

PRIMITIVE & RETROGRADE
PROVISIONS OF VALUATION UNDER
GST LEADING TO ARBITRARY
DOUBLE TAXATION

By: Puneet Agrawal
B. Com (H), CA, LLB
Partner
Athena Law Associates

1. Under the Model GST Law (hereinafter referred to as the GST Law), value for payment of GST is the '*transaction value*' computed as per the provisions of section 15 of the GST Law.

Concept of transaction value

2. As per section 15(1) of the Act, 'transaction value' refers to the **price** actually paid or payable for the said supply. However, transaction value is not restricted to price alone; section 15(2) of the GST law provides that the 'transaction value' shall *inter alia* also include the following:
 - a. ...;
 - b. Value of goods / services provided *free of charge*, by the recipient, in connection with the supply of goods / services;
 - c. Royalties & license fees related to supply of goods / services, payable by the recipient, to the extent the same are not included in the price actually paid or payable;....

Scope of this article

3. The scope of this article is limited to the analysis and repercussions of section 15(2)(b) and 15(2)(c) mentioned above.

Background of this provision

4. It is important to note that the said inclusions in transaction value defined under the GST Law are an exact replica of *pari materia* provisions under the Central Excise Valuation (Determination of Price of Excisable Goods) Rules, 2000 [Explanation 1 to Rule 6] and Customs Valuation (Determination of Value of Imported Goods) Rules, 2007 [Rule 10(1)(b) & Rules 10(1)(c)].

Rationale of these inclusions under Central excise law

5. Unlike GST law, which is transaction based tax and applies to every supply of all kind of goods and services, Central Excise Act is an event based tax. Central excise applies on the act of manufacture unconcerned with any transaction.
6. Thus the legislature had to choose some basis for computing the value for Central excise purpose, which it chose as the "transaction value". The Legislature's concept of transaction value was notional full value of the goods, including the value of all materials / services etc., which have gone into the making of, and which have contributed towards the value of, the final product.

Why is the case of GST wholly different from Central excise

7. Concept of GST is wholly different. GST is a transaction based tax which is charged on every supply of whatsoever nature. In a given transaction, the natural concept of value would be the **price charged** by the taxable person from the recipient, and being implicit in the transaction that should have formed the basis for computing value for payment of GST. The concept of GST is more akin to the present day VAT and Service tax.
8. This concept of Valuation under Central excise and VAT was succinctly explained by the Supreme Court in the case of *Moriroku UT India P. Ltd.* [(2008) 4 SCC 548]. In that case it was explained that the value under Central excise is a notional value which

includes the value of free issue materials/ services, as against value for sales tax/ VAT which only concerns itself with the real value/ consideration.

Free issue materials and services are already taxed: again taxing the same would amount to double taxation

9. Even more important reason from a practical perspective for not adding free issue materials / services for the purpose of valuing the goods / services being supplied is that – under the GST regime supply of all goods and services of whatsoever nature are chargeable to tax and thus these free issue materials / services would have already been taxed at the time when they would have been supplied by the vendor of those goods/ services to the recipient.

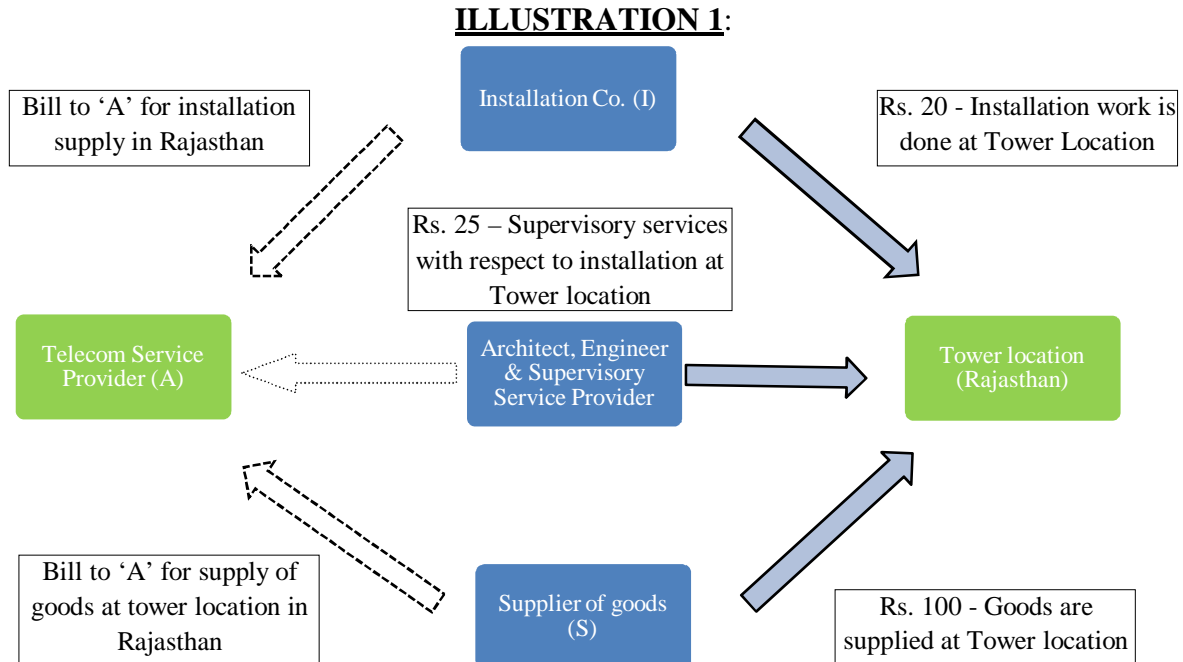
Royalties and license fees are already taxed, taxing the same over again would also be a case of double taxation

10. Likewise, the case of royalties and license fees would also be a case of double taxation as the same would be first liable to GST in its own right. Thereafter, it would also be added to the value of goods / services supplied, in relation to which royalty and license fee is payable by the recipient, as a condition of the said supply.

11. The aforementioned provisions of the Model GST Law would thus have the effect of double taxation, i.e. taxing a value much higher than the final value addition.

Illustrations

12. The afore mentioned situation could be better understood by way of illustrations, as provided below –



13. In the above illustration, Telecom Service Provider Company (A) places an order with the Supplier of goods (S), to supply certain goods at their tower location in Rajasthan for a price of, lets say, Rs. 100.

14. 'A' places another order with the Installation Co. (I), to install the said goods at their tower location in Rajasthan for a price of Rs. 20 (say).

15. Further 'A' also engages Architects, Engineers and Supervisors for the design, engineering and supervision of the installation work, which is being done by 'I', valued at Rs. 25 (say).
16. As per sub-clause (b) to section 15(2), the value of goods supplied by the recipient, free of charge, are to form part of the Transaction Value. The said sub-clause (b) reads as follows:

“the value, apportioned as appropriate, of such goods and/or services as are supplied directly or indirectly by the recipient of the supply free of charge or at reduce cost for use in connection with the supply of goods and/or services being valued, to the extent that such value has not been included in the price actually paid or payable;”

17. The effect of the aforementioned provision to the illustration at hand would be that the goods worth Rs. 100, which has already suffered GST in the hands of 'S', would again be taxed in the hands of 'I' in addition to value of supply of service provided by him.

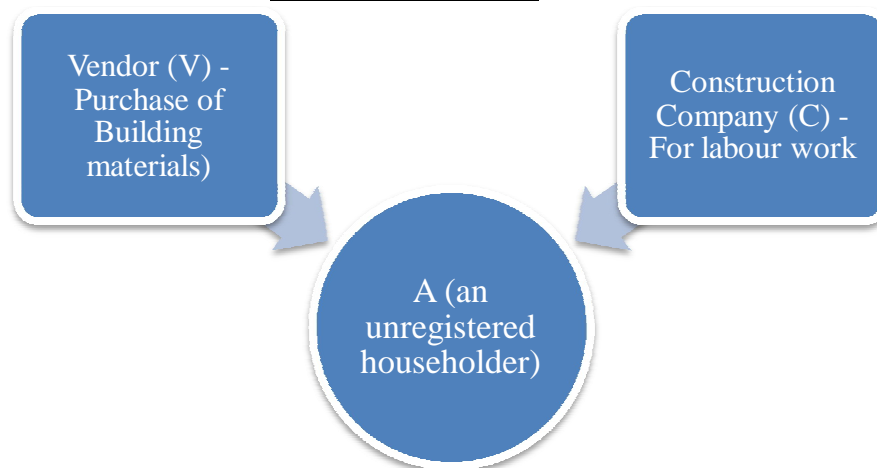
Value of supply of service by 'I' =

Rs. 100 (supply of goods free of charge by the recipient)
 +
Rs. 25 (supply of services free of charge by the recipient)
 +
Rs. 20 (value actually charged by 'I' for the installation work done by him)

Rs. 145

18. Out of this, Rs. 125 has already suffered tax when the installation materials and Architects, Engineers and Supervisors services were procured by A. Now the same Rs. 125 is again included in value of services of S leading to unnecessary double taxation.

ILLUSTRATION 2:



19. In the above illustration, 'A' places an order with the Vendor (V), to supply building materials for a price of: Rs. 100 (say)
20. 'A' places order with a Construction Co. (C), to do the labour work for a consideration of: Rs. 20 (say)
21. In the aforementioned example, for the purpose of valuation of supply of services by 'C', the value of building materials provided by 'A', free of charge, to 'C', in relation to supply of service by 'C', would also be added, as per the provisions of Section 15(2)(b) of the GST Law.

The value on which 'C' is required to pay GST =

Rs.100 (*Value of building materials provided by 'A', free of charge*)

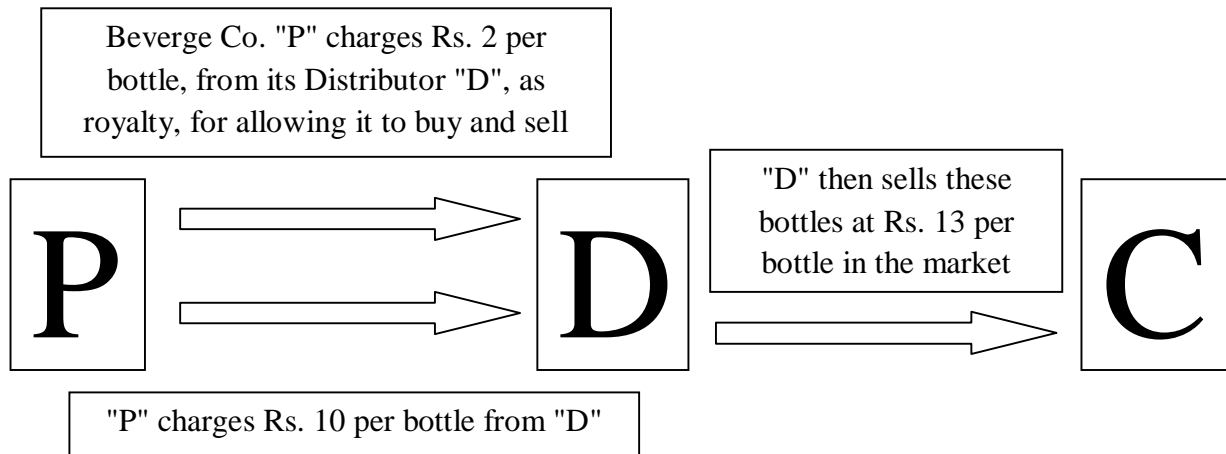
+

Rs.20 (*Value of labour work, as charged by 'C'*)

= Rs. 120

22. In such circumstances, building materials are being taxed twice, by reason of the application of the provision of Section 15(2)(b), which provides for addition of the value of goods / services provided free of charge by the recipient, in relation to the supply of goods / services.
23. Further, in the above mentioned illustration, if 'A' engages Architects / Engineers for the purpose of designing & advising in relation to the construction work, the value of supply of such service provided by the Architects / Engineers would also form part of the valuation, on which 'C' would be required to pay GST.
24. Further, if (say 'A') decides to also carry out the supervisory activity of the construction work himself (let's say, curing), then such services would be required to be valued, and tax would also be charged while valuing the services provided by 'C'.

ILLUSTRATION 3:



25. In the above illustration, GST would apply as follows:
- a. Royalty fee: GST on Rs. 2
 - b. Sale of bottle by P to D: In this case GST would be payable on following value:
$$\begin{aligned} & \text{Rs.10 (Sale Price of bottle charged by 'P' from 'D')} \\ & + \\ & \text{Rs.2 (Value of royalty charged by 'P')} \\ & \text{-----} \\ & = \text{Rs. 12} \end{aligned}$$
 - c. Total Value on which GST payable on each bottle purchased by D: Rs. 14
26. The illustrations can be multiplied endlessly without altering the result i.e. double taxation.

In sum

27. It is clearly evident from the illustrations above, including the value of free issue materials and services, and the value of royalty and license fee charged as a condition of supply of any goods and services, would only lead to double taxation.
28. In the GST scenario, when all goods and services would be taxed, it would suffice to tax each supplier of goods or services on the actual value he charges, and that would itself ensure that tax is paid on the total value addition.