INPUT TAX CREDIT, TDS PROVISIONS, CONTRAVENTIONS

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The concept of Vat which has been introduced with effect from 1.4.2005 finds its justification and background in the White Paper on State Level Value Added Tax released by the empowered committee of State finance ministers on 17th January, 2005, being reducing the cascading effect of tax, rationalization of the overall tax burden and fall in prices to final consumers.

The input tax credit forms the main ingredient of the vat system of taxation in order to achieve the avowed objective of reducing cascading effect of taxes as laid down in the White Paper.

Set off provisions

Section 48 of the MVAT Act, 2002 provides for set off or refund of tax paid by the dealer on his purchases subject to the conditions and restrictions that the State government may impose under the rules. The set off or refund shall be granted to the dealer of the following taxes:

A) Tax paid under the earlier law on any earlier sales or purchases of capital assets which are in stock as on 31.3.2005 and any other goods which are held in stock as on 1.4.2005 by the dealer liable to pay tax subject to section 84 read with rule 51 of the MVAT Rules, 2005,

B) Tax paid on any earlier sale or purchase of goods under the MVAT Act, 2002 subject to rules 52, 53, 54 and 55 of the MVAT Rules, 2005,

C) Tax paid under the Maharashtra Tax on Entry of Motor Vehicles into Local Areas Act, 1987 to the dealer purchasing or importing motor vehicles,

D) Tax paid under the Maharashtra Tax on Entry of Goods into the Local Areas Act, 2002.

Main conditions for grant of set off

1. As per section 48(2) of the act, in order to be eligible for grant of set off, the dealer has to produce a valid tax invoice of the selling dealer containing the certificate that the registration certificate of the selling dealer was in force on the date of sale by him and the due tax, if any, payable on the sale has been paid or shall be paid and the certificate has to be signed by the selling dealer or a person authorized by him. The tax invoice has to be in conformity with the provisions of section 86 of the Act. The form of certificate is prescribed in rule 77 of the MVAT Rules for different categories of dealers. However, CST paid on interstate purchases is not eligible for set off.
2. Rule 55(1) prescribes that the dealer in order to be eligible for grant of set off has to be a registered dealer at the time of purchase or entry of goods or he should have effected

purchase or entry of goods after 1st April of the year in which he has obtained registration and held the goods or capital assets or goods manufactured from these purchases in stock till the date of effect of registration.

3. Set off is allowable as and when the purchases are made, irrespective of its disposal. However, this is subject to the restrictions specified in Rule 53 and the negative list provided under rule 54.

4. Section 48(5) provides that in no case the set off or refund of tax on any purchase of goods shall exceed the amount of tax in respect of the same goods actually paid into the Government Treasury except to the extent of purchase tax payable on purchases of goods by the dealer. In case of PSI units under the deferred scheme of payment of tax, it is provided that tax shall be deemed to have been received in the government treasury for the purpose of this sub-section.

   In the case of M/s Mahalaxmi Cotton Ginning Pressing and Oil Industries reported in 51 VST 1(Bom), the constitutional validity of section 48(5) has been upheld and the Court has held that where the amount of tax has not been paid by the seller into Government Treasury, the purchaser who has claimed set off will have to pay the tax with interest under section 30(2) of the MVAT Act, 2002. This has resulted in heavy burden on the purchaser since he is called upon to prove the payment having been made by the seller.

5. As per Rule 55(1)(b), in order to claim set off, the claimant dealer has to maintain an account of purchases in a chronological order showing the following details:
   a) The date on which the goods were purchased.
   b) The name of the selling dealer and his TIN No. if registered and the description of goods.
   c) The number of tax invoice under which the goods are purchased.
   d) The purchase price of goods
   e) The amount of tax recovered by the selling dealer.

Rules for grant of set off

The State Government has imposed certain conditions and restrictions while granting set off as per Section 48 and these are incorporated in Rules 52 to 55.

Rule 52

Rule 52 provides for grant of set off of following sums:

a. Tax paid separately on purchases made from the registered dealer of goods being capital assets and goods the purchases of which are debited to the profit and loss account or as the case may be trading account.
b. Tax paid in respect of entry made after the appointed day under the Maharashtra Tax on the Entry of Motor Vehicles into Local Areas Act, 1987, and
c. Tax paid in respect of entry made after the appointed day under the Maharashtra Tax on Entry of Goods into Local Areas Act, 2003.
d. The purchase tax paid by the claimant dealer under the MVAT Act.

Some of the examples for claim of set off under Rule 52 are packing material, consumables, printing and stationary, repairs to machinery, sales promotion expenses, computer stationary, etc.

Issues

1. When an asset is purchased but it forms a part of capital work in progress, can it be considered as capital asset or when it is capitalized as asset that it becomes a capital asset.

   Since clause (a) of subsection (1) states that the set off shall be granted to the claimant dealer on purchases of goods being capital assets and not on goods being treated as capital assets, the set off shall be available on purchases of capital asset without considering its treatment in books of accounts. Further, 'capital asset' has been defined under section 2(5) of the MVAT Act that "it shall have the meaning assigned to it under the Income Tax Act, 1961, excluding jewellery held for personal use or property not connected with business". Under the Income Tax Act, 1961, capital asset has been defined in section 2(14) as meaning 'property of any kind held by the assessee whether or not connected with business but does not include stock in trade, consumable stores or raw materials held for the purposes of business or profession'. Thus property of any kind connected with business is capital asset under the MVAT Act on which set off is admissible. However, care should be taken that the set off is not claimed again when the asset is capitalized.

2. When the purchases of goods is centralized in Maharashtra for a concern having branches in other states, whether set off can be claimed in Maharashtra for full purchases or only for the purchases debited to the unit in Maharashtra?

   In this case full set off can be claimed in Maharashtra for goods purchased in Maharashtra and goods can be stock transferred to the other branches outside Maharashtra against Form F. However, retention under Rule 53(3) would be applicable excluding on transfer of capital assets and fuel and natural gas.

3. Where composition tax is charged separately in the invoice, whether set off is available to the claimant dealer?

   In clause (a) of sub-rule (1) the claimant dealer is eligible to claim set off of sum collected separately by the seller of 'tax' on purchases. The term 'tax' is defined under section 2(29) of the Act as meaning sales tax or purchase tax leviable or as the case may be, payable under the Act and includes any amount payable by way of composition. Thus, set off can be claimed of composition tax charged separately.

4. Where goods purchased are lost in fire in the same year in which they are purchased, whether set off can be claimed? Also, if the insurance claim is received, whether set off can be claimed?

   Since Rule 52 provides for set off of tax paid on purchases of goods with no correlation to goods being sold and the tax being levied at each stage of the transaction, therefore, the dealer will be entitled to claim set off on such goods even though the goods are lost in fire. Once the goods are purchased, the set off becomes eligible as such. The insurance money received being in the nature of compensation for loss of goods will not affect the claim of set off. However, Rule 53(5), Rule 53(6) must be kept in mind.

5. Where machinery was purchased in the month of June 2013 after paying vat and the Company was not registered in June 2013. Whether the Company can claim set off of vat paid on purchase of machinery for the period 2013-14? Will it make a difference if the Company purchased machinery on 31st March, 2013 and it was not registered on this date?

   As per Rule 55(1), if the dealer gets registered anytime after 1st April till the end of the year and the asset is not sold till the date of effect of registration, he can claim set off of vat paid on the asset for that period. Thus, in this case, if the dealer gets registered before March 14 and does not sell the machinery before that date he will be eligible to claim set off for the period 2013-14 even though he was not registered at the time of purchase of machinery. If the machinery is purchased on 31st March, 2013, no set off is available in the next year since the Company is not registered during the year ending 2013.

6. Where expenses are incurred on annual maintenance contract for a period of three years and at the end of the first year the amount relating to the next two years is transferred to prepaid expenses, whether the company can claim the set off of entire expenses incurred in the first year itself or should it claim on proportionate basis in each year?

Since the amount is transferred to prepaid expenses as per the Accounting Standards, however, for claiming set off, it would make no difference whether the expenses are debited to profit and loss account or treated as prepaid expenses and shown in Balance Sheet as long as the same is supported by a valid tax invoice.

Rule 52A

Rule 52A prescribes claim of set off in respect of purchases from Mega Unit

This rule has been inserted by Notification No.Vat 1511/CR-44/Taxation 1dated 17.3.2011. Under this rule, notwithstanding Rules 52 and 53- the dealer purchasing goods (other than declared goods) which are originally manufactured by a Mega Unit is entitled to claim set off in respect of goods to the extent of aggregate of

a) The taxes paid or payable under the CST Act, 1956 on inter-state resale of corresponding goods and
b) The taxes paid on the purchases of the goods, if these are resold locally under the Act.

The set off under this rule can be claimed only in the month in which the corresponding goods are sold by the dealer claiming set off.

Nothing under this rule would apply on purchases of goods which are used in the State for manufacturing of goods.

Rule 53

Rule 53 provides that the set off available under any rule shall be reduced and shall be disallowed in part or full in the event of any of the contingencies as specified in this rule.

Rule 53(1) : If the claimant dealer has used any taxable goods as fuel, then an amount equal to three per cent of the corresponding purchase price shall be reduced from the amount of set off otherwise available in respect of the said purchases.

In this case the meaning of fuel has to be understood in order to apply retention. The dictionary meaning of ‘Fuel’ is ‘material such as coal, gas or oil that is burned to produce heat or power’.

The following issues arise:

1. Whether steam purchased can be considered as fuel and retention is applicable? Steam, unlike power is not tax free. However, it is produced by burning of materials like coal, LDO, furnace oil, etc. Thus steam cannot be considered as fuel since it is not burnt to produce heat but it is heat itself. Thus, no retention would be applicable to purchase of steam.

2. Where lubricating oil is used in the machinery, whether retention would be applicable? In this case since the oil is not burnt, it will not be considered as fuel but will be considered as consumable stores on which full set off will be available. In the case of Gupta Metallics and Power Ltd. in 54 VST 292 (Bom), the High Court has held that set off on coal used as raw material in the manufacturing process is admissible in full.

Rule 53(1A)

In addition to retention of set off on taxable goods used as fuel, on purchases of natural gas, retention of three per cent of the purchase price would apply unless the natural gas is resold or sold interstate or in the course of export or dispatched to branch or agent otherwise than by reason of sale. Natural Gas is a mixture of gases rich in hydrocarbons and is used as fuel for generating electricity and heat. It would include gases like methane, nitrogen, propane, ethane, carbon dioxide, etc. The Explanation further provides that natural gas converted from one form to another form and sold will be deemed to have been sold or resold and no retention would apply on such sale.

This rule would have a far reaching effect since natural gas when used as a raw material in addition to being used as fuel would also qualify for retention under this rule. On products manufactured out of natural gas, the cascading effect off taxes would prevail increasing the cost of the product which would affect the marketability of the product in the international market.

Rule 53(2) and 53(9)(b)(i)

Under clause (a) of rule 53(2) a dealer manufacturing tax free goods has to reduce the set off to the extent of two per cent of purchase price of corresponding goods excluding capital assets and fuel and natural gas, out of the total set off available. However, no retention would apply if the manufactured tax free goods are sarki pend, de-oiled cakes and in case of any tax free goods if they are exported outside the territory of India.

Under clause (b) where there is no manufacture of tax free goods but tax free goods are resold and are packed in any material, then set off would be reduced by two percent of the purchase price of corresponding purchases of packing material from the total set off available. However no reduction will be made if the goods packed are exported outside India.

For the purpose of determining the purchase price of corresponding goods, rule 53(9)(a) provides that reference to corresponding goods shall be construed as reference to

corresponding goods resold and in case of manufactured goods sold, it would include goods contained in the manufactured product. The corresponding goods would not include consumables, stores, goods treated as capital assets, parts, components, and accessories of capital assets.

Eg. if the dealer is publishers of periodicals which is a tax free item, then set off will be reduced on corresponding goods used in manufacture of periodicals which would include paper, ink, etc. which are contained in the tax free product ie. periodical. However, set off would be allowable on consumables, stores, capital assets and its components in accordance with the other rules.

Rule 53(9)(b)(i) provides that where both taxable goods and tax free goods are being manufactured and it is not possible to ascertain the purchase price of the goods by reference to the books of accounts, the purchase price of corresponding taxable goods shall be computed by applying the ratio of sale price of taxable goods and tax free goods or if there is no sales price, then by applying the ratio of value of taxable goods and tax free goods.

Rule 53(3) and 53(9)(b)(ii)

Under this rule, in case of dispatches of goods made by the dealer outside the state to his own place of business or to his agent or to his principal as the case may be, there will be retention of set off to the extent of four percent of the purchase price of corresponding taxable goods excluding goods treated as capital assets or used as fuel and natural gas.

A number of issues arise under this rule:

1. Where goods dispatched to branch are returned, whether retention would be applicable? As per the proviso, the retention would not apply if the goods dispatched are brought back to the State within a period of six months after processing or otherwise. To calculate the retention on the goods dispatched net of returns, we may follow rule 55(5) which states that where it is not possible to identify the goods purchased and returned, it shall be presumed that the goods have been consumed in the chronological order in which they were acquired.
2. Whether transfer of machinery or computer to the other unit outside Maharashtra is liable for retention under this rule? The rule specifically excludes capital assets from the purview of retention.
3. Where articles are to be distributed by way of promotional campaign to stockists or distributors whether retention under this rule would be applicable? In the DDQ decided by the Commissioner in the case of IPCA Laboratories on 9/3/2012, it was contended

by the applicant that for free articles transferred to branch there is no sale consideration in any of the states and therefore there should be no retention. Further as per Rule 53(9)(a), the corresponding taxable goods would not include consumables, stores, capital assets and goods used as fuel which is due to the fact that these goods are used in manufacturing in the other State and not resold there. Therefore the other state does not get taxes. Hence, no retention should be applicable for distribution of free articles. However, the Commissioner held that the provisions of the rule were clear and unambiguous leaving no scope for interpreting the provision otherwise and therefore when the claimant dealer dispatches any taxable goods outside the State then his set off gets reduced irrespective of whether the goods are for sale or not and he is hit by rule 53(3).

4. Where stationary items are purchased centrally and are dispatched to various branches for use by the branches, whether retention would apply? There can be two sets of arguments. One is that since the goods are dispatched to the branches, retention would become applicable as per the provisions of the rule. The second argument is that the question of retention should not arise since these items dispatched are merely inter unit transfers for use by the branches and are not meant for sale. They do not have a sales price in order to apply retention. The same DDQ of the Commissioner as stated above refers to branch transfer of stationary items and holds that irrespective of its use in other states, once the goods are dispatched to the branches, the provisions of the rule 53(3) become applicable.
5. For goods sent for job work, whether retention would apply? Since the rule provides for retention only when the goods are dispatched to his own place of business or of his agent or where the claimant dealer is a commission agent to the place of business of his principal, there will be no retention when the goods are sent for job work.
6. For understanding the term 'corresponding taxable goods' one may refer to rule 53(9)(a) which states that the term shall be construed as referring to corresponding goods which are dispatched outside the state or used in relation to the manufacture of goods dispatched and are contained in the goods so dispatched. The expression 'corresponding taxable goods' excludes consumables, stores, or goods treated as capital assets, parts, components and accessories of capital assets. Packing material used with the goods so dispatched shall be considered as 'corresponding taxable goods'. Thus, for the purpose of applying retention, only the purchases corresponding to goods dispatched shall be considered. In case of manufactured goods, only the goods contained in the manufactured goods shall be considered for retention. No retention will be applied to purchases of consumables, etc.

Eg. In case of a manufacturer of spices, when the spices are sent to other branches outside Maharashtra by way of stock transfer, the retention would be applicable on purchases of goods used in spices like pepper, cumin seeds, fenugreek seeds, etc. which are contained in the manufactured product spices. On items like machinery parts, machine oil, etc. which are not contained in the manufactured product spices, no retention would apply and full set off would be available.

7. Where goods are sent to the branch for further processing and returned, whether retention would be applicable? eg. gold jewellery sent to branch for further polishing and returned within six months, such branch transfer of goods will not qualify for retention of set off although the goods are processed and returned, as per the provisions of the rule.
8. For applying retention of set off on stock transfer, one has to consider the method of valuing stock transfer for applying ratio proportion method to sales and stock transfer. Earlier, there was no method prescribed for valuing stock transfers but with the amendment made wef 1.11.2008, rule 53(9)(b) prescribes the method of valuing stock transfers as value of goods inclusive of excise duty as it appears in the books of accounts of the goods dispatched. The ratio of this value of stock transfers and the sales price of other goods has to be worked out and applied to purchases of corresponding goods to compute retention of set off of four percent under this rule.
9. From the method prescribed in rule 53(9)(b), it can be seen that the ratio of cost price of stock transfer inclusive of excise and sales price of goods will be computed. However, it is to be seen if this method is a scientific method of computation. There are a number of methods being used for transfer of goods to branches or consignee. Some of the methods used for computation are: at selling price, at selling price less margin of profit, at cost, at less than MRP, etc. In all these cases, the cost price of goods will have to be computed separately. Also for the purpose of computing cost price of goods sent to branch some of the methods available as per the Accounting Standards are average cost or weighted average cost method.
10. However, one may keep in mind that whichever method is followed, it should be followed consistently. Also at the year end, the ratio for the full year will have to be calculated at the time of audit which will be different from the monthly ratio computed while filing return as per the given periodicity.

Rule 53(4)

Where the dealer has made a sale by transfer of property in goods (whether as goods or in some other form) involved in the execution of works contract and has opted for composition method of tax under section 42(3), the corresponding amount of set off other than on capital

assets and goods in which property is not transferred is reduced and set off is allowed as follows:

a) Where the dealer has opted for composition tax of 8%, the set off shall be allowed to the extent of 16/25 of the eligible set off.
b) Where the dealer has opted for composition of 5% of the contract value in case of construction contract, the set off shall be reduced by 4% of the purchase price from the amount of set off as calculated.

Further under the explanation to the rule, it is stated that the claimant dealer shall also include a sub-contractor if the principal contractor has awarded the part or whole of the contract to the sub-contractor and the principal contractor has opted for composition of tax.

The issues arising under this rule are as follows:

1. Where the goods are purchased by the sub-contractor, however the principal contractor discharges the liability on the whole contract and gives the declaration in Form 409 to the sub-contractor, can set off of tax paid on purchases made by the sub-contractor be claimed by the main contractor?

   There is no specific bar to the main contractor claiming set off of purchases made by the sub-contractor which are used in the execution of works contract. However, the sub-contractor should not have claimed the set off on said purchases. The set off claim should be supported by the necessary documents obtained from the sub-contractor. Under section 45(4) of the MVAT Act, 2002, where there is a sale effected by way of works contract and the contractor awards the works contract to the sub-contractor, the relationship between the contractor and the sub-contractor is that of principal and agent and both of them shall jointly and severally be liable to pay tax in respect of the works contract. Since the liability to pay tax is joint and several, the main contractor should be able to claim set off of purchases made by the sub-contractor.

2. When a contract is awarded by the employer to the main contractor for say for Rs. 50 lacs and the main contractor in turn awards the entire contract to the sub-contractor for Rs.40 lacs and the sub-contractor discharges his liability on Rs.40 lacs under composition scheme, then whether the main contractor is liable to discharge any liability on the balance value of the contract of Rs.10 lacs? Will the main contractor be eligible to claim set off ?

   Where the main contractor is following the normal method or table method the tax liability will be calculated on the value of goods transferred in the execution of works contract. Since in the given case the main contractor has not transferred any property in

goods to the principal, there will not be any vat liability on Rs.10 lacs. It has been held by the Supreme Court in the case of Larsen and Toubro in 17 VST 1 that under such type of works contract it is the sub-contractor who is liable to pay taxes since the transfer of property in goods is by the sub-contractor to the principal on the principle of accretion and there is no property vested in the main contractor so as to effect transfer. However, if the main contractor is opting for composition method, he will have to discharge his liability on the balance contract since in the composition method the liability is on the entire contract value and not on the value of goods transferred during execution of works contract. The main contractor is entitled to claim set off in both the cases, however, when he opts for composition, he will be liable for retention under this rule. Also in such a case the certificate in Form 407 and declaration in Form 408 is a must.

3. Where the main contractor awards a part of the contract to the sub-contractor and for the contract undertaken by him, opts for composition u/s 42(3), his set off claim shall be reduced under this rule, as also the sub-contractor while claiming set off on his purchases will have to reduce his claim of set off as per the explanation to the rule.

Rule 53(5)

When the business of the dealer is discontinued, then the set off on purchases of goods corresponding to the goods held in stock at the time of discontinuance would not be allowable at all. The disallowance would not cover purchases of capital assets. Also the rule would not apply if the business is transferred or disposed of or is continued by any other person. Thus in case of amalgamation of companies the set off on goods held in stock on the date of the court order will be allowable to the amalgamated company.

Rule 53(6)

This rule is a bone of contention since the rule is framed in such a way that it gives rise to many legal issues. The rule provides for reduction in set off when sales of goods is less than 50% of the total receipts of the business in case of hotels and clubs and other than hotel and restaurant.

In case of hotel or club which has not opted for composition scheme, the set off is allowable only of

i) purchases corresponding to food and drinks (alcoholic or non alcoholic) sold, served or supplied and

ii) capital assets and consumables pertaining to kitchen and sale of food and drinks so sold, served or supplied.

For dealers other than hotel or restaurant and not being a manufacturer, set off shall be allowed only of those purchases in that year for which the corresponding goods are sold or resold within six months of the date of purchase or are consigned to branch or agent. Also set off on packing material used in packing of goods so sold is allowable.

In case of manufacturing dealer who is not principally engaged in job work or labour, he can claim set off on purchases of plant and machinery along with parts, components and accessories of such plant and machinery, consumables, stores and packing material for a period of three years from the date of effect of certificate of registration.

The term 'receipts' have been explained as meaning receipts pertaining to all activities including business activities carried out in the State excluding value of goods consigned to branch or agent. This would include receipts like dividend, interest on fixed deposits with bank and companies, insurance claim, miscellaneous income, etc.

The issues that arise are:

1. In case of Works contract, where the labour portion is more than 50%, whether it can be said that rule 53(6) becomes applicable? This is not to be because the term 'sales' has been defined in section 2(24) as including works contract as deemed sales. Also rule 58 of MVAT Rules, 2005 provides for determination of taxable turnover out of the total contract price. Thus the expression receipts includes receipts out of sales and non sales income and therefore, the entire works contract being sale of goods, the same cannot be vivisected to remove labour and expense portion in order to apply rule 53(6).

2. Rule 53(6)(b) provides that for dealers other than hotel and restaurant, set off is allowable on such purchases for which the corresponding goods are sold within six months. It is nearly impossible to compute sales to have been made within six months unless a proper stock register is maintained. Further, it is not specified in the rule as to when the set off would be allowable, whether at the time of purchases or when the corresponding goods are sold within six months.
3. In case of a manufacturer, he should not be principally engaged in labour or job work. This will depend upon the facts and circumstances of the case. For instance, the dealer may have purchased machinery in the first year of business for manufacturing activity but before starting, it may have done labour job and in the next year full-fledged

production is started. In such a case, he cannot be considered to be principally engaged in job work.

Thus, if his sales are less than 50% of total receipts, he can claim set off on plant and machinery and its components, consumables, stores and packing material for a period of three years. This rule provides an impetus to manufacturers in the earlier years when market for its product is yet to be established.

4. For hotels and clubs not opting for composition scheme, where the sales of goods is less than 50% of total receipts the set off allowable is restricted to purchases corresponding to food and drinks (whether or not alcoholic) sold and served and purchases of consumables and capital assets pertaining to kitchen and supply of food and drinks. This would mean set off on all consumables used in preparing food and capital assets pertaining to kitchen would be allowable. Any furniture and furnishings used in the dining area would be out of the purview of claim of set off whereas for furniture used in kitchen, set off would be allowable. Utensils, stove, oven, etc, would be assets used in kitchen on which set off would be allowable. Where the sales exceed 50% of total receipts, rule 53(6) would not apply but rule 54(k) as such would apply in case of hotels, so that capital assets not pertaining to supply of food would be ineligible for set off. For clubs, set off would be allowable on other items subject to rule 53 and 54.

   As a matter of fact the terms ‘hotel’ and ‘restaurant’ have been used interchangeably connoting the same meaning although ‘hotel’ would mean a place which provides accommodation in addition to meals and a ‘restaurant’ is a place to have food without any accommodation facilities.

5. In case of restaurants, eating houses, refreshment room, boarding establishment, factory canteen, clubs, hotels and caterers excluding hotel and restaurant with gradation of four star or above, supplying or serving food and non-alcoholic drinks, the State Government has by notification under section 42(2) provided for composition scheme of payment of tax with the condition that no set off is allowable on purchases corresponding to any goods sold, resold or used in packing of goods so sold or resold. This would mean that for items other than corresponding goods, set off is allowable. However under rule 54(k), for hoteliers, set off on purchases of capital assets not pertaining to supply of food and drinks including alcoholic drinks is not allowable at all, irrespective of whether it is under composition scheme or otherwise. But for restaurants, clubs, factory canteen, refreshment room, boarding establishment and caterers rule

54(k) is not applicable and they can claim set off on other than corresponding goods subject to rule 53 and 54.

Rule 53(7A)

The rule provides for reduction in set off to the extent of 3% of purchase price on purchases of office equipment, furniture and fixtures which are treated as capital assets and which are not used in the business of transfer of right to use.

Issues:

1. Whether electric installation in office premises is eligible for set off ? Since there is no specific provision for disallowance or reduction in set off on electric installation, set off is allowable under rule 52 irrespective of whether it is installed in factory or office premises.
2. Where the sales of goods are less than 50% of total receipts and rule 53(6) is applicable in which case set off is allowable only on corresponding goods, whether set off is allowable on office equipment and furniture and fixtures? Since each rule is a specific rule, although under the specific contingency of sales being less than 50% of receipts, set off is restricted to only corresponding goods, set off on all other items is allowable under the respective rule and shall be allowable on office equipment and furniture subject to retention under rule 53(7A).
3. Whether air-conditioners installed in factory building would qualify for retention under this section? It can be said that if the plant requires air-conditioning for running the machinery, set off will be allowable in full under rule 52, but if the air conditioners are used in the factory office, retention would be applicable.

Rule 53(7B)

As per the Rule, where the dealer is holding a license for transmission or as the case may be, distribution of electricity under the Electricity Act, 2003 or is a generating company as defined under the Act, then save as otherwise provided under sub-rule (1) and (1A), an amount equal to two per cent of the purchase price of the goods purchased including goods treated as capital assets by him for use in generation, transmission or distribution of electricity shall be reduced from the amount of set off available in respect of the said purchases of goods including goods treated as capital assets.

Thus, where any taxable goods like coal are used as fuel, the set off shall be reduced under rule 53(1). Also set off on natural gas shall be reduced either under rule 53(1) or (1A). For goods used in generation, transmission or distribution of electricity otherwise than falling under rule 53(1) and 53(1A), the set off shall be reduced under this rule.

Rule 53(8)

The rule provides that the claimant dealer shall reduce the amount of set off in the period in which the contingencies specified in the rule occur and claim only the balance set off. If the deduction exceeds the amount of set off available in that period, the dealer shall pay the excess amount in respect of that period.

Eg. If natural gas is purchased in the month of March 2013, it will qualify for retention in the month of March 2013. However if it is resold in the month of April 2013, the set off so reduced in the month of March 2013 will become available in the month of April 2013 in accordance with the period in which the contingency has occurred.

Rule 53(10)

The rule specifically provides reduction in set off in case of dealer executing a contract of processing of textiles by two per cent of the purchase price of the property transferred during the said processing and as regards packing material used for packing of textiles. For other purchases including capital assets, set off would be available subject to other rules.

Rule 54

Rule 54 provides for negative list where no set off is admissible in respect of the purchases which are listed in the provision.

Rule 54(a)

Under this rule no set off is admissible on purchases of motor vehicles (being passenger vehicles) which are treated by the claimant dealer as capital assets and parts, components and accessories thereof and the expression 'motor vehicles' shall have the same meaning as assigned to them in the Motor Vehicles Act, 1988. Under the notification dated 21st May, 2013, the exclusion clause whereby set off which was admissible on transfer of right to use the vehicle has been removed wef 1.5.2013 and therefore, set off is now inadmissible on purchase of motor vehicles by dealers who are in the business of hiring of vehicles.

1. Where the passenger vehicle is used for delivery of goods sold to customers, eg. Maruti Omni, SUV, can set off be disallowed under this rule?
   Although the expression 'goods vehicle' referred to under this rule is removed wef 1.5.2013, however, under the Motor Vehicles Act 'goods vehicle' is defined to mean any

motor vehicle constructed or adapted for use solely for the carriage of goods or any motor vehicle not so constructed or adapted when used for the carriage of goods. Thus, even if the passenger vehicle is used for delivering goods, it will be considered as a goods vehicle and set off will be allowable.

2. Whether set off is inadmissible on motor car repairs expense debited to Profit and Loss Account?

   Since under the rule set off is inadmissible on parts, components and accessories of vehicles and these would always be expenses debited to Profit and Loss Account, set off on motor car repairs would be inadmissible.

Rule 54 (d)

Under this rule set off is not admissible on purchases of consumables and goods treated as capital assets in case of a dealer principally engaged in job work or labour work and not engaged in manufacturing of goods for sale and when incidental to job work or labour, scrap or waste is obtained and sold.

We have to understand the term 'principally engaged in job work or labour'. Whether it means that more than 50% of his activity is that of job work or labour, in which case what would be the balance activity since the rule further says that the dealer should not be engaged in the manufacturing of goods for sale. Whether the balance activity would be trading which would not be the case since a trader would not involve himself with job work activity.

Further, as per the rule, if the dealer is engaged in manufacturing activity although he is principally engaged in job work, then this rule would not apply.

This rule has to be read with rule 53(6)(b) where in case of a dealer whose receipts from sale of goods are less than 50% of the total receipts and he is a manufacturer not principally engaged in job work, then he shall be entitled to set off on purchases of plant and machinery and its components and accessories, consumables, stores and packing material for a period of three years from the date of effect of certificate of registration. This means that after three years if his sales remain at less than 50% of total receipts, he shall not be eligible to claim set off on purchases of capital assets, parts, components and accessories, stores, consumables and packing material, but will only be able to claim set off of raw materials to the extent the corresponding goods are sold within six months of the date of purchase or are consigned to branch or agent.

Eg. If a dealer ‘A’ is engaged in job work activity which is say 60% of all the activities and he is not a manufacturer, and he is selling waste, then he will be covered by rule 54(d). If he is engaged in job work activity to the extent of 40% and his manufacturing activity is to the extent of 60%, then he will not be covered by rule 54(d) but will be covered by rule 53(6)(b) only if his receipts from goods are less than 50% of total receipts which may include dividend, interest, etc.

Rule 54(f)

Rule 54(f) provides that no set off shall be admissible in respect of purchases of goods of incorporeal or intangible nature other than

i) Import licenses including special import licenses, duty free advance licenses and any other scrips issued under the foreign trade policy under the Foreign Trade (Development and Regulation) Act, 1992, export permit or license or quota, SIM Cards,
ii) Software in the hands of a dealer who is trading in software,
iii) Copyright which is sold within twelve months of the date of purchase.

Certain issues that arise are:

1. Whether a software developer will also be excluded from the application of this rule. Eg. A Company ‘X’ is engaged in the production and selling of customized accounting software. They have purchased licensed software for windows, MS Office, etc. We have to consider whether set off is allowable to such developer and if he can be considered as a trader in software. It may be considered that if he is regularly carrying on the activity of selling customized software set off should be allowable considering him to be a dealer in software.
2. Whether set off is allowable on purchase of software required by a manufacturer for running the plant like in diamond industry or in printing of magazines or running the chemical plant on the ground that such software forms a part of the plant. This is a debatable issue. In my opinion such software has to be treated as plant and set off would be allowable under rule 52 since the definition of plant is wide and includes the apparatus or tool of the trade with which the business is carried on.

Rule 54(g) and (h)

As per rule 54(g), set off will be denied on purchases made by an employer by way of works contract when the contract results in immovable property other than plant and machinery.

As per rule 54(h), set off will be denied on purchases of any goods by a dealer, the property in which is not transferred [whether as goods or in some other form] to any other person and which are used in the erection of immovable property other than plant and machinery.

The above rules apply to an employer and not a works contractor.

The issues which arise are:

1. The term 'plant and machinery' is not defined under the Act and in the absence of such statutory definition, the word has to be given the ordinary meaning. In Scientific Engineering House v/s Commr of Income Tax, Andhra Pradesh in 157 ITR 86 (SC), the apex court has explained the meaning of the expression 'Plant'. The court observed "that 'Plant' was not necessarily confined to an apparatus which was used for mechanical operations or process or was employed in mechanical or industrial business. The test to be applied was : Did the article fulfill the function of a plant in the assessee's trading activity ? Was it a tool of his trade with which he carried on his business ? If the answer was in the affirmative, it would be a 'plant'.

   However, in one of the Maharashtra State Tribunal decision in Vat Appeal Nos. 205 and 204 of 2010 decided on 11/7/2011 in the case of M/s Sachin Impex, the question arose whether set off was allowable on purchases of cement and other building material used in the execution of works contract of construction of wall of building on which crane was mounted and used as support for movement of crane. The crane was used for lifting raw material used in the manufacture of accessories of Central Air-conditioning System. The Hon'ble Tribunal relied on the decision of Supreme Court in case of State of Bihar vs Steel City Beverages and other in 112 STC 186 where the court had held that in respect of an industry manufacturing soft drinks and beverages, "plant" would mean that apparatus which is used for manufacturing soft drinks or beverages and not articles like crates and bottles used for storing the manufactured product. The Hon'ble Tribunal concluded that the tax paid on purchases of cement and other building material used in execution of works contract which resulted in construction of building is not a plant and machinery and as such not eligible for set off u/r 54(g) of the MVAT Rules.

   However, in case of Steel City Beverages, the word 'plant' was explained in the context of Bihar Sales Tax Supplementary (Deferment of Tax) Rules where deferment of taxes was to be limited to the extent of fixed capital investment and in this context the term 'plant' was explained. Thus the facts and circumstances of the case would determine whether the works contract has resulted in immovable property or plant and machinery.

2. Whether the following items can be considered as plant and machinery or is to be treated as immovable property for the purpose of rule 54(g)?
   a. Shed constructed for sub-station.
   b. Boiler room
   c. Shed for protecting the tank used for mixing of raw materials
   d. Foundation prepared for installation of vessels or machinery
   e. Construction of silos for storing the products.

The above are a few examples of works contract which are amenable to different interpretations. In the case of State of Gujarat vs Minu Chemicals Pvt. Ltd. in 50 STC 339, the Gujarat High Court held that residue tank used for carrying out certain chemical processes was an integral part of plant and machinery. Also in the case of M/s Ballarpur Industries Ltd. in 20 MTJ 497, the Hon'ble Tribunal held that set off was admissible on cement purchased for construction of tanks used for soaking of bamboos and preparation of wooden pulp used for producing paper for the reason that the use of cement was integrally connected with the manufacture of the final product ie. paper.

Thus, we can see that in all the above cases the works contract has resulted in plant and machinery which would not qualify for disallowance of set off u/r 54(g) and (h).

3. Where the purchases by way of works contract is for painting of the factory building or civil repairs to the existing factory building, can it be treated as resulting in immovable property?
   The painting and repairs contract do not result in erection of immovable property. These are the expenses which are debited to the Profit and Loss Account and set off is allowable on these expenses.

4. Where the contractor has purchased shuttering material, steel, etc, which is used in the erection of immovable property, can it be considered as plant and set off available as per rule 54(g)?
   It has been held by the Allahabad High Court in the case of Harijan Evam Nirbal Varg Avas Nigam Ltd. vs Commr. of Income Tax in 229 ITR 776 (All) that the relevant test to be applied for treating an item as plant is to see if the item fulfils the function of plant in the assessee's business and is a tool of his trade. If it is so, it has to be treated as plant. Similar view was held by the Rajasthan High Court in the case of Commr. of Income Tax vs Mohta Construction Company in 273 ITR 276 (Raj) where the High Court held that the shuttering material was plant on which depreciation was allowable. Thus, the contractor can claim set off on shuttering material used in civil construction treating it as plant and rule 54(g) would not apply.

Rule 54(j)

Under this rule, no set off shall be admissible on purchases made after 20.6.2006 of mandap, tarpaulin, pandal, shamiana, decoration of such mandap, pandal or shamiana, and furniture, fixtures, light and light fittings, floor coverings, utensils and other articles ordinarily used along with a mandap, pandal or shamiana where the claimant dealer has opted for composition of tax under section 42(4) of the Act.

A question arises whether for purchases made for the period 1.4.2005 to 19.6.2006, the set off is admissible of the above items to a composition dealer. Since there is no specific disallowance under any provision, the set off would be admissible for the intervening period.

Rule 54(k)

As referred earlier, no set off is admissible to a hotelier on purchases which are treated as capital assets and which do not pertain to supply of food or any other article for human consumption or any drink (whether or not intoxicating). This rule is applicable to both composition and normal dealers since there is no specific reference to that.

Rule 55B

Applicability of set off to developers and units in Special Economic Zone

By Notification dated 16th May, 2013, rule 55B is inserted to be effective from 15th October, 2011. The rule provides that the provisions of rules 53(6), 54(g) and 54(h) shall not be applicable to the developers and units in processing area of the Special Economic Zone. The Explanation to the Rule provides that 'processing area' shall mean the processing area as demarcated under section 6 of the Special Economic Zones Act, 2005(28 of 2005) but excluding educational institutions, hospitals, hotels, residential or commercial complexes, leisure and entertainment facilities or any other facilities allowed for authorized operations, as may be notified by the State Government, under section 50 of the said Act, for their operations and maintenance.

The Trade Circular No.8T of 2013 dated 29/11/2013 issued by the Commissioner states that developers of SEZ engaged in construction and development of processing and non-processing zones and providing utilities in SEZ as also units in SEZ may undertake construction or development activity which may result in immovable property on which no set off would be admissible as per rule 53(6), rule 54(g) and rule 54(h). To provide an impetus to SEZs, the Government Resolution is issued to provide that the developers of SEZ and units in SEZ would be eligible for refund of Value Added tax paid on purchases in respect of processing area of SEZ.

Section 6 of the SEZ Act, 2005 provides for demarcation of the area by the Central Government or any authority specified by it, into processing area for setting up units for activities being manufacture of goods or rendering services or area exclusively for trading and warehousing purposes and non-processing area for activities other than those specified as above.

Co-developers are not covered under this rule and therefore they will not be eligible to claim set off as per provisions of rule 55B.

Works Contract TDS

Under Section 31(1)(b), the Commissioner by notification may require any class of employers to deduct tax as may be specified out of the amount payable (excluding the amount separately charged as tax or service tax by the contractor) by such employer to a dealer to whom a works contract has been awarded towards execution of the said works contract. A notification to that effect has been issued whereby the rate of deduction of tax is specified at 2% in case of registered contractor and 5% in case of unregistered contractor where the contract price exceeds in aggregate Rs.5 lakhs.

It may be noted that no deduction of tax is to be made by the principal contractor on payment made to sub-contractor where the contract has been assigned to the sub-contractor. Also no deduction is to be made in respect of interstate works contract.

Further, no tax is to be deducted on any advance payment made by the employer. Tax shall be deducted only when the advance payment is adjusted against the bill raised for execution of works contract.

Where the employer does not deduct or after deducting fails to pay the tax, he shall be deemed not to have paid the tax within time and all the provisions of the Act including the provision for interest shall become applicable to such unpaid tax.

The employer is required to provide a certificate in Form 402 to the contractor who shall claim the credit in the period in which the certificate is received by him. In no case the contractor can be asked to make the payment of tax himself to the extent to which the tax is deducted.

Contraventions

Under Section 74(1A), where any person knowingly with the intention to defraud revenue, issues a false tax invoice and thereby makes a false claim in respect of the set off or the

refund, or claims any other deduction that results into reduced tax liability or increases the amount of refund or abets any of these offences shall, on conviction, be punished with a rigorous imprisonment for a term which shall be at least one year and which may extend to two years and a fine.

Whoever fails to deduct the tax deductible at source or to pay the tax deductible at source or file a return as required under section 31, without sufficient cause, shall, on conviction, be punished with a simple imprisonment for a term up to six months and a fine.

Conclusion

We may summarise that there are a number of issues arising under the rules for grant of set off and the same have to be dealt with according to the facts of each case. There are a number of grey areas which are not yet settled neither tested under different circumstances and time alone would decide such issues.