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# Input Tax Credit on Demo Vehicles

[Circular No. 231/25/2024-GST dated 10.09.2024]



## I. **Brief background of the issues involved**

In India buying a vehicle is a big family decision. Before buying a vehicle, customers always prefer to take test drives of the vehicles they are interested in, sometimes multiple test drives are taken before the decision is arrived at. With the advent of GST in 2017, question as to the eligibility of Input Tax Credit (ITC) of these demo vehicles has been in debate since then. There was near unanimity in legal circles that vehicle dealers were eligible for ITC. Then, there were multiple Advance rulings which allowed ITC and then there were few which said that ITC was not allowed. Few advance rulings said that as the dealer is capitalizing the demo vehicles in their books of accounts, ITC won't be allowed. This circular tries to put an end to this conundrum of views.

## II. **Legal abstract on which this entire issue revolves:**

*17 (5) Notwithstanding anything contained in sub-section (1) of section 16 and sub-section (1) of section 18, input tax credit shall not be available in respect of the following, namely: —*

*(a) motor vehicles for transportation of persons having approved seating capacity of not more than thirteen persons (including the driver), except when they are used for making the following taxable supplies, namely: —*

***(A) further supply of such motor vehicles; or***

*(B) transportation of passengers; or*

*(C) imparting training on driving such motor vehicles;*

## III. **Questions answered by this circular:**

1. Availability of ITC on demo vehicles in terms of section 17(5) (a) of Central Goods & Services Tax Act, 2017 (hereinafter referred to as the 'CGST Act').
2. Availability of ITC on demo vehicles in cases where such vehicles are capitalized in the books of account by the authorized dealers.

## IV. Models of Business in the Industry

Automobile Retail works under 2 business models worldwide:

### a. Dealership Model:

Dealers purchase the vehicle from the manufacturer on their own account whereby the title in the vehicle is passed on to the dealer. After due process, dealer sells the vehicle to the customer. In this case, all vehicles including demo vehicles are purchased by the dealer on its own. Vehicle Manufacturer raises tax invoice on the dealer and dealer then raises a tax invoice on the customer.

### b. Agency Model:

Dealer maintains the entire infrastructure like showroom and service station, it purchases the demo vehicles as per the policy of the manufacturer, uses these demo vehicles to give test drives to potential customers. Once the end customer chooses to buy a vehicle, manufacturer sells it directly to him, whereby the invoice for the vehicle is raised by manufacturer directly on to the customer. Demo vehicles after their due use as test drive vehicles are sold in open market.

What is common between both the business models is that demo vehicles are only intended to provide a touch and feel to the customers, dealers never intend to hold on to these vehicles as normal buyers do. These demo vehicles are sold off as per stated policy of the manufacturers. Secondly the interface that the customer gets when he comes to the showroom is same in both the models, he is greeted by the staff of the dealer at a premises held by the dealer, for him there is absolutely no difference in terms of buying experience other than the fact that the Sale invoice is issued by different entity in the 2 business models.

## **V. Implications of Motor Vehicle Act on Automobile Retail business and demo vehicles in specific.**

Under the Motor Vehicle Act, 1988, vehicle dealers are required to register themselves and take license to operate. Some important abstracts from this regulatory law is important for this discussion:

- a. Section 39 of the Motor Vehicle Act provides that a vehicle cannot move in public without getting registered, however vehicle dealers are exempted from application of this provision subject to certain conditions.
- b. Rule 33 of the Central Motor Vehicle Rules prescribe that Dealer is exempt from registering the vehicle if he has a valid Trade Certificate.
- c. Rule 39 prescribes the use of trade registration mark – popularly known as TC mark or TC Plate. Rule 40 prescribes the restrictions on use of the trade certification, registration mark and number. It clearly says that vehicle is allowed to be used on TC plate by the dealer.
- d. Rule 41 prescribes the purpose for which a vehicle having TC plate can be used, sub-rule (c) provides that TC plate vehicle can be used for a “Reasonable trial or demonstration”.

**It is interesting to note that dealers working in both the models discussed above are treated similarly in terms of the Motor Vehicle Act. Both are allowed to ply demo vehicles on public roads without registration.**

## VI. Clarification given in the circular:

1. The intention behind the law is to allow ITC of motor vehicles **based on the nature of business in which the said motor vehicle is being used**. The taxable supplies, permitted for the purpose of ITC as per provisions of clause (a) of section 17(5) of CGST Act are:
  - a. Further supply of such motor vehicles,
  - b. Transportation of passengers and
  - c. Imparting training on driving such motor vehicles.
2. Demo vehicles are used by authorized dealers to provide trial run and to demonstrate features of the vehicle to potential buyers. Accordingly, it is to be seen whether the Demo vehicles in question can be said to be used for making *“further supply of such motor vehicles”*, as specified in the sub-clause.
3. Usage of the words “such motor vehicles” instead of “said motor vehicle”, in the sub-clause, implies that the intention of the lawmakers was twofold:
  - a. To allow ITC of the motor vehicle, which is itself further supplied,
  - b. To also allow ITC of the motor vehicle which is being used for the purpose of further supply of similar type of motor vehicles.

As demo vehicles are used by authorized dealers to provide trial run and to demonstrate features of the vehicle to potential buyers, it helps the potential buyers to make a decision to purchase a particular kind of motor vehicle. **Therefore, as demo vehicles promote sale of similar type of motor vehicles, they can be considered to be used by the dealer for making ‘further supply of such motor vehicles’ and therefore ITC of demo vehicles is allowed to them.**

4. Where the authorized dealer merely acts as an agent or service provider to the vehicle manufacturer (OEM) for providing marketing service, including providing facility of vehicle test drive to the potential customers of the vehicle on behalf of the manufacturer **and is not directly involved in purchase and sale of the vehicles to end customer.** In such cases, the sale invoice for the vehicle is directly issued by the vehicle manufacturer to the customer. For providing facility of vehicle test drive to the potential customers of the vehicle, the dealer purchases demo vehicle from the vehicle manufacturer. The dealer may sell the said demo vehicle to a customer after a specified time or kilometers as per agreement with the vehicle manufacturer on payment of applicable GST. In such a case, the authorized dealer is merely providing marketing and/or facilitation services to the vehicle manufacturer and is not making the supply of motor vehicles on his own account. **Therefore, the said demo vehicle cannot be said to be used by the dealer for making further supply of such motor vehicles and therefore in such cases, ITC in respect of such demo vehicle would not be allowed to the said dealer.**
5. Demo vehicles when capitalized in the books of accounts by the authorized dealer, the said vehicle falls in the definition of “capital goods” under section 2(19) of CGST Act. GST law recognizes that capital goods are also eligible for ITC, accordingly, ITC on demo vehicles even if capitalized will be available to the authorized dealers, however, the dealer must not have claimed depreciation on the GST component.
6. There may be some cases where motor vehicles for transportation of persons are used by an authorized dealer for purposes other than for making further supply of such motor vehicles, say for transportation of its staff employees/ management etc. In such cases, the same cannot be said to be used for making ‘further supply of such motor vehicles’ and therefore, ITC in respect of such motor vehicles would not be eligible.

## **VII. Summarization of the clarifications.**

Clarifications given in this circular can be summarized as under:

- A.** Dealers who are into purchase and sale of vehicles (on their own account) will be eligible for ITC on purchase of demo vehicles as they are into overall business of supply of that vehicle and demo vehicles are used in furtherance of that business.
- B.** Dealers who are into purchase and sale of vehicles (on their own account) will be eligible for ITC on purchase of demo vehicles even if the said demo vehicle is capitalized in the books of accounts. They need to take care that they do not claim depreciation on the GST and Cess component of which they have availed ITC.
- C.** Dealers who are agents of the vehicle manufacturer whereby the new vehicles are sold directly by the manufacturer to the end customer will not be eligible to claim ITC on demo vehicles.
- D.** Vehicles used for purposes other than demonstration will not be eligible, for example courtesy vehicles or staff transportation vehicles.

## VIII. Conclusion

Automobile sector is one of the highest taxed sectors under GST after certain sin goods. There are all kinds of Advance rulings and Appellate Advance rulings adding to the confusion on the issue of eligibility of ITC on demo vehicles. This circular brings much needed clarity on this very important subject, it would not be out of place to say 'Der aaye durust aaye'.

However, it will also bring heart burn for a section of auto retail segment which works under the agency model. Circulars are important tools for reducing litigation and therefore we believe that any circular of this nature must be put in the public in a draft mode for discussion before it is finalized so as to avoid litigations. Legal interpretation drawn in Para 4.6 will give rise to enormous level of litigation of sector of the trade. I also believe that the interpretation in para 4.6 will result in revenue loss for the government as dealers will now be forced to pay GST at lower rate under the margin scheme prescribed vide notification 8/2018-CTR.

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