

WORKS CONTRACT

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Under the State Sales Tax Laws, before the 46th Amendment to the Constitution of India, the Sales Tax was applicable only on the sales covered under the sale of goods Act (Normal sale). The indivisible works contracts were not covered under the State Sales tax Acts since works contracts were not normal sales. The Supreme Court confirmed this legal status in its land mark judgment in the case of *Gammon & Dunkerely* (9 STC 353). Due to this legal status, the states were denied the levy of Sales Tax on the indivisible works contracts. Such contractors were outside the clutches of sales tax laws.

The then Finance Ministers of the States have requested the then Union Finance Minister to take necessary legal steps so as to levy Sales Tax on indivisible works contracts.

Finally, the 46th amendment to the Constitution of India has been made on 2nd February, 1983 to add a sub-article (29-4) as under,

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

After the said 46th Amendment to the Constitution, the States were empowered to levy Sales Tax / Works Contract Tax on such sales, called as “Deemed sales” involved in the execution of works contract. Due to the said amendment, the concept of ‘Deemed Sale’ was introduced. The important features of deemed sales are as under,

- (a) It is not a normal sale as defined under sale of goods Act but a deemed sale of goods subject to sales tax by the States.
- (b) In the deemed sales’ the states can levy Sales tax only on ‘the transfer of property in goods’. In other words, the states can levy Sales Tax / VAT only on the ‘Material Value’ of the works contract and not on the ‘labour portion’ of the works contract.
- (c) If in a contract there is no transfer of property in goods from the contractor to the contractee, then No sales tax is applicable on such contracts, called as “ Pure Labour Jobs”.
- (d) Under the deemed Sale , an artificial break up of indivisible works contract has to be made to arrive at the ‘material’ value and the ‘labour’ value of the contract.

Therefore, after the 46th Amendment to the Constitution of India, the States are empowered to levy sales tax (now VAT) on such deemed sales but only on the 'Material Value' of the works contract. The High Courts and the Supreme Court have suggested methods on "How to arrive at a material value from the total Contract Price". (*Gannon Dunkerly's SC Judgement* 1993) (88 STC 204).

For the purposes of works contract there is no separate charging section under VAT Act as it was under U.P. Trade Tax Act namely Sec. 3-F. The only provision in the name of charging provisions have been made in Sec.3(6)(a) of the VAT Act which says-

Transfer of sale of goods-

- (i) involved in the execution of works contract in which property in goods is transferred or
- (ii) in cases is transfer of right to use any goods.

Now if you compare it with the provisions of Sec.3-F we find that most important charts of charging section i.e. whole scheme of Act for determining turnover and for allowing statutory deductions of various types are absolutely missing in the charging provision and also in connecting Rules-9 of the VAT Rules.

For the convenience of all of you I am reproducing Sec. 3-F of the U.P. Trade Tax Act which runs as follows:-

3-F. Tax on the right to use any goods or goods involved in the execution of works contract.

1. Notwithstanding anything contained in section 3-A or Section 3AAA or section 3-D but subject to the provisions of section 14 and 15 of the Central Sales Tax Act, 1956, every dealer shall, for each assessment year, pay a tax on the net turnover of—
 - a) 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; or
 - b) transfer of property in goods (whether as goods or in some other form) involved in the execution of a works contract, at such rate not exceeding twenty per centum, as the State Government may, by notification declare and different rates may be declared for different goods or different classes of dealers.
2. For the purposes of determining the net turnover referred to sub-section (1), the following amounts shall be deducted from the total amount received or receivable by a dealer in respect of a –
 - a) transfer referred to clause (a) of sub-section (1) whether such

transfer was agreed to during the assessment year or earlier:-

- i) the amount representing the sales value of the goods covered by section 3, 4 and 5 of the Central Sales Tax Act, 1956;
 - ii) the amount representing the value of the goods exempted under section 4;
 - iii) the amount received as penalty for default in payment or damages for any loss or damage caused to the goods by the person to whom such transfer was made,
- b) transfer referred to in clause (b) of sub-section (1),-
- i) the amount representing the sales value of the goods covered by section 3,4 and 5of the Central Sales Tax act, 1956;
 - ii) the amount representing the value of the goods exempted under section 4;
 - iii) the amount representing the value of the goods on the sale or purchase whereof tax has been levied or is leviable under this Act at some earlier stage;
 - iv) the amount representing the value of the goods manufactured in a new unit exempted under section 4-A or section 4-AAA;
 - v) the amount representing the value of the goods supplied to the contractor by the contractee, provided that the ownership of such goods remains with the contractee under the terms of the contract;
 - vi) the amount representing the labour charges for the execution of works contract;
 - vii) the amount representing the labour charges for the execution of works contract;
- all amounts paid to the sub-contractors as the consideration for the execution of the works contract, whether wholly or in part;
- Provided that no deduction under this sub-clause shall be allowed unless the dealer claiming the deduction produces proof that the sub-contractor is a registered dealer liable to tax under this Act and that such amount is included in the return of turnover filed by such sub-contractor under the provisions of this Act;
- viii) the amount representing the charges for planning, designing and architects fees
 - xi) the amount representing the charges for obtaining on hire or otherwise machinery and tools used for the execution of the works contract;
 - x) the amount representing the cost of consumables used in the execution of the works contract;

- xi) the amount representing the cost of the establishment and other similar expenses of the contractor to the extent it is relatable to the supply of labour and services;
- xii) the amount representing the profit earned by the contractor to the extent it is relatable to the supply of labour and services.

Where in respect of a transfer referred to in clause (b) of sub-section (1), the contractor does not maintain proper accounts or the accounts maintained by him are not found by the assessing authority to be worthy of credence and the amount actually incurred towards charges for labour and other services and profit relating to supply of labour and services are not ascertainable, such charges for labour and other services and such profits may, for the purpose of deductions under clause (b) of sub-section (2), be determined on the basis of such percentage of the value of works contract as may be prescribed and different percentages may be prescribed for different types of works contract.

Now in addition to Sec. 3-F of the Act there was Rule 44-B which is as follows:-

44-B- Determination of turnover of goods involved in the execution of works contracts –

The tax under section 3-F on the turnover relating to the business of transfer of property in goods (whether as goods or in some other form) involved in the execution of works contract shall be computed on the net turnover relating to the works contract. In determining the net turnover, the amounts specified in clause (b) of sub-section (2) of section 3-F shall be deducted, if they are included in the gross turnover.

Explanation – for the purposes of this rule, gross turnover shall mean the aggregate of the amounts received or receivable by a dealer in an assessment year as valuable consideration for the transfer of property in goods used in the execution of works contract, whether or not the amount receivable as valuable consideration for such transfer is separately shown in the works contract and whether the execution of such works contract commenced during the year or earlier, and includes any advance received by the dealer towards valuable consideration of the works contract.

Now let us compare the aforesaid provisions with Rules-9 of the VAT Rules which is as follows:-

Rule 9 and rule 10 for determination of turnover of sale of goods involved in the execution of works contract;-

Now the question of determination of Taxable Turnover are enumerated in Rule-9 of U.P. Vat Rules having the same deductions available U/s 3-F of Erstwhile U.P. Trade Tax Act.

But certain points Requires the attention of all concerned;-

Determination of turnover of sale of goods involved in the execution of works contract.

9. (1) Subject to other provisions of these rules, the tax on turnover of sale of goods where such sale is affected by way of transfer of property in goods (whether as goods or in some other form) involved in the execution of a work contract shall be computed on the taxable turnover of sale of taxable goods. For the purposes of determining the taxable turnover of sale of such goods, the amounts specified below shall be deducted if included in the gross amount received or receivable in respect of the works contract:-
- (a) all amounts representing the value of goods consumed in execution of the works contract; in which property in goods is not transferred in the execution of the works contract;
 - (b) all amounts representing the value of exempt goods and amount of profit thereon;
 - (c) all amounts representing the rent paid or payable in respect of machinery and other equipments taken on hire for use in the execution of such works contract;
 - (d) all amounts representing the value of service and labour and profit thereon;
 - (e) all amounts representing the value of goods in which property has been transferred in the 11 execution of the works contract as a result of sale in the course of inter-state trade or commerce;
 - (f) all amounts representing the value of goods in which property has been transferred in the execution of the works contract as a result of sale in the course of export of goods out of the territory of India or sale in the course of import of goods into the territory of India;
 - (g) all amounts representing the value of goods in which property has been transferred as a result of a sale outside the State;
 - (h) all amounts representing the value of non-vat goods purchased from within the State in the circumstances in which the dealer executing the works contract himself is liable to pay tax on turnover of purchase of such goods;
 - (i) all amounts representing value of non vat goods where such goods are purchased by the dealer from a registered dealer.
 - (j) the amount representing the cost of establishment and other similar expenses of the contractor to the extent it is relatable to supply of labour and services, and profit thereon.

Explanation: For the purposes of clauses (a) and (e) to (h), the value of goods referred to in such clauses include amount of profit thereon.

- (2) Where any amount has been deducted by the contractee from the amount of the contract on account of breach of any condition of the contract, such amount shall be deemed part of amount payable to the contractor in respect of such contract.
- (3) Where accounts maintained by the contractor do not show separately the value of labour and services and amount of profit accrued on such labour and services, or accounts maintained by the dealer are not worthy of credence or if the dealer has not maintained accounts, for the purpose of determining turnover of goods in which transfer of property in goods has taken place, in cases other than those mentioned in the table below, an amount, representing twenty percent of gross amount received or receivable, shall be deducted towards labour and services and amount of profit accrued thereon and in the cases described or mentioned in column 2 of the table given bellow, amount of deduction towards such labour and services and amount of profit accrued thereon shall be computed at the rate percentages, given in column 3 against the entry in column 2 of the table, of the amount received or receivable.

Description of works contracts Rate.

- 1- Fabrication and installation of plant and machinery 10%
- 2- Fabrication and erection of structural works including fabrication, supply and erection of iron trusses, purline 10%
- 3- Fabrication and installation of cranes and hoists 10%
- 4- Fabrication and installation of elevator(lifts) and escalators 10%
- 5- Supply and installation of air conditioning equipment including deep freezers, cold storage plants, humidification plants and dehumidifier 10%
- 6- Supply and installation of air conditioners and air coolers 10%
- 7- Supply and fitting of electrical goods, Supply and installation of electrical equipment including transformers 10%.
- 8- Supply and fixing of furnitures and fixtures, partitions, including contracts of interior decorations 10%
- 9- Construction of railway coaches and wagons on under carriages supplied by railways 10%

- 10- Construction of bodies of motor vehicle and construction of trailers 10%
- 11- Fabrication and installation of rolling shutters and collapsible gates 30%
- 12- Civil works like construction of building, bridge, roads, dams, barrages, spillways and diversions, sewages and drainage system 30%
- 13- Installation of doors, doors frames, windows, window frames and grills 30%
- 14- Supply and fixing of tiles, slabs, stone and sheets 30%
- 15- Sanitary fitting for plumbing, for drainage or sewerage system 30%
- 16- Whitewashing, painting, and polishing 40%

Explanation: For the purposes of this rule, where period of execution of a works contract is spread over several tax periods or several assessment years, the aggregate, of all amounts of deductions towards labour and services; and amount of profit accrued thereon, shall not exceed the percentage of the gross amount receivable in respect of execution of such works contract.

- (4) For removal of doubts it is hereby made clear that, for the purposes of this rule, in arriving at the turnover of sale of goods involved in the execution of a work contract, amounts of following nature shall not be deducted from the gross amount receivable.
 - (a) any amount proposed to be deducted in the name of any tax or fee or any other levy;
 - (b) any amount which has been deducted by the contractee from the contractor as demurrage or penalty or a fine or in any other name for breach of any conditions of the contract or otherwise;
 - (c) any amount which has been deducted by the contractee from the contractor as compensation;

Now we compare provisions under U.P. Trade Tax Act and VAT Act in this regard we find following discrepancies in provisions under VAT Act:-

1. No benefit allowed where the material is supplied by the contractee to the contractor? Weather input shall be available if this is treated as a sales from contractee to contractor.
2. No deduction for the sub-contractor allowable although as it was available in Erstwhile Act. The Reason of non allowance of this deduction is to be examined in the light of point of

Taxation whether it may be allowable under VAT or not this is a question to be examined. To my mind there is no value addition from the sub-contractor to contractor while executing works contract and there is also only one set of sales in the transactions of works contract where sub-contractor steps into shoes of a contractor and this the underlying principal due to which even benefit of T.D.S. has been provided under section 34 of UPVAT ACT.

3. The question of supply of goods by the sub-Contractor made in the course of inter-state trade of commerce or sale in the course of import is also to be examined.
4. One important point is that deduction is available under sub-rule (e) of rule 9 that all amounts representing the value of goods in which property has been transferred in the execution of works contract as a result of sale in the course of inter state trade and commerce:

In under section 3-F(2)(iii) it was provided that transfer of property of goods whether as goods or in some other form involved in the execution of works contract, the amount representing the value of goods on the sale or purchase whereof tax has been levied or is leviable under this Act at some earlier stage shall be deducted.

But under Rule-9 of VAT Rule no such provision has been incorporated. Rule 9(1)(a) of the VAT Rules says amount representing the value of goods **consumed** in the execution of works contract shall be deducted.

Now the word consumed have not been defined under the common parlance it means when an article loses its identity as it is while as it is while making other goods then only it can be called that goods have been consumed like in the case of welding electrodes which loses its life while making the welding in works contract, then electrodes has been consumed. Such type of provision would leave lot of litigation.

Under Sec.3-F of the old Act it was mentioned that the provisions U/s. 3-F would be subject to Sec. 13 & 14 of the Central Sales Tax Act. As you all know provisions of Sec. 13 & 14 of the CST Act are of much significance for the convenience person I have enclosed both the sections with my paper.

Now in this connection the important question before us is whether State Government have power to ignore or override the provisions of Central Act and levy multiple point tax on goods mentioned U/s.14 and withdraw concessions given Sec.15 of the Central Sales Tax Act. In my opinion to some extent these provisions are ultravires in nature and such type of action to be discussed in detail and should be challenged before the Hon'ble High Court.

Now I come to provisions relating to compounding which has been given in Sec.6 of VAT Act which are as follows:-

Section 6- Composition of tax liability

- (a) No composition Scheme has been brought under UPVAT Act, 2008. But composition scheme in vogue under old Act has been continued only for civil contracts till the end of that particular contract or which the dealer opted under the U.P. Trade Tax Act.
- (b) Benefit of input tax credit not allowable to the dealer opting for Composition.
- (c) The dealer opting for Composition is not authorize to issue tax invoice.
- (d) If the goods has been purchased from a dealer who has opted for Composition, no input tax credit is allowed.

Composition of tax liability – Non-entitlement of input-tax credit (ITC).

Dealer opting for composition of tax liability shall not be entitled to claim credit of input tax and where such dealer has claimed credit of input tax, the same shall stand reversed and shall be payable.

- (1) Compounding Scheme announced u/s 7-D of UPTT Act – Whether shall be continued under this Section 6?

Sub-section (2) of “Repeal and saving” section 81 of the Uttar Pradesh Value Added Tax Act, 2008 provides as under;

- (2) Notwithstanding such repeal,
 - (a) any notification, rule, regulation, order or notice issued, or any appointment or declaration made, or confiscation made, or any penalty or fine imposed, any forfeiture, cancellation or any other thing or any action taken under the repealed enactment, and informed immediately before such commencement shall, so far as it is not inconsistent with the provision of this Act, be deemed to have been issued, made, granted, done or taken under the corresponding provisions of this Act.
 - (b) any right, privilege, obligation or liability acquired, accrued, accrued or incurred under the repealed Act, shall not be affected and manufacturing units enjoying benefit of exemption from payment of tax u/s4-AA of the repealed Act or the units enjoying facility of moratorium for payment of tax u/s 8(2-AA) of the said Act shall be entitled to claim moratorium for payment of tax in accordance with provisions of section 42.”

Important words in the above quoted sub-section (2) clause (a) are “order”, “inforce immediately before such commencement”, “is not inconsistent with the provisions of this Act” and “be deemed to have been issued, made, granted, done or taken under the corresponding provision of this Act”. A study of this clause shows that any order made under the repealed enactment, and in force immediately before the commencement of the Uttar Pradesh Value Added Tax Act, 2008 shall, so far as it is not inconsistent with the provisions of this Act, be deemed to have been issued, made, done or taken under the corresponding provisions of this Act.

Compounding schemes are offered by the department, accepted by the dealers and an order is issued by the department accepting the offer. As such it is an “order”. Also it is an order u/s 7-D of the repealed enactment. Some schemes are such wherein period of operation had not expired before the commencement of the Uttar Pradesh Valued Added Tax Act, 2008. Such schemes are “in force immediately before such commencement”. Such schemes are not inconsistent with the provisions of section 6 of this Act as languages of section 7-D of the UPTT Act and section 6 of this Act are same. Therefore, such compounding section u/s 7-D of the UPTT Act should be deemed to have been issued under the provisions of section 6 of this Act.

Even according to clause (b) of sub-section (2) of “Repeal and Saving” section 81 of the Act “any right, privilege, obligation or liability acquired, accrued or incurred under the repealed Act shall not be affected”.

Section 6. of the Uttar Pradesh General Clauses Act 1904 (Act No.1 of 1904) deals with the effect of “Repeal and Saving” as imder’

“Section 6 Effect of repeal,— Where any Uttar Pradesh Act repeals any enactment hitherto made or hereafter to be made then, unless a different intention appears, the repeal shall not—

- (a) revive anything not in force or existing at the time at which the repeal takes effect; or
- (b) affect the previous operation on any enactment so repealed or anything duly done or suffered thereunder; or
- (c) affect any right, privilege, obligation or liability acquired, accrued or incurred under any enactment so repealed; or
- (d) affect any penalty, forfeiture or punishment incurred in respect of any offence committed against any enactment so repealed; or
- (e) affect any remedy, or any investigation or legal proceeding commenced before the repealing Act shall have come into

operation in respect of any such right, privilege, obligation, liability, penalty, forfeiture or punishment as aforesaid.

And any such remedy may be enforced and any such investigation or legal, proceedings may be continued and concluded, and any such penalty, forfeiture or punishment imposed as if repealing Act had not been passed.”

I would like to invite your attention on one of the important question on Works Contract. Whether constructions of Flats/ apartments by a Developer or a builder after purchase of a land and allotment of such flat to deferent persons, accepting payment of price as per prescribed schedule before construction and delivery of property will amount of construction of flats by developer for prospective buyers or not.

In the case of *K. Raheja Development Corporation vs. State of Karnataka* [2005 NTN (vol.27)-243- It was held—

“Building flats or commercial units as Developer for prospective purchase after entering into agreement with them will amounts to Works Contract.”

It was further held that under the definition of work contract even an owner of the property carrying on a works contract is liable to tax and tax shall be leviable on value of the goods property whereof its transfers in the execution of works contract. It was further held that if agreement is entered into after the flats/units is also constructed, then there is no works contract. But so long as the agreement is entered into before the construction will complete it would be a works contract.

The Judgment *K. Raheja Development Corporation*, case was based on the judgment in *Mittal Investment Corporation vs. A.C.C.T., Zone-I, Bangalore S.T.A. Nos. 35 to 38 of 1998* decided on 1999. In that judgment provisions of Karnataka Sales Tax Act, 1957 which on paramateria with the provisions of U.P. Trade Tax Act were considered and interpreted with provisions of Karnataka Ownership Flats (Regulation of Promotion of Construction sales, management and transfer) Act, 1974 were considered.

Thereafter the aforesaid issue came before the Allahabad High Court Division Bench in *Assotech Realty private limited Vs. State of U.P. and another* 2007 NTN (vol. 34)-67. Hon’ble High Court after accepting the writ petition of High Court order distinguished the case of *K. Raheja Development Corporation* by holding that if terms and allotment letter of Flats based is clear that there was no transfer of ownership before the deed. The payment schedule can not nature of the transaction such transactions was not works contract under clause (m) of section 2 read with Section 3-F of the Act.

In both the cases the language of the agreement between builder and buyer, play a significant role. Therefore while advising the client who are engaged in business of Construction of flats and units. We should carefully study and draft the agreement between builders and buyers. Specially keeping in mind the aforesaid Judgments.
