

Understanding GST Model law – Def. Works Contract- Part - 15

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The GST article series was started with the basic concepts, now on definition. Next would be the transitional provisions (specified and left out) and ending up with some miscellaneous parts of GST not covered in the series.

Introduction

There are various kinds of contract entered in course of business. Some contracts are entered to make a sale of goods in course of business, while some are pure labour contracts. There is a third kind of contract which are composite contracts of goods, composite contract of services and composite contract of goods and services. These include works contract and others. The composite contracts “others” have found no place in the GST law and may follow the dominant motive of whether goods or services dominate unless rules come to clarify the same.

Works contract involves transfer of property in goods in course of execution of works contract. In short works contract is material plus labour contract which is together / simultaneous.

The definition of sale under the constitution earlier did not include goods incorporated in an indivisible works contract. Therefore the same was not liable for sales tax. After the 46th amendment it has become possible for the states to levy sales tax on the value of goods involved in a works contract in the same way in which the sales tax was leviable on the goods and materials sold by virtue of introduction of Article 366(29A) which defines “tax on the sale or purchase of goods as follows:

(29A) “tax on the sale or purchase of goods” includes—

.....
(b) a tax on the transfer of property in goods (whether as goods or in some other form) involved in the execution of a works contract;

.....
and such transfer, delivery or supply of any goods shall be deemed to be a sale of those goods by the person making the transfer, delivery or supply and a purchase of those goods by the person to whom such transfer, delivery or supply is made;”

This amendment created a legal fiction making the position of works contract on par with sale. Even the composite contract embodied in a single document would be deemed to be divisible as distinct and separate contract one for sale of materials and goods for money consideration liable to tax and the other for labour and service not liable to VAT.

On the other side, there was lot of discussion and debate as to whether works contract is subject matter of service tax. The service tax on “works contract” was introduced w.e.f. 1.06.2007. This category seeks to tax those services wherein transfer of property in goods is involved during the execution of works contract. The tax would be on services involved in the execution of a works contract. **This category however deals with only certain type of activities wherein the**

transfer of property in goods is involved and not all type of services wherein the goods are also transferred like Management, Maintenance and repair Services, Business auxiliary etc.

Under negative list based taxation wef 1/7/2012, service tax is leviable on taxable services. The term service is defined to include declared service. In the declared services definition, service portion in a works contract is specifically included.

Works contract for the purpose of service tax is specifically defined in section 65B (54) to mean the contracts for the specified purposes which involves transfer of property in goods in the execution of such contract and such transfer of property in goods is leviable to tax as sale of goods.

Works contract as defined under the Finance Act, 1994 post 1.7.2012 reads as follows:

Sec- 65(54) – ‘Works Contract’ means a 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 movable or immovable property or for carrying out any other similar activity or a part thereof in relation to such property.

Under GST tax would be levied on supply of goods and/or services. The concept of works contract continues under GST, whereby it would be taxable to GST.

In this back drop paper writer has examined the definition of works contract under GST.

Works contract under GST

In section 2(107) of Model GST law “**works contract**” means:

- an agreement for carrying out for cash, deferred payment or other valuable consideration,
 - building,
 - construction,
 - fabrication,
 - erection,
 - installation,
 - fitting out,
 - improvement,
 - modification,
 - repair,
 - renovation or commissioning
- of any moveable or immovable property;

Comments:

- *The definition seems to be borrowed from state VAT laws definition of works contract [it only does not cover manufacture/processing which is covered in works contract under K-VAT]. Similar definition is present in Karnataka VAT.*
- *Works contract is treated as supply of service under GST.*
- *The term service is defined to mean anything other than goods. If anything other than goods is service, what about immovable property-is it to be treated as supply of service? In view of paper writer expected that the negative list would set out immovable property to be excluded from GST levy.*
- *Deeming works contract to be service may have been done with intention to overcome the confusion prevalent under present laws, where both VAT and Service tax are levied on works contract, by deeming works contract both as sale of goods under VAT **AND** service under service tax law.*
- *WCT would be considered as a service.*

- *Tax could be payable on the value of the transaction being price payable by customer.*
- *The Valuation rules specifically provide for inclusion of free of cost materials/services supplied by customer in value of works contract. It is expected that several changes would be made when final Valuation rules are released.*
- *There is no special valuation rule[such as to pay on 40%/70% of gross amount] or to compute and pay on abated value[including land value] say on 30% of such total amount vide notfn 26/12-ST[these options are presently there in service tax].*
- *Composition scheme is not available to works contractors as it is service. This is a blow to small sub-contractors who cannot go under composition scheme and forced to opt for normal taxation scheme.*
- *The credit on the goods and/or services acquired in execution of works contract resulting in immovable property/goods/services used in construction of immovable property restricted.*
- *Expected rates would be ranging from 18-22%[comprised of CGST say 8% and SGST 10% to CGST say 10% and SGST 12%]. Compared with present mean effective tax rates of 10.15%[14.5%*70% of gross amount charged] and ST of 5.6%(15%*40%)[total 15.75%]. Presently there is a huge cascading of excise duty credit which is not availed and not available.*
- *GST would be tax imposed on 100% base value of transaction of works contract. Under present taxation regime, VAT being imposed on say 70%[ad hoc basis of valuation of materials] and service tax on 40%[for new constructions] of base amount of contract means that tax is being paid on more than 100% of the contract value.*

Position under existing provisions

Under Service tax law:

- *Service tax could be paid after deducting value of materials from gross amount charged. Alternately on 40% of gross amount charged[for new construction of buildings/structures/installation of plant machinery equipment]; on 70% of gross amount charged for finishing works of immovable property and repairs and similar works done on goods.*
- *At present there is restriction to avail credit on inputs used for executing works contract.*
- *Also a restriction for availing credit of ST paid on input services of construction and works contract of buildings/civil structures/laying foundation/structures for support for capital goods. Such credit can be availed only by a person who engages in providing services of construction/works contract.*
- *No ST is applicable on constructed property sold after completion.*
- *Credit to extent attributed to construction sold after completion, [on which ST is not charged] is to be reversed wef 1.4.2016.*

Under VAT laws:

- *VAT rates- residuary rate in most states, for works contract range from 12.5-15%*
- *VAT can be paid on actual value of materials used for execution of works contract.*
- *Alternately when value of materials cannot be determined from the books of accounts, VAT can be paid on ad hoc basis after claiming deduction for the labour portion, prescribed under respective state VAT laws.*

- *In Karnataka VAT, the ad hoc deduction ranges from 10% to 40%.*
- *For some categories of works contracts VAT can be paid at lesser rates such as 5.5% in Karnataka for contracts set out in Sixth Schedule.*
- *Composition rate is prescribed in VAT laws, ranges from 1-5% in most states. There are restrictions on interstate procurements and on executing interstate contracts on composition dealer.*
- *No VAT is applicable on constructed areas sold after completion.*
- *Credit attributed to the completed construction treated as inputs used other than for business and to be reversed under VAT.*

Landmark decisions

1. The Larger Bench of SC in L&T Limited v. State of Karnataka (2013-TIOL-46-SC-CT-LB) has upheld levy of sales tax / VAT on construction and sale of flats, holding building contracts to be species of "works contract". Larger Bench has, thereby, approved the ratio laid down by 2-Judge Bench of SC in Raheja Development. However, it has clarified that construction activity undertaken by the developer would be "works contract" only from the stage when developer enters into a contract with the flat purchaser.
This is decision under VAT equally applicable under service tax and possibly under GST also.
2. In L&T decision (2008-TIOL-158-SC-VAT) as the transfer of property in goods, as effected by the sub-contract, resulted in direct sale to the contractee and consequently it did not involve multiple sales either in favour of the main contractor or in favour of the contractee. The Apex Court upheld that no VAT from both contractor and sub-contractor.
This decision would not hold good in GST as supply is much wider than transfer of property or provision of service.
3. The credit on construction or works contract service of new building is restricted. In Red Hat India Pvt Ltd Vs Principal Commr, Service Tax, Commissionerate, Pune (2016-TIOL-1300-CESTAT-MUM) it was held that works contract services are **eligible only when used for construction services.** [This is in context of input service definition wef 1.4.2011].
4. In C.C.Ex. Cus & ST Vapi Vs M/s S V Jiwani (2016-TIOL-503-HC-MUM-ST) The assessee is a service provider in the category of "works contract service, construction service in respect of commercial or industrial Building structures. They provided services of construction of industrial building, setting up of plant and factory and infrastructure thereof, paid full service tax and availed cenvat credit inputs and input **services**. The respondent claimed that having paid the ST in full, the input credit can be availed of. High Court disposed off the matter holding that revenue is not put to a loss.

Conclusion

In this article the paperwriters have examined the definition of works contract under GST and the possible implications. Once the final act and rules are in place this article would need to be revisited.

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