

Service Tax on Works Contract -Valuation –Cenvat Credit - Point of Taxation after 01-07-2012

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Service tax provisions in respect to “Works Contracts” have undergone major changes after introduction of new service tax regime. Works contract in itself is a very lengthy subject and law relating to Works Contract in Service Tax is available in a very scattered way. I am trying to summarize all the legal provisions relating to Works Contract in this new service tax regime in a series of articles. This article is the second one in the series. If you have not read the first article, you can view it by [clicking here](#).

I am covering following points in this article.

- Valuation of service portion in works contract
- CENVAT Credit availability in works contract
- Point of Taxation in Work Contract Service

VALUATION OF SERVICE PORTION IN WORKS CONTRACT

Section 67 of the Finance Act covers the “Valuation of taxable services for charging service tax”. We can summarize this section 67 as follows.

Relevant Clause	Type of Consideration	Mode of Valuation
67(1)(i)	Where provision of service is for a consideration in money	“Gross Amount Charged” by the service provider for such service provided or to be provided by him.
67(1)(ii)	Where provision of service is not for wholly in money or for partly in money	“Gross Amount Charged” plus money value of the “Consideration in kind”
67(1)(iii)	Consideration not ascertainable	As may be determined in the prescribed manner.

Definition of relevant terms

Term	Definition
Consideration	<i>“Consideration”</i> includes any amount that is payable for the taxable service provided or to be provided.
Gross Amount Charged	<i>“Gross Amount Charged”</i> includes payment by cheque, credit card, deduction from account and any form of payment by issue of credit notes or debit notes and book adjustment, and any amount credited or debited, as the case may be, to any account, whether called “Suspense A/c” or by any other name, in the books of accounts of a person liable to pay service tax, where the transaction of taxable service is with any associated enterprise.

VALUATION OF WORKS CONTRACT SERVICE

As the value of service portion in a works contract is generally not ascertainable, the valuation of Works Contract Service will always be governed by Section 67(1)(iii) where the government has prescribed “**Service Tax (Determination of Value) Rules, 2006**” for the valuation.

RULE 2A of “Service tax (Determination of Value) Rules, 2006 governs the valuation of “Works Contract Service”, which is summarized as follows.

Rule 2A gives two options for determination of value of Works Contract Service. These are;

1. Segregation Method
2. Composition Method

SEGREGATION METHOD

Following is the formula for calculation of Works Contract Service under *Segregation Method*.

Value of Works Contract Service	=	Gross Amount Charged	-	Value of property in Goods Transferred
<i>Value of Service Portion</i> of Works Contract		<i>Gross Amount Charged</i> for the works contract		<i>Value of property in goods transferred</i> in the execution of the said works contract
Shall Include		Shall not include		Where VAT or sales tax is paid or payable on the actual value of property in goods

<ul style="list-style-type: none"> - Labour charges - Sub contractor charges for labour& services - Planning, designing and architect's Fees - Machinery and tools hire charges - Consumables i.e. water, electricity, fuel used - Cost of establishment of contractor related to labour and services - Profit portion pertaining to labour and services. 	<ul style="list-style-type: none"> - VAT or sales tax paid or payable 	<p>transferred, such value adopted can be taken as Value of Property in goods transferred under this rule.</p>
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COMPOSITION METHOD

Following is the formula for calculation of Works Contract Service under ***Composition Method***.

Value of Works Contract Service	=	Total Amount Charged	X	Specified % rate
Total Amount Charged	=	Gross Amount Charged <i>(As defined earlier)</i>	+	The fair market value of all goods and services
Fair Market Value of all goods and Services	=	The fair market value of all goods and services supplied in or in relation to the execution of the works contract	-	The amount Charged for such goods or services if any + VAT or Sales tax levied thereon.

Following is the specified % rate for different types of works contracts.

S.N.	Nature of Works Contract	Specified % rate on which tax is payable
1	Works contract for execution of original works i.e.	

- All new constructions
- All types of additions and alterations to abandoned or damaged structures on land that are required to make them workable
- Erection, commissioning or installation of plant, machinery or equipment or structures whether prefabricated or otherwise

40%

2 Works contract for

- Maintenance or repairs or
- Reconditioning or restoration or
- Servicing

Of Any GOODS

70%

3 Works contract not covered above and including

- Maintenance, repair,
- Completion and finishing i.e. glazing, plastering,
- Floor and wall tiling,
- Installation of electrical fitting

Of an IMMOVABLE PROPERTY

60%

KEY POINTS

Following key points can be summarized in respect to above methods of valuation of works contract service.

Integration of Valuation with State VAT Laws

It seems that, the government has drafted these two methods of valuation after taking into consideration the various state laws applicable for works contract. Generally, for VAT purpose, the state laws have these 2 types of methods, in which a person can either adopt the “Segregation Method” or “Composition / Exemption Method”.

The government has integrated the valuation rule with state laws, which is in my view a good step to reduce the taxation conflict between the “State Government” and “Central Government”.

Assessee can use different method for different contracts

The assessee has liberty to choose the method of valuation for every separate works contract he is entering. For one works contract, he can choose “Segregation Method” and for other he can use “Composition Method”.

AVAILABILITY OF CENVAT CREDIT IN WORKS CONTRACT SERVICE

Under rule 2A of Service Tax (Determination of Value) Rules, 2004, explanation -2 provides as follows.

“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”

Key Points

CENVAT credit on Inputs not Allowed

As per explanation 2 of the determination of valuation rules, the provider of works contract service cannot take CENVAT credit of inputs (goods) used in relation to the execution of works contract.

As per earlier provisions, the service provider had the option to pay service tax on full value of contract and thereafter claim CENVAT credit on inputs (goods) used in execution of works contract.

But this option has not been provided in the rules applicable from 01.07.2012. Thus, in effect, the service provider in any case cannot claim the CENVAT credit of inputs (goods) used in execution of works contract.

CENVAT credit on Input Services and Capital Goods Allowed

As per explanation 2 of the determination of value rules, there is no restriction on claiming the CENVAT credit of Input Services and Capital Goods. Thus the provider of works contract service can claim CENVAT credit of Input Services and Capital Goods as per the CENVAT Credit rules 2004.

POINT OF TAXATION OF WORKS CONTRACT SERVICE

After 01-07-2012, the payment of service tax is governed by section 68 of the Finance Act. The point of taxation rules, 2011 have been prescribed under section 68.

What is Point of Taxation

The point of taxation is the point when the liability for payment of service tax becomes due/ payable to the government.

We can summarize the point of taxation rule in following way.

S.N.	Condition	Point of taxation
1	Where invoice for the service is issued within 30 days from the “Completion of taxable service”	

Tax will be payable at the time of issue of invoice.²Where invoice for the service is issued after 30 days from the “Completion of taxable service”

Tax will be payable at the time of completion of provision of service³Where payment is received by the service provider before raising the invoice or before completion of provision of service

Tax will be payable at the time of receipt of advance amount, to the extent of such amount

What the term “Completion of provision of service” means:

Completion of provision of service

This term is not defined anywhere under the service tax law but, as per departmental clarification in circular no. 144/13/2011 S.T. dated 18-06-2011 it has been clarified that;

“This would include not only the physical part of providing the service but also the completion of all other auxiliary activities that enable the service provider to be in a position to issue the invoice. Such auxiliary activities could include activities like measurement, quality testing etc. which may be essential pre-requisites for identification of completion of service. The test for the determination whether a service has been completed would be the completion of all the related activities that place the service provider in a situation to be able to issue invoice. However such activities do not include flimsy or irrelevant grounds for delay in issuance of invoice.”

Thus generally above clarification will govern the meaning of the term “Completion of provision of service”.

“Completion of provision of service” in case of “Continuous Supply of Service”

In proviso to rule 3 of Point of Taxation Rules, an exception / deeming provision has been created to define the term completion of provision of service. It seems that this proviso is coming at wrong place. Its better place should have been in Rule 4A of the Service Tax Rules, 1994.

Meaning of “Completion of provision of service” in case of “Continuous supply of service”
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As per proviso to Rule 3 of “Point of Taxation Rules”

*“In case of continuous supply of service where the provision of the whole or part of the service is determined periodically on the completion of an event in terms of a **contract**, which requires the receiver of service to make any payment to service provider, **the date of completion of each such event as specified in the contract shall be deemed to be the date of completion of provision of service.**”*

Works Contract Service is a Continuous Supply Service

As per rule 2(c) of Point of Taxation Rules, 2011, the term “Continuous Supply of Service” is defined as below.

“Continuous Supply of Service” means any service which is

- *Provided or to be provided continuously or on recurrent basis, under a contract for a period exceeding three months with the obligation of payment periodically or from time to time, or*
- *Where the central government, by a notification in the official gazette, prescribes provision of a particular service to be a continuous supply of service, whether or not subject to any conditions.*

As per **notification No. 38/2012 dated 20.06.2012**, the government has notified following 2 services which shall be deemed to be “Continuous Supply of Service” w.e.f. 01-07-2012.

- *Telecommunication Services*
- *Service portion in execution of a works contract.*

Thus, it is clear that the “Works Contract Service” in any case will be deemed to be continuous supply of services under the Point of Taxation Rules, 2011 and accordingly provisions related to Continuous Supply of Service will be applicable on it.

In summary, in case of works contract service, if the contract or work order provides specific dates by which certain amount of work is to be completed and payment is to be released, then the date mentioned in the contract will be deemed to be the date of completion of provision of service for the purpose of service tax.

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