

## **GST Guidance Note -5**

### **Valuation**

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#### **5.01 Concept of valuation under GST**

One of the important aspects of taxation is determination of the value on which tax is sought to be computed and collected. The GST law has been designed on value addition principle and has adopted the 'transaction value' approach for defining the tax base.

The scheme of valuation hovers around 'transaction value' Section 15 of the CGST Act, 2017 contain the valuation provisions and the scenarios where an adjustment should be made to arrive at the taxable value.

## 5.02 Transaction Value

Section 15 of the CGST Act, 2017 states that the taxable value would be the transaction value of supply i.e. 'price paid or payable' for the supply of goods or services provided the supplier and the recipient are not related to each other and price is the sole consideration.

Though the term 'price' is not defined in the GST law, the Sale of Goods Act, 1930 defines the price which is contractually agreed between the parties to supply. The phrase 'paid or payable' implies that the consideration would include all sums which have accrued to the supplier.

Any taxes, fees, charges levied under any law other than CGST Act, SGST Act, UTGST Act and GST (Compensation to the States) Act, expenses incurred by the recipient on behalf of the supplier and incidental expenses like commission and packing incurred by the supplier are also to be added (if not forming part of price) to the price to arrive at the transaction value.

In case of supply between two related persons or cases where money value of the supply is not available the price will be determined as per the prescribed valuation rules.<sup>1</sup>

## 5.03 Valuation if supply is from a related person

As stated above, price would be adopted as the transaction value only if supply is between unrelated persons. In case of a supply between two related persons the value of the supply will be determined as per prescribed valuation rules.

Broadly speaking, a person who is under the influence of another person is called a related person. Under GST Law, by way of Explanation in section 15, various categories of related persons have been specified viz.

- a. Persons are officers or directors in one another's business
- b. Persons are legally recognized partners – say joint venture partners
- c. Employers and their employees
- d. One of the parties directly or indirectly controls the other or they are controlled by a third person or they together control a third person
- e. Members of the same family
- f. Sole agent or distributor or concessionaire Special rules need to be framed for valuation of related party transactions as the value assigned to such

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<sup>1</sup> Chapter V – Rules 27 to 35 of the Central Goods and Services Tax Rules, 2017

transactions by the supplier may not represent an arm length price or an uninfluenced price.

#### 5.04 Inclusions in the taxable value

Following amounts have to be included in the value of supply:

- i. Any taxes, duties, cesses, fees and charges levied under any other statute (other than GST)
- ii. Expenses incurred by the recipient on behalf of the supplier
- iii. Incidental expenses, such as, commission and packing, charged by the supplier to the recipient
- iv. Subsidies (excluding the services provided by a Government) directly linked to the price

#### 5.05 Treatment of supplies made by the recipient (e.g., FOC material)

Supplies made by the recipient to supplier, which are either not in relation to supply or, if in relation to the supply, the supplier was not liable to be paid for by the supplier, are not includible in transaction value. For better understanding let us take following examples:

**Example 1:** A Limited awards contract for construction of two thousand electrical towers. Steel is major raw material for these towers. Under the contract A Limited will supply required quantity of steel to the contractor. Contractor will arrange for all other materials and deliver complete tower at designated place and time. Value of steel will not be included in taxable value for GST as the supplier was not liable to pay for the steel as per the contract.

**Example 2:** Let us expand the above example. Standard bill of materials prescribe 10 tons of steel for each tower. Two percent is standard permissible scrap percentage. Thus for two thousand towers, required steel is 20400 tons. The contractor draws 21500 Tons of steel from stores. While paying to contractor, A Limited deducts value of 1100 tons of steel. This becomes supply of Steel by A Limited to contractor liable for GST.

There is another dimension of looking at this situation. A Limited did not want to supply any goods to contractor. The deduction made by A Limited is by way of penalty for over consumption, taxable as service in terms of entry 5.(e) of the Schedule II of the CGST Act, i.e. 'agreeing to the obligation to refrain from an

act, or to tolerate an act or a situation, or to do an act'.

**Example 3:** In example 1 if as per the contract the steel was to be provided by the contractor and A Limited ends up supplying part of the quantity of steel required, say 5000 tons, lying in its store, the value of 5000 tons of steel will be liable to GST in the hands of A Limited. The contractor will be eligible to avail input tax credit on such supplies by A Limited.

## 5.06 Treatment of discounts in valuation

The sales tax and excise law experience litigation over deduction of discounts. Trade discounts granted at the time of sale or at the time of removal of goods were generally deductible under the sales tax/excise law. The issue arose especially where discounts were granted after sale or removal of goods.

The GST law seems to have simplified the law to the extent that any pre-supply discount given before or at the time of delivery and which is recorded in the invoice is allowed to be excluded from the value. A discount, called by whatever name (trade discount, cash discount, quantity discount, turnover discount and so on), is deductible from total value for arriving at taxable value if indicated in invoice.

Discount given after the time of delivery can also be excluded provided (a) such discount is established in terms of the agreement between a supplier and the recipient and (b) input tax credits attributable thereto are reversed by the recipient.

It is not necessary for the supplier to claim GST benefit for post-supply discounts. The GST law does not prohibit a supplier from issuing a commercial/accounting document for settlement of transactions/accounts in respect of a particular supply transaction. In contract law terminology, it is merely an alteration of the original contract price (section 62 of the Contract Act, 1872). GST law cannot override the contract/commercial terms and make it mandatory for the supplier to raise a credit note with a GST reversal.

## 5.07 Determination of value when the consideration is not wholly in the form of money

According to rule 27 of the CGST Rules, in such cases the following values will be taken sequentially:

1. Open market value of the supply.
2. In case open market value is not available total money value of supply

(monetary consideration plus money value of non-monetary consideration).

3. In case it is not possible to determine the value as above, then value of supply of the like kind and quality.
4. Further if it is not possible to determine taxable value through above methods then cost plus ten percent markup method will be adopted to determine the value. The rules do not provide for a mechanism to determine such cost. In such cases, it may be advisable to apply the generally accepted accounting/costing standards. Cost Accounting Standards issued by Cost Accounting Standards Board (CASB) may form a reliable basis.
5. Finally in the absence of all the above options the value is determined as per residual method i.e. best judgment assessment relying on any reasonable means that is consistent with the statutory provisions as well as any other previous rules. The person invoking valuation under this method need to establish failure of preceding methodologies and also give a justifiable basis of valuation.

#### **5.08 Determination of value for supplies to related persons, captive consumption, depot transfers or supplies through agents**

The manner of valuation in such cases is provided in the valuation rules. In case of supplies between related persons valuation will be on principles similar to the principles as enumerated in point 5.07 above. If the goods are intended for further supply as such by the recipient, the supplier has been given an option to value the goods at ninety percent of the price charged for the supply of goods of like kind and quality by the recipient to his customers, provided such customers are not a related person.

However, second proviso to rule 28 provides that if recipient is eligible for **full** input tax credit, the value declared in the invoice will be accepted as open market value, i.e. the transaction value. This is purely on the rationale that any under-valuation would be revenue neutral since the output tax at the supplier's end would become the input tax credit at the recipient's end. It may be interesting to note that the proviso does not explicitly state whether the full input tax credit should be examined at the entity level or at the invoice level. A view can be taken that the test of full input tax credit should be examined at the invoice level and not the assessee level.

For supplies made or received through agents, open market value of goods supplied or, at the option of the supplier, ninety percent of the price charged by the recipient in the normal course of trade to his customer will be the transaction value.

## 5.09 Supplies for which special valuation rules are framed in draft valuation rules

Valuation rules provide for special treatment to services in relation to purchase or sale of foreign currency including money changing, air travel agent services and services in relation to life insurance business. The erstwhile service tax law also provided for special valuation provisions in respect of money changing services, air travel agent, life insurance and lottery distribution and selling agents. Table below captures the special provisions in valuation rules.

Sl	Description of service	Valuation under GST law
1	Purchase or sale of foreign currency including money changing	<p>Option 1:</p> <ul style="list-style-type: none"> <li>Where one of the currencies is Indian Rupees</li> </ul> <p>Difference between buying rate and selling rate of currency and RBI reference rate multiplied by total units of foreign currency.</p> <p>If RBI reference rate is not available, 1% of the gross amount of Indian Rupees</p> <ul style="list-style-type: none"> <li>Where neither of the currencies is Indian Rupees</li> </ul> <p>1% of the lesser of the two amounts the person changing money would have received by converting any of the two currencies in Indian rupees.</p> <p>Option 2:</p> <ul style="list-style-type: none"> <li>One percent of the gross amount of currency exchanged for an amount upto one lakh rupees, subject to minimum amount</li> </ul>

		<p>of two hundred and fifty rupees.</p> <ul style="list-style-type: none"> <li>• One thousand rupees and half of a percent of the gross amount of currency exchanged for an amount exceeding one lakh rupees and up to ten lakh rupees</li> <li>• Five thousand rupees and one tenth of a percent of the gross amount of currency exchanged for an amount exceeding ten lakh rupees subject to a maximum amount of Rs. sixty thousand rupees</li> </ul>
2	Booking of tickets for air travel by an air travel agent	<ul style="list-style-type: none"> <li>• Domestic bookings – five percent of basic fare</li> <li>• International bookings – ten percent of basic fare</li> </ul>
3	Life Insurance business	<ul style="list-style-type: none"> <li>• Where policy has dual benefits of risk coverage and investment</li> <li>- Gross premium charged less amount allocated for investments or savings if such allocation is intimated to the policy holder at the time of collection of premium</li> </ul> <p>Single premium policy where allocation for investments and savings is not intimated to the policy holder – ten percent of the single premium</p>

		<p>Other cases</p> <p>Twenty five percent of premium charged for first years and twelve and a half percent for subsequent years</p> <ul style="list-style-type: none"> <li>• Where policy has benefit of risk coverage only</li> </ul> <p>Entire premium charged</p>
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### 5.10 Value of token or voucher or coupon

Rule 32(6) of the CGST Rules provides that the value of a token, or a voucher, or a coupon, or a stamp (other than postage stamp) which is redeemable against a supply of goods or services or both shall be equal to the money value of the goods or services or both redeemable against such token, voucher, coupon, or stamp.

### 5.11 Value for second hand goods

Rule 32(5) of the CGST Rules, 2017 provides that where a taxable supply is provided by a person dealing in buying and selling of second hand goods i.e., used goods as such or after such minor processing which does not change the nature of the goods and where no input tax credit has been availed on the purchase of such goods, the value of supply shall be the difference between the selling price and the purchase price and where the value of such supply is negative, it shall be ignored. This is known as the margin scheme.

Further, notification No.10/2017-Central Tax (Rate), dated 28.06.2017 exempts Central Tax leviable on intra-State supplies of second hand goods received by a registered person, dealing in buying and selling of second hand goods [who pays the central tax on the value of outward supply of such second hand goods as determined under sub-rule (5)] from any supplier, who is not registered. This has been done to avoid double taxation on the outward supplies made by such registered person, since such person operating under the Margin Scheme cannot avail input tax credit on the purchase of second hand goods.

Thus, Margin Scheme can be availed of by any registered person dealing in buying and selling of second hand goods [including old and used empty bottles] and who satisfies the conditions as laid down in Rule 32(5) of the CGST Rules.

Persons who purchase second hand goods after payment of tax to supplier of such goods will be governed by this valuation rule only when they do not avail input tax credit on input supply. If Input tax credit is availed, such persons will be governed by normal GST valuation.

Separate valuation rule has been provided for supply of goods repossessed from a defaulting borrower. If the defaulting borrower is not registered person, the purchase value will be purchase price in the hands of such borrower reduced by five percentage points for every quarter or part thereof. The repossessing lender agency will be liable to GST on supply value reduced by computed purchase price. However, if the defaulting borrower is not registered, the repossessing lender agency will discharge GST at the supply value without any reduction for actual/notional purchase value.

### **5.12 Notification of service providers to treat value of inter se supplies between distinct persons as ‘Nil’.**

Rule 32(7) of the CGST Rules empowers the Government on recommendations of the GST Council, to notify such class of service providers for whom the value of taxable services between distinct persons will be treated as nil. This will apply only in cases where input tax credit on such service is available to the recipient distinct person. It may be recollected that distinct person means same person with different GST registration number. This provision will enable the Government to simplify transaction load for such notified persons who would otherwise have to issue invoices for each inter distinct person transaction in taxable services with no revenue implications as credits are available to the recipient. Till date no such notification has been issued.

### **5.13 Meaning of ‘open market value’**

As per explanation (a) to chapter IV of the CGST Rules ‘Open market value’ means the full value in money, excluding GST, where the supplier and the recipient of the supply are not related and price is the sole consideration, to obtain such supply at the same time when the supply being valued is made.

## 5.14 Meaning of 'like kind and quality'

As per explanation (b) to chapter IV of the CGST Rules supply of like kind and quality means any other supply made under similar circumstances that, in respect of the characteristics, quality, quantity, functional components, materials and reputation is the same or, closely or substantially resembles same.

## 5.15 Key difference in method of valuation in Excise and Sales Tax/VAT regime and that under GST

Under Central Excise, Service Tax and VAT generally levy of tax is on transaction value. For certain goods, such as cigarettes, excise duty and VAT is levied on per piece basis (rupees per thousand). For certain notified goods, excise duty is levied on the basis of capacity of production. In last few years for many of the commodities, method of valuation under Central Excise has moved away from transaction value to 'Maximum Retail Price less abatement' concept.

Under VAT, levy of tax is on sale price. Here 'price' is the sole determinant of taxable value. 'Price' generally corresponds to 'transaction value'. Though after insertion of Article 366(29A), barter has become taxable under VAT, yet none of States have framed valuation rules for levy of tax on barter. Some of the States have tried to levy VAT on 'Maximum Retail Price less abatement' concept. However it was struck down by Courts for the reason that tax on sale or purchase must be on occurrence of taxing event of sale transaction and the measure which can make the tax levy effective must have nexus with the taxable event.

For works contract State and Centre, provide respective laws to arrive at values of respectable portions.

Under GST concept of valuation on transaction value has been retained. There is no proposal (except for levy of compensation cess) for levy of tax on per piece basis, or on the basis of production capacity or on 'Maximum Retail Price less abatement' value.

Following table summarizes the difference:

<b>Tax</b>	<b>Ad valorem Transaction value</b>	<b>Ad valorem Computed value</b>	<b>Piece rate valuation</b>	<b>Transaction value less abatement</b>	<b>MRP less abatement</b>	<b>Production capacity based</b>
Central Excise	✓	✓	✓	X	✓	✓
Service Tax	✓	✓	X	✓	X	X
VAT/ CST	✓	X	✓	✓	X	X

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