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Understanding GST Model law – Def. Works Contract

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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(110) of Model GST law “works contract” means:

- A contract wherein transfer of property in goods is involved in the execution of such contract and includes contract for,
 - building,
 - construction,
 - fabrication,
 - completion,
 - erection,
 - installation,
 - fitting out,
 - improvement,
 - modification,
 - repair,
 - maintenance,
 - renovation,
 - alteration or commissioning
- of any immovable property;

Comments:

- Clause (2) section 3 of model GST law provided schedule II wherein it stated few transactions as supply of service and they are as follows: -

- (1) Construction of a complex, building, civil structure or a part thereof, including a complex or building intended for sale to a buyer, wholly or partly, except where the entire consideration has been received after issuance of completion certificate, where required, by the competent authority or before its first occupation, whichever is earlier.

Explanation: - For the purposes of this clause-

- (i) the expression "competent authority" means the Government or any authority authorized to issue completion certificate under any law for the time being in force and in case of non-requirement of such certificate from such authority, from any of the following, namely:-
 - (a) an architect registered with the Council of Architecture constituted under the Architects Act, 1972; or
 - (b) a chartered engineer registered with the Institution of Engineers (India); or

- (c) a licensed surveyor of the respective local body of the city or town or village or development or planning authority;
 - (ii) the expression "construction" includes additions, alterations, replacements or remodeling of any existing civil structure;
 - (2) works contract including transfer of property in goods (whether as goods or in some other form) involved in the execution of a works contract;
 - (3) transfer of the right to use any goods for any purpose (whether or not for a specified period) for cash, deferred payment or other valuable consideration; and
 - (4) Supply, by way of or as part of any service or in any other manner whatsoever, of goods, being food or any other article for human consumption or any drink (other than alcoholic liquor for human consumption), where such supply or service is for cash, deferred payment or other valuable consideration.
- GST model law defines service as **"services"** means anything other than goods;
Explanation 1:- Services include transactions in money but does not include money and securities;
Explanation 2:- Services does not include transaction in money other than an activity relating to the use of money or its conversion by cash or by any other mode, from one form, currency or denomination, to another form, currency or denomination for which a separate consideration is charged. The term service is defined to mean anything other than goods. If anything other than goods is service, what about immoveable property-is it to be treated as supply of service? In view of paper writer expected that the negative list would set out immoveable 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.*
 - *Works contract service should not be confused with new concepts of either mixed supply or composite supply which are defined with illustrations for better understanding in model GST law.*

The definition of both mixed supply and composite supply are reproduced here

- "mixed supply" means two or more individual supplies of goods or services, or any combination thereof, made in conjunction with each other by a taxable person for a single price where such supply does not constitute a composite supply;

Illustration: A supply of a package consisting of canned foods, sweets, chocolates, cakes, dry fruits, aerated drink and fruit juices when supplied for a single price is a mixed supply. Each of these items can be supplied separately and is not dependent on any other. It shall not be a mixed supply if these items are supplied separately.

- "composite supply" means a supply made by a taxable person to a recipient comprising two or more supplies of goods or services, or any combination thereof, which are naturally bundled and supplied in conjunction with each other in the ordinary course of business, one of which is a principal supply;

Illustration: Where goods are packed and transported with insurance, the supply of goods, packing materials, transport and insurance is a composite supply and supply of goods is the principal supply.

- “principal supply” means the supply of goods or services which constitutes the predominant element of a composite supply and to which any other supply forming part of that composite supply is ancillary and does not constitute, for the recipient an aim in itself, but a means for better enjoyment of the principal supply;

From the revised model GST law, few statements on works contract under GST law can be drawn, they are

- WCT would be considered as a service.
- Since works contract is said to be a service transaction, service providers of WCT cannot avail the benefit of composition levy as the composition is not applicable for service providers
- 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.
- There is specific restriction in availing input tax credit paid on “Works Contract” service. Works contract services when supplied for construction of immovable property other than plant and machinery are not eligible for credit. However, when such service is used for further supply of works contract service credit is allowed.

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 immoveable 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 weft 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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