

**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. R. Rajasekharan Nair, Deputy Commissioner (Audit & Inspection), O/o.CCT, Tvpm.
2. A. Biji Kumari Amma, Deputy Commissioner (Legal Wing), O/o.CCT, Tvpm.
3. A. Ashok Kumar, Deputy Commissioner (Internal Audit), O/o.CCT, Tvpm.

Sub: KVAT Act, 2003 – Clarification U/s.94 – Contract for construction of Air Defence Ship - Tax liability under the Act - Orders Issued.

Ref: Application from M/s Cochin Shipyard Limited, Kochi dated 18/7/2009.

ORDER No.C3/32151/09/CT DATED 8/2/2010.

1. M/s Cochin Shipyard Limited, Kochi has preferred an application U/s 94 of the KVAT Act, 2003 seeking clarification on the tax liability under the Act on the Contract for construction of Air Defence Ship for Indian Navy.

2. The applicant is a Government of India undertaking engaged in the business of ship building, ship repair and allied activities. The applicant has both KVAT and CST registrations on the rolls of AC (Assessment) Special Circle II Ernakulam.

3. The applicant contends that the President of India has entered into a contract with the applicant for building an Air Defence Ship referred as 'P71' for naval operations on 12/5/2007. An LOI was placed in August 1999 and subsequently Work orders in Jan 04 and Nov 05, prior to signing of the contract.

4. The construction of the ship is to be executed in two phases. The first phase for the construction of the hull up to launching of the vessel after construction, and the second phase for balance completion and the procurement installation / positioning of the weaponry and other contingencies.

5. The applicant contends that the contract for the first phase is divided into two parts i.e. fixed price part and cost plus part. The fixed price part, denotes the contract price for construction of the vessel and the cost plus part denotes the value of outsourced design works / materials and machines to be procured. The applicant will be eligible to claim stage payments from the fixed price part as per Clause No. 2 Of Article III of the contract as and when the physical completion of the stages are achieved. Regarding payments for the cost plus part, Indian Navy will ensure sufficient funds to the applicant for procurement of materials and machinery for the project. The interest, if any, received on such funds belongs to Navy. The applicant can operate the account on behalf of Indian Navy as authorized by Indian Navy. For the cost plus activity, Indian Navy will pay the applicant 5% of the total expenditure incurred as consideration for the yard efforts/ handling charges and 7.5% as mark up.

6. The applicant further contends that agreement proceeds on the premise that the applicant is procuring materials from the list of vendors identified by the Indian Navy, by issuing

purchase orders on behalf of Indian Navy and making payments to the vendors accordingly. These goods are received by the company on behalf of the Indian Navy, distinctive identification codes are allotted and as and when required, released for production. The applicant claims that the imported items are exempt from Customs Duty and the indigenous items are exempt from Excise Duty in the hands of the company and the same are stored in the Bonded Stores / General stores of the company. The payment for procurement by the company is made from the funds provided by the Indian Navy.

7. The applicant has submitted a copy of the Contract between the President and the applicant. The applicant further contends that the features of the present contract that distinguish it from the typical ship building contracts are as follows:

- Active supervision by the owners over the work of construction of the vessel and in procurement of material for construction.
- Goods once procured for the construction immediately becomes the property of owner and also the scrap generated, all the stores such as equipment, machinery etc. after the completion of the project will belong to the owner.
- Under the contract the title and risk of all the properties is with the owner although the applicant is entrusted with safe custody.
- On the termination of the contract, the applicant is not entitled for any amount towards damages, and will receive payment only on such work, as had been completed on the date of termination of the contract.
- The vessel cannot be sold by the applicant to a third party, in the event of the owner reneging on the contract, since it is a specialised vessel - an Air Defence ship- the design and detailed engineering which are confidential.

8. The applicant has requested clarification on the following points:

- a. Whether this contract attracts any tax under KVAT Act, 2005 since the materials are procured on behalf of Indian Navy and Indian Navy is the sole owner at all the time for the entire procurements as well as the ship under construction as per the contractual terms.
- b. Or under the circumstances whether it could be treated as a “sale of a chattel as a chattel” and tax if any is to be paid at the time of raising the final invoice at the time of delivery of the vessel.
- c. Or whether the nature of transaction is a works contract, wherein tax is applicable on the value of the materials transferred, as and when materials are procured and issued to production.

9. The authorized representative of the applicant was heard and the contentions raised were examined.

10. From the terms of the contract, especially with that of the cost plus part, the materials as per specifications of the owner are imported by the applicant, and the payment received by them includes a profit part also and the materials are incorporated in the work. Though as per the terms of the contract there is a term that the “goods so imported shall remain under the ownership of Navy and it shall not in any way used by the builder for any other purpose”, in all

practical aspects when the contract in toto is analysed it is very clear that it is in fact a contract for supply of ship built as per the specifications of the Navy and materials purchased from those vendors approved by the Navy. On an analysis of the whole terms of agreement it can be concluded that the terms of contract is nothing but a sale of chattel as such and hence it is a contract of supply of ship which is executed between the Government of India and M/s Cochin Shipyard Limited . It is a contract for supply of a ship i.e. supply in the form of goods and the rate applicable is the rate of goods and exemption towards labour cannot be claimed in this case. It could be treated as a sale of a chattel only.

The issues raised above are clarified accordingly.

Deputy Commissioner (A&I)
O/o CCT

Deputy Commissioner (LW)
O/o CCT

Deputy Commissioner (IA)
O/o CCT

To,

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Advocates,
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