

# Bimal Jain

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Dear Professional Colleague,

## SC explains distinction between “Contract for sale of goods” and “Works contract”

We are sharing with you an important judgement of the Hon’ble Supreme Court of India, in the case of **Kone Elevator India Private Limited Vs. State of Andhra Pradesh [2014-TIOL-57-SC-CT-CB]** on following issue:

### Issue:

**Whether supply, erection, installation and commissioning of lift at customer's premises constitute "Contract for sale of goods" or "Works contract"?**

### Facts & Background:

Kone Elevator India Private Limited (“**the Petitioner**” or “**the assessee**”) is engaged in the manufacture, supply and installation of lifts involving civil construction. For the Assessment Year 1995-96, the Hon’ble Sales Tax Appellate Tribunal, Andhra Pradesh (“**the Tribunal**”), considering the case of the Petitioner, opined that the nature of work is a "Works contract", for the erection and commissioning of lift cannot be treated as "Sale". On a revision being filed, the Hon’ble High Court of Andhra Pradesh (“**the Hon’ble HC**”) affirmed the view of the Tribunal and dismissed the revision filed by the Revenue. Grieved by the decision of the Hon’ble HC, the State of Andhra Pradesh preferred Special Leave Petition (“**SLP**”) to the Hon’ble Supreme Court of India wherein leave was granted and by judgment dated February 17, 2005 in **State of A.P. Vs. Kone Elevators (India) Ltd. [(2005) 3 SCC 389 = 2005-TIOL-30-SC-CT-LB]**, the view of the High Court was overruled.

The three Judge Bench of the Hon’ble Supreme Court applied the “Dominant nature test” and finally ruled that the assessee carries on business of selling lifts and elevators and the major component of the end product is the material consumed in producing the lift to be delivered and the skill/ labour employed for converting the main components into the end product are incidentally used. Therefore, the delivery of the end product by the assessee has to be constituted as a “Sale” and not a “Works contract”.

After the pronouncement in the said case, the State Government called upon the Petitioner to submit returns treating the transaction as sale. Being aggrieved by the aforesaid order of the three Judge Bench of the Hon’ble Supreme Court, the Petitioner preferred a petition before the Hon’ble Supreme Court of India under Article 32 of the Constitution.

It was assiduously urged by the Petitioner that the "predominant intention test" was no longer relevant after the decision of the Hon’ble Supreme Court of India in **Bharat Sanchar Nigam Ltd. and another Vs. Union of India and others [2006-TIOL-15-SC-CT-LB]**, which has been further explained in **Larsen and Toubro Limited and another Vs. State of Karnataka**

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**and another [2013-TIOL-46-SC-CT-LB]**. Hence, supply and installation of lift cannot be treated to be a contract for Sale. It was further argued that a lift comprised of components or parts (goods) like lift car, motors, ropes, rails, etc., and each of them had its own identity prior to installation and they are assembled/ installed to create the working mechanism called lift. Thus, the installation of these components/ parts with immense skill is rendition of service, for without installation in the building, there was no lift.

## **Held:**

It is held by the five Judge Constitution Bench of the Hon'ble Supreme Court of India that four concepts have emerged from various SC judgments, which are:

- i. **The Works contract is an indivisible contract but, by legal fiction, is divided into two parts, one for sale of goods, and the other for supply of labour and services;**
- ii. **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;**
- iii. **The term "Works contract" as used in Clause (29A) of 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**
- iv. **Once the characteristics of Works contract are met with in a contract entered into between the parties, any additional obligation incorporated in the contract would not change the nature of the contract.**

**Dominant nature test" or "overwhelming component test" or "the degrees 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 (29A)(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.

The conclusion of the three Judge Bench being based on the bedrock of incidental service for delivery, does not correctly lay down the law, for the contract itself profoundly speaks of obligation to supply goods and materials as well as installation of the lift which obviously conveys performance of labour and service, satisfying the fundamental characteristics of "Works contract".

Therefore, five Judge Constitution Bench of the Hon'ble Supreme Court of India overruled the judgement of three Judge Bench and allowed the writ petition filed by the Petitioner.

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Overruling of 2005 judgment given by three Judge Bench of the Hon'ble Supreme Court of India by five Judge Constitution Bench **changing the classification of contracts for supply, erection, installation and commissioning of elevators from "Contract of sale of goods" to "Works contract", will impact the presently ongoing matters of litigation on the concerned issue.**

*Hope the information will assist you in your Professional endeavours. In case of any query/information, please do not hesitate to write back to us.*

Thanks & Best Regards.

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