Service Tax
Works contract & Renting of Immovable property
Clarification or Controversy

Circular 98/1/2008 – ST, dated: January 4, 2007

This circular is issued to clarify issues with respect to Erection, commissioning or installation service; commercial; industrial construction service or construction of complex service.

1.

Issue: Whether or not Commercial or Industrial Construction Service or Works Contract Service used for Construction of an immovable property, could be treated as Input service for the output service namely renting of immovable property service.

Clarification: Immovable property is neither subjected to central excise duty nor to service tax. Input credit of service tax can be taken only if the output is a 'service' liable to service tax or a 'goods' liable to excise duty. Since immovable property is neither 'service' nor 'goods' as referred to above, input credit cannot be taken.

Controversies:

- Where the department contends that immovable property is not a service or goods is the levy of service tax on renting of immovable property justifiable in the first instance?
- Construction of an immoveable property brings an asset into existence. Where such asset is used for the purpose of generation of revenue, which is made a subject matter of service tax, is disallowing CENVAT credit in respect of service received for bringing that asset into existence (i.e. construction of Immovable property) justifiable under law?

The authors of this article are of the view that classifying renting of immoveable property as a service is bad in law. Further this circular would rather than clarify the existing doubt only attract further litigation as the words of this circular can itself be used to strike down the said levy.

II

Background: Service tax is leviable on the value equivalent to the gross amount charged for the works contract less value of the transfer of property in goods involved in the execution of the works contract which is leviable to VAT / sales tax.

Issue: Whether or not, excise duty paid on goods, subjected to levy of VAT / sales tax under works contract service, can be taken as credit under the CENVAT Credit Rules, 2004?

Clarification: Value for the purposes of levy of service tax under works contract service does not include the value pertaining to transfer of property in goods involved in the execution of a works contract leviable to VAT / sales tax. Works contract service provider is, therefore, not eligible to take credit of excise duty paid on such goods involved in the execution of works contract.

The authors are of the view that the Works Contractor cannot claim CENVAT credit of excise duty paid on material. However they can claim CENVAT Credit of Service Tax paid on input services and CENVAT Credit of excise duty paid on Capital goods.

III

Background: Works Contract (Composition Scheme for Payment of Service Tax) Rules, 2007 provides option to pay service tax @ 2% of the gross amount charged for the works contract. However, the service provider opting for composition scheme for payment of service tax should exercise the option **prior to payment of service tax.**

Issue:

(i) In respect of Contracts entered into prior to 01.06.07 for providing erection, commissioning or installation, and commercial or residential construction service, and

(ii) Service tax has already been paid for part of the payment received before 01.06.2007 under the respective taxable service.

Whether in such cases, the service provider can revise the classification to works contract service from the respective classification and pay service tax for the amount received on or after 01.06.07 under the Composition Scheme?

Clarification: The contract for the service under the category mentioned under Issue (i), where tax was paid under the said category, contract for service was a single composite contract. Part of service tax liability corresponding to payment received was discharged and the balance amount of service tax is required to be paid under the same Classification even on or after 01.06.07 depending upon the receipt of payment.

Classification of a taxable service is determined based on the nature of service provided whereas liability to pay service tax is related to receipt of consideration. Vivisecting a single composite service and classifying the same under two different taxable services depending upon the time of receipt of the consideration is not legally sustainable.

In view of the above, a service provider who paid service tax prior to 01.06.07 for the taxable service, is not entitled to change the classification of the single composite service for the purpose of payment of service tax on or after 01.06.07 and hence, is not entitled to avail the Composition Scheme.

Controversies:

- Where this circular requires a service provider to continue paying service tax on ongoing projects initiated before 01.06.2007 under the classification commercial or industrial construction service or construction of complex service on the contention that a single composite service cannot be classified under two different taxable services depending upon the time of receipt of consideration, Whether the service provider can opt to discharge service tax under the composition scheme of Works contract on new projects which will be executed in the same way as the ongoing projects? In such a case is it justifiable to Classify new projects under the new Classification and the old projects under the old Classifications.
- Whether the Words- "should exercise the option **prior to payment of service tax"** Can be read to mean before commencement of project or before Discharge of service liability for the period falling after 01.06.2007.
- If the works contractor is allowed to pay service tax under the classification "Works Contract", then the service coming to force from 01.06.07 he is liable to pay service tax only under the head Works contract. In this backdrop will the payment made under the classification "erection, commissioning or installation service, commercial or industrial construction service or construction of complex service" become a payment with no specific levy and thus be refundable?
- The classification rule 1 says the sub-clause providing most specific description shall be preferred to the sub-clauses providing a more general classification. As per this classification Specific entry is "Industrial construction service or construction of complex service". The classification rule 3 also specifies that the Service which come first in among the sub-clause which equally merit consideration is to be taken.

  The intention of legislature by introduction of Chapter "Works contract" was to make the entry under works contract more specific. If this intention of the legislature is not given effect for ongoing projects, and in spite of the existence of the specific classification namely "commercial or industrial construction service or construction of complex service" can the said service be classified under Works Contract Service?

  If yes, whether a service provider can opt for composition scheme under "works contract". If not, will not the insertion of the new entry become redundant?

The authors of this article are of the view that with the co-existence of the entries "erection, commissioning or installation service, commercial or industrial construction service or construction of complex service" and "works contract" and instructing service provider to pay service tax on ongoing projects under the prior entry and on new projects under the new entry is not legally sustainable and can be challenged before the court.