



## *Advance Ruling treating EPC contracts for construction of solar power plants as works contract*

### *Executive Summary*

This tax alert summarises a recent advance ruling of the Maharashtra Bench of the Authority for Advance Ruling given vide Advance Ruling No. GST-ARA-01/2017B-01, dated 17<sup>th</sup> February 2018. The applicant (M/s Giriraj Renewables Pvt Ltd., Mumbai) preferred an application for Advance ruling to obtain clarification as to whether supply of turnkey EPC Contract for construction of a solar power plant wherein both goods and services are supplied can be construed as a Composite Supply in terms of Section 2(30) of CGST Act and whether principal supply in such case can be said to be solar power generating system taxable at 5% GST. Further, whether the benefit of concessional rate of 5% of solar power generation system and parts thereof would also be available to sub-contractors.

The Authority observed that the supply of the Solar Power Plant which includes engineering, design, procurement, supply, development, testing and commissioning brings an immovable property into existence and accordingly the same satisfies the definition of works contract as envisaged under section 2(119) of the CGST Act 2017. Hence, the supply of Turnkey Engineering, Procurement and Construction (EPC) Contract for construction of a solar power plant constitutes a works contract and not a composite supply in terms of section 2(30) of the CGST Act, accordingly, the concessional rate of 5% GST which has been provided for supply of solar power generating systems and parts for their manufacture shall not be applicable to the applicant.

## ***Facts of the Case***

- The applicant is an EPC Contractor and undertakes turnkey contract for setting-up of a solar power plant which includes supply of various goods and services.
- Under the GST regime, various rates have been prescribed for goods and services. As per Notification No. 1/2017-Integrated-tax (Rate) dated 28<sup>th</sup> June 2017, solar power generating systems and parts for their manufacture are taxable at concessional rate of 5%. The concessional rate of 5% has been provided inter-alia to the following (when covered under heading 84, 85 or 94):
  - (i) Photovoltaic cells, whether or not assembled in modules or made up into panels
  - (ii) Solar power generating system
  - (iii) Parts for manufacture of solar power generating system and photo voltaic modules

## ***Issue before the Authority***

- (i) Whether supply of turnkey Engineering, Procurement and Construction (EPC) Contract for construction of a solar power plant wherein both goods and services are supplied can be construed to be a Composite Supply in terms of Section 2(30) of CGST Act 2017.
- (ii) If yes, whether the Principal Supply in such case can be said to be 'solar power generating system' which is taxable at 5% GST.
- (iii) Whether benefit of concessional rate of 5% of solar power generation system and parts thereof would also be available to sub-contractors.

## ***Applicant's Contention***

- The scope of work of entire contract is one turnkey EPC contract for setting-up of a solar power plant which includes provision of goods and services and hence the same qualifies as a composite supply. The principal supply in such case is provision of the solar power generating system and accordingly, the entire contract (including service portion) should be taxable at the concessional rate of 5%.
- Composite supply has been defined under section 2(30) of the CGST Act and the essential conditions for a supply to qualify as composite supply are:
  - (i) two or more taxable supplies of goods or services or both
  - (ii) taxable supplies should be naturally bundled
  - (iii) taxable supplies should be supplied in conjunction with each other
  - (iv) one taxable supply should be the principal supply

In such case, in terms of section 8 of the CGST Act, a composite supply comprising two or more supplies, one of which is a principal supply, shall be treated as a supply of such principal supply and the entire transaction is taxed as per the principal supply.

- The service portion of EPC contracts is only 10 to 15% of the contract while the remaining is supply of goods. This also substantiates the fact that provision of services is incidental to supply of goods and hence, the supply of goods should form the principal supply and the entire contract should be taxed as principal supply of 'solar power generating system'.
- The term 'solar power generating

system' has not been defined under the GST Law. Reference may be made to judicial decisions under the erstwhile excise laws wherein scope of the term 'solar power generating systems' have been examined. Typically, a system includes various components/parts which are manufactured/assembled together for performing a function. In the present case, the term system should include all goods provided under the contract which help in end-to-end generation as well as transmission of electricity, hence, where a contract is awarded as a whole for supply of solar power generation system consisting of various components as well as services, the entire contract should qualify as a solar power generating system and accordingly, the same should be taxed at concessional rate of 5%. The intention of both the parties i.e., supplier and the recipient is to supply the whole of solar power generating system in totality which consists of various goods and services such as erection, commissioning etc.

- The solar power plants are capable of being removed from the place of their first installation and commissioning and the same can be transferred from one place to another. Accordingly, solar power plants are movable goods and does not constitute immovable property. The fact of movability of solar power plant is also substantiated by the terms of draft agreement which contemplates the possibility of transferring the Plant from one place to another.
- In certain cases, the contractor engages various sub-contractors who further supply the goods to such contractor or engage in provisioning of certain portion of the contract. Notification No. 1/2017-Integrated Tax (Rate) which provides concessional rate on solar power

generating system does not specify the persons who would be eligible for concessional rate of 5% i.e., developer, contractor or manufacturer / supplier / sub-contractor. Since, the concessional rate of 5% is provided to renewable energy products and parts thereof, the same should be applicable to all suppliers providing such products as long as it can be established (through certification or otherwise) that these are to be used in solar power generation system.

### ***GST Officer's Contention***

- The Applicant undertakes works of installation, testing and commissioning of solar power plant. The solar power system is designed to meet the demands of the buyer. The goods are procured as per the requirements, installed, tested and after commissioning, the ownership of solar power plant is handed over to the buyer. Accordingly, it is not something sold out of shelf.
- It is a contract for supply and installation of solar power plant and it is not the case where chattel is being sold as chattel. Further, the solar power system cannot be shifted to any other place without dismantling the same. Hence, the transaction is to be treated as works contract in terms of Section 2(119) of the CGST Act and not a composite supply as envisaged under section 2(30) of the CGST Act.

### ***Authority's Ruling***

- The Authority, on perusal of the terms of draft agreement for Supply of Solar Power Plant, observed that the recipient expects the contractor i.e., the applicant to perform all activities from engineering, design to procurement of the materials and also perform the testing and

commissioning. In contracts of such a nature, the liability of the contractor does not end with the procuring of materials but it extends till the successful testing and commissioning of the system. Therefore, transaction constitutes a ‘works contract’ in common parlance, but the question is whether it is a ‘works contract’ in terms of GST Law. As a corollary, the crux of the issue is whether the transaction of supply of solar power plants results into any immovable property.

- The term ‘immovable property’ has not been defined under the GST Law. However, there are a plethora of judgements of Hon’ble Supreme Court and the Hon’ble High Courts which have helped to understand the term ‘immovable property’. The principles laid down in such judgements stand good under all statutes unless any specific definition is available under a given statute.

- The principles enshrined in the judicial pronouncements when seen in the fact matrix of the instant case leads to the following inferences:

(i) The contract would be to develop a 60MWAC solar power plant for onward sale of power to consumers. It is a big project and has a permanent location. Such a plant would, therefore, have an inherent element of permanency.

(ii) The output of the power plant i.e., power would be available to identifiable segment of consumers. Thus, this output supply would involve an element of permanency for which it would not be possible and prudent to shift base from time to time or locate the plant elsewhere at frequent intervals.

(iii) The project would be using goods

which would be imported. Are such high-end equipment frequently dislocated? Would there not be damage to the materials if moved places frequently and if so, would it perform as effectively as it would have when without damage?

(iv) The definition of the word “Commissioning” as found in the agreement brings out the enormity of the scale of operations and how the transaction would fall in the scope of an immovable property- *“Commissioning” means the functional operation of plant (including each unit thereof), following the installation and energization of Evacuation Infrastructure to Grid Substation and Installation and energization of the Plant to the Evacuation Infrastructure, subsequently and the evacuation of power is possible from the Plant to the Grid Substation”*

(v) The agreement clauses also refer to a definition of “GO” – means Government Order issued by Karnataka Renewable Energy Development Limited for development of the Plant. Such a renewable energy project would invariably have an essential element of permanency. There is also involvement of other agencies, as well viz. Karnataka Renewable Energy Development Limited and Karnataka Power Transmission Company Limited. This means that the project would be established under Governmental Rules and Regulations. It is most unlikely that a project would be moved from place to place once it has been put into place after obtaining the essential permits and licenses.

(vi) A renewable energy project would remain connected to the Grid. In this regard, we find the definitions in the agreement clauses as:

“Grid” means Grid Substation to which Plant is to be connected for commercial operations:

“Grid Sub-station” shall mean 110/33kV Government sub-station situated in the state of Karnataka, India.

Thus, it can be seen that the Plant would be connected to the Grid Sub-station for purposes of commercial operations. After having established and commissioned such a project which is connected to a Grid Sub-station, who would be taking the Project to a different location. It would be farfetched an argument that the Project could be shifted to a different location just to prove that the Project is movable.

(vii) The Owner has also to obtain approvals and permits (as per Applicable Law) required for Commissioning and operation of the Plant. Do such permits and documents have a frequent changeover in terms of the place, the owner and project name being constant? Such permissions definitely have an element of permanency.

(viii) Under the clause about ‘Obligations of the Contractor’, we find that the contractor is responsible for the construction of civil structure or buildings as a part of Project. A civil structure cannot be moved. It has to be demolished. Does one still have

to offer the argument that the transaction results into a movable property?

- In view of the above, the Authority observed that the supply of the Solar Power Plant which includes engineering, design, procurement, supply, development, testing and commissioning is a “works contract” in terms of section 2(119) of the CGST Act 2017 and not a composite supply as envisaged under section 2(30) of the CGST Act.
- As per Para 6 of Schedule II of the CGST Act, works contract under section 2(119) of the CGST Act constitutes supply of services, hence, the concessional rate of tax as applicable to supply goods shall not be applicable
- The question relating to availability of the benefit of concessional rate of 5% on solar power generation system and parts thereof to the sub-contractors has not been answered by the Authority since no documents or specific information relating to such sub-contracting was produced by the applicant for examination.

### ***Our Comments***

The view taken by the AAR shall result in increase in cost of setting-up of solar power plants which shall be detrimental to the said industry.