



Clarifying the Principle of Accretion and Avoiding Double Taxation

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A. Introduction

THE Supreme Court in *Authority for Clarification and Advance Rulings, Gandhinagar, Karnataka & Anr. vs M/s Skyline Construction and Housing Pvt. Ltd.* ([2025 TIOL-82-SC-VAT](#)) has delivered a significant judgment clarifying the scope of taxability of works contracts, particularly on the issues of contractor-sub-contractor relationship, valuation provisions, and the doctrine of accretion.

Interestingly, the Court distinguished its earlier ruling in *Builders' Association of India* [[2002-TIOL-602-SC-CT-CB](#)] and reaffirmed the principles laid down in *State of Andhra Pradesh v. Larsen & Toubro Ltd. & Others* [[2008-TIOL-158-SC-VAT](#)].

This judgment holds substantial importance for understanding how value addition and property transfer operate in works contracts and their treatment under indirect tax law.

B. Factual Matrix

The assessee was engaged in executing works contracts, part of which was sub-contracted to other entities commonly known as sub-contractors. It approached the Authority for Advance Ruling (AAR) under the Karnataka VAT Act, 2003, seeking clarity on whether payments made to sub-contractors should be included in its taxable turnover.

The AAR ruled against the assessee, holding that no deduction was permissible in the absence of an express provision allowing it under the Act. The Karnataka High Court, however, overturned this view, allowing deduction of sub-contractor payments subject to prescribed conditions.

Aggrieved, the Department appealed to the Supreme Court.

C. Issue Before the High Court

The High Court formulated the following two questions of law:

1. Whether under the KVAT Act, for the purpose of computing liability, the consideration received for execution of works contract includes any consideration received or paid to sub-contractors?
2. Whether under Section 15 of the KVAT Act, the principal contractor is entitled to deduction of payments made by him to sub-contractors?

The High Court answered these questions as follows:

1. The consideration for execution of works contract does not include the consideration received and paid to sub-contractors.

2. Under Section 15 of the KVAT Act, the principal contractor is entitled to deduction of payments made to sub-contractors, subject to fulfilment of prescribed conditions.

Thus, both questions of law were answered against the Revenue Department and in favour of the taxpayer.

D. Issue Before the Supreme Court

Whether, in the absence of an express provision under the KVAT Act, the main contractor is entitled to reduce from its taxable turnover the amounts paid to sub-contractors for the portion of work executed by them?

E. Department's Submissions

The Department argued that:

- The High Court erred in setting aside the AAR's ruling.
- The decision in *Larsen & Toubro* was inapplicable as the issue in that case related to constitutional validity, not computation.
- Section 15 of the KVAT Act taxed the total turnover, and exclusion of sub-contractor payments would defeat this legislative intent.
- Reliance was placed on Builders' Association of India to argue that the entire contract value should be subject to tax at the hands of the main contractor.

F. Taxpayer's Submissions

The assessee contended that:

- Tax is leviable only on the portion of the contract actually executed by the main contractor.
- Payments made to sub-contractors represent separate deemed sales from the sub-contractor to the contractee, as recognized in *Larsen & Toubro*.
- Inclusion of sub-contractor's value in the main contractor's turnover would amount to double taxation.

G. Supreme Court's Analysis and Findings

(i) Statutory Context

The Court examined relevant definitions under the KVAT Act, including "*taxable sale*," "*total turnover*," "*works contract*," and "*composition of tax*."

(ii) Doctrine of Accretion: *Gannon Dunkerley and Co.*

Referring to the locus classicus *State of Madras v. Gannon Dunkerley & Co. (Madras) Ltd.* [[2002-TIOL-493-SC-CT-LB](#)], the Court reiterated that in works contracts, property in goods passes to the buyer by the principle of accretion - i.e., as and when the work is executed and embedded in the land.

As per the maxim "*quicquid plantatur solo, solo cedit*" - whatever is affixed to the soil becomes part of the soil. This theory of accretion was first articulated by *Blackburn, J. in Appleby v. Myres* [(1867) LR 2 CP 651, at pp. 659-660].

This principle forms the bedrock of taxation of works contracts even post the 46th Constitutional Amendment, which merely enabled taxing the transfer of property in goods during execution, without altering the nature of such transfer.

(iii) Sub-contractor Relationship: Larsen & Toubro Ltd.

Building on *Larsen & Toubro Ltd.*, the Court reaffirmed that since property in goods passes on the basis of accretion, the deemed sale occurs directly between the sub-contractor and the contractee, even if no direct contractual relationship exists between them.

Therefore, the same value cannot simultaneously be taxed in the hands of the main contractor.

(iv) Distinguishing Builders' Association of India

The reliance placed by the revenue department on the judgment of the Supreme Court in *Builders' Association of India & Ors. (supra)* was held to be completely misconceived. In that case, the controversy was whether, in the context of works contracts, it was open to the State to formulate an alternative composition scheme providing for a lump sum rate of tax on the contract value so that the exact value of goods may not have to be computed.

It was in that context that the Supreme Court upheld the validity of the provision, noting that it only provided an optional alternate method of computation.

Whereas in the present case, the issue was one of **interpretation**, not **constitutionality**. To the extent the contract was executed through sub-contractors, it could not be said that the works contract was executed by the main contractor. Hence, the total consideration for the works contract executed by the main contractor could be derived only after reducing the payments made to sub-contractors.

Thus, the Court held that the judgment in *Builders' Association of India (supra)* had no applicability to the present case.

H. Conclusion

The Supreme Court upheld the Karnataka High Court's view that payments made to sub-contractors are deductible from the main contractor's taxable turnover.

It further clarified that such deduction is not akin to input tax credit - rather, the value itself falls outside the charging provision, as the deemed sale occurs between the sub-contractor and the contractee.

Accordingly, the Department's appeal was dismissed.

I. Key Takeaways

1. **Doctrine of Accretion Reinforced:** Property in goods passes progressively as work is executed - a foundational aspect of works contract law.
2. **No Double Taxation:** The same transaction cannot be taxed both in the hands of the main contractor and sub-contractor.
3. **Sub-contractor = Direct Deemed Seller:** Even without privity of contract, the sub-contractor's execution results in a deemed sale to the contractee.
4. **Clarification for Valuation:** Deduction of sub-contractor value is a necessary step to compute correct turnover under VAT and, by analogy, under GST.

J. GST Perspective: Continuing Relevance

Although the case arose under the VAT regime, its reasoning holds continuing relevance under the GST framework. The core principles of **value addition, contractual privity, and transfer of property through accretion** still underpin how composite and works contracts are interpreted.

Moreover, the Court's recognition that a sub-contractor's supply is independently taxable and not part of the main contractor's turnover echoes the GST law's architecture under Sections 9 and 15 of the CGST Act.

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