

**DEPARTMENT OF COMMERCIAL TAXES, KERALA**  
**PROCEEDINGS OF THE AUTHORITY FOR CLARIFICATION**  
**U/s.94 OF THE KERALA VALUE ADDED TAX ACT, 2003.**

**Members present are:**

**1. T.V. Kamala Bai.**  
**Joint Commissioner (Law),**  
**Office of the Commissioner of Commercial Taxes, Thiruvananthapuram.**

**2. Suchala Kumar. S.K.**  
**Joint Commissioner (Audit & Inspection),**  
**Office of the Commissioner of Commercial Taxes, Thiruvananthapuram.**

**3. Mathew Thomas.**  
**Joint Commissioner (General),**  
**Office of the Commissioner of Commercial Taxes, Thiruvananthapuram.**

Sub:- KVAT Act, 2003 – Clarification U/s 94 – Works contract and the admissibility of interest on capital fund, depreciation of machinery and wages to managing partner in the computation of taxable turnover – Orders issued.

Read:- Applications from Sri. T.S. Ramaswamy, Kochi dtd. 5/10/2010 & 4/1/2013.

**ORDER No.C3/32753/10/CT DATED 23/4/2013.**

1. Sri. T.S. Ramaswamy, Kochi has preferred an application U/s 94 of the Kerala Value Added Tax Act, 2003 seeking clarification on the admissibility of deductions on interest for capital fund, remuneration to the managing partner and depreciation of machinery used in the execution of works contract.

2. The applicant has referred Rule 10(2)(a) of the Kerala Value Added Tax Rules, 2005 which reads:

*In relation to a works contract in which transfer of property takes place not in the form of goods but in some other form, the taxable turnover in respect of the transfer of property involved in the execution of works contract shall be arrived at after deducting the following amount from the total amount received or receivable by the dealer for the execution of the works contract such as;*

- (i) labour charges for the execution of work,*
- (ii) charges for planning and designing and the architect's fee;*
- (iii) charges for obtaining on hire or otherwise, machinery and tools used for the execution of the works contract, or where the machinery is owned by the contractor, the interest paid on any loan taken for the purchase of the machinery;*
- (iv) cost of consumables used;*
- (v) cost of establishment and overhead charges of the dealer to the extent it is relatable to the supply of labour and service;*
- (vi) profit earned by the dealer to the extent it is relatable to supply of labour and services;*

*Provided that notwithstanding anything contained in clause (a) when the turnover arrived at after deducting the amounts mentioned in clause (a) falls below the cost of goods transferred in the execution of works contract, an amount equal to the cost of the goods transferred in the execution of works contract together with profit, if any, shall be the taxable turnover in respect of such works contract.*

3. The applicant would contend that Hon'ble Supreme Court in the case **State of Jharkhand and Others Vs. Voltas Ltd., East Singhbhum** reported in **(2009) 17 KTR 564 (SC)** categorically says that only value of goods sold can be put to taxation in a works contract. The incidence of levy is sale. This ratio, even though rendered in the context of Bihar Finance Act and Rules, applies *mutatis mutandis* to the Kerala Value Added Tax Act and Rules also, because, the former is exactly the counter part of the latter. After all, works contracts in all the States belong to the same genre evolved from the amendment to Constitution at Article 366 through Clause (29A). When tax is leviable on works contracts based on sale, i.e., value of goods transferred, then, the receipt method of calculating tax on works contracts which is seen adopted by the Department is against law, since law as interpreted by the Supreme Court is the law of the land.

4. The applicant would also contend that Article 265 of the Constitution of India says that tax can be levied only through the authority of law, the substantive law clearly says that incidence of levy is transfer as interpreted by the Supreme Court in the case **State of Jharkhand and Others Vs. Voltas Ltd., East Singhbhum** reported in **(2009) 17 KTR 564 (SC)**. Matter being so, when the total receipts are going to be taxed, then it becomes a case of excess of the available power and more, a case of laxity of jurisdiction. The Value Added Tax Act has no jurisdiction at all to tax a receipt.

5. The applicant would further contend that on a bare reading of item No. V and VI of Rule 10(2)(a) of the Kerala Value Added Tax Rules, 2005 it becomes vivid that both are different. It is very clear that what has weighed with the Department is the second leg of these items which casts a common embargo which is as follows ***to the extent it is relatable to the supply of labour and services***. It is a rule of statutory interpretation, well settled by the Latin maxim ***expressio unis est exclusio alterius*** which means that express mentioning of one thing excludes all the others. Here, the express mentioning of cost of establishment and overhead charges in item No. V excludes the profit earned by the dealer relatable to the labour and service listed in item No.VI. It is a case vice versa also i.e., item no.VI cannot take within item No. V because both are separately enlisted.

6. The applicant placing reliance on the judgment of the High Court of Patna in the case **Larson & Turbo Ltd. Vs. State of Bihar and Others (2004) 13 STC (354)** would contend that Hon'ble Court had categorically delivered regarding labour and other charges; *One cannot confuse labour charges with other*

*charges. When the Legislature itself has provided different categories - one labour charges and the other general category as other charges then the State Legislature is obliged to enact follow up legislation by prescribing the manner and the extent of deductions in relation to any other charges. Likewise here the cost of establishment and overhead charges in item No. V and profit earned by the dealer relating to the labour and services listed in item No.VI are to be distinguished by the authorities.*

7. The applicant contends that without prejudice to the above, the assessment of works contract in which transfer of property takes place not in the form of goods but in some other form, the taxable turnover in respect of transfer of property involved in the execution of works shall be arrived at after deducting certain amounts from the total amount received or receivable by the dealer. The deduction of certain amounts from the turnover is admissible, such as the interest paid on any loan for purchase of machinery. In the same context, if any fund raised for the purchase of machinery by way of capital appropriated, the interest becomes payable on the capital provided by partners. It is as good as obtaining loan from bank. The firm is liable to provide interest to the partners from whom the capital is arranged. In the circumstances, the amount provided for the purchase of machinery is eligible to be deducted for arriving the taxable turnover. Otherwise, it will not be in the spirit of Entry 54 as interpreted by the Hon'ble Supreme Court.

8. The applicant would further contend that according to the partnership deed, amounts paid to partners by way of salary is to be accounted as remuneration to partners. The managing partner who is authorised for the overall supervision of work at different sites is also entitled for any remuneration which would be deductible to arrive at the taxable turnover. These expenses are incurred for the charges related to the supply of labour involved in the service. Such payments effected to the managing partner shall be considered as wages and the same shall be deductible for the computation of taxable turnover.

9. The applicant would also contend that depreciation is to be considered as a charge incurred for the wear and tear of machinery / articles which would be treated as an expense to the execution of work. Depreciation to the machinery / article would be considered as an expense incurred for the work, as far as the dealer in works contract is concerned. It is irrecoverable till the life time of that machinery. In accounting practice, certain amount is treated as depreciation for arriving at the realisable value of those assets at the end of the year. The

charging of depreciation diminishes its value, year by year. Therefore, the amount of depreciation is to be considered as an expense incurred for the machinery in the execution of contract work. Hence, the amount is also liable to be deductible for the computation of taxable turnover. It is noteworthy that, paradoxically, instead of purchase of machinery, if it is hired; the hire charges paid is an allowable amount. If the Supreme Court decision of 2009 interpreting Entry 54 is implemented, then there will not be such an issue.

10. The applicant would also contend that instead of giving exemption to all items other than commodity sales, the Government through the introduction of Rule 10(2)(a) grants reliefs to only certain categories. The assessing officer tries to read into that Rule and further dilutes the relief. This is illegal in the wake of Entry 54 to List II, as interpreted by various Supreme Court decisions and finally in the Voltas Case in 17 KTR 564. In the case of the applicant, if the Supreme Court decision is implemented, then there would be no question of Rule 10(2)(a) and there is question of misreading into item VI in the Rule 10(2)(a). The Supreme Court ruling favors the purchase method of taxation. Rule 10(2)(a) favors receipt method which is altogether different. The receipt method restricts the relief. Since it is 10(2)(a) exemption, the direct expenses are deducted from the contract receipt alone. No deduction of cost overheads are given. This is actually not in confirmation with the mandate of Entry 54 of List II of the VII<sup>th</sup> Schedule of the Constitution and that of Hon'ble Supreme Court in Voltas Case of 2009, because many things other than sale get their role in the calculation. This method of 10(2)(a) based on total work receipt is without logic and is a mere wash down, in order to minimize the exemption.

11. The applicant has requested to clarify to following points:

- a. Whether the interest payable on purchase of machinery using the capital fund is deductible to arrive at taxable turnover likewise the interest paid on any loan taken for the purchase of machinery is deductible?
- b. Whether the wages admissible to managing partner engaged in site supervision for the execution of work is deductible to arrive at the taxable turnover of a partnership firm?
- c. Depreciation considered as wear & tear of a machinery/article which is treated as an expense for the execution of the work. Can it be deducted as an expense incurred for the execution of work, deductible for computing taxable turnover?

12. The applicant was heard in the matter and the contentions raised were examined.

13. The first issue raised by the applicant is whether the interest payable on purchase of machinery using the capital fund is deductible to arrive at taxable turnover. The interest paid on any loan taken for the purchase of machinery is deductible. Interest paid on capital fund is substantially different from the interest paid on loans. Capital fund is provided by its share holders in their capacity as shareholders, and interest on capital is actually an income provided to shareholders. Loan is provided by any independent financial institution or shareholders in their capacity as a financial institution. When shareholders extend loan in the capacity as a financial institution, it cannot be termed as capital fund. Hence it is clarified that the interest paid on capital fund used to acquire capital machinery cannot be deducted from the total amount received or receivable.

14. Secondly, the applicant has requested to clarify whether the wages paid to the managing partner engaged in site supervision for the execution of work is deductible to arrive at the taxable turnover of a partnership firm. According to Rule 10(2)(a)(v), there is allowable deduction for *cost of establishment and overhead charges of the dealer to the extent it is relatable to the supply of labour and service*. Wages paid to the managing partner engaged in the site supervision can be included within this overhead charges to the extent it is related to the supply of labour and service.

15. With respect to the third issue raised by the applicant, Rule 10(2)(a) does not provide for any deduction on the value of depreciation of machinery from the total amount received or receivable by the dealer. Hence depreciation of machinery cannot be allowed as a deduction in the computation of taxable turnover.

The issues raised above are clarified accordingly.

**T.V. Kamala Bai**  
**Joint Commissioner (Law)**

**Suchala Kumar. S.K.**  
**Joint Commissioner (A&I)**

**Mathew Thomas**  
**Joint Commissioner (General)**

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