PIONEER ONE

MERCHANTING TRADE TRANSACTION

The concept of Merchant trade transaction (MTT) has been prevalent for quite a few years now, yet very few people know about it, we thought it will be in greater interest to re-introduce the concept of merchant trade, this newsletter will act as a brief overview of the provisions upon which a Merchanting trade transaction operates.

At the outset, let us first understand what a Merchanting trade transaction is,

- A merchant trade is a transaction between three parties, the importer, exporter and the customer to whom the goods are delivered,
- Essentially in a merchant trade, the goods will be shipped from a foreign country to another foreign country thorough an indian intermediary (also referred to as the merchant trader).

Conditions to be satisfied to classify a trade as a merchanting trade

- For a trade to be classified as a merchanting trade, goods acquired **shall not enter the Domestic Tariff Area.**
- Goods involved in merchant trade should be those goods which are permitted for exports/imports under the prevailing foreign trade policy (FTP) of India.
- The goods should not undergo any transformation and should be meant only for transport from the country of the supplier to the country of the buyer. (however the RBI has started allowing transformation subject to certain conditions and approval from A bank)
- Both the export leg and import leg of a merchant trading transaction should be routed through the same AD bank.
- A merchanting trade transaction should **always result in a PROFIT/GAIN** to the merchant trader.

How does a Merchanting transaction work?

- It is essentially like a **"bill to ship to"** type of transaction, but with foreign parties.
    - The merchant trader in India will purchase the goods from a non-resident supplier and give instructions to deliver the goods directly to his customer located in another foreign territory
    - The importer/merchant trader will make payment to the exporter for the goods purchased.
    - The importer/merchant trader will receive payment from the customer for the goods supplied.
    - The difference between the export proceeds and import payment is the income earned by the merchant trader which is also called as merchanting margin.

Merchanting trade transaction – GST Implication:

As per Schedule III of the CGST Act, 2017 "Supply of goods from a place in the non-taxable territory to another place in a non-taxable territory without such goods entering into India" is neither a supply of goods nor a supply of services.

A Merchanting Trade Transaction fits exactly into this definition, by virtue of which is exempt from the levy of GST.

Settlement Mechanism of a MTT:

- Entire cycle of a merchanting trade (both export leg and import leg) should be completed within 9 months (270 days) from the date of commencement.
- There should not be any outlay of foreign exchange beyond 4 months (i.e. if the merchant trader has received an advance from his customer in respect of the export, the import leg payment in respect of such trade should be completed within 4 months).
- Third party payments for export and import legs of the MTT are not allowed. (i.e. the payments should not be bourne by any person other the parties to the MTT contract)

Date of commencement of a merchanting trade transaction – Date of shipment (or) export leg receipt (or) import leg payment (whichever is earlier)

Date of completion of a merchanting trade transaction – Date of shipment (or) export leg receipt (or) import leg payment (whichever is later)

In other words, the start date shall be the date of receipt of export leg receipt/advance or date of payment of import leg payment/advance whichever is earlier, in cases where no advance payment is made or received, the date of shipment shall be considered as the date of commencement of the merchanting trade transaction. (It must be noted that the same provision shall apply in case of determining the date of completion too)

To put it in simpler terms,

Commencement of MTT	Completion of MTT	Max permitted duration	Remarks
Date of shipment	Import leg payment (or) export leg receipt (whichever is later)	9 months	
Export leg receipt	Import leg payment	4 months	If export leg receipt is received first, the import payment should be made within 4 months, since the provisions require that there should not be any outlay of foreign beyond 4 months.
Import leg payment	Export leg receipt (or) date of shipment (whichever is later)	9 months	

Documentary evidence.

The traditional evidence of exports and imports being shipping bill and bill of entry respectively will not be available in respect of merchanting trade transactions. This is because, the goods will never enter India.

Instead of the traditional documentary evidences, the main documents evidencing a merchant transaction are invoices, payment receipts and bill of lading (transport documents).

Following are the illustrative list of documents that act as evidence of a MTT,

1. Purchase order	5. Packing list	9. Merchant trade declaration
2. Delivery proof	6. Import Manifest	10. Swift Message
3. Transport documents / bill of lading	7. Export Invoice	11. Form A2
4. Invoice	8. FIRC (Foreign inward remittance certificate)	12. Debit authority for import payment

Responsibilities of an AD bank in a Merchant Trading Transaction

1. The AD Bank shall satisfy itself with the bonafides of the transaction.
2. The KYC and AML guidelines should be strictly adhered to by the bank while handling such transactions.
3. The AD bank shall verify the documents like invoice, packing list, transport documents and insurance documents and satisfy itself about the genuineness of the trade.
4. AD bank shall ensure **one-to-one matching** in case of each MTT and report defaults in any leg by the traders to the concerned Regional Office of the Reserve Bank, on half yearly basis, within 15 days from the close of each half year, i.e. June and December
5. If the merchant trader receives an advance payment against the export, AD bank should tag the same for making the payment under import leg of the transaction.
6. Payment for import leg may also be allowed to be made out of the balances in EEFC account of the merchant trader.

How is the merchanting profit/gain calculated?

- As stated above, a merchanting trade transaction should always result in a profit/gain to the Indian merchant trader. Such profit/gain is also referred to as merchanting margin.
- The merchanting margin is calculated as follows,

Merchanting Margin = Export Proceeds – Import Payments – Related Expenses

What are the consequences of not adhering to the above mentioned provisions and other regulations issued by RBI in this regard?

- Merchant traders with outstanding of 5% or more of their annual export earnings shall be liable for caution listing.

Payment of agency commission:

- There may be certain transactions where a merchant trader will be required to pay commission to an agent abroad or in India with respect to the export leg or import leg of the merchanting trade transaction.
- As per the regulations issued by RBI in this regard, payment of Agency commission by any form or manner is not allowed. However, in exceptional cases, RBI may allow payment of a reasonable amount as agency commission subject to the following conditions,
    1. The MTT has been completed in all regards.
    2. The payment of agency commission shall not result in the merchant trader ending into a loss.
    3. The trader should make a specific request to the AD bank in this regard with all the required details relating to the commission to be paid.

Write off of unrealized export leg amount

There may be certain situations warranting write off of amount owed to the merchant trader from his customer in the export leg.

The AD bank shall allow write off only in the following cases,

1. The customer (MTT buyer) has been declared insolvent. (certificate from liquidator needed)
2. The goods have been destroyed by the port of that country (certificate from appropriate authority in the country of MTT buyer required)
3. The unrealized balance represents the balance due in cases where the transaction has been settled by the Indian Embassy, foreign chamber of commerce or any other similar organization.

PIONEER ONE CONSULTING LLP
Accounting I Audit I Compliance I Consulting I Tax
#13, Chittaranjan Road, Teynampet,
Chennai – 600018
Phone: +91-44-4092-5800
E-Mail: reach@pioneerone.in
Website: www.pioneerone.in