



### **Issues in valuation of works contract**

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#### **Introduction**

Valuation of the service is one of the important aspects as to computation/assessment of service tax for any service tax assessee. Within the valuation of taxable services, concept of valuation of works contract is one which is a matter of dispute under service tax law.

The valuation provisions for determining the service portion in the execution of works contract is specifically given under the Service Tax (Determination of Value) Rules, 2006. Rule 2A provides the following methods for valuation of works contract.

#### **What is works contract service?**

The services are defined to include declared services. Declared service has an entry works contract. Works contract has been defined vide Section 65B(54) which is to cover the contract wherein there is a transfer of property in goods involved in the execution of such contract which is leviable to tax as sale of goods.

Such contract is for specified purposes of carrying out construction, erection and others relating to any moveable or immoveable property. What is taxable under declared service entry of works contract is service and not the works contract.

#### **Discussion on valuation of taxable service**

The valuation of taxable service in relation to services involved in execution of works contract has been provided in Rule 2A of Service Tax (Determination of Value) Rules, 2006. In terms of said Rule 2A(i), the value of the service portion in the execution of a works contract would be equivalent to-

- The gross amount charged for the works contract.
- Less the value of transfer of property in goods involved in the execution of the said works contract.
- Less VAT or sales tax paid or payable, if any, on transfer of property in goods involved in the execution of said works contract.

The question arises how to determine the value of the goods said to have been transferred in the execution of works contract. For this it should be done in the following manner-

- Where VAT/sales tax has been paid on the actual value of transfer of property in goods involved in the execution of the works contract, i.e. based on records maintained the actual value of goods transferred is identified and VAT/Sales Tax is paid accordingly, then the same value be taken as deduction for computing taxable value for payment of service tax(Rule 2A(i)).
- If it is not so, then the value may have to be determined in any manner which can be substantiated with on sufficient documentary evidence (irrespective of the method adopted for VAT/Sales Tax) that value can be deducted and service tax paid on balance.
- In case the valuation has not been or cannot be determined by the above methods, then taxable service has to be compulsorily be determined and be tax paid by the person liable to pay tax as per the manner mentioned below as per Rule 2A(ii):
  - If the works contract is for original works, the service tax should be payable on 40% of the total amount charged for the works contract.
  - If the works contract is for maintenance or repair or reconditioning or restoration or servicing of any goods, the service tax should be payable on 70% of the total amount charged for the works contract
  - If the contract is for other than the above, including, maintenance, repair, completion and finishing services such as glazing, plastering, floor and wall tiling, installation of electrical fittings of an immovable property, service tax would be payable on 70% (60% till 1.10.14) of the total works contract value.

For the purpose of the above computations, there are few aspects which are relevant:

First, the term ‘total amount’ is relevant for computation of taxable value based on fixed percentage as discussed above. In this regard, the said term is defined to consider the total sum of the following:

- Gross amount charged for the works contract
- 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.

Out of the said amount the following has to be deducted-

- Any amount already charged for the said goods or services
- VAT/Sales tax if any levied thereon.

### **Issues in valuation of works contract**

**Issue: Whether deduction can be claimed for the VAT paid portion of works contract of construction of new building and service tax paid on the balance?**

**Comments:***If service provider is able to bifurcate the value of materials transferred in each case, then it can follow the option to discharge VAT on the value of material transferred and service tax on the balance.*

*However, if service provider cannot bifurcate the value of material transferred, but is paying VAT on the adhoc basis, such as on 75% of material value under Local VAT laws. Then the adhoc deduction as provided in the ST Valuation Rules would apply. Accordingly, service provider would have to pay service tax on 40% of the value of the invoice.*

**Issue: If there is separate contract for supply of material and separate for labour for construction of new building. Whether the service tax has to be compulsorily paid on gross amount charged on presumptive basis on 40% of total amount charged?**

**Comments:***There is no need to do so. For taxing purpose if possible to be divisible into material and service portion, the same can be done and should not be considered as one. Pay VAT on supply portion and service tax on the service portion. This view is upheld in the decision of Karnataka High Court in State of Karnataka vs Transglobal Power Ltd., STRP No.525/2013 & STRP Nos 727-761/2013, dated 16.10.2014.*

**Issue: How to value the works contract to pay service tax under joint charge by receiver of service being business entity body corporate?**

**Comments:**

*Service receiver cannot deduct the 50% service tax liability payable by it from payments to be made to the contractors. It has to pay the liability from its own pocket unless contractually it is the sub contractor who has to pay. The valuation could be done on following basis:*

- a. *When the sub-contractor's invoice has a break up of material and labour, the service tax liability of 50% to be paid on the labour portion by Service receiver.*
- b. *Where a gross amount charged by contractor without break up of material and*

labour, then the easiest method for determining the value of the taxable service and payment of service tax is as per the manner mentioned below:

- (i) If the works contract is for original works such as construction of new commercial building/residential complex, the service tax should be payable on 40% of the total amount charged for the works contract. 50% of such liability arrived at on such basis to be paid by Service receiver. Presently 2.8%.
- (ii) If the works contract is for maintenance or repair or reconditioning or restoration or servicing of any goods, the service tax should be payable on 70% of the total amount charged for the works contract. 50% of such liability arrived at on such basis to be paid by Service receiver. Presently 4.9%.
- (iii) **If the contract is for other than the above**, including, maintenance, repair, completion and finishing services such as glazing, plastering, floor and wall tiling, installation of electrical fittings of an immovable property, service tax would be payable on 70% of the total works contract value. 50% of such liability arrived at on such basis to be paid by Service receiver.

**Issue: Whether to pay service tax on adhoc basis under ST Valuation Rules on 40% or 70% of amount charged for interiors contract for new commercial complex?**

**Comments:** The work done by service providers for interiors such as that of showroom should be original work, due to the reason that it is work for the first time and certainly in a newly constructed building. Therefore it attracts tax on 40% of total amount. Effective tax may be 4.944% [40% of gross amount charged \* 12.36% till 31.5.2015] and 5.6% [40% of gross amount charged \* 14% from 1.6.15].

**Whether value of free issue material to be included to pay service tax on works contract?**

**Comments:**

In Rule 2A, there is no power to tax the value of materials or services supplied on free of cost basis. When opting for valuation under Rule 2A, there is no need to include value of materials supplied by customer on FOC basis.

The issue was settled to some extent by the LB in *Bhayana Builders Pvt Ltd. Vs CST, Delhi* 2013 (32) STR 49 (Tri-LB). In this case it was held that "The value of goods and materials supplied free of cost by a service recipient to the provider of the taxable construction service, being neither monetary or non-monetary consideration paid by or flowing from the service

*recipient, accruing to the benefit of service provider, would be outside the taxable value*

**Conclusion**

In this article the paper writer has sought to examine some common issues on valuation of works contract under service tax law. The service tax law is evolving with several grey areas, and in case decided to opt a particular method of valuation, better to intimate department by means of RPAD letter and seek confirmation of understanding.