

Issues in availing GST Exemption on Composite Supply of Operation & Maintenance Work Contract to the Government



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In the interest of general public, the GST Law provided exemption for composite supply to the Government involving predominantly supply of services, where the value of supply of goods constitutes not more than 25 per cent in relation to an activity to perform a function entrusted to a Panchayat or Municipality. However, litigations have surged in view of taxing the operation & maintenance activity under divisible works contract, which also consist of construction activity, under the notion being treated as indivisible works contracts. Another issue is whether exemption available to the main contractor is also available to the sub-contractor or not. If the subcontractor charges GST, the main contractor cannot claim input tax credit of the same, as the outward supply is exempt. In such case, it would result in an additional cost to the contractor as well as to the consumer, which will defeat the purpose of exemption, in turn, defeating the objective of public welfare. The Service Tax Law also had provision for exempting sub-contractors when they executed works contract for the main contractor availing of the exemption. On similar lines, the Government needs to issue a relevant clarification to put an end to litigation surrounding the matter.

Background

The 25th GST Council Meeting held on 18-01-2018 has proposed to amend Entry Serial No. 3 of the Exemption Notification No. 12/2017-Central Tax (Rate) dt. 28-06-2017 to expand the scope of pure service and include composite supplies where the principal supply is of service and involves both services as well as materials. For example-

- (i) Water supply for domestic, industrial and commercial purposes [Sl. No. 5 of the Twelfth Schedule of Article 243W of the Constitution]: A contract for

the purification of water given to an external agency involving mainly purification services with some portion of supply of materials like alum, chlorine, water treatment agents etc.

- (ii) Public health, sanitation conservancy and solid waste management [Sl. No. 6 of the Twelfth Schedule of Article 243W of the Constitution]: A contract for the maintenance of compactor machines used for garbage disposal given to an external agency involving both maintenance services as well as the supply of damaged spare parts.



- (iii) Provision of urban amenities and facilities such as parks, gardens, playgrounds [Sl. No. 12 of the Twelfth Schedule of Article 243W of the Constitution]: A contract for maintenance of parks/gardens given to an external agency involving both maintenance service as well as supply of damaged items like decorative litter bins, display boards etc.

Insertion of Entry 3A to Notification No. 12/2017 for exemption of composite supply:

As per the decision of the 25th GST Council Meeting, the Entry Serial No. 3A has been inserted in Notification No. 12/2017- Central Tax (Rate) dt. 28-06-2017 (vide amendment Notification No. 2/2018-Central Tax (Rate) dt. 25-01-2018) for exempting the composite supply of goods and services in which the value of supply of goods constitutes not more than 25 per cent of the value of the said composite supply provided to the Central Government, State Government, Union territory, local authority, or a Governmental authority or Government Entity by way of any activity in relation to any function entrusted to a Panchayat under Article 243G of the Constitution or in relation to any function entrusted to a Municipality under Article 243W of the Constitution. However, the words "Governmental Authority" or "Government Entity" have been omitted w.e.f. 01-01-2022 vide Notification No. 15/2021 – Central Tax (Rate) dt. 18-11-2021, read with amendment Notification No. 22/2021- Central Tax (Rate) dt. 31-12-2021. Therefore, the exemption is no longer available for composite supply to a Government Authority or Government Entity w.e.f. 01-01-2022. On analysis of the above notification, the following conditions are to be fulfilled for availing exemption:

- i. Composite Supply in which the value of supply of goods constitutes not more than 25 per cent of the value of the said composite supply.
- ii. The recipient should be the Government or a Local Authority (to Governmental Authority or

Government Entity for the period from 25-01-2018 to 31-12-2021).

- iii. Service activities are provided in relation to the function entrusted to the Panchayat or Municipality under Article 243G/243W of the Constitution.

In this regard, the ingredients of Entry Serial No. 3A of Notification No. 12/2017- Central Tax (Rate) dt. 28-06-2017, as amended, are explained below-

a. Composite Supply

As per Sec 2(30), "composite supply" means a supply made by a taxable person to a recipient consisting of two or more taxable supplies of goods or services or both, or any combination thereof, which are naturally bundled and supplied in conjunction with each other in the ordinary course of business, one of which is a principal supply.

As per section 2(90), "principal supply" means the supply of goods or services which constitutes the predominant element of a composite supply and to which any other supply forming part of that composite supply is ancillary. The tax liability on the value of composite supply of goods or services shall be based on the principal supply, either taxable or non-taxable.

There are conflicting decisions in allowing exemption for composite supply to the Government/ Government Authority. The West Bengal GST AAR vide Order No. 07/WBAAR/2022-23 dt. 18.08.2022 in the case of Berhampur Warehousing Private Limited held that the composite supply of services by way of milling of food grains into flour (atta) to the Food & Supplies Department, Govt. of West Bengal for distribution of such flour under the Public Distribution System is eligible for exemption under entry serial no. 3A of Notification No. 12/2017-Central Tax (Rate) dt. 28.06.2017, as amended, since the value of goods involved in such composite supply does not exceed 25% of the value of supply.

b. List of Services entrusted to the Panchayat under Article 243G

1. Agriculture, including agricultural extension.
2. Land improvement, implementation of land reforms, land consolidation, and soil conservation.
3. Minor irrigation, water management, and watershed development.
4. Animal husbandry, dairying, and poultry.
5. Fisheries.
6. Social forestry and farm forestry.
7. Minor forest produce.

8. Smallscale industries, including food processing industries.
 9. Khadi, village, and cottage industries.
 10. Rural housing.
 11. Drinking water.
 12. Fuel and fodder.
 13. Roads, culverts, bridges, ferries, waterways, and other means of communication.
 14. Rural electrification, including the distribution of electricity.
 15. Non-conventional energy sources.
 16. Poverty alleviation programme.
 17. Education, including primary and secondary schools.
 18. Technical training and vocational education.
 19. Adult and non-formal education.
 20. Libraries.
 21. Cultural activities.
 22. Markets and fairs.
 23. Health and sanitation, including hospitals, primary health centres, and dispensaries.
 24. Family welfare.
 25. Women and child development.
 26. Social welfare, including the welfare of the handicapped and mentally retarded.
 27. Welfare of the weaker sections, and in particular, of the Scheduled Castes and the Scheduled Tribes.
 28. Public distribution system.
 29. Maintenance of community assets.
- c. List of Services entrusted to the Municipality under Article 243W**
1. Urban planning, including town planning.
 2. Regulation of land-use and construction of buildings.
 3. Planning for economic and social development.
 4. Roads and bridges.
 5. Water supply for domestic, industrial, and commercial purposes.
 6. Public health, sanitation, conservancy, and solid waste management.
 7. Fire services.
 8. Urban forestry, protection of the environment, and promotion of ecological aspects.
 9. Safeguarding the interests of weaker sections of society, including the handicapped and mentally retarded.
 10. Slum improvement and upgradation.
 11. Urban poverty alleviation.
 12. Provision of urban amenities and facilities such as parks, gardens, and playgrounds.
 13. Promotion of cultural, educational, and aesthetic aspects.
 14. Burials and burial grounds; cremations, cremation grounds; and electric crematoriums.
 15. Cattle pounds; prevention of cruelty to animals.
 16. Vital statistics, including registration of births and deaths.
 17. Public amenities, including street lighting, parking lots, bus stops, and public conveniences.
 18. Regulation of slaughter houses and tanneries.

Exemption for Composite Supply of Operation & Maintenance Work Contract

i. In case of Divisible Contract

For example, the State Government or Local Authority awards a works contract in respect of a Water Supply Project to the contractor with the scope of work for the construction, supply, installation, and commissioning of Water Treatment Plant on a turnkey basis and also for the operation & maintenance activity of the Water Treatment Plant for five years upon completion of construction of such Plant. A single agreement was entered into for two separate activities with two separate considerations-



- (a) one for the completion of the water treatment plant on turnkey basis.
- (b) another for the operation and maintenance activity of the water treatment plant for 5 years.

The question would arise as to whether the operation & maintenance activity is a part of the turnkey project or amounts to separate activity under a divisible contract. In case a single contract is entered into with two separate considerations for two separate activities of Works Contract, it would be treated as a divisible contract. In case, two separate contracts are entered into, and each contract contains a "Cross-fall breach clause", it would be treated as an indivisible contract though separate contracts are entered into. In an indivisible contract, the whole contract becomes void in case one activity of the contract is not performed. The Cross-fall breach clause means any breach in one contract would automatically be classified as a breach of the other contract. In this regard, it is pertinent to refer to the decision of the West Bengal AAR in the case of IAC Electrical Pvt Ltd., vide order no. 05/WBAAR/2018-19 dt. 28/05/2018 wherein the provisions relating to the Cross-fall breach clause have been dealt with in detail. Hence, the contract for construction, supply, installation etc., of the Water Treatment Plant does not affect the operation & maintenance activity of the said Plant under the Divisible Contract. The scope of the operation & maintenance activity will start and operate only after the completion of the construction activity of the Water Treatment Plant.

Accordingly, both the activities are not related to each other and the scope of one activity is different from the scope of another activity. After completion and commissioning of the Water Treatment Plant, the activity of operation & maintenance of the said Plant would start. Hence, the Contract of construction of the Water Treatment Plant activity and the operation

& maintenance activity are to be considered as separate contracts. In such a situation, the operation & maintenance activity shall be exempt from GST subject to the fulfilment of the ingredients specified under entry serial no. 3A of the Notification No. 12/2017-Central Tax (Rate) dt. 28.06.2017, as amended.

The above view has been further confirmed in the case of Suez India (P.) Ltd., vide Order No. 17/WBAAR/2021-22 dt 31-12-2021 wherein the AAR, West Bengal held that the contract of design, construction, and operation & maintenance of water distribution networks for municipal bodies would be amounting to a composite supply being an indivisible single contract which has two or more supplies of goods or services or both naturally bundled and supplied in conjunction with each other for a single lump sum amount. However, two separate contracts were signed: one for construction of water distribution networks and another for operation & maintenance work, along with a letter of acceptance. The AAR observed that the scope of work as per the contract would include supply, laying, installation and commissioning of distribution network along with operation & maintenance for which a single letter of acceptance has been issued wherein there is no split of contract value. Therefore, it would qualify as a works contract and attract 12% GST.

In the above case, GST exemption is not available to the operation & maintenance activity, since there is no split of contract value though two separate contracts were signed under a single Letter of Acceptance. Hence, in order to avail of the exemption, separate consideration must be mentioned for each activity in a divisible contract, and it must not contain a "Cross-fall breach clause".

ii. Independent Contract for Composite Supply of Operation & Maintenance work

There is no dispute in availing exemption in case of an independent contract with separate consideration for composite supply of operation & maintenance work being awarded and that fulfills the ingredients of entry serial no. 3A of Notification No. 12/2017-Central Tax (Rate) dt. 28-06-2017.

Exemption to Sub-Contractor

Another dispute is regarding whether the composite supply allotted by the main contractor to the subcontractor is also exempted from GST. Logically, GST should be exempted when the work is awarded to the sub-contractor by the main contractor since the ultimate customer is the Government/Government Authority. Moreover, in the Service Tax Regime, the works contract service provided by the sub-contractor was exempt when service was provided by the main contractor and was exempt as per Notification No.



25/2012-ST dt. 20-06-2012 as amended. However, as per the language of Entry serial no. 3A of GST Notification No. 12/2017- Central Tax (Rate) dt. 28-06-2017 as amended, the composite supply with a value

of supply of goods less than 25% to the Government/ Government Authority is exempted, but it does not make any mention of the supplies made by the sub-contractor to the main contractor as shown below-

Sl. No	Chapter, Section, Heading, Group or Service Code (Tariff)	Description of Services	Rate (per cent.)	Condition
(1)	(2)	(3)	(4)	(5)
3A	Chapter 99	Composite supply of goods and services in which the value of supply of goods constitutes not more than 25 per cent of the value of the said composite supply provided to the Central Government, State Government, Union territory, local authority or (omitted the words Government Authority or Government Entity w.e.f 01-01-2022) by way of any activity in relation to any function entrusted to a Panchayat under article 243G of the Constitution or in relation to any function entrusted to a Municipality under article 243W of the Constitution.	Nil	Nil

In this regard, it is pertinent to refer to the decision of the 25th GST Council Meeting, as per which the GST rate of the main contractor and sub-contractor has been brought at par. Thus, against Entry serial no. 3 in Col. 3 for item (ix) & (x) of Notification No.11/2017-Central Tax (Rate) dt. 28-06-2017 as amended vide Notification No. 01/2018-Central Tax (Rate) dt. 25.01. 2018, the sub-contractors are included for claiming a lower rate of tax, provided that their services have been procured by the main contractor in relation to a work entrusted to it by the Government or a Government Authority, as the case may be, as reproduced below-

Sl. No.	Chapter, Section or Heading	Description of Service	Rate (per cent.)	Condition
(1)	(2)	(3)	(4)	(5)
3	Heading 9954 (Construction services)	(ix) Composite supply of works contract as defined in clause (119) of section 2 of the Central Goods and Services Tax Act, 2017 provided by a sub-contractor to the main contractor providing services specified in item (iii) or item (vi) above to the Central Government, State Government, Union territory, a local authority, (omitted the words "Government Authority" or "Government Entity" w.e.f. 01-01-2022) Note: Item/Entry no. (ix) under Serial No. 3 in column no. (3) and (4) omitted w.e.f. 18-07-2022 vide Notification No. 03/2022- Central Tax (Rate) dt. 13-07-2022.	6 (omitted w.e.f. 18-07-2022)	

Sl. No.	Chapter, Section or Heading	Description of Service	Rate (per cent.)	Condition
(1)	(2)	(3)	(4)	(5)
		(x) Composite supply of works contract as defined in clause (119) of section 2 of the Central Goods and Services Tax Act, 2017 provided by a sub-contractor to the main contractor providing services specified in item (vii) above to the Central Government, State Government, Union territory, a local authority, (omitted the words Government Authority or Government Entity w.e.f. 01-01-2022)	2.5 (6% w.e.f. 18-07-2022 vide Notification No. 3/2022 Central Tax-(Rate) dt. 13-07-2022)	

Though the CGST Act does not define the word “sub-contractor,” Notification No.11/2017- Central Tax (Rate) dt. 28-06-2017 as amended makes a mention of a sub-contractor whose services are procured by a main contractor. Thus, the provisions of the GST Act clearly identify a sub-contractor as a supplier of works contract services to the main contractor. Hence, the ‘Nil GST Rate’ as per exemption Notification No. 12/2017-Central Tax (Rate) dt. 28-06-2017, as amended, is also to be applied to the services provided by a sub-contractor to the main contractor in respect of operation & maintenance activities, considering the analogy of the decision of the 25th GST Council Meeting, as per which the GST rate of the main contractor and sub-contractor has been brought at par.

However, the Telangana AAR, in the case of Immense Construction Company vide order No. 23/2023 dt 13-11-2023, held that the services provided by the subcontractor to the main contractor are not covered by the GST exemption since there is no mention of sub-contractors making the supply of such services to a contractor under Entry serial no. 3A of Notification No. 12/2017-Central Tax (Rate) dt. 28-06-2017, as amended. The exemption is not a general exemption but is subject to conditions specified therein, namely, that the supply has to be made to the Government or a Local Authority etc.

Conclusion

After considering the above detailed analysis, it may be concluded that the composite supply of operation & maintenance work contracts to the Government is entitled to exemption. Otherwise, it causes injustice to the assessee and the ultimate customer in case the exemption is denied. It is also to be noted that the decisions of judiciary authorities / apex courts are yet to be made available in respect of the above exemption. However, in case of a composite supply by the sub-contractor to the main contractor, the issue is not free from litigation in view of action of the Department’s action to levy GST on the composite supply of operation & maintenance work awarded to the subcontractor by the main contractor. It is an appropriate time for the Government to come out with a Circular clarifying the position of law to avoid litigation and make the law for easier for business.



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