

SUPREME COURT OF INDIA

Indian Hume Pipe Co. Ltd.

Vs.

State of Rajasthan

C.A.No.9879 of 2017

(A.K.Sikri and Ashok Bhushan,JJ.,)

28.08.2017

JUDGMENT

A.K.Sikri,J.,

SLP (Civil) No.11539 of 2015

1. All these appeals are filed by the same appellant, namely, M/s. India Hume Pipe Co. Ltd. (hereinafter referred to as the 'assessee'). The singular issue that arises is also identical in all these appeals. The only reason for filing number of appeals is that the said issue pertains to different Assessment Years.
2. The issue that has arisen in these appeals is as to whether Works contract given to the assessee is divisible in nature, in the facts of the case, and hence the imposition of tax and penalty made under Section 7AA of the Rajasthan Sales Tax Act, 1954 is justifiable and sustainable in law.
3. In order to have clarity in the matter and better grasp of the lis, it is necessary to glance through the relevant facts under which the aforesaid issue has arisen for consideration.
4. In the year 1954, the State Government of Rajasthan enacted the Rajasthan Sales Tax Act in order to tax the sales and purchase of any goods. The assessee is a company engaged in manufacturing and laying of pipelines for water supply schemes. The Public Health and Engineering Department (for short, 'PHED') of the State Government invited tenders for providing and laying of pipes complete with suitable jointing material specials, valves and construction of valve chamber, anchor blocks table crossing, including testing and commissioning of pipelines. On August 23, 1988, a work order was issued by PHED in favour of the assessee and the assessee, under the contracts/agreement dated January 11, 1989, agreed to provide PSC pipes manufactured by it and had entered into the contracts with PHED for providing and laying of pipelines.

5. On June 28, 1989, a notification inserting Rule 10B in the Rajasthan Sales Tax Rules, 1955 granting exemption to Works contract came to be issued with retrospective effect from May 28, 1987. Another work order was placed by the respondent in favour of the assessee on July 10, 1989. Pursuant to this, another notification dated March 04, 1992 came to be issued by the respondent wherein it exempted tax on Works contract relating to dams and canals. The respondent issued another work order dated August 10, 1992 in favour of the assessee for commission of pipeline in a dam. Meanwhile, the assessee filed an application dated September 17, 1992 before the Commercial Tax Officer seeking exemption from paying tax. However, the same was rejected by the Commercial Tax Officer vide his order dated September 26, 1994 making it clear to the assessee that the pipes manufactured and supplied by it fall within the definition of ‘sale of goods’ and that the contract is divisible in nature. 75% value of the contract was treated as consideration for sale of goods.

6. The appellate authority, Single Judge as well as the Division Bench of the High Court of Rajasthan, after dealing with merits of the case, affirmed the order passed by the Commercial Tax Officer holding that the assessee is not entitled to claim exemption under Section 7AA for supply of pipelines as that was termed as ‘sale’ .

7. We may mention that the State Government also issued notification dated March 29, 2001 wherein laying of pipeline with material has been categorized as Works contract and because of this the assessee’s work, after the said notification, is considered as Works contract and has been granted exemption from that date. We are, thus, concerned with the execution of this Works contract prior to the year 2001.

8. Mr. Arvind Datar, learned senior counsel appearing for the assessee, at the outset, drew the attention of this Court to the decision of the Constitution Bench in the case of *Kone Elevator India Private Limited v. State of Tamil Nadu*¹. He laboured to demonstrate that instant appeals were squarely covered by the aforesaid judgment wherein it was held that a single, composite contract for the supply of goods, labour and service will be treated as a Works contract and that it is not permissible to label a contract as a contract of sale of goods or as a Works contract depending on the proportion the component of supply of goods bears to the component of supply of labour and service. Unless there are clearly two contracts, one for supply of goods and the second for supply of labour and services, they cannot be treated separately.

9. Describing the nature of the contract awarded to the assessee, Mr. Datar emphasized that it was for the manufacture, supply and commissioning of pipelines for the supply of water to cities and towns from certain specified dams and the Indira Gandhi Canal by PHED. In this composite works contract, the assessee was inter alia required to:

- “(i) establish a factory near the working site for manufacturing pipes of specified dimensions;
- (ii) test the pipes;

(iii) undertake civil works like digging of trenches, etc.;

(iv) lay the pipes with welding, jointing, etc. and fill up the trenches; and

(v) sectional testing and commissioning of complete pipeline and other ancillary works.

In support, he also referred to certain clauses of the work order which, according to him, amply demonstrate that the assessee was supposed to undertake civil work extensively. In addition, relying upon Rule 10B of the 1955 Rules, Mr. Datar contended that the assessee was entitled to characterisation of its contract under the said Rule and once this exercise is undertaken, it would be apparent that the contract in question was works contract, which was indivisible in nature.

10. Mr. Tushar Mehta, learned Additional Solicitor General appearing for the respondents, countered the aforesaid submissions and maintained that the works contract involved in this case is rightly held to be divisible in nature. According to him, two types of work orders had been issued by the State Government. As per those orders, the work of supply of pipes and the works for contract of civil work are two different contracts in which the first part is concerned with sale of pipes on which tax has been imposed in accordance with the rates applicable to the pipes, and for which exemption cannot be issued as supply in such cases falls within the definition of 'sale'. He submitted that the assessing authority had examined the work order in holding that the works contract was divisible and had also rightly rejected the application for exemption on the ground that the sale of pre-stressed cement concrete pipe falls within the definition of 'sale of goods' under the Act.

11. He also argued that the term 'works contract' appearing in Article 366(29A)(b) of the Constitution of India takes within its fold all genres of works provide for labour and services. For sustaining levy of tax on goods, deemed to have been sold in execution of a works contract, the following three conditions must be fulfilled:

(i) there must be a works contract;

(ii) goods should have been involved in execution of a works contract; and

(iii) property in those goods must be transferred to a third party either as goods or in some other form. Mr. Mehta argued that the works contract executed by the assessee is a contract which is divisible under work orders and, thus, the imposition of tax and penalties made under Section 7AA of the Rajasthan Sales Tax Act, 1954 is in accordance with law.

12. Mr. Mehta also referred to the terms and conditions of the agreement and submitted that in the contract substantial part of the value of the contract pertains to the cost of PSC pipes, jointing material specials, valves etc. which were manufactured by the assessee in their

factory at Kekri and were supplied to the State Government. It was, thus, submitted that the High Court has rightly interpreted the contract and arrived at a correct conclusion and on these facts, the judgment of this Court in *Kone Elevator India Private Limited* is not applicable. Instead he relied upon the judgment of this Court in the matter of *State of Karnataka and Others v. Pro Lab and Others*² in support of his submissions.

13. We have given due consideration to the submissions made by counsel for both the parties.

14. Thrust of the arguments of the counsel for the appellants is that the contract in question was a single, composite contract for laying pipelines for supply of water from dams and canals to certain cities and towns in the State of Rajasthan and it cannot be treated as divisible contract. In other words, the submission was that being a single indivisible contract, it was not permissible for the State to extract divisibility component therein and impose sales tax on the purported sale of goods.

15. In the first instance, it may be mentioned that the High Court has examined the nature of contract in question and has come to the conclusion that as per the terms and conditions thereof, substantial part of the value of the contract pertained to the cost of PSC pipes, joining material specials, valves, etc. which were manufactured by the assessee in its factory at Kekri and were not supplied to the State Government. The High Court, thus, affirmed the findings of the authorities below on this aspect and concluded that the findings with regard to sale of pipes involved in the works contract are findings of facts which did not require any interference.

16. We are inclined to agree with the aforesaid approach of the High Court, namely, when it is found on facts that the works contract executed by the assessee is a divisible contract, the argument of the assessee that it is to be treated as one single and composite contract needs to be rejected on the facts of this case. On these facts, we are also of the opinion that *Kone Elevator India Private Limited* is not applicable. In that case, the Court was required to determine whether a particular contract was works contract for the purposes of Article 366(29A)(b) of the Constitution. The Court held that in order to determine such a question, the enquiry will have to be on the issue as to whether the contract in question is a composite one for supply of goods, labour and service or whether it is not one such single composite contract but two clearly separate contracts, one for supply of goods only and the other for supply of labour and services only. The Court further held that if it is a composite contract, even as per the constitutional philosophy contained in Article 366(29A), it is no longer permissible to weigh what proportion the component of supply of goods bears to the component of supply of labour and service in the composite contract (whether in terms of the consideration payable or otherwise), and then depending on whether the proportion of supply of goods component is high, label it as a 'contract for sale of goods' and after the said proportion is low then label it as a 'works contract'. The Court, thus, held that if it is a composite contract for supply of goods, labour and service, then it must be held to be a works contract as per Article 366(29A)(b) of the Constitution.

17. In the instant case, there is no dispute that the contract in question was a works contract. The issue is altogether different, namely, that of divisibility. It may be mentioned that before Article 366(29A) of the Constitution was amended with effect from March 01, 1983, the test applicable was ‘dominant nature test’ or ‘degree of intention’ or ‘overwhelming component test’ or ‘degree of labour and service test’. This Court in *Larsen and Toubro Limited and Another v. State of Karnataka and Another*³ clarified that post amendment, i.e. with effect from March 01, 1983, these tests are no longer applicable. It is also made clear that the works contract is an indivisible contract, but, by legal fiction, is divided into two parts, one for the sale of goods and the other for supply of labour and services. Affirming the aforesaid dicta in *Larsen and Toubro Limited*, this Court in *Kone Elevator India Private Limited* summarised the legal position in the following manner:

“37. Having dealt with the aforesaid authorities, as advised at present, we shall refer to certain authorities as to how the term “works contract” has been understood in the contextual perspective post the constitutional amendment. In *Hindustan Shipyard Ltd.*, the Court observed that the distinction between a contract of sale and a works contract is not free from difficulty and has been the subject-matter of several judicial decisions. It is further observed that neither any straitjacket formula can be made available nor can such quick-witted tests devised as would be infallible, for it is all a question of determining the intention of the parties by culling out the same on an overall reading of the several terms and conditions of a contract. Thereafter, the two-Judge Bench set out three categories of contracts and explained the contours, namely, (i) the contract may be for work to be done for remuneration and for supply of materials used in the execution of the work for a price; (ii) it may be a contract for work in which the use of the materials is accessory or incidental to the execution of the work; and (iii) it may be a contract for supply of goods where some work is required to be done as incidental to the sale. Thereafter, it opined that the first contract is a composite contract consisting of two contracts, one of which is for the sale of goods and the other is for work and labour; the second is clearly a contract for work and labour not involving sale of goods; and the third is a contract for sale where the goods are sold as chattels and the work done is merely incidental to the sale.

38. Commenting on the said decision in *Larsen and Toubro*, a three-Judge Bench opined that after the Forty-sixth Amendment, the thrusts laid down therein are not of much help in determining whether the contract is a works contract or a contract for sale of goods. We shall elaborate the perception as has been stated in *Larsen and Toubro* at a later stage.

69. Considered on the touchstone of the aforesaid two Constitution Bench decisions in *Builders' Assn. and Gannon Dunkerley* (2), we are of the convinced opinion that the principles stated in *Larsen and Toubro* as reproduced by us hereinabove, do correctly enunciate the legal position. Therefore, “the dominant nature test” or “overwhelming component test” or “the degree of labour and service test” are

really not applicable. If the contract is a composite one which falls under the definition of works contracts as engrafted under clause (29-A)(b) of Article 366 of the Constitution, the incidental part as regards labour and service pales into total insignificance for the purpose of determining the nature of the contract.”

18. In the case of Pro Lab, same very argument, which is advanced in this case, was repelled and in the process judgment in Kone Elevator India Private Limited was also discussed and taken note of, in the following manner:

“22. It was also argued that photograph service can be exigible to sales tax only when the same is classifiable as works contract. For being classified as works contract the transaction under consideration has to be a composite transaction involving both goods and services. If a transaction involves only service i.e. work and labour then the same cannot be treated as works contract. It was contended that processing of photography was a contract for service simpliciter with no elements of goods at all and, therefore, Entry 25 could not be saved by taking shelter under clause (29-A) of Article 366 of the Constitution. For this proposition, umbrage under the judgment in B.C. Kame case was sought to be taken wherein this Court held that the work involving taking a photograph, developing the negative or doing other photographic work could not be treated as contract for sale of goods. Our attention was drawn to that portion of the judgment where the Court held that such a contract is for use of skill and labour by the photographer to bring about desired results inasmuch as a good photograph reveals not only the aesthetic sense and artistic faculty of the photographer, it also reflects his skill and labour.

23. Such an argument also has to be rejected for more than one reasons. In the first instance, it needs to be pointed out that the judgment in Kame case was rendered before the Forty-sixth Constitutional Amendment. Keeping this in mind, the second aspect which needs to be noted is that the dispute therein was whether there is a contract of sale of goods or a contract for service. This matter was examined in the light of law prevailing at that time, as declared in Dunkerley case as per which dominant intention of the contract was to be seen and further that such a contract was treated as not divisible. It is for this reason in BSNL and Larsen and Toubro cases, this Court specifically pointed out that Kame case would not provide an answer to the issue at hand. On the contrary, the legal position stands settled by the Constitution Bench of this Court in Kone Elevator India (P) Ltd. v. State of T.N. Following observations in that case are apt for this purpose: (SCC p. 31, para 44)

“44. On the basis of the aforesaid elucidation, it has been deduced that a transfer of property in goods under clause (29-A)(b) of Article 366 is deemed to be a sale of goods involved in the execution of a works contract by the person making the transfer and the purchase of those goods by the person to whom such transfer is made.

One thing is significant to note that in Larsen and Toubro, it has been stated that after the constitutional amendment, the narrow meaning given to the term ‘works contract’ in Gannon Dunkerley (1) no longer survives at present. It has been observed in the said case that: (Larsen and Toubro case, SCC p. 750, para 72)

‘72. ... 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, [for] the additional obligations in the contract would not alter the nature of the contract so long as the contract provides for a contract for works and satisfies the primary description of works contract.’

It has been further held that: (Larsen and Toubro case , SCC p. 750, para 72)

‘72. ... 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” [because] nothing in Article 366(29-A)(b) limits the term “works contract” to contract for labour and service only.’ ”

19. The history of legislative and constitutional amendment pertaining to works contract is well known, which has been stated and restated by this Court in number of cases. The entire position is summarised in Pro Lab case as well and, therefore, it is not necessary to burden this judgment by repeating the same. Purpose would be served by reproducing paragraph 20 of the said judgment wherein the legal position is summarised as follows:

“20. To sum up, it follows from the reading of the aforesaid judgment in Larsen and Toubro case that after insertion of clause (29-A) in Article 366, the works contract which was indivisible one by legal fiction, altered into a contract, which is permitted to be bifurcated into two: one for “sale of goods” and the other for “services” , thereby making goods component of the contract exigible to sales tax. Further, while going into this exercise of divisibility, dominant intention behind such a contract, namely, whether it was for sale of goods or for services, is rendered otiose or immaterial. It follows, as a sequitur, that by virtue of clause (29-A) of Article 366, the State Legislature is now empowered to segregate the goods part of the works contract and impose sales tax thereupon. It may be noted that Entry 54 of List II of Schedule VII to the Constitution of India empowers the State Legislature to enact a law taxing sale of goods. Sales tax, being a subject-matter of the State List, the State Legislature has the competency to legislate over the subject.”

20. It clearly follows from the above that by virtue of the Forty Sixth Amendment to the Constitution, a single and indivisible contract is now brought on par with a contract containing two separate agreements. It has also now become a settled position in law that the State Governments have power to levy sales tax on value of material in execution of the works contract. This position is brought about by creating friction whereby the transfer of

moveable property in a works contract is deemed to be sale, even though it may not be well within the meaning of Sale of Goods Act. In Larsen and Toubro case it was further held that the value of goods which can constitute a measure of levy of the tax has to be the value of goods at the time of incorporation of the goods in the works even though property in goods passes later. Taxing the sale of goods element in a works contract is permissible even after incorporation of goods, provided tax is directed to the value of goods at the time of incorporation and does not purport to tax the transfer of immovable property (refer to paragraph 124).

21. In the present case, the assessing authority, after scrutinising the agreement in question between the assessee and the State Government, returned a finding of fact that manufacture and supply of PSC pipes, jointing material specials, valves, anchor blocks, etc. do not fall within the scopes of buildings, bridges, dams, roads and canals. It was also held that the agreement was clearly in two parts, namely, (i) sale and supply of PSC pipes, jointing material specials, valves, anchor blocks, etc. and (ii) the remaining part being supply of labour and services. These findings are upheld not only by the appellate authority but also by the Single Judge of the High Court as well as the Division Bench of the High Court. It may also be mentioned at this stage that the assessee has, in fact, admitted that it had no grievance against the finding that supply of pipes was nothing but the sale of pipes involved in the execution of the contracts and, therefore, it was excisable to sales tax. In view of the findings recorded by the authorities below, this element of sale of goods shall apply to jointing material specials, valves, anchor blocks, etc. as well. Thus, we are unable to find any fault with the impugned judgment of the High Court.

22. These appeals are, accordingly, dismissed with costs.

Judgment Referred.

¹(2014) 7 SCC 0001

²(2015) 8 SCC 0557

³(2014) 1 SCC 0708