

GST for Amortisation cost on FOC Basis

It is a common practice in the manufacturing industry to outsource a part of the manufacturing activity to third parties such as contract manufacturers/job-workers. The original equipment manufacturers (OEM) often provide the component manufacturers (CM) with moulds and dies to be used for manufacturing so as to maintain quality and standardize the production process.

There is a contract between CM and OEM for supply of a component which requires a special type of mould/die to produce the component. The mould/die is provided on free of cost (FOC) basis to CM and the cost is borne by OEM. Should GST on the amortised part of such mould/die be included in the value of component or not?

GST is normally payable on the value of supply as determined under Section 15 of the CGST Act, 2017.

As per the section, the value of a supply shall be the transaction value which shall be the actual price paid or payable by unrelated parties and where price is the sole consideration for the supply.

However, Section 15(2)(b) specifically provides that the value of a supply shall include any amount that is payable by the supplier but has incurred by the recipient of the supply and has not been included in the value of the supply. The value of moulds and dies shall therefore be included in the value of supplies of CM only in case the CM was liable to incur the expenses for the moulds but the same has been incurred by the OEM.

With respect of this, clarification by CBIC by way of circular No. 47/21/2018–GST on 8-6-2018 has been provided as below:

1. Para 1.2 of this circular clarifies that the value of moulds and dies are not to be included in the value of supply by CM when the cost of the moulds and dies are not to be incurred by the CM contractually.
2. Para 1.3 clarifies that the value of moulds and dies are to be included in the value of supplies by CM if the contract between CM and OEM specifies that the supply of component shall be made by using the mould or die belonging to CM but the same has been supplied by OEM on FOC basis.

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As per the facts involved in advance ruling [In Re: Nash Industries Pvt. Ltd., 2018-VIL-266-AAR], CM was responsible for manufacture of mould which is used to manufacture finished goods but the cost of mould is borne by OEM. The Authority, while interpreting Section 15(2)(b) of the CGST Act, 2017 held that no goods can be manufactured without a “customized mould”. Hence the authority is of the view that the value of supply of finished goods by CM to OEM must include the amortized value of the mould provided on FOC basis, irrespective of the contractual arrangement between the parties. The decision is contrary to the circular.

The Maharashtra advance ruling placed reliance on the above stated circular and held that the amortized value of mould was not required to be included in the value of finished goods in case where the agreement between the parties clearly states that the cost of mould/die must be incurred by the OEM [In Re: Lear Automotive India Private Limited, 2018-VIL-318-AAR].

Conclusion:

It has become imperative for the contract manufacturing industry to revisit their agreements with the OEMs in light of the clarification issued by the CBEC and the rulings of the AAR to safeguard themselves from any avoidable exposure and GST liability in the future.