

Issues in Taxation of Works Contract

Presentation by:

Rajat Talati

Talati & Co

Chartered Accountants, Mumbai

rajat@talatico.com

at

All Maharashtra Tax Convention –

Nagpur Branch of ICAI

On 4.5.2013

Verification of W/c transactions

Preparatory work

- ◆ Works contract
 - Nature of contract
 - Method followed for discharge of tax
 - ◆ Rule 58
 - ◆ Proviso to rule 58(1)
 - ◆ Gannon Dunkerly (88 STC 204)
 - ◆ Composition u/s 42(3)
 - Method adopted to work out break up of taxable T.O
 - Whether tax collected separately?
 - Goods consumed away in execution of contract

Verification of W/c transactions

Preparatory work (Cont...)

- ◆ Method followed for accounting
 - AS 7 – project completion method
 - Transfer of property v. Accounting
- ◆ Reconciliation of T.O of sales (MVAT Act) with sales as per books of Account
 - Labour /supervision charges
 - T.O. offered for ser. Tax
- ◆ Interstate W/c v. Branch transfer

Verification of W/c transactions

Preparatory work (Cont...)

◆ Deductions

- Branch transfer (OMS) – method of valuation
- Non-taxable charges

How is gross T.O. of sales determined?

E.g. 20% deduction as per table to rule 58

- Architect's fees
- Cost of site office

Method adopted to value deduction

- Site-wise accounting
- Ratio proportionate basis for site expenses. E.g. labour paid for polishing tiles, hire charges for diff. sites

Sub-contracting

- ◆ Main contractors & Sub contractors - Relationship shall be deemed to be that of the Principal & Agent [Sec45(4)]
 - liability to pay tax shall be joint & several
 - Deductions will be given to either, based on producing prescribed certificates
 - Who discharges the tax, sub-contract or main contractor
 - Forms (407 & 408) or Forms (406 & 409)
 - Mismatch- recent exercise by Dept

W /C vs. Sales

- ◆ Splitting of the contract
 - On shore supplies
 - Off shore supplies
 - On shore & off shore services
 - On shore composite contract e.g. civil work
- ◆ Separate pricing & deliverables
- ◆ Umbrella agreement
- ◆ Performance guarantees & inter-woven mile-stones & payment terms

[refer – splitting accepted proposition- BHEL & Indure (SC)]

Inter-state w/c

- ◆ What is it?
 - When is works contract said to be covered by CST Act?
 - ◆ SC Builders Asso[88:STC:248] – 20th Century [119 STC 182]
- ◆ Inter-state movement of
 - Raw material/processing material / components
 - Finished goods – not requiring to work upon
- ◆ Is 'in transit sale' possible in inter-state w/c?
 - Very controversial
 - Is 'sale in the course of imports' possible?
- ◆ Is deduction u/r 58(1) – table deduction available? Mahim Patram (6:VST:248) (SC)
- ◆ Is 'composition scheme' available for a inter-state w/c

Composition scheme

- ◆ Is VAT payable on service tax element?
 - MSTT – Nikhil Comforts SA 30/2012 dt. 31.3.12
 - Clarification issued by Commissioner- lease transaction
- ◆ Is deduction u/r 57(1) available?
 - (Painter – LB SA no. 1053 to 1056 of 06 dt 8.5.09)

Adhoc deduction as per proviso to Rule 58(1)(a)

- ◆ Is dealer to justify such a deduction?
- ◆ Is it that the Business Auditor to attempt to calculate rule 58(1) deduction & then compare with adhoc deduction?

Adhoc deduction as per proviso to Rule 58(1)(a)

- ◆ Is 'depreciation' on plant & machinery' used at site available as deduction u/r 58(1)? – refer L & T [34 VST 53 (kar)]
 - Is interest on loan for the project allowable?
- ◆ Software AMC
 - Is it a works contract or is it right to use?
 - What is the nature of contract?

Works contract TDS

- ◆ Claim of credit
 - TDS certificates – formats
 - For earlier periods – amended sec 31(4)
 - If on sale/supply contract TDS is deducted?
- ◆ Deduction of TDS
 - Indivisible contracts
 - Notification – employer
 - Interstate W/C – no TDS deductible

W/C TDS – non deduction by employer

- ◆ What is the fall out?
 - Levy of interest & penalty
- ◆ If contractor has paid tax. Can it be said that no further liability on 'employer'? [Refer Hindustan Coca Cola Beverages P Ltd (SC) 293 ITR 226]

BOOT contracts

- ◆ Is it liable to VAT?
- ◆ Ref DDQ: Ashok Buildcon
 - If yes,
 - ◆ When
 - ◆ On what amount

Cost + GP

- ◆ Constitutional powers of the state
- ◆ Is cost + GP method legal?
 - Old works contract act
 - Common practice
- ◆ Trade circular no.18T/2012 dt 6.9.12
- ◆ BHC WP 2440/2012 dt 30.10.12 – BAI upheld the circular
- ◆ Challenge to SC - pending

Cost + GP = Dilemma

- ◆ Dealers have filed return
- ◆ MVAT Audit based on Cost + GP
 - What next
 - How to rework u/r 58(1)
 - Can there be any difference between 58(1) & Cost + GP working?
 - What should auditor do?
 - ◆ Will disclosure suffice?

The background is a solid dark brown color. On the left side, there is a large, faint, light brown grid pattern that resembles a stylized spiral or a series of concentric arcs intersected by radial lines. In the upper right quadrant, there is a small cluster of several overlapping squares in a lighter shade of brown.

Levy of VAT on Builders & developers

Levy of tax

- ◆ Sales tax – levy on sale of movables
- ◆ Sale by builder – Is it taxable under Sales tax? K. Raheja Development Corp (SC) 141 STC 298
 - Booking
 - Under construction
 - After completion of construction

Contract for constructions

- ◆ Relationship
 - Employer / awarder & contractor
 - Application of labour & goods in execution of contract
 - Works contract – VAT attracted

Legal History

contd....

- ◆ K.Raheja Dev.Corp.
(SC)[141:STC:298]

Facts :

- 2 agreements with prospective buyer
 - ◆ One for sale of land [undivided portion]
 - ◆ Construction contract

SC in K. Raheja's case

- Separate consideration for both
- SC held
 - ◆ Contract for construction is subject to W/C Tax / VAT
 - ◆ Transfer of property while execution of W/C
 - ◆ Definition of W/C under Karnataka Sales Tax Laws – considered
 - ◆ If 'transferred' before construction is complete – W/C attracted.

Writ Petition (BHC) – MCHI [2007]

- ◆ Challenged
 - ◆ Wires in the amendment
 - ◆ Actions of the State VAT Dept
- ◆ Stand – Petitioners
 - ◆ Action is to take immovable property
 - ◆ Amendment is unconstitutional
- ◆ Interim order
 - ◆ Not to insist on registration, assessment in case of members of MCHI
 - ◆ Submission of statements

Writ Petition (BHC) – MCHI [2007]

contd....

- ◆ BHC final order dt 30.10.12
 - Upholding the levy
 - Provisions of MOFA discussed
 - BHC - Maratha bandhkam
 - ◆ Assessment reqd to determine nature of contract
- ◆ Departmental approach
 - Circulars - FAQ issued
 - ADMn appln filed by 31.10.12
 - Returns filed & taxes paid
 - MVAT Audit reports filed

Different Schemes for taxation of W/C under MVAT Act

- ◆ Normal scheme u/r 58(1) –Gannon Dunkerly (SC) – 88 STC 204
 - Take deductions as given
 - Amt paid to registered Sub-contractor [F 407 & F 408]
 - Balance taxable @ 4, 5, or 12.5% as the case may be

Table –Adhoc deduction

- ◆ Deduction as per table- proviso to rule 58(1)
 - Take deduction @30%
 - Amt paid to registered Sub-contractor [F 407 & F 408]
 - Balance taxable @ 4, 5, or 12.5% as the case may be

Land cost - deduction

- ◆ Insertion of rule 58(1A)
 - Need
 - ◆ Representation – Land cost included.
 - ◆ Argued before various courts
 - Rule w.e.f. 20.06.2006 [retrospective amendment]
 - ◆ Land cost deduction based on ready reckoner – Stamp Act
 - ◆ Land cost deduction – not to exceed 70% of the 'agreement value'

Rule 58 (1A)

- ◆ Computation as per Rule 58(1A)

| | |
|-------------------------------|-------------|
| Contract value say | 10,00,000/- |
| Less: ready reckoner rate say | 6,00,000/- |
| Balance | 4,00,000/- |
| Less: dedn u/r 58(1) say | 1,20,000/- |
| Balance taxable @4% or 12.5% | 2,80,000/- |

Going forward....

- ◆ MCHI has challenged this BHC ruling before SC.
 - At SC matter heard- decision awaited
- ◆ Two columns under Stamp Act
 - Reckoner for land
 - Reckoner for constructed premises.
- ◆ No equity between 2 contractors having projects in different localities

Practical difficulties for implementation

- ◆ Notwithstanding the legal position
- ◆ Reckoner value
 - How to divide between flats
 - When to allow deduction
 - ◆ Progressive collection of money
 - Increase in recknor value
 - TDR potential - 1.4 times ready recknor value



Composition Scheme for Builders & Developers

C.A. RAJAT TALATI, MUMBAI

General Composition Scheme- 42(3)

- ◆ Composition Scheme u/s 42(3)
 - Pay composition amt @5% of contract price after deducting amt paid to sub-contractor [F 407 & F 408]
 - ITC in excess of 4% paid on purchases

Works contract composition scheme u/s 42(3A) -1% scheme

- ◆ For builders & developers issued u/s 42(3A) of the MVAT Act, 2002 vide notification dt. 9.7.2010
- ◆ Features of composition scheme
 - Available only to the registered dealer
 - Composition amount payable is @1% of the aggregate amount specified in the agreement or the values specified for stamp duty in respect of agreement, whichever is higher
 - Agreements registered on or before 1.4.2010 covered by the scheme
 - Composition amount paid by making E-payment & include turnover of 'sale' in the sales tax returns

Works contract composition scheme

- **No set off** in respect of the purchases.
- Concessional interstate purchase agst **Form C is not allowed** if composition is opted.
- Developers cannot issue Form 409 to subcontractor but charge applicable VAT @5% on its billing to the developers.
- Developers to not to issue tax invoice. Once the methods of computation of tax liability in respect of the contract is opted, the same cannot be changed

Issues

Is it Qua Project /contract /agreement?

- Is this scheme qua project, qua contract / agreement or qua dealer?
- Scheme envisages transfer of land / interest in land along with the construction, to the society, is this scheme applicable in majority of cases?
- URD period
 - ◆ Scheme is only for RD
 - ◆ Builders are URD
 - ◆ Is it available from 1.4.2010 till date of effect of RC? Would administrative relief granted as special cases? If yes, from what date – 20.3.2006 or 1.4.2010?

Issues

- RD developers
 - ◆ Are the agreements entered into after 1.4.2010 but payment(s) / part payments(s) received prior to 31.3.2010 eligible under the scheme?
 - If yes, dealer could have paid tax under the MVAT Act & Rules for period prior to 31.3.2010. can such dealer revise the earlier return and claim refund of the taxes so paid under those returns?
 - ◆ Paid taxes in past as regular W/C or @5% (construction contract). Can they now switch over to new composition scheme?
 - ◆ Under the scheme, purchases against form 'C' is not allowed. If for a particular project, in past (before 1.4.2010) builder has issued form 'C' for some purchases, can he opt for 'composition' u/s. 42(3A) for that project?

Issues

- ◆ Form 406 & 409 would have been issued in past, would it be required to withdraw it?
- ◆ The scheme provides that the dealer opting for the scheme cannot issue form 409 to the sub-contractor. The sub-contractor would charge the applicable VAT. [ratio laid down by the Supreme Court in the case of Larsen & Toubro Ltd]. Can the scheme be challenged?
- ◆ Dealer has paid tax u/s 42(3) for period upto to 31.3.2010. Can he opt for composition u/s 42(3A) for agreement entered into after 1.4.2010?
 - If yes, will it be eligible for set off for period upto 31.3.2010?
 - How to compute liability upto 31.3.2010 & after 1.4.2010?

Practical issues

- At the time of booking flat, booking letter is given. Is composition amount payable on such receipts?
- On cancellation of booking – can the VAT collected @1% & claimed as goods return? Will period of 6 months apply? Will the fresh agreement entered in to after 1.4.2010 for the same flat eligible under the scheme?
- How is investor transaction treated?
- Scheme do not provide for set off. Is set off available on construction machineries, centring material, expenses (purchases) debited to P & L A/c etc, where the property never gets transferred? Purchases prior to the effective date of Registration certificate?

Practical issues

- Can purchases against form C made for construction equipments, machinery etc?
- Can such a dealer receive goods as stock transfer against form F
- Can the sub-contractor issue form C for inter-state purchases?
- With regard to service tax, certificate issued by architects, chartered engineers & licensed surveyors for issue of 'completion certificate' is considered. Can such certificate be also considered / acceptable under the MVAT Act?
- What is the treatment for 'OC' issued for part of the building

Practical issues

- Will 'demand letter' issued by the builder sufficient for the purposes of the Act? Will it be construed as collection of VAT?
- Whether persons making payments to the builders / developers are liable to deduct WCT TDS?
- Will the following amount mentioned in the agreement form part of taxable amount u/s 42(3A)?
 - ◆ Advance society maintenance
 - ◆ Open parking space
 - ◆ Amenities like club membership
 - ◆ Common facilities like electricity sub-section charges approach road etc.

Issues

Redevelopment Scheme

- Redevelopment scheme : is VAT payable on flats / premises given free of cost to the land owner / member of the existing societies / any other interested parties? If yes, on what amount?
 - ◆ In the above case, will the notional value of 'displacement charges / amount', rental paid for temporary accommodation added?
- Is this barter arrangement? What is 'valuable consideration'?

W/C composition scheme u/s 42 (3A) is it available?

| Particulars | RD | RD + MCHI MEMBER | URD | URD + ADM RELIEF AVAILED |
|---|---------------------------------|---------------------------------|---------------------------------|-----------------------------------|
| a) New Project (started after 1.4.2010) | ✓ | ✓ | ✗ | ✓ |
| b) Transit cases – i.e. on going projects which were started before 1.4.2010 & continues there after | | | | |
| i) Construction completed | | | | |
| Agreement entered into before 1.4.2010 | ✗ - covered by other provisions | ✗ - covered by other provisions | ✗ - covered by other provisions | ✗ - covered by other provisions |
| Agreement registered after 1.4.2010 | ✓ | ✓ | ✗ | ✓ |
| If agreement registered after OC received | Not liable | Not liable | Not liable | Not liable |

W/C composition scheme u/s 42 (3A) is it available?

| Particulars | RD | RD + MCHI MEMBE R | URD | URD + ADM RELIEF AVAILED |
|---|----|----------------------------|-----|-----------------------------------|
| Agreement registered but part / full payment received after 1.4.2010 | x | x | x | x |
| Agreement registered into after 1.4.2010 but full payments received before 1.4.2010? | ✓ | ✓ | x | ✓ |
| ii) Construction in progress | | | | |
| Agreement entered into before 1.4.2010 – tax not paid earlier | x | x | x | x |
| Agreement entered into before 1.4.2010 – partly tax paid under other composition method [u/s 42(3)] | x | x | NA | NA |
| can revised return be filed to avail 42(3A)? | Y | Y | NA | NA |
| | | | | |



THANK YOU