Service Tax on Construction Contracts

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on 24 October 2012

Understanding Implication of Service Tax on Real Estate

[Collation of Relevant Material]

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Real Estate & Service Tax

1.1 Definition of term Service – Section 65B(44)

Section 65B (44) defines service as - "service" means any activity carried out by a person for another for consideration, and includes a declared service, but shall not include—

(a) an activity which constitutes merely,—

(i) a transfer of title in goods or immovable property, by way of sale, gift or in any other manner; or

(ii) a transaction in money or actionable claim;

(b) a provision of service by an employee to the employer in the course of or in relation to his employment;

(c) fees taken in any Court or tribunal established under any law for the time being in force.

1.2 Declared Service – Section 66E

Declared Services – Service has been defined to include declared services. Declared Services are defined under Section 65B (22) of the Finance Act, 1994 to mean any activity carried out by a person for another person for consideration and declared as such under Section 66E of the Finance Act, 1994. It means for a service to come under the category of declared services, it has to satisfy two basic conditions conjunctively:

a. it must be an activity by one person to another for consideration

b. it must be specified(i.e. declared) under section 66E

Need for Declared Service

The definition of service in the first instant is very wide to cover any transaction done for a consideration. However, there exist few activities which would overlap with the other levies of state with a marginal difference, thereby questioning the constitutional validity of the levy under service tax. In some cases there may be a doubt whether that activity could possibly called a service at all. To rest the doubt about the validity of a transaction to be considered as service, the authority has intended to declare such activities to be a service. To give an instance, the first declared service "renting of immovable property service" was challenged as to whether it was a “service” as well as the competence of the Union to levy the tax on a property, which is a subject to state governance. Similarly most of the declared services were challenged. For all events and purposes these transactions shall be deemed to be service.

The following are covered under the negative list relating to the Real Estate Industry

(a) renting of immovable property;
(b) **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 is received after issuance of completion-certificate by the competent authority.

**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) architect registered with the Council of Architecture constituted under the Architects Act, 1972; or

(B) chartered engineer registered with the Institution of Engineers (India); or

(C) 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;

(h) **service portion** in the execution of a **works contract**;

**The discussion on the entries in aspects in declared list is as follows:**

**A. Renting of Immovable Property [Para(a) of Section 66E]**

It was already taxable. Validity of the levy was upheld by many courts. P&H-Shumbh Steel, Orrisa-Utkal Builders, Gujrat HC-Cinemax, Delhi HC- Home Retail, and Mumbai HC also.

S.65B: “Renting” means allowing, permitting or granting access, entry, occupation, usage or any such facility, wholly or partly, in an immovable property, with or without the transfer of possession or control of the said immovable property and includes letting, leasing, licensing or other similar arrangements in respect of immovable property.

**Renting in negative list (S.66D)**

Services relating to agriculture or agricultural produce by way of renting or leasing vacant land with or without a structure incidental to its use are covered under the negative list vide section 66D(d)(iv). The transaction could be without any sort of the structure, however, in case there is any structure, even that has to be used incidental to agriculture.

Services by way of renting of residential dwelling for use as residence is also covered under the Negative list vide section 66D(m) of the Act.

**Exemption under Notification No. 25/2012-ST dated 20.06.2012**
Renting of precincts of a religious place meant for general public (Para5 of Notification 25/2012)

Renting of immovable property to an educational institution in respect of such service relating to providing of education (given in Para9 of the said notification)

Renting of a hotel, inn, guest house, club, campsite or other commercial places meant for residential or lodging purposes, having declared tariff of a unit of accommodation below rupees one thousand per day or equivalent (Para18 of the said Notification)

Services by way of vehicle parking to general public excluding leasing of space to an entity for providing such parking facility. (Para24 of the said Notification)

Thus, parking charges collected at cinema theatres, malls etc, is exempted from service tax as it falls under services by way of motor vehicle parking to general public.

**Covers**

a. Renting for temporary purpose like marriages or other social functions because it includes renting without transfer of possession or control,

b. Permitting use of property for vending/dispensing machine

c. Allowing erection of tower

d. Renting for entertainment or sports

e. Renting of theatres by owners to film distributor

**Place of property determines taxability**

If immovable property is in non taxable territory and is owned by person in taxable territory it shall not be taxable.

**B. Construction of Complex [Para(b) of Section 66E]:**

a. This entry is mentioned as “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 is received after issuance of certificate of completion by a competent authority”. The expression "construction" includes additions, alterations, replacements or remodeling of any existing civil structure.

b. This service intends to cover whole or part of the construction of a complex, which refers to a group of building, construction of independent building, and construction of civil structure. Such construction whether put to use for commerce or industry, whether the same is used for residential purpose, whether for charitable purpose, whether for
the public purpose or by Government would be irrelevant for determining the coverage under this declared service. However, there are few exemptions are there in Negative list and in Mega Exemption Notification No.25/2012-ST.

c. Importance of the 2nd limb of the entry: This limb plays a vital role in determining the taxability of the activity. The entire activity of the builder/developer/promoter would be deemed to be service only if any amount has been received prior to issuance of completion certificate by a Competent Authority. If any amount is received in this behalf after the issuance of completion certificate, then the activity would be a mere transfer of title in immovable property and thereby doesn't falling under the definition of service. The same was also there in the earlier regime by way of an Explanation to the taxable service definition w.e.f., 01.07.2010.

d. "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) architect registered with the Council of Architecture constituted under the Architects Act, 1972; or

(B) chartered engineer registered with the Institution of Engineers (India); or

(C) licensed surveyor of the respective local body of the city or town or village or development or planning authority;

Service in Negative List U/S-66D

No specific entry pertaining to construction activity.

Exemption under Notification No. 25/2012-ST dated 20.06.2012

Refer Exemption Chapter of the Material

Valuation Mechanism:

<table>
<thead>
<tr>
<th>Construction Contract not coupled with transfer of property</th>
<th>Construction Contract coupled with transfer of property in goods</th>
<th>Construction contract intended for sale which includes value of land as well</th>
</tr>
</thead>
<tbody>
<tr>
<td>As per section 67 of the Act.</td>
<td>As per Rule 2A of the Service Tax (Determination of value Rules, 2006.</td>
<td>Option given in Notification No.26/2012-ST for abatement of 75%(with condition)</td>
</tr>
</tbody>
</table>

Detailed analysis for Valuation is provided in Valuation Chapter of the Material
C. Works Contract [Para(h) of Section 66E]:

a. It is worthy to note that the phrase used is ‘works contract’ and not work contract. ‘Works’ has a defined and accepted legal meaning. As per Black’s Law dictionary ‘work’ means ‘buildings or structures on land’.

b. Works contract has been defined in section 65B of the Act as 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, maintenance, repair, renovation, alteration of any movable or immovable property or for carrying out any other similar activity or a part thereof in relation to any movable or immovable property. (‘building or structure on land’ substituted by immovable property). The definition of works contract was earlier given as an explanation to Section 65(105)(zzza) which is amended to fit into the new scheme of declared services.

c. In terms of Article 366(29A) of the Constitution of India, transfer of property in goods involved in execution of works contract is deemed to be a sale of such goods.

d. It is a well settled position of law, declared by the Supreme Court in BSNL’s case [2006 (2) STR 161 SC], that a works contract can be segregated into a contract of sale of goods and contract of provision of service.

e. This declared list entry has been incorporated to capture this position of law in simple terms under section 66E.

Scope of Works Contract

a. The basic requirement is that the activity should be subject to sales tax. However, definition of works contract under service tax and CST/State VAT is quite different.

b. Buildings and structures on land means not only buildings or structures attached to earth but also things permanently fastened to a building or structure attached to earth.

c. Pipeline or conduit are structures on land contracts for construction of such structure would be covered under works contract

d. Contracts for erection commissioning or installation of plant, machinery, equipment or structures, whether prefabricated or otherwise be treated as a works contract if:

- Transfer of property in goods is involved in such a contract; and

- The machinery equipment structures are attached or embedded to earth after erection commissioning or installation

e. contracts for painting of a building, repair of a building, renovation of a building, wall tiling, flooring be covered under ‘works contract’

f. Pure labour contracts are not works contracts
Valuation in Works Contract

Broadly, there are two methods for valuation

(a) Calculate value of service and pay service tax

i) Value of service = Gross amount – value of property in goods

ii) If not (i) value of service shall be

a. For execution of original works => 40% of total amount shall be value

b. For maintenance or repair or reconditioning or restoration or servicing of any goods => 70% of total amount shall be value

c. For other works contracts => 60% of total amount shall be value

(b) Composition scheme i.e. service tax shall be percentage of total value of works contract including value of free material supplied by customer. But as of now, the negative list based taxation has not notified the effectiveness of composition scheme.

In either case, CENVAT credit cannot be availed of excise duty paid on goods, the property of which is transferred to customer. Thus, CENVAT credit cannot be availed on excise duty paid on building material like cement, steel, tiles, fittings, etc. Cenvat Credit available for goods for which property is not transferred subject to reversal under Rule 6 of Cenvat Credit Rules. [expected to be re examined prior to 1.7.2012 and changes put in place to take the concept of seamless credit further.]

Exemption for Works Contracts - Notification 25/2012

Refer Exemption Chapter of the Material

Reverse Charge mechanism applied for works contract

a. Where service provider is- Individual or HUF or proprietary firm or partnership firm, registered or not or AOP

b. And service recipient is company under Companies Act or business entity registered as body corporate located in taxable territory

c. 50% tax shall be payable by service provider and 50% shall be payable by service recipient.

1.3 Negative List – Section 66D.

Under the negative list, the entry which merits consideration is:-
(m) Services by way of renting of residential dwelling for use as residence;

Clause 41 of Section 65B defines renting as - "renting" means allowing, permitting or granting access, entry, occupation, use or any such facility, wholly or partly, in an immovable property, with or without the transfer of possession or control of the said immovable property and includes letting, leasing, licensing or other similar arrangements in respect of immovable property;

1. SERVICES BY WAY OF RENTING OF RESIDENTIAL DWELLING FOR USE AS RESIDENCE

‘Renting’ has been defined in section 65B as “allowing, permitting or granting access, entry, occupation, usage or any such facility, wholly or partly, in an immovable property, with or without the transfer of possession or control of the said immovable property and includes letting, leasing, licensing or other similar arrangements in respect of immovable property’.

Snap shot on taxability/ non-taxability of Renting Transactions:

<table>
<thead>
<tr>
<th>If</th>
<th>Then</th>
</tr>
</thead>
<tbody>
<tr>
<td>A residential house taken on rent is used only or predominantly for commercial or non-residential use.</td>
<td>The renting transaction is not covered in this negative list entry.</td>
</tr>
<tr>
<td>A house is given on rent and the same is used as a hotel or a lodge</td>
<td>The renting transaction is not covered in this negative list entry because the person taking it on rent is using it for a commercial purpose.</td>
</tr>
<tr>
<td>Rooms in a hotel or a lodge are let out whether or not for temporary stay</td>
<td>The renting transaction is not covered in this negative list entry because a hotel or a lodge is not a residential dwelling.</td>
</tr>
<tr>
<td>Government department allots houses to its employees and charges a license fee</td>
<td>Such service would be covered in the negative list entry relating to services provided by Government and hence non-taxable.</td>
</tr>
<tr>
<td>Furnished flats given on rent for temporary stay</td>
<td>These are in the nature of lodges or guest houses and hence not treatable as a residential dwelling</td>
</tr>
</tbody>
</table>

1.4Mega Exemption – Notification No. 25/2012 dated 20.06.2012

5. Services by a person by way of-

(a) renting of precincts of a religious place meant for general public; or
(b) conduct of any religious ceremony;

12. Services provided to the Government, a local authority or a governmental authority by way of construction, erection, commissioning, installation, completion, fitting out, repair, maintenance, renovation, or alteration of-

(a) a civil structure or any other original works meant predominantly for use other than for commerce, industry, or any other business or profession;

(b) a historical monument, archaeological site or remains of national importance, archaeological excavation, or antiquity specified under the Ancient Monuments and Archaeological Sites and Remains Act, 1958 (24 of 1958);

(c) a structure meant predominantly for use as (i) an educational, (ii) a clinical, or (iii) an art or cultural establishment;

(d) canal, dam or other irrigation works;

(e) pipeline, conduit or plant for (i) water supply, (ii) water treatment, or (iii) sewerage treatment or disposal; or

(f) a residential complex predominantly meant for self-use or the use of their employees or other persons specified in the Explanation 1 to clause 44 of section 65 B of the said Act;

13. Services provided by way of construction, erection, commissioning, installation, completion, fitting out, repair, maintenance, renovation, or alteration of,-

(a) a road, bridge, tunnel, or terminal for road transportation for use by general public;

(b) a civil structure or any other original works pertaining to a scheme under Jawaharlal Nehru National Urban Renewal Mission or Rajiv Awaas Yojana;

(c) a building owned by an entity registered under section 12 AA of the Income tax Act, 1961 (43 of 1961) and meant predominantly for religious use by general public;

(d) a pollution control or effluent treatment plant, except located as a part of a factory; or

(e) a structure meant for funeral, burial or cremation of deceased;

14. Services by way of construction, erection, commissioning, or installation of original works pertaining to,-

(a) an airport, port or railways, including monorail or metro;

(b) a single residential unit otherwise than as a part of a residential complex;

(c) low-cost houses up to a carpet area of 60 square metres per house in a housing project approved by competent authority empowered under the ‘Scheme of Affordable Housing in Partnership’ framed by the Ministry of Housing and Urban Poverty Alleviation, Government of India;
(d) post-harvest storage infrastructure for agricultural produce including a cold storages for such purposes; or
(e) mechanised food grain handling system, machinery or equipment for units processing agricultural produce as food stuff excluding alcoholic beverages;

29. Services by the following persons in respective capacities -

(a) sub-broker or an authorised person to a stock broker;

(b) authorised person to a member of a commodity exchange;

(c) mutual fund agent to a mutual fund or asset management company;

(d) distributor to a mutual fund or asset management company;

(e) selling or marketing agent of lottery tickets to a distributor or a selling agent;

(f) selling agent or a distributor of SIM cards or recharge coupon vouchers;

(g) business facilitator or a business correspondent to a banking company or an insurance company, in a rural area; or

(h) sub-contractor providing services by way of works contract to another contractor providing works contract services which are exempt;

Relevant definitions

(q) “general public” means the body of people at large sufficiently defined by some common quality of public or impersonal nature;

(y) “original works” means has the meaning assigned to it in Rule 2A of the Service Tax (Determination of Value) Rules, 2006;

(zc) “residential complex” means any complex comprising of a building or buildings, having more than one single residential unit;

(zb) “religious place” means a place which is primarily meant for conduct of prayers or worship pertaining to a religion, meditation, or spirituality;

(ze) “single residential unit” means a self-contained residential unit which is designed for use, wholly or principally, for residential purposes for one family;

1.5 Place of Provision of Service Rules

What is Relevance of Place of Provision of Service?
With the introduction of new scheme of tax, the determination of tax is dependent upon whether the services are provided within the taxable territory or not. If it is provided within the taxable territory, it would be taxable and if not in taxable territory not taxable. This would be the position irrespective where the service provider or service receivers are located.

Services being intangible it requires guidelines as to determination of the place providing service to ascertain taxability considering whether it is provided within taxable territory or not. For providing such guidelines Place of Provision of Services Rules, 2012 is notified.

**Determining Location of service provider and location of service receiver:**

Before we go to indentify the place of provision of service, one has to first identify where the location of service provider and location of service receiver.

The location of a service provider or receiver (as the case may be) is to be determined by applying the following steps sequentially:

A. If the service provider/receiver has obtained only one registration, may be centralized (in case of multiple places) or otherwise (having only one place) - the premises for which such registration is taken is the location

B. In other cases i.e. either no registration is taken or multiple registration is taken the location of service provider/receiver is identified sequentially as follows:

   a. If services are provided from Business Establishment (place where management and control exist) – Place of such business establishment is the location

   b. If services are not so provided but from other establishment (fixed establishments) – Place of such fixed establishment is the location

   c. If the services are provided from / received by more than one locations - the establishment most directly concerned with the provision of service / use of the service is the location

   d. In the absence of any places mentioned above – usual place of residence is the location.

**Determination of place of provision**

The Place of Provision of Services has been structured by breaking up the services from Rule 4 to Rule 12 into sectors i.e. on following basis (separately explained later as to its scope):

a. Rule 4-Based on the performance of service

b. **Rule 5-Based on location of immovable property**
c. Rule 6-Based on place of holding event

d. Rule 7-Based on performance of services at more than one location

e. Rule 8-Based on the provision of service where provider and recipient both located in taxable territory

f. Rule 9-Based on specified services where place of provision is at location of service provider

g. Rule 10-Based on destination based transportation of goods services

h. Rule 11- passenger transportation service based on place where the passenger embarks on the conveyance for a continuous journey,

i. Rule 12- based on services provided on board conveyance in course of a passenger transport operation.

When none of these specific rules is applicable, then the place of provision is determined based on default Rule 3, according to which, the place of provision of service would be based on location of recipient of service. However, in the ordinary course of business, the location of service receiver is not available (say for example walk in customers where the location of service receiver is not known ordinarily), then the place of provision is the place of the service provider.

**Power of Central Government to notify the place of provision**

In addition to the above determination as mentioned above, Rule 13 empowers the Central Government to notify the type of services or circumstances in which cases the place of provision would be the place of effective use and enjoyment of a service. As on date the Central Government has not notified any type services in this regard.

<table>
<thead>
<tr>
<th>Rule</th>
<th>Situations</th>
<th>Place of provision of Service</th>
</tr>
</thead>
<tbody>
<tr>
<td>5</td>
<td>Services provided directly related to an immovable property including a. services of experts and estate agents, b. provision of hotel accommodation by a hotel, inn, guest house, club, or campsite, by whatever, name called, c. grant of rights to use immovable property, d. services for carrying out or co-ordination of construction work, including architects or interior decorators</td>
<td>Location of the immovable property located or intended to be located.</td>
</tr>
</tbody>
</table>

**Relevant definitions from the Rules**
Relevant Rules

RULE 3. Determination of point of taxation. — For the purposes of these rules, unless otherwise provided, “point of taxation” shall be:

a. the time when the invoice for the service [provided or agreed to be provided] is issued:

Provided that where the invoice is not issued within the time period specified in rule 4A of the Service Tax Rules, 1994, the point of taxation shall be the date of completion of provision of the service;

b. in a case, where the person providing the service, receives a payment before the time specified in clause (a), the time, when he receives such payment, to the extent of such payment:

Provided that for the purposes of clauses (a) and (b),

i. 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;

ii. wherever the provider of taxable service receives a payment up to rupees one thousand in excess of the amount indicated in the invoice, the point of taxation to the extent of such excess amount, at the option of the provider of taxable service, shall be determined in accordance with the provisions of clause (a).

Explanation - For the purpose of this rule, wherever any advance by whatever name known, is received by the service provider towards the provision of taxable service, the point of taxation shall be the date of receipt of each such advance.

RULE 4. Determination of point of taxation in case of [change in effective rate of tax]. — Notwithstanding anything contained in rule 3, the point of taxation in cases where there is a [change in effective rate of tax] in respect of a service, shall be determined in the following manner, namely:-

(ba) “change in effective rate of tax” shall include a change in the portion of value on which tax is payable in terms of a notification issued in the Official Gazette under the provisions of the Act, or rules made thereunder;

(c) “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 for 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 condition;

(d) “invoice” means the invoice referred to in rule 4A of the Service Tax Rules, 1994 and shall include any document as referred to in the said rule
(a) in case a taxable service has been provided before the [change in effective rate of tax],-

(i) where the invoice for the same has been issued and the payment received after the [change in effective rate of tax], the point of taxation shall be date of payment or issuing of invoice, whichever is earlier; or

(ii) where the invoice has also been issued prior to [change in effective rate of tax] but the payment is received after the [change in effective rate of tax], the point of taxation shall be the date of issuing of invoice; or

(iii) where the payment is also received before the [change in effective rate of tax], but the invoice for the same has been issued after the [change in effective rate of tax], the point of taxation shall be the date of payment;

(b) in case a taxable service has been provided after the [change in effective rate of tax],-

(i) where the payment for the invoice is also made after the [change in effective rate of tax] but the invoice has been issued prior to the [change in effective rate of tax], the point of taxation shall be the date of payment; or

(ii) where the invoice has been issued and the payment for the invoice received before the [change in effective rate of tax], the point of taxation shall be the date of receipt of payment or date of issuance of invoice, whichever is earlier; or

(iii) where the invoice has also been raised after the [change in effective rate of tax] but the payment has been received before the [change in effective rate of tax], the point of taxation shall be date of issuing of invoice.

RULE 5. Payment of tax in case of new services. — Where a service is taxed for the first time, then, -

(a) no tax shall be payable to the extent the invoice has been issued and the payment received against such invoice before such service became taxable;

(b) no tax shall be payable if the payment has been received before the service becomes taxable and invoice has been issued within fourteen days of the date when the service is taxed for the first time.

Definitions/ Meaning

The “Change in effective rate of tax”, which include a change in the portion of value on which tax is payable as per the provisions of the Finance Act, 1994 or rules made thereunder. Earlier this was in the form of an explanation to the Rule 4.

The term “continuous supply of service” is defined to mean any service which is provided, or to be provided,

a. Continuously or on recurrent basis,

b. under a contract,

c. for a period exceeding three months,

d. with the obligation for payment periodically or from time to time.
e. 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 condition;

PoT as defined under Rule 2(e) means the point in time when a service shall be deemed to have been provided. The intent is to provide for the point when service shall be deemed to be provided for the purpose of Rule 6 of Service Tax Rules which provides for the liability to pay Service Tax.

**Date of Payment (Rule 2A):**

The new rule has been inserted for the purpose of setting out what is “date of payment”. Accordingly, earlier of the following dates would be considered as date of payment i.e.,

a. Date on which the payment is entered in the books of account; or

b. Date on which the payment is credited to the bank account of the person liable to pay tax.

Further the date of book entry would not be considered and only date of credit into bank account would be considered if all the three conditions below are fulfilled:

a. Between the date of entry and date of credit, there is change in effective rate of tax or when a service is taxed for the first time; and

b. The credit in the bank account is after four working days from the said date of rate change or new levy;

c. The payment is made by way of an instrument which is credited to bank accounted.

The above said principle would equally apply for determining the date of receipt as well.

**Point of Taxation in general-Rule 3**

The above definition of continuous supply of service has been amended to capture the concept in a more wholesome manner, namely the recurrent nature of services and the obligation for payment periodically or from time-to-time.

Since the essence of the rule in case of continuous supply of service is the same as the main Rule, the separate rule for continuous supply of service [Rule 6] is being merged with the main rule.

Thus, the PoT in general is summed up as under:

<table>
<thead>
<tr>
<th>Sl. No.</th>
<th>Scenario</th>
<th>Point of Taxation</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Invoice Issued within 30 days from the completion of service</td>
<td>Date of Invoice</td>
</tr>
<tr>
<td>2.</td>
<td>Service Completed, but invoice not issued within 30 days</td>
<td>Date of Completion of Service</td>
</tr>
</tbody>
</table>
Rule 3 is general rule, identifies three events either of which may be defined as PoT as per the provided Rules. The said three events are:

a. Issuance of Invoice

b. Rendering of Service if the invoice is not issued within 30 days of completion of provision of service

c. Receipt of Payment

The thumb rule is that PoT shall coincide with the event occurring earliest.

**Point of taxation where there is a change in rate of Taxes-Rule 4**

Rule 4 states that point of taxation as stated in Rule 3 shall not be applicable for determination of date (point of taxation) in cases where there is change of rate of tax in respect of a particular service.

The change of rate means not only the change of rate by amendment in the Act, but also covers change of rate by amendment in exemption notification. Further also it cover a change in abatement rate or value on which the duty needs to be computed.

When there is change of tax rate for a particular service the point of taxation shall be decided in accordance with Rule 4 as under:

Rule 4 provides for determination of PoT in such cases in the following manner:

<table>
<thead>
<tr>
<th>Rule</th>
<th>Event prior to change of effective rate</th>
<th>Event subsequent to change of effective rate</th>
<th>Point of Taxation</th>
</tr>
</thead>
<tbody>
<tr>
<td>4(a)</td>
<td>Services rendered</td>
<td>Invoice issued and payment received</td>
<td>Issuance of Invoice or receipt of payment,</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Assumptions:

a) The present rate is 10%, changed rate (in the future) is 12%.

b) Words used in table: Before is in relation to the service, invoice or payment as mentioned in the header.

The rate changes from 10% to 12% as on **14th May**

<table>
<thead>
<tr>
<th>Rule</th>
<th>Service Provided</th>
<th>Invoice Issued</th>
<th>Payment</th>
<th>Point of Taxation</th>
<th>Remarks</th>
</tr>
</thead>
<tbody>
<tr>
<td>4(a) (i)</td>
<td>Before (10%) (30th April)</td>
<td>After (12%) (15th May)</td>
<td>After (12%) (31st May)</td>
<td>Date of invoice or payment, whichever is earlier i.e. 15th May</td>
<td>As service was already taxable, and the tax point invoice issued date, ST charged @ 12%</td>
</tr>
<tr>
<td>4(a) (ii)</td>
<td>Before (10%) (30th April)</td>
<td>Before (10%) (5th May)</td>
<td>After (12%) (31st May)</td>
<td>Date of invoice i.e. 5th May</td>
<td>ST shall be charged @ 10%</td>
</tr>
<tr>
<td>4(a) (iii)</td>
<td>Before (10%)</td>
<td>After (12%)</td>
<td>Before (10%)</td>
<td>Date of payment i.e. 31st May</td>
<td>ST shall be charged @ 10%</td>
</tr>
</tbody>
</table>
Taxability of services coming into service tax net for first time - Rule 5:

Rule 5 states the taxability of a transaction being chargeable to Service tax for the first time. It provides if the invoice has been issued & payment has been received before the service becoming taxable, then service tax need not be paid.

If payment has been received before the service becoming taxable & invoice has been issued within 14 days of the date when the service is taxed for the first time. Then service tax need not be paid.

1.7 Principles of Interpretation (Classification) of Service

Service Tax was introduced for the first time in the year 1994 through insertion of Chapter V of Finance Act, 1994. There is no Service tax Act as such. The services were earlier classified as per section 65A of the Act. Section 65A provided for principles for classification of service specified in erstwhile section 65. However, in the Finance Act, 2012, radical changes have been made and now service tax law has done away with the service specific description of services.

Under the system of Indirect Taxation, classification plays a very important role. The importance of classification is, however, somewhat diluted if the rate of taxation is uniform for all the categories. Though the service tax rate is constant for all categories of services i.e., 12%, still the accurate classification of taxable services has its own importance and the uniform rate should not be taken to suggest that there is no need for classification. Thus, the classification provision was introduced by the Finance Act, 2003 by inserting section 65A. However, Classification provisions which was contained in
section 65A is no longer applicable from 1st of July, 2012, by virtue of notification 21/2012-ST, dated 5th June, 2012. The law makers at the same time felt the need to introduce a new section providing for the principles/ rules to interpret specified description of services or bundled services. Hence, Finance Act, 2012 introduced Section 66F.

**LAW PRIOR TO 1ST JULY, 2012**

Before understanding the new provisions it is always better to get a hand of the old law. Section 65A was inserted in the Finance Act, 2003, which provided for classification of taxable services. The classification of taxable services was determined according to the terms of the definition of erstwhile ‘taxable service’ prescribed in the various sub clauses of section 65(105). This was given under sub section (1) of section 65A. However, when for any reason a taxable service was prima facie classifiable under two or more sub-clauses of section 65(105), the following rules of classification were required to be applied:

- The sub-clause which provides the most specific description was preferred to sub-clauses providing a more general description. [clause (a)]

- Composite services consisting of a combination of different services which was not able to be classified in the manner specified above was classified as if they consisted of a service which gives them their essential character, insofar as this criterion was applicable. [clause (b)]

- When a service was not able to be classified in either of the manner specified in clause (a) or clause (b), it was required to be classified under the sub-clause which occurs first among the sub-clauses which equally merit consideration. [clause (c)]

**LAW AFTER 1ST JULY, 2012**

**Principles of interpretation of specified descriptions of services or bundled services.**

After the notified date i.e., 1st July, 2012 all the services have become taxable except those specified in the Negative List. Although the negative list based taxation obviated the need for descriptions of services and classification of services, such descriptions has continued to exist in the following areas:

- In the Negative list of services.
- In the Declared list of services.
- In exemption notification 25/2012.
- In the Place of Provision Rules, 2012.
- In few other rules and notifications (e.g., CENVAT Credit Rules, 2004)
Despite doing away with the service-specific descriptions, there will be some descriptions where some differential treatment will be available to a service or a class of services. Hence, Section 66F has laid down the principles of interpreting the same.

SCOPE OF SUB SECTION (1) TO SECTION 66F:

The sub section (1) of section 66F provides that any input service required to provide main service will not be covered in main service. This means input service will be considered as a separate service. This position was also prevalent prior to 1st July, 2012. The sub section reads as follows:

“Unless otherwise specified, reference to a service (herein referred to as main service) shall not include reference to a service which is used for providing main service.”

The sub section (1) of the section 66F deals with interpretation of specified description of services. This is emphasizing that the classification of the main contract cannot be used for the sub-contract or any other service provided for rendering the main service. This means, if a service (main service) is specifically excluded or exempted by way of Negative List or Exemption notification then any service used for providing the main service is precluded from the same benefit.

For example, ‘provision of access to any road or bridge on payment of toll’ is in Negative List. However, service provided for collection of toll or security of cash would not fall under negative list – Paras 4.8.2 and 9.1.1 of CBEC’s Taxation of Services: An Education Guide' published on 20.06.2012.

If construction of a Government building is exempt (main service), architect or labour supplier providing service to builder/contractor for such contract will not be able to avail that exemption, even if used to provide ‘main service’.

However, if a contractor outsources the work of construction to a sub-contractor, the service provided by the sub-contractor is exempt. This is because of a specific exemption given under Notification No. 25/2012-ST dated 20.06.2012 effective from 01.07.2012 which provides that if the main Works contract is exempt, sub-contractor providing works contract service to main contractor will be exempt from service tax. This exemption is only when the sub-contractor provides works contract service and not in other cases.

SCOPE OF SUB SECTION (2) TO SECTION 66F

Section 66F(2) reads as follows-

“Where a service is capable of differential treatment for any purpose based on its description, the most specific description shall be preferred over a more general description”

This sub section implies that if a particular service is classifiable under more than one category then the category of service which specifically covers such service will be preferred than the general service. The same can be understood with the examples. For example, a hotel rents out a conference room for an official conference where lunch is also
served. It can be classified as ‘mandap keeper’ or ‘convention service’. Between these two entries, ‘convention service’ is more specific as it covers only conventions which are like official function. ‘Mandap keeper’ is general description as it includes official, social as well as business functions. Hence, such service will be a ‘convention service’. – CBEC circular No. 51/13/2002-ST dated 07.01.2003.

The same principle was applied in Coal Handlers P Ltd. v. CCE (2007) 6 STT 513 (CESTAT), where it was held that C&F Agent is specific description compared to ‘business auxiliary services’.

It is also otherwise a general rule of interpretation that a specific heading should be preferred over general heading. There are many Supreme Court cases supporting the same, like CCE v. Frito Lay India (2009) 242 ELT 3 (SC), and Hindustan Poles Corporation v. CCE (2006) 196 ELT 400 (SC), etc.

SCOPE OF SUB SECTION (3) TO SECTION 66F

It is pertinent to understand what Bundled Services is before proceeding to sub section (3) of section 66F. The meaning of ‘Bundled Services’ has been given in Explanation to section 66F(3) of the Finance Act, 1994. It means a bundle of provision of various services wherein an element of provision one service is combined with an element or elements of provision of any other service or services. Basically it is a composite service consisting of two or more services. For example, an airline provides movie or catering on board. Each service involves differential treatment as the manner of determination of value of two services for the purpose of charging service tax is different.

However, if the service provider clubs two or more services to provide a single service to a service recipient and such single service is already present in the statute as a separate entry in Negative List, or exemptions or Declared services, then the same will be accordingly classified instead of following the principle of Bundled services. Two rules have been prescribed for determining the taxability of such bundled services in sub-section (3) of section 66F of the Act. These rules, which are explained below, are subject to the provisions of the rule contained in sub section (2) of section 66F, viz a specific description will be preferred over a general description as explained above. The sub-section (3) of section 66F reads as follows:

“Subject to the provisions of sub-section (2), the taxability of a bundled service shall be determined in the following manner, namely:— (a) if various elements of such service are naturally bundled in the ordinary course of business, it shall be treated as provision of the single service which gives such bundle its essential character; (b) if various elements of such service are not naturally bundled in the ordinary course of business, it shall be treated as provision of the single service which results in highest liability of service tax.”

Section 66F(3)(a) explains that if services are naturally bundled in the ordinary course of business then it should be classified as per the category of service which gives it the essential character. For example, a hotel provides a 4-D/3-N package with the facility of breakfast. This is a natural bundling of services in the ordinary course of business. The service of hotel accommodation gives the bundle the essential character and would, therefore, be treated as service of providing hotel accommodation.
It is provided in section 66F(3)(b) of the Act that when various services are not naturally bundled in the ordinary course of business, then the service shall be the one attracting highest service tax liability. The following has been given in the Education Guide issued by CBEC on 20th June, 2012.

For example, premises are rented which are partly for residential purposes and partly for manufacturing activity. Thus, it is not service bundled in ordinary course of business. In such case, though residential use is not taxable, commercial use is taxable. Hence, the entire bundle will be treated as renting of commercial property.

1.8 Valuation of taxable services for charging Service tax – Section 67

(1) Subject to the provisions of this Chapter, service tax chargeable on any taxable service with reference to its value shall, —

(i) in a case where the provision of service is for a consideration in money, be the gross amount charged by the service provider for such service provided or to be provided by him;

(ii) in a case where the provision of service is for a consideration not wholly or partly consisting of money, be such amount in money, with the addition of service tax charged, is equivalent to the consideration;

(iii) in a case where the provision of service is for a consideration which is not ascertainable, be the amount as may be determined in the prescribed manner.

(2) Where the gross amount charged by a service provider, for the service provided or to be provided is inclusive of service tax payable, the value of such taxable service shall be such amount as, with the addition of tax payable, is equal to the gross amount charged.

(3) The gross amount charged for the taxable service shall include any amount received towards the taxable service before, during or after provision of such service.

(4) Subject to the provisions of sub-sections (1), (2) and (3), the value shall be determined in such manner as may be prescribed.

Explanation.—For the purposes of this section,—

(a) “consideration” includes any amount that is payable for the taxable services provided or to be provided;

(b) [ ** * ]

(c) “gross amount charged” includes payment by cheque, credit card, deduction from account and any form of payment by issue of credit notes or debit notes and 3[book adjustment, and any amount credited or debited, as the case may be, to any account, whether called “Suspense account” or by any other name, in the books of account of a person liable to pay service tax, where the transaction of taxable service is with any associated enterprise.
SERVICE TAX (DETERMINATION of VALUE OF TAXABLE SERVICE) RULES, 2006

Rule 2A: Determination of value of service portion in the execution of a works contract

What is works contract as per the new definition?

There was lot of discussion and debate as to whether works contract is a subject matter of service tax. It is now specifically set out in the definition of service 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.

The specified purposes are for

1. carrying out:
   a. construction,
   b. erection,
   c. commissioning,
   d. installation,
   e. completion,
   f. fitting out,
   g. repair,
   h. maintenance,
   i. renovation,
   j. alteration of
      any moveable or
      immovable property
2. for carrying out
   a. any other similar activity or
b. a part thereof in relation to

i. any moveable or

ii. immovable property

It is important to note that the scope and coverage of the definition of works contract is now very vide and covers many other services which was earlier covered under different categories like, management maintenance or repair services, Business Auxiliary Services, Authorized Service Station, etc.,

**Valuation for works Contract**

The valuation of taxable service in relation to services involved in the execution of works contact has been separately dealt with in Rule 2A of the valuation Rules. In terms of the said Rule, the value of service portion in the execution of a Works Contract would be equivalent to –

a. The gross amount charged for the works contract

b. less the value of transfer of property in goods involved in the execution of the said works contract.

c. Less the VAT or Sales Tax paid or payable, if any, on transfer of property in goods involved in the execution of the said works contract The same would be computed in following

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

1. 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.

2. 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).

3. 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:

a. 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.

b. 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
c. If the contract is for other than the above, including, maintenance, repair, completion and finishing services such as glazing, plastering, floor and wall tailing, installation of electrical fittings of an immovable property, service tax would be payable on 60% of the total works contract value.

For the purpose of the above computations, there are few things which are relevant. Firstly, the term ‘Total amount’ which 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:

a. Gross amount charged for the works contract

b. 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-

a. Any amount already charged for the said goods or services

b. VAT/Sales tax if any levied thereon.

For determining the fair market value of goods and services so supplied, generally accepted accounting principles have to be followed. The determination of fair market value is going to be an very challenging task as may be difficult to convince the revenue authorities about the methodology adopted.

Though there was specific wording in the earlier provision as to goods and services supplied by the service recipient, the same is silent in the present rule. Obviously the same is implied.

Secondly the term ‘Original works’ has been defined to mean all new constructions; all types of additions and alterations to, abandoned or damaged structures on land that are required to make them workable and erection, commissioning or installation of plant, machinery or equipment or structures, whether pre-fabricated or otherwise.

Thirdly, for the purpose of computing the value of services involved in the works contract, it is specifically said that the following shall be included.

a. Labour charges for execution of the works;

b. Amount paid to a sub-contractor for labour and services;

c. Charges for planning, designing and architect’s fees;

d. Charges for obtaining on hire or otherwise, machinery and tools used for the execution of the works contract;

e. Cost of consumables such as water, electricity, fuel, used in the execution of the works contract;
f. Cost of establishment of the contractor relatable to supply of labour and services;
f. Other similar expenses relatable to supply of labour and services;
h. Profit earned by the service provider relatable to supply of labour and services;

**Eligibility of CENVAT Credit:**

As regards to CENVAT Credit, there is no bar on availment of credit of service tax paid on any inputs services in relation services involved in such works contract. However as far as duty paid on goods are concerned, it is specifically restricted for 'inputs' used in or in relation to the said works contract. It would be interesting to note that benefit of CENVAT Credit of Capital Goods would to be available.

**Transition for existing schemes**

Many service providers who are presently paying taxes under different schemes, are all required to fall into one umbrella as discussed above and there is no option for them to continue under their old scheme. This may create lot of difficulties in various running contracts, where the prices are fixed based on earlier tax structure and Work Orders are issued on particular basis. Further the computation of service tax to some extent depends upon the scheme under which the payments are being made under their respective state sales tax/VAT laws. Therefore the impact of the same has to be examined. Further question would arise in cases where reverse charge as discussed below, how the past contracts to be given effect to.

**Reverse Charge**

In respect of services provided or agreed to be provided by way of works contract, by:

a. any individual,
b. Hindu Undivided Family or
c. proprietary firm or
d. partnership firm, whether registered or not,

including association

Provided or agreed to be provided to –
a. any company formed or registered under the Companies Act, 1956 (1 of 1956) or
b. a business entity registered as body corporate
The service tax only to the extent of 50% of service tax payable has to be paid by the service provider and balance 50% has to be paid by the service recipient.

As a consequence of this, the specified service recipients who are not at all providing any taxable service would also be liable to register under service tax and pay service tax for the services received. This would add additional compliance to such companies/corporate bodies.

Further question arises where the service provider is eligible to claim the benefit of small service providers exemption, whether the service recipient is liable to be registered and paying tax, in the opinion of paper writers, the same is not required as the 50% of the tax needs to be paid is that of service tax payable, whereas the service tax payable after claiming exemption would be Nil.

Relevant extracts of Service Tax – E-Guide

**Definition of Service**

**2.1 Activity**

**2.1.1 What does the word ‘activity’ signify?**

‘Activity’ has not been defined in the Act. In terms of the common understanding of the word activity would include an act done, a work done, a deed done, an operation carried out, execution of an act, provision of a facility etc. It is a term with very wide connotation.

Activity could be active or passive and would also include forbearance to act. Agreeing to an obligation to refrain from an act or to tolerate an act or a situation has been specifically listed as a declared service under section 66E of the Act.

**2.2 Consideration**

**2.2.1 The phrase ‘consideration’ has not been defined in the Act. What is, therefore, the meaning of ‘consideration’?**

As per Explanation (a) to section 67 of the Act “consideration” includes any amount that is payable for the taxable services provided or to be provided.

Since this definition is inclusive it will not be out of place to refer to the definition of ‘consideration’ as given in section 2 (d) of the Indian Contract Act, 1872 as follows-

“When, at the desire of the promisor, the promisee or any other person has done or abstained from doing, or does or abstains from doing, or promises to do or abstain from doing, something, such act or abstinence or promise is called a consideration for the promise”
In simple terms, ‘consideration’ means everything received or recoverable in return for a provision of service which includes monetary payment and any consideration of non-monetary nature or deferred consideration as well as recharges between establishments located in a non-taxable territory on one hand and taxable territory on the other hand.

2.2.2 What are the implications of the condition that activity should be carried out for a ‘consideration’?

♦ To be taxable an activity should be carried out by a person for a ‘consideration’

♦ Activity carried out without any consideration like donations, gifts or free charities are therefore outside the ambit of service. For example grants given for a research where the researcher is under no obligation to carry out a particular research would not be a consideration for such research.

♦ An act by a charity for consideration would be a service and taxable unless otherwise exempted. (for exemptions to charities please see Guidance Note 7)

♦ Conditions in a grant stipulating merely proper usage of funds and furnishing of account also will not result in making it a provision of service.

♦ Donations to a charitable organization are not consideration unless charity is obligated to provide something in return e.g. display or advertise the name of the donor in a specified manner or such that it gives a desired advantage to the donor.

2.2.3 What is the meaning of monetary consideration?

Monetary consideration means any consideration received in the form of money. ‘Money’ has been defined in section 65B and includes not only cash but also cheque, promissory note, bill of exchange, letter of credit, draft, pay order, traveler’s cheque, money order, postal or electronic remittance or any such similar instrument.

2.2.4 What is non-monetary consideration?

Non-monetary consideration essentially means compensation in kind such as the following:

♦ Supply of goods and services in return for provision of service

♦ Refraining or forbearing to do an act in return for provision of service

♦ Tolerating an act or a situation in return for provision of a service

♦ Doing or agreeing to do an act in return for provision of service

Illustrations
<table>
<thead>
<tr>
<th>If</th>
<th>And in return</th>
</tr>
</thead>
<tbody>
<tr>
<td>A agrees to dry clean B's clothes</td>
<td>B agrees to click A's photograph</td>
</tr>
<tr>
<td>A agrees not to open dry clean shop in B's neighborhood</td>
<td>B agrees not to open photography shop in A's neighborhood</td>
</tr>
<tr>
<td>A agrees to design B's house</td>
<td>B agrees not to object to construction of A's house in his neighborhood</td>
</tr>
<tr>
<td>A agrees to construct 3 flats for B on land owned by B</td>
<td>B agrees to provide one flat to A without any monetary consideration</td>
</tr>
</tbody>
</table>

**Then**

For the services provided by A to B, the acts of B specified in 2nd column are non-monetary consideration provided by B to A. Conversely, for services provided by B to A, similar reasoning will be adopted.

### 2.2.5 Is the value of non-monetary consideration important?

Yes. The non-monetary consideration also needs to be valued for determining the tax payable on the taxable service since service tax is levied on the value of consideration received which includes both monetary consideration and money value of non-monetary consideration.

### 2.2.6 How is the money value of non-monetary consideration determined?

The value of non-monetary consideration is determined as per section 67 of the Act and the Service Tax (Determination of Value) Rules 2006, which is equivalent money value of such consideration and if not ascertainable, then as follows:-

♦ On the basis of gross amount charged for similar service provided to other person in the ordinary course of trade;

♦ Where value cannot be so determined, the equivalent money value of such consideration, not less than the cost of provision of service.

For details please refer to point no 8.1.8 and 8.1.9 of this Guide.

### 2.3 Activity for a consideration

The concept 'activity for a consideration' involves an element of contractual relationship wherein the person doing an activity does so at the desire of the person for whom the activity is done in exchange for a consideration. An activity done without such a relationship i.e. without the express or implied contractual reciprocity of a consideration would not be an 'activity for consideration' even though such an activity may lead to accrual of gains to the person carrying out the activity.
Thus an award received in consideration for contribution over a lifetime or even a singular achievement carried out independently or without reciprocity to the amount to be received will not comprise an activity for consideration.

There can be many activities without consideration. An artist performing on a street does an activity without consideration even though passersby may drop some coins in his bowl kept after feeling either rejoiced or merely out of compassion. They are, however, under no obligation to pay any amount for listening to him nor have they engaged him for his services. On the other hand if the same person is called to perform on payment of an amount of money then the performance becomes an activity for a consideration.

Provisions of free tourism information, access to free channels on TV and a large number of governmental activities for citizens are some of the examples of activities without consideration.

Similarly there could be cases of payments without an activity though they cannot be put in words as being “consideration without an activity”. Consideration itself pre-supposes a certain level of reciprocity. Thus grant of pocket money, a gift or reward (which has not been given in terms of reciprocity), amount paid as alimony for divorce would be examples in this category. However a reward given for an activity performed explicitly on the understanding that the winner will receive the specified amount in reciprocity for a service to be rendered by the winner would be a consideration for such service. Thus amount paid in cases where people at large are invited to contribute to open software development (e.g. Linux) and getting an amount if their contribution is finally accepted will be examples of activities for consideration.

2.3.1 Would imposition of a fine or a penalty for violation of a provision of law be a consideration for the activity of breaking the law making such activity a ‘service’?

No. To be a service an activity has to be carried out for a consideration. Therefore fines and penalties which are legal consequences of a person's actions are not in the nature of consideration for an activity.

2.3.2 Would the payments in the nature as explained in column A of the table below constitute a consideration for provision of service?

<table>
<thead>
<tr>
<th>S. No.</th>
<th>A</th>
<th>B</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Amount received in settlement of dispute.</td>
<td>Would depend on the nature of dispute. Per se such amounts are not consideration unless it represents a portion of the consideration for an activity that has been carried out. If the dispute itself pertains to consideration relating to service then it would be a part of consideration.</td>
</tr>
<tr>
<td>2.</td>
<td>Amount received as advances for</td>
<td>Such advances are consideration for the agreement to perform a service.</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>---</td>
<td>---</td>
<td></td>
</tr>
<tr>
<td>3.</td>
<td>Deposits returned on cancellation of an agreement to provide a service.</td>
<td>Returned deposits are in the nature of a returned consideration. If tax has already been paid the tax payer would be entitled to refund to the extent specified and subject to provisions of law in this regard.</td>
</tr>
<tr>
<td>4.</td>
<td>Advances forfeited for cancellation of an agreement to provide a service.</td>
<td>Since service becomes taxable on an agreement to provide a service such forfeited deposits would represent consideration for the agreement that was entered into for provision of a service.</td>
</tr>
<tr>
<td>5.</td>
<td>Security deposit that is returnable on completion of provision of service.</td>
<td>Returnable deposit is in the nature of security and hence do not represent consideration for service. However if the deposit is in the nature of a colorable device wherein the interest on the deposit substitutes for the consideration for service provided or the interest earned has a perceptible impact on the consideration charged for service then such interest would form part of gross amount received for the service. Also security deposit should not be in lieu of advance payment for the service.</td>
</tr>
<tr>
<td>6.</td>
<td>Security deposits forfeited for damages done by service receiver in the course of receiving a service</td>
<td>If the forfeited deposits relate to accidental damages due to unforeseen actions not relatable to provision of service then such forfeited deposits.</td>
</tr>
<tr>
<td>7.</td>
<td>Excess payment made as a result of a mistake</td>
<td>If returned it is not consideration If not returned and retained by the service provider it becomes a part of the taxable value.</td>
</tr>
<tr>
<td>8.</td>
<td>Demurrages payable for use of services beyond the period initially agreed upon e.g. retention of containers beyond the normal period.</td>
<td>This will be consideration and is covered by clause (x) of sub-rule (1) to Rule 6 of the Valuation Rules.</td>
</tr>
</tbody>
</table>

2.3.3 Can a consideration for service be paid by a person other than the person receiving the benefit of the service?
Yes. The consideration for a service may be provided by a person other than the person receiving the benefit of service as long as there is a link between the provision of service and the consideration. For example, holding company may pay for services that are provided to its associated companies.

2.4 By a person for another

2.4.1 What is the significance of the phrase ‘carried out by a person for another’?

The phrase ‘provided by one person to another’ signifies that services provided by a person to self are outside the ambit of taxable service. Example of such service would include a service provided by one branch of a company to another or to its head office or vice-versa.

2.4.2 Are there any exceptions wherein services provided by a person to oneself are taxable?

Yes. Two exceptions have been carved out to the general rule that only services provided by a person to another are taxable. These exceptions, contained in Explanation 2 of clause (44) of section 65B, are:

♦ an establishment of a person located in taxable territory and another establishment of such person located in non-taxable territory are treated as establishments of distinct persons. [Similar provision exists presently in section 66A (2)].

♦ an unincorporated association or body of persons and members thereof are also treated as distinct persons. [Also exists presently in part as explanation to section 65].

Implications of these deeming provisions are that inter-se provision of services between such persons, deemed to be separate persons, would be taxable. For example, services provided by a club to its members and services provided by the branch office of a multinational company to the headquarters of the multi-national company located outside India would be taxable provided other conditions relating to taxability of service are satisfied.

2.4.3 Are services provided by persons who have formed unincorporated joint ventures or profit-sharing arrangements liable to be taxed?

The services provided, both by the so constituted JV or profit sharing association of persons (AOP), as well as by each of the individual persons constituting the JV/AOP will be liable to be taxed separately, subject of course to the availability of the credit of the tax paid by independent persons to the JV/AOP and as otherwise admissible under Cenvat Rules.

2.4.4 Who is a ‘person’? Is it only a natural person or includes an artificial or a juridical person?

‘Person’ is not restricted to natural person. ‘Person’ has been defined Section 65 B of the Act. The following shall be considered as persons for the purposes of the Act:

♦ an individual

♦ a Hindu undivided family
2.4.5 Are Government and local authorities also liable to pay tax?

Yes. However, most of the services provided by the Government or local authorities are in the negative list.

2.5 Activities specified in the declared list are services.

Declared Services are activities that have been specified in Section 66 E of the Act. When such activities are carried out by one person for another in the taxable territory for a consideration then such activities are taxable services. For guidance on the declared services please refer to Guidance Note 6.

2.6 Activity to be taxable should not constitute only a transfer in title of goods or immovable property by way of sale, gift or in any other manner

- Mere transfer of title in goods or immovable property by way of sale, gift or in any other manner for a consideration does not constitute service.

- Goods has been defined in section 65B of the Act as ‘every kind of moveable property other than actionable claims and money; and includes securities, growing crops, grass and things attached to or forming part of the land which are agreed to be severed before sale or under contract of sale’.

- Immovable property has not been defined in the Act. Therefore the definition of immovable property in the General Clauses Act, 1897 will be applicable which defines immovable property to include land, benefits to arise out of land, and things attached to the earth, or permanently fastened to anything attached to the earth.

2.6.1 What is the significance of the phrase ‘transfer of title’?

Transfer of title’ means change in ownership. Mere transfer of custody or possession over goods or immovable property where ownership is not transferred does not amount to transfer of title. For example giving the property on rent or
goods for use on hire would not involve a transfer of title.

### 2.6.2 What is the significance of the word ‘only’ in the said exclusion clause in the definition of ‘service’?

The word ‘only’ signifies that activities which constitute only:

- ♦ transfer of title in goods or immovable property; or
- ♦ transfer, supply or delivery which is deemed to be a deemed sale of goods or constitute; or
- ♦ a transaction in money or an actionable claim-are outside the definition of service.

A transaction which in addition to a transfer of title in goods or immovable property involves an element of another activity carried out or to be carried out by the person transferring the title would not out rightly be excluded from the definition of service. Such transactions are liable to be treated as follows-

- ♦ If two transactions, although associated, are two discernibly separate transactions then each of the separate transactions would be assessed independently. In other words the discernible portion of the transaction which constitutes, let’s say, a transfer of title in goods, would be excluded from the definition of service by operation of the said exclusion clause while the service portion would be included in the definition of service. For example a builder carrying out an activity for a client wherein a flat is constructed by the builder for the client for which payments are received in installments and on completion of the construction the title in the flat is transferred to the client involves two elements namely provision of construction service and transfer of title in immovable property. The two activities are discernibly separate. The activity of construction carried out by the builder would, therefore, be a service and the activity of transfer of title in the flat would be outside the ambit of service.

- ♦ In cases of composite transactions, i.e. transactions involving an element of provision of service and an element of transfer of title in goods in which various elements are so inextricably linked that they essentially form one composite transaction then the nature of such transaction would be determined by the application of the dominant nature test laid down by the Supreme Court in BSNL’s case. The judgment has been explained in detail in point no 2.6.3. Although the judgment was given in the context of composite transactions involving an element of transfer in title of goods by way of sale and an element of provision of service, the ratio would equally apply to other kind of composite transactions involving a provision of service and transfer in title in immovable property or actionable claim.

### 2.6.3 What is the manner of dealing with composite transactions which in addition to a transfer of title in goods involve an element of provision of service?

The manner of treatment of such composite transactions for the purpose of taxation, i.e. are they to be treated as sale of goods or provision of service, has been laid down by the Honorable Supreme Court in the case of Bharat Sanchar Nigam Limited v. Union of India [2006(2) STR 161 (SC)]. The relevant paras 42 and 43 of the said judgment are reproduced below
“42. Of all the different kinds of composite transactions the drafters of the 46th Amendment chose three specific situations, a works contract, a hire purchase contract and a catering contract to bring within the fiction of a deemed sale. Of these three, the first and third involve a kind of service and sale at the same time. Apart from these two cases where splitting of the service and supply has been Constitutionally permitted in Clauses (b) and (g) of Clause 29A of Art. 366, there is no other service which has been permitted to be so split. For example the clauses of Article 366(29A) do not cover hospital services. Therefore, if during the treatment of a patient in a hospital, he or she is given a pill, can the sales tax authorities tax the transaction as a sale? Doctors, lawyers and other professionals render service in the course of which can it be said that there is a sale of goods when a doctor writes out and hands over a prescription or a lawyer drafts a document and delivers it to his/her client? Strictly speaking with the payment of fees, consideration does pass from the patient or client to the doctor or lawyer for the documents in both cases.

43. The reason why these services do not involve a sale for the purposes of Entry 54 of List II is, as we see it, for reasons ultimately attributable to the principles enunciated in Gannon Dunkerley's case, namely, if there is an instrument of contract which may be composite in form in any case other than the exceptions in Article 366(29-A), unless the transaction in truth represents two distinct and separate contracts and is discernible as such, then the State would not have the power to separate the agreement to sell from the agreement to render service, and impose tax on the sale. The test therefore for composite contracts other than those mentioned in Article 366 (29A) continues to be – did the parties have in mind or intend separate rights arising out of the sale of goods. If there was no such intention there is no sale even if the contract could be disintegrated. The test for deciding whether a contract falls into one category or the other is to as what is the substance of the contract. We will, for the want of a better phrase, call this the dominant nature test.”

The following principles emerge from the said judgment for ascertaining the taxability of composite transactions:

♦ Except in cases of works contracts or catering contracts [exact words in article 366(29A) being - ‘service wherein goods, being food or any other article of human consumption or any drink (whether or not intoxicating) is supplied in any manner as part of the service’] composite transactions cannot be split into contracts of sale and contracts of service.

♦ The test whether a transaction is a ‘composite transaction’ is that did the parties intend or have in mind that separate rights arise out of the constituent contract of sale and contract of service. If no then such transaction is a composite transaction even if the contracts could be disintegrated.

♦ The nature of a composite transaction, except in case of two exceptions carved out by the Constitution, would be determined by the element which determines the ‘dominant nature’ of the transaction.

a. If the dominant nature of such a transaction is sale of goods or immovable property then such transaction would be treated as such.

b. If the dominant nature of such a transaction is provision of a service then such transaction would be treated as a service and taxed as such even if the transaction involves an element of sale of goods.
♦ In case of works contracts and ‘service wherein goods, being food or any other article of human consumption or any drink (whether or not intoxicating) is supplied in any manner as part of the service’ the ‘dominant nature test’ does not apply and service portion is taxable as a ‘service’ This has also been declared as a service under section 66E of the Act. For guidance on these two types of composite transactions and the manner of determining the value portion of service portion of such composite transactions please refer to point nos. 5.8 and 5.9 of this Guidance Paper.

♦ If the transaction represents two distinct and separate contracts and is discernible as such then contract of service in such transaction would be segregated and chargeable to service tax if other elements of taxability are present. This would apply even if a single invoice is issued.

The principles explained above would, mutatis mutandis, apply to composite transactions involving an element of transfer of title in immovable property or transaction in money or an actionable claim.

2.6.4 Why has notification 12/2003-ST been deleted?

Notification 12/2003 – ST exempted so much of the value of all taxable services as was equal to the value of goods and materials sold (emphasis supplied) by the service provider to the service recipient subject to condition that there is documentary proof of such value of goods and materials. This was necessary under the regime of taxation of services based on specified descriptions as some of the specified descriptions could include an element of transfer of title in goods.

On the other hand, under the negative list scheme, specified descriptions of taxable services have been done away with and transactions that involve transfer of title in goods or are ‘deemed to be sale of goods’ under the Constitution are excluded from the ambit of service by the very definition of service. Therefore if, in the course of providing a service, goods are also being sold by a service provider for which there is such documentary proof as to make the sale a distinct and separate transaction then the activity of sale of such goods gets excluded from the definition of service itself. The essence and intent of notification no 12/2003 has, therefore, been fully captured in the definition of service itself.

2.6.5 Will the goods portion in transactions like annual maintenance contracts or erection and commissioning or construction be includible in the value of services consequent to the deletion of Notification 12/2003-ST?

All the examples given in the question now comprise “works contracts” and only the service portion of such contracts comprise service. By the express provisions contained in the definition of service (which is mandated by constitutional provisions) it is not possible to tax the goods portion of works contracts. However the principles of segregation of the value of goods are provided in Rule 2A of the Valuation Rules. Thus there is no basis for the taxation of goods in such contracts even after the deletion of the stated notification.

Even for the sale of any equipment for which a separate contract for warranty or after sales services or maintenance is entered the discernible sales portion is not to be included in the discernible portion of the value of service. For all practical purposes these will be two separate contracts. However for artificial segregation of value between goods and
services, to save either of the taxes on goods or services, the benefit was neither available earlier under the stated notification and the position continues to be the same under the new regime.

2.6.11 What is the meaning of ‘immoveable property’?

‘Immoveable property’ has not been defined in the Act. Therefore, the definition of ‘immoveable property’ as given in clause (26) of the General Clauses Act, 1897 has to be taken as per which “immovable property” shall include land, benefits to arise out of land, and things attached to the earth, or permanently fastened to anything attached to the earth.

Declared Service

6.1 Renting of Immovable Property

Renting has been defined in section 65B as “allowing, permitting or granting access, entry, occupation, usage or any such facility, wholly or partly, in an immovable property, with or without the transfer of possession or control of the said immovable property and includes letting, leasing, licensing or other similar arrangements in respect of immovable property”

6.1.1 Is renting of all kinds of immovable property taxable?

No. Renting of certain kinds of immovable properties is specified in the negative list. These are:

- renting of vacant land, with or without a structure incidental to its use, relating to agriculture. (S.I no. (d) (iv) of Exhibit A1)
- renting of residential dwelling for use as residence (Sl. No. (m) of Exhibit A1)
- renting out of any property by Reserve Bank of India
- renting out of any property by a Government or a local authority to a non-business entity.

Renting of all other immovable properties would be taxable unless covered by an exemption (refer 6.1.2).

6.1.2 Are there any exemptions in respect of renting of immovable property?

Yes. These are:

- Threshold level exemption up to Rs. 10 lakh.
- Renting of precincts of a religious place meant for general public is exempt.
- Renting of a hotel, inn, guest house, club, campsite or other commercial places meant for residential or lodging purposes, having declared tariff of a room below rupees one thousand per day or equivalent is exempt.
- Renting to an exempt educational institution

6.1.3 Would permitting usage of a property for a temporary purpose like conduct of a marriage or any other social function be taxable?

Yes. As per definition allowing or permitting usage of immovable property, without transferring possession of such property, is also renting of immovable property.

6.1.4 Would activities referred to in column 1 of a table below be chargeable to service tax?

<table>
<thead>
<tr>
<th>No.</th>
<th>Journey</th>
<th>Taxability</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Renting of property to an educational body</td>
<td>Exempted if provided to an educational institution for the purpose of education which is exempt from the levy of service tax.</td>
</tr>
<tr>
<td>2.</td>
<td>Renting of vacant land for animal husbandry or floriculture</td>
<td>Not chargeable to service tax as it is covered in the negative list entry relating to agriculture</td>
</tr>
<tr>
<td>3.</td>
<td>Permitting use of immoveable property for placing vending/dispensing machines</td>
<td>Chargeable to service tax as permitting usage of space is covered in the definition of renting</td>
</tr>
<tr>
<td>4.</td>
<td>Allowing erection of a communication tower on a building for consideration.</td>
<td>Chargeable to service tax as permitting usage of space is covered in the definition of renting</td>
</tr>
<tr>
<td>5.</td>
<td>Renting of land or building for entertainment or sports</td>
<td>Chargeable to service tax as there is no specific exemption.</td>
</tr>
<tr>
<td>6.</td>
<td>Renting of theatres by owners to film distributors</td>
<td>Chargeable to service tax as the arrangement amounts to renting of immoveable property.</td>
</tr>
</tbody>
</table>

6.1.5 Whether hotels/restaurants/convention centres letting out their halls, rooms etc. for social, official or business functions or letting out of halls for cultural functions fall within the scope of this declared list service?

Halls, rooms etc. let out by hotels/restaurants for a consideration for organizing social, official or business functions or letting out of halls for cultural functions are covered within the scope of renting of immovable property and would be taxable if other elements of taxability are present.

6.2 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 is received after issuance of certificate of completion by a competent authority.
This service is already taxable as part of construction of residential complex service under clause (zzzh) of sub-section 105 of section 65 of the Act and as part of service in relation to commercial or industrial construction under clause (zzq) of sub-section 105 of section 65 of the Act. This entry covers the services provided by builders or developers or any other person, where building complexes, civil structure or part thereof are offered for sale but the payment for such building or complex or part thereof is received before the issuance of completion certificate by a competent authority.

### 6.2.1 What would be the liability to pay service tax on flats/houses agreed to be given by builder/developer to the land owner towards the land /development rights and to other buyers. If payable, how would the services be valued?

Here two important transactions are identifiable: (a) sale of land by the landowner which is not a taxable service; and (b) construction service provided by the builder/developer. The builder/developer receives consideration for the construction service provided by him, from two categories of service receivers: (a) from landowner: in the form of land/development rights; and (b) from other buyers: normally in cash.

Construction service provided by the builder/developer is taxable in case any part of the payment/development rights of the land was received by the builder/developer before the issuance of completion certificate and the service tax would be required to be paid by builder/developers even for the flats given to the land owner.

It may be pointed out that in a recent judgement passed by the Mumbai High Court in the case of *Maharashtra Chamber of Housing Industry and Others v. Union of India* [012-TIOL-78-HC-Mum-ST] has upheld the Constitutional validity of levy of service tax, under clauses (zzzh) and (zzzzu) of section 65, on similar construction services provided by a builder. A relevant portion of the judgement is reproduced below:

"29. The charge of tax under Section 66 of the Finance Act is on the taxable services defined in clause (105) of Section 65. The charge of tax is on the rendering of a taxable service. The taxable event is the rendering of a service which falls within the description set out in sub-clauses (zzq), (zzzh) and (zzzzu). The object of the tax is a levy on services which are made taxable. The fact that a taxable service is rendered in relation to an activity which occurs on land does not render the charging provision as imposing a tax on land and buildings. The charge continues to be a charge on taxable services. The charge is not a charge on land or buildings as a unit. The tax is not on the general ownership of land. The tax is not a tax which is directly imposed on land and buildings. The fact that land is subject to an activity involving construction of a building or a complex does not determine the legislative competence of Parliament. The fact that the activity in question is an activity which is rendered on land does not make the tax a tax on land. The charge is on rendering a taxable service and the fact that the service is rendered in relation to land does not alter the nature or character of the levy. The legislature has expanded the notion of taxable service by incorporating within the ambit of clause (zzq) and clause (zzzh) services rendered by a builder to the buyer in the course of an intended sale whether before, during or after construction. There is a legislative assessment underlying the imposition of the tax which is that during the course of a construction related activity, a service is rendered by the builder to the buyer. Whether that assessment can be challenged in assailing constitutional validity is a separate issue which would be considered a little later. At this stage,
what merits emphasis is that the charge which has been imposed by the legislature is on the activity involving the provision of a service by a builder to the buyer in the course of the execution of a contract involving the intended sale of immovable property.

30. Parliament, in bringing about the amendment in question has made a legislative assessment to the effect that a service is rendered by builders to buyers during the course of construction activities. In our view, that legislative assessment does not impinge upon the constitutional validity of the tax once, the true nature and character of the tax is held not to fall within the scope of Entry 49 of List II. So long as the tax does not fall within any head of legislative power reserved to the States, the tax must of necessity fall within the legislative competence of Parliament. This is a settled principle of law, since the residuary power to legislate on a field of legislation which does not fall within the exclusive domain of the States is vested in Parliament under Article 248 read with Entry 97 of List I."

Value, in the case of flats given to first category of service receiver will be the value of the land when the same is transferred and the point of taxation will also be determined accordingly.

6.2.2 What would be the service tax liability in the following model – land is owned by a society, comprising members of the society with each member entitled to his share by way of an apartment. Society/individual flat owners give ‘No Objection Certificate’ (NOC) or permission to the builder/developer, for re-construction. The builder/ developer makes new flats with same or different carpet area for original owners of flats and additionally may also be involved in one or more of the following: (i) construct some additional flats for sale to others; (ii) arrange for rental accommodation or rent payments for society members/original owners for stay during the period of reconstruction; (iii) pay an additional amount to the original owners of flats in the society.

Under this model, the builder/developer receives consideration for the construction service provided by him, from two categories of service receivers. First category is the society/members of the society, who transfer development rights over the land (including the permission for additional number of flats), to the builder/developer. The second category of service receivers consist of buyers of flats other than the society/members. Generally, they pay by cash.

Re-construction undertaken by a building society by directly engaging a builder/developer will be chargeable to service tax as works contract service for all the flats built now.

6.2.3 When a certain number of flats are given by the builder/developer to a land owner in a collaborative agreement to construct, lieu of the land or development rights transferred, will such transferee be required to pay service tax on further sale of flats to customers?

Yes. The service tax will be required to be paid by such transferee if any consideration is received by him from any person before the receipt of completion certificate.

6.2.4 What would be the service tax liability on conversion of any hitherto untaxed construction /complex or part thereof into a building or civil structure to be used for commerce or industry, after lapse of a period of time?
Mere change in use of the building does not involve any taxable service. If the renovation activity is done on such a complex on contract basis the same would be a works contract as defined in clause (44) of section 65B service portion, which would also be taxable if other ingredients of taxability are present.

**6.2.5 What would be the service tax liability on Build-Operate-Transfer (BOT) Projects?**

Many variants of this model are being followed in different regions of the country, depending on the nature of the project. Build-Own-Operate-Transfer (BOOT) is a popular variant. Generally under BOT model, Government, concessionaire (who may be a developer/builder himself or may be independent) and the users are the parties. Risk taking and sharing ability of the parties concerned is the essence of a BOT project. Government by an agreement transfers the ‘right to use’ and/or ‘right to develop’ for a period specified, usually thirty years or near about, to the concessionaire.

Transactions involving provision of service take place usually at three different levels: firstly, between Government and the concessionaire; secondly, between concessionaire and the contractor and thirdly, between concessionaire and users.

At the first level, Government transfers the right to use and/or develop the land, to the concessionaire, for a specific period, for construction of a building for furtherance of business or commerce (partly or wholly). Consideration for this taxable service may be in the nature of upfront lease amount or annual charges paid by the concessionaire to the Government. Such services provided by the “Government” would be in the negative list entry contained in clause (a) of section 66D unless these services qualify as ‘support services provided to business entities’ under exception sub-clause (iv) to clause (a) of section 66D. ‘Support services have been defined in clause (49) of section 65B as ‘infrastructural, operational, administrative, logistic marketing or any other support of any kind comprising functions that entities carry out in the ordinary course of operations themselves but may obtain as services by outsourcing from others for any reason whatsoever and shall include advertisement and promotion, construction or works contract, renting of movable or immovable property, security, testing and analysis’. If the nature of concession is such that it amounts to ‘renting of immovable property service’ then the same would be taxable. The tax is required to be paid by the government as there is no reverse charge for services relating to renting of immovable property. In this model, though the concessionaire is undertaking construction of a building to be used wholly or partly for furtherance of business or commerce, he will not be treated as a service provider since such construction has been undertaken by him on his own account and he remains the owner of the building during the concession period. However, if an independent contractor is engaged by a concessionaire for undertaking construction for him, then service tax is payable on the construction service provided by the contractor to the concessionaire.

At the third level, the concessionaire enters into agreement with several users for commercially exploiting the building developed/constructed by him, during the lease period. For example, the user may be paying a rent or premium on the sub-lease for temporary use of immovable property or part thereof, to the concessionaire. At this third level, concessionaire is the service provider and user of the building is the service receiver. Service tax would be leviable on the taxable services provided by the concessionaire to the users if the ingredients of taxability are present.
There could be many variants of the BOT model explained above and implications of tax may differ. For example, at times it is possible that the concessionaire may outsource the management or commercial exploitation of the building developed/constructed by him to another person and may receive a pre-determined amount as commission. Such commission would be a consideration for taxable service and liable to service tax.

6.2.6 If the builder instead of receiving consideration for the sale of an apartment receives a fixed deposit, which it converts after the completion of the building into sales consideration, will it amount to receiving any amount before the completion of service.

This may be a colorable device wherein the consideration for provision of construction service is disguised as fixed deposit, which is unlikely to be returned. In any case the interest earned by the builder on such fixed deposits will be a significant amount received prior to the completion of the immovable property. As clarified at serial no. 5 of the table in point no 2.3.2 interest in such cases would be considered as part of the gross amount charged for the provision of service.

6.2.7 In certain States requirement of completion certificate are waived of for certain specified types of buildings. How would leviability of service tax be determined in such cases?

In terms of Explanation to clause (b) of section 66E in such cases the completion certificate issued by an architect or a chartered engineer or a licensed surveyor of the respective local body or development or planning authority would be treated as completion certificate for the purposes of determining chargeability of service tax.

6.2.8 If the person who has entered into a contract with the builder for a flat for which payments are to be made in 12 installments depending on the stage of construction and the person transfers his interest in the flat to a buyer after paying 7 installments, would such transfer be an activity chargeable to service tax?

Such transfer does not fall in this declared service entry as the said person is not providing any construction service. In any case transfer of such an interest would be transfer of a benefit to arise out of land which as per the definition of immoveable property given in the General Clauses Act, 1897 is part of immoveable property. Such transfer would therefore be outside the ambit of ‘service’ being a transfer of title in immoveable property.

6.8 Service portion in execution of a works contract

Works contract has been defined in section 65B of the Act as 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 moveable or immoveable property or for carrying out any other similar activity or a part thereof in relation to such property.
Typically every works contract involves an element of sale of goods and provision of service. In terms of Article 366 (29A) of the Constitution of India, transfer of property in goods involved in execution of works contract is deemed to be a sale of such goods. It is a well settled position of law, declared by the Supreme Court in BSNL's case [2006(2) STR 161 (SC)], that a works contract can be segregated into a contract of sale of goods and contract of provision of service. This declared list entry has been incorporated to capture this position of law in simple terms.

It may be pointed out that prior to insertion of clause (29A) in article 366 of the Constitution defining certain categories of transactions as 'deemed sale' of goods the position of law, as declared by the Supreme Court in Gannon Dunkerley's case (AIR1958SC560) was that a works contract was essentially a contract of service and no sales tax could be levied on goods transferred in the course of execution of works contract. It is only after the constitutional amendment that VAT or sales tax is leviable on such goods. The remaining portion of the contract remains a contract for provision of service.

Further, with a view to bring certainty and simplicity, the manner of determining the value of service portion in works contracts has been given in rule 2A of the Valuation Rules. For details on valuation please refer to point no. 8.2 of this Guide.

6.8.1 Would labour contracts in relation to a building or structure treated as a works contract?

No. Labour Contracts do not fall in the definition of works contract. It is necessary that there should be transfer of property in goods involved in the execution of such contract which is leviable to tax as sale of goods. Pure labour contracts are therefore not works contracts and would be leviable to service tax like any other service and on full value.

6.8.2 Would contracts for repair or maintenance of motor vehicles be treated as 'works contracts'? If so, how would the value be determined for ascertaining the value portion of service involved in execution of such a works contract?

Yes. Contracts for repair or maintenance of moveable properties are also works contracts if property in goods is transferred in the course of execution of such a contract. Service Tax has to be paid in the service portion of such a contract.

6.8.3 Would contracts for construction of a pipe line or conduit be covered under works contract?

Yes. As pipeline or conduits are structures on land contracts for construction of such structure would be covered under works contract.

6.8.4 Would contracts for erection commissioning or installation of plant, machinery, equipment or structures, whether prefabricated or otherwise be treated as a works contract?

Such contracts would be treated as works contracts if -

♦ Transfer of property in goods is involved in such a contract; and
The machinery equipment structures are attached or embedded to earth after erection commissioning or installation.

6.8.5. Would contracts for painting of a building, repair of a building, renovation of a building, wall tiling, flooring be covered under ‘works contract’?

Yes, if such contracts involve provision of materials as well.

6.8.6 Is the definition of ‘works contract’ in clause (54) of section 65B in line with the definition of ‘works contract’ in various State VAT laws?

The definition of ‘works contract’ in clause (54) of section 65B covers such contracts which involve transfer of property in goods and are for carrying out the activities specified in the said clause (54) in respect of both moveable and immovable properties. This is broadly in consonance with the definition of ‘works contract’ in most of the State VAT laws. However, each State has defined ‘works contracts’ differently while dealing with works contract as a category of deemed sales. There could, therefore, be variations from State to State. For service tax purposes the definition in clause (54) of section 65B would be applicable.

6.8.7 What is the way to segregate service portion in execution of a works contract from the total contract or what is the manner of determination of value of service portion involved in execution of a works contract?

For detailed discussion on this topic please refer to Guidance Note 8, in particular point no 8.2.

Negative List

4.13 Services by way of renting of residential dwelling for use as residence

‘Renting’ has been defined in section 65B as “allowing, permitting or granting access, entry, occupation, usage or any such facility, wholly or partly, in an immovable property, with or without the transfer of possession or control of the said immovable property and includes letting, leasing, licensing or other similar arrangements in respect of immovable property’.

4.13.1 What is a ‘residential dwelling’?

The phrase ‘residential dwelling’ has not been defined in the Act. It has therefore to be interpreted in terms of the normal trade parlance as per which it is any residential accommodation, but does not include hotel, motel, inn, guest house, camp-site, lodge, house boat, or like places meant for temporary stay.

4.13.2 Would renting of a residential dwelling which is for use partly as a residence and partly for non residential purpose like an office of a lawyer or the clinic of a doctor be covered under this entry?

This would also be a case of bundled services as renting service is being provided both for residential use and for non residential use. Taxability of such bundled services has to be determined in terms of the principles laid down in section...
4.13.3 Would the nature of renting transactions explained in column 1 of the table below be covered in this negative list entry?

<table>
<thead>
<tr>
<th>If</th>
<th>Then</th>
</tr>
</thead>
<tbody>
<tr>
<td>(i) a residential house taken on rent is used only or predominantly for commercial or non-residential use.</td>
<td>the renting transaction is not covered in this negative list entry.</td>
</tr>
<tr>
<td>(ii) if a house is given on rent and the same is used as a hotel or a lodge</td>
<td>the renting transaction is not covered in this negative list entry because the person taking it on rent is using it for a commercial purpose.</td>
</tr>
<tr>
<td>(iii) rooms in a hotel or a lodge are let out whether or not for temporary stay</td>
<td>the renting transaction is not covered in this negative list entry because a hotel or a lodge is not a residential dwelling.</td>
</tr>
<tr>
<td>(iv) government department allots houses to its employees and charges a license fee</td>
<td>such service would be covered in the negative list entry relating to services provided by government and hence non-taxable.</td>
</tr>
<tr>
<td>(v) furnished flats given on rent for temporary stay (a few days)</td>
<td>such renting as residential dwelling for the bonafide use of a person or his family for a reasonable period shall be residential use; but if the same is given for a short stay for different persons over a period of time the same would be liable to tax.</td>
</tr>
</tbody>
</table>

Mega Exemption

7.5 Religious places/ceremonies (Details at Sr. No. 5 of Exhibit A3)

7.5.1 Is renting of precincts of a religious place taxable?

Yes. However, exemption is available only if the place is meant for general public. General public is also defined in the mega notification 25/2012-ST as the body of people at large sufficiently defined by some common quality of public or impersonal nature.

7.5.2 Am I liable to pay service tax for conducting religious ceremonies for my client?
No. Conduct of religious ceremonies is exempt under Sr. no. 4 of mega exemption. Religious ceremonies are life-cycle rituals including special religious poojas conducted in terms of religious texts by a person so authorized by such religious texts. Occasions like birth, marriage, and death involve elaborate religious ceremonies.

7.9 Construction (Details at Sr No 12 to 14 of Exhibit A3)

7.9.1 Which are the construction services exempted when provided to the Government, a local authority or a governmental authority?

Exemption is available to the services by way of construction, erection, commissioning, installation, completion, fitting out, repair, maintenance, renovation, or alteration of:

A. a civil structure or any other original works meant predominantly for use other than for commerce, industry, or any other business or profession

B. a historical monument, archaeological site or remains of national importance, archaeological excavation, or antiquity specified under Ancient Monuments and Archaeological Sites and Remains Act, 1958

C. a structure meant predominantly for use as (i) an educational, (ii) a clinical, or (iii) an art or cultural establishment

D. canal, dam or other irrigation works

E. pipeline, conduit or plant for (i) water supply (ii) water treatment, or (iii) sewerage treatment or disposal

F. a residential complex predominantly meant for self-use or the use of their employees or other persons specified in the of a religious building

7.9.2 What is the significance of words predominantly for use other than for commerce, industry, or any other business or profession?

The exemption is available for a civil structure or any other original works meant predominantly for use other than for commerce, industry, or any other business or profession. The significance of the word predominantly is that benefit of exemption will not be denied if the building is also incidentally used for some other purposes if it is used primarily for commerce, industry, or any other business or profession.

7.9.3 I am a contractor in number of projects for constructing roads. What is my tax liability on construction of roads under different types of projects?

Construction of roads for use by general public is exempt from service tax. Construction of roads which are not for general public use e.g. construction of roads in a factory, residential complex would be taxable.

7.9.4 I am engaged in construction of hospitals and educational institutes. Am I required to pay service tax?
If you are constructing such structures for the government, a local authority or a governmental authority, you are not required to pay service tax. If you are constructing for others, you are required to pay tax.

7.9.5 What is the service tax liability on construction of a religious building?

Service tax is exempt on construction of a building owned by an entity registered under section 12 AA of the Income tax Act, 1961 and meant predominantly for religious use by general public.

7.9.6 I am constructing a residential complex for my client. The houses are predominantly meant for self-use or the use of the employees. Am I required to pay service tax?

If your client is other than the Government, a local authority or a governmental authority, you are required to pay service tax. However, exemption is available for services provided to the Government, a local authority or a governmental authority by way of construction of a residential complex predominantly meant for self-use or the use of their employees or other persons specified in the Explanation 1 to clause 44 of section 65 B of the said Act.

7.9.7 What is the service tax liability on construction of two – floor house constructed through a contractor? My contractor is demanding service tax. Is he right in doing so?

Service tax is payable on construction of a residential complex having more than one single residential unit. Single residential unit is defined in the notification and means a self-contained residential unit which is designed for use, wholly or principally, for residential purposes for one family. If each of the floors of your house is a single residential unit in terms of the definition, the contractor is rightly demanding service tax. If the title of each of floors is capable of being transferred to another person by mutation in land/ municipal records, both the floors may be considered as separate single residential units.

7.9.8 Are repair, maintenance of airports, ports and railways liable to tax?

Yes. They are liable to service tax and the same will be available as input tax credit to railways, port or airport authority, if other conditions are met.

7.9.9 I am setting up a wheat flour mill. The supplier of machines is demanding service tax on erection and installation of machineries and equipments in the flour mill. Is he is right in demanding service tax?

There is no service tax liability on erection or installation of machineries or equipments for units processing agricultural produce as food stuff excluding alcoholic beverages. You are processing wheat which is made from processing an agricultural produce. Similarly erection or installation of machineries or equipment for dal mills, rice mills, milk dairies or cotton ginning mills would be exempt.

7.11.10 What is the tax liability on services by the intermediaries to entities those are liable to pay tax on their final output services? (Details at Sr. No 29 of Exhibit A3)
Services by following intermediaries are exempt from service tax:

A. sub-broker or an authorised person to a stock broker;
B. authorised person to a member of a commodity exchange;
C. mutual fund agent to a mutual fund or asset management company;
D. distributor to a mutual fund or asset management company;
E. selling or marketing agent of lottery tickets to a distributor or a selling agent;
F. selling agent or a distributor of SIM cards or recharge coupon vouchers;
G. business facilitator or a business correspondent to a banking company or an insurance company in a rural area; or
H. sub-contractor providing services by way of works contract to another contractor providing works contract services which are exempt;

7.11.11 Whether the exemption provided in the mega-exemption to services by way of construction of roads, airports, railways, transport terminals, bridges, tunnels, dams etc., is also available to the sub-contractors who provide input service to these main contractors in relation to such construction?

As per clause (1) of section 66F reference to a service by nature or description in the Act will not include reference to a service used for providing such service. Therefore, if any person is providing services, in respect of projects involving construction of roads, airports, railways, transport terminals, bridges, tunnels, dams etc., such as architect service, consulting engineer service etc., which are used by the contractor in relation to such construction, the benefit of the specified entries in the mega-exemption would not be available to such persons unless the activities carried out by the sub-contractor independently and by itself falls in the ambit of the exemption.

It has to be appreciated that the wordings used in the exemption are ‘services by way of construction of roads etc’ and not ‘services in relation to construction of roads etc’. It is thus apparent that just because the main contractor is providing the service by way of construction of roads, airports, railways, transport terminals, bridges, tunnels, dams etc., it would not automatically lead to the classification of services being provided by the sub-contractor to the contractor as an exempt service.

However, a sub-contractor providing services by way of works contract to the main contractor, providing exempt works contract services, has been exempted from service tax under the mega exemption if the main contractor is engaged in providing exempt services of works contracts. It may be noted that the exemption is available to sub-contractors engaged in works contracts and not to other outsourced services such as architect or consultants.

Guidance Note 9 – Rules of Interpretation
Despite doing away with the service-specific descriptions, there will be some descriptions where some differential treatment will be available to a service or a class of services. Section 66F lays down the principles of interpretation of specified descriptions of services and bundled services. These are explained in paras below-

9.1 Principles for interpretation of specified descriptions of services

Although the negative list approach largely obviates the need for descriptions of services, such descriptions continue to exist in the following areas -

♦ In the negative list of services.
♦ In the declared list of services.
♦ In exemption notifications.
♦ In the Place of Provision of Service Rules, 2012
♦ In a few other rules and notifications e.g. Cenvat Credit Rules, 2004.

There are two principles laid down which are contained in clauses (1) and (2) of section 66F of the Act.

9.1.1 What is the scope of the clause (1) of section 66F: ‘Unless otherwise specified, reference to a service (hereinafter referred to as the “main service”) shall not include reference to a service which is used for providing the main service’

This rule can be best understood with a few illustrations which are given below -

♦ ‘Provision of access to any road or bridge on payment of toll’ is a specified entry in the negative list in section 66D of the Act. Any service provided in relation to collection of tolls or for security of a toll road would be in the nature of service used for providing such specified service and will not be entitled to the benefit of the negative list entry.

♦ Transportation of goods on an inland waterway is a specified entry in the negative list in section 66D of the Act. Services provided by an agent to book such transportation of goods on inland waterways or to facilitate such transportation would not be entitled to the negative list entry.

9.1.2 What is the scope of clause (1) of section 66F: ‘where a service is capable of differential treatment for any purpose based on its description, the most specific description shall be preferred over a more general description’.

This rule can also be best understood with some illustrations which are given below -

♦ The services provided by a real estate agent are in the nature of intermediary services relating to immovable property. As per the Place of Provision of Service Rule, 2012, the place of provision of services provided in relation to immovable
property is the location of the immovable property. However in terms of the rule 5 pertaining to services provided by an intermediary the place of provision of service is where the intermediary is located. Since Rule 5 provides a specific description of ‘estate agent’, the same shall prevail.

♦ Pandal and Shamiana is an existing service and will remain a subject of taxation. Likewise service provided by way of catering is a taxable service and entitled to abatement. There is abatement when the two are provided in combination. Since the combination is more a specific entry than the two provided individually, there is no need to apply the later rule of bundled services, where the character could be judged by the service which provides it the essential character.

9.2 Taxability of ‘bundled services’.

‘Bundled service’ means a bundle of provision of various services wherein an element of provision of one service is combined with an element or elements of provision of any other service or services. An example of ‘bundled service’ would be air transport services provided by airlines wherein an element of transportation of passenger by air is combined with an element of provision of catering service on board. Each service involves differential treatment as a manner of determination of value of two services for the purpose of charging service tax is different.

Two rules have been prescribed for determining the taxability of such services in clause (3) of section 66F of the Act. These rules, which are explained below, are subject to the provisions of the rule contained in sub section (2) of section 66F, viz a specific description will be preferred over a general description as explained in para 7.1.2 above.

9.2.1 Services which are naturally bundled in the ordinary course of business

The rule is – ‘If various elements of a bundled service are naturally bundled in the ordinary course of business, it shall be treated as provision of a single service which gives such bundle its essential character’

Illustrations-

♦ (A hotel) provides a 4-D/3-N package with the facility of breakfast. This is a natural bundling of services in the ordinary course of business. The service of hotel accommodation gives the bundle the essential character and would, therefore, be treated as service of providing hotel accommodation.

♦ A 5 star hotel is booked for a conference of 100 delegates on a lump sum package with the following facilities:

  • Accommodation for the delegates
  • Breakfast for the delegates,
  • Tea and coffee during conference
  • Access to fitness room for the delegates
  • Availability of conference room
As is evident a bouquet of services is being provided, many of them chargeable to different effective rates of tax. None of the individual constituents are able to provide the essential character of the service. However, if the service is described as convention service it is able to capture the entire essence of the package. Thus the service may be judged as convention service and chargeable to full rate. However it will be fully justifiable for the hotel to charge individually for the services as long as there is no attempt to offload the value of one service on to another service that is chargeable at a concessional rate.

9.2.2 Services which are not naturally bundled in the ordinary course of business

The rule is – ‘If various elements of a bundled service are not naturally bundled in the ordinary course of business, it shall be treated as provision of a service which attracts the highest amount of service tax.’

Illustrations -

♦ A house is given on rent one floor of which is to be used as residence and the other for housing a printing press. Such renting for two different purposes is not naturally bundled in the ordinary course of business. Therefore, if a single rent deed is executed it will be treated as a service comprising entirely of such service which attracts highest liability of service tax. In this case renting for use as residence is a negative list service while renting for non-residence use is chargeable to tax. Since the latter category attracts highest liability of service tax amongst the two services bundled together, the entire bundle would be treated as renting of commercial property.

9.2.3 Significance of the condition that the rule relating to ‘bundled service’ is subject to the provisions of sub-section (2) of section 66F.

Sub-section (2) of section 66 lays down: ‘where a service is capable of differential treatment for any purpose based on its description, the most specific description shall be preferred over a more general description’ (refer para 7.1.2 above). This rule predominates over the rule laid down in sub-section (3) relating to ‘bundled services’. In other words, if a bundled service falls under a service specified by way of a description then such service would be covered by the description so specified. The illustration, relating to a bundled service wherein a pandal and shamiana is provided in combination with catering service, given in the second bullet in para 7.1.2 above explains the operation of this rule.

9.2.4 Manner of determining if the services are bundled in the ordinary course of business

Whether services are bundled in the ordinary course of business would depend upon the normal or frequent practices followed in the area of business to which services relate. Such normal and frequent practices adopted in a business can be ascertained from several indicators some of which are listed below -

♦ The perception of the consumer or the service receiver. If large number of service receivers of such bundle of services reasonably expect such services to be provided as a package then such a package could be treated as naturally bundled
in the ordinary course of business.

♦ Majority of service providers in a particular area of business provide similar bundle of services. For example, bundle of catering on board and transport by air is a bundle offered by a majority of airlines.

♦ The nature of the various services in a bundle of services will also help in determining whether the services are bundled in the ordinary course of business. If the nature of services is such that one of the services is the main service and the other services combined with such service are in the nature of incidental or ancillary services which help in better enjoyment of a main service. For example service of stay in a hotel is often combined with a service or laundering of 3-4 items of clothing free of cost per day. Such service is an ancillary service to the provision of hotel accommodation and the resultant package would be treated as services naturally bundled in the ordinary course of business.

♦ Other illustrative indicators, not determinative but indicative of bundling of services in ordinary course of business are -
  • There is a single price or the customer pays the same amount, no matter how much of the package they actually receive or use.
  • The elements are normally advertised as a package.
  • The different elements are not available separately.
  • The different elements are integral to one overall supply – if one or more is removed, the nature of the supply would be affected.

No straight jacket formula can be laid down to determine whether a service is naturally bundled in the ordinary course of business. Each case has to be individually examined in the backdrop of several factors some of which are outlined above.

9.2.5 Manner of determination of taxability of ‘composite transactions’ wherein an element of provision of service is combined with an element of sale of goods

Please refer to point no 2.6.3 of this Guidance Note.

Valuation

With the introduction of system of taxation of services based on the negative list there has been no fundamental change in the manner of valuation of service for the purpose of payment of service tax. The broad scheme remains the same barring some marginal changes carried out to align the scheme of valuation of taxable services and the Service Tax (Determination of Value) Rules, 2006 with the new system of taxation. Broadly these changes in the Valuation Rules are as follows:-

♦ As compared to the existing two schemes for valuation of works contract services - one under the rule 2A of the Valuation Rules and second under the Works Contract (Composition Scheme for Payment of Service Tax) Rules 2007 has
been replaced with a unified scheme under the new rule 2A of Service Tax (Determination of Value) Rules, 2006.

♦ There are certain changes in rule 6 of the Service Tax (Determination of Value) Rules, 2006.

♦ All notifications that prescribed the abatements for working out the taxable value from the gross amount charged have been merged into one single exemption notification i.e., notification no. 26/2012- ST dated 20/6/12.

The broad scheme of valuation and provisions of Valuation Rules have been explained through a set of examples, questions and answers below.

8.1. Broad Scheme of Valuation.

8.1.1 How is value of service relevant for the purpose of payment of service tax?

In terms of the charging provisions contained in Section 66B, service tax is levied @ 12% on the value of taxable services. Therefore, value of service provided is relevant for determining the amount of service tax payable when a taxable service is provided by a person to another.

8.1.2 What is the value on which service tax is to be paid?

The manner of value of service is provided in Section 67. As per sub-section (1) of Section 67 wherever Service Tax is chargeable on any taxable service with regard to its value then its value shall-

(i) in a case where the provision of service is for a consideration in money, be the gross amount charged by the service provider for such service provided or to be provided by him;

(ii) in a case where the provision of service is for a consideration not wholly or partly consisting of money, be such amount in money as, with the addition of service tax charged, is equivalent to the consideration;

(iii) in a case where the provision of service is for a consideration which is not ascertainable, be the amount as may be determined in the prescribed manner.

8.1.3 If the gross amount charged is inclusive of service tax payable then would service tax be chargeable on the gross amount?

No. As per sub-section (2) of section 67 where the gross amount chargeable by the service provider is inclusive of service tax payable then the value of such taxable service shall be such amount as, with the addition of such tax payable, is equal to the gross amount charged. For example if the gross amount charged for provision of service is Rs.1500 then the value of taxable service would be Rs. 1339.29 (1500 x 100/112) as after including the tax payable at Rs. 1339.29 @ 12% (which works out to Rs. 160.71) the total amount (1339.29 + 160.71) comes to Rs.1500.

8.1.4 Is it necessary that gross amount charged should have been received by the service provider prior to provision of service?
No. As per sub-section (3) of Section 67 the gross amount charged includes any amount received towards the taxable service before during or after the provision of such service.

8.1.5 What is the meaning of 'consideration' referred to in sub clause (1) Section 67?

The concept of consideration comes from the very root of the definition of service contained in clause (44) of section 65B as per which service has been defined as an activity carried out by a person for another 'for consideration'.

For detailed discussion on consideration please refer to Point 2.2 of this Guide. The consideration could be monetary or non-monetary.

8.1.6 If provision of service is for the consideration for money then what will be the manner of determining the value of taxable service?

In terms of clause (i) of sub-section (1) of Section 67 in case provision of service is for consideration in money, then the value of taxable service shall be the gross amount charged by the service provider for such service provided or agreed to be provided by him.

8.1.7 What is the meaning of 'gross amount charged'?

'Gross amount charged' has been defined in Explanation (c) of Section 67 to include 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 account” or by any other name, in the books of account of a person liable to pay service tax, where the transaction of taxable service is with any associated enterprise.

8.1.8 What is the manner of determining the value of non-monetary consideration?

As per clause (ii) of sub-section (1) of section 67 of the Act where the consideration received is not wholly or partly consisting of money the value of taxable service shall be the equivalent money value of such consideration. If the same is not ascertainable then the value of such consideration is determined under clause (iii) of section 67 read with rule 3 of the Service Tax (Determination of the value) Rules 2006 as follows:-

♦ On the basis of gross amount charged for similar service provided to other person in the ordinary course of trade;

♦ Where value cannot be so determined, the equivalent money value of such consideration, not less than the cost of provision of service.

8.1.9. As per clause (iii) of sub-section (1) of Section 67 in cases where provision of service is for a consideration which is not ascertainable then the value of taxable service shall be the amount as it may be determined in the prescribed manner. What are the situations where consideration is not ascertainable and what is the manner for determining the value in such cases are prescribed?
There may be several situations wherein it may be difficult to determine the consideration received by service provider for provision of a service. Such situations can arise on account of several factors such as consideration of service being embedded in the total amount received as consideration for a composite activity involving elements of provisions of service and element of sale of goods or consideration for service being included in the gross amount charged for a particular transaction or consideration of service being wholly or partly in the nature of non-monetary consideration.

The manner has been prescribed under Service Tax (Determination of Value) Rules 2006. These rules inter-alia provide provisions in respect of the following situations:

♦ Determination of value of service portion involved in execution of works contract.

♦ Determination of value of service in relation to money changing.

♦ Determination of value of service portion involved in supply of food and any other article of human consumption or any drinks in a restaurant or as outdoor catering.

♦ Determination of value where such value is not ascertainable.

♦ The said rules also specify certain expenditures or costs that are incurred by the service provider which have to be included or excluded.

♦ The said rules also specify certain commissions or costs that are received by the service provider that have to be included or excluded while arriving at the taxable value.

In addition to the Service Tax (Determination of Value) Rules 2006, certain sub-rules in rule 6 of the Service Tax Rules, 1994 also provide simplified compounded mechanism for determination of value of taxable services in specified situations.

These specified aspects of determination of value under the Service Tax (Determination of Value) Rules 2006 and the Service Tax Rules, 1994 have been dealt individually with in point nos. 8.2 to 8.7 below.

8.1.10 In addition to the two set of rules explained in point no 8.1.9 above, that have a bearing on the valuation of services, are there any exemption notifications that exempt certain portion of the gross amount charged from levy of service tax or in other words provide for abatements to arrive at the value of taxable services?

Yes. Earlier there were a number of exemption notifications that prescribed the abatements for various categories of services. As another measure of simplification now all such abatements for specified category of services have been merged into a single notification no 26/2102 – ST dated 20/6/12 which has been dealt with in point no. 8.8 below.

8.2 Valuation of service portion in execution of a works contract
Works contract has been defined in clause (54) of section 65B of the Act. Typically every works contract involves an element of sale of goods and provision of service. It is a well settled position of law, declared by the Supreme Court in BSNL’s case [2006(2) STR 161 (SC)], that a works contract can be segregated into a contract of sale of goods and contract of provision of service. With a view to bring certainty and simplicity the manner of determining the value of service portion in works contracts has been provided in Rule 2A of the Service Tax (Determination of Value) Rules, 2006. In order to align this rule with the new system of taxation of services based on the negative list the old Rule 2A has been replaced by a new rule by the Service Tax (Determination of Value) Second Amendment Rules, 2012. The new provisions have been explained in this note

8.2.1 What is the manner of determination of value of service portion in execution of a works contract from the total contract?

The manner for determining the value of service portion of a works contract from the total works contract is given in Rule 2A of the Service Tax (Determination of Value) Rules, 2006. As per sub-rule (i) of the said Rule 2A the value of the service portion in the execution of a works contract is 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.

<table>
<thead>
<tr>
<th>Gross amount includes</th>
<th>Gross amount does not include</th>
</tr>
</thead>
<tbody>
<tr>
<td>Labour charges for execution of the works</td>
<td>Value of transfer of property in goods involved in the execution of the said works contract.</td>
</tr>
<tr>
<td>Amount paid to a subcontractor for labour and services</td>
<td>Note: As per Explanation (c) to the said sub-rule (i), where value added tax or sales tax has been paid or payable on the actual value of property in goods transferred in the execution of the works contract, then such value adopted for the purposes of payment of value added tax or sales tax, shall be taken as the value of property in goods transferred in the execution of the said works contract.</td>
</tr>
<tr>
<td>Charges for planning, designing and architect’s fees</td>
<td></td>
</tr>
<tr>
<td>Charges for obtaining on hire or otherwise, machinery and tools used for the execution of the works contract</td>
<td></td>
</tr>
<tr>
<td>Cost of consumables such as water, electricity, fuel, used in the execution of the works contract</td>
<td></td>
</tr>
</tbody>
</table>
Cost of establishment of the contractor relatable to supply of labour and services and other similar expenses relatable to supply of labour and services

Value Added Tax (VAT) or sales tax, as the case may be, paid, if any, on transfer of property in goods involved in the execution of the said works contract.

Profit earned by the service provider relatable to supply of labour and services

8.2.2. Is there any simplified scheme for determining the value of service portion in a works contract?

Yes. The scheme is contained in the clause (ii) of rule 2A of the Service Tax (Determination of Value) Rules, 2006.

As per this scheme the value of the service portion, where value has not been determined in the manner as provided in clause (i) of rule 2A (explained in point 8.2.1 above), shall be determined in the manner explained in the table below:

<table>
<thead>
<tr>
<th>Where works contract is for...</th>
<th>Value of the service portion shall be...</th>
</tr>
</thead>
<tbody>
<tr>
<td>(A) execution of original works</td>
<td>forty percent of the total amount charged for the works contract</td>
</tr>
<tr>
<td>(B) maintenance or repair or reconditioning or restoration or servicing of any goods</td>
<td>seventy per cent of the total amount charged including such gross amount</td>
</tr>
<tr>
<td>(C) in case of other works contracts, not included in serial nos. (A) and (B) above, including contracts for maintenance, repair, completion and finishing services such as glazing, plastering, floor and wall tiling, installation of electrical fittings.</td>
<td>sixty percent of the total amount charged for the works contract</td>
</tr>
</tbody>
</table>

Important: As per the Explanation (II) to clause (ii) of rule 2A of the said Rules, ‘total amount’ referred to in the second column of the table above would be the sum total of gross amount charged for the works contract and the fair market value of all goods and services supplied in or in relation to the execution of works contract, under the same contract or any other contract, less (i) the amount charged for such goods or services provided by the service receiver; and (ii) the value added tax or sales tax, if any, levied to the extent they form part of the gross amount or the total amount, as the case may be.
8.2.3 How is the fair market value of goods or services, so supplied, be determined to arrive at the total amount charged for a works contract?

As per the proviso to Explanation (II) to clause (ii) of rule 2A of the Valuation Rules the fair market value of the goods or services so supplied shall be determined in accordance with the generally accepted accounting principles.

8.2.4 What are “original works”?

As per Explanation (I) to clause (ii) of rule 2A of the Valuation Rules ‘Original works’ means:

♦ 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 pre-fabricated or otherwise.

8.2.5 Can the manner of determination of ‘total amount charged’ be explained by way of a suitable example?

The manner of arriving at the ‘total amount charged’ is explained with the help of the following example pertaining to works contract for execution of ‘original works’.

<table>
<thead>
<tr>
<th>S. No.</th>
<th>NOTATION</th>
<th>AMOUNT (in Rs.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Gross amount received excluding taxes</td>
<td>95,00,000</td>
</tr>
<tr>
<td>2</td>
<td>Fair market value of goods supplied by the service receiver excluding taxes</td>
<td>10,00,000</td>
</tr>
<tr>
<td>3</td>
<td>Amount charged by service receiver for</td>
<td>25,00,000</td>
</tr>
<tr>
<td>4</td>
<td>Total amount charged (1 +2-3)</td>
<td>1,00,00,000</td>
</tr>
<tr>
<td>5</td>
<td>Value of service portion(40% of 4 in case of original works)</td>
<td>40,00,000</td>
</tr>
</tbody>
</table>

Note: When the service provider pays partially or fully for the materials supplied by the service receiver, gross amount charged would inevitably go higher by that much amount.

8.5 Inclusion or exclusion from value of certain expenditure or costs borne by the service provider.

Rule 5 of Service Tax (Determination of Value) Rules, 2012 lays down the details of expenditure and cost borne by the service provider which have to be included or excluded while determining the value of taxable service.
8.5.1 What is the expenditure or costs that are to be included in the value of taxable services as per rule 5 of the Valuation Rules?

As per Rule 5 any expenditure or cost that are incurred by the service provider in the course of providing taxable services are treated as consideration for taxable service provided or agreed to be provided and shall be included in the value for the purpose of charging Service Tax on the said service.

However, Explanation to sub-rule (1) of Rule 5 clarifies that for the value of telecommunication services shall be the gross amount paid by the person to whom the service is actually provided (i.e. the subscriber).

8.5.2 Which costs or expenditure is to be excluded from the value of taxable service as per Rule 5?

As per sub rule (2) of Rule 5 the expenditure or cost incurred by the service provider as a pure agent of the recipient of the service shall be excluded from the value of taxable service if all the following conditions are satisfied:

♦ the service provider acts as a pure agent of the recipient of service when he makes payment to third party for the goods or services procured;

♦ the recipient of service receives and uses the goods or services so procured by the service provider in his capacity as pure agent of the recipient of service;

♦ the recipient of service is liable to make payment to the third party;

♦ the recipient of service authorises the service provider to make payment on his behalf;

♦ the recipient of service knows that the goods and services for which payment has been made by the service provider shall be provided by the third party;

♦ the payment made by the service provider on behalf of the recipient of service has been separately indicated in the invoice issued by the service provider to the recipient of service;

♦ the service provider recovers from the recipient of service only such amount as has been paid by him to the third party;

and

♦ the goods or services procured by the service provider from the third party as a pure agent of the recipient of service are in addition to the services he provides on his own account.

8.5.3 What is the meaning of pure agent?

Pure agent has been defined in Explanation to sub-rule 2 of Rule (5) of the Valuation Rules as a person who-

♦ enters into a contractual agreement with the recipient of service to act as his pure agent to incur expenditure or costs in the course of providing taxable service;
♦ neither intends to hold nor holds any title to the goods or services so procured or provided as pure agent of the recipient of service;

♦ does not use such goods or services so procured; and

♦ receives only the actual amount incurred to procure such goods or services.

8.6 Cases in which commission, costs etc. received by the service provider will be included or excluded.

Rule 6 of the Valuation Rules deals with specific situation where certain commission or costs received by the service provider would be included as part of the taxable service.

INCLUSIONS

♦ the commission or brokerage charged by a broker on the sale or purchase of securities including the commission or brokerage paid by the stock-broker to any sub-broker;

♦ the adjustments made by the telegraph authority from any deposits made by the subscriber at the time of application for telephone connection or pager or facsimile or telegraph or telex or for leased circuit;

♦ the amount of premium charged by the insurer from the policy holder;

♦ the commission received by the air travel agent from the airline;

♦ the commission, fee or any other sum received by an actuary, or intermediary or insurance intermediary or insurance agent from the insurer;

♦ the reimbursement received by the authorised service station, from manufacturer for carrying out any service of any motor car, light motor vehicle or two wheeled motor vehicle manufactured by such manufacturer;

♦ the commission or any amount received by the rail travel agent from the Railways or the customer;

♦ the remuneration or commission, by whatever name called, paid to such agent by the client engaging such agent for the services provided by a clearing and forwarding agent to a client rendering services of clearing and forwarding operations in any manner;

♦ the commission, fee or any other sum, by whatever name called, paid to such agent by the insurer appointing such agent in relation to insurance auxiliary services provided by an insurance agent; and

♦ the amount realized as demurrage or by any other name whatever called for the provision of service beyond the period originally contracted or in any other manner relatable to the provision of service.

EXCLUSIONS
♦ initial deposit made by the subscriber at the time of application for telephone connection or pager or facsimile (FAX) or telegraph or telex or for leased circuit;

♦ the airfare collected by air travel agent in respect of service provided by him;

♦ the rail fare collected by [rail travel agent] in respect of service provided by him;

♦ interest on delayed payment of any consideration for the provision of services or sale of property, whether moveable or immovable;

♦ the taxes levied by any Government on any passenger travelling by air, if shown separately on the ticket, or the invoice for such ticket, issued to the passenger;

♦ **accidental damages due to unforeseen action not relatable to the provision of service;**

♦ **subsidies or grants disbursed by the Government, not in the nature of directly influencing the value of service.**

(italics indicate the additions made in the Service Tax (Determination of Value) Second Amendment, Rules, 2012)

**8.6.1. Does the interest for delayed payment for provision of a service includable in the taxable value?**

No. In terms of clause (iv) of Sub-rule 2 of Rule 6 delayed payments of any consideration for provision of service is excluded from the value of taxable service.

**8.6.2. What is the scope of the exclusion entry related to accidental damages due to unforeseen actions not relatable to the provisions of service?**

This inclusion has been inserted vide the Serviced Tax (Determination of Value) Second Amendment Rules, 2012. In terms of this exclusion accidental damages are not to be included in the value of service provided the following two conditions are specified:

♦ The damages are due to unforeseen actions.

♦ The damages are not related to provisions of service.

**Examples-**

♦ Insurance Companies provide insurance services to the clients for which the premium is charged. The premium charged is a consideration for the insurance service provided. However, in case due to an unforeseen action ,like an accident etc., a compensation is paid by the insurance company to the client then the money would not be included as part of value of taxable service as it is not relatable to the provisions of service but is only in the nature of consequence of provisions of insurance service.
In case a landlord who has rented out his office building to a tenant receives compensation from the tenant for the damage caused to the building by an unforeseen action then such compensation would not form part of the value of taxable service related to tenant of his building as an unforeseen damage caused by the tenant is not relatable to provision of service of renting of the office building.

8.6.3. What is the scope of the exclusion entry relating to subsidies and grants disbursed by the Government, not in the nature or directly influencing the value of service?

This exclusion entry has also been inserted by the Service Tax (Determination of Value) Second Amendment Rules, 2012. A subsidy influences the price directly when the price goes down proportionately to the amount of subsidy. In terms of this exclusion any subsidy or grant disbursed by the Government cannot form part of the value of taxable service unless such subsidy or grant directly influences the value of such service.

8.8 Notified abatements for determining the taxable value.

All abatements available to services of specified categories have now been merged in one exemption notification no 26/2012-ST dated 20/6/12. In terms of the said notification, exemption is granted from so much of the service tax leviable, as is in excess of the service tax calculated on a value which is equivalent to a percentage specified in the corresponding entry in column (3) of the following Table, of the amount charged (or in some cases of specified amount) by such service provider for providing the said taxable service, unless specified otherwise, subject to the relevant conditions specified in the corresponding entry in column (4) of the said Table:

<table>
<thead>
<tr>
<th>Sl. No.</th>
<th>Description of taxable service</th>
<th>%</th>
<th>Conditions</th>
</tr>
</thead>
<tbody>
<tr>
<td>12.</td>
<td>Construction of a complex, building, civil structure or a part thereof, intended for a sale to a buyer, wholly or partly except where entire consideration is received after issuance of completion certificate by the competent authority</td>
<td>25</td>
<td>(i) CENVAT credit on inputs used for providing the taxable service has not been taken under the provisions of the CENVAT Credit Rules, 2004. (ii)The value of land is included in the amount charged from the service recipient.</td>
</tr>
</tbody>
</table>

1.10 Transition under Service tax for Construction Contracts

In order to understand the transition options available, we first have to note the various options which existed prior to 01.07.2012 and the options available post 01.07.2012.

Valuation Alternatives under the old law .ie. prior to 01.07.2012:
Option-1: Abatement scheme:

This scheme has been provided to service providers who are engaged in the provision of ‘Commercial or Industrial Construction’ and ‘Construction of Complex’. The following alternatives are available for discharging service tax:

Situation A: This is applicable when the gross amount charged includes the value of goods supplied along with the provision of the service. However, the same shall not include the value of land. Then the service tax is payable on 33% of gross amount charged. This is notified vide Notification No. 1/2006-ST dated 01.03.2006 on a condition that cenvat credit of inputs, input services and capital goods is not allowed.

Situation B: This is applicable when the gross amount charged includes the value of goods supplied along with provision of service and also includes the value of land. Then service tax is payable on 25% of such gross amount charged. This is notified vide Notification No. 1/2006-ST dated 01.03.2006 on a condition that cenvat credit of inputs, input services and capital goods is not allowed.

Situation C: This is applicable only if the service provider engaged in providing the completion and finished services. There is no abatement specified and hence liable at full rate.

Option-2:

Composition scheme:

This scheme is applicable only if the service provided falls under the definition of ‘works contract’ and has made a declaration to the authorities for opting payment of service tax vide this scheme before making the first payment. Once the declaration is made he can remit the service tax under this scheme.

Situation D: This is more apt when the material portion transferred along with the service provided cannot be reckoned. In such a case, the service provider can remit the service tax at 4% + cesses on the gross amount charged, which shall include the value of goods/materials. The free supply of the goods and services received from service receiver shall also stand to be included in gross amount charged from contracts entered post 07.07.09. The service provider is eligible for claiming cenvat credit on duty paid on input services and capital goods except inputs.

Option- 3:

Valuation under Rule 2A of the Service Tax (Determination of Value) Rules, 2006:

Situation E: The service provider can pay service tax on the labour portion at full rate after adopting the process laid under Rule 2A. This is more relevant if the service provider knows the value of the transfer of property in goods involved while execution of works contract. The gross amount charged will be equal to amount charged for works contract minus the value of property in goods involved and VAT. However, it also specifies certain other items which are to be included
for arriving the gross amount charged. However, the rule is silent about availment of cenvat credit of inputs, input services and capital goods.

Valuation alternatives under the new law i.e after 01.07.2012:

The ‘Works Contract’ has been defined under the new law to include such contracts where transfer of property in goods involved along with services pertaining to the movable properties. The service portion involved in execution of works contract service is declared to be a service under Section 66E of Finance Act.

Option-1:

Valuation under Rule 2A of the Service Tax (Determination of Value) Rules, 2006:

Situation A- New: The service provider can pay service tax on the labour portion at full rate after adopting the process laid under Rule 2A. This is more relevant if the service provider knows the value of the transfer of property in goods involved while execution of works contract. The gross amount charged will be equal to amount charged for works contract minus the value of property in goods involved and VAT. However, it also specifies certain other items which are to be included for arriving the gross amount charged. The only difference being that cenvat credit on inputs is specifically disallowed under the new law and however the credit of input services and capital goods are allowed.

Situation B - New: If the service provider is unable to reckon the value of as provided in the manner as per Rule 2A, then he shall be liable to pay service tax in the following manner:

Works contract for executed:

a. for original works – 40% of the total amount charged for works contract

b. for maintenance and repair or reconditioning or restoration or servicing of any goods – 70% of total amount charged for works contract

c. any other work not covered above including maintenance, repair, completion and finishing service such as glazing, plastering, floor and wall tiling, installation of electrical fitting of an immovable property – 60% of total amount charged for works contract.

Cenvat credit on inputs is restricted but the service provider can avail the credit of input services and capital goods.

Note:

1. For this purpose “original works means -

a. All new constructions,
b. all types of additions and alterations to abandoned or damaged structures on land that are required to make them workable,

c. Erection, commissioning or installation of plant, machinery or equipment or structures, whether pre-fabricated or otherwise.

2. 'Total Amount' means the sum total of the gross amount charged for the works contract and the fair market value of all goods and services supplied in or in relation to the execution of works contract, whether or not supplied under the same contract or any other contract after deducting the amount charged for such goods or services, if any and VAT, if any levied thereon. Fair market value of goods and services shall be determined in accordance with generally accepted accounting principles.

Option -2:

Valuation of service portion involved in construction of complex, building, civil structure or a part thereof vide Entry No: 26/2012-ST dated 20.06.2012:

Situation – C New: This is the case where service provider has engaged in construction of complex, building, civil structure or a part thereof, intended for a sale to a buyer, wholly or partly except where entire consideration is received after issuance of completion certificate by the competent authority. The service portion in such a contract is deemed as 25% of the total amount charged on condition that value of land is included in such total amount.

Explanation:

The amount charged shall be the sum total of the amount for the service including the fair market value of all goods and services supplied by the recipient(s) in or in relation to the service, whether or not supplied under the same contract or any other contract after deducting the amount charged for such goods or services supplied to the service provider, if any and VAT, if any levied thereon. Fair market value of goods and services shall be determined in accordance with generally accepted accounting principles.

For easy comprehension, the situations are tabled as under:

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<table>
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<tbody>
<tr>
<td>A</td>
<td>67% abatement</td>
</tr>
<tr>
<td>B</td>
<td>75% abatement</td>
</tr>
<tr>
<td>C</td>
<td>Completion &amp; Finishing Services</td>
</tr>
<tr>
<td>D</td>
<td>Composition Scheme</td>
</tr>
<tr>
<td>E</td>
<td>Rule 2A Valuation</td>
</tr>
<tr>
<td>Num</td>
<td>Situation</td>
</tr>
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<td>-----</td>
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<tr>
<td>1.</td>
<td>A, B, D</td>
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<td>2.</td>
<td>A, B, D</td>
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<tr>
<td>3.</td>
<td>A, D</td>
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<tr>
<td>6.</td>
<td>B</td>
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<td>7.</td>
<td>C</td>
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<td>8.</td>
<td>C</td>
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<td>9.</td>
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<td>10</td>
<td>E</td>
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</tbody>
</table>
The final decision on what option is applicable and which option is ideal would depend on the other tax laws like the Stamp Act in the relevant state as well as the Local VAT laws. After the final decision has been made as far as service tax is concerned considering that the law is new, it maybe advisable to write to the revenue department seeking their confirmation disclosing the following:

a. The background of your transaction/s in detail. [ may attach sample of different types of agreements]

b. The method of accounting followed including registers maintained and their formats.

c. The treatment of credit. [ Now most options have allowability of cenvat credit for input services and central excise duty paid on capital goods]

d. This could possibly ensure that at no point of time the penalties could be fastened on you. Also the period of demand could be limited to 18 months from the date of the SCN backwards rather than 5 years as maximum provided.

Recommended Read

- Composition Scheme available for Service Providers
- GST on Construction and Real Estate
Very good explanation

KALYANA SUNDAR

Dear Mr Madhukar the contents are very informative and if possible can you send this article in word format for my use thanks and regards N Kalyana Sundar CA

KAPIL RAMAKANT AGRAWAL

Thanks....

@VAIBHAVJ

very well explained, bookmarked...

PONNERISATISH

Hi Madhukar, Sub contractor of works contract, who is exempted from paying service tax as per Negative list. How can he setoff input cenvat& input Service credit . Can he claim refund for the same. Pleas explain.

AMIT

JUST AmaZInG.... SuPeRb... WoRk!!!!

SRIVANI

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