

**RECENT DECISION OF SUPREME COURT IN M/s TATA MOTORS LTD.
Vs. Dy. Commissioner of Commercial Taxes,**

Provision of Warranty for any goods is a customary practice in any commercial transaction, Being given by the original manufacturer of such goods, the warranty gives comfort to the customer that in the event of loss due to breakage/dysfunctional etc. to any Component or Part of the goods sold, the same will be replaced by the manufacturer during the warranty period. It may be noted that very often many goods are being sold by the original manufacturers thru' their Distributors/Agents considering the commercial expediency. Therefore the activity of replacement of any Component or Part of any goods is carried out by the manufacturer thru the net work of his Distributors/Agents in order to provide better and speedy service to the Customer.

The question of whether replacement of Component/Part during the warranty period attracts tax under erstwhile Sales-tax/Trade Tax regime, arose in the year 1990-91 in the case of Mohd. Ekram Khan & Sons Vs. Commissioner of Trade Tax, Lucknow reported in 136 STC 515 (2004) in Civil Appeal No.9618/2003.

Facts of the case in Mohd Ekram Khan's case:

The Assessee is a Dealer of Automobile manufacturer Mahindra & Mahindra (OEM). Vehicles are sold by OEM to the assessee by charging applicable sales-tax at the originating state. As per the dealership agreement, whenever the assessee sells a vehicle of OEM, he is required to undertake free maintenance of vehicle during the warranty period free of costs. Such maintenance includes the activity of replacing damaged Part/Spare of the Vehicle. For this purpose, the assessee purchases sufficient Parts/ Spares of the Vehicle and keeps the same as part of his inventory. Like Vehicles, this purchase of Parts/Spares also suffers sales-tax at the originating state.

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During the relevant assessment year (1990-91), the assessee replaced some Parts of the vehicles sold during the warranty period and sent a list of such Parts to the OEM. The OEM on scrutiny of such list, issued a Credit Note to the assessee for the value of spares/parts replaced at free of costs.

The Trade Tax Officer in Lucknow, while finalizing the assessment of the assessee for the years 1990-91 & 96-97 levied Trade tax on the value of credit note issued by the OEM to the assessee. The Assessee has been unsuccessful in its appeal before the Commissioner while on second appeal before the Tribunal, it was held that there is no sale taking place on replacement of Spares/Parts by the assesses and hence based on various High Courts' decision deleted the levy of tax. The Revenue then carried the matter to the Lucknow Bench of Allahabad High Court which set aside the order of Tribunal and held that the said transaction involves sale and levy of trade tax thereon is justified.

The Assessee being aggrieved by the Order of the High Court carried the matter to Hon'ble Supreme Court. The Apex Court after elaborately considering the facts and various judicial pronouncements held against the assessee on the premise that the assessee has received payment from the OEM for the Parts supplied to the customers during the warranty period. In particular the Apex Court considered the following rulings:

- a. Premier Automobiles Ltd. Vs. Union of India
- b. Prem Motors Vs. Commissioner of Sales-tax (M.P. High Court – 61 STC 244)
- c. Commissioner of Sales-tax, New Delhi Vs. Premnath Motors Pvt. Ltd. (Delhi HC reported in 43 STC 52)
- d. Geo Motors Vs. State of Kerala – Kerala HC – 122 STC 285

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Let us consider in brief the observations of various High Courts on this issue.

In the case of Premier Automobiles Ltd. Vs. Union of India, it was held that replacement of defective parts during warranty period would not involve any Sale.

In the case of Prem Motors Vs. Commissioner of Sales-tax, the Madhya Pradesh High Court while rejecting the contention of the revenue held that what is effectively done is a passing on, of the Parts, from the manufacturer to the customer, but in order to avoid delay and prevent any inconvenience to the customer, the Dealer replaces the Part first and gets them replenished from the manufacturer later. The cost for the same is reimbursed by the manufacturer to the Dealer. Thus it concluded that this is neither a sale of Parts by the Dealer to the customer nor to the manufacturer.

In the case of Commissioner of Sales-tax, New Delhi Vs. Premnath Motors Pvt. Ltd., the Delhi High Court came out with a different logic in that a Dealer sells cars along with a warranty, under which it is agreed that it would replace the parts **free of cost**. When such a part is replaced, it becomes a Part of the Car and the property in it stands transferred to the buyer. There is no separate consideration paid for the Part so transferred and, hence, the only reasonable inference is that the consideration for the Part or Parts that might be replaced, under the warranty, was not separately specified since it is included in the price fixed and paid for the Car at the time of its sale. The price so fixed and received is, thus, a consolidated price for the Car and the Parts that may have to be supplied by way of replacement, in pursuance of the warranty.

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In Geo Motors Vs. State of Kerala case, the Kerala High Court adopted the reasoning of Delhi High Court in Premnath Motors's case by stating that even though the Automobile Dealer purchases Spares/Parts from OEM by giving Form "C", such a transaction was purely for replacement and hence could not be categorized as 'Sale'.

Following principles evolve upon conclusions of various High Court's decisions:

- a. Where there is no consideration, no sale is involved;
- b. The relationship between the Dealer of an Automobile and that of OEM is one that of Principal & Agent
- c. When a Vehicle is sold, it is sold along-with Warranty to the customer.
- d. Replacement of Spare/Parts by the Dealer to his customers is in pursuance of warranty is given by the OEM to the customer.
- e. Responsibility to replace the defective Spare/Part lies with the OEM and not with the Dealer.

The decision of Apex Court in Mohd. Ekram Khan's case, rather than dwelling on the above five crucial points relied on the following theories and concluded that tax (Trade Tax) is payable on the value of credit note issued by the OEM to its Dealer:

- a. The facts cited in various decisions of High Court are distinguishable;
- b. Basic issue as to the nature of transaction between the assessee and the OEM has been lost sight of; if the Parts/Spares are supplied to the customers directly by the OEM, the position is different.

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- c. If the OEM had purchased Spare/Parts from an open market, he would have paid taxes for replacement of defective parts. There is no difference if the dealer himself supplies such defective parts & received the price from OEM
- d. There is a consideration by way of Credit Note from OEM to the assessee.

Based on the decision of Apex Court in this case, the High Courts of Bombay, Gujarat & Allahabad held a consistent view in favour of the revenue.

Recently the decision of Apex Court in Mohd. Ekram Khan's case came up for consideration while dealing with a case of M/s TATA Motors & Others Vs. Dy. Commissioner of Commercial Taxes, in Civil Appeal No. 1822/2007.

While arguing for TATA Motors & its Dealers, the learned Sr. Counsel for the assessee put forward the following arguments in support of his contentions:

- a. Dealership agreement between the OEM and the assessee clearly enunciates that any defect in the Part/Spare have to be replaced by the OEM free of cost and within reasonable time;
- b. Price fixed by the OEM is a consolidated price for the Vehicle and for the Spare/Parts that may have to be replaced during Warranty period;
- c. Object of providing free warranty is that the buyer invests heavy amount on purchase of Vehicle and hence he needs to be assured of good running in a trouble-free manner;
- d. Cost of Spare/Parts replaced during warranty period is part of the cost of Vehicle sold and the property in it stands transferred to the buyer
- e. A promise must be supported by a consideration in order to be an enforceable collateral contract. The case of a contract for replacement of Spare/Parts is similar to that of collateral contract.

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The counsel further submitted some of the observations made by the Apex Court in Mohd. Ekram Khan's case were *per incuriam* (error in judgement) and hence needs to be referred to a larger Bench. What the Apex Court has missed out in this case is the basic commercial principle of replacement. Assuming that in the absence of assessee, if the vehicle is sold by the OEM directly to the buyer, the situation would be that the OEM will replace the defective Spare/Part during the warranty to which the Apex Court agrees that there is no incidence of tax on this type of transaction. Just because the said transaction is routed thru a Dealer, the Apex Court came to a wrong conclusion that there is a consideration involved in the transfer of Spare/Parts from OEM to the Dealer and hence tax incidence gets triggered. The Apex court in Mohd. Ekram Khan's case failed to appreciate the fact that it is only due to commercial expediency that the transaction of replacement is passed thru' a Dealer and in order to serve the customer in a better way.

After hearing the detailed arguments of Sr, Counsel, the Apex Court bench headed by Justice Sanjay Kishan Kaul saw merits in the arguments and referred its decision in Mohd. Ekram Khan's case to a larger bench.

It is hoped that the larger bench will concur with the decisions of various High Courts as referred above.