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# CONSTRUCTION INDUSTRY IN INDIA

A short guide on **The Indian construction industry**, the engine of the **Indian economy**.

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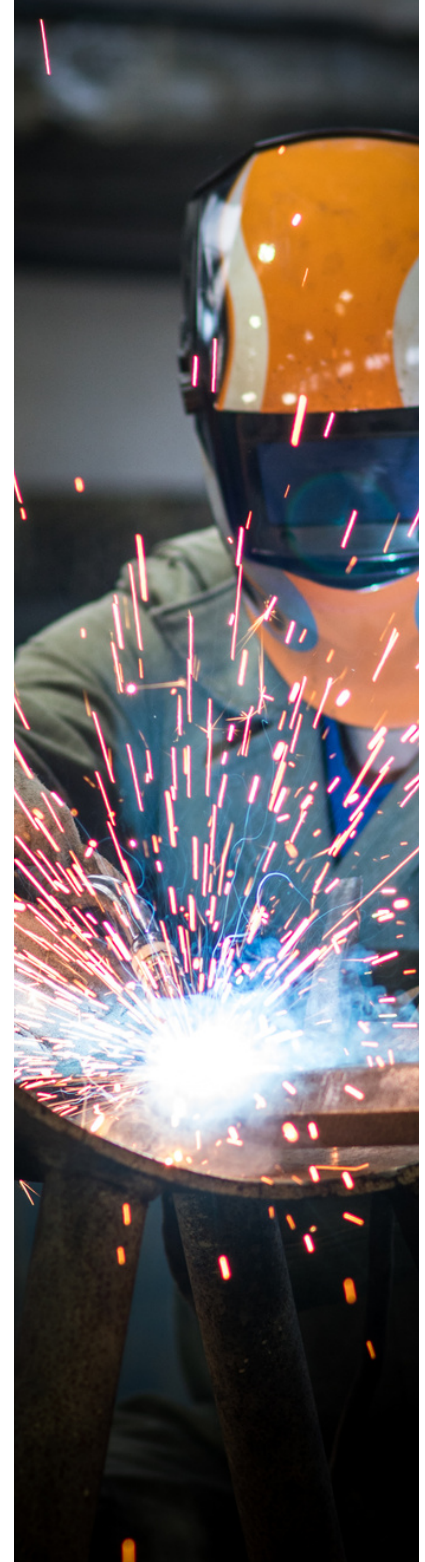
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# INTRODUCTION

The term "construction" means any form of building or assembling but is generally limited to the creation or performance of work in relation to immovable property. This includes both building and construction works, according to the technical subject matter of the contract. In India, construction is among the top ten largest sectors attracting the highest Foreign Direct Investment ("FDI").

In the last two years, FDI inflows into the construction sector, including infrastructure activities, have increased dramatically, from US\$ 1861 million to US\$ 2258 million. Price Waterhouse Coopers forecasts that by 2030, the global volume of construction output will increase by 85% to US\$ 15.5 trillion, with three countries—China, the United States, and India—leading the way and accounting for 57% of all global growth.

The construction industry is expected to be one of the highest drivers of economic growth worldwide. It encompasses a wide range of activities, such as complex infrastructure projects, engineering works, commercial and residential construction, built-up works, and development projects. The construction industry has important linkages with other sectors, so that its impact on Gross Domestic Product ("GDP") and economic development goes well beyond the direct contribution of construction activities.



# INDUSTRY SCENARIO

The construction sector is a crucial driver of the Indian economy. The industry is highly responsible for propelling India's overall development and enjoys intense focus from the government for initiating policies that would ensure the country's time-bound creation of world-class infrastructure. The construction sector includes power, bridges, dams, roads, and urban infrastructure development. The Indian construction industry is expected to reach \$1 trillion by 2025. The construction industry market in India works across 250 sub-sectors with linkages across sectors.

By 2030, more than 40% of the population is expected to live in urban India (33% today), creating a demand for 25 million additional mid-end and affordable units. Under the National Infrastructure Pipeline (NIP), India has an investment budget of \$1.4 trillion on infrastructure - 24% on renewable energy, 19% on roads and highways, 16% on urban infrastructure, and 13% on railways. Schemes such as the revolutionary Smart City Mission (targeting 100 cities) are expected to improve quality of life through modernized/ technology driven urban planning.



# LICENSING



Other than the specific consents/approvals required for the project construction work and under labour legislation by a contractor engaging labour, no specific consents are required by contractors (domestic or foreign) to carry out construction work.

In addition, local construction professionals must be registered. For example, architects must be registered under the Indian Architects Act 1972 and can only practice under the provisions of that Act. Foreign architects can also be appointed as consultants or designers in India for a specific project with the prior approval of the Central Government.

## Compliances and approvals:

An indicative list of licences and consents required by a project is set out below:

- land rights or permission/approval to use agricultural land for commercial purposes or forest land for non-forest purposes (Forest (Conservation) Act 1980);
- environmental clearance from the Ministry of Forest and Environment. Consent to establish and operate from the respective state pollution control board (SPCB), Water (Prevention and Control of Pollution) Act 1974, and Air (Prevention and Control of Pollution) Act 1981 is required before starting any project;
- coastal regulatory zone clearance is required if the project falls within the coastal regulatory zone;
- approval for the use of boilers (Indian Boilers Act 1923);
- authorisation for storage of hazardous waste;
- registration of the proposed design and construction of the power plant under the Factories Act 1948;
- if a certain percentage of workers have been hired from outside the state where the project is located, the developer must acquire a registration under the Inter State Migrant Workmen;
- No Objection Certificate ("NOC") from the Ministry of Defence if the project is located near an international border or an air force base and
- an approval for the use of water for the plant (ground water or sea water).

The above list is not exhaustive and will vary depending on the nature of the project and other factors.

# CONTRACTUAL ISSUES

## Contractors' Risks

Generally, under construction contracts, the risks are allocated to the party that is best suited to manage them. Typically, the risks allocated to a contractor are:



- **Design/construction risk** : The contractor is required to undertake construction in accordance with the agreed technical standards.
- **Delay risk** : Usually, contracts provide for a fixed scheduled commissioning date by which the contractor must commission the project. Any extension of time is granted only in certain specified cases, such as a force majeure event, approved variations, or any delay caused by the owner.
- **Cost overruns** : Construction contracts usually provide for a fixed price with escalation permitted in specific instances, such as suspension by the owner or modification of scope by the owner.
- **Performance parameters:** Contractors are typically responsible for ensuring the project's performance within agreed-upon parameters. These parameters are benchmarked against the performance parameters agreed upon under the offtake contract. For supply contracts, upon delivery of equipment, the latter may be subject to certain tests to ensure compliance with the performance parameters at the time of acceptance.
- **Change in law:** The risk of a change in law is usually negotiated between the owner and the contractor. Further, a change in taxes is treated differently based on the agreed allocation of taxes between the parties.



## Excluding liability

Limitation of liability clause under contracts are valid under the Indian law if they comply with the requirements of the relevant legislation. The courts have recognized that exemption from liability can be prevented by statute, and in such cases, the statute will prevail. The employer will not be permitted to limit its liability under a contract of service for personal injuries caused to the employee by the negligence of the persons in common employment with the employee.

Further, criminal liability cannot be excluded by any contractual clause.

The courts in India usually enforce limitation of liability clauses, unless enforcement would defeat the purpose of the contract or be against public interest or policy.



## Caps on liability

Contractors usually require a cap on liability in the construction contract to limit the relevant party's liability in case of a breach to an agreed amount. The non-defaulting party cannot claim an amount greater than the agreed limitation. Limitation of liability clauses usually have two aspects:

- where the parties mutually waive and release each other from liability for any indirect or consequential loss or
- add a financial cap on the contractor's liability, which is typically agreed as a percentage of the contract price, with the owner preferring 100% of the contract price and the contractor negotiating a lower threshold, and the cap includes all other contract pay-outs such as liquidated damages ("LD"), indemnity claims, and so on.

Further, there are sub-caps on the contractor's LD liability. For example, delay LD and performance LD are capped at an agreed percentage (10%–20%) of the contract price, with an overall cap on both types of LD (20%–30% of the contract price).

# PROJECT INSURANCE

## Compulsory insurance

There are many different types of insurance designed to protect property owners, developers, and contractors through the various phases of a construction project. Certain types of construction insurance are required for all projects; these compulsory insurances are:

- The Employee State Insurance Act, 1948 (ESI Act) requires every business (which includes construction projects) that employs more than ten people to procure registration and employees insurance. This covers several contingencies, such as maternity leave, sickness, disablement, or death due to employment hazards, leading to a loss of wages and earning capacity.
- The Gratuity Act, 1972 requires every employer (other than an employer or an establishment belonging to or under the control of the central government or a state government, or an employer who has established a gratuity fund and has obtained an exemption from the government) to obtain insurance for its liability to pay gratuity to the employees from the Life Insurance Corporation of India ("LIC").
- The Public Liability Insurance Act of 1991 mandates every owner (who owns or controls the handling of a hazardous substance at the time of an accident) to take out insurance to cover harm to any person (other than a worker) or damage to any property resulting from an accident while handling a hazardous substance.
- The Motor Vehicles Act of 1988 requires anyone using a motor vehicle in a public place to have insurance against third-party risk.



## **Non-compulsory insurance**

While it is not mandatory, all construction contracts usually require broadly the following types of insurance to be maintained by the contractor:

- contractor's all-risk policy during the construction stage;
- plant and equipment insurance for cargo and transportation of the plant and equipment to the project site;
- insurance of the works during construction, testing and commissioning, and during the defect liability period, and design defect cover;
- insurance covering bodily injury, sickness, disease, or death suffered by the contractor's personnel or any third party arising out of the execution of the work;
- insurance covering loss or damage to the contractor's equipment and materials, including any loss or damage while in transit until their arrival at the site and
- insurance covering all personal accident claims (not covered by the Employees' Compensation Act of 1923 (EC Act)).

# LEGAL FRAMEWORK

India's construction industry is an example of uneven legislation and confusing interpretation, which causes disagreements and extended litigation in the construction laws. Construction companies must comply with a variety of laws to do business in India.

The laws affecting construction companies in India:

## **The Contract Labour (Regulation and Abolition), 1970-**

The Contract Labour (Regulation and Abolition) Act 1988 is a law that regulates the use of contract labour in India. Under this law, contractors must ensure that their workers are treated fairly and are not subjected to slave labour or human trafficking. The Contract Labour (Regulation and Abolition) Act also prohibits employers from forcing employees to work excessive hours or under unsafe conditions.

## **Factories Act of 1993-**

The Factories Act 1993 is a law that regulates working conditions at factories in India. Under this law, Indian factories must provide free drinking water to their workers and ensure they are provided with adequate lighting, heating, ventilation, and cleanliness. The Factories Act also requires that employers provide a safe place for their workers to rest and change their clothes. The Act also requires employers to pay sick leave wages if an employee is sick or injured while on the job.

### **Indian Contract Act, 1872 -**

Construction contracts in India are governed by the Indian Contract Act, 1872. This law sets out the principles governing contract formation, performance, and termination. The act also provides for remedies available to parties in contract disputes. In addition, the Indian Contractors (Regulation and Inspection) Act, 1986, specifies certain requirements that must be met by contractors who wish to operate in the country.

### **Environmental Law in India -**

Construction companies in India are required to take appropriate measures to prevent environmental degradation and protect workers and the public from harm. Environmental law, which establishes standards for hazardous materials and imposes fines for violations, aims to protect forests and their resources by regulating activities like logging and mining. This law also provides incentives for companies to adopt sustainable practices, such as using recycled materials, and requires construction companies to report any accidents that occur during or after construction.

# TAX REGIME

Goods and Service Tax ("GST") on construction materials has rationalized the taxation system and subsumed various state and central government taxes. The government also levies GST on construction contracts. There are varieties of materials used at the construction sites, including cement, sand, bricks, marbles, etc. Hence, a proper taxation system was introduced to manage the cost of these goods. However, GST on construction material varies based on the material used, which still makes the calculations hefty for the dealers and buyers. Here is an overview of these rates:

Materials	GST rates
Sand	Asphaltic rocks, oil shale/bituminous, tar sand, natural asphaltites, asphalt- 18% Natural sand- 5%
Mica	12%
Bricks	5% - 28%
Cement	28%
Crushed stones, pebbles, gravel	5%
Granite and marble	Blocks- 12% Not in blocks- 28%
Steel and Iron	18%
Building stones	5%
Tiles	5% - 28%
Coal	5%
Wallpaper	28%
Varnish and paint	28%
Bathroom interiors and appliances	<ul style="list-style-type: none"> <li>• Pipes and tubes, fitting- 18%</li> <li>• Other items- 28%</li> </ul>
Electrical appliances	28%

To calculate the rate of GST on construction contracts, one needs to have prior knowledge of the type of property it is. It is to be noted that any property in which one can readily move without any repair, renovation, or work does not require paying GST on construction material, services, contracts, etc. Apart from this situation, people entitled to selling and construction of building/resultant have to pay GST as mentioned in GST on construction contracts.

<b>Taxation rates for residential and commercial properties (GST on construction)</b>		
<b>Nature of service</b>	<b>Gross rate</b>	<b>Effective Rate</b>
Affordable residential apartment in a Residential Real Estate Project ("RREP") (Commence on or after 01.04.2019 or ongoing projects opted for new rates) intended for sale.	1.5 %	1 %
Residential apartment (other affordable residential apartments) in a RREP (commenced on or after 01.04.2019) or ongoing projects opted for new rates), intended for sale.	7.5 %	1 %
Commercial Apartments in a RREP (commenced on or after 01.04.2019 or ongoing projects opted for new rates) intended for sale.	7.5 %	5 %
Affordable residential apartment in Real Estate Projects ("REP"), other than in a RREP (commenced on or after 01.04.2019, or ongoing projects opted for new rates), intended for sale.	1.5 %	1 %
Residential apartment (other than affordable residential apartments) in REP other than in a RREP (Commenced on or after 01.04.2019, or ongoing projects opted for new rates) intended for sale.	7.5 %	5 %
Ongoing projects in specified schemes (of lower rate of tax) where the promoter has not opted for new rates.	12 %	8 %
Commercial Apartments in REP other than in RREP.	18 %	12 %
Ongoing Residential apartments as on 31.03.2019 , other than affordable residential apartments, where promoter has chosen to pay at old rates (other than mentioned from 1 to 6 above).	18 %	12 %

# Real Estate Regulation Authority

RERA new regulations 2022 also mandate the distribution of registration fees, municipal taxes, water and energy costs, maintenance fees, ground rent, and other fees as specified in the agreement.

The builder is responsible for all outgoings such as water and electricity until possession is handed over to the buyers.

·According to RERA's new regulations for 2022, the buyer may pay no more than 10% of the entire sum to the builder unless the agreement to sell is completed.

A person who is applying under the individual category shall have to submit the affidavit that the REAL ESTATE business is not the primary source of Income and he is doing this as a part-time occupation.

RERA has empowered homebuyers by introducing the concept of consent of the majority. In case a builder intends to make any changes to the project plans or specifications, they must obtain the consent of at least two-thirds of the buyers. This provision ensures that builders cannot unilaterally alter the project's scope or features without the consent of the majority, protecting the interests of the buyers.

## **Increase in Total Fines**

When a violation is discovered, the Real Estate Regulatory Authority ("RERA") shall require the perpetrator to cease the infringement and remediate the consequences immediately or within a time frame designated by RERA. In the event of non-compliance, RERA may levy a warning fee. Before the modification, the total fine did not exceed Bahraini Dinars Twenty Thousand (20,000); however, the altered wording of Article 11 (a/2) of the Law now states that the total fine cannot exceed Bahraini Dinars Fifty Thousand.



# DISPUTE RESOLUTION



In project contracts, the most common formal dispute resolution mechanism is arbitration, with parties having the right to approach civil courts for interim relief. If the contracting parties are Indian and the project is based in India, ad hoc arbitration under the Indian Arbitration and Conciliation Act 1996 is often chosen.

If the contractor is a foreign entity, it usually prefers institutionalised arbitration, such as under the Singapore International Arbitration Centre Rules (SIAC Rules), London Court of International Arbitration Rules (LCIA Rules), or International Chamber of Commerce Rules (ICC Rules).

In addition, subject to the arbitration provisions, the Indian courts for a particular state (usually where the project is located or where the parties are based) are granted jurisdiction to decide all matters arising under the contract.

Further, under the Specific Relief (Amendment) Act, 2018, state governments, in consultation with the Chief Justice of the High Court, are entitled to designate one or more civil courts as special courts to try suits relating to infrastructure projects under the Specific Relief Act, 1963.

### **Alternative Dispute Resolution Method**

In India, generally, the most common alternative dispute resolution methods are arbitration, conciliation, mediation, and negotiation. The Indian Arbitration and Conciliation Act (1996) recognises the settlement of disputes through arbitration, conciliation, and mediation.

Most dispute resolution clauses in construction contracts provide that when any dispute arises, the parties must seek to resolve the dispute by mutual consultation between the respective chief executive officers of the parties, duly empowered to resolve the dispute, failing which the parties are entitled to initiate arbitration.



# HOW CAN WE HELP?

We have extensive experience in construction projects, in both the public and private sectors, advising on issues including contracts, professional appointments and collateral warranties.

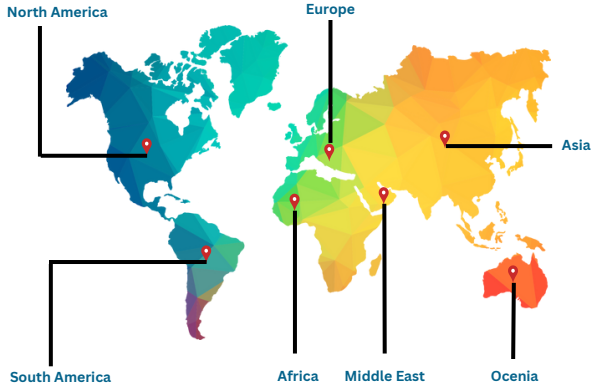
We also deal with insolvencies and disputes arising out of construction projects, such as payment, defects, time or health and safety issues, through mediation, adjudication, arbitration or the courts.

Our expert team can advise on and deal with every stage of the construction process, including:

- procurement;
- contracts including building contracts, sub-contracts, consultant appointments, collateral warranties and bonds;
- dispute resolution, including adjudication;
- health and safety issues;
- contractor insolvency and
- defects liability.



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