

SERVICES IN EXECUTION OF WORKS CONTRACT

1. Introduction

Any contract, where both services and property in goods are involved, is known as works contract. Works contract are partially subject to VAT i.e. to the extent of cost of material which is being transferred from contractor to contractee. Works contract are also partially subject to service tax i.e. to the extent of consideration which has been charged on account of labour/ services.

Construction agreement for civil structure, erection and installation of machinery and annual maintenance contract, are some of the popular examples of works contract which subject to VAT as well as service tax. Service tax was applicable on these works contracts under the following categories of services even upto 31-05-2007:

- (i) Commercial or industrial construction services w.e.f. 01-07-2003
- (ii) Complex construction services w.e.f. 16-06-2005
- (iii) Erection, Commissioning or Installation Services w.e.f. 01-07-2003

As there are no fixed principles by which one can distinguish a contract for sales from a contract of work and labour. [State of Gujarat vs. Variety Body Builders [1976] 38 STC 176 (SC)]. Hence, the taxability of such contracts has been a matter of litigation both in respect to applicability of VAT and Service Tax.

The Government has brought this service into service tax net with a view to overcome pronouncement in **Daelim Industrial Co Ltd. V CCE (2004)** wherein it was held that a composite works contract can not be vivisected and part of it subject to tax. A turnkey works contract, not encompassing any contract for service, cannot be subject to service tax.

2. Meaning of Taxable Service as made taxable w.e.f. 01-06-2007

Taxable service means **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.**

Explanation.—For the purposes of this sub-clause, “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 purposes 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 or a civil structure or a part thereof, or of a pipeline or conduit, primarily for the purposes of commerce or industry; or
 - (c) construction of a new residential complex or a part thereof; or
 - (d) completion 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; - Section 65 (105) (zzzza) of Finance Act 1994(which governs the levy of service tax).

3. Nature of taxable service

The essential ingredients of this service are as under:-

- a. Service are provided **by any person**; and
- b. Service are *provided or to be provided to any other person*; and
- c. Services are in **relation to execution of works contract**.

The introduction of this service has settled the issue regarding the applicability of service tax in the case of works contract of the nature of erection, commissioning or installation, construction or turnkey projects. It is worth mentioning here that Service Tax is payable by only by those service providers who are providing services with respect to works contracts of the following nature only:

- (i) A contract wherein 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 carrying out **any of five purposes** specified in Explanation to Section 65(105)(zzzza).

In addition, the works contracts in respect of specified infrastructure projects namely road, airports, railways, transport terminals, bridges, tunnels and dams are specifically excluded from the scope of levy of Service Tax. In different words, other kinds of works contracts for instance Contract for Outdoor Catering Services or Complex Construction Services will continue to be taxable under the respective category of service subject to the conditions specified under respective service.

Relevant case Laws

Supreme Court in case of **K. Raheja Development Corporation V State of Karnataka (2006)(3) S.T.R. 337(S.C.)** has clarified in relation to Karnataka Sales Tax Act(hereinafter referred to as "Act") that the activities undertaken by builders for construction of flat/building for or on behalf of the prospective customers for consideration in cash or deferred payment is covered under the works contract and not under sale. In the Act, there is a wide definition of Works Contract which includes any agreement for carrying

out building or construction activity for cash, deferred payment or other valuable consideration. A works contract, within the meaning of the Act, can also be for construction of Commercial Units. However, it must be clarified here that if the agreement is entered into after the flat or unit is already constructed than there would be no works contract but so long as the agreement is entered into before the construction is complete, it would be a works contract.

Relying on the principles laid down in the above judgment .of **K.Raheja Development Corporation** case in case VAT is payable by real state developers on installment sales then Company shall also be liable to pay service tax under this category of service specifically.

However, in case of **Assotech Realty Private Limited V State of U.P. {2007(7) S.T.R. 129 (All)}** Allahabad High Court, after taking into consideration the terms and conditions of the agreement between the petitioner (i.e. ASSOTECH) and prospective customers, held that the petitioner (i.e. ASSOTECH) continues to remain the owner of the apartments/flats including all constructions till such time the sale deed is executed and registered in favour of the prospective allottees/purchasers. The payment of instalments by the prospective allottees/purchasers does not transfer any, title or interest in the construction undertaken by the petitioner. Thus the constructions undertaken by the petitioner (i.e. ASSOTECH) cannot be said to have been undertaken by it for and on behalf of the prospective allottees/purchasers. It, therefore, can not be subjected to tax under the U.P. Trade Tax Act 1948 and the action in imposing tax on such constructions treating them to be works contract, is wholly without jurisdiction.
still awaited.

Further, in the case **Bharat Sanchar Nigam Ltd. (BSNL) v Union of India (2006) 145 STC 91 (SC)** as pronounced by the larger bench of Supreme Court service tax shall be leviable on the value of services provided at the time of execution of works contract and VAT shall be leviable on the value of goods involved in the works contract. This judgment has further made it clear that service tax and VAT both shall be leviable

on the portion of services and goods respectively provided in the works contract.

4. Valuation of Taxable Service

Rule 2A of Service Tax (Determination of Value) Rules, 2006 as applicable with effect from 01.06.2007 provides that value of works contract services shall be deemed to be 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.

The gross amount charged for the works contract shall not include Value Added Tax (VAT) or sales tax, as the case may be, paid, if any, on transfer of property in goods involved in the execution of the said works contract. However it shall include the following-

- (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;

The rule also provides that where 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 for the purposes of payment of Value Added Tax or sales tax, as the case may be, 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.

5 Rate of Tax

Alike all other services, the rate of service tax applicable on services provided in execution of works contract is 12%. However, special composition scheme for payment of service tax has been introduced by the Government for the service providers providing services in execution of works contract

5A Composition Scheme for Payment of Service Tax by Service Providers providing services in execution of Works Contract w.e.f. 01.06.2007.

A composition scheme has been introduced for service providers providing services in execution of works contract. These service providers have been given an option to pay service tax @ 2% of the **gross amount** of the works contract. However, the gross amount of works contract shall not include Value Added Tax (VAT) or sales tax, as the case may be, paid on transfer of property in goods involved in the execution of the said works contract. In case service providers avail this option then they **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. In other words, service providers opting for Composition Scheme can take CENVAT Credit of duties or cess paid on **Input Services** and **Capital Goods** used in or in relation to the said works contract.

5B Option to exercise Composition Scheme in respect of each contract before making payment of Service Tax for such Contract

The option for availing the composition scheme for payment of service tax is available to service providers on contract to contract basis. In other words, a service provider can avail the option of making payment of service tax @2% in respect to one particular contract and he can pay service tax at normal rates for any other contract. The option to pay service tax under the composition scheme shall be exercised **before** payment of

service tax in respect of the works contract and the option so exercised shall be applicable for the entire works contract and **shall not be withdrawn until the completion of the said works contract.**

For availing the benefit of composition scheme, the service provider providing services in execution of works contract has to write a letter to the department on a simple paper in his own words because there is no prescribed format for such an intimation letter.

5C Option to excise Composition Scheme not available in respect of existing Works Contracts

The option for availing the benefit of Composition Scheme for payment of Service Tax is available only in respect of those works contract on which payment is made on or after 01-06-2007. In other words, the benefit of Composition Scheme for payment of Service Tax can not be availed in respect of existing works contracts i.e. those works contract which commenced before 01-06-2007 and full payment in respect of which has been received on or before 31-05-2007.

6 Exemption Limit of Rs. 8 lacs

Exemption Limit has been provided to small service providers in respect of taxable services of aggregate value not exceeding Rs 8 Lacs in any financial year subject to certain conditions vide **Notification No. 4/2007 dated 1.3.2007** which has amended **Notification No. 6/2005 dated 1.3.2005**

7 Specific Exemption

Taxable service provided or to be provided in relation to execution of works contract for construction of ports and other ports.

8 CENVAT Credit Rules

The assessee will be entitled to claim credit of service tax paid on **input services** received and consumed in relation to providing of output taxable services. The assessee will also be entitled to claim credit of duty paid on **inputs** and **capital goods** consumed and used in relation to providing output taxable services. However, in case service providers opt for Composition Scheme then they **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. In other words, service providers opting for Composition Scheme can take CENVAT Credit of duties or cess paid on **Input Services** and **Capital Goods** used in or in relation to the said works contract.

To summarise, the specific inclusion of services in execution of works contract has certainly settled most of the issues in relation of applicability of service tax on works contract. This service has been made taxable by the Government after considering all the suggestions and recommendations of the users and professionals; thereby it shall result in minimum litigation.