

Works Contract – Treatment of Free Supply of Goods under Sales Tax and Service Tax



Works contract taxation is considered to involve a lot of complexities and controversies. Unlike other commercial transactions, transaction of works contract is of special nature as it attracts two indirect taxes i.e., tax on sale and tax on service, arising out of single commercial activity. The exercise of determination of taxable turnover in case of works contract, whether under VAT/Sales tax law or under Service tax law is not a simple exercise but is rather a complicated exercise. Determination of taxable value require consideration of several factors such as the point of time of transfer of property in goods, the State in which such property passed, status of agencies involved in the execution of contract viz. principal, contractor, sub-contractor etc. Many times, the contractee itself supplies whole or part of goods for use in work. Taxability of such supplies had been a bone of contention between revenue and assessee. Under VAT/Sales tax law, position is almost settled. However, as the service tax is comparatively new law, absolute clarity is yet to emerge under said law. Read on to know more...

When Value of Material Issued is Adjusted by Contractee

N.M.Goel & Co. vs. Sales Tax Officer, Rajnandgaon and Another [1989] 72 STC 368 (SC); [1989] 1 SCC 335; [1988] 38 ELT 733 (SC) Judgment dated 28th October 1988 is perhaps the parent decision on the controversy under VAT/Sales tax law. Here, the assessee was awarded contract for construction of godowns by Central Public Works Department (PWD). The tender and in-turn the contract was for entire work and included cost of goods used. In order to ensure that quality material is used in construction, the PWD undertook to supply such



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materials and stores as, from time to time, were required by the contractor-assessee to be used for the purpose of performing the contract. The value of such quantity of materials and stores so supplied was specified at a rate and got set-off or deducted from sums due to the contractor-assessee as consideration of undertaking work. The contract also provided that all material so supplied to the contractor shall remain the absolute property of Government and shall not be removed on any account from the site of the work, and shall be at all times open to inspection by the Engineer-in-Charge. Any unused material in good condition was liable for return to PWD. Revenue demanded purchase tax and entry tax from contractor-assessee contending that free supply of goods by PWD to contractor was in effect purchase by contractor from PWD and PWD being not a dealer registered under the Sales tax and Entry tax Acts. The assessee contested levy and submitted that the property in subject goods, in no point of time, ever passed to them and continued to remain with PWD although the PWD has in final bills debited the price of the goods so supplied. Revenue contended that property in goods remained with the PWD only till the time goods were at site and not incorporated in work. Once the material was consumed in the construction work, the property passed to the contractor-assessee and there was sale. The Supreme Court observed that mere passing of property or not is not sufficient to decide whether there was a sale or not. There might be several transactions where property in goods passes from one person to another yet there is no sale (like service contracts where property in some incidental goods gets transferred to service recipient). It was held that for attracting levy of tax, there must be sale of goods. The primary object of the bargain judged in its entirety must be viewed. Holding that by use or consumption of materials in the work of construction, there was passing of the property in the goods to the assessee from the PWD and transaction amounted to sale by PWD to contractor the Supreme Court observed that in a transaction of this type, though there is no inherent sale, a sale inheres from the transaction. By appropriation and by the agreement, there was a sale which was liable to tax.

In *Cooch Behar Contractors Association and Others vs. State of West Bengal and Others* [1996] 103 STC 477 (SC) Judgment dated 11th September 1996

So long as there is no attempt on the part of contractor and contractee to assign values to the material supplied by contractee for incorporation in work, and recovery thereof from contractor, there is no liability to tax. The position will remain so, even if values are assigned for limited purpose of recovery of value of unused or unaccounted material. However, if any recovery is made towards unused or unaccounted material that will be liable to tax.

the court applied N.M.Goel & Co. (*supra*) to hold that a sale namely, a transfer of property in goods supplied by the owner/contractee to the contractor for use in the execution of a works contract takes place when such goods are actually used in the construction work provided prices of such goods are deducted from or adjusted against bills or dues of the contractor.

In *Rashtriya Ispat Nigam Limited vs. State of Andhra Pradesh* [1998] 109 STC 425 (SC) Judgment dated 18th February 1998 the assessee tried to distinguish N.M.Goel & Co. (*supra*) case urging that in Goel's case the contractor had the liberty to retain the goods that were supplied to him by the employer (contractee), the deduction of the value thereof was on supply, not on use, there was no penal provision which would operate for non-return of such goods, the contract used the word 'sale', and there was no restriction on the use of the goods. However, the Supreme Court was not impressed with the contention and observed that there was no material difference between the contracts in the case in hand and the contract in Goel's case and held that there was no reason whatsoever to conclude that Goels' case was not properly decided and that it required reconsideration.

A three Judges Bench of Supreme Court in *Karya Palak Engineer C.P.W.D., Bikaner vs. Rajasthan Taxation Board, Ajmer and others* [2004] 136 STC 641 (SC); [2004] 25 NTN 1004 Judgment dated 12th August 2004 followed above three judgments to reject the argument that there was no sale in the transfer of materials supplied by the contractee to contractor.

In *B. Seenalah and Co. vs. Commercial Tax officer and others* [2001] 124 STC 248 (Andhra Pradesh HC) Division Bench Judgment dated 21st June 2001 the assessee undertook contract for laying of roads. Under the contract, the contractor

was under an obligation to extract boulders at the specified quarries and convert the boulders into the required sizes of the metal for the purpose of laying the road. The same has to be loaded at the place of conversion of the boulders into metal and has to be transported and unloaded at the place of laying the road. In respect of boulders extracted from the specified quarries, the assessee was liable to pay seigniorage fee and the same was deducted out of the amounts payable to the assessee-petitioner. The High Court held that after extraction of boulders, they became property of the contractor and when same was incorporated in work, i.e., road laying, there was transfer of property liable to tax.

No Value Adjustment

In all the above cases, the value of materials supplied was deducted by the contractee while making payment to the contractor. However, if no value is recovered from the contractor for material supplied, such supplies remain out of tax ambit. In *Mukhya Rail Path Nirikshak, Saharanpur vs. the Commissioner of Trade Tax, U.P.* [2007] 33 NTN 86 (Allahabad HC) single member Bench Judgment dated 6th November 2006 the assessee-contractee entered into contract with various contractors for manufacturing and supply of sleepers for Railway tracks. For the purpose contractee issued Pig Iron to some contractors free of cost. Two separate prices were stipulated for the sleepers; higher rate was stipulated in case where the contractors had to use 100% material and the lesser rate was fixed in a case where the contractee had to supply 50% iron free of cost. Authorities below assessed tax on such issue which was upheld by Tribunal observing that in case where 50% iron was supplied by the contractee, less rate has been settled keeping in view the valuation of the material and thus, supply of the pig iron was sale. Before High Court, the contractee

contended that rates were decided separately and, also, that no amount was charged for the material issued to the contractors. The High court held that there was no sale involved. Decisions of Apex Court in *NM Goel & Co. (supra)*; *Rashtriya Ispat Nigam Ltd (supra)* and *Karyapalak Engineer CPWD Bikaner (supra)* were not applicable as in those cases, the value of material supply was deducted while making payment which was not situation in the present case. It was further held that settlement of rates at lesser price will not be covered by the expression 'other valuable consideration' as that expression takes colour from the proceeding expression, i.e., 'cash or deferred payment'. It can only mean some other monetary payment in the nature of cash or deferred payment.

In *State of Tamil Nadu vs. Sri Meenakshi Plastic Industries* [2010] 33 VST 466 (Madras HC) Division Bench Judgment dated 25th June 2009 the assessee was engaged in the manufacture of plastic products. In the course of manufacture of products to be supplied to its customers, the assessee was supplied with certain component parts, viz., holder supporter, separator, serving guide roller and spools etc., by the customers themselves. The assessing authority held that for the purpose of sales tax, the sale value inclusive of component supplied by the assessee's customers is chargeable to tax in as much as the said value was the basis for charging Excise duty. The High Court disapproved such conclusion observing that when the customer supplied the components to the assessee, they continue to retain ownership and even though such components form part of the ultimate product, the value of such components did not form part of the ultimate price at which the product was sold by the assessee to customers. It was not the case of Revenue that the price fixed by the assessee for the product included the value of components supplied by the Customers. While levying sales tax on the value inclusive of value of components supplied by the customers, the authorities below failed to apply the basic difference between levy of Excise duty and Sales tax in as much as Excise duty is levied on the value of the product, based on the manufacture, while the levy of sales tax is based on transfer of property in goods from seller to the buyer.

From the above discussion, it can be safely concluded that so long as there is no attempt on the part of contractor and contractee to assign values

Works contract is essentially a Service contract. It is by virtue of Article 366 (29-A) of Constitution that Sales tax/VAT is levied on goods contents of service. Section 66E(h) of the Finance Act 1994 includes 'service portion in the execution of a works contract' in the net of taxable service. Rule 2A of Service Tax (Determination of value) Rules, 2006 provide for determination of value of service portion in the execution of a works contract.

Substituted Rule 2A in Service Tax (Determination of value) Rules, 2006 by excluding the word 'used' has actually cleared the doubts. Unless service recipient recovers value of goods supplied from or adjusts against bills or dues of contractor, there is no supply by contractor to contractee and, therefore, there is no tax liability on value or fair market value of such goods.

to the material supplied by contractee for incorporation in work, and recovery thereof from contractor, there is no liability to tax. The position will remain so, even if values are assigned for limited purpose of recovery of value of unused or unaccounted material. However, if any recovery is made towards unused or unaccounted material that will be liable to tax. The contract between parties should ensure that contractor should not be permitted to divert or use goods so supplied for any purpose other than the targeted contract. It would be better, if goods are issued strictly as per agreed Bill of Material (BOM).

Turnover Tax on Works Contracts

In *Pawan Kumar Jain vs. Commercial tax Officer and others* [2010] 35 VST 397 (Madhya Pradesh HC) Division Bench Judgment dated 25th March 2010 the assessee-contractor undertook construction work for CPWD and telecom Departments. Items like iron, steel and cement were supplied by respective contractees for whom the work was executed. In addition to regular sales tax, Revenue demanded Turnover tax on resale of such goods to contractees after incorporation in work. The assessee disputed liability urging that in case goods are used in process of construction, it would not amount to resale as resale ordinarily means sale of goods in the same form in which they were purchased without subjecting them to any process. In case of construction contracts, items like cement *etc.*, are first processed to convert them in concrete and as such original identity of goods is lost. The High Court rejected the argument as contrary to the legal provision and observed that definition of sale, includes transfer of property in goods 'whether as goods or in some other form' involved in the execution of a works contract, within ambit of sale.

Input Tax Credit

After introduction of VAT, the contractor has become eligible to claim set-off of tax leviable on supply of goods by contractee which has taken colour of sale because of recovery of its value from contractor. In *Lajpat Rai Chanana vs. State of Haryana & Ors* [2011] 38 PHT 390 (Punjab & Haryana High Court) Division bench Judgment dated 23rd February 2011, the assessee was a works contractor to whom materials required in the execution of the work were supplied by the Contractee. Such supplies were treated by the authorities as sale by the contractee to the contractor. The contractor petitioner claimed input tax credit of the tax paid by the contractee. The High Court held that the contractor-petitioner was entitled to input tax credit of the tax paid by the contractee subject to furnishing of tax invoices issued by the contractee.

Accounting in the Hands of Contractor

Expert Advisory Committee (EAC) of ICAI, in an opinion finalised on 21st-22nd May 2013¹ has opined that 'Buyer Furnished Equipment' (BFEs) cannot be considered as inventories/WIP by Contractor. Cost of BFEs cannot be considered as part of sales value/contract revenue. Querist (the company) was engaged in construction of Warships and Submarines and some of the equipments were supplied by the buyer for installation in 'to be constructed ship' on 'free of cost' basis. The opinion was based on the fact that orders in respect of BFEs were directly placed by the buyer and also payment in respect of them was made by the buyer. These were then supplied to the company for installing in the ship and the buyer paid installation charges which were included in the contract price. Thus, the company neither incurred any cost of BFEs nor any amount was recoverable on account of such equipments except installation charges. Accordingly, the EAC was of the view that such equipments are not 'assets' that may be considered as a part of work-in-progress. The EAC explained that in fact, after installation in the ship, the BFEs are returned to the buyer after completion of the ship. Thus, these are only held by the company in the capacity of a bailee. Since, these cannot be considered as 'asset', therefore, these cannot be considered as 'inventory nor as work-in-progress.

¹ Published in *The Chartered Accountant* – December 2013 pages 62 to 64

Valuation under Service Tax law

For understanding the position under Service tax law, we shall have to start from 'Commercial or Industrial Construction Services'. This service was brought into tax net *w.e.f.* 10th September 2004. Taxable value was gross amount charged by the service provider for such service. Being ceased of the situation that such service require substantial material, and also that these materials are normally procured from the market and are not covered under the duty paying document as such service provider will not be eligible to claim credit of excise duty paid on such inputs, an option was given to service providers *vide* notification number 15/2004-ST dated 10th September 2004 to opt for abatement of 67% towards cost of material and pay tax on 33% of the Gross amount charged. This notification was amended *vide* notification number 04/2005-ST dated 1st March 2005 to include explanation of the effect that "*gross amount charged*" shall include the value of goods and materials supplied or provided or used by the provider of the construction service for providing such service." Interpretation of this explanation created controversy. Revenue had stand that value of goods supplied by contractee was includible in all cases whereas assessee claimed that such inclusion in taxable value was not permissible in view of Section 67 of the Finance Act, 1994 as when the goods are provided by the service recipient there is no charge by service provider for such goods. Said Section 67 provide for valuation of taxable services for charging service tax. While the Madras High Court in the *Larsen & Toubro Ltd, Chennai vs. UOI* [2007] 7 STR 123 (Madras); 2007-TIOL-176-HC-Mad-ST, the Delhi High Court in the *Era Infra Engg Ltd vs. UOI and others* [2010] 33 VST 153 (Del); 2008-TIOL-386-HC-Del-ST and the Calcutta High Court in the *Simplex Infrastructures Ltd's case* 2010-TIOL-899-HC-Kol-ST took a *prima facie* view that, the value of the Free of cost materials cannot be included under the 'gross amount charged', CESTAT in the *Jaihind Projects Ltd vs. CST, Ahmedabad* [2010] 18 STR 650; 2010-TIOL-124-Cestat-Ahm in final decision took the view that service tax has to be paid on the free supply of materials. Another Division bench of *Tribunal in Cemex Engineers vs. CST, Cochin* in [2010] 17 STR 534; 2009-TIOL-2208-Cestat-Bangalore took the view that such value of free of cost goods was not

includible. Noticing the conflict between decisions, the matter was referred to larger Bench. In the meantime, another Bench of Delhi Tribunal, in an *ex-parte* order (nobody appeared for the assessee), in the case of *Paharpur Cooling Towers Limited vs. Commissioner of CE* [2013] 31 STR 227 Judgment dated 5th February 2013, upheld inclusion of value of free supplied material in gross amount of taxable service holding that adjudicating authority has rightly decided the issue against the assessee following taxation of incremental value principal.

Larger Bench in *Bhayana Builders (P) Limited vs. Commissioner Service Tax* 2013-TIOL-1331-Cestat-Del-LB; [2013] 32 STR 49 (Tri.-LB) *vide* Judgment dated 6th September 2013 has discussed almost all possible arguments by Revenue and assessee. Among other technical arguments, Revenue pressed in service decision in N.M.Goel's case (*supra*) in its favour. The Larger bench dispelled such contention observing that in cases under discussion, the agreement between parties do not provide for recovering the cost of the free supplies by the recipient from the service providers, *i.e.*, recoveries from the consideration agreed between the parties, to be paid to the service provider.

The Larger Bench in principal agreed that notification number 15/2004-ST (*supra*) being an exemption notification, the Government was at liberty to define what components should comprise the gross value charged for providing a taxable service. However, mere enlargement of the contours of 'gross amount charged' in a condition incorporated in an exemption notification would not amount to bringing to the net a value which is not taxable under Section 67 of the Act. For the purpose the larger Bench relied on *Intercontinental Consultants And Technocrats Pvt Limited vs. Union of India* 2012-TIOL-966-HC-Del-ST; [2013] 29 STR 9 Judgment dated 30th November

Another controversy for valuation under Service tax pertains to the question whether the assessee can opt for different methods of valuation under VAT/ Sales tax law and under Service tax law. In other words, can the assessee opt for payment of VAT/ Sales Tax on actual value of goods and for Service Tax on derived value of service? The answer appears to be 'no'.

2012 wherein it was held that that rule 5(1) of the Service tax (Determination of value) Rules, 2006 which provides for inclusion of the expenditure or costs incurred by the service provider in the course of providing the taxable service (service of consulting engineers) in the value for the purpose of charging service tax is *ultra vires* Section 66 and 67 of the Finance Act, 1994 and travels much beyond the scope of those Sections. The High Court concluded that the provisions of Rule 5(1) of the valuation Rules are repugnant to Sections 66 and 67 of the Act since the provision purport to tax not only, what is due from the service provider under the charging Section, but seeks to extract something more from him by including in the valuation of the taxable service other expenditure and costs which are incurred by the service provider in the course of providing taxable service.

The Larger Bench held that 'free supplies,' incorporated into the construction even on an extravagant inference would not constitute a non-monetary consideration remitted by the service recipient to the service provider for providing a service, particularly since no part of the goods and material so supplied accrues to or is retained by the service provider.

The Larger Bench also referred to Circular F.No. V/DGST/22/Audit/Misc./1/2004 dated 16th February 2006 of DGST wherein the Board explained that in case of 'construction of complex services' 67% abatement is for goods and material supplied. Invoking principle of *contemporanea expositio* it was held that understanding of authorities of identical expression for 'construction of complex services' was applicable for 'Commercial or Industrial Construction Services' also. Value of only such goods and materials which are supplied or provided by the service provider can be included in taxable value.

It was finally concluded that goods and materials, supplied/provided/used by the service provider for incorporation in the construction, which belong to the provider and for which the service recipient is charged towards the value of such supply/provision/use and the corresponding value whereof was received by the service provider, to accrue to his benefit, whether independently specified as attributable to the specific material/goods incorporated or otherwise, would alone constitute the gross amount charged. This is not to say that an exemption Notification cannot enjoin a condition that the

value of free supplies must also go into the gross amount charged for valuation of the taxable service. If such intention is to be effectuated the phraseology must be specific and denuded of ambiguity. The Delhi High Court in *G D Builders vs. Union of India and Another* 2013-TIOL-908-HC-DEL-ST Judgment dated 13th November 2013 while examining challenge to Explanation to Notification No. 15/2004-ST dated 10th September 2004, Explanation to Notification No. 18/2005-ST dated 7th June 2005 and with respect to certain entries in Notification No. 1/2006-ST dated 1st March 2006 held that only the service component can be brought to tax as per provisions of Section 67 which stipulates that value of taxable service is the gross amount charged by the service provider for such services provided or to be provided by him and not the value of the goods provided by customers of service provider and the service tax cannot be charged on the value of the goods used in the contract (para 31).

Negative List Regime of Service Tax

Works contract is essentially a Service contract. It is by virtue of Article 366 (29-A) of Constitution that Sales tax/ VAT is levied on goods contents of service. Section 66E(h) of the Finance Act 1994 includes 'service portion in the execution of a works contract' in the net of taxable service. Rule 2A of Service Tax (Determination of value) Rules, 2006 provide for determination of value of service portion in the execution of a works contract. In general, Service tax is leviable after excluding value of goods on which VAT/Sales tax has been paid. The Supreme Court in *Gannon Dunkerly & Co vs. State of Rajasthan / Larsen & Toubro Ltd vs. UOI* [1993] 88 STC 204 (SC) 398 judgment dated 17th November 1992 gave a list of eight deductions (exclusions) from gross amount charged for the purpose of levy of tax under Sales tax Act. That list has been incorporated as Rule 2A(i)(b) for inclusion in taxable value for the purpose of levy of Service tax.

The Rule 2A(ii) gives an option to the service provider for paying tax on derived value. Such value is derived as certain fixed percentage of total amount charged. 'Total amount charged' has been defined in Explanation attached to sub-rule. That Explanation, for ready reference is reproduced below:

"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 the 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:

Provided that the fair market value of goods and services so supplied may be determined in accordance with the generally accepted accounting principles.

The words 'in or in relation to' has been used after the word 'supplied'. The word 'used' as was the case in notification number 04/2005 dated 1st March 2005 is conspicuously absent. It is settled law that goods used in the execution of a works contract stand transferred from the contractor to the contractee at the time goods are incorporated in the construction (work). One cannot transfer something which he does not own.

Five Judges Bench of Supreme Court in *Sunrise Associates vs. Govt. of Nct of Delhi & Ors* [2006] 145 STC 576; 3 VST 151 (SC); 5 SCC 603; TIOL-40-SC-CT-LB Judgment dated 28th April 2006 has observed that the word "property" may denote the nature of the interest in goods and when used in this sense means title or ownership in a thing. The word may also be used to describe the thing itself. The two concepts are distinct, a distinction which must be kept in mind when considering the use of the word in connection with the sale of goods. In the Dictionary of Commercial law by A. H. Hudson (1983 Edition) the difference is clearly brought out. The definition reads thus:

"Property" - In commercial law this may carry its ordinary meaning of the subject-matter of ownership. But elsewhere, as in the sale of goods it may be used as a synonym for ownership and lesser rights in goods".

Hence, when used in the definition of 'goods' in the different sales tax statutes, the word 'property' means the subject matter of ownership. The same word in the context of a 'sale' means the transfer of the ownership in goods."

Thus, it can be said that substituted Rule 2A in Service Tax (Determination of value) Rules, 2006 by excluding the word 'used' has actually cleared the doubts. Unless service recipient recovers value of goods supplied from or adjusts against bills or dues of contractor, there is no supply by contractor to

contractee and therefore there is no tax liability on value or fair market value of such goods.

Service Tax (Determination of value) Rules, 2006 are subject to sub-Sections (1), (2) and (3) of Section 67. Tax can be levied on consideration. Consideration may be in the form of money or in the form other than money but the fact remains that 'consideration' is what flows from transferee to transferor. In case of free supply of goods, value of which is not recovered by the contractee from contractor, goods always remain property of contractee as at no point of time, ownership in the goods, as understood under the Sale of goods Act is transferred to contractor. The scheme of levy of Service tax on works contract is mirror image of scheme of taxation of works contract under VAT/Sales tax law. The word 'supplied' used in Explanation, so far it relates to goods, is synonyms to word 'sale' and thus is in the sense of legal ownership and not in the sense of mere physical possession. The explanation is added merely to prevent splitting of contracts.

In *Inox Air Products Ltd vs. Commissioner of CE* 2012-TIOL-510-HC-Mum-ST; 24 taxmann.com 114 (Bom) Judgment dated 9th July 2012 the question before Bombay High Court was whether electricity supplied free of cost by the service recipient to provider of operations and maintenance service of plant was includible in taxable value. The High Court held that electricity supplied free of cost by the customers to the assessee does not in any way amount to additional consideration, received by the assessee, in kind. Service tax is on the value of consideration received in cash or kind for the services rendered. Therefore, unless the cost of electricity supplied free of cost constitutes the consideration received by the assessee, the cost of electricity would not be includible in the value of taxable service. The larger Bench in Bhayana Builders (P) Limited's case (*supra*) making a reference to *Moriroku UT India (P) Ltd vs. State of U.P.*[2008] 224 ELT365 (SC); 2008-TIOL-45-SC-CT opined that principal of taxation under the sales tax law that it is the consideration for the transfer of the property in goods from the seller to the buyer, that has to be taken into consideration for the purpose of levy of tax, is equally applicable to the levy of service tax under the provisions of the Finance Act, 1994 and in particular in the context of the specific language in Section 67 of the Act.

Another controversy for valuation under Service tax pertains to the question whether the assessee

can opt for different methods of valuation under VAT/Sales tax law and under Service tax law. In other words, can the assessee opt for payment of VAT/Sales Tax on actual value of goods and for Service Tax on derived value of service? The answer appears to be 'no'. As already noted above, the scheme of levy of Service tax on works contract is mirror image of scheme of taxation of works contract under VAT/Sales tax law. Clause (ii) in Rule 2A of Service Tax (Determination of value) Rules, 2006, which provides for option of payment of tax on derived value, is deliberately put after the 'actual value computation' method prescribed as clause (i). Clause (ii) starts with the words 'where the value has not been determined under clause (i)'. Thus, the option of going by derived value method is available only when clause (i) fails. It is true that words used are 'has not been determined' and not 'cannot be determined' or 'is not determinable' yet a clue of Legislature's intention may be taken from scheme of valuation under State VAT Rules. In almost all State VAT Rules, option of going by abatement route (also referred to as Table method) is available where the contractor has not maintained accounts which enable a proper evaluation of different deductions. Though it is open to the tax payer to interpret the law in the fashion which is most beneficial to it, but it would be illogical for the assessee to claim that for the purpose of admission of liability under VAT/Sales tax law, it has maintained full set of Books of Accounts yet for the purpose of Service tax, it opted for ignoring those records. Having said this, so long words used are 'has not been determined' it remains a debatable issue. Let us wait for either amendment in rule or issue of clarification by CBEC. Till that time, for risk averse tax payers, a better bet would be to have same basis under VAT/Sales tax law and Service tax law.

Whether Tax is Payable on Tax

As works contract is subject to tax under Service Tax as well as under VAT/Sales tax law, another consequential controversy is about liability to tax on tax. Explanation (a) to clause (i) of Rule 2A of Service Tax (Determination of value) Rules, 2006 clarifies that gross amount charged for the works contract shall not include 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. However, under the VAT law there is no such clear provision. Commissioners of Commercial Taxes in various states have issued clarification on this. Except for the State of Maharashtra, all other States, which have issued clarification, have held that no VAT is payable on Service Tax element of amount charged from contractee².

In a recent clarification issued under Section 67 of Andhra Pradesh VAT Act, in case of a dealer engaged in the business of tyre re-treading, for the question whether VAT is applicable on service tax paid, it was held that VAT is applicable on the sale or deemed sale of goods. If the tax invoice or bill of sale does not set out correctly the amount for which the goods are sold, the sale price is the total amount of consideration for the sale of goods as may be determined by the assessing authority. Since service tax is relatable to the labour/service component of the works contract, no tax can be levied on service/labour component and service tax as long as the value of the goods is correctly set out in the sale invoice, in a works contract³. The Andhra Pradesh Sales Tax & VAT Appellate Tribunal (STAT) in *Indian Commerce & Industries Co. Pvt. Ltd., Secunderabad vs. State of Andhra Pradesh* [2012] 55 APSTJ 89 Judgment dated 2nd July 2012 has held that Service Tax Collected on the value of services rendered, not relatable to the value of goods which is included in the sale invoice is eligible for deduction for the purpose of quantifying the liability of VAT.

In another clarification issued under Section 67 of Andhra Pradesh VAT Act, in case of a dealer engaged in servicing of two, three and four wheelers who has opted for composition under Section 4(7)(b) of the VAT Act, the question raised was whether VAT is payable on service tax also. It was clarified that works contractor opting for composition under Section 4(7)(b) was required to pay tax at 5% on the total amount (including the material portion and labour/service portion) received or receivable towards execution of works contract. It was further clarified that total consideration received or receivable towards the execution of any work without any distinction between various components built into such consideration was liable to tax at five percent under Section 4(7)(b) of the VAT Act⁴. ■

² Whether VAT is payable on Service tax charged in Works contract - [2012] 52 VST (Journal) 1

³ A.R.Com/63/2012 (C.T.D. Order No. A.R.41), dated May 23, 2013 – Fortune Tire Tech Limited, Hyderabad – [2013] 63 VST (St) 158.

⁴ A.R.Com/6/2013 (C.T.D. Order No. A.R.27), dated March 01, 2013 – M.G.Brothers, Anantpur – [2013] 62 VST (St) 46.