

GST IMPLICATIONS ON SALES PROMOTIONAL SCHEMES

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Nowadays, trade & industry executes certain attractive promotional methodology to accelerate the sale of their respective products and It has been noticed that there are several promotional schemes which are offered by taxable persons to increase sales volume and to attract new customers for their products.

These methods or tools ranges from types of discounts, involvement of free samples, allocation of warranty supplies, provision of extra quantity of the products. Such employ of these promotional schemes is indispensable in current era of cut throat competition; it is of great importance to understand the GST implications with respect to the aforesaid schemes.

It is perceive that major of the promotional schemes are either in the terms of free supplies or in the nature of discounts, regardless of the fact how it is accepted by the customers. While the definition of supply requires the presence of consideration so to ensure for a transaction to constitute a supply, further, certain transaction listed under Schedule I of the CGST Act, 2017 are covered under the ambit of supply despite when performed without consideration.

The chargeability of tax on the aforesaid promotional schemes in the nature of free supplies needs to be assessed in accordance with Schedule I of the CGST Act 2017. Moreover, implications of discounts shall be examined in accordance with Section 15 which governs Value of Supply of particular transactions executed.

Moreover, the tax consequences in regard to these promotional schemes need an examination in the light of restrictions imposed for availment of input tax credit & attention is invited towards the provisions of Section 17(5) of the CGST Act 2017.

Some of these schemes have been examined and clarification on the aspects of taxability, valuation, availability or otherwise of Input Tax Credit in the hands of the supplier. The summarization of GST implications on certain promotional schemes that are announced by trade & industry:

- **Free Samples**

The implementation of free samples is usually exercised for newer products to penetrate or probe the market area. Such free samples are conventionally distributed to a person who happens to be unrelated without any consideration. It is imperative to mark a note that supplies to related persons without consideration are covered under Schedule I of the CGST Act 2017. Accordingly, it is clarified that samples which are supplied free of cost, without any consideration, do not qualify as “supply” under GST, except where the activity falls within the ambit of Schedule I of the said Act..

However, the input tax credit of goods distributed as free samples shall be ineligible in terms of blocked credit in accordance with clause (h) of Section 17(5) of the CGST Act 2017. However, where the activity of distribution of gifts or free samples falls within the scope of “supply” on account of the provisions contained in Schedule I of the said Act, the supplier would be eligible to avail of the ITC.

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.

- **Excess / Extra Units - Quantity of the Same Product / / Buy one get one free offer**

The provision of an extra unit/quantity of the either same or similar product is entirely an efficient marketing approach. This implementation is commonly undertaken by FMCG companies and retail shopping outlets.

For Illustration –Buy 1 get 1 offers or 20% extra quantity offers on shampoos, hair oils, soaps etc. In the instant case, the cost of the 1 free unit/extra quantity of shampoo is principally included in sale price of the 1 unit for which the customer is paying.

It may appear at first glance that in case of offers like “**Buy One, Get One Free**”, one item is being “supplied free of cost” without any consideration.

In fact, it is not an individual supply of free goods but a case of two or more individual supplies where a single price is being charged for the entire supply. It can at best be treated as supplying two goods for the price of one.

Taxability of such supply will be dependent upon as to whether the supply is a composite supply or a mixed supply and the rate of tax shall be determined as per the provisions of section 8 of the said Act

Such promotional schemes are introduced to provide the buyer an inducement to purchase/buy more quantity at a given attractive price indirectly by offering something free. Hence, offering extra units/quantity of the same product is in the nature of discounts.

Some suppliers also offer periodic / year ending discounts to their stockiest, etc. For example- Get additional discount of 1% if you purchase 10000 pieces in a year, get additional discount of 2% if you purchase 15000 pieces in a year. Such discounts are established in terms of an agreement entered into at or before the time of supply though not shown on the invoice as the actual quantum of such discounts gets determined after the supply has been effected and generally at the year end. In commercial parlance, such discounts are colloquially referred to as "volume discounts". Such discounts are passed on by the supplier through credit notes.

Further, discounts offered by the suppliers to customers (including staggered discount under "Buy more, save more" scheme and post supply / volume discounts established before or at the time of supply) shall be excluded to determine the value of supply provided they satisfy the parameters laid down in sub-section (3) of section 15 of the said Act, including the reversal of ITC by the recipient of the supply as is attributable to the discount on the basis of document (s) issued by the supplier.

Hence, there shall not be GST liability required to be discharged on the extra unit/quantity of the product being offered as a promotional scheme. Further, no reversal of credit is required in respect of the extra units/quantity being offered for free/no value.

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.

- **Providing Free Gifts to dealers /distributors / extended hand of business**

Major companies propose free gifts to dealers / distributors on achieving certain level of targets to incentivize/ encourage the distribution channel process. These goods may be manufactured by the company itself or may be procured from outside.

For illustration, companies present household appliances like television, mobile, air conditioning, etc, to dealers / distributors on achieving commercial sales targets. The tax implications in this regard needs to be examined under Entry 1 of Schedule I which is as under:

"Permanent transfer or disposal of business assets where input tax credit has been availed on such assets"

The term Business Assets has not been defined under the Act. According to meaning rule, 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.

Considering the wide definition of business assets, 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.

It pertinent to note here that the essential condition here is the availment of input tax credit in respect of the goods. In case input tax credit is availed on any goods being distributed as gifts, the transaction shall be covered under the ambit of supply and tax shall be levied.

However, Section 17(5) disallows the availment of input tax credit in case of goods being distributed as gifts. Hence, ITC shall be disallowed on such

goods being distributed as gifts to the distributors. Further, in the absence of availment of ITC, the transaction shall not be covered under the definition of supply.

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.

One may have a contrary view, the goods distributed to distributors free of cost is a part of 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.

Goods distributed to distributors are 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.

- **Supply under warranty**

It is a general practice in major electronic goods industries, automobile industries to offer warranties on the sale of their products. A warranty is primarily an undertaking by the manufacturer to the end-customer wherein all defects on account of faulty manufacture of the goods have to be repaired and the faulty parts in the product shall be replaced free of cost to the customer.

This warranty may be the basic warranty for which no extra charges are charged or paid by the customer. On the other hand, warranty may be extended warranty which is chargeable and is optional for the customer to purchase.

In the event where goods are supplied to the customer under warranty, no consideration is demanded for the replacement of parts or the provision of repair services. In such an instance, the transaction between unrelated persons shall not be

covered under the definition of supply and no tax shall be chargeable.

At this juncture, it is relevant to give attention to upon the fact, when such goods were procured by customer; the value of supply included the value of goods and services that may be supplied under warranty (on an approximate basis). Hence, in this case the question of levying tax on the goods and services supplied under warranty should not arise.

Further, there is no restriction on the availment of ITC on goods or services supplied under warranty, hence, no reversal of credit is required as it not hit by Section 17(5) of CGST Act 2017.

- **Free Articles**

Under promotional schemes, an article if offered for free along with the purchase of the principal product. For illustration - a laptop bag may be offered for free on the purchase of a laptop for which the customer is paying. In this very case, the cost of the free laptop bag happens to be included in the price of the laptop. It is just an arrangement from the supplier side to penetrate the customer's requirement to believe that the laptop bag is for free.

The discount or the value of the free article shall not be included in the value of the laptop for the purpose of computing the GST liability. Hence, there shall be no GST supposed to be paid on the free article being offered as a part of marketing or promotional schemes. Further, there is also no requirement to reverse the input tax credit in this regard as it not hit by Section 17(5) of CGST Act 2017.