

Impact of GST on Free Supplies & Free Samples:

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The Goods and Services Tax (GST) regime has introduced the concept of 'supply' as a taxable event and done away with the erstwhile taxable events of sale, service, manufacture etc. The taxability and valuation of 'Free Supplies' has been a subject matter of dispute *qua* taxation, valuation and credit restrictions in the past under erstwhile indirect tax laws.

While the term 'free supply' is not defined under GST law, a 'free supply' in general sense, means a supply of goods or services without consideration. Under GST law, the incidence of tax is 'supply'. The term 'supply' has been defined in an inclusive manner under Section 7 of the CGST Act. The term 'supply' as defined under Section 7 of CGST Act, 2017, includes all forms of supply such as sale, transfers, exchanges, barter etc. made or agreed to be made for a consideration in the course or furtherance of business.

Free Supplies between related /distinct person

Further, clause (c) of Section 7 (1) provides that the activities specified in Schedule I, made or agreed to be made without a consideration, is a supply under GST. As per Para 2 to said schedule, supplies between related persons or distinct persons in the course or furtherance of business even if not for a consideration shall be termed as supply. As a result, free supplies between unrelated persons are not 'supplies', therefore, not taxable, whereas free supplies between related persons are 'supplies' and therefore, such supplies are eligible to GST. In other words, GST shall be levied on the supplies made even without consideration between distinct or related persons on such value as determined in accordance with Section 15 of CGST Act, 2017 read with Valuation Rules under CGST Rules, 2017.

Scope of Para I to Schedule I to Section 7 of CGST Act, 2017

The said schedule also provides under Para 1 that the **permanent transfer or disposal of business asset where input tax credit (hereinafter referred to as ITC) has been availed** on such asset is treated as supply. The term Business Assets has not been defined under the Act. According to general rule of interpretations, if the language used has a natural meaning we cannot depart from that meaning unless, reading the statute as a whole, the context directs us to do so. According to the plain meaning rule, absent a contrary definition within the statute, words must be given their plain, ordinary and literal meaning. In the instant case, the term Business Asset is of very wide connotation. It includes every asset of the business including capital goods, finished goods etc. The clause stated above includes free supplies between both related and unrelated person.

As per our understanding, such clause shall cover following types of situations:

(a) **Disposal of Old Machinery to NGO** – A company has purchased a machinery and has availed input tax credit in respect of GST paid on such procurement. Further after few years, company disposed of such machinery by transferring it to NGO. Such transfer shall be considered as supply in terms of para stated above. Thus, GST shall be levied on the transfer of such assets on the value as determined under Section 15 of CGST Act, 2017 read with CGST Rules, 2017.

(b) **Disposal of old machinery to related person / distinct person** without consideration can also be covered under the said Para as there is no restriction to the same and consequently the same shall be considered as supply in terms of Para 1 and Para 2 of Schedule I to the CGST Act, 2017.

In the opinion of the author, business assets specified in Para 1 shall include only those capital assets which are being used in the course or furtherance of business. Thus, input tax credit reversal is not required in the said case. However, transfer and disposal of such assets shall be considered as supply and GST is leviable on the same. Department should clarify in this regard to bring clarity and to avoid unnecessary litigation.

Gifts to incentivise Distributors

These are marketing strategy adopted by various companies. Gifts provided to Distributors includes:

- (a) Goods which are manufactured by company itself or goods in which they are dealing on their own
- (b) Goods purchased from other vendors

On procurement of such goods or manufacturing of such goods, input tax credit in respect of the same is availed by the companies. Considering the wide definition of

business assets (as discussed above), such goods shall easily be referred to as business assets. Hence, transfer of such business assets on which input tax credit has already been availed shall be considered as supply and hence the same shall be exigible to GST.

However, in term of Section 17(5)(h) of CGST Act, 2017, notwithstanding anything contained in Section 16(1) and Section 18(1) of CGST Act, 2017, input tax credit in respect of goods, destroyed, written off or disposed of by way **of gift** or free samples shall not be available. The term gift has not been defined in the Act, thus, we would like to resort to definition provided under Gift Tax Act, 1858.

Section 2 (xii) "Gift" means the transfer by one person to another of any existing movable or immovable property voluntarily and without consideration in money or moneys worth and includes transfer or conversion of any property referred in Section 4, deemed to be a gift under that section.

As per above stated definition, any transfer by one person to another of any existing movable or immovable property voluntarily and without consideration shall be considered as Gift. Thus, goods provided free of cost shall fall under definition of gifts and accordingly input tax credit in respect of them has to be reversed.

A conjoint reading of Section 17(5)(h) of CGST Act, 2017 and Schedule I to CGST Act, 2017 demands harmonious interpretation of law. Such harmonious interpretation clearly indicates that if the goods are disposed of by way of gift, section 17(5)(h) of CGST Act, 2017 shall be applicable and accordingly input tax credit in respect of the same shall not be allowed. Thus, the same shall not be considered as supply. However, if such goods are disposed of by any way other than gift, then the same shall be considered as supply in terms of Para stated above and accordingly shall be exigible to GST and reversal of credit shall not be required.

According to the opinion of the author, goods distributed to distributors free of cost is a sales promotion expense in the hands of the companies, thus it cannot be considered as gift. In this regard, we would like to refer to the case of **FEDERAL COMMISSIONER OF TAXATION v. McPHAIL (1968) 117 CLR 111 26 March 1968** wherein Hon'ble High Court has provided that to constitute a "gift", the property should be transferred voluntarily and not as a result of a contractual obligation and no advantage of material character was received by transferor. Relevant text of the judgement is reproduced as under:

6. But it is, I think, clear that to constitute a "gift", it must appear that the property transferred was transferred voluntarily and not as the result of a contractual

obligation to transfer it and that no advantage of a material character was received by the transferor by way of return.

Goods distributed to distributors is benefitting the companies in promoting their sales. Thus, the same shall not be considered as gift. Hence, input tax credit should be available in respect of such goods. Here it is essential to highlight here that Department might litigate on the said issue and disallow the input tax credit in respect of goods distributed to incentivise the distributors considering them as Gift as there is no clarity in this regard.

Gifts for Marketing

Companies offer various schemes in the market so as to increase the sale of the products such as buy 2 get 1 free etc. Here we would like to mention that such gifts are in the nature of discounts. Such schemes are introduced to give to the buyer an Incentive to purchase more quantity at a lesser price indirectly by giving something free & hence it is actually a Discount in real sense (which we may call by whatever name Trade Discount/Quantity discount etc.....) One may also refer the decision of Hon'ble Supreme Court in CCE Vs. Hindustan Lever Ltd (2002) (142) ELT 513 (SC).

In terms of Section 15 of CGST Act, 2017, such value of discount, shall not be included in the value of supply so as to compute GST liability. According to the opinion of the author, no reversal is required in respect of such goods provided free of cost.

However, in terms of Section 17(5)(h) of CGST Act, 2017, such goods provided free of cost can be considered as gift and department may ask for the reversal of the credit in respect of the same. Thus, it is recommended that in the invoice under such schemes, companies shall reduce the value of the product provided free of cost, as a trade discount, from the total value of the products including the product which is to be provided as gift. In such a case, companies shall be eligible to avail input tax credit of such goods sold without any fear of litigation.

Further, CBIC's Sectoral FAQ (available on CBIC website) further suggested following :-

Question - *How the Invoicing should be done for free goods given along with sale so that corresponding input tax credit is not required to be reversed for products under scheme ?*

Answer - *Invoice Value would include value of all goods including those supplied free. In such cases, ITC is not required to be reversed.*

Disposal by way of Free Samples

Various Companies engaged in Pharmaceuticals, Cosmetics, Food Products etc. distributes free samples to customers/branches across the country. Such free samples transferred to customers shall not fall under definition of supply and accordingly no GST shall be leviable on the same.

For Free Samples there is provision for ITC Reversal u/s 17(5). The same reads as under:

(5)..Notwithstanding anything contained in sub-section (1) of section 16 and subsection(1) of section 18, input tax credit shall not be available in respect of the following, namely: –

(a)

(b)

.....

(h) goods lost, stolen, destroyed, written off or disposed of by way of gift or free samples; and

.....

Further, it also essential to bring to your attention the CBIC's Sectoral FAQ (available on CBIC website where following has been provided:

Question – *What are the requirements for clearance of physician samples distributed free of cost?*

Answer – *In case of clearance of physician samples distributed free of cost, the ITC availed on the said samples has to be reversed in view of the provisions under Section 17(5)(h) of the CGST Act, 2017. No tax is payable on clearance of physician samples distributed free of cost as the value of supply is zero and no credit has been availed.*

Hence according to section 17(5) of the CGST Act, input tax credit will not be available for goods given as gifts or free samples. Thus, if the taxpayer avails the input tax credit on account of a purchase of goods, and later gives these goods as free samples, then he will have to reverse the input tax credit so availed.

Distribution of Samples through Branches

Further, we would like to deal a scenario where a company distributes free samples through its branches. In such a case, transfer of free samples to the branch, being related person, shall be exigible to GST and further input tax credit in respect of such samples shall be allowed. However, branch needs to reverse the input tax credit of GST paid on such samples to the company. The same can be explained with the help of an example:

A supplied 2000 sample costing (including all inputs used for manufacturing samples and are eligible for ITC) Rs 60 each to its Branch located in Haryana. Accordingly, A charged GST on supply of such samples on value as provided under Section 15 of CGST Act, 2017 read with Rules thereunder, say Rs 100 (including the value of all inputs, salary and other expenses). Consequently, tax invoice shall be issued in respect of the same. In view of the same, A is entitled to avail the credit in respect of the inputs used for manufacturing such goods, i.e. Rs 60.

Further, when B shall distribute the samples free of cost to the customers, then B is required to reverse the credit in respect of GST paid on amount charged by A from branch i.e. on Rs 100. Such reversal would be much more than what is required to be reversed by A, had the samples were given free of cost by A only. A would have reversed the credit on Rs 60, however, branch needs to reverse the credit on Rs 100. Thus, this aspect also has to be taken into consideration while deciding on distributing free samples via branches.

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- Indirect Taxes Committee