

GST Alert 08/2024-25

Date 28.06.2024

Clarification on Warranty related Transactions

Circular No. 195/07/2023-GST dated 17.07.2023

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216/1/2024-GST dated 26.06.2024

As per recommendations of the GST Council in its 50th meeting, certain clarifications on warranty related transactions had been issued vide circular 195/07/2023-GST dated 17.07.2023. Many representations were made for further clarification on certain issues and for revision of certain clarification on extended warranty. Council in its 53rd meeting held on 22.06.2024 deliberated and CBIC has issued further clarification vide circular no. [Circular No. 216/1/2024-GST dated 26.06.2024]

We had issued an alert no. 02/2023-24 dated 25.07.2023 on the earlier circular, as the current circular expands and amends earlier circular, we have issued this alert consider both the circulars.

Issue No. 1 : Replacement of parts as well as other goods 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. It may so happen that the entire car is required to be replaced under warranty or a washing machine is entirely replaced.

Question : Whether manufacturer is required to pay GST on replacement of parts / goods as such 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. Same legal analogy shall apply if the entire car is replaced due to faulty manufacturing, this will be true for entire washing machine being replaced.

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.

Question : Will ABC be required to reverse the ITC of 1 lac on engine as it is replaced without any consideration and whether manufacturer is required to reverse ITC on spare parts used by it for replacement under warranty?

Clarification : In the above case, the value of original car supplied along with warranty by ABC to XYZ included the likely cost of replacement of parts or goods 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, similar would be the case of the manufacturer, it will also not be required to reverse any ITC on the parts/goods replenished by it to ABC.

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 PQR 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 by using the engine held by it in its stock.

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

Further, is the manufacturer required to pay GST or reverse any ITC on the parts / goods supplied by it to ABC for replenishment of the parts / goods used by ABC from its stock.

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.

Manufacturer ABC will not be required to pay any GST nor will it be required to reverse any ITC on the parts / goods being supplied by it to ABC under warranty.

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.
- D. Another, scenario is contemplated in the new circular whereby, the parts / goods are sent by the manufacturer under the cover of delivery challan which is then replaced by the distributor, there would be no GST implications in this scenario, no tax will be payable and no ITC reversal would be required.

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

NJJ views : Clarification given for sr. no 4 of circular 195 in point c has been retained. 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. Further, scenario 4 is the best of all and will be very trade friendly.

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 supplying 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. PQR then pays 45,000 plus tax to ABC and retains 5000 plus tax for itself.

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, GST would be payable at the rate applicable to the car.

NJJ views : **New circular maintains the earlier espoused legal understanding and has not chosen to correct its earlier stand. In our view the view taken by the circular is wrong for the following reasons.**

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 1 day or 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.

Issue No. 8 : Manufacturer / third party directly sells Extended Warranty to the



customer at the same time when the car is sold by the dealer.

Dealer gets a commission from the manufacturer or third party

Example : PQR sells a car to XYZ for 10 lacs. This car comes with a standard warranty of 2 years. At the same time, the customer also purchases extended warranty for another 2 years from ABC or third party and pays the consideration of 50,000 to ABC or another third party.

PQR gets a commission of 5000 from PQR or third party.

Question : What would be the GST liability on Extended Warranty sold by the manufacturer or a third party?

Clarification : XYZ has purchased the car from PQR whereas he is purchasing extended warranty from ABC, both these transactions are happening at the same time, albeit with 2 different suppliers. In such scenarios, supply of extended warranty will be treated as a separate supply from the original supply of goods and will be taxable as supply of services.

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

Conclusion

These twin clarification in most parts are 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, couple of clarifications on Extended warranty highlighted above lack legal backing and therefore will now have to tested in the courts. Industry and trade association must again press upon the GST Council and Central and State Government or again review the reviewed circular.

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