GROSS AMOUNT AT CROSS ROADS…..

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Valuation, *per se,* is litigation prone, be it Excise or Customs and Service Tax is no exception. The valuation provisions under service tax are so flamboyant that they are sure to undergo a thorough evolution and revolution, in days to come, due to varied interpretations and judicial interventions. In this article, we have chosen to address one of a highly interesting and intrinsic component of Service Tax valuation.

"Gross amount" is a term, which is going to be the bone of contention for the bulk of the litigations in the valuation of taxable services Section 67 of the Finance Act, 1994 defines the value of taxable service as "gross amount charged by the service provider". The said section also specifies certain inclusions as well as exclusions.

As pointed out earlier, gross amount charged by the service provider is always considered as the value of taxable service, subject to the provisions of Section 67 ibid. Often, the said gross amount would not be the consideration only for the services rendered by the service provider. During the course of rendering the service, the service provider would be required to incur certain expenses, which would be reimbursed by the customer. There are conflicting circulars on the subject as to whether such reimbursements shall be included in the gross amount or not and we refrain from making the pond more murkier, for the time being.

Similarly, the service providers would often purchase and use several goods and materials, during the course of such service and the gross amount charged by him from his customer, would also include the value of such goods and materials also. More often than not, segregating the value of such goods and materials used during the course of service, would be practically very difficult, due to variety of reasons. As the levy of service tax is only on the taxable services and not on the value of goods and materials used and sold during the course of service, the legislators have made adequate provisions in this regard. Section 67 itself provides for certain exceptions in this regard.

As per Notification 12/2003 ST Dated 20.06.2003, value of goods and materials sold by the service provider to the recipient of service is excluded from the value of taxable service, for the purpose of computation of service tax liability. This is subject to the conditions that there must be documentary proof towards such value of goods and materials and no Cenvat credit should be taken in respect of such goods and materials sold. The benefit of this Notification is available for all taxable services.

Several other Notifications have also been issued, to provide for abatement from the gross amount charged, in cases where the gross amount charged by the service provider also includes the value of goods and materials. The following Notifications may be referred to in this regard.

Notification 19/2003 ST Dt. 21.08.2003	Applicable for erection, commissioning and installation service. An abatement of 67 % is admissible from the gross amount charged, in case of supply of

	plant, machinery or equipment and erection, commissioning and installation of the said plant, machinery or equipment.
Notification 15/2004 ST Dt. 10.09.2004.	Provides for 67 % abatement, in case of commercial or industrial construction service.
Notification 18/2005 ST Dt. 07.06.2005.	Provides for 67 % abatement, in case of services of construction of residential complex.

These Notifications have common conditions like, non availment of notification 12/2003, non availment of Cenvat credit on such goods and materials, etc.

The purpose of these Notifications have been explained in various Circulars, which are reproduced below:

Circular No. 62/11/2003 Dated 21.08.2003.
Notification No. 19/2003-Service Tax, dated 21-8-2003 has been issued which provides that in case of a contract which involves the commissioning or installation service along with supply of plant, machinery or equipment, service tax will be payable only on 33% of the gross amount charged for commissioning or installation and supply of plant, machinery or equipment. It is optional for the assessee to avail of this notification. It is emphasized under this notification that the gross amount (33% of which is chargeable to service tax) shall include the value of the plant, machinery, equipment, parts and any other material sold by the service provider along with the commission or installation service. The benefit of this notification can be availed for a contract only if the exemption under Notification No. 12/2003-Service Tax, dated 20-6-2003 is not availed for that contract.

Circular No. 80/10/2004 Dated 17.09.2004.
The gross value charged by the building contractors include the material cost, namely, the cost of cement, steel, fittings and fixtures, tiles etc. Under the Cenvat Credit Rules, 2004, the service provider can take credit of excise duty paid on such inputs. However, it has been pointed out that these materials are normally procured from the market and are not covered under the duty paying documents. Further, a general exemption is available to goods sold during the course of providing service (Notification No. 12/2003-S.T.) But the exemption is subject to the condition of availability of documentary proof specially indicating the value of the goods sold. In case of a composite contract, bifurcation of value of goods sold is often difficult. Considering these facts, an abatement of 67% has been provided in case of composite contracts where the gross amount charged includes the value of material cost. *(refer Notification No. 15/2004-S.T., dated 10-9-2004)*. This would, however, be optional subject to the condition that no credit of input goods, capital goods and no benefit (under Notification No. 12/2003-S.T.) of exemption towards cost of goods are availed.

Now to the crux of the issue.

Whether the value of goods and materials supplied by the client / customer shall also be included in the gross amount, for the purpose of computing the abatement?

Notification 19/2003 pertaining to erection, commissioning and installation service, contains the following Explanation:

> *Explanation.* - For the purposes of this notification, the gross amount charged shall include the value of the plant, machinery, equipment, parts and any other material sold by the commissioning and installation agency, during the course of providing commissioning or installation service.

From the above, it may be observed that the gross amount charged shall include the value of the plant, machinery, equipment, parts and any other material **sold** by the erection, commissioning and installation agency, during the course of providing the service. The materials supplied by the customer / client, would not be sold by the service provider and hence the same is not includible in the term gross amount.

But, the issue not so simple in case of other services, viz., commercial or industrial construction and construction of residential complex.

Originally, Notification 15/2004 did not contain any such Explanation. Later, the following Explanation was added in the notification, vide Notification 4/2005 Dt. 01.03.2005.

> *Explanation.* - For the purposes of this notification, the "gross amount charged" shall include the value of goods and materials supplied or provided or used by the provider of the construction service for providing such service.'.

Similar Explanation is available under Notification 18/2005 also.

A reading of the above explanation would reveal that what is sought to be included is the **"value of goods and materials supplied / provided / used by the service provider"**, as against the "value of goods and materials sold", under Notification 19/2003. In as much as the goods and materials supplied by the customer / client are also **used** by the service provider for providing such service, one may tend to argue that the value of such FOC supplies shall also be included in the gross amount, for computing the abatement. To put it illustratively, if a service provider charges Rs.8,00,000 for the goods and materials sold by him as well as for the services rendered by him and the customer / client also supplies materials worth Rs.2,00,000, one may argue that in as much as the goods and materials supplied by the customer / client are also **used** by the service provider, the same shall also be included in the "gross amount charged", as per the Explanation and hence the service tax payable would be Rs.33,000 (10 % on 33 % of Rs.8,00,000 + Rs.2,00,000).

But, we strongly feel otherwise, for the following reasons.

- The legislative intention behind these notifications are explained in the above referred circulars and it may be inferred therefrom that the benefit of abatement has been provided only in respect of composite contracts, where bifurcation of the value of goods and materials sold is often difficult.

- As per Section 67, which is the magna carta for valuation under service tax, there is no provision to add the value of FOC supplies, in the value of taxable service (Unlike the case of Rule 6 under CE Valuation Rules). An exemption Notification cannot override Section 67.
- The terms / supplied / provided / used, in the Explanation shall be read *ejusdem generis.* When the term goods and materials supplied / provided, refer only to the goods and materials supplied by the service provider, the term "used' cannot be given an extended meaning so as to cover the goods and materials supplied by the customer / client.
- The explanation says only "value of goods and materials supplied / provided / used" and not "value of **all** goods and materials supplied / provided / used.

In view of the above, we are of the opinion that the value of FOC items supplied by the customer / client, need not be includes by a construction service provider, for the purpose of computing the 67 % abatement.

Before parting…

The department may also argue that when the value of goods and materials supplied, provided or used is not included in the gross amount charged, the amount charged cannot be considered as "gross amount charged" as per the Explanation, and the benefit of the notification itself cannot be claimed. Such an interpretation would only result in an academic addition and not any enhanced revenue collection, as detailed below:

Let us see an illustration. Let us assume that the value of FOC supply items shall be included in the gross amount charged, for the purpose of claiming abatement. Accordingly, in our earlier example, the service tax payable would be 10 % of 33 % of (Rs.8,00,000 + Rs.2,00,000) = Rs.33,000. The service provider would raise a bill on his customer for Rs.8,00,000 plus service tax payable of Rs.33,000. Let us assume that the customer refuses to bear the service tax on the value of materials supplied by him and pays only Rs.8,26,400 (Rs. 8,00,000 towards value plus service tax of Rs.26,400 i.e. 10 % of 33 % of Rs.8,00,000). It is an undisputed fact that service tax liability is only on realization. As such, in this case the service provider would pay a service tax of only Rs.26,400 to the government. Ultimately, the addition of the value of materials supplied by the customer is only an academic exercise. It is a famous maxim *that "When God closes one door, He opens the other"*. In revenue matters, when one loophole is plugged, the other gets opened!