Tax

Landmark Singapore Decision on GST Liability for Goods Sold via Direct Selling Business Model

Executive Summary

The recent landmark decision of *Herbalife International Singapore Pte Ltd v Comptroller of Goods and Services Tax* [2023] SGHC 54 lays down the principles in calculating the Goods and Services Tax ("**GST**") liability for goods sold via a direct selling model where the goods are supplied only to members who are registered with the business ("**Members**") at a discount and the Members may in turn sell the goods to consumers. The primary issue before the Singapore High Court was whether GST should be levied on the discounted rate of goods sold by the business to its Members or the open market value of the goods. Ruling in favour of the business in this case, Herbalife International Singapore Pte Ltd ("**Herbalife**"), the Singapore High Court held that it should be the discounted rate of the goods.

This landmark decision will impact all direct marketing companies. Herbalife was represented by Vikna Rajah, Head of Tax & Trust practice and Co-Head of Private Wealth practice, and Koh Chon Kiat, Senior Associate in the Tax & Trust practice.

In this Update, we consider the decision of the Singapore High Court.

Brief Facts

Herbalife is a Singapore incorporated company that is in the business of marketing, selling and distributing nutritional supplements, weight-management products and other personal care products ("**Nutritional Products**"). Herbalife does not sell directly to its consumers. Instead, it adopts a "direct selling" business model which involves Herbalife selling its Nutritional Products only to registered Members. To be a Member, an individual has to purchase a membership pack containing materials that form a comprehensive agreement ("**Membership Agreement**") which regulates the terms and conditions governing, among other matters, the Member's conduct, the marketing and sale of the Nutritional Products as well as sign an application form to adhere to those terms and conditions.

When a Member sells the Nutritional Products to consumers, they retain as profit the difference between the price they pay to Herbalife and the price they are contractually bound to sell the Nutritional Products. Herbalife sells its Nutritional Products to its Members at varying discount tiers. These discount tiers start at 25% ("**Standard Discount**"), which is the discount that all Members are entitled to, and there are three further tiers of 35%, 42% and 50% ("**Tiered Discounts**"). The Members are under no contractual obligation to sell the Nutritional Products they purchase from Herbalife, as they may personally consume the Nutritional Products.

The respondent, the Comptroller of Goods and Services Tax ("**Comptroller**"), issued Notices of Assessment and Additional Assessments for the accounting periods of 1 January 2012 to 31 March 2017 on the basis that GST should be imposed on the contractually stated retail price of the Nutritional Products sold by Herbalife Singapore to its Members by taking the position that the consideration furnished by the Members is not wholly consisting of money, as a part of that consideration comprises a supply of sales and marketing services provided by the Members to Herbalife Singapore.

Herbalife objected against the Notice of Comptroller's Decision and appealed to the GST Board of Review ("**Board**") on the basis that GST should have been imposed on the discounted prices of the Nutritional Products as the Tiered Discounts were purely volume based and there was no contractual promise undertaken by the Members to provide any sales and marketing services to Herbalife Singapore.

The Board disagreed with the Comptroller's position that Members provide sales and marketing services to Herbalife in exchange for the Tiered Discounts. However, the Board disallowed Herbalife's appeal by finding that for the purposes of section 17(3) of the Goods and Services Tax Act 1993 ("**GST Act**"), the contractual obligations undertaken by the Members pursuant to the terms and conditions in the Membership Agreement constituted non-monetary consideration for the supply of Nutritional Products at the Tiered Discounts.

Issues Before the High Court

The appeal concerned the GST liability of transactions between Herbalife and its Members. It was undisputed that the Nutritional Products supplied by Herbalife to its Members are liable to GST. The contentious issue was in relation to the value of such supplies on which GST is levied. In other words, whether GST should be imposed on the discounted price (i.e. the contractually stated retail price less the Standard Discount or Tiered Discount) or the open market value (i.e. the contractually stated retail price) of the Nutritional Products. On appeal, the disputed amount of GST was S$2,187,089.99.

The relevant parts of section 17 of the GST Act provides as follows:

> ***Value of supply of goods or services***
>
> *17.– (1) For the purposes of this Act and subject to the Third Schedule, the value of any supply of goods or services shall be determined in accordance with this section.*
>
> *(2) If the supply is for a consideration in money, its value shall be taken to be such amount as, with the addition of the tax chargeable, is equal to the consideration.*
>
> *(3) If the supply is not for a consideration or is for a consideration not consisting or not wholly consisting of money, the value of the supply shall be taken to be its open market value.*

Essence of Parties' Submissions

Herbalife's submissions

Herbalife's position was that the discounted price of the Nutritional Products is taken as the value of the supply.

First, Herbalife submitted that the Members' undertaking of terms and conditions stipulated in the Membership Agreement did not fulfil the requirements to be considered non-monetary consideration under the GST Act. The Members' consideration supplied in exchange for the discounted rate of the Nutritional Products consisted wholly of money and as such fell to be valued under section 17(2) of the GST Act.

Second, Herbalife submitted that section 17(3) of the GST Act did not cover the facts of this case and any lacuna in the GST Act must be remedied by Parliament, not the courts. Section 19 of the UK Value Added Tax Act 1994 ("**VAT Act 1994**"), which deals with the same subject matter as Singapore's section 17 of the GST Act, was unable to bring to tax goods sold via a direct selling business model such as Herbalife's in the present appeal. This necessitated the UK Parliament to enact a special valuation provision in paragraph 2 of the Sixth Schedule of the VAT Act 1994 ("**Special Valuation Provision**"). The Special Valuation Provision is notably absent in the GST Act, and hence there is a lacuna in Singapore's GST Act that must be remedied by Parliament.

Comptroller's submissions

The Comptroller's position was that the the contractually stated retail price of the Nutritional Products less the discount of 25% is taken as the value of the supply.

First, the Comptroller submitted that the terms and conditions in the Membership Agreement are contractual obligations undertaken by the Members which fulfil the requirements to constitute non-monetary consideration under the GST Act.

Second, the Comptroller submitted that Herbalife's business structure resulted in a revenue leakage as if Herbalife's Members were GST registered then the final sale to end-consumers would be taxable supplies and GST would be levied on the full price of the Nutritional Products and not the discounted price. Further, the Comptroller submitted that the revenue leakage was addressed by section 17(3) of the GST Act. The Comptroller submitted that the UK enacted the Special Valuation Provision as a derogation from the EU Council Directive 77/338/EC and given that Singapore did not face the same legislative constraints as the UK such a derogation is unnecessary in the Singapore context. The Comptroller submitted that the open market value was the retail price of the Nutritional Products.

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Decision of the High Court

The meaning of "consideration" under revenue law

The High Court ("**Court**") examined the Third Schedule of the GST Act to determine whether, on the facts, the supply in question was made in exchange for some form of non-monetary consideration. The Court opined that the rules of consideration that applied to contract law could not be directly applied to revenue law and that consideration in revenue law was not only concerned with the taxability of a supply, but the taxable value to be ascribed to a supply. The question to ask was "what was the payment in the taxable transaction?". The Court noted that the UK's VAT regime accommodated the expansive definition of consideration because the taxable value of the supply included the valuation of such consideration (section 19(3) of the VAT Act 1994). However, Singapore's GST regime was different because the mechanism to value taxable supplies made for non-monetary consideration was valuation at the open market value. The Court cautioned that draconian taxing outcomes could occur if non-monetary items of *de minimis* value were accepted to fall within the scope of non-monetary consideration in section 17(3) of the GST Act.

The Court agreed with the decision of the Board that two requirements should be considered when determining whether the undertaking of obligations could constitute non-monetary consideration and proceeded to refine the requirements further.

- The first requirement was whether the undertakings were independent of, and not ancillary to, the supply of the Nutritional Products. The Court opined that regular terms of trade would not ordinarily be considered non-monetary consideration unless they contractually demanded the provision of something non-monetary in exchange for the supply of goods.

- The second requirement was whether the undertakings provided a benefit which went beyond the monetary transaction in question. The Court opined that the word "benefit" used by the Board should not be interpreted too broadly as this would render nugatory any attempt to restrict the scope of consideration for GST purposes. In the context of section 17(3) of the GST Act, for something to be considered non-monetary consideration furnished by the recipient of a supply it must be sufficiently valuable and it must be clear that it was given by the recipient in exchange for the supply of goods.

The Court highlighted that a useful indicator of whether a "benefit" is provided in exchange for the supply of goods is whether there was parity of value between the non-monetary "benefit" and the good received. Hence, the non-monetary benefit made up for the discrepancy between the money paid and the regular price of the product. In cases where parties did not explicitly provide for the value apportioned to the non-monetary consideration, the contractual arrangement when construed by the court may evince tangible monetary value attributed to non-monetary elements. Parity of value may be determined objectively by the court.

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Comparison of UK VAT Act with Singapore's GST Act

The Court rejected the Comptroller's submissions on the comparison between the UK's VAT Act and Singapore's GST Act. The Court examined the UK's VAT Act 1994 and compared section 19(3), which focussed on the nature of the consideration furnished and was comparable with Singapore's section 17(3) of the GST Act, with the Special Valuation Provision. The Court opined that the Special Valuation Provision was directly worded to address specific business structures involving the sale of goods through non-taxable agents. The Court noted that if, as submitted by the Comptroller, section 19(3) of the VAT Act 1994 applied such that taxable supplies made by direct selling companies to their agents could have been taxed at the retail price at which their agents on-sold the products, there would have been no need for the UK to seek to enact the Special Valuation Provision. The Court found that the Special Valuation Provision had to be enacted due to the same revenue leakages as was observed in this appeal. This revenue leakage could not be addressed by section 19(3) of the VAT Act 1994. The UK needed to enact the derogation because the Special Valuation Provision was inconsistent with Article 11(A)(1)(A) of the EU Sixth Directive which required the value of a taxable supply to include everything which constituted consideration i.e. monetary and non-monetary consideration.

The Court agreed with Herbalife that the Special Valuation Provision and its corresponding absence in Singapore's GST Act was a strong indicator that direct selling cases ordinarily did not involve supplies made for non-monetary consideration which would cause it to fall within section 17(3) of the GST Act.

The result

Based on the facts of the case, the Court found that that the undertakings that constituted the terms of trade imposed by Herbalife on its Members did not constitute non-monetary consideration. Further, the Court found that the Board erred in finding that the obligations provided Herbalife with a benefit that equated to consideration because it was pivotal to the functioning of Herbalife's direct selling structure. The "benefits" received by Herbalife were just the compliance of its Members with the contractual terms of trade as opposed to valuable consideration within the meaning of section 17 of the GST Act.

The Court concluded by noting that the Comptroller had not pointed to a tangible thing, whether in the form of a good, service, or something else furnished by the Members to Herbalife which had objective parity of value with the discount that the Members received, thereby brining it within section 17(3) of the GST Act.

The Court cautioned that if the meaning of consideration in section 17(3) of the GST Act was interpreted too broadly there may be implications on numerous commercial practices that might not be intended to be covered and this threatened to introduce considerable uncertainty as to the taxable value of these supplies. Hence, the solution to the revenue leakage lay not in expanding the scope of non-monetary consideration but in the adoption of a special value provision which specifically addressed business models akin to Herbalife without the potential negative collateral effects on commercial practices. This must be left to Parliament.

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Concluding Words

The Court's decision provides helpful guidance on the meaning of consideration under GST law and whether contractual undertaking of obligations could constitute non-monetary consideration for the purposes of section 17(3) of the GST Act.

Where the terms and conditions found in an agreement between a direct selling business and its members are considered to be terms of trade which are imposed by the business on its members either to qualify to receive the supply, to regulate the use of the goods once obtained or to regulate the conduct of its members, such terms and conditions do not constitute non-monetary consideration under GST law.

Further, where the contractual obligations undertaken by members of the business are conditions to purchase the goods for consideration in money and not furnished in exchange for the goods, the benefits obtained by the business are merely the compliance of its members with the terms and conditions as opposed to valuable consideration under GST law.

It should also be noted that where members of the business are not contractually obligated to sell the goods and have the discretion to choose what they wish to do with the goods, they would not be providing non-monetary consideration to the business in the form of marketing services.

In light of this landmark decision, there will be far reaching implications for the direct selling industry as the decision demonstrates that discounts granted purely on the volume of goods purchased by its members will not be taxed on the retail price of such goods but rather the discounted price. Similar multi-level marketing players should review their internal business metrics with respect to discounts and ensure that they are aligned with the current position under Singapore revenue law.

For more information, please feel free to contact the team below.

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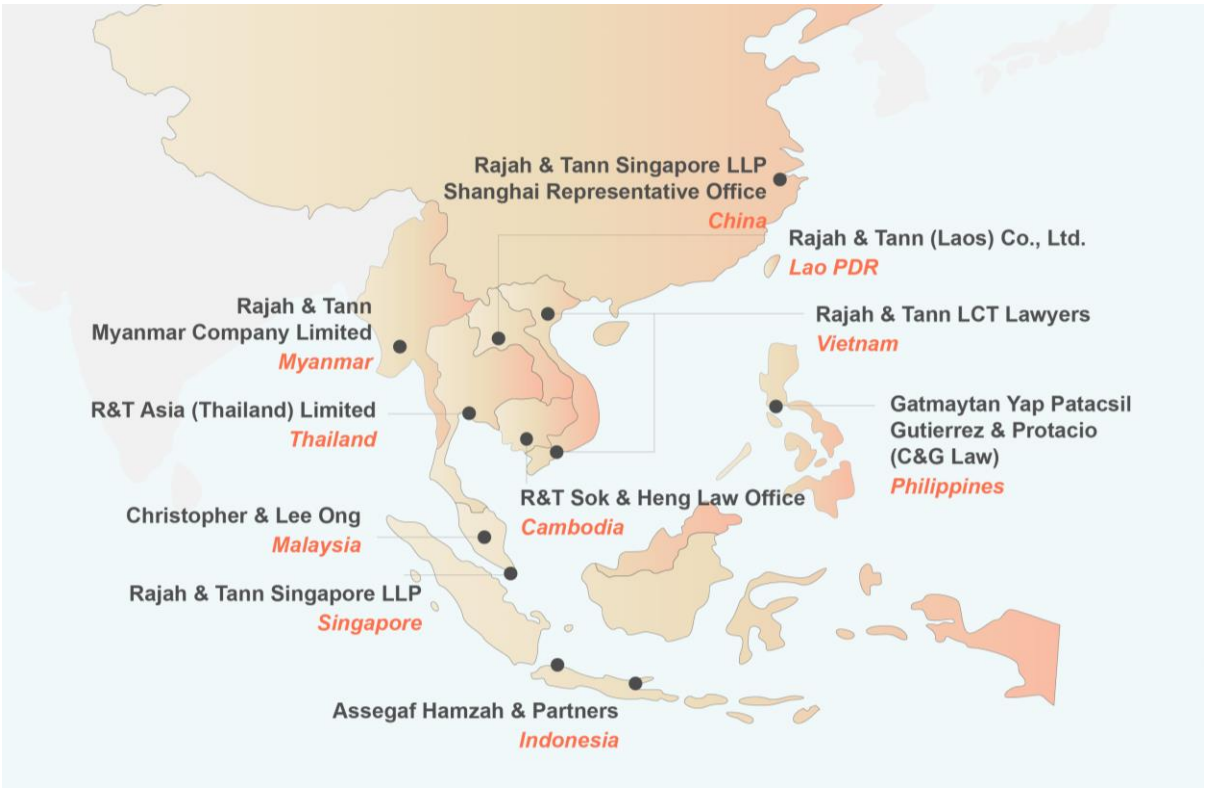

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