WORKS CONTRACT AND TAX IMPLICATION

WCT UNDER THE ANDHRA PRADESH VALUE ADDED TAX

After the spurt in infrastructure industry lot of activities are happening in this field, which are falling within the ambit of sales tax as well as service tax. Since sales and services are governed by two different statutes and that too by two different level of government it is of paramount importance to know the exact liability under these statutes. If a person knows the exact duties under these laws before planning the infrastructure activities it will be helpful in saving the time and cost which otherwise will be drained in disputes as well as he can make lot of saving through a neat tax planning within the boundaries of Sales Tax and Service Tax.

Work contract is a term used for those contracts under which the Vendor or the Supplier undertakes to carry out the work by supplying the materials as well as executing the work which involves the consumption of the material so supplied. As this kind of activities involve supply of goods and rendering of services they attracts tax on Goods as well as tax on Services. Work contract is defined in the Andhra Pradesh Value Added Tax, 2005 as follows:

WORKS CONTRACT [Section 2 (45)]
Work contract includes any agreement for carrying out for cash of for deferred payment or for any other valuable consideration, the building construction, manufacture, processing, fabrication, erection, installation, lying, fitting out, improvement, modification, repair or commissioning of any movable or immovable property.

The above said definition vividly explains what amounts to work contract and also it is to be noted that this is an inclusive definition which covers activities similar to the one mentioned above.

Chargeability of Work Contract under the Andhra Pradesh Value Added Tax, 2005
Section 4 (7) of the Act lays down the chargeability aspects of the work contracts under clause (a) to (i):-

Section 4(7) (a) states that the contractor executing work contract should maintain perfect account for the materials consumed and labour utilized for the execution of the contract. Also he should pay the tax at the appropriate rates for the material used in the execution of the contract. If the contractor is not maintaining so he will pay tax @ 12.50% subject to the standard deduction mentioned in the VAT Rule.

Section 4(7)(b) states that any dealer who executes work contract for Government or Local authority may opt for composition scheme and pay tax @ 4%.

Section 4(7)(c) states that any dealer executing work contract for others (other than the Government and local authority) may opt for composition scheme and pay tax @ 4% of the total consideration.

Section 4(7)(d) states that where the dealer is engaged in the construction of residential apartments, houses, buildings or commercial complexes may opt for composition scheme and pay tax @ 4% on twenty percent of the consideration received or receivable or the market value fixed for the purpose of stamp duty whichever is higher.

Section 4(7)(e) states that the dealer who opted for composition scheme, goes for any purchase outside the state and for import or from a person within the state who is not a VAT dealer shall pay tax at applicable rate on such purchases as well as such goods will not be considered for determining the value for composition scheme on which he needs to pay tax @ 4%.

Section 4(7)(f) states that when a TOT dealer executes any work contract he needs to pay tax @ 1% on total value of goods at the time of incorporation or usage of such goods. If he could not determine the value at the time of incorporation he shall pay tax @1% on the total consideration received or receivable subject to the deduction if any prescribed. TOT dealer is one whose turnover for a period of twelve consecutive months exceeds rupees five lakhs but does not exceed rupees forty lakhs.

Section 4(7)(g) states that where the work contract is of the nature of interstate trade or import or export as per the CST Act then such work contracts are not covered by this ACT.

Section 4(7)(h) states that no tax shall be payable under clause (a), (b) or (c) of this sub-section on the amount paid to a sub-contractor, where the sub-contractor is a registered dealer under this act and his turnover as per the return includes the consideration so received from the contractor executing work contract under this ACT.

Section 4 (7) (i) states that no tax shall be payable under the clause (d) by the sub-contractor provided the following conditions are satisfied.

a. Main contractor opted for composition scheme.
b. Such sub-contractor shall pay VAT at applicable rate on materials procured through inter- state purchase or purchase from a person other than VAT dealer.

Above said sections from Value Added Tax Act , 2005 explains the work contracts that are covered under this ACT and how they are taxable. Procedural aspects of work contract are discussed in details in Value Added Tax Rule, 2005 which are explained below.

Rule 17 deals with the work contract

Rule 17(1) enunciates the following points:-

a. VAT dealer executing work contract can avail input tax credit on the eligible purchase @ 90% of the tax paid on the purchase of such goods which are consumed in the execution of work contract.
b. If the contractor registered under VAT awards any part of the contract to the registered sub-contractor he need not pay tax on the consideration paid for the sub-contract.
c. Following are allowed as deduction in the contract value to arrive at taxable turnover.

1. Labour charges incurred for the execution of work.
2. Charges for planning, designing and architects fees.
3. Charges for obtaining on hire or otherwise machinery and tools used for the execution of the work contract.
4. Cost of consumables such as water, electricity, fuel, etc. used in the execution of the work contract, the property in which, is not transferred in the course of execution of works contract.
5. Cost of any other service which relates to the execution of work contract.

As per Rule 17(1)(g) , where the VAT dealer has not maintained the accounts to determine the correct value of the goods at the time of incorporation he shall pay the tax at the rate of twelve and half percent on the total consideration subject to the deduction mentioned in the table below. In such cases the VAT dealer **shall not be eligible to claim input tax credit and shall not be eligible to issued tax invoices**.

SL NO	TYPE OF CONTRACT	PERCENTAGE OF DEDUCTION
1 (a)	General Electrical Contract	25%
1(b)	All Structural Contract	35%
2	Installation of Plant and Machinery	15%
3	Fixing of marbles slabs, polished granite stones and tiles (other than mosaic tiles)	35%
4	Civil works like construction of buildings, bridges , roads, etc.	30%
5	Fixing of sanitary fittings for plumbing, drainage and the like	15%
6	Painting and polishing	20%
7	Laying of pipes	20%
8	Tyre re-trading	40%
9	Dying and painting of textiles	40%
10	Printing of reading material, cards, pamphlets, posters and office stationery	40%
11	All other contracts	30%

Rule 17(2) – Treatment of work contract executed for State Government or Local Authority under composition:-

a. Where a dealer executes any work contracts the value of which exceeds Rs. 5,00,000/- awarded by the State Government or a local authority then he must register under VAT Act as a VAT dealer.
b. Where the VAT dealer decides to opt for composition scheme he has to declare the same by filing **Form 250** before commencement of the work and pay tax @ 4% on the total value of the contract.

c. Where tax is deducted at source the contractor VAT dealer shall obtain Form 501 from the Contractee.
d. The contractor VAT dealer shall declare in VAT Form 200 the amount received and receivable and the tax due there on.
e. The contractor shall file VAT from 200 along with Form 501 otherwise he will not be eligible to avail the tax credit and needs to pay the tax.
f. Where the Contractee fails to pay the tax deducted at source within fifteen days he needs to pay the same with interest for such delayed payment.
g. Where the contractor opted for composition scheme for the execution of work contract then he is not eligible to claim input tax credit.
h. Where the VAT dealer awards any part of the contract to a registered sub-contractor then he need not pay tax on the value of the sub-contract.
i. Where there is a tax deducted at source from the Contractee payments, the same has to be extended to the subcontractor by issuing Form VAT 501B by the main contractor. Such sub-contractor has to file the Form 501B along with Form VAT 200 to avail the credit.

Rule 17 (3) – Treatment of work contract other than for State Government or Local Authority under composition scheme.

a. Contractor executing work contracts under composition scheme needs to get himself registered as a VAT dealer.
b. He shall pay tax at the rate of 4% on the total consideration received or receivable.
c. Where the VAT dealer opts for composition scheme he needs to declare the same in Form VAT 250 and if he wants to opt out of composition scheme he can do so by filing form VAT 250A.
d. On receipt of the payment the contractor shall pay tax at the rate of 4% on the amount received or receivable and mention the same in Form VAT 200 while filing the return of income.
e. The contractor VAT dealer shall obtain form VAT 501A in respect of any tax deducted at source which needs to be filed along with Form VAT 200.
f. The contractor VAT dealer shall not be eligible for input tax credit and shall not be eligible to issue tax invoices.
g. Where the VAT dealer awards a part of the work contract to any sub-contractor he shall not pay tax on the same.
h. Where the Contractee fails to pay tax deducted at source within 15 days he shall pay the same with interest for such delayed period.
i. In case of tax deducted are source and the sub-contractor is engaged by the contractor he shall pass on the same to the sub-contractor by issuing form VAT 501B which the sub contractor needs to file along with From VAT 200.

Rule 17 (4) – Treatment of Apartment Builders and Developers under composition scheme :-

a. Where a dealer executes a contract for construction and selling of residential apartments and commercial complexes and opts for composition scheme he must get himself registered as a VAT dealer.
b. The contractor VAT dealer shall intimate the prescribed authority about his intention to undertake the contract under composition scheme in Form VAT 250.
c. If the dealer wants to withdraw from composition scheme he needs to do so by filing Form VAT 250A.
d. The contractor opted for composition scheme has to pay 4% tax on the 25% of, the total consideration or the market value declared for stamp duty and registration, whichever is higher. 75% of the amount i.e. balance will be allowed as a deduction under composition scheme.
e. When the contractor opted for composition scheme he is not eligible to avail input tax credit and cannot raise tax invoice.
f. Where any portion of the contract is awarded to a sub-contractor he is not eligible to avail the deduction in respect of the value of the sub-contract.
g. The VAT dealer shall pay 1% of the consideration or on the value for stamp duty whichever is higher by way of a demand draft in favour of commercial tax department to the sub-registrar at the time of registration. These DDs will be forwarded to the commercial tax department by the sub-registrar.

Rule 17(5) – TOT dealer

a. Where the contractor is a TOT dealer as per section 7(4)(e), then he needs to pay 1% on the value of goods at the time of incorporation of the goods in the execution of the contract.
b. Where the TOT dealer is not maintaining accounts for ascertaining the value of goods , then he shall pay tax at the rate of 1% on the total consideration subject to the following deductions.
    i. Labour charges for the execution of the works.
    ii. Charges for planning, designing and architect's fees
    iii. Charges for obtaining on hire or otherwise machinery and tools used for the execution of the works contract.
    iv. Cost of consumables such as water, electricity, fuel, etc. used in the execution of the work contract, the property in which is not transferred in the course of execution of a works contract.
    v. Cost of establishment of the contractor to the extent it relates to the supply of labour and services.
    vi. Any other similar expenses relatable to supply of labour and services.
    vii. Profit earned by the contractor to the extent it is relatable to supply of labour and services.

Rule 18 - Tax Deducted at Source

Every Contractee who engages contractor for executing work contract needs to deduct tax at source and remit the same to the Government, from the payment made to the contractor. The rate of deduction is as follows.

SL NO	CONTRACT	RATE
1	Contract for laying or repairing of roads and contracts for canal digging, lining and repairing	2% of 70% of the amount payable as consideration for the executing of work
2	All other category of contract other than the one mentioned above	4% of 70% of the amount payable as consideration for the execution of works contract.

The contractor shall supply Form VAT 501A to the contractee in which the contractee will fill the relevant column which pertains to the deduction and send back to the contractor. The contractor shall submit the Form VAT 501A along with the VAT return in Form VAT 200.

Form VAT 501B needs to be given by the contractor to the sub-contractor if he engages sub contractor to execute any portion of the work contract. The sub-contractor files the Form 501B along with VAT return in Form VAT 200.

SERVICE TAX AND WORKS CONTRACT

Earlier works contract were out of the service tax coverage and later on they were partially covered by the introduction of erection, commissioning or installation service. Finance Act 2007 brought works contract under service tax net and from then came the introduction of composition scheme whereby works contract is fully covered within the ambit of Service Tax levy.

Section 65(105) of the Finance Act defines works contract as "any service provided or to be provided 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.

For the purpose of sub-clause (zzzza), 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 purpose 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 of a civil structure or a part thereof of a pipeline of conduit, providing for the purpose of commerce or industry; or,
c. Construction of a new residential complex or a part thereof; or
d. Completions 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;

Value of taxable Service

Value of taxable service is the gross amount charged for rendering service.

As per rule 2A of the Service Tax (Determination of value) Rule, 2006

Value of works contract service shall be equivalent to the gross amount charged for the works contract less the value of transfer of property in goods involved in the execution of the said works contract.
It may be noted that:-

a. Gross amount charged for the work contract shall not include Value Added Tax or Sales Tax 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 the execution of works
    ii. Amount paid to the 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 the supply of the labour and services;
    vii. Other similar expenses relatable to the supply of labour and services; and
    viii. Profits earned by the service provider relatable to the supply of labour and services.

Where the Value Added Tax or Sales Tax as the case may be has been paid on the actual value of transfer of property in goods, involved in the execution of the works contract, then such value adopted so, shall be taken as the value of transfer of property in goods involved in the execution of the said works contract for determining the value of works contract service as stated above.

Composition scheme under Service Tax

In the case of contractor executing works contract he can opt for composition scheme under Service Tax if he is not maintaining accounts to track the exact component of materials and services. Under composition scheme he can pay 4% service tax on the gross consideration received or gross amount charged for works contract.

If the assessee opts for composition scheme he cannot avail CENVAT Credit on inputs (i.e. Excise duty on Materials used as per Rule 3(2) of Works Contract (composition scheme for payment of service tax) Rules, 2007. The assessee can avail CENVAT credit of input services when he opts for composition scheme. Also the assessee has the option to choose composition scheme or normal scheme in respect of each and every works contract.

It he contractor opts for composition scheme in respect of a contract he cannot change the option until the completion of the said works contract.

CENVAT credit and composition scheme

It is to be noted that when a contractor executes a work contract he will be paying the following input taxes:-

a. Excise duty on materials used in the execution of works contract (e.g. cement, steel, etc.).
b. Service tax on input services like architect fees, consultant fees, etc.
c. Service tax on capital goods such as machinery hires charge etc.

Under composition scheme, Rule 3(2) prohibits the availing of CENVAT credit mentioned in (a) above. Hence the contractor can avail CENVAT credit on service inputs and capital goods which is clarified by circular 96/7/2007 ST dated 23.08.2007.

Also the contractor and the contractee can plan the tax aspect in such a way that the contractee or the service receiver would like to avail the service tax credit or CENVAT credit on capital goods he can do so by purchasing the same and supplying it to the contractor who is executing works contract. The contractee can ask the contractor for normal scheme instead of going for composition scheme where the credit could not be passed on to the contractee.

General Exemptions

In the following cases service tax is not charged on works contract;-

a. Service provided to the United Nations or an international organization notified by the Central Government.
b. Service provided to a developer of Special Economic Zone (SEZ) of a unit in SEZ. In this case exemption is available by way of refund of tax.

c. Service provided to the foreign diplomatic mission or consular post in India.
d. Value of goods and materials sold by the service provider to the service receiver during the course of any taxable service, provided he has not availed CENVAT credit on such goods and materials or if CENVAT credit is taken the same is paid before effecting such transfer.

Exemption to Services Provided to Ports (Notification No 25/2007 ST dated 22.05.2007)

As per the above said notification commercial or industrial construction service provided in relation to the execution of works contract to construct port or other port is exempted from service tax. It is to be noted that service provided in relation to the completion and finishing, repair, alteration, renovation, restoration, maintenance or repair to an existing port or other ports are not exempted.

In the case of contractor carrying on works contract he has the following options under VAT and Service TAX

SL NO	**VAT**	**SERVICE TAX**
1	**Composition**	**Composition**
2	**Normal**	**Composition**
3	**Composition**	**Normal**
4	**Normal**	**Normal**

Depending on the complexity of the contract, keeping records for materials and services as well as based on the tax benefits the contractor can chose any of the option and discharge the statutory obligation under VAT and Service Tax in case of Works contract carried out by him.