



NITYA'S INSIGHT

Issue 1 | Includability of tool amortisation cost in assessable value of goods for levy of GST

November 27, 2018

Dear Reader,

This is to update you on a recent ruling of the Authority on Advance Rulings in Karnataka ('AAR') in the case of ***Nash Industries (I) Private Limited, 2018-VIL-266-AAR***. The AAR has held that tool amortisation cost (dies and moulds supplied by vehicle manufacturer to component manufacturer on free of cost ('FOC') basis) shall be included in the value of components under Section 15 of the Central Goods and Services Tax Act, 2017 ('CGST Act').

Facts of the Case

The applicant was engaged in the manufacture of automotive components as per the specifications given by its customer. In order to manufacture the same, tailor-made tools were required. Such tools were provided by the customer to the applicant on FOC basis. The AAR held as follows:

- The transfer of tools by the customer to the applicant will not qualify as supply under Clause 1 (Permanent transfer of business assets) of Schedule I of the CGST Act. This is because tools were given by customer to applicant temporarily and that too for limited purpose.
- The amortized value of tools will be included in the assessable value of components under Section 15(2)(b) of CGST Act which provides for inclusion of amount liable to be incurred by the supplier but incurred by the recipient. The applicant could not have manufactured the components without such tools. Accordingly, the applicant was required to incur such cost which was incurred by the customer on its behalf.

Legal Analysis

- Section 15(2)(b) of the CGST Act states that the value of supply shall include an amount that the supplier is liable to pay in relation to the supply but the same has been incurred by the recipient and which has not been included in the price actually paid or payable for the goods or services or both.
- In respect of supply of tools on FOC basis to job-worker or component manufacturer, CBIC issued two Circulars:
 - ***Circular No. 38/12/2018-GST dated March 26, 2018*** ('Circular 1') issued in relation to job-work. As per Circular 1, in case of job-work, assessable value of job-work will include value of tools provided on FOC basis and whose value has not been included in the job work charges. Hence, as per Circular 1, value of tools provided on FOC basis should be included in the value of job-work supply.
 - ***Circular No.47/21/2018-GST dated June 8, 2018*** ('Circular 2') issued in relation to component manufacturers. Circular 2 clarifies that where the Original Equipment Manufacturer ('OEM') provides its tools to component manufacturer on FOC basis, value of such tools shall not be added to the assessable value of components (referred to as 'Scenario 1'). On the other hand, the value of tools shall be added to the assessable value of components where the contract requires component manufacturer to use its own tools but still the same are provided by OEM on FOC basis (referred to as 'Scenario 2').

NITYA's Comments

We are of the view that this ruling is incorrect for the following reasons:

- *The AAR did not consider the conditions of the agreement entered between applicant and its customers appropriately. The facts of the case are akin to Scenario 1 and the supplier is not bound to procure tools for manufacture of components. In the automotive industry, it is always OEM's obligation to procure the tools and supply the same to component manufacturer. Hence, Section 15(2)(b) of CGST Act has incorrectly been invoked in this case.*
- *The Applicant wrongly relied upon the valuation provisions under the Excise law to submit that the amortized value of FOC tools must be included. The Excise law levied excise duty on intrinsic value of the goods while intent of GST is to levy tax on consideration involved (except in specified cases). The valuation provisions of GST law are more akin to VAT laws. In respect of VAT laws, the Supreme Court dealt with an identical situation and held that the cost of FOC tools is not includible in assessable value for payment of VAT. (Refer: **Moriroku UT India Private Limited v. State of UP, 2008-VIL-07-SC**)*
- *Circular 2 correctly concludes inclusion of value of tools in Scenario 2 and exclusion in Scenario 1. Section 15(2)(b) of the CGST Act is invocable only where the component manufacturer was contractually liable to arrange the tools but the same is arranged by the OEM (Scenario 2). Section 15(2)(b) is not applicable where OEM is contractually liable to provide the tools in the first place. The AAR has not even considered Circular 2 which is specific to the facts of this case.*

For the above reasons, we are of the view that Circular 1 is also incorrect and the subsequent Circular 2 issued by CBIC lays down the correct legal position.

In the light of above, we are of the view that taxpayers are not required to amortise the cost of tools received on FOC basis from their customers. However, considering the above ruling, the taxpayers can expect litigation with the departmental authorities on this issue which can be reasonably defended for the reasons given above.

Trust you will find the update useful. In case of any clarifications, please feel free to revert.

Regards,

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