

Credit note issued by manufacturer to dealer in consideration of completion of warranty obligation exigible to sales tax - SC

22 May 2023



Summary

In a landmark ruling, the Supreme Court (SC) has held that the credit note issued by the manufacturer (the assessee) to the dealer, in consideration of replacement of a defective part to complete the warranty obligation of manufacturer, is exigible to sales tax. The dealer is acting on behalf of the manufacturer or as an intermediary between the manufacturer and the customer of the automobile and discharging his obligation under a collateral contract. The manufacturer compensates the dealer by the issuance of a credit note. Hence, the credit note issued by a manufacturer in favour of a dealer is a valuable consideration within the meaning of the definition of 'sale'.

Facts of the case

- Tata Motors (the appellant/manufacturer) sells vehicles and spare parts to Marudhara Motors (the dealer) by charging the Central Sales Tax Act (CST). The dealer sells these goods to customers through invoices collecting local sales tax.
- Under the dealership agreement, the dealer would provide the replacement of warranty goods sold to the customer. There exists a separate warranty agreement between the manufacturer and the ultimate customer to whom such vehicles are sold by the dealer.
- The dealer collects defective components from the customers and replaces them with the stock purchased from the manufacturer, and then returns them to the manufacturer. Then, the manufacturer issues credit notes to the dealer for the components after satisfying itself that the components were defective.
- Pursuant to the SC's decision in the case of Mohd. Ekram Khan, the assessing authority (AA) initiated assessment proceedings and held that the dealer had supplied the parts and received the price. The Deputy Commissioner (Appeals) upheld the levy of tax and set aside the order to levy tax and interest.
- The Rajasthan Tax Board (RTB) issued a common judgement for all the appeals filed, set aside the Deputy Commissioner's (Appeals) order and stated that the transaction of replacing the defective parts did not fall within the definition of 'sale'.
- The revenue filed revision petitions before the Rajasthan High court (HC), which dismissed these petitions and affirmed the decision passed by the RTB, stating that the facts of the present case differ from Mohd. Ekram Khan's case by underlining three distinguishing factors. Firstly, the relationship between the manufacturer and dealer reflected a principal-to-principal relationship; secondly the transaction between the manufacturer and the dealer is independent of the transaction between the manufacturer and the customer, and thirdly, the warranty obligation was being discharged free of cost.

Issues before SC:

- Whether a credit note issued by a manufacturer to a dealer of automobiles, in consideration of the replacement of a defective part in the automobile sold pursuant to a warranty agreement being collateral to the sale of the automobile, is exigible to sales tax under the sales tax enactments of the respective states?
- Whether its judgment in the case of Mohd. Ekram Khan calls for reconsideration in terms of the reference order dated 5 December 2019? In other words, whether the aforesaid case has been correctly decided or not?

SC observations and ruling [CIVIL APPEAL No.1822/2007, order dated 15 May 2023]

- **There should be an agreement:** It was observed in the decision of Gannon Dunkerley and Co. that there should be an agreement between the parties for the purpose of transferring title in the goods, which presupposes capacity to contract that should be supported by money consideration, and property must be transferred.
- **Dealer acting as an intermediary between manufacturer and customer:** The dealer is acting on behalf of the manufacturer or as an intermediary between the manufacturer and the customer of the automobile and discharging his obligation under a collateral contract. Hence, it is a warranty given by the manufacturer through the dealer to the customer during the period of warranty.
- **No warranty unless there is sale of goods:** The dealer discharges his warranty obligation pursuant to the earlier sale of the automobile made by him to the customer, where the transaction of sale is accompanied by a collateral contract in the form of a warranty. There cannot be a warranty unless there is a sale of goods in the first place. That is why a warranty is termed as a contract collateral to the main contract of sale.

- **Sale between a dealer and manufacturer of the automobile of the spare parts:** On the one hand, there is the transfer of property between the dealer and the customer/purchaser of the automobile, and on the other hand the receipt of a valuable consideration by the dealer for the same from the manufacturer in the form of a credit note. Therefore, whether the transaction, resulting in payment by way of a credit note to a dealer is a sale within the definition of sale, has to be considered.
- **Credit note is exigible to sale tax as it is a valuable consideration:** 'Price' is the amount of consideration that a seller charges the buyer for parting with the title to the goods. The valuable consideration has a wider connotation but must be read *ejusdem generis* to cash and deferred payment. The nature of consideration in the form of a credit note is monetary in nature. The manufacturer compensates the dealer by issuance of a credit note. Hence, the credit note issued by a manufacturer in favour of a dealer is a valuable consideration within the meaning of the definition of 'sale' under the CST Act.
- **Decision given in the case of Mohd. Ekram Khan is not erroneous:** The SC held that the judgement in the case of Mohd. Ekram Khan is applicable to a situation where a manufacturer issues a credit note to a dealer acting under a warranty given by the manufacturer pursuant to a sale of an automobile where the dealer replaces a defective part of the automobile by a spare part maintained in the stock of the dealer or when the same is purchased by the dealer from the open market.
- **SC allowed the appeal filed by the Revenue:** The appeals filed by the dealers are dismissed. The appeals filed by the Revenue are allowed.

Our comments

Earlier, the SC, in the case of Mohd. Ekram Khan, had held that that when a dealer receives a credit note from the manufacturer while discharging his obligation under a warranty clause and uses a spare part from his own stock to replace a defective part, the transaction between the manufacturer and the dealer constitute sale on which the dealer was liable to pay sales tax. In this regard, the SC has clarified that the above-mentioned judgement does not call for any interference.

However, where the dealer received a spare part from the manufacturer of the automobile to replace a defective part under a warranty collateral to the sale of the automobile, principles of this ruling will not apply.

This is a significant ruling and will have widespread ramifications under GST as well, especially for automobiles, electronic appliances, plant and machinery manufacturers, etc., where manufacturers issue credit notes to the dealer for replacement or reimbursement of the defective parts.

Contact us

To know more, please visit www.grantthornton.in or contact any of our offices as mentioned below:

NEW DELHI

National Office,
Outer Circle,
L 41, Connaught Circus,
New Delhi - 110001
T +91 11 4278 7070

NEW DELHI

6th Floor, Worldmark 2,
Aerocity,
New Delhi - 110037
T +91 11 4952 7400

AHMEDABAD

Unit No - 603 B, 6th Floor,
Brigade International
Financial Center,
GIFT City Gandhinagar,
Ahmedabad - 382355

BENGALURU

5th Floor, 65/2, Block A,
Bagmane Tridib,
Bagmane Tech Park,
CV Raman Nagar,
Bengaluru - 560093
T +91 804 243 0700

CHANDIGARH

B-406A, 4th Floor,
L&T Elante Office Building,
Industrial Area Phase I,
Chandigarh - 160002
T +91 172 433 8000

CHENNAI

9th floor, A wing, Prestige
Polygon, 471 Anna Salai,
Mylapore Division, Teynampet,
Chennai - 600035
T +91 44 4294 0000

DEHRADUN

Suite No 2211, 2nd Floor,
Building 2000, Michigan Avenue,
Doon Express Business Park,
Subhash Nagar,
Dehradun - 248002
T +91 135 264 6500

GURGAON

21st Floor, DLF Square,
Jacaranda Marg,
DLF Phase II,
Gurgaon - 122002
T +91 124 462 8000

HYDERABAD

Unit No - 1, 10th Floor,
My Home Twitza, APIIC,
Hyderabad Knowledge City,
Hyderabad - 500081
T +91 40 6630 8200

KOCHI

6th Floor, Modayil Centre Point,
Warriam Road Junction,
MG Road
Kochi - 682016
T +91 484 406 4541

KOLKATA

16th floor, Ambuja Eco-Centre,
Plot No. 4, EM Bypass, EM Block,
Salt-Lake Sector-V, Kolkata,
West Bengal - 700091
T +91 33 4444 9300

MUMBAI

11th Floor, Tower II,
One International Center,
SB Marg Prabhadevi (W),
Mumbai - 400013
T +91 22 6626 2600

MUMBAI

Kaledonia, 1st Floor,
C Wing,
(Opposite J&J Office),
Sahar Road, Andheri East,
Mumbai - 400069

NOIDA

Plot No 19A, 2nd Floor,
Sector - 16A,
Noida - 201301
T +91 120 485 5900

PUNE

3rd Floor, Unit No 310-312,
West Wing, Nyati Unitree,
Nagar Road, Yerwada
Pune - 411006
T +91 20 6744 8800

For more information or for any queries, write to us at GTBharat@in.gt.com



Follow us @GrantThorntonIN

© 2023 Grant Thornton Bharat LLP. All rights reserved.

"Grant Thornton Bharat" means Grant Thornton Advisory Private Limited, the sole member firm of Grant Thornton International Limited (UK) in India, and those legal entities which are its related parties as defined by the Companies Act, 2013, including Grant Thornton Bharat LLP.

Grant Thornton Bharat LLP, formerly Grant Thornton India LLP, is registered with limited liability with identity number AAA-7677 and has its registered office at L-41 Connaught Circus, New Delhi, 110001.

References to Grant Thornton are to Grant Thornton International Ltd. (Grant Thornton International) or its member firms. Grant Thornton International and the member firms are not a worldwide partnership. Services are delivered independently by the member firms.