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UDYOG Software (India) Ltd.

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Udyog Whitepaper

NOVEMBER 2013

Dealership agreements – Excise duty and service tax [Part I: Excise duty]

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Introduction

A dealership is a business entity authorized to sell the principal's products in a specified area. It operates by purchasing and reselling the products from the principal. Certain clauses are found in typical dealership agreements. These include fixing of end price and dealer margins, and stipulations about display, advertisements, and customer service.

Dealer agreements have recurrently been the subject of controversy in central excise and service tax. Below we look at some of the typical issues. This month's paper deals with the issues in central excise; the next part will deal with the issues in service tax.

Excise duty

Non-monetary consideration from dealer

In central excise, the department scrutinizes the clauses of a dealership agreement with a view to establish whether there is any non-monetary consideration for the goods and to demand excise duty on such an alleged consideration. Before 2000, the value of goods for excise duty was the normal price payable for the goods. Since 2000 it has been the actual transaction value for each consignment of goods. In both cases the value included price payable as well as any non-monetary consideration that was received for the goods. Scrutiny of the dealership agreement would establish whether the sale of the goods was made in exchange for anything in addition to the money value paid. For example, if the agreement stipulated that the dealer must supply 10 MT of a specified raw material to the factory of the principal each month, free of cost, this would be an additional consideration.

The cases in central excise have mostly involved disputes around pre-delivery inspection charges for motor vehicles, free warranty servicing provided in terms of the supplier's promise to the end customer, and sharing of costs for advertisement of the product.

Pre-delivery inspection and after-sales service: pre- 2000

Pre-delivery inspection (PDI): This issue generally arises with vehicles in which the dealer has to inspect the vehicles before sale to the customer to ensure that no transit damage took place. For this he charges an amount to the customer. The department was of the view that because the PDI was done by the dealer in terms of agreement with the manufacturer, it amounted to a non-monetary consideration to the manufacturer; and that the amount charged to the customer for the PDI should be considered as part of the assessable value of the vehicle.

After-sales servicing: For many products, the dealer provides warranty services to the customer whether or not the particular piece was purchased from him. Here, the department was of the view that warranty is offered by the manufacturer and therefore the dealer provides the services as an agent of the manufacturer and not independently. Therefore the cost of such services, which is built into the dealer margin, should be part of the manufacturer's value for the purpose of excise duty.

The CBEC issued a circular no. 355/71/97-CX dated 19 November 1997, in which it instructed its field officers that the value of PDI and after-sale services was includible in assessable value:
"Dispute has arisen from the fact that these services are provided by the dealer and no separate charges for these services are paid by the manufacturer to the dealer. The dealer is incurring the expenses out of

the margin allowed by the manufacturer. So, the question to be decided is whether a portion of dealer's margin has to be included in the assessable value.
In other words, the question for consideration is whether after-sale services are provided on behalf of the manufacturers or by dealer on their own. From the facts stated above, it is obvious that pre-delivery inspection and three further services are compulsory on the part of the customer to remain eligible for any claim under warranty and are being provided by the dealer only on behalf of the manufacturer. In these circumstances, the difference between the sale price and the amount paid to the manufacturer by the dealer i.e. dealer's margin also contain provision for rendering PDI and three after-sale services. These services being on behalf of the manufacturer, their value will be includible in the assessable value."

In 1992 a three-member bench of the Supreme Court held in the case of Kirloskar Brothers Limited v Union of India, reported as 1992 (59) ELT 3 (SC), that a higher discount given to dealers in particular areas on account of their obligation to provide after-sales service was not deductible from assessable value. However as case law evolved, the stand of the CBEC lost favour. The issue of PDI and after-sale servicing was decided for the pre-2000 period by the CESTAT in the case reported as Mahindra & Mahindra Limited v CCE Bombay, 1998 (103) ELT 606 (Trib), in which the CESTAT held that the PDI was an activity occurring after the removal of goods from the factory and had no nexus with manufacture or marketability of the product, and was therefore not part of the assessable value for excise. The old case of Kirloskar Brothers was not referred to in this order and was apparently not cited in arguments. Appeal filed by the department against this order was dismissed by the Supreme Court, as reported in Collector v Mahindra & Mahindra Limited, 1999 (111) ELT A126 (SC).

In the wake of the failure of its appeal in the Supreme Court, the CBEC issued another circular number 681/72/2002-CX dated 12 December 2002 in which it withdrew the circular extracted above, and clarified that, "…PDI (Pre-Delivery Inspection) and free after sales service provided by the dealer of vehicle, during the warranty period will not be included in the assessable value."

In the meantime, the valuation provisions in central excise had changed with effect from 1 July 2000. There were changes in section 4 of the Central Excise Act, which now embraced the concept of "transaction value", and there was also a new set of valuation rules, the Central Excise (Determination of Price of Excisable Goods) Rules 2000. Thereupon, in the same breath as it withdrew the old circular for the old period, as mentioned in the previous paragraph, the CBEC hastened to say that, "The withdrawal of these Circulars will apply to past cases only as the provisions of the new section 4 introduced w.e.f. 1-7-2000 were not the subject matter of dispute before the Apex Court. Moreover, for the period from 1-7-2000, the Board has already clarified the position regarding PDI and free after sale service vide Sl. No. 7 of Circular No. 643/34/2001-CX., dt. 1-7-2002". This serial number 7 of circular dated 1 July 2002 used the same logic as before, to say that the cost of PDI and after-sales service as incurred by the dealer will be part of the assessable value of the goods in the hands of the manufacturer. (This has since been quashed by the Bombay High Court, as shall be discussed below.)

Advertisement by dealers

Many dealer agreements contain clauses that require the dealer to share the cost of advertisement of the product in his jurisdiction. The rationale is that both the principal and the dealer benefit from such advertisement. However, the department did not subscribe to this reasoning. From December 1996, the assessee was required to fill out a questionnaire on valuation circulated under CBEC Circular no. 272/106/96-CX dated 21 November 1996, which included a rather loaded question number (C-viii) to this effect: "Are your wholesale dealers/distributors/ sole selling agents etc., undertaking on your behalf any advertisements or sales promotion activities or any servicing or other activity for the goods manufactured and marketed by you, either by express or implied instructions/understanding/ agreement? Yes / No". The operative words were "on your behalf", and a manufacturer may well take the view that advertisement by the dealer was not on his behalf but was for mutual benefit. However, he ticked 'No' at his peril, because then he would face a case of suppression of facts in addition to the demand for excise duty.

Opinion was divided in courts regarding the status of advertisement costs borne by the dealer vis-à-vis the assessable value of the product in the hands of the manufacturer. The history of this issue evolved along much the same route as that of PDI and after-sales service. Initially, in the case of Peico Electronics & Electricals Limited v CCE Pune, 1994 (71) ELT 1053 (Trib), the Tribunal followed the case of Kirloskar Brothers (supra) to hold that discount provided to the dealer for the purpose of carrying out advertisement was not deductible from assessable value of the product in the hands of the manufacturer. This was upheld by the Supreme Court, as reported in 2000 (116) ELT A72 (SC). However in a landmark judgment in the case of Philips India Limited v CCE Pune, 1997 (91) ELT 540 (SC), the Supreme Court held that, "It seems to us clear that the advertisement which the dealer was required to make at its own cost benefited in equal degree the appellant and the dealer and that for this reason the cost of such advertisement was borne half

and half by the appellant and the dealer. Making a deduction out of the trade discount on this account was, therefore, uncalled for". It used a similar reasoning to quash the demand of excise duty on the cost of after-sales service by the dealer.

July 2000 onwards: dealer services under 'transaction value'

From 1 July 2000, the assessable value in section 4 of the Central Excise Act 1944 was changed (from the earlier 'normal price') to 'transaction value', which is the actual price paid or payable for each consignment. 'Transaction value' was defined very broadly, to include
"in addition to the amount charged as price, any amount that the buyer is liable to pay to, or on behalf of, the assessee, by reason of, or in connection with the sale, whether payable at the time of the sale or at any other time, including, but not limited to, any amount charged for, or to make provision for, advertising or publicity, marketing and selling organization expenses, storage, outward handling, servicing, warranty, commission or any other matter". Further the section included a declaration that "the price-cum-duty of the excisable goods sold by the assessee shall be the price actually paid to him for the goods sold and the money value of the additional consideration, if any, flowing directly or indirectly from the buyer to the assessee in connection with the sale of such goods, and such price-cum-duty, excluding sales tax and other taxes, if any, actually paid, shall be deemed to include the duty payable on such goods".

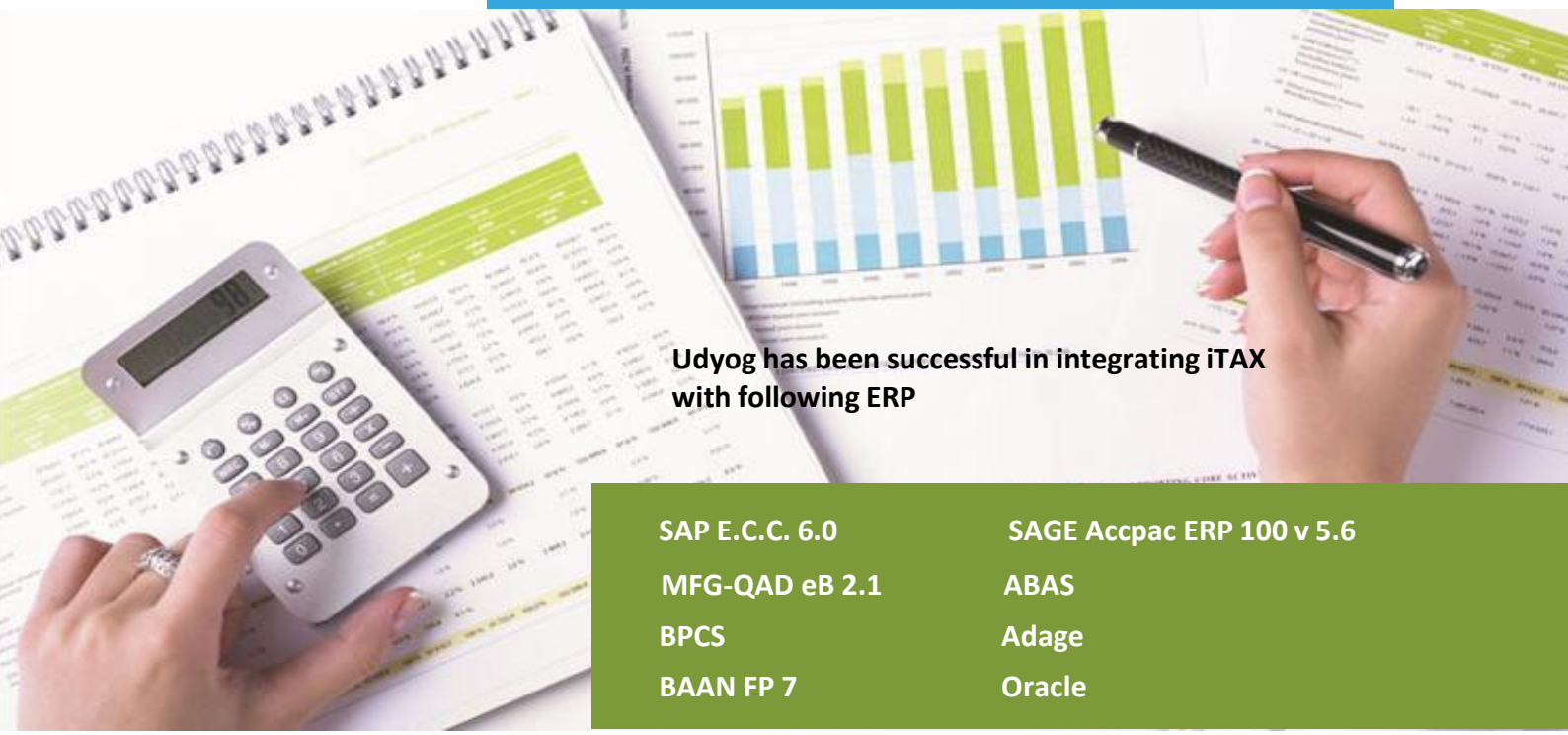
In the light of this definition of transaction value, a Larger Bench of the CESTAT answered a reference by holding that amounts charged by dealers for PDI and after-sale service are to be included in the assessable value of the products in the hands of the manufacturer. This order, reported as Maruti Suzuki India Limited v CCE Delhi-III, 2010 (257) ELT 226 (Trib LB), was appealed to the Supreme Court, but the Supreme Court has refused to grant an interim order of stay, as reported in Maruti Suzuki India Limited v Commissioner, 2913 (291) ELT A81 (SC).

In the meantime the department is in appeal to the Supreme Court against an earlier order of the CESTAT in the case of Maruti Suzuki India Limited, in which the CESTAT held, under the same post 2000 provisions, that joint advertising done by manufacturer and dealer, in which the manufacturer does not have the legal right to enforce advertisement by the dealer, is a mutual arrangement and its cost cannot be added to assessable value. In a later case of the same kind, the High Court of Punjab & Haryana ordered the CESTAT to hear the matter without pre-deposit of the disputed amounts. This was reported as Maruti Suzuki India Limited v Union of India, 2012 (276) ELT 313 (P&H).

Against this backdrop, the Bombay High Court quashed clause 7 of the CBEC circular 643/34/2002-CX dated 1 July 2002 and that part of the CBEC circular 681/72/2002-CX dated 12 December 2002 that confirmed the said clause 7 of the earlier circular. As already discussed above, the said clause 7 contained the instruction that the value of pre-delivery inspection and after-sales service provided by the dealers is to be included in the assessable value of the vehicles for excise in the hands of the manufacturer.

Thus the issue of whether the cost of pre-delivery inspections, after-sales service and advertisement by the dealer, should be part of the manufacturer's value for excise duty, has not yet attained finality. It can only be said at this point that the point to be determined is whether these costs constitute additional consideration flowing from the dealer to the manufacturer in connection with the sale of the goods. We may note that the Supreme Court in Philips India (supra) has held that the dealer benefits equally from these activities; hence it could be contended even in the present position of law that the money value of these activities is not intended to flow to the manufacturer.

(to be concluded in the next part, which will cover service tax on dealership agreements)



Udyog has been successful in integrating iTAX with following ERP

SAP E.C.C. 6.0	SAGE Accpac ERP 100 v 5.6
MFG-QAD eB 2.1	ABAS
BPCS	Adage
BAAN FP 7	Oracle

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