

Valuation of Taxable Services

Question 1

Briefly explain the following with reference to the provisions of Finance Act, 1994 and Service Tax (Determination of Value) Rules, 2006

- (i) Bundled Service
- (ii) Gross amount charged
- (iii) Original Works in the context of Rule 2A of Valuation Rules, 2006
- (iv) Total amount in the context of Rule 2A of Valuation Rules, 2006

Answer

- (i) **Bundled Service:** 'Bundled service' means a bundle of provision of various services wherein an element of provision of one service is combined with an element or elements of provision of any other service or services. For example, air transport services provided by airlines wherein an element of transportation of passenger by air is combined with an element of catering service on board.

According to provisions of section 66F of Finance Act, 1994, the taxability of a bundled service shall be determined in the following manner:

Position of various elements of such service	Treatment for the purpose of charging service tax
If various elements of such service are naturally bundled in the ordinary course of business	As provision of the single service which gives such bundle its essential character. For example , if a hotel provides a 4D/3-N package with the facility of breakfast, it will be considered a case of naturally bundled service. Since the service of hotel accommodation gives the bundle the essential character, it will be treated as service of providing hotel accommodation.
If various elements of such service are not naturally bundled in the ordinary course of business	As provision of the single service which results in highest liability of service tax. For example, two floors of a house are given on rent for two different purposes-Ground Floor for the purpose of running a shop and first floor for residential purpose. Renting for aforesaid two purposes is not naturally bundled in the ordinary course of business. Resultantly, if consolidated rent agreement is entered for providing renting of both the said floors, it will be considered as a single

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	service which results in highest liability of service tax. Renting of residential dwelling for use as residence falls within the purview of Negative List of Services under section 66D. On the other hand, renting for the purpose of running a shop is subject to service tax. Since the latter category of renting attracts highest liability of service tax between two services bundled together, entire renting would be treated as renting for commercial purposes. As a consequence, service tax will be levied on the gross amount charged for renting of both the floors.
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- (ii) **Gross amount charged:** Explanation (c) to section 67 of the Finance Act, 1994 provides that “gross amount charged” includes payment by cheque, credit card, deduction from account and any form of payment by issue of credit notes or debit notes and book adjustment.

However, in case of transaction of taxable service is with any **associated enterprise**, any amount credited or debited, as the case may be, to any account, whether called “Suspense account” or by any other name, in the books of account of a person liable to pay service tax will also fall within the purview of term “gross amount charged.”

The significance of term “gross amount charged” lies in the fact that wherever any taxable service is provided for a consideration in money, service tax is chargeable on the gross amount charged by the service provider for such service provided or to be provided by him.

- (iii) **Original Works in the context of Rule 2A of Valuation Rules, 2006:** According to substituted Rule 2A of Service Tax(Determination of Value) Rules, 2006 with effect from 01.07.2012 the term “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.

The significance of term “original Works” can be appreciated from the fact that when works contract is for execution of original works, value of **service portion shall be forty percent** of the total amount charged for the works contract in pursuance of Rule 2A of Service Tax(Determination of Value) Rules, 2006. As a result, less service tax amount will be payable as compared to other two situations under foregoing Rule.

- (iv) **Total amount in the context of Rule 2A of Valuation Rules, 2006:** According to Explanation 1(b) to Rule 2A of Service Tax(Determination of Value) Rules, 2006 “total amount” means the sum total of the gross amount charged for the works contract and

the fair market value of all goods and services supplied in or 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 or services, if any; and
- (ii) The value added tax or sales tax, if any, levied thereon.

Computation of "Total amount" can be appreciated from the following **practical example**:

(i)	Gross Amount charged for the works Contract	₹1,00,000
(ii)	Add: Fair Market Value of goods/services (supplied by the contractee)	₹ 70,000
(iii)	Less: The amount charged for such goods/services (supplied by the contractee)	₹ 10,000
(iv)	Less: the value of VAT, levied on goods supplied by the contractee	₹ 1,250
(v)	Total Amount (i) + (ii) –(iii)-(iv)	₹ 1,58,750

Further, according to Proviso to Explanation I (b) the fair market value of goods and services so supplied is required to be determined in accordance with the generally accepted accounting principles.

Question 2

Explain in brief the manner of determination of value as per rule 3 of the Service Tax (Determination of Value) Rules, 2006.

Answer

Subject to provisions of Section 67 of Finance Act, 1994, the value of taxable service, where such value is not ascertainable, shall be determined by the service provider in the following manner as per **Rule 3** of the Service Tax (Determination of Value) Rules, 2006:

- (a) The value of such taxable service shall be equivalent to the gross amount charged by the service provider **to provide similar service to any other person in the ordinary course of trade**. However, the aforementioned gross amount charged must be the sole consideration.
- (b) Where the value cannot be determined in accordance with above clause, the service provider is required to determine the **equivalent money value of such consideration**. However, such value shall in no case be less than the cost of provision of such taxable service.

Question 3

Compute service tax liability from the following particulars:

Gross Amount charged by the service provider for providing works contract service	₹1,00,000
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Actual Value of material transferred in the above works contract	₹ 70,000
CENVAT Credit of duty on value of material transferred	₹ 8,750
Service Tax paid on Input Services	₹ 1,000
CENVAT Credit of capital goods used in the provision of works contract service	₹ 1,000
Rate of Service Tax	12.36%

Answer

Computation of Service Tax liability

S.No.	Particulars	Amount
(i)	Gross Amount charged	₹ 1,00,000
(ii)	Actual Value of goods transferred	₹ 70,000
(iii)	Value of service portion in the execution of works contract i.e. (ii) - (i)	₹ 30,000
	Service Tax on ₹ 30,000 @12.36% = 3,708 Less: CENVAT credit On Inputs = NIL On Input Services = 1,000 On Capital Goods (50%) = 500 Service Tax Payable	₹ 2,208

Question 4

Write a brief note explaining the circumstances under which expenditure or costs incurred by a service provider as a pure agent of the recipient of service shall be excluded from the value of taxable services under the Service Tax (Determination of Value) Rules, 2006.

Answer

Exclusion of Expenditure or costs incurred as a pure agent: Expenditure or costs incurred by the service provider as a **pure agent of the recipient of the service** shall be excluded from the value of the taxable service if **all** the following conditions are satisfied **cumulatively** as per Rule 5(2) of Service Tax(Determination of Value) Rules 2006:-

- The service provider acts as a pure agent of the recipient of the service while making payment to the third party.
- The recipient of service receives and uses the goods or services so procured by the service provider in his capacity as pure agent of the recipient of service.
- The recipient of service is liable to make payment to the third party.
- The recipient of service authorizes the service provider to make payment on his behalf.

- (e) The recipient of service knows that the goods and services for which payment has been made by the service provider shall be provided by the third party.
- (f) The payment made by the service provider on behalf of the recipient of service is separately indicated in the invoice issued by the service provider to the recipient of service.
- (g) The service provider recovers from the recipient of service only such amount as has been paid by him to the third party.
- (h) The goods or services procured by the service provider from the third party as a pure agent are in addition to the service he provides on his own account.

In order to truly appreciate the application of above-mentioned conditions in practical situations, following simple **example** is given:

Delhi based Mr. Raj is a commission agent of Mumbai based XYZ Ltd. Thus, Mr. Raj provides **Business Auxiliary Services** to XYZ Ltd. He is directed by XYZ Ltd. to purchase certain goods on its behalf to the extent of ₹ 10,00,000/- and to make the payment to the concerned seller. Further, Mr. Raj also takes the purchase invoice of said goods in the name of XYZ Ltd. Mr. Raj raises the invoice of ₹ 50,000/- [together with service tax @ 12.36%] as commission charges on XYZ Ltd. in respect of his Business Auxiliary Services. Besides, he will include above-mentioned ₹ 10,00,000/- in the invoice but will not charge any service tax on it because in respect of this amount he is **acting as pure agent of XYZ Ltd.** The above-mentioned conditions of pure-agent are being tested below:

- (a) The service provider [Mr. Raj in the present case] acts as a pure agent of the recipient of the service [i.e. XYZ Ltd. in the present case] while making payment to the third party [i.e. concerned seller of said goods]
- (b) The recipient of service [i.e. XYZ Ltd.] receives and uses the goods so procured by the service provider in his capacity as pure agent of the recipient of service.
- (c) The recipient of service [i.e. XYZ Ltd.] is liable to make payment to the third party.
- (d) The recipient of service [i.e. XYZ Ltd.] authorizes the service provider [i.e. Mr. Raj] to make payment on his behalf.
- (e) The recipient of service [XYZ Ltd.] knows that the goods for which payment has been made by the service provider [Mr. Raj] shall be provided by the third party [concerned seller of said goods]
- (f) The payment made by the service provider [Mr. Raj] on behalf of the recipient of service [XYZ Ltd.] is **separately indicated** in the invoice issued by the service provider to the recipient of service.
- (g) The service provider [Mr. Raj] recovers from the recipient of service only such amount as has been paid by him [₹ 10,00,000/-] to the third party [concerned seller of said goods]

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- (h) The goods procured by the service provider [Mr. Raj] from the third party [concerned seller of goods] as a pure agent are in addition to the service he provides on his own account.

Since all the prescribed conditions are fully satisfied in the present case, it may be safely inferred that Mr. Raj acts as pure agent on behalf of XYZ Ltd. in the present case.

Question 5

Kirti Ltd. was awarded a contract in September, 2012 for providing plastering services in respect of an immovable property for ₹ 2,00,000/-. The material required for plastering is also required to be supplied by Kirti Ltd. Whether the foregoing plastering services are subject to Service Tax and if so, how the service tax liability will be computed?

Answer

Kirti Ltd. has agreed to provide materials which are leviable to tax as sale of goods. In addition, it is also required to provide its services to its client. Therefore, its services fall within the scope of term 'works contract' as defined under Section 65B (54) of Finance Act, 1994. As a result, aforesaid Services of Kirti Ltd. are subject to Service Tax. As the value of materials transferred in the execution of said works contract has not been separately given, the value of Works Contract Services has to be determined in accordance with Rule 2A(ii) of Service Tax (Determination of Value) Rules, 2006 which is effective from 01.07.2012. Further, the present contract will get covered under Rule 2A(ii)(C) of Service Tax (Determination of Value) Rules, 2006. Therefore, Service Tax **shall be payable on sixty per cent of the total amount charged** for the works contract. The computation of service tax payable has been exhibited below:

Sixty per cent of the total amount charged	₹ 1,20,000/- [₹ 2,00,000 X 60%]
Rate of Service Tax	12.36%
Amount of Service Tax payable	₹ 14,832/- [which is 7.416% of the total amount charged of ₹ 2 lakh]

Question 6

Indian Oil Corporation [IOC] has awarded a contract in August, 2012 for ₹ 140 lakh to M/s Jagjit Construction Ltd. in respect of alterations to one of its buildings. The said building was abandoned by IOC five years ago. The materials required for carrying out the alterations will be supplied by Jagjit Construction Ltd. itself. The purpose of awarding the foregoing contract is to make the said building workable. Whether the aforesaid services of Jagjit construction Ltd. are subject to Service Tax and if so, determine the amount of service tax payable?

Answer

According to Explanation 1(a)(ii) to Notification No. 24/2012 dated 06.06.2012 "original works" means all types of additions and alterations to abandoned or damaged structures on land that are required to make them workable. Since Jagjit Construction Ltd. has been awarded a

contract for carrying out alterations in respect an abandoned building with a view to make it workable, the contract falls within the purview of term “original works”. Further, as there is involvement of materials {which is subject to VAT} during the course of execution of such contract, it will fall within the purview of ‘Works Contract’. As the value of materials transferred in the execution of said works contract has not been separately given, the value of Works Contract Services has to be determined in accordance with Rule 2A(ii) of Service Tax(Determination of Value) Rules, 2006 which is effective from 01.07.2012. Further, the present contract will get covered under Rule 2A(ii)(A) of Service Tax (Determination of Value) Rules, 2006. Therefore, Service Tax **shall be payable on forty per cent of the total amount charged** for the works contract .The computation of service tax payable has been exhibited below:

Forty percent of the total amount charged	₹ 56 lakh [₹ 140 lakh X 40%]
Rate of Service Tax	12.36%
Amount of Service Tax payable	₹ 6,92,160/-[which is 4.944% of the total amount charged of ₹ 140 lakh]

Question 7

Airports Authority of India (AAI) awarded a contract for construction of an airport in Nicobar Islands to Ananyana Construction Ltd. for ₹ 2345 lakh in August, 2012. Whether the aforesaid services of Ananyana construction Ltd. are subject to Service Tax and if so, determine the amount of service tax payable?

Answer

According to **Explanation 1(a)(i) to Notification No. 24/2012 dated 06.06.2012** “original works” means all new constructions. Since in the present case Ananyana Construction Ltd. has been awarded a contract for construction of an airport in Nicobar Islands, the contract falls within the purview of term “original works”. However, it is to be borne in mind that **Entry No. 14(a) of Notification No. 25/2012 dated 20.06.2012** provides, amongst other things, exemption to services by way of construction of an airport. Therefore, aforesaid services of Ananyana construction Ltd. are not subject to Service Tax

Exercise

1. Discuss whether the Central Excise Officer has power to reject the value of taxable service.
2. Write a detailed note on concept of pure agent.