

Bimal Jain

FCA, ACS, LLB, B.Com (Hons)

Composition Scheme for on-going works contract prior and post 1st July, 2012

Dear Professional Colleague,

We are sharing with you **FAQ on Works Contract Composition scheme w.e.f 1st July, 2012** and analysis of an important recent judgment of the Hon'ble Supreme Court in the case of **M/s Nagarjuna Construction Company Ltd. Versus Government of India & ANR [2012-TIOL-107-SC-ST]** on the following issue:-

Issue: Whether benefit of composition under Works Contract is admissible to on-going contracts as on 01.06.2007?

Background & Facts: AFTER introduction of service tax on Works Contract service with effect from 01.06.2007 and notifying the Works Contracts (Composition Scheme for Payment of Service Tax) Rules, 2007 [*hereinafter referred to as Composition Rules*], many assesseees who were paying service tax under various taxable services like Erection, Commissioning or Installation, commercial or industrial construction service or construction of complex service, etc., by availing the abatement of 67% as per Notification No. 1/2006 – ST dated 01.03.2006 and paying effectively at the rate of 3.96% (33% on 12%), opted to pay service tax on on-going contract at the rate of 2% under erstwhile Rule 3(1) of Composition Rules.

Rule 3(1) of the Composition Rules states that *“Notwithstanding anything contained in section 67 of the Act and rule 2A of the Service (Determination of Value) Rules, 2006, the person liable to pay service tax in relation to works contract service shall have the option to discharge his service tax liability on the works contract service provided or to be provided, instead of paying service tax at the rate specified in section 66 of the Act, by paying an amount equivalent to 2% {changed to 4% w.e.f 1-3-2008 & thereafter 4.8% w.e.f 1-4-2012} of the gross amount charged for the works contract.”*

Thereafter, the Board had intervened and issued a Circular No. 98/1/2008-ST, dated 4.1.2008 [*hereinafter referred to as Impugned Circular*], clarifying that for on-going works contracts, the benefit of composition would not be admissible. In a Writ Petition filed before the High Court of Andhra Pradesh, the Court upheld the validity of Circular and held that the Circular is wholly in conformity with the provisions of Rules 3(3) of the Composition Rules, which specify that *“The provider of taxable service who opts to pay service tax under these rules shall exercise such option in respect of a works contract prior to payment of service tax in respect of the said 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.”*

Bimal Jain

FCA, ACS, LLB, B.Com (Hons)

An appeal was filed thereafter in the Supreme Court against the order of AP High Court. The appellants pleaded that the impugned Circular is contrary to the provisions of Rule 3(3) of the Composition Rules and Section 65(105)(zzzza) of the Finance Act, 1994. By virtue of the impugned Circular, the appellant and other similarly situated persons would be deprived of the benefit under the Rules. As per Rule 3(3) of the Composition Rules, the appellant is entitled to opt for payment of 4% of the gross amount charged for the works contract only but, by virtue of the impugned Circular, the appellant would not get an opportunity to avail of the option provided under Rule 3(3) of the Composition Rules **for on-going works contract**. Hence, the respondent authorities cannot take away the benefit given to the appellant under Rule 3(3) of the Composition Rules in lieu of impugned circular and therefore, the impugned Circular is bad in law.

The appeal has now been decided by the Supreme Court.

Held:

The Supreme Court held that:

After hearing both sides, the Supreme Court ruled:

On perusal of Rule 3(3) of the Composition Rules, it is very clear that the assessee who wants to avail of the benefit under Rule 3 of the said Rules, **must opt to pay service tax in respect of a works contract before payment of service tax in respect of the works contract and the option so exercised is to be applied to the entire works contract and the assessee is not permitted to change the option till the said works contract is completed.**

In the instant case it is an admitted fact that the appellant- assessee had already paid service tax on the basis of classification of works contract which was in force prior to 1st June, 2007. In the circumstances, it cannot be said that the appellant had exercised a particular option with regard to the mode of payment of tax after 1st June, 2007 with regard to reclassified works contract.

Impugned Circular is not discriminatory in nature. Those who had paid tax as per the provisions and classification existing prior to 1st June, 2007 and those who opted for payment of tax under the provisions of Rule 3 of the Composition Rules and paid tax before exercising the option belong to different classes and, therefore, it cannot be said that the Impugned Circular or the provisions of Rule 3(3) of the Composition Rules are discriminatory.

Thereby, it is decided that benefit of composition is not admissible to on-going works contracts as on 01.06.2007

FAQ on Works Contract Composition scheme w.e.f 1st July, 2012:

Mobile: +91 98106 04563; E-mail: bimaljain@hotmail.com

Bimal Jain

FCA, ACS, LLB, B.Com (Hons)

Query:

Whether Works Contract Composition Provisions exists after paradigm shift in Taxation of Services w.e.f 1st July, 2012?

Answer:

No as Works Contract (Composition Scheme for Payment of Service Tax) Rules, 2007 is rescinded w.e.f 1st July, 2012 vide Notification No. 35/2012 Dated 20/06/2012

Query:

What happen to on-going works contract on which assessee were discharging the Service tax liability under the erstwhile Composition scheme?

Answer:

Valuation of such works contract to be governed by Rule 2A as substituted under the Service Tax determination of Valuation Rules vides Notification No. 24/2012-ST dated 6-6-2012, effective from 1st July, 2012.

Query:

What options available under Rule 2A as vide Notification No. 24/2012-ST dated 6-6-2012?

Answer:

There are two options available under Rule 2A as illustrated below.

Option 1: Pay Service Tax on actual service portion in the execution of a works contract i.e. the Gross amount charged for the works contract

- **Less** the value of property in goods transferred in the execution of the said works contract
- **Less** 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
- **Add** Value of other service, which includes, -
 - (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;

Bimal Jain

FCA, ACS, LLB, B.Com (Hons)

- (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 relating to supply of labour and services;
- (vii) other similar expenses relating to supply of labour and services; and
- (viii) profit earned by the service provider relating to supply of labour and services;

Further, where value added tax or sales tax has been paid or payable on the actual value of property in goods transferred in the execution of the works contract, then, such value adopted for the purposes of payment of value added tax or sales tax, shall be taken as the value of property in goods transferred in the execution of the said works contract for determination of the value of service portion in the execution of works contract.

Option 2: To pay service tax at specified rate:

- Pay Service Tax on 40% value of ***original works***
- Pay Service Tax on 70% value of maintenance or repair or reconditioning or restoration or servicing of ***any goods***
- Pay Service Tax on 60% value of **all other works contract** i.e. maintenance, repair, completion and finishing services such as glazing, plastering, floor and wall tiling, installation of electrical fittings of an ***immovable property***

Explanation 1. for this Rule-

(a) "**original works**" means-

(i) all new constructions;

(ii) all types of additions and alterations to abandoned or damaged structures on land that are required to make them workable;

(iii) erection, commissioning or installation of plant, machinery or equipment or structures, whether pre-fabricated or otherwise;

(b) "**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-

Mobile: +91 98106 04563; E-mail: bimaljain@hotmail.com

Bimal Jain

FCA, ACS, LLB, B.Com (Hons)

(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

It means that any goods or services provided by Contractee to Contractor either on Free of Costs basis or chargeable basis would be included in the gross consideration charged by Contractor on formula prescribed i.e. FMV less Amount charged by Contractee along with VAT/ Sales tax, if any levied thereon.

Explanation 2. For the removal of doubts, it is clarified that the provider of taxable service **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.

Hope the information will assist you in your Professional endeavours. In case of any query/ information, please do not hesitate to write back to us.

Thanks & Best Regards.

Bimal Jain

FCA, ACS, LLB, B.Com (Hons)

Mobile: +91 9810604563

E-mail: bimaljain@hotmail.com

Mobile: +91 98106 04563; E-mail: bimaljain@hotmail.com