GST on tools and dies manufactured for foreign buyers

CA Ashish Chaudhary (ashish@hiregange.com)

CA Manish Sachdeva ***(***manishkumar@hiregange.com)

The present article lays a discussion into the taxability of Tools, Dies, Jigs *familia* when made for overseas customers but retained in India. Section 16 of the IGST Act has accorded export of zero-rated status. Zero rated supply is broad term per international standards, wherein the government allows zero rate of tax on output along with refund/set off of the input taxes, the Indian laws however only recognize "exports" as zero supplies.

The definition of export of goods is taken from the Customs Act, 1962 ('CA'), as *"taking out of India to a place outside India"* [Section 2 (5)]. A conjoint reading of both provisions implies that goods shall be treated as zero rated **only if they are taken Outside India**. Such embargo gives rise to some formidable situations where although the supply is ultimately consumption is the destination, however tax relief is not accrued owing to rigid definitions.

Suppose a tier 1 manufacturer which makes automobile components for OEMs. For manufacturing specified the components, the manufacturer requires Dies and Moulds ('D&M'). The manufacturer makes D&M and retains it with himself and thereafter using D&M manufactures components. The consideration for D&M is a separate one from the consideration of the components. So long as the taxes continues to be available as credit for a recipient, the taxation of components and D&M are not much of debate, however the situation becomes adverse as soon as the tax on D&M starts becoming cost, enters the foreign OEM.

The Authority for Advance Ruling, Karnataka in re, **Dolphine Die Cast (P) Ltd. 2020 (5) TMI 604**, had an occasion to examine the taxability and zero rated status of Dies manufactured by Indian manufacturer for a foreign OEM. The authority after considering the definition of export under Section 2 (5) *ibid*, held as follows;

- Since the die did not move out of India to a place outside India, the supply does not amount to manufacture of goods
- The place of supply is determinable under Section 10 (1) (c) of the IGST Act viz. basis the rule of ‘non movement of goods’, hence the transaction qualifies as intra-state supply
- The authority also decided in a reverse case scenario that had the die been made by a die manufacturer outside India, but is not imported into India – then the Indian importer need not pay GST on the same [see to this effect contrary ruling by WB AAR in Swapa Printing Works Private Limited]

Although the decision in Dolphine Die Cast (P) Ltd. supra appears to be correct on the literal interpretation of the IGST Act, however the situation is gruesomely adverse when it comes to principles of VAT. In the following paragraphs, we examine potential ways through which an Indian manufacturer can mitigate tax costs on this count;

1. Taking out of India

The definition of export under Section 2 (5) *ibid* is borrowed from the Customs Act, 1962 of the Customs Law. Since the D&M are never taken outside India, therefore on a strict reading, the supplies of D&M may not qualify as exports under Section 2(5) *ibid*. However, Section 2 comes with a rider of "contextual reference" i.e. Section 2 defines Export as under sub Section 5 unless the context requires otherwise. The contextual reference is a debatable satire and requires the totality of facts in case divergence must be adopted.

In **Commissioner of Expenditure Tax vs Darshan Surendra Prekh [1968 AIR 1125]**, the Hon'ble Supreme Court observed that It is a settled rule of interpretation that in arriving at the true meaning which is assigned thereto by the definition in cl. (g) of to be viewed isolated from its context; it must be viewed in its whole context, the title, the preamble and all the other enacting parts of the statute. Also see, **Printers (Mysore) Ltd v Asstt. Commercial Tax Officer [**1994-VIL-27-SC**] and Ashok Kapil vs Sana Ullah (Dead) and Others [**1996 (6) SCC 342**].**

An essence can be drawn from the above judgments that, although Zero rated are only exports, but exports must not necessarily be restricted with Section 2 (5) in isolation. If a good ground is propounded to exhibit that export can be things even other than those **"taking out of India",** then the benefit of Zero rating shall be permitted.

2. Contract Optimization

Following Models may be think of to neutralize the tax cost arising out of retained D&M supplies;

a. Split the value between goods and services

From a financial costing perspective, the costing of D&M is tilted more towards design and development and lesser towards the actual engineering. In fact, actual engineering in some cases merely extends to be only tightening of the fasteners and jolts. A major chunk of the cost is towards **"In house Designing, Re-designing, developing the prototype on the computer, testing, and finalization".** These words could sounds more of services than goods. While it is difficult to testify that entire contract price for D&M can be slated towards services, still though it can be split to very good extent under the Umbrella of services. Support could be sought from the judgment of Hon'ble Chennai CESTAT in case of ***Mahle IPL Ltd vs Commissioner of Central Excise and Service Tax, Chennai III [****2014-VIL-494-CESTAT-CHE-ST****]***

By adopting the above approach, the place of supply of the service element would be 'location of recipient of services' viz. the foreign territory in the present case [**Circular No. 141/10/2010-TRU Dated 13/05/2011,** Para 3]. In case of export of services, the export criteria can be satisfied, when the Tooling Revenue are categorized as Services. Therefore to the extent possible, splitting may thought for.

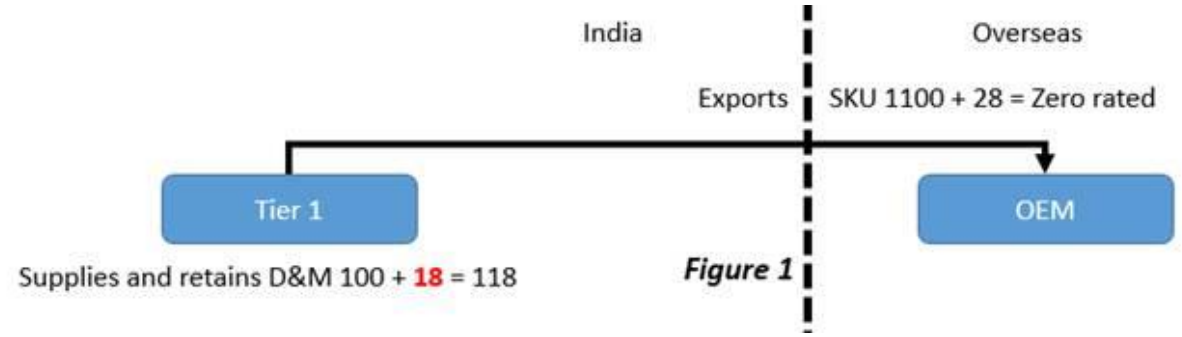
b. Supply as Composite Supply or Mixed Supply

Individual Contracts of (1) D&M and (2) components with OEM could be merged or even modified with cross fall breach etc. The attempt is to club the multiple supplies of D&M and component as single supply. A singular contract with appropriate co-terminus clauses of D&M and components can be offered as composite supply;

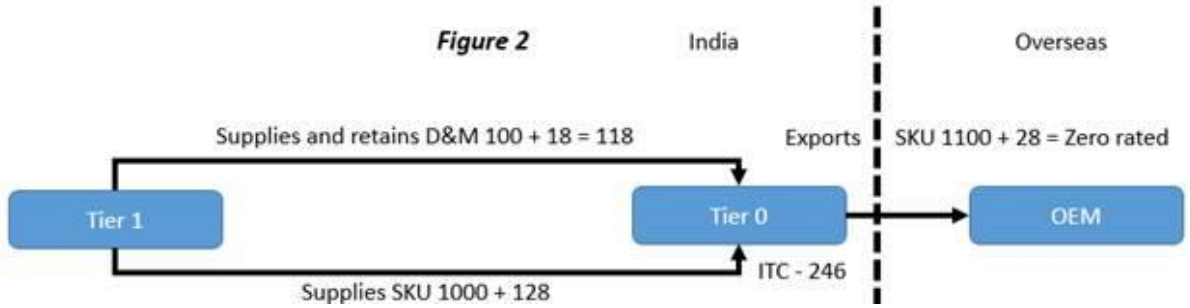
Since the components would be exported, the tax treatment that of component would prevail and therefore tax on D&M would be payable as tax on components – and since the components would be exported out of India, GST may not be leviable.

c. An Intermediary in the supply chain

GST on D&M Supply is cost for an overseas OEM (unregistered), but an intermediary between the OEM and Tier could neutralize the tax cost. Unless of course, the legitimacy of transaction is challenged. This could illustrated through following pictorial;



The GST 18 charged on D&M is un-absorbable, hence a tax cost. The said cost can be converted into ITC by introducing a 'Tier 0' or 'Contract Party' to execute the Exports.



3. The tax treatment in foreign jurisdictions

It is worthwhile to discuss how some of the developed foreign jurisdictions tackle the incongruity of situations like this.

In **UK, United Kingdom Value Added Tax Act, 1994**, unlike Indian GST, the scope of zero rated supplies is not limited to exports, so that imbalance or anti-VAT apprehensions could be countered *qua* other commodities/ transactions as well. Section 30 (2A) of the UK VAT Act read with S. No. 3 of Schedule 8, Group 13 provides zero rating of D&M to the extent they are used for exporting components outside UK [also refer **UK VAT Notice 701/22 (updated 05 Oct 2017)**]

Similarly in **Australia**, Section 38-188 of **A New Tax System (Goods and Services Tax) Act, 1999** provides for zero rating of Tooling used with synonymic conditions as provided in UK VAT Act. Similar propositions are incorporated under Section 21A (1) of the Singapore Goods and Services Tax Act. Chinese also have a similar method of neutralization of D&M situation.

In **New Zealand** after an adverse ruling from the New Zealand Tax Review Authority in ***XX (An Exporter) vs Commissioner of Inland Revenue [2013] NZTRA 4*** in this regard, Section 11 (p) in the New Zealand GST Act 1985 to was introduced to neutralize the D&M situation at hand.

To conclude, is important for the government to acknowledge the broader sense of zero rating. In fact, where-ever an acute need was felt in the Duty Free Shop cases, the government has essentially zero-rated goods sold by DFS to international buyers, by making output goods exempt and at the same time allowing refund of the input tax. Similar mechanism should also be provided by the government in case of D&M sold to buyers. In the meanwhile, the government acknowledges the lacuna, it would be paramount for the die manufactures to optimize their position to the extent possible. A proper representation before the government for respite to the automotive players could also be explored, who were already facing the grunt of economic slowdown and now facing uprising red due to pandemic.

For any information/ feedback, please reach to manishkumar@hiregange.com or ashish@hiregange.com