

Levy of GST on supply on supply of Free medical instrument with other goods to hospitals for a specific period

2018 TaxPub(GST) 0547 (AAR-Ker)

IN THE AUTHORITY FOR ADVANCE RULINGS, KERALA

B.G. KRISHNAN & B.S. THYAGARAJABABU, MEMBER

Abbott Healthcare (P.) Ltd., In re

Advance Ruling No. Ker/15/2018

26 September, 2018

Appellant by: Darshan Boram, Advocate

JUDGMENT

The applicant has adopted the business model of placing their own medical instruments at the premises of hospitals or laboratories and supplied the pharmaceutical products, reagents, diagnostic kits etc to be used in such equipments by executing an agreement. The applicant sought for advance ruling on the following:

- (i) Whether the placement of specified medical instruments to unrelated customers like hospitals, labs, etc., for their use without any consideration, for a specific period constitute supply?
- (ii) Whether such movement of goods constitutes otherwise than by way of supply under GST?

The authorized representative of the applicant was heard. It is stated that the applicant placed its own specified medical equipments to identified hospitals or laboratories by executing an agreement. The applicant placed the equipment in the premises of hospitals or laboratories without receiving any consideration. The employee of the hospitals or laboratories where the equipment is installed has the full right to use the machine during the period of contract. But the title and ownership of the instrument continues to be with the applicant. The users of the instruments only possess a non-transferable light to use the said instruments during the tenure of agreement. These medical or diagnostic equipments transferred from the warehouse located in Ahmedabad to Kerala against delivery challan.

The hospitals or laboratories at which the instrument is installed are bound to procure specified quantity of reagents, calibrators, disposals etc. from the applicant till the tenure of agreement. The price of these products is also specified in the agreement. These products are supplied against tax invoice. If the hospital fails to purchase specified minimum quantity of the products such as reagents, calibrators, disposals etc., the applicant is entitled to recover the same from the hospital, equal to the volume of deficit purchase. As the applicant has faced certain difficulties while transporting the instrument against delivery challan, this clarification was sought for.

The issue is examined in detail. The applicant is providing two components to the respective hospitals or laboratories. One is the medical instrument and the other one is the products like reagents, calibrators, disposals etc to be used in that machine. The terms and conditions of the agreement reveal that it is an indivisible contract for the supply of instrument and the products to be used in the instrument. The customer can avail the service provided by the applicant only if both the instrument and reagent are available simultaneously. Therefore if an instrument to be placed in a hospital or laboratories, the customer has a

monthly minimum purchase obligation to procure specified quantity of the products like reagents, calibrators, disposals etc from the instrument provider.

The applicant supplied instrument to the premises of the customer free of cost. This instrument as such has no utility. It became usable only upon using of the products like reagents, calibrators, disposals etc. As far as a customer is concerned, service or functionality of the equipment is available only when both the components come together. Hence the supply of instrument and reagent is naturally bundled and becomes a composite supply. The medical instrument is taxable @ 18% GST vide HSN 9027 whereas the products like drugs or medicines including their salts and esters and diagnostic test kits are taxable @ 5% GST vide HSN 30. Supply of instrument is a one time activity and supply of reagent is a continuous activity, till the termination of the agreement. This transaction being a composite supply, the applicable tax rate is the tax rate of instrument, which is the principal supply. Receipt of individual consideration for each component in a contract has no significance. Whatever the consideration derived out of such agreement is the supply receipt exigible to tax. This being a composite supply applicable tax rate is @ 18% GST.

But the applicant established a business model, in such a way to split the supply by independent transactions. One transaction is the supply and installation of instrument owned by the applicant, at the premises of the customer on free of cost, till the tenure of contract. The 2nd transaction is supply of per-defined minimum quantity of consumables like reagents, calibrators, disposals etc on the pre- fixed prices. The applicant has designed such a modus operandi with the ultimate objective to avoid payment of tax at higher rate, which is applicable for composite supply colourable business model of free supply of instrument accompanied with a monopoly purchase Obligation to procure reagents, calibrators, disposals etc is a contrivance to keep out of the ambit of composite supply.

Even though the customer has a right to use the instrument, during the tenure of contract, physically no consideration is realized from the customer with the objective to avoid payment of tax at higher rate. If any visible rent is realized from customer for the right to use the machine/instrument, the transaction is of supply of service covered under Heading 9973 i.e. transfer of the right to use of any goods for any purpose whether or not for a specified period for cash. deferred payment or other valuable consideration falls under S.No. 17 (iii) Heading 9973 of *Notification No. 11/2017-Central Tax (Rate), dt. 28-6-2017* and attract same rate of tax on supply of like goods involving transfer of title of goods; in the instant case @ 18%.

Once the instrument is installed in the premises of a hospital, the hospital reserves the full control and right to use the equipment by applying the products like reagents, calibrators, disposals etc supplied by the applicant. Neither the instrument nor the products like reagents, calibrators, disposals etc provided by the applicant has any independent use or existence. Hence, it is an undisputed fact that, the supply of instrument and the products are conjoined and inter-dependent which constitutes a composite supply. The objective of creating a colourable business frame never alters the characteristics of combination of goods or utilities to provide a specified service. In order to obtain the required service of diagnosis, the hospital/labs require two unique components such as instrument and the products like reagents. calibrators, disposals etc. By the combination of these two components, the desired output is generated and hence these two components are inter-dependent and not separable. As both these components are naturally bundled, the impugned supply of instrument and reagents based on an agreement constitute composite supply. In this composite supply the principal supply is the instrument. Hence the entire receipts covered under this agreement attract the tax rate of principal supply i.e., the instrument.

The name of agreement executed between the parties is styled as the reagent supply and instrument use agreement. The applicant provides instrument for the use of the customer subject to a condition that customer shall procure agreed quantity of products as per the scheduled time limit. The customer is also responsible for the Cost of any repairs required in connection with any damage caused to the instrument due to negligence or misuse. The agreement between the parties, established that the supply of two components are indispensable for the fulfillment of contract and getting required output.

Hence the supply of two components based on the strength of agreement qualifies the concept of combination or two or more naturally bundled' supply and becomes composite supply.

The supply of instrument and the products to a hospital/laboratory is for monetary consideration. Being a composite supply, it is the discretion of the parties to fix the point of exchange of consideration. While supplying the instrument, the applicant deferred the consideration and merged it with the price of products like reagents, calibrators, disposals etc. As the applicant has monopoly to control the minimum quantity of procurement of consumables/products, the rent/cost of the equipment for the particular period is merged with the price of products. But there is no visible or explicit demarcation of rent/cost of the equipment and cost of products. This veil can be lifted once specified quantity of Consumable is not procured by the recipient hospital. In such scenario there is clear provision in the agreement to the effect that, if the customer fails to meet its exclusive purchase obligation or its minimum purchase obligation, the applicant shall have the right to recover the deficit amount from the customer. From this, it is clear that the price realized from the Customer includes subsumed rent of the equipment also. That is why if required quantity of consumable is not used, the customer hospital has the liability to pay the deficit amount.

In the light of the discussion above, we come to the conclusion that the essential nature of the transaction, as evidenced by the agreement, is the right to use the machine/instrument and the supply of goods, namely; reagents etc are only incidental or ancillary to the right to use of the machine/instrument. The supply of goods namely; reagents etc have no independent existence severed from the supply of right to use the machine/instrument. Though as per the contract, consideration is charged only in respect of supply of the reagents etc; the consideration charged for the supply of reagents etc is inextricably linked with the supply of the right to use the machine/instrument as the transaction of supply of reagents has no legs to stand without being accompanied by the right to use the machine/instrument.

Therefore, the different elements of the transaction as evidenced by the agreement; namely the provision of the right to use the machine/instrument without consideration and the supply of reagents etc for consideration with a Clause that a minimum amount/quantity of such reagents etc shall be procured are integral to an overall supply namely; the right to use the machine instrument; which is the principal supply. Hence as per provisions of section 8 of the GST Acts; the entire transaction is liable to GST under S.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.

In view of the observations stated above, the following rulings are issued:

The placement of specified medical instruments to unrelated customers like hospitals, labs etc. for their use without any consideration, against an agreement containing minimum purchase obligation of products like reagents, calibrators, disposals etc for a specific period constitute composite supply. The principal supply is the transfer of right to use of any goods for any purpose and is liable to GST under S.No. 17 (iii) -- Heading 9973 of *Notification No. 11/2017-Central Tax (Rate), dt. 28-6-2017*.