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Research Paper

(Abridged)

GST on "Pre-packaged and Labelled Food Items"

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Research Paper on

“GST on Pre-Packaged and Labelled Food Items”

Background:

The food processing industry of India, also called a “Sunrise Sector”, is one of the largest industries in India, if not the world. India is the largest country in terms of food production, processing, supply, and consumption. India’s food market is ranked 6th in the world, with 70% of sales and 5th in production, consumption, and export. India exports 13% of its overall manufacturing output and 6% of its industrial investment. Manufacturing and agriculture contribute 8.80% and 8.39% respectively, to India’s Gross Value Addition. The burgeoning industry is further proved by the rise in export of food products from India. According to data released by the Ministry of Commerce and Industry, agricultural and processed food product exports increased by 14% in the first three months of FY 2022-23 compared to the same period in FY 2021-22.

The food industry has not been spared under the tax laws as well, be it in the form of sale of food items or restaurant services. In the pre-GST era, most of the food items such as wheat, rice, flour, pulses were Nil rated under Central Excise Act, other than a few goods such as condensed milk, malt, and certain starches. When it came to State VAT laws, food items were taxed differently in every State. Where states like Maharashtra taxed pulses, grains, flours etc at 4%, Karnataka had exempted VAT on such products. Kerala VAT taxed 5% on branded food items and on processed & preserved meat.

Taxation of food items in the GST era has also seen a multitude of developments and changes. When GST was introduced w.e.f 1st July 2017, tax of 5% was made applicable on rice, wheat, cereals, flour etc., when **“put up in a container and bearing a registered brand name”** as it was decided in the 15th GST Council Meeting that branded cereals were a value-added product and could be taxed at 5%. However, during the GST Council in its 21st Meeting held on 9th September 2017, it was noted that after the provision was put in place, deregistration of brand names had started. Considering the additions suggested by the Fitment Committee, the Council approved to amend the phrase to include the condition that - a mark or name in respect of which actionable claim is available shall be deemed to be a registered brand name.

Accordingly, vide Notification No. 27/2017-Central Tax (Rate) and Notification No. 41/2017-Central Tax (Rate), such specified goods were made taxable to 5% GST if they were:

“put up in unit container and, -

(a) bearing a registered brand name; or

(b) bearing a brand name on which an actionable claim or enforceable right in a court of law is available [other than those where any actionable claim or any enforceable right in respect of such brand name has been voluntarily foregone, subject to the conditions as in the ANNEXURE]”.

Post this amendment, it was seen that various businesses supplying such specified food items were voluntarily foregoing their brand name for claiming exemption under GST given the competitive advantage that unbranded businesses had over them.

Consequently, quoting the Hon’ble Finance Minister in her tweets dated 19th July 2022, the Fitment Committee found that there was rampant misuse of the provisions by reputed manufacturers and brand owners which gradually led to fall in GST revenue from these persons. Further, various Industry Associations wrote to the Government to uniformly tax all packaged commodities irrespective of brand name.

Accordingly, the following was recommended in the 47th GST Council Meeting on 29th June 2022:

“C Withdrawal of exemptions [Approval of recommendations made by GoM on rate rationalization]

C1. Hitherto, GST was exempted on specified food items, grains etc when not branded, or right on the brand has been foregone. It has been recommended to revise the scope of exemption to exclude from it prepackaged and pre-labelled retail pack in terms of Legal Metrology Act, including pre-packed, pre-labelled curd, lassi and butter milk.”

Thus, it may be said that the Government intends to bring “prepackaged and pre-labelled retail pack” of food items into the tax net.

Consequently, Notification No. 6/2022-Central Tax (Rate) dated 13th July 2022 was issued wherein GST was made applicable on such food items when it is “pre-packaged and labelled”. It may be noted that the term used in the Notification differs from the terms used in the Council Recommendations Press Release, specifically removing the words “retail pack”.

What is “pre-packaged and labelled?”

The term has been defined in Notification No. 6/2022-Central Tax (Rate) as under:

*“The expression ‘pre-packaged and labelled’ means a ‘**pre-packaged commodity**’ as defined in clause (l) of section 2 of the Legal Metrology Act, 2009 (1 of 2010) where, the package in which the commodity is pre-packed or a label securely affixed thereto is **required to bear the declarations** under the provisions of the Legal Metrology Act, 2009 (1 of 2010) and the rules made thereunder.”*

Therefore, in order to be considered as “pre-packaged and labelled”, the following two conditions are to be fulfilled:

- a. It shall fall under the definition of “pre-packaged commodity” under Section 2(l) of Legal Metrology Act, 2009
- b. The package bears the declarations under the provisions of the Legal Metrology Act and the rules made thereunder.

Analysis of Relevant Provisions under Legal Metrology Act

Meaning of “pre-packaged commodity”:

The term “pre-packaged commodity” is defined in Legal Metrology Act (LMA) as follows:

*“(l) “pre-packaged commodity” means a commodity which **without the purchaser being present** is placed in a package of whatever nature, whether sealed or not, so that the product contained therein **has a pre-determined quantity**.”*

Thus, a pre-packaged commodity is a commodity which is:

1. Packed without purchaser being present;
2. May or may not be sealed;
3. Product has a pre-determined quantity

From a plain reading of the definition, it can be said that any goods which have been packed prior to identification of purchaser AND which has a pre-determined quantity would be considered as “pre-packaged” commodity. Milk/curd packets, rice or wheat flour packets displayed on store shelves would be suitable examples for the same.

Those not included would be cases where goods are packed based on quantity desired by the purchaser and in the presence of the purchaser. For example, food items such as rice, rava, flour etc., sold at METRO or DMart where packaging is done based on quantity customised by the consumer.

Declarations required under LMA:

This takes us to Section 18 of LMA which provides as under:

*“18. Declarations on pre-packaged commodities.— (1) No person shall manufacture, pack, sell, import, distribute, deliver, offer, expose or possess for sale any pre-packaged commodity unless such package is in such standard quantities or number and **bears thereon such declarations and particulars** in such manner as may be prescribed.”*

(2) Any advertisement mentioning the retail sale price of a pre-packaged commodity shall contain a declaration as to the net quantity or number of the commodity contained in the package in such form and manner as may be prescribed.”

Thus, in order to manufacture or sell as pre-packaged commodity, declarations as per Rules prescribed is mandatory. For this, reference to Legal Metrology (Packaged Commodities) Rules, 2011 (hereinafter referred to as PC Rules) is necessary.

Chapter II of PC Rules consists of Rules 3 to 23 which provides:

- 1) Exemption from application of the Chapter
- 2) Declarations to be made on every package
- 3) Manner of declarations
- 4) Inspection of packages

Rule 3 of the PC Rules provides the following to which Chapter II shall not apply:

- (a) packages of commodities containing quantity of more than 25 kilogram or 25 litre
- (b) cement, fertilizer and agricultural farm produce sold in bags above 50 kilogram
- (c) packaged commodities meant for industrial consumers or institutional consumers

Further, Rule 6 requires the declarations to be made on retail packages such as name and address of manufacturer and packer/importer, country of origin, common & generic name of the commodity, MRP, best before or use by date, etc.

Reading Rule 3 with Rule 6, the above declarations are not mandatory for the following:

1. Cement packs of more than 50kg
2. Fertilizer of more than 50kg
3. Agricultural farm produce of more than 50kg
4. Other Commodities packaged in bags of more than 25kg
5. Any packaged commodity (irrespective of quantity) meant for industrial consumers
6. Any packaged commodity (irrespective of quantity) meant for institutional consumers

Here, it is also pertinent to understand the meaning and implications of the terms “industrial consumer” and “institutional consumer”.

What is “industrial consumer” and “institutional consumer”?

The term “industrial consumer” has been defined under Rule 2(bb) of PC Rules as under:

*“(bb) “industrial consumer” means the consumer who buys packaged commodities directly from the manufacturer or from an importer or from wholesale dealer **for use by that industry** and the package shall have declaration ‘**not for retail sale**’;”*

Further, the term “institutional consumer” is defined under Rule 2(bc) of PC Rules as below:

*“(bc)“institutional consumer” means the institution which buys packaged commodities bearing a declaration ‘**not for retail sale**’, directly from the manufacturer or from an importer or from wholesale dealer **for use by that institution and not for commercial or trade purposes**;”*

Thus, an industrial consumer is:

- a) A consumer
- b) Who buys packaged commodities
- c) Directly from manufacturer/importer/wholesale trader
- d) For use by that industry;
- e) Shall have declaration ‘not for retail sale’

An institutional consumer is:

- a) An institution
- b) Which buys packaged commodities
- c) Bearing a declaration ‘not for retail sale’
- d) Directly from manufacturer/importer/wholesale trader
- e) For use by that institution

For further analyses of the terms “industrial consumer” and “institutional consumer”, including the various judgements and open issues, please refer to the full-length research paper.

From the definitions and plethora of judgements, following could be concluded regarding definition of “institutional consumers” and “industrial consumers”:

1. Commodities sold to manufacturers and service providers which are used by them for further manufacture or provision of service is covered under the definitions and exempt from declarations under Rule 6.

2. One other criterion to understand whether a sale is for institutional or industrial consumers is to check whether declaration of Retail Sale Price (RSP) is made. Given the object of the Legal Metrology Act, RSP is required only when a commodity is packed for “retail sale”. If such packaging with RSP is not made since the sale was for a negotiated price.
3. Such institutional or industrial consumer shall purchase the commodities from manufacturers/importers/wholesale dealers.
4. Shall contain the declaration “not for retail sale” in such packs.

Open issue:

The amended definition of “institutional consumer” requires that the commodities be used for other than trade and commercial purposes. The question arises, would service providers such as restaurants be excluded from the definition since they operate on a commercial basis? If such interpretation is taken, then it would deviate from the analyses of earlier definitions and Supreme Court judgements. Further, it is also seen that inspection, etc., by the Legal Metrology Department is conducted only on commodities meant for end consumers and not for those meant for any manufacturer/service provider. Thus, the intention of the Government by inserting the terms “not for commercial or trade purposes” still remains unclarified.

GST Implications on supply of pre-packaged food items to “industrial consumers” and “institutional consumers”:

If specified food items under Notification No. 6/2022-Central Tax (Rate) is supplied to an industry (for further manufacture/production) or to any service provider for provision of service (such as to restaurants for preparation and supply of food), declarations under Rule 6 of PC Rules is not required, thus, GST would not be applicable.

Further, Attention is brought to Sl. No 7 of CBIC’s FAQs which clarifies that Supply of packaged commodity **for consumption by industrial consumer or institutional consumer** is excluded from the purview of the Legal Metrology Act by virtue of rule 3 (c) of Chapter-II of Legal Metrology (Packaged Commodities) Rules, 2011, thus exempt from GST.

Provisions related to “Wholesale packages”:

Chapter III of PC Rules contains Rule 24 which provides for declarations w.r.t wholesale packages. The rule is extracted hereunder:

“24. Declarations applicable to be made on every wholesale package

Every wholesale package shall bear thereon a legible, definite, plain and conspicuous declaration as to –

(a) The name and address of the manufacturer or importer or where the manufacturer or importer is not the packer, of the packer;
(b) the identity of the commodity contained in the package; and
(c) the total number of retail package contained in such wholesale package or the net quantity in terms of standard units of weights, measures or number of the commodity contained in wholesale package;
Provided that nothing in this rule shall apply in relation to a wholesale package if a declaration similar to the declarations specified in this rule, is required to be made on such wholesale packages by or under any other law for the time being in force."

In this regard, it is important to analyse the definition of "wholesale package". The term is defined in Rule 2(r) of PC rules as under:

*"(r) "wholesale package" means **a package containing-***

(i) a number of retail packages, where such first mentioned package is intended for sale, distribution or delivery to an intermediary and is not intended for sale direct to a single consumer; or
(ii) a commodity sold to an intermediary in bulk to enable such intermediary to sell, distribute or deliver such commodity to the consumer in smaller quantities; or
(iii) ten or more than ten retail packages provided that the retail packages are labeled as required under the rules."

Thus, as an illustration, the following would be considered as "wholesale packages":

1. A 40-kg pack containing 4 no.of 10kg bags of rice flour, sold to wholesalers/retailers
2. One 50kg pack containing wheat flour sold to distributors
3. 30 bags of 1kg maida flour which are packed as per declarations under Rule 6, packed in a 30kg bag.

It may be noted that there is no specific declaration of RSP required in case of wholesale packages. This could be a differentiating factor when deciding if a package is retail or wholesale. Further, the intention for requirement of declarations on wholesale packages seems to be to only identify the commodities/retail packs in the wholesale package.

GST implications on wholesale packages:

In order to be considered in the definition of "prepacked and labelled" under GST, a packaged commodity is required to have declarations as per PC Rules. Rule 24 of PC Rules specifically provides for declarations required for wholesale packages. Now question arises, whether the declarations under Rule 24 will be considered for the purpose of GST? If yes, then that would imply that all wholesale

packages (irrespective of quantity) would be liable to GST as it fulfils the conditions in definition of “prepacked and labelled”. Let’s analyse further.

The Government has clarified in its FAQs that:

*“Yes, if several packages intended for retail sale to ultimate consumer, say 10 packages of 10 Kg each, are sold in a larger pack, then GST would apply to such supply. Such package may be sold by a manufacturer through distributor. These individual packs of 10 Kg each are meant for eventual sale to retail consumer. However, a package of say rice containing 50 Kg (in one individual package) would not be considered a pre-packaged and labelled commodity for the purposes of GST levy, **even if rule 24 of Legal Metrology (Packaged Commodities) Rules, 2011, mandates certain declarations to be made on such wholesale package**”*

From the above, it could be said that the intention of the Government is to levy GST on all packaged commodities meant for retail sale which is eventually sold to ultimate consumer. In case of wholesale packages which are meant for industrial purpose, for example, when packed in bulk, although declarations are required under PC Rules, the same is not considered for the purpose of levy of GST.

However, it may be noted that the FAQs is neither a circular nor a notification. It does not make any changes to the GST provisions in the Acts. Setting aside the argument of intention of Government, the legal/litigation validity of the said FAQs needs to be assessed on case-to-case basis.

This gap in the legal interpretation and intention of the Government may cause issues to businesses. It would be beneficial if the Government clarifies the same through a circular or notification.

GST Implications – Summarised:

On what instances is GST applicable on pre-packaged and labelled goods?

To summarise, GST is applicable on specified food items when they are “prepacked and labelled” as defined in Notification No. 06/2022-Central Tax (Rate). Reading this with Legal Metrology Act and Packaged Commodities Rules, GST is applicable on pre-packaged commodities which are required to make declarations under Rule 6 of Packaged Commodity Rules. To summarise, GST is applicable on specified goods:

- packed in bags of 50kg or less in case of agricultural farm produce
- packed in bags of 25kg or less for other products

As is clear from FAQs issued by the Government, the intent is to tax all packages less than 25kg (whether sold to dealers or ultimate consumers). However, the legal lacuna discussed under the head “GST Implications on wholesale packages” continues to remain (since there has been no clarifications regarding the same from the Govt yet).

Cases where pre-packaged goods on which GST is not applicable:

1. Agricultural farm produce more than 50kg
2. Other specified food items when packed in bags of more than 25kg
3. Sale of pre-packaged food items mentioned above when sold to any industry or institution for use by such industry/institution.
4. Any commodity with net weight of 10g/10ml or less (except tobacco and tobacco products)
5. Any package containing fast food items packed by restaurant or hotel and the like
6. Goods containing scheduled formulations and non-scheduled formulations covered under Drugs (Price Control) Order, 2013 made under section 3 of the Essential Commodities Act, 1955.
7. Any thread which is sold in coil to handloom weavers
8. Export of prepackaged and labelled goods specified in table above

Input Tax Credit Implications for businesses:

Businesses engaged in taxable supplies of pre-packaged and labelled goods would be eligible to avail ITC of all input, input services and capital goods subject to fulfilment of conditions and restrictions specified in Section 16, 17 and 18.

Specifically, businesses in such industries would be required to apportion common inputs (such as rent, transportation charges etc.) between the taxable turnover (supply of pre-packaged goods 25kg or less) and exempt supplies (supply of pre-packaged goods more than 25kg). For this, Rule 42 and 43 of CGST Rules would be required to be followed.

For list of eligible and ineligible credits, please refer to the full-length research paper.

ITC on inputs held in stock

Business entities which were previously exclusively engaged in supplying exempt goods will now end up being engaged in supplying taxable supplies also due to the implication of Notification No. 6/2022-Central Tax (Rate).

In terms of Section 18(1)(d) of the CGST Act 2017:

“Where an exempt supply of goods or services or both by a registered person becomes a taxable supply, such person shall be entitled to take credit of input tax in respect of inputs held in stock and inputs contained in semi-finished or finished goods held in stock relatable to such exempt supply and on capital goods exclusively used for such exempt supply on the day immediately preceding the date from which such supply becomes taxable. Provided that the credit on capital goods shall be reduced by such percentage points as may be prescribed in rule 40 of CGST rules.”

Further, Section 18(2) specifies that a registered person shall not be entitled to take ITC under sub-section (1) of section 18, in respect of any supply of goods or services or both to him after the expiry of one year from the date of issue of tax invoice relating to such supply.

Thus, ITC may be availed on:

- a) Inputs in stock relatable to such previously exempted supply
- b) Inputs in semi-finished goods in stock relatable to such previously exempted supply
- c) Inputs in finished goods in stock relatable to such previously exempted supply
- d) Capital goods exclusively used for such previously exempted supply

Rule 40 of CGST Rules provides for the following conditions and procedures for availing ITC in such cases:

1. ITC on capital goods u/s 18(1)(d), shall be claimed after reducing the tax paid on such capital goods by 5% points per quarter of a year or part thereof from the date of the invoice.
2. The registered person shall within a period of 30 days from the date of becoming eligible to avail ITC shall make a declaration, electronically, on the common portal in FORM GST ITC-01 to the effect that he is eligible to avail ITC as aforesaid. This time limit may be extended by the Commissioner by a notification.
3. The declaration in ITC-01 shall specify the details relating to the inputs held in stock or contained in semi-finished/finished goods in stock, or as the case may be, capital goods on the day immediately preceding the date from which the supplies made by the registered person becomes taxable.
4. The declaration shall be duly certified by a practicing chartered accountant or a cost accountant if the aggregate value of the claim on account of CGST, SGST, UTGST and IGST exceeds Rs. 2 Lakhs.

5. The ITC claimed in accordance with the above provisions shall be verified with the corresponding details furnished by the corresponding supplier in GSTR-1/GSTR-4.

Now, question arises, whether businesses can claim ITC of inputs held in stock and capital goods through Form ITC-01 (even after expiry of 30 days from date of taxability) i.e., after 17th August 2022. Please refer to the full-length research paper to know more.

Impact on the Country:

Will this amendment encourage businesses to violate the provisions of LMA?

Post introduction of this amendment w.e.f. 18th July 2022, it is seen that many industries and businesses have began to pack their products such as rice, wheat, flour etc., in packs of 26kg to get GST exemption. Packing it in 26kg will also get them exempted from declarations requirements under Rule 6 of Packaged Commodities Rules. If few businesses in the industry start packing in 26kg to avoid price rise due to GST, the other players will also follow suit in the competitive pressure.

In such cases, when businesses are prompted to get themselves out of LMA net, due to GST implications, will the Government decide to tax such food items irrespective of quantity and delinking it from Legal Metrology law?

Further, this may also lead to retailers to start selling in loose form. Question arises if this will lead to affecting the quality of the product or increase in adulteration?

Would it lead to increase in cash business?

One of the objectives of introduction of GST was to create a transparent economy. The benefit of Input Tax Credit pushed businesses to register under GST and disclose their transactions in their returns. However, GST on pre-packaged food items meant for retail sale goes beyond this objective and aims to tax B2C transactions where there is no scope for ITC benefit. Taking into consideration competitive aspects also, businesses may tend to go into unaccounted sales to avoid GST. Compliance of procedures such as GST registration & returns, proper accounting of transactions may prompt smaller retailers/wholesalers to resort to unaccounted sales.

Impact on “Poverty line” in India:

In order to counter GST implications, businesses may tend to sell the food items in loose form, which would lead to distribution of sub-standard products in black markets, making it more affordable for those below poverty line. This may lead to spread of ill-health and unhygienic livelihood.

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