Circular dated 08.06.2018 on Servicing of Cars may open a Pandoras box under Goods and Services Tax Laws

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The levy of Goods and Services Tax ('GST') is on supplies of goods or services or both. Intra-state supplies are levied Central Goods and Services Tax ('CGST') and State Goods and Services Tax ('SGST')/ Union Territory Goods and Services Tax ('UGST') whereas inter-state supplies are subject matter of Integrated Goods and Services Tax ('IGST'). As is well known, the erstwhile Indirect tax enactments treated goods and services separately under different laws resulting in distortion of the Credit mechanism. Further, transactions where there was interlinkage of goods and services, often came with complications of the levy itself, valuation issues, classification issues and so on.
One would have thought with the advent of GST laws which encompasses both goods and services within its domain, classification/rate of tax issues would curtail. The law itself provides for treatment of transactions which involve supply of multiple goods/services and defines them as ‘composite supply’ or ‘mixed supply’. The relevant definitions are quite clear:

**The Central Goods and Services Tax Act, 2017**

**Section 2 (30)** “composite supply” means a supply made by a taxable person to a recipient consisting of two or more taxable supplies of goods or services or both, or any combination thereof, which are naturally bundled and supplied in conjunction with each other in the ordinary course of business, one of which is a principal supply;

**Illustration:** Where goods are packed and transported with insurance, the supply of goods, packing materials, transport and insurance is a composite supply and supply of goods is a principal supply.

...

**Section 2 (74)** “mixed supply” means two or more individual supplies of goods or services, or any combination thereof, made in conjunction with each other by a taxable person for a single price where such supply does not constitute a composite supply;

**Illustration:** A supply of a package consisting of canned foods, sweets, chocolates, cakes, dry fruits, aerated drinks and fruit juices when supplied for a single price is a mixed supply. Each of these items can be supplied separately and is not dependent on any other. It shall not be a mixed supply if these items are supplied separately.

...

**Section 2 (90)** “principal supply” means the supply of goods or services which constitutes the predominant element of a composite supply and to which any other supply forming part of that composite supply is ancillary;

Section 8 of the Central Goods and Services Tax Act, 2017 (‘CGST Act’) also prescribes the manner of determination of the tax liability on such supplies:
Section 8. Tax liability on composite and mixed supplies. – The tax liability on a composite or a mixed supply shall be determined in the following manner, namely:

(a) a composite supply comprising two or more supplies, one of which is a principal supply, shall be treated as a supply of such principal supply; and

(b) a mixed supply comprising two or more supplies shall be treated as a supply of that particular supply which attracts the highest rate of tax.

As is seen, section 8 of CGST Act reads as ‘shall’ and is therefore required to be strictly complied with. There is, thus, no further option given in law while determining tax liability of ‘composite supply’ or ‘mixed supply’.

In so far as ‘composite supply’ is concerned, an assessee is required to determine the ‘principal supply’ of the transaction or the essence of the transaction and apply this rate of tax on the entire transaction. Whereas, in case of ‘mixed supply’ (an unnatural bundle), colour is required to be taken from the highest rate of tax of the goods/service which forms part of the ‘mixed supply’ and the entire transaction is required to be taxed at this highest rate of tax.

In other words, the ‘essentiality test’ should be the determining factor while applying the rate of tax on ‘composite supply’. Therefore, one is expected to interpret the contract where the supply involves multiple taxable goods or taxable services or both, determine the essence of the contract and then apply the rate of tax on the basis of the taxable good or taxable service which gives the essential character to the contract. The law does not appear to permit an
artificial splitting of the contract by simply showing separate value of taxable goods / services and then apply the individual rates of such taxable goods / taxable services. This may lead to distortion of the GST system.

The Supreme Court in the case of *All India Federation of Tax Practitioners vs UOI 2007 (7) SCC 527* while dealing with Service tax laws, succinctly stated:

6. At this stage, we may refer to the concept of “Value Added Tax” (VAT), which is a general tax that applies, in principle, to all commercial activities involving production of goods and provision of services. VAT is a consumption tax as it is borne by the consumer....

11. At this stage, we may state that the above discussion shows that what was the economic concept, namely, that there is no distinction between consumption of goods and consumption of services is translated into a legal principle of taxation by the aforesaid Finance Acts of 1994 and 1998.

This resonance of the economic concept also stands noted in European Jurisprudence where it is well settled that a supply which comprises a single supply from an economic point of view should not be artificially split so as to distort the functioning of the VAT system.

Consequent to the above, a supply which is composite in nature and comprises of both taxable goods/ taxable services should not be permitted to be split for the purposes of application of rate of tax. The ‘essentiality test' / principal nature of supply needs to be determined and a single rate of tax applied accordingly. In cases of, unnatural bundle such as ‘mixed supply', the highest rate of tax is to be the determining factor.

The Ministry of Finance – Tax Research Unit itself applied the above rationale in its *Circular No. 34/8/2018-GST dated 01.03.2018* (F. No. 354/17/2018-TRU) wherein it was clarified:
1. Whether retreading of tyres is a supply of goods or services?

In retreading of tyres, which is a composite supply, the pre-dominant element is the process of retreading which is a supply of service. Rubber used for retreading is an ancillary supply. Which part of a composite supply is the principal supply, must be determined keeping in view the nature of the supply involved. Value may be one of the guiding factors in this determination, but not the sole factor. The primary question that should be asked is what is the essential nature of the composite supply and which element of the supply imparts that essential nature to the composite supply.

Supply of retreaded tyres, where the old tyres belong to the supplier of retreaded tyres, is a supply of goods (retreaded tyres under heading 4012 of the Customs Tariff attracting GST @ 28%)

During the Service tax regime, the Ministry of Finance – Central Board of Excise & Customs vide Circular No. 96/7/2007-ST dated 23.08.2007 on the issue of authorized service station/ spare parts clarified as follows:

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| 036.03/23-8-07 | Whether spare parts sold by a service station during the servicing of vehicles is liable to payment of service tax? | Service tax is not leviable on a transaction treated as sale of goods and subjected to levy of sales tax/VAT. Whether a given transaction between the service station and the customer is a sale or not, is to be determined taking into account the real nature and material facts of the transaction. Payment of VAT/sales tax on a transaction indicates that the said transaction is treated as sale of goods. Any goods used in the course of providing service are to be treated as inputs used for providing the
Where spare parts are used by a service station for servicing of vehicles, service tax should be levied on the entire bill, including the value of the spare parts, raised by the service provider, namely, service stations. However, the service provider is entitled to take input credit of excise duty paid on such parts or any goods used in providing the service wherein value of such goods has been included in the bill. The service provider is also entitled to take input credit of service tax paid on any taxable services used as input services for servicing of vehicles.

During the Service tax enactment, there were several decisions which held that value of spare parts was not to be included in ‘authorised service station’ service. This was primarily due to competency of legislation as Service tax laws did not extend to goods. Such decisions may not have relevance with the change in law to GST, as now, goods as well as services fall within the competence of GST laws.

However, Ministry of Finance – Central Board of Indirect Taxes and Customs in a recent Circular No. 47/21/2018-GST 08.06.2018 (F. No. CBEC-20/16/03/2017-GST) when dealing with servicing of cars has clarified as follows:

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| 2.      | How is servicing of cars involving both supply of goods (spare parts) and services (labour), where the value of goods and services are shown separately, to be treated under GST? | 2.1 The taxability of supply would have to be determined on a case to case basis looking at the facts and circumstances of each case.  
2.2 Where a supply involves supply of both goods and services and the... |
There appears to be certain level of dichotomy in the view of the Board from time to time. With the advent of GST laws, one would have expected that principal nature of supply would have been the determining factor in the illustration at hand and a single rate of tax been made applicable. The Circular dated 08.06.2018 does covenant that taxability of supply would be determined looking at facts and circumstances of each case. However, given the issue at hand, Sr. No. 2 of Circular dated 08.06.2018 certainly has the potential to open a pandoras box for all concerned under GST laws and may have wide ramifications when dealing with issues concerning applicability of rate of tax with reference to transactions which involve usage of both goods and services.

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