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Is provision of medical instrument for use without any consideration a supply under GST

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Abstract

With the advent of GST in India, supply became the taxable event and this made the place of supply and time of supply particularly, and the act of supply in general significant. The GST laws mandate registration under section 22 of the Central Goods and Services Tax Act, 2017 (hereinafter referred as the CGST act, 2017) for all business. Almost every realm of service is now covered under the scope of supply under section 7 of the CGST Act, 2017 and free supplies are also clearly covered within the scope of the said section.

Few Pharmaceutical companies are engaged in importing and distributing medical equipment and providing healthcare solutions in India and beyond. These Companies place certain medical equipment at unrelated hospitals, labs etc., on a free-of-cost basis in exchange of a minimum purchase obligation arising out of an agreement between its clients.

In a sequence of rulings from the AAR to the Kerala High Court and back to the AAR, questions regarding a unique case of free supply of Taxable Pharmaceutical Instruments based on a periodic supply contract was presented before the Authority. The discussed rulings answered what is Periodic Supply Contracts, Composite Supply, Naturally Bundled Supply and Indivisible Supply and raised various new questions and avenues for discussion. And, this article, in particular, attempts to analyse the nature of such purchase agreements and the possibility of availing Input Tax Credit on the medical instruments.

Keywords: Supply, consideration, free of cost supplies, mixed supply and composite supply

Introduction

The Central Board of Indirect Taxes and Customs is continuously working to hamper the basic concept of seamless Input Tax Credit (ITC) and another case is equipment related to diagnostics which are placed at unrelated customer place such as hospitals, labs etc.

Equipment is moved on agreement at Free of Cost (FoC) with a condition to buy consumables with minimum cap, to be used on the said equipment, only from the equipment owner and a default of non-lifting would cost.

The decision of Authority for Advance Ruling (AAR) Kerala was appealed up to Kerala High Court which remanded the matter back to the AAR. It dealt with 'Periodic Supply Contracts', 'Composite Supply', 'Naturally Bundled Supply' and 'Indivisible Supply' and raised various new questions and avenues for discussion.

This article ventures into clauses of an agreement which would keep availing of ITC intact even when the equipment is not directly generating revenue and, in this context, the authors put forth the following questions for examination, being.

1. Is equipment placed at FoC against a minimum purchase obligation vesting on its clients, be treated as Supply?
2. If supply, what's the kind of supply is this?
3. When it's supply without direct revenue, the fate of ITC is?

Placement of medical equipment at free of cost with the clients is supply

This model is driven by the business exigencies to enhance business prospects, as the capital expenditure is one minimised by any industry as strategy for plug and play and labs and hospitals are no exception. Equipment manufacturers came up with innovative ideas in which equipment are placed at FoC but the cost is recovered by ensuring a minimum quantity is lifted by the client while keeping the equipment in the Books of the manufacturer/distributor. While depreciation benefits are also only for the same, physical possession and control is left with the Lab/Hospital.

As per section 7 of CGST Act, 2017 for any activity to be treated as supply, it must be within the 'scope of supply'. Definition of "Supply" is wide and an inclusive one; and therefore

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requires certain parameters for an activity / transaction to be categorised within the meaning and scope of 'supply' as detailed below.

1. The supply shall involve goods or services.
2. The supply should be in the course or furtherance of business.
3. The supply should be made for a consideration except in the case of activities specified under Schedule to the CGST/SGST Act.

Supply involves transfer of goods: It is seen that instrument installed at the labs clearly fall within the definition of goods under section 2 (52) and the right granted to the labs for the use of the machine falls within the scope of the term "transfer" defined u/s 7 (1) (a) of the Act. Hence, Transfer is a supply as specified in the Schedule II of the Act.

"1. Transfer (b) Any transfer of right in goods or of undivided share in goods without the transfer of title thereof, is a supply of services;"

With the activity of placing the medical equipment with the labs, the right-to-use of the same shifts to the premise of its placement without the transfer of ownership creating a transaction involving 'transfer of goods'.

The supply is in the course of furtherance of business

Given the nature of the transaction executed, it can be deduced from section 2 (17) (a) & (c) that the transaction involved is made in the course of furtherance of business.

The supply is made for a consideration: In the present scenario, an agreement exists between the Companies and labs which vests an obligation on the recipient of such transfer to subscribe to a minimum quantity purchase as a threshold failing which a penalty deficit amount is charged. Although agreeing to purchase a minimum quantity of reagents, calibrators etc., may not form a part of consideration, a penalty clause within the agreement may be assumed as a non-monetary consideration as per section 2 (31) (b), for the purpose of this transaction, is considered a 'Supply' within the ambit of section 7.

This categorisation was deeply discussed and distinguished by the Hon'ble Kerala HC ^[1] and AAR the Act. Hence, Transfer is a supply as specified in the Schedule ^[2] in the case of Abbott Healthcare Pvt. Ltd. vs. The commissioner of State Tax Kerala and Ors.

Initially, it was held that the entire transaction attracts GST under Sl. No. 17 (iii)- Heading 9973-Transfer of the right to use any goods for any purpose (whether or not for a specified period) for cash, deferred payment or other consideration, it is indeed a transaction of a composite supply and therefore liable to GST. The HC acknowledged this transaction but remanded back the matter on Jurisdictional constraints.

Upon careful perusal of conditions laid out in section 7 (1), the AAR observed that there is a transaction involving goods/services and that such transaction is in the course or furtherance of the business and that the specific transaction is made for a consideration being, as per the Agreement, there exists a minimum purchase obligation, failing which there exists an obligation to pay a deficit amount and as per section 2 (31) (b), every act or abstinence that is a motivation to induce a person, is consideration and there is no requirement that it must be in monetary form.

The AAR held that, without transferring ownership, the applicant grants a non-transferable right to use the medical

equipment for a predetermined time. In addition, aside from the right to use the medical instruments, the applicant owns all rights, titles, and interests in them. Therefore, holding that such placements qualify as supply of service as per Para 1(b) of the Schedule II, this time answering the question raised before the Authority.

Transfer of right in goods without transfer of title is a supply of service

On placing of medical equipment with the labs, the right-to-use of the same shifts to the premise of its placement without the transfer of ownership. Therefore, there is only an expressed transfer of a non-transferable right-to-use conferred upon the labs with the sole intention of increasing their income from the purchase of reagents, calibrators etc., by the clients. This creates a 'transfer of right in goods without the transfer of title of the equipment'. Transfer of right in goods as a supply being specified in Sch. II(1)(b), establishes the nature of this transaction as a 'supply of service'; And, as per Sch. II(5)(f), of the Act.

"5(f) - transfer of the right to use any goods for any purpose (whether or not for a specified period) for cash, deferred payment or other valuable consideration"

It can be established that this transaction qualifies as a Supply of service.

Eligibility of ITC: The Eligibility to claim Input Tax Credit is provided in section 16 of the Act. From the perusal of section 16(1) & (2), any person who is registered under GST, meeting the conditions that are mentioned below can claim the input tax credit, provided that GSTR2 returns has been filed.

- The dealer should possess the tax invoice or the debit note that is issued by the supplier of input or the input services.
- The said goods or services or both should be received.
- The supplier has made the GST payment that is charged to the government concerning such supply.
- When the goods are received in instalments the input tax credit can be claimed only when the last lot is received.
- No Input tax credit is allowed if depreciation has been claimed on the tax component of a capital good.

Provided that all these conditions are satisfied, and the nature of the transaction discussed hereinabove being established as a 'supply of service', it is established that ITC can be claimed by the Pharmaceutical Companies on such transactions.

Conclusion

- Placing equipment at client place is a supply attracting GST u/s 7.
- The nature of this transaction is a 'Supply of service' as per Ent. 1 (b) and as per Ent. 5 (f) of Schedule II it is a 'Transfer of right in good without transfer of title'.
- Category of transaction is "Composite Supply" and attracts the tax rate applicable to dominant items proving to be naturally bundled as decades-old practice.
- **ITC:** One of the conditions being receipt of consideration and here consideration being continuous in nature, the same is fulfilled to avail ITC while other conditions are fulfilled.

References

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