

GST - Credit entitlement on free samples

In the past year our country has witnessed some bold decisions taken by the Government, one of which was passing of 101st Amendment Act to the Constitution paving the way for Goods and Services Tax Act (GST). At the time of writing this article, the revised Model GST law issued in November, 2016 remains in draft form and is still subject to further amendments and debate in Parliament. This article seeks to highlight some of the significant issues pertaining to the 'act of giving free samples' under GST, as set out in the Revised Model GST Law ("RMGL") and Draft Rules (issued to date) which may be of interest to most businesses.

What happens presently?

It is pertinent to note that Excise duty is levied on removal of goods from the factory, meaning thereby, as and when free samples are removed from the factory, liability to pay excise duty arises. As far as State VAT laws are concerned, to tax a transaction there has to be monetary consideration and therefore free samples do not attract any VAT/CST liability. However, majority of the States have a provision for reversal of proportionate input tax credit in those cases where free samples are given.

How it will pan out under GST?

Provisions allowing a taxable person input tax credits under GST are carved out under Section 16 of RMGL. To put things in context, the specific provision in sub-section (1) of Section 16 is reproduced below:

*"Every registered taxable person shall, subject to such conditions and restrictions as may be prescribed and within the time and manner specified in section 44, be entitled to take credit of input tax charged on any supply of goods or services to him which are used or intended to be used **in the course or furtherance of his business** and the said amount shall be credited to the electronic credit ledger of such person."*

Furthermore, Section 17(4)(g) of RMGL provides that "notwithstanding anything contained in sub-section (1) of Section 16 and sub-sections (1), (2), (3) and (4) of Section 18, input tax credit shall not be available in respect of the following":

*"goods lost, stolen, destroyed, written off or disposed of by way of gift or **free samples**"*

On conjoint reading of the above provisions, giving free samples would require reversal of proportionate credit.

What is the intention of this provision under GST law?

- Is it to allow the department to use this opportunity to deny the credit and agitate?
- Is it really intended to simplify the tax laws or to provide better clarity and avoid litigation?
- Does the provision clarify the approach to be adopted by a taxable person in interpreting the terms, i.e. whether to reverse or not?

Well, the answer on a simple reading is really not clear. The Finance Minister has emphasized at various fora that GST strives for seamless flow of credits. Where on one hand GST is opening up new credits in the form of “Credit of goods/services used in laying the support structures of capital goods” and on the other hand it has a provision disallowing the valid and genuine credits to the taxpayer. This provision in law is defeating the very purpose of introducing GST.

Why does any businessman give free samples?

This is done to apprise the customer, with whom he is having a long standing relationship, of the characteristics and quality of the product and induce him to order in bulk. This particular act of giving free samples is similar to the promotional and advertising activities undertaken by every business which are the basic ingredients and inevitable to thrive in such cut throat competition. In pharmaceutical industry, manufacturers of medicines cannot effect the sale of their products so long as free samples of such products are not distributed amongst the doctors, who can test the potency and medical value of these articles. Free supply of samples of these articles is an essential part of sale of rest of the articles of the lot manufactured. Moreover, when a manufacturer supplies a portion of the goods as free samples, the cost which that manufacturer has incurred in manufacturing these samples is always taken into account by him in fixing the price of the rest of the articles of that lot manufactured by him. Thus, albeit indirectly, the exchequer will get GST even on the value of the samples, and there is no revenue loss as such to the government. Similar observation has been made by courts in the cases of *Ruby Laboratories* [(1971) 27 STC 326 Guj.] and *Mahavir Enterprises* [(2002) 34 APSTJ 72]. If business promotion and advertisement expenses are not specifically excluded and are considered as ‘*in the course or furtherance of business*’, then why not giving free samples?

What does the provision achieve?

Reversing the credit on account of free samples under GST might not be the intention of law, however such language used in law gives rise to doubts. This is a potential area where a representation can be made to the appropriate authority and industry can list down the repercussions of the above provision and pray to the government to come up with suitable amendments in the final law to remove the distortions and enable them to keep the credit chain flowing.