

GST UPDATE ON ITC ADMISSIBILITY ON DEMO CARS AND VARIOUS ANCILLARY ISSUES

GST law was introduced with the objective of seamless flow of input tax credit but on actual implementation of CGST Act, 2017, admissibility of input tax credit has been restricted subject to provisions contained in section 17(5) of the CGST Act, 2017. The input tax credit on motor vehicles was disputed matter in the erstwhile Cenvat Credit Rules, 2004 and is also an interpretational issue in GST era. The present update seeks to discuss ITC admissibility and other GST implications on demo cars used by automobile dealers in light of the decision pronounced by Authority of Advance Ruling in the case of **CHOWGULE INDUSTRIES PVT. LTD. [2019 (27) G.S.T.L. 272 (A.A.R.-GST)]**.

The AAR has allowed input tax credit on demo cars used by the automobile dealer even when the said car was capitalised in the books of accounts. It has been held by AAR that demo cars are essential part of marketing and sales promotion to facilitate sale of cars and is definitely used by the automobile dealer in course or furtherance of business. Accordingly, it was held that input tax credit is admissible with respect to demo cars. As regards, applicability of section 17(5) of the CGST Act, 2017, it was stated that the restriction given under this section does not apply if motor vehicles are used for further supply of such vehicles. It was held that the GST Act does not specify the time within which further supply is to be effected and so section 17(5) would not be applicable.

The above decision is favourable to the assessee and it is very rare that AAR pronounces ruling in favour of the applicant. Nonetheless, let us examine the admissibility of input tax credit on demo cars vis a vis provision contained in

section 17(5) of the CGST Act, 2017. The amended provision is produced for the sake of convenient reference as follows:-

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;***

The hon’ble AAR has held that the GST Act does not specify the time within which further supply of such motor vehicles is to be effected and so demo cars that are sold after 2-3 years are not hit by the restriction imposed by section 17(5). In this regard, respectfully submitting that the above contention if accepted would allow input tax credit to be availed by every assessee as motor vehicle purchased by any assessee will be sold after use ultimately whether after 2-3 years or after 9-10 years. If such an interpretation is adopted, the restriction contained in the above section would become otiose and redundant. Now, the following question arise on referring the above language of the provision:-

Whether it is necessary that the motor vehicles that are used for further supply of motor vehicles should be available as stock in trade and should not be capitalised? In our opinion, the answer to the above question is NO as whether the motor vehicles are considered as stock in trade by the automobile dealer or as capital goods in case of demo cars, it does not make any difference as far as the same is used in the course or furtherance of business of selling cars.

Whether it is necessary to keep record of one-to-one correlation of the motor vehicles purchased by automobile dealer so as to satisfy the requirement of sub-clause (A)? The answer in our opinion is NO as if interpretation is taken that the input tax credit will be ineligible with respect to motor vehicles except when they are used for making further supply of **SUCH** motor vehicles, then absurd results would be derived wherein every assessee would be eligible to take the input tax credit as motor vehicles purchased by assessee is sold at some time or the other. Consequently, the reasoning adopted by the AAR may be misused to mean that time of sale of such motor vehicle is not relevant as the same is not specified in the provision.

However, the author believes that though the input tax credit of demo cars should be logically allowed to the automobile dealer but the reasoning and justification given by the AAR for its eligibility is not justifiable in terms of the restriction contained in section 17(5) of the CGST Act, 2017.

Now, another aspect which needs to be analysed is the GST implication on sale of demo cars subsequently by the automobile dealer. As it has been confirmed by the AAR that input tax credit is admissible to the automobile dealer for demo cars which is capitalised, then it implies that the benefit of margin scheme available for sale of second hand cars would not be applicable in case of sale of such demo cars by the automobile dealer as the condition for availing margin scheme is that the input tax credit should not have been taken on such motor vehicle. Therefore, GST would be payable according to the provision contained in section 18(6) of the CGST Act, 2017 read with Rule 44(1)(b), i.e. input tax credit reduced by 5% for each quarter for the life of capital goods used or tax on transaction value, whichever is higher. This aspect has been confirmed in the AAR discussed in the update also.

To sum up, it can be concluded that if the input tax credit is allowable for demo cars which are capitalised by automobile dealers, then the benefit of margin scheme is not available to them on subsequent sale of such demo cars. However, if the input tax credit is not allowable on demo cars on the grounds that it is covered by restriction placed by section 17(5), automobile dealer would be able to avail the benefit of margin scheme. Capitalisation of demo car has no implication on claiming input tax credit because input tax credit is allowable to assessee engaged in transportation of passengers in which case also the motor vehicles are being capitalised.

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