ANALYSIS OF AMENDMENT IN Service Tax (Determination of Value) Rules, 2006 BY NN 24/2012 ST DATED 06.06.2012:

(Before proceeding further please read the disclaimer at the bottom of this write up)

Along with Finance Bill 2012, notification number 11/2012 ST dated 17.03.2012 has been issued and amended Service Tax (Determination of Value) Rules, 2006 wef 01.07.2012. However, now NN 24/2012 ST Dated 06.06.2012 has superseded NN 11/2012 ST dated 17.03.2012 even before it became effective. It has amended valuation rules wef 01.07.2012 as under:

S. No.	Rules Amended	WEF	Amendment
1.	Rule 2A: Determination of value of taxable services involved in the execution of a works contract	01.07.2012	Substituted
2.	Rule 2C: Determination of value of service in relation to money changing	Do	Amended
3.	Rule 2C: Determination of value of taxable service involved in supply of food and drinks in a restaurant or as outdoor catering	Do	Newly Inserted
4.	Rule 3: Manner of determination of value	Do	Amended
5.	Rule 5: Inclusion in or exclusion from value of certain expenditure or costs	Do	Amended
6.	Rule 6: Cases in which the commission, costs, etc., will be included or excluded	Do	Amended
7.	Rule 7: Actual consideration to be the value of taxable service provided from outside India	Do	Omitted

HERE IMPORTANT THING IS THAT WE SHOULD IGNORE THE AMENDMENTS BROUGHT BY NN 11/2012 ST DATED 17.03.2012.

A. Rule 2A has been substituted and now if value of works contract service can-not be determined normally as per these rules then it shall be determined as per provisions of rule 2A (1) (ii) which provides abatement in respect of value of goods involved in execution works contracts. Now there are three method for valuation of works contracts services as under:

1. As per Composition Scheme (i.e. to pay service tax @ 4.80% instead of 12%)
2. As per Rules 2A(1)(i) (i.e. value to be determined normally)
3. As per Rules 2A(1)(ii) (i.e. By availing abatement in respect of value)

Here interesting point is that option 3 above available when value can-not be determined under option 2. Conclusively value under works contract services can be determined as under:

Before introduction of Negative list approach (i.e. up to 30.06.2012) valuation of works contract service is done as under:

S. NO.	PARTICULARS	OPT FOR COMPOSITION SCHEME	NOT OPT FOR COMPOSITION SCHEME
1.	Value	Gross amount charged = + Value of all goods (including goods received free of cost) + value of all services -vat or sales tax -cost of machinery and tools used for execution of work. [As per explanation of rule 3 of Works Contract (Composition Scheme for Payment of Service Tax) Rules,	Value of works contract service= + Gross amount charged – value of goods –sales tax/vat (As per rule 2A of SERVICE TAX (DETERMINATION OF VALUE) RULES, 2006)

		2007]	
2.	CENVAT credit may be taken	1. Input services 2. Capital goods But CENVAT credit cannot be taken of **input and goods** involved in execution of work.[Rule 3 (2) of of the Works Contract (Composition Scheme for Payment of Service Tax) Rules, 2007] The CENVAT credit of **tax paid** on following taxable services 1. Erection, commissioning and installation services u/s 65 (105)(zzd), 2. Commercial or industrial construction services u/s 65 (105) (zzq) 3.Construction of complex services u/s 65 (105)(zzzh), shall be available only to the **extent of 40%** of the service tax paid when such tax has been paid on the full value of the service after availing CENVAT credit on inputs. {(WEF 01.03.11) [Rule 3 (2A) of of the Works Contract (Composition Scheme for Payment of Service Tax) Rules, 2007]}	1. Inputs 2. Input services 3. Capital goods But CENVAT credit cannot be taken of **goods** involved in execution of work. [As per Circular No.98/1/2008-ST dated 04.01.08]
3.	Rate of service tax	4.944% (4.80% + 3% of 4.80)	12.36%

Relevant portion with respect to WCS of changes in definition of input service as per CENVAT Credit Rules, 2004

List of Services Specified Under Rule 2 (l) (ii) (A) of CENVAT Credit Rules, 2004

Input Service

1. Port Services [65 (105) (zn)]
2. Port Services in other port [65(105)(zzl)]
3. Air Port Services [65(105)(zzm)]
4. Commercial or Industrial Construction Services [65(105)(zzq)]
5. Construction of Complex Services [65(105)(zzzh)]
6. Works Contract Services [65(105)(zzzza)]
7. Architect's Services [65 (105) (p)]

If the above services are used for the

(a) construction of a building or a civil structure or a part thereof; or

(b) laying of foundation or making of structures for support of capital goods

then these services shall not be considered as input services and accordingly CENVAT credit shall not be allowed. In other words, if the above services are used for provision of services **other than construction etc.** in clause (a) & (b) then they shall be included in the definition of input services and accordingly CENVAT credit shall be taken.

After introduction of negative list approach i.e. wef 01.07.2012, provisions related with valuation of works contract services are as under:

<table>
<tr><th>S. NO.</th><th>PARTICULARS</th><th>OPT FOR COMPOSITION SCHEME</th><th colspan="2">NOT OPT FOR COMPOSITION SCHEME</th></tr>
<tr><td>1.</td><td>Value</td><td>Gross amount charged =

+ Value of all goods (including goods received free of cost)

+ value of all services

-vat or sales tax

-cost of machinery and tools used for execution of work.

(As per explanation of rule 3 of Works Contract (Composition Scheme for Payment of Service Tax) Rules, 2007)</td><td>Value of service portion in execution of works contract service=

+ Gross amount charged

– value of goods

–sales tax/vat

(As per rule 2A(i) of SERVICE TAX (DETERMINATION OF VALUE) RULES, 2006)</td><td colspan="2">If value cannot be determined under 2A(i) of SERVICE TAX (DETERMINATION OF VALUE) RULES, 2006) then it shall be determined under Rule 2A(ii) as under

<table><tr><td>Case</td><td>Value of service portion in execution of works contract service</td></tr><tr><td>works contracts entered into for execution of <u>original works</u></td><td>40% of the total amount charged</td></tr><tr><td>works contract entered into <u>for maintenance or repair or reconditioning or restoration or</u></td><td>70% of the total amount charged</td></tr></table></td></tr>
</table>

				servicing of any goods	
				other works contracts	**60%** of the total amount charged

Most Important Note:

We found that some practitioners are considering and advising following values as brought by NN 11/2012

Case	Value of service portion in execution of works contract service
works contracts entered into for execution of **original works**	40% of the total amount charged
works contracts entered into for execution of **original works where gross amount charged includes value of**	25% of the total amount charged

<table>
<tr><td></td><td></td><td></td><td></td><td><table>
<tr><td><u>land</u></td><td></td></tr>
<tr><td>other works contracts</td><td>60% of the total amount charged</td></tr>
</table>

<u>These provision are not applicable at all as same has been substituted by NN 24/2012 even before they became effective.</u></td></tr>
<tr><td>2.</td><td>Cenvat credit may be taken</td><td>1. Input services
2. Capital goods
But cenvat credit cannot be taken of input and goods involved in execution of work.[Rule 3 (2) of of the Works Contract (Composition Scheme for Payment of Service Tax) Rules, 2007]

The CENVAT credit of tax paid on following taxable services 1. Erection, commissioning and installation services u/s 65 (105)(zzd),</td><td colspan="2">1. Input services
2. Capital goods
But cenvat credit cannot be taken of input and goods involved in execution of work. [As per Circular No.98/1/2008-ST dated 04.01.08 and explanation 2 of Rule 2A]</td></tr>
</table>

		2. Commercial or industrial construction services u/s 65 (105) (zzq) 3.Construction of complex services u/s 65 (105)(zzzh), shall be available only to the **extent of 40%** of the service tax paid when such tax has been paid on the full value of the service after availing CENVAT credit on inputs. {(WEF 01.03.11) [Rule 3 (2A) of of the Works Contract (Composition Scheme for Payment of Service Tax) Rules, 2007]}	
3.	Rate of service tax	4.944% (4.80% + 3% of 4.80)	12.36%

B. Rule 2B amended and reference to the following services has been omitted

1. Banking and other financial services section (65) (105) (zm)
2. Foreign exchange broker & money changing services section (65) (105) (zzk)

It is done in tune with introduction of negative list approach as classification of services would no longer require.

C. New Rule 2C has been **inserted** **to determine value of taxable service involved in supply of food and drinks in a restaurant or as outdoor catering as under**:

2C. Determination of value of service portion involved in supply of food or any other article of human consumption or any drink in a restaurant or as outdoor catering.- Subject to the provisions of section 67, **the value of service portion**, in an activity wherein goods being food or any other article of human consumption or any drink (whether or not intoxicating) is supplied in any manner as a part of the activity at a restaurant or as outdoor catering, shall be the specified percentage of the total amount charged for such supply, in terms of the following Table, namely:-

Table

Sl. No.	Description	Percentage of the total amount
(1)	(2)	(3)
1.	Service portion in an activity wherein goods, being food or any other article of human consumption or any drink(whether or not intoxicating) is supplied in any manner as a part of the activity, **at a restaurant**	40
2.	Service portion in outdoor catering wherein goods, being food or any other article of human consumption or any drink(whether or not intoxicating) is supplied in any manner as a part of such **outdoor catering**	60

Explanation 1. - For the purposes of this rule, “total amount” means the sum total of the gross amount charged and the fair market value of all goods and services supplied in or in relation to the supply of food or any other article of human consumption or any drink (whether or not intoxicating), 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 goods classifiable under Chapters 1 to 22 of the Central Excise Tariff Act, 1985 (5 of 1986).**

D. In Rule 3 for the words "where the consideration received is not wholly or partly consisting of money" the words "where such value is not ascertainable" shall be substituted.

E. In explanation to Rule 5 for the words **"services specified in section 65(105)(zzzx) of the Finance Act, 1994, the value of taxable service shall be the gross amount paid by the person to whom telecom service is provided by the telegraph authority"**, the words **"the value of the telecommunication service shall be the gross amount paid by the person to whom telecommunication service is actually provided."** shall be substituted.

F. In rule 6(1) following clause shall be **inserted**:

1. "(x) the amount realised as **demurrage or by any other name** whatever called for the provision of a service beyond the period originally contracted or in any other manner relatable to the provision of service."

Now value of taxable services shall include demurrage charges. Demurrages charges are payable for use of services beyond the period initially agreed upon e.g. use of containers beyond the normal period.

Earlier CBEC through Circular No. 121/3/2010-ST dated 26.04.2010 has clarified that to retain the container beyond the pre-holding period is neither a service provided on behalf of the client (Business Auxiliary Service) nor is it an infrastructural support in the business of either the shipping lines or the customer (Business Support Service). Such charges can at best be called as 'penal rent' for retaining the containers beyond the pre-

determined period. **Therefore, the amount collected as 'detention charges' is not chargeable to service tax.**

From July 1, 2012 service tax will be levied on the demurrage amount ordered by a court.

Demurrage charges are usually related to transportation or shipment business and refer to penalty paid for exceeding the free time allowed for loading, unloading, shipment or delivery. "In some specific cases or dispute settlements in which the court orders for the payment of cost against loss or as demurrage charge will attract service tax on it," SK Goel, chairman, Central Board of Excise and Customs (CBEC), told HT.

But no tax will be levied on compensation paid, claims or alimony out of a divorce suit, he said.

"Usually compensation or cost that the court awards is not taxable, but henceforth any such cost ordered by the court after a dispute settlement that would be paid in the form of a demurrage charge — whether it's in transportation or a contractor's failure to complete a building causing loss to the client would attract 12% service tax," said JK Mittal, Supreme Court lawyer and tax consultant.

Source: **http://www.hindustantimes.com/business-news/CorporateNews/Charges-on-penalty-will-now-attract-Service-Tax/Article1-868984.aspx**

Relevant extract of DOF letter dated 16.03.2012

This change will become relevant in the context of negative list where such amounts may be collected in the name of demurrage but will actually be in all respects a service.

2. Rule 6(2)(iv) shall be substituted as under:

Old provision:

the value of any taxable service, as the case may be, **does not include**

(iv) interest on loans.

New provision:

the value of any taxable service, as the case may be, **does not include**

(iv) interest on delayed payment of any consideration for the provision of services or sale of property, whether moveable or immoveable;

Relevant extract of DOF letter dated 16.03.2012

This will keep such amounts outside the value and thus not be relevant for reversal of credits under rule 6(3) of CCR, 2004. Interest on loans will now be an exempt income rather than an exclusion from value.

3. In rule 6(2) following clauses shall be inserted:

"(vi) **accidental damages** due to unforeseen actions not relatable to the provision of service; and"

"(vii) **subsidies and grants disbursed** by the Government, not directly affecting the value of service."

Now these charges are expressly excluded from the value of any taxable services.

Relevant extract of DOF letter dated 16.03.2012

iii Under the list of exclusions in sub-rule (2) from taxable value "accidental damages due to unforeseen actions not relatable to the provision of service" is being added. This again is in view of the negative list approach to taxation of services and to confine inclusions of demurrages to those under category I above and not beyond.

2.2.8 Would the payments in the nature as explained in column A of the table below constitute a consideration for provision of service?

S. No.	A	B
	Nature of payment	Whether consideration for service?
1.	Amount received in settlement of dispute.	Would depend on the nature of dispute. Per se such amounts are not consideration unless it represents a consideration. If the dispute itself pertains to consideration relating to service then it would be a part of consideration. For example the amount may represent payments for an executed works contract in dispute.
2.	Amount received as advances for performance of service.	Such advances are consideration for the agreement to perform a service.
3.	Deposits returned on cancellation of an agreement to provide a service.	Returned deposits are in the nature of a returned consideration. If tax has already been paid the tax payer would be entitled to refund subject to provisions in this regard.
4.	Advances forfeited for cancellation of an agreement to provide a service.	Since service becomes taxable on an agreement to provide a service such forfeited deposits would represent consideration for the agreement that was entered into for provision of service.
5.	Security deposit that is returnable on completion of provision of service.	Returnable deposit is in the nature of security and hence do not represent consideration for service.
6.	Security deposits forfeited for damages done by service receiver in the course of receiving a service	If the forfeited deposits relate to accidental damages due to unforeseen actions not relatable to provision of service then such forfeited deposits would not be a consideration in terms a clause

		proposed to be inserted in rule 6 of the Valuation Rules.
7.	Fines and penalties paid for violation of provisions of law.	These are not considerations as no service is received in lieu of payment of such fines and penalties.
8.	Excess payment made as a result of a mistake.	If returned it is not consideration. If not returned and retained by the service provider it becomes a part of the taxable value.
9.	Demurrages payable for use of services beyond the period initially agreed upon e.g. use of containers beyond the normal period.	This will be consideration and is being so provided in the amendments made to Rule 6 of the Valuation Rules.

G. Rule 7 shall be omitted:

In the Negative List approach, Rule 7 may not be required; therefore it is proposed to omit the same.

Rule 7 was as under:

7. Actual consideration to be the value of taxable service provided from outside India.–

(1) The value of taxable service received under the provisions of section 66A, shall be such amount as is equal to the actual consideration charged for the services provided or to be provided.

(2) Notwithstanding anything contained in sub-rule (1), the value of taxable services specified in clause (ii) of rule 3 of Taxation of Services (Provided from Outside India and Received in India) Rules, 2006, as are partly performed in India, shall be the total consideration paid by the recipient for such services including the value of service partly performed outside India.

I hope above is useful for you. Your valuable feedback in respect of same would be highly appreciated.

(Disclaimer: The above analysis has been drafted as per various provisions of Finance Act 1994, and notifications and circulars issued thereunder. The analysis may not be entirely correct for reader to reader due to different interpretations by different readers. The readers are advised to take into the consideration the prevailing legal position before acting on any of the comments in this reply. We shall not be responsible for any loss caused based on this interpretation.)

With Warm Regards,

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