

# Composite Contracts: Indirect Tax Aspects

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# SIMPLE EXAMPLE

Product	VAT Rate	Case 1 (Grocery Store)		Case 2 (Eating House)	
Bread	0.00%	50.00	0.00		
Butter	12.50%	50.00	6.25		
Tomatoes	0.00%	25.00	0.00		
Sandwich	4.00%			125.00	5.00
TOTAL		125.00	6.25	125.00	5.00

- Can the Grocery Store pay tax of Rs. 5/- as sale of sandwich
- Can the eating house be called upon to pay tax of Rs. 6.25 on “butter component” of the sandwich
- Can the eating house exclude “bread and tomatoes” components of sandwich since they are exempt from tax?
- What if the eating house charges Rs. 10 extra for extra butter on the sandwich? What will be the tax rate on the same?

# Key Traits...

- Multiple Constituent Elements
- Customer interested in single outcome
- Most of the Constituent Elements are not outcomes in themselves but a means to achieve the outcome

# Composite Contract for Supply of Multiple Goods

- Assembled/Manufactured Product
  - Sandwich / Computer
- Packing Materials and Accessories
  - Milk packed in bottles
  - Safety Kits along with motor cars
- Diverse Set of Goods
  - Biscuits and Toys

# Composite Contract for Supply of Goods with Ancillary Services

- Sale of Jewellery
  - with Customised Gift Packing
- Sale of Refrigerator
  - with warranty
- Sale of Microwave
  - with training on use of the microwave
- Supply of Food by Restaurant
  - With Home delivery

# Provision of Diverse Spectrum of Services

- A stock broker not only buying and selling securities for the investor but also advising him on potential transactions
- A transporter also assisting in the loading and unloading of the goods and the clearance of the goods at the octroi check-post
- A hospital offering cable connection
- A credit card company offering accident cover

# Provision of Service involving ancillary use of materials

- A chartered accountant submitting an audit report
- A doctor also dispensing some medicines from his own dispensary
- A coaching class providing study materials to the students
- A testing agency using chemicals to test the product

# Performance of Work involving transfer of materials

- Construction Contracts
- Repair Contracts
- Turnkey Assignments
- EPC Contracts



# Broad Indirect Tax Framework

- Goods attract dual levy:
  - Centre Level Excise Duty at the stage of 'Manufacture'
  - State Level Sales Tax at the stage of 'Sale'
    - Certain transactions deemed to be 'sale'
  
- Services attract single levy:
  - Centre Level Service Tax on Provision of Services
  - State Level Taxes on Specific Services like Luxuries, Entertainment, Passenger Transportation, etc.

# Key Indirect Taxes : Important Traits..

# Composite Contracts: Judicial Thinking

- A composite contract should not be vivisected to levy a tax on a specific component of such a contract but should be analysed as a whole
  - State of Madras vs. Gannon Dunkerley & Co 9 STC 353 (SC)
- Even in cases where the agreements provide for progressive payments based on individual milestones
  - Sentinel Rolling Shutters & Engg. Co. vs. CST 4 SCC 260 (SC)
- Even if specific price breakup is given for individual milestones
  - Daelim Industrial Co. Ltd. vs. CCE 155 ELT 457 (Tri) as approved by SC
- Even if there are separate agreements
  - CIT vs. Sundwiger Empg & Co. 262 ITR 110 (AP)

# Composite Contracts: Legislative Perspective

- Gannon Dunkerley's case
- 46th Constitutional Amendment to deem certain “transactions” to be “sales”
  - transfer of property in goods (whether as goods or in some other form) involved in the execution of a works contract
- The deeming fiction valid only for the said lists and not beyond that
  - Geo Miller & Co vs. State of MP 5 SCC 209 (SC)
  - BSNL vs. UOI 3 SCC 1 (SC)

# Dominant Intention Test: Summary

- Substance of the Transaction Important
- Method of Charging not relevant
- *“Intention” is a slippery phrase and needs to be analysed based on the circumstances and legal obligations arising from the contract.*
- However, 46th Constitutional Amendment dilutes the test in the case of deemed sales (one of which is works contracts)

# Tabulation of Indirect Tax Implications (No Overlaps)...

Sr.	Nature of Composite Contract	Provisions
1.	Composite Contract for Supply of Multiple Goods	Only VAT Payable. Rate/Exemptions to be determined based on the dominant intention
2.	Composite Contract for Supply of Goods with Ancillary Services	Only VAT Payable. No exclusion on account of amounts charged for services rendered prior to delivery of goods
3.	Provision of Diverse Spectrum of Services	Only Service Tax Payable. Rate/Exemptions to be determined based on the dominant intention for naturally bundled services. Highest Rate applicable for artificially bundled services
4.	Provision of Service involving ancillary use of materials	Only Service Tax Payable. No exclusion under the new regime for the value of the goods.

# Tabulation of overlapping areas

Sr.	Nature of Composite Contract	Provisions
5.	Works Contracts	Both VAT and Service Tax Payable. VAT Payable on the value of the goods transferred. Service Tax Payable on the balance value
6.	Catering Contracts	Both VAT and Service Tax Payable. Service Tax payable on the service portion. Currently, VAT applicable on the full value, but the position likely to be contested.
7.	Other Deemed Sales	These are not composite contracts and therefore no case of overlap. In practice, one finds overlapping due to conservatism.

# Works Contracts: Indirect Tax Aspects

## Service Tax



# Law Applicable w.e.f. 01.07.2012

- Definition:
  - ▣ 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 construction, erection, commissioning, installation, completion, fitting out, repair, maintenance, renovation, alteration of any moveable or immovable property or for carrying out any other similar activity or a part thereof in relation to such property

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- Vivisection

# Valuation...

# Presumptive Valuation

Nature of Works Contract	Presumptive Service Value
Execution of original works	40% of the total amount charged
Works contracts connected with moveable properties	70% of the total amount charged
Works contracts, other than contracts for execution of original works, including contracts for completion and finishing services such as glazing, plastering, floor and wall tiling, installation of electrical fittings.	60% of the total amount charged

# Exclusions and Exemptions

- ME 12: Services provided to the Government, a local authority or a governmental authority by way of construction, erection, commissioning, installation, completion, fitting out, repair, maintenance, renovation, or alteration of specified structures
- ME 13: Services provided by way of construction, erection, commissioning, installation, completion, fitting out, repair, maintenance, renovation, or alteration of specified structures
- ME 14: Services by way of construction, erection, commissioning, or installation of original works pertaining to specified structures
- GE 40: Exemption (Outright/through Refund) for services rendered to SEZ Units/Developers

# ME 12 : Services to Government

- ME 12: Services provided to the Government, a local authority or a governmental authority by way of construction, erection, commissioning, installation, completion, fitting out, repair, maintenance, renovation, or alteration of -
  - a civil structure or any other **original works** meant predominantly for other than for commerce, industry, or any other business or profession;
  - a historical monument, archaeological site or remains of national importance, archaeological excavation, or antiquity specified under the Ancient Monuments and Archaeological Sites and Remains Act, 1958 (24 of 1958);
  - a structure meant predominantly for use as (i) an educational, (ii) a clinical, or (iii) an art or cultural establishment;
  - canal, dam or other irrigation works;
  - pipeline, conduit or plant for (i) water supply (ii) water treatment or (iii) sewerage treatment or disposal; or
  - a residential complex predominantly meant for self-use or the use of their employees or other persons specified in the *Explanation 1* to clause 44 of section 65 B of the said Finance Act;

# ME 13: Specified Infrastructure

- ME 13: Services provided by way of construction, erection, commissioning, installation, completion, fitting out, repair, maintenance, renovation, or alteration of,-
  - Road, bridge, tunnel, or terminal for road transportation for use by general public;
  - A civil structure or any other original works pertaining to a scheme under
  - Jawaharlal Nehru National Urban Renewal Mission or Rajiv Awaas Yojana;
  - Building owned by an entity registered under section 12 AA of the Income tax Act, 1961(43 of 1961) and meant predominantly for religious use by general public;
  - Pollution control or effluent treatment plant, except located as a part of a factory; or
  - A structure meant for funeral, burial or cremation of deceased;

# ME 14: Specified Infrastructure

- ME 14: Services by way of construction, erection, commissioning, or installation of original works pertaining to:-
  - Airport, port or railways, including monorail or metro;
  - **Single residential unit** otherwise than as a part of a **residential complex**;
  - Low- cost houses up to a carpet area of 60 square metres per house in a housing project approved by competent authority empowered under the 'Scheme of Affordable Housing in Partnership' framed by the Ministry of Housing and Urban Poverty Alleviation, Government of India;
  - Post- harvest storage infrastructure for agricultural produce including a cold storages for such purposes; or
  - Mechanized food grain handling system, machinery or equipment for units processing agricultural produce as food stuff excluding alcoholic beverages;

# Impact to Sub Contractors

- ME 29: Services by the following persons in respective capacities -
  - (h) sub-contractor providing services by way of works contract to another contractor providing works contract services which are exempt;
- Sub Contractor vs. Service Provider
- Works Contractor vs. Labour Contractor
- Also consider the scope of specific exemption entries



# Works Contracts: Indirect Tax Aspects

## Value Added Tax



# Identification of Appropriate Jurisdiction..

- The place from where the movement of goods begins
- All sales during a single movement will have similar jurisdiction
- Exclusions on account of
  - Import, High Seas Sales, Sale in the Course of Import (SICOI)
  - Interstate Procurements, for direct delivery to the site
  - Interstate Procurements, for delivery to be obtained by contractor, but to be used at the site

# Calculation of Works Contract Tax

- Specific Exclusions to be considered
- Impact of SC decision in L&T
  - Single Sale Theory
- Impact of Composition Schemes and Input Tax Credit
- Credit of Works Contract TDS
- Whether VAT payable on service tax component also?

Thank You for a patient hearing