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Valuation Complexities in Works Contract

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❖ *Clause (h) of Section 66E with effect from 01.07.2012 declare following service as taxable service.*

(h) service portion in the execution of a works contract;

Therefore tax is payable only on the service portion in execution of works contract. The taxable value of service can not included the value of material used in execution of works contract.

❖ *Prior to 01.07.2012 taxable service was defined in Section 65(105) (zzzza) as follows:-*

“(zzzza) to any person, by any other person in relation to the execution of a works contract, excluding works contract in respect of roads, airports, railways, transport terminals, bridges, tunnels and dams.

Explanation. — For the purposes of this sub-clause, “works contract” means a contract wherein, —

(i) transfer of property in goods involved in the execution of such contract is leviable 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;*

The earlier definition of taxable service did not specifically specified that taxable service is only service portion in execution of works contract. Therefore Hon'ble Tribunal in case of S. V. Jiwani 2014(35) STR 351 (Tri. Ahmd) has held that the service provider providing works contract service can pay the service tax on gross amount (including value of material) in case the service provider chooses to avail the credit of excise duty paid on input like Cement Steel etc.

Case of Kone Elevator

The five member bench of Hon'ble Supreme Court in the case of Kone Elevator India Pvt. Ltd. v/s State of Tamil Nadu [2014] taxmann.com 150/45 GST 494. Over held earlier judgment of Kone Elevator and held that in installation of the lift, there is considerable skill and experience is required. Thus it has element of service . The services element is not incidental or ancillary to the supply of parts. Hence services of supply of lift and installation of lift is works contract.

Works contract as defined in various VAT Act and defined in service tax is different.

(a) The definition of works contract in service tax as given in Section 65B(54) as follows:

“works contract” means a contract wherein transfer of property in goods involved in the execution of such contract is leviable to tax as sale of goods and such contract is for the purpose of carrying out construction, erection, commissioning, installation, completion, fitting out, repair, maintenance, renovation, alteration of any movable or immovable property or for carrying out any other similar activity or a part thereof in relation to such property;

(b) Section 2(24) of Maharashtra VAT Act defines “Sale”. The clause b(ii) of explanation which deals with works contract reads as follows:

“(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.”

It will be observed from above scope of works contract in VAT Act is much wider than scope of works contract in service tax. Hence there will be number of contract which can be considered as works contract in VAT Act but will not be considered as works contract in service tax.

VALUATION OF WORKS CONTRACT

RULE 2A OF SERVICE TAX (DETERMINATION OF VALUE) RULES, 2006.

2A. Determination of value of service portion in the execution of a works contract.—Subject to the provisions of section 67, the value of service portion in the execution of a works contract, referred to in clause (h) of section 66E of the Act, shall be determined in the following manner, namely:-

(i) 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.

Explanation. — For the purposes of this clause, —

(a) 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, —

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;*
- (c) 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.*

❖ *As per rule 58 of Maharashtra Value Added Tax Rule 2005, the value of goods involved in execution of works contract shall be determined by effecting the following declaration form value of entire contract.*

- a) Labour and service charges for the execution of the works*
- b) Amount paid by way of price for sub-contract, if any, to sub-contractors;*
- c) Charges for planning, designing and architect's fees;*
- d) Charges for obtaining on hire or otherwise, machinery and tools for the execution of the works contract;*
- e) 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;*

- f) *Cost of establishment of the contractor to the extent to which it is relatable to supply of the said labour and services;*
- g) *Other similar expenses relatable to the said supply of labour and services, where the labour and services are subsequent to the said transfer of property;*
- h) *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 deduction 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.

<i>Sr. No.</i>	<i>Type of Works Contract</i>	<i>Amount to be deducted from the contract price (expressed as a percentage of the contract price)</i>
<i>(1)</i>	<i>(2)</i>	<i>(3)</i>
1.	<i>Installation of plat and machinery</i>	<i>Fifteen per cent</i>
2.	<i>Installation of air conditioners and air coolers</i>	<i>Ten per cent</i>
3.	<i>Installation of elevators (lifts) and escalators</i>	<i>Fifteen per cent</i>
4.	<i>Fixing of marble slabs, polished granite stones and tiles (other than mosaic tiles)</i>	<i>Twenty five per cent</i>
5.	<i>Civil works like construction of buildings, bridges, roads, etc.</i>	<i>Thirty per cent</i>
6.	<i>Construction of railway coaches on under carriages supplied by Railways</i>	<i>Thirty per cent</i>
7.	<i>Ship and boat building including construction of barges, ferries, tugs, trawlers and dragger</i>	<i>Twenty per cent</i>

Sr. No.	Type of Works Contract	Amount to be deducted from the contract price (expressed as a percentage of the contract price)
(1)	(2)	(3)
8.	<i>Fixing of sanitary fittings for plumbing, drainage and the like</i>	<i>Fifteen per cent</i>
9.	<i>Painting and polishing</i>	<i>Twenty per cent</i>
10.	<i>Construction of bodies of motor vehicles and construction of trucks</i>	<i>Twenty per cent</i>
11.	<i>Laying of pipes</i>	<i>Twenty per cent</i>
12	<i>Tyre re-treading</i>	<i>Forty per cent</i>
13	<i>Dyeing and printing of textiles</i>	<i>Forty per cent</i>
14	<i>Annual Maintenance contracts</i>	<i>Forty per cent</i>
15	<i>Any other works contract</i>	<i>Twenty five per cent</i>

(ii) Where the value has not been determined under clause (i), 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, namely:—

(A) in case of works contracts entered into for execution of original works, service tax shall be payable on forty per cent of the total amount charged for the works contract;

(B) in case of works contract, not covered under sub-clause (A), including works contract entered into for, -

(i) maintenance or repair or reconditioning or restoration or servicing of any goods; or

(ii) maintenance or repair or completion and finishing services such as glazing or plastering or floor and wall tiling or installation of electrical fittings of immovable property,

service tax shall be payable on seventy per cent. of the total amount charged for the works contract.]

Upto 39-09-2010, taxable portion of works contracts in the nature of completion and finishing services such as glazing, plastering, floor and wall tiling, installation of electrical fittings of an immovable property, maintenance or repair of immovable property, etc was at sixty per cent of the total amount charged for the works contract.

Explanation 1.—For the purposes of this rule,—

(a) “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;

❖ SERVICE TAX IMPOSED ON CONSTRUCTION SERVICES

(25b) [“commercial or industrial construction”] means-

*(a) construction of a new building or a civil structure or a part thereof;
or*

(b) construction of pipeline or conduit; or

- (c) completion and finishing services such as glazing, plastering, painting, floor and wall tiling, wall covering and wall papering, wood and metal joinery and carpentry, fencing and railing, construction of swimming pools, acoustic applications or fittings and other similar services, in relation to building or civil structure; or*
- (d) repair, alteration, renovation or restoration of, or similar services in relation to, building or civil structure, pipeline or conduit*

which is –

- (i) used, or to be used, primarily for; or*
- (ii) occupied, or to be occupied, primarily with; or*
- (iii) Engaged or to be engaged, primarily in,*

commerce or industry, or work intended for commerce or industry, but does not include such services provided in respect of roads, airports, railways, transport terminals, bridges, tunnels and dams;

❖ *Definition of Erection, Commissioning or installation (prior to 1-07-2012).*
Clause 65[(39a) “erection, commissioning or installation” means any service provided by a commissioning and installation agency, in relation to, —

(i) erection, commissioning or installation of plant, [machinery, equipment or structures, whether pre-fabricated or otherwise]; or

(ii) installation of —

(a) electrical and electronic devices, including wirings or fittings there for; or

(b) plumbing, drain laying or other installations for transport of fluids; or

(c) heating, ventilation or air-conditioning including related pipe work, ductwork and sheet metal work; or

(d) thermal insulation, sound insulation, fire proofing or water proofing; or

(e) lift and escalator, fire escape staircases or travelators; or

(f) such other similar services;]

(b) 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:*

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

Explanation 2.—For the removal of doubts, it is clarified 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, 2004.”

❖ *The Hon'ble Tribunal in case Galaxy Mercantile Ltd. has observed as follows with regard to availing credit on input used for in execution of works contract:*

“further there is nothing in the said order of the Hon'ble High Court to reflect upon the fact that said warehouse was got constructed by availing the services of the 'Works Contract Service' provider or the construction or commercial institution service provider. As such, at this prima facie stage, we find that the ratio of the above decision of the Hon'ble Andhra Pradesh High Court is not applicable to the facts of the instant case.”

Thus, it is held service recipient cannot avail the credit of excise duty paid on the input. The explanation only prohibits availment of credit to provider of service and not to recipient of service.

Valuation of Works Contract Service

- ❖ *Service portion in the execution of works contract shall be determined as per Service Tax (Determination of Value) Rules, 2006*
- *Rule 2A of Service Tax (Determination of value) Rules, 2006*
 - *Option 1 : Actual Method*
 - *Option 2 : Composition Method*

Option 1 : Actual Method

	<i>Particulars</i>	<i>Amount (Rs.)</i>
A	<i>Gross Amount Charged for Works Contract (Note 1)</i>	<i>xxxx</i>
B	<i>(i) Less : Vat / Sales tax paid / Payable</i>	<i>(xxxx)</i>
	<i>(ii) Less : value of Property in goods transferred in execution of works contract (Note 2)</i>	<i>(xxxx)</i>
C	<i>Net Amount Chargeable for Service Tax (A-B)</i>	<i>Xxxx</i>
D	<i>Service Tax on "C" above @ 12.36%</i>	<i>Xxxx</i>
E	<i>Less : Input Cenvat Credit</i>	<i>(xxxx)</i>
F	<i>Net Service Tax Payable (D-E)</i>	<i>Xxxx</i>

❖ **Note 1 : Gross amount of Works contract shall include :**

1. *Labour Charges for execution of works contract.*
2. *Amount paid to a Sub-Contractor for labour & Services*
3. *Charges for planning, designing and architect's fees.*
4. *Charges for obtaining on hire or otherwise, machinery and tools used for the execution of the works contract.*
5. *Cost of consumables such as water, electricity, fuel used in the execution of works contract.*
6. *Cost of establishment of the contractor relatable to supply of labour and services.*
7. *Other similar expenses relatable to supply of labour and services.*
8. *Profit earned by the service provider relatable to supply of labour and services.*

❖ **Note 2 : Value of property in goods transferred in the execution of Works contract :**

Value of property in goods transferred in the execution of works contract shall be value taken for VAT purpose.

❖ Option 2 : Composition Method

Sr. No	Nature of Contract	Taxable Value	Net Service Tax liability (in % age)
A.	<p><i>Execution of Original Works</i> <i>i.e.</i> (i) <i>All new constructions</i> (ii) <i>Erections</i> (iii) <i>Commissioning</i> (iv) <i>Installation</i></p>	<p>40% of "Total amount Charged" for Works Contract</p>	<p>4.944%</p>
B.	<p><i>Execution of contract for</i> (i) <i>Maintenance or</i> (ii) <i>Repair or</i> (iii) <i>Reconditioning or</i> (iv) <i>Restoration or</i> (v) <i>Servicing</i> of any goods</p>	<p>70% of "Total amount Charged" for Works Contract</p>	<p>8.652%</p>
C.	<p><i>In case of other works contract, including</i> (i) <i>Maintenance,</i> (ii) <i>Repair,</i> (iii) <i>Completion and</i> (iv) <i>Finishing services such as glazing, plastering, floor and wall tiling, installation of electrical fittings</i> of an immovable property</p>	<p>70% "Total Amt Charged" for WC. <i>Till 30-09-2014.</i> <i>Taxable value under this category was 60% of the gross amount charged.</i></p>	<p>8.652%</p>

Explanation 1 – for the purpose of clause (II) of rule 2A

❖ “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;

❖ “total amount” means

Sr. No.	Particulars	Amount (Rs.)
1.	Sum total of gross amount charged for the works contract	xxx
2.	Add : 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, 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	xxx

THANK YOU

BALANCED VIEW

PRESENTED BY

S.S.GUPTA