

**IN THE CUSTOMS, EXCISE & SERVICE TAX
APPELLATE TRIBUNAL, CHENNAI**

Service Tax Appeal No. 40556/2017

(Arising out of Order in Original No. CHN-SVAX-60/2016-2017 dated 15.12.2016 passed by the Principal Commissioner of Service Tax – I, Chennai)

IL & FS Water Ltd.

No. A5, Navins Presidium
No. 103, Nelson Manickam Road
Aminjikarai, Chennai – 600 023.

Appellant

Vs.

Commissioner of GST & Central Excise

Chennai North Commissionerate
26/1, Mahatma Gandhi Road
Nungambakkam, Chennai – 600 034.

Respondent

APPEARANCE:

Shri R. Viswanathan, Chartered Accountant for the Appellant
Shri M. Selvakumar, Authorised Representative for the Respondent

CORAM

Hon'ble Shri M. Ajit Kumar, Member (Technical)
Hon'ble Shri Ajayan T.V., Member (Judicial)

FINAL ORDER NO. 40553/2026

Date of Hearing: 19.01.2026
Date of Decision: 30.04.2026

Per M. Ajit Kumar,

This appeal challenges Order-in-Original No. CHN-SVAX-60/2016-2017 dated 15.12.2016 passed by the Principal Commissioner of Service Tax-I, Chennai (impugned order).

2. The appellant, registered with the Service Tax Department, provides Works Contract Service, Management, Maintenance or Repair Service, and Management Consultant Service, and avails CENVAT credit on input services. Departmental audit noted that, for a water supply project for M/s. Indian Oil Corporation Ltd. at Paradip, Odisha, the appellant paid service tax at the normal rate only on the service

portion of the works contract, excluding the value of goods transferred on which VAT was paid. The department viewed the material component as trading/exempted activity and alleged that the appellant wrongly availed common input service credit without maintaining separate accounts or reversing credit under Rule 6(2) and Rule 6(3)/6(3A) of the CENVAT Credit Rules, 2004. Accordingly, after due process the Ld. Adjudicating Authority confirmed the demand with interest of Rs. 2,83,34,028/-, for the period 2010-11 to 2014-15, under Rule 14 of the CCR, 2004 read with the proviso to section 73(1) of the Finance Act, 1994, and imposed penalties under section 77 and section 78. Aggrieved, the appellant is in appeal before this Tribunal.

3. The Ld. Chartered Accountant Shri R. Viswanathan appeared for the appellant and Ld. Authorized Representative Shri M. Selvakumar appeared for the respondent.

3.1 Shri R. Viswanathan Ld. C.A. for the appellant submitted as follows:

A. The appellant is carrying out the following services;

- (a) Management Consultancy
- (b) Works Contract Service
- (c) Maintenance and Repair

No other works contracts other than present contract or related expenditure were incurred during the relevant years.

B. The project, under dispute, arose from an IOC tender for laying down pipes from River Mahanadi to IOC Plant at Paradip, to supply treated water for 25 years on a Build, Own, Operate and Transfer (BOOT), basis (including design, construction, operation and maintenance). Under this arrangement, M/s IL & FS Paradip Refinery

Water Ltd. (**IPRWL**) a public ltd Co., formed for the purpose of developing the water supply project, engaged the Appellant as a contractor only for development and construction. The same was fully subcontracted by the appellant to M/s Lanco Infratech Ltd.

C. The Appellant's dominant activity in the said project was execution of the works contract, not trading in goods. The impugned order incorrectly characterised transfer of property in goods under the works contract as "trading". The finding that materials were transferred "as such" without change, alteration or accretion is untenable. It also wrongly attributed input-service CENVAT credit to the alleged trading activity, while ignoring the fact that Rule 2(e) even if applicable would only be from 01.04.2011, and failed to verify the Appellant's separate books of account or consider the replies furnished to the Audit Department.

D. Further, it erroneously treated the deemed-sale value in a works contract as an "exempt service" and, on that basis, invoked Rule 6(3A). Deemed sale of goods is excluded from "service" under Section 65B(44)(a)(ii); it cannot be equated with trading, and Rule 2(e) (post 01.07.2012) cannot be used to treat the sale value in a works contract as trading or an exempt service.

E. CENVAT credit was taken only on input services used for that contract (including management consultancy, maintenance and repairs, and labour services). The credit relates to the period prior to commencement of the contract, and its inclusion for FY 2010-11 under Rule 6(3A) is legally unsustainable because "trading" was not declared an "exempt service" during that period.

F. They maintained separate records for availment and compliance of the inputs/ input services. The invoices for each of the activities are accounted for separately. The input services are accounted separately. The Cenvat credit availed was the same as those availed in earlier periods when they were not carrying out works contract.

G. Credit on works contract service invoices of Lanco Infratech Ltd. (with separate material and service billing) was used only to discharge output service tax on the works contract provided to IPRWL. The credit pertained solely to the service portion and was proportionately disallowed as reflected in the records.

H. Reliance on Departmental Letter No. 334/3/2011 dated 28.02.2011 issued by JS TRU II, is misplaced, and the observation that the Appellant's contentions lack logic or substance is unsupported by any findings of fact.

I. As per section 73(1) of the Finance Act 1994, the SCN should be issued within 18 months from the relevant date as no suppression was involved and duty was discharged as per their books of account.

J. As no question of reversal of credit arose, no ground for interest and imposition of penalty is made out.

The Ld. C.A. prayed that the impugned order may be set aside and the appeal allowed.

3.2 Ld. A.R. Shri M. Selvakumar appearing for Revenue, submitted:

A. Service tax is leviable only on the service portion of "execution of works contract" during the impugned period.

B. CENVAT credit is available only for inputs/input services used for dutiable final products or taxable output services. For common inputs/services, Rule 6 of the CENVAT Credit Rules, 2004 mandates

proportionate reversal/payment to the extent used for exempted goods/services. With effect from 01.07.2012, "services on which no service tax is leviable under Section 66B" are treated as "exempted services". No service tax is applied to the value attributable to transfer of title in goods (sale/deemed sale) in a works contract, which is covered under "trading" and is an "exempt service".

C. The appellant has entrusted the entire work to a sub-contractor who in turn undertakes service activity and supplies the materials required for executing the contract while raising bills on the appellant and paying sales tax on such sales. Since the material component is separable and transferred without change in nature, property in goods passes by transfer (not by accretion/ accession/ blending). Hence the material portion is "trading / transfer of title in goods" and is an exempted service for Rule 6.

D. From 01.07.2012 (negative list regime), trading of goods is on the negative list and, as no service tax is leviable under Section 66B on the material portion, it is covered as an exempted service.

E. Reliance was placed on Departmental Letter No. 334/3/2011 dated 28.02.2011 issued by JS TRU II and further clarified by CBEC Circular No. 943/04/2011 CX dated 29.04.2011, that trading constituted an exempted service even prior to 01.04.2008.

He stated that the appeals are without merits and may be rejected.

4. We have heard the parties and examined the issue. The dispute in the present appeal arises from a demand raised under the CENVAT Credit Rules, 2004, alleging wrongful availment of CENVAT credit on common input services on the premise that the Appellant was engaged

in "trading" of goods in addition to provision of taxable works contract service.

4.1 The impugned order proceeds on the footing that the material portion of the contract represents "trading" of goods, since materials were allegedly billed and transferred "as such" by the Appellant to IPRWL. On this basis, the adjudicating authority concluded that the Appellant was providing both taxable services and exempted services (trading), and consequently invoked Rule 6(3A) of the CENVAT Credit Rules, 2004, for proportionate reversal of credit.

4.2 The adjudicating authority also treated the value of deemed sale of goods in a works contract as an exempt service and, applying Rule 2(e) of the CENVAT Credit Rules, 2004, held that reversal under Rule 6 was mandatory, including for the period FY 2010-11.

5. The core issue that arises for determination is whether the billing of goods, used in the project, by the sub-contractor to the appellant and thereafter onwards to IPRWL during execution of the works contract can be treated as "trading" or an "exempted service" for the purpose of Rule 6 of the CENVAT Credit Rules, 2004, so as to warrant reversal of CENVAT credit on common input services.

6. In **Vanguard Rolling Shutters Vs CST** [(1977) 39 STC 372 (SC) / AIR 1977 SC 1505], it was observed by the Hon'ble Supreme Court that it is difficult to lay down any rule of universal application to decide whether a contract is a works contract or contract for sale of goods. If the contract is primarily for supply of materials at prices agreed and the work or service is incidental to the execution of contract, it will be contract for sale. On the other hand, where contract

is primarily a contract of work and labour and materials are supplied in execution of such contract, it is a works contract.

7. Hence whether the activity is a sale or works contract depends upon the facts, the terms and conditions and the intention of the parties. A three Judge Bench of the Hon'ble Supreme Court in **Hindustan Aeronautics Limited Vs State Of Karnataka** [1984 AIR 744 / 1984 SCR (2) 248], examined the difference between contract of service and contract for sale of goods. It held:

"It is well settled that the difference between contract of service and contract for sale of goods, is, that in the former, there is in the person performing work or rendering service no property in the things produced as a whole notwithstanding that a part or even the whole of materials used by him had been his property. In the case of a contract for sale, the thing produced as a whole has individual existence as the sole property of the party who produced it some time before delivery and the property therein passed only under the contract relating thereto to the other party for price. It is necessary, therefore, in every case for the courts to find out whether in essence there was any agreement to work for a stipulated consideration. If that was so, it would not be a sale because even if some sale may be extracted that would not affect the true position. **Merely showing in the bills or invoice, it was contended on behalf of the appellant, the value of materials used in the job would not render the contract as one of sale.** The nature and type of the transactions are important and determinative factors. **What is necessary to find out, in our opinion, is the dominant object.**

It was urged before us that contract of sale is one whose main object was to transfer property in and the delivery of the possession of a chattel to the buyer. If the principal object of works undertaken by the party was a transfer of a chattel qua chattel, the contract would be for sale. It is necessary to find out whether the contract was primarily a contract for supply of materials at a price agreed to between the parties and the work or service rendered is only incidental to the execution of the contract. Mere transfer of property in goods used in the performance of a contract was not sufficient. To constitute a sale, there must be an

agreement expressed or implied relating to the sale of goods and the performance of the agreement by passing of title in those very goods.

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In the case of **Sentinel Rolling Shutters & Engineering Company Pvt. Ltd. Vs The Commissioner of Sales Tax** [(1978) 42 STC 409 (SC)], this Court reiterated that tests indicated in several decisions of this Court to distinguish between a contract for sales and a contract for work and labour were not exhaustive and did not lay down any rigid or inflexible rule applicable alike to all transactions. These did not give any magic formula by the application of which one could say in every case whether a contract was a contract for sale or a contract for work and labour. These merely focused on one or the other aspect of the transaction and afforded some guidance in determining the question, but basically and primarily, **whether a particular contract was one for sale of goods or for work and labour depended upon the main object of the parties gathered from the terms of the contract, the circumstances of the transactions and the custom of the trade.** In that case, the assessee who was carrying on business as engineers, contractors, manufacturers and fabricators had entered into a contract with a company for fabrication, supply, erection and installation of two rolling shutters in two sheds belonging to that company for a price which was inclusive of charges for "erection at site". The contract provided, among others, that the delivery of the goods was to be ex-works and once the delivery was effected, rejection claims would not be entertained. All masonry works required before or after erection were to be carried out by the company at its own cost. Payments were to be made on overall measurements which should be checked by the company before installation. The actual transportation charges were to be in addition to the price stipulated in the contract and the terms of payment provided "25 per cent advance, 65 per cent against delivery and remaining after completion of erection and handing over of the shutters to the satisfaction" of the company. The assessee had submitted the bill to the company after completion of the fabrication of the rolling shutters, but before they were erected and installed at the premises of the company. On the question whether the contract was a contract for sale or a contract for work and labour, the High Court had held, agreeing with the Sales Tax Tribunal, that

the contract was a divisible contract, which essentially consisted of two contracts, one for the supply of rolling shutters for money and the other for service and labour and that the amount payable at the stage of delivery represented the sale price of rolling shutters and it was liable to sales tax. **On appeal, by special leave, this Court held that the contract was one single and indivisible contract and the erection and installation of the rolling shutters was as much a fundamental part of the contract as the fabrication and supply. The contract was clearly and indisputably a contract for work and labour and not a contract for sale.**

It cannot be said as a general proposition that in every case of works contract, there is necessarily implied the sale of the component parts which go to make up the repair. That question would naturally depend upon the facts and circumstances of each case. Mere passing of property in an article or commodity during the course of performance of the transaction in question does not render the transaction to be transaction of sale. Even in a contract purely of works or service, it is possible that articles may have to be used by the person executing the work, and property in such articles or materials may pass to the other party. That would not necessarily convert the contract into one of sale of those materials. In every case, the Court would have to find out what was the primary object of the transaction and the intention of the parties while entering into it. It may in some cases be that even while entering into the contract of work or even service, parties might enter into separate agreements, one of work and service and the other of sale and purchase of materials to be used in the course of executing the work or performing the service. But, then in such cases the transaction would not be one and indivisible, but would fall into two separate agreements. One of work or service and the other of sale. These principles can be deduced from the decision of this Court in **The State of Himachal Pradesh and Others v. Associated Hotels of India Ltd.** [(1972) 29 STC 474 (SC)], In the decision in the case of **The State of Madras v. Gannon Dunkerley & Co. (Madras) Ltd.** [(1958) 9 STC 353 (SC) / (1959) SCR 379], this Court had stated that according to the law, both of England and of India, in order to constitute a sale, it is necessary that there should be an agreement between the parties for the purpose of transferring title to goods, which of course pre-supposed capacity to contract, that it must be supported by money consideration that as a result of

transaction the property must actually pass in the goods. Unless all these elements were present, there would be no sale.

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The fact that there is supply of materials for the purpose of execution of the work contracts undertaken by the appellant cannot be disputed. But the question then arises whether that can be taken as pursuant to a distinct contract with a view to execute the work undertaken. In this connection we have already mentioned the principles enunciated by the statement of **Halsbury's Laws of England**, Third Edition Volume 34 pages 6 and 7 para 3. It would be appropriate, in our opinion, because it clearly enunciates the principles, to refer to the statement of law in Benjamin's Treatise on the Law of Sale of Personal Property with reference to the **French Code and Civil Law** [Eighth Edition (1950) at pages 167-168], where the learned Editor has deduced the principles that would be applicable in deciding the controversy before us. These principles are:-

"1. **A contract whereby a chattel is to be made and affixed by the workman to land or to another chattel before the property therein is to pass, is not a contract of sale, but a contract for work, labour and materials, for the contract does not contemplate the delivery of a chattel as such.**

2. When a chattel is to be made and ultimately delivered by a workman to his employer, the question whether the contract is one of sale or of a bailment for work to be done depends upon whether previously to the completion of the chattel the property in its materials was vested in the workman or in his employer. **If the intention and result of the contract is to transfer for a price property in which the transferee had no previous property then the contract is a contract of sale. Where, however, the passing of property is merely ancillary to the contract for the performance of work such a contract does not thereby become a contract of sale.**

3. Accordingly

(i) Where the employer delivers to a workman either all or the principal materials of a chattel on which the workman agrees to do work, there is a bailment by the employer, and a contract for work and labour, or for work, labour and materials (as the case may be), by the workman. Materials added by the workman, on being affixed to or blended with the employer's materials thereupon vest in the employer by accession and not under any contract of sale.

(ii) Where the workman supplies either all or the principal materials, the contract is a contract for sale of the completed chattel, and any materials supplied by the employer when added to the workman's materials vest in the workman by accession."

(emphasis added)

8. **BOOT contracts are a form of Turnkey contracts and are contracts for labour, work or service and not for sale of goods, though goods are used in executing the contract for labour, work or service.** When a contractor undertakes a project, the buyer pays for cost of the structure which includes cost of material used, labour and other services offered by the contractor. Property in goods is passed on to buyer and there is no contract for supply of goods as such. It does not contemplate the delivery of a chattel as chattel. **The laying of pipeline, as in this case, is an example of works contract, where passing of property in the pipe is part of the works contract.**

9. In **Kone Elevator India Pvt. Ltd. Vs State of Tamil Nadu** [(2014) 7 SCC 1 / 2014 (304) E.L.T. 161 (S.C.)], the Hon'ble Supreme Court observed that **the installation obligation in a contract for manufacture, supply and installation of lift is not merely incidental, but was a profound part of the entire contract.** That

various components were assembled together and installed at site as a permanent fixture to the building. **The goods, skill and labour elements are intimately connected with one another and the contract is not divisible.**

10. At this stage it would be profitable to examine the relevant parts of the contract, which are reproduced below:

“TRANSPORTATION OF WATER FROM MAHANADI RIVER AT CUTTACK TO PARADIP FOR PARADIP REFINERY PROJECT N BUILD-OWN-OPERATE-TRANSFER (boot) BASIS

This contract made at Chennai on this the 4th day of February 2010 BETWEEN . . .

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(F) **The scope of the Project is for construction, operation and maintenance of the following over a project term of 25 years**

i. Water intake structure in the upstream of Zobra Barrage over Mahanadi River at Cuttack, with facilities like sedimentation, settling tank and pumping etc.,

ii. **Water transmission pipeline for approx. 93 km, to meet the supply requirement of phase 1 and 7 km parallel pipe line to meet the supply requirement of phase II of desired quantity of water from Intake at Cuttack to Paradip Refinery Complex at Paradip.**

iii. One Reinforced Cement Concrete lined raw Water reservoir of capacity 2,65.000 M' at refinery for storage of water,

iv. Water treatment plant of suitable design and capacity to meet the uninterrupted supply requirement of minimum 3950 m³/hour,

v. Three number treated water RCC Sumps and the clear water pumphouse (only civil work).

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1. CONTRACT, DEFINITION AND INTERPRETATION

“**BOOT Agreement**’ means the Agreement dated 29th January 2010 pursuant to which Indian Oil Corporation Ltd. granted to

the BOOT Contractor, the concession rights to build, own and operate the Project.

"**Contract**" means this Contract (including the Schedules) as may be amended, supplemented or modified in accordance with the provisions hereof.

"**Contract Price**" means that total lump sum (as may be varied or adjusted under Clause 12. or clauses referred to therein) and stated in the Schedule of Payments payable to the Contractor for the discharge of all of its obligations under the Contract for Detailed Design, design of Temporary Works, execution, testing, commissioning (including of the Works and the remedying defects in accordance with the provisions of the Contract.

"**Works**" or "**Scope of Work**" means the works relating to the development, design, construction of the Project to be undertaken by the Contractor in accordance with the provisions hereof, including Performance Standards and services, things to be designed, engineered, constructed, supplied, executed, manufactured, installed, completed, tested, commissioned, rectified, replaced, made good, carried out and undertaken and any other permanent, temporary or urgent works required hereunder in respect of Project in accordance with the Contract.

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4. THE CONTRACTOR

4.1 General Obligations

i. The obligation of the Contractor under this Clause 4.1 is to complete all the Works for Project facilities within the period given in accordance with the Contract which shall be in uniformity with the BOOT Agreement.

viii. Scope includes design, engineering, procurement, installation, construction, commissioning, testing and handing over of the Facility on a fixed price basis in fulfilment of Performance Criteria.

xii. **The Contractor shall provide all superintendence, labour, Plant, Materials, Contractor's Equipment, Temporary Works and all other things, whether of a temporary or permanent nature, required in and for the carrying out of Works.**

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8. COMMENCEMENT, DELAY & SUSPENSION

8.4 Contract Price, Payment Terms & RA Bills

i. Contract Price

The lump sum Contract Price is Rs.465 crores (Rupees Four hundred and sixty five crores only) payable to the Contractor for the Works and his obligations under the Contract and includes all Costs of the Contractor in doing so. This includes a Sum of Rupees Seven Crores and Seventy Five Lacs only as payment for Pre-Construction Activity.

The Contract Price takes into account all exemptions available for the Project. Any statutory variation in Taxes and Duties or any new levies shall be compensated by IWL.”

11. The BOOT contract outlined above is a single, indivisible contract for a water transmission project using pipelines. It's not severable into separate provisions like sale and service, each of which could be enforced independently, whereby failing to perform one provision would not necessarily breach the entire contract. For a "sale" to exist, there must be an agreement to sell movable property, a transfer of title and a money consideration. This contract lacks a separate agreement involving the transfer of title for consideration. While the sub-contractor provides the materials needed to execute the contract and bills the appellant, after discharging sales tax, it doesn't constitute trading activity. It flows from the design of the business activity. The appellant only reimburses the sub-contractor for the materials consumed in the project and onward bills IPRWL, the contract holder, for these costs. These reimbursements are part of the "Contract Price".

12. In a contract primarily for work and labour, a separate activity of "trading" is not intended. The contract doesn't specifically mention sale of goods or "trading". The transfer of property in goods consumed while executing the contract is a part of the execution of the works contract. Furthermore, the legal fiction introduced by Article 366(29A)(b) in the Constitution, which divides the contract into a sale

and service, should only be used for its intended purpose: levying tax on both sale and service in an indivisible contract. It can't be used to convert the reimbursement of payment for goods by the sub-contractor into "trading" or treat the value of the deemed sale of goods as an "exempt service".

13. In **Imagic Creative Pvt. Ltd Vs Commissioner Of Commercial Taxes** [2008 (9) S.T.R. 337 (S.C.)], the Hon'ble Supreme Court held as under:

26. We have noticed hereinbefore that a legal fiction is created by reason of the said provision. Such a legal fiction, as is well known, should be applied only to the extent for which it was enacted. It, although must be given its full effect but the same would not mean that **it should be applied beyond a point which was not contemplated by the legislature or which would lead to an anomaly or absurdity.**

14. The appellants in his reply to the SCN has submitted to the Ld. Adjudicating Authority that they maintained separate records for availment and compliance of the inputs/ input services. The invoices for each of the activities including input services are accounted for separately. The Cenvat credit availed was the same as those availed in earlier periods when they were not carrying out works contract. Further that the credit on works contract service invoices of Lanco Infratech Ltd. (with separate material and service billing) was used only to discharge output service tax on the works contract provided to IPRWL. The credit pertained solely to the service portion and was proportionately disallowed as reflected in the records. This has not been refuted in the impugned order.

15. In the light of the discussions above that the activity of the appellant reimbursing the sub-contractor for materials purchased and utilized in the project, does not amount to "trading activity" or an

“exempt service”. Rule 6(3) of Cenvat Credit Rules 2004 would hence not be applicable and no intimation was required to be filed by the appellant. They were however required to avail eligible credit as specifically provided in the Act and Rules for inputs, input services and capital goods. There is no allegation that the input credit was availed wrongly. This being so the impugned order merits to be set aside and the demand for duty under Rule 6(3A) of Cenvat Credit Rules 2004 along with interest does not survive. No case for penalty is hence made out.

16. Accordingly, we set aside the impugned order and allow the appeal. The appellant is eligible for consequential relief as per law. The appeal is disposed of accordingly.

(Order pronounced in open court on 30.04.2026)

Sd/-
(AJAYAN T.V.)
Member (Judicial)

Sd/-
(M. AJIT KUMAR)
Member (Technical)

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