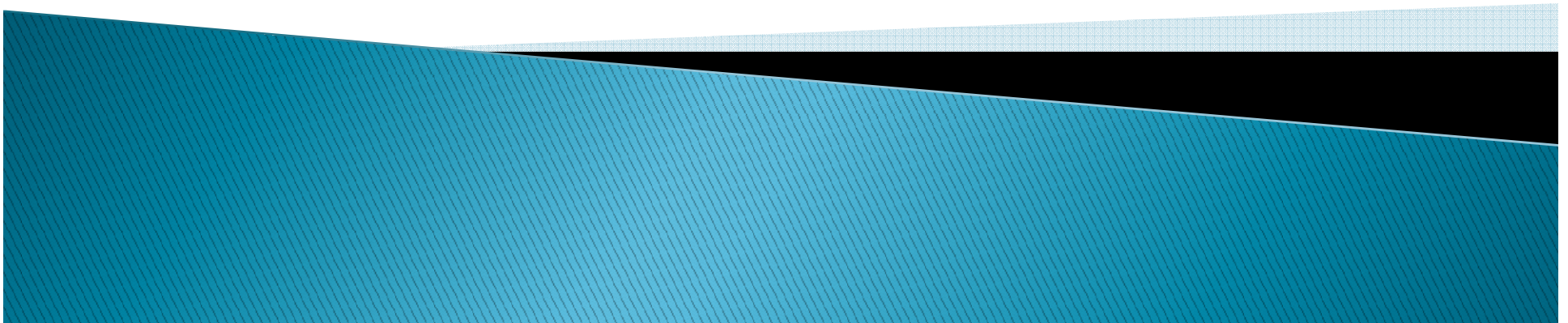


VAT & Service Tax on works contract Construction Industry

Bharat Raichandani
Advocate

Mumbai, 31.05.2014




SERVICE-DEFINED

- Section 65B(44) defines 'Service' as:
any activity carried out by a person for another for consideration

 - And includes Declared Services

 - Not to include:
 - Mere Transfer of title in:

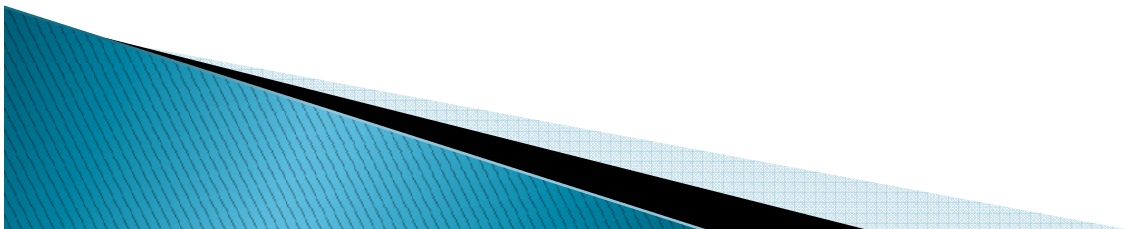
 - Goods or Immovable property
By way of sale/gift or in any other manner

 - *"such transfer, delivery or supply of any goods which is deemed to be a sale within the meaning of clause (29A) of article 366 of the Constitution."*
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The L&T Case

Background

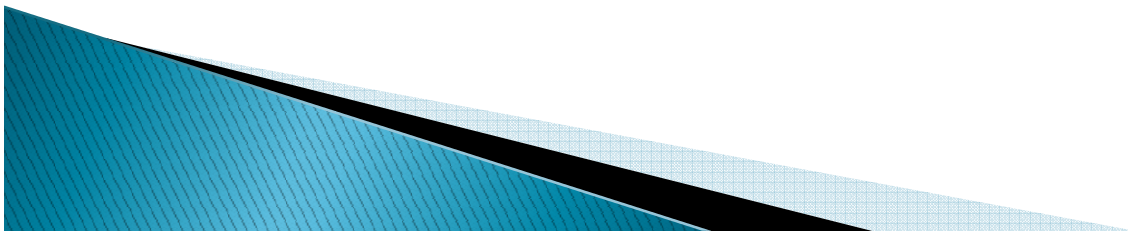
- Any agreement entered into by the Builder/Promoter before the completion of construction tantamounts to works contracts and hence, liable to Value Added Tax (VAT)/Sales Tax
- K Raheja Development Corporation 2005 (5) SCC 162



Analysis

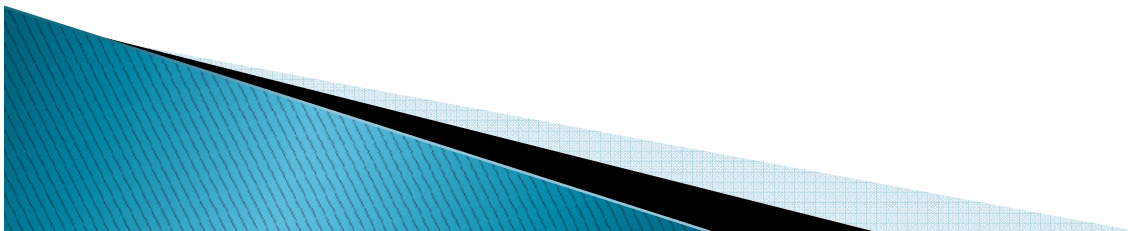
Summary of the observations contained in Para 101 of the judgment:

(i) For sustaining the levy of tax on the goods deemed to have been sold in execution of a works contract, three conditions must be fulfilled: (one) there must be a works contract, (two) the goods should have been involved in the execution of a works contract and (three) the property in those goods must be transferred to a third party either as goods or in some other form.



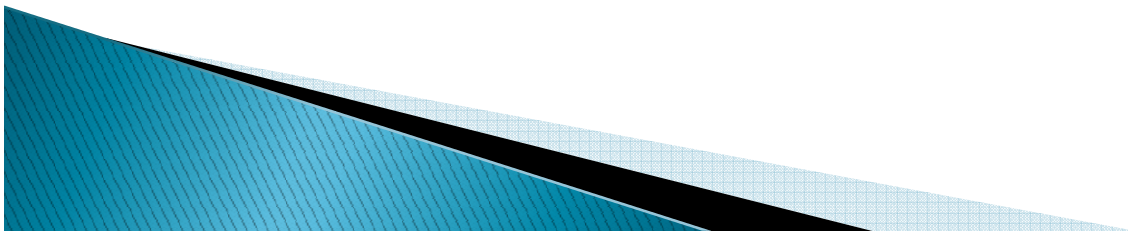
Analysis

- (ii) For the purposes of Article 366(29–A)(b), in a building contract or any contract to do construction, if the developer has received or is entitled to receive valuable consideration, the above three things are fully met. It is so because in the performance of a contract for construction of building, the goods (chattels) like cement, concrete, steel, bricks etc. are intended to be incorporated in the structure and even though they lost their identity as goods but this factor does not prevent them from being goods.



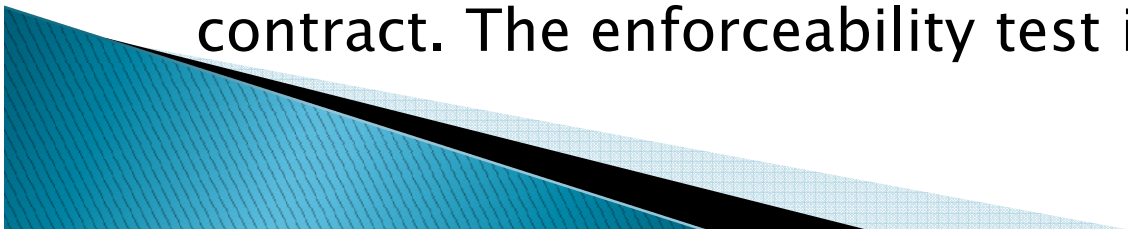
Analysis

- (iii) Where a contract comprises of both a works contract and a transfer of immovable property, such contract does not denude it of its character as works contract. The term “works contract” in Article 366 (29-A)(b) takes within its fold all genre of works contract and is not restricted to one specie of contract to provide for labour and services alone. Nothing in Article 366(29-A)(b) limits the term “works contract”.
- (iv) Building contracts are species of the works contract.



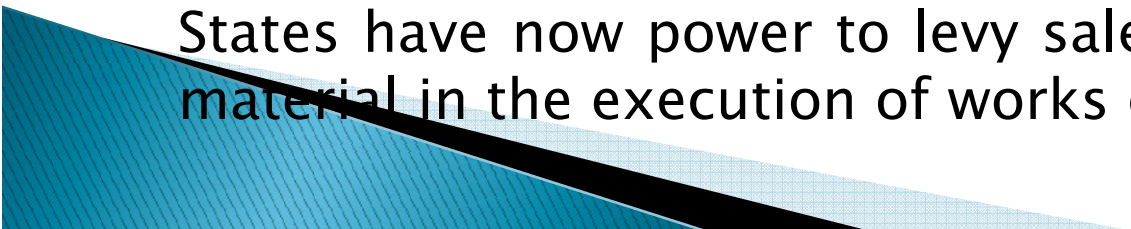
Analysis

- (v) A contract may involve both a contract of work and labour and a contract for sale. In such composite contract, the distinction between contract for sale of goods and contract for work (or service) is virtually diminished.
- (vi) The dominant nature test has no application and the traditional decisions which have held that the substance of the contract must be seen have lost their significance where transactions are of the nature contemplated in Article 366(29-A). Even if the dominant intention of the contract is not to transfer the property in goods and rather it is rendering of service or the ultimate transaction is transfer of immovable property, then also it is open to the States to levy sales tax on the materials used in such contract if such contract otherwise has elements of works contract. The enforceability test is also not determinative.



Analysis

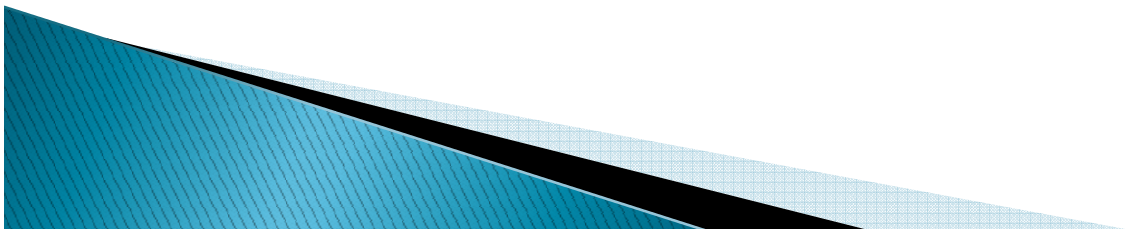
- (vii) A transfer of property in goods under clause 29–A(b) of Article 366 is deemed to be a sale of the goods involved in the execution of a works contract by the person making the transfer and the purchase of those goods by the person to whom such transfer is made.

 - (viii) Even in a single and indivisible works contract, by virtue of the legal fiction introduced by Article 366(29–A)(b), there is a deemed sale of goods which are involved in the execution of the works contract. Such a deemed sale has all the incidents of the sale of goods involved in the execution of a works contract where the contract is divisible into one for the sale of goods and the other for supply of labour and services. In other words, the single and indivisible contract, now by Forty–sixth Amendment has been brought on par with a contract containing two separate agreements and States have now power to levy sales tax on the value of the material in the execution of works contract.
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Analysis

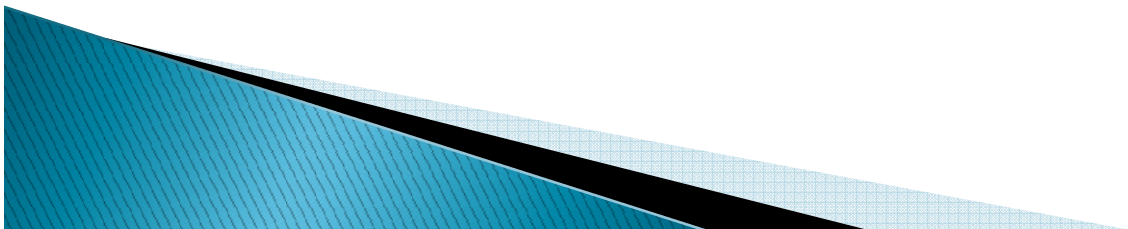
- (ix) The expression “tax on the sale or purchase of goods” in Entry 54 in List II of Seventh Schedule when read with the definition clause 29–A of Article 366 includes a tax on the transfer of property in goods whether as goods or in the form other than goods involved in the execution of works contract.

- (x) Article 366(29–A)(b) serves to bring transactions where essential ingredients of ‘sale’ defined in the Sale of Goods Act, 1930 are absent within the ambit of sale or purchase for the purposes of levy of sales tax. In other words, transfer of movable property in a works contract is deemed to be sale even though it may not be sale within the meaning of the Sale of Goods Act.



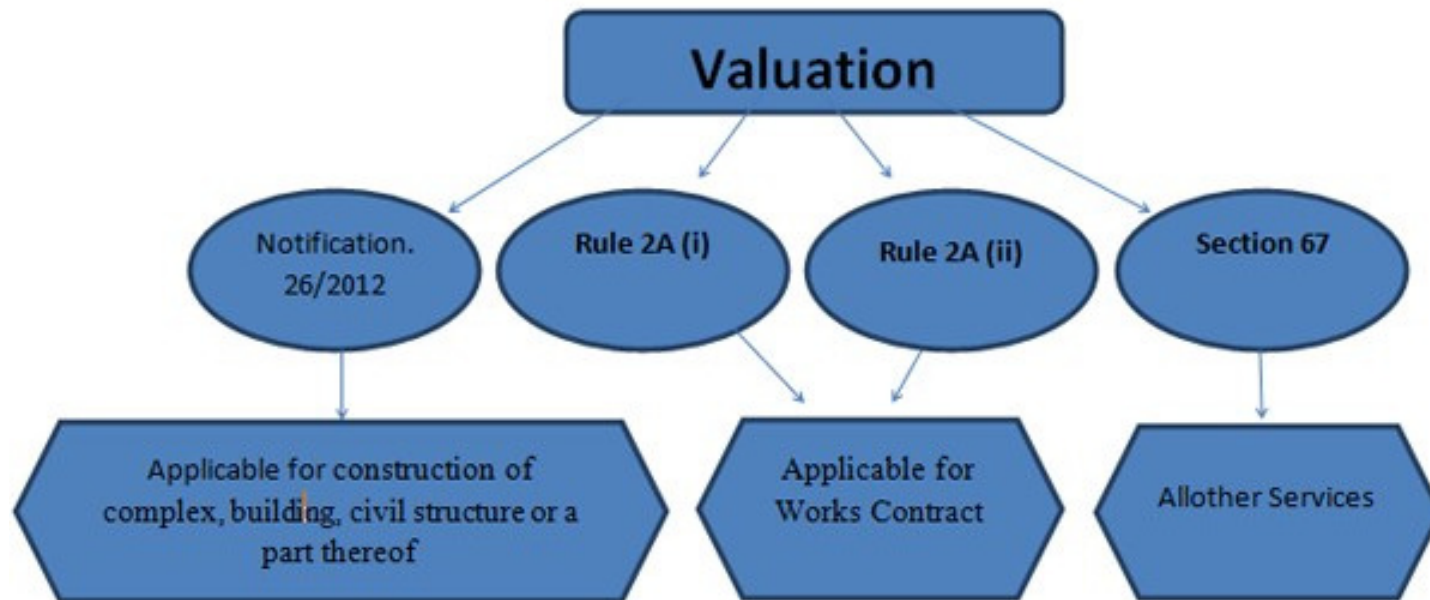
Analysis

- (xi) Taxing the sale of goods element in a works contract under Article 366(29-A)(b) read with Entry 54 List II is permissible even after incorporation of goods provided tax is directed to the value of goods and does not purport to tax the transfer of immovable property. The value of the goods which can constitute the measure for the levy of the tax has to be the value of the goods at the time of incorporation of the goods in works even though property passes as between the developer and the flat purchaser after incorporation of goods.



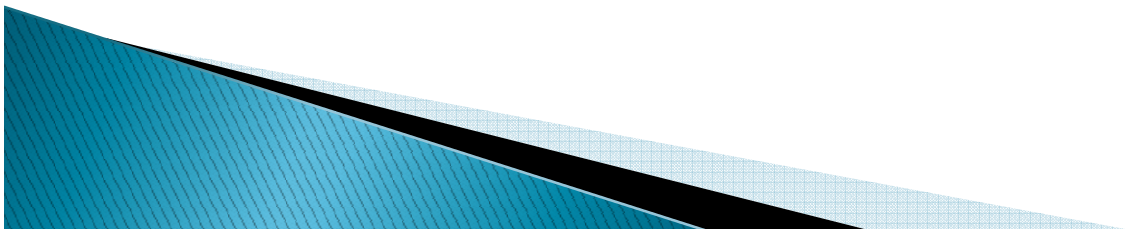
Valuation

VALUATION



VALUATION : RULE 2A

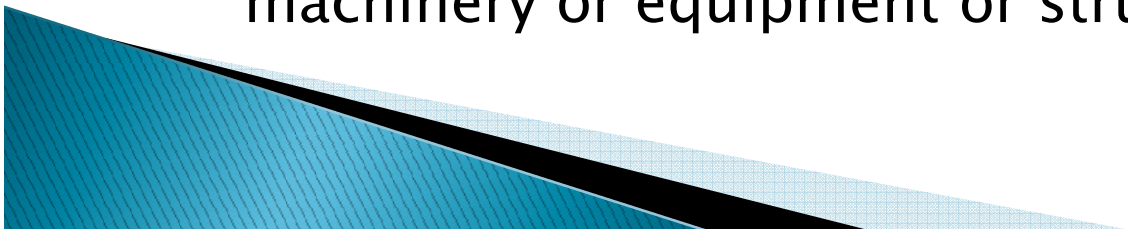
- With effect from July 1, 2012
- Works Contract Service
 - Rule 2A substituted
 - Value of service = Gross amount charged less actual value of goods transferred in execution
 - Actual value of goods for VAT purposes to be considered for determining material value



VALUATION: RULE 2A

- Where value is not determined then:
 - Service value shall be computed as :
 - Original work – 40% of total amount charged
 - Contract for maintenance or repair, renovation or restoration of any goods – 70%
 - Other works – 60%

- Original works means:
 - All new constructions
 - All types of additions and alterations to abandoned or damaged structures on land that are required to make them workable
 - Erection, commissioning or installation of plant, machinery or equipment or structures



VALUATION: RULE 2A

➤ 'Total amount' means:

Gross amount charged

Plus

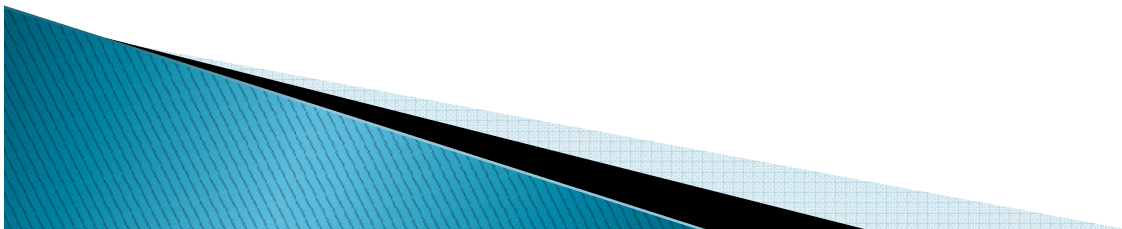
FMV of all goods and services supplied in or in relation to the contract whether or not supplied under the same contract

Less

The amount charged for such goods and services, and

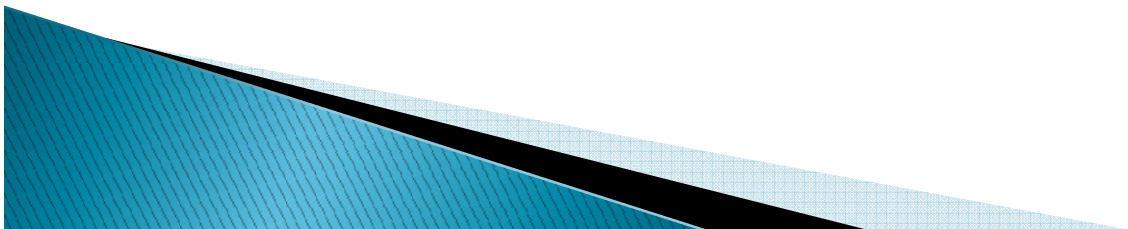
Less

VAT or sales tax levied thereon Specific bar inserted for availing excise duty credit in respect of inputs used in works contract services



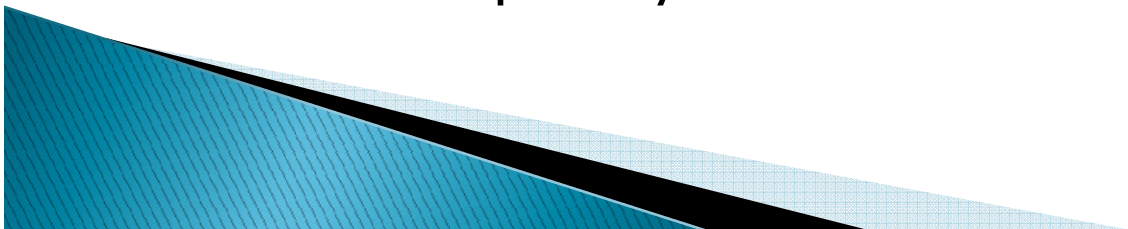
REVERSE CHARGE

- Whether service provider to charge full rate of tax?
- Payment of entire tax by service provider:
 - Service recipient absolved?
- Different options be exercised by provider and receiver?



Some ISSUES

- Land Value?
- Construction pre July, 2010 – Sale After 2010?
- Electricity charges?
- Reimbursements?
- Security deposits – maintenance or repair service
– Pre formation of society?
- Input service credit– taxable as well as non
taxable supplies?
- Stamp Duty?

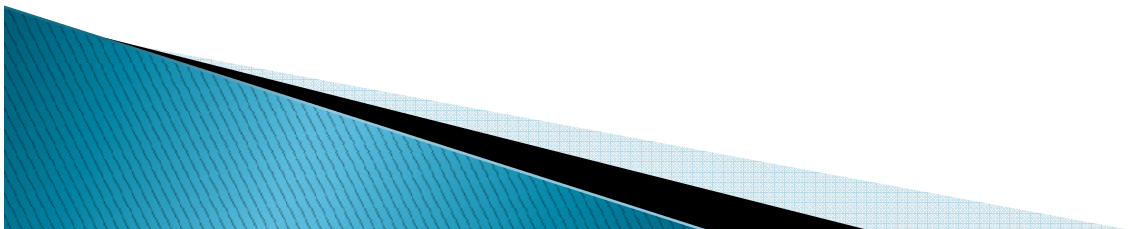


VAT

VAT in Real Estate

➤ What is Real Estate ?

- Immovable property
 - Land
 - Sale of Flats/Dwellings/Bungalows/Buildings /premises/ tenements
 - Other Contracts incidental or ancillary to above ;
 - Under Construction Contracts by Builders and Developers
 - Civil Contracts
 - Construction Contracts
 - Other Contracts
- Are all contracts “Works Contracts” ??



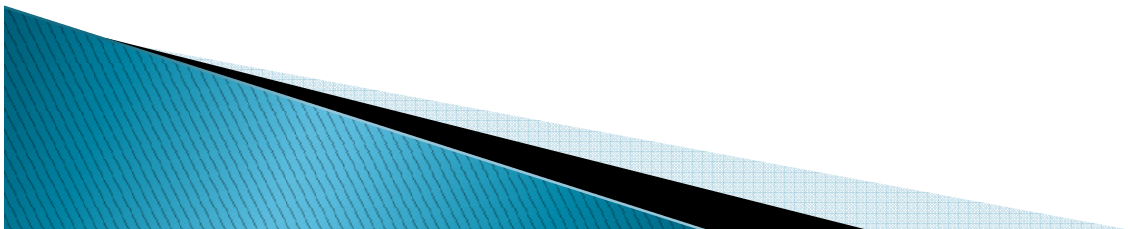
Kone Elevators (2014-TIOL-57-SC)

[2005] 140 STC 22, the Supreme Court held that contract was for sale of goods as opposed to a works contract - claim of deduction on account of labour was rejected:

- The execution of the contract had two major components - the work of preparation of the site and the supply of the lift

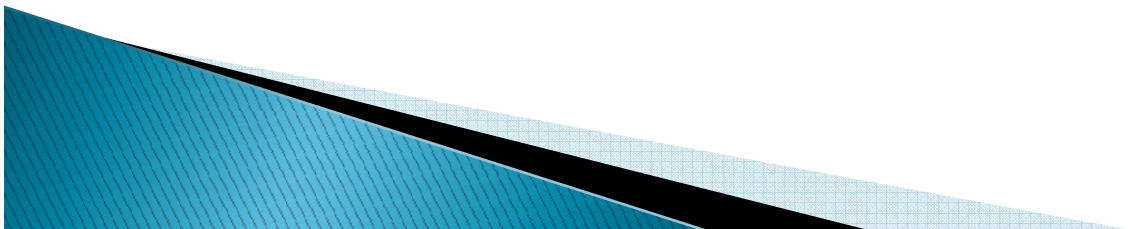
- Skill and labour involved in converting the main components into end product was merely incidental

Overruled by Full Bench - by 4:1 majority - held works contract



Larsen and Toubro 146 STC 616 (SC)

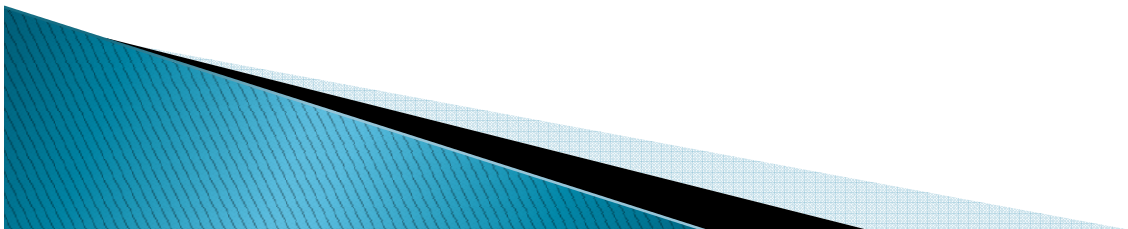
- Affirms Andhra Pradesh High Court judgment
- Sub-contractor – Supply of main contractor or customer?



Revised Return

Revised returns

- Trade Circular dated 21.02.2014 – Amendment to Rule 58 of the MVAT Rules
- Trade Circular dated 17.04.2014



THANK YOU

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Advocate

