

Recent judgment under WORKS CONTRACT

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KONE ELEVATOR INDIA PVT. LTD.

Vs.

State of Tamil Nadu and Ors.

Supreme Court dated 06th May, 2014

CONTROVERSY

- ✘ Whether a contract for manufacture, supply and installation of Lifts in a building is a “contract for sale of goods “ or a “works contract”

In case if it's a “sale” then entire consideration is taxable whereas in case it is a “works contract” consideration is subject to allowable deductions

HISTORY

- ✘ SC (3 members) had earlier passed judgment in the case of Kone Elevator (KE) that it is a Contract of Sale and not Works Contract
- ✘ Earlier judgment heavily relied on decision of SC in the case of Hindustan Shipyard Ltd. Wherein the test applied was that if the bulk of material used belongs to manufacturer then it is a pointer that the Contract is for Sale of Goods

...HISTORY

- ✘ KE petitioned that the earlier judgment did not consider the following SC judgments ;
 - State of Rajasthan vs. Man Indl. Corpn.
 - State of Rajasthan vs. Nenu Ram
 - Vanguard Rolling Shutters vs. CST

...HISTORY

Prior to the decision of the SC in the case of BSNL and L & T; the law was understood as follows –

- where a contract was divisible by itself, then the element of sale would be taxed as an ordinary sale of goods;
- where a contract was for supply of goods and services, if the predominant intention was supply of goods, the element of service was ignored and the entirety of the contract was taxed as sale; and

...HISTORY

- as law did not provide for dividing, by a legal fiction, a contract of mix nature, could not be taxed under the law of Sales Tax;
- subsequently an amendment was made to the Constitution (46th amendment) whereby such transactions could be taxed by the States

REASONS TO HOLD IT AS WORKS CONTRACT

- ✘ Lift comprises of various components or parts (Goods) having individual identity prior to installation which are assembled/ installed to create the working mechanism called lift
- ✘ The installation of these components/ parts with immense skill is rendition of service, for without installation in the building there is no lift

...REASONS TO HOLD IT AS WORKS CONTRACT

- ✘ Immense skill required for installation and the separate components/ parts of lift are not sold like goods, it becomes operational only after it is installed, adjusted, tested and commissioned in a building
- ✘ In an earlier judgment in the case of State of Madras vs. Gannon Dunkerley deciphered Sales of Goods Act - there is no agreement for sale of various items used in the Contract; it was a indivisible contract

WORKS CONTRACT – FOUR IMPORTANT CONCEPTS

- ✘ Works Contract is an indivisible contract but by legal fiction is divided into 2 parts; one for sale of goods and the other for supply of labour and services
- ✘ The concept of “dominant nature test” or for that matter, the “degree of intention test” or “overwhelming component test” for treating a contract as a “Works Contract” is not applicable

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- ✘ The term “Works Contract” as used in Clause (29A) of the Article 366 of the Constitution takes in its sweep all genre of works contract and is not to be narrowly construed to cover one species of contract to provide for labour and service alone; and
 - ✘ Once the characteristics of works contract are met with in a contract entered, any additional obligation incorporated in the contract would not change the nature of the contract

REASONS FOR DISSENTING ORDER

- ✘ Major work done by Petitioner at its place
- ✘ Petitioner brings the lifts and hoists it at the place of buyer
- ✘ “the contract must disclose in no uncertain terms that it was one for carrying out ‘the work’ and the supply of the materials were part of such agreement to carry out any such specified work. Here, it is the other way around

...REASONS FOR DISSENTING ORDER

- ✘ Cutting of walls to fix frames, etc equated to incidental work for fixing a fan or air conditioner
- ✘ Bombay High Court judgment in the case of Otis Elevator held valid/ distinguished – payment terms

No straight jacket formula can be made applicable for the determination of the nature of contract, for it is depended on the facts and circumstance of each case.

THANK YOU