
(1983) 12 SC CK 0017
In the Supreme Court Of India
Case No : Civil Appeal No. 1658 of 1982

Hindustan Aeronautics Limited	Vs	APPELLANT
State of Orissa		RESPONDENT

Date of Decision : 16-12-1983

Acts Referred:

Central Sales Tax (Orissa) Rules, 1957 — Rule 12(3)
Central Sales Tax Act, 1956 — Section 7(1)

Citation : AIR 1984 SC 753 : (1984) 1 CompLJ 150 : (1983) 2 SCALE 1101 : (1984) 2 SCC 16 : (1984) 2 SCR 267 : (1984) 55 STC 327 : (1984) 16 UJ 818

Hon'ble Judges : V. D. Tulzapurkar, J;Sabyasachi Mukherjee, J;R. S. Pathak, J

Bench : Full Bench

Advocate : S.T. Desai, Y.S. Murthy and C.S.S. Rao, for the Appellant; V.S. Desai and R.K. Mehta, for the Respondent

Final Decision : allowed

Judgement

Sabyasachi Mukharji, J.—This is an appeal by special leave from the order dated 31st December, 1981 passed by the Sales Tax Tribunal, Orissa. The appellant who was the assessee under the Central Sales Tax Act, 1956 went up in appeal against the confirming orders of Assistant Commissioner in respect of the assessment years 1974-75, 1975-76 and 1976-77. The Sales Tax Officer, Koraput 1 Circle, Jeypore had made the orders under Rule 12(3) of the Central Sales Tax (Orissa) Rules, 1957 making demands of Rs. 1,21,38,586.00 for the year 1974-75, Rs. 1,29,64,637.00 for the year 1975-76 and Rs. 1,37,72,652.00 for the year 1976-77. The appellant is a dealer registered u/s 7(1) of the Central Sales Tax Act, 1956 under Koraput I Circle in the State of Orissa.

2. M/s. Hindustan Aeronautics Limited (hereinafter referred to as 'H.A.L.') of which appellant is a division was established on 1st October, 1964. The objective of formation of the H.A.L. was to carry on in India and elsewhere, the business, inter alia, in aeroplanes including manufacture, assembling, buying and selling etc. of the same. In its division at Sunabeda, manufacture of MIG engines for

MIG aircrafts required for-defence and overhauling of aero engines of Indian Air Force were undertaken. Some of the MIG engines manufactured by it were sent to Nasik Division of H.A.L. and some to Indian Air Force as per instructions from the Ministry of Defence. The appellant received payments from Government of India or Indian Air Force for the manufacturing programme. In respect of payments so received, the Sales Tax Officer, Koraput I Circle levied Central Sales Tax on the ground that the transactions were interstate sales. This was disputed by the appellant according to whom the latter was only an agent of the Government of India. In the alternative it was contended that the transactions were nothing but works contract and as such not exigible to Central Sales Tax.

3. Being aggrieved by the decision of the Tax Authorities as mentioned hereinbefore, the appellant had gone up in appeal before the Tribunal. The Tax Authorities had negatived both the contentions of the appellant. As common question of law on similar facts was raised, the same was disposed of by one order by the Tribunal. Before the Tribunal, only one ground namely, that the transaction represented works contract was urged.

4. It is necessary at this stage to understand the background in which the manufacture of MIG engines were undertaken by H.A.L. In this connection it is material to refer to the letter dated 22nd September, 1970 to the Chairman of the appellant company for and on behalf of the President of India by the Joint Secretary to the Government of India, Ministry of Defence, Department of Defence Production. As the said letter is important, it is necessary to set out the letter :

Secret Annexure "A" EXTRACT OF No. 11(228)/69/1/DP/Contracts Government of India, Ministry of Defence, Department of Defence Production, New Delhi. the 22nd September, 1970. The Chairman, Hindustan Aeronautics Ltd., Indian Express Building, Vidhana Veedhi, Bangalore-1 Sub : -Manufacture of MIG-21 M Aircraft and other equipment in India. Dear Sir,

On behalf of the President of India, I have to state that an Agreement was signed on 30th October, 1969 (copy already forwarded to you) between the Government of India and the Government of Union of Soviet Socialist Republics for the manufacture under licence.

2. The manufacture of the said Equipment as defined in the above said Agreement is hereby entrusted to Hindustan Aeronautics Limited, Bangalore in terms of the said Agreement. Under this entrustment the responsibility for the proper implementation of the Agreement shall be exclusively that of Hindustan Aeronautics Limited except that the Government may from time to time advise the Company about the programme of manufacture of the said Equipment.

3. All payments falling due under the said Agreement to the Government of the Union of Soviet Socialist Republics shall be made by Hindustan Aeronautics Limited, Bangalore on behalf of the Government.

4. This entrustment shall remain in force till it is revoked or altered by the President of India.

5. The Government of the Union of Soviet Socialist Republics is being informed of this entrustment and they are being requested to cooperate and deal directly with Hindustan Aeronautics Limited, and do all things necessary for the effective operation of the said Agreement according to the terms thereof.

5. There was another letter regarding the determination of premium under Emergency Risks (Goods) Insurance Act, 1962. The said letter on behalf of the Government of India stated, *inter alia*, as follows :

That the materials imported by H.A.L. for manufacture/assembly of Aircraft/Engines/Helicopter/other equipment and also goods, stocks and stores work-in-progress etc. for which 'on account' payments have been made and are being made by DCDA(AF) are the property of I.A.F. and that the items manufactured out of the categories of materials stated above are to be supplied only to the Indian Air Force or as authorised by Government of India. The materials therefore belong to the Government of India.

6. It may be mentioned as appearing from the order of the Sales Tax Tribunal that there was an agreement between Government of U.S.S.R. and the Government of India on 29th August, 1962 whereby Government of U.S.S.R. had granted a licence to the Government of India for manufacture of special equipment and assembling of aircrafts. Thereafter both the Governments signed a protocol on 29th September, 1964 in the matter of manufacturing of MIG aircrafts in India. Government of India in their turn by the secret letter dated 22nd September, 1970 mentioned herein before entrusted the manufacture of the said aircrafts to H.A.L., Bangalore. In pursuance of the said entrustment, H.A.L. undertook the work of assembling and manufacturing of MIG engines. For the implementation of the entrustment H.A.L. has three divisions namely Koraput (in the State of Orissa), Nasik (in the State of Maharashtra) and Hyderabad (in the State of Andhra Pradesh). At Koraput and Hyderabad, engines which are electronic equipments were respectively manufactured and the MIG aircrafts were finally assembled at Nasik for delivery to the Government of India.

7. In this background, the question that arose before the Tribunal was whether the contract between the Union of India and the appellant for manufacture and supply of MIG engines was a contract of sale as contended by the Revenue or a works contract as submitted by the assesses. There is no consolidated document on record to show the terms of contract between the Union of India and the appellant. Both sides for this purpose relied upon some correspondence and invoices which are on record. Mention in this connection may be made to a communication which is in the form of a corrigendum to the Ministry's letter regarding 'on account' payments to H.A.L. for MIG Aircrafts, the letter dated 28th July, 1970 from the Under Secretary to the Government of India, Ministry of Defence, to the Chief Accounts Officer, High Commission for India in U.K. and the

Chief Accounts Officer, Embassy of India in Washington on the subject of "Procurement of bought out items against the requirements of I.A.F. for 1st and 2nd line servicing", which dealt with the procedure sanctioned by the Government of India for the purpose of "avoiding two customers viz. Hindustan Aeronautics Limited and the Indian Air Force going to the same supplier abroad for the same items", the letter dated 20th December, 1971, from the Under Secretary to the Government of India, Raksha Mantralaya, Raksha Utpadan Vibhag, written to the General Manager of the Nasik Division of the appellant, the letter of 28th April, 1969 on the subject of "On Account" payments to H.A.L. for I.A.F. manufacturing programmes of H.A.L. Nasik, Koraput and Hyderabad", letter dated 8th December, 1972 from Under Secretary to the Government of India, Ministry of Defence on "pricing of H.A.L. manufactured aircraft and margin profit etc." and the invoice dated 19th March, 1976.

8. Reliance was also placed on behalf of the Revenue before us, on the order of the Assistant Commissioner of Sales Tax for the assessment years 1974-75 and 1975-76, wherein he had referred to a statement furnished with a copy of the claim against price proposal for 6 F2S details engines as accepted by the Government by their letter dated 4th June, 1976. That claim is against price proposal for 6 F2S details engines accepted by the Government. Their break up is as follows :-

Imported materials.	Rs. 48,39,454.08	Indigenous material and MCH-Freight etc.	
	Rs. 2,64,925.79		Total material cost Rs. 51,04,579.27
Labour cost	Rs. 7,96,480.60	Sundry direct charges	Rs. 12,87,865.89
			Total Rs. 56,58,724.36
		Profit @ 15% on HAL's effort	Rs. 2,47,809.00
			Rs. 69,06,533.36 or Rs. 69,06,533.00

The Break up of HAL's effort also indicated as follows:- "Freight Rs. 66,320.41
Material Overhead Rs. 1,03,067.55 Ind. materials Rs. 96,536.03
Rs. 2,64,925.79 Labour cost Rs. 2,96,480.00 Training cost
& other expenses Rs. 6,000.00 Tooling expenditure Rs. 1,50,000.00 Last test
expenses Rs. 8,34,342.65 Insurance freight Rs. 1,00,347.67
Total HAL's effort Rs. 16,52,096.71 15% profit on HAL's
effort Rs. 2,47,814.00"

9. The Assistant Commissioner had observed that after the engines were despatched to Nasik Division to be fitted in the Aircrafts, the bill used to be drawn by H.A.L. and the debit was raised against the Government of India. After sanction of the price, the payment was made. The Assistant Commissioner had further observed that it appeared from this letter that six MIG engines were delivered by H.A.L. to I.A.F., the cost of which was Rs. 69,06,530.00. He had further observed that it was significant to note that the sanction had been accorded for payment towards the cost of 6 engines delivered to I.A.F. According to the Assistant Commissioner, the argument advanced on behalf of the assessee that the delivery was made to Nasik Division which was a branch of H.A.L. appeared to be inconsistent with the sanction order. He had further observed that MIG engines were delivered to Nasik Division whereas the invoice was raised and payment received from the Government of India. The

purpose of giving physical delivery, according to the Assistant Commissioner, of the MIG engines to Nasik Division was for the purpose of fitting in the Aircrafts. In that event, according to the Assistant Commissioner, Nasik Division became the custodian or the trustees of the MIG engines for which the price had already been paid to H.A.L. The Assistant Commissioner concluded that the property in the engines passed to the Government of India and not to H.A.L., Nasik Division. He had further observed that the break up of the cost was towards the material cost, labour cost and sundry direct charges. The total cost came to Rs. 68,58,724.36. The further break up of the total cost of Rs. 68,58,724.36 was imported materials, indigenous material and MCH freight etc., labour cost and sundry direct charges. Apparently the cost of the material both imported as well as procured locally had been charged in the bill. According to the Assistant Commissioner, further profit of 15% had been charged on H.A.L.'s effort which included freight, material overhead, indigenous material, labour cost, training cost and other expenses, tooling expenditure, last test expenses, insurance and freight. The total cost of these items as per the bill stood at Rs. 16,52,096.71. 15 % of this had been charged towards the profit. The Assistant Commissioner had further observed that profit was charged as in a commercial transaction in case of sale. Commission was allowed in case of agency transaction between the Principal and the Agent. But in the supply of MIG engines, a profit had been charged. The Assistant Commissioner concluded that this gave a clear indication that this was a case of transaction of sale and not of agency. We are unable to accept this reasoning of the Assistant Commissioner. According to us the procedure indicated in the break up has to be understood in the background of the entire transaction between the parties. The pricing procedure had to be judged in the light of the entire facts and circumstances especially in the background that the entire transaction was entrusted to H.A.L. Bangalore in terms of the agreement between the Government of India and the Government of U.S.S.R. for the manufacture on behalf of the Government of India of MIG engines for which licences had been granted by the Government of U.S.S.R. to the Government of India. The letter dated 22nd September, 1970 set out hereinbefore indicated clearly that under the entrustment the responsibility for the proper implementation of the areement would be exclusively that of the appellant except that the Government might from time to time advise the Company about the programme of manufacture of the equipments. The various correspondence referred to hereinbefore, in our opinion, lead to the irresistible conclusion that the property in the aircrafts as well as in the equipments and spares used in them were always in the Government. These were procured for and on behalf of the Government of India in pursuance of the agreement with the Government of India and U.S.S.R. The entrustment of jobs on behalf of the Government and the incidental necessary works to be done in these connections had to be performed by the appellant. In this background, the pricing, the invoice the transactions have to be understood.

10. We have-referred to the several correspondence which, according to us,

indicate that the property in the aircrafts, in the equipments and the materials had always been with the Government. The materials imported under the licence or procured indigenously for the manufacture were always and had always remained the property of the Government. The appellant had no properly, in any part thereof, and had no right to dispose of or disposal ever these materials and spares. These had to be regulated by the procedure envisaged in the agreement between the parties. The test by which these transactions should be judged in deciding whether this was a works contract or a contract of sale of any part of the material has been emphasised in several decisions of this Court. Some of these principles have been reiterated in the decision of Hindustan Aeronautics Ltd. Vs. State of Karnataka, .

11. As emphasised by this Court, there is no rigid or inflexible rule applicable alike to all transactions which can indicate distinction between a contract for sale and a contract for work and labour. But the tests indicated in the several decisions of this Court merely focused on one or the other aspect of the transaction and afforded some guidance in determining the question, but basically and primarily, whether a particular contract was one of sale or for work and labour depended upon the main object of the parties in the circumstances of the transactions. In a contract for sale, the main object of the parties is to transfer property in and delivery of possession of a chattel as a chattel to the buyer. It has to be emphasised, taking into consideration the correspondence and circumstances under which this entrustment had to be understood that at no point of time before the delivery of MIG engines, H.A.L. was the owner of the property either in the equipment or in the spares or in the aircrafts and as such there could not have been transfer of any property from H.A.L. to the Government of India. The H.A.L. only performed the job entrusted to them for and on behalf of the Government and all incidental steps naturally entering into contract, procurement, payment of price and billing and invoices had to be done in that light. There was no transfer of property in the MIG Aero Engines by H.A.L. to the Government of India. The materials and equipments sent by the Government of U.S.S.R. and the MIG Aero Engines assembled by H.A.L. from such materials belonged to the Government of India at all material times. The appellant had no ownership in the materials which were all supplied by the Government of U.S.S.R. nor in the finished products and no question of sales tax on the impugned transaction could arise. Even on the indigenous materials procured or manufactured by the appellant in the process of fitting in and assembling, the appellant had no disposing power as the appellant was never the owner of these materials.

12. The payments required in the work of "manufacture of MIG-21M Aircrafts and other equipments in India" were to be made as indicated in the letter dated 22nd September, 1970 by the appellant on behalf of the "Government of India".

13. The entire correspondence and the nature of the instructions from time to time issued by the Government indicated that the function of H.A.L. was the

implementation of the said entrustment.

14. There cannot be any question, in our opinion, of any sales tax in respect of Aero-Engines transferred to the Nasik Division of H.A.L. for installing the same in Aircrafts. It was the transfer of the Aircrafts to the Nasik Division for the purpose of completion of the job and the making of the invoices was a matter of accounting and carrying out the job of entrustment. As had been emphasised by this Court, that the primary difference between a contract for work or service and a contract for sale of goods is that in the former there is in the person performing or rendering service no property in the thing produced as, a whole notwithstanding that a part or even the whole of material used by him may have been his property. In the case of a contract for sale, the thing produced as a whole has individual existence as the sole property of the party who produced it some time before delivery and the property therein passes only under the contract relating thereto to the other party for price. This cannot be said to be in respect of any of the items involved in these transactions. These transactions were carried out in implementation of the entrustment job for the manufacture by H.A.L. and all payments and actions taken in this behalf were on behalf of the Government of India.

15. We are therefore of the opinion that the Tribunal was in error in concluding that there was sale involved in these transactions. It is not necessary for us in this connection to refer to the principles in detail which the Court should accept in deciding in each particular case the nature of the transactions. These principles have been reiterated in the decision of this Court in the case of Hindustan Aeronautics Ltd. Vs. State of Karnataka, .

16. In the above view of the matter, the appeal is allowed, The assessments are set aside. Necessary adjustments and refund, if necessary, of the tax paid should be done accordingly. In the facts and circumstances, parties will bear their respective costs throughout.