GST VALUATION OF STOCK TRANSFERS TO AGENTS, RELATED AND DISTINCT PERSONS

Introduction:

It has been a year since GST has rolled out. Though the trade is familiar with the concept of supply and valuation under GST law, yet few of them are facing certain practical difficulties in aligning their business to GST. In this article, we are going to touch up on the GST aspects relating to establishment of a branch, agent or any other related entity.

The Concept of Related Persons, Distinct Persons & Agents under GST Law:

- Related persons mean a person who is a member of family, officer, director of another business, partners, employer and employee, a person or an entity who holds 25% or more voting stocks or shares in a company and they can either directly or indirectly controls the other. Related persons also include legal persons, and sole agent or sole distributor or sole concessionaire.
- Distinct persons are the offices or establishments of a single entity which are located in different states for which more than one registration under GST is required to be obtained in each of the states in which such offices or establishments are located. Each such offices or establishments located in different states having separate registration shall be treated as distinct persons for GST law.
- Agent means a person who acts in a way of representative character to supply or to receive goods or services or both on behalf of principal. Agent includes a factor, broker, commission agent and del credere agent etc.,

Schedule I of CGST Law:

To become a supply, presence of consideration is a pre-requisite. However, certain activities are listed under Schedule I of Central Goods and Services Tax Act, 2017, are deemed to be supply even if they are undertaken without consideration. These include;

- Permanent transfer or disposal of business assets where input tax credit has been availed on such assets;
- Supply of goods or services or both between the related persons and distinct persons made in the course or furtherance of business and
- Supply of goods by a principal to his agent or an agent to a principal, where agent should undertake to supply or receive the goods on behalf of principal and where the condition of undertakes and further supply should satisfy to become a supply.

Destination Based Consumption Tax:

GST is called a consumption-based tax as it was payable to a state in which goods or services are actually consumed. Here the tax is levied, and revenue is collected by the consuming state where the goods or services or both are actually consumed. In a case where the goods or services or both procured and consumed in a same state then tax is levied (i.e., Intra-state supply) by the same state and revenue is also called by the same state. In order to satisfy this principle of destination-based consumption tax, whenever goods are moved to branches or agents located in other states, such movement is considered as supply in order to move the taxes involved in the said goods from origin state to destination state as origin state losses the right to retain or recover any taxes on the goods that are transferred to other states for consumption in those states.

Valuation in Case of Related Persons and Distinct Persons:

Rule 28 of the Central Goods and Service Tax Rules, 2017 provide for valuation with respect to a supply which takes place between the distinct persons and related persons. Accordingly, the value of supply shall be the open market value or price charged for goods or services of like kind and quality, if the open market value is not available. If value of the supply cannot be determined in terms of open market value or on the basis of price charged for goods or services of like kind and quality, then it should be determined by applying cost plus 10% mark-up or by residual method as prescribed in Rule 30 and Rule 31 respectively. The residual method means applying the valuation by reasonable means consistent with general provisions relating to valuation of supply.

Two provisos are provided for the Rule 28, whereas the first proviso provides an option to the supplier either valuing the supply at open market value or ninety percent of the price charged for goods or services of like kind and quality. This option is available only in case of stock transfer of those goods which the recipient is intended for further supply to an unrelated customer.

Whereas second proviso provides that in cases where recipient of goods is eligible to take full input credit of those goods that are stock transferred, then whatever the value adopted by the supplier shall be deemed to be the open market value.

Both the conditions laid down in the above discussed provisos, do not restrict the recipient of supply to claim ITC but the first proviso requires the recipient to further supply such goods to an unrelated supplier while the second proviso does not require so. Therefore, stock transfers for further supply can be valued on the basis of open market value which could be any value as declared by supplier in the invoice (second proviso) or on the basis of 90% of the price charged for goods of like kind and quality (first proviso).

For example, ABC Ltd. is incorporated in Telangana with their Head Office (HO) also in same State. ABC Ltd. has branches in different states like Karnataka, Tamil Nadu and Kerala. Here HO has transferred the goods at a cost of Rs. 2,00,000 to its branch located in Karnataka for further supply and it also transferred the capital goods costing 2,00,000 (as available in the open market) to a branch located in Kerala.

In the first instance, where the goods are transferred for the further supply then HO has an option of valuing the goods at a cost of Rs. 2,00,000 or 1,80,000 (90% of OMV). Since, the receiving branch is entitled to full ITC, HO can even transfer the goods at a value less than Rs. 1,80,000/- to their liking by mentioning the same in the invoice issued for this purpose.

For the second instance, he can transfer the goods at Rs 2,00,000 (OMV) or any value less than Rs. 2,00,000 (as he can declare the same in the invoice), as second proviso provides for an option of valuing the goods at whatever price if the recipient is entitled to full ITC. This rule is not applicable for valuing stock transfers to agents as separate rule by way of Rule 29 has been prescribed for this purpose.

Valuation in Case of Stock Transfers between Principal and Agent:

By virtue of Rule 29, principal or agent has an option of valuing the goods for supply either at open market value of the goods or at ninety percent of the price charged for the supply of goods of like kind and quality by recipient to his customer not being a related person. Whereas, the option of ninety percent. of price charged for like kind and quality can only be applied when the principal or agents intended it to further supply. Where the value of a supply is not determinable under OMV or 90% of price charged for like kind and quality, then the value of supply shall be determined by the application of cost plus 10% mark-up or residual method under rule 31. (determining by way of reasonable mean).

For example,

1. The principal supplies tyres and tubes to his agent. Agent, supplies tyres and tubes of similar type and quality in consequent supplies at a price of Rs 3,500 per set on the day of supply. Another independent agent is also supplying tyres and tubes of similar type and quality to the said agent at the price of Rs 3,000 per set. Hence, the value of the supply made by the principal can be valued either at Rs 3,000 per set (the open market value of tyres and tube) or he can exercise the option of valuing the tyres and tubes at 90% of INR 3,500 (goods like kind and quality) per set i.e. INR 3,150.

<u>Comparative Analysis of Tax Implications on Supplies between Related person, Distinct person and Agent</u>

Let us understand the comparative analysis of tax implications on supplies between related persons, distinct persons and agents with an illustration.

Example

Prefix Limited manufactures a chipset at cost of Rs.100 and it distribute the same to their branches and agents located within the states and other states. Prefix has a distributor, which is a partnership firm and the partners in the partnership firm are the directors of the Prefix. Here, Prefix transfer the chipset to their distributors at a cost of Rs. 70. Where a cost of similar chipset which manufactures by the others cost Rs. 90 (OMV). Can Prefix transfer the chipset at a cost of Rs. 70 or not to the distributors?

We will analyse the example by case to case, in case where –

<u>Stock Transfers Takes Place Between Branches</u>

Prefix has an option of valuing the goods by applying the first proviso (i.e. 90% of the price charged for the goods of like kind and quality) or Second proviso (i.e. value declared in the invoice shall be the open market value). In this case Prefix can apply second proviso for valuing the same at Rs. 70/- while it is distributing the same to their branches.

Here, Prefix has a branches within the state and another states. It has benefit of supplying the goods without payment of tax while supplying to branch located in the same state as it is does not become a separate distinct person unless the same obtains the separate registration in same State.

<u>Stock Transfers Takes Place Between Related Persons</u>

By applying the second proviso, Prefix can value the goods at cost of Rs. 70, where it is supplying the goods to their Related persons i.e. Partnership firm. In case of Related Person, the benefit of supplying the goods without payment of tax even if the related persons are located in the same state is not available as supplies between related persons located in same state also amounts to deemed supply under schedule I.

Stock Transfers Takes Place Between Principal and Agent

Prefix cannot value the goods at a cost of Rs. 70, when the transfers takes place between the agent. In this case, Rule 28 does not apply in case of agents where a separate rule (Rule 29) has been prescribed for valuing the goods when supply takes place between the Principal and Agent. Prefix has to value the goods at Rs. 100 or 81 (90*90/100=81) by applying the rule 29. There is no such benefit available like branches, even though the agents are located within the state or another state.

For easy comprehensive of rules, we will understand the same by below table.

Stock Transfers to	**Taxability of Supply within the State**	**Benefit of Second Proviso**
Distinct person	No	Yes
Related Person	Yes	Yes
Agent	Yes	No

In view of the valuation problems between related persons, distinct persons or agents. In cases where there is a time lag between the manufacturing and supply of goods to customers, it is advisable for manufacturing entity to have a branch office i.e. Distinct Persons as it has a liberty of valuing the goods at their choice by applying the second proviso to rule 28. In cases where there is no such time lag between manufacturing and supply of such goods to customers, then they can choose to set up either a branch or appoint an agent or a related distributor considering other business factors.

In case of principal and agent, majority of a transactions takes place without consideration. By considering the term supply and valuation mechanism specified in valuing such supply, principal supplier may require with additional tax compliance and requirement of additional working capital for paying such taxes even for agents located in same state as that of principal. Hence, this rule may have a serious implications on the principal-agent relationship.

Conclusion:

Summing up, GST implications will vary depending upon the type of supply chain that a particular entity wishes to establish. If the time lag for supply to ultimate customer is more, it is advisable to set-up a branch as this will have less tax impact compared to setting up of consignment agent or a related distributor. This is purely from GST perspective. If the other factors relating to business demand for set up of consignment agent or distributor, one should take into consideration the GST tax proposition also into consideration and accordingly take the decision.