

Taxation of Works Contract under Service tax

Works Contract Meaning:-

Any agreement for execution of works relating to civil works, construction, manufacture, processing, fabrication, erection, Installation, fitting out, improvement, modification, repair or commissioning of any movable or immovable property for cash/deferred payment or other valuable consideration is a works contract.

Few examples of Works Contract are as follows:

- 1)** 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
- 2)** Construction of a new residential complex or apart thereof
- 3)** Completion and finishing services, repair, alteration, renovation or restoration of, or similar services
- 4)** Turnkey projects including engineering, procurement and construction or commissioning (EPC) projects.

Types of Works Contract:-

- 1) **Divisible Works Contract** is where the elements of sale of goods (i.e. Material) and Labour are clearly segregated.
- 2) **Indivisible Works contract** is where the parties agree for lump-sum consideration for the entire contract. The sale consideration of the material used in the contract and remuneration for Labour is not separately identifiable.

Various definition of Works Contract under various laws:-

It may be Noted that the term Works contract has not been defined in constitution of India. Further, Constitution of India also has not delegated any power to Central or State government to define 'Works contract'.

Hence, common understanding of the term is more relevant than definition under any tax law.

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Under Central Sales Tax Act Section 2(ja) of Central Sales Tax Act	Works Contract means a contract for carrying out any work which includes constructing, altering, building, assembling, manufacturing, processing, fabricating, erection, installation, fitting out, improvement, repair or commissioning of any movable or immovable property.
Under MVAT Act Explanation (b)(ii) to section 2(24) of Maharashtra VAT Act	Works Contract includes an agreement for carrying out for cash, deferred payment or other valuable consideration, the building, construction, manufacturing, processing, fabrication, erection, installation, fitting out, improvement, modification, repair or commissioning of any movable or immovable property.
Under Service Tax Law Section 65B(54) of Finance Act, 1994 as introduced w.e.f 01.07.2012	Works Contract mean 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 any work 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.

Service Tax On Works Contract:-

Service tax on works contract was imposed on 1.06.2007. However, it was restricted to the scope of immovable property. Its scope has been extended to movable property also w.e.f. 01.07.2012.

Further Reverse Charge Mechanism have been introduced and made applicable to works contract service where service receiver is body corporate and service provider is individual or proprietary firm, HUF or AOP.

Works contract is a composite contract for supply of goods and services, A Composite contract is vivisected and Vat / sales tax is leviable on the transfer of property involved in the execution of works contract vide Article 366(29A)(b) of the Constitution of India and service tax will be leviable on services provided in relation to the execution of works contract.

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Taxation of Works contract:-

Basically service tax is payable on value of service as calculated in rule 2A(i) of Service Tax (Determination of value) Rules, 2006.

If value is not determined under rule 2A(i), then service tax can be paid under Lump sum Deduction under rule 2A(ii). It may be noted that valuation under rule 2A(ii) can be made only if valuation under rule 2A(i) has not been done.

Valuation rule 2A(i) - The value can be calculated either on basis of value of services or by deducting value of material (if State vat was paid on actual value of such material and not when State Vat was paid under Lump sum Deduction under State Vat)

Valuation:-

	The Gross amount charged for the works contract
Less	a. The value of property in goods transferred in the execution of the said works contract
Less	b. 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
Add	c. Value of other service, which includes,
	(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;

Further, 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.

In case of finding of Value of services in Composite Contract not possible then, Service tax can be paid under Lump sum Deduction/ Specified rate under rule 2A(ii).

Taxation of Works Contract under Service tax

Lump sum Deduction/Specified rate under Service Tax- Under Lump sum Deduction/Specified rate method service tax is payable at a specified percentage of total amount i.e. total value of works contract including value of free material supplied by customer either under same contract or under different contract. CENVAT credit cannot be availed of excise duty or cess paid on any input goods, the property of which is transferred to customer. (Please note this provisions is for not to avail excise duty or cess paid on any input goods and not for Input Service and Capital goods)

The percentage is as follows;

A	Original Works(i.e. New Construction)	40% of Total Amount
B	Maintenance or repair or reconditioning **	70% of Total Amount
C	Other works Contract(excl. (A) & (B) above) **	60% of Total Amount
D	If Construction contract (need not be works contract) includes value of Land	25% of Total Amount

**** As per Finance Bill, 2014 In Rule 2A of the Service Tax Valuation Rules. Category 'B' & 'C' of works contract proposed to be merged into one single category, with Service portion as 70% with effect from 1st Oct, 2014.**

Explanation 1 to Rule 2A(ii) defines;- "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;

Explanation 1(b) to rule 2A(ii) defines;- 'Total Amount' means-

the sum total of gross amount charged for the works contract and the **fair market value** of all goods and services supplied 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 and services, if any and (ii) the value added tax or sales tax, if any, levied thereon. In Short, if customer (or any other person) supplies some good or services free, its value will have to be added while calculating 'total amount'.

Prima facie, the Lump sum Deduction/Specified rate method is very simple & attractive. However, **the Lump sum Deduction is risky in view of the provision that fair market value of material or service supplied free of cost for use in execution of works contract** by customer is required to be added while calculating service tax under Lump sum Deduction.

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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.

Reverse Charge under Works Contract:-

As per notification 30/2012-ST, dated 20-06-2012, the service tax in respect of services Viz. renting of Motor vehicle, Manpower supply or security services and works contract; If **service provider** is Individual, HUF, Proprietary or Partnership firm, AOP located in taxable territory and **service receiver is Business Entity registered as body corporate** located in the taxable territory, then the service tax is to the extent of 50% is payable by the service recipient and balance 50% by the service provider.

'Partial reverse charge' wherein both service provider and service receiver are liable to pay service tax as per defined %.

'Body Corporate' has meaning assigned to it in section 2(7) of companies Act, includes a company incorporated outside India, but does not include-(a) Corporation Sole, (b) Registered co-operative society, (c) Any other body corporate(except a company defined under companies Act) as may be notified by central Government. A section 25 Company is a body Corporate but it is not a Business Entity.

Hence, reverse charge does not apply to if works contract service is provided to such company. It may be noted that in partial reverse charge mechanism the service receiver is not bound by the valuation adopted by the service provider, when the service tax liability is required to be shared between them. Since the liability of service receiver and service provider are different and independent of each other the service provider can independently avail or forgo abatement or choose a valuation option depending on the data available with the person.