

## CHAPTER-6

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### TAXATION OF WORKS CONTRACT UNDER SERVICE TAX

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Works contract is a contract for the provision of service as well as supply of materials. As decided by Apex Court in BSNL v. UOI 2006 (2) S.T.R. 161 (S.C.), a works contract can be segregated into a contract of sale of goods and contract of provision of service.

Prior to 01/07/2012, taxable service under works contract service was defined in section 65(105) (zzzza). The said definition was narrower in scope than the present definition. The definition prior to 01/07/2012 excluded the levy of

works contract in respect of Road, airport, railways, transport, terminals, dams. It also excluded repairs and maintenance in respect of goods. The present definition of works contracts under section 65B (54) is much wider in scope.

Revenue from works contract services in 2011-12 is 4178.94 crore which has been increased to Rs 4454.87 Crore in 2012-13 with an increase of 6.60%.

Prior to understanding the taxability of services of works contract, let us understand what 'Works Contract' is.

#### Concept of Works Contract:

The distinction between a contract of sale of goods and contract of work is often a fine one. The question, whether a contract is one for "sale of goods" or for executing works, is largely one of facts, depending upon the terms of the contract, including the nature of obligation to be discharged there under and the surrounding circumstances. The Supreme Court in the case of the HAL V/s State of Karnataka, (1984) (55 STC 314) held, 'A contract of sale is a contract whose main ob-

ject is the transfer of the property in, and the delivery of the possession of, a chattel as a chattel to the buyer. Where, the main object of work undertaken by the payee of the price was not the transfer of chattel qua chattel, the contractee's one of work and labour. The test is, whether or not the work and labour bestowed end in anything that can properly become the subject of sale; neither the ownership of the materials, nor the value of the skill and labour as compared with the value of the materials, is conclusive, although such matters may be taken into consideration in determining, in the circumstances of a particular case, whether the contract was in substance one for work and labour or one for the sale of a chattel.

It further held 'where passing of property was merely ancillary to the contract for the purpose of the works, such a contract does not thereby become a contract of sale. Mere passing of property in an article or commodity during the course of performance of the transaction in question does not render the transaction to be a transaction of sale. Even in a contract purely of work or service, it is possible that articles may have to be used by the person executing the work, and property in such articles or materials may pass to the other party. That would not necessarily make the contract into one of sale of those materials. In every case, the court would have to find out what was the primary object of the transaction and the intention of the parties while entering into it. It may in some cases be that even while entering into the contract of work or even service, parties might enter into separate agreements, one of work and services and the other of sale and purchase of materials to be used in the course of executing the work or performing the service. But then in such cases the transaction would not be one and indivisible but would fall into two separate agreements, one of work or service, and the other of sale'.

In other case of the same company V State of Orissa (55 STC 327), the Supreme Court held 'The primary difference between a contract for work or service and a contract for sale of goods is that in the former there is in the person performing or rendering service no property in thing produced as a whole notwithstanding that a part or even the whole of material used by him may have been his property. In

case of a contract for sale, the thing produced as a whole has individual existence as the sole property of the party who produced it sometime before delivery and property therein passes only under the contract relating thereto to the other party for price’.

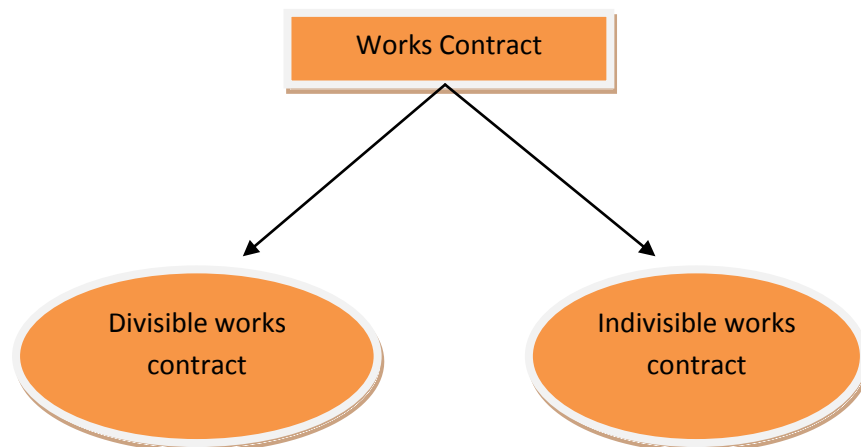
The Karnataka High Court in the case of Shankar Vital Motor Co. Ltd V State of Karnataka (15 STC 771) stated that ‘The expression “sale of goods” is not to be construed in its popular sense but it must be interpreted in its legal sense and should be given the same meaning which it has in the sale of goods Act,1930. One of the tests to find whether a given case is a “Sale of Goods” or “work contract” is to see whether, the work done by a person is work done on his own chattel, or on the chattel of someone –else. If it is on his own chattel and that chattel is later sold, then it is “sale of goods”, but if the work is done on customer’s chattel then it is “work contract”’.

Any agreement for execution of works relating to civil works, construction, manufacture, processing, fabrication, erection, Installation, fitting out, improvement, modification, repair or commissioning of any movable or immovable property for cash/deferred payment or other valuable consideration is a works contract.

Few examples of Works Contract are as follows: -

1. Construction of a new building or a civil structure or a part thereof, or of a pipeline or conduit, primarily for the purposes of commerce or industry.
2. Construction of a new residential complex or a part thereof.
3. Completion and finishing services, repair, alteration, renovation or restoration of, or similar services.
4. Turnkey projects including engineering, procurement and construction or commissioning (EPC) projects.

### Types of works contract



**Divisible Works Contract** is where the elements of sale of goods (i.e. Material) and Labour are clearly segregated.

**Indivisible Works contract** is where the parties agree for lump-sum consideration for the entire contract. The sale consideration of the material used in the contract and remuneration for Labour is not separately identifiable.

## **6.1 Meaning of Works Contract with various definitions**

Section 65B(54) of Finance Act, 1994 as introduced w.e.f 01.07.2012:-

“Works Contract” means a contract wherein,—

- (i) Transfer of property in goods involved in the execution of such contract is liveable to tax as sale of goods, and
- (ii) Such contract is for the purposes of carrying out:—
  - a) Erection, commissioning or installation of plant, machinery, equipment or structures, whether pre-fabricated or otherwise, installation of electrical and electronic devices, plumbing, drain laying or other installations for transport of fluids, heating, ventilation or air-conditioning including related pipe work, duct work and sheet metal work, thermal insulation, sound insulation, fire proofing or water proofing, lift and escalator, fire escape staircases or elevators; or
  - b) Construction of a new building or a civil structure or a part thereof, or of a pipeline or conduit, primarily for the purposes of commerce or industry; or
  - c) Construction of a new residential complex or a part thereof; or
  - d) Completion and finishing services, repair, alteration, renovation or restoration of, or similar services, in relation to (b) and (c); or
  - e) Turnkey projects including engineering, procurement and construction or commissioning (EPC) projects;

Meaning of the following important terms as used in the definition of Works Contract Services are discussed below:-

- Construction
- Erection
- Installation
- Commissioning
- Completion and fitting out
- Maintenance
- Repair
- Alteration
- Renovation

Meaning of Construction: - The word 'construction' is defined in dictionaries as follows:

- the building of something, typically a large structure (as per New Oxford Dictionary of English)
- to make or form by combining or arranging parts or elements (as per Webster's Ninth New College Dictionary)
- the act or process of constructing (the Chamber's Dictionary)
- the process of bringing together and correlating a number of independent entities so as to form a definite entity. Thus the creation of something new, as distinguished from the repair or improvement of something already exists. The act of fitting an object for use or occupation in usual way, and for some distinct purpose (as per Black's Law Dictionary)

Meaning of Erection:- As per *Webster's Concise Dictionary* 'erection' means the act of erecting or the state of being erected. As per *Concise Oxford Dictionary* 'erection' means the act of erecting, and erect, means to construct a building, wall etc.

Meaning of installation:- The installation is defined as follows-

- ◆ The word installation means the bringing of an entire piece of plant on to a site and putting into a position on the site. It does not mean that putting together of parts, piece, pipe by pipe, bolt by bolt, weld by weld, until it gradually becomes one whole. (*Law Lexicon Dictionary*)
- ◆ Install is to establish in a connected place, condition or status. The word 'installation' is defined as something that is installed for use or act of installing. The meaning of the word 'install' simply means putting the item in particular place in a specified manner to facilitate its use on long term basis. (*Webster's Ninth New Collegiate Dictionary*)

Meaning of Commissioning:- The 'commissioning' means commencement of item which has been installed. It involves the process of testing the installed item method by method.

In *Indian Hume Pipe Co. Ltd v. CCE [2008] 16 STT 136 (Chennai -CESSTAT)* it was held that 'Erection' connotes construction or building of a structure, and laying of pipeline does not involve erection. There is no ambiguity in the expression 'installation'.

It applies to machinery already made which are formally made ready to operate at the site. Installation implies setting up the machinery ready for use, like giving power connection or installing driver software in the case of a machine run with the aid of computer software. Commissioning involves the operationalisation of the machinery after which it starts functioning regularly. In laying of long distance pipeline, earth is dug up and pipes laid or jointed, and the pipes pass through sumps with boosters at intervals, if necessary. This activity will not involve erection.

Meaning of Maintenance:- Maintenance is defined as follows:

‘The upkeep of a property or equipment (Webster’s Ninth New Collegiate Dictionary)’

The upkeep or preservation of condition of property including cost of ordinary repairs necessary and proper from time to time for that purpose (*Black’s Law Dictionary*)

‘Maintenance’ is to keep a machine, building etc., in a good condition by periodically checking and servicing or repairing, whereas ‘Repair’ is a one time activity. Maintenance is a continuous process of which repairing may be incidental or ancillary.



Meaning of Repair:- In short it means removal of defects from items.

The meaning of the word 'repair' is different from the meaning of the word 'Manufacture'. Repair means restore in good condition, renovate or mend by replacing or re-fixing parts.

As long as the product does not lose its identity as such, the process shall be one of repair and not manufacture. However, if the product after carrying out the process is commercially different, the process will mount to manufacture. In the case of *East India Transformer & Switch Gears (P.) Ltd v. CCE 1989(43) ELT 561 (CEGAT- NewDelhi)*, the Tribunal held that where the process consisted of replacement of transformer oil and HT Leg oils and change of some minor parts, the process did not amount to process of manufacture, as it did not result in losing its identity as such. Service tax is payable only when the process carried out by the above person amounts to repair.

Meaning of Alteration:- It is defined in various dictionaries as follows:

- Alteration as per the *New Oxford Dictionary* means 'the action or process of altering or being altered'
- 'alteration' as per *Webster's Ninth New Collegiate Dictionary* means 'the act or process of changing'
- 'alteration' as per *The Chambers Dictionary* means 'to Modify'
- 'alteration' as per *Black's Law Dictionary* means 'variation, changing, making different, a change of a thing from one form or state to another, making a thing different from what it was without destroying its identity.'

Thus, alteration means the act or process of making a change to anything without destroying its identity.

Meaning of Renovation:- One of the meaning of the term ‘renovate’ which is appropriate in the present context, is to repair and plant an old building or a piece of furniture etc, so that it is in good condition.

The activity of erection, commissioning and installation is not restricted to installation and commissioning of any plant, machinery or equipment or structure, but it cover all items of installation service provided in respect of any goods.

It is evident from above definition that works contract services has covered almost all type of constructions whether it is of repair, alteration, renovation, restoration or building of civil structure no matter whether it is for commerce/industry or for residential purposes.

Guidelines to ascertain works contract: - There is no standard formula by which a “contract of sale” and “works contract” may be distinguished from one other. To ascertain whether a transaction is a works contract as contemplated in Article 366(29A)(b), the following points should be kept in mind that have emerged from various court decisions in regard to works contract:

- The essence of the contract or the reality of transaction as a whole has to be taken into consideration, in judging whether the contract is for a sale or for work and labour.
- If the thing to be delivered has any individual existence before the delivery as the sole property of the party who delivers it, then it is a sale.
- If the main object of the contract is the transfer from A to B, for a price, of the property in a thing in which B had no previous property, then the contract is a contract of sale.

- If the bulk of material used in the construction belongs to the manufacturer who sells the end product for a price that will be a stronger pointer to a conclusion that the contract is in substance one for the sale of goods and not one for work and labour.
- The nature of the contract has to be determined on the terms of the contract and not from the entries in the invoice. The invoice does not represent any transaction, nor is it evidence of a contract for work or for sale of goods.

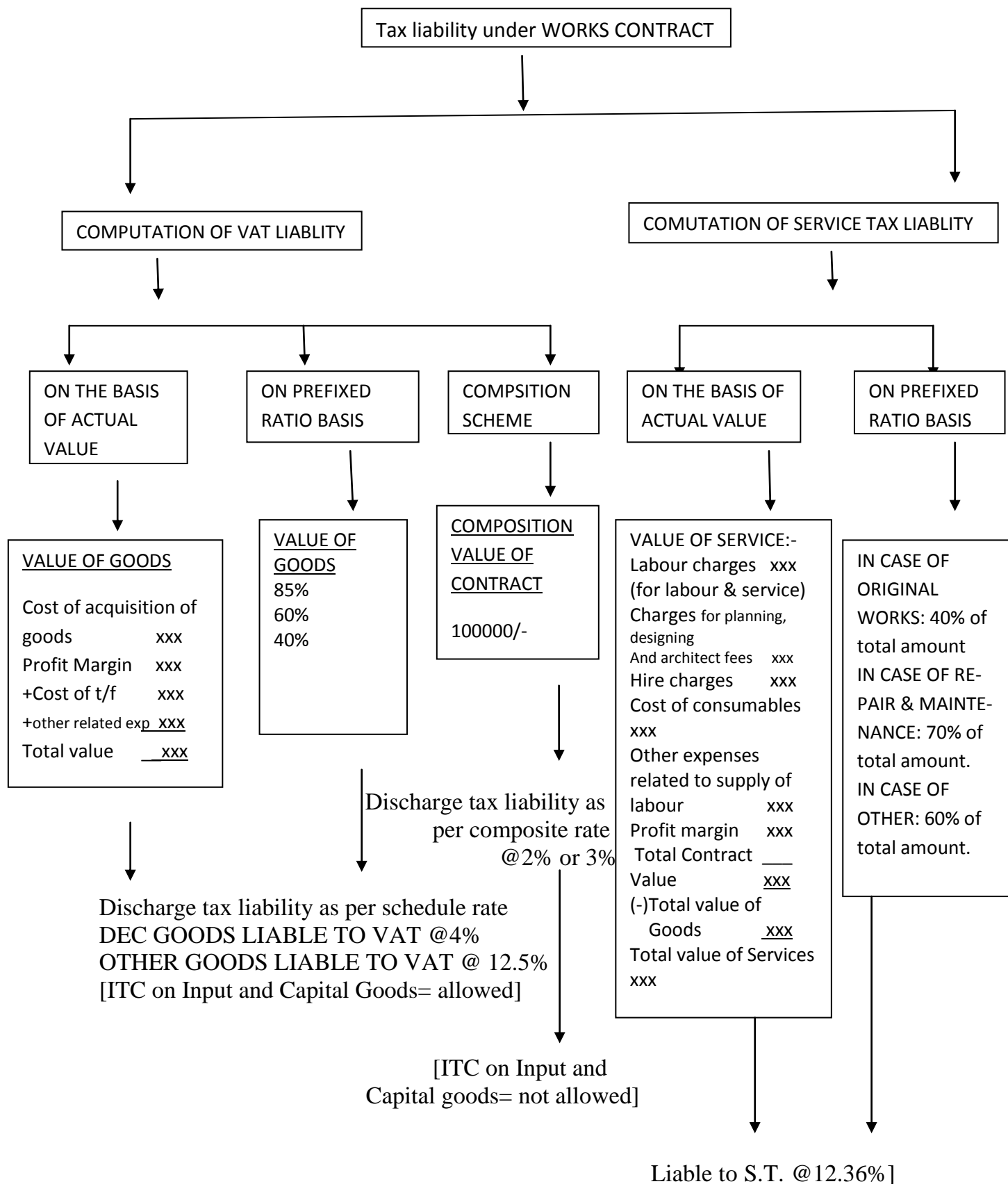
## **6.2 Taxability of Works Contract Service**

Clause (h) of section 66E specifies service portion in execution of works contract as taxable service. Thus tax is leviable only on the value of service portion of works contract. The manner of determining the value of services in works contract is provided in Rule 2A of the Valuation Rules, 2006

The provisions of valuation rules have been summarized as under: -

-TDS is deductible u/s 194C on total value of contract  
 -WCT is also deducted under state vat law,  
 -

Reverse charge is also applicable in case of service tax 50%-50%



Where the VAT has been paid/payable on actual value:-

**RULE 2A (i)**

Where the VAT has been paid on the actual value of goods transferred in execution of works contract, in such as case, value of service portion in the execution of a works contract shall be equivalent to the gross amount charged for the works contract less the value of property in goods transferred in the execution of the said works contract.

**RULE 2A (ii)**

Where value added tax or sales tax has been paid or payable on the actual value of property in goods transferred in the execution of the works contract, then, such value adopted for the purposes of payment of value added tax or sales tax, shall be taken as the value of property in goods transferred in the execution of the said works contract for determination of the value of service portion in the execution of works contract under this clause.

***Explanation:***

- (a) The gross amount charged for the works contract shall not include value added tax or sales tax, as the case may be, paid or payable, if any, on transfer of property in goods involved in the execution of the said works contract.
- (b) Value of works contract service shall include (The word include indicates that the list is illustrative in nature)
  - (i) Labour charges for execution of the works,
  - (ii) Amount paid to a sub-contractor for labour and services,

- (iii) Charges for planning, designing and architect's fees,
  - (iv) Charges for obtaining on hire or otherwise, machinery and tools used for the execution of the works contract,
  - (v) Cost of consumables such as water, electricity, fuel used in the execution of the works contract,
  - (vi) Cost of establishment of the contractor relatable to supply of labour and services,
  - (vii) Other similar expenses relatable to supply of labour and services, and
  - (viii) Profit earned by the service provider relatable to supply of labour and services;
- The provider of taxable service shall not take Cenvat credit of duties or cess paid on any inputs, used in or in relation to the said works contract, under the provisions of CENVAT Credit Rules, 2004. It is to be noted that the provider only will not be able to avail Cenvat credit on inputs; there is no restriction on service receiver.
  - Thus, there is restriction on availment of Cenvat credit on inputs and not on credit on input services or of capital goods. The logic behind not allowing Cenvat credit on inputs is that on the goods, VAT will be charged and that is a state subject. However Cenvat Credit Rules, 2004 excludes the following from the definition of Input Service as given in 2(l) of Cenvat Credit Rules, 04 as so far they are used for
    - a) Construction or Execution of Works contract of a building or a civil structure or a part thereof; or
    - b) Laying of foundation or making of structures for support of capital goods.

**Example:-**

- A Ltd enters into contract with B Ltd for execution of works contract for Rs 50,00,000 excluding taxes. The contract is divided into two parts, Rs 30,00,000 for goods portion and Rs 20,00,000 for service portion. The service tax is required to be paid at 12.36% on Rs 20,00,000.

Liability of Service Tax Where the VAT has not been paid / payable on actual value but is paid under composition scheme:-

- Where the value cannot be determined as per (i) above (i.e., VAT has been paid under composition scheme), in such a case, the person liable to pay tax on the service portion involved in the execution of the works contract shall determine the service tax payable in the following manner:-

Sr No	Situation	Value of Service in execution of works contract
A	In case of original works contract	40% of the total amount charged for works contract
B	In case of works contract entered into for maintenance or repair or reconditioning or restoration or servicing of any goods (Thus, activities relating to immovable property are not covered)	70% of the total amount charged for the works contract
C	Other works contract not covered by (A), or (B), above including maintenance, repair, completion and finishing services such as glazing, plastering, floor and wall tiling, installation of electrical fittings of an immovable property	60% of the total amount charged for the works contract

- The term 'original works' means:
  - (i) All new constructions;
  - (ii) All types of additions and alterations to abandoned or damaged structures on land that are required to make them workable;
  - (iii) Erection, commissioning or installation of plant, machinery or equipment or structures, whether pre- fabricated or otherwise;
- The term "total amount" means the sum total of the gross amount charged for the works contract and the fair market value of all goods and services supplied in or in relation to the execution of the works contract, whether or not supplied under the same contract or any other contract, after deducting-
  - (i) The amount charged for such goods or services, if any; and
  - (ii) The value added tax or sales tax, if any, levied thereon;

The fair market value of goods and services so supplied may be determined in accordance with the generally accepted accounting principles.

Example(s):-

- A Ltd enters into contract with B Ltd for execution of works contract for Rs 50,00,000 excluding taxes. There is no bifurcation in the contract. The VAT is charged as per composition scheme under works contract. In this case, the value of service will be 40% of Rs 50,00,000/- in case of original works.



- A Ltd enters into contract with B Ltd for execution of works contract for Rs 50,00,000 excluding taxes. There is no bifurcation in the contract. The VAT is charged as per composition scheme under works contract. In the contract, B Ltd has agreed to provide Cement to A Ltd worth 20,00,000. In this case, the value of service will be 40% of Rs 70,00,000/- in case of original works.
- A Ltd enters into contract with B Ltd for execution of works contract for Rs 50,00,000 excluding taxes. There is no bifurcation in the contract. The VAT is charged as per composition scheme under works contract. In the contract, B Ltd has agreed to provide Cement to A Ltd worth 20,00,000; however, for this, B Ltd will charge A Ltd Rs 15,00,000. In this case, the value of service will be 40% of Rs 55,00,000/- [ 50 lacs + 20 Lacs -15 Lacs] in case of original works.

## **6.2 Exemption to Works Contract Services for various project of general use**

Not all the works contracts are taxable. There are certain exemptions given for services of certain nature provided to certain person. The said exemption is given by way of Notification No 25/2012-ST dated 20-06- 2012. The list is as under:

❖ Services provided **to the Government, a local authority or a governmental authority** by way of construction, erection, commissioning, installation, completion, fitting out, repair, maintenance, renovation, or alteration of –

- a) A civil structure or any other original works meant predominantly for use other than for commerce, industry, or any other business or profession;
- b) A historical monument, archaeological site or remains of national importance, archaeological excavation, or antiquity specified under the Ancient Monuments and Archaeological Sites and Remains Act, 1958 (24 of 1958);
- c) A structure meant predominantly for use as:-
  - an educational,
  - a clinical, or
  - an art or cultural establishment;
- d) Canal, dam or other irrigation works;
- e) Pipeline, conduit or plant for
  - water supply
  - water treatment, or
  - sewerage treatment or disposal; or

f) A residential complex predominantly meant for self-use or the use of their employees or other persons specified in the Explanation 1 to clause 44 of section 65 B of the said Act, referred as under:

- The functions performed by the Members of Parliament, Members of State Legislative, Members of Panchayats, Members of Municipalities and Members of other local authorities who receive any consideration in performing the functions of that office as such member; or
- The duties performed by any person who holds any post in pursuance of the provisions of the Constitution in that capacity; or
- The duties performed by any person as a Chairperson or a Member or a Director in a body established by the Central Government or State Governments or local authority and who is not deemed as an employee before the commencement of section 65B. [Sr No 12 of Notification]

❖ Services provided by way of construction, erection, commissioning, installation, completion, fitting out, repair, maintenance, renovation, or alteration of,-

- (a) A road, bridge, tunnel, or terminal for road transportation for use by general public;
- (b) A civil structure or any other original works pertaining to a scheme under Jawaharlal Nehru National Urban Renewal Mission or Rajiv Awaas Yojana;
- (c) A building owned by an entity registered under section 12 AA of the Income tax Act, 1961(43 of 1961) and meant predominantly for religious use by general public;

- (d) A pollution control or effluent treatment plant, except located as a part of a factory; or
  - (e) A structure meant for funeral, burial or cremation of deceased; [Sr No 13 of Notification]
- ❖ Services by way of construction, erection, commissioning, or installation of original works pertaining to,
- (a) An airport, port or railways, including monorail or metro;
  - (b) A single residential unit otherwise than as a part of a residential complex;
  - (c) Low- cost houses up to a carpet area of 60 square metres per house in a housing project approved by competent authority empowered under the ‘Scheme of Affordable Housing in Partnership’ framed by the Ministry of Housing and Urban Poverty Alleviation, Government of India;
  - (d) Post- harvest storage infrastructure for agricultural produce including a cold storages for such purposes; or
  - (e) Mechanised food grain handling system, machinery or equipment for units processing agricultural produce as food stuff excluding alcoholic beverages; [Sr No 14 of Notification]

Works contract service provided by Sub-Contractor:- As per item no 29(b) of the notification No. 25/2012-ST dated 20-06-2012 sub contractor providing services by way of works contract is exempt from payment of Service Tax, provided such services are provided to main contractor who is also providing services of works contract which is exempt from payment of service tax. Thus following conditions must be satisfied for claiming exemption under this entry:-

- (a) The main contractor has provided the services classifiable under works contract which is exempt from payment of Service Tax. For Example: item no 12(a) exempts construction of civil or any other original works meant predominately for use other than commerce, industry or any other business or profession when the services are provided to Government, Local Authority, or Government Authority.

Thus say, person 'X' provides services of construction of building for Bhabha Atomic Research Centre falls under Department of Ministry of Government of India. The said construction would be exempt from payment of service tax under item no. 12(a).

- (b) Sub contractor 'Y' has provided services taxable under works contract. Further, assume in our example given in (a) above, that 'X' appoints sub-contractor 'Y' for providing construction service. If 'Y' provides the services without using any material, his services will not be classified under works contract category. Therefore, exemption from payment of service tax under this item will not be available to Sub contractor 'Y'. However, if sub contractor 'Y' uses the material, property of which is transferred to contractor 'X', the services provided by sub contractor 'Y' would be classified under Works Contract Category. Therefore exemption under this item would be available to sub-contractor 'Y'.

### Whether joint development liable?

One thing the assessee have to analyse is whether there exists a service provider who provides the works contract service and a service receiver who receives such service. In the absence of such service, there would not be a liability under service tax. Sometimes, the construction activity may not be undertaken on behalf of a client/customer but may be undertaken by the builder/developer on his own account and the constructed property sold to buyers.

In such situations, there would be no liability under service tax as there is no distinct service provider and service receiver and the builder/developer cannot provide service to himself. This has also been decided by the Gauhati High Court in *Magus Construction (P) Ltd Vs UOI* (2008 (05) LCX 0057).

The assessee are advised to be careful even where partly constructed property plus land is transferred to prospective buyers and then the remainder of construction work undertaken on their behalf as the entire amount involved in the project would not be liable to service tax because of the land and partly built up unit being sold/transferred to the buyers and then works contract service in relation to construction being provided. Due care is to be taken to ensure that the agreements are properly drawn up to indicate the various components and the amounts being charged for the same.

#### **6.4 Cenvat credit on inputs used in service portion of works contract**

In case of works contract service and also service of construction of residential/commercial flats and buildings, Cenvat Credit of service tax paid on input services and excise duty paid on capital goods will be available. However, no Cenvat credit of input goods is available in case falling under Rule 2A(ii), as explanation to rule 2A(ii) provides that the provider of taxable service shall not take CENVAT CREDIT of duties or cess paid on any inputs, used in or in relation to the said works contract, under the provisions of Cenvat Credit Rules, 04.

Scope of CENVAT CREDIT on inputs:-CENVAT CREDIT shall be allowed on inputs only in the case falling under Rule-2A(i) and that too, only in relation to inputs forming part of value of works contract service, in other words the ED paid on inputs wherein property is transferred in the execution of works contract, shall not be allowed as credit because such inputs does not form part of “Service Portion in the execution of a works contract” under Rule 2(K)(B) of the Cenvat Credit Rules, 04.

However credit of input services will be allowed subject to the definition of input service as defined in 2(l) of Cenvat Credit Rules, 04.

Definition of Input services as given in Cenvat Credit Rules, 2004 is given hereunder for having more clarity on availability of Cenvat credit on input services:-

#### **INPUT SERVICE means any service-**

- (i) Used by a provider of output service for providing an output service; or
- (ii) Used by a manufacturer, *whether directly or indirectly*, in or in relation to the manufacture of final products and clearances of final products upto the place of removal,

**And includes** services used in relation to-

- ⇒ Modernization, renovation or repairs of a factory, premises of provider of output service or an office relating to such factory premises,
- ⇒ Advertisement or sales promotion, market research,
- ⇒ Storage upto the place of removal, procurement of inputs,
- ⇒ Accounting, auditing, financing, recruitment and quality control, coaching and training, computer networking, credit rating, share registry,
- ⇒ Security, business exhibition, legal services,
- ⇒ Inward transportation of inputs or capital goods and outward transportation upto the place of removal;

**But excludes:-**

A. Service portion in the execution of a works contract and construction services including service listed under clause (b) of section 66E of the Finance Act in so far as they are used for-

- (a) Construction or execution of a Works Contract of a building or a civil structure or a part thereof;
- (b) Laying of foundation or making of structures for support of capital goods,

EXCEPT for the provision of one or more specified services; or

B. Services provided by way of renting of a Motor Vehicle, in so far as they relate to a motor vehicle, in so far as they relate to a motor vehicle which is not a capital goods; or



C. Services of a general insurance business, servicing repair and maintenance, in so far as they relate to a motor vehicle which is not a capital goods, except when used by-

(i) A manufacturer of a motor vehicle in respect of a motor vehicle manufactured by such person; or

(ii) An insurance company in respect of a motor vehicle insured or reinsured by such person; or

D. Such as those provided in relation to outdoor catering, beauty treatment, health services, cosmetics and plastic surgery, membership of a club, health and fitness centre, life insurance, health insurance and travel benefits extended to employees on vocation such as Leave or home travel concession, when such services are used primarily for personal use or composition of any employee.

## 6.5 Reverse Charge under Works Contract

Central government has power to notify the service and the extent of service tax payable each by the service receiver and service provider. In pursuance of this power, central govt has issued notification no 30/2012 dated 20.06.2012 under which responsibility of depositing tax is casted on the service receiver and service provider both in pre fixed proportion.

The idea behind this is whenever a service provider provides services to a organised sector service receiver has to deposit a certain % of service tax and consequently govt can catch the person providing the service and service provider in unorganised would not be able to evade the service tax.

In India, many of persons are working in unorganised sector and hence proper books of accounts are not maintained by them and even they are not aware about the various statutory laws casted on them, which cause difficulty to government in tracing the service providers who are liable to pay service tax. Reverse charge mechanism is very helpful in trapping such type of service providers.

As per **Notification no. 30/2012-ST, dated 20-06-2012**, the service tax in respect of works contract, if service provider is Individual, HUF, Proprietary or Partnership firm, AOP located in taxable territory and service receiver is Business Entity registered as body corporate located in the taxable territory, then the service tax is to the extent of 50% is payable by the service recipient and balance 50% by the service provider.

**Before applying this provision, it is necessary to understand what the body corporate does means, which is further elaborated here in detail.**

‘Body Corporate’ has meaning assigned to it in section 2(7) of companies Act, includes a company incorporated outside India, but does not include-

- (a) Corporation Sole,
- (b) Registered co-operative society,
- (c) Any other body corporate(except a company defined under companies Act) as may be notified by Central Government.

Society registered under the society registration act is not a body corporate:-The question whether a particular institution or body, other than that specified in sub clauses (a),(b),(c) of clause 7 of section 2, is a body corporate under the said act has to be decided with reference, among other things, to the status, mode of incorporation, constitution etc., of the institution.

Generally, the organisation would be considered as corporate body, i.e. a body which has been or is incorporated under some statute and which has a perpetual succession, a common seal and is a legal entity apart from the members constituting it, will come within the definition of the term ‘Body Corporate’.

In the light of the judgement of the Supreme Court in Board of Trustees v. State of Delhi AIR 1962 SC 458, such a society should not be deemed to be a ‘Body Corporate’ within the meaning of the aforesaid provisions of the Companies Act.

Consistent with the interpretation of the expression ‘Body Corporate’ as stated above, a society should be excluded from the scope of the expression ‘Body Corporate’ occurring in various provisions of the Companies Act.

### Body Corporate includes LLP

As per provisions of Rule 2(1)(d) of Service Tax rules, 1994 partnership firm includes limited liability partnership. It is evident from the said provisions that normally partnership will not cover LLP.

It has been clarified in Circular No 8(26)/2(27)/63-PR dated 13-03-1963 that body which has been or is incorporated under some statute and which has a perpetual succession, a common seal and is a legal entity apart from the members constituting it, it will be considered as body corporate. Section 3 of the LLP Act also provides as follows:-

- ◆ A limited liability partnership is a body corporate formed and incorporated under this act and is a legal entity apart from that of its partners.
- ◆ A limited liability partnership shall have perpetual succession.
- ◆ Any change in the partners of a limited liability partnership shall not affect the existence, rights or liabilities of the limited liability partnership.

Thus LLP has perpetual succession and has a separate legal entity. Any change in the constitution of the LLP doesn't affect the existence, rights or liabilities of the LLP.

The above view is further strengthened by *circular No. 30A/2011, dated 26/05/2011* issued by Ministry of Corporate Affairs in which it is further clarified that LLP is a body corporate as per Section 3(1) of the Limited Liability Partnership Act, 2008.

The provision relating to person liable to pay service tax in case of works contract services are summarized in the following table:-

<i><b>Sr No.</b></i>	<i><b>Service provider</b></i>	<i><b>Service receiver</b></i>	<i><b>Service tax payable by</b></i>
1	Individual, HUF, Proprietary firm, partnership firm, association of person located in taxable territory.	Business Entity registered as body corporate and located in taxable territory	Service receiver as well as service provider
2	Individual, HUF, Proprietary firm, partnership firm, association of person located in taxable territory.	Persons other than Business Entity registered as body corporate and located in taxable territory	Service provider
3	Company, Body Corporate, Society, Trust	Any person	Service provider
4	Any other service provider	Any service recipient	Service provider

It may be noted that in partial reverse charge mechanism the service receiver is not bound by the valuation adopted by the service provider, when the service tax liability is required to be shared between them. Since the liability of service receiver and service provider are different and independent of each other the service provider can independently avail or forgo abatement or choose a valuation option depending on the data available with the person.

### **Some important issues under Reverse charge:-**

*A company is licensed under section 25 of Companies Act. Would it be liable to pay service tax under reverse charge?*

In Great Lakes Institute of Management v. CST (2008) 12 STT 306 (CESTAT), it was prima facie held that a non-profit company incorporated under section 25 of Companies Act is not a undertaking any 'commercial' activity – confirmed in Great Lakes Institute of Management v. CST (2008) 12 STT 296 (CESTAT) – followed in CCE v. Karl Kubel Institute for Development Education (2009) 22 STT 513 (CESTAT SMB) \* CCE v. Badruka Institute of Foreign Trade (2010) 24 STT 575 (CESTAT) \* CCE v. Institute of Insurance and Risk Management (2010) 25 STT 234 (CESTAT).

Hence, it should not be liable to pay service tax under reverse charge.

*Would an educational institute be liable to pay service tax under reverse charge mechanism?*

A society or trust is not a body corporate. Even a company registered under section 25 is not 'business entity' and hence not liable under reverse charge.

The service provider of works contract service is not charging service tax in his invoice. Is the service receiver still liable to pay service tax? Is he required to pay entire 100% service tax?

The service provider may not be charging service tax for various reasons like turnover below ` 10 lakhs or carelessness or ignorance. Even then, the service receiver is liable to pay service tax on 50% of the amount. He is not liable to pay entire 100% service tax even if the service provider does not pay his portion of service tax,

*How the service provider should prepare his invoice where service receiver is liable for paying 50% of service tax?*

In his invoice he should charge only 50% of service tax and state that balance is payable by service receiver under Notification No. 30/2012-ST dated 20-6-2012.

The service provider has charged entire 100% service tax and we have paid it to him. Are we still liable to pay 50% service tax?

A statutory obligation cannot be passed on to other by mutual agreement. The service receiver will still be statutorily liable to pay service tax on 50% of amount (though it is possible that Appellate Authority or Tribunal may take lenient view in initial stages).

However, service receiver should not go for short cuts like asking service provider to pay entire service tax.

*Can the service provider and service receiver calculate value on different basis?*

Department has clarified as follows -

The service recipient would need to discharge liability only on the payments made by him. Thus the assessable value would be calculated on such payments done. (Free of cost material supplied and out of pocket expenses reimbursed or incurred on behalf, of the service provider need to be included in the assessable value in terms of Valuation Rules) The invoice raised by the service provider would normally indicate the abatement taken or method of valuation used for arriving at the taxable value.

However since the liability of the service provider and service recipient are different and independent of each other, the service recipient can independently avail or forgo abatement or choose a valuation option depending upon the ease, data available and economics.

However, as stated above, valuation under rule 2A (ii) of Valuation Rules (under composition scheme) is permissible only if valuation under rule 2A(i) [on actual basis] has not been done. Hence, if the service provider has made valuation under rule 2A(i), it will not be correct on part of service receiver to adopt rule 2A(ii) for valuation.

However, the service receiver is responsible for his part of valuation and his part of liability of service tax. Hence, if he is not satisfied with valuation done by service provider, he can do valuation independently.

## **6.6 Provisions relating to Point of Taxation**

Now it needs to be analyzed about the position of works contract which are ongoing as on 01-07-2012 i.e., the date on which Negative list came into force. The point at which the tax will be payable is governed by the provisions of Rule 3 of Point of Taxation Rules, 2011 the provisions of which are as under w.r.t continuous supply service.

- The point of taxation will be
  - Date when invoice is issued for services provided or to be provided; (invoice is required to be issued within 30 days, otherwise, the point of taxation will be the date of provision of service
  - Date when the payment is received for services provided or to be provided; **Whichever is earlier**
- In case of continuous supply of service where the provision of the whole or part of the service is determined periodically on the completion of an event in terms of a contract, which requires the receiver of service to make any payment to service provider, the date of completion of each such event as specified in the contract shall be deemed to be the date of completion of provision of service;



After change in provision with respect to works contract (i.e., on or after 01-07-2012), the following provisions will apply

(a) Works contract services provided upto 30-06-2012

Where the services has been provided before 30-06-2012 (before change in effective rate of tax) and

- The invoice for the same has been issued and the payment received on or after 01-07-2012 (after the change in effective rate of tax), the point of taxation shall be date of payment or issuing of invoice, whichever is earlier (i.e., the provisions on or after 01-07-2012 will apply); or
- Where the invoice has also been issued prior to change in effective rate of tax (i.e., upto 30-06-2012) but the payment is received after the change in effective rate of tax (i.e., on or after 01-07-2012) , the point of taxation shall be the date of issuing of invoice (i.e., provisions upto 30-06-2012 will apply); or
- Where the payment is also received before the change in effective rate of tax (i.e., upto 30-06-2012), but the invoice for the same has been issued after the change in effective rate of tax (i.e., on or after 01-07-2012), the point of taxation shall be the date of payment (i.e., provisions upto 30-06-2012 will apply);

(b) Works contract services provided on or after 01-07-2012

Where the services will be provided on or after 01-07-2012 (after change in effective rate of tax) and

- Where the invoice w.r.t services to be provided has been issued prior to the change in effective rate of tax (i.e., upto 30-06-2012) and the payment of which is received on or after 01-07-2012, then the point of taxation shall be the date of payment (i.e., the provision on or after 01-07-2012 will apply); or
- Where the invoice has also been raised after the change in effective rate of tax (i.e., on or after 01-07-2012), but the payment has been received before the change in effective rate of tax (i.e., upto 30-06-2012, the point of taxation shall be date of issuing of invoice. (i.e., the provision on or after 01-07-2012 will apply);
- Where the invoice has been issued and the payment for the invoice received before the change in effective rate of tax, the point of taxation shall be the date of receipt of payment or date of issuance of invoice, whichever is earlier. Thus, the payment and invoices w.r.t services which will be provided on or after 01-07-2012 has been made and received upto 30-06-2012, then the provisions upto 30-06-2012 will have to be followed.

Following implications can be drawn from above provision:-

- (i) The contractor who was constructing a residential complex having 12 or less than 12 residential units was exempted upto 30-06-2012. The said project is going on. Upto 30-06-2012, Rs 60,00,000 has been received and invoice of Rs 70,00,000 has been made. Thus, there will not be any service tax on 70,00,000.

There will not be service tax even on Rs 10,00,000 received after 01-07-2012 which was billed upto 30-06-2012 but the payment has not been received. [As per Rule 3 and 4 of Point of Taxation Rules, 2011 read with Circular No. 162/13 /2012 –ST dated 06-07-2012 issued vide F No F. No. 354/111/2012-TRU]

- (ii) Mr A provides painting service. The said service constitutes completion and finishing service and is also liable to works contract. i. There is a project going on. No advance has been received nor has any bill been made upto 30-06-2012. The service tax will have to be paid at 7.416% ( $12.36\% \times 60\%$ ) if the bill is made after 01-07-2012 w.r.t above service or payment is received after 01-07-2012.
- (iii) If in the above case, service has been completed on 28-06- 2012, then it is obligatory to issue invoice within 30 days, otherwise, the services will be deemed to have been provided on 28-06-2012 and service tax will have to be paid at 4.12% under the provisions upto 30-06-2012 (Rate of 4.12% under composition scheme).
- (iv) Mr A receives advance for the project on 28-06-2012 that is going to commence on 01-08-2012, in this case, the service tax is required to be paid at 7.416% ( $12.36\% \times 60\%$ ) as service will be provided on or after 01-07-2012 (change in effective rate of tax).

Contracts wherein value of land is included in the amount charged from service receiver.

- There is separate valuation Rule for valuation of works contract. Sr No 12 of Notification No 26/2012-ST dated 20.06.2012 as amended by Notification No 2/2013 w.e.f. 01.03.2013 provides abatement in case where amount charged from buyer includes cost of land which is as under:
  - 75% abatement is provided for services provided in case of construction of complex, building, civil structure or a part thereof, intended for a sale to a buyer, wholly or partly except where entire consideration is received after issuance of completion certificate by the competent authority where the residential unit is having a carpet area upto 2000 Sq Feet or where the amount charged is less than Rs 1 crore.
  - 70% abatement in other cases
- Notification 30/2012-ST mandates a service receiver to make payment of service tax of 50% as a recipient of service in case service is provided by an individual, HUF, AOP, BOI to a Body Corporate.
- A question that arises is whether reverse charge will also be applicable in case where abatement is claimed by provider as the value of land is included in the total amount received.
- In this case, even though abatement is claimed, it does not cease to be works contract. Abatement of 75% / 70% is provided because the amount received from customers include the value of land.

In other cases, the value will be 40% in case of original works and where the amount received include the value of land, the effective taxable value will be 25% or 30% of the total amount received.

- There is less tax in case of abatement is because it includes value of land. Where the value of land is not there, then it becomes a composite contract with material and services wherein on material portion, vat or sales tax will be levied and on service portion, service tax will be levied. In case of a composite contract which also includes value of land, in such case, vat or sales tax will be levied and on service portion, service tax will be levied and on land portion, nothing will be levied. Land is not goods. Vat is levied on goods. Similarly, sell of land is also not a service as per the definition of service which reads as "service" means any activity carried out by a person for another for consideration, and includes a declared service, but shall not include—

⇒ An activity which constitutes merely,—

A transfer of title in goods or immovable property, by way of sale, gift or in any other manner; or [Sec 65B(44) of the Finance Act, 1994]’

- Thus, as land is neither goods nor service and as a result, VAT or service tax cannot be levied on the same. As a result, higher deduction in value is given by way of abatement where the contract includes value of land.
- It is to be noted that where service tax is paid under works contract as per Rule 2A of Service Tax (Determination of Value) Rules, 2006 or by claiming abatement:
  - The Cenvat credit of inputs shall not be available
  - The Cenvat credit of input services is available subject to restrictions, if any.

## **6.7 Where services is provided by Government**

As per clause (a) of section 66D services provided by Government except four services specified in sub clause (i) to (iv) are non taxable. Sub clause (iv) specifies support service as taxable service provided by Government. The definition of support service is given in section 65B(49) which inter-alia includes service by works contract provided by Government. Therefore, works contract services provided by Govt or local authority will be considered as support services.

## **6.8 Circulars/notifications and Court Decisions**

As we have discussed earlier there is lots of confusions in market for the taxability of works contract services, to clear these confusions or to explain the scope of taxable services and the scheme of service tax CBEC (Central Board of Excise and Customs) issues circulars or instructions letters from time to time.

Further, section 93 and 94 of chapter V and section 96-I of chapter VA of the Finance Act, 1994 empower the Central Government to issue notifications to exempt any service from service tax and to make rules to implement service tax provisions. Accordingly, notifications on service tax have been issued by the Central Government from time to time.

These notifications usually declare date of enforceability of service tax provisions, provide rules relating to service tax, make amendments therein, provide or withdraw exemptions from service tax or deal with any other matter which the Central Government may think would facilitate the governance of service tax matters.

In respect to works contract services also some circulars or notification has been issued by the Central Government to provide clarity on some disputed issues and to make rules for taxation of Works Contract Services.

Some of the important circulars and notification are discussed hereunder:-

✓ **Circular No. 138/07/2011 dated 06.05.2011 Exemption under service tax shall depend on the classification of services**

*If the service provider is providing Works Contract Services in respect of construction of Dams, Tunnels, Roads Bridges etc. then aforementioned works contract services are exempt from Service Tax. However, such works contract services providers engage sub contractors who provide services such as Architect's services, consulting engineers services, construction of complex services, design services, erection, commissioning or installation services, Management, maintenance or repairs services etc. The representations by Jaiprakash Associates Limited seeks to extend the benefit of such exemption to the sub contractors providing various services to the WCS provider by arguing that the service provided by the sub-contractors are in relation to the exempted works contract service and hence they deserve classification under WCS itself.*

In respect of above situation, it has been clarified in Circular No 138/07/2011 dated 06.05.2011 that services received by works contract service provider from its sub contractors are distinctly classifiable under the respective sub clauses of 65(105) of the Finance Act by their description. When a descriptive sub clause is available for classification, the service cannot be classified under another sub clause which is generic in nature. As such, the services that are being provided by the sub contractors of Works Contract Service Providers are classifiable under the respective heads and not under Works Contract Services.

Therefore, it is clarified that the services provided by the sub contractors/consultants and other service providers are classifiable as per section 65A of the Finance Act, 1994 under respective sub clauses of clause (105) of section 65 and chargeable to service tax accordingly.

## **Clarification by Department**

- (i) Section 65A of the Finance Act, 1994 provides for classification of taxable services, which mention that classification of taxable services shall be determined accordingly to the terms of the sub clauses (105) of section 65. When for any reason, a taxable service is prima facie, classifiable under two or more sub clauses of clause (105) of section 65, classification shall be effected under the sub clause which provides the most specific description and not the sub clauses that provide a more general description.
- (ii) In this case the service provider is providing WCS and he in turn is receiving various services like Architect service, consulting engineers service, construction of complex, design service, erection, commissioning or installation, management, maintenance or repair etc, which are used by him in providing output service. The services received by the WCS provider from its sub contractors are distinctly classifiable under the respective sub clauses of section 65(105) of the Finance Act by their description. When a descriptive sub clause is available for classification, the service cannot be classified under another sub clause which is generic in nature. As such, the services that are being provided by the sub-contractors of WCS providers are classifiable under the respective heads and not under WCS.
- (iii) Attention is also invited to Circular No 96/07/2007- ST, dated 23<sup>rd</sup> August 2007 regarding clarification on technical issues relating to taxation of services under the Finance Act, 1994. The relevant portion is reproduced below,-



*A taxable service provider outsources a part of the work by engaging another service provider, generally known as sub-contractor. Service tax is paid by the service provider for the total work. In such cases, whether service tax is liable to be paid by the service provider known as sub contractor who undertakes only part of the whole work. A sub- contractor is essentially a taxable service provider. The fact that services provided by such sub-contractors are used by the main service provider for completion of his work does not in any way alter the fact of provision of taxable services by the sub-contractor. Services provided by sub contractors are in the nature of input services.*

Service tax is, therefore liveable on any taxable services provided, whether or not the services are provided by a person in his capacity as a sub-contractor and whether or not such services are used as input services. The fact that a given taxable service is intended for use as an input service by another service provider does not alter the taxability of the service provided.

Therefore, it is clarified that the services provided by the sub contractors/ consultants and other service provider are classifiable as per section 65 A of the Finance Act, 1994 under respective sub clauses (105) of section 65 of the Finance Act, 1994 and chargeable to Service Tax accordingly.

✓ **Partial Modification of clarification given in Circular NO 138/07/2011 dated 06-05-2011**

In partial modification of clarification given in Circular No . 138/07/2011 dated 06-05-2011 that if service provided by the subcontractors to the main contractor are independently classifiable under WCS, then they will also not subject to levy of service tax. The relevant extract of above mentioned Circular no 147/16/2011 is given below for ready reference:-

*“it may happen that the main infrastructure projects of execution of works contract in respect of roads, railways, airports, transport terminals, bridges, tunnels and dams, is sub divided into several sub-project is assigned by the main contractor to the various sub contractors . in such a case if the sub contractors are providing works contract service to the main contract, then service tax is obviously not liveable on the works contract service provided by such sub-contractor.”*

✓ **Notification No 35/2012-ST dated 20.06.2012**

***Composition Scheme For Payment of Service Tax by Service Providers Providing Services In Execution of Works Contract with effect from 01.06.2007. (The composition scheme has been rescinded w.e.f. vide Notification No 35/2012 dated 20.06.2012)***

A composition scheme has been introduces for service providers providing services in execution of works contract. These service providers have been given an option to pay service tax @4.8% [4% from 01.03.2008 to 31.03.2012 and 2% from 01.06.2007 to 29.02.2008] of the gross amount of the works contract. However, according to explanation to Rule 3(1) of Works Contract (Composition Scheme for payment of service tax) Rules, 2007, the gross amount of Works Contract shall not include Value Added Tax (VAT) or sales tax, as the case may be,

paid on transfer of property in goods involved in execution of the said works contract.

1. The said explanation has been substituted by Notification No 23/2009-ST Dated 07.07.2009 according to the new explanation gross amount charged for the works contract shall be the sum including :-

- (i) **value of all goods** used in or in relation to the execution of the works contract, whether supplied under any other contract for a consideration or otherwise; and
- (ii) **value of all the services** that are required to be provided for the execution of the works contract; and
- (iii) **charges for obtaining machinery and tools** used in execution of said works contract **on hire**.

However, the gross amount charged for the works contract shall exclude-

- (i) VAT/ Sales tax paid on transfer of property in goods involved in execution of the said works contract; and
- (ii) The cost of machinery and tools used in the execution of the said works contract.

Thus, with effect from 07.07.2009, value of material supplied by the contractee to the contractor for use in the execution of works contract shall be included in the value of works contract for payment of service tax under the composition scheme.

**Hence, composition scheme would be available only to those works contracts where the gross value of works contract includes value of all goods used in relation to the execution of works contract whether received free of cost or for consideration under any other contract.**

It is to be noted that the said substituted explanation is applicable only with effect from 07.07.2009. Hence it shall not apply to current works contract. In other words, where the execution under the contract has commenced or where any payment, (except by way of credit or debit to any account) has been made in relation to the said contract on or before 07.07.2009, the gross amount charged shall have to be calculated as per erstwhile explanation only.

With this explanation effective with effect from 07.07.2009, the lacuna in respect of free supply of material and in respect of separate sale contract and works contracts have been plugged. Thus, now after the said amendment, value of goods received free of cost from the client shall be included in the gross amount charged. Further, total value of goods used in the works contract, whether the main contract is spitted into a sale contract (for a portion of goods required to execute the works contract) and works contract (for only a portion of the total value of goods and labour charges), thus reducing the value of works contract for the purposes of calculating service tax.

**Important Case Laws giving significant decisions on taxability of works contract services:-**

**➤ KONE ELEVATOR INDIA PVT LTD V/S STATE OF ANDHRA PRADESH**

The constitution bench of the Hon'ble Supreme Court held that:-

- In the case of lift/elevators, the contracts involve obligation to supply goods and material as well as installation of lift/elevators, thereby it satisfies the fundamental characteristics of a Works Contract.
- Principal of 'dominant nature test' laid down in BSNL decision is not relevant for 'Works Contract' transactions after *Larsen & Turbo* judgment [2014(34)S.T.R. 481(S.C.) = 2014(303) E.L.T.3(S.C.)]

- Four concepts were emerged for 'works contract'
  - \* Works contract is an indivisible contract but, by legal fiction, is divided into two parts, one for sale of goods, and the other for supply of labour and service;
  - \* Concept of “dominant nature test” or, for that matter, the “degree of intention test” or “overwhelming component test” for treating a contract as a works contract is not applicable;
  - \* Term ‘Works Contract’ as used in Clause(29A) of Article 366 of the constitution takes in its sweep all genre of works contract and is not to be narrowly construed to cover one species of contract to provide for labour and service alone;
  - \* Once the characteristics of works contract are met within a contract entered into between the parties, *any additional obligation incorporated in the contract would not change the nature of the contract.*

In view of the above decision of the hon'ble supreme court, the natural question that comes to mind is,

When the main objective of the transaction is a sale contract, can there be a separate works contract?

Will not amount to selling twice by one person to another person under one sale transaction?

Once as deemed sale under works contracts (sale of the materials transferred in the course of execution of works contract) and again as normal sale(sale of lift/flat)under sale contract?

The deemed sale concept enshrined in article 366(29A)(B) covers the transfer of property in the course of execution of works contract. The property in goods is transferred when the ownership is transferred by way of deeming fiction. This can happen when there is no further sale after the completion of works contracts.

When the contractor constructs a building for the owner, it is works contract and the deeming fiction price and there is deemed sale of the goods transferred in course of execution of works contract. This is because of the fact that after completion of works contract there is no further sale by the contractor again. So there is only one sale. But if the constructed building is also sold by the contractor/person who has executed the works contract, then as per the *Kone and L&T* decision, there will be two sales by the same person to the same buyer under one transaction. First sale is deemed sale of the property transferred as works contract and again the sale of the building/lift as per the sale contract.

The inter value of the lift/flat is covered by the sale transaction. In that case, can there be any segment of the transaction, which can regard as works contract? It is by hyper technical interpretation the property in the construction material or the supply/installation of lift gets transferred to the customer any time prior to the sale of the flats or the lift as per sale contract.

The supreme court in builders' association of India V. State of Karnataka, 2002-TIOL-602-SC-CT, has examined the legislative history of the 46<sup>th</sup> constitutional amendment and held that it was brought into existence to overcome the implication of the *Gannon Dunkerly* case. In that case the contractor was constructing building on the land of the customer. The Supreme Court had held that the property in the goods gets transferred by way of incorporation in the works contract and there is no sale of either the construction materials for the entire building. The constitutional amendments refer to transfer of property in goods involved in the execution of Works Contract when there is no sale of the entire building. Such transfer is deemed to be sale of the goods because the works contractor does not sell the entire building.

If a person constructs a building and sells it, then it is a sale of building and hence a works contract does not apply. If the works contract still applies by hyper technical interpretation of law, then there will be two sales. One that of the building material in course of execution of works contract and the second is the building itself which already includes the value of deemed sale.

The bench, in builders' association case, held that the property passes when the materials are incorporated in the works contract. It reiterated the view that there is deemed sale of the goods involved in the execution of the works contract and not of the conglomerate i.e. the entire building that is constructed. Therefore, the transactions for sale of "lift" or "flat" being classified as works contract in *Kone/L&T* case is not in consonance with the type of works contract covered by the 46<sup>th</sup> constitutional amendment described in the building' association case.

The thread of reasoning that runs through the constitutional amendment does not warrant a single transaction to be classified both as works contract and also a sale contract. The concept of deemed sale would apply only to those transactions where property in the goods used in the course of execution of works contract gets transferred to the customer by way of incorporation or accretion to the customer's property. This is the situation involved in the first *Gannon Dunkerly* case, which was sought to be overcome by the constitutional amendment. The subsequent benches have interpreted its deeming provision for Works Contract in this manner. But nowhere a sale contract is classified as works contract resulting in the incidence of sale twice against a single transaction.

➤ **NAGARJUNA CONSTN. CO. LTD. *Versus* GOVERNMENT OF INDIA 2012(28) S.T.R. 561 (S.C.)**

Where Service Tax has already been paid prior to 01.06.2007, option to pay service tax under the Composition Scheme cannot be exercised

Honourable supreme court of the India, vide its order dated 09.11.2012, in the case of Nagarjuna Construction Co Ltd. Vs Government of India 2012(28) S.T.R. 561(S.C.), while dismissing the appeal of the appellant, observed as follows:

“27. On perusal of Rule 3(3) of the 2007 Rules it is very clear that the assessee who wants to avail of the benefit under Rule 3 of the 2007 Rules must opt to pay service tax in respect of a works contract before payment of service tax in respect of the works contract and the option so exercised is to be applied to the entire works contract and the assessee is not permitted to change the option till they said works contract is completed.

29. We do not accept the submission of the learned counsel appearing for the appellant that the Impugned Circular is discriminatory in nature. Those who had paid tax as per the provisions and classification existing prior to 1st June, 2007 and those who opted for payment of tax under the provisions of Rule 3 of the 2007 Rules and paid tax before exercising the option belong to different classes and, therefore, it cannot be said that the Impugned Circular or the provisions of Rule 3(3) of the 2007 Rules are discriminatory.”



➤ **Decisions by various courts on the issue that Works contract cannot be subject to service tax prior to 01.06.2007**

- ◆ Cemex Engineers Vs Commissioner of Service Tax, Cochin 2010(17) S.T.R. 534(Tri-Bang)
- ◆ Commissioner of service tax, Bangalore Vs Turbotech Precision Engineering Pvt Ltd 2010 (18) S.T.R. 545(Kar)
- ◆ ABB Ltd Vs Commissioner of Service Tax, Bangalore 2010(10) S.T.R. 610 (Tri-Bang)

➤ **Cemex Engineers Vs Commissioner of Service Tax, Cochin 2010(17) S.T.R. 534(Tri-Bang)**

Honourable tribunal, Bangalore vide its order dated 31.03.2009, in the case of Cemex Engineers Vs Commissioner of Service Tax, Cochin 2010(17) S.T.R. 534(Tri-Bang), while allowing the appeal of the appellant, observed as follows:

“The point in the issue in the show cause notice is with regard to the availment of Notification No.15/2004 and 8/2005, in terms of which an abatement of 67% on taxable value was claimed and further, the inclusion of the value of the materials supplied by the service recipient. The revenue has interpreted the explanation to the Notification to mean that the value of the materials supplied should be included.”

“The appellant has elaborately argued that the words ‘supplied’ or ‘provided’ or ‘used’ would only indicate the materials supplied by the construction service provider, who is the appellant and it would definitely not mean the value of the material supplied by the recipient of the service. In support of the above contention, the decision of the Hon’ble High Court of Madras in the case of Larsen and Toubro Ltd. Vs UOI(supra) was relied on.”

“...insisting on including the cost of materials supplied by service receiver will be contrary to Section 67 of the Finance Act, according to which, the value of the taxable services shall be the gross amount charged by the service provider for such service. The cost of materials supplied by the service receiver would not be covered in terms of Section 67. Moreover the said Section provides for exclusion of cost of materials in respect of such services. Another important legal contention taken by the appellant is that they had been registered under ‘Works Contract’ provisions for the purpose of sales tax. They have produced the certification of registration. It is also stated that the works contract came into service tax net only with effect from 1-6-2007.”

**4.1** The period involved in the present case is from 1-10-2005 to 31-3-2006. Therefore, legally works contract cannot be liable to service tax prior to 1-6-2007. In such circumstances, no Service Tax is liveable in respect of the works contract carried out by the appellant during the relevant period. On this ground also the impugned order has no merits. Hence, the same is set aside and the appeal is allowed with consequential relief.”

➤ **Commissioner of service tax, Bangalore Vs Turbotech Precision Engineering Pvt Ltd 2010 (18) S.T.R. 545(Kar)**

Honourable High Court of Karnataka, vide its order dated 15.04.2010, in the case of Commissioner of service tax, Bangalore Vs Turbotech Precision Engineering Pvt Ltd 2010 (18) S.T.R. 545(Kar), while dismissing the appeal by Revenue observed as follows:

“**8.** From the combined reading of the definition of Consulting engineer prior to 2006 and after 2006, it is clear to the Court that the service rendered by the Company had not been included under the definition of consulting engineer prior to 2006 as it stood under Section 65(13). As a matter of fact, this Court has decided the said point in CEA 12/2007 on 1st April 2010 stating that prior to the Amendment Act, 2006; the Companies were not included under the definition of consulting engineer.

When we have taken such a view, considering the relevant assessment year in the present case we have to hold that the service rendered by the assessee-Company during relevant period cannot be brought under the category of consulting engineer. If the service rendered by the assessee cannot be considered as a consulting engineer, the question of calling upon the assessee to pay the service tax under the Finance Act, brought the assessee under the word consulting engineer does not arise at all. Therefore, the said point has to be answered against the revenue and in favour of the assessee.

**10.** This section has come into force with effect from 1-6-2007. After considering the contract entered into between the assessee and its employer, the case of the assessee falls under Section 65(105)(zzzza) Explanation (a) and (e). Even though the assessee's case falls under the definition of works contract, but the revenue has no power to call upon the assessee to pay service tax, interest and penalty therein, since the provisions of law has come into force with effect from 1-6-2007.

➤ ABB Ltd Vs Commissioner of Service Tax, Bangalore 2010(10) S.T.R. 610 (Tri-Bang)

Honourable tribunal, Bangalore, vide its order dated 19.07.2010 in the case of ABB Ltd Vs Commissioner of Service Tax, Bangalore 2010(10) S.T.R. 610 (Tri-Bang) while allowing the appeal of the appellant, observed as follows:

“turnkey projects including engineering and procurement and construction or commissioning projects were considered as works contract. From the combined reading of the three contracts entered by M/s. Power Grid Corporation for the purpose of execution of turnkey project, it can be noticed that these three agreements would satisfy the definition of works contract as envisaged under Section 65(105)(zzzza) of the Finance Act 1994. If that be so, the service tax liability if any will be on the appellants from 1-6-2007. It is also be to noticed that the CBEC vide Circular No. B1/16/2007-TRU dated 22-5-2007 has in paragraph 9.9 and 9.10 has clarified as under:-

“Presently, erection, commissioning or installation service [Section 65(105)(zzd)], commercial or industrial construction service [section 65(105)(zzq)] and construction of complex service [section 65(105)(zzzh)] are separate taxable services.

9.9 Various trade and industry associations have raised apprehension in respect of classification of a contract either under the newly introduced works contract service or under erection, commissioning or installation and commercial or residential construction services.

9.10 Contracts which are treated as works contract for the purpose of levy of VAT/sales tax shall also be treated as works contract for the purpose of levy of service tax. This is clear from the definition under section 65(105)(zzzza).”

**“18.** We find that on this basic issue whether the contract in question would be a “works contract” or “any other contract”, matter could be decided. If no service tax liability arises on a agreement, which is to be considered as works contract and as understood by contractual parties and State Government, and also on the face of clarification given by CBEC clarifying as to, that a contract which is treated as a works contract for the purpose of levy of VAT/Sales Tax shall be treated as works contract for the purpose of levy of service tax, in our considered view revenue has no case in the issue before us.”

➤ **M/s Alidhara Texspin Engineers Vs CCE & CC, Vapi 2010(20) S.T.R. 315**

Where the entire contract value is taken as an assessable value for the purpose of payment of excise duty, no service tax is liable to be paid by the assessee.

Honourable Tribunal, Ahmedabad, vide its order dated 24.08.2010, in the case of M/s Alidhara Texspin Engineers Vs CCE & CC, Vapi 2010(20) S.T.R. 315 (Tri-Ahmd.) while allowing the appeal of the appellant, observed as follows:

“.....where an activity so Integrarely related and connected with the manufacturing activity and the purchase orders are for the complete plant and machineries, duty commissioned, without sowing any segregated amount recovered for erection and commissioning and where the entire contract value is taken as an assessable value for the purpose of payment of excise duty, no service tax is liable to be paid by the assessee. The decision of the Tribunal in the case of Lincon Helios (India) Limited relied upon by the Commissioner in his impugned order laying to the contrary, cannot be followed in as much as the same stands rendered by a Single Member Bench in Contradiction to the Divisional Bench Judgement available in the case of Allengers Medical Systems limited(referred supra). Further the said judgment in the case of *Lincoln Helios (India) Limited* was rendered in the year 2006 whereas the *Allengers Medical Systems* judgment stands passed in the year 2009, which stands passed after considering the Hon’ble Supreme Court judgment in the case of *State of Andhra Pradesh v. Kone Elevators (India) Limited* - 2005 (181) [E.L.T.](#) 156 (S.C.), as also Tribunal decision in the case of *Idea Mobile Communications Limited v. Commissioner* - 2006 (4) [S.T.R.](#) 132 (Tribunal)

**15.** In view of our above discussions, we hold that appellants were not liable to pay any service tax. Accordingly, the impugned order confirming the demand and imposing penalties upon them is set-aside and appeal is allowed with consequential relief. Inasmuch as we have allowed the appeal on mere, the issue of demand being barred by limitation is only of academic interest and it's not being gone into."

➤ **CCE Raipur Vs M/s BSBK Pvt Ltd 2010(18) S.T.R. 555(Tri-L.B.)**  
**Composite Contracts can be vivisected (Daelim Case overruled)**

Honourable Tribunal, Delhi, vide its order dated 06.05.2010, in the case of CCE, Raipur Vs BSBK Pvt Ltd 2010(18) S.T.R. 555 held as follows:-

**"11.** In view of the legal and Constitutional provisions it can irresistibly be concluded that a contract whether composite or Turnkey may involve an activity or cluster of activities in the nature of services and such services may be provided in the course of execution of such contracts while incorporating goods into the contract concerned. Such discernible services may be advice, consultancy or technical assistance and depending upon the nature of the activity, they may be classifiable under appropriate category of taxable service under Section 65A of the Finance Act, 1994. When Article 366(29-A)(b) to the Constitution has made indivisible contracts of the aforesaid nature divisible to find out goods component and value thereof, it can be unambiguously be stated that the remnant part of the contract may be attributable to the scope of service tax under the Provisions of Finance Act, 1994.

**12.** On the aforesaid legal and Constitutional background as well for the reasons stated, the Reference may be answered stating that turnkey contracts can be vivisected and discernible service elements involved therein can be segregated and classifiable as well as valued for levy service tax under Finance Act, 1994 provided such services are taxable services as defined by that Act and depending on the facts and circumstance of each case, services by way of advice, consultancy or technical assistance in the case of turnkey contract shall attract service tax liability.”

➤ **Blue Star Ltd V/s CCE, Hyderabad- II Consideration received for execution of Works Contract cannot be vivisected and part of it cannot be subject to tax**

Honourable Tribunal, Bangalore, vide its order dated 12.11.2007, in the case of Blue Star ltd Vs CCE, Hyderabad-II, 2007 (8) STJ 440 (CESTAT- Bangalore), while allowing the appeal of the appellant, observed as follows:

“7. On a very careful consideration of the issue, we find that the appellants had already discharged duty liability on that portion of the value of the gross amount received attributable to the services rendered but the Revenue is disputing the computation of the value at certain percentages. While demanding the differential duty, we find that the entire contract value has been taken to arrive at the Service Tax liability. The appellants have contended that 80 to 90% of the contract value is attributable to the value of the various goods supplied to the appellants who are undertaking the services of supply, installation, erection, commissioning of Air Conditioning Plants. We find that the demand of Service Tax on the entire amount received under the contract is not at all justified. Moreover, the fact that the appellants entered into Works Contract is not in dispute. It has been pointed out that even the State Government authorities have registered the contract as Works Contract. Further, the same issue has been decided in the appellant’s favour in the Final Order No. 1727/2006 dated 9-10-2006. Therefore, the Bench is bound to fol-

low the ratio of the above mentioned order passed by the Bench. Reliance has been placed on the decision of the Tribunal in the case of *CCE&C v. Larsen & Toubro Ltd.* - 2006 (4) [S.T.R.](#) 63 (Tri.) = 2006 (4) STT 12 (CESTAT- Mumbai) and also the *Daelim Industrial Co. Ltd. v. CCE, Vadodara* and *Larsen & Toubro Ltd. v. CCE, Cochin* - [2006 (3) [S.T.R.](#) 223 (Tri.-Del.) = 2004 (174) [E.L.T.](#) 322 (Tri.-Del.)] by Delhi (sic). Following the ratios of the above cases, the appeal of the appellants has been allowed with consequential relief. In view of the above, there is no justification for demanding duty on the entire gross receipt. Hence, we set aside the impugned order and allow the appeal with consequential relief, if any.

## 6.9 Practical Issues

Some of the practical problems which are being faced by the service providers are discussed hereunder with their solutions:-

Valuation of Works Contract Service where the contractor uses goods supplied by the service recipient **free of cost**:-

As regards classification of works contract service, it is submitted that definition of works contract service has been worded keeping in view of provision contained in sub clause (d) of clause (29A) of Art. 366 of the Constitution of India, inserted by Section 4 of the Constitution Act, 1982.

On perusal of the various sub clauses of clause 29A of Art, 366 of the Constitution of India, it is evident that the supplies or delivery of goods in transactions mentioned therein are declared as 'deemed sale' for the purpose of taxation. Thus, a legal fiction has been created in order to tax the services as transaction of sale or purchase of goods. It, therefore, appears that it will not be legally correct to test such transactions strictly on the principles of sale or purchase of goods. Moreover, the constitutional provision authorizes taxation of goods involved in the execution of works contract by the States as sale of goods. Under the circumstances, the ownership of goods involved in execution of works contract before delivery of the



same to the service recipient as goods or in some other form is not a relevant consideration for classification of works contract in our view. However, the issue can be debated in the light of use of the words 'Transfer of property in goods' in sub clause (b) of clause (29A) of Art. 366 of the Constitution.

As regards to valuation for the purpose of levy of Service Tax, we are of the opinion that the value of goods and materials supplied by the service recipient free of cost to the service provider for use in execution of works contract can be treated as consideration for providing service in execution of works contract only in cases where the service provider has asked for such supplies and the same is accounted for in the books of accounts of the service provider. In this connection, reference can be made to the larger bench of the Hon'ble Tribunal judgement in the case of *Bhayana Builders Pvt Ltd v. CST* [2013 (32) S.T.R. 49 (Tri. LB)].

As pointed out in the query, the valuation of works contract service is required to be done as per the provisions contained in Rule 2A of the Service Tax (Determination of Value) Rules 2006, value of service portion in the execution of works contract to be included in the value of taxable service. As per provisions contained in clause (i) of the Service Tax Rules, 2006, value of service portion in the execution of a works contract shall be equivalent to the gross amount charged for the works contract less the value of property in goods transferred in the execution of the said works contract and clause (c) of the explanation below the said clause (i) of Rule 2A provides that where value added tax or sales tax has been paid or payable on the actual value of property in goods transferred in the execution of works contract, then, such value adopted for the purposes of payment of value added tax or sales tax, is to be taken as the value of property in goods transferred in the execution of the said works contract for determination of value of the service portion in the execution of works contract under this clause. Thus it is felt in those cases where Sales Tax/ VAT is not payable or paid on the value of goods or materials supplied free of cost, the fair value of such goods or materials is required to be taxed as value of service which is apparently impermissible in law because the charging section for levy of Service Tax does not authorise such levy on value of goods, in our opinion.

In addition, it is submitted that statutory provisions for valuation of taxable service are contained in Section 67 of the Finance Act, 1994. A bare reading of the said provision reveals that the value of taxable service for levy of service tax is the gross amount including money value of consideration charged and received or to be received by the service provider for providing such service.

In view of the above discussions, we are of the view that value of goods and materials supplied free of cost to the service provider for use in execution of works contract is not includible in the gross amount for levy of Service Tax in cases where property in such goods is not transferred to the service provider by the supplier of such goods. In this connection reference can be made to Hon'ble Delhi High Court judgements in the case of *Era Infra Engineering Ltd v. UOI* [2008(11) STR 3 (Del.)] and in *Intercontinental Consultants & Technocrats pvt Ltd v. UOI* [2013 (29) S.T.R. 9(Del)].

In all these judgements, similar or identical provisions made in the Rules/ Notifications have been practically struck down by the courts.

Problem faced by assessee due to Reverse Charge where industry is already facing increased input costs:-

The liability to pay service tax on reverse charge basis is partly on the service provider and partly on the service recipient on certain specified services provided by non-body corporate such as cab services for employee transportation, works contract services and supply of manpower services. In addition, in certain states such as Andhra Pradesh, there is also the issue of the dual levy of Value Added Tax (VAT) and service tax on the same transaction of cab rentals.

At a time when the industry is already facing increasing input costs, this has further added to the tax burden. The difficulties of the service exporters are further aggravated due to the challenges encountered in ensuring faster service tax refunds from the tax authorities. As a result, non-issuance of quick service tax refund continues to pose one of the biggest challenges for this sector.

As the definition of what constitutes to be a works contract under the present regime has been aligned with the VAT laws of most states, the issue of the dual levy of VAT and service tax on contracts for customized software development and maintenance services still persists.

From an indirect tax perspective, Industry is hoping that the GST would obviate issues of double taxation on transactions such as the right to use of software and maintenance contracts and also further simplify the present indirect taxation regime. This would also enable the industry to be globally competitive in today's economic environment.

*Non- Payment of VAT/Sales Tax by service provider:-* It will be evident from the analysis of definition of works contract services mentioned above that, for classification under this service, the property in goods transferred in execution of Works Contract must be liveable to VAT/Sales Tax. Some of the State VAT laws provides exemption to small scale dealers and they are not required to pay VAT/Sales Tax if their turnover does not exceed the prescribed limit. This does not mean that sales tax/ Vat is not liveable. It means tax is levied but exempt from payment of sales tax/VAT.

Thus, non payment of Sales tax or VAT by the service provider, owing to exemption, by itself, cannot be the basis for concluding that the contract is not a works contract.

*Inclusion of value of goods supplied by the Service Provider:-*

As per clause(ii) of Rule 2A of Service Tax (Determination of Value) Rules, 2006, the value of works contract services shall be the specified percentage of total amount. The words 'Total Amount' is defined in Explanation 1(b) of Rule 2A (ii) as follows:

"total amount" means the sum total of the gross amount charged for the works contract and the fair market value of all goods and services supplied in or in relation to the execution of the works contract, whether or not supplied under the same contract or any other contract, after deducting-

- i. amount charged for such goods or services, if any; and
- ii. The value added tax or sales tax, if any, levied thereon:

Provided, that the fair market value of goods and services so supplied may be determined in accordance with the generally accepted accounting principles.

As per the explanation, fair market value of goods and services so supplied in or in relation to execution of the works contract is required to be included.

The issue relating to inclusion of value of free supply of goods received by the service provider who intends to claim the benefit of erstwhile *Notification No. 1/2006-ST dated 1-3-2006* has been a matter of litigation.

The explanation in erstwhile *Notification No. 1/2006-ST dated 1-3-2006* defined the word "gross amount charged" as follows:

Explanation:- The gross amount charged shall include the value of goods and materials supplied or provided or used by the provider of the construction service for providing such service.

The Chennai High Court in the case of *Larsen & Toubro Ltd v. UOI* [2007] 11 STT 27(Mad.) and Delhi High Court in the case of *Era Infra Engg. V. UOI*[2008] 16 STT 403(Delhi)- have granted interim stay on inclusion of value of free supply in computing gross amount charged. The Delhi High Court has observed as follows:

“11. Our attention has been drawn to an order passed by the Madras High Court in *Larsen & Toubro Ltd v. UOI* [2007] 11 STT 27 wherein the Madras High Court has come to the Prima Facie view that insistence on value of goods supplied and provided free by the client of an assessee cannot be included for the purposes of calculating taxable services.

12. in view of the facts that we have narrated above as well as the interim order passed by the Madras High Court, we are of the opinion that while the adjudication proceedings may go on and be concluded by the Respondents, they will not include for the purposes of determining the taxable services the supply of free material to the Petitioner and to his extent the Explanation appearing against Serial No 7 in the table given in the notification dated 1<sup>st</sup> March 2006 will not be applied to the detriment of the Petitioner.”

Therefore, this issue may continue as a matter of litigation.

*Is printing a works contract?*

Indeed printing (both on textile and paper) has been held as ‘works contract’ for the purpose of sales tax. However, in my view, service tax will not apply for the following reasons.

Carrying out an intermediate production process as job work in relation to agriculture, printing or textile processing is exempt – Sr No. 30(a) of Notification No. 25/2012-ST dated 20-6-2012 effective from 1-7-2012.

Thus, if printing is done on job work basis, it is out of purview of service tax. If entire printing work is done with material (e.g. letterheads, Invoice books, balance sheet etc.), the activity is 'manufacture'.

Any process amounting to manufacture or production of goods is not taxable service – Clause (f) of Negative List of services as per section 66D of Finance Act, 1994 introduced w.e.f. 1-7-2012.

“Process amounting to manufacture or production of goods” means a process on which duties of excise are leviable under section 3 of the Central Excise Act, 1944 (1 of 1944) or any process amounting to manufacture of alcoholic liquors for human consumption, opium, Indian hemp and other narcotic drugs and narcotics on which duties of excise are leviable under any State Act for the time being in force – section 65B(40) of Finance Act, 1994 effective from 1-7-2012.

The reason is that excise duty is payable if activity is 'manufacture'.

No service tax even if excise duty is exempt, if activity is manufacture – If Central Excise duty is leviable on a particular process, as the same amounts to manufacture, then such process would be covered in the negative list even if there is a central excise duty exemption for such process. – Para 4.6.2 of CBE&C's 'Taxation of Services : An Education Guide' published on 20-6-2012.

Products printed on paper are excisable goods – Products printed on paper are excisable goods covered under chapter 49 of Central Excise Tariff. Heading 4911 99 90 covers all residual printed matter. Thus, these are 'excisable goods' and hence the activity of printing on paper are taxable goods.

In short, activity of printing on paper (or even textile) would not be liable to service tax.

Would reverse charge apply in case the company buys material printed on paper or textile?

Though reverse charge applies in case of works contract, reverse charge mechanism is only a mode of collection of service tax. That provision is not a levy of service tax. Thus, if an activity is not liveable to service tax, no service tax would be payable simply because that activity is covered under definition of works contract.

Whether the service tax is applicable on job work of stitching, embroidery and washing and finishing of garments?

Textile processing is not subject to service tax and hence service tax should not apply.

We are tailors and receive cloth from customers, we cut the loth as per dimensions and give them to skilled workers for stitching on job work basis. We then supply the stitched cloths to our customers, putting mark of our shop. Is there any liability of service tax or excise duty?

Your job workers will not be liable. Even your activity will not be subject to service tax, since stitching cloth is ‘manufacture’ and hence outside the service tax net. Further, readymade garments are subject to excise only if they are branded. Putting your house mark is not ‘branding’ of goods.

Textile processing is dyeing & printing done in a factory in the initial stage. Zari work or other similar work is done on completed sarees when they arrive for sale in shops. Can this zari work be termed as textile processing and exempt under service tax?

The term ‘textile processing’ has not been defined in service tax law. Hence, it is not necessary that only dyeing and printing will get covered since both ‘processing’ and ‘textile’ are very broad terms.

Embroidery work done on job work basis is 'manufacture' and hence service tax does not apply – CBE&C letter Dy No. 2305/Commr(ST)/2011 dated 15-7-2011.

This principle should apply here also [Even otherwise, it is textile job work and is exempt].

Is photography a works contract?

Photography can be 'works contract' if it is subject to State Vat and then service tax will be payable on 70% value. Reverse charge will also apply. Otherwise, it will be simply service contract.

Service tax will be payable on entire amount. Reverse charge will not apply – see *Aggarwal Colour Advance Photo System v. CCE* (2011) 33 STT 33 = 13 taxmann.com 192 = 48 VST 190 (CESTAT 3 member bench).

It can also be argued that 'photography' is 'manufacture' as new and identifiable product comes into existence. In fact, 'photograph' is excisable goods covered under central excise tariff heading 49119100. If so, it is outside the service tax provisions completely.

We give vehicles, machinery etc. for repairs. The service provider charges separately for spare parts/components used and his job charges (either in same bill or separate bills). Would this activity get covered under 'works contract'?

Basically, 'works contract' is a composite contract where intention of parties is not to consider supply of material and provision of service as independent contracts.

As stated above, since the term 'works contract' has not been defined in Constitution, it has to be understood the way it was understood while introducing Article 366(29A) in Constitution of India and not as defined in CST Act or State VAT Act.



In my view, in case of repair contracts, there are two independent contracts – one for supply of goods and other for provision of services.

In *State of Andhra Pradesh v. Kone Elevators (India) Ltd.* AIR 2005 SC 1581 = (2005) 3 SCC 389 = 181 ELT 156 = 140 STC 22 (SC 3 member bench), it was observed, 'There is no standard formula by which one can distinguish a 'contract for sale' from a 'works contract'. The question is largely one of the fact depending upon the terms of the contract, including the nature of obligations there-under and the surrounding circumstances. If the intention is to transfer for price a chattel in which the transferee had no previous property, then the contract is a contract for sale.

Ultimately, the true effect of an accretion made pursuant to contract has to be judged not by artificial rules but from the intention of parties to the contract. In a 'contract of sale', the main object is the transfer of property and delivery of possession of the property, whereas the main object in a 'contract for work' is not the transfer of property but it is one for work and labour. Another test to be often applied to is : when and how the property of the dealer in such a transaction passed to the customer : is it by transfer at the time of delivery of the finished article as a chattel or by accession during the process of work on fusion to the movable property of the customer? If it is former, it is a 'sale'; if it is the latter, it is 'works contract'. – - The essence of the contract or the reality of the transaction as a whole has to be taken into consideration.

The predominant object of the contract, the circumstances of the case and the custom of trade provides a guide in deciding whether the transaction is 'sale' or 'works contract'. – - It is settled law that the substance and not the form is material in determining the nature of transaction. No definite rules can be formulated to determine the question. In this case, dealer had contract for supply of lift and its installation at site.

It was held that it is a contract of 'sale' and not a 'works contract'. Skill and labour employed for converting the main components into lift was only incidentally used.

In aforesaid case, Supreme Court has held that 'custom of trade' and 'substance over form' are important. The custom of the trade of repairs has always been to treat the two activities (supply of material and provision of service) as separate contracts. In substance also, these are two independent contracts.

Looking from another angle, Article 366(29A) of Constitution of India states that a tax on the transfer of property in goods (whether as goods or in some other form) involved in the execution of a works contract – ***and*** such transfer, delivery or supply of any goods shall be deemed to be a sale of those goods by the person making the transfer, delivery or supply and a purchase of those goods by the person to whom such transfer, delivery or supply is made.

This deeming provision does not say that this is only for purpose of sales tax. It is also well settled that a deeming provision has to be extended to its logical conclusion.

Lord Asquith in *East End Dwelling Co. Ltd. v. Finsbury Burrough Council* (1952) PC 109 (B) = 1951 (2) All ER 587 (HL) had said: "If you are bidden to treat an imaginary state of affairs as real, you must surely, unless prohibited from doing so, also imagine as real the consequences and incidents which, if the putative state of affairs had in fact existed, must inevitably have flowed from or accompanying it. . . . The Statute says that you must imagine a certain state of affairs; it does not say that having done so, you must cause or permit your imagination to boggle when it comes to the inevitable corollaries of that state of affairs'.

Hence, in my view, the deeming provision will apply to any contract made in India after introduction of Article 366(29A) in Constitution of India w.e.f. 2-2-1983. In sum, such contract of repairs would not be a works contract.

However, in case of comprehensive maintenance contracts like AMC, it is a composite contract and intention of parties is not to treat the supply of material and provision of service as two separate contracts. In such cases, it will be a 'works contract'.

Would contract of erection and commissioning be a works contract' if the supplier of equipment himself undertakes the job of erection and commissioning?

What has been discussed above would equally apply to contract of erection and commissioning. If the intention of parties is to treat the two contracts as different contracts, then this will not be a 'works contract'.

However, intention would depend on facts of the case. For example, if there is no option to the customer in splitting the contract or if warranty of equipment is valid only if erection and commissioning is done by supplier, the contract can be treated as 'works contract'.

We execute erection and commission contract which is a contract independent of supply of machinery, which is supplied to us by customer. We use some cement, steel and other material while undertaking erection and commissioning. Would it be a works contract?

Indeed this will be a 'works contract'. In such case, option is available to pay service tax on 40% of the 'total amount' of the contract.

However, risk in this scheme is that "Total amount" means the sum total of gross amount charged for the works contract and the fair market value of all goods and services supplied in or in relation to the execution of works contract, whether or not supplied under the same contract or any other contract.

Thus, a view is possible that the value of machinery should be added and then the 40% amount should be calculated. Hence, it may be much cheaper to pay service tax on full value of contract after claiming deduction of value of steel, cement or other material used.

We have given contract for pest control. They are using chemicals etc. Is it a works contract service?

This is not a works contract as the chemicals get consumed during the process. Property in the chemicals does not get transferred to the customer

We are providing cleaning services. Is the service coming under reverse charge?

What is stated above applies to cleaning services also. This is not works contract service.

XU limited provides a photocopy machine to Y Limited. XU also maintains the machine. Can XU gets the benefit of abatement under the works contracts?

This is really a transfer of right to use goods as control and possession has been transferred to customer. Vat should apply and not service tax.

We have purchased rubber stamp as per our requirement & rubber stereo for printing machine. Rubber stamp supplier charge vat @12.5% on total value but service portion involved in total value. Can making of rubber stamp cover under works contract?

It is 'manufacturing activity' and hence service tax should not apply.

Is tyre retreading is works contract as the person is using some material while re-conditioning of tyre? If yes, then what is value of service tax?

It is indeed works contract. If value of material is not ascertainable, service tax should be paid on 70% of the value.

Is Income Tax TDS applicable on value of works contract including service tax or excluding service tax?

TDS should be on entire amount including service tax. Thus, turnover appearing in your Income Tax 26AS statement will be gross amount. However, you can claim deduction of service tax paid and hence there will be no extra Income Tax Liability. Now the Income Tax Act has been amended and no TDS is being deducted on Service Tax amount charged by service provider.