

Negative Blues – IX

Composition scheme for ongoing contracts.

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When service tax was imposed on works contracts from 01.06.2007, Notification 32/2007 ST Dated 22.05.2007 has introduced Works Contract (Composition scheme for payment of Service Tax) Rules, 2007 whereby service tax can be paid at 2 % on the gross amount. Later the rate was revised to 4 % with effect from 01.03.2008 and to 4.8 % from 01.04.2012. The scheme is project specific. As per the scheme, one has to opt for payment of service tax under this scheme before making any service tax payment on the works contract and the option once exercised shall be final and cannot be changed till the completion of the project. Those who do not opt for composition scheme would be governed by Rule 2 A of the Service Tax (Determination of Value) Rules, 2006, according to which they can pay service tax at applicable rate on gross amount minus value of transfer of property in goods.

This composition scheme has been rescinded vide Notification 35/2012 ST Dated 20.06.2012, with effect from 01.07.2012. A new Rule 2 A has also been substituted in Service Tax (Determination of Value) Rules, 2006, vide Notification 24/2012 ST Dated 06.06.2012, with effect from 01.07.2012. As per this new rule, if VAT is paid on actual value, such value can be excluded from gross amount and service tax @ 12 % can be paid on the remaining value. In cases where VAT is not paid on actual basis, the value of service is deemed to be 40 % of gross amount in case of original works; 70 % of gross amount in case of works contract entered into for maintenance or repair or reconditioning or restoration or servicing of any goods and 60 % of gross amount in all other cases.

Now, the moot question is how service tax has to be paid on those works contracts, where composition scheme has already been opted and the contract is continuing even after 01.06.2012.

If it is presumed that after 01.07.2012, service tax on such ongoing works contract shall be paid only in accordance with Rule 2 A *ibid*, it would not lead to any difficulty if the contract is in the nature of "original work". There would not be any monetary implication as service tax payable @ 12 % on 40 % of the value would also work out to 4.8 % which was the rate under the composition scheme also. But, if the works contract was in the nature of finishing services, as per Rule 2 A *ibid*, service tax has to be paid @ 12 % on 60 % of the value, which makes the effective rate as 7.2 %. Is it so? Or, one can switch over to exclusion of actual value on which VAT is paid after 01.07.2012 (first part of Rule 2A)?

Two views are possible in this regard.

It may be observed Works Contract (Composition scheme for payment of Service Tax) Rules, 2007 has been rescinded with a saving clause. To reproduce Notification 35/2012,

*In exercise of the powers conferred by sections 93 and 94 of the Finance Act, 1994 (32 of 1994), the Central Government hereby rescinds the notification of the Government of India, in the Ministry of Finance (Department of Revenue) No. 32/2007 " Service Tax, dated the 22nd May, 2007, published in the Gazette of India, Extraordinary, Part II, Section 3, Sub-section(i), vide number G.S.R. 378(E), dated the 22nd May 2007, **except as respects things done or omitted to be done before such rescission.***

The effect of such saving clause is that the rights accrued under the rescinded provisions or the liabilities incurred under the rescinded provisions would not get altered even after such rescission. By opting for the composition scheme, one has exercised one's right to opt for the scheme or undertaken to discharge the liability under the scheme. Either it is a right accrued under the erstwhile composition scheme, or a liability incurred under the said composition scheme, such right or liability would not be obliterated upon rescission of the scheme, by virtue of the saving clause. Further, Section 38 A of the Central Excise Act, 1944, dealing with effect of amendment, rescission, etc. of Rules, Notifications, etc. has also been made applicable to Service tax, vide Section 83 of the Finance Act, 1944. For ready reference, section 38 A ibid is reproduced below.

SECTION 38A. Effect of amendments, etc., of rules, notifications or orders.

— *Where any rule, notification or order made or issued under this Act or any notification or order issued under such rule, is amended, repealed, superseded or rescinded, then, unless a different intention appears, such amendment, repeal, supersession or rescinding shall not -*

(a) revive anything not in force or existing at the time at which the amendment, repeal, supersession or rescinding takes effect; or

(b) affect the previous operation of any rule, notification or order so amended, repealed, superseded or rescinded or anything duly done or suffered thereunder; or

(c) affect any right, privilege, obligation or liability acquired, accrued or incurred under any rule, notification or order so amended, repealed, superseded or rescinded; or

(d) affect any penalty, forfeiture or punishment incurred in respect of any offence committed under or in violation of any rule, notification or order so amended, repealed, superseded or rescinded; or

(e) affect any investigation, legal proceeding or remedy in respect of any such right, privilege, obligation, liability, penalty, forfeiture or punishment as aforesaid,

and any such investigation, legal proceeding or remedy may be instituted, continued or enforced and any such penalty, forfeiture or punishment may be imposed as if the rule, notification or order, as the case may be, had not been amended, repealed, superseded or rescinded.

Hence, it can be argued that in respect of ongoing contracts, one can continue to pay service tax @ 4.8 %, i.e. the rate prescribed under the erstwhile composition scheme, irrespective of the nature of contract (i.e. even though it was for finishing services) even after 01.07.2012, till the completion of the contract. For new contracts entered into after 01.07.2012, obviously, one has to choose from the options available under rule 2A.

But there can be a contrary view also.

As per Rule 2 (ba) of the Point of Taxation Rules, 2011, "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. Earlier service tax was payable on the gross amount, under the composition scheme. Now, by rescinding the composition scheme and introducing new Rule 2 A, the value on which service tax is payable has been changed. So this is "change in effective rate of tax" as contemplated in the POT Rules, 2011.

Rule 4 of the POT Rules, 2011 deals with the rate of tax applicable in case of change in effective rate of tax. The effect of this rule can be tabulated as below:

Provision of Service	Issue of Invoice	Receipt Payment	Applicable rate
Before 01.07.2012	After 01.07.2012	After 01.07.2012	Date of invoice or date of payment whichever is earlier. So new rate will apply. Rule 4 (a) (i)
Before 01.07.2012	Before 01.07.2012	After 01.07.2012	Date of invoice. So old rate will apply. Rule 4 (a) (ii)
Before 01.07.2012	After 01.07.2012	Before 01.07.2012	Date of payment. So old rate will apply. Rule 4 (a) (iii)
After 01.07.2012	Before 01.07.2012	After 01.07.2012	Date of payment. So new rate will apply. Rule 4 (b) (i)
After 01.07.2012	Before 01.07.2012	Before 01.07.2012	Date of invoice or date of payment whichever is earlier. So old rate will apply. Rule 4 (b) (ii)
After 01.07.2012	After 01.07.2012	Before 01.07.2012	Date of invoice. So new rate will apply. Rule 4 (b) (iii)

So on the one hand it can be argued that even for works contracts involving only finishing services, one can continue to pay 4.8 % service tax, it can also be counter argued that service tax has to be paid as per the rate applicable on POT as determined under Rule 4 of the POT Rules.

Author's view.

The effect of saving clause is to protect the actions during the period when the old rules were in force. If a person has not paid service tax on a works contract prior to 01.07.2012, when demand of service tax is made on him after 01.07.2012, he can stake his claim for the composition scheme. If a person has already paid service tax prior to 01.07.2012 under composition scheme, after recession of the scheme, no fresh demand of service tax can be made against him after 01.07.2012. But, the liability for the period after 01.07.2012 has to be determined only with reference to the rate applicable on point of taxation, as determined under the POT Rules. Further, if VAT was being paid on actual basis, though composition scheme was opted for payment of service tax, one can opt for payment of service tax under first part of Rule 2 A of the Valuation Rules (gross amount minus value of goods sold), after 01.07.2012.

Will the board clarify?