

GST - Impact on Second Hand Goods Industry (An Undiscussed Theory)



The industry of second hand goods in India is substantially growing for the last few decades. There is a huge market of traders dealing in only second-hand commodities which include four wheelers, two wheelers and electronic items like mobiles, laptops, gaming consoles, wrist-watches, women hand bags, jewellery etc. Most of these businesses involve luxury items. Even small group commodities like books, clothes, etc. are gaining attention over the period. There are a lot of re-commerce websites, selling pre-owned luxury items including high-fashion apparel, footwear, clothing accessories, mobiles, imported stuff, etc. Such websites are gaining attention among the fashionistas who want best brands without affecting their pockets. Since the second hand goods industry has been growing much and has become an important part of the economy today, it is quite important to study how the GST Law would affect the said industry in a long term. Read on to know more...



CA. Pratik Dhruve

(The author is a member of the Institute. He can be reached at dhruve.2060@gmail.com)

(A) Legality of Tax Levy on Second Hand Goods (Constitution of India)

One would argue as to how can a sale of second hand item be taxed because the Government has already collected the tax from the seller at the time of buying it, being the end consumer at the time of buying.

The Constitution of India, vide Article 246 and 246A, empowers the Union and the States to make laws with respect to any matters enumerated in the Seventh Schedule. Entry 92A of Union list in Schedule VII and Entry 54 of State list mention "taxes on the sale or purchase of goods other than newspapers". Article 366(12) of the Constitution defines goods as "goods includes all materials, commodities and articles".

Hence, the goods are deemed to include second hand goods by whatever name called such as pre-owned goods, used goods, etc.

(B) Meaning of Second Hand Goods under GST Law

The GST Acts/rules do not define second hand goods. Also none of the other laws including Excise, State VAT Laws have defined second hand goods.

Looking at the definition of Goods, Section 2(52) of the Central Goods and Services Tax Act states that "goods means every kind of movable property other than money and securities but includes actionable claim, growing crops, grass and things attached to or forming part of the land which are agreed to be severed before supply or under a contract of supply".

Hence second hand goods, since not specifically excluded in the definition, are included in the definition of goods and the GST law shall apply to second hand goods in the same manner as it applies to new goods.

(C) Levy of GST on Sale of Second Hand Goods

As per Section 7(1) of the Central Goods and Services Tax Act, the expression supply includes all forms of supply of goods or services or both such as sale, transfer, barter, exchange, licence, rental, lease or disposal made or agreed to be made for a consideration by a person in the course or furtherance of business.

Hence, supply of second hand goods made for a consideration in the course or furtherance of business shall be taxable under GST law and all the provisions of GST law shall be applied to such supply.

(D) Levy of GST on Purchase of Second Hand Goods (Reverse Charge Mechanism)

Section 9(4) of the Central Goods and Services Tax Act states as under:

Second hand goods, since not specifically excluded in the definition, are included in the definition of goods and the GST law shall apply to second hand goods in the same manner as it applies to new goods.

"the central tax in respect of the supply of taxable goods or services or both by a supplier, who is not registered, to a registered person shall be paid by such person on reverse charge basis as the recipient and all the provisions of this Act shall apply to such recipient as if he is the person liable for paying the tax in relation to the supply of such goods or services or both."

This means that if the recipient, being a registered person, gets supply from any supplier, being an unregistered person, the tax on such supply shall be borne and paid by the recipient. This would have a significant impact on the business of unregistered persons and by implementing this mechanism, the Government has shifted the burden of collecting tax from unregistered persons to registered persons.

As far as the second hand trade is concerned, the Ministry of Finance has issued a notification on 28th June 2017 [Notification No. 10/2017-Central Tax (Rate)] stating that any intra-state supplies of second hand goods received by a registered person, dealing in buying and selling of second hand goods, from any supplier who is not registered, shall be exempt from the whole of the central tax leviable thereon under sub-Section 4 of Section 9 of the Central Goods and Services Tax Act, 2017. Similar exemptions are also there in respective State GST Acts. However, it shall be noted that the Ministry has not issued such exemption under IGST Act and hence, any supplies received from an



unregistered person from outside the State shall not be exempt and shall be liable to IGST.

We will understand this with the help of an example. ABC & Co. is a registered dealer of second hand goods being electronic items like mobiles, laptops, etc. It may procure the second hand goods from three different sources as below:

Example 1: Purchases from registered dealers:

ABC & Co. buys second hand mobiles in bulk from XYZ & Co., which also has a business of new and/or old mobiles and accessories. XYZ & Co. is registered with GST.

Since the supplier XYZ & Co. is registered, it would issue a GST invoice and would charge GST to the recipient ABC & Co. Hence, the question of Reverse charge does not arise as the supplies are made by a registered person.

Example 2: Purchases from unregistered dealers or customers (from within the State):

Mr. T walks in to the shop of ABC & Co. to sell his old mobile which he bought before a year or so. Mr. T would surely be not registered, being a normal customer. The normal interpretation of Reverse Charge Mechanism would be that since the supplier is unregistered, ABC & Co. would be liable to pay tax. But this is not the fact and the reverse charge would not apply to this supply. The reason is explained below:

A supply, as per Section 7(1) as stated above, shall be a taxable supply only if it fulfills all the basic conditions stated therein. In order to constitute a 'supply', the following elements are required to be satisfied:

- a) the activity involves supply of goods or services or both
- b) the supply is for a consideration unless otherwise specifically provided for
- c) the supply is made in the course or furtherance of business
- d) the supply is made in the taxable territory
- e) the supply is a taxable supply
- f) the supply is made by a taxable person.

In the above example 3, the supply made by Mr. T to ABC & Co. is not made in the course or furtherance of business of Mr. T. In fact, Mr. T does not have any business of mobiles as such. Hence, the supply shall not attract the Reverse Charge and no tax shall be payable either by Mr. T or by ABC & Co., regardless of the consideration involved.

This has also been supported and notified by the GST council vide its Notification No.10/2017-Central Tax (Rate) dated 28th June 2017.

Example 3: Purchases from unregistered dealers or customers (from outside the State):

ABC & Co. (Maharashtra) buys second hand mobiles in bulk from PQR & Co. (Gujarat). PQR & Co. is not registered with GST.

Since the supplier PQR & Co. is unregistered, supply attracts Reverse Charge and the recipient ABC & Co. shall be liable to pay tax on such purchase. There is no exemption for inter-state supplies of second hand goods and also, there is also no notification granting exemption to such supplies. Notifications have been issued only for intra-state supplies.

However, it shall be noted that ABC & Co. can claim such tax paid as an input tax credit against its other liabilities as per the provisions of Input Tax Credit Rules.

(One may argue that PQR & Co. cannot supply goods to other state without registration; still such transactions may happen in economy and this needs to be discussed from the view point of ABC & Co. i.e. the recipient as it is not violating any of the provisions stated).

(E) Valuation of Second Hand Goods

Section 15(5) of the Central Goods and Services Tax Act states that the value of such supplies as may be notified by the Government on the recommendations of the Council shall be determined in such manner as may be prescribed.

Rule 32(5) of "the Central Goods and Service Tax (CGST) Rules, 2017 state as below:

"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 purchase of such goods the value of supply shall be the difference between the selling price and purchase price and where the value of such supply is negative it shall be ignored."

(F) Conditions for Attracting the Provisions of Margin Scheme as per Rule 32(5)

A few conditions shall be followed by a second hand goods dealer to avail the benefit of the rule of margin scheme:

- a) The supply should be of second hand goods only.
- b) Pre-owned goods are not necessarily deemed to be second hand goods or used goods. The goods should actually be used before.
- c) The person should be dealing in both buying and selling of second hand goods. Just one or two sales of unwanted second hand goods/assets cannot be deemed to be dealing in such goods.
- d) Minor processing is allowed. The dealer can carry out minor processing like repairs, refurbishing, re-boxing, etc.
- d) Nature of goods should not change. If different accessories and goods are bought and assembled into a new kind of product, which is different in nature as compared to the goods bought earlier, the valuation rule benefit would not apply.
- e) No input tax credit should have been availed on purchases. The taxes paid on purchases either to seller or to Government under reverse charge, both should not have been claimed as Input tax credit.
- f) Losses cannot be set-off. Where the selling price is lower than the purchase price, tax on losses shall be NIL and such negative margin cannot be set-off for tax payable on other positive margins.

Such valuation rule is often known as margin scheme or differential scheme in many countries. To understand this rule better, we shall continue with the above mentioned three examples of procurements by ABC & Co. discussed under the Reverse Charge Mechanism. Let us find out how much GST needs to be paid on sales made by ABC & Co. in different scenarios.

Example 1: Purchases from registered dealers:

ABC & Co. has bought second hand goods from registered dealer (XYZ & Co.) and it would have paid GST to the supplier as mentioned on GST invoice

issued by XYZ & Co. Since it would have already paid the tax, it will surely claim the input tax credit for GST paid and hence, the above valuation rule does not apply when such goods are sold further. Hence, ABC & Co. shall be liable to pay GST on entire sales value and shall claim Input tax credit of GST paid on purchases.

Example 2: Purchases from unregistered dealers or customers (from within the State):

ABC & Co. has bought goods from an unregistered customer Mr. T. ABC & Co. will not have to pay GST under Reverse Charge mechanism since intra-state supplies of second hand goods are exempt vide Notification No. 10/2017. Since it would have not paid any GST, there is no question of availing input tax credit and hence, the marginal valuation rule does apply. Hence, ABC & Co. shall be liable to pay GST only on the differential value i.e. sales value minus purchase value.

Example 3: Purchases from unregistered dealers or customers (from outside the State):

ABC & Co. (Maharashtra) buys second hand mobiles in bulk from PQR & Co. (Gujarat). PQR & Co. is not registered with GST. Since ABC & Co. would have paid GST under Reverse Charge Mechanism, it will claim the input tax credit for such GST paid and hence, the marginal valuation rule does not apply and GST shall be payable on entire sales value.

(G) Provisions of Issuing a Tax Invoice under GST for Supplies of Second Hand Goods

Wherever the supply of second hand goods attract the provision of Rule 32(5), and wherever the margin scheme valuation is opted, the supplier shall not issue a taxable invoice and the recipient of such goods shall not claim any ITC on such goods.

In every other case where margin scheme is not applicable, the supplier shall issue a taxable invoice as per the provisions of GST Rules.

Wherever the supply of second hand goods attract the provision of Rule 32(5), and wherever the margin scheme valuation is opted, the supplier shall not issue a taxable invoice and the recipient of such goods shall not claim any ITC on such goods. In every other case where margin scheme is not applicable, the supplier shall issue a taxable invoice as per the provisions of GST Rules.

(H) Overall Impact on Second Hand Goods Industry

To summarise,

- (a) For the second hand dealers who procure such goods from registered dealers, there would be not much impact to their profitability as they would bear GST on such purchases which needs to be further claimed as Input Tax Credit due to which the benefit of marginal valuation would not be available.
- (b) The second hand dealers who procure goods from unregistered dealers or customers within the State, would carry a much lower tax burden i.e. on one hand, no input tax to be paid on purchases, and on the other hand, when such goods are sold, tax payable only on their margins and hence, they would end up in having a highly better profitability as well as a better cash flow as compared to the earlier tax regime.

(I) GST Rates on Second Hand Goods

Since there is no distinction between new goods and second hand goods under GST Law, the GST rates to be applied to used goods would be the same as if they were new goods.

(J) Global Scenario of Tax on Second Hand Goods

The transactions of second hand goods being sold by non-taxable individuals not having business are exempt in most of the countries all over the globe. Also many of the countries having VAT/GST laws have margin schemes for dealers in second hand goods. Countries like Singapore, Malaysia have specific rules and guidance notes for taxes on second hand cars. New Zealand specifically excludes "livestock" and "goods consisting of any fine metal of any degree of purity" from the definition of second hand goods, which is quite logical. Countries like



For the second hand dealers who procure such goods from registered dealers, there would be not much impact to their profitability as they would bear GST on such purchases which needs to be further claimed as Input Tax Credit due to which the benefit of marginal valuation would not be available.

Albania, Belgium, Finland, Israel, Italy, Mauritius, UK, etc. have special arrangements by way of profit margin schemes and simplified tax measures for dealers of art works, collectibles, antiques etc.

(K) Position in Indian GST Law

Regarding the existing Indian GST Law, the second hand goods have been mentioned only at one instance i.e. Rule 32(5) of the rules for Determination of Value of Supply. There is no such mention elsewhere and hence, all the rules other than for valuation, shall apply in the same manner as they apply to new goods. However, GST Council is expected to frame out detailed rules for valuation, since the industries of vehicles, mobiles, jewellery, etc. have a significant volume and amount of transactions and these industries are a substantial part of the overall business economy.

References:

- 1) *The Central Goods and Services Act*
(<http://cbec.gov.in/htdocs-cbec/gst/cgst-act.pdf>)
- 2) *Integrated Goods and Services Act*
(<http://cbec.gov.in/htdocs-cbec/gst/igst-act.pdf>)
- 3) *CGST Rules*
(<http://www.cbec.gov.in/resources//htdocs-cbec/gst/cgst-rules-15112017.pdf>)
- 4) *FAQs on GST by CBEC, New Delhi*
(<http://cbec.gov.in/htdocs-cbec/gst/new-faq-on-gst-second-edition.pdf>)
- 5) *Malaysia - Guide on Relief for second-hand goods (Margin Scheme) issued by Royal Malaysian Customs*
(http://gst.customs.gov.my/en/rg/SiteAssets/industry_guides_pdf/New_Folder/GUIDE%20ON%20MARGIN%20SCHEME%2002112015.pdf)
- 6) *Singapore - GST Guide for Motor Vehicle Traders (Second Edition) issued by Inland Revenue Authority of Singapore IRAS*
(https://www.iras.gov.sg/irashome/uploadedFiles/IRASHome/eTax_Guides/etaxguide_GST_Motor%20Vehicle.pdf)
- 7) *New Zealand - GST on special supply rules*
(<http://www.ird.govt.nz/gst/additional-calcs/calc-spec-supplies/calc-special/special-supplies-r-v.html>) ■