GOODS & SERVICE TAX FOR CIVIL CONTRACTS (GOVT CONTRACTORS)

JOURNEY FROM OLD REGIME TO GST

Works Contract Has Been A Mystery For Almost Half A Century And Yet It Fancies Every Avid Leaner Of Indirect Tax. It Is A Composite Contract Involving Both Transfer Of Property And Provision Of Labour. We Shall Examine The Implications Of Goods And Services Tax Law ("GST Law") On Works Contract In This Paper.

Works Contract

And

VAT

This Charge Started By *State Of Madras V. Gannon Dunkerley & Co. (Madras)* Ltd., *1958-VIL-01-SC* Is Still In Its Never Ending Journey. The Constitution Bench Of Apex Court Held That In A Building Contract Which Was One And Entirely Indivisible, *There Was No Sale Of Goods* And It Was Not Within The Competence Of The State Legislature To Impose A Tax On The Supply Of Materials Used In Such A Contract, Treating It As A Sale. It Further Held That *It Is A Composite Contract And Consists Of Transfer Of Property In Goods But Labour And Service Elements As Well.*

Accordingly, Government Came Out With A Solution Viz., By Introducing Provision Of Deeming Sale In The Constitution Of India

Constitutional Amendment –

The Constitution Was Amended By 46th Amendment And Clause (29-A) Was *Inserted In Article 366, Clause (29A) Of Article 366* Is In The Following Terms.

"(29-A) Tax On The Sale Or Purchase Of Goods Includes-
"(A) ....
(B) A Tax On The Transfer Of Property In Goods (Whether As Goods Or In Some Other Form) Involved In The Execution Of A Works Contract;
(C) ...."

After The Ammendment In Constituion In The Case Of **Builders' Assn. Of India V. Union Of India** This Challenge Was Ultimately Repelled And Apex Court Stated:-

"… After The 46th Amendment, ***It Has Become Possible For The States To Levy Sales Tax On The Value Of Goods Involved In A Works Contract*** *In The Same Way In Which The Sales Tax Was Leviable On The Price Of The Goods And Materials Supplied In A Building Contract Which Had Been Entered Into In Two Distinct And Separate Parts As Stated Above."*

Works Contract

In

VAT Laws

<u>VAT Acts Have Defined Works Contract In More Or Less Similar Manner. Definition As Provided In VAT Acts Are As Under</u>

1.Uttarakhand

"Works Contract" Includes Any Agreement For Carrying Out, For Cash, Deferred Payment Or Other Valuable Consideration, Building, Constructing, Manufacture, Processing, Fabrication, Erection, Installation, Fitting Out, Improvement, Modification, Repair Or Commissioning Of Any Movable Or Immovable Property;

2. Delhi

“Works Contract” Includes Any Agreement For Carrying Out For Cash Or For Deferred Payment Or For Valuable Consideration, The Building Construction, Manufacture, Processing, Fabrication, Erection, Installation, Fitting Out, Improvement, Repair Or Commissioning Of Any Moveable Or Immovable Property.

Thus, It Is Pertinent To Note That Specific Transaction Are Included In Works Contract Under State VAT Acts.

Valuations Settled – Gannon Drunkley II

Hon'ble Court Held That The Value Of The Goods Involved In The Execution Of A Works Contract Will, Therefore, Have To Be Determined By Taking Into Account The ***Value Of The Entire Works Contract And Deducting Therefrom The Charges Towards Labour And Services Which Would Cover***:

A) Labour Charges For Execution Of The Works;

B) Amount Paid To A Sub-contractor For Labour And Services;

C) Charges For Planning, Designing And Architect's Fees;

D) Charges For Obtaining On Hire Or Otherwise Machinery And Tools Used For The Execution Of The Works Contract;

E) Cost Of Consumables Such As Water, Electricity, Fuel Etc. Used In The Execution Of The Works Contract The Property In Which Is Not Transferred In The Course Of Execution Of A Works Contract; And

F) Cost Of Establishment Of The Contractor To The Extent It Is Relatable To Supply Of Labour And Services;

G) Other Similar Expenses Relatable To Supply Of Labour And Services;

H) Profit Earned By The Contractor To The Extent It Is Relatable To Supply Of Labour And Services.

Thus, ***This Was The First Time When The Circle For Taxability Of Works Contract Under Sales Tax (VAT) Got Complete And The State Governments Got Their Right To Tax Such Transactions.***

VAT Law Usually Provide For Three Methods Of Computation Of Value For The Levy Of VAT:

1. Actual Value

This Method Requires Calculation Of Actual Value Of Goods Whose Property Is Transferred Via The Executed Works Contract. The Formulae For This As Provided In Gannon Drunclety II Has Been Replicated In Most Of The VAT Laws. It Is Provided That To Arrive At The Taxable Turnover Arising From The Execution Of A Works Contract, From The Total Consideration Paid Or Payable To The Dealer Under The Contract One Has To Exclude The Charges Towards Labour, Services And Other Like Charges (Nature Provided In Case Above).

2. Deemed Value

If A Dealer Does Not Want To Or Cannot Make Calculation On Actual Basis, A Choice Has Been Given To Him In Terms Of Prescribed Percentages Of Value Towards Labour, Services And Other Like Charges. For Example

Sl. No.	Type Of Contract	Labour, Service And Other Like Charges Are Percentage Of Total Value Of The Contract
1	Fabrication And Installation Of Plant And Machinery.	Twenty Five Percent
2	Fabrication And Erection Of Structural Works Of Iron And Steel Including Fabrication, Supply And Erection Of Iron Trusses, Purloins And The Like.	Fifteen Percent
3	Fabrication And Installation Of Cranes And Hoists.	Fifteen Percent

3. Composition Scheme(Mostly Preferred By The Contractors)

In A Composition Scheme, Government Provides For Payment Of VAT A Predefined Rate On The Entire Consideration Of The Contract Say ***2%,4% Or 6%***. Such Composition Schemes Are Usually Restrictive In Terms Of Inter-state Purchase And Sale And Input Credits.

Kone Elevator – The Settler

In Kone Elevator India Pvt. Ltd. *2014-VIL-12-SC-CB,* ***Five Member Bench, By Majority, Of Supreme Court Held That Supply And Installation Of Lifts Is A Works Contract Overruling Its Earlier Decision In The Same Case.***

The Court Observed That There Cannot Be Any Single Formula Which Can Be Applicable For The Determination Of The Nature Of The Contract, For It Depended On The Facts And Circumstances Of Each Case. Upholding The Contract As Works Contract, It Was Held That ***"Once There Is A Composite Contract For Supply And Installation, It Has To Be Treated As A Works Contract, For It Is Not A Sale Of Goods/Chattel Simpliciter. It Is Not Chattel Sold As Chattel Or, For That Matter, A Chattel Being Attached To Another Chattel".***

Thus, The Nature Of Works Contract Was Now Settled And Its Valuation Shall Be What Has Been Settled By ***Gannon Drunkley II*** And Adopted As Part Of Their Rules By Most Of The State VAT Laws.

Works Contract

And

Service Tax

Works Contract Has Been Defined In Service Tax Vide Section 65B(54) As Under:

"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;

Thus, The Definition Is Wider In Terms Of Understanding But Has Been Again Restricted To 10 Activities.

Valuation

Rule 2A Of Service Tax (Determination Of Value) Rules, 2006 Deals With Valuation Provision In Case Of Works Contract. The Rule Provides For Two Options For Determination Of Value Of Services In A Works Contract. ***The Two Options Are Not A Choice, But When The First Option Is Not Possible, Only Then The Second Option Is To Be Resorted To***.

Option I :

When Value Of Value Added Tax Has Been Paid On The Actual Value Of Transfer Of Property In Goods

This Option Is Available In Cases ***Where The Contractor Knows The Exact Portion Of Goods As Is Used In Works Contract And Property In Which Has Been Transferred To The Contractee On Actual Value.*** It Is Further Provided That Under This Option, Gross Amount Shall Not Include The Value Added Tax / Sales Tax Paid, If Any, On Transfer Of Property In Goods Involved In The Execution Of The Said Works Contract. However, It Further Provides That The Gross Amount Shall Include The Following Items:

SNO	Items
1	Labour Charges For Execution Of The Works
2	Amount Paid To A Sub-contractor For Labour And 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 The 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; And
8	Profit Earned By The Service Provider Relatable To Supply Of Labour And Services;

Option II :
If Option I Is Not Possible To Be Followed, Service Tax Shall Be Paid In The Following Manner

Type Of Works Contract	Manner Of Computation Of Service Tax
Original Works (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;	Sevrice Tax Shall Be Payable On 40% Of The Total Amount Including Such Gross Amount
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 70% Of The Total Amount Charged For The Works Contract

<u>But Service Tax Was Exempted In The Following Cases:-</u>

Services Provided By Way Of Construction, Erection, Commissioning, Installation, Completion, Fitting Out, Repair, Maintenance, Renovation, Or Alteration Of,-

Sno	Items
(A)	***<u>A Road, Bridge, Tunnel, Or Terminal For Road Transportation For Use By General Public</u>***
(B)	***<u>A Civil Structure Or Any Other Original Works Pertaining To A Scheme Under Jawaharlal Nehru National Urban Renewal Mission Or Rajiv Awaas Yojana;</u>***
(Ba)	A Civil Structure Or Any Other Original Works Pertaining To The ‟In-situ Rehabilitation Of Existing Slum Dwellers Using Land As A Resource Through Private Participation‟ Under The Housing For All (Urban) Mission!Pradhan Mantri Awas Yojana, Only For Existing Slum Dwellers.
(Bb)	A Civil Structure Or Any Other Original Works Pertaining To The „Beneficiary-led Individual House Construction/ Enhancement Under The Housing For All (Urban) Mission/Pradhan Mantri Awas Yojana;
(Bc)	A Building Owned By An Entity Registered Under Section 12 AA Of The Income Tax Act, 1961(43 Of 1961) And Meant Predominantly For Religious Use By General Public;
(Bd)	A Pollution Control Or Effluent Treatment Plant, Except Located As A Part Of A Factory; Or A Structure Meant For Funeral, Burial Or Cremation Of Deceased; -

PROPOSED

MODEL GOODS & SERVICE TAX

FOR

WORKS CONTRACT

(Whether For Govt Contractors or Private Contractors)

As Per Sec. 2(119) Of CGST Act ***"Works Contract" Is A Mixture Of Goods And Services , It Is Neither A Composite Supply Nor A Mixed Supply***.

The Section Further Says ***" Works Contract" Means A Contract For Building, Construction, Fabrication ,Completion, Erection, Installation , Fitting Out, Improvement , Modification, Repair ,Maintenance, Renovation, Alteration,*** Or Commissioning Of Any Immovable Property Wherein Transfer Of Property In Goods (Whether As Goods Or In Some Other Form) Is Involved In The Execution Of Such Contract. Thus Even When There Is A Transfer Of Property In Goods During Execution Of Any Works Contract , Such Supply Will Be Included In Works Contract Only.

For Example ,Construction Of A New Building, Installation And Commissioning Of Cooling Towers, Etc.

Further, GST Schedule II (Entry 5(B)) Clearly States That The ***<u>Following Activity Shall Be Treated As Supply Of Service:-"Construction Of A Complex, Building, Civil Structure Or A Part Thereof , Including A Complex Or Building Intended For Sale To A Buyer, Wholly Or Partly</u>***

Except

Where The Entire Consideration Has Been Received After Issuance Of Completion Certificate, Where Required , By The Competent Authority Or After Its After Occupation, Whichever Is Earlier."

Further There Is One More Clause In Schedule II (Entry 6(A)) Which States That The ***Following Composite Supplies Shall Be Treated As A Supply Of Services Namely:-***

"Works Contract Under S. 2(119)"

This Means ***Works Contract Will Be Treated As Service And Tax Would Be Charged Accordingly (Not As Goods Or Part Goods / Part Services) Which Was Done In The Current Regime.*** Consequently GST Rates, Time Of Supply Rules, Place Of Supply Rules, Valuation Rules As Are Applicable On Services Will Apply To Works Contracts. While Deciding Whether A Supply Is Intra-State Or Inter-State, ***The Place Of Supply Of Service Shall Be Applicable To The Works Contract.***

Now, Let Us Understand The Different Provisions Applicable To A Works Contract Service Provider In The GS Scenario:-

1. Registration:- Section 22 Says That Every Supplier Shall Be Liable To Be Registered Under This Act In The State Or Union Territory , Other Than Special Category States, From Where He Makes A Taxable Supply Of Goods Or Services Or Both, ***If His Aggregate Turnover In A Financial Year Exceeds Twenty Lakh Rupees.*** Provided That Where Such Person Makes Taxable Supplies Of Goods Or Services Or Both ***From Any Of The Special Category States , He Shall Be Liable To Be Registered If His Aggregate Turnover In A Financial Year Exceeds Ten Lakh Rupees.***

Explanation:- The Expression " Special Category States" Shall Mean The States As Specified In Sub-Clause (G) Of Clause (4) Of Article 279A Of The Constitution.

Now, Let Us Understand The Different Provisions Applicable To A Works Contract Service Provider In The GS Scenario:-

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Explanation:- The Expression " Special Category States" Shall Mean The States As Specified In Sub-Clause (G) Of Clause (4) Of Article 279A Of The Constitution.

Construction Sector Over The Years Has Got Used To Payment Of Taxes ***Under Simplified Composition Schemes On The Total Project Value Without Any Input Tax Credit*****.** Due To Unorganized Nature Of This Sector, There Shall Always Be A Class Of Contractors Who May Not Be Able To Maintain Records As Per The Prescribed Norms.

However Under GST Regime There Is No Such Scheme Of Taxation. Section 10(2)(A) Of CGST Act Further States That A Person Supplying Services Other Than Restaurant Services Is Not Eligible To Opt For Composition Scheme.

Hence, ***A Works Contract Service Provider Whose Turnover Exceeds Twenty Lakh Rupees Or Twenty Lakh Rupees In Case Of Specified States Is Required To Get Himself Registered As A Normal Supplier(Not Eligible For Composition). This Will Be A Big Blow To The Small Sub-Contractors Who Cannot Opt For Composition Scheme. They Will Be Forced To Register For Normal Taxation Scheme Increasing Their Compliances And Costs.***

Now The Question Arises In Which State The Works Contract Service Provider Has To Take Registration?

Let Us Understand This By Way Of An Example, ABC Ltd. Is Engaged In Construction Of Residential Buildings In Delhi, Mumbai, Hyderabad And Punjab. In This Case, The Company Should Obtain Registration In All The States Where It Has A Project Office.

2. Levy And Collection Of Taxes:-

There Shall Be Levied A Tax Called The CGST / SGST Or IGST On All Intra-State Or Inter-State Supplies Of Goods Or Services Or Both . Hence, GST Will Be Levied Based On The Place Of Supply On The Rates Of Services.

3. Time Of Supply

Time Of Supply Means The Point In Time When Goods/Services Are Deemed To Be Supplied/ Rendered. It Enables Us To Determine The Rate Of Tax, Value, And Due Dates For Payment Of Taxes.

The Liability To Pay CGST / SGST Will Arise At The Time Of Supply As Determined For Goods And Services. Time Of Supply Shall Be As Under For The Purpose Of Determining A Regular Works Contract Would Be As Under: Section 12(2) Says That The Time Of Supply Of Services Shall Be The Earliest Of The Following Dates, Namely:—

(A) ***The Date Of Issue Of Invoice By The Supplier, If The Invoice Is Issued Within The Period Prescribed Under Sub-Section (2) Of Section 31 Or The Date Of Receipt Of Payment, Whichever Is Earlier;***

Or

(B) ***The Date Of Provision Of Service, If The Invoice Is Not Issued Within The Period Prescribed Under Sub-Section (2) Of Section 31 Or The Date Of Receipt Of Payment, Whichever Is Earlier;*** Or

Or

(C) The Date On Which The Recipient Shows The Receipt Of Services In His Books Of Account, In A Case Where The Provisions Of Clause (A) Or Clause (B) Do Not Apply.

If The Supplier Receives An Amount Up To ₹1000/- In Excess Of The Invoice Amount, The Time Of Supply For The Extra Amount Shall Be The Date Of Issue Of Invoice (At The Option Of The Supplier)

Date Of Invoice	**Date Of Receipt Of Payment**	**Date When Supplier Recorded Receipt In Books**
25 May 2017	**12 July 2017**	**12 July 2017**
Time Of Supply In This Case		
25 May 2017		
Time Of Supply In Case Of Continuous Service		
Where The Due Date Of Payment Is Ascertainable From The Contract, The Date On Which The Payment Is Liable To Be Made By The Recipient Of Service, Whether Or Not Any Invoice Is Issued Or Any Payment Has Been Received By The Supplier Of Service		
Where The Due Date Of Payment Is Not Ascertainable From The Contract, Each Such Time When The Supplier Of Service Receives The Payment, Or Issues An Invoice, Whichever Is Earlier		
Where Payment Is Linked To The Completion Of An Event, The Time Of Completion Of That Event		

Time Of Supply Under Reverse Charge

Reverse Charge Means The Liability To Pay Tax Is On The Recipient Of Goods/Services Instead Of The Supplier. In Case Of Reverse Charge, Time Of Supply Shall Be Earliest Of The Following Dates-

The Date Of Payment

OR

The Date Immediately After SIXTY (60) Days From The Date Of Issue Of Invoice By The Supplier

Date Of Payment	Date Of Invoice	Date Of Entry In The Books Of Receiver
15 July 2017	*01 July 2017*	*18 July 2017*
Time Of Supply Of Service In This Case		
15 July 2017		
If It Is Not Possible To Determine The Time Of Supply Under (A) Or (B) , The Time Of Supply Shall Be The Date Of Entry In The Books Of Account Of The Receiver Of Service.		
For Clause (A)- The Date Of Payment Shall Be Earlier Of-		
1. The Date On Which The Recipient Entered The Payment In His Books OR		
2. The Date On Which The Payment Is Debited From His Bank Account		

4. Place Of Supply:

Place Of Supply In Case Of WCT Shall Be Governed By Place Of Supply Of Service Rules Which Are As Follows:-

Location Of The Immovable Property Is Used To Determine The Taxability Of A Transaction Involving Supply Of Service.

In Case, The Immovable Property Is Situated In The Same State As That Of The Place Of Registration , CGST And SGST Shall Be Levied And I***n Case, The Immovable Property Is Situated Outside The State In Which The Registration Is Obtained , IGST Will Be Levied.***

5. Input Tax Credit

Section 17 (5)(C) : Input Tax Credit Shall Not Be Available In Respect Of The Following, Namely:

“ Works Contract Services When Supplied For Construction Of An Immovable Property (Other Than Plant And Machinery) Except Where It Is An Input Service For Further Supply Of Works Contract Service”

The Restriction ***Does Not Apply To Plant And Machinery And Also In Case The Input Services Are Further Used For Supply Of Works Contract Service(Contractor Can Avail The ITC In Respect Of Services Availed From The Sub-Contractor).***

6. Abatement

No Abatement Has Been Prescribed For Works Contract Service So Far As Was There In The Earlier Regimes (Pre- GST).

According To GST Model Law For Works Contract:-
Since There Is No Scheme For Works Contract As "Works Contract Has Been Assumed As Supply Of Service" So No Option Is Left For Contractors.They Will Have To Pay Direct Tax On The Contract Amount.

For Example :-

Suppose My Contract Bond Is Of 1,00,00,000
I Have Purchase Material For Which I Have Invoices From Registered Dealers Is Of 30,00,000 And Suppose I Paid Tax @15% Gst On Materials I.E 4,50,000
My Tds Deducted @1 % I.E 1,00,000

Now Calculation Of Tax

If 18% Then The Tax Liability Is 18,00,000
In This Case I Will Get Benefit Of ITC
Subtracting Itc From Net Tax Liability=18,00,000-4,50,000=13,50,000
So My Net Tax Payable Will Be=13,50,000 – 1,00,000(Tds Deducted)=12,50,000

<u>QUESTION1:-</u>

That In Kone Elevator India Pvt. Ltd. *2014-VIL-12-SC-CB,* ***Five Member Bench, By Majority, Of Supreme Court Held That "Once There Is A Composite Contract For Supply And Installation, <u>It Has To Be Treated As A Works Contract, For It Is Not A Sale Of Goods/Chattel Simpliciter</u>. It Is Not Chattel Sold As Chattel Or, For That Matter, A Chattel Being Attached To Another Chattel"***

Then The Question Arises That <u>Why In The Model GST Law Works Contract Is Treated As Supply Of Services</u>.

<u>**QUESTION2:-**</u>

That In VAT The Government Provided The Composition Scheme (2%,4% & 6%) To The Works Contract Bussiness Which Was Mostly Preferred By The Contractors

Then The Question Arises That Why In The Model GST Law There Is No Composition Scheme Provided For Works Contract Bussiness.

QUESTION3:-

That When In Service Tax Services Provided By Way Of Construction, Erection, Commissioning, Installation, Completion, Fitting Out, Repair, Maintenance, Renovation, Or Alteration Of,-

Sno	Items
(A)	***A Road, Bridge, Tunnel, Or Terminal For Road Transportation For Use By General Public***
(B)	***A Civil Structure Or Any Other Original Works Pertaining To A Scheme Under Jawaharlal Nehru National Urban Renewal Mission Or Rajiv Awaas Yojana;***

Were Exempted Then The Question Arises That Why In The Model GST Law Works Contract Is Treated As Supply Of Services.

<u>QUESTION4:-</u>

That In Income Tax Act 1961, The Works Contract Comes Under Section 44AD In Which It Is Provided That

1. <u>If The Turnover Is Less Then 2 Crore The Deemed Profit Should Be Greater Then Or Equal To</u>

<u>(a)8% In Case Of Payment Through Cash Mode .</u>

<u>(b)6% In Case Of Payment Through Cheque/ Digital Mode.</u>

2. <u>If The Turnover Is Greater Then 2 Crore The Profit Can Be Taken Less The 8%.</u>

Then The Question Arises That Why In The Model GST Law The Tax Of 18% Will Be Given.

THANK YOU

PRESENTED

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