
(1993) 02 GUJ CK 0034
In the Gujarat High Court
Case No : Sales Tax Reference No. 10 of 1989

Patel Tiles Factory

APPELLANT

Vs

State of Gujarat

RESPONDENT

Date of Decision : 26-02-1993

Acts Referred:

Gujarat Sales Tax Act, 1969 — Section 62, 69

Citation : (1993) 02 GUJ CK 0034

Hon'ble Judges : M.B. Shah, J;C.V. Jani, J

Bench : Division Bench

Advocate : R.D. Pathak and S.L. Modi, for the Appellant; Y.F. Mehta, AGP, instructed by H.V. Chhatrapati, for the Respondent

Judgement

M.B. Shah, J.—The applicant is a registered dealer under the Gujarat Sales Tax Act, 1969 (hereinafter referred to as "the Sales Tax Act"). Its business is to manufacture and supply tiles to the Government in execution of the written contracts entered into with the Government from time to time. The applicant entered into a contract with the State Government (PWD) for supply of 7,804 square metres hydraulic pressed blocks (hereinafter referred to as "the tiles") for Panam Main Canal Project. The applicant filed an application to the Commissioner of Sales Tax u/s 62 of the Sales Tax Act to determine the question as to whether transaction of supply of the tiles under the contract amounted to a "sale of goods". The Deputy Commissioner of Sales Tax, Ahmedabad, by his order dated September 5, 1983, arrived at the conclusion that the contract between the applicant and the Government amounted to a contract of sale for supplying the tiles for a sum of Rs. 74,333.12. The applicant had posed further question as to whether transaction of receipt of cement from the Government in terms of the contract for use in the execution of the said work amounted to purchase of goods by the applicant within the meaning of the Sales Tax Act. The Deputy Commissioner of Sales Tax held that cement supplied by the Government in terms of the contract would not be considered as purchase of cement by the applicant.

2. The applicant filed Appeal No. 23 of 1983 before the Gujarat Sales Tax Tribunal at Ahmedabad ("the Tribunal", for short). The Tribunal, by its judgment and order dated June 28, 1985, arrived at the conclusion that supply of tiles by the applicant to the Government on the basis of the contract amounted to sale of such tiles. The Tribunal further held that, in an application u/s 62 of the Sales Tax Act, it was not open to it to determine the sale price and that the said contention was not canvassed before the Deputy Commissioner of Sales Tax. The Tribunal, therefore, dismissed the appeal.

3. Against the judgment and order of the Tribunal, the applicant preferred an application for making a reference to this Court as provided u/s 69 of the Sales Tax Act. The Tribunal, by its order dated June 15, 1988, referred the following questions for our decision :

1. Whether, on the facts and in the circumstances of the case and on proper interpretation of the terms of contract No. B-1/PC-3/36 of 1979-80 entered into by the applicant with PWD, the Tribunal is right in holding that the supply of hydraulic pressed blocks (tiles) by the applicant to the Government, in due execution of the said contract, would amount to sale of such tiles under the Gujarat Sales Tax Act, 1969 ?

2. Whether, on the facts and in the circumstances of the case, the Tribunal was right in holding that the question about determination of sale price of sale, if any, as referred to in the above question was outside the purview of section 62 of the Gujarat Sales Tax Act, 1969 ?

4. Re : Question No. 1 :

From the discussion by the Tribunal and the terms of the contract entered into between the applicant and the Government, which is produced on record, the following main features of the contract would throw light as to whether the contract entered into between the applicant and the Government is that of contract for sale of tiles or it is a works contract for manufacturing tiles.

I. (a) As per Schedule "B" of the tender agreement, the name of the work is "supplying hydraulically pressed block tiles" for S.N. 2/R, 3/L, 4/L, 6/BB, 6/R, 10/L, 61/R, 11/RA, 13/L of 7/R (Kakanpur) District, Panam Main Canal. As per Schedule "B" to the contract, the quantity of tiles fixed is for 7,804 square metres. The rate fixed is Rs. 7.50 per square metre and the estimated cost is Rs. 58,530.

(b) The applicant had agreed to supply tiles for a total sum of Rs. 74,333.10, i.e., by adding 27 per cent above the estimated cost.

These terms indicate that there was a contract between the applicant and the Government for supply of fixed quantity of tiles at a fixed price within the stipulated time.

II. (a) After the tiles are manufactured, there is a condition to the effect that, out

of the said manufactured tiles, sample tiles selected at random from any lot of production should be got tested at the departmental laboratory at Kadana or at Baroda. The relevant tests, like tests for strength, resistance to wearing and water absorption, should be done. The cost of materials should be borne by the contractor. The testing charges would be borne by the department. It is further provided that the tiles, which did not conform to the specified test results, should be rejected and no payment would be made for those rejected tiles.

(b) There is further condition that the applicant is required to take proper care in loading and unloading of the tiles to avoid damages and breakages. It further provides that the damaged blocks would be rejected.

These terms specifically indicate that, till the tiles were manufactured, the ownership in the tiles remained with the contractor and after manufacture of the tiles they are required to be approved by the department for their purchase. The department is entitled to reject the same if they did not conform to the specified test results. For the said rejected tiles, the department is not required to make any payment.

III. There is further term which provides that the Government was to supply cement for manufacturing tiles. It provides that cement should be supplied by the department in the standard jute bags on loose at the place and rate mentioned in the part showing position of supply of cement.

Schedule "A" to the contract further provides as under :							Sr. No.
Description	Quantity	Rate	Place	of			
85.844	MT	494	per	MT	Panam	Store,	1 Cement Godhra

It further provides that the rate quoted above are inclusive of all charges. Empty cement bags are required to be returned to the PWD stores in serviceable condition and the cost of such empty cement bags not so returned will be recovered from the contractor at the rate of Re. 1 per bag. In view of the aforesaid term, it seems that the Government was to supply 85.844 metric tonnes of cement to the applicant at the fixed rate of Rs. 494 per metric tonne. The place of delivery was also fixed at Panam Store, Godhra. The applicant was required to return empty cement bags in serviceable condition, failing which, it was required to pay Re. 1 per bag.

IV. Another term upon which heavy reliance was placed by the learned advocate for the applicant is condition No. 21 which reads as under :

"Sales tax : The rates quoted by the contractor shall be deemed to be inclusive of sales tax on all the materials that he will have to purchase for performance of this contract. No general or State sales tax on completed item of work of this contract is payable at present. If such tax becomes payable during the currency of the contract they will be paid by the department."

On the basis of this condition, it is sought to be contended that on the completed item of work of the contract, i.e., tiles manufactured by the applicant, the applicant is not required to pay sales tax.

V. All other materials, except cement, that is to say, sand and chips, machineries and equipments which are required to be used for manufacture of tiles and labour, etc., were to be brought by the applicant.

5. Keeping these aspects in mind, we would like to deal with the submissions of the learned advocate for the applicant that the aforesaid contract for supplying tiles was works contract. For this purpose, he contended that :

(i) the contract was executed in "B-1" form which is meant for works contract, and not in form "D" for supply of goods;

(ii) the main ingredient for manufacturing tiles is cement and that was to be supplied by the PWD, Hence also, it should be inferred that it was works contract and not the contract for sale of tiles;

(iii) the entire manufacturing process of tiles was prescribed and it was to be supervised by the Executive Engineer or his agent as per the terms of the contract. This would also indicate that it was a works contract; and

(iv) the State Government was knowing that, as it was works contract, at the relevant time sales tax was not payable in respect of works contract. Therefore, condition No. 21 specifically provides that sales tax was not payable on the completed work of the contract.

6. The learned advocate for the applicant also relied upon the decision of the Kerala High Court in the case of Construction Company and Another Vs. State of Kerala, in support of his contention.

7. Mr. Mehta vehemently submitted that the judgment and order passed by the Tribunal holding that the contract between the parties was a sale of tiles is justified considering the terms of the contract. He also referred to the decision of the Supreme Court in the case of Commissioner of Sales Tax, Gujarat Vs. Sabarmati Reti Udyog Sahakari Mandali Ltd., .

8. Dealing with the similar contention raised by the assessee in the case of Commissioner of Sales Tax, Gujarat Vs. Sabarmati Reti Udyog Sahakari Mandali Ltd., , the court has observed that it is well-settled that whether a particular transaction is a contract of sale or a works contract depends upon the true construction of all the terms and conditions of the document, when there is one. A contract of sale is a contract whose main object is the transfer of the property in, and the delivery of the possession of a chattel as a chattel to the buyer. Dealing with the facts of that case, the court further observed that the terms and conditions with regard to supervision of the work and other such terms relating to a stage in the process of proper and efficient manufacturing of bricks and are not inconsistent in a contract of sale. The court further observed that the true

test in the case is whether in making the contract brick produced was transferred as a chattel for consideration and in that case the property in the bricks was entirely of the assessee. The essence of the contract was therefore delivery of the bricks after manufacture.

9. In the case of Construction Company [1975] 36 STC 320 (SC), the Division Bench of the Kerala High Court has specifically observed that whether a contract for service or for execution of work involves a taxable sale of goods will, of course, have to be decided on the basis of a careful scrutiny of the facts and circumstances of each case. After referring to various decisions of the Supreme Court, the court has held as under :

"A contract for works can be said to involve a sale of goods which is liable to sales tax only if there is an independent term in the said contract for the sale of any specific goods by one party to the other for money consideration and not merely an incidental transfer of title to some goods as ancillary to the performance of work or service."

10. In that case, considering the various terms of the contract, the court has given finding that, a combined reading of all the terms and conditions of the agreement entered into between the assessee and the Board clearly leads to the conclusion that the transaction was in essence only a contract for the performance of the work of manufacture and supply of the stipulated number of concrete poles of varying sizes in accordance with the specifications mentioned in the Schedule to the agreement. The court held that the contract was given for the work of manufacturing poles at Kunnamkulam : that the poles, when manufactured, automatically became the property of the Board on whose behalf the work of manufacture was carried out by the assessee in execution of the contract and no element of sale of specific chattel was involved in the transaction; the consideration stipulated to be paid to the contractor was for the work which he had undertaken to perform and not by way of sale price of the poles to be produced and delivered by him. Therefore, in our view, the decision in the case of Construction Company and Another Vs. State of Kerala, would not be of any assistance of the contentions which are raised by the learned advocate for the applicant.

11. Mr. Pathak, learned advocate for the applicant, has further referred to the decision of the Supreme Court in the case of Hindustan Aeronautics Ltd. v. State of Karnataka [1984] 55 STC 314 (Kar). In our view, in this decision also, the principle laid down is the same. The court has observed that it is well-settled that the difference between contract of service and contract for sale of goods, is, that in the former, there is in the person performing work or rendering service no property in the things produced as a whole notwithstanding that a part or even the whole of materials used by him had been his property. In the case of a contract for sale, the thing produced as a whole has individual existence as the sole property of the party who produced it some time before delivery and the property therein passed only under the contract relating thereto to the other

party for price. In this case also, the court has referred to the oft-quoted paragraph from Halsbury's Laws of England, Third Edition, Volume 34, which is as under :

"A contract of sale of goods must be distinguished from a contract for work and labour. The distinction is often a fine one. A contract of sale is a contract whose main object is the transfer of the property in, and the delivery of the possession of, a chattel as a chattel to the buyer. Where however the main object of work undertaken by the payee of the price was not the transfer of chattel qua chattel, the contract is one of work and labour. The test is, whether or not the work and labour bestowed and in anything that can properly become the subject of sale; neither the ownership of the materials, nor the value of the skill and labour as compared with the value of the materials, is conclusive, although such matters may be taken into consideration in determining, in the circumstances of a particular case, whether the contract was in substance one for work and labour and one for the sale of a chattel."

12. Further, the court has referred to the following statement of law in Benjamin's Treatise on the Law of Sale of Personal Property with reference to the French Code and Civil Law, Eighth Edition (1950) at pages 167-168, which clearly enunciates the principle for deciding as to whether it is a works contract or a contract for sale;

"1. A contract whereby a chattel is to be made and affixed by the workman to land or to another chattel before the property therein is to pass, is not a contract of sale, but a contract for work, labour and materials, for the contract does not contemplate the delivery of a chattel as such.

2. When a chattel is to be made and ultimately delivered by a workman to his employer, the question whether the contract is one of sale or of a bailment for work to be done depends upon whether previously to the completion of the chattel the property in its materials was vested in the workman or in his employer. If the intention and result of the contract is to transfer for a price property in which the transferee had no previous property then the contract is a contract of sale.

Where, however, the passing of property is merely ancillary to the contract for the performance of work such a contract does not thereby become a contract of sale.

3. Accordingly -

(i) Where the employer delivers to a workman either all or the principal materials of a chattel on which the workman agrees to do work, there is a bailment by the employer, and a contract for work and labour, or for work, labour and materials (as the case may be), by the workman.

Materials added by the workman, on being affixed to or blended with the employer's materials, thereupon vest in the employer by accession, and not

under any contract of sale.

(ii) Where the workman supplies either all or the principal materials, the contract is a contract for sale of the completed chattel, and any materials supplied by the employer when added to the workman's materials vest in the workman by accession."

13. The learned Editor has emphasised that where passing of property was merely ancillary to the contract for the purpose of the work, such a contract does not thereby become a contract for sale. This principle can also be deduced from the observations of the decision of *Robinson v. Graves* [1935] 1 KB 579.

14. Applying the aforesaid principles, in our view, the Tribunal was right in holding that the agreement entered into between the applicant and the PWD was for sale of tiles. We are not reiterating all terms and conditions of the agreement, which are fully incorporated by the Tribunal in its judgment. The Tribunal has extensively dealt with almost all the terms and conditions which have bearing on the question. But, considering the salient features of the agreement, which we have referred to hereinabove, it is apparent that the contract between the parties was for sale of manufactured tiles by the applicant and not of a works contract, because :

(i) the contract entered into between the applicant and the Government was for supply of "hydraulically pressed blocks (tiles)" at the fixed price within the stipulated time. The quantity fixed for supply was 7,804 square metres for a sum of Rs. 74,333.10. By letter dated November 30, 1979 (annexure 4/2) the applicant was informed that its tender for supply of hydraulic pressed blocks (tiles) has been accepted for Rs. 74,333.10 and that it was asked to furnish security deposit for a sum of Rs. 1,463. In the subsequent letter dated December 4, 1979 (annexure 5), the applicant was asked to start manufacture and supply of the tiles and complete the contract work within the stipulated time;

(ii) the ownership in the manufactured tiles was to pass to the department only if the said tiles conformed to the specified test results and were approved by the department for, purpose. The department was entitled to reject the tiles if they did not conform to the specified standard and/or were damaged;

(iii) there is no term in the contract to suggest, that the contractor was to be paid only for labour charges or for minor materials like sand, chips, etc., for manufacture of tiles.

(iv) the machineries for manufacture of the tiles also were to be brought by the applicant;

(v) fixed quantity of cement at the fixed price was to be supplied by the department. There was also a condition to return empty cement bags and if the said empty bags were not returned the applicant was to pay Re. 1 per bag;

15. However, the contention by the learned advocate for the applicant that the

contract was executed for supply of tiles in form B-1 and it was not executed in form "D", and therefore, it indicates that it was a works contract, requires to be rejected, because a form in which the contract is executed is not a criterion for determining as to whether the contract was for supply and sale of the tiles or it was a works contract. As stated earlier, in such a contract, whether a particular transaction is contract of sale or works contract depends upon the true construction of the terms and conditions of the agreement between the parties and, therefore, the form in which the contract is executed would hardly be material for determining the nature of the contract.

16. The learned advocate for the applicant further submitted that, as the main ingredient (cement) for manufacture of tiles was supplied by the department, inference can be drawn that the contract is works contract. As stated earlier, in the present case, no doubt, cement was supplied by the department, but it was supplied at the fixed rate on the condition that the applicant should not use cement for any other purpose. If it used, then it would be required to pay price of cement as well as additional amount as fixed therein. The reason for supply of cement may be that, for preparing tiles, cement is supplied at a fixed rate or at a controlled price. It also can be to ensure manufacture of tiles of proper quality and strength. In the case of Commissioner of Sales Tax, Gujarat Vs. Sabarmati Reti Udyog Sahakari Mandali Ltd., the land was given free for manufacture of bricks; the land can be used for excavating soil for manufacture of bricks and it was given to the contractor free of rent from the land reserved by the Government for that purpose. The contractor has no right to sell the bricks, brick-bats, chharas or any other materials manufactured to any other private parties. If, however, it was found that the materials had been sold by the assessee to private parties or other bodies, he should pay to the department at the rate of 10 per cent of the value of materials at the tender rates. The Supreme Court after referring to its earlier decision in the case of Chandra Bhan Gosain v. State of Orissa [1963] 14 STC 766 (Ori) observed that what was supplied to the company by the appellant was not the earth which he got from it but bricks, which, we think, are something entirely different. It could not have been intended that the property in the earth would continue in the company in spite of its conversion into such a different thing as bricks. Similarly, in this case, cement is supplied at the fixed rate. Cement supplied to the applicant loses its identity once it entered into the manufacture of tiles at the hands of the applicant. From cement, entirely different commodity, namely, tiles, is manufactured. The ownership in the tiles vest in the assessee till they are sold to the PWD. Hence, it cannot be said that, as cement was supplied by the department, the contract was works contract and not for supply of manufactured tiles at the fixed rate.

17. The learned advocate for the applicant further submitted that the entire manufacturing process was agreed to be supervised by the department and, therefore also, it would indicate that it was a works contract. This aspect is also dealt with by the Supreme Court in the case of Commissioner of Sales Tax, Gujarat Vs. Sabarmati Reti Udyog Sahakari Mandali Ltd., and the court has

observed that all such terms relate to a stage in the process of proper and efficient manufacturing of goods and are not inconsistent in a contract of sale. The Government in its overall interest and anxiety for general welfare could insist on compliance with certain beneficial legal measures and also insist on certain terms which will ensure efficient production of the material. Such terms do not negate the concept of a contract of sale of the goods which are ultimately manufactured. The terms in the present case indicate what type of sand the applicant was required to use and where it was to be stored; which machinery the applicant was required to bring; how much cement he was required to mix with the sand; size of mould; size of block and its curing. All these conditions, in our view, were incorporated to see that the tiles of a specific size were manufactured from proper material including cement in proper manner.

18. The learned advocate for the appellant has also relied upon condition No. 21 which deals with payment of sales tax. We have referred to the said condition in the previous paragraph. It specifically provides that the rates quoted by the contractor shall be deemed to be inclusive of sales tax on all materials that he will have to purchase for performance of the contract. It also provides that no general or State sales tax on completed item of work of this contract is payable at present and if such tax becomes payable during the currency of the contract they will be paid by the department. In our view, the payment of sales tax does not depend upon the volition of the parties. In most of the cases, the party may not pay sales tax if it is left to his volition. Whether sales tax is required to be paid or not depends upon provisions of the Sales Tax Act and, therefore, a statement in the agreement that no sales tax on the completed item of work of the contract was payable would hardly be relevant factor for deciding that the agreement is for works contract.

19. In this view of the matter, in our view, the Tribunal rightly held that, in the circumstances of the case, and on proper interpretation of the terms of contract No. B-1/PC-3-36 of 1979-80 entered into by the applicant with the PWD, the supply of hydraulic pressed blocks (tiles) by the applicant to the Government, in due execution of the said contract would amount to sale of such tiles under the Gujarat Sales Tax Act, 1969. Hence, question No. 1 is answered in the affirmative in favour of the Revenue and against the assessee.

20. Re : Question No. 2 :

The learned advocate for the applicant has not pressed the question as to whether the Tribunal was right in holding that the determination of sale price of the goods supplied by the applicant was outside purview of section 62 of the Sales Tax Act as the said question is already determined by the Division Bench of this Court in the case of Bengal Electric Lamp Works Ltd. v. State of Gujarat reported in [1991] 83 STC 309. In any case, the Tribunal was right in holding that the question cannot be entertained at the appellate proceedings because it was not canvassed before the Deputy Commissioner of Sales Tax. Further, such question cannot be determined u/s 62 of the Sales Tax Act by the Deputy

Commissioner. Hence, question No. 2 is also answered in the affirmative in favour of the Revenue and against the assessee.

21. In the result, questions Nos. 1 and 2 are answered in the affirmative in favour of the Revenue and against the assessee. There shall be no order as to costs.

22. Reference answered in the affirmative.