



*LawPublicus*  
The Legal Portal

Volume 1 : Issue 9  
2021

July, 2021

Email ID: [Lawpublicusportal@gmail.com](mailto:Lawpublicusportal@gmail.com)  
Website: [www.Lawpublicus.com](http://www.Lawpublicus.com)  
Address: A18 Dayanand Colony Lajpat Nagar - 4  
New Delhi

## **Disclaimer**

No part of this publication may be reproduced or copied in any form by any means without prior written permission of Editor-in-chief of ***LawPublicus*** The Legal Portal. The Editorial Team of ***LawPublicus*** holds the copyright to all articles contributed to this publication. The views expressed in this publication are purely personal opinions of the authors and do not reflect the views of the Editorial Team of ***LawPublicus***. Though all efforts are made to ensure the accuracy and correctness of the information published, ***LawPublicus*** shall not be responsible for any errors caused due to oversight or otherwise.

FOR ***LawPublicus*** The Legal Portal

## **Editorial Team**

### **Editor-in-Chief**

#### **Mr. Nikhil Kumar Chawla**

Partner - LawPublicus LLP  
Senior Corporate Counsel (Litigation)  
M/s Investors Clinic Infratech (P) Ltd.  
Contact: +91-9654441680  
+91-9654030411  
Email ID: [Nikhilchawla29@gmail.com](mailto:Nikhilchawla29@gmail.com)  
[Lawpublicusportal@gmail.com](mailto:Lawpublicusportal@gmail.com)

### **Senior Editor(s)**

#### **Dr. Amita Rathi**

Associate Professor – JEMTEC Greater Noida  
Contact: +91-9999612484  
Email ID: [Amrita.gn@jagannath.org](mailto:Amrita.gn@jagannath.org)

#### **Advocate K.S. Rana**

Advocate  
Contact: +91-9910326424  
Email ID: [Jyotideeprana@gmail.com](mailto:Jyotideeprana@gmail.com)

#### **Dr. Payal Jain**

Sr. Assistant Professor – IIMT (GGSIPU), East Delhi  
Contact: +91-99991733257  
Email ID: [Payaljain.iimt@gmail.com](mailto:Payaljain.iimt@gmail.com)

Editor(s)

**Dr. Vijeta Verma**

Assistant Professor – JEMTEC Greater Noida

Contact: +91-9911393623

Email ID: [Vijetaverma.gn@jagannath.org](mailto:Vijetaverma.gn@jagannath.org)

**Dr. Prashant Kumar**

Assistant Professor – IMRT, Lucknow

Contact: +91-9889109882

Email ID: [Prshntkumar6@gmail.com](mailto:Prshntkumar6@gmail.com)

**Dr. Shishma Kushwaha**

Assistant Professor – JEMTEC Greater Noida

Contact: +91-9718485919

Email ID: [Shishmakushwaha.gn@jagannath.org](mailto:Shishmakushwaha.gn@jagannath.org)

**Ms. Shivangi Sharma**

Assistant Professor – CLS, Gitarattan International Business  
School

Contact: +91-9891496247

Email ID: [Shivangi.sharma@gitarattanedu.in](mailto:Shivangi.sharma@gitarattanedu.in)

**Ms. Kriti Sharma**

Assistant Professor – GGSIPU

Contact: +91-9891354307

Email ID: [Kritisharmaks30@gmail.com](mailto:Kritisharmaks30@gmail.com)

**Ms. Yantakshikaa Sharma**

Partner - LawPublicus LLP

Career Counsellor

Contact: +91-9711249637

Email ID: [Yantakshika@gmail.com](mailto:Yantakshika@gmail.com)

## **About Us**

***LawPublicus*** The Legal Portal is a leading journal of multidisciplinary research. It is a free, peer-reviewed, open-access journal that provides insight into diverse and dynamic legal matters.

***LawPublicus*** is a novel initiative by legal minds. As the its name suggests, it is platform for young minds to ignite their willingness and inventiveness in order to contribute to the field of law through new ideas, opinions and thereby contributing to an informed citizenry.

We hope to provide a forum for young and enthusiastic writers to voice their feelings and research on interdisciplinary approaches. We also have in view to evaluate, explore and deliberate, under the tutelage of seasoned editors and academic experts, on current trends and projections based thereon in legal studies. LawPublicus focuses not only on the scholarly writings but also on numerous other approaches such as discussions, interviews, and debates with experts and qualified & industrial professionals.

We are determined and excited to bring authentic, creative and individual ideas and socially-related problems into attention.

***LawPublicus*** calls for research papers, articles, short notes, book reviews & case commentaries, that are distinctive and unpublished.

With this thought, we hereby present to you

***LawPublicus*** The Legal Portal

**“WHETHER WORKS**  
**CONTRACT IS SUPPLY**  
**OF GOODS OR SUPPLY**  
**OF SERVICE OR BOTH”**  
**– AN OVERVIEW**  
**UNDER TNVAT**

---

***Authored By:***

***Ms. P. Lavanya***

**Designation: Advocate at Madras High Court**

---

## **“WHETHER WORKS CONTRACT IS SUPPLY OF GOODS OR SUPPLY OF SERVICE OR BOTH” – AN OVERVIEW UNDER TNVAT**

By: P. Lavanya

### **ABSTRACT**

*Beyond our comfort zone the country has to move from developing tag to developed economy tag, for that the country has come across many changes to provide transparent and effective business atmosphere. Perhaps changes in terms of Value Added Tax (VAT), Service Tax, GST, etc., Which makes the taxation works more complicated and always held up with uncertainty and unclear. It is being necessary to have a backup by an agreement of transfer of property, since transfer of property involves in every sale and purchase. And also, it would be safe to proceed by collecting intention of the parties in their contracts where contract is classified accordingly. Both the transferor and transferee have duty and responsibility towards each other in the contract entered between them for the agreed work. Both for moveable and immoveable property the works contract can be executed. The true fact is works contract is a combination of supply of goods and supply of services. Pre-GST and VAT can be levied respectively on service part and goods transferred under works contract. Thus, a person in condition to pay both the taxes on a single transaction. It's to be noted that not every transfer of property is a contract of 'sale' under Sale of goods Act, 1930. And there was no proper definition for the term 'works contract' hence this paper looks to the interpretation with help of various judicial pronouncements, challenges, issues during transaction and post transaction, to help the viewers to understand 'levy of tax' 'exemption' under VAT and Service Tax, and other interstate works contract with help of interview-based clarification.*

**INTRODUCTION:**

With reference to the Era prior to the 46th amendment and Era after the 46th amendment of our constitution. In the past, tax can be levied only on 'sale of goods' as defined in Madras General Sales Tax Act and Sale of Goods Act. Before the 46th amendment, Dunkerley's Case is the master guide and as per the decision by the SC in this case, no tax can be levied on works contract. Transfer of property involved in the execution of works contract is taxable.

The general accepted principle is that when a transaction is liable for value added tax(VAT), then the same transaction will not be liable for the service tax. Similarly when service tax is paid on a transaction there will not be any liability under the VAT. But sometimes there will be overlap between VAT and service tax. VAT being a tax levied by the state government, the state government has to collect VAT on most of the transactions to reach its revenue. When service tax is being levied by the central government, the central service tax department is not worried about the VAT demand by the state government department. It is pertinent to note that in between demands of these governments the poor tax payer is saddled with the service tax and VAT demand on the same transaction, for example - works contract, software, royalty received from franchisees, right to use the goods, etc., In some cases even though both laws have clear demarcation, there is a overlapping of service tax and VAT. Construction contract falls under this category which will come under works contract. There are many types of works contract like

- dyeing contracts,
- vehicle repair contracts,
- electrical contracts,
- annual maintenance contracts for computers etc.

The term 'works contract' which includes any agreement for cash or online payment to carry out the processing, fabrication, erection, installation, fitting out, improvement, modification, repair or commissioning of any moveable or immovable property defined in Section 2(43) of the Tamil Nadu Value Added Tax Act, 2006. Requirements for works contract: Agreement - oral or written; Contractor- one who execute the contract; Contractee- person who gives contract to contractor.

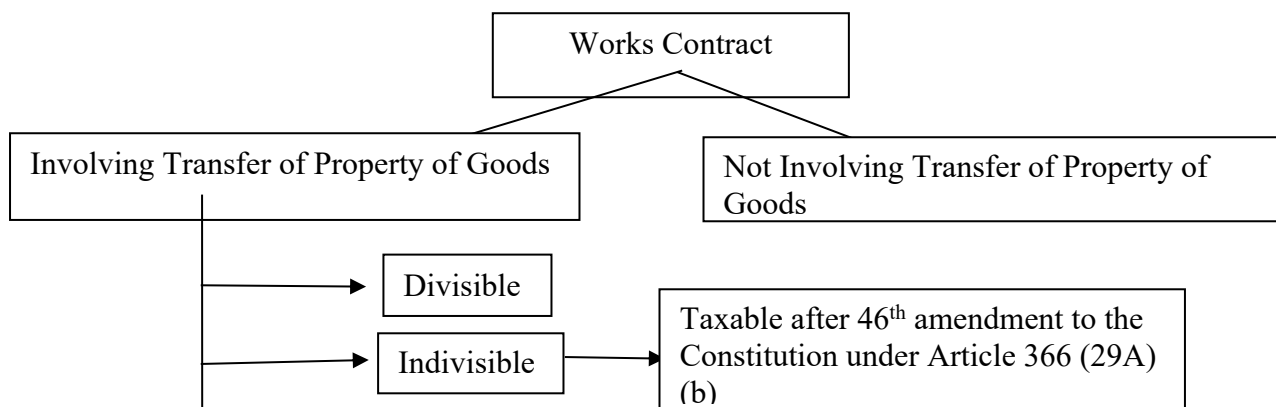


**SALE VS. WORKS CONTRACT:****Sale**

- Transfer of property in ascertained goods E.g.: any movable goods.
- No change in form before and after delivery.
- Transfer of property is a distinct activity.
- only after it is completion property in final article will pass
- Finished products is identified by its commercial identity & marketability to any.
- Purely an agreement between buyer and seller for supply of goods.

**Works Contract**

What is so important is to identify whether an act is covered under the scope of levy in the course of execution of works contract or not. If it is so covered, then the next question would be the quantification of such levy i.e., based on the tax rate. In execution of works contract there should be transfer of property in goods. The divisible contracts, Pure labour contracts or service contracts are outside the scope of the works contract. Form of goods has no relevance. In works contract transaction vesting of property must occur not by contract but on the theory of accretion and accession. Passing of the property in goods must not be only incidental to the contract but also have dominant intention to affect it in execution of works contract. Such goods, which are being transferred, should be involved in the execution of works contract.



Key Points: Goods used in the execution of contract are not physically transferred; Transfer of property is not made immediately; Transfer may be in the same form or some other form; Goods may not be ascertained goods; Possession is handed over only at the end; Payment is received on part during execution; Work may be continued in the next period also; Tax deducted at source under VAT; Contract is the basic document; Contractor should get registered in the state in which work was carried.

**VAT AUDIT IN TNVAT ACT 2006**

- Through TNVAT (Third Amendment) Act, 2012 - VAT Audit introduced in TNVAT Act.
- Filing of audit under Section 63-A
- Every reg. dealer having TOTAL TURNOVER (Taxable sale turnover and purchase turnover + exempted + zero rated + interstate – Turnover effected in other states) exceeding Rs. 1 crore shall get his accounts audited.
- The Chartered accountant or the Cost Accountant will do audit
- Time limit – Rule 16A of TNVAT Rules – Form WW to be submitted within 9 months from the end of the year in duplicate.

**SCHEDULES AND RATE OF TAX**

S.NO.	SCHEDULE	TAX RATE
1.	1 <sup>ST</sup> – PART A	1%
2.	1 <sup>ST</sup> – PART B	5%
3.	1 <sup>ST</sup> – PART C	14.5%
4.	2 <sup>ND</sup>	NON-VAT GOODS – VARIOUS RATES (Alcoholic liquors, Aviation turbine oils, petrol, diesel etc.,)
5.	3 <sup>RD</sup>	COMPOUNDING SYSTEM FOR HOTELS
6.	4 <sup>TH</sup> – PART A	EXEMPTED GOODS
7.	4 <sup>TH</sup> – PART B	EXEMPTED GOODS
8.	5 <sup>TH</sup>	ZERO RATE SALE TO INTERNATIONAL ORGANISATIONS
9.	6 <sup>TH</sup>	TRANSIT PASS
10.	7 <sup>TH</sup>	COMPOUNDING RATES TO BRICK KILN

**Commodities subject to transit pass**

- ✓ Diesel engines, Kerosene
- ✓ Marbles
- ✓ Raw rubber
- ✓ Refrigerators, air-conditioners, air-coolers and water coolers
- ✓ Washing machines
- ✓ Alcoholic liquors of all kinds for human consumption other than toddy and arrack
- ✓ Foreign liquors
- ✓ Plastic granules and plastic raw materials
- ✓ Petrol, High speed / light diesel oils
- ✓ Vegetable oils including refined oils from 08/11/2013
- ✓ Iron and steel from 08/11/2013

**METHODS OF TAX PAYMENTS OF WORKS CONTRACT**

1. Goods identification method – Section 5
2. Percentage deduction method – Rule 8 (5)
3. Compounding Method – Section 6

**Goods Identification Method – Sec 5**

Firstly, materials involved in the execution of works contract shall be identified. Secondly, transport charges and conversion charges if any shall be added to the landed cost of material purchased. Thirdly, reasonable profit margin is added to the cost of material plus transport charges and conversion charges. And then rate of tax for such purchase shall be traced from the First schedule to TNVAT Act. Finally, purchase tax under section 12 will apply.

**Percentage Deduction Method – Rule 8(5)**

When the labour and other like charges are not available separately and the same is not ascertainable from the books and records maintained by the dealer, it has to be calculated at the rates specified in Rule 8(5) on contract price.

S. No	Types of WC	Labour
1.	Electrical Contracts	15
2.	All Structural Contracts	15
3.	Sanitary Contracts	25
4.	Watch and / or clock repairs Contracts	50

5.	Dyeing Contracts	50
6.	All other Contract	30

**Composition Method – Sec 6**

Tax is payable @2% on civil works contract receipts and @ 5% in case of non civil works contract by exercising an option in writing to pay tax under this method. VAT is payable on the total contract value. Option to be exercised by applying to the assessing authority along with the first monthly return for the financial year or in the first monthly return after the commencement of the works contract. Option once exercised shall be final for that financial year. Dealers having exercised this option are not entitled to input tax credit. Dealer paying tax under this compounding method should not make interstate purchases or import from foreign countries. Dealers opting to pay tax under this compounding system of tax payment have to maintain a register with details of contracts and payments received.

**WCT TDS – SECTION 13**

Every person responsible for paying any sum to any dealer for execution of WC shall at time of payment of such sums have to deduct tax as follows.

S.No	Nature of Contract	Rate of TDS
1.	Civil Works Contract	2%
2.	Civil Maintenance works contract	2%
3.	All other works contract	5%

**Provisions Relating to WCT TDS – Rule 9**

TDS to be deducted at the time of payment to the party. To be remitted on or before 20th of the succeeding month. Form R has to be submitted to the assessing authority at the time of remittance of the amount deducted. Form T to be given to the deductee for each deduction separately within 15 days of remitting the tax. A copy must be sent to the assessing authority. For non-deduction or non-remittance the authorities can recover the TDS with interest @ 2% p.m. and along with penalty.

**Applicability of WCT TDS**

If there is no transfer of property in goods during the execution of any work. (E.g. Pure labour contract). When the dealer produces no deduction certificate in Form S (obtained from

assessing authority). Where the amount paid or credited or likely to be paid during the year by such person to the dealer for execution of works contract including civil works contract does not or is not likely to exceed Rs. 1 lakh. Interstate works contract.

### **VAT & SERVICE TAX - APPLICABLE ON CERTAIN WORKS CONTRACTS:**

Subject to VAT levied by the state government and rendering of taxable service subject to service tax levied by the central government, on certain works contracts both taxes are applicable in such transaction (sale of goods / materials) on the contract price. Examples : Construction contracts, Civil Jobs, Annual Maintenance Contracts (AMCs), Erection of Plant and Machinery etc.

In such Works Contracts / Taxable Services, as per the provisions of VAT & Service tax the working for levy of VAT & Service tax is to be done, separately. He can pay Service tax on the actual labour portion and VAT on actual Material value only in case, where the contractor opts for A-1 legal option of actual labour deduction method. No deduction for levy of service tax for the Contractor in A-2 (Standard deduction) and B (Composition Tax). Under the service tax, towards the value of material / goods involved the abatements are available for specific Taxable Services. Under the construction service 67% Abatement from the contract value is available.

### **INTER STATE WORKS CONTRACTS**

The definition of 'Sale' has amended by the Central Government under the Central Sales Tax Act, 1956. With the said amendment, 'Interstate works contract' was introduced and the states are empowered to levy C.S.T. on the interstate works contract.

When under a individuals works contract, the contractor dispatches his goods from one state to another it is called interstate works contract and the sections 3, 4, 5 of the C.S.T. Act are applicable to such deemed sales. Accordingly, on such deemed interstate sales the State of dispatch can collect the Central Sales Tax. In the cases of indivisible works contracts the contractors may not be allowed the interstate depot transfers since such dispatches are made to the sites of the Contractee situated in other state and the same are allotted for the specific Contractee. With or without C/D forms the contractor would charge CST as applicable and would invoice to the Contractee from the state of dispatch. However, in the interstate works contracts also, C.S.T. is payable only on the 'Material Value' of the Contract and not on the

Labour' portion of the Contract. In ***Projects and Services Centre and Another Vs. State of Tripura***<sup>1</sup>- Materials supplied from other states to Tripura to be used in works contract. Held not liable to local tax in Tripura but interstate works contract from the State where movement of goods commences.

In ***East India Cotton Mfg. Co. Ltd. Vs. State of Haryana***<sup>2</sup>.- Grey cloth sent by contractors for processing like bleaching, dyeing, sizing, printing etc. held as interstate works contract.

In ***Hindustan Zinc Ltd. Vs. State of A.P.***<sup>3</sup>- Zinc of specified category and purity sent for fulfilling monthly requirements from smelter plants in A.P. to Kolkata as stock transfer. The court disallowed the claim as the goods sent for specific order from TISCO and IISCO.

In ***Commr. Trade Tax, U.P. Lucknow Vs. Advance Spectra Tec (P)Ltd.***<sup>4</sup>- Dealer having works contract in U.P and offices outside U.P goods sent from offices outside U.P to U.P for the purpose of use in the existing contract. Value of such stocks transfer to be deducted from T.O in U.P. since it is interstate works contract from other states.

### **CONSTITUTIONAL PERSPECTIVE:**

The Indian Constitution has supreme power above all and is considered to be the “Mother of all Law”, where the powers are vested to enact laws in the matters between Central and States which is enumerated in 7<sup>th</sup> Schedule. It acts as machinery by which laws are made. Such ‘Division of Power’ between the Union and the State Governments plays as an important characteristic of the Constitution. Article 246 of the Constitution deals with ‘Distribution of Legislative Powers’. The legislative power under the Indian Constitution is subject to the limitation of the rule that a State Legislature cannot legislate extra-territorially, though Parliament does not suffer from this limitation.

According to Article 246, Union has been given exclusive power to make laws in respect of the matters listed in List I [called Union List] of the Seventh Schedule. And in respect of the matters listed in the List II [called State List] States have been given power to make laws as

---

<sup>1</sup> (82 STC 89)

<sup>2</sup> (90 STC 221)

<sup>3</sup> (47 VST 1) (CSTAA)

<sup>4</sup> (2011) 38 VST 336 (All).

per Seventh Schedule. Further, this article also gives power to Union and States to make laws in respect of matters not included in either Union List or State List but listed in List III [called Concurrent List]. The power given to the States in respect of matters listed in Concurrent List is subject to limitation of Article 254. It means that in the event of any inconsistency between the laws made by Parliament and laws made by the State Legislature, the former will prevail. Overall it is important to note that there is no implied restriction on the States while exercising powers under legislative heads unless expressly provided in the Constitution itself. In Entry 54 of List II, the works contract i.e., levy of tax on transfer of property in goods are enumerated. It is well settled that these laws are not free from disputes.

The Constitution (Forty Sixth Amendment) Act, 1982, granted powers to State Governments to enact laws for providing the levy of tax on the transfer of property involved in the execution of works contract, which to hitherto was not possible in lieu of Honorable Supreme Court's decision in the case of *State of Madras Vs. Gannon Dunkerley & Co (Mad) Ltd*<sup>5</sup>. Even after the said amendment in the Constitution of India on the subject under context, there still persist disputes between the trade and the tax authorities.

As a result of the 46th Amendment to the constitution, the contract which was single and indivisible was altered by a legal fiction into a contract which could be divisible into contract for sale of goods and contract for supply of labour and services. If the legal fiction introduced by *Article 366(29A)(b)* is carried to its logical end, it follows that even in a single and indivisible works contract there is a *deemed sale of the goods* which are involved in the execution of a works contract. After the 46th amendment, it has become possible for the States to levy sales tax on the value of goods involved in a works contract in the same way in which the sales tax was leviable on the price of goods and materials.

In the case of *Gannon Dunkerley and Co Vs. State of Rajasthan*<sup>6</sup>-the Hon'ble Supreme Court held that the measure of levy of the tax contemplated by Article 366(29-A)(b) is the value of goods involved in the execution of works contract. The value of goods for levying tax can be assessed only on the basis of cost of acquisition of the goods by the contractor and not on the basis of the value at the time of incorporation of such goods in the works contract as

---

<sup>5</sup> [1958] 9 STC 353 (SC).

<sup>6</sup> (SC) 88 STC 204

incorporation of the goods in the works forms part of the contract relating to work and labour which is distinct from the contract for transfer of property in goods. Therefore, the cost of incorporation of goods in the works cannot be made a part of the measure for levy of tax contemplated by Article 366(29A)(b).

**RELEVANT CASE LAWS:** Court Decisions guiding WC & its taxability before 46<sup>th</sup> amendment:

***Hindustan Shipyard Ltd. v. State of Andhra Pradesh***<sup>7</sup>: Following points emerged in Hindustan Shipyard Case.

- Difficult to lay down any inflexible rule.
- Transfer of property of goods for a price is the linchpin of definition of sale.
- Substance of the contract and not form is to be looked in.
- Things to be delivered has individual existence before the delivery as sole property of the person who delivers it, then it is Sale.
- If bulk of material used belongs to the manufacturer who sell the end product, it is a strong point that it is Contract for Sale.
- However, the above tests are not decisive.

***Associated Cement Companies Ltd., Vs CC***<sup>8</sup>

–Intention of the Contract is immaterial.

–Even if dominant intention of the contract is rendering of service

–Being it as a WC , if material is involved in that WC then,

–The state is empowered to levy sales tax on the material used in such contract

***Builders' Association of India Vs. UOI***<sup>9</sup>

- By legal fiction,
- Indivisible contract becomes divisible into
  - sale of goods,
  - supply of labour and
  - Supply of service

---

<sup>7</sup> 2000 AIR SCW 2582; (2000) 6 SCC 579; 119 STC 533; 2000(5) SCALE 216.

<sup>8</sup> 2001 (1) 124 STC 59

<sup>9</sup> 73 STC 370 (SC)



***State of Tamilnadu vs. Anandam Viswanathan*<sup>10</sup>**

- The finished product supplied to a particular customer is not a commercial commodity.
- In the sense that it cannot be sold in the market to any other person.
- Hence the transaction is only a WC

***State of Gujarat v. Kailash Engineering Co.*<sup>11</sup>**

If Unfinished goods are held as the property of the buyer, then it is a WC.

***State of Madras v. Gannon Dunkerley & Co.*<sup>12</sup>**

- Tax can be levied only on sale of goods.
- It is an indivisible Works Contract, and so there is no sale of goods.
- The material used therein becomes property of the other by the theory of Accretion.
- Hence no sale tax can be levied on such material.

***State of Madras v. Voltas Ltd.*<sup>13</sup>**

–WC for designing, fitting and commissioning on AC equipment.

–It is not sale of goods

***Studio Sujatha V. Commissioner of Sales Tax*<sup>14</sup>**

Photographers taking photograph of clients, developing negatives and supply it to the clients not a case of WC.

Monthly returns already filed can be revised even after filing VAT audit report despite as per statute time limit is 6 months from the last day of the month to which return pertains. Because, errors can be corrected only after audit.<sup>15</sup>

When the purchasing dealer has properly paid the tax to the selling dealer and has proper evidence as laid down in Rule 10(2) of TNVAT Rules, he cannot be denied credit simply because selling dealer has not paid the tax and not filed monthly return.<sup>16</sup>

---

<sup>10</sup> (1989) 1 SCC 613; (1989) 73 STC 1 (SC)

<sup>11</sup> (1967) 19 STC 13 (SC); AIR 1976 SC 2108

<sup>12</sup> AIR 1958 SC 560; 1959 SCR 379; (1958) 9 STC 353 (SC)

<sup>13</sup> (1963) 14 STC 446 and 861 (Mad HC)

<sup>14</sup> 17 VST 289, Orissa H.C

<sup>15</sup> (2014) 41 taxmann.com 19 (P&H)

<sup>16</sup> *Sri Vinayaga Agencies Vs The Assistant Commissioner*, 29th Jan, 2013 – Madras HC

Also when RC of selling dealer have been cancelled with retrospective effect, ITC reversal is not warranted when RC was in vogue.<sup>17</sup> In *DCIT Madurai Vs M/s. Jalaram Depot*<sup>18</sup> the Madras High Court, Madurai Branch held that stock difference cannot be arrived in terms of money value in an arbitrary manner.

**No Spot collection:** During the time of inspection by the enforcement wing officers, spot collection of VAT is against law and the same is without any authority of statutory provisions. HC has directed the enforcement wing officer to return the cheque collected during the time of inspection.<sup>19</sup> If any statement containing wrong facts are recorded during the time of inspection, the dealer may file a detailed objection informing the real facts immediately after inspection by way of RPAD.

**No Purchase Tax on Traders:** If a trader purchases goods from untaxed sources and sells the same as such (without involved in manufacturing activity) or without dispatch of goods to other states otherwise than by way of sale, he will not liable for purchase tax held in *State of Tamilnadu Vs S. Vaithyanatha Swamy*.<sup>20</sup>

**Restoration of input tax credit:** Petitioner has reversed the entire input tax credit for stock transfer outside the state instead of keeping beyond 3%. This was noticed after 3 years. Hence the petitioner filed an application with the department to consider restoration of input tax credit. Petition was not considered by the department for long time hence they filed a writ petition. Madras High Court considered the writ and directed to department to consider the representation of the petitioner and to pass appropriate order.<sup>21</sup>

### **COMMON ERRORS THAT MAY BE OBSERVED DURING VAT AUDIT**

- Not raising an invoice for sales.
- Non-payment of net tax within 20th of subsequent month.
- Non-payment of VAT on unregistered dealer purchase.
- Tax payments for URD purchases, set off not availed.

---

<sup>17</sup> *Tamilnadu PlyVs Commercial Tax officer*, 2014 (8) TMI 22 – Madras High Court

<sup>18</sup> WP No 100/2012 Dt 11/10/2012.

<sup>19</sup> *Muragents Vs Commercial Tax Officer, Mannargudi and another*, 61 VST Page 35.

<sup>20</sup> Madras HC, 53 VST page 323.

<sup>21</sup> *Madura Coats Pvt. Ltd., Vs Commercial Tax Officer*, 2014 (7) TMI 2010

- Tax payments for URD purchases, set off availed immediately rather than at the time of sale (dealer) or at the time of use in manufacture (manufacturer).
- Exemptions claimed though items not specifically covered.
- Exemptions claimed though the conditions are not fulfilled.
- Stock transfer of goods without payment of CST where the buyer or consignee is known.
- Inputs set offs missed out due to lack of knowledge on admissibility.
- Non reversal of 5% for stock transfer out of the state
- Non reversal of 3% for interstate sales
- Inputs set offs not proportionately reduced for rejection of inputs.
- Set offs availed for inputs used to manufacture exempted items.
- Inputs set off not availed for the inputs used commonly in taxable and no taxable items.
- Input set off availed on Xerox copy of tax invoice.
- Availing and utilizing the set off on defective input documents such as: no TIN No., VAT not clearly indicated on invoice, no serial number.
- Availing VAT credit set off on construction materials where the dealer does not deal in such goods
- Not debiting tax when the materials on which set offs are availed are removed to the service wing of the factory or to the service unit.
- Goods being classified under a wrong heading
- Calculation of value for discharging tax without considering the discount granted to customers.
- Frequent delays in taking the input set off necessitating the payment of tax
- The system of non-updation of sales registers for cancelled invoices.
- The absence of a system of recording entry in the job work control register when the goods are sent for job work or when they are returned back along with recording the scrap returned.
- The system of sending and receiving the materials without delivery challans/ documents.
- Failure to intimate the Department about the change in the constitution of the firm or company.
- ITC reversal based on department's oral instruction without validating the same with consultants or referring law.
- System of cancellation of invoices without VAT Reversal

- Availing the credit based on material receipt without materials being inwarded – Invoices without GRNs or security gate pass entry
- System of non-reconciliation where materials are sent for job worker. Esp in case of materials sent are in kgs but received in numbers.
- System of non-reconciliation of turnover as per VAT return and Excise returns.
- System of non-reconciliation of ITC figure as per VAT return and GL

#### **INTERVIEW BASED CLARIFICATIONS:**

1. **IS WORKS CONTRACT LIABLE TO TAX UNDER TAMILNADU VAT ACT, 2005?** Yes. The value of sale of goods used in the execution of works contract is liable to tax. The liability however arises if the contractor is registered or is liable to be registered under TNVAT Act, 2005.
2. **WHO HAS TO BE REGISTERED FOR VAT?** The following works contractors are required to be registered for VAT regardless of turnover threshold: Every dealer executing any works contract exceeding Rs.5 lakhs for State Government or local authority; Every dealer opting to pay tax by way of composition on works contract.
3. **HOW DO I CALCULATE MY TAX LIABILITY AS A WORKS CONTRACTOR, IF I AM A VAT DEALER?** Every works contractor needs to pay tax on the value of goods used at the time of incorporation in the execution of works contract, at the rates applicable to such goods. However, if he is unable to determine the value of goods, he needs to pay tax @ 12.5% on the total value, subject to certain deductions.
4. **IS THERE ANY PROVISION FOR PAYMENT BY WAY OF COMPOSITION FOR WORKS CONTRACTORS?** Yes. There are different schemes of composition for different works contractors. a) If you are a dealer executing works contract for State Government / Local authority, you may opt to pay tax @ 4% on the total value of such contract. In such cases tax @ 4% will be collected at source and will be remitted to the department. b) In case you are constructing and selling residential apartments, houses, buildings or commercial complexes, you can opt to pay tax by way of composition at the rate of 4% on 25% of the total consideration received or receivable or the market

value whichever is higher. The balance 75% of the total consideration will be allowed as deduction. c) If you are executing any other works contracts you may opt to pay tax by way of composition for any specific contract at the rate of 4% of 50% of the value of contracts. The balance 50% of the total value will be allowed as deduction.

5. **WHAT IS THE PROCEDURE FOR OPTING FOR COMPOSITION?** You need to fill in Form VAT 250 and submit in your tax office. If you are- (i) a contractor executing works for State Government & local authority and / or (ii) a contractor executing works other than for State Government and local authority and building apartments; you are required to exercise option for each contract before the end of the month in which the work has commenced. The composition so opted for shall be valid for that specific contract. If you are a builder & developer of apartments, once an option is exercised, the composition shall be effective from the 1st day of the month in which application is made and shall terminate on the last day of the month in which the application for withdrawal is made.
6. **IF I AM A TOT DEALER, WHAT IS MY TAX LIABILITY?** You must pay tax at the rate of 1% on the value of the goods used in works contract and you will not be eligible to claim input tax credit. If you are a TOT dealer and did not maintain accounts to determine the correct value of goods you must pay tax at 1% on total value of contract from which the following expenditure will be deducted. a) Labour charges b) Charges for planning, designing and architecture c) Hire charges for machines and tools d) Cost of consumables such as water, electricity fuel etc. e) Cost of establishment relating to labour and services f) Other expenses relating to labour and services g) Profits earned relating to labour and services.
7. **IF I AM A VAT DEALER EXECUTING WORKS CONTRACT, WHAT ARE THE METHODS OF CALCULATING MY TAX LIABILITY?** You need to pay tax only on the value of the goods used at the time of incorporation in the execution of the works contract at the rates applicable to those goods. To arrive at the taxable turnover, the expenditure mentioned in Answer to Q.6 above can be deducted from the total value of the contract. If you are a VAT dealer executing works contract and did not maintain accounts to determine the value of the goods, you are liable to pay tax @ 12.5% of the total value of the contract reduced by the standard deductions prescribed

in AP VAT Rules 2005. For Eg: If you are a contractor involved in installation of plant & machinery, and you have not maintained accounts for determining the value of the goods used in the contract, a standard deduction of 15% will be allowed from the value of the contract. You will need to pay tax @ 12.5% on the balance 85% of the value of the contract.

8. **CAN I ISSUE A TAX INVOICE IF I HAVE OPTED FOR COMPOSITION?** No. You cannot issue a tax invoice, if you have opted to pay tax by way of composition.
9. **IF I AM A SUB-CONTRACTOR WHAT IS MY TAX LIABILITY UNDER AP VAT ACT 2005?** A sub-contractor of a main contractor who executes works for State Government or local authority is exempt to the extent of the value of the such sub-contract. In this case the main contractor will be liable to pay tax on the total value of the contract. The sub-contractor will not be eligible to claim input tax credit on goods used in the execution of such sub-contract. Other sub-contractors are not exempt. Such sub-contractors can either opt to pay tax by way of composition or pay at the normal rate applicable to the goods. If the sub-contractor opts to pay tax by way of composition, no input tax credit will be allowed. Other sub-contractors can claim input tax credit provided they are registered for VAT.
10. **WHAT ARE THE PROVISIONS FOR TAX COLLECTION AT SOURCE (TCS) IN THE AP VAT ACT 2005?** If you are a VAT dealer and executing works contracts for State Government Departments or local authority, such contractees concerned shall collect the tax at the rate of 4% for each payment released to you by applying tax fraction of 1/26 to such payment and issue a certificate to you to that effect. In such cases you are not directly required to pay tax related to such transactions.
11. **ARE THERE ANY PROVISIONS FOR TAX DEDUCTION AT SOURCE?** Any Company or Government Undertaking shall deduct tax at the rate of 2% of the amount paid or payable to the contractor registered as a VAT dealer and issue a certificate to the contractor. Any firm which awards any contract exceeding Rs.10 lakhs to a VAT dealer, shall also deduct tax @ 2% of the amount paid or payable to such contractor. The contractor shall send that Form to the prescribed authority within 15 days from the

date of each payment made to him. The contractor needs to pay tax if the tax deducted is less than what he has declared on the VAT return or what he is liable for.

**CONCLUSION :**

Hope all said and done the very concept of works contract under TN Value Added Tax do not countenance multiplicity of levies. Though works contract is a composition of supply of goods and supply of service, under para 6 of Schedule II of the CGST Act, the legislature has treated the works contract as supply of service. And also it is necessary to banish Central Tax Act, Entry Tax Act, and such other parallel statutes to govern work contracts. If it is not possible to avoid leakage of revenue, to avoid arbitrary assessments by the taxing authorities, to ensure easy tax compliance by the contractors, to ensure transparency of payments made as consideration money for execution of work contracts by the contractees, a self-contained uniform Tax on works Contracts Act need be enacted by Parliament which should be administered by the State Government and the resultant fruits of revenue be appropriated by the respective states.

---

*This case study is for information purpose only. Nothing contained herein shall be deemed or interpreted as providing legal or investment advice.*