

Sectoral Impact- Outsourced Manufacturing or Job Work - GST

Revised Law

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Background:

The manufacturing industries (larger and medium) nowadays stick to their core competencies and get most jobs done on job work basis. Some concerns go in for contract manufacturing in which case the processor becomes a vendor and job work does not apply. The alternative nomenclatures used for job work are: sub-contracting, loan licensing, processing or labour charges. At times the principal send tools needed as well as part/ entire raw material required for the process free of cost. The material procured by principal may be sent directly to the job worker from the supplier. In certain situations, the finished goods may be sent directly from the job workers premises to the customer within or outside the State. The job worker invariably uses some consumables, machinery and tools for doing the job, which are procured by him on payment of local VAT and central excise duty. At times he may also use some own material which is transferred but not consumed. He would also be using taxable input services for completing the job.

Majority of job worker entrepreneurs today are not registered under any of the indirect taxes even if they are actually required to be registered. Customers may be deducting TDS and the job worker himself may not be filing any returns at all.

Normally job workers are not registered under central excise since their value of clearances are less than 150 lakhs. They are also not registered under VAT as they mainly do labour charges. Even when they supply goods integrated in the job work they choose to avoid registration knowingly or unknowingly. Under service tax they are liable as long as the principal pays. Also in

certain industries like printing, agriculture there is no liability. Many job worker who are liable for service tax like in case of VAT do not register.

Further most of them are contributing citizens who may not be educated or organized making out their living honorably. GST would require them to get educated and disciplined to some extent otherwise their services to the businesses would reduce over a period of time.

What is Job Work?

Job work is understood as the processing or working on goods supplied by the principal so as to complete a part or whole of the process. The job work undertaken maybe:

- the initial process,
- intermediate process,
- assembly,
- packing or any other completion process or complete manufacture.

The goods sent for job work may be raw material, component parts, semi-finished goods and the resultant goods could also be a variation of the same or the complete product.

The goods are returned back to the owner after such job work /processing. The property in goods remains with the person, who supplies the material. When there is no transfer of property in goods, there is no sale and no sales tax leviable on the same.

Section 2 (61) of Model GST law has defined job work as follows – *“means undertaking any treatment or process by a person on goods belonging to another registered taxable person and the expression “job worker” shall be construed accordingly”* This definition which seems to be similar, however, the use of phrase ‘any treatment or process by a person on goods belonging to another’ makes the definition susceptible to be interpreted even to cover the activities like repair. We hope that the definition of ‘job work’ will be made more precise in the final version of the law

Tax Implication under Present Law (Pre GST):

The CST/ VAT would be applicable only where the job worker transfers any goods while doing the job work. Examples could be powder coating or electroplating where powder or chemicals are procured by the job worker.

Excise duty is applicable where the process amounts to manufacture at the job worker's end. In M. M. Khambatwala's case (1996 (84) ELT 161 (SC)), the Supreme Court held that the job worker is to be considered as the manufacturer of goods although the raw materials are supplied by the principal. There is a small scale exemption however of Rs.150 Lakhs which can be availed subject to eligibility. The valuation of job work in case of manufacture by the job worker could be at the ultimate sale price of the principal and would always include the value of material supplied free of cost.

Where the process amounts to manufacture, it cannot be said to be service. There are a few specific exemptions to industries such as textiles, printing where even if the value of manufacture was to exceed Rs.150 lakhs there would be no liability.

Service tax is applicable for intermediate processes not amounting to manufacture. The major exemption is for those goods which are subjected to central excise duty after further processing (intermediate processing). Also the job work pertaining to printing, textile, agriculture and some other specified industries is exempt from service tax.

Today lakhs of job workers are not registered under local VAT, service tax or central excise even though they may be at times liable under indirect taxes. The disputes presently faced have been on account of:

- Whether the activity amounts to 'manufacture' or 'job work'
- ➔ Whether materials are transferred or consumed?
- ➔ Whether the material is negligible or substantial?
- ➔ Whether the cenvat credit of capital goods and inputs used by the job worker can be availed by the Principal while working under Notification 214/86- CE?

- ➔ Whether the re-packers/ minor processor of some fast moving consumer goods liable as deemed manufacturers are liable to pay excise duty on the entire value including material supplied? In this case the value of the goods supplied free of cost is also an issue.
- ➔ Whether the Rs. 150 lakhs exemption is available to branded products?
- ➔ What is to be done with the scrap or rejected material arising at the time of job work?

Job work under GST:

There are 2 options for job work:

- A. On payment of GST: The supply of goods to a job worker registered under GST would normally be on payment of IGST if it is interstate and on CGST and SGST when supplied within the State. The levy shifting to supply would lead to all job workers whether big or small being forced to get under the GST regime. Tax would be payable on supply of materials by the principal to the job worker unless there is any exemption notification [like agriculture related processing]. The job worker would supply back on the gross value including his charges and GST would be charged on that value. Job worker would be eligible to input tax credit on capital goods, inputs used and input services.
- B. Without payment of GST: The Special procedure could be followed.

Special Procedure for job work under Section 55:

Registered taxable persons can send inputs and /or capital goods without payment of GST to job worker on intimation to department and subject to prescribed conditions. The conditions attached to this special procedure are:

1. Job worked goods to be returned within 1 year,
2. Capital goods(other than dies, moulds, jogs & fixtures) are returned within 3 years,
3. Job worker who is registered can further supply the inputs/ processed goods.
4. Supply from unregistered job workers premises only if that premises is declared as a place of business by the principal. (sender of inputs),
5. Principal would maintain the stock records and reconciliations,
6. Where the inputs/ semi-finished goods are not received back in 1 year then it would be deemed that material originally sent is a supply liable to GST from the date when it was sent,

7. Similarly if Capital Goods are not received back in 3 years, it would be a supply on the date on which it was originally sent.
8. Scrap by unregistered job worker would have to be on payment of GST by either the job worker or the principal,
9. Registered job worker would charge the GST on his charges and principal would be eligible for credit,
10. Unregistered job worker would claim the threshold exemption. The principal maybe liable to pay the GST on reverse charge ONLY if such services are specified under Section 8 (3). Credit would be available thereof if liable.

Note: These provisions have been borrowed from earlier Notification. 214/86 to some extent.

Procedure On payment of GST:

The procedure for job work carried out by paying GST on the supply made by the principal to job worker could be as under:

- a. The principal would charge GST to the job worker on supply of dies, moulds, capital goods of raw material/ components.
- b. The job worker would avail the credit of GST charged and supply back with the applicable GST.
- c. The job worker would also be eligible for the credits on materials, capital goods used in his job work activity. The differentiation between the consumables and goods transferred would become irrelevant.
- d. The capital goods such as plant and machinery, mould and dies used for processing the customer's goods even when supplied free of cost to job worker would be under payment of GST.
- e. The valuation of resultant goods could be based on the present central excise rules. For captive consumption of principal, the value of goods supplied along with job work charges could be reckoned. For supply to ultimate customer, the price to the customer may have to be adopted. For supply to depot of the principal the price at depot at the time of supply could be adopted. The valuation of such processed goods could be disputed. We await the valuation rules for clarity.

Challenges/ Impact of GST on Job Work

1. Lakhs of job workers would require to be registered under GST for the 1st time. Earlier Rs. 150 lakhs exemption for those engaged in manufacture is now only Rs. 20 lakhs.
2. They may have to learn to account and bill properly.
3. Their turnover would multiply as value of material would get added.
4. There could be valuation issues at the job workers end unless the valuation rules (to be notified) are followed.
5. The job worker who is required to register could become cost effective if they were to capture all credits of capital goods/ stocks in hand (section 167/ 168/ 169) under central excise as well as VAT.
6. The working capital requirement of the manufacturer would increase as GST would be payable on all supplies towards job work unless special procedure under section 55 opted for.
7. Job workers would also need more working capital as they would need to pay the differential GST.

Transitional Provisions Applicable to Job workers

The transitional provisions set out the compliance as well as enabling credit carry forward as well as hitherto not availed to be availed. The relevant ones are briefly discussed hereunder:

- a. The job worker who is registered under central excise, service tax or VAT presently would be migrated into GST provisionally. Additional Information would need to be provided to make it final. (section 166)
- b. Job workers who need to register for the first time would have to apply. (Section 23)
- c. Registered job workers having balance of credit in CENVAT or VAT could carry forward the same as on appointed date. (Section 167)
- d. Unavailed credit on capital goods (50% or more) can be claimed [as it would not have been carried forward] post GST implementation. (Section 168)

- e. Central excise duty / VAT paid on stocks in hand can be claimed subject to conditions. (Section 169) If job worker also a manufacturing exempted goods then credit on stock of such goods available. (Section 170)
- f. Inputs/ semi-finished/ finished goods received by job worker prior to GST could be returned within 6 months of implementation date or extended period of 2 months without payment of GST provided both Principal & Job worker have declared the inputs. (Section 175/ 176/177)
- g. If not returned the ITC would be recovered under GST Section 184 from the Principal.

Conclusion:

The industries who were depending on the job workers for economies of cost and sticking to their core competencies may not be much affected under GST. The credit available to the job workers earlier being lost could be captured. Those who were using the job work route for claiming the SSI exemption for units under Rs. 150 Lakhs may not be able to do so under GST.

It may take some time for the job workers to come to terms with need to be within GST. Extensive change management and training would be needed to get acceptability to GST. The manufacturer would surely see a reduced cost of manufacture due to seamless credit at all stages of job work. The savings in logistic costs due to GST may also be an incidental advantage.
