

**Customs, Excise & Service Tax Appellate Tribunal  
West Zonal Bench at Ahmedabad**

REGIONAL BENCH-COURT NO.2

**Service Tax Appeal No. 10009 of 2014- DB**

(Arising out of OIA-VAD-EXCUS-002-APP-418-13-14 dated 08.10.2013 passed by the Commissioner ( Appeal), Central Excise, Customs and Service Tax-VADODARA)

**Jagaji Construction Company**

**.....Appellant**

502-c, Manubhai Tower,  
Sayajigunj, VADODARA-GUJARAT

*VERSUS*

**Commissioner of CGST &  
Central Excise Vadodara I**

**.....Respondent**

Central GST Building, Race Course Circle,  
Vadodara, Gujarat-390007

**APPEARANCE:**

Shri Mrugesh Pandya, Advocate appeared for the Appellant

Shri Himanshu P Shrimali, Superintendent (AR) appeared for the Respondent

**CORAM:**

**HON'BLE MEMBER (JUDICIAL), DR. AJAYA KRISHNA VISHVESHA  
HON'BLE MEMBER (TECHNICAL), MR. SATENDRA VIKRAM SINGH**

**Final Order No. 10009/2026**

DATE OF HEARING: 01.09.2025  
DATE OF DECISION: 15.01.2026

**SATENDRA VIKRAM SINGH**

1. M/s. Jagaji Construction Company, Vadodara (Appellant) have been awarded a contract dated 17.07.2006 by M/s. BLB Mall Management Company Pvt. Ltd. to construct a shopping mall (BLB Mall) at Sarabhai Industries, Vadodara at a cost of Rs. 6,55,41,780/- including all direct and indirect costs, duty, taxes, sale tax, VAT, service tax on any inputs, royalty on quarried items etc. The construction which began in October 2006, was completed in March, 2008 on Rate Contract basis. The basic rate for cement and steel was taken as Rs.200/- per bag and Rs.27,500/- per MT respectively. On the basis of intelligence that appellant was not paying proper service tax, an enquiry was initiated against them in Jan 2010. Vide letter dated 24.03.2010, the appellant confirmed to have received an amount of Rs.6,27,36,379/- for construction of BLB Mall during the period from December 2006 to 2008-09 which included TDS, VAT and security deposit but not the service tax.

1.1 Scrutiny of ST-3 returns revealed that the appellant had paid service tax of Rs.7,66,424/- in 2007-2008 on taxable value of Rs.3,70,64,728/- and service tax of Rs.64,114/- in 2008-09 on taxable value of Rs.31,12,351/- under Work Contract (Composition Scheme For Payment of Service Tax) Rules, 2007 inserted vide Notification No.32/2007-ST dated 22.05.2007. Vide letter dtd 06.05.2010, M/s. BLB Mall intimated supply of 933.355 MT of steel to the appellant for execution of said work. The officers recorded statements of Shri Anilbhai D Patel, Proprietor of the firm on 28.05.2010. After conducting investigation, a show cause notice dated 13.03.2012 was issued to appellant proposing recovery of service tax of Rs.35,93,850/- by invoking proviso to Section 73(1) of the Finance Act, 1994, along with interest under Section 75 and penalties under Sections 76,77 and 78 of the Finance Act, 1994. The notice also alleged failure of the appellant to obtain registration under Commercial or Industrial Construction Service at the relevant time, failure to assess due service tax and pay the same and non-filing of ST-3 returns for the said service.

1.2 In adjudication, the Additional Commissioner vide order dated 28.02.2013 confirmed the proposed demand of service tax along with interest and imposed equal penalty under Section 78 of the Finance Act, 1994 besides penalty under Section 76 and a penalty of Rs.5,000/- under Section 77(2). Aggrieved with this order, the appellant filed appeal before the Commissioner (Appeals) who vide impugned order dtd. 08.10.2013 upheld the order and rejected their appeal. Hence, the present appeal before this Tribunal.

2. In their appeal, appellant took the following grounds:-

- The work undertaken by them amounts to works contract for the purpose of State's sales tax/ VAT laws. They have paid substantial sales tax on materials used in construction of mall and attached proof of the payment of sales tax.

- Hon'ble Tribunal as well as Hon'ble Apex Court have held that composite works contract cannot be artificially vivisected and subjected to levy of service tax under different category of Service. They cited the following case laws:-
  - a) M/s. Daelim Industrial Co. Ltd. v/s. CCE, Vadodara 2003 (155) ELT 457 (Tri Del.) {Also upheld by Apex Court vide 2004 (170) ELT A181 (SC)}.
  - b) L & T Ltd. v/s. CCE, Cochin 2004 (174) ELT 322 (Tri. Del.)
  - c) Petrofac International Ltd. Vs., CCE, Cochin 2004 (178) ELT 725 (Tri. Bang.)
  - d) IN RE: ISHIKAWAJIMA-HARIMA HEAVY IND. CO. LTD. 2005 (182) ELT 281 (Commr. Appl.)
  - e) Ircon International V/s. CCE, Mumbai 2005 2 STT 264 (Tri-Del)
  - f) CCE Vadodara v/s. L&T Ltd. 2006(4) STR 63(Tri-Mum)
  - g) M/s. Orissa Sponge Iron Ltd. 2007-TIOL-1091-CESTAT-BHUW
  - h) M/s. Turbotech Precision Engg. Pvt. Ltd. 2006 (3) S.T.R. 765 (Tri. - Bang)
- Hon'ble Apex Court in the case of Imagic Creative Pvt. Ltd. 2008 (9) STR 337 (SC) specifically prohibited levy of sales tax on service element of a composite contract. For the same reasons, no service tax can be levied on the element of goods supplied/ sold during execution of works.
- Works contract service came into existence w.e.f. 01.06.2007. The works undertaken by them are to be treated as works contract for the purposes of charging service tax w.e.f. 01.06.2007 only and no service tax can be charged for the period prior to 01.06.2007.
- CBEC in para 9.10 of its Circular No.B1/16/2007-TRU dated 22.05.2007 has clarified that all those contracts which qualify works contract under the Sales Tax Laws equally qualify as works contract for the purpose of levy of service tax. It is settled law that composite contract cannot be vivisected so as to levy service tax on the labour element involved in such works contracts under different categories of services.

- Works Contract Service is a more specific description vis-a-vis other categories of services involved in execution of such contracts, as in the present case. For these reasons, impugned order of Commissioner (Appeals) deserves to be set aside. They rely on Circular No.128/10/2010-ST dated 24.08.2010, which mentions that- *"The matter has been examined. As regards the classification, with effect from 01.06.2007 when the new service 'works contract' service was made effective, classification of aforesaid services would undergo a change in case of long term contracts even though part of the service was classified under the respective taxable service prior to 01.06.2007. This is because 'works contract' describes the nature of the activity more specifically and, therefore, as per the provisions of section 65A of the Finance Act, 1994, it would be the appropriate classification for the part of the service provided after that date."*
- Similar decision was given by Hon'ble Karnataka High Court in the case of CST Bangalore Vs. Turbotech Precision Engg. Pvt. Ltd. reported at 2010 (18) STR 545 (Kar) and by Mumbai Tribunal in the case of CCE Raigad Vs. Indian Oil Tanking Ltd. reported at 2010 (18) STR 577 (Tri-Mumbai).
- Revenue accepted service tax paid by them under works contract service w.e.f 01.06.2007 without raising any objection which gave them bonafide belief that their activity falls under works contract service.
- Service tax has been demanded on free supply materials which is not sustainable as clarified by CBIC vide DOF No.334/13/2009-TRU dated 06.07.2009. It is mentioned that explanation appearing in sub rule (3) is being amended to provide that composition scheme would be available only to such works contracts where the gross value of works contracts includes the value of all goods used in or in relation to the execution of works contract whether received free of cost or for

consideration under any other contract. This clarification will not apply to those works contract which were entered into prior to this date.

- Hon'ble CESTAT Larger Bench in the case of Bhayana Builders Pvt. Ltd. reported at 2013 (32) STR 49 (Tri.-LB) have held that, *"The value of goods and materials supplied free of cost by a service recipient to the provider of the taxable construction service, being neither monetary or non-monetary consideration paid by or flowing from the service recipient, accruing to the benefit of service provider, would be outside the taxable value or the gross amount charged, within the meaning of the later expression in Section 67 of the Finance Act, 1994.* It has been held that free supplies into construction even on extravagant inference would not constitute a non-monetary consideration remitted by the service recipient to the service provider for providing service particularly since no part of the goods and materials so supplied accrues to or is retained by the service provider." This decision has also been upheld by Hon'ble Apex Court as reported at 2018 (10) GSTL 118 (SC).

3. During hearing, learned Counsel highlighted various case laws relied upon by them in the matter to argue that construction work undertaken by them in respect of shopping mall is a Works Contract Service which came into service tax net w.e.f. 01.07.2007. They were already registered with state VAT under "Works Contract" w.e.f. 01.07.2002. The said service was not leviable to service tax as per decision of Hon'ble Supreme Court in the case of Commissioner of C. Ex. & Cus. Kerala Vs. Larsen & Toubro Ltd (cited supra). The appellant has correctly paid service tax @2% of the gross amount by availing Composition scheme under the works contract service. Relying on CBIC Circular No.150/1/2012-ST dated 08.02.2012, he pleaded that value of free supply material (i.e. 933 MT steel) by the service recipient is not includible in the value for payment of service tax.

3.1 Relying on Circular No.98/1/2008-ST dated 04.01.2008, and Circular No.128/10/2010-ST dated 24.08.2010, he pleaded that they are eligible to pay service tax under composition scheme under works contract service as they paid service tax in respect of present contract relating to construction of shopping mall after 01.06.2007. As regards, availment of Cenvat Credit of Rs.2,866/-, he mentioned that the appellant had wrongly taken this credit in August-2007 which was paid by them in 2011. He pleaded to allow their appeal by setting aside the impugned order. He placed reliance on the following case laws:-

- a) M/s. Daelim Industrial Co. Ltd. v/s. CCE, Vadodara 2003 (155) ELT 457 (Tri. Del.)
- b) ST. Electricals Pvt. Ltd. Vs Commissioner of Central Excise, Pune-I-2019 (20) G.S.T.L. 273 (Tri.-Mumbai). {Also upheld by Hon'ble Apex Court as reported at 2024 (338) E.L.T. 388 (S.C.)}.
- c) Commissioner of Service Tax Vs. Bhayana Builders (P) Ltd. 2018 (10) G.S.T.L. 118 (S.C.).
- d) Anand Nishikawa Co. Ltd. Vs. Commissioner of Central Excise, Meerut - 2005 (188) E.L.T. 149 (S.C.).

4. Learned AR on the other hand argued that the appellant began construction of shopping mall in October 2006 against the work order awarded to them in July 2006. The service provided by the appellant is classifiable as "Commercial and Industrial Construction Service" against which they did not pay service tax in spite of receipt of consideration amount, from time to time. Had recipient of service not supplied 933 MT of Steel, the appellant would have purchased it for construction of mall. Therefore, free supply material value is liable to be added in consideration amount for arriving at gross amount before allowing abatement as per Notification No. 01/2006-ST dated 01.03.2006 to determine taxable value of service. Learned AR also argued that the appellant started providing Commercial and Industrial Construction

Service, since October-2006 without obtaining registration with Service Tax Department until they obtained registration under "Works Contract Service" on 16.07.2007. They neither filed ST-3 returns nor paid any service tax. On the basis of intelligence, department came to know of their activities involving service tax liability on the appellant. He therefore, justifies invocation of proviso to Section 73(1) in the case, for demanding service tax for the larger period and imposition of penalty under Section 78 of the Finance Act, 1994 upon the appellant.

5. We have heard both the sides. The issues to be decided in this case are-

(a) Whether activity of construction of shopping mall by the appellant is classifiable under "Civil and Industrial Construction Service or under Works Contract Service"?

(b) Whether value of free supply materials is includible to arrive at gross value for charging service tax?

(c) Whether extended period is invocable for demanding service tax for larger period and imposition of mandatory penalty?

5.1 Regarding first issue, we find that the appellant were awarded a contract by M/s. BLB Mall Management Company Private Limited for construction of a shopping mall at Sarabhai Industries, Vadodara at value of Rs.6,55,41,760/- which included all direct and indirect costs, duties, taxes, sales tax, VAT, service tax on any inputs, Royalty on quarried items etc. The steel was to be supplied by the recipient of service free of cost. We find that this is a composite contract which includes not only cost of raw materials but also various service components such as Labour, Supervision etc. Hon'ble Supreme Court in the case of Commissioner of Central Excise & Customs, Kerala Vs. Larsen & Toubro Ltd reported at 2015 (39) STR 913 (SC) has clearly held that prior to 01.06.2007, Section 65(105) of Finance Act,1994 had levied service tax on contracts simpliciter and not composite indivisible works contract. There was

no charging section specifically for levying service tax only on works contract, and measure of tax with service element derived from gross amount charged for the works contract less value of property in goods transferred in execution of works contract. Therefore, composite contracts which cannot be vivisected have to be dealt with under Works Contract service which is liable to be taxed w.e.f. 01.06.2007 and not prior to that, as there was no such scheme to levy service tax before enactment of Finance Act, 2007 which specifically made such contracts liable to service tax. The relevant paras are reproduced below:-

**14.** *Crucial to the understanding and determination of the issue at hand is the second Gannon Dunkerley judgment which is reported in (1993) 1 SCC 364. By the aforesaid judgment, the modalities of taxing composite indivisible works contracts was gone into. This Court said :-*

*"On behalf of the contractors, it has been urged that under a law imposing a tax on the transfer of property in goods involved in the execution of a works contract under Entry 54 of the State List read with Article 366(29-A)(b), the tax is imposed on the goods which are involved in the execution of a works contract and the measure for levying such a tax can only be the value of the goods so involved and the value of the works contract cannot be made the measure for levying the tax. The submission is further that the value of such goods would be the cost of acquisition of the goods by the contractor and, therefore, the measure for levy of tax can only be the cost at which the goods involved in the execution of a works contract were obtained by the contractor. On behalf of the States, it has been submitted that since the property in goods which are involved in the execution of a works contract passes only when the goods are incorporated in the works, the measure for the levy of the tax would be the value of the goods at the time of their incorporation in the works as well as the cost of incorporation of the goods in the works. We are in agreement with the submission that measure for the levy of the tax contemplated by Article 366(29-A)(b) is the value of the goods involved in the execution of a works contract. In Builders' Association case [(1989) 2 SCC 645 : 1989 SCC (Tax) 317 : (1989) 2 SCR 320] it has been pointed out that in Article 366(29-A)(b), "[t]he emphasis is on the transfer of property in goods (whether as goods or in some other form)". (SCC p. 669, para 32: SCR p. 347). This indicates that though the tax is imposed on the transfer of property in goods involved in the execution of a works contract, the measure for levy of such imposition is the value of the goods involved in the execution of a works contract. We are, however, unable to agree with the contention urged on behalf of the contractors that the value of such goods for levying the tax can be assessed only on the basis of the cost of*

*acquisition of the goods by the contractor. Since the taxable event is the transfer of property in goods involved in the execution of a works contract and the said transfer of property in such goods takes place when the goods are incorporated in the works, the value of the goods which can constitute the measure for the levy of the tax has to be the value of the goods at the time of incorporation of the goods in the works and not the cost of acquisition of the goods by the contractor. We are also unable to accept the contention urged on behalf of the States that in addition to the value of the goods involved in the execution of the works contract the cost of incorporation of the goods in the works can be included in the measure for levy of tax. 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 and, therefore, the cost of incorporation of the goods in the works cannot be made a part of the measure for levy of tax contemplated by Article 366(29-A)(b).*

*Keeping in view the legal fiction introduced by the Forty-sixth Amendment whereby the works contract which was entire and indivisible has been altered into a contract which is divisible into one for sale of goods and other for supply of labour and services, the value of the goods involved in the execution of a works contract on which tax is leviable must exclude the charges which appertain to the contract for supply of labour and services. This would mean that labour charges for execution of works, [item No. (i)], amounts paid to a sub-contractor for labour and services [item No. (ii)], charges for planning, designing and architect's fees [item No. (iii)], charges for obtaining on hire or otherwise machinery and tools used in the execution of a works contract [item No. (iv)], and the cost of consumables such as water, electricity, fuel, etc. which are consumed in the process of execution of a works contract [item No. (v)] and other similar expenses for labour and services will have to be excluded as charges for supply of labour and services. The charges mentioned in item No. (vi) cannot, however, be excluded. The position of a contractor in relation to a transfer of property in goods in the execution of a works contract is not different from that of a dealer in goods who is liable to pay sales tax on the sale price charged by him from the customer for the goods sold. The said price includes the cost of bringing the goods to the place of sale. Similarly, for the purpose of ascertaining the value of goods which are involved in the execution of a works contract for the purpose of imposition of tax, the cost of transportation of the goods to the place of works has to be taken as part of the value of the said goods. The charges mentioned in item No. (vii) relate to the various expenses which form part of the cost of establishment of the contractor. Ordinarily the cost of establishment is included in the sale price charged by a dealer from the customer for the goods sold. Since a composite works contract involves supply of materials as well as supply of labour and services, the cost of establishment of the contractor would have to be apportioned between the part of the contract involving supply of materials and the part involving supply of labour and*

*services. The cost of establishment of the contractor which is relatable to supply of labour and services cannot be included in the value of the goods involved in the execution of a contract and the cost of establishment which is relatable to supply of material involved in the execution of the works contract only can be included in the value of the goods. Similar apportionment will have to be made in respect of item No. (viii) relating to profits. The profits which are relatable to the supply of materials can be included in the value of the goods and the profits which are relatable to supply of labour and services will have to be excluded. This means that in respect of charges mentioned in item Nos. (vii) and (viii), the cost of establishment of the contractor as well as the profit earned by him to the extent the same are relatable to supply of labour and services will have to be excluded. The amount so deductible would have to be determined in the light of the facts of a particular case on the basis of the material produced by the contractor. The value of the goods involved in the execution of a works contract will, therefore, have to be determined by taking into account the value of the entire works contract and deducting therefrom the charges towards labour and services which would cover —*

- (a) Labour charges for execution of the works;*
- (b) amount paid to a sub-contractor for labour and services;*
- (c) charges for planning, designing and architect's fees;*
- (d) charges for obtaining on hire or otherwise machinery and tools used for the execution of the works contract;*
- (e) cost of consumables such as water, electricity, fuel, etc. used in the execution of the works contract the property in which is not transferred in the course of execution of a works contract; and*
- (f) cost of establishment of the contractor to the extent it is relatable to supply of labour and services;*
- (g) other similar expenses relatable to supply of labour and services;*
- (h) profit earned by the contractor to the extent it is relatable to supply of labour and services.*

*The amounts deductible under these heads will have to be determined in the light of the facts of a particular case on the basis of the material produced by the contractor.*

*Normally, the contractor will be in a position to furnish the necessary material to establish the expenses that were incurred under the aforesaid heads of deduction for labour and services. But there may be cases where the contractor has not maintained proper accounts or the accounts maintained by him are not found to be worthy of credence by the assessing authority. In that event, a question would arise as to how the deduction towards the aforesaid heads may*

*be made. On behalf of the States, it has been urged that it would be permissible for the State to prescribe a formula on the basis of a fixed percentage of the value of the contract as expenses towards labour and services and the same may be deducted from the value of the works contract and that the said formula need not be uniform for all works contracts and may depend on the nature of the works contract. We find merit in this submission. In cases where the contractor does not maintain proper accounts or the accounts maintained by him are not found worthy of credence it would, in our view, be permissible for the State legislation to prescribe a formula for determining the charges for labour and services by fixing a particular percentage of the value of the works contract and to allow deduction of the amount thus determined from the value of the works contract for the purpose of determining the value of the goods involved in the execution of the works contract. It must, however, be ensured that the amount deductible under the formula that is prescribed for deduction towards charges for labour and services does not differ appreciably from the expenses for labour and services that would be incurred in normal circumstances in respect of that particular type of works contract. Since the expenses for labour and services would depend on the nature of the works contract and would not be the same for all types of works contracts, it would be permissible, indeed necessary, to prescribe varying scales for deduction on account of cost of labour and services for various types of works contracts.” (at paras 45, 47 and 49)*

**17.** *We find that the assesseees are correct in their submission that a works contract is a separate species of contract distinct from contracts for services simpliciter recognized by the world of commerce and law as such, and has to be taxed separately as such. In Gannon Dunkerley, 1959 SCR 379, this Court recognized works contracts as a separate species of contract as follows :-*

*“To avoid misconception, it must be stated that the above conclusion has reference to works contracts, which are entire and indivisible, as the contracts of the respondents have been held by the learned Judges of the Court below to be. The several forms which such kinds of contracts can assume are set out in Hudson on Building Contracts, at p. 165. It is possible that the parties might enter into distinct and separate contracts, one for the transfer of materials for money consideration, and the other for payment of remuneration for services and for work done. In such a case, there are really two agreements, though there is a single instrument embodying them, and the power of the State to separate the agreement to sell, from the agreement to do work and render service and to impose a tax thereon cannot be questioned, and will stand untouched by the present judgment.” (at page 427)*

**18.** *Similarly, in Kone Elevator India (P) Ltd. v. State of T.N. - (2014) 7 SCC 1 = [2014 \(34\) S.T.R. 641](#) (S.C.) = [2014 \(304\) E.L.T. 3](#) (S.C.), this Court held :-*

*"Coming to the stand and stance of the State of Haryana, as put forth by Mr. Mishra, the same suffers from two basic fallacies, first, the supply and installation of lift treating it as a contract for sale on the basis of the overwhelming component test, because there is a stipulation in the contract that the customer is obliged to undertake the work of civil construction and the bulk of the material used in construction belongs to the manufacturer, is not correct, as the subsequent discussion would show; and second, the Notification dated 17-5-2010 issued by the Government of Haryana, Excise and Taxation Department, whereby certain rules of the Haryana Value Added Tax Rules, 2003 have been amended and a table has been annexed providing for "Percentages for Works Contract and Job Works" under the heading "Labour, service and other like charges as percentage of total value of the contract" specifying 15% for fabrication and installation of elevators (lifts) and escalators, is self-contradictory, for once it is treated as a composite contract invoking labour and service, as a natural corollary, it would be works contract and not a contract for sale. To elaborate, the submission that the element of labour and service can be deducted from the total contract value without treating the composite contract as a works contract is absolutely fallacious. In fact, it is an innovative subterfuge. We are inclined to think so as it would be frustrating the constitutional provision and, accordingly, we unhesitatingly repel the same." (at para 60)*

**19.** *In Larsen & Toubro Ltd. v. State of Karnataka, (2014) 1 SCC 708 = [2014 \(34\) S.T.R. 481](#) (S.C.) = [2014 \(303\) E.L.T. 3](#) (S.C.), this Court stated :-*

*"In our opinion, the term "works contract" in Article 366(29-A)(b) is amply wide and cannot be confined to a particular understanding of the term or to a particular form. The term encompasses a wide range and many varieties of contract. Parliament had such wide meaning of "works contract" in its view at the time of the Forty-sixth Amendment. The object of insertion of clause (29-A) in Article 366 was to enlarge the scope of the expression "tax on sale or purchase of goods" and overcome Gannon Dunkerley (1) [State of Madras v. Gannon Dunkerley and Co. (Madras) Ltd., AIR 1958 SC 560 : 1959 SCR 379]. Seen thus, even if in a contract, besides the obligations of supply of goods and materials and performance of labour and services, some additional obligations are imposed, such contract does not cease to be works contract. The additional obligations in the contract would not alter the nature of contract so long as the contract provides for a contract for works and satisfies the primary description of works contract. Once the characteristics or elements of works contract are satisfied in a contract then irrespective of additional obligations, such contract would be covered by the term "works contract". Nothing in Article 366(29-A)(b) limits the term "works contract" to contract for labour and service only. The learned Advocate General for Maharashtra was right in his submission that the term "works contract" cannot be confined to a contract to provide labour and*

*services but is a contract for undertaking or bringing into existence some "works". We are also in agreement with the submission of Mr. K.N. Bhat that the term "works contract" in Article 366(29-A)(b) takes within its fold all genre of works contract and is not restricted to one specie of contract to provide for labour and services alone. Parliament had all genre of works contract in view when clause (29-A) was inserted in Article 366." (at para 72)*

**24.** *A close look at the Finance Act, 1994 would show that the five taxable services referred to in the charging Section 65(105) would refer only to service contracts simpliciter and not to composite works contracts. This is clear from the very language of Section 65(105) which defines "taxable service" as "any service provided". All the services referred to in the said sub-clauses are service contracts simpliciter without any other element in them, such as for example, a service contract which is a commissioning and installation, or erection, commissioning and installation contract. Further, under Section 67, as has been pointed out above, the value of a taxable service is the gross amount charged by the service provider for such service rendered by him. This would unmistakably show that what is referred to in the charging provision is the taxation of service contracts simpliciter and not composite works contracts, such as are contained on the facts of the present cases. It will also be noticed that no attempt to remove the non-service elements from the composite works contracts has been made by any of the aforesaid Sections by deducting from the gross value of the works contract the value of property in goods transferred in the execution of a works contract.*

**25.** *In fact, by way of contrast, Section 67 post amendment (by the Finance Act, 2006) for the first time prescribes, in cases like the present, where the provision of service is for a consideration which is not ascertainable, to be the amount as may be determined in the prescribed manner.*

**26.** *We have already seen that Rule 2(A) framed pursuant to this power has followed the second Gannon Dunkerley case in segregating the 'service' component of a works contract from the 'goods' component. It begins by working downwards from the gross amount charged for the entire works contract and minusing from it the value of the property in goods transferred in the execution of such works contract. This is done by adopting the value that is adopted for the purpose of payment of VAT. The rule goes on to say that the service component of the works contract is to include the eight elements laid down in the second Gannon Dunkerley case including apportionment of the cost of establishment, other expenses and profit earned by the service provider as is relatable only to supply of labour and services. And, where value is not determined having regard to the aforesaid parameters, (namely, in those cases where the books of account of the contractor are not looked into for any reason) by determining in different works contracts how much shall be the percentage of the total amount charged for the works contract, attributable to the service*

*element in such contracts. It is this scheme and this scheme alone which complies with constitutional requirements in that it bifurcates a composite indivisible works contract and takes care to see that no element attributable to the property in goods transferred pursuant to such contract, enters into computation of service tax.*

**27.** *In fact, the speech made by the Hon'ble Finance Minister in moving the Bill to tax Composite Indivisible Works Contracts specifically stated :-*

*"State Governments levy a tax on the transfer of property in goods involved in the execution of a works contract. The value of services in a works contract should attract service tax. Hence, I propose to levy service tax on services involved in the execution of a works contract. However, I also propose an optional composition scheme under which service tax will be levied at only 2 per cent of the total value of the works contract."*

**28.** *Pursuant to the aforesaid speech, not only was the statute amended and rules framed, but a Works Contract (Composition Scheme for Payment of Service Tax) Rules, 2007 was also notified in which service providers could opt to pay service tax at percentages ranging from 2 to 4 of the gross value of the works contract.*

**43.** *We need only state that in view of our finding that the said Finance Act lays down no charge or machinery to levy and assess service tax on indivisible composite works contracts, such argument must fail. This is also for the simple reason that there is no subterfuge in entering into composite works contracts containing elements both of transfer of property in goods as well as labour and services.*

**44.** *We have been informed by counsel for the revenue that several exemption notifications have been granted qua service tax "levied" by the 1994 Finance Act. We may only state that whichever judgments which are in appeal before us and have referred to and dealt with such notifications will have to be disregarded. Since the levy itself of service tax has been found to be non-existent, no question of any exemption would arise. With these observations, these appeals are disposed of."*

5.2 Similar finding was given by Hon'ble Karnataka High Court in the case of CST Bangalore Vs. Turbotech Precision Engg. Pvt. Ltd. reported at 2010(18) STR 545 (Kar), which held that complex contracts involving supply of goods and services (Works Contracts) were not subject to service tax before June 1, 2007 and that such contracts should not be split for taxation.

5.3 Therefore, we hold that indivisible composite contract awarded to the appellant in this case, is leviable to service tax under works contract service only w.e.f 01.06.2007. For the prior period, it will not be leviable to service tax as held by the lower authorities under civil or industrial construction service. Accordingly, we hold that the demand of service tax against the appellant is sustainable only for the period with effect from 01.06.2007.

5.4 Regarding payment of service tax under Composition Scheme, Rule 3(1) & 3(2) of the Works Contract (Composition Scheme For Payment of Service Tax) Rules, 2007 are reproduced below:-

*3.(1) Notwithstanding anything contained in section 67 of the Act and rule 2A of the Service (Determination of Value) Rules, 2006, the person liable to pay service tax in relation to works contract service shall have the option to discharge his service tax liability on the works contract service provided or to be provided, instead of paying service tax at the rate specified in section 66 of the Act, by paying an amount equivalent to Two per cent of the gross amount charged for the works contract.*

*Explanation [ Substituted by Notification No. 23/2009-ST dated 07.07.2009]-  
For the purposes of this subrule, gross amount charged for the works contract shall be the sum,*

*(a) Including-*

*(i) The value of all goods used in or in relation to the execution of the works contract, whether supplied under any other contract for a consideration or otherwise; and*

*(ii) The value of all the services that are required to be provided for the execution of the works contract;*

*(b) Excluding-*

*(i) The value added tax or sales tax as the case may be paid on transfer of property in goods involved; and*

*(ii) The cost of machinery and tools used in the execution of the said works contract except for the charges for obtaining them on hire:*

*Provided that nothing contained in this Explanation shall apply to a works contract, where the execution under the said contract has commenced or where any payment, except by way of credit or debit to any account, has been made in relation to the said contract on or before the 7th day of July, 2009.*

*(2) The provider of taxable service shall not take CENVAT credit of duties or cess paid on any inputs, used in or in relation to the said works contract, under the provisions of CENVAT Credit Rules, 2004.*

5.5 As regards Rule 3(2), we find that the appellant had wrongly taken Cenvat credit of Rs.2,866/- in August 2007 which they on their own, paid in 2011 and thus, it can be taken as non avilment of Cenvat Credit by the appellant. As the appellant satisfies both the rules, we hold that they are eligible to pay service tax under Works Contract (Composition Scheme For Payment of Service Tax) Rules, 2007.

5.6 Regarding free supply materials, we find that CBIC vide Circular No. No.150/1/2012-ST dated 08.02.2012 has clarified that the meaning of the expression, "Gross Amount" appearing in Rule 3(1) of the Works Contract (Composition Scheme for Payment of Service Tax) Rules, 2007 is qualified by the explanation inserted in the said Rule w.e.f. 07.07.2009. Since, explanation is clarificatory and prospective in nature, inclusion of value of free of cost supplies of goods and services in or in relation to the execution of Works Contract in the gross amount for the purpose of payment of service tax on Works Contract in the Composition Scheme, is a legal requirement only w.e.f. 07.07.2009 when the explanation became part of Rule 3(1). It therefore clarifies that where execution of Works Contract has commenced prior to 07.07.2009, or where any payment (except payment through credit or debit) has been made towards a Works Contract prior to 07.07.2009, then in those cases, gross amount for the purpose of payment of service tax does not include the value of free of costs supplies. In view of the above, of service tax on free supply steel valued at Rs. 2,56,67,261/- is not legally correct and therefore, the same is set aside.

5.7 As regards invocation of extended period of limitation, we find that this issue has been discussed in detail by both the lower authorities. The appellant

was awarded a Contract for construction of mall in July 2006 and the work began in October-2006. They neither approached the department for clarification whether their activity is liable to service tax nor did they obtain registration and filed ST-3 returns. They took registration in July, 2007 when department, initiated investigation against them on the basis of credible intelligence. We therefore, agree with the lower authorities that the appellant has suppressed his turn over from the department with intent to evade payment of service tax and therefore, proviso to Section 73(1) has correctly been invoked for demanding the service tax for the larger period. For the same reasons, we also uphold penalty on the appellant under Section 78 of the Finance Act, 1994.

5.8 In the light of what has been discussed above, we deem it fit to remit the matter to the Adjudicating Authority to redetermine service tax liability on the appellant by extending the benefit of Works Contract (Composition Scheme for Payment of Service Tax) Rules, 2007. He shall also redetermine penalty amount on the appellant under Section 78 of the Finance Act, 1994. We uphold penalty of Rs.5,000/- under Section 77(2) of the Finance Act, 1994 for failure to file ST-3 returns in time and also for delayed payment of service tax. We however, set aside penalty on the appellant under Section 76 of the Finance Act, 1994 as penalty under Section 78 is held imposable.

6. The appeal is disposed of by remand in above terms.

*(Pronounced in the open court on 15.01.2026)*

**(DR. AJAYA KRISHNA VISHVESHA)  
MEMBER ( JUDICIAL )**

**(SATENDRA VIKRAM SINGH)  
MEMBER ( TECHNICAL )**