

Chapter 1: Introduction

1.1 Background

Service Tax was introduced through Chapter V of Finance Act, 1994 in the year 1994.

There has been steady rise in service tax collection from ₹ 410 crore during 1994-95 to ₹ 1,54,780 crore during 2013-14. The increase in service tax is mainly due to addition of number of taxable services, which have increased from 3 in 1994 to all the services, except those specified in the negative list after the introduction of negative list approach with effect from 1 July 2012. The increase in service tax is also due to the overall increase in the economy.

Works contract service (WCS) was added to list of taxable services with effect from 1 June 2007. The scope of this service has been expanded from time to time through changes/amendments in the Finance Acts.

WCS is among top ten contributors to service tax collections and during 2013-14, ₹ 7,434 crore which is 4.80 per cent of overall service tax collection were contributed by WCS. The works contract seeks to tax those services wherein transfer of property in goods is involved during the execution of works contract. The tax would be on the services involved in execution of works contract.

Usually liability of service tax is affixed either on the service provider or on the service recipient. With effect from 1 July 2012 a new method of taxation was brought into effect whereby the liability of payment of service tax falls on both i.e., the service provider as well as service receiver in case of certain selected services. In case of WCS the service tax in respect of services provided by individual, Hindu Undivided Family, proprietary firm or partnership firm including association of persons located in the taxable territory to a business entity registered as a body corporate, located in the taxable territory is partially payable (50 per cent) by recipient of service and remaining 50 per cent by service provider.

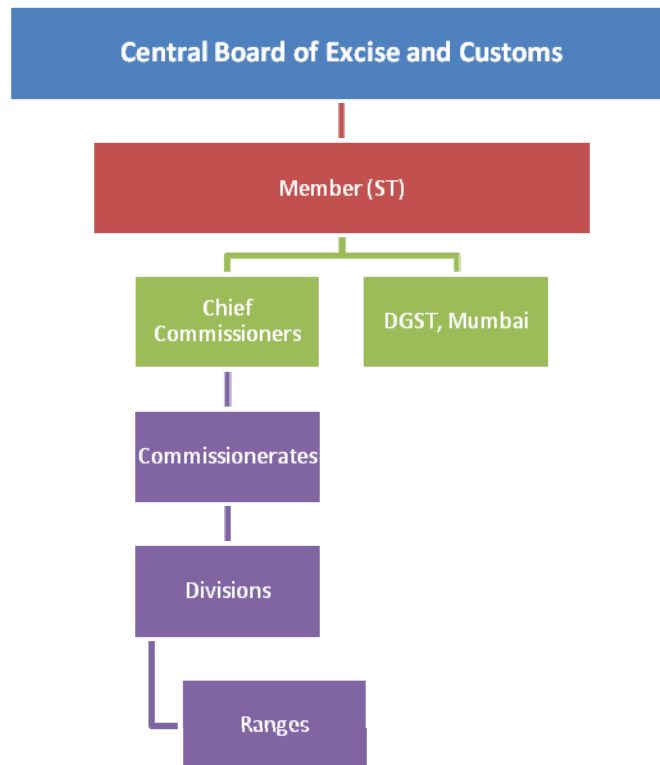
1.2 Organisational set-up

Central Board of Excise and Customs (CBEC) set up under the Central Boards of Revenue Act, 1963 is a part of the Department of Revenue under the Ministry of Finance, Government of India. It deals with the tasks of formulation of policy concerning levy and collection of Customs, Central Excise duties and Service Tax, prevention of smuggling and administration of

matters relating to Customs, Central Excise, Service Tax and Narcotics. The Board is the administrative authority for its subordinate organisations, including Custom Houses, Central Excise and Service Tax Commissionerates and the Central Revenues Control Laboratory. Member (Service Tax) in the CBEC have the overall charge of the matters relating to Service Tax. They are assisted by Chief Commissioners/Commissioners.

Chart 1.1 depicts the organisational structure under CBEC, concerned with the collection of service tax revenues and the monitoring of the same.

Chart 1.1: Organogram of CBEC



1.3 Legal provisions

1.3.1 Taxable services

1.3.1.1 Between 1 June 2007 and 30 June 2012

‘Works contract service’ in Section 65(105)(zzzza) of the Finance Act, 1994 means,

“Any service provided or to be provided to any person, by any other person in relation to the execution of a works contract, excluding works in respect of roads, airports, railways, transport terminals, bridges, tunnels and dams.

For the purposes of this sub-clause, “works contract” means a contract where,

- i. transfer of property in goods involved in execution of such contract is leviable to tax as a sale of goods, and
- ii. such contract is for the purposes of carrying out:-
 - a. erection, commissioning or installation of plant, machinery, equipment or structures, whether pre-fabricated or otherwise, installation of electrical and electronic devices, plumbing, drain laying or other installations for transport of fluids, heating, ventilation or air-conditioning including related pipe work, duct work and sheet metal work, thermal insulation, sound insulation, fire proofing or water proofing, lift and escalator, fire escape staircases or elevators; or
 - b. construction of a new building or a civil structure or a part thereof, or of a pipeline or conduit, primarily for the purposes of commerce or industry; or
 - c. construction of a new residential complex or part thereof; or
 - d. completion and finishing services, repairs, alteration, renovation or restoration of, or similar services in relation to (b) and (c); or
 - e. turnkey projects¹ including engineering procurement and construction or commissioning (EPC) projects.”

1.3.1.2 From 1 July 2012

Section 65(44) defines "service" to mean any activity carried out by a person for another for consideration, and includes a declared service while excluding a few activities such as an activity which constitutes merely a transfer of title in goods or immovable property, by way of sale, gift or in any other manner.

The service portion in the execution of a works contract is a declared service as per Section 66E(h) of the Act (with effect from 1 July 2012).

Section 65B (introduced with effect from 1 July 2012) of the Finance Act, 1994, deals with "Interpretations". Clause (54) of Section 65B reads,

Works contract means 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 movable or immovable property or for carrying

¹ The word 'turnkey project/contract' have been defined in the Black's Law Dictionary as "Engineering procurement and construction contract – a fixed price, schedule-intensive construction contract –typically used in the construction of single purpose project in which the contractor agrees to a wide variety of responsibilities, including the duties to provide for the design, engineering, procurement and construction of the facility to prepare start up procedures, to conduct performance test, to create operation manuals and to train people to operate the facility".

out any other similar activity or a part thereof in relation to such property. However, services provided by way of construction, erection, commissioning, installation, completion, fitting out, repair, maintenance, renovation or alteration of a road, bridge, tunnel or terminal for road transportation for use by general public were exempted vide notification dated 20 June 2012.

1.3.2 Valuation of taxable service

Under Section 67 of the Act, the value of taxable service is required to be computed in the following manner:

- a. Where the provision of service is for a consideration received wholly in money, the value shall be the gross amount charged by the service provider for provision of service.
- b. Where the provision of service is for a consideration which is not wholly or partly consisting of money, the value shall be such amount in money as, with the addition of service tax charged, is equivalent to the consideration.
- c. Where the provision of service is for a consideration which is not ascertainable, the value shall be the amount as may be determined in the manner prescribed in the Valuation Rules.

Further, the Section provides that

- a. Where the gross amount charged is inclusive of service tax payable, the value shall be such amount, as with addition of tax payable, is equal to the gross amount charged.
- b. 'Consideration' includes any amount payable for the service provided or to be provided.
- c. The term 'gross amount charged' shall 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 enterprises.

1.3.2.1 Rules applicable between 1 June 2007 and 30 June 2012

Provisions relating to determination of value of service portion in the execution of a works contract are contained in the Service Tax (Determination of Value) Rules, 2006 which came into force with effect from 1 June 2007 vide notification dated 19 April 2006.

Rule 2A of the Service Tax (Determination of Value) Rules, 2006, provides that the value of taxable service in relation to services involved in the

execution of a works contract shall be determined by the service provider in the following manner:

(i) Value of works contract service determined shall be equivalent to the gross amount charged for the works contract less the value of transfer of property in goods involved in the execution of the said works contract.

- a. However, gross amount charged for the works contract shall not include 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;
- b. value of works contract service shall include-
 - i. labour charges for execution of the works;
 - ii. amount paid to a sub-contractor for labour and services;
 - iii. charges for planning, designing and architects' fees;
 - iv. charges for obtaining on hire or otherwise, machinery and tools used for the execution of the works contract;
 - v. cost of consumables such as water, electricity, fuel, used in the execution of the works contract;
 - vi. cost of establishment of the contractor relating to supply of labour and services;
 - vii. other similar expenses relating to supply of labour and services; and
 - viii. profit earned by the service provider relating to supply of labour and services;
- c. Where VAT or sales tax has been paid on the actual value of transfer of property in goods involved in the execution of works contract, then such value adopted for the purposes of payment of VAT or sales tax, as the case may be, shall be taken as the value of transfer of property in goods involved in the execution of the said works contract for determining the value of works contract service.

Works contract is a composite contract (i.e. service plus material component involved) and hence specific provisions have been made in respect of valuation. Broadly, two options are available to service provider.

- a. Calculate value of service as per rule 2A of the Service Tax (Determination of Value) Rules, 2006 and pay service tax at 10.30 per cent (upto March 2012) or 12.36 per cent as the case may be, inclusive

of education cess and secondary and higher education cess on such value. In such case, assessee can not avail Cenvat credit of inputs. Thus the assessee can avail Cenvat credit of input services and capital goods.

- b. Pay service tax as per rule 3(1) of Works Contract (Composition Scheme for Payment of Service Tax) Rules, 2007, at 4.8 per cent (from 1 April 2012 and upto 1 July 2012) (exclusive of education cess and secondary and higher secondary cess) of gross amount charged for works contract. This was as per the provisions of the erstwhile Works Contract (Composition Scheme for Payment of Service Tax) Rules, 2007. As per rule 3(2) of Composition scheme, the assessee cannot avail Cenvat credit of inputs. Thus, the assessee can avail Cenvat credit of input services and capital goods.

The rate under the composition scheme as introduced in 2007 was two per cent which was subsequently raised to four per cent from 1 March 2008. This rate was further enhanced to 4.8 per cent from 1 April 2012.

In both the cases VAT/sales tax will not be included in the value for the purpose of calculating service tax.

Assessee could treat each 'works contract' separately and choose either option (a) or (b) above, in each case. There was no compulsion that he had to follow the same option in respect of all works contracts executed by him.

1.3.2.2 Rules applicable from 1 July 2012

With effect from 1 July 2012 position related to valuation has been inserted in rule 2A (ii) of Service Tax (Determination of Value) Rules, 2006 as follows:-

- (ii) Where the value has not been determined as under clause (i), mentioned in paragraph no. 1.2.2.1 above, the person liable to pay tax on the service portion involved in the execution of the works contract shall determine the service tax payable in the following manner, namely:-
 - a. in case of works contracts entered into for execution of original works, service tax shall be payable on 40 per cent of the total amount charged for the works contract;
 - b. in case of works contract entered into for maintenance or repair or reconditioning or restoration or servicing of any goods, service tax shall be payable on 70 per cent of the total amount charged for the works contract;
 - c. in case of other works contracts, not covered under sub-clauses (A) and (B), including maintenance, repair, completion and finishing services

such as glazing, plastering, floor and wall tiling, installation of electrical fittings of an immovable property , service tax shall be payable on 60 per cent of the total amount charged for the works contract;

Explanation 1 : For the purpose of this rule

- a. "Original works" means-
 - i. all new constructions;
 - ii. all types of additions and alterations to abandoned or damaged structures on land that are required to make them workable;
 - iii. erection, commissioning or installation of plant, machinery or equipment or structures, whether pre-fabricated or otherwise;
- b. "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 the works contract, whether or not supplied under the same contract or any other contract, after deducting-
 - i. the amount charged for such goods or services, if any; and
 - ii. the value added tax or sales tax, if any, levied thereon:

Provided that the fair market value of goods and services so supplied may be determined in accordance with the generally accepted accounting principles.

Explanation 2 - For the removal of doubts, it is clarified that the provider of taxable service shall not take Cenvat credit of duties or cess paid on any inputs, used in or in relation to the said works contract, under the provisions of Cenvat Credit Rules, 2004.

1.4 Why we choose this topic

WCS is one of the top ten revenue contributing services, with revenue collection of ₹ 3,092 crore, ₹ 4,179 crore, ₹ 4,455 crore and ₹ 7,434 crore during 2010-11, 2011-12, 2012-13 and 2013-14 respectively. There are several distinctive provisions in the rules relating to works contract which also make this an area worth our examination; such provisions include the erstwhile composition scheme in respect of works contract, the newly introduced partial reverse charge mechanism and the provision of valuation under rule 2A of the Service Tax (Determination of Value) Rules, 2006.

1.5 Audit objectives

Through examination of departmental and assessee records, we sought to ensure:-

- a. the adequacy of rules, regulations, notifications, circulars/ instructions/trade notices etc., issued from time to time in relation to levy, collection and assessment of service tax relating to works contract services;
- b. whether the extant provisions of law are being complied with adequately;
- c. whether there was an adequate mechanism to identify and bring in potential service providers into tax net for levy of service tax; and
- d. whether there was an effective monitoring and internal control mechanism.

1.6 Scope of audit and coverage

We selected 30 per cent of the Commissionerates/Divisions/Ranges. While doing so the Commissionerates/ Divisions/Ranges with maximum number of assessees as well as high revenue collected during 2010-11 to 2013-14 under WCS had been selected with the minimum of two Divisions and two Ranges. Besides at least five assessees paying service tax over ₹ three crore per year, through Cenvat plus PLA and at least two assessees paying service tax over ₹ one crore but less than ₹ three crore per year, through Cenvat plus PLA from each selected Commissionerate had been covered.

We carried out examination of records at 33 selected Commissionerates, 66 Divisions and 116 Ranges (exclusive ST, integrated CE and ST CDRs and LTUs) and 237 assessees for conducting the performance audit on WCS. The period of examination of this performance audit is from 2010-11 to 2013-14.

1.7 Audit findings

The service tax collected by the selected Commissionerates for the year 2013-14 is ₹ 5,164 crore. We noticed system and compliance issues viz., non-registration, non/short payment of service tax, incorrect availing and utilisation of Cenvat credit, incorrect exemption etc., involving financial implication of ₹ 543.46 crore. The department intimated the recovery of ₹ 3.92 crore.

1.8 Acknowledgement

We acknowledge the co-operation extended by Central Board of Excise and Customs (CBEC) and its field formations, in providing the necessary records for the conduct of this audit.

We discussed the audit objectives and scope of the Performance Audit in an entry conference with CBEC on 14 August 2014 and exit conference was held on 18 June 2015. The Ministry furnished the reply to the recommendations in June 2015 which are included in this report.