BINDING GENERAL RULING (VAT): NO. 6

DATE: 25 March 2011

ACT : VALUE-ADDED TAX ACT, NO. 89 OF 1991 (the VAT Act)

SECTIONS : SECTIONS 1, 20 and 21

SUBJECT : DISCOUNTS, REBATES AND INCENTIVES IN THE FAST MOVING CONSUMABLE GOODS INDUSTRY

1. Purpose

This ruling serves to provide –

- a legal framework for the treatment of discounts, rebates and incentives in the Fast Moving Consumable Goods (FMCG) industry, and
- guidelines in determining whether the supplier is required to issue a credit note or receive a tax invoice for discounts, rebates and incentives granted.

2. Background

It is common in the FMCG industry to grant allowances[1] in the form of discounts, rebates and incentives to retailers. These allowances may either result in the previously agreed consideration for a supply being altered, or may represent payment for a supply of services by the retailer to the supplier.

The FMCG industry is currently experiencing difficulties in classifying which allowances alter the previously agreed consideration for a supply or represent payment for a supply of services.

3. Allowances provided in the FMCG industry

In the FMCG industry, the supplier and the retailer enter into a terms of trade agreement in terms of which a combined allowance is determined which consists of various components. General characteristics of such an agreement consist of the following:

- The allowances are determined upfront.
- A list of all the categories of allowances provided is stated in the agreement.

Allowances can be divided into two categories, namely, variable allowances and fixed allowances.

3.1 Variable allowances

A variable allowance is granted to a retailer subject to the retailer satisfying certain conditions stipulated in the terms of trade agreement. A variable allowance is granted based on conditions that must be met by the retailer. In some instances, the supplier

[1] For purposes of this document, the term "allowance" will include discounts, rebates and incentives.

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grants the allowance immediately, irrespective of whether the conditions are met or not.

The allowance is not indicative of any actual services but is included in the terms of trade agreement to quantify the reduction of the purchase price. At the time of sale, the supplier accounts for the full purchase price in terms of a tax invoice issued. When the allowance is granted, the supplier makes provision for the allowance evidenced by a credit note. The net effect in the supplier's books is the reduced balance due by the retailer.

Set out below is a non-exhaustive list and a brief description of the variable allowances in the FMCG industry:

- *Guaranteed allowances* – Allowances received from and paid by suppliers on all purchases/sales, irrespective of the volumes purchased/sold.
- *Early settlement allowances* – Allowances received for prompt payment of due accounts.
- *Growth rebates* – Allowances linked to a volume/value target. A percentage discount is provided when a certain growth percentage has been achieved.
- *Advertising allowances* – An allowance that is determined as a percentage of turnover for each purchase/sale and is not linked to a specific advertising service. *Distribution/warehousing allowances* – Payments made by the supplier in return for warehousing/redistribution of stock by the retailer and thereby saving the supplier the costs to store/distribute stock.
- *Swell allowances* – An allowance provided, calculated as a percentage of turnover, regardless of actual damages or breakages occurring in relation to products. No records are kept of these products and the products are not returned. The types of products to which a swell allowance will apply are determined upfront. This is to simplify the process of providing an allowance for actual damages or breakage.
- *Category management allowances* – An allowance for the exchange of information by suppliers and retailers to determine which products sell faster in order to prioritise shelf space for such products. The allowance is granted for data gathering purposes and to make the supply chain more effective.
- *Incentive discount/trade rebates* – Discounts from suppliers which are all deducted off the supplier's invoice as a reduction to the selling price (supplier) or cost price (retailer).
- *Franchise store allowances* – An allowance given for advertising.
- *Broadbase range scorecard allowance* – An allowance to incentivise retailers to deliver on pre-agreed targets, including areas of support, efficiency and growth.
- *House/brand/quality assurance allowance* – An allowance that qualifies as a cost recovery for quality tests done on products.
- *Bulk allowances* – A volume-based efficiency allowance, also known as a bulk-buy discount, whereby retailers are incentivised to purchase in a manner which reduces the cost of supplying products into their stores. The discount will be an amount per baler or unit or a percentage of the value of those purchases.

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- *Tallies* – This allowance is an amount per product purchased/sold. It is product-specific and agreed for goods near its sell-by date.

3.2 Fixed allowances

A fixed allowance is granted based on the condition that an actual supply is performed. Fixed allowances in the FMCG industry include the following:

- *New store allowance* – An allowance for the promotion of products with the opening of a new store.
- *Major refurbishment allowance* – A payment to revamp a retailer's store to meet the required standards.
- *Specific promotional/Gondola/Ad hoc allowance* – Payment for promotional support or specific advertising service with the purpose to drive additional sales that does not form part of the annual agreed support grid.
- *Post-recession allowance* – Assistance provided to stores to decrease the effects of a recession.

4. Issues

The issues under consideration are whether an allowance is regarded as a –

- reduction of the purchase price in which case a credit note must be issued; or
- consideration paid for a supply of a service in which case a tax invoice must be issued.

5. The law and its application

A vendor making a taxable supply of goods or services must issue a tax invoice to a recipient within 21 days of making that supply. The recipient must retain the tax invoice to substantiate any input tax deduction for the goods or services acquired. Tax invoices form part of the records that vendors (that is, suppliers and recipients) are required to keep under section 55, and are used to create a paper trail for audit purposes.

The details shown on a tax invoice may, in certain circumstances, be incorrect due to various reasons, for example, due to the granting of a discount. Section 21 therefore makes provision for a credit or a debit note to be issued in these instances.

5.1 Instances in which credit notes must be issued (Section 21)

A supplier (or the recipient[2]) is required to issue a credit note for an allowance granted if the allowance –

- alters the original purchase price of a supply of goods or services in terms of an agreement with the recipient; and
- results in the tax charged on the tax invoice in relation to that supply being incorrect (that is, the amount of tax charged shown on the tax invoice exceeds the actual tax charged).

[2] The Commissioner, in terms of section 21(5), may in certain circumstances direct that the recipient, as opposed to the supplier, may issue a credit note.

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A credit note must contain the particulars specified in section 21(3), subject to section 21(5).

5.2 Instances in which a tax invoice must be issued

A credit note cannot be issued in instances where an allowance does not adjust the price at which goods and services were originally supplied.

An allowance granted to a retailer for having performed a specific function or task (for example, providing specific advertising services), is a supply of a service from the retailer to the supplier. Allowances granted to compensate, subsidise, reward or reimburse a retailer for expenses incurred for or activities undertaken on behalf of the supplier constitutes consideration for a separate supply of services by the retailer to the supplier.

The retailer, as supplier of these services, must issue a tax invoice within 21 days of the date of the supply in accordance with section 20.

5.3 Recipient-created tax invoices, debit and credit notes

To the extent that circumstances exist where a supplier is unable to issue a tax invoice, debit or credit note due to circumstances beyond the supplier's control, provision is made for the Commissioner to allow the recipient of a supply to issue a tax invoice for a supply made by a supplier.

The circumstances considered to be beyond the supplier's control are where the recipient of the supply is –

- in control of determining the quantity or quality of the supply; or
- responsible for measuring or testing the goods sold by the supplier.

Interpretation Note No. 56 deals with recipient-created tax invoices, credit notes and debit notes and states which conditions must be met to qualify for the issuing of recipient-created tax invoices, credit notes and debit notes.

6. Ruling

The Commissioner, with regard to allowances granted in the FMCG industry, issues the following binding general ruling (BGR).

Variable allowances are regarded as a reduction in the original purchase price and a credit note as envisaged in section 21(3), subject to section 21(5), must be issued. Fixed allowances are regarded as consideration for the supply of a service and a tax invoice must be issued, where the supplier of a service is a vendor under section 20.

This BGR is conditional upon the supplier maintaining an updated list of all the allowances received or granted for each calendar or financial year, which indicates whether the allowance results in a tax invoice, credit note or debit note being issued. Such list as well as agreements or statements substantiating this classification must be retained as part of record-keeping requirements contemplated in section 55.

To the extent that this BGR does not provide for a specific scenario in respect of allowances granted or received, a VAT Ruling must be applied for from the Commissioner.

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This BGR is issued in accordance with section 76P of the Income Tax Act, No. 58 of 1962, as made applicable to the VAT Act by section 41A. This ruling is effective from the date of issue until it is withdrawn or amended, the relevant legislation is amended or a decision of the courts differ materially from this ruling.

Legal and Policy Division
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