

Tax Credit on Goods Destroyed Could Be a Game Changer

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With the introduction of GST Act, 2017, there is a free flow of Input tax credit if the conditions related to ITC are fulfilled & the expense incurred is in the course of or for furtherance of the business. Continuous and seamless chain of input tax credit is one of the key feature of Goods & Service Tax which further removed the cascading effect of taxes. If a manufacturer, wholesaler, supplier, e-commerce operator is registered under the GST, then they are eligible to claim the input tax credit for tax paid for the purchases made by them. However, there are specific goods and services on which GST Act does not allow the taxpayer to avail credit like gifts, free samples, ITC pertaining to immovable property, ITC on motor vehicles subject to certain conditions.

In this article, we would like to discuss in detail the treatment under GST incase goods are destroyed or disposed of as gift or free samples.

As per the provisions under GST, if goods are lost, stolen, destroyed, written off or disposed of by way of gift or free samples, ITC is not allowed and if taken needs to be reversed. Simultaneously, there is another provision which states that permanent transfer or disposal of business assets even if without consideration is treated as supply. The very existence of two provisions with respect to one transaction i.e. transfer of goods which is also a business asset leads the taxpayer in a predicament. A lot of care must be taken not to reverse credit when in fact output tax should have been on the outward supply. Any wrong treatment can result in loss of credit after time lapse and output tax still being demanded.

Permanent transfer or disposal of business assets even if without consideration is treated as supply. Since the terms used i.e. permanent transfer, disposal and business assets are not defined under GST law, hence reference shall be made to the dictionary meaning or the meaning of these terms in common parlance. Permanent Transfer would mean to give over the perpetual legal possession or ownership of something. Thus, if goods are disposed of as gift or free samples, they shall fall under the definition of permanent transfer. Further, disposal means getting rid of something that is unwanted or useless. Thus, if the goods are given as gift or free samples, it need not be construed as a disposal. The expression 'disposed' is not used as a synonym of 'sale'. Disposed is akin to discard or get-rid-off or clear away and implies articles that are 'unfit for sale'. Whereas, the expression 'sale' always implies an assurance of merchantability even if it is offered at a deep discount due to change in trends or end of season, etc. The term business asset is not defined under GST. In general accounting, an **asset** is any resource owned by a business or an economic entity. It is anything (tangible or intangible) that can be owned or controlled to produce value and that is held by an economic entity and that could produce positive economic value. Goods do have the economic value and are de facto business assets and thus permanent transfer or disposal of goods shall be considered as supply even if it is without consideration. Hence, by virtue of the said provisions disposal of goods by way of gift or free samples shall be considered as supply. However, there is another provision in GST which specifies that ITC needs to be reversed in the said case.

CBIC issued the circular clarifying the treatment in case of gift or free samples. However, it also doesn't clearly specify the final treatment. It states that goods or services or both which are supplied free of cost shall not be treated as supply under GST but it lays down the exception in case of activities mentioned in Schedule I of CGST Act which specifies that permanent transfer or disposal of goods as supply even if without consideration shall be treated as supply. However, it also specifies that 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.

As stated above, disposal means getting rid of something that is unwanted or useless and the block credit is on disposal of goods as gifts or free samples, hence it can be inferred that if the goods which are unfit for sale or useless and are given as gift or free samples, then ITC shall be reversed. However, if the contrary persists and ITC has been availed on goods, the act of giving the goods as gifts or free samples shall be treated as supply. However, this may be challenged by some experts and this requires more clarity.

Next issue which is very much pertinent during this pandemic and the lockdown in various states is businesses may have some goods which got destroyed due to their perishable nature or any other reasons. This has created another issue with respect to the treatment of input tax credit already availed by the registered supplier. The dispute behind this is that GST had been already paid on destroyed goods which has not been sold. As per the provision of GST Act, Input tax credit of the damaged goods shall not be allowed because no consideration has been received & further remain unutilized in the business. Hence, already taken Input Tax Credit needs to be reversed as it is blocked credit under law and has not been used in the course or furtherance of business. However, the conditions for availing the credit states that input tax credit shall be available on any goods or services or both which are used or intended to be used in the course of or furtherance of business. Thus, even if the goods were intended to be used in the course of or furtherance of business, input tax credit shall be available. Further, the input tax credit is not available if the goods are destroyed. Destroyed is not an expression that is used to refer to normal wear and tear. Thus, if the goods were intended to be sold, however they got destroyed due to their short shelf life, ITC shall be available and need not be reversed. However, this will be a matter of litigation and subject to challenge by the department.

Thus, even though with GST, various benefits have flown to the taxpayers by way of input tax credit of both goods and services, however it is also a Pandora's Box with lots of conditions and snags attached to it. The tax payer has to be various cautious while taking and reversing any credits. Any error can result in loss of credit due to the time limitation under the GST provisions and interest and penalties on account of any wrong/excess credit taken. Thus, it is rightly said that "Nothing worth having comes easy".