Impact under GST on Job work transactions

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Goods and Service Tax (GST) upcoming in India is likely to result in widening the tax base substantially by covering large number of potential taxpayers who are hitherto not covered in the tax net either due to their activity not being in the nature of taxable or due to some exemption being claimed. It is talked that the present assessee base on Central side itself is expected to rise to approximately 60 lacs assessees from existing base of apprx. 15 lacs. One of major contributor in this rise would be job workers who may not be required to get registered under present taxation system. The paper writer has analysed impact on job workers in the proposed GST regime *viz a viz* current taxation system.

The manufacturing industries now-a-days stick to their core competencies and get most jobs done on outsourced basis. The sending of raw materials/semi-finished materials for some process as per the directions of principal manufacturer is known as job work. This is widely used method in many industries.

Meaning of job work

Job work is understood as the processing or working on goods supplied by the principal so as to complete a part or whole of the process. The work may be the initial process, intermediate process, assembly, packing or any other completion process. The goods sent for job work maybe raw material, component parts, semi finished goods and even finished goods. The resultant goods could also be a variation of the same or the complete product.Examples of common job works are slitting, machining, welding, painting, electroplating, assembly, powder coating etc.

1. Provision under Central Excise and Service Tax

A. <u>Meaning of Job work under Central Excise</u>

Job work is defined in Notification No. 214/86 dated 25.03.1986and under Rule 2(n) of the Cenvat Credit Rules, 2004

> "Job work" means processing or working upon of raw materials or semi-finished goods supplied to the job worker/ so as to complete a part or whole of the

process resulting in the manufacture or finishing of an article or any operation which is essential for the aforesaid process.

If one were to go by the definition of the term "job work", it is evident the raw materials have to be supplied by another person. In Prestige Engineering India Ltd v CCE Meerut, - 1994 (9) TMI 66, the Supreme Court held that when the job worker contributed his own material to the goods supplied by the customer and engaged in manufacturing, the activity was not one of job work. However, minor additions by the job worker would not take away the fact that the activity was one of job work.

B. <u>Job Work and Manufacture (under Central Excise)</u>

Since excise duty is on 'manufacture', duty liability arises only when the goods are manufactured during job work. The test as to whether the process amounts to manufacture or not would be determined as per section 2(f) of Central Excise Act, 1944 which defines manufacture as including any process incidental or ancillary to the completion of the manufactured product..... Various decision of the Supreme Court have arrived at a conclusion that where the product undergoes a change whereby a new article having a distinctive name, character or use emerges or not from the said process in manufacture (Honorable Supreme Court in Delhi Cloth and General Mills Co. Ltd Vs UOI 1962 (10) TMI 1 - SUPREME COURT OF INDIA)

C. <u>Liability under Central Excise and Service Tax</u>

- **Process amount to manufacture:**If the process undertaken by the job worker amounts to manufacture/ deemed manufacture as per the definition or decided case laws, the job worker would be liable to pay duty of excise on the goods so manufactured. Alternatively, the principal manufacturer who has supplied the goods for job work may furnish a declaration under Notification No. 214/86 dated 25.03.1986 (which exempts goods manufactured by a job worker from duty of excise)based on which job worker would not be required to charge duty of excise. The goods must be used in manufacturing process by principal manufacturer which should result in a dutiable product being manufactured on which duty of excise is being charged. The activity undertaken by job worker would not be liable to service tax also as any process amounting to manufacture or production of goods is covered by Negative list.

- **Process does not amount to manufacture:**Where the processing undertaken by the job worker does not amount to manufacture, the said job worker could be liable

to service tax.But before determining the same, one need to examine the exemption provided in Notification No. 25/2012 ST 20.06.2012 (called as Mega Exemption Notification). As per the said Notification, **job work in relation of any goods on which appropriate duty is payable by the principal manufacturer, is exempted**. Appropriate duty means "duty payable on manufacture or production under a Central Act or a State Act, but shall not include 'Nil' rate of duty or duty wholly exempt". It means that if the duty is charged on final product by principal manufacturer, there is no liability on job worker to charge service tax. On the contrary, if appropriate duty is not paid by principal manufacturer, the job worker would be liable to charge service tax.

D. Valuation

Prior to 2007 valuation of job work was as per the ratio of **Ujagar Prints 1989 (1) TMI 124,**It was held by Supreme Court that in respect of goods manufactured on job-work basis, assessable value would be the job charges (including the profit of the job-worker if not already included in the job-charges) plus the cost of the materials used in the manufacture of the item (including the cost of the materials supplied free of cost to the job-worker).

Rule 10A had been introduced in Central Excise Valuation (Determination of Price of Excisable goods) Rule 2000, in respect of the goods produced or manufactured by Job Worker which provides for valuation as follows:

- **Goods directly sold from job worker premise:**Where the goods are sold by the raw material supplier/principal manufacturer from the factory of job worker - the value would have to be the transaction value of the goods so sold by the raw material supplier/principal. This will apply only when the raw material supplier and the buyer of the goods are not related and price is the sole consideration for the sale and the goods are sold for delivery at the time of removal from the job worker's factory.

  Illustration: Let the value of raw materials supplied by principal be Rs. 1,00,000 and the job workers conversion cost be Rs. 15,000 and his profit margin be Rs. 5,000. If the principal sells the goods processed by the job worker at Rs. 1,50,000. Then assessable value would be Rs. 1,50,000 (that is the price charged by the principal for sale of the processed goods).

- **Goods not sold from job worker premise**: In a case where the goods are not sold by the principal manufacturer at the time of removal of goods from the factory of job-worker, but are transferred to some other place from where the said goods are to be sold after their clearance from the factory of the job worker - the normal transaction value of such goods sold from such other place at or about the same time has to be adopted. This, in other words follows the principle of depot based valuation under Central Excise applicable where goods are cleared to depots of manufacturers and sold therefrom. Where such goods are not sold at or about the same time, then the normal transaction value of such goods at the time nearest to the time of removal of said goods from the factory of job worker is to be adopted. The cost of transport from the premises where from the goods are sold, to the place of delivery, would not be included in assessable value.

Valuation under service tax would be on gross amount charged towards labour charges. Where the nature of work undertaken is works contract, value would be arrived at as per options provided under Rule 2A of Service Tax (Determination of Value) Rules, 2006.

2. Provisions under CST/VATAct

A. Interstate job work: The goods may be sent outside state for job work.In the absence of any sale, there would be no liability on principal manufacturer to charge CST. The material may be sent along with a declaration that the goods have been sent on job work.

The work undertaken by job worker may or may not involve use of material. Where no material is used, there is no liability to charge CST as there is no transfer of property involved.When the job worker uses materials there would be a transfer of property in goods involved and the transaction would be taxable. The taxability would depend upon the following:

a. **Material Billed separately**: This would be a divisible contract in which job worker would charge the applicable CST on the materials transferred by him. He would also bill pure labour charges. In such cases the work order, purchase order or contract should be clear on the values ascribed towards the material and labour. It is advisable to keep the valuation of each of the components in such bifurcated contract near to the reality.

b. **Composite Billing**: In this case the value of material would be included in the total amount. This is called works contract. The material portion would be liable to CST. The various State governments have specified some deemed deduction for labour where the works contract or cannot arrive at the actual value of goods. The example could be annual maintenance contracts, galvanizing, electroplating, powder coating, painting of components, re-melting of scrap zinc/ brass etc. These transactions are liable for tax deduction at source when they provide services to the specified institutions.

Similarly, there could be contracts such as painting of portrait etc. in which some consumables are used. In these cases though there is a material transfer, the activity has been understood clearly to be service by the Court's by applying dominant motive test and consequently there is no liability to charge CST.

B. Job work within state: Where principal manufacturer and job worker are located within same state, there would be no liability on principal manufacturer to charge VAT in the absence of sales. The liability charge VAT would be same as discussed above in case of interstate job works.

3. Applicability of GST on job work

Having discussed the impact under Central Excise, Service Tax and CST/VAT, now we shall discuss the taxability under proposed GST regime.

The taxable events under present laws are manufacture (Central Excise), provision of service (Service Tax) and sale (CST/VAT) respectively for applicability of different kind of taxes. Under proposed GST regime, all these concepts would lose relevance and the taxable event would only be "supply of goods" and "supply of services". The goods supplied by principal supplier to job worker would be supply of goods chargeable to CGST/SGST in case of intra state job work and IGST, in case of inter- state job work. The job worker would be entitled to take the credit of tax charged by principal supplier. When the goods would be supplied back by job worker, he is also required to charge the tax in the same manner as charged by principal supplier. Following could be certain aspects which would be relevant under GST:

- **Valuation:** Supply of goods by principal supplier to job worker would be on account of other than sales. Now the question arises as to on what value the principal supplier is required to charge GST as the principal supplier is not going to receive any consideration from job worker towards such supply. One possible

option could be the price to be arrived at based on intrinsic value of goods. This can be arrived at by taking the price of comparable goods. Another option could be wherein tax to be charged on the cost of product being supplied which could be determined based on cost accounting record. Similarly, job worker may charge duty based on intrinsic value of goods in the form in which it is supplied by him after processing. This can be done based on the price at which supplied by principal supplier + his job work charges (including material and labour).

- **Nature of taxes and credit:** In case of job work within state, both principal supplier and job worker would be required to charge CGST and SGST. In case of inter-state movement, IGST would be charged. The tax charged by one party would be eligible as credit to another which may be adjusted against discharging their output liability.

- **Treatment of additional 1 % tax:** In case of interstate supply of goods, additional 1% tax would also be levied for initial 2 years. However, it is proposed not to levy this tax where supply of goods is other than on account of sales. Hence, principal supplier would not be required to charge this additional tax on supply of goods to job worker. Similarly, the job worker needs not to charge this tax to the extent material supplied by principal supplier. However, he has added certain material from his sources, there would be transfer of property in goods to that extent and this supply may be liable to additional tax of 1%. The tax so charged will not be admissible as credit to the principal supplier.

- **Tax on supply of capital goods:** There would be no distinction between capital goods and other goods in the GST regime. Hence, the supply of capital goods by principal supplier will also entail levy of GST on the value of goods supplied. The value could be arrived at the book value/intrinsic value/value of similar goods etc. Where the value of capital goods supplied is very large, this is likely to result in substantial cash outflow by principal supplier. The tax so charged though would be available as credit to job worker but it may be possible that the liability of job worker on output is very less due to which the same may remain unutilised for very long period.

- **Requirement of submission of forms**: Under present law, the principal supplier and job worker is required to transfer the material on the basis of Annexure –II challan, delivery challan, forms under CST/VAT Act etc. All these requirements are expected to be done away under proposed GST regime. Though there could be

some documentary evidence/format which may be prescribed to capture the transactions other than of supply.

- **Booking of revenue in books of account**: The distinction between supply and sale will continue in the post GST regime also. All supply may not be considered sales. As the transaction would not be on account of sale, it shall not be recorded as revenue in the books of principal supplier as well as job worker as revenue can be booked only when there is transfer of property in goods which is guided by Accounting Standards issued by ICAI. If all supplies are treated as revenue in the books of account, the revenue would be inflated in the books of both principal supplier as well as job worker which would be incorrect. It could be possible that separate series of invoice/documentary evidence may be permitted to record such transaction so that these can be distinguished from sale.

The GST law has not yet been put in public domain, there is possibilities of few of these aspects could be applicable with certain modifications.