
(1996) 12 AP CK 0040

In the Andhra Pradesh High Court

Case No : Tax Revision Case No's. 138, 139, 148, 149, 150 and 154 of 1989

Hindustan Shipyard Limited

APPELLANT

Vs

State of Andhra Pradesh

RESPONDENT

Date of Decision : 23-12-1996

Acts Referred:

Andhra Pradesh General Sales Tax Act, 1957 — Section 2

Citation : (1997) 106 STC 387

Hon'ble Judges : S.S. Mohammed Quadri, J;B.S. Raikote, J

Bench : Division Bench

Judgement

Syed Shah Mohammed Quadri, J.—M/s. Hindustan Shipyard Limited, Visakhapatnam, is the petitioner in these tax revision cases. As facts giving rise to these cases and contentions urged are common, we have heard them together and are disposing of by a common judgment.

2. The petitioner, under different contracts, delivers ships to various persons. It is the nature of the transaction which is the subject-matter of these contracts that is debated before us. The contention of the petitioner is that the nature of transaction covered by the contracts is one of the agreement to build the ship, in other words a works contract. Whereas the contention of the sale tax authorities is that the transaction was nothing but sale of goods. The assessing authorities levied the tax on those transaction treating them as agreements of sale of ships. The appellate authority - Deputy Commissioner dismissed the appeals. Not satisfied with the orders of the appellate authority - Deputy Commissioner, the petitioner filed appeals before the Sales Tax Appellate Tribunal. The Tribunal disposed of the appeals filed by the petitioner in respect of different assessment years following its own decision in T.A. No. 566 of 1985 and batch dated 19th July, 1989. In view of the said judgment and following the judgment of this Court in Hindustan Shipyard Ltd. v. Commercial Tax Officer (1970) 1 An WR 197, the Tribunal allowed certain appeals which, according to it, are covered by the ratio of the said judgment and dismissed certain other appeals holding that the said

judgment had no application having regard to the terms of the contract in those cases. Challenging the validity of the orders of the Tribunal, the abovesaid revisions are preferred by the petitioner.

3. Sri P. Ramachandra Reddy, the learned Senior Counsel appearing for the petitioner, submits that the only distinguishing feature relied upon by the Tribunal in dismissing the appeals is the risk and insurance clauses and that similar clause are found in the contract which is the subject-matter of the judgment of Division Bench in Hindustan Shipyard case (1970) 1 An WR 197, which also relates to the same petitioner for the assessment year 1967-68.

4. The learned Government Pleader on the other hand contends that the agreements which witness the transactions relating to these cases are entirely different from the transaction entered into by the petitioner in the year 1967-68 and that various clauses in the present agreements point out to the fact that the transactions are sale but not works contracts.

5. Essentially, the question raised relates to the interpretation of the "contract". It is settled law that the substance but not the form of the agreement is material in determining the nature of transaction. No definite rule can be formulated to determine the question as to whether a particular given contract is a contract for sale of goods or is a works contract.

6. It would be apt to read here the definitions which are relevant for our purpose. Section 2(n) of the Andhra Pradesh General Sales Tax Act, 1957, for short "the Act", read as under :

""Sale" with all its grammatical variations and cognate expressions means every transfer of the property in goods (whether as such goods or in any other form in pursuance of a contract or otherwise) by one person to another in the course of trade or business, for cash, or for deferred payment, or for any other valuable consideration or in the supply or distribution of goods by a society (including a co-operative society), club, firm or association to its members, but does not include a mortgage, hypothecation or pledge of, or a charge on goods."

For the purpose of sale under the Act, the transfer of property in the goods in sine qua non. The expression "will contract" is defined in section 2(t) of the Act as under.

""Works contract" includes any agreement for carrying out for cash or for deferred payment or for any other valuable consideration, the building construction manufacture, processing, fabrication, erection, installation, fitting out, improvement, modification, repair or commissioning of any movable or immovable property."

7. A perusal of this definition shows that it is inclusive definition and brings within its sweep the activity of carrying out building construction, manufacture, processing, fabrication, erection, installation, fitting out, improvement, modification, repair or commissioning of any movable or immovable property. It

is clear that for the purposes of works contract, the concept of passing of title is alien whereas that is the important ingredient of sale. We have already observed above that the question whether a transaction is a "sale" or "works contract", has to be determined with reference to relevant clauses of the agreement and this question of fact has to be determined with reference to the fact of each case. We think that the following examples will explain the difference between "sale" or "works contract". When we go to purchase a suit, there will be readymade suits, purchase of which would squarely fall within the meaning of "sale". But there can also be a case where the tailor manufactures a suit on what is called "made to measure". For that purpose, the purchaser has to select his own cloth, he may pay the price of the cloth then and there or the price of cloth may be paid later when the suit is made ready. At the time of delivery of the made to measure suit, the transaction fall within the meaning of the "sale", but when we go to a tailor's shop with our own cloth and get the suit stitched, the contract is one of "works contract". The distinction between second and third category appears to be fine but the distinction does exist. If this distinction is kept in mind, it would help us to discern as to under what category, the present transaction would fall.

This question has come for consideration of this Court as well as the Supreme Court.

8. In *State of Gujarat Vs. Kailash Engineering Co.*, the engineering concern constructed coaches over the chassis supplied by the Western Railways. The relevant provisions of the contract were : (a) on purchase of materials brought on the site where the coaches were to be constructed, the ownership in them would vest in the Railways; (b) the duty of the engineering concern was to construct, erect and furnish coach bodies on the underframes supplied to it. During the process of construction of the coach bodies, the unfinished bodies in the process of erection were treated as the property of the Railways and the unfinished bodies were to be in the charge of the engineering concern during construction and it was made liable to reimburse the Railways for any loss to the coaches by fire, etc. The coach bodies were not separately described as units or components to be supplied by the said concern to the Railways. The Supreme Court held that such terms of the contract indicated that the engineering concern was not the owner of the ready coaches and that the property in those coaches vested in the Railways even during the process of construction and that the transaction was clearly a works contract and did not involve any sale.

9. The principle laid down in the above decision was applied by the Division Bench of this Court in *Hindustan Shipyard Ltd. v. Commercial Tax Officer* (1970) 1 An WR 197 . In that case, the petitioner was described as builder and the person for whose benefits, the ships were built, was described as the owner. The petitioner was to build the ships according to the specifications given by the owner and the owner was entitled to depute his own supervisory staff and the builder was to act on their instructions. The delivery of the ships was to be made at any of the three ports at Bombay or Calcutta or any other port specified by

the owners. Any material utilised was the property of the owners from the date of first instalment amount. It was also stipulated that all parts should bear the marks of the owners and that they should become the property of the owners. The assessing authority treated the transaction as one of "sale", but the petitioner's contention is that it was "works contract" within the meaning of section 2(t) of the Act and therefore not liable to be taxed. The notice issued by the Commercial Tax Officer was challenged by the petitioner before the High Court invoking the jurisdiction under article 226 of the Constitution of India. Following the said judgment of the Supreme Court, in *State of Gujarat Vs. Kailash Engineering Co.*, the Bench held that whatn the builders had to do under the contract, was to complete the ship from out of the material belonging to the owners under their supervision according to their requirements. The building skill, the technical know-how and the manual labour were being supplied by the builders. The materials not used for the purposes of contract were to be reverted to and become property of the owner. The Bench further pointed out that the right which the builders had under the agreement over the property in the vessel and its engines, etc., further confirmed that the property in them vested in the owners. The agreement does not therefore deal with the sale of ships, but only with the construction and is therefore a "works contract".

10. In *Union of India (UOI) Vs. The Central India Machinery Manufacturing Company Ltd. and Others*, Central India Machinery Manufacturing Company Limited entered into a contract with Union of India through Railway Board for the manufacturing and supply of wagons to the Railways for a price which was fixed taking the wagon as a unit. The salient features in the contract were that as soon as the vehicle was completed, the company would get it examined by the Inspecting Officer and would submit to the purchaser "on account" bill for 90 per cent of the value of the vehicle and within 14 days of the receipt of such bill together with the certificate of the Inspecting Officer, the purchaser was to pay 90 per cent of the bill and on such payment the vehicle would become the property of the purchaser. The balance of 10 per cent was to paid after delivery of the vehicle. The Special Conditions of Contract, inter alia, provided that "on account" payment up to 90 per cent of the value of the steel and other materials procured by the company for the order, would be made against such materials on production of a certificate from the officer of the Inspection and Liaison Organisation and on furnishing the necessary indemnity bond to the paying authority. As the company was to be supplied with wheel sets and axle-boxes free of cost f.o.r. against a proper undertaking for their safe custody, the company was obliged to hold as trustee for Government "any raw materials for the execution of the contract" procured with the assistance of Government either by issue from Government stock or purchase under agreement made or permit or licence and to use such materials economically and solely for the purpose of the contract against which they were issued and not dispose of them without the permission of the Government "On accountant" payment was part of the "full contract price" for each completed wagon and that the Government had the pre-

emptive right to purchase all surplus or unserviceable materials from the company on its being paid such price as the Government might fix with due regard to the condition of the materials. It was also provided that when any State sales tax and inter-State sales tax on the stock or order become payable under law such payments would be reimbursed by the Railway Board and that it would not include sales tax on materials including steel or components. On those terms of the contract, the High Court of Gujarat took the view that the contract was a "works contract" being a contract for the manufacture and sale of wagons to the Union of India by the company. On appeal to the Supreme Court, it was held that the terms and conditions of the contract, read as a whole and indubitably, led to the conclusion that the property in the materials procured or purchased by the company against 90 per cent value which was taken as advance from the Railways, did not before their use in the construction of the wagons pass to the Railways. It was also held that with the exception of a relatively small proportion of the components supplied by the Railways, the entire wagon including the material at the time of its completion for delivery was the property of the company and that as the bulk of the materials used in the construction of the wagons belonged to the company, which sold the wagons for a price, the contract was a contract for the sale of wagons and not a works contract.

11. In a subsequent decision of this Court in *P.S. and Company Vs. State of Andhra Pradesh*, a similar question arose for consideration. There the petitioner was carrying on the business of the manufacturing and repair works of ships and ferries. It had entered into an agreement with the Government of India for construction and supply of harbour ferry. The contract provided that the construction was to be supervised and inspected by the Government representative. The ferry was to be delivered within 18 months from the date of the order to the consignee at Port Blair. The payment clause provide that the price should be paid in six instalments against bank guarantee. The ferry was to be delivered afloat at Visakhapatnam for provisional acceptance and at Port Blair for final acceptance with fully covered insurance at the instance of the builder. Any damage during the passage from Visakhapatnam to Port Blair was to be rectified by the builder though at an additional cost. The raw material required for the construction of the ferry could be purchased on the basis of the essentiality certificate issued by the Government. But the builder had an option to purchase the same from the open market. On those terms, it was held that under the contract, the builder was to complete the ferry from out of the material belonging to him and by his own men though under the supervision of the purchaser and also subject to the terminal payments to be made by the purchaser. The ferry as a whole had individual existence ready to be delivered and therefore on delivery the seller become entitled to the remaining payment of cost price and on such payment the transaction became complete. That process was a strong pointer in favour of the contract being one for sale and nothing else. It was held that the transaction was one of sale and not a works contract

for labour.

12. From the above discussion it follows that the terms of a given contract would be determinative of the nature of the transactions, whether it is a "sale" or a "works contract". Therefore the question whether the transaction is a "sale" or a "works contract" has to be ascertained on facts of each case on proper construction of terms and conditions of the agreement between the parties.

13. On the facts of the cases on hand the Tribunal, having considered the terms of the agreements, held that in the contracts in question the risk passes to the purchaser only on delivery and by the date of the delivery the ship would be in existence as such it would be a sale of property. The Tribunal also noted that the transfer of the ship by the petitioner was for price fixed and that the title in the ship did not vest with the purchaser till the delivery. The third feature highlighted by the Tribunal is that the bulk of the material used in the construction had to be procured by the manufacturer with its own costs and the purchaser has nothing to do with the procurement or escalation of costs or decrease in the costs of the material and that the materials were not purchased in the name of the purchaser but they were purchased in the name of the petitioner and were not earmarked for any particular ship except the engine. In view of the above features the Tribunal concluded that the cases did not fall within the ratio of the judgment in Hindustan Shipyard case (1970) 1 AN WR 197.

14. We shall now refer to the relevant terms of the contract in the present cases. In the contract, the petitioner is described as "the builder" and the person placing the contract was described as "owner". Article 2 which deals with the price, provides the method of payment as follows :

"(a) 5% of the contract price upon signing this contract.

(b) 10% of the contract price upon builder producing adequate documentary evidence to the owner confirming that the builder has placed order for main engine and steel requirement.

(c) 10% of the contract price upon keel laying of the vessel.

(d) 15% of the contract price upon builder submitting its certificate to the owner that 50% by weight of the steel of the vessel's hull has been erected (panels placed on berth).

(e) 15% of the contract price upon launching of the vessel.

(f) 10% of the contract price upon builder submitting its certificate to the owner that the main engine has been lowered in position on board the vessel.

(g) 15% of the contract price upon satisfactory completion of the dock trials.

(h) 20% of the contract price upon delivery of the vessel."

15. The builder was to submit the constructional drawings required to the Lloyd's Register of Shipping and after their approval, they will be submitted to the owner

for information. However, the owner had a right to suggest changes. If any major change or alternation was required by the owner, then mutual agreement will be arrived at in writing between them. The owner had also the right to appoint supervisory staff. Regarding delivery of the ship, it was provided that the owner shall fulfil its obligations for payment as stipulated in the contract and that the delivery of the vessel shall be effected forthwith upon acceptance thereof by the owner as provided thereunder.

16. Clause (1) of article 12 states that vessel shall become the property of the owner as soon as the first instalment of the price is paid and shall continue to be so until it is handed over and that to safeguard the interest of the owner, the builder has to keep the vessel insured against all risks including builders' risk, war risks, etc., for the amount equal to the cost incurred by the builder on the construction of the vessel at any point of time subject to the condition that the amount shall not be less than the total price instalments paid by the owner. In our view in this clause the words "shall become the property of the owner" are used in a limited sense so as to prevent the builder from dealing with in any other manner.

17. Article 7 may also be reads here :

"Title and risk. - Title and risk of the vessel shall pass to the owner upon acceptance when delivery of the vessel is effected, as stated above, it being expressly understood that, until such delivery is effected, the vessel and equipment thereof is at the entire risk of the builder, including, but not limited to, risks of war, insurrection and seizure by Government or authorities, whether Indian or foreign, and whether at war or at peace."

Article 7 which deals with the title and risk, provides that the title and risk of the vessel shall pass to the owner upon acceptance when delivery of the vessel is effected as provided in the contract. The clause further provides that it being expressly understood that, until such delivery is effected, the vessel and equipment thereof, is at the entire risk of the builder, including, but not limited so, risks of war, insurrection and seizure by Government or authorities, whether Indian or foreign and whether at war or at peace.

18. One more clause needs consideration and that deals with property in the vessel as under :

"Article 15 : Property in the vessel. - Without prejudice to article 17 hereof, the vessel as constructed and her engines, boilers and machinery and all materials from time to time intended for her or appropriated to the contract whether in the building berth, fitting out basin, workshop or elsewhere shall immediately after payment of the first instalment on account of vessel as the work proceeds, become the property of the owner and such property shall be conspicuously marked with the hull number or with other appropriate markings for identification, as belonging to vessel/owner as its property and shall not be within the ownership or disposition of the builder. Until the vessel is completed

and delivered, the builder shall not use or permit to be used any such part/s materials, equipment and machinery so allocated to the vessel for any other vessel. The owner to the extent of payment made by him will have a right to mortgage his interest in materials mentioned above to Indian Government, lender and/or Shipping Development Fund Committee for loans taken by owner and formalities as required by lender/owner shall be completed by the builder. But the builder at all times shall have a lien on the abovementioned property for any unpaid portion of the price. All materials and other things appropriated, but not used for the purpose of this contract, shall after completion of the vessel, become the property of the builder."

19. Sri Ramachandra Reddy submits that this clause is identical with the clause referred to in the decision in *State of Gujarat Vs. Kailash Engineering Co.,* , and therefore the property in the ship will pass in favour of the owner immediately on payment of the first instalment, and that the contract in question is a "works contract". We are unable to agree with the learned counsel. It is no doubt true that this clause does say that immediately after payment of the first instalment all the material, on account of the vessel, as the work proceeds, shall become the property of the owner and such property shall be conspicuously marked with the hull number or with other appropriate marking for identification as belonging to the vessel/owner and shall not be within the ownership or disposition of the builder; but from the last sentence in that clause that the appropriated material which was not used for the purpose of contract shall be the property of the builder, clearly clarifies the intention of the parties. The clause, read as a whole, indicates that marking hull number, etc., on the material is only for identification and for preventing diversion of material for other uses and that as the unused material remains the property of the builder, it is not possible to conclude that at that stage the title in the ship passed to the owner so as to treat the contract as a "works contract".

20. Clause 17 which deals with insurance, provides, inter alia, that in the event of vessel getting destroyed or damaged before delivery to the owner, the builder's obligation is to refund the instalments to the owner together with interest at the rate of 5 per cent per annum and that on payment of such instalments, the owner shall have no further right or claim. From this clause, it is manifest that in the event of vessel getting destroyed or damaged before the delivery to the owner, the obligation of the builder is to refund the instalments together with interest to the owner. Had the title passed to the owner on payment of the first instalment itself, as contended, the question of the builder refunding the instalment price to the owner would not have arisen. This position, in our view, clearly points to the fact that the title in the material, much less in the ship, does not pass to the owner on payment of the first instalment. This clause together with other clauses whittles down the rigour of clause 15.

All the clauses referred to above indicate that the property in the ship passes only on the delivery.

21. It is also contended that in so far as T.R.C. Nos. 138 and 139 of 1989 are concerned, there is no risk clause and that therefore the basis on which the Tribunal declined to follow the judgment in the petitioner's case in Hindustan Shipyard Ltd. v. Commercial Tax Officer (1970) 1 An WR 197, is the result of misreading of the agreement by the Tribunal. The contention appears to be somewhat misconceived. We have gone through the agreements and we find that the risk clause is there in the said agreements which are the subject-matter of T.R.C. Nos. 138 and 139 of 1989.

22. From the reading of the clauses referred to above, we are of the view that the terms of the agreement in question are analogous to "made to measure" category where the material is supplied by the owner and the vessel/ferry is manufactured by the petitioner and that the transactions, subject-matter of the contracts, are "sale" but not a "works contract".

23. For the above reasons, we do not find any illegality in the order of the Tribunal to warrant our interference in the revisions. We, therefore, affirm the orders of the Tribunal.

24. In the result, the tax revisions cases are dismissed but, in the circumstances of the case, we leave it to the parties to bear their own costs.

25. Petitions dismissed.