

Change in effective service Tax rate on works Contract w.e.f 01.10.2014

Service Tax on service portion in Works Contract (effective from 1st October, 2014)

Service portion in the execution of a work contract is subjected to provisions of partial Reverse Charge Mechanism in case such service has been provided by any individual, HUF or partnership firm, whether registered or not, including association of persons, located in the taxable territory to a business entity registered as body corporate located in taxable territory. As per existing rules in such cases 50% of service tax is payable both by service provider and service recipient.

The valuation of service portion in Works Contract is governed by **Rule 2A of Service Tax (Determination of Value) Rules, 2006** which provides two options for the same.

OPTION I: Value of service portion in execution of work contract shall be equivalent to the gross amount charged for the works contract less the value of property in goods transferred in execution of said works contract.

OPTION II: There were three categories. The categories and there valuation of service portion is tabulated as under:-

SI No	Categories	Valuation principle
1	Original works	40% of the total amount charged for works contract
2	Works contract entered for maintenance or repair or reconditioning or restoration or servicing of any goods.	70% of the total amount charged for works contract
3	Other work contracts including maintenance, repair, completion and finishing services such as glazing, plastering, floor and wall tiling, installation of electrical fittings of an immovable property 70% of the total amount charged	60% of the total amount charged for works contract

The change that has been brought by Union Budget, 2014-15 is amendment of **Rule 2A of Service Tax (Determination of Value) Rules, 2006** wherein they have merged the categories 2 and 3 above into a single category with percentage of service portion as 70%.

This change will come into effect from 1st October, 2014 and same has been notified vide Notification No. 11/2014-ST dated 11th July, 2014. It has been explained in the TRU, MoF, GoI letter No D.O.F No. 334/15/2014-TRU dated 10th July, 2014 that this rationalisation by way of merger of categories has been made to avoid disputes of classification between these two categories.

It is pertinent to mention here that the service provider and recipient would continue to pay 50% each of total service tax payable.

Due to above amendment, the service tax liability in respect of third category (maintenance, repair, completion and finishing services such as glazing, plastering, floor and wall tiling, installation of electrical fittings of an immovable property) has been hiked as from 1st October, 2014, service tax would be computed on 70% of the amount charged instead of 60%, due to which the effective service tax rate on the total amount charged would be hiked from 7.416% to 8.652%, out of which 4.326% (3.708% under existing provisions) of total amount charged would be paid both by service recipient and service provider.

As the above amendment is applicable from 1st October, 2014 in certain borderline cases, confusion may creep in like whether old or new rate, i.e., 60% or 70% would be applicable where service has been completed before 1st October, 2014 but invoice has been raised and payment made after said date.

In order to solve the above and like issues, we need to fall back on the Rule 4 of the Point of Taxation Rules, 2011 which mandates determination of point of taxation in case of change in effective tax rate. As per Rule 2(ba) of said Rules "change in effective rate of tax" include change in portion of value on which tax is payable in terms of notification issued or Rules made there-under.

As in case of work contracts of maintenance, repair, completion and finishing services such as glazing, plastering, floor and wall tiling, installation of electrical fittings of an immovable property, the percentage of value of service has been increased from 60% to 70%, it is a change in effective rate of tax and thus Rule 4 of the Point of Taxation Rules, 2011 will come into play.

Rule 4 of Point of Taxation Rules, 2011 is being reproduced as under:-

Determination of point of taxation in case of change of rate of tax:- Notwithstanding anything contained in rule 3, the point of taxation in cases where there is a change in effective rate of tax of tax in respect of a service, shall be determined in the following manner, namely:

(a) in case a taxable service has been provided before the change in effective rate of tax,-

- (i) where the invoice for the same has been issued and the payment received after the change in effective rate of tax, the point of taxation shall be date of payment or issuing of invoice, whichever is earlier; or
- (ii) where the invoice has also been issued prior to change in effective rate of tax but the payment is received after the change in effective rate of tax, the point of taxation shall be the date of issuing of invoice; or
- (iii) where the payment is also received before the change in effective rate of tax, but the invoice for the same has been issued after the change in effective rate of tax, the point of taxation shall be the date of payment;

(b) in case a taxable service has been provided after the change in effective rate of tax,-

- (i) where the payment for the invoice is also made after the change in effective rate of tax but the invoice has been issued prior to the change in effective rate of tax, the point of taxation shall be the date of payment; or
- (ii) where the invoice has been issued and the payment for the invoice received before the change in effective rate of tax, the point of taxation shall be the date of receipt of payment or date of issuance of invoice, whichever is earlier; or
- (iii) where the invoice has also been raised after the change in effective rate of tax but the payment has been received before the change in effective rate of tax, the point of taxation shall be date of issuing of invoice.

After determining Point of Taxation as per above Rule, it is to be seen whether it falls before 1stOctober, 2014 or on or after said date. If same is fixed prior to said date then the valuation would be determined by existing rules and 60% would be regarded as taxable value and where it falls on or after said date then 70% rate shall be applicable. The application of Rule 4 is illustrated below:-

S.No	Date Of Provision of Service	Date Of Invoice	Date Of Payment	POT as per Rule 4	Valuation principle applicable, i.e., New (70%) or existing (60%).
1	30-09-2014	02-10-2014	05-10-2014	02-10-2014	New
2	30-09-2014	30-09-2014	05-10-2014	30-09-2014	Old
3	04-10-2014	30-09-2014	05-10-2014	05-10-2014	New
4	30-09-2014	02-10-2014	30-09-2014	30-09-2014	Old
5	02-10-2014	30-09-2014	30-09-2014	30-09-2014	Old
6	02-10-2014	02-10-2014	30-09-2014	02-10-2014	New