

A snippet of indirect tax on EPC Contracts

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EPC (Engineering, Procurement and Construction) contracts are typically entered into by owner or end user to mitigate and transfer the risk to the contractor who would be responsible for the complete project, viz., designing, procurement, construction and commissioning of the project. EPC contracts are more popular for power plants, oil and gas, industrial plants and large infrastructure projects. Given the scope of an EPC contract, it is a bundle of various goods and different types of labour / services, in various proportions for execution of the contract.

This article aims to share certain highlights of how one can optimize cost by efficient planning of transactions from an indirect tax perspective.

Magnifying lens on Indirect tax:

Goods and Services Tax (GST)

Through the lens - Supplier's perspective: The big question that arises under GST laws is whether the EPC contracts tantamount to works contract. Under the erstwhile State VAT laws and Service tax provisions, works contract covered a gamut of transactions involving movable and immovable property; however, under the GST laws, works contract^[1] is limited to only contracts which results into an immovable property. A general notion which runs in every persons' mind is that EPC contracts are essentially works contract. Beware, the contractors have to first analyse whether the contract being executed results into immovable property; if yes, then it would tantamount to works contract; else, a bundle of various and different types of supplies.

Apropos its characterisation under GST, works contracts are treated as supply of services^[2]. Thus, mostly liable to GST @ 18%.

In the context of **renewable energy projects**, it is interesting to take note of the following:

- Bio-gas plant; Solar power based devices; Solar power generator; Wind mills, Wind Operated Electricity Generator (WOEG); Waste to energy plants / devices; Solar lantern / solar lamp; Ocean waves/tidal waves energy devices/plants; Photo voltaic cells, whether or not assembled in modules or made up into panels – If the said goods are supplied along with construction or

engineering or installation or other technical services, while it would be a contract and consequently as a 'supply of service', the law provides for a deemed valuation at 70% of the gross amount charged as supply of goods at 12% and balance 30% as supply of service at 18%[\[3\]](#).

- Appellate Authority of Advance Ruling, Maharashtra[\[4\]](#) - has held that supply of/construction of a turnkey contract of solar power plant is a 'composite supply' and falls within the definition of works contract, thus liable to GST @ 18%.
- Authority for Advance Ruling, Rajasthan[\[5\]](#) - has held that EPC contract for design, engineering, procurement, transportation, delivery, development, erection, installation, testing of solar power generating system is works contract service, thus, liable to GST @ 18%.
- Appellate Authority of Advance Ruling, Karnataka[\[6\]](#) - has held that supply of the PV module which is the major component of the Solar Power Plant is a distinct supply and is not naturally bundled with the supply of the remaining components & parts of the Solar Power Plant and the supply of the services of Erection, Installation and Commissioning of the Solar Power Plant; thus liable to GST as separate and distinct contracts.

Given the apparent difference in views in the above cited AAR and AAAR which were pronounced prior to the amendment vide N.No.08/2021 - CT(R) dated 30.09.2021, nonetheless, one will have to decipher the contracts in detail to see whether an EPC contract for renewable energy would fall under the notification dated 30.09.2021 or a separate supply of goods and services.

EPC contracts, **other than renewable energy**, will also need a thread-bare analysis to check whether the contract results in an immovable property, that being so, it would be works contract services. In this context reference of AAR Tamil Nadu in the case of Tata Projects Ltd. [\[7\]](#) is of relevance, wherein it was held that "Establishment of an Integrated Cryogenic Engine & Stage Test Facility' at ISRO Propulsion Complex (IPRC), Mahendragiri is a composite contract, wherein various supplies of goods and services are naturally bundled together; supply of materials in conjunction with the service for erection of the systems provided by the applicant at the Integrated Cryogenic Engine & Stage Test Facility making all the systems together as an immovable property, the whole contract is also a Works Contract".

Should one consider splitting the contract? While there is no straight jacket answer, the following merit consideration:

- the judgment of the Hon'ble Apex Court under the erstwhile VAT law in the case of Kone Elevator India Pvt. Ltd.[\[8\]](#) wherein it was held 'If there are two contracts, namely, purchase of the components of the lift from a dealer and installation service of the same, it would be two distinct transactions viz., one contract for sale of goods and another for service for installation; but in case of a pregnant one, once there is a composite contract for supply and installation, it has to be treated as a works contract, for it is not a sale of goods/chattel simpliciter';
- the definition ascribed to composite supply[\[9\]](#) and mixed supply[\[10\]](#) under the GST law;
- eligibility to claim input credit of GST on such contracts; and
- where the contract involves import of major machinery, wherein EPCG benefits / MOOWR may be availed.

Through the lens - Recipient's perspective: Eligibility of input tax credit (ITC) for the recipient plays a very crucial role on the working capital of a business entity as well as the mode of execution. Where an EPC contract results into an immovable property, recipient of goods or service will have to do a deeper analysis of eligibility to the ITC, since there are restrictions placed on availment of ITC in the context of immovable property.

- ITC on work contract service is blocked and restricted, when supplied for construction of immovable property, **other than plant and machinery or where it is an input service for further supply of works contract service**[\[11\]](#).

Plant and machinery[\[12\]](#) is defined to mean apparatus, equipment, and machinery fixed to earth by foundation or structural support that are used for making outward supply of goods or services or both and includes such foundation and structural supports but **excludes**— (i) land, building or any other civil structures; (ii) telecommunication towers; and (iii) pipelines laid outside the factory premises.

The end recipient of works contract service (contractee) in an EPC contract, being the final recipient of goods / services, will not further provide works contract service; therefore, whether the contractee will be entitled to ITC if the final output results into immovable property is a question to be analysed. If the EPC contract results into fixing apparatus, equipment, and machinery to the earth by foundation or structural support, then ITC contracts would be eligible.

- ITC on goods or services or both received by a taxable person for construction of an immovable property (**other than plant or machinery**) on his own account including when such goods or services or both are used in the course or furtherance of business is ineligible^[13].

It is interesting to note that in Section 17 (5) (d) the phrase used is 'plant or machinery' and not 'plant and machinery' as in Section 17 (5) (c). *The phrase plant or machinery has not been defined in the GST law and therefore it would be appropriate to borrow the meanings from any other law which may be akin to the GST (transaction tax laws) or the general / legal English dictionaries.*

Thus, if goods or services or both are received **on own account** for construction plant **or** machinery resulting into immovable property, ITC is eligible, whereas works contract service provided for construction of plant or machinery resulting into an immovable property by a contractor to the end recipient (contractee), ITC is not eligible. Thus, given that a works contract is also a 'service', it would be prudent to infer that ITC would be eligible on plant or machinery resulting into immovable property even where the same is executed by a works contractor; however, the same may have to be contested, if the ITC is disallowed by the tax authorities.

EPCG Scheme under Foreign Trade Policy

Export Promotion Capital Goods (EPCG) Scheme allows import of capital goods (except those specified in the negative list) for preproduction, production and post-production at zero customs duty subject to an Export Obligation (EO) equivalent to 6 times of duties, taxes and cess saved on capital goods, to be fulfilled in 6 years reckoned from date of issue of Authorisation.

Therefore, if an EPC contract involves importation of large value machinery, it may be worth exploring whether the contractee can import the goods directly by splitting the contract or entering separate contract wherein the transfer of property (TOP) in goods is made in favour of the contractee at the time of importation and the installation and commissioning of the machinery is executed under a separate contract. The pros and cons of splitting the EPC contract, both from a business as well as a commercial perspective will have to be analysed before executing the same, considering transfer of the risk to the contractor who is responsible for designing, procurement, construction and commissioning of the project.

MOOWR Scheme:

Manufacturing and Other Operation in Warehouse Regulations, 2019 (MOOWR) scheme allows import of goods (both inputs and capital goods) under customs duty deferment with no interest liability. Limited to the subject of EPC contracts, this scheme allows all the indirect tax benefits that an EOU is entitled to; hence EOU Scheme is not separately listed as a benefit hereto. If the EPC contracts involve high value of import of capital goods, this scheme certainly merits an evaluation. NOTE: The Finance Act, 2023 inserted Section 65A in Customs Act, 1962 (effective date yet to be notified), which inter alia seeks to withdraw IGST and GST Compensation Cess exemption currently made available to all imports under this scheme, which means, once the said Section is made effective, duty deferment will be applicable only to the Basic Customs Duty.

CBIC^[14] in July 2022 has issued an instruction that MOOWR, 2019 permission should not be granted for warehousing of imported solar panels/solar modules and related accessories etc. declared as capital goods to generate electricity (from sunlight). However, the Hon'ble Delhi High Court in the case of ACME Heergarh Powertech Private Limited^[15] has struck down the said instruction which denied the benefits to warehousing of solar power generating units under MOOWR while also stating that it is open for the Government to adopt appropriate remedial measures, if they be of the opinion that solar power generation by virtue of permissions granted u/s 65 is negatively impacting local generators or distorts the "level playing field" - viz., issue of such instructions restricting the benefits is ultra vires; if the Government so believes, it should take the path of amending the scheme and the relevant provisions.

While the Government could have opted to challenge this decision, the Government has in fact taken the path of amending the provisions. Section 65 of the Customs Act, 1962 is proposed to be amended vide the Finance Bill, 2024 to empower the Government to specify any manufacturing processes and other operations in relation to any class of goods that shall not be permitted in a warehouse. In furtherance to this proposed amendment, it will not be a surprise if the Government notifies that warehousing of imported solar panels/solar modules and related accessories etc. to generate electricity (from sunlight), would not be permitted under Section 65.

Epilogue:

Considering the complexities of determining GST (whether it is works contract or not) in the hands of the contractor / supplier, eligibility of input tax credit under GST to the recipient (contractee) and availability of customs duty benefit under Foreign Trade Policy / Customs Act, it is recommended that a deeper study be carried out before awarding any EPC contracts.

[1] Section 2 (119) of CGST Act, 2017

[2] Section 7(1A) read with para 6 (a) to Schedule II of CGST Act, 2017

[3] Sl. No. 201A of Schedule II to Notification No.1/2017-Central Tax (Rate) dated 28.06.2017[Entry inserted vide N.No.08/2021 – CT(R) dated 30.09.2021] & Sl. No. 38 of Notification No.11/2017-Central Tax (Rate) dated 28.06.2017 [Inserted vide N.No. 27/2018-Central Tax (Rate) dated 31-12-2018 w.e.f. 01-01-2019]

[4] Giriraj Renewables Private Limited - [\[TS-461-AAAR-2018-NT\]](#)

[5] Frizo India Private Limited - [\[TS-570-AAR-2018-NT\]](#)

[6] Giriraj Renewables Private Limited - [\[TS-479-AAAR-2018-NT\]](#)

[7] 2020 (32) G.S.T.L. 452 (A.A.R. - GST - T.N.)

[\[8\]](#) 2014 (304) E.L.T. 161 (SC)

[\[9\]](#) Section 2(30) of CGST Act, 2017

[\[10\]](#) Section 2(74) of CGST Act, 2017

[\[11\]](#) Section 17(5) (c) of CGST Act, 2017

[\[12\]](#) Explanation to Section 17 of CGST Act, 2017

[\[13\]](#) Section 17(5) (d) of CGST Act, 2017

[\[14\]](#) Instruction No. 13/2022 -Customs dated 09.07.2022

[\[15\]](#) TS-168-HC-2024 (DEL)-CUST