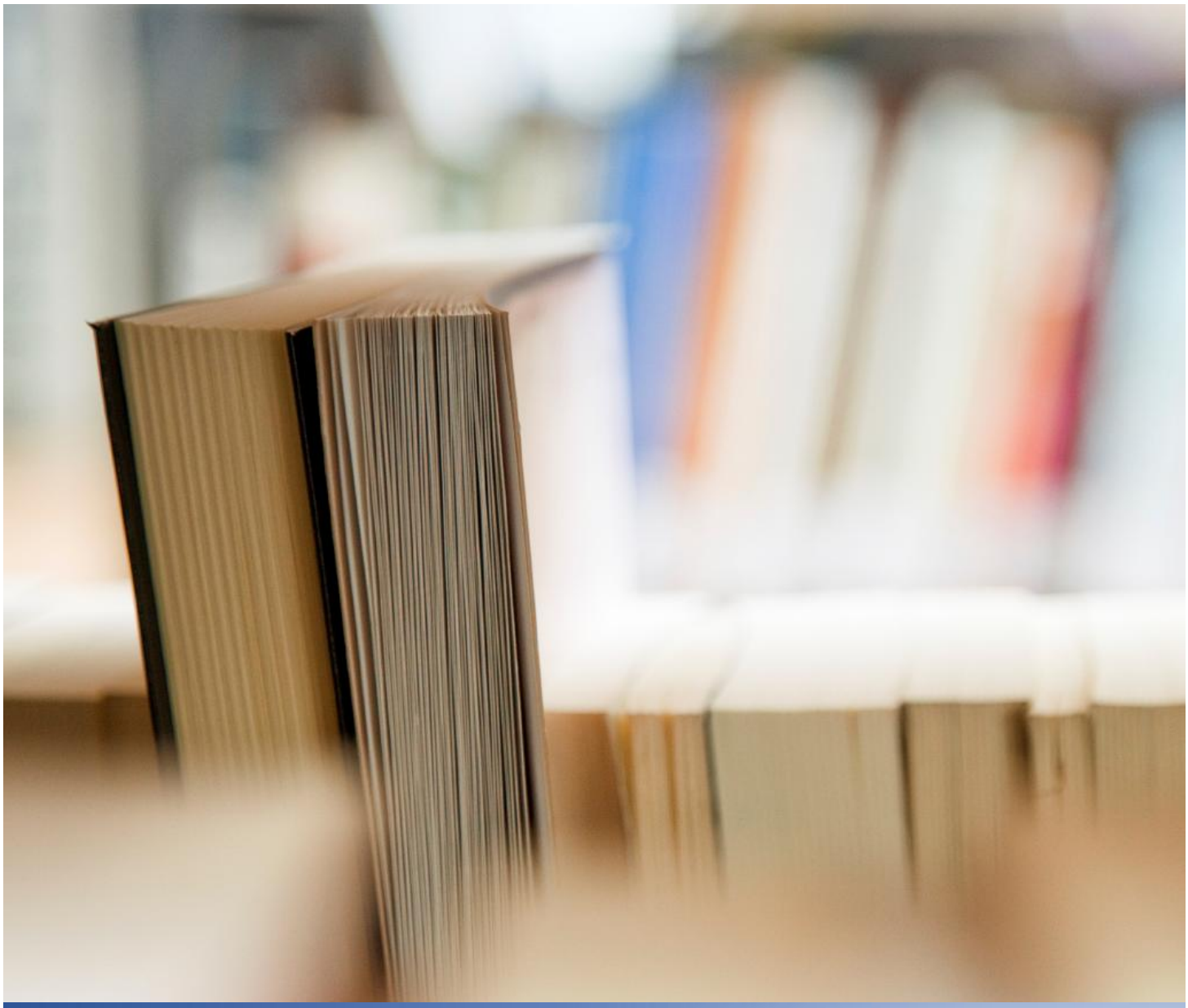

Works Contract under GST

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Works contract under GST – The Pandora's box yet to be opened

Under the current tax regime, there have been few bigger disputes than the classification of works contract. It is currently being subjected to both Service Tax and VAT. This actually results in a tussle between the Centre and State wherein both try to bring the greater proportion of tax within their fold. The fact that there cannot be clear demarcation between goods and services in case of an indivisible works contract further compounds this problem. The Central Government tends to assume a greater portion of the contract as service while the State Government tends to do the same for goods. The ultimate impact that arises in this situation is that the taxpayer ends up paying taxes on a value which is much higher than that of the contract value. In certain cases, it runs to as much as 40% more than the actual value. This is currently occurring inspite of the fact that VAT and Service Tax should not be levied on the same value of a transaction.

Another aspect of dispute with respect to works contract is with regard to distinction against construction of immovable property service. The line which distinguishes each type of service is blurred. The assessee makes the classification in such a way wherein lower share of tax is attracted but the Department always makes the classification wherein they get the higher share of tax. This leads to litigations more often than not.

Applicability of the Dominant Intention test for works contract has been another area of litigation over the past few years. As and when the law has matured over the years, this test has declared as redundant in case of works contract.

All the above mentioned major disputes present today have been put through the light of the GST Act passed by the Parliament. This article analyzes if these disputes will be resolved or compounded after GST comes in. Also, if there are any new issues which are set to arise with respect to works contract, that has also been depicted here.

Analysis of the Works Contract definition

Firstly, let us examine the definition of works contract as per Clause 2(110) of the Revised Model GST Law : -

"Works contract means a contract for building, construction, fabrication, completion, erection, installation, fitting out, improvement, modification, repair, maintenance, renovation, alteration or commissioning of any immovable property wherein transfer of property in goods (whether as goods or in some other form) is involved in execution of such contract"

On careful analysis of this definition, we find that it can be broken into two parts.

The first part of the definition uses the word 'means'. It has referred to fourteen action words all of which are in relation to immovable property. Hence, this part purports to include within this ambit these treatments made to immovable property. Since, this

part has been made restrictive by the use of the term 'means', any treatment not covered within these terms will not form part of the works contract.

The second part of the definition puts in a further condition that the works contract should involve transfer of property in goods whether as goods or in some other form. The percentage of the goods involved in the execution of contract is immaterial till there is some transfer of goods. 'In some form' can transfer of goods in the form of immovable property as well. This second part of the definition has largely been borrowed from Service Tax wherein similar terminology is used for description of works contract.

The definition of works contract also creates skepticism in our mind with regard to movable property. The draft Model GST law which was released in June, 2016 clearly stated that the agreement in relation to actions carried out on movable property lied within the ambit of the definition of works contract. Movable property has consciously been removed by the GST Council when issuing the Revised Model CGST/SGST law in November, 2016. Even under the GST acts passed by the Parliament, movable property has not been explicitly stated in the definition of works contract. Since, the works contract does not explicitly include the actions carried out in relation to movable property anymore, an interesting question arises in our minds. Does works contract not include transfer of property in goods in relation to movable property? Upon inferring the intent of the legislature behind specifically deleting the word 'movable property', the reason might be exclusion from the works contract definition. So, prima facie works contract may be excluding movable property.

There is another angle for analyzing the issue whether movable property will be considered as works contract or not. It can be inferred from the provisions of place of supply of goods. It states where the goods are assembled or installed at site, then it will be considered as supply of goods. It has been clarified in Schedule II that works contract can only be considered as supply of services. The fact that installation or assembly of goods is treated under goods and not services proves that it should ideally not be treated as a works contract.

Composite Supply and Dominant Intention Test

Under the current law, the dominant intention test has plagued a number of cases in the history of Indirect taxes. This test basically means that in order to determine whether a particular contract is that of goods or service based on the predominant intention of that contract. In the landmark judgement of BSNL (2006-TIOL-15-SC-CT-LB), the Supreme Court held that the sale element in works contract is separable once they are covered by the concept of deemed sales under Article 366(29A) of the Constitution. So, the sale element can be segregated in a works contract for chargeability to VAT. This view has been upheld by the Apex Court in the case of Kone Elevator India Private Limited (2014-TIOL-57-SC-CT-CB) wherein the dominant intention was discarded. Thereby, it considered manufacture, supply and installation

of elevators as works contract and not contract for sale. Even, the full bench judgement of Supreme Court in case of Larson and Toubro Limited (2013-TIOL-46-SC-CT-LB) relied on these views and gave a similar judgement against the dominant intention test. It seemed that the concept of dominant intention test had been settled and it may not haunt the industry in the days to come.

However, with the concept of Composite Supply proposed to have an advent under GST, it may not be prudent to write off the Dominant Intention Test just yet.

As per the GST Acts, composite supply means a supply made by a taxable person to a recipient comprising two or more supplies of goods or services or any combination thereof, which are naturally bundled and supplied in conjunction with each other in the ordinary course of business, one of which is a principal supply.

Principal supply means the supply of goods or services which constitutes the predominant element of a composite supply and to which any other supply forming part of that composite supply is ancillary and does not constitute for the recipient an aim in itself but a means for better enjoyment of the principal supply.

Upon analyzing the two definitions given above, it can be inferred that when there is a supply of multiple naturally bundled goods or services, the predominant supply will prevail. This means that the predominant supply will be considered for rate and other purposes for the entire contract of supply. This concept seems very identical to that of the dominant intention test prevailing under the erstwhile law. Let us analyze how far can the bar on dominant intention test apply under GST. Article 366(29A) of the Constitution which covers works contract considers tax on sale or purchase of goods. GST is in fact leviable on supply of goods or services. So, the prohibition of this Dominant Intention Test enforced through the BSNL may not apply anymore. Hence, the Dominant Intention test is free to be applied.

It is now essential to understand the repercussions of the dominant intention test applying. On one hand, composite supply relating to movable property involving two or more supplies should be tested for determining the principal supply using the refined version of Dominant Intention test. It can be classified as either goods or services depending on the principal supply. On the other hand, composite supply of works contract relating to immovable property will be deemed as service under Schedule II of the GST Law. So, actions carried out on immovable property will always be service and the dominant nature will be immaterial. The provisions of goods and services are poles apart in terms of time of supply, place of supply, valuation etc. So, we can expect a wide disparity of treatment for immovable property and movable property even though the process may be similar. This might keep alive the age old dispute of classification between movable and immovable property. In case of genuine disputes, the taxable person will be following one of the two concepts which will be more beneficial to him. On the other hand, the Department with the intent of raising more revenue will classify it otherwise. To summarize, a huge point of litigation is in the offing with regard to this classification.

Works contract vs Construction of Immovable property

From the definition of works contract discussed above, we find that it specifically includes a number of actions relating to immovable property including construction. So, it may seem that the construction of immovable property is a subset of works contract. But, this provision seems to be inconsistent upon analyzing the entire law.

Firstly, Schedule II has clearly distinguished between works contract and construction of immovable property. This is because separate clauses have been provided for each of these supplies for treating them as service.

Secondly, when the portion of blocked credit under Section 17 of the CGST Act is read, it is found that input works contract services are not allowable as input tax credit when used against construction of immovable property service. It also states that if input works contract service is expected to be used against output works contract service, then it will be allowable. Now, if the construction of immovable property service is already a part of the works contract service, then where does the question of allowing one and disallowing the other comes in? Possibly, the government has changed the definition of works contract under GST compared to the Service tax law to include immovable property but has failed to recognize the different treatments given to both these kind of services throughout the Act.

Even if we go by the current meaning of construction of immovable property service under the Service Tax, the results are still disastrous. This is because if the works contract services are not allowed to be set off against construction of immovable property service, then it spells doom for the construction industry. The current tax scenario under Cenvat Credit Rules allows this set off to take place which is just and rightful. GST has been popularized to have seamless flow of credit and purports to allow set off of those credits which have never been allowed before. But here, we are finding that a justifiable input tax credit has been restricted under GST. This is set to cause ripples within the construction industry.

Restructuring of transactions for planning taxes under Works contract

The most basic tax planning tool in today's scenario is to take a decision about the structuring of goods and services under Works contract. Most of the taxpayers make a cost benefit analysis to determine whether they should enter separate contracts for goods and services or whether it should be structured as a works contract. The tax liability using each of these scenarios is calculated to make the best possible decision. How the department treats this contract is a completely different playing area. But, the taxpayers have this mechanism usually planned out for every contract to ensure lower tax liability for them.

Since, GST intends to tax both goods and services, this kind of tax planning tool should ideally have been put to rest. But, this tax planning tool is expected to be even more vigorous under GST. For example, in a contract for painting, lets' say paints are taxed at 12% at 18% and labour/works contract at 18%. Any taxable person will enter into

two different contracts for goods and services. The goods portion will only attract a tax of 12% as against 18% which would have been applicable had it been classified into one single works contract service.

Conclusion

The GST law will largely be shaping the future of our nation's growth in days to come. The greater the transparency in law, the higher will be the flourishment of trade and commerce. This especially applies to areas like works contract which have been plaguing them for decades now. Now is the time to vaccinate these chronic diseases otherwise they will continue to cast down the confidence of the industry on the legal framework of the country.

Ending with a quote by Hellen Keller – "Optimism is the faith that leads to achievement. Nothing can be done without hope and confidence"

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