

Is Building Cess applicable on supply of goods/equipment - analysing the recent SC decision

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1. Introduction and background

In 1996, the Parliament enacted the Building and Other Construction Workers' (Regulation of Employment and Conditions of Service) Act 1996 (BOCW Act) and the Building and Other Construction Workers' Welfare Cess Act 1996 (Welfare Cess Act) [1]. The BOCW Act provided for the constitution of the Building and Other Construction Workers Welfare Board (Board) in every state 'so as to provide and monitor social security schemes and welfare measures for the benefit of building and other construction workers'. The Welfare Cess Act aims to levy cess for the welfare of workers engaged in building and other construction work so as to create a fund for such welfare schemes. The Board constituted under BOCW Act is responsible for collection of this cess under the

Welfare Cess Act - commonly, and hereafter referred to as 'Building Cess'. Building Cess is collected at a state level, typically by the ministry/department responsible for labour welfare. Section 3 of Welfare Cess Act is the charging section for Building Cess and the relevant part reads as follows:

"3. Levy and collection of cess.- (1) There shall be levied and collected a cess for the purposes of the Building and Other Construction Workers (Regulation of Employment and Conditions of Service) Act, 1996, at such rate not exceeding two per cent but not less than one per cent, of the cost of construction incurred by an employer, as the Central Government may, by notification in the Official Gazette, from time to time specify....."

Pursuant to this, the central government vide notification no. SO 2899 dated 26 September 1996 specified the rate of Building Cess at one percent (1%) for all building and other construction projects in India.

The term "building and other construction work" has been defined under Section 2 (d) of BOCW Act and given a wide connotation:

"2.(d) "building or other construction work" means the construction, alteration, repairs, maintenance or demolition of or in relation to, buildings, streets, roads, railways, tramways, airfields, irrigation, drainage, embankment and navigation works, flood control works (including storm water drainage works), generation, transmission and distribution of power, waterworks (including channels for distribution of water), oil and gas installations, electric lines, wireless, radio, television, telephone, telegraph and overseas communications, dams, canals, reservoirs, watercourses, tunnels, bridges, viaducts, aqueducts, pipelines, towers, cooling towers, transmission towers and such other work as may be specified in this behalf by the appropriate Government, by notification but does not include any building or any construction work to which the provisions of the Factory Act, 1948 (63 of 1948), or the Mines Act, 1952 (35 of 1952), apply;" (Emphasis added)

Thus, most industrial construction activities including power projects and road construction projects would get covered within the ambit of BOCW Act and Welfare Cess Act. However, this does not include scenarios where the welfare provisions for labourers under the Factory Act 1948 or the Mines Act 1952 get attracted[2].

Taxable base for Building Cess: As noted above, Building Cess is to be levied on 'the cost of construction incurred by an employer'. The term 'cost of construction' has not been defined in the Welfare Cess Act. Rule 3(1) of the Building and Other Construction Workers' Welfare Cess Rules, 1998 (Welfare Cess Rules) provide that 'cost of construction' "shall include all expenditure incurred by an 'employer' in connection with the building or other construction work but shall not include

- (i) cost of land; and
- (ii) any compensation paid or payable to a worker or his kin under the Workmen's Compensation Act, 1923

Thus, the Welfare Cess Rules merely exclude cost of land and any compensation paid or payable to a worker under the Workmen's Compensation Act 1923 without defining 'cost of construction'.

Clearly, there is ambiguity vis a vis the exact coverage of the phrase 'cost of construction', especially in the context of large projects like setting up of a factory/plant/ power generation or transmission projects/other infrastructure projects etc which involve appointing contractors under complex, high-value EPC/construction contracts.

To elaborate, such complex, high-value EPC/construction contracts often contain separate scopes of work and price for supply of equipment/goods, installation/commissioning and other services, and civil construction works - at times, these separate scopes will form part of the same contract and at times, multiple inter-connected contracts will be entered into for such separate scopes of work. It has always been debated as to whether 'cost of construction' only includes the cost vis a vis the civil construction works or does it include the entire value of the contract/contracts including even the value of supply of equipment/goods.

By and large, the industry took a position that 'cost of construction' should be restricted to the costs having a direct nexus with the activity of construction like the costs for civil/construction works and not include the costs associated with pure supply of equipment/goods. This aspect has also been subject matter of litigation in various High Courts across India.

It is in this context that one needs to look at the recent Supreme Court judgment (dated 12 May 2021) in *Uttar Pradesh Power Transmission Corporation Ltd (UPPTC) and Another vs. CG Power and Industrial Solutions Limited and Another* (2021-VIL-56-SC).

2. **Supreme Court's judgment in UPPTC**

CG Power and Industrial Solutions Limited (Contractor) obtained an order from UPPTC for construction of 765/400 KV Substations, at Unnao, Uttar Pradesh on a turnkey single-point responsibility basis for which 4 inter-connected contracts were entered into:

- (i) First contract - Supply and Delivery of Equipment & Material
- (ii) Second contract - Handling, Erection, Testing and Commissioning Works
- (iii) Third contract - Civil works
- (iv) Fourth contract - Operation and maintenance for three years.

On a review of the various contracts, the Supreme Court noted that the *first and second Contracts shall cover all works, other than civil works, required to complete total scope under these specifications. The THIRD Contract shall cover all civil works including required materials under its scope.*"

The Contractor had submitted 2 performance bank guarantees under the first contract above which was duly performed, and the bills of the Contractor cleared. However, in a subsequent audit inspection from CAG, it was pointed out that Building Cess was not collected and deposited vis a vis this first contract for supply and delivery of equipment & material. While UPPTC initially replied stating that Building Cess was not payable on such scope of supply of goods (not being construction work), it subsequently changed tack, and vide a letter dated 1 June 2018, UPPTC informed the bank that consequent upon successful performance of the transformer and isolators supplied by the Contractor, the bank guarantees against the abovementioned first (supply) contract were partly discharged and instructed the bank to retain an amount of around INR 2.6 Crore from the earlier bank guarantees and issue an amended bank guarantee extending its validity.

In December 2018, there was correspondence from UPPTC suggesting recovery of Building Cess vis a vis the abovementioned first (supply) contract by encashment of the above bank guarantee. Against this, the Contractor filed a writ in January 2019 in the Lucknow bench of the Allahabad High Court. The Allahabad High Court vide a brief (three pages) judgment dated February 24, 2020 quashed the letter(s) from UPPTC seeking to recover Building Cess on the abovementioned first (supply) contract.

However, the High Court's reasoning for the same focussed solely on the point that if Building Cess was leviable, it would be necessary for the concerned authorities to undertake the exercise of assessment and levy under the Welfare Cess Act, before the same could be realized from the Contractor - recovery could not have been based on the audit report of the CAG. It is pertinent to note that while the Allahabad High Court set aside those letters, it was *"however with the liberty to proceed in the matter under the Cess Act of 1996 and the Rules framed thereunder if the Act of 1996 is applicable on first contract"*. Thus, the legal question as to whether Building Cess was leviable apropos the first contract (of supply of goods) was not answered by the High Court.

The matter reached the Supreme Court through an appeal by UPPTC. Supreme Court refused to interfere with/overturn the High Court's judgment and thus upheld the quashing of the letter(s) from UPPTC seeking to recover Building Cess on the abovementioned first (supply) contract.

The Supreme Court went on to add/highlight the following aspects:

- (i) There was nothing in any of the contractual documents which enabled UPPTC to withhold any amount from the bills raised by the Contractor.
- (ii) The Supreme Court perused the provisions of the Welfare Cess Act and Rules (along with judgments expounding on the scope thereof) at length and went on to hold that *"The clear statutory scheme of the BOCW Act excludes a supply contract from within its ambit"* - even though, this was not something the High Court had dealt with.
- (iii) The Supreme Court also took note of the fact that *'several public authorities and corporations, such as the Delhi Metro Rail Corporation and Karnataka Power Transmission Corporation Limited, have issued instructions that no cess under the BOCW Act is leviable on a contract for supply of goods'*.
- (iv) The Supreme Court also held that the Contractor (ie., CG Power and Industrial Solutions Limited) apparently neither qualifies as an 'employer' nor as a 'contractor' as defined under the BOCW Act *"in respect of the first, second and fourth contracts"* (ie., contracts other than the civil works contract).
- (v) The Supreme Court agreed with the arguments made by the Contractor that *'the four contracts had been treated as a singular contract solely for the purposes of responsibility for timely execution. For all other intents and purposes, including levy of any tax or fees, the contract for supply was understood by the parties as a separate and distinct contract.'*
- (vi) The Supreme Court noted and emphasized that *"UPPTCL has changed its stand only after the CAG report. Cess in respect of the First Contract has been deducted only in view of the audit objection raised by the Office of Comptroller and Auditor General (CAG)."*

Implications of this judgement: In light of the above points, this judgment has been welcomed by the industry - especially in light of the points (ii), (iii), (iv) and (v) above. After all, these appear to validate a long-standing position taken by many in the EPC/construction space that Building Cess should be leviable only on the civil construction portion.

This may also be attempted to be relied upon as a persuasive/indirect authority for upholding splitting of a turnkey scope into multiple interconnected contracts in a large construction project and treating such contracts as separable contracts from tax purposes. This is an issue which has arisen repeatedly, not only in the context of Building Cess but also apropos other indirect

taxes in the pre-GST era and continues to be relevant in the GST era too.

This may also lead to contractual/other refund claims by contractors who have faced withholding of amounts on account of Building Cess even on the value of supply and other contracts (other than civil construction) - coming days may see some litigation in this regard.

However, before deciding upon any path of action on the basis of this Supreme Court judgment, the following caution points ought to be taken into account.

3. Caution points

(i) We have already noted above that the legal question as to whether Building Cess was leviable apropos the first contract (of supply of goods) was not answered by the High Court. Despite that, the Supreme Court went on to hold that "*The clear statutory scheme of the BOCW Act excludes a supply contract from within its ambit*" - it is not clear from the judgment if this was a specific question of law that was raised for determination by the Supreme Court;

(ii) It is not clear whether, either before the High Court or the Supreme Court, section 3(2) of the Welfare Cess Act was brought to the notice of the court(s). Section 3(2) is the charging section for Building Cess and mandates that "*The cess levied under sub-section (1) shall be collected from every employer in such manner and at such time, including deduction at source in relation to a building or other construction work of a Government or of a public sector undertaking....*"

Thus, the Welfare Cess Act specifically envisages withholding by government/PSU entities (UPPTC clearly qualifies as one) on account of Building Cess. Rule 4(3) of the Welfare Cess Rules also echo the same. Even though these provisions have been excerpted in the judgment, there is no discussion whatsoever vis a vis the effect of these provisions on the right of UPPTC to collect Building Cess by invocation of bank guarantee after release of contractual payments to the Contractor. The entire discussion in this regard revolves around the rights under the contracts for withholding - in paragraph 59, there is even a statement that such withholding by UPPTC is not comparable to deduction of Income Tax at source, but there is no reference to the withholding obligations of UPPTC under the Welfare Cess Act and Rules. This aspect may be highlighted by the Government in seeking a review of this judgment.

(iii) Whether or not a supply contract can be included in the taxable base for Building Cess has been a subject matter of various High Court judgements (reaching varying conclusions) - some of those judgements are discussed below:

(a) *Government of Andhra Pradesh vs. Lakamsani Samba Siva Rao and Ors.*(MANU/AP/0694/2015) - The High Court of Andhra Pradesh and Telangana considered a scenario where separate agreements were entered into for construction and for supplying of all plant machinery and equipment. In paragraph 16, they held as under:

"Though two separate agreements were executed, the work that was undertaken by the contractors cannot be separated. It was like a composite contract for construction/erection and commissioning of the plant. If the argument, such as advanced by learned counsel for the appellants in these appeals, is accepted that will defeat the very object of Act Nos. 27 and 28. In every construction work/activity, the contractors and/or the principal employer would execute two agreements, one for supply of materials and the other for construction/erection of buildings such as blast furnace and cranes. The expression 'the cost of construction' as employed in Section 3(1) of Act No. 28, in our opinion, would mean the entire cost incurred for construction of a building, such as crane or blast furnace, since its construction and erection cannot be separated. It was a composite contract for construction/erection of crane with material. Therefore, the submission of the learned counsel for the appellants in these three appeals must be rejected."

The special leave petition filed in Supreme Court against this judgment was dismissed.

(b) *Technical Associates Limited vs. Assistant Labour Commissioner, Jabalpur* (2012 (3) MPLJ 475) - Madhya Pradesh High Court held the value of supply of goods will need to be included for levy of Building Cess

(c) *Aramesta Captive Power Company Pvt. Limited and others vs. State of Chhattisgarh and others* (Writ Petition (T) No. 7503 of 2010 - The issue before Chhattisgarh High Court was something else. But in the course of reaching its conclusion, in paragraph 9, the court held the following in favour of contractors: "*Some of the contracts which have been entered into are combined contracts dealing both with construction and works of other nature, such as design etc. There can be no manner of doubt that cess would only be payable on the construction activity and the construction aspect of the contract. Cess would not be payable on those items which do not fall under the construction activities. However, this is not to be decided by this Court. A machinery and procedure has been prescribed under the BOCW Cess Act itself for doing needful. Section 4 provides that the employer shall file return and in this return the employer can show which portion of the contract relates to the construction activity and which does not. The assessment of the return has to be done by the authority under Section 5 of the BOCW Cess Act."*

However, none of these High Court judgments appear to have been brought to the notice of the Supreme Court.

(iv) The Supreme Court decision in *Lanco Anpara Power Limited (Supra)* emphasized upon the fact that the BOCW Act and the Welfare Cess Act have a 'superior purpose' "*.... since the purpose of this Act is to take care of a particular necessity i.e. welfare of unorganised labour class involved in construction activity, that needs to be achieved and not to be discarded. Here the doctrine of Purposive Interpretation also gets attracted....*". For the sake of completeness of analysis, it might have been ideal for the Supreme Court to dwell into the impact of this 'superior purpose' while interpreting the coverage of Building Cess given that:

(a) The definition of 'cost of construction', the taxable base for Building Cess includes "*...all expenditure incurred by an*

'employer' in connection with the building or other construction work..."and 'in connection with' is a phrase of wide amplitude;
and

(b) Some of the High Courts, as discussed above, relied on the welfare objective of these legislations to hold that Building Cess will be leviable even on the value of supply of goods

4. Concluding thoughts

While this Supreme Court judgment is a welcome development and does indeed appear to support the long-standing industry position in this regard, given the caution points above, this may not yet be the last word on whether Building Cess will be leviable on scope of/contract of supply of equipment/materials.

It may thus be prudent for contractors/bidders as well as project owners to ensure that all aspects of the liability towards Building Cess are specifically negotiated and documented in the relevant contract/tender documents.

[1] For a detailed understanding of the nature, objectives and coverage of these legislations, it may be useful to refer to the Supreme Court decision in *Dewan Chand Builders and Contractors vs. Union of India* [(2012) 1 SCC 101] where the Supreme Court discussed and upheld the constitutional validity of Building Cess.

[2] Please refer to the Supreme Court decision in *Lanco Anpara Power Limited v. State of Uttar Pradesh and Ors* [(2016) 10 SCC 329] for a better understanding of this exclusion where the welfare provisions for labourers under the Factory Act, 1948 or the Mines Act, 1952 get attracted.