coverage of the definition of services, the ambiguity on their taxability continues even under the GST regime. While there as ruling of the AAR<sup>3</sup> which holds that such Liquidated damages are taxable as a declared supply in the hands of the contractee under the provision Schedule II (5)(e), such ruling is likely to be contested at an appellate stage.

Implementation of the anti-profiteering provisions is one of the key areas of debate within the industry players. While the regulations seek to prevent entities from making profits on account of GST, an overarching anti-profiteering provision under the GST law without clear guidance or explicit rules has led to considerable ambiguity, primarily on account of the following:

- a) Lack of clarity on the granularity of anti-profiteering analyses i.e. at aggregate company level, product category or SKU level, impact *qua* price controlled products
- b) Can the Indian tax payers resort to mechanism followed by tax payers in other jurisdictions with similar anti-profiteering provisions (such as Australia/ Malaysia?). Will the tax authorities accept the same?
- c) Whether transition costs incurred by the Company on account of GST implementation may be absorbed while computing a revised anti-profiteering compliance price.
- d) On which date such price reductions were/ are to be made effective.

Recently, the National Anti-Profiteering Authority (NAPA) has issued two orders – one for a company dealing in automobiles<sup>4</sup> and another for one engaged in rice business<sup>5</sup>. In both these cases, the authority ruled in the favour of the companies. However, it is not clear as to exactly how the revised price computations were carried out by the companies and factors differ basis the nature of the product and business.

<sup>1</sup> *Kansai nerolac paints limited 2018-TIOL-09-AAR-GST (No GST-ARA-18/2017-18/B-25)*

<sup>2</sup> *Caltech Polymers Pvt Ltd 2018- CT/531/18-C3 DATED 26/03/2018*

<sup>3</sup> *Maharashtra state power generation company 2018-VIL-33 AAR (No GST- ARA-15/2017-18/B-30)*

<sup>4</sup> *Dinesh Mohan Bhardwaj Vs Vrandavaneshwree Automotive Pvt Ltd - 2018-TIOL-01-NAPA-GST*

<sup>5</sup> *Kumar Gandharv v. KRBL Limited - TS-173-NAA-2018-NT*



Implementation of the GST has undoubtedly been one of the biggest events in the highly fragmented FMCG and retail industry. It has made companies re-examine their supply chain networks to optimize their number of warehouses, locations and linkages. The typical value chain is highlighted below for ready reference:



## 1. Rate rationalization

The biggest challenge since the GST implementation for the FMCG and retail sector has been the effective rate of tax. While GST was expected to simplify taxation and bring uniformity, the different tax rate slabs and higher rates for consumer durables led to an increase in the cost of some items of mass consumption. Given the same, the GST council has been working on rationalization of rates. In a recent GST council meeting<sup>6</sup> broad rate reductions were introduced with a specific focus on products such as sanitary napkins, domestic electrical appliances/ white goods (food grinders, mixers, shavers, hair dryers etc.). Businesses continuously need to analyze the impact of the rate rationalization, especially from an anti-profiteering perspective.

## 2. Classification related issues (medicaments vs. cosmetics) -

The classification of certain cosmetics such as skin care preparations which also have medicinal properties and contain recognized medical ingredients has been historically subject to litigation since medicaments or ayurvedic items are taxed at a lower rate, whereas cosmetics are typically taxed at a higher rate. The test for determining whether a preparation can be classified as a medicament or not depends upon whether it is meant primarily for use in treatment of skin disorders or diseases and whether the ingredients therein have known or recognised therapeutic value or not. While there is an advance ruling<sup>7</sup> on this issue that discusses some of the jurisprudence under the previous regime, and sets out some principles on how preparations can be classified as medicaments, a clarification in this regard with more concrete parameters could go a long way in ensuring consistent treatment and minimal disputes. However, there is difficulty in providing absolute guidance as the products are themselves unique in nature.

## 3. Marketing/ discount schemes

While all business have to offer different types of marketing schemes and offers, in the FMCG and retail the industry is structured in a way that the manufacturers/ importers offer a variety of pre and post-sale discounts and incentives, free samples etc. to dealers/ distributors. While the industry players, during implementation of GST have taken positions relating to different types of marketing schemes, a conclusive clarification on the same is still not available. Further, in some States, officers at the ground level have also commenced raising queries relating to the practices adopted. Key issues pertaining to the same are as follows:

- **Tax treatment of different types of schemes** – There are diverse range of schemes offered by FMCG and retail players to its distribution network, and due to the ecosystem these keep evolving. Various categories of such transactions are as follows:
  - Post sale discounts such as price discount, purchase based schemes, category growth, trade discount, turnover target discounts
  - Special discounts such as festival price discount, liquidation support and other seasonal rebates

<sup>6</sup> Press releases issued post the 28<sup>th</sup> GST council meeting dated 22 July 2018

<sup>7</sup> Akansha Hair & Skin Care – Ruling dated 9 April 2018



- Merchandiser support, visibility allowance and security deposits received from exclusive outlets
- Corporate or bulk buy discounts
- Other allowances such as loading/ unloading allowance, freight allowance and event support

The aforesaid schemes can either be cash discount or it could also be additional quantity supply. It also requires factual examination whether the secondary market schemes qualify as post sale discounts eligible for deduction under section 15(3)(b) or be considered as a 'subsidy directly linked to price' under Section 15(2)(e) of the CGST Act. If it qualifies as 'subsidy directly linked to price', it would attract GST in the hands of recipient. It is essential to ascertain the tax treatment, ITC impact of different types of schemes, as well as maintain appropriate documentation so that the entire value chain adopts appropriate tax practices.

- **Promotional schemes, off take discounts** - Company issues promotional schemes and provides off take discounts to stockist/ retailer wherein on buying some specified quantity of a product, the distributors will get additional quantity of that product free of cost (e.g.. buy 10 items with additional 2 items free). Further, the chargeable as well as free supplies are mentioned on the face of the same invoice (e.g. it is mentioned 10 units chargeable and 2 units free). Basis the above, the issue under consideration is whether input tax credit is required to be reversed on the goods supplied based on commercial terms without consideration under the said transaction. One view on this issue is that the free goods supplied are not in the nature of 'gifts' but are akin to a quantity discount and thus, no input credit reversal should be required for the same. However, this view has to be formally confirmed by the GST authorities.
- **Free samples given to potential customers/ Gifts to dealers/ distributors** - Company distributes its products as a part of marketing initiatives, etc. as free samples or gifts to dealers/ distributors for reaching targets such as gold coins etc. As per Section 17(5)(g), input tax credit shall not available for goods supplied as free samples. While currently, credit reversal is required, industry is representing that credit reversal should not be required as distribution of the said goods as free samples is required for promotion of the sale of these goods and are thus used in course and furtherance of business. Further, while generating e-way bill for the same, industry should seek clarification regarding the taxable value to be reported on the e-way bill for such FOC supplies. Procedure/ mechanism for computation of credit reversal on account of goods distributed as free samples, used for personal use etc. is not clear in the law. Further, no specific provision is there in the CGST Act for requirement to reverse credit in case of free of cost services (such as free trips to customers on achieving certain targets, etc.).

## 4. Combo packs

There are various marketing campaigns operative in this sector to increase customer engagement and combo packs (combinations of different types of products) is a regular phenomenon. For combo packs where price breakup is also shown on the invoice, an issue may arise as to whether the same can be treated as mixed supply (and therefore taxable at highest rate applicable to the individual items) or individual supply (taxable at tax rates applicable to respective individual products). Given the statutory norm, mere mention of the price breakup on the invoice may not always change the characterization of a mixed supply to an individual supply. However, there is no clarification on the practical constituents of qualifying as a mixed supply and the issue needs to ideally be analyzed based on facts of each situation.

## 5. Loyalty points redemption

Various retailers run different kinds of loyalty schemes where customers accumulate points and subsequently, on purchase of goods, can make full or part payment through the accumulated points. At present, there is some lack of clarity on the treatment of these points. While some treat it as a discount, some choose to pay GST on the entire value of the goods (including the equivalent of points). The question is whether GST should be paid on the amount after reducing the sum attributable to loyalty points, as it is essentially in the nature of quantity or off-take discount offered to frequent customers (provided the other prescribed conditions are met). Further, given the extensive supply chain in this industry, the loyalty point redemption transaction through the supply chain also needs to be evaluated to ensure appropriate tax treatment at each leg of the transaction.

## 6. Vouchers

The payment modes are constantly evolving and new ways of making payments are being added. In this industry some of the most commonly used payment modes are pre-paid cash cards/ gift cards, meals / goods



vouchers and gift vouchers. The holder of such cards/ vouchers are generally entitled to a discount or equivalent monetary value for purchase of goods/ services. 'Voucher', for the purposes of GST, necessarily means that instrument which should be accepted as consideration (wholly or partly) for a supply. Therefore, a voucher is an asset for the recipient, and without a recipient, a 'voucher' would lose its meaning. Further, there is a specific time of supply in case of vouchers i.e. in case of supply of vouchers by a supplier, the time of supply shall be—

- (a) the date of issue of voucher, if the supply is identifiable at that point; or
- (b) the date of redemption of voucher, in all other cases.

Further, the rate of tax for vouchers is the rate applicable to goods or services they are issued in respect of or that applicable at the time of redemption. Given the specific provisions relating to vouchers, while the general view is that GST is to be paid at the time of redemption of voucher in case of purchases by customers, it is imperative to evaluate each type of transaction to ensure that the appropriate point of taxation is adopted.

## 7. Sales returns, customer refunds and other miscellaneous transactions

- **Excess collection of money from customers** - In case of excess collection of money from customers on account of rounding off difference, the issue is as to whether GST to be paid on additional amount recovered. There is no specific relaxation in GST law as regards non-payment of GST on excess amount or net amount collected from customer due to rounding-off difference.
- **Sales return from a different State** - In case of inter-State supply, where goods are returned by customer in a State different from where the goods were issued (say from Delhi), whether credit note (and subsequent tax adjustment) can be claimed by the State which originally invoiced the good (in the absence of receipt back of goods to such State).
- **Sales return in case of closure of branch/ warehouse in a State** - Similarly, where the customer returns goods in different State due to closure of the office/ warehouse of the State from where the invoice was issued (say in Delhi), whether there would be credit blockage in the State of Delhi on account of making a non-taxable supply from Delhi (in so much so that Delhi would not make any taxable supply of goods in future once returned by the dealer since the goods would be lying at different State).
- **Refund provided to customers** – In certain cases, if the customer is unhappy with the product or in case of an expired/ faulty product, refund is provided to the customers. The issue to be considered is whether the same may be construed as a separate supply liable to GST. In this case, a position is possible that there is no underlying supply of goods in the course of furtherance of business by the customer is such a scenario and thus, this should not qualify as a separate supply.
- **Compliance requirements for credit note/ debit notes** - Given the quantum of low value high volume of transactions, the requirement for raising one credit note/ debit note per invoice was creating a compliance and administrative nightmare for the industry. Given the same, in order to simplify the compliances, an amendment to the law is issued allowing for issuance of a consolidated debit note/ credit note covering multiple invoices.

## 8. Return of expired goods

Section 142 of the Central Goods and Service Tax Act, 2017 (CGST Act) prescribes that if goods are returned by a registered person on which duty was paid not prior to 1 January 2017, such returns will be treated as a supply. Separately, where goods are written off or destroyed, input tax credit of such goods will not be available as per Section 17(5)(g) of the CGST Act. In this regard, as per the letter issued by the GST authorities on return of expired stock<sup>8</sup>, it has been clarified that ITC taken on expired / damaged go should be reversed basis the aforementioned provision. Further, on return of goods, a deduction of GST paid cannot usually be claimed since the return occurs after September of the following financial year. The aforementioned clarifications leads to the following issues:

- Company is burdened with double tax cost on account of input credit reversal and no deduction of tax paid

<sup>8</sup> Letter 349/57/2017-GST dated 26 December 2017 issued by CBEC in response to Pharma Association queries





- It leads to a confusion as to whether the tax credit to be reversed is that of the tax amount to be charged by the returning person or that of the inputs that were consumed in the manufacture of the expired goods.
- The ultimate manufacturer of the expired goods, who paid the tax to the Government at the time of the original sale / supply, should not be required to reverse any ITC, at the destruction of the expired goods, as the goods were already tax paid.

Given that the supply chain is extensive and often involves multiple stockists/ sub-stockist, maintaining a paper trail in case of sales return (especially of expired stock) may become effort intensive. Further, in case the goods are sold by sub-stockists to each other (especially across States), there is no way of identifying the original invoices.

## 9. Input Service Distributor vs. Cross Charge

Under GST, supplies between State registrations of an entity are subject to tax, even if the same is without consideration. In view of this, companies are required to undertake analysis of activities undertaken by Head office for its branches and vice versa; identify the value of such services and discharge tax liability thereon or distribute it in by obtaining an Input Service Distributor registration. The said exercise involves huge effort and time. Further, it leads to complexities and additional GST compliances.

## 10. Area based exemptions/ Benefits under State Industrial policy

In pre-GST regime, industry used to enjoy fiscal benefits in the North Eastern region, Himachal Pradesh, Uttarakhand and J&K in the form of excise duty exemptions/ refunds. Now under GST, those refund benefits have been withdrawn and are proposed to be compensated/refunded as budgetary support. The current proposal restricts refunds to the extent of prescribed percentage of CGST / IGST payout in cash (i.e. after adjusting all input credits) for units in the fiscal benefit zones for area based exemptions whereas percentage of SGST benefit for State Industrial policy.

This may result in substantial reduction of GST refunds as compared to the present benefits granted and may make certain units unviable. Further, it is to be highlighted that the proposed refund model seems to restrict the eligibility of refund to only actual manufacturers, thereby not addressing concerns related to principal manufacturers who operates through business models such as third party manufacturer (3Ps) and job working arrangements, mainly in Himachal & Uttarakhand. Thus, the quantum impact of such change in the benefit schemes should be carefully evaluated to enable that the principle of *promissory estoppel* is not deviated from. Also, if the flow of benefits stand altered (eg. Benefit earned per year in absolute terms remains constant), the question whether this be factored as a cost increase for anti-profiteering purposes needs to be debated. Further, some industry players have filed writ petitions against this reduction in the quantum of benefits, which are currently pending.

### In conclusion

GST has impacted the Retail and FMCG sector by readjusting tax brackets and potentially reducing distribution costs for various companies over the long run. Some companies have “gain” with lower taxes and distribution costs, and thus have responded by increasing product volume and lowering prices, while others may have “lost” with higher taxes, and thus need to compensate by increasing prices. This is why there is an ongoing attempt on the part of the GST authorities to rationalize the tax rates. However, the two rate rationalizations in 23<sup>rd</sup> GST council meeting in November 2017 and 28<sup>th</sup> GST Council meeting in July 2018 have been positive for this segment as a whole.



**Disclaimer:** *The above-mentioned updates are intended for informational purposes only. They constitute some select important points in the GST law. There could be other additional features that too may be important.*

# *Thank you*



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