

Allowing discount in period for which VAT return is no longer adjustable 1/2/21



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Many wholesalers and service providers allow volume discounts and other types of after-sales discounts. This article explores how a discount affects the VAT charged earlier in accordance with legislation.

We have often seen the State Revenue Service ("SRS") deny a taxable person's right to reduce the VAT paid to the government earlier by a discount allowed for supplies made in a tax period for which the 3-year time limit for adjusting the VAT return has expired, even though the discount was allowed in a period for which the time limit for filing adjustments has not yet expired. For example, if a discount was allowed in December 2020 for goods or services supplied in 2017, the SRS disagrees with the taxable person's right to adjust the VAT charged.

When building legal relationships with business partners, a trader can agree on the price of goods or services with a discount. In more complex cases the price can be adjusted to reflect any inflation or deflation indices describing the industry or economy. No matter how the parties choose to name a later reduction in the agreed price, according to its economic substance this is a discount that reduces what the supplier has actually received in return for the supply.

Section 34(1) of the VAT Act provides that the taxable amount in a supply of goods or services is the consideration for the goods or services supplied. Under section 1(2) a consideration is the monetary value of goods or services the supplier receives and should receive as payment from the customer or another party for the supply excluding VAT regardless of whether full or partial payment is made.

The taxable amount is to be determined by reference to any reduction in the agreed price (a discount) the supplier has allowed –

- at the time of the supply under section 39(1) of the VAT Act, or
- after the customer received the goods or services under section 39(2).

A discount is a price reduction in favour of the customer¹ (e.g. for a repeat purchase, bulk buying, to loyal customers, or for seasonal goods).

So section 39 of the VAT Act implies that allowing a discount gives the supplier a right to adjust the VAT charged earlier.

Now, section 125(5) provides that any document that meets the requirements prescribed by section 125(1) and either amends or specifically refers to the original tax invoice is also treated as a tax invoice. So the supply for which an adjusting invoice is issued is a taxable supply whose taxable amount is reduced or increased by the parties because of certain economic conditions (e.g. the agreed supply volume has been reached to qualify for a discount, or the customer has found the goods to be of poor quality and agrees with the seller on a rebate).

Section 120(1) of the VAT Act provides that VAT on a domestic supply of goods or services where the supplier accounts for VAT must be reported on the VAT return for the tax period in which the supply was

made and a tax invoice issued.

So, the taxable amount of a supply can be adjusted only on the basis of an adjusting tax invoice. Under paragraph 3 of the Cabinet of Ministers' Rule No. 40 of 15 January 2013, *Value Added Tax Returns*, the amount of a discount allowed after receipt of goods or services must be reported by the taxable person on the VAT return for the tax period in which the discount was allowed. This procedure is also prescribed by the SRS's guidance on completing the VAT return and its appendices.

In view of this, we disagree with the SRS's opinion that the taxable person cannot reduce the VAT paid to the government earlier by a discount related to a tax period for which the time limit prescribed by section 16(1)(6) of the Taxes and Duties Act has expired. VAT on the discount becomes chargeable when the parties have agreed on it, an adjustment has been actually made, and a tax invoice issued. This procedure is applicable regardless of the tax period in which the goods or services covered by the discount were supplied.

¹ A definition from the Latvian Academic Terms Database