

WESTERN INDIA REGIONAL COUNCIL OF ICAI

***CLASSIFICATION & VALUATION ISSUES
ARISING IN REVERSE CHARGE
UNDER SERVICE TAX***

21ST NOVEMBER 2015

Valuation under Service Tax - General Provision

- ▶ No fundamental change in the manner of valuation of services post July 1, 2012.
- ▶ Old Rule 2A of the Valuation Rules and Works Contract (Composition Scheme for payment of service tax) Rules, 2007 is being replaced by new Rule 2A of Service Tax (Determination of Value) Rules, 2006.
- ▶ If provision of service is for consideration in money, value of taxable service shall be **gross amount charged**. {67(1)(i)}
- ▶ Gross Amount Charged = Value of Taxable Service + Service Tax Charged.

Valuation – General Provision continued...

- ▶ Where the consideration received is not wholly or partly in money, value of taxable service shall be the equivalent money value of such consideration. {67(1)(ii)}
- ▶ If consideration is not ascertainable then the amount as may be determined in the following manner:-
- ▶ **(a)** the value of such taxable service shall be equivalent to the gross amount charged by the service provider to provide similar service to any other person in the ordinary course of trade and the gross amount charged is the sole consideration;
- ▶ **(b)** where the value cannot be determined in accordance with clause (a), the service provider shall determine the equivalent money value of such consideration which shall, in no case be less than the cost of provision of such taxable service.

Valuation – General Provision continued...

- ▶ Can Value of Goods supplied form part of Taxable Value?

Under the negative list scheme, specified descriptions of taxable services have been done away with and transactions that involve transfer of title in goods or are 'deemed to be sale of goods' under the Constitution are excluded from the ambit of service by the very definition of service. Therefore if, in the course of providing a service, goods are also being sold by a service provider for which there is such documentary proof as to make the sale a distinct and a separate transaction then the activity of sale of such goods gets excluded from the definition of service itself. (Para 2.6.4 of Education Guide)

Import of Service – Case Study 1

- ▶ Determination of rate of exchange.- The rate of exchange for determination of value of taxable service shall be the applicable rate of exchange as per the generally accepted accounting principles on the date when point of taxation arises in terms of the Point of Taxation Rules, 2011. (from 1st October 2014)
- ▶ Generally Accepted Accounting Principles
- ▶ Point of Taxation in case of associated concerns
- ▶ Point of Taxation in case of others

Import of Service – Case Study 2

- ▶ A Ltd has its HQ in India and Branch / Liaison Office in UK.
- ▶ Overseas Branch receives remittances from HO (India) on regular basis to meet local expenses
- ▶ During the course of the service tax audit revenue demands service tax from HO on such remittances on the ground that i) HO & Branch are two distinct entities and ii) activities carried out by branch are liable to be taxed under reverse charge.
- ▶ A Ltd. denies such liability to pay service tax. Is A Ltd correct in law in its approach?

Value of Goods in Works Contract

- ▶ Value of Works Contract Service to include
 - ▶ labour charges for execution of the works;
 - ▶ amount paid to a sub-contractor for labour and services;
 - ▶ charges for planning, designing and architect's fees;
 - ▶ charges for obtaining on hire or otherwise machinery and tools used for the execution of works contract;
 - ▶ cost of consumables such as water, electricity, fuel used in the execution of the works contract;
 - ▶ cost of establishment of the contractor relatable to supply of labour and services;
 - ▶ other similar expenses relatable to supply of labour and services; and
 - ▶ profit earned by the service provider relatable to supply of labour and services;
- ▶ Effective from July 1, 2012, value of goods in the works contract service can be worked out by using following methods:-
 - ▶ Method 1 – Actual Deduction Method
 - ▶ Method 2 – Standard Deduction Method

Valuation - WCT – Case Study 3

- ▶ A Ltd. was awarded a works contract for the construction of original civil structure by B Pvt. Ltd.
- ▶ Contract price is inclusive of all cost and local VAT but excluding service tax.
- ▶ A Ltd procures goods property in which stood transferred during execution of contract.
- ▶ A Ltd. has paid Central Excise Duty on such goods (inputs).
- ▶ A Ltd desires i) to collect service tax at full rate on the entire contract price (excluding Local VAT) and ii) to avail CENVAT of Central Excise Duty paid on such inputs.
- ▶ Is A Ltd correct in law in its approach?

Valuation - WCT – Case Study 4

- ▶ A Ltd. was awarded a works contract for the construction of original civil structure by B Pvt. Ltd.
- ▶ Contract price is inclusive of all cost and local VAT but excluding service tax.
- ▶ Under the local VAL laws A Ltd opts for regular assessment but claims standard deduction say @ 30% of contract price towards labour and service portion and discharges local VAT on balance 70% of contract price.
- ▶ A Ltd. desires to pay service tax on 30% of the contract price before local vat.
- ▶ Is A Ltd correct in law in its approach?

Valuation – WCT - Case Study 5

- ▶ A Ltd. was awarded a works contract for the construction of original civil structure by B Pvt. Ltd.
- ▶ Contract price is inclusive of all cost and local VAT but excluding service tax.
- ▶ A Ltd opts for standard deduction method i.e. 60% of the contract price before VAT to arrive at taxable portion of service tax.
- ▶ B Pvt. Ltd. supplies free of cost to A Ltd. i) Diesel (HSD) ii) construction equipments for construction period iii) Water iv) Electricity Charges v) imported chemicals vi) land to be used as site and / or storage yard
- ▶ A Ltd. pays service tax on contract price without considering fair market value of items mentioned above.
- ▶ Is A Ltd. correct in law in its approach?

Valuation – WCT - Case Study 6

- ▶ A Ltd. was awarded a works contract for the construction of original civil structure by B an individual.
- ▶ Contract was agreed to be completed within a period of 2 years.
- ▶ Contract actually gets completed in 3 years and B recovers liquidated damages from A Ltd. in accordance with contract terms.
- ▶ Is B liable to pay service tax on the amount of liquidated damages so recovered?

Valuation – Directors' Fees - Case Study 7

- ▶ A Ltd. an Indian Company has its Head Quarter in Mumbai.
- ▶ It holds its Board Meeting away from its Head Quarter.
- ▶ Directors attending Board Meeting are paid Fees plus cost towards air fare & Lodging Boarding Expenses.
- ▶ A Ltd. Discharges service tax liability under reverse charge on the amount of Directors Fees excluding air fare & lodging cost.
- ▶ Is A Ltd. correct in its approach?

Valuation – Manpower Supply -Case Study

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- ▶ A Ltd. receives services of B an individual in the field of security services.
- ▶ B raises invoice based on the mandays spent in the month.
- ▶ B also raises separate debit note towards Employer's provident fund contribution together with proof of such payment into Government Treasury.
- ▶ A Ltd. discharges service tax liability under reverse charge on the invoice value excluding the value shown in the debit note.
- ▶ Is A Ltd correct in its approach?

Classification – Manpower Supply – Case Study 9

- ▶ A Ltd. is engaged in the business of Market Research that measures and analyzes the TV viewership patterns.
- ▶ A Ltd. engages services of freelancers for collecting data from end customers.
- ▶ These freelancers are appointed on a principal to principal basis.
- ▶ These freelancers are paid retainership fees.
- ▶ During the course of the audit, revenue authorities holds that the amount paid to freelancers by A Ltd. is liable to service tax under reverse charge under Manpower Category.
- ▶ Is stand of the revenue correct?

Classification – Construction Services - Study 10

- ▶ A Ltd was awarded contract for construction of Metro Railway.
- ▶ It engages services of B an individual for piling works & pouring of concrete. (Concrete supplied free of cost to B by A)
- ▶ B claims these services as exempt services under clause 14 of the mega exemption notification.
- ▶ During the course of the audit, revenue authorities holds that these services do not fall under works contract category and hence not entitled to exemption in the hands of B.
- ▶ Is stand of the revenue correct?

Classification – Construction Services - Study 11

- ▶ A Ltd. intends to participate in a business exhibition.
- ▶ It awards a contract to B a Partnership Firm for design and production of Finished Display Cases to be used by it in the said Exhibition.
- ▶ The contract scope excludes pre and post exhibition dismantling or any building works.
- ▶ B charges service tax at full rate in its first invoice raised on A Ltd.
- ▶ A Ltd seeks your advice on what is correct nature of contract in the instant case?

Classification – Rent a Cab Services -Study 12

- ▶ A Ltd. is registered as Air Travel Agent Service.
- ▶ Its business activities include group ticket bookings on domestic and international routes.
- ▶ It also arranges car rental services for its customers across India.
- ▶ These cars were taken on hire from car owners who are mostly individuals.
- ▶ Car owners charge service tax at full rate to A Ltd. who in turn charges service tax at full rate to its customers.
- ▶ During the course of the audit, revenue authorities hold that A Ltd is liable to pay service tax on rentals so paid under reverse charge?
- ▶ Is stand of the revenue authorities correct?

Classification – GTA Services -Study 13

- ▶ A Ltd. is engaged in the business of manufacturing of Engineering Goods.
- ▶ It is having its production facility in Nasik.
- ▶ For transporting finished goods, from its factory to customers' location, it avails services of a B an individual.
- ▶ B owns fleet of trucks and uses the same in transporting goods of A Ltd.
- ▶ B does not issue any consignment notes.
- ▶ A Ltd. Pays freight to B.
- ▶ Is A Ltd. liable to discharge service tax liability under Reverse charge mechanism on freight so paid?

Classification – Legal Services -Study 14

- ▶ A Ltd. incurred following expenses:-
 - a) Notary Charges
 - b) Advocate fees for defending case in court of law
 - c) Advocate fees in connection with verifying property related documents
 - d) Fees to Chartered Accountant for filing income tax return and VAT returns

A Ltd seeks your advice on applicability of reverse charge on each of the above items of expenses?

Miscellaneous Issues

- ▶ Is it possible for service receiver to opt for method of valuing works contract service different from service provider?
- ▶ Can service receiver be absolved from his liability under reverse charge in case entire service tax is collected & paid by the service provider?
- ▶ Can scope of service be defined mutually post July 1, 2012
- ▶ Is service recipient exempted under reverse charge if service provider is small service provider?
- ▶ Treatment of fabrication jobs under various options
- ▶ Recent SC decision holding no ST on WCT services prior to 1st June 2007.

Classification & Valuation issues arising under reverse charge under Service Tax

