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C.M.A.No.276 of 2021

IN THE HIGH COURT OF JUDICATURE AT MADRAS

RESERVED ON : 22.03.2024

PRONOUNCED ON : 22.07.2024

CORAM

THE HONOURABLE MR.JUSTICE K.RAJASEKAR

C.M.A.No.276 of 2021

and

C.M.P.No.1853 of 2021

M/s.Medopharm,
No.28, Puliyur 2nd Main Road,
Trustpuram, Kodambakkam,
Chennai – 600 024,
Represented by the Manager.

..Appellant/Petitioner

Vs.

The Employees State Insurance Corporation,
No.143, Sterling Road,
Nungambakkam,
Chennai – 600 034,
Represented by the Assistant Director.

.. Respondent/Respondent

PRAYER: Civil Miscellaneous Appeal filed under Section 82 of the Employees' State Insurance Act, 1948, to set aside the order and decree dated 16.08.2017 in E.I.O.P.No.95 of 2008 passed by the learned Judge, Principal Labour Court, (Employees' Insurance Court), Chennai.



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For Appellant : Mr.D.Abdullah
For Respondent : Mr.C.V.Ramachandramurthy
Senior Panel Counsel

JUDGMENT

This Civil Miscellaneous Appeal has been filed by the appellant challenging the order passed in E.I.O.P.No.95 of 2008 dated 16.08.2017 by the Presiding Officer, Principal Labour Court, (Employees' Insurance Court), Chennai.

2. The parties are referred to hereunder according to their litigative status and ranking before the Employees Insurance Court.

3. The facts leading to filing of this appeal are as follows:

The appellant herein is an Establishment situated at Chennai and it is covered under the Employees State Insurance Act, 1948 ['ESI Act' in short], required to pay contributions in accordance with Section 40 of the ESI Act. The Social Security Officer (formerly Insurance Inspector) of the respondent Corporation had visited the premises of the appellant and conducted inspection of the records for the period from January 2006 to June 2007 and it was found that there are some conversion charges paid to non-coded



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contractors. Based on the report of the Social Security Officer, the respondent issued a show cause notice in Form C-18 on 24.01.2008, claiming a sum of Rs.2,24,348/- as alleged omitted contribution for the period from April 2005 to March 2006. On receipt of the notice, the employer appeared before the respondent Corporation and agreed to pay the amount as claimed, which is disputed by the appellant herein. After due enquiry, an order under Section 45-A of the ESI Act was issued on 21.10.2008, demanding the appellant to pay the arrears of contribution for a sum of Rs.2,24,348/- for the period from April 2005 to March 2006.

4. Aggrieved by the order passed under Section 45-A of the ESI Act, the appellant approached the ESI Court, by invoking Section 75 of the ESI Act, to set aside the order passed by the respondent herein dated 21.10.2008, claiming a sum of Rs.2,24,348/- for the period from April 2005 to March 2006.

5. The case of the petitioner is that the petitioner has outsourced the conversion process by handing over raw materials to various persons and they in turn produce the drugs/medicines and handed over the same to the



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petitioner. The petitioner used to pay the conversion charges for the services rendered by the outside contractors and the petitioner is not having any control or supervision over the work done by the other contractors. There are invoices to prove the amounts paid to other contractors and Establishments. Those conversion charges shall not be added under the component of wages to be paid by the petitioner. In Form C-18 notice, the Social Security Officer has given a report stating Rs.2,24,348/- as omitted contribution. These are the amounts settled for raising the bill for the four factories, namely, Ace Pharmaceuticals, Bayshore Plastics (P) Limited, San Plast and P.D. Plastisizers and Chemicals and all these four Establishments are independent having their own staff and workers. They have independent premises and their place of work is far away from the petitioner's Establishment. Those Establishments are doing conversion work not only for the petitioner, but also to many others in the field of medicines and pharmaceuticals. Hence, the petitioner is not liable to pay the contributions claimed.

6. The respondent Corporation filed a written statement stating that the Social Security Officer of the respondent Corporation visited the



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petitioner Company and conducted inspection for the period from January 2006 to June 2007 and ledger verification from April 2005 to March 2006.

On inspection, it was found that conversion charges was paid to coded/exempted/non-coded contractors. It is stated that the petitioner did not produce even the copy of invoice for verification and therefore, the Insurance Company referred the matter to the Authorised Officer and the Authorised Officer proposed determination of contribution of Rs.2,24,348/- in respect of amount paid to the non-coded contractors. A show cause notice was issued to the petitioner on 24.01.2008 and the petitioner was afforded an opportunity of personal hearing. The petitioner appeared and sought for several adjournments. On 06.10.2008, the petitioner appeared before the Authorised Officer and agreed to pay the dues without any dispute. This clearly shows that the petitioner agreed that 'conversion charges' are wages under Section 2(22) of the ESI Act and contribution is liable to be paid by them. It was further contended that the conversion charges are paid to contractors to convert the raw materials supplied by the petitioner into drugs and medicines. Thus, the conversion of raw materials supplied by the petitioner is incidental or preliminary to and in connection with the work of the factory or Establishment and therefore, the employees of the immediate



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employer engaged in conversion fit well within the definition of Section 2(9) and contribution in respect of them is liable to be paid by the petitioner Company. Hence, only after due enquiry, the Authorised Officer issued orders under Section 45A dated 21.10.2008, confirming the contribution claimed in the show cause notice dated 24.01.2008 and prayed to dismiss the petition.

7. After recording of evidence, the ESI Court, in its order dated 16.08.2017, dismissed the petition and held that the respondent only after having inspected the records of the appellant Establishment, arrived contribution to be paid by the appellant and accordingly, the appellant is bound to pay the amount claimed by the respondent.

8. Aggrieved over the order passed by the ESI Court, the appellant herein has approached this Court on the ground that the ESI Court failed to note that contributions on conversion charges paid to third party Establishments are not chargeable unless such conversion had been done under the supervision and control of the principal employer.



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9. The learned counsel for the appellant submitted that they have engaged contractors for manufacturing certain medicines on behalf of the Establishment herein and they are paying the charges for the same. Admittedly, these persons, who are employed by the contractors, are doing the work of the Establishment, but in the premises, which do not belong to the Establishment herein. In support of his submission, the learned counsel for the appellant relied on the following judgments:

(i) Judgment of the Hon'ble Apex Court in ***Prestige Engineering (India) Ltd., Vs. Collector of Central Excise, Meerut*** reported in ***1994 AIR SCW 4338*** and

(ii) the judgment of the Bombay High Court in ***Commissioner of Income Tax Vs. Neo Pharma Private Limited*** reported in ***(1982) 28 CTR Bom 223***.

10. I have considered the submissions made on both sides and perused the materials available on record. The substantial question of law framed by this Court reads as follows:

(i) Whether the employees, who are involved in the manufacturing activities of the petitioner/Establishment herein and have been paid



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conversion charges, would fall within the definition of Section 2(9) of the ESI Act and whether the charges paid to them under the head 'conversion charges' will fall within the definition of 'wages' under Section 2(22) of the ESI Act?

11. Admittedly, the petitioner's Establishment is covered under the ESI Act. The Social Security Officer has also inspected the petitioner's Establishment on various dates and perused the records. He has noted down in the inspection report that there are conversion charges paid to four non-coded Units. The report of the Social Security Officer was recorded and it was also served on the Establishment. The order shows that one Mr.D.V.Chandrasekar, representative of the Establishment also appeared during enquiry and the Establishment has not filed any objections for the show cause notice in Form C-18 nor produced any documents to show that they are not liable to pay contributions for the conversion charges as stated in the show cause notice.

12. In the impugned order passed under Section 45-A of the Act, it is recorded by the Officer that the official of the Establishment appeared and



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agreed to pay the amount. Admittedly, the petitioner Establishment has not produced any documents to support their case that they are not liable to pay the contribution, since they have supplied the raw materials to the other non-coded Establishments and received the manufactured drugs and medicines. Only before the ESI Court, they have come forward to mark the invoices raised in favour of the above four Establishments, which have been marked as exhibits P3 to P28. These documents were all photocopies and no original copies were marked. Except these invoices, no supporting documents including the statement of accounts were produced to authenticate the invoices marked by the Establishment. Before the ESI Court, P.W.1, the official of the Establishment was cross-examined and he has admitted that these exhibits P3 to P28 did not contain the cost of the material, which was transported and the Inward Register of receiving the finished or manufactured medicines have not been produced. It is also admitted by him that they have not produced any statement of accounts. Further, as a manufacturer of medicines, the petitioner requires drug manufacturing licence by way of doing conversion and the same was also not produced before the ESI Court.



13. Admittedly, the conversion work was carried out by the non-coded establishments. Section 2(9) of the Act provides the definition of 'employee', who are covered under the ESI Act. Section 2(9) of the ESI Act reads as follows:

"(9) "employee" means any person employed for wages in or in connection with the work of a factory or establishment to which this Act applies and

(i)who is directly employed by the principal employer, on any work of, or incidental or preliminary to or connected with the work of, the factory or establishment, whether such work is done by the employee in the factory or establishment or elsewhere; or

(ii)who is employed by or through an immediate employer, on the premises of the factory or establishment or under the supervision of the principal employer or his agent on work which is ordinarily part of the work of the factory or establishment or which is preliminary to the work carried on in or incidental to the purpose of the factory or establishment; or

(iii)whose services are temporarily lent or let on hire to the principal employer by the person with whom the person whose services are so lent or let on hire has entered into a contract of service;

and includes any person employed for wages on any work connected with the administration of the factory or establishment or any part, department or branch thereof or with the purchase of raw materials for, or the distribution or sale of the products of, the factory or establishment or any person engaged as apprentice, not being an apprentice engaged under the Apprentices Act, 1961 (52 of 1961), and includes such person engaged as apprentice whose training period is extended to any length of time but does not include?

(a)any member of the Indian naval, military or air forces; or

(b)any person so employed whose wages (excluding remuneration for overtime work) exceed such wages as may be prescribed by the Central Government a month:

Provided that an employee whose wages (excluding remuneration for overtime work) exceed such wages as may be prescribed by the Central Government at any time after (and not before) the beginning of the contribution period, shall continue to be an employee until the end of that period;"



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Section 2(9)(ii) states that a person employed by or through an immediate employer on the premises of a factory or establishment or under the supervision of the principal employer or his agent on work which is ordinarily part of the work of the factory or establishment or which is preliminary to the work carried on in or incidental to the purpose of the factory or establishment.

14. Section 40 of the ESI Act mandates the principal employer to pay contribution in respect of every employee, whether directly employed by him or by or through an immediate employer. Section 40 of the ESI Act reads as follows:

“40. Principal employer to pay contributions in the first instance. — (1) The principal employer shall pay in respect of every employee, whether directly employed by him or by or through an immediate employer, both the employer’s contribution and the employee’s contribution.

(2) Notwithstanding anything contained in any other enactment but subject to the provisions of this Act and the regulations, if any, made thereunder, the principal employer shall, in the case of an employee directly employed by him (not being an exempted employee), be entitled to recover from the



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employee the employee's contribution by reduction from his wages and not otherwise :

Provided that no such deduction shall be made from any wages other than such as relate to the period or part of the period in respect of which the contribution is payable] or in excess of the sum representing the employee's contribution for the period.

(3) Notwithstanding any contract to the contrary, neither the principal employer nor the immediate employer shall be entitled to deduct the employer's contribution from any wages payable to an employee or otherwise to recover it from him.

(4) Any sum deducted by the principal employer from wages under this Act shall be deemed to have been entrusted to him by the employee for the purpose of paying the contribution in respect of which it was deducted.

(5) The principal employer shall bear the expenses of remitting the contributions to the Corporation."

Section 40 states that even if the principal employer engages an employee through another person, i.e., an immediate employer, the principal employer is liable to pay contribution. Section 41 mandates the principal employer to pay the contribution in respect of employee employed by or through an immediate employer and recover the same from the immediate employer.

Section 41 of the ESI Act reads as follows:



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"41. Recovery of contribution from immediate employer:

(1) A principal employer, who has paid contribution in respect of an employee employed by or through an immediate employer, shall be entitled to recover the amount of the contribution so paid (that is to say the employer's contribution, as well as the employee's contribution, if any) from the immediate employer, either by deduction from any amount payable to him by the principal employer under any contract, or as a debt payable by the immediate employer.

(1A) The immediate employer shall maintain a register of employees employed by or through him as provided in the regulations and submit the same to the principal employer before the settlement of any amount payable under sub-section (1).

(2) In the case referred to in sub-section (1), the immediate employer shall be entitled to recover the employee's contribution from the employee employed by or through him by deduction from wages and not otherwise, subject to the conditions specified in the proviso to sub-section (2) of section 40.

15. The judgment of the Bombay High Court relied on by the learned counsel for the appellant in ***Commissioner of Income Tax Vs. Neo Pharma Private Limited*** cited supra is relating to interpretation of Section 256(1) of



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the Income Tax Act and the meaning of the term 'manufacturing or processing of goods' or 'conversion of raw materials' etc. The judgment of Hon'ble Apex Court in ***Prestige Engineering (India) Ltd Vs. Collector of Central Excise*** cited supra is also relating to collection of imposition of excise for the job work carried on by the company. Both the judgments are not relating to extension of ESI Act to the employees in a factory. Hence, those judgments are not relevant to the issue involved in this case.

16. In this case, the Establishment claims that the employees of contractors are not directly engaged by them and they have been engaged by other employer. However, the Establishment has not produced any materials or evidence to show that the third party Establishment, i.e., the employer, who involves in manufacturing the medicines for the Establishment, is paying the contributions on behalf of his employees.

17. The burden of proving the fact that the employees who have involved in manufacture of medicines for the appellant/Establishment are also receiving the benefits of the ESI Act, lies on the Establishment herein. Admittedly, the Establishment has paid payments to the employees under the



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caption “conversion charges”. Since there is no evidence produced by the appellant that these employees are already covered under the ESI Act, as per Section 40, it is mandate on the part of the appellant herein to pay the contributions for the employees, who have carried on the work of the Establishment herein. It is contended that the Establishment has no supervisory control over the employees, who are engaged by the immediate employer.

18. The ESI Court has elaborately considered the case of the Establishment and held that the appellant has failed to produce the necessary audit accounts to prove the exhibits, Ex.P3 to Ex.P28, which are the invoices. Since these invoices have not been supported or corroborated by any documents, the ESI Court has rejected the same. The ESI Court has further held that P.W.1 had admitted before the authorities that he is ready to pay the contributions during the enquiry on 06.10.2008. As observed by the ESI Court, except for production of invoices, which shows that the Establishment have received some products for the purpose of doing conversion, there is no proof produced with regard to the cost of the raw materials supplied by the Establishment. In the absence of any document to



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show that there is a separate contract for manufacturing and charges to be paid and the employees involved in the manufacturing process are being extended with the benefits, the Establishment is not entitled to claim that since they are not supervising the third party Establishment, they are not liable to pay contribution.

19. In ***Royal Talkies, Hyderabad and others Vs. Employees State Insurance Corporation*** reported in (1978) 4 SCC 204, the Apex Court has considered the definition of 'employee' under Section 2(9) of the ESI Act and held as follows:

"15. The primary test in the substantive clause being thus wide, the employees of the canteen and the cycle stand may be correctly described as employed in connection with the work of the establishment. A narrower construction may be possible but a larger ambit is clearly imported by a purpose-oriented interpretation. The whole goal of the statute is to make the principal employer primarily liable for the insurance of kindred kinds of employees on the premises, whether they are there in the work or are merely in connection with the work of the establishment."



20. In ***Regional Director, ESI Corporation, Madras Vs. South India***

Floor Mills (P) Limited reported in (1986) 3 SCC 238, the Apex Court has once again considered the scope of Section 2(9) of the ESI Act and has held as follows:

"6. It appears from the definition that three categories of persons as mentioned in clauses (i), (ii) and (iii) of Section 2(9) can be employees. We are, however, concerned with the category under clause (i) inasmuch as in all the cases before us the workers concerned were directly employed by the principal employers, namely, the respondent companies. Under category (i), in order to be an employee a person must be employed directly by the employer for wages in the factory or establishment on any work which should be incidental or preliminary to or connected with the work of the factory or establishment. The definition seems to be very wide and brings within the purview various types of employees. As soon as the conditions under the definition are fulfilled, one becomes an employee within the meaning of the definition.

....

13. The Act is a piece of social security legislation enacted to provide for certain benefits to employees in case of sickness, maternity and employment injury. To hold that the workers employed for the work of construction of buildings for the expansion of the factory are not employees within the meaning of



Section 2(9) of the Act on the ground that such construction is not incidental or preliminary to or connected with the work of the factory will be against the object of the Act. In an enactment of this nature, the endeavour of the court should be to interpret the provisions liberally in favour of the persons for whose benefit the enactment has been made. "

21. In ***Sushilaben Indravadan Gandhi and another Vs. New India Assurance Company Limited and others*** reported in (2021) 7 SCC 151, the Apex Court has considered the employer-employee relationship and narrated the various tests adopted by the Apex Court under various circumstances and after considering the judgments of

1. ***Dharangadhra Chemical Works Ltd. Vs. State of Saurashtra*** cited supra
2. ***Chintaman Rao Vs. State of M.P. [AIR 1958 SC 388]***
3. ***Shankar Balaji Waje Vs. State of Maharashtra [AIR 1962 SC 517]***
4. ***Birdhichand Sharma Vs. Civil Judge*** cited supra,

has observed in paragraph 32 as follows:

"32. A conspectus of all the aforesaid judgments would show that in a society which has moved away from being a simple agrarian society to a complex modern society in the computer age, the earlier simple test of control, whether or not actually



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exercised, has now yielded more complex tests in order to decide complex matters which would have factors both for and against the contract being a contract of service as against a contract for service. The early “control of the employer” test in the sense of controlling not just the work that is given but the manner in which it is to be done obviously breaks down when it comes to professionals who may be employed. A variety of cases come in between cases which are crystal clear — for example, a master in a school who is employed like other employees of the school and who gives music lessons as part of his employment, as against an independent professional piano player who gives music lessons to persons who visit her premises. Equally, a variety of cases arise between a ship's master, a chauffeur and a staff reporter, as against a ship's pilot, a taxi driver and a contributor to a newspaper, in order to determine whether the person employed could be said to be an employee or an independent professional. The control test, after moving away from actual control of when and how work is to be performed to the right to exercise control, is one in a series of factors which may lead to an answer on the facts of a case slotting such case either as a contract of service or a contract for service. The test as to whether the person employed is integrated into the employer's business or is a mere accessory thereof is another important test in order to determine on which side of the line the contract falls. The three-tier test laid down by some of the English judgments, namely, whether wage or other



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remuneration is paid by the employer; whether there is a sufficient degree of control by the employer and other factors would be a test elastic enough to apply to a large variety of cases. The test of who owns the assets with which the work is to be done and/or who ultimately makes a profit or a loss so that one may determine whether a business is being run for the employer or on one's own account, is another important test when it comes to work to be performed by independent contractors as against piece-rated labourers. Also, the economic reality test laid down by the US decisions and the test of whether the employer has economic control over the workers' subsistence, skill and continued employment can also be applied when it comes to whether a particular worker works for himself or for his employer. The test laid down by the Privy Council in Lee Ting Sang v. Chung Chi-keung [Lee Ting Sang v. Chung Chi-keung, (1990) 2 AC 374 (PC)] , namely, is the person who has engaged himself to perform services performing them as a person in business on his own account, is also an important test, this time from the point of view of the person employed, in order to arrive at the correct solution. No one test of universal application can ever yield the correct result. It is a conglomerate of all applicable tests taken on the totality of the fact situation in a given case that would ultimately yield, particularly in a complex hybrid situation, whether the contract to be construed is a contract of service or a contract for service. Depending on the fact situation of each case,



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all the aforesaid factors would not necessarily be relevant, or, if relevant, be given the same weight. Ultimately, the Court can only perform a balancing act weighing all relevant factors which point in one direction as against those which point in the opposite direction to arrive at the correct conclusion on the facts of each case."

The above recent judgment of the Apex Court provides various tests to be followed including three tier test laid down by some english judgments.

22. As stated in the earlier paragraphs, Section 40 and 41 of the ESI Act is applicable to the Establishment herein and the conversion work claimed by the Establishment is treated as manufacturing activity. There is no evidence to show that there is separate contract entered between the appellant and the four other Establishments and those employees who were working under the four Establishments, are not doing any work either incidental or in connection with the Establishment herein. Admittedly, no document or agreement was produced by the Establishment to show that they have entered into a separate contract for doing conversion work. In the absence of such documents, the persons involved in the manufacturing activities of the Establishment shall be considered that they have been



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directly engaged by the Establishment herein. Hence, their contention that those employees are not being engaged by the Establishment herein is rejected.

23. As discussed in the earlier paragraphs, even though it is a repetition, I reiterate once again that the evidence placed on record only shows that those employees are involved in manufacturing activities for the Establishment herein and have been controlled through their immediate employers and charges have been paid to them under the caption “conversion charges”. Accordingly, those employees fall within the definition of 'employee' under Section 2(9)(i) of the ESI Act, since they have been engaged directly by the Establishment herein. The Establishment has failed to prove their case that they are not liable to pay contribution under Section 40 of the ESI Act. Since the manufacturing activity is carried on for the Establishment herein, they are liable to pay contribution to the employees. Therefore, this Court is of the view that these employees are covered under the definition of Section 2(9) of the ESI Act and the conversion charges paid is only wages paid to the employees. Since the Establishment claims that they have engaged immediate employer and they are bound to pay contributions under Section 40 of the ESI Act, if there is an



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immediate employer, the Establishment can very well recover the same from the immediate employer.

24. In the result, the Civil Miscellaneous Appeal is dismissed and the order passed by the learned Judge, Principal Labour Court, (Employees' Insurance Court), Chennai in E.I.O.P.No.95 of 2008 dated 16.08.2017 stands confirmed. There shall be no order as to costs. Consequently, connected miscellaneous petition stands closed.

22.07.2024

Index : Yes / No
Speaking Order : Yes / No
Neutral Citation : Yes / No
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To
1.The Principal Labour Court,
Employees' Insurance Court,
Chennai.

2.The Section Officer,
V.R. Section,
High Court, Chennai.



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K.RAJASEKAR,J.

Lm

Pre-Delivery Judgment made in
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