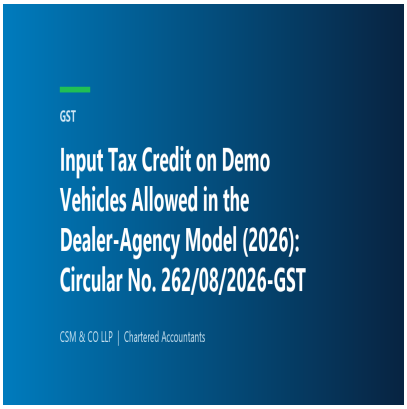

Input Tax Credit on Demo Vehicles Allowed in the Dealer-Agency Model (2026): Circular No. 262/08/2026-GST

Description

Last updated: 26 October 2026 · Written and reviewed by CA Meet Dhrangadhariya, CSM & Co LLP

Quick summary

- Circular No. 262/08/2026-GST, dated 26/10/2026, allows input tax credit on demo vehicles even where an authorised dealer merely acts as an agent for the vehicle manufacturer, reversing a stricter position taken in 2024.
- Under the earlier circular, a dealer in this “dealer-agency model” - where the manufacturer sells directly to the customer and the dealer only facilitates - was denied credit, because the dealer itself was not making a further supply of the vehicle.
- The new circular finds no real difference between the dealer-agency model and the traditional model where the dealer buys and resells vehicles on its own account - in both, the demo vehicle serves the same test-drive purpose and is eventually sold at a written-down value with tax paid on that sale.
- Section 17(5)(a)(A) of the CGST Act uses the words “such motor vehicles,” not “the said motor vehicle” - language the circular reads as permitting credit where a vehicle supports the sale of similar vehicles generally, not only where the very same vehicle is itself resold.
- Para 4.6 of Circular No. 231/25/2024-GST, which had blocked credit for the dealer-agency model, is formally withdrawn; credit on demo vehicles is now available in both business models.

A dealer’s demo car - the one every showroom keeps for test drives - has had an inconsistent GST credit position depending on exactly how that dealer’s business is structured with the manufacturer. Circular No. 262/08/2026-GST, dated 26 October 2026, fixes that inconsistency by withdrawing a restrictive 2024 clarification.

New to terms such as “dealer-agency model” or “section 17(5)”? See the technical terms explained in simple words further down.

At a glance

- **Circular:** No. 262/08/2026-GST, GST Policy Wing, CBIC, dated 26 October 2026.
- **Issued under:** section 168(1) of the CGST Act.

- **Withdraws:** para 4.6 of Circular No. 231/25/2024-GST, dated 10 September 2024.
- **Result:** input tax credit on demo vehicles is now available to authorised dealers in the dealer-agency model, exactly as it already was in the traditional dealership model.

The two models, and what the 2024 circular had said

There are two common ways vehicle sales are structured:

- **Traditional dealership model:** the dealer buys a fleet of new vehicles from the manufacturer and resells them to customers on its own account, designating some vehicles as demo units for test drives.
- **Dealer-agency model:** the manufacturer sells new vehicles **directly** to the customer; the dealer only buys demo vehicles from the manufacturer to facilitate test drives and otherwise acts as a marketing or facilitation agent.

Para 4.6 of the 2024 circular had held that in the dealer-agency model, since the dealer itself is **not making the further supply of the vehicle on its own account**, the demo vehicle could not be said to be used by the dealer for making a further supply - so credit on it was blocked under section 17(5)(a)(A) of the CGST Act, and unavailable to the dealer.

Why that position has been reversed

The circular finds **no real practical difference** between the two models that would justify different GST treatment:

- In both models, the demo vehicle is purchased by the authorised dealer from the manufacturer against a tax invoice, and is typically recorded as a capital asset in the dealer’s own books.
- In both models, the vehicle must be held as a demo unit for a mandatory period, and is thereafter generally sold at a written-down value, with applicable tax paid at that point.
- Both types of vehicles are treated alike under the Central Motor Vehicle Rules, 1989.
- In both models, the demo vehicle serves the identical purpose: letting a prospective customer experience the car before buying.

Denying credit to one business model but not the other, the circular concludes, creates a discriminatory outcome with no underlying difference in substance.

The textual argument: “such motor vehicles,” not “the said motor vehicle”

Section 17(5)(a)(A) of the CGST Act excludes from the input-credit block any vehicle used for **“further supply of such motor vehicles”** - and the circular places weight on the word “such,” which it reads as covering vehicles used for furthering the supply of **similar** motor vehicles generally, not only the specific vehicle that is itself later resold. Since demo vehicles in both models support the sale of similar vehicles, the circular holds that credit should be available in both.

What this means in practice

- **Para 4.6 of Circular No. 231/25/2024-GST is formally withdrawn.**
- Input tax credit on demo vehicles is **no longer blocked** under clause (a) of section 17(5) of the CGST Act for a dealer operating under the dealer-agency model.

- The rest of the earlier circular, and the basic section 17(5)(a) restriction on vehicles with seating capacity up to 13 persons (subject to the further-supply, passenger-transport, and driving-training exceptions), is unaffected.

How CSM & Co LLP can help

If credit on demo vehicles was earlier denied or reversed on the strength of the withdrawn para 4.6, this clarification may open the door to revisiting that position - please reach out to our team and we will be happy to assist with a review.

Technical terms explained in simple words

Term	What it means
Dealer-agency model	An arrangement where the manufacturer sells vehicles directly to the customer, and the dealer only facilitates sales and keeps demo vehicles for test drives.
Traditional dealership model	An arrangement where the dealer itself buys and resells vehicles to customers, keeping some as demo vehicles.
Section 17(5)(a)	The CGST Act provision blocking input tax credit on certain motor vehicles, unless used for further supply, passenger transport, or driving training.
Written-down value	The reduced book value of an asset like a demo vehicle after accounting for its use and depreciation, at which it is typically sold.

Frequently asked questions

What changed for demo vehicle input tax credit in 2026?

Circular No. 262/08/2026-GST withdraws para 4.6 of the earlier Circular No. 231/25/2024-GST, which had denied input tax credit on demo vehicles to an authorised dealer operating in the “dealer-agency model.” Credit on demo vehicles is now allowed in that model as well.

What is the dealer-agency model, and how is it different from the traditional dealership model?

In the dealer-agency model, the vehicle manufacturer sells new vehicles directly to the customer, and the dealer only keeps demo vehicles to facilitate test drives, acting more like a marketing agent. In the traditional model, the dealer buys a fleet from the manufacturer and resells vehicles to customers on its own account, designating some as demo vehicles.

Why was credit denied under the 2024 circular in the dealer-agency model?

Because the dealer in that model was not itself making a further supply of the vehicle to the customer - the manufacturer sold directly - so the demo vehicle could not be said to be used by the dealer for “further supply of such motor vehicles” under section 17(5)(a)(A), the exception that allows credit.

What is the reasoning behind allowing credit in both models now?

The circular finds no practical difference between the two models: in both, the demo vehicle is purchased from the manufacturer against a tax invoice, held for a mandatory period, treated as a capital asset, and eventually sold at a written-down value with tax paid at that time. It also reads the phrase “such motor vehicles” in section 17(5)(a)(A) as covering vehicles used to promote the sale of similar vehicles generally, not only the identical vehicle resold.

Does this circular change the GST treatment of motor vehicle credit generally?

No. The restriction under section 17(5)(a) on vehicles with a seating capacity of up to 13 persons, and its three exceptions - further supply, passenger transport, and driving training - remain unchanged. The circular only clarifies that a demo vehicle in the dealer-agency model qualifies under the “further supply of such motor vehicles” exception, just as it already did in the traditional dealership model.

Official sources

- CBIC - GST Circulars (CGST)
- GST Portal

Related reading

- 57th GST Council Meeting (October 2026): Arrest Powers Removed, Faster Refunds and Wider ITC

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meetsoni