

Circular No	:	681
Date of Issue	:	8.3.1994
Section(s) Referred	:	194C
Statute	:	Income-Tax Act

Subject: Deduction of income-tax at source under section 194C of the Income-tax Act, 1961, from payments made to contractors/sub-contractors-Supreme Court judgment dated 23rd March, 1993, in Associated Cement Co. Ltd. v. CIT-Instructions-Regarding.

Sub-section (1) of section 194C of the Income-tax Act, 1961, lays down that any person responsible for paying any sum to any resident (herein-after referred to as "contractor") for carrying out any work (including supply of labour for carrying out any work) in pursuance of a contract between the contractor and the bodies mentioned therein shall, at the time of credit of such sum to the account of the contractor or payment thereof in cash or by issue of a cheque or draft or by any other mode, whichever is earlier, deduct an amount equal to 2 per cent. of such sum as income-tax on the income comprised therein.

2. Sub-section (2) of section 194C of the Income-tax Act, 1961, lays down that when a contractor makes payment of any sum to a resident sub-contractor in pursuance of a contract made with him for carrying out the whole or any part of the work undertaken by the contractor, or, for supplying any labour, the contractor shall deduct an amount equal to 1 per cent. of such sum as income-tax on the income comprised therein.

3. Section 194C was introduced with effect from 1st April, 1972. Shortly after its introduction, the Board issued Circulars No. 86, dated 29th May, 1972 (F. No. 275/9/72-ITJ), No. 93, dated 26th September, 1972 (F. No. 275/100/72-ITJ), and No. 108, dated 20th March, 1973 (F. No. 131(9)/73-TPL), in this regard.

4. Some of the issues raised in the above-mentioned circulars need to be reviewed in the light of the judgment dated March 23, 1993, delivered by the Supreme Court of India in Civil Appeal No. 2860(NT) of 1979- Associated Cement Co. Ltd. v. CIT [1993] 201 ITR 435.

5. The Supreme Court has held that ". . . there is nothing in the sub-section which could make us hold that the contract to carry out a work or the contract to supply labour to carry out a work should be confined to ' works contract ' . . .". Their Lordships have further held that "' Any work ' means any work and not a ' work contract ', which has a special connotation in the tax law . . . ' Work ' envisaged in the sub-section, therefore, has a wide import and covers ' any work ' which one or the other of the organisations specified in the sub-section can get carried out through a contractor under a contract and further it includes obtaining by any of such organisations supply of labour under a contract with a contractor for carrying out its work which would have fallen outside the ' work ' but for its specific inclusion in the sub-section ".

6. It may be pointed out that this appeal before the Supreme Court was by virtue of a special leave petition against the judgment in Writ Petition No. 2909 of 1978 of the Patna High Court in the case of Associated Cement Co. Ltd. v. CIT [1979] 120 ITR 444. The Patna High Court, while dismissing the writ petition of the aforesaid company, observed that " In a very broad sense, a work done by one person is service rendered to another and indeed one of the dictionary meanings of the word ' service ' is work ".

7. The conclusion flowing from the aforesaid judgments of the Supreme Court and the Patna High Court is that the provisions of section 194C would apply to all types of contracts including transport contracts, labour contracts, service contracts, etc. In the light of these judgments, the Board have decided to withdraw their above mentioned Circulars Nos. 86 and 93 and para 11 of Circular No. 108 and issue the following guidelines in regard to the applicability of the provisions of section 194C:--

(i) The provisions of section 194C shall apply to all types of contracts for carrying out any work including transport contracts, service contracts, advertisement contracts, broadcasting contracts, telecasting contracts, labour contracts, materials contracts and works contracts.

(ii) No deduction at source under section 194C shall be required to be made if the consideration for the contract does not exceed the prescribed amount which at present is Rs. 10,000 (ten thousand only).

(iii) The provisions of section 194C would not apply in relation to payments made for hiring or renting of equipments, etc.

(iv) The provisions of section 194C would not apply in relation to payments made to banks for discounting bills, collecting/receiving payments through cheques/drafts, opening and negotiating letters of credit and transactions in negotiable instruments.

(v) Service contracts would be covered by the provisions of this section since service means doing any work as explained above.

(vi) The provisions of this section will not cover contracts for sale of goods

(a) Since contracts for the construction, repair, renovation or alteration of buildings or dams or laying of roads or airfields or railway lines or erection or installation of plant and machinery are in the nature of contracts for work and labour, income-tax will have to be deducted from payments made in respect of such contracts. Similarly, contracts granted for processing of goods supplied by the Government or any other specified person, where the ownership of such goods remains at all times with the Government or such person, will also fall within the purview of this section. The same position will obtain in respect of contracts for fabrication of any article or thing where materials are supplied by the Government or any other specified person and the fabrication work is done by a contractor.

(b) Where, however, the contractor undertakes to supply any article or thing fabricated according to the specifications given by the Government or any other specified person and the property in such article or thing passes to the Government or such person only after such article or thing is delivered, the contract will be a contract for sale and as such outside the purview of this section.

(c) In *State of Himachal Pradesh v. Associated Hotels of India Ltd.* [1972] 29 STC 474, the Supreme Court observed that where the principal objective of work undertaken by the payee of the price is not the transfer of a chattel qua chattel, contract is of work and labour. The test is whether or not the work and labour bestowed end in anything that can properly become the subject of sale; neither the ownership of the materials nor the value of skill and labour as compared with the value of the materials is conclusive although such matters may be taken into consideration in determining, in the circumstances of a particular case, whether the contract is, in substance, one of work and labour or one for the sale of a chattel. A building contract or a contract under which a movable is fixed to another chattel or on the land, where the intention plainly is not to sell, the article but to improve the land or the chattel and the consideration is not for the transfer of the chattel, but for the labour and work done and the material furnished, the contract will be one of work and labour. In case of doubt, whether a particular contract is a contract for work and labour or for sale, the matter should be decided in the light of the principles laid down by the Supreme Court in the above mentioned case.

(vii) The provisions of this section would apply in relation to payments made to persons who arrange advertisement, broadcasting, telecasting, etc.

(viii) The provisions are wide enough to cover not only written contracts but also oral contracts.

(ix) Where the total payment under the contract is likely to exceed Rs. 10,000 for the entire period during which the contract will remain in force, income-tax will have to be deducted at source. In a case where, at the time when the contract was entered into, it was expected that the total payment thereunder would not exceed Rs. 10,000 but later on it is found that the payment exceeds that amount, deduction should be made in respect of earlier payments as well.

(x) The percentage deduction prescribed in law is with reference to the amount of payment and not "income comprised in the payment". The person responsible for making payment, therefore, is not required to estimate the income comprised in the payment.

(xi) In a case where advance payments are made during the execution of a contract and such payments are to be adjusted at the time of final settlement of accounts, tax will have to be deducted at the time of making advance payments if the total payment is likely to exceed Rs. 10,000.

(xii) Where any contractor is the recipient of any amount under a contract but the income of the recipient is not subject to income-tax, such contractor may obtain a certificate from his Assessing Officer under section 194C(4) for receiving payment without deduction of tax at source.

(xiii) Every contractor, other than an individual or a HUF, who is responsible for paying any sum to any sub-contractor (who is resident in India), in pursuance of a contract with such sub-contractor for carrying out or for the supply of labour for carrying out, wholly or in part, of the work undertaken by the contractor or for supplying whether wholly or partly any labour which the contractor had undertaken to supply, will be required to deduct income-tax at the rate of 1 per cent. of such sum.

8. It may be noted that--

(i) The term " service contracts " would include services rendered by such persons as lawyers, physicians, surgeons, engineers, accountants, architects, consultants, etc. However, services rendered for which payment is in the nature of salaries which is chargeable under the head of income " A. Salaries " in Chapter IV of the Income-tax Act, 1961, shall not be covered by section 194C.

(ii) The term " transport contracts " would, in addition to contracts for transportation and loading/unloading of goods, also cover contracts for plying of buses, ferries, etc., along with staff (e.g., driver, conductor, cleaner, etc.). Reference in this regard is also invited to Board's Circular No. 558, dated 28th March, 1990.

(iii) The term " materials contracts " in the context of section 194C would mean contracts for supply of materials where the principal contract is for work and labour and not a contract for sale of materials.

9. Board's Circular No. 86, dated 29th May, 1972, and No. 93, dated 26th September, 1972, and para 11 of Circular No. 108, dated 20th March, 1973, are hereby withdrawn. Board's Circular No. 558, dated 28th March, 1990, is reiterated.

10. It is clarified that this circular explaining the provisions of section 194C will apply with effect from 1st April, 1994. Tax deductions made in accordance with Circulars Nos. 86, 93 and 108 up to 31st March, 1994, will be regarded as compliance of the provisions of section 194C.

11. Copies of this circular will be available with the Directorate of Income-tax (RSP & PR), 6th Floor, Mayur Bhavan, New Delhi-110 001.

12. Hindi version will follow.

Sd./-

Rajesh Chandra.
Under Secretary,
Central Board of Direct Taxes

[F.No.275/54/93-IT (B), dated 8.3.94 from CBDT]