
(1968) 02 CAL CK 0028
In the Calcutta High Court
Case No : C.R. No. 1428 (W) of 1964

Indo Impex Limited

APPELLANT

Vs

Commercial Tax Officer and Others

RESPONDENT

Date of Decision : 13-02-1968

Acts Referred:

Constitution of India, 1950 — Article 226

Citation : (1969) 2 ILR (Cal) 95 : (1968) 22 STC 66

Hon'ble Judges : D. Basu, J

Bench : Single Bench

Advocate : B.R. Jhunjunwala and Arun Prokash Sarkar, for the Appellant; B.C. Dutta, for the Respondent

Final Decision : Allowed

Judgement

D. Basu, J.—This petition under Article 226 of the Constitution is directed against the order dated 25th February, 1961, passed by respondent No. 2 (Assistant Commissioner), which is at annexure H, directing a fresh assessment and the fresh order of assessment made by respondent No. 1 (Commercial Tax Officer) on 27th October, 1964 (annexure I to the petition), in pursuance of the aforesaid direction.

2. Though the petition has become somewhat clumsy after amendment, the substance of the petitioner's case is that the agreement at annexure A by which the petitioner-company contracted with the Calcutta Corporation to install certain electric lamp posts, constituted an indivisible works contract and did not include any separate contract to supply materials so as to be assessable to sales tax On the value of the materials so supplied. The facts of the case are as follows :

3. In pursuance of an invitation for tender from the Calcutta Corporation for the installation of electric lamps on its streets, the petitioner submitted its tender and entered into the agreement at annexure A and executed that contract. For the assessment year 1957-58, the petitioner submitted its return at annexure B

to the petition under the Bengal Finance (Sales Tax) Act, 1941 (hereinafter referred to as "the Act") and, in pursuance of the notice issued by respondent No. 1, produced before him its books of account as well as the bills submitted by it to the Corporation (a Copy of which is at annexure BB).

4. In his assessment order for the year 1957-58, which is at annexure C, respondent No. 1 assessed sales tax under the Act upon a turnover of Rs. 46,052-2-6 on account of "sales from electrical contract" rejecting the petitioner's claim for exemption on that account.

5. Aggrieved by the said order, petitioner appealed to respondent No. 2 (Appeal Case No. 339/58-9) (annexure D), but the appeal was dismissed by the order at annexure E. The petitioner then applied in revision against the appellate order to respondent No. 3 (Additional Commissioner, Commercial Taxes) and pressed on his claim for exemption on the authority of the decision of the Supreme Court in *The State of Madras Vs. Gannon Dunkerley and Co., (Madras) Ltd.*,

6. Respondent No. 3, by his order at annexure G, quashed the order of assessment and remanded the case to the Assistant Commissioner for passing a fresh order of assessment after making an inquiry as to whether the contract was an indivisible works contract or involved two contracts, one for the supply of materials and another for the supply of labour.

7. In pursuance of the foregoing remand order, respondent heard the matter again and passed his order dated 25th February, 1961 (annexure H), holding that the agreement involved a separate contract for the supply of materials but that since some of the items of the petitioner's bill included labour charges together with the materials supplied, respondent No. 2 sent back the case to respondent No. 1 "to pass a fresh order after causing necessary scrutiny so as to determine the value of the materials sold or supplied against each item of work as per tender".

8. Respondent No. 1 heard the petitioner and examined his books of account together with copies of the agreements and bills and came to the conclusion that the entire amount of Rs. 46,052 represented the price of materials supplied and assessed tax on that amount by his order dated 27th October, 1964 (annexure I).

9. Petitioner now challenges the validity of the orders at annexures H and I, referred to above. The primary question to be determined is whether the agreement at annexure A constituted an indivisible works contract or included a distinct and separate agreement to sell the materials used in the execution of the work. But before going into the contents of the agreement, it would be useful to analyse the decisions of the Supreme Court relating to this matter.

(i) The leading case on the point, which still holds the field, is *The State of Madras Vs. Gannon Dunkerley and Co., (Madras) Ltd.*, There a building contractor agreed to execute works to be paid for "according to measurements at the rates specified in the schedule thereto". The Supreme Court held that there was no

agreement between the parties to sell the materials used in the construction of the buildings and that the assessment of the cost of the materials by deducting from the contracted rates a statutory proportion to represent the cost of labour was illegal.

(ii) In *Pandit Banarsi Das Bhanot Vs. The State of Madhya Pradesh and Others*, the decision in *Dunkerley's case*¹ was followed to declare unconstitutional a statutory provision by which sales tax was payable in respect of building contracts as such and to restrain the taxing authorities from compelling the assessee to file returns in respect of his "receipts from contract works for the purpose of assessment".

(iii) *Firm of Peare Lal Hari Singh Vs. The State of Punjab and Another*, was also a case of building contract. It was reiterated in this case that whether the contract was an indivisible one or not was to be determined upon a construction of the agreement (page 441) and, from the fact that the tender was invited as well as accepted for execution of the specified building works for a lump sum showed that there was no separate agreement for the sale of materials.

In *Firm of Peare Lal Hari Singh Vs. The State of Punjab and Another*, the State relied strongly upon Rule 33 of the General Conditions of Contracts issued by the Government as follows :

All stores and materials brought to the site shall become and remain the property of the Government and shall not be removed off the site without the permission...of the G.E. But whenever the works are finally completed, the contractor shall at his own expense forthwith remove from the site all surplus stores and materials originally supplied by him and upon such removal, the same shall revert in and become the property of the contractor.

But notwithstanding the strong terms of the above clause the Court held that the above term was the usual one in Government contracts inserted "with the object of ensuring that materials of the right sort are used in the construction and not with the intention of purchasing them" and did not convert "what is lump sum contract for construction of buildings into a contract for the sale of materials used therein". In support of this conclusion the Court relied upon two other considerations :

(a) That under other terms of the contract, the materials brought by the contractor were subject to the approval of the authorities as to their quality and that the latter had the power of rejecting them even after completion of the works, if they were of inferior quality, in which case, the contractor was to remove them and rebuild with proper materials.

(b) The clause as to reversion of the surplus materials after completion of the construction could not suggest that the Government was reselling them to the contractor upon completion of the works.

(iv) The facts in the next case of *Carl Still G.M.B.H. and Another Vs. The State of*

Bihar and Others, are closer to those of the instant case since it was a case of erection of plants and machinery and the appellant contracted to supply all materials and labour for the erection of the plants "for an all-inclusive price". The Sales Tax Authorities, relying on a statutory provision to the effect that in a works contract the materials used were to be treated as sold by the contractor, asked the appellant for returns and production of books of account. The majority of the Court (4:1) following *The State of Madras Vs. Gannon Dunkerley and Co., (Madras) Ltd.*, held that the point for determination as to whether the materials used were assessable to sales tax could be answered only by a true construction of the terms of the agreement and came to the conclusion that the lump sum price indicated that it was an indivisible contract for the construction of specified works (page 1619) and did not involve any contract for the sale of materials. In this agreement, too there was a clause similar to that in *Firm of Peare Lal Hari Singh Vs. The State of Punjab and Another*, namely, that the property in the materials was to pass to the owner as soon as they were brought on the site by the contractor, nevertheless, the Court held, applying the decision in *Firm of Peare Lal Hari Singh Vs. The State of Punjab and Another*, that this was a term inserted with the object of ensuring quality and that it did not mean that the materials were being sold to the owner, as would be evident from another term of the agreement that in case of damage or destruction of the materials during execution of the works, the loss would fall not on the owner but on the contractor. In the result, the statutory provision in question which provided for a fictional splitting up of the contract for separating the value of the materials was struck down as unconstitutional and the assessment proceedings were quashed (page 1621).

(v) *Government of Andhra Pradesh Vs. Guntur Tobaccos Ltd.*, was, of course, a case of packing materials being supplied free of charge with the sale of tobacco but the question of assessability of the value of the packing materials was decided by the majority of the Court on the application of the propositions arrived at in the foregoing cases relating to building contracts and it was held, upon a review of the terms of the agreement, that the supply of the packing materials was only incidental to the contract for sale of tobacco and that there was no contract for the sale of the packing materials for a price. The Court observed that the case was similar to that of a works contract and that in either case, it was the terms of the agreement between the parties that was to determine the question of assessability (page 1404). There were clearer pronouncements as to the effect of a term in such agreement that the property in the materials was to pass to the owner before completion of the work.

The fact that in the execution of a contract for work some materials are used and property in the goods so used passes to the other party, the contractor undertaking to do the work will not necessarily be deemed on that account to sell the materials... 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... there must be a contract in which there is not merely a transfer of title to the 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.

10. Let us now advert to the decisions relied upon on behalf of the respondents.

(a) The facts in *Chandra Bhan v. State of Orissa* [1963] 14 S.T.C. 766 at p. 769 have little analogy to those of the instant case. In *Chandra Bhan's* case, [1963] 14 S.T.C. 766 at p. 769 there was no works contract but a contract for the supply of bricks to a company for a price though the bricks were to be manufactured out of earth belonging to the company. The contention that it was only a contract for labour on material found was rejected on the ground that the essence of the contract was delivery of the bricks as chattels and it was not a mere incident of a labour contract ; on the other hand, application of labour was an incident for the contract for delivery of the bricks. That bricks were salable as such was found by the Court from the term in the contract that the assessee could not sell the bricks to any other party without the permission of the company.

(b) *Patnaik and Company Vs. State of Orissa*, was also a case of supply of goods to be manufactured by the assessee, namely, the manufacture of a bus on chassis to be supplied by the employer. Both this case and that of *Chandra Bhan* [1963] 14 S.T.C. 766 at p. 769 just cited are authority for the proposition that where the essence of the contract is the sale of specific goods after manufacture, it is immaterial that the manufacture is to be made on some basic material supplied by the employer, or at his specification or even under his supervision *Patnaik and Company Vs. State of Orissa*, But as observed in *Chandra Bhan's* case [1963] 14 S.T.C. 766 at pp. 769, the Court can infer a separate and independent contract for sale of goods as distinguished from a composite works contract only where it is established that it was "the intention of the parties in making the contract that a chattel should be produced and transferred as a chattel for a consideration".

(c) In the case of *John Mowlem v. Commissioner of Sales Tax* [1967] 19 S.T.C. 59 apart from the works contract, the assessee had undertaken to procure and supply certain plant and machinery and the title to those plants etc. was not to pass as part of the execution of the works contract. It was held that there was a severable contract relating to the supply of the plant and machinery.

(d) That the decision in *Patnaik and Company Vs. State of Orissa*, relating to the building of bus body rested on the particular features of the agreement in that case has been explained by the Supreme Court in the recent case of *State of Gujarat Vs. Kailash Engineering Co.*, which related to an agreement to build railway coaches on under frames already belonging to the railway. The Court held that it was not a contract for sale of the coach bodies but a works contract for the erection of coach bodies because of the following terms of the contract. The title to the materials brought by the contractor for the purpose of building the

coaches vested in the railway as soon as they were brought to the site and "there was no question of ownership" of the materials passing to the employer only after the finished body was constructed, as in *Patnaik and Company Vs. State of Orissa*, In *Patnaik and Company Vs. State of Orissa*, , the unfinished bus bodies remained the property of the contractor till delivery was made to the employer but in the case of *State of Gujarat Vs. Kailash Engineering Co.*, the property in the unfinished bodies passed on to the railway even during the process of construction.

(e) Respondents also relied on the Bombay decision in *Commissioner of Sales Tax v. Arun Electrics* [1965] 16 S.T.C. 385 where notwithstanding a lump sum rate for the execution of an electrical installation contract, a separate contract for the supply of materials used in the work was implied. This decision has, however, been reversed by the Supreme Court on 16th December, 1965 (*Arun Electrics v. Commissioner of Sales Tax* [1966] 17 S.T.C. 576).

11. The propositions emerging from the foregoing decisions may be formulated as follows :-

(i) In order to constitute a "sale of goods" there must be an agreement between the parties for the sale of the very goods in which eventually the property passes : *Dunkerley's case*, [1959] S.C.R. 379. 414. In the generality of building contracts, the agreement between the parties is that the contractor should construct a building according to the specifications contained in the agreement, and in consideration therefore receive the payment as provided therein. There is in such agreement neither a contract to sell the materials used in construction, nor does property pass therein as movables. The materials pass to the owner of the building only as an accretion to the building. A contract for the sale of materials cannot be implied from such an agreement (*Dunkerley's case*) [1959] S.C.R. 379 414, 424-425.

(ii) Where the agreement constitutes a single contract as in the preceding paragraph, it is not open to the State "to split up that agreement into its component parts, single out that which relates to the supply of materials and to impose a tax thereon treating it as a sale" (*Dunkerley's case*, [1959] S.C.R. 379 418, 423-424).

(iii) Where the contract is one for execution of work for a lump sum as offered by a tender and accepted by the contractor, no separate agreement for supply of material is involved *Firm of Peare Lal Hari Singh Vs. The State of Punjab and Another*, and *Carl Still G.M.B.H. and Another Vs. The State of Bihar and Others*, even though there is a term in the agreement that the property in the materials would pass to the employer as soon as the goods were brought to the site by the contractor.

(iv) Parties may, however, enter into distinct and separate contracts, one for the transfer of materials for money consideration and the other for payment of remuneration for services and for work done. In such a case, there are really two

agreements, though there is a single instrument embodying them and, in such a case, the power of the State to separate the agreement to sell from the agreement to do work and to impose a tax thereon cannot be questioned *The State of Madras Vs. Gannon Dunkerley and Co., (Madras) Ltd.*,

(v) The burden of showing that a works or service contract involves a taxable sale of the materials used is upon the taxing authorities and the burden is not discharged by merely showing that property in goods which belonged to the party performing the service or executing the contract stands transferred to the other party *Government of Andhra Pradesh Vs. Guntur Tobaccos Ltd.*,

12. Coming to the terms of the agreement before me (at annexure A) the tender and acceptance was for execution of the work by piece-work "and the unit of the work was one lamp post to be installed at the specified street according to the standard specification" and the rate payable to the petitioner was a lump sum of Rs. 432-4-0 per unit and this sum was "7 1/2 per cent, below the respective rates specified in the departmental estimate". The payment of the sum referred to would be made "on the completion of the work or on the termination of the agreement". The Chief Engineer was given the power to terminate the agreement on specified notice if "the contractor does not carry out the work in a workmanlike manner and with suitable materials, labour and plant or if the contractor makes delay in taking up, proceeding with or completing the work."

13. Prima facie, it was an entire and indivisible works contract for a lump sum to which the decisions in the *Dunkerley* group of cases and, in particular *Carl Still G.M.B.H. and Another Vs. The State of Bihar and Others*, are applicable.

14. On behalf of the respondents, however, certain other terms are relied upon to show that there was a stipulation to sell the materials required for the installation, as follows :-

(a) Clause 2 says that-

All materials supplied by the contractor for use in the work must be of the best quality and approved by the Engineer-in-charge. Any materials rejected by the aforesaid officer must be removed forthwith from the worksite by the contractor free of charge.

15. This term requiring approval is, however, a term to ensure quality with which we are already familiar since the observations in *Firm of Peare Lal Hari Singh Vs. The State of Punjab and Another*, and does not indicate any agreement for the sale of materials.

(b) More emphasis has been paid on behalf of the respondents on the second and third paragraphs of Clause 2 which read as follows :-

The materials (viz., stone etc.) will be supplied to the contractor by the Corporation at the rates annually fixed by the Chief Engineer... The contractor shall not supply his own materials whenever such Corporation materials are

available ; any such unauthorised supply by the contractor shall not be paid for.

16. Should the indented quantities of Corporation materials fall short or be in excess, they must be adjusted by further indents or by sending back the surplus; if, however, the shortage be small and negligible in the opinion of the Engineer-in-charge, he may in his discretion allow the contractor to supply the deficiency himself, but in such cases 10 per cent. of the cost of materials so supplied by the contractor at the Corporation rates shall be deducted from his bill.

17. If the contractor retains possession of any surplus materials issued to him by the Corporation, a deduction of 50 per cent, over the cost of materials so retained shall be made from his bill."

(a) It is clear from the above terms that all materials were stipulated to be delivered by the Corporation and that the contracted amount of Rs. 432-4-0 per lamp post was payable to the petitioner only by way of his labour, supervision charges etc. Normally, thus the contract involved no sale of materials at all.

(b) There was, however, an exceptional contingency when the petitioner might have to supply materials, namely, when the Corporation supply was short and the Corporation was unable to meet the deficiency and, further, the Engineer-in-charge allowed the shortage to be made up by the contractor himself.

18. In the instant case, therefore, the existence of the term for supply of materials in a specified contingency is not enough to enable the respondents to assess sales tax upon any subjective estimate of the value of materials involved in execution of the work. It must be shown by the respondents, further, that such exceptional contingency did take place, the petitioner did supply a definite quantity of materials, charged their value in his bills at the Corporation rate less 10 per cent. over and above the lump sum of Rs. 432-4-0 per lamp post. The onus to show this is upon the respondents as it has been laid down by the Supreme Court that in cases of works contracts where the authorities want to assess tax on the supply of materials, the burden is upon the authorities to show that there was an independent sale of materials. In this case, the assessing authority (respondent No. 1) has failed to discharge that onus.

(i) In his return (annexure B) the petitioner did not show any sale of materials used in the execution of the work. It stated that Rs. 33,578 was realised by the petitioner on account of "sales of goods other than sales involved in the execution of contracts" and it appears that the petitioner has paid tax on this amount or, at least, there is no dispute as to the liability in respect of this amount.

19. Besides the foregoing amount, the petitioner showed the sum of Rs. 46,052-2-6 to be the sum received by him as the "cost of executing contract". The dispute is as regards this amount. The petitioner made it clear that this amount was "not liable for taxation" and that the petitioner was including it in the return only "under protest". From the return thus, it was not possible to infer

that the whole or any part of this amount represented the value of any materials supplied by the petitioner in the execution of the contract.

(ii) Nor does the bill produced by the petitioner (annexure BB, page 19) gives any contrary indication. It shows that the petitioner did not charge more than Rs. 384-6-0 per post, which was not in excess of the contractual amount and that the only thing that the petitioner did was to give particulars of the items which were involved in the erection of a lamp post, but in respect of each of the items, the petitioner referred to the Corporation rate for execution of the work and there was no extra charge on account of the sale of any materials.

20. What the respondent No. 1 did was a curious thing. Instead of proceeding to ascertain the value of the materials supplied by the petitioner item by item, as the Assistant Commissioner had directed him to do, he relied upon a statement obtained from the petitioner where the total amount realised on account of completed contract was shown as Rs. 71,401 out of which Rs. 25,349 was shown as contracting charges including labour, carriage and cartage, leaving a balance of Rs. 46,052. It was concluded by respondent No. 1 that the whole of the balance of Rs. 46,052 must be the value of materials supplied by the petitioner as he had, in the return, already excluded labour charges. In the amendment petition the petitioner stated that he was obliged to submit a return like this upon the threat of respondent No. 1 that unless it made a statement like this, the respondent would assess tax on the entire sum of Rs. 71,401. Whether this allegation of coercion be true or not, it is clear that the respondent No. 1 cannot, in the circumstances of this case, levy tax upon the sum of Rs. 46,052 so long as it is not shown by the department (onus being upon them) that (a) the Corporation failed to supply materials as stipulated in the agreement, (b) that the petitioner did supply materials under the exceptional clause of the agreement under orders of the Engineer-in-charge, and (c) that the petitioner did, in fact, charge from the Corporation any sum in excess of the stipulated amount of Rs. 432 less 10 per cent. claimed as the value of materials, if any, supplied by the petitioner. If the amount charged by the petitioner be not in excess of Rs. 432 less 7 1/2 per cent, per post, the respondents are without jurisdiction, on the basis of the agreement at annexure A to levy any sales tax upon the petitioner on account of execution of the disputed contract.

21. The liability to pay sales tax is a question of law and cannot rest on any statement of the petitioner which in the instant case cannot but be due to a mistake about his legal position. At any rate, respondent No. 1 has not discharged his onus. In the result both the impugned orders at annexures H and I must be quashed and respondent No. 1 must be directed to make a fresh order of assessment after coming to a definite finding on the three points (a) to (c) which have been formulated in the previous paragraph of this judgment.

22. The rule is made absolute in the above modified form but since respondent No. 1 has not only failed to discharge his onus under the law but even to carry out the directions given by his own departmental superior, he must bear the

costs of this petition, which is assessed at five gold mohurs.