Tax Alerts cover significant tax news, developments and changes in legislation that affect Indian businesses. They act as technical summaries to keep you on top of the latest tax issues. For more information, please contact your EY advisor.

Executive summary

This Tax Alert summarizes a recent order \(^{[1]}\) passed by the National Anti-Profiteering Authority (NAA) under Goods and Services Tax (GST).

It was alleged that although the GST rate had reduced from 28% to 18% with effect from 15 November 2017, the respondent, an FMCG company, had not reduced the MRP of the products sold by it. Further, the base price of the products had been increased so that the MRPs continue to be the same even after the reduction in GST rates.

While NAA admitted respondent’s claim of having passed on the benefits through grammage increase, it disallowed certain other amounts claimed by the respondent in computing the amount of profiteering.

The NAA held a case of profiteering and ordered the respondent to pay the amount so profiteered. The respondent was also required to commensurately reduce its prices henceforth.

Background

› As per the provisions of Section 171 of the Central Goods and Services Tax (CGST) Act, any reduction in rate of tax on any supply of goods or services or the benefit of Input Tax Credit (ITC) shall be passed on to the recipient by way of commensurate reduction in prices.

› The National Anti-profiteering Authority (NAA) has been constituted under the GST law to examine whether benefit arising due to ITC or tax rate reduction has resulted in commensurate reduction in price of goods or services supplied by the registered person.

› The process has been laid down to enable the recipient and other specified persons to file an application for bringing the cases of profiteering before the notified authority.

Facts

› The respondent is an FMCG company engaged in the manufacture of consumer goods comprising of four major categories viz. home care, personal care, food, and refreshments.

› The Standing Committee on Anti-profiteering had received applications alleging that although the GST rate had reduced from 28% to 18% with effect from 15 November 2017, the respondent had not reduced the MRP of the products sold by it. Further it was alleged that the base price of the products had been increased so that the MRPs continue to be the same even after the reduction in GST rates.

› The Standing Committee confirmed that prima facie there was evidence of non-compliance of provisions of Section 171, and thus the matter was referred to the Director General of Anti-profiteering (DGAP) for further investigation in accordance with Rule 129 of the CGST Rules, 2017.

› The DGAP, in course of its investigation, had issued a notice to the respondent asking whether the respondent accepted that the benefit of reduction in rates of tax had not been passed on by way of commensurate reduction in prices.

› Respondent was required to submit various documents/ records, reply regarding allegation made by the applicants and suo moto declaration of the amount of profiteering.

› During the course of the DGAP investigation, the respondent had suo moto computed and deposited an amount of INR 160.23 crores which it claimed was the additional realization on account of rate reductions.

› Post investigation, DGAP submitted its report to the NAA in accordance with Rule 129(6) of the CGST Rules, 2017.

DGAP’s Report

› As per the DGAP’s report, the investigation had revealed that the allegation of profiteering made against the respondent was duly established as

› It had increased the base price of the products thus maintaining the same selling price which were existing on 14 November 2017 or

› It had not reduced the selling price of the products commensurately, despite reduction in the GST rates from 28% to 18% or from 18% to 12% with effect from 15 November 2017.

› Report further stated that since the respondent itself admitted profiteering and suo moto quantified the profiteered amount, the provision of Section 171(1) of the CGST Act, 2017 had been contravened by the respondent.

› The DGAP determined the profiteered amount by the respondent at INR 419.67 crores. In addition, the DGAP stated that INR 76.06 crore which was claimed as transitional credit under Section 140(3) of CGST Act by the respondent through the TRAN-2 statements in February 2018, was not passed on to the recipients and thus was liable to be included in the profiteered amount.

Respondent’s contentions:

› The respondent submitted that despite inflationary pressures, it had passed on the full benefit of GST rate reduction and not increased its prices until February 2018. It objected to the DGAP report which alleged that the respondent had made extra profit without corresponding increase in the sales due to the rate reduction.

› It claimed that the DGAP had not appreciated that the introduction of GST had necessitated key accounting changes. It had also contended that the increase/decrease in the profit of a company was influenced by various factors such as volume, mix, cost of materials, inflation and overhead efficiencies and not just sales growth.

› The respondent submitted various reasons for deployment which it had claimed as deductions from higher sales realization on account of GST rate reduction.

› The respondent stated that they and their redistribution stockists (RS) had a large inventory of finished goods which was lying in factories, distribution centers and was also in transit and hence, it required nearly 60 days to pass the benefit of rate reduction.

› Where it was possible to print the MRP online, the same

---

2 Notification No. 41/2017 - Central Tax (Rate) dated 14 November 2017
had changed. For certain products, it implemented the change at the manufacturing stage itself by reducing the MRP or by adjusting the grammage.

- Further, the respondent claimed that its contract with the Canteen Stores Department (CSD)/Central Police Force (CPF)/Central Railway Police Force (CRPF) did not include taxes and hence, it had not earned any amount due to reduction in the GST rates. It sought deduction of the amount of supply made to CSD/CPF/CRPF on this ground from the amount of profiteering computed by DGAP.

- The respondent also sought deduction on account of
  
  (i) Pricing Deployment due to the pricing initiatives w.e.f. 15 November 2018 which had resulted in either reduction in MRPs or increase in the grammage;

  (ii) Trade Term Supply Deployment by which it had floated various promotional schemes as an interim measure to give benefit of tax reduction;

  (iii) Fiscal Deployment because of proportionate reduction in refund amount which it was getting due to area based exemptions;

  (iv) Writing off the existing packaging material.

- The respondent has stated that if the base prices would have remained unchanged, the GST deposited would have been lesser than what he has already paid to the Government. GST collected on the profiteered amount should be allowed as deduction as such amount is already paid to the Government.

- The respondent submitted that Rule 126 of the CGST Rules, 2017 gives power to the NAA to determine the methodology and procedure for determination as to whether the reduction in the rate of tax or benefit of input tax credit has been passed by way of commensurate reduction in price.

- Laying down the methodology and procedure with clarity and informing all stakeholders viz. manufacturers, dealers, retailers, service providers, customers, etc. was of critical importance.

- It contended while Section 171 of the CGST Act, 2017 had laid down the broad principles, the methodology should define the scope of the expressions "profiteering" "commensurate" and "reduction in price".

- While, the respondent acknowledged that the NAA had notified the “Methodology and Procedure” in exercise of powers under Rule 126 of the CGST Rules 2017, it contended that the same only dealt with the procedural aspects and did not deal with the issue of ‘Methodology of determination’ which was the crux of Rule 126.

- It stated that the Methodology alone was a guiding factor which could help in deciding the question of profiteering as per Section 171 and Rule 126. Therefore, its case should be taken up for adjudication only after formulating the methodology as contemplated under Rule 126.

- It further submitted that the term ‘profiteering’ had not been defined in the GST law and thus should be understood in its natural and common parlance. It relied on various dictionary definitions of ‘profiteering’ which suggested that it was a pejorative term which connoted unethical, immoral, illegal and contumacious conduct on the part of the supplier whereby it earned disproportionately large and unfair profit.

- The respondent claimed that supplier’s intent and conduct under the given circumstances, keeping in view it’s complexity of the operations and feasibility of implementing various alternatives, were critical and important factors before judging its actions as honest and bona fide or as dishonest and contumacious resulting in undue gain to it.

- It submitted that considering the enormity of the operations and the logistical difficulties, it did all that was possible to sub-serve the intent of the law. It also mentioned that its intention should be judged by the fact that it kept the Government informed all the time and thus its actions could not be called unethical, immoral or contumacious.

- The respondent also submitted that it had voluntarily deposited the excess amount which could not be passed on to the consumer, with the Government.

### Ruling of the National Anti-profiteering Authority

- The NAA held that the respondent had resorted to profiteering. While NAA has admitted the respondent’s claim of having passed benefits through grammage increase, it disallowed certain other amounts claimed by the respondent from the total amount of profiteering computed by DGAP.

- The views of the NAA are summarized as follows:

  - **Grammage benefit (higher quantity for same price)** - Benefit should be passed on by way of reduction in price only as per Section 171. Giving extra quantity is forced on the consumers. NAA held that passing on extra quantity could be one of the modes of passing on the benefit especially considering the fact that reducing the prices on low value products could be cumbersome and sometimes impractical.

- NAA allowed the claim of respondent on the ground that the anti-profiteering measures have been incorporated in the tax laws for the first time and the respondent had tried to pass on the benefit of tax reductions by increasing the quantity. But in future, if there is any reduction, the same should be passed on in the form of commensurate reduction in the price in accordance with Section 171.
Grammage benefit in excess of GST rate reduction - The law provides for “commensurate reduction” in prices to the extent of the rate reduction. Any greater reduction in prices is entirely a business call. The amount of profiteering has to be calculated by keeping the recipient in the center. The additional benefit given to one recipient cannot be offset with the denial of benefit to another recipient.

Area-based fiscal benefit - The respondent had claimed certain amount as deduction on account of reduction in area-based incentive when calculated in absolute terms. The NAA held that the incentive was proportionately restricted to the extent of tax paid. Since the respondent was still eligible to get the same proportionate refund of actual CGST/IGST paid in cash as was available to it prior to the reduction of rates, there was no loss to the respondent in absolute terms.

Methodology to calculate profiteering - This authority under Rule 126 has already promulgated the “Methodology and procedure” vide notification dated 28 March 2017 which has been exhibited on its website. The computation of the profiteered amount has to be done on the basis of the facts of each case and hence no general methodology can be prescribed for the same. As per the provisions, the Authority has power to “determine” and not “prescribe” the methodology.

Writing off packing material - The Government had allowed manufacturers to use old packing material by affixing revised MRP where the original MRP was visible. However, the respondent preferred to repackaged goods using new material. It was a business call to not use stickers and rather go for fresh packing material. Operational difficulty in following a law can never be a ground for disobedience of law. Hence, deduction on this account cannot be allowed.

Supplies to CSD/CPF/CRPF - As the contract terms with these recipients were exclusive of taxes, the respondent has not gained any amount on account of reduction in GST rates.

Tax on profiteering amount - The Authority observed that the respondent has denied the benefit of the reduction to its customers to the extent of the additional GST charged by it.

For example: If for a product with base price INR 100, rate was reduced from 28% to 18%, selling price should have gone down from INR 128 to INR 118. In case the supplier increases the base price to INR 108.47 and then charges INR 19.53 as GST @ 18%, making selling price again equal to INR 128.

Although supplier here might have paid the extra tax of INR 1.53 to the Government but he cannot claim this as deduction from his profiteered amount as the recipient has paid INR 1.53 more than what he is supposed to pay. Thus, the entire sum of INR 1.53 amounts to profiteering.

Sale of semi-finished goods - On the contention that sale of semi-finished goods was not made for consumption as the finished goods were ultimately purchased back by the respondent, and hence such sales should be excluded for computation of profiteering, NAA observed that such argument will not hold in as much as the goods were final products for the respondent even though it is an input for third party manufacturers. For lack of evidence that the same goods sent to manufacturers were returned to it for further processing, the claim cannot be accepted.

Passing of TRAN - 2 credit - Since the TRAN-2 credit is ipso facto ITC and furthermore, Section 140(3) requires the registered persons to pass on the benefit of TRAN-2 credit to the recipient, the provisions of section 171 are applicable and can be invoked, as the legislative intent behind section 171 is to prevent profiteering on account of denial of benefit of ITC.

Trade discount to dealers - The respondent had suggested to its dealers that while the packs carried the old MRPs, if they reduced the prices for their consumers, the same would be reimbursed. The respondent’s claim that it had provided various discounts to its dealers to further pass on the benefit to the consumers is not established as it is not supported by any credible documentary evidence. Further, the consumer would have never got the benefit of tax reduction unless the MRP was revised by the respondent on the packs and the bar codes were changed, which does not seem to have happened. Thus, the NAA did not accept the claim.

Wrongly collected input tax credit from RS - The respondent had collected INR 36.19 crores from its RS which was the excess realization made by them on the closing stocks on 15 November 2017. NAA observed that the direction of the respondent to its RS not to pass on the benefit and refund the amount of ITC which as legally due to them, had no sanction of law and thus, illegal. The respondent had intimated the NAA that this amount was deposited in the Consumer Welfare Fund (CWF). NAA held that since the respondent had itself admitted that this amount is profiteered, it cannot be allowed as a deduction from the amount of profiteering computed by DGAP.

The respondent had admitted that an amount of INR 0.06 crores could not be recovered from seven of its RS and was thus not deposited into the CWF. The NAA held that since the seven RS have enjoyed the benefit of rate reduction without passing on the benefit to the customers, the same needs to be recovered from the respondent.

Finally, the NAA held that the respondent had profiteered an amount of INR 455.92 crores on account of non-passing on benefit to its customers, accrued due to the reduction in rate of tax.

Further, the respondent had availed an amount of INR 78.97 crores as transitional credit, the benefit of which was also not passed on by it. While allowing deduction to the extent of INR 72.57 crore on account of grammage benefit and supplies to CSD/CPF/CRPF, it directed the respondent to deposit the balance amount (after considering the amount already paid) into the Consumer Welfare Fund.

The NAA also directed the respondent to reduce the prices of its products by way of commensurate reduction keeping in view the reduced rates of tax and benefit of ITC.
The period of investigation in the present matter was 15 November 2017 to 28 February 2018. NAA directed the DGAP to conduct investigations for future periods to determine whether benefit of tax reductions have been passed on for all products.

It also directed that a fresh notice be issued to the respondent asking why penalty should not be imposed on it.

Comments:

While NAA’s view on allowing the benefit to be passed on in the form of grammage increase in case of low value items where price reduction could be impractical, seems appropriate, it may give rise to subjectivity in determining such exceptional circumstances.

A lenient view has been taken even in respect of other items of increased grammage with a caution to taxpayer that such adjustment will not be permitted in future and instead, the benefit will need to be passed on in the form of price reduction only.

The observation of the Authority conveys that reduction in price, in excess of what is required due to rate change, will be ignored and will not be treated as the benefit passed on while computing the profiteering amount. Thus, it emphasizes that the profiteering needs to be calculated at specific product level and not at entity level.

The decision to make taxpayer deposit the GST collected on profiteered amount into Consumer Welfare Fund, despite the fact that such tax had been already paid to the Government, may result in loss to taxpayer. Proper mechanism should be put in place to enable the Government to transfer the tax so collected into Consumer Welfare Fund.

It is relevant to note that while the application against profiteering was filed only with respect to rate reduction w.e.f. 15 November 2017, the Authority has determined the profiteering on transitional credit which was not alleged in the applications.

The ruling suggests that the Government may not prescribe any specific mechanism for computation of profiteering amount. It is pertinent to note that litigation in this regard has already commenced. An appeal had been filed earlier by another taxpayer before Delhi High Court challenging the constitutional validity of anti-profiteering provisions due to absence of methodology and guidelines for determining the profiteering amount. It will be interesting to see the outcome of the appeal.
Our offices

Ahmedabad
2nd floor, Shivalik Ishaan Near C.N. Vimghalaya Ambawadi
Ahmedabad - 380 015
Tel: +91 79 6608 3800
Fax: +91 79 6608 3990

Bengaluru
6th, 12th & 13th floor “UB City”,
Canberra Block No.24 Vittal Mallya
Road Bengaluru - 560 001
Tel: +91 80 4027 5000
+91 80 6727 5000
+91 80 2224 0696
Fax: +91 80 2210 6000

Ground Floor, ‘A’ wing Divyasree
Chambers
# 11, O’Saughnessy Road Langford
Gardens Bengaluru - 560 026
Tel: +91 80 2222 2222
Fax: +91 80 2222 1111

Chandigarh
1st Floor, SCO: 166-167 Sector 9-C,
Madhya Marg Chandigarh - 160 009
Tel: +91 172 331 7800
Fax: +91 172 331 7888

Chennai
Tidel Park, 6th & 7th Floor
A Block (Module 601, 701-702) No.4,
Rajiv Gandhi Salai Taramani, Chennai - 600 113
Tel: +91 44 6654 8100
Fax: +91 44 2224 5420

Delhi NCR
Golf View Corporate Tower B Sector 42,
Sector Road Gurgaon - 122 002
Tel: +91 124 464 4000
Fax: +91 124 464 4050

3rd & 6th Floor, Worldmark I IGI Airport
Hospitality District Aerocity, New Delhi -
110 037
Tel: +91 11 6671 8000
Fax +91 11 6671 9999

4th & 5th Floor, Plot No 2B
Tower 2, Sector 126
NOIDA - 201 304
Gautam Budh Nagar, U.P.
Tel: +91 120 671 7000
Fax: +91 120 671 7171

Hyderabad
Oval Office, 18, iLabs Centre Hitec
City, Madhapur Hyderabad - 500 081
Tel: +91 40 6736 2000
Fax: +91 40 6736 2200

Jamshedpur
1st Floor, Shantiniketan Building
Holding No. 1, SB Shop Area Bistupur,
Jamshedpur - 831 001
Tel: +91 657 663 1000
BSNL: +91 657 223 0441

Kochi
9th Floor, ABAD Nucleus
NH-49, Maradu PO
Kochi - 682 304
Tel: +91 484 304 4000
Fax: +91 484 270 5393

Kolkata
22 Camac Street 3rd
Floor, Block “C” Kolkata - 700 016
Tel: +91 33 6615 3400
Fax: +91 33 2281 7750

Mumbai
14th Floor, The Ruby
29 Senapati Bapat Marg Dadar
(W), Mumbai - 400 028
Tel: +91 22 6192 0000
Fax: +91 22 6192 1000

5th Floor, Block B-2 Nirlon
Knowledge Park
Off. Western Express Highway
Goregaon (E)
Mumbai - 400 063
Tel: +91 22 6192 0000
Fax: +91 22 6192 3000

Pune
C-401, 4th floor Panchshil
Tech Park Yerawada
(Near Don Bosco School)
Pune - 411 006
Tel: +91 20 6603 6000
Fax: +91 20 6601 5900

Ernst & Young LLP

EY | Assurance | Tax | Transactions | Advisory

About EY
EY is a global leader in assurance, tax, transaction and advisory services. The insights and quality services we deliver help build trust and confidence in the capital markets and in economies the world over. We develop outstanding leaders who team to deliver on our promises to all of our stakeholders. In so doing, we play a critical role in building a better working world for our people, for our clients and for our communities.

EY refers to the global organization, and may refer to one or more, of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. For more information about our organization, please visit ey.com.

Ernst & Young LLP is one of the Indian client serving member firms of EYGM Limited. For more information about our organization, please visit www.ey.com/in.

Ernst & Young LLP is a Limited Liability Partnership, registered under the Limited Liability Partnership Act, 2008 in India, having its registered office at 22 Camac Street, 3rd Floor, Block C, Kolkata - 700016

© 2019 Ernst & Young LLP. Published in India. All Rights Reserved.

This publication contains information in summary form and is therefore intended for general guidance only. It is not intended to be a substitute for detailed research or the exercise of professional judgment. Neither Ernst & Young LLP nor any other member of the global Ernst & Young organization can accept any responsibility for loss occasioned to any person acting or refraining from action as a result of any material in this publication. On any specific matter, reference should be made to the appropriate advisor.

Join India Tax Insights from EY on LinkedIn
Download the EY India Tax Insights App Logo