(1995) 08 AP CK 0037

In the Andhra Pradesh High Court

Case No : Tax Revision Case No''s. 288, 295, 296, 298, 301, 305 and 306 of 1987

State of Andhra Pradesh APPELLANT

Vs

Bharat Dynamics Limited. RESPONDENT

Date of Decision : 17-08-1995

Acts Referred:
Central Sales Tax Act, 1956 — Section 3

Citation : (1997) 106 STC 158

Hon'ble Judges : S.S. Mohammed Quadri, J;G. Bikshapathy, J

Bench : Division Bench

Judgement

G. Bikshapathy, J.—This batch of revision cases arises out of a common question of law relating to the issue, as to whether the transaction constitute a contract of work or a contract of sale. Seven separate revision cases have been filed by the department against the common order of the Sales Tax Appellate Tribunal, Hyderabad, in appeals arising under the Central Sales Tax Act, 1956 and A.P. General Sales Tax Act, 1957 in respect of the assessment years 1971-72 to 1977-78. As common question of law is involved in all these revision cases, they are being dealt with under common order. The parties hereinafter will be referred to as they are arrayed before the Sales Tax Appellate Tribunal, Hyderabad.

2. The appellant - M/s. Bharat Dynamics Limited, Hyderabad, is a company incorporated under the Companies Act. It is a Government of India undertaking under the Ministry of Defence. According to the memorandum of association, the main objects of the company, among other things, relate to "manufacture of missiles in India or elsewhere either independently or in collaboration with others and for the said purpose to manufacture, assemble, fit up, repair, covert, overhaul, maintain and deal or undertake sales promotion in the following devices, apparatus and equipment as also all components, fittings, tools and implements, accessories and materials used or required in connection therewith". The Government of India entered into an agreement with a Free French

Company - Societe Nationale Industrielle Aero Spatiale (SNIAS) for manufacture in India certain military equipment, for the purpose of which the foreign company agreed to place the technical know-how at the disposal of the Government of India. The French company also agreed to supply the required equipment and raw materials. All the rights, accruing to the Government of India under the said agreement were assigned in favour of the appellant-company. In pursuance of this assignment the appellant-company manufactured the equipment and delivered to the Ministry of Defence, and debited the price thereof to the "on account" of Government of India, and the said stands credited with the "on account" payments. In respect of the supplies made to the Defence department during the years 1971-72 to 1977-78, the assessing authority held them as inter-State sales between the appellant-company and Government of India u/s 3(a) of the Central Sales Tax Act and subject them to tax as per the Act.

3. Aggrieved by the assessment for the year 1971-72 the appellant-company preferred appeals to the first appellate authority. The first appellate authority held that the transaction representing supply of the defence equipment in question do not partake of the character of sale and that it was only a work carried out on behalf of Government of India. This order of the Assistant Commissioner was revised by the Deputy Commissioner by his order on the ground that the transaction effected by the appellant-company are in the nature of sales. In respect of the appeals for the subsequent years, the Assistant Commissioner dismissed the appeals holding that it is a transaction of sale. These appeals were filed by the assessee before the Tribunal against the orders of the Deputy Commissioner and also against the orders of the Assistant Commissioner. The question that fell for consideration before the Tribunal in the batch of appeals was :

"Whether, on the facts and in the circumstances of the case, the supplies made by the appellant to the Government could be regarded as sales or works contract ?"

The Tribunal after considering the documents and also the procedure adopted by the parties in the transaction felt that it is a works contract and not a sale.

4. Aggrieved by the said orders of the Tribunal, the present revision cases have been filed by the State. The learned counsel for the State reiterated his contentions as were advanced before the Tribunal. It is strenuously contended by the learned counsel for the State that the transactions by virtue of the entrustment of the contract between the Government of India and the French company should be regarded as outright sales exigible to tax. It is further contended that the documents exchanged between the parties and also the annual report of the appellant-company would establish that it is a transaction of sale and not a contract for works. The learned counsel referred to various recitals in the agreement which was concluded on March 2, 1970 between the President of India and the French company for the manufacture of the equipment. According to clause 1 of the agreement the licenser, i.e., Societe Nationale

Industrielle Aero Spatiale has granted licence to the licensee, i.e., the President of India, "a full, sole, and exclusive licence and authority to use and exercise the said system and to reproduce, manufacture, get manufactured the said system in the territory of India in accordance with the provisions of the agreement. By clause 17, the licensee agreed to pay the licenser a total sum of 7 million Francs for manufacture and sale of the said system, supply of technical documents. By letter dated March 18, 1971 the Government of India entrusted to the appellant-company the manufacture of the equipment and other rights and obligations. In the said letter the Government of India also entrusted to the company with the sale and disposal of the system, etc., on behalf of the president of India in terms of the said agreement. The Government of India by their letter dated August 30, 1976, directed the Director of Emergency Risk Insurance Scheme to examine materials held by the appellant-company as the goods held by the appellant-company are required to be supplied to Government and they are the properties of Government of India. It also contended that the relationship between the appellant-company and the Government should be regarded as debtor and creditor as the amounts are advanced by the Government of India from time to time to enable the appellant-company to get the raw materials imported and to perform the connected works.

5. The learned counsel also argued that it is a transaction of sale and the same can be evidenced from the annual report where it is described as the sale to the Government of India. Further in the price structure of the products manufactured by the appellant-company, the element of profit was also included. The price determined by the Government of India was on "Cost plus" basis. Hence, by considering the above events it has to be treated that it is not a case of contract for work and on the other hand it is a case of sale.

Heard the learned counsel for the assessee-company.

The Supreme Court considered this aspect, as to whether a particular transaction is sale or works contract in number of cases. It is necessary to refer to the said cases for arriving at a just conclusion.

6. In Union of India v. Central India Machinery Manufacturing Co. Ltd. [1977] 40 STC 246, the question that fell for consideration before the Supreme Court was whether the contract for manufacture and supply of wagons to the railways is a contract of sale or a contract for works. In the said case, the respondent-company entered into a contract with the Union of India entered through the Railway Board for manufacture and supply of wagons to the railways for a price which was fixed taking the wagon as a unit. The contract was governed by general conditions of contract with special conditions attached thereto. The special conditions provide, inter alia, that "on account" payment up to 90 per cent of the value of the "steel and other materials" procured by the company for the order would be made against such materials on production of a certificate from the officer. However, "on account" payment was not permissible against steel procured by the company from a source other than the floating stock held

by the railways, except when an offer to procure it from that source was refused. The company was to be supplied with wheel sets and axle-boxes free of cost against a proper undertaking for their safe custody. It is also one of the special conditions that the stores and articles of the railway kept at site should be covered by proper indemnity. The "on account" payment was part of the "full contract price" for each completed wagon and the Government reserved the pre-emptive right to purchase all surplus or unserviceable materials from the company. On a consideration of the terms and conditions of the contract, the High Court took a view that the contract was a contract for sale of wagons and not works contract.

7. In the said case, the Supreme Court found that the terms and conditions of the contract, read as a whole, indubitably led to the conclusion that the property in the materials was procured or purchased by the company against 90 per cent of the value of which advance was taken from the railways. With the exception of a relatively small proportion of the components supplied by the railways, the entire wagon including the material at the time of its completion for delivery was the property of the company. As the bulk of the materials used in the construction of the wagons belonged to the company, which sold the wagons for a price, the contract was a contract for the sale of wagons and not a works contract. The Supreme Court, in these circumstances, held that it was a contract for sale of wagons and not works contract.

8. The Supreme Court further observed "that although neither the ownership of the materials nor the value of the skills and labour as compared with the value of the materials is conclusive in deciding the question whether the contract is in substance one for work and labour or one for the sale of chattel, if the bulk of the material used in the construction belonged to the manufacturer who sold the end-product for a price that would be a strong pointer to the conclusion that the contract is in substance one for sale of goods and not one for work and labour". Therefore considering the special features of contract in that case, the Supreme Court held that it is a contract for sale of wagons and not a works contract.

9. In Hindustan Aeronautics Ltd. v. State of Karnataka [1984] 55 STC 314, the Supreme Court had again considered the characteristics of works contract, as well as the contract of sale. In the said case, an agreement was entered into between the Hindustan Aeronautics Ltd. (a Government of India Undertaking, registered under the Companies Act) and the President of India, in respect of servicing and maintenance of certain Air Force planes to the specified standards. The company in the course of its execution of the contract had to supply certain spare parts of the aircraft as a result of their use in the process of their overhauling the aircrafts. After the work was completed, a final bill was prepared wherein it showed labour charges and material charges separately. The sales tax authorities sought to subject to tax that portion of the total turnover of the appellant for the relevant years in question which was equivalent to the money value of the spare parts of the aircraft which the appellant had supplied to the

Indian Air Force, as a result of their use in the process of repairing and servicing and overhauling of the aircrafts, their instruments and accessories which were sent to the appellant for the aforesaid purpose during the relevant years in question.

The High Court of Karnataka on further reference affirming the view of the Tribunal, held that the sale of spare parts was clearly in contemplation by parties, that the documents in question constituted composite contracts and that sales tax was attracted.

10. On appeal to the Supreme Court, by the company the decision of the Karnataka High Court was reversed. The Supreme Court while interpreting the agreement held "the expression all items provisioned will be the property of the Government and will be issued on contract loan" indicted that though gathered and processed or manufactured by the appellant, the appellant would have no property in those goods and would not be able to dispose of or deal with them but they would be treated as the property of the Government. The fact that those materials were separately placed at cost plus 10 per cent profits was to ensure quick and proper execution of the work and was a neutral factor. Therefore, the spare parts and materials were supplied by the appellant in the course of execution of works contracts, thee was no sale thereof and their turnover was not exigible to sales tax.

Further, the Supreme Court observed as follows :

"It cannot be said as a general proposition that in every case of works contract, there is necessarily implied the sale of the component parts which go to make up the repair. That question would naturally depend upon the facts and circumstances of each case. Mere passing of property in an article or commodity during the course of performance of the transaction in question does not render the transaction to be transaction of sale. Even in a contract purely of work or service, it is possible that articles may have to be used by the person executing the work, and property in such articles or materials may pass to the other party. That would not necessarily convert the contract into one of sale of those materials. In every case, the court would have to find out what was the primary object of the transaction and the intention of the parties while entering into it. It may in some cases be that even while entering into the contract of work or even service, parties might enter into separate agreements, one of work and service and the other of sale and purchase of materials to be used in the course of executing the work of performing the service. But, then in such cases the transaction would not be one and indivisible, but would fall into two separate agreements, one of work or service and the other of sale."

11. While interpreting the contract, the Supreme Court held that there was supply of material for the purpose of execution of works contract undertaken by the company and hence the passing of property was merely ancillary to the contract for the purpose of work. Such contract does not thereby become a

contract of sale. Therefor, the principles settled by the Supreme Court in the case of Hindustan Aeronautics Ltd. v. State of Karnataka [1984] 55 STC 314, are exhaustive on the subject.

12. In the said case, the Supreme Court also discussed the principles settled in State of Himachal Pradesh v. Associated Hotel of India Ltd. [1992] 29 STC 474 (SC), The State of Madras Vs. Gannon Dunkerley and Co., (Madras) Ltd., , The Commissioner of Commercial Taxes, Mysore, Bangalore Vs. Hindustan Aeronautics Ltd., , State of Gujarat (Commissioner of Sales Tax, Ahmedabad) Vs. Variety Body Builders, and Ram Singh and Sons Engineering Works Vs. Commissioner of Sales Tax, U.P., .

13. Another case of the Supreme Court on the subject is Hindustan Aeronautics Limited v. State of Orissa [1984] 55 STC 327. In the said case, Hindustan Aeronautics Ltd., was entrusted by the Government of India with the manufacture of MIG air-crafts for which the Government had obtained licence from the U.S.S.R. under an agreement. The Government of India entrusted responsibility for proper implementation of the agreement was exclusively of HAL, except that the Government could from time to time advice HAL about the programme of manufacture. All payments falling due under the agreement to the Government of U.S.S.R. had to be made by HAL on behalf of the Government of India. The material imported by HAL for the manufacture as well as goods, stocks and stores, work-in-progress, etc., were the property of the Air Force and the items manufacture by HAL were to be supplied only to the Air Force or as authorised by the Government. Some of the engines manufactured by HAL in its division in Orissa were sent to Nasik Division where the MIG aircraft was finally assembled for delivery to the Government of India. After the engines were dispatched to Nasik Division, the Orissa Division of HAL drew bills and raised debits against the Government of India. The bills indicated a break-up of the material cost, labour cost and sundry direct charges and further profit at a percentage. The sales tax authority held that the entrustment to HAL of the manufacture MIG engines amounted to a contract of sale and Central sales tax was attracted when the engines were delivered to the Nasik Division and invoices were raised for payment and payment was received from the Government of India. HAL claimed that the transaction represented works contract. The company was also unsuccessful before the Tribunal. On appeal to the Supreme Court, by special leave, against the orders of the Tribunal, it was held that at no point of time before the delivery of MIG engine, the HAL was the owner of the property either in the equipment or in spares or in the aircrafts and as such there was no transfer of property from HAL to Government of India. The HAL only performed the job entrusted to them for and on behalf of the Government of India. The materials and equipment sent by the Government of U.S.S.R. and the MIG engines assembled by HAL from such materials belonged to the Government of India at all material times. The HAL had no ownership in the materials which were all supplied by the Government of U.S.S.R. nor it had the ownership in the finished products and no question of sales tax on the transaction could arise.

Even on the indigenous materials procured or manufactured by HAL in the process fitting in and assembling, HAL had no disposing power as it was never the owner of these materials.

14. The Supreme Court further observed : "the primary difference between a contract for work or service and a contract for sale of goods is that in the former there is in the person performing or rendering service no property in the thing produced as a whole notwithstanding that a part or even the whole of material used by him may have been his property. In the case of a contract for sale, the thing produced as a whole has individual existence as the sole property of the party who produced it some time before delivery and the property therein passes only under the contract relating thereto to the other party for price."

15. The facts of the case on hand are fully covered by the decision of the Supreme Court in Hindustan Aeronautics Ltd. v. State of Orissa [1984] 55 STC 327. In the instant case also the contract is between the BDL and the French company for supply and manufacture of defence equipment. The entrustment letter by the Government of India to the appellant-company is also in similar terms. The terms and conditions of contract were also to the same effect, that the raw material and the assembly parts are to be imported by the appellant-company from the French company and that there is no possibility of any other material to be used for manufacture of the instruments. It would thus be manifest from the correspondence and the invoices and the notification issued by the Government on the subject that the appellant-company is only an intermediary agent for fulfilling the contract entered into between the Government of India and the French company. The Government in reality was the owner of the goods. It is also to be noted that while manufacturing the equipment and instruments if any fabrication was required, even that process is required to be treated as ancillary to the main manufacturing and the same cannot be bisected for attracting the sales tax.

16. In this regard, it is relevant to refer to Halsbury''s Laws of England, Third Edition, Vol. 34, where in it is clearly stated that 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 quo chattel; the contract is one of work and labour. The test is whether or not the work and labour bestowed end 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 chattel.

17. 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, the learned author has deduced the principles that would be applicable in deciding the controversy, whether a contract is a contract of sale or works contract : These principles are :

1. A contract whereby a chattel is to be made and affixed by the workman to land or 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."

18. The learned counsel also relied on the decision rendered in Bharat Engineering and Foundry Works Vs. State of Madhya Pradesh and Others, . The facts of the said case are different. In that case, the petitioner was a fabricator of iron and steel goods. It entered into various contracts with Bhilai Steel Plant (BSP). In the assessment proceedings, he showed sales of certain amount and also disclosed that he received certain amount as labour charges, which were said to have been received by him on the basis of that transaction relating to them were not contacts of sale of goods, but contract of work and labour. The Sales Tax Officer refused to accept the transaction as works contract and included in the turnover. On appeal the Deputy Commissioner held that in certain contracts material was supplied free of cost by the BSP for fabrication and in certain other cases, it was supplied on cost recovery basis. Therefore, the Deputy

Commissioner held that in this case, where the material was supplied on free of cost, the contract was purely for work and labour and in the latter case it is a contract of sale. The Jabalpur Bench of Madhya Pradesh High Court accepted the view of the Deputy Commissioner on this point. The principles noted by the Bench is that the material supplied by the steel plant to the petitioner on cost basis became the property of the petitioner before it was fabricated and so the contract was for supply of fabricated goods was in the nature of sale. But in case where material was supplied to the petitioner free of cst, the property in the material remained in the steel plant when it was fabricated and so the contract of supply of fabricated goods in such cases was contract for work and labour.

19. The principles that could be deduced from the decided cases are : (1) that the issue, whether a contract is one for sale of goods or for executing works or rendering services, is largely one of fact, depending upon the terms of contract including the nature of obligations to he discharged thereunder and the surrounding circumstances; (2) Neither the ownership of the material nor the value of skill and labour as compared with the value of material is conclusive in deciding the issue. But if the bulk of material used by the manufacturer belonged to the manufacturer, who sold the end products for a price, that would be a strong pointer to the conclusion that the contract is in substance one for sale and not one for work and labour; (3) The substance of the documents constituting the contract and also the form had to be looked into; (4) Mere passing of property in an article during the course of performance of the transaction in question does not render the transaction to be transaction of sale; (5) In every case the court would have to find out the primary object of the transaction and intention of parties while entering into it; (6) Charging of profit is not a conclusive proof to determine the nature of transaction; (7) In the contract for work or service there is in the person performing or rendering service no property in the thing produced as a whole notwithstanding that a part or even the whole of the material used by him may have been his property. While in the case of a contract for sale, the thing produced as a whole has individual existence as the sole property of the party who produced it some time before delivery and the property therein passes only under the contract relating thereto to other party for a price.

20. Therefore, applying the abovesaid principles to the instant case, we find that the Government of India entrusted to the appellant-company to manufacture certain defence equipment on the basis of the agreement entered into between the Government of India and the French company. The entire raw material was supplied by the French company and the finished goods are to be sold on behalf of Government of India. The value of the supplies were adjusted against the advance received from Government of India. The interest accrued on the advance was not appropriated by the company. The goods imported under collaboration agreement vested with Government of India. Therefore, the cumulative effect of all the transactions would clearly indicate that the Government of India is the owner of the property and the property never passed

on to the appellant-company. It was only an intermediary functionary to manufacture instruments, and effect sales on behalf of the Government of India. Hence, it has to be necessarily held a case of contract for work and labour and not a contract for sale. The order of the Tribunal cannot be held to be illegal or erroneous.

For the reasons stated above, the revision cases are dismissed. No costs.

21. Petition dismissed.

