

### Clarification on Warranty Transactions

As per recommendations of the GST Council in its 50<sup>th</sup> meeting, certain clarifications on warranty related transactions have been issued vide circular 195/07/2023-GST dated 17.07.2023. Following is the gist of this circular and our comments thereon, we have taken live examples to amplify these important clarifications:

**Issue No. 1 : Replacement of parts under warranty by the manufacturer directly to the Customer.**

**Example :** Car manufacturer ABC Ltd offers a warranty for the car sold by it to the customer XYZ for first 2 years. The car encounters some problem with the engine during the second year and ABC provides replacement of the engine and engine replacement services to XYZ during the warranty period, without separately charging any consideration.

**Question :** Whether manufacturer is required to pay GST on replacement of parts under warranty?

**Clarification :** When ABC sold the car to XYZ, warranty of 2 years was factored inside the price of the car and therefore GST thereon was also paid. When the car encountered a problem with its engine, ABC fulfilled its warranty obligation by replacing the engine without charging any additional consideration from XYZ. As GST was already paid initially and additional consideration was not charged from XYZ, there would be no GST payable on supply of engine and its replacement service by ABC. However, if any additional consideration is charged by ABC from the customer, either for replacement of any part or for any service, then GST will be payable on such supply with respect to such additional consideration.



NJJ views : This clarification will resolve many issues taken up by department and will be useful to industry, especially the OEMs.

**Issue No. 2 : Reversal of ITC on spare parts used by the manufacturer for replacement under warranty?**

Example : Continuing with the above example, ABC purchased the engine from FIAT Ltd. which it replaced in the car of XYZ. ABC paid 1 lac of GST on the purchase of the engine and had availed its ITC as well. Will ABC be required to reverse the ITC of 1 lac on engine as it is replaced without any consideration.

Question : Whether manufacturer is required to reverse ITC on spare parts used by it for replacement under warranty?

Clarification : In the above case, as the value of original car supplied along with warranty by ABC to XYZ included the likely cost of replacement of parts and/ or repair services to be incurred during the warranty period. Therefore, these supplies cannot be considered as exempt supply and accordingly, ABC, who provides replacement of parts and/ or repair services to the customer during the warranty period, is not required to reverse any ITC in respect of the said replacement parts or on the repair services provided.

NJJ views : Again, a very good clarification, hence no further comments are required.

**Issue No. 3 : Replacement of parts and/ or repair services provided by a distributor without charging any consideration from the customer, as part of warranty on behalf of the manufacturer.**

Example : ABC has many distributors across India, ABC sells the car to its distributor on



principal-to-principal basis and the distributor sells it to customers.

ABC sells a car to PQR who is its distributor in Ahmedabad, PQR further sells the car to XYZ. Just as in issue no. 1, engine is required to be replaced in car of XYZ. PQR replaces the engine on behalf of ABC.

**Question** : Whether GST would be payable on replacement of parts and/ or repair services provided by a distributor without any consideration from the customer, as part of warranty on behalf of the manufacturer?

**Clarification** : As no consideration is being charged by PQR (distributor) from the customer, no GST would be payable by PQR on the said activity of providing replacement of engine as well as associated repair services to XYZ. However, if any additional consideration is charged by PQR from the customer, then GST will be payable on such supply with respect to such additional consideration.

**NJJ views** : Clarification is in line with the legal provisions; however, one needs to note that this clarification is for the transaction between the distributor and the customer only. It is a known fact that the distributor does not bear the cost of replacement, that situation is covered in next clarification below.

**Issue No. 4** : **GST liability on distributor on replacement of parts on behalf of Manufacturer?**

**Example** : On behalf of ABC, PQR replaces the engine in the car of XYZ by using,

- A. the engine available with him in his stock of spares.
- B. Raising a requisition for an engine from ABC, which it sends on delivery challan without any consideration payable by PQR to ABC.
- C. From a supply of engine already received from ABC



In the 3 scenarios above, Is PQR required to raise tax invoice and pay GST on the said supply, if yes, whether the recipient of the supply is eligible for the ITC thereof?

Question : Whether distributor is required to pay GST on replacement of parts on behalf of Manufacturer?

Clarification : A. Scenario 1 - PQR supplies engine to XYZ on behalf of ABC from the engine available with him in his stock. PQR will have to raise Tax Invoice on ABC for the cost of the engine and PQR would be eligible for the ITC on the original purchase of engine,

B. Scenario 2: PQR gets an engine from ABC on requisition made by him under a delivery challan. PQR is not required to pay any consideration for the same to ABC. In such case, no GST is payable by anyone as there is no flow of consideration.

C. Scenario 3: PQR receives an engine from ABC under cover of a tax invoice which it uses for replacement. ABC can raise a credit note on PQR and adjust the output tax of the original tax invoice and PQR would be required to reverse the ITC so availed.

Further, in all the above scenarios, ABC would be eligible for availing ITC towards the engine.

NJJ views : Board has tried to cover all the ways in which the industry transacts replacements of the spares used in warranty. Scenarios 1 and 3 are interchangeable in fact, however circular has given 2 different procedures which was avoidable. Supreme Court in case of Tata Motors has specifically said that Credit notes raised by manufacturer would be treated as consideration and the distributor would have to pay VAT in similar cases, hence, **we believe that procedure listed at scenario 1 whereby the distributor raises a tax invoice on the manufacturer is legally more viable**



as well as practical and therefore easier to follow than the one listed in scenario 3.

**Issue No. 5 : Repair services supplied by distributor to the customer under warranty.**

**Example :** On behalf of ABC, PQR provides repair services to XYZ under warranty and doesn't charge any consideration.

**Question :** Whether Repair services supplied by distributor to the customer under warranty are taxable under GST?

**Clarification :** In this case PQR is supply of service to ABC and therefore PQR should raise Tax Invoice on ABC, it would be eligible to avail ITC on this.

**NJJ views :** Very good clarification, hence no further comments are required.

**Issue No. 6 : Extended Warranty sold at the time of sale of original goods.**

**Example :** PQR sells a car to XYZ for 10 lacs. This car comes with a standard warranty of 2 years. However, XYZ wants extended warranty for another 2 years which PQR sells him for another 50,000. XYZ pays 10.50 lacs to PQR for the car plus 2 years extended warranty.

**Question :** What would be the GST liability on Extended Warranty sold at the time of sale of original goods?

**Clarification :** XYZ enters into an agreement of extended warranty with ABC at the time of original supply, then the consideration for such extended warranty becomes part of the value of the composite supply, the principal supply being the supply of car, and GST would be payable at the rate applicable to the car.



**NJJ views** : **Warranty is a contract for covering the risk of manufacturing defects in the vehicle for a specified period. Usually, all goods come with a specified period of warranty coverage. Few manufacturers and third-party vendors provide extended warranty coverage beyond the original warranty which usually starts operating after minimum 1 year of the original warranty contract. However, it may so happen that when the original goods are being sold, the manufacturer or distributor entices the customer with buying warranty for an extended period beyond the main warranty.**

**For classifying 2 supplies of goods and/or services as composite supply, it is necessary for them to be:**

- a. Naturally bundled.**
- b. Supplied in conjunction with each other in the ordinary course of business.**

**It is a known fact that the customer has a clear choice of buying an extended warranty at any time of his choosing before the expiry of the original warranty, it is not naturally bundled with the original goods. Secondly, extended warranty is not sold in conjunction of the original goods in ordinary course of business as extended warranty is a choice product which the customer may not even choose to buy. Lastly the operation of extended warranty starts much after the goods are sold and delivered.**

**This clarification will force the suppliers to artificially defer sale of extended warranty to a future date and also create litigation for past period.**



**Issue No. 7 : Extended Warranty sold at any time AFTER sale of original goods.**

**Example :** PQR sells a car to XYZ for 10 lacs. This car comes with a standard warranty of 2 years. After 6 months of the original sale, XYZ chooses to buy an extended warranty for another 2 years which PQR sells him for another 50,000.

**Question :** What would be the GST liability on Extended Warranty sold at any time after sale of original goods?

**Clarification :** XYZ enters into an agreement of extended warranty with PQR 6 months after the original supply, accordingly same would be a separate contract and GST would be payable by the supplier (service provider, whether manufacturer or the distributor or any third party), depending on the nature of the contract (i.e., whether the extended warranty is only for goods or for services or for composite supply involving goods and services).

**NJJ views :** Clarification in a subtle way says that GST on warranty would be payable by the supplier “depending on the nature of the contract whether the extended warranty is only for goods or for services or for composite supply involving goods and services”.

**As explained above, contract of warranty is a risk cover that one buys to safeguard from future defects in the goods. Specific goods that may need to be supplied is not identifiable at the instance of extended warranty sale and hence Warranty is essentially a Supply of service and therefore must be classified as a Service and taxed accordingly.**

**Conclusion**

Most part of the clarification is in line with the business practices as well as legal provisions and therefore must be applauded as it will help in avoiding unnecessary litigation, having said so, last 2 issues on Extended warranty needs reconsideration as they are against the legal



provisions. Industry and trade association must represent these issues with the GST Council and Central and State Government, to reconsider and change these 2 clarifications before it is too late, they will create litigations of huge proportions which will take years to resolve.

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