
(2013) 06 KL CK 0012

In the High Court Of Kerala

Case No : W.A. No's. 2213, 2214, 2215, 2216, and 2217 of 2012 and 135, 136, 137, 138 and 140 of 2013

Malabar Gold Private Limited

APPELLANT

Vs

Commercial Tax Officer, Kozhikode and Others

RESPONDENT

Date of Decision : 24-06-2013

Acts Referred:

Citation : (2013) 32 STR 3 : (2013) 63 VST 497

Hon'ble Judges : T.R. Ramachandran Nair, J;A.V. Ramakrishna Pillai, J

Bench : Division Bench

Advocate : Joseph Prabakar and Abraham George Jacob, for the Appellant; Thomas Mathew Nellimoottil, Senior Standing Counsel, CB EX and George Mecheril, Special Government Pleader for Taxes, for the Respondent

Judgement

T.R. Ramachandran Nair, J.—W.A. Nos. 2213, 2214, 2215, 2216 and 2217 of 2012 are filed by the same petitioner in the five writ petitions, viz., W.P. (c) Nos. 38505 of 2010, 38524 of 2010, 28351 of 2011, 28376 of 2011 and 20269 of 2012 and W.A. Nos. 135, 136, 137, 138 and 140 of 2013 are filed by the Commissioner of Central Excise and Customs, who was, the second respondent in all the writ petitions, aggrieved by the common judgment rendered by the learned single judge Malabar Gold Private Limited Vs. Commercial Tax Officer Circle III, Commissioner of Central Excise and Customs Calicut Commissionerate and State of Kerala, The petitioner in the writ petitions is Malabar Gold Private Limited, a private limited company (hereinafter referred to as "the company") registered under the Companies Act, 1956. The Commercial Tax Officer, Circle in, Kozhikode and the State of Kerala represented by the Secretary to Government, Department of Commercial Taxes, Trivandrum, are the contesting respondents. The company is engaged in marketing, trading, export and import of jewellery, gold ornaments, diamond ornaments, platinum ornaments, watches, etc., under the name of "Malabar Gold". It is a registered dealer in the Office of Commercial Tax Officer, Circle III, Kozhikode bearing RC Nos. 32110830404 and 32110830404C under the Kerala Value Added Tax Act, 2003 (for short, "the KVAT

Act") and Central Sales Tax Act, 1956, respectively. It is having Service Tax Registration No. AADCM9043RST001 dated March 28, 2006 issued u/s 69 of the Finance Act, 1994 under the category of "franchise services".

2. The whole background of the case and the circumstances under which the company approached this court by filing writ petitions, are narrated hereinbelow: The Commercial Tax Officer, Circle in, Kozhikode, by separate notices, proposed to assess the company on the ground of alleged non-payment of tax under the KVAT Act on the amount of royalty received from franchisees for use of trade mark. The same is in respect of the following assessment years: 2006-07, 2007-08, 2008-09, 2009-10 and 2010-11. The company had reported the total taxable turnover under the KVAT Act and paid the applicable VAT on the said turnover which is not under dispute. The royalty received from the franchisee companies for the respective years is as shown below:

3. The appellant-company had paid service tax on the said amounts under the taxable category of "franchise services" coming u/s 65(47) of the Finance Act, 1994.

4. In the similar proposal notices issued for the respective years, the Commercial Tax Officer (first respondent) informed the company that royalty received by a dealer from franchisees for use of trade mark would attract VAT under entry SI. No. 68 of the Third Schedule to the KVAT Act, 2003 and the transfer of right to use any goods would be taxable u/s 6(1) of the said Act. The company, in their replies, mainly took up the contention that the transaction actually attracts service tax alone and they have already paid service tax of 10 per cent/12 per cent and the transaction of franchise would not fall under the ambit of sale of goods under the KVAT Act. In that context the company relied upon the decisions of the apex court in Bharat Sanchar Nigam Ltd. and Another Vs. Union of India (UOI) and Others, and Imagic Creative Pvt. Ltd. Vs. The Commissioner of Commercial Taxes and Others, . Overruling the objections, the Commercial Tax Officer issued proceedings imposing tax at four per cent as well as interest at 12 per cent under the KVAT Act. In two cases penalty u/s 67 of the Act was also imposed. A decision of the apex court in Tata Consultancy Services Vs. State of Andhra Pradesh, and that of the decision of a Division Bench of this court in Mechanical Assembly Systems (India) Pvt. Ltd. Vs. State of Kerala, were relied upon.

5. The learned single judge Malabar Gold Private Limited Vs. Commercial Tax Officer Circle III, Commissioner of Central Excise and Customs Calicut Commissionerate and State of Kerala, by the impugned judgment, rejected the contentions of the company and held that the royalty received by the dealer is exigible to tax u/s 6(1)(c) of the KVAT Act. Aggrieved by the same, the company has come up in appeals and the Commissioner of Central Excise and Customs has come up in five appeals.

6. We heard learned counsel for the appellant-company, Shri Joseph Prabakar,

Shri Thomas Mathew Nellimoottil, learned Senior Standing Counsel appearing for the Commissioner of Central Excise and Customs and Shri George Mecheril, learned Special Government Pleader for Taxes appearing for the State of Kerala and Commercial Tax Officer.

7. At the outset, learned counsel appearing for the company, submitted that the entire legal issues are covered in favour of the company in the light of the binding decision of the apex court in *Bharat Sanchar Nigam Ltd. and Another Vs. Union of India (UOI) and Others*, which interpreted article 366(29A)(d) and List II, entry 54. It is submitted that the nature of the transaction is a franchise agreement and the company has different franchisees who have executed similar agreements. The terms of the said agreement will show that the franchisees can store and sell products and the show room should have the name board "Malabar Gold" as per the design approved by the company. The royalty fee being paid by the franchisees is a percentage of the annual net profit of the franchisees. It is submitted that in the elaborate replies given to the proposal notices, the company had explained the whole concept of "franchise agreement", the concept of "goods", the relevant constitutional principles under articles 246 and 254 and had placed reliance upon entry 97 of List I under the Seventh Schedule to the Constitution and had explained the scope of entry 54 of List II. It is submitted that in the light of the judgment of the apex court in *Imagic Creative Pvt. Ltd. Vs. The Commissioner of Commercial Taxes and Others*, the payment of service tax as well as VAT are mutually exclusive and hence once the transaction is clearly covered under the relevant provision for payment of service tax, then it cannot be charged for sales tax or VAT again. It is submitted that in the light of the peculiarities of the franchise agreement and the concept of "right to use the goods" under article 366(29A), the tests required to satisfy the same, laid down by the apex court in *Bharat Sanchar Nigam Ltd. and Another Vs. Union of India (UOI) and Others*, are not satisfied here.

8. The learned counsel also explained that there is no transfer of trade mark to the franchisees in the transaction. The agreement does not permit the franchisees to further transfer the trade mark to a third party or to use it exclusively to the exclusion of the appellant-company. Once the company takes a decision to withdraw the permission granted to the franchisees to use the trade mark, then the franchisees have to stop using the same. Therefore, there is no absolute transfer in favour of the franchisees and the entire control is vested with the franchisor company. Even with regard to the concept of "right to use", the decision of the apex court in *Tata Consultancy Services Vs. State of Andhra Pradesh*, has clearly laid down that the item concerned should be capable of abstraction, consumption and use which can be transmitted, transferred, delivered, stored, possessed, etc. The learned counsel relied upon various paragraphs of the judgment in *Bharat Sanchar Nigam Ltd. and Another Vs. Union of India (UOI) and Others*, and contended that what is involved in the transaction herein is only a mere licence to use the trade marks and the franchisee has no legal right to use the same to the exclusion of the franchisor. The franchisee does

not get any right to transfer the right to others also. Learned counsel further submitted that assuming that there is a conflict between the entries in Lists I and II under the Seventh Schedule to the Constitution, the legislation, viz., Finance Act, 1994 will prevail.

9. With regard to the entry serial No. 68 of the Third Schedule to the KVAT Act, 2003, it is submitted that trade mark is not an item specifically included among the "intangible goods" mentioned therein and the same is confined to copy right, patent and REP licence. The attempt by the Revenue is to rope in trade mark under item (4) "others", which cannot be justified.

10. The learned counsel for the appellant-company further submitted that the decision of the Division Bench of this court in Mechanical Assembly Systems (India) Pvt. Ltd. Vs. State of Kerala, is distinguishable on its facts. What was involved therein is a transfer on a permanent basis of a know how. It is also pointed out that the said decision was rendered at the time when the Kerala General Sales Tax Act was in force and this court held therein that the transfer of technical know how through technical personnel would satisfy the definition of sale. Learned counsel further submitted that the subsequent decisions of this court reported in Jojo Frozen Foods (P) Ltd. Vs. State of Kerala, and Kreem Foods Private Limited Vs. State of Kerala, even though considered the exigibility to sales tax of the royalty received from the dealers, they were under the KGST Act and in all the three decisions quoted above, the disputed periods were prior to 2003. The service tax for franchise service was introduced with effect from July 1, 2003, whereas the KVAT Act was notified to be effective from April 1, 2005 only. Therefore, the Division Bench had no occasion to consider the effect of the provisions under the Finance Act, 1994. It is also submitted by the learned counsel that the facts of the respective decisions show that those were cases where there was no transfer from one dealer to another whereas, herein the appellant-company has only allowed the use of the trade mark and there is no outright transfer. It is only a licence alone. It is also submitted that therein this court had no occasion to consider the constitutional bar arising under the respective provisions of the Constitution. In the two subsequent decisions, their Lordships followed the former judgment in Mechanical Assembly Systems (India) Pvt. Ltd. Vs. State of Kerala, and herein, even the definition of "goods" is not attracted. In this context learned counsel submitted that in the light of entry 97 of List I of the Seventh Schedule, the Central Government is fully empowered to bring in under service tax law a particular transaction. Herein, therefore, the attempt to bring in franchise service to the exigibility to tax under the KVAT Act will result in repugnancy, as the said Act is the later one, being introduced only from April 1, 2005, whereas the service tax law was in force from July 1, 2003. Learned counsel referred to the relevant findings of the learned single judge and submitted that those findings could not be supported in the light: of the declaration of law by the apex court in Bharat Sanchar Nigam Ltd. and Another Vs. Union of India (UOI) and Others, . We were also taken through the various clauses of the franchise agreement, made available before this court in the paper

book at page 103. Particular reference was made to the questions formulated in para 32 of the judgment in the above case and the findings rendered in paragraphs 43, 50, 56, 63, 64, 65, 73 to 81, 88 and 92 in SCC (paragraphs 43, 50, 55, 62, 63, 64, 72 to 80, 86 and 91 in VST) of the judgment rendered by the honourable Ms. Justice Ruma Pal and paragraphs 96 and 97 of the concurring judgment of the honourable Dr. Justice A.R. Lakshmanan. It is submitted that the said judgment has been discussed and relied upon in the subsequent decision of the apex court in Imagic Creative Pvt. Ltd. Vs. The Commissioner of Commercial Taxes and Others, . Learned counsel also relied upon the decision of a Division Bench of the Bombay High Court in The Commissioner of Sales Tax Maharashtra State Vs. Rolta Computer and Industries Private Limited, wherein also the dictum laid down in Bharat Sanchar Nigam Ltd. and Another Vs. Union of India (UOI) and Others, was followed. It is submitted that the learned single judge even though has sought to distinguish Bharat Sanchar Nigam Ltd. and Another Vs. Union of India (UOI) and Others, on the difference in the set of facts, the legal principles laid down by the apex court will govern this case also. It is also submitted that the apex court, in the judgment in Bharat Sanchar Nigam Ltd. and Another Vs. Union of India (UOI) and Others, has approved the earlier decision in State of Andhra Pradesh and Another Vs. Rashtriya Ispat Nigam Ltd., In the said decision, in a similar matter wherein only the right to use a machine was given, the apex court adopted the principle regarding retention of effective control of the machinery by the transferor even though the machinery was used by a contractor. It was found that the respondent-company and the contractor were not free to make use of the machinery for the works other than the project work of the respondent. In this context, learned counsel submitted that the appellant is free to use the trade mark and free to allow other franchisees to use the same. Learned counsel further submitted that in the judgment by a Division Bench of this court in Jojo Frozen Foods (P) Ltd. Vs. State of Kerala, the judgment of the Andhra Pradesh High Court in Rashtriya Ispat Nigam Ltd. Vs. Commercial Tax Officer, Company Circle, Visakhapatnam, which was confirmed by the apex court in State of Andhra Pradesh and Another Vs. Rashtriya Ispat Nigam Ltd., did not arise for consideration and therefore also the Division Bench judgments of this court in Jojo Frozen Foods (P) Ltd. Vs. State of Kerala, and Kreem Foods Private Limited Vs. State of Kerala, are distinguishable. Learned counsel further submitted that the decision of the Bombay High Court in Commissioner of Sales Tax Vs. Duke and Sons Private Limited, relied upon by this court in Jojo Frozen Foods (P) Ltd. Vs. State of Kerala, considered the provisions under the Maharashtra Sales Tax on the Transfer of the Right to use any Goods for Any Purpose Act, 1985 which was not the situation in the above two cases. Learned counsel went on to argue that even if the dictum laid down in those cases could be found justified on the special facts of the said cases, in the light of the change of law now as introduced by the Finance Act, 1994 with effect from July 1, 2003, imposition of service tax on franchisors and the KVAT Act being in later point of time, those decisions are clearly distinguishable. Learned counsel for the appellant-company further submitted that the learned single

judge Malabar Gold Private Limited Vs. Commercial Tax Officer Circle III, Commissioner of Central Excise and Customs Calicut Commissionerate and State of Kerala, did not go into the question whether service tax alone is payable by the company and did not consider the other related legal issues.

11. The learned Senior Central Government Standing Counsel appearing for the Commissioner for Central Excise and Customs, Shri Thomas Mathew Nellimoottil supported the above arguments. It is submitted the learned standing counsel that the company is paying service tax on the franchise agreement which is covered by the entry u/s 65(105)(zze) read with section 65(47). Therefore, there is no ambiguity in the matter with regard to the payment of service tax and on the same element there is no question of application of the provisions of the KVAT Act. It is submitted that there cannot be any liability for payment of tax under the two enactments for the same transaction. Herein, the transaction is only one and the liability is only to pay service tax. Learned standing counsel also submitted, by referring to the various clauses in the franchise agreement, that herein there is no delivery, transfer of possession or exclusive right being given to the transferee for any purpose and the right given as evident from the various clauses in the agreement will loom large while considering the legal issue. Learned standing counsel further submitted that the impugned judgment cannot be supported. It is further submitted that the service tax alone is applicable herein and the State cannot overlook the provisions of the Finance Act, 1994 which will override the provisions of the KVAT Act.

12. The learned Special Government Pleader for Taxes, while supporting the judgment of the learned single judge Malabar Gold Private Limited Vs. Commercial Tax Officer Circle III, Commissioner of Central Excise and Customs Calicut Commissionerate and State of Kerala, raised a preliminary objection that the writ appeals filed by the Commissioner of Central Excise and Customs are not maintainable, as they are not aggrieved parties. It is submitted that no directions have been issued against the said appellant. Learned Special Government Pleader further submitted that the judgments of this court in Mechanical Assembly Systems (India) Pvt. Ltd. Vs. State of Kerala, , Jojo Frozen Foods (P) Ltd. Vs. State of Kerala, and Kreem Foods Private Limited Vs. State of Kerala, will show that the transactions by way of transfer of know-how as well as right to use the trade mark were found to be covered by the provisions of the KGST Act. It is therefore submitted that those principles will squarely apply herein, as rightly found by the learned single judge Malabar Gold Private Limited Vs. Commercial Tax Officer Circle III, Commissioner of Central Excise and Customs Calicut Commissionerate and State of Kerala,

13. In Jojo Frozen Foods (P) Ltd. Vs. State of Kerala, and Kreem Foods Private Limited Vs. State of Kerala, the very same situation arising herein, have been considered and the assesseees were found to be liable to pay sales tax on the royalty received by the dealer from the franchisees for use of trade mark. It is submitted that the transaction in question is not a different one. The same is

covered by article 366(29A) of the Constitution and herein specifically clause (d) of the article will have relevance. The KVAT Act received the assent of the President of India on December 10, 2004.

14. The learned counsel for the appellant had submitted that the assessment orders in the decided cases were prior to 2003 which is not disputed by the learned Special Government Pleader for Taxes.

15. It is submitted that entry 68 of Schedule III will apply to intangible properties and trade mark will come under item (4) "others". The principle of ejusdem generis will squarely apply and therefore the proposal as per the notices issued are clearly justified.

16. The learned Special Government Pleader further elaborated his contentions, by referring to the clauses in the franchise agreement, that no service element is provided therein and therefore the transaction is not exigible to service tax. It is further submitted that the learned single judge Malabar Gold Private Limited Vs. Commercial Tax Officer Circle III, Commissioner of Central Excise and Customs Calicut Commissionerate and State of Kerala, was right in finding that if the company has got any grievance regarding the collection of service tax, they will have to challenge it in appropriate proceedings. It is also submitted that in the light of the assent given by the President of India to the KVAT Act, article 254(2) of the Constitution will be attracted. By relying upon the principles stated in Tata Consultancy Services Vs. State of Andhra Pradesh, learned Special Government Pleader submitted that the said judgment will show that intellectual property will also answer the definition of "goods" and thus trade mark herein will also come within the same. By referring to the judgment of the apex court in M. Karunanidhi Vs. Union of India and Another, wherein the various tests for determining repugnancy have been laid down by a Constitution Bench, it is submitted that there is no repugnancy here. It is submitted that it may also be a case where both Service Tax Act and VAT Act will apply. He further submitted that clause 18 of the franchise agreement will show that the franchisee is not an agent and is treated as principal itself. It is therefore submitted that the plea that the franchisee is not having any control, cannot be supported.

17. The learned counsel for the appellant reiterated the contentions in the reply to the arguments of the learned Special Government Pleader and submitted that the State cannot take the stand that the principles in Bharat Sanchar Nigam Ltd. and Another Vs. Union of India (UOI) and Others, have no application herein and the State has also not explained how the present proposal is legally sustainable in the light of the said principles.

18. Before going into the contentious issues, we will refer to the relevant provisions. Sections 65(47) and 65(48) of the Finance Act gives the definitions of "franchise" and "franchisor" as follows:

(47) "Franchise" means an agreement by which the franchisee is granted representational right to sell or manufacture goods or to provide service or

undertake any process identified with franchisor, whether or not a trade mark, service mark, trade name or logo or any such symbol, as the case may be, is involved;

(48) "Franchisor" means any person who enters into franchise with a franchisee and includes any associate of franchisor or a person designated by franchisor to enter into franchise on his behalf and the term "franchisee" shall be construed accordingly.

19. Section 65(105) read with sub-clause (zze) provides as follows:

(105) Taxable service" means any service provided or to be provided.--

(zze) to a franchisee, by the franchisor in relation to franchise.

(other sub clauses omitted)

20. "Intellectual property right" defined u/s 65(55a) and "Intellectual property service" defined u/s 65(55b) are as follows:

(55a) "Intellectual property right" means any right to intangible property, namely, trade marks, designs, patents or any other similar intangible property, under any law for the time being in force, but does not include copyright;

(55b) "Intellectual property service" means,--

(a) transferring temporarily; or

(b) permitting the use or enjoyment of, any intellectual property right.

21. Section 65(55b)(a) was amended by omitting the words "whether permanently or otherwise" by the present definition with effect from June 16, 2005. Thus, now temporarily transferring the trade mark and permission to use the trade mark are covered by taxable service of intellectual property right.

22. The relevant provisions of the KVAT Act are section 2(xiii) which defines "sale" and Explanation V thereof which are extracted below:

(xiii) "Sale" with all its grammatical variations and cognate expressions means any transfer whether in pursuance of a contract or not of the property in goods by one person to another in the course of trade or business for cash or for deferred payment or for other valuable consideration, but does not include a mortgage, hypothecation, charge or pledge.

Explanation V.--A transfer of right to use any goods for any purpose (whether or not for a specified period) for cash, deferred payment or other valuable consideration shall be deemed to be a sale.

23. We will also refer to section 6 which provides for levy of tax on sale or purchase of goods and sub-section 1(c) is important which reads as follows:

6. Levy of tax on sale or purchase of goods.--(1) Every dealer whose total

turnover for a year is not less than ten lakhs rupees and every importer or casual trader or agent of a non-resident dealer, or dealer in jewellery of gold, silver and platinum group metals or silver articles or contractor or any State Government, Central Government or Government of any Union Territory or any Department thereof or any local authority or any autonomous body whatever be his total turnover for the year, shall be liable to pay tax on his sales or purchases of goods as provided in this Act. The liability to pay tax shall be on the taxable turnover,--

(a) and (b)

(c) In the case of transfer of the right to use any goods for any purpose whether or not for a specified period, at the rate of four per cent at all points of such transfer.

24. Entry Serial No. 68 of the Third Schedule to the KVAT Act, 2003 reads as follows:

1. Copy right
2. Patent
3. REP licence DEPB licence
4. Others.

25. It may be relevant to consider the important terms of the model franchise agreement between the appellant and its franchisees which is produced as serial No. 16 of the paper book at page 103. For easy reference, we will extract the following clauses of the agreement:

MALABAR GOLD" FRANCHISE AGREEMENT

This agreement made at Calicut on this the 2nd day of May, 2007, between M/s. Malabar Gold Private Limited, a company registered under Companies Act having its Corporate Office, 17/1491-D, 3rd Floor, Malabar Gate, Ram Mohan Road, Calicut 673 004, Kerala, (Hereinafter referred to as "Franchiser" which expression shall unless repugnant to the context includes its successors in interest, assigns, persons or institutions claiming through or under it) represented by its Managing Director, Mr. Ahammed M.P., S/o. Mamed Kutty Haji, aged 50 years, residing at 5/697-H, Malabar Hills Housing Colony, K.P. Chandran Road, Erandhipalam P.O., Calicut, Kerala 673 006.

AND

M/s. Malabar Cochin Arcade Pvt. Ltd. with its Registered Office at 17/1491-D, 3rd Floor, Malabar Gate, Ram Mohan Road, Calicut 673 004 (hereinafter referred to as "Franchisee" which expression shall unless repugnant to the context includes its successors in interest assigns, persons or institutions claiming through or under it) having its Gold Showroom at 4G/515-A, Opp. Grand Hotel, M.G. Road, Ernakulam 682 101, represented by its Director, Mr. Nishad A.K., S/o. Assan Kutty, aged 36 years, residing at 27/151-A, Malabar Place, Parayanchery,

Kuthiravattom (PO), Calicut 673 016.

PREAMBLE

(I) Whereas Malabar Gold has acquired good reputation, goodwill and customer acceptability and credibility and is the sole owner of the brand name "Malabar Gold" and it's Logo.

(II) Whereas the Franchisee is desirous of securing the franchise to pursue the activities that have been mentioned below under the name of "Malabar Gold" getting the benefit and advantage of the goodwill, reputation and customer base and has requested Malabar Gold to grant the licence to the Franchisee to pursue the undermentioned activities at the showroom authorised by Malabar Gold.

- (i) Retailing of gold ornaments
- (ii) Retailing of diamond and other precious stone ornaments.
- (iii) Retailing of premium watches.
- (iv) Retailing of platinum and other premium fashion accessories.
- (v) Any other items introduced by Malabar Gold in future.

Terms and Conditions

After mutual discussions and negotiations Malabar Gold has agreed to grant permission subject to the following terms and conditions which are to be strictly complied by the Franchisee.

(1) Omitted.

(2) Products

The Franchisee agrees not to stock, exhibit or sell any products in the authorised showroom during the period of this agreement, except the products authorized by Malabar Gold, which may include products manufactured or sourced by Malabar Gold.

(3) Trade name

Means the trade name of Malabar Gold and/or its associates and shall include any distinctive name/style used or which may be used in future from time to time, by Malabar Gold and/or its associates and shall also include any letter, word, design or logo of malabar gold and/or its associates or associated with Malabar Gold or which may be associated with Malabar Gold and/or its associates with its business.

Notwithstanding anything contained herein, The Franchisee hereby warrants, covenants and undertakes with Malabar Gold that at no time, during the Term, or post termination of this Agreement, for whatsoever cause, the Franchisee shall make or be entitled to make:

(A) Any claim to the trade name, or trade names or to any part of the name or names for the time being of Malabar Gold or to the name or any part thereof under which Malabar Gold is carrying on for the time being the business in the field of franchise, new business opportunities and other allied services nor shall the Franchisee use as part of the style of its business any name(s), mark(s) or logo(s), which is or which are deceptively or confusingly similar to the trade name or names or part of its business.

(B) The Franchisee hereby expressly agrees, admits and acknowledges that all rights, title and interest in the trade name or trade names or in the name or names of Malabar Gold in its business or in any letter, work design, logo, business name or part of the style of its business arising out of their use exclusively belongs to Malabar Gold, and no right, title or interest is granted by Malabar Gold to the Franchisee to use Malabar Gold's trade names, style and logo and the name of the division under which Malabar Gold is from time to time carrying on the business.

(C) Nothing in this Agreement shall confer any permanent right or interest to the Franchisee in any trade mark, trade name, service mark, design, logo or the name of Malabar Gold or presently being used by it in respect of any other items other than relating to the business and nothing herein will create any ownership right on the printed matters, books published, magazines, periodicals, and software of any kind, audio and video cassettes and other promotional and business aids and material supplied by Malabar Gold to the Franchisee for use in the business under this Agreement. The franchisee agrees to take prior written approval of Malabar Gold and/or its business associates in respect of usage of above mentioned material.

(D) The Franchisee specifically undertakes that it shall have no right, title, lien, licence, etc., on the business material content and material thereof and the permission to deal and/or resell the business material content and material thereof granted to it through Malabar Gold shall terminate on the expiry or termination of this agreement whichever is earlier.

(E) The Franchisee shall not do anything which will cause injury to the trade name of reputation or Malabar Gold and that the Franchisee agrees to indemnify and keep Malabar Gold indemnified against all claims whatsoever and from all liabilities, damages or injury of any description which may occur or affect Malabar Gold for any failure by the Franchisee to perform its obligations under this agreement or from any act or omission whatsoever on the part of the Franchisee or its servants or agents.

4. Support from malabar gold

Malabar gold at its sole discretion will provide assistance in the following areas at cost for the authorised showroom:

Feasibility studies for the showroom

Project plan for setting up the showroom

Selection of site

Design of building

Design of interiors

Design of organisation structure

Developing job descriptions for key positions

Recruitment of key personnel

Training of key personnel

Launch plan for showroom

Identification of suppliers for gold, diamonds, etc.

Selection of appropriate product mixes

Tie up with reputed brands for sale and display of their products

Sourcing of items like computers, software, testing equipment, tools, etc.

Implementation of appropriate systems and procedures

Sourcing of common items like hoardings, brochures, posters, packing material, compliments, etc.

Centralized marketing services like film shooting, advertisement designs TV and newspaper releases, etc.

Access to centralized customer database

Benchmarking services through comparison of performance with other "Malabar Gold" showrooms

Option to purchase items made at in-house production centre at discounted rates specified by Malabar Gold

Assisting to raise fund from financial institutions to carry larger stock level

Arranging eminent personalities and celebrities as brand ambassadors of "Malabar Gold".

5. Showroom operations

5.1. Standardisation.--The franchisee agrees that the showroom will be set up in accordance with the special standardised designs and decor of "Malabar Gold" and strict adherence is insisted upon in the specified layout uniformity of equipments and approach for maintaining the standard of image and reputation of "Malabar Gold". The strict and continuing adherence to the standards, uniformity and other requirements, set out herein is expressly made a condition

of this Agreement. Except as specifically otherwise authorised by Malabar Gold, the Franchisee shall not alter the appearance of the exterior or interior of any premises used as the show room of the Franchisee.

5.2. Location.--The Franchisee agrees to stock and sell only products authorised by Malabar Gold at the authorised showroom located at the following address. M/s. Malabar Cochin Arcade Pvt. Ltd., 40/515-A, Opp. Grand Hotel, M.G. Road, Ernakulam District, Pin-682 101, Kerala State and/or other centers that may be opened in future by the franchisee, with the prior written approval of Malabar Gold.

5.3. Name board and display.--The showroom shall have a name board "Malabar Gold" conspicuously displayed as per the design approved by Malabar Gold. Malabar Gold will specify the approved design from time to time by specific circulars. The Franchisee will not use any other logo or name including the name under which the franchise is taken without the written approval of Malabar Gold. The Franchisee agrees to display and maintain Malabar Gold's trade marks, trade names, service marks, logos and advertising and promotional materials including posters at such premises, in the manner authorised by Malabar Gold from time to time. The Franchisee agrees to maintain and display signs of Malabar Gold only. The colour, colour scheme, size, design and location of such signs shall be, from time to time, be specified by Malabar Gold. The Franchisee shall not place additional signs, posters, trade marks, trade names, service marks and logos on premises other than those authorised by Malabar Gold. For such usage of Malabar Gold trademark(s), trade name(s), service mark(s) and logo(s).

5.4. Exclusivity.--The Franchisee undertakes that the showroom and its infrastructure shall not be used for any purpose or activities other than that provided under this agreement. The Franchisee shall also not conduct any business other than "Malabar Gold" business in the name of the entity that has taken up the "Malabar Gold" franchise. The Franchisee shall offer the business covered by this Agreement and any other Business (s) that Malabar Gold may introduce from time to time and intimated by Malabar Gold.

5.5. The Franchisee shall operate the show room in accordance with the standards, specifications and procedures set out by Malabar Gold from time to time. The Franchisee agrees further that changes in such standards, specifications and procedures may become necessary from time to time and agrees to accept such modifications, revisions and additions which Malabar Gold in good faith considers necessary. The Franchisee agrees not to deviate from the standards as laid down by Malabar Gold from time to time.

5.6. Maintenance.--It is the responsibility of the Franchisee during the tenure of the franchise to ensure that the exterior and interior of the showroom is always maintained in the prescribed standard and quality to the satisfaction of Malabar Gold.

5.7. The Franchisee undertakes to retain the said premises/showroom until

subsistence of this agreement (and such renewals as may be mutually agreed from time to time). The Franchisee shall duly and punctually pay all payments/charges/duties/levies and other moneys necessary for effecting and keeping up such premises to the Landlord/Licensors and/or to the Government/statutory authorities. The Franchisee shall furnish to Malabar Gold a copy of such agreement with the landlord/licensor and its renewals as well as payments made to Government/Statutory authorities as and when sought by Malabar Gold.

5.8. Operational expenses.--The Franchisee shall meet from its own funds, all expenses related to the operations of the showroom including salary of employees, rent, electricity and water charges, local promotion expenses phone/fax bills, etc., promptly and all other incidental and related costs for the carrying on of the business.

5.9. Local promotion advertising and publicity.--The Franchisee agrees to spend on local promotion, advertising and publicity in connection with the showroom. Malabar Gold shall have the right to prescribe the manner and frequency of the advertising and promotional methods, which the Franchisee will be obliged to carry out at its own cost.

5.10. Shared promotion, advertising and publicity.--The Franchisee agrees to share the proportionate amount spent on inter-national/national/regional/State/territory promotion, advertising and publicity for the brand name "Malabar Gold", Malabar Gold will decide the proportionate share to be borne by each Franchisee.

5.11. Records.--The Franchisee agrees to maintain such records as may be required by Malabar Gold to understand product preference, product movement customer trends, financial position, stock position, etc., and send regular reports as specified by Malabar Gold relating to those items from time to time.

5.12. Personnel/employment of staff-

(i) The Franchisee agrees to employ such persons (including Executive Directors, Managers, Executives, Staff, etc.) with the qualification, experience and competence as prescribed by Malabar Gold on a part time or full time basis for the purpose of carrying out the activities under this agreement. The Franchisee also agrees to fix the remuneration and terms and conditions of employment of these persons and to terminate their services if it is found to be detrimental to the interests of Malabar Gold and as prescribed by Malabar Gold if required for the better running of the business.

(ii) The persons employed by the franchisee shall be the employees of the Franchisee and there is absolutely no employer employee relationship between such persons and Malabar Gold. Malabar Gold shall not be liable or responsible for any demands or claims or liabilities relating to such employees whatsoever including under the labour laws or any other laws applicable to them.

(iii) It shall be the responsibility of the Franchisee to observe all the statutory requirements for the employees including, but not confined to the Shops and

Commercial Establishments Act, Workmen's Compensation Act, Employees' Provident Fund, Employees' Family Pension, ESI and other applicable labour and allied laws.

(iv) The Franchisee hereby indemnifies Malabar Gold from all or any such claims that may arise regarding such employment or employees.

(v) The Franchisee agrees not to utilise the services of any of these persons for any service other than those specified for the showroom. Malabar Gold shall not in any way be liable to bear the loss/damage, liability, debts incurred by the Franchisee or their employees in running the said activities. The Franchisee shall be responsible for the proper conduct and behaviour of all their employees, both part time and full time; in their interaction with all external and internal parties including customers. These persons will be expected to conform to the code of conduct and standards set out by Malabar Gold through specific circulars from time to time.

(vi) It is hereby clarified and declared that the persons employed by the Franchisee at the Franchisee's office are the employees of the Franchisee only and none of them shall be entitled to claim any status as the employees of Malabar Gold nor shall any of them be entitled to any benefits, perquisites and amenities available with Malabar Gold. It is hereby further clarified that Malabar Gold will not be concerned or be made a party to any dispute between the Franchisee and its employees.

(vii) The Franchisee shall be entirely responsible and shall comply with all applicable statutes like PF, ESI, Minimum Wages Act, Payments of Wages Act, etc., in terms of coverage, returns, record maintenance and like in relation to the employee of the Franchisee. The Franchisee shall also make payment of all benefits as admissible under different enactments to its employee(s), including weekly rest days, leave, national holidays, overtime if any, bonus/gratuity, if applicable, from time to time. Malabar Gold will not be liable for any non-compliance on part of Franchisee and only the Franchisee shall be held responsible for all legal consequences.

(viii) The Franchisee shall maintain all requisite records, registers, accounts books, etc., which are obligatory under any law as applicable to the services being provided under this agreement and shall provide any information as may be required under any statutory obligation.

(ix) However, in case, Malabar Gold is not satisfied with the performance of any employee of the Franchisee or continuance of the employee at the Office of the Franchisee is detrimental to the interest of Malabar Gold, then the Franchisee shall take necessary steps to safeguard the interest of Malabar Gold indicated as above.

5.15. Packing materials.--All packing material used by franchisee will exhibit the logo "Malabar Gold" through specific circulars from time to time.

5.16. Stationery.--The Franchisee agrees to use the "Malabar Gold" logo on its letterhead, envelopes, etc., used for business purposes contemplated under this agreement and Malabar Gold through specific circulars may approve stationery only in such form as from time to time. The Franchisee agrees to take prior written approval of Malabar Gold in respect of all stationary material, business cards and promotional material used by the Franchisee for the purpose of conducting business under the terms of this agreement.

5.17. Inspection.--The Franchisee agrees that malabar gold or its representatives shall have the right to inspect the premises of the show room and inspect all documents records and accounts whenever they deem fit to ensure conformity with the terms of this agreement.

Clauses 6 to 11 omitted.

12. Transfer of rights

The Franchisee agrees not to sub-let or sub-lease or in any way sell, transfer, discharge or distributes or delegate or assign the rights under this agreement in favour of any third party except with the prior written consent of Malabar Gold.

Clauses 13 to 17 omitted.

18. Agency

(i) The Franchisee agrees that it is not an agent of Malabar Gold and it is not entitled to enter into any contract on behalf of Malabar Gold. The relationship between Malabar Gold and the Franchisee shall be one of principal to principal basis.

(ii) The parties hereto agrees that the Franchisee is an independent business concern "Malabar Gold" shall not be liable or responsible for any loss sustained by the franchisee either in the conduct of business or in any other manner. Nothing herein contained shall constitute the Franchisee as an agent, legal representative, partner, subsidiary, joint venture or employee of Malabar Gold. The Franchisee shall have no right or power to, and shall not bind or obligate Malabar Gold in any way, manner or thing whatsoever, nor represent that he has any right to do so.

(iii) In all public records and in its relationship with other persons, on its letter heads and business forms, the Franchisee shall indicate its independent ownership of the said business and that the Franchisee is the person authorised by Malabar Gold to conduct the business in respect of the Businesses as is the subject-matter of this agreement.

Clauses 19 to 21 omitted

22. Royalty

For being allowed to operate the "Malabar Gold" franchise, the Franchisee will pay Malabar Gold a royalty of 10 per cent of the Net Profit before computing

depreciation and income tax. The royalty amount is calculated for every calendar month and shall be remitted by the 15th of the succeeding month by means of a Demand Draft payable to Malabar Gold at Calicut. At the end of every financial year the actual annual profit of the Franchisee will be calculated and settled.

Clauses 23 and 24 omitted.

25. Cancellation/termination

25.1. Violation--Malabar Gold reserves the right to terminate this agreement without prior notice at any time during the period of this agreement in the event of violation by the Franchisee of any of the terms of this agreement and Malabar Gold shall be the sole authority to determine the existence and extent of any violation.

25.2. Definition.--Without prejudice to the generic meaning of the expression violation of the agreement and without limiting its wide scope in any manner it is expressly agreed that the following acts/conduct shall constitute violation of the agreement.

25.2.1 Stocking or selling of any unauthorised merchandise or counterfeit products.

25.2.2. Suspension of the business in the showroom for any reason whatsoever for more than seven days consecutively, except in the case of riots, natural calamities, bandhs, acts of god and nature.

25.2.3. Change in the management, constitution, control of the Franchisee.

25.2.4. The showroom becoming unfit for operation for any reason whatsoever.

25.2.5. Involvement in any conduct, which may in the opinion of Malabar Gold adversely affects the name, image and goodwill of Malabar Gold.

25.2.6. Failure to do business in accordance with the business plans of Malabar Gold.

25.2.7. Ceasing to conduct the showroom or defaults under any lease or sub-lease or loses its rights to the possession on the premises in which the same is located.

25.2.8. Conduct of any other business similar to Malabar Gold's business activity or any activity, which will cause a loss/diversion of business from malabar gold.

25.2.9. Questioning, disputing or attacking the validity, rights, title or interest of Malabar Gold or Malabar Gold's logo, trade marks, designs, patents, copy rights or other intellectual property rights, and other material whether copy righted or not.

25.2.10. Committing any other breach of any of its obligations hereunder and the failure to remedy any such breach, within 30 days from the receipt of written

notice from Malabar Gold or any other breach of any of its obligations hereunder where the same is not capable of remedy.

25.3. On termination.--Upon expiry of this agreement or an earlier termination of this agreement, the franchisee will be bound by the following:--

- (1) The franchisee will make all payments due to Malabar Gold.
- (2) The franchisee will stop usage of and return display board, publicity material, hoardings, sign boards and all such materials which indicate the franchisee's association with the franchiser or franchiser's trade marks.
- (3) The Franchisee undertakes to return forthwith all literature, promotional materials, sign boards, visual support items, logos, stamps and seals of Malabar Gold. It is agreed that the Franchisee shall forfeit all rights and privileges conferred upon the Franchisee by this agreement and the Franchisee shall not be entitled to use the trade name or materials of Malabar Gold.
- (4) The franchisee will not take undue advantage of being an Ex-Franchisee by making representations, express or implied.
- (5) The franchisee will not complete in the same product category/trade for a minimum period of two years from termination of this agreement in the name/or for the benefit of himself/immediate family members.

26. As already noticed, service tax on franchise service was introduced with effect from March 1, 2003. The KVAT Act is brought into force as per the relevant notification, with effect from April 1, 2005 and the notification is available at page 117 of the paper book. The same is published as SRO No. 139 of 2005 dated April 1, 2005.

27. We will now discuss the principles stated by this court in the three judgments, viz., Mechanical Assembly Systems (India) Pvt. Ltd. Vs. State of Kerala, , Jojo Frozen Foods (P) Ltd. Vs. State of Kerala, and Kreem Foods Private Limited Vs. State of Kerala, In the first of the decisions, the relevant assessment year was 1999-2000. The facts referred to in para 2 of the judgment will show that the petitioner therein was a private limited company engaged in the manufacture of combustible paper cartridge cases for use of the defence force. It entered into an agreement on April 15, 1999 with another company by name Mas Combustible Pack Ltd. (MCP), Cherthala with its factory at Hyderabad for providing technology for production of combustible cartridge cases (CCC) and to help continuously by undertaking the repairs and maintenance required for machinery of the said company. The petitioner-company also agreed to depute suitable personnel to MCP factory at Hyderabad for supervising uninterrupted production of CCC The petitioner-company was entitled for five per cent of the sales turnover of CCC towards remuneration for the services rendered. For the consideration received, of a sum of Rs. 1,24,19,567 for the assessment year 1999-2000, as royalty the Sales Tax Officer proposed to levy tax under the KGST Act treating the income from royalty as turnover taxable under the Act. It was

contended by the petitioner-company that technical know-how will not come under the definition of "goods" and therefore the amount cannot be subjected to tax under the KGST Act. After considering the contentions of the learned counsel for the petitioner that offering technology by deputing suitable personnel and that technical know-how unless incorporated in a tangible media and transferred, cannot constitute "goods" for the purpose of levy of sales tax, the Division Bench, speaking through honourable Justice K.S. Radhakrishnan (as his Lordship then was), rejected the said contention. It was held in para 8 that "technical know-how can also be transmitted, transferred, delivered, stored or possessed, etc. Agreement would definitely indicate that there is a transfer of technology for the manufacture of CCC deputing personnel for consideration, i.e., through human media. Transfer of technology in any manner either through floppy disc, CD or through deputing personnel, etc., would constitute sale within the meaning of section 2(xxi) of the Kerala General Sales Tax Act." The interpretation of the term "goods" by the apex court in *Tata Consultancy Services Vs. State of Andhra Pradesh*, and the meaning of the term "goods" under article 366(12) of the Constitution of India have been relied on and the meaning of the term "goods" in article 366(12) of the Constitution was held as very wide and include all types of immovable properties whether those properties are tangible or intangible.

28. We find from the said judgment that the question considered therein was with regard to the transfer of know-how by deputing personnel and whether the same will attract the payment of tax under the KGST Act. It is true that the amount received was termed as royalty, but it was a case of outright transfer of the know-how itself and it was not a case of transfer of the use of know-how as pointed out by the learned counsel for the petitioner.

29. A later Division Bench in *Jojo Frozen Foods (P) Ltd. Vs. State of Kerala*, presided over by the honourable Chief Justice H.L. Dattu (as his Lordship then was), relied upon the dictum laid down in *Mechanical Assembly Systems (India) Pvt. Ltd. Vs. State of Kerala*, for considering whether the royalty income received by the assessee attracts levy under the KGST Act. The Division Bench also relied upon the judgment of the Bombay High Court in *Commissioner of Sales Tax Vs. Duke and Sons Private Limited*, and that of the Madras High Court in *S.P.S. Jayam and Co. Vs. The Registrar, Tamilnadu Taxation Special Tribunal, The Deputy Commercial Tax Officer and The State of Tamilnadu*, . In *Kreem Foods Private Limited Vs. State of Kerala*, also, the Bench presided over by the honourable Chief Justice H.L. Dattu (as His Lordship then was) took the same view.

30. It is submitted by the learned counsel for the appellant-company that the assessment years in both the latter cases are prior to 2003 which is not disputed by the learned Special Government Pleader for Taxes. In all the three cases therefore, the receipt of royalty by the assessee was held as liable to payment of tax under the KGST Act.

31. The question is whether the dictum laid down in those cases are

distinguishable in the light of the peculiar facts of the present case and in the light of the provisions of the Finance Act, 1994 which are relied upon by the learned counsel for the appellant, whereby service tax on franchise service was introduced with effect from July 1, 2003 and the question will be whether the principles laid down in Bharat Sanchar Nigam Ltd. and Another Vs. Union of India (UOI) and Others, will support the plea of the appellant.

32. Both sides have relied upon the relevant principles explaining the meaning of the term "goods" by the apex court in Tata Consultancy Services Vs. State of Andhra Pradesh, Therein, in para 19 in SCC; (para 16 in STC) the apex court held as follows (page 633 in 137 STC):

Thus this court has held that the term "goods", for the purposes of sales tax, cannot be given a narrow meaning. It has been held that properties which are capable of being abstracted, consumed and used and/or transmitted, transferred, delivered, stored or possessed, etc., are "goods" for the purposes of sales tax. The submission of Mr. Sorabjee that this authority is not of any assistance as a software is different from electricity and that software is intellectual incorporeal property whereas electricity is not, cannot be accepted. In India the test, to determine whether a property is "goods", for purposes of sales tax, is not whether the property is tangible or intangible or incorporeal. The test is whether the concerned item is capable of abstraction, consumption and use and whether it can be transmitted, transferred, delivered, stored, possessed, etc. Admittedly in the case of software, both canned and uncanned, all of these are possible.

33. Therefore, the relevant test is whether the item concerned is capable of abstraction, consumption, use and whether it can be transmitted, transferred, delivered, stored, possessed, etc. The specific item considered in the said case was software, both canned and uncanned and it was held that all the tests are possible in relation to the said item of goods.

34. The learned Special Government Pleader for Taxes relied upon paragraphs 25 to 27 in SCC (paragraphs 22 to 24 in STC of the above judgment which dealt with the definition of the term "goods" under article 366(12) of the Constitution of India. It was relied upon to show that both properties whether tangible or intangible, are also covered under the item of "goods". The principles enunciated under para 19 in SCC (para 24 in STC of the judgment was reiterated therein which are as follows (page 640 in 137 STC):

In our view, the term "goods" as used in article 366(12) of the Constitution of India and as defined under the said Act is very wide and include all types of movable properties, whether those properties be tangible or intangible...

35. Now we will come to the judgment of the apex court in Bharat Sanchar Nigam Ltd. and Another Vs. Union of India (UOI) and Others, Therein, the provisions of the Constitution under article 366(29A)(d) and (12) and Schedule VII, List II entry 54 and List I entry 92C came up for interpretation. In para 32, the issues which arose for consideration have been dealt with under items (A) to

(E) which are the following (page 114 in 3 VST):

(A) What are "goods" in telecommunication for the purposes of article 366(29A) (d)?

(B) Is there any transfer of any right to use any goods by providing access or telephone connection by the telephone service provider to a subscriber?

(C) Is the nature of the transaction involved in providing telephone connection a composite contract of service and sale? If so, is it possible for the States to tax the sale element?

(D) If the providing of a telephone connection involves sale is such sale an inter-State one?

(E) Would the "aspect theory" be applicable to the transaction enabling the States to levy sales tax on the same transaction in respect of which the Union Government levies service tax?

36. The learned counsel for the appellant-company stressed that the answer to item (E) will be relevant for the purpose of this case, apart from the other important findings. Article 366(29A) was introduced by the Constitution (Forty-sixth Amendment) Act, 1982. The background of the introduction of the same has been discussed in paragraphs 39 to 44 of the judgment. Sub-clause (d) of article 366(29A) of the Constitution is relevant for the purpose of this case which reads as follows (page 117 in 3 VST):

366 (29A) "tax on the sale or purchase of goods" includes-

(a) to (c), (e) and (f) omitted.

(d) a tax on the transfer of the right to use any goods for any purpose (whether or not for a specified period) for cash, deferred payment or other valuable consideration.

37. In the light of the introduction of the same, if the relevant tests are satisfied, the same will be a deemed sale. In para 43, the apex court held that even after introducing separate categories of deemed sales in the said article, the meaning of the word "goods" was not altered. For easy reference, we extract the said paragraph hereunder (pages 118 and 119 in 3 VST):

43. The State of Madras Vs. Gannon Dunkerley and Co., (Madras) Ltd., survived the 46th Constitutional Amendment in two respects. First, with regard to the definition of "sale" for the purposes of the Constitution in general and for the purposes of entry 54 of List II in particular except to the extent that the clauses in article 366(29A) operate. By introducing separate categories of "deemed sales", the meaning of the word "goods" was not altered. Thus the definitions of the composite elements of a sale such as intention of the parties, goods, delivery, etc., would continue to be defined according to known legal connotations. This does not mean that the content of the concepts remain static.

Courts must move with the times. But the 46th Amendment does not give a licence for example to assume that a transaction is a sale and then to look around for what could be the goods. The word "goods" has not been altered by the 46th Amendment. That ingredient of a sale continues to have the same definition. The second respect in which *The State of Madras Vs. Gannon Dunkerley and Co., (Madras) Ltd.*, has survived is with reference to the dominant nature test to be applied to a composite transaction not covered by article 366(29A). Transactions which are mutant sales are limited to the clauses of article 366(29A), All other transactions would have to qualify as sales within the meaning of Sale of Goods Act, 1930 for the purpose of levy of sales tax.

38. Importantly, it was held that "Thus the definitions of the composite elements of a sale such as intention of the parties, goods, delivery, etc., would continue to be defined according to known legal connotations. But the 46th Amendment does not give a licence for example to assume that a transaction is a sale and then to look around for what could be the goods. The word "goods" has not been altered by the 46th Amendment. That ingredient of a sale continues to have the same definition..."

39. In para 50, the manner by which the court will have to approach to find out what are the "goods" in a sale transaction, has been explained thus (page 121 in 3 VST):

50. What are the "goods" in a sales transaction, therefore, remains primarily a matter of contract and intention. The seller and such purchaser would have to be *ad idem* as to the subject-matter of sale or purchase. The court would have to arrive at the conclusion as to what the parties had intended when they entered into a particular transaction of sale, as being the subject-matter of sale or purchase. In arriving at a conclusion the court would have to approach the matter from the point of view of a reasonable person of average intelligence.

40. In para 56 the principles stated in *Tata Consultancy Services Vs. State of Andhra Pradesh*, with regard to the meaning of the term "goods" were quoted and the said view was adopted in para 57 in SCC (para 55 in VST). We extract the said paragraphs hereunder (page 122 in 3 VST):

56 This view was adopted in *Tata Consultancy Services Vs. State of Andhra Pradesh*, for the purposes of levy of sales tax on computer software. It was held:

A "goods" may be a tangible property or an intangible one. It would become goods provided it has the attributes thereof having regard to (a) its utility; (b) capable of being bought and sold; and (c) capable of being transmitted, transferred, delivered, stored and possessed. If a software whether customized or non-customised satisfies these attributes, the same would be goods.

57. This in our opinion, is the correct approach to the question as to what are "goods" for the purposes of sales tax. We respectfully adopt the same.

41. In para 73 their Lordships held that the dictum laid down in 20th Century

Finance Corpn. Ltd. and Another Vs. State of Maharashtra, cannot be cited as art authority for the proposition that delivery of possession of the goods is not a necessary concomitant for completing a transaction of sale for the purposes of article 366(29A)(d) of the Constitution. In paragraphs 74 and 75 in SCC (paras 73 and 74 in VST) the question whether actual delivery of goods is necessary for effecting the transfer of right to use the "goods" was considered. The said paragraphs are extracted hereinbelow (pages 127 and 128 in 3 VST):

74. In determining the situs of the transfer of the right to use the goods, the court did not say that delivery of the goods was inessential for the purposes of completing the transfer of the right to use. The emphasized portions in the quoted passage evidences that the goods must be available when the transfer of the right to use the goods take place. The court also recognized that for oral contracts the situs of the transfer may be where the goods are delivered (see para 26 of the judgment).

75. In our opinion, the essence of the right under article 366(29A)(d) is that it relates to user of goods. It may be that the actual delivery of the goods is not necessary for effecting the transfer of the right to use the goods but the goods must be available at the time of transfer must be deliverable and delivered at some stage. It is assumed, at the time of execution of any agreement to transfer the right to use, that the goods are available and deliverable. If the goods, or what is claimed to be goods by the respondents, are not deliverable at all by the service providers to the subscribers, the question of the right to use those goods, would not arise.

42. In the light of the principles stated therein, it can be seen that actual delivery of the goods is not necessary for effecting transfer of right to use the goods, but the goods must be deliverable and delivered at some stage. Significantly, it was held that if the goods, or what is claimed to be goods by the respondents, are not deliverable at all by the service providers to the subscribers, the question of the right to use those goods, would not arise.

43. The above paragraphs are highlighted by the learned counsel for the appellant to point out that at the time of execution of any agreement to transfer the right to use the goods, the goods should be available and deliverable. The above paragraphs will definitely support the said contention of the learned counsel. The matter was further explained from paragraphs 76 onwards in SCC (paragraphs 75 onwards in 3 VST), after considering the judgment of the apex court in State of Andhra Pradesh and Another Vs. Rashtriya Ispat Nigam Ltd., We extract paragraphs 76, 77, 78 and 79 in SCC (paras 75, 76, 77 and 78 in VST) hereunder (page 128 in 3 VST):

76. In State of Andhra Pradesh and Another Vs. Rashtriya Ispat Nigam Ltd., it was claimed by the sales tax authorities that the transaction by which the owner of certain machinery had made them available to the contractors was a sale. The court rejected the submission saying that:

...the transaction did not involve transfer of right to use the machinery in favour of contractors... The effective control of the machinery even while the machinery was in use of the contractor was that of the respondent-company; the contractor was not free to make use of the machinery for the works other than the project work of the respondent or..." (para 4 page 315)

77. But in the case of Aggarwal Brothers Vs. State of Haryana and Another, when the assessee had hired shuttering in favour of contractors to use it in the course of construction of buildings it was found that possession of the shuttering materials was transferred by the assessee to the customers for their use and, therefore, there was a deemed sale within the meaning of sub-clause (d) of clause (29A) of article 366. What is noteworthy is that in both the cases there were goods in existence which were delivered to the contractors for their use. In one case there was no intention to transfer the right to use while in the other there was.

78. But if there are no deliverable goods in existence, as in this case, there is no transfer of user at all. Providing access or telephone connection does not put the subscriber in possession of the electromagnetic waves any more than a toll collector puts a road or bridge into the possession of the toll payer by lifting a toll gate. Of course the toll payer will use the road or bridge in one sense. But the distinction with a sale of goods is that the user would be of the thing or goods delivered. The delivery may not be simultaneous with the transfer of the right to use. But the goods must be in existence and deliverable when the right is sought to be transferred.

79. Therefore, whether goods are incorporeal or corporeal, tangible or intangible, they must be deliverable. To the extent that the decision in State of Uttar Pradesh and Another Vs. Union of India (UOI) and Another, held otherwise, it was in our humble opinion erroneous.

44. In the light of the principles stated in Bharat Sanchar Nigam Ltd. and Another Vs. Union of India (UOI) and Others, it can be seen that if there are no deliverable goods in existence, there is no transfer of user at all. The delivery may not be simultaneous with the transfer of the right to use also and in the case of tangible or intangible goods also, it was held that the goods must be deliverable.

45. In para, 81 in SCC (para 80 in VST) it was held that "Therefore, the deemed sales included in entry 54, List II would also be subject to the limitations of articles 286 and 366(29A). Finally, in para 92 in SCC (para 91 in VST), the questions were answered as hereunder (page 132 in 3 VST):

92. For the reasons aforesaid, we answer the questions formulated by us earlier in the following manner:

(A) Goods do not include electromagnetic waves or radio frequencies for the purpose of article 366(29A)(d). The goods in telecommunication are limited to

the handsets supplied by the service provider. As far as the SIM cards are concerned, the issue is left for determination by the assessing authorities.

(B) There may be a transfer of right to use goods as defined in answer to the previous question by giving a telephone connection.

(C) The nature of the transaction involved in providing the telephone connection may be a composite contract of service and sale. It is possible for the State to tax the sale element provided there is a discernible sale and only to the extent relatable to such sale.

(D) The issue is left unanswered.

(E) The aspect theory would not apply to enable the value of the services to be included in the sale of goods or the price of goods in the value of the service.

46. Against question (E), viz., whether the aspect theory will apply, it was held that it will not apply to enable the value of the services to be included in the sale of goods or the price of goods in the value of the service.

47. In the concurring judgment, the relevant principles were laid down in paragraphs 96 and 97. The said paragraphs are extracted below (page 133 in 3 VST):

96. The entire infrastructure/instruments/appliances and exchange are in the physical control and possession of the petitioner at all times and there is neither any physical transfer of such goods nor any transfer of right to use such equipment or apparatuses.

97. To constitute a transaction for the transfer of the right to use the goods the transaction must have the following attributes:

(a) There must be goods available for delivery;

(b) There must be a consensus ad idem as to the identity of the goods;

(c) The transferee should have a legal right to use the goods-consequently all legal consequences of such use including any permissions or licenses required therefor should be available to the transferee;

(d) For the period during which the transferee has such legal right, it has to be the exclusion to the transferor--this is the necessary concomitant of the plain language of the statute-viz., a "transfer of the right to use" and not merely a licence to use the goods;

(e) Having transferred the right to use the goods during the period for which it is to be transferred, the owner cannot again transfer the same rights to others.

48. Thus, with regard to transfer of right to use, the said tests were laid down to constitute a transaction as such. Sub-para (d) of para 97 will show that for a transferee to obtain legal right, it has to be the exclusion to the transferor and

significantly it was held that the same is a necessary concomitant of the plain language of the statute, viz., a "a transfer of the right to use" and not merely a licence to use the goods. Sub-para (e) shows that after the right to use the goods is transferred for the relevant period, the owner cannot again transfer the same right to others. On the facts of the said case, it was held that in the relationship between a telecom service provider and the consumer such tests are not applied.

49. For the purpose of this case, learned counsel for the appellant relied upon sub-paragraphs (d) and (e) of para 97 and the relevant earlier paragraphs we have already quoted.

50. In the light of the above tests, if the franchise agreement in this case is analysed, it can be seen that it is only a licence to use the trade mark and the transfer of its use is not to the exclusion of the transferor, viz., the appellant-company "Malabar Gold Private Limited" Here, the company retains the right to transfer the same to others also. It is explained by the learned counsel for the appellant that already 16 such franchisees are there and the same type of agreement has been executed between them.

51. In the light of the dictum laid down by the apex court as above, specifically in relation to article 366(29A)(d) and entry 54 of List II, the learned Special Government Pleader is not right in submitting that the said principles cannot be attracted here, as the facts are different and that we will have to understand the same only on the facts of the said case and the transaction therein. We cannot agree. The whole concept of "goods" and "sale" and the relevant principles prior to the introduction of article 366(29A) and the relevant principle which may apply after introduction of the said article therein, have been emphasised by the apex court in the said decision. Learned counsel for the appellant is right in submitting that the said principles will have application to understand the scope and ambit of the term "right to use".

52. Bharat Sanchar Nigam Ltd. and Another Vs. Union of India (UOI) and Others, was again considered by the apex court in Imagic Creative Pvt. Ltd. Vs. The Commissioner of Commercial Taxes and Others, Their Lordships, in the said judgment, considered a case of composite contract and held that demand to pay sales tax for the value of the entire contract irrespective of element of service provided, is not correct. Therein, article 366(29A) of the Constitution, section 12 of the Karnataka Sales Tax Act, 1957 and section 66 of the Finance Act, 1994 came up for consideration. In para 19, the findings contained in paragraphs 44 and 45 and 50 of Bharat Sanchar Nigam Ltd. and Another Vs. Union of India (UOI) and Others, have been extracted and in para 26 their Lordships considered the true effect of the legal fiction created under article 366 (29A) and held as follows (page 384 in 12 VST):

26. We have noticed hereinbefore that a legal fiction is created by reason of the said provision. Such a legal fiction, as is well known, should be applied only to

the extent for which it was enacted. It, although must be given its full effect but the same would not mean that it should be applied beyond a point which was not contemplated by the Legislature or which would lead to an anomaly or absurdity.

53. In para 28 (para 33 in 12 VST), it was held that "payments of service tax as also the VAT are mutually exclusive. Therefore, they should be held to be applicable having regard to the respective parameters of service tax and the sales tax as envisaged in a composite contract as contradistinguished from an indivisible contract." Finally, with regard to the particular facts of the case, it was held that "It is, therefore, difficult to hold that in a case of this nature, sales tax would be payable on the value of the entire contract; irrespective of the element of service provided..."

54. The Bombay High Court in *The Commissioner of Sales Tax Maharashtra State Vs. Rolta Computer and Industries Private Limited*, followed the dictum laid down in *Bharat Sanchar Nigam Ltd. and Another Vs. Union of India (UOI) and Others*, and *State of Andhra Pradesh and Another Vs. Rashtriya Ispat Nigam Ltd.*, The question which arose for consideration was under the Maharashtra Sales Tax on the Transfer of the Right to use any Goods for any Purpose Act, 1985. In that case, the ONGC entered into an agreement with the respondents who are engaged in the business of computers data processing and software consultancy, to get their quotation, inventory and financial accounting applications processed from the respondents on certain terms and conditions. The respondents charged Rs. 2,500 per hour for CPU. The question was whether the transaction will attract payment of tax under the above stated enactment. The Commissioner of Sales Tax who determined the question on the application of the respondents, held that as soon as the ONGC is allowed to use the terminal, transfer of right to use the computer starts and it continues till the use of the terminal is continued and therefore it attracts sales tax under the said Act. The Division Bench of the Bombay High Court, while considering the question, relied upon the principles stated by the apex court in *Bharat Sanchar Nigam Ltd. and Another Vs. Union of India (UOI) and Others*, to consider whether the delivery of goods is necessary for effecting transfer of right to use the goods and paragraphs 72, 75, 76 and 98 of the above judgment, have been extracted at pages 326 and 327. Thereafter, it was held as follows in page 327 in 25 VST:

From these observations, it is clear that even though the actual delivery of the goods is not necessary for effecting transfer of right to use the goods but the goods must be available at the time of transfer, must be deliverable and delivered at some stage...

55. It was further held that the goods, i.e., computers and terminals were always in possession of the respondents and they were never delivered or handed over to the ONGC. It is also observed that "merely because a person agrees to provide service to a particular customer during a particular period of time of day to the exclusion of all other customers for the purpose of convenience, it does not mean that goods have been actually delivered to that particular customer to

the exclusion of not only other customers but also to the exclusion of owner himself. Nature of the contract and the transaction between the respondents and the ONGC was nothing more than service contract whereby certain services were provided by the respondents to the ONGC." It was finally held that "sales tax cannot be levied on the said transaction." The view taken in the above judgment clearly supports the argument of the learned counsel for the appellant herein.

56. We will also refer to the judgment of the apex court in State of Andhra Pradesh and Another Vs. Rashtriya Ispat Nigam Ltd., which was also heavily relied upon by the learned counsel for the appellant. Therein, section 5E of the Andhra Pradesh General Sales Tax Act, 1957 came up for consideration, by which tax on the, amount realised in respect of any right to use goods, was imposed. That was a case where the respondent was lending highly sophisticated and valuable imported machinery to the contractors engaged in the execution of the contracted project work on specified hire charges. The, question was whether there was transfer of goods and whether the provisions of section 5E of the Act are attracted. The apex court was of the view that the transaction does not involve transfer of right to use the machinery. It was held as follows in para 4 (page 116 in 126 STC):

...On a careful reading and analysis of the various clauses contained in the agreement and, in particular, looking to clauses 1, 5, 7, 13 and 14, it becomes clear that the transaction did not involve transfer of right to use the machinery in favour of contractors. The High Court was right in arriving at such a conclusion. In the impugned order, it is stated and rightly so in our opinion, that the effective control of the machinery even while the machinery was in use of the contractor was that of the respondent-company/the contractor was not free to make use of the machinery for the works other than the project work of the respondent or move it out during the period the machinery was in his use; the condition that the contractor would be responsible for the custody of the machinery while it was on the site did not militate against respondent's possession and control of the machinery...

57. The crucial test, i.e., the respondent retained effective control and possession of the machinery, was held to be the factor which is relevant.

58. Herein, it is submitted that the terms of the franchise agreement will show that the company retains the effective control and merely because there is an agreement by way of franchise agreement enabling the franchisees to use the trade mark on the products of the company, it cannot be said that the franchisees have got effective control of the trade mark. Here, the franchisee's rights are limited. It is bound to sell the products of the appellant-company. Even while the franchise agreement with one is in force, the company can use the trade mark on their own and can enter into franchise agreement with other parties. The effective control is with the appellant-company during the term of the agreement. We find force in the said submission and the dictum laid down by the apex court in Bharat Sanchar Nigam Ltd. and Another Vs. Union of India

(UOI) and Others, will support the plea of the appellant-company.

59. Even though learned Special Government Pleader for Taxes vehemently submitted that the agreement herein does not contain any service element, we cannot agree. Clause 4 of the agreement is under the heading "Support from Malabar Gold". They are providing various services as mentioned therein including feasibility studies for the showroom, project plan for setting up the showroom, selection of site, design of interiors, etc.. Clause 5 also is important in understanding the said aspect. In the light of the above discussion, we are unable to hold that the provisions of the KVAT Act as referred to by the learned Special Government Pleader for Taxes, will apply herein, as the transaction herein will not come within the term "deemed sale" in the light of the non fulfilment of certain conditions provided in Bharat Sanchar Nigam Ltd. and Another Vs. Union of India (UOI) and Others,

60. The issue therefore can be considered in the light of the dictum laid down in Bharat Sanchar Nigam Ltd. and Another Vs. Union of India (UOI) and Others, Herein, the term "franchise is included in section 65(105)(ze) of the Finance Act. The same is a taxable service and the taxable event is the service rendered by the company. Thus, any service provided or to be provided to a franchisee will come within the purview of the said provision. The meaning of the terms franchise and franchisor u/s 65(47) and (48) are also important. Going by the definition of franchise, it is an agreement by which the franchisee is granted representational right to sell or manufacture goods or to provide service or undertake any process identified with franchisor, whether or not a trade mark, service mark, trade name or logo or any such symbol, as the case may be, is involved. The terms of the agreement herein will show that Clause II of the Preamble has specifically given under items (i) to (v) the activities to be carried out by the franchisee which are as follows:

- (i) Retailing of gold ornaments.
- (ii) Retailing of diamond and other precious stone ornaments.
- (iii) Retailing of premium watches.
- (iv) Retailing of platinum and other premium fashion accessories.
- (v) Any other items introduced by MALABAR GOLD in future.

61. Clause 2 under the heading "products" will show that the franchisee cannot stock, exhibit or sell any products in the authorised showroom during the period of the agreement except the products authorised by Malabar Gold, which may include products manufactured or sourced by Malabar Gold. Therefore, the same will definitely satisfy the meaning of "franchise" as contained in section 65(47) of the Finance Act, 1994. The learned Special Government Pleader for Taxes referred to the agreement herein and said that no service is referred to in the clauses therein. We do not agree, in the light of clauses 3, 4 and 5 of the model agreement as already noticed. Since what is termed as "taxable service" is any

service to be provided to a franchisee by a franchisor in relation to a franchise, the terms of the agreement will have to be understood in that context.

62. In the light of the principles stated in para 98 of the judgment in Bharat Sanchar Nigam Ltd. and Another Vs. Union of India (UOI) and Others, the provisions of the agreement especially clauses (3) and (5) will show that the franchisor retains the right, effective control and possession and it is not a case of transfer of possession to the exclusion of the transferor. We notice that under clause (12) the franchisee has no right to sub-let or sub-lease or in any way sell, transfer, discharge or distribute or delegate or assign the rights under the agreement in favour of any third party, which is also significant. On termination of the agreement also, going by clause 25.3, the franchisee shall forfeit all rights and privileges conferred on them by the agreement and the franchisee will not be entitled to use the trade name or materials of ""Malabar Gold". Merely because, going by clause 18, the franchisee is not an agent, it will not get any other exclusive right.

63. Since this court in the two judgments relied upon by the learned Special Government Pleader, viz., Jojo Frozen Foods (P) Ltd. Vs. State of Kerala, and Kreem Foods Private Limited Vs. State of Kerala, had no occasion to consider entry 97 and the provisions u/s 65(105)(z) of the Finance Act and the definition of franchise and franchisor u/s 65(47), (48) of the Finance Act, and those judgments related to transactions of pre 2003 period, we are of the view that the same are distinguishable on the facts of this case. The judgment in Mechanical Assembly Systems (India) Pvt. Ltd. Vs. State of Kerala, as we have already explained, is a case, of exclusive transfer of know-how.

64. One of the judgments relied upon by the learned Special Government Pleader for Taxes is that of the Andhra Pradesh High Court in Nutrine Confectionery Co. Pvt. Ltd. Vs. State of Andhra Pradesh, Therein, the transaction involved is by way of an agreement between the petitioner company and the assignee companies and a royalty of Rs. 500 per ton of production by the assignee, has been granted to the petitioner company for the use of trade and logo for the goods. The matter was considered u/s 2(h) of the Andhra Pradesh General Sales Tax Act, 1957. The Bench was of the view, after going through the terms of the agreement, that "the assignee is free to make use of the trademark and logo. The petitioner does not in any manner regulate the use of trademark or logo although, keeping in view the facilities available with the assignee, the petitioner undertook to suggest suitable terms provide formulas and recipes and suggest locations for marketing." After analysing the agreement therein, it was held that the consideration received as royalty, is taxable u/s 5E of the Andhra Pradesh General Sales Tax Act. We have already analysed the terms of the agreement herein. Even though learned Special Government Pleader for Taxes placed heavy reliance on the judgment in Nutrine Confectionery Co. Pvt. Ltd. Vs. State of Andhra Pradesh, we are of the view that the same is distinguishable on the facts of the said case and in the light of the provision u/s 5E of the Andhra Pradesh

General Sales Tax Act also.

65. Therefore, even though both sides relied upon the provisions of articles 246 and 254 of the Constitution of India, we need not enter into a finding on the said question, as we are of the view that the tests laid down in *Bharat Sanchar Nigam Ltd. and Another Vs. Union of India (UOI) and Others*, are squarely applicable here. Herein, it cannot be said that there are goods deliverable at any stage which is the test laid down by the apex court in paragraphs 78 and 79 in SCC (paras 77 and 78 in VST) of *Bharat Sanchar Nigam Ltd. and Another Vs. Union of India (UOI) and Others*, and for that reason also, there is no transfer of right to user at all. Coupled with the same, is the fact that during the period in question the franchisee is having the right, it is not to the exclusion of the franchisor and as it is seen that even during the period during which the transaction is going on, the franchisor can again transfer the right to others, the tests laid down in sub-paragraphs (d) and (e) under para 97 of *Bharat Sanchar Nigam Ltd. and Another Vs. Union of India (UOI) and Others*, are not satisfied.

66. Therefore, we are unable to agree with the view taken by the learned single judge. The view taken in para, 14 of the judgment is that the transaction in question is a deemed sale as defined u/s 2(x)(iii) of the KVAT Act. The above view was taken by, concluding that the trade mark of the appellant is transferred to the franchisees for their use and the consideration received is the royalty paid to the appellant. In para 17, the principles stated in *Bharat Sanchar Nigam Ltd. and Another Vs. Union of India (UOI) and Others*, were distinguished on the facts of the said case and it was held that in the said case the court was not dealing with a case, involving transfer of intellectual property rights such as trade mark. It was held that there is total transfer of trade mark on payment of royalty which alone will attract the provisions of the KVAT Act. With great respect, we are unable to agree with the same. Accordingly, we allow the appeals reversing the judgment of the learned single judge See *Attorney-General v. Edison Telephone Company of London* [1880] 6 QBD 244. and hold that the franchise agreement will not attract the provisions of the KVAT Act. No costs.