

# TAX FLASH NEWS

10 January 2020



## AAR ruling, holding that free supply of medical instrument and reagents to be composite supplies quashed by High Court of Kerala

### Background

The High Court of Kerala<sup>1</sup> has quashed the order of the Authority for Advance Ruling (AAR)<sup>2</sup> and the Appellate Authority for Advance Ruling (AAAR)<sup>3</sup>, which had held that placement of Medical Instrument and supply of reagent, calibrators, disposables, etc. is a composite supply, principal supply being supply of medical instrument.

The High Court had remanded back the matter to the AAR for fresh consideration.

### Facts of the case

The petitioner is in the business of supply of pharmaceutical products, diagnostic kits, etc. In the instant case, the petitioner had entered into Reagent Supply and Instrument agreement with various unrelated hospitals, laboratories, etc. By virtue of the agreement, the petitioner is required to place diagnostic medical instruments for specified periods at the premises of such hospital/laboratories without any consideration.

Under the said agreement, the hospital/laboratories have an obligation to purchase specified quantities of reagent, calibrators, disposables, etc. at the prices specified in the agreement through the distributors of the petitioner.

Based on the above facts, the petitioner had filed an application before the AAR, to seek a ruling on whether the free placement of medical instrument at the premises of an unrelated-parties would constitute 'supply' or whether it constitutes 'movement of goods otherwise than by way of supply'.

The AAR examined the issue in the backdrop of the agreement and ruled that the petitioner was making two supplies, namely, of medical instrument and of reagent, calibrators, disposables, etc. to be used along with the instrument. Since the instrument supplied had no utility unless the reagent, calibrators, disposables, etc. are bought along with it, the two supplies are to be treated as naturally bundled to form composite supply.

Treating the said supply of medical instrument as the principal supply, the AAR held that the supply of reagent, calibrators, disposables, etc. shall be required to be taxed at the rate applicable to supply medical instrument.

The order of the AAR was subsequently confirmed by the AAAR. Aggrieved, by the same, the petitioner filed a writ before the High Court of Kerala.

### High Court decision

The High Court has observed in its order that the findings of the AAR with regards to treating both the supply, i.e. supply of medical instrument and the supply of reagent, calibrators, disposables, etc. as a composite supply is without jurisdiction. The AAR did not go into the real issue for which the application was filed before the AAR i.e. whether the supply of instruments per se constituted a taxable supply, or whether it constitutes 'movement of goods otherwise than by way of supply'.

In addition to the above, the Court made the following further observations –

The concept of enhancement of utility of the instrument through supply of reagent, calibrators, disposables, etc., are relevant for the purpose of valuation of the supply of medical instruments, the same cannot be applied to determine whether the supply is a composite supply.

<sup>1</sup> Abbott Healthcare Pvt. Ltd. [2020-VIL-08-KER]

<sup>2</sup> 2018-VIL-196-AAR

<sup>3</sup> 2019-VIL-13-AAAR

The supplies are made by two different taxable persons; the supply of instrument by the petitioner and the supply of the reagent, calibrators, disposables, etc. by the distributor, who purchases it from him on principal to principal basis. Although it could be argued that there is a relationship between the said persons that influences the valuation of the supply, the same does not take away from the fact that the supplies are made by two different taxable persons.

There is no material to suggest that the two supplies are bundled and supplied in conjunction with each other in “the ordinary course of business”. The business model of supply of reagent, calibrators, disposables, etc. through distributors has been followed by the petitioner for a considerable time, and it shows that placement of instrument is not bundled with sale of reagent, calibrators, disposables, etc. in the ordinary course of business.

Based on the above observation, the High Court remitted the matter back to the AAR for fresh decision on the query raised before it by the petitioner.

### Our comments

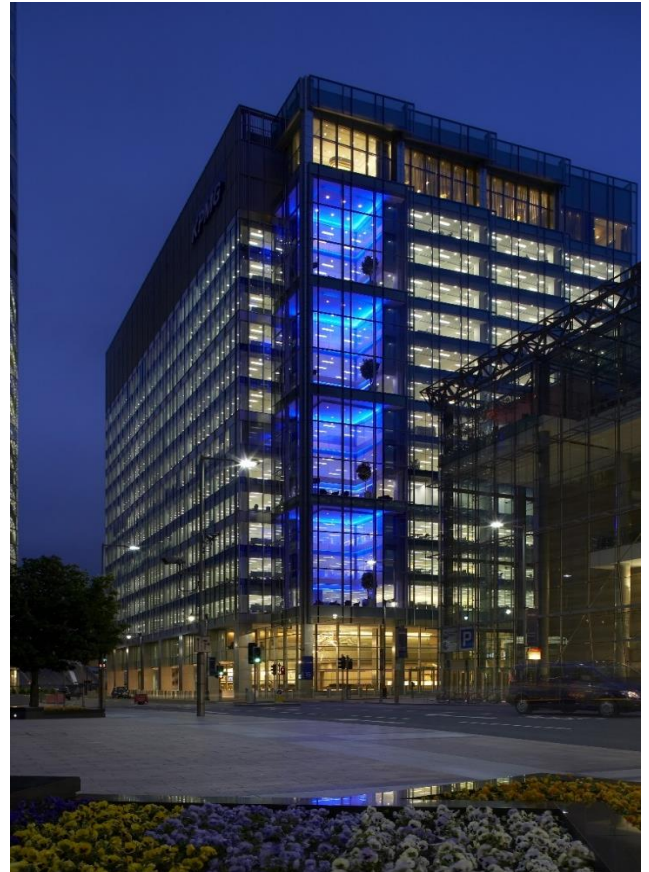
This is an important ruling, both on the jurisdiction of AAR and also on the interpretation of ‘composite supply’.

The High Court has clearly stated that both AAR and AAAR have exceeded their jurisdiction in dealing with the question raised by the petitioner and accordingly have remanded back the matter to AAR to pass a fresh decision on the query raised before by the petitioner.

As regards, the composite supply, the High Court has clearly mentioned that supplies made by two different persons cannot be clubbed together to constitute composite supply. Further, the clubbing of the supplies may be considered for valuation purposes and not for the purpose of altering the nature of the supply, findings in relation to composite supply must take into account supplies effected at a given point in time on ‘as is where is’ basis.

The ruling gives a much-needed respite to the companies dealing in medical instrument/devices, because these instruments are taxed at a higher GST rate than the reagents.

It will be interesting to follow the case, as to how the AAR rules on the query raised by the petitioner i.e. whether free supplies made to an unrelated parties would constitute ‘supply’ or whether it constitutes ‘movement of goods otherwise than by way of supply’.



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