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Taxation of Works Contracts under MVAT Act

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Sales Tax (VAT) on Works Contracts

The taxation of works contracts has always been a matter of curiosity, controversies and complications. Ever since the evolution of the concept of 'deemed sales', under the sales tax laws, it has remain a mystery to understand that which are the transactions liable to tax under the guise of 'works contract'.

The High Courts of various States as well as the Hon'ble Supreme Court of India has to intervene time and again to decide whether a particular transaction can be taxed or not under the sales tax laws of a particular State. There are number of judgments pronounced by the most knowledgeable and honorable judges of the highest courts of the States as well as the apex court. And there are number of judgments which are contradicted by another judgment of the same court and there are many cases still waiting justice.

Assuming that a particular contract is a 'works contract', tax can be levied by the State Government on the value of the transfer of property in goods (whether as goods or in some other form) involved in the execution of such a contract. It may be noted that under the sales tax laws, tax can be levied on the 'sale price' of goods. The term, 'goods', has been well defined to include all kinds of moveable properties (with certain exceptions). Howsoever immovable properties are not considered goods, hence cannot be taxed under the sales tax laws. For example sale of land or a building standing thereon are not liable to tax. But cement and bricks etc. used by a contractor, in a construction contract, may be considered as passing of property in goods i.e. cement and bricks etc., being movable goods, hence may be subjected to tax as works contract.

But such a contract is normally a composite contract wherein the contractor is required to use his material as well as labour and skill. It is not just a contract for sale of cement and bricks but a contract for constructing building, in the execution of which property in certain goods passes from the contractor to the contractee. The State can levy tax only on the value of goods and not on the labour and service portion of the contract. In all such cases of composite contracts, the question arises is that what is the value of goods on which tax can be levied? The Hon'ble Supreme Court has given useful direction in this regard.

It may be noted that pure labour contracts, where contractor does not use his own material, there is no liability under the State Sales Tax (VAT) laws. Such contracts are considered as 'service contracts'. Likewise simple contracts for supply of goods are considered as contract for sale of goods, liable to tax as normal sale transaction. However, where the contract is a composite contract involving material and labour both, it may fall in the category of 'Works Contract'. The works contract, involving transfer of property in goods involved in the execution of such contracts, are liable to tax under the provisions of MVAT Act as deemed sale transactions. The rate of tax on the value of goods (in which transfer of property takes place) shall be same as applicable to the commodity as per Schedule A to E. The Sale Price of goods, liable to tax, has to be determined in accordance with Rule 58 of MVAT Rules.

Works Contract – Definition under the MVAT Act:

Although MVAT Act does not contain an exact definition of 'Works Contract', howsoever some indication has been given in section 2(24), which defines 'sale'. Sub-section (b) (ii) provides as follows, (w.e.f. 06.08.2007):

“(ii) the transfer of property in goods (whether as goods or in some other form) involved in the execution of a works contract including, an agreement for carrying out for cash, deferred payment or other valuable consideration, the building, construction, manufacture, processing, fabrication, erection, installation, fitting out, improvement, modification, repair or commissioning of any movable or immovable property.”

Works Contract – Sale Price:

Rule58. (1) The value of the goods at the time of the transfer of property in the goods (whether as goods or in some other form) involved in the execution of a works contract may be determined by effecting the following deductions from the value of the entire contract, in so far as the amounts relating to the deduction pertain to the said works contract: -

- (i) Labour and service charges for the execution of the works contract;
- (ii) Amounts paid by way of price for sub-contract, if any, to sub-contractors;
- (iii) Charges for planning, designing and architect's fees;
- (iv) Charges for obtaining on hire or otherwise, machinery and tools for the execution of the works contract;
- (v) Cost of consumables such as water, electricity, fuel used in the execution of works contract, the property in which is not transferred in the course of execution of the works contract;
- (vi) Cost of establishment of the contractor to the extent to which it is relatable to supply of the said labour and services;
- (vii) Other similar expenses relatable to the said supply of labour and services;
- (viii) Profit earned by the contractor to the extent it is relatable to the supply of said labour and services:

Provided that where the contractor has not maintained accounts which enable a proper evaluation of the different deductions as above or where the commissioner finds that the accounts maintained by the contractor are not sufficiently clear or intelligible, the contractor or, as the case may be, the Commissioner may in lieu of the deductions as above provide a lump sum deduction as provided in the Table below and determine accordingly the 'sale price' of the goods at the time of the said transfer of property.

It may be noted that a dealer, executing works contract, is eligible for full input tax credit as per the normal provisions. He is also entitled to collect tax separately by issuing a Tax Invoice.

Works Contract – Sale Price

TABLE

Serial No. (1)	Type of Works contract (2)	*Amount to be deducted from the contract price (%) (3)
1.	Installation of plant and machinery	Fifteen per cent
2.	Installation of air conditioners and air coolers	Ten per cent
3.	Installation of elevators (lifts) and escalators	Fifteen per cent
4.	Fixing of marble slabs, polished granite stones and tiles (other than mosaic tiles)	Twenty five per cent
5.	Civil works like construction of buildings, bridges, roads, etc.	Thirty per cent
6.	Construction of railway coaches or under carriages supplied by Railways	Thirty per cent
7.	Ship and boat building including construction of barges, ferries, tugs, trawlers and dragger	Twenty per cent
8.	Fixing of sanitary fittings for plumbing, drainage and the like	Fifteen per cent
9.	Painting and polishing	Twenty per cent
10.	Construction of bodies of motor vehicles and construction of trucks	Twenty per cent
11.	Laying of pipes	Twenty per cent
12.	Tyre re-treading	Forty per cent
13.	Dyeing and printing of textiles	Forty per cent
14.	Annual Maintenance. Contracts	Forty per cent
15.	Any other works contract	Twenty Five per cent. (w.e.f. 01.04.06)

* The percentage given in the Table should be applied on total contract price after deducting the price on which tax is paid by sub-contractor. It is also provided that if any tax is separately charged by the contractor as per terms of contract then the deduction should be after excluding such separate tax.

Rule 58(1A), (1B) and (1C): (builders/ developers, etc., discussed separately)

(2) The value of goods so arrived at under sub-rule (1) shall, for the purposes of levy of tax, be the sale price or, as the case may be, the purchase price relating to the transfer of property in goods (whether as goods or in some other form) involved in the execution of a works contract.

Rate of Tax

After determining the sale price through any one of the above methods, the contractor is required to pay tax at the rate at which such goods (used in the execution of works contract) is liable to tax as per schedule A to E.

Schedule 'A' – Essential Commodities (Tax free)	Nil
Schedule 'B' – Gold, Silver, Precious Stones, Pearls etc.	1%
Schedule 'C' – Declared Goods, Industrial Inputs, and Such other specified goods	5%
Schedule 'D' – Foreign Liquor, Country Liquor etc. Motor Spirits	20% at specified rates
Schedule 'E' – All other Goods (not covered by A to D)	12.5%

Thus if the goods, used in the execution of a works contract, is say falling under Schedule 'A', the rate of tax shall be Nil, if falling under Schedule 'C', the rate of tax shall be 5%, and likewise if it is Schedule 'E' goods, the rate of tax is 12.5%.

If, in a particular contract, there are several commodities used, which may be falling under more than one schedule then it would be necessary to divide the sale price in the same proportion in which the goods of various categories have been used in the execution of such a contract.

Works Contract – Composition Schemes

I. Composition Scheme for all kinds of Works Contracts

Section 42(3) of the MVAT Act provides for a Works Contract Composition Scheme, whereby a dealer, at his option, may choose to pay tax @ 8% on the total contract value.

(After deducting there from the amount paid towards works contract executed by a registered sub-contractor, if any.)

If a contractor chooses to opt for this composition scheme then setoff is restricted to 64% of the total eligible setoff in respect of such goods used in the execution of such works contract. However he is eligible to collect tax by issuing a Tax Invoice.

II. Composition Scheme for notified Construction Contracts

For construction contracts, there is separate Composition Scheme, effective from 20th June 2006, which is applicable in respect of notified construction contracts only. Under this scheme, the contractor, at his option, can discharge his liability by paying tax @ 5% on the total contract value of a notified construction contract. If the contractor opts for this scheme, the setoff on inputs will be restricted to the amount which is in excess of 4% of the purchase price. In other words the setoff on inputs will be denied @ 4% on the purchase price of eligible purchases.

III. Composition Scheme for Builders & Developers

Sub-section (3A) is inserted w.e.f. 1-4-2010 to empower State Government by issue of notification to provide composition scheme for registered dealer who undertakes construction of flats, dwellings or buildings or premises and transfer them in pursuance of an agreement along with the land or interest underlying the land. Accordingly a Notification has been issued providing for a composition scheme whereby a dealer (builder/developer) can discharge his tax liability by paying composition amount @ 1% without entitlement for any setoff. (Discussed separately)

Notes:

- (1) A dealer, executing works contract, whether chooses to pay tax u/r 58 or under the composition scheme, u/s 42(3), i.e. I or II above, is entitled to issue tax invoice in respect of all such sales affected by him by way of execution of works contract, by charging tax separately in such tax invoice.
- (2) A dealer (contractor) is free to chose either sale price method or composition scheme, as he may deem fit, qua each contract. There is no requirement of any prior approval etc.

- (3) The retention/reduction of setoff shall not apply to setoff on capital assets, the goods, the property in which not passes in the execution of works contract. (w.e.f. 08.09.2006)
- (4) The relationship between the contractor and sub-contractor is considered as that of principal and agent. Thus the responsibility for payment of tax is joint and several. It has been provided, therefore, that liability to pay tax may be discharged either by the main contractor or by the sub-contractor. If the main contractor chooses to pay tax on the entire contract, he may issue a declaration and certificate (in Form 406 and 409) whereby the sub-contractor shall not be liable to pay tax on the portion of work undertaken by him. Similarly where the sub-contractor undertakes to pay tax, he shall issue a declaration and a certificate, (in Form 407 and 408), to the main contractor regarding payment of taxes made by him on his portion of works contract. Thus the main contractor will be liable to pay tax only on the difference.

Costruction Contracts:

Notification No VAT.1506/CR-134/Taxation-1-- In exercise of the powers conferred by clause (i) of the Explanation to sub-section (3) of section 42 of the Maharashtra Value Added Tax Act, 2002 [Mah. IX of 2005], the Government of Maharashtra hereby notifies the following works contracts to be the '**Construction Contracts**' for the purposes of the said sub-section, namely :-

(A) Contracts for construction of,--

- (1) Buildings,
- (2) Roads,
- (3) Runways,
- (4) Bridges,
- (5) Railway overbridges,
- (6) Dams,
- (7) Tunnels,
- (8) Canals,
- (9) Barrages,
- (10) Diversions,
- (11) Rail tracks,
- (12) Causeways, Subways, Spillways,
- (13) Water supply schemes,
- (14) Sewerage works,
- (15) Drainage,
- (16) Swimming pools,
- (17) Water Purification plants and
- (18) Jettys

- (B)** Any works contract incidental or ancillary to the contracts mentioned in paragraph (A) above, if such work contracts are awarded and executed before the completion of the said contracts.

Works Contract – TDS

Section 31 of MVAT Act provides that the Commissioner may, by notification, require any dealer or person or class of dealers or persons (hereafter referred as ‘the employer’) to deduct tax on such amount payable on the purchases effected by them, as may be notified. All such employers shall have to: - (See Rule 40)

- (a) Deduct tax, at prescribed rate, from the amount paid or payable to a contractor during a given period.
- (b) Deposit the amount so deducted with the Govt. treasury within 21 days from the end of month in which such tax deducted or required to be deducted. (Challan Form MTR-6, w.e.f. 21.05.2013, earlier Form 210)
- (c) Issue a certificate of deduction of tax, immediately, in Form 402.
- (d) Maintain necessary records in prescribed format, Form 404.
- (e) Submit Annual Return within three months from the end of year to which such return relates i.e. by 30th June of next financial year. This return is now e-return (Form 424) w.e.f. 21st May 2013 (earlier the employer/s were required to submit manual return in Form 405 to the jurisdictional Joint Commissioner of Sales Tax).

Notes:

1. The TDS provisions are applicable only to specified employers.
2. A contractor, awarding sub-contracts, is not required to deduct TDS from such sub-contractor/s.
3. TDS provisions are not applicable in respect of works contract liable to tax under the CST Act.
4. TDS not required to be deducted where the amount or the aggregate of the amount payable to a dealer by such employer is less than rupees 5 lacs during the financial year.
5. TDS is required to be deducted on the amount paid/payable in respect of works contract. Thus TDS not to be deducted on taxes (whether VAT or service tax) charged separately by the contractor.
6. No TDS on advance payments, however TDS on such advances to be deducted at the time when such advance is adjusted towards the amount payable.

7. A contractor can apply in Form 410 for a certificate of no deduction of tax at source if the contract is not a works contract.

Employers notified for the purposes of TDS

1. The Central Government and any State Government,
2. All Industrial, Commercial or Trading undertakings, Company or Corporation of the Central Government or of any State Government, whether set up under any special law or not, and a Port Trust set up under the Major Ports Act, 1963,
3. A Company registered under the Companies Act, 1956,
4. A local authority, including a Municipal Corporation, Municipal Council, Zilla Parishad, and Cantonment Board,
5. (i) A Co-operative Society (other than a Co-operative Housing Society) registered under the Maharashtra Co-operative Societies Act, 1960.

(ii) A Co-operative Housing Society, registered under the Maharashtra Co-operative Societies Act, 1960, (which has awarded contracts of value aggregating to rupees 10 lakh or more in the previous year or as the case may be, in the current year).
6. A registered dealer under the Maharashtra Value Added Tax Act, 2002.
7. An Insurance or Finance Corporation or Company; and any Bank included in the Second Schedule to the Reserve Bank of India Act, 1934, and any Scheduled Bank recognised by the Reserve Bank of India.
8. Trusts, whether public or private.

Rate of TDS

The notified employers are required to deduct TDS, from the amount payable to a contractor @ 2% if the contractor is a registered dealer otherwise @ 5% w.e.f 01.04.2012. (Earlier the rate was 4% up to 31-03-2012).

Tax on Sale of under construction flats and units by builders & developers:

Whether liable to Tax: Decisions of various High Courts and Supreme Court of India

Applicability in Maharashtra:

Circular No. 12 T of 2007, dated 07-02-2007, issued by the Commissioner of Sales Tax, Maharashtra, clarifying about applicability of the ratio of judgment delivered by the Supreme Court in case of K. Raheja [*M/S. K. Raheja Development Corporation 141 STC 298 (S.C)*] stated that the same will now be applicable to the proceedings under MVAT Act, w.e.f. 20th June 2006. This circular further clarifies that if the agreement is entered into after the flat or unit is already constructed, then there would be no works contract, but so long as agreement is entered into before the construction is complete, it would be a Works Contract.

It may be noted that the matter of levying tax on sale of under construction flats/units was challenged through various writ petitions. All those writ petitions were disposed off by the Hon'ble Bombay High Court from time to time. The matter was also considered by the Hon'ble Supreme Court of India. And, at present, it can be said that though some of the transactions of sale of under construction flats/units may be liable to tax as 'works contract' depending upon the nature of agreement and stage of construction, etc., but at the same time one cannot hold a view that all such transactions are liable to tax.

It may specifically be noted that Hon'ble Bombay High Court, through the discussion involved in the disposal of writ petition of MCHI, has not or never held that all transactions of agreements to sale flats (under construction contracts), entered into by and between the builders/developers and the purchaser, are liable to tax as 'works contract'. The High Court, by its order dated 10th April 2012, has just upheld the constitutional validity of amendment to section 2(24) of MVAT Act. The amendment itself does not provide for levy of tax in such a situation. It is, in fact, the Circular No. 12 T of 2007, dated 07-02-2007, issued by the Commissioner of Sales Tax, Maharashtra, which has created the controversy. A further Trade Circular, dated 6th August 2012, issued by the Commissioner of Sales Tax, was challenged in another writ petition [WP(L) 2405 of 2012], filed by Mr. Ashok R. Gokani and others. The

same was disposed off by the Hon'ble Bombay High Court on 30th October 2012. In its order, the High Court has clearly said that "A Trade Circular issued by the Commissioner of Sales Tax cannot foreclose the quasi-judicial powers and / or functions of the Assessing Authorities."

The Hon'ble High Court has further stated, at para (3) of its order, "We clarify that the issue as to whether a particular contract constitutes a works contract or involves an element of a works contract is a matter which shall be decided on the facts of the individual case if it is raised by the assessee in accordance with the provisions of the Maharashtra Value Added Tax Act, 2002. The learned Advocate General appearing on behalf of the State of Maharashtra has, on instructions, conceded to this position. Moreover, it would not be either appropriate or proper for the Court to make a generalized determination without having regard to the facts of the particular case."

In the above background let's now consider the specific provisions contained under the MVAT law in this regard:-

Deduction from sale price for cost of land & other deductions in case of Construction Contracts related to sale of under construction units by builders/developers:

[Rule 58(1A)]

- i. In case of a construction contract, where along with the immovable property, the land or, as the case may be, interest in the land, underlying the immovable property is to be conveyed, and the property in the goods (whether as goods or in some other form) involved in the execution of the construction contract is also transferred to the purchaser, the value of the said goods at the time of the transfer shall be calculated after deducting cost of the land from the total agreement value.
- ii. The cost of the land shall be determined in accordance with the guidelines appended to the Annual Statement of Rates prepared under the provisions of the Bombay Stamp (Determination of True Market Value of Property) Rules, 1995, as applicable on the 1st January of the year in which the agreement to sell the property is registered

Provided that, after payment of tax on the value of goods, determined as per this rule, it shall be open to the dealer to provide before the Department of Town Planning and Valuation that the actual cost of the land is higher than that determined in accordance with the Annual Statement of Rates (including guidelines) prepared under the provisions of the Bombay Stamp (Determination of True Market Value of Property) Rules, 1995. On such actual cost being proved to be higher than the Annual Statement of Rates, the actual cost of the land will be deducted and excess tax paid, if any, shall be refunded. [Rule 58(1A)]

- iii. The deduction u/r. 58(1) shall be made after deducting cost of land as per rule (1A).
- iv. No deduction for cost of land is applicable in cases of payment of tax under the composition scheme for builders & developers.

[Rule 58(1B)]

(a) Where the dealer undertakes the construction of flats, dwellings, buildings or premises and transfers them in pursuance of an agreement along with the land or interest underlying the land then, after deductions under sub-rules (1) and (1A) from the total contract price, the value of the goods involved in the works contract shall be determined after applying the percentage provided in column (3) of the following TABLE depending upon the state at which the purchaser entered into contract.

TABLE

Sr. No.	Stage during which the developer enters into a contract with the purchaser.	Amount to be determined as value of goods involved in works contract.
(1)	(2)	(3)
(a)	Before issue of the Commencement Certificate.	100%

(b)	From the Commencement Certificate to the completion of plinth level.	95%
(c)	After the completion of plinth level to the completion of 100% of RCC framework.	85%
(d)	After the completion of 100% RCC framework to the Occupancy Certificate.	55%
(e)	After the Occupancy Certificate.	Nil%

(b) For determining the value of goods as per the Table clause (a), it shall be necessary for the dealer to furnish a certificate from the Local or Planning Authority certifying the date of completion of the stages referred above and where such authority does not have a procedure for providing such certificate then such certificate from a registered RCC consultant.

[Rule 58(1C)]

If the dealer fails to establish the stage during which the agreement with the purchaser is entered, then the entire value of goods as determined after deductions under sub-rules (1) and (1A) from the value of the entire contract, shall be taxable.

Composition Scheme for Builders/Developers

This is a Special Scheme announced for Builders/Developers. For the purposes, enabling provisions have been made in the MVAT Act, 2002 by inserting section 42(3A) vide amendment effected in April, 2010. Under the said enabling power, the state government has notified this Composition Scheme vide Gazette Notification dated 09.07.2010. The salient features of this new Scheme can be noted briefly as under;

- a) The Scheme applies to Builders/Developers, who undertake the construction of flats etc., wherein they also transfer land or interest underlying the land.
- b) The Scheme shall apply to registered dealers only.

- c) The Scheme is applicable to agreements registered on or after 01.04.2010. Therefore, even if the agreement is executed earlier but registered on or after 01.04.2010, it will be eligible for composition scheme.
- d) The Composition money is 1% of the agreement amount, specified in the agreement or value adopted for the purpose of stamp duty, whichever is higher.
- (e) The dealer/s opting for this composition scheme shall not be eligible to claim set off of taxes paid on purchases.
- (f) The dealer/s opting for this composition scheme shall not be eligible to effect any purchases against 'C' forms.
- (g) The dealer/s opting for this composition scheme shall not issue form no. 409 to the sub-contractors in respect of the works contract/s in respect of which composition is opted.
- (h) The further conditions is that the dealer will not be entitled to change the method of computation of tax liability. (From the plain reading, it appears that this condition is to be seen qua each contract and not the project as a whole.)
- (i) The last condition mentions is that the dealer under this Composition Scheme should not issue tax invoice.
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