
(1969) 02 AHC CK 0003
In the Allahabad High Court
Case No : Sales Tax Reference No. 268 of 1966

Commissioner, Sales Tax

APPELLANT

Vs

Noorullah Ghazanffurullah

RESPONDENT

Date of Decision : 10-02-1969

Acts Referred:

Uttar Pradesh Sales Tax Act, 1948 — Section 11(3)

Citation : (1970) 26 STC 100

Hon'ble Judges : R.S. Pathak, J; R.L. Gulati, J

Bench : Division Bench

Advocate : P.N. Pachauri, for the Respondent

Judgement

R.L. Gulati, J.—At the instance of the Commissioner of Sales Tax, Uttar Pradesh, the Additional Revising Authority, Sales Tax, Varanasi Range, Varanasi, has submitted this reference u/s 11 (3) of the U.P. Sales Tax Act for the opinion of this court on the following question of law :

Whether upon the facts and in the circumstances of the case, the disputed item was a pure works contract and, therefore, non-taxable ; or whether it amounted to supply and sale of railway coaches by the assessee to the railway authorities and, therefore, taxable ?

2. The assessee, M/s. Noorullah Ghazanffurullah is a firm of contractors which carries on business at Allahabad. In the assessment year 1958-59, the assessee executed a contract of building railway coaches for the North Eastern Railway on the underframes supplied by the railway. The coaches were to be built according to the specifications and drawings annexed to the agreement on a siding within the railway yard for which the assessee had to pay a nominal rent of Re. 1 per month. The assessee was required to build altogether 14 coaches-eight first-third class coaches and 6 janata tourist cars. The assessee was to receive payment at the rate of Rs. 62,300 for each first-third class coach plus a sum of Rs. 800 for fixing dynamo, suspension, gear etc. and Rs. 57,900 for each C.T.T. coach plus

Rs. 800 for fixing dynamo, suspension, gear etc. This was inclusive of the cost of all materials and labour charges for building, furnishing, finishing and polishing. The contract was to be completed within a stipulated time.

3. In the assessment year in question, the assessee received a total payment of Rs. 5,87,265 upon which the Sales Tax Officer levied sales tax at the rate of 3 pies per rupee rejecting the assessee's plea that no sales tax was payable as the payment pertained to a contract of work and labour not involving any sale of goods. The assessee appealed to the Judge (Appeals) but did not succeed. The appellate authority also held the amount in question to be liable to sales tax. The assessee then applied in revision to the Judge (Revisions) who accepted the assessee's plea and held that the contract executed by the assessee did not involve sale of goods but was purely a works contract. The revising authority relied upon the decision of this court in *Kays Construction Company Vs. The Judge (Appeals) Sales Tax and Another*, . That was also a case of a contract of building, of railway coaches for the Northern Railway. The revising authority found that the agreements in the two cases were worded identical. In fact the revising authority found that originally it was one contract a part of which was executed by Kays Construction Co. and the other part was executed by the assessee. In *Kays Construction Co. [1962] 13 S.T.C. 302*, this court held the contract to be of works relying upon two decisions of the Supreme Court in the *State of Madras v. Gannon Dunkerley & Co. (Madras) Ltd. [1998] 9 S.T.C. 353* and in *Carl Still G.m.b.H. v. State of Bihar and Ors. [1961] 12 S.T.C. 449*.

4. The instant case is completely covered by the decision of this court in *Kays Construction Co. [1962] 13 S.T.C. 302*. But the learned standing counsel contends that the case of *Kays Construction Co. [1962] 13 S.T.C. 302* is not correctly decided. For this submission, he has relied upon the decision of the Supreme Court in *Patnaik and Company Vs. State of Orissa*, and a decision of this court in *Commissioner of Sales Tax, U.P. v. Haji Abdul Majid and Sons [1963] 14 S.T.C. 435* which has been approved by the Supreme Court in the case of *Patnaik and Company Vs. State of Orissa*, . In the case of *Patnaik and Company Vs. State of Orissa*, , the contract was for building bus bodies on chassis supplied by the Government of Orissa. On a consideration of the terms of the contract, the Supreme Court by a majority of two to one held the contract to be a contract of sale of bus bodies and not a contract of work or service. In that case the Supreme Court observed that the answer to the question must depend on a consideration of the contract and the real intention of the parties, which must be gathered by looking at the contract as a whole. Their Lordships then set out extensively the various terms of the contract and after analysing them, expressed the opinion that the contract was a contract for sale of completed bodies. The main reason behind this conclusion of the Supreme Court is contained in paragraph 18 of the judgment of Sikri, J., who delivered the majority judgment and the same may, with advantage, be reproduced :

The next point to be noticed is that under the contract the property in the bus

body does not pass to the Government till the chassis with the bus body is delivered at the destination or destinations to be named by the controller except in the case contemplated in Clause 6 of the agreement. That clause provides that if some work is not satisfactorily done and the body builder on receipt of a written order does not dismantle or replace such defective work or material at his own cost within seven days, the controller would be entitled to get the balance of the work done by another agency and recover the difference in cost from the body builder. The controller is entitled for this purpose to take delivery of the unfinished body. But even in this case the property in the unfinished body would not pass to the Government till the unfinished body is seized.

5. The case of Haji Abdul Majid [1963] 14 S.T.C. 435 is also a case relating to the contract of building bus bodies and there also this court after taking into consideration the terms of the contract held the contract to be a contract of sale of bodies.

6. The learned counsel for the assessee, on the other hand, has placed reliance upon a more recent decision of the Supreme Court in State of Gujarat Vs. Kailash Engineering Co., . That was also a case dealing with the contract of building railway coaches. In that case the Supreme Court after considering a large number of clauses of the contract came to the conclusion that the contract was a works contract involving building, erecting and furnishing of railway coaches on the underframes belonging to the railways. The main consideration which prevailed with their Lordships was that the property in the finished coaches passed to the railway administration automatically without any transfer on the part of the contractor. In fact, their Lordships came to the conclusion that the property in the coaches never vested in the assessee at all and continued to vest in the railway even when the coaches were in the process of manufacture. The case of Patnaik and Company Vs. State of Orissa, was distinguished by their Lordships on the ground that in that case the property in the bus bodies remained vested in the assessee at all stages until it passed to the Government after paying the price thereof to the contractor.

7. Whether the contract in the instant case is a contract of works or a contract of sale of goods, would depend upon the intention of the parties to be gathered from the terms of the contract. After having a close look at the contract I am of the opinion that the same is more akin to the contract in the case of State of Gujarat Vs. Kailash Engineering Co., .

8. To begin with, I might reproduce the preamble of the agreement:

Whereas the contractors have agreed to build for the North Eastern Railway 8 bogies first and third class coaches and 6 bogies janata tourist cars, in accordance with the specifications and drawings annexed hereto and marked as annexure A on IRS underframes to be supplied by the railways and the railways have agreed to give the work to the contractors on terms and conditions hereinafter mentioned and accepted by both the parties.

9. It is significant to note that the contract of building coaches has been described as work and does not mention or envisage any contract of sale of coaches. The amount payable in respect of each coach as mentioned in Clause 3 of the agreement shows that it is a lump sum amount for the entire work involving the cost of material, cost of construction, fittings, erection and polishing etc. There occurs in that clause the following paragraph which, to my mind, is material:

If after the date of submission of the tender, the Central or State Government imposes any sales tax on finished coaches (as distinct from the sales tax on its component parts) the said tax on finished coaches will be the responsibility of the railway. The sales tax actually payable at the time of the tender, i.e. on 18th December, 1956, will be the responsibility of the contractors and the railway will not be responsible to refund it to the contractors.

10. This recital shows that according to the understanding of the parties no sales tax was leviable on the finished coaches presumably because the contract did not involve the sale of coaches. The provision that if, after the date of the contract, sales tax on finished coaches came to be levied, the same would be paid by the railway and not by the assessee, shows that the property in the coaches vested automatically in the railway and not as a result of any sale ; otherwise there appears to be no rational reason why the railway should have undertaken to accept the liability for sales tax which falls primarily upon the seller under the provisions of the Sales Tax Act.

11. Clause 4 contains another significant provision. It provides that "when the progress of work on any coach exceeds 50 per cent, or 75 per cent., an "on account" payment will be made on the completion of each coach." This condition shows that the property in the coaches was to vest in the railway even while they were in the process of being built, otherwise there is no reason why the railway should have agreed to make payments to the contractor in respect of the unfinished coaches. Then there is Clause No. 5 under which the Chief Mechanical Engineer of the railway has a right to vary or alter the specifications at any time and the contractor would be bound to carry out the order of the Chief Mechanical Engineer. If the variation or alteration entailed more expenditure on the part of the contractor, the Chief Mechanical Engineer was to sanction payment of such additional expenditure on application of the contractor as he might determine in his sole discretion. Likewise if the alteration involved reduction in expenditure, the Chief Mechanical Engineer in his discretion would reduce the amount payable to the contractor under the agreement. A term like this, in my opinion, would be inconsistent with a contract of sale and would be more apposite in a contract of works. Clause 11 is another significant clause which provides that the contractor shall indemnify the railway against damage deterioration, loss or destruction of the railway property entrusted to the contractor or used by him under the contract, while such property remained in his charge. This shows that the property in all the materials employed in the execution of the contract whether

supplied by the railway or procured by the assessee was to vest at all times in the railway. The same clause goes on to say that the contractor shall be responsible for claims which may be made by his employees under the labour laws like the Workmen's Compensation Act and the Payment of Wages Act or Factories Act etc. These clauses, in my opinion, are not consistent with a contract of sale. Had it been a contract of sale, there was no occasion for the provisions like these under which the contractor has been made responsible for the claims of his employees. The railway really would have nothing to do with the contractor's workmen. Then there is a clause under which the Chief Mechanical Engineer can suspend the work for such period as he thinks fit. In a contract of sale a provision like this would be entirely out of place. Clause No. 12 relates to the determination of the contract. It provides that the contract would be liable to determination if the contractor becomes bankrupt or insolvent or suspends payment or compounds with its creditors. A provision like this is consistent only with a contract of work and of service and is wholly irrelevant to a contract of sale under which the railway would be unconcerned with the contractor's bankruptcy or insolvency.

12. After having considered the terms of the contract in the instant case I might as well state the general principle involved in such cases which is now well settled. The principle is that, "in order that there should be a sale of goods which is liable to sales tax as part of a contract for work under a statute enacted by the Provincial or State Legislature, there must be a contract in which there is not merely transfer of title to goods as an incident of the contract, but there must be a contract, express or implied, for sale of the very goods which the parties intended should be sold for a money consideration, i.e., there must be in the contract for work an independent term for sale of goods by one party to the other for a money consideration" : (see *Government of Andhra Pradesh v. Guntur Tobaccos Ltd.* [1965] 16 S.T.C. 240. The same principle has been restated by the Supreme Court in *Commissioner of Sales Tax, M.P., Indore v. M.P. Electricity Board, Jabalpur* Since reported at [1970] 25 S.T.C. 188, (C.A. Nos. 1153 to 1168 of 1968) decided on 26th November, 1968, in the following terms :

A contract of sale is a contract whose main object is the transfer of the property in and the delivery of possession of, a chattel as a chattel to the buyer. Where the main object of work undertaken by the payee of the price is not the transfer of a chattel qua chattel, the contract is one for work and labour.

13. In the instant case, it is not the case of the department that there was a contract of sale between the parties of the material utilised in the construction of the railway coaches. Sales tax has been levied upon the entire payment received by the assessee for building coaches as if there was a contract of sale of coaches as such. It is also well settled that in a case like this the burden lies upon the taxing authorities to show that there was taxable sale and that burden is not discharged by merely showing that the property in the goods which belonged to the party performing service or executing contract stood transferred to the other

party. In the case before us, that burden has not been discharged by the taxing authorities. No material has been placed before us to show that the assessee had entered into a contract, of sale of coaches to the railway. Indeed such a contract would be most unusual. While it may be possible to infer such a contract with regard to bus bodies, it is not possible in the absence of express terms in the contract to infer such a contract in regard to the building of railway coaches. Railway coaches are not sold in the market nor it is usual to come across persons dealing in the construction and sale of railway coaches.

14. I am, therefore, of the opinion that having regard to the terms of the contract and other attendant circumstances, the contract entered by the assessee was a contract of work and labour not involving any sale of goods.

15. The case of *Government of Madras v. Simpson & Co. Ltd.* [1968] 21 S.T.C. 21, another recent case decided by the Supreme Court need not detain us long. That was a case where a dealer in motor-cars, motor parts and accessories fitted Perkins engines to the vehicles of the customers. The bill that he made specified separately the cost of the supply and fitting of Perkins engines. On these facts the Supreme Court held that the transaction involved the sale of diesel engines even though the same had been fitted by the assessee to the cars of his customers. This case is clearly distinguishable.

16. I, therefore, answer the question by saying that the disputed item was a pure works contract not liable to sales tax.

17. The assessee is entitled to his costs which I assess at Rs. 100. The fee of the learned counsel for the department is also assessed at the same figure.

R.S. Pathak, J.

18. I agree that the contract before us does not envisage the sale of coaches by the assessee to the railway. We are here concerned with what is essentially a works contract. I would answer the question referred accordingly.

19. The cases on the point have been discussed by my brother Gulati, J., but I may mention the reasons which have prevailed with me.

20. The contract between the assessee and the North Eastern Railway required the assessee to build railway coaches. The underframes were to be supplied by the railway and on those underframes the assessee was to do "the entire job of body construction including painting etc." This is not a case where what is supplied by the assessee is a composite unit distinct from the underframes. There is in the contract before us reference to a completed coach only and it is a completed coach which the assessee delivers to the railway. Significantly, the underframes remain throughout the property of the railway. The contract provides that when underframes are supplied to the assessee they will be supplied only after the assessee executes an indemnity bond for their safe custody. The property in the underframes does not pass to the assessee and it cannot be said, therefore, that when the assessee completes the coach what it

delivers to the railway is an article in which it held the entire property. What it delivers to the railway is a coach, an essential part of which has always been railway property. It cannot, therefore, be said to sell the coach to the railway.

21. Then, there is the stipulation that the contracted amount paid to the assessee for constructing the coaches will not, except in the case of war, be increased on account of the increase in the price of materials or wages of labour. Clearly, the contract does not take into account the price of materials only which go into the completion of the coach but additionally mentions the wages of labour as a distinct factor of reference.

22. Some of the other terms of the contract afford further indication that this is a works contract. The solvency of the assessee throughout the period of execution of the contract has been considered as a material factor and the contract can be determined if the assessee becomes bankrupt or insolvent or goes into liquidation. Such a term is unusual where the contract is merely for the sale of goods. It assumes greater relevance in a works contract where the continued capacity of the contractor while executing the contract is an important consideration. The manner in which the contract is executed is a matter which the railway is entitled to take into account. The contract may be determined if in the opinion of the Chief Mechanical Engineer the assessee becomes unable to execute the contract with efficiency or at a rate of progress so slow that it will be unable to complete the work in time. Ordinarily, if it were a contract for the sale of goods, the date of delivery of the goods is alone relevant and not the efficiency or rate of progress shown during the execution of the work. Where the contract is determined in such circumstances the railway is entitled to entrust its completion to and get the work done by, another at the risk and expense of the assessee or itself employ labour and supervise the work at the expense of the assessee and supply materials necessary for completing the work or any part of it and debit the assessee with the cost of labour and the price of materials so used.

23. Throughout, the contract speaks of the execution and completion of work under it. There is specific reference in it to the quality of the work, where it will be carried out, how executed and to what degree it will afford the basis of interim payments to the assessee. When the railway decides to rescind the contract on account of a default by the assessee while executing it, the contract provides for measuring up the work of the assessee completed so far before entrusting the unexecuted part of the work to another agency for completion.

24. When all these considerations are taken into account cumulatively, it seems to me that the contract before us is certainly not a contract for the sale of goods. If anything, it is a works contract.

25. It may be that there is a sale of goods to the extent that the assessee supplies dynamo, suspension, gear etc. because the contract separately refers to a payment of Rs. 800 for dynamo, suspension, gear etc. per coach, but the

revenue has made no attempt at any stage to disassociate this clause in the contract from the remaining part of it and has pressed its case on the basis that the entire contract is one for the sale of whole coach. It is, therefore", not necessary to enter into that question here.

26. The assessee is entitled to its costs-which I would assess at Rs. 100. Counsel's fee is assessed in the same figure.

By the Court

27. We answer the question referred to this court as follows :-

The sum of Rs. 5,87,265 does not represent the turnover of sale of railway coaches by the assessee to the railway authorities but is an amount received by the assessee under a works contract and is not taxable.

28. The assessee is entitled to its costs which we assess at Rs. 100. Counsel's fee is assessed in the same figure.