

(1996) 03 KAR CK 0012
In the Karnataka High Court
Case No : S.T.R.P. No's. 112 and 113 of 1994

State of Karnataka

APPELLANT

Vs

Shaw Wallace and Company Ltd.

RESPONDENT

Date of Decision : 25-03-1996

Acts Referred:

Central Sales Tax Act, 1956 — Section 9 (2)
Karnataka Sales Tax Act, 1957 — Section 12 A, 12 A (1A)

Citation : (1998) 110 STC 506

Hon'ble Judges : S. Rajendra Babu, J;R.V. Raveendran, J

Bench : Division Bench

Advocate : Smt. Vidya, Government Pleader, for the Appellant; C. Natarajan and K.P. Kumar, for M/s King and Patridge, for the Respondent

Judgement

S. Rajendra Babu, J.—The revision petitions are directed against the order of the Karnataka Appellate Tribunal by which the Tribunal held that certain sales effected by the respondents are second sales and those transactions do not attract tax under the Karnataka Sales Tax Act, 1957.

2. The respondent is a dealer registered under the Karnataka Sales Tax and Central Sales Tax Acts. In the annual return as revised, filed on May 2, 1984, the respondent disclosed a turnover under the KST Act in the sum of Rs. 20,45,44,295.41 and taxable turnover in a sum of Rs. 2,23,82,933.09. Under the CST Act, a taxable turnover in a sum of Rs. 16,136.88 was disclosed. The Assistant Commissioner of Commercial Taxes concluded the assessment on August 29, 1984 both under the KST and CST Acts determining the total turnover of Rs. 20,45,71,897.93 and a taxable turnover of Rs. 3,85,82,493.85 under the KST Act. For the purpose of the CST Act, he determined the taxable turnover at Rs. 16,136.88 which was subsequently rectified substituting the total turnover relating to bottles used for filling liquors by Rs. 2,14,977.45 in place of Rs. 2,41,977.45 as originally assessed. On May 3, 1986, the Commercial Tax Officer (Intelligence) inspected the business premises of the respondent. Thereafter, on

processing of the documents seized thereto, reopened the proceedings u/s 12A of the KST Act and made an order on August 19, 1989. He also revised the assessments made both under the KST and CST Acts. The revised total turnover as redetermined was at Rs. 26,50,28,634.69. For purpose of CST Act, an order was made on August 19, 1989 u/s 9(2) of the CST Act read with section 12A(1A) of the KST Act levying penalty in a sum of Rs. 40,00,000. The matter was carried in appeal. The appeal was allowed in part while the penalties were set aside. The matter was carried in further appeal to the Tribunal. The Tribunal allowed the appeal of the respondent as stated earlier. Hence, this petition which is filed on behalf of the State.

3. It is urged on behalf of the petitioner that the true nature of the transaction between M/s. India Breweries and Distilleries Ltd. (IBDL) and M/s. Shaw Wallace, respondent herein having not been properly appreciated by the Tribunal, the view taken by the Tribunal that the sales that have been effected by the respondent are second sales is erroneous having regard to the nature of the agreement between the respondent and M/s. IBDL. It is specifically contended that the terms of the contract would disclose that there should be sale of rectified spirit by IBDL to the respondent and thereafter the respondent would manufacture Indian Made Foreign Liquor (IMFL) with the assistance of M/s. IBDL or in other words, the contract with M/s. IBDL was only a works contract and manufacture was made for and on behalf of the respondent. It is urged, the contract entered into between the respondent and IBDL was only to camouflage the true nature of the transaction. If properly examined, the only conclusion that could be drawn is as urged for the State.

4. On behalf of the respondent, it was made clear though at the first place, the contract between the respondent with IBDL could also lead to the conclusion supporting the contention put forth on behalf of the State, a proper analysis would clearly indicate that there has been a sale of liquor by IBDL to the respondent. Therefore, the conclusion drawn by the Tribunal is justified and not interference is called for particularly in view of the decisions of the Supreme Court in Union of India (UOI) and Others Vs. Cibatul Limited, , Sidhosons and Others Vs. Union of India (UOI) and Others, , Union of India v. Central India Machinery Manufacturing Company Ltd. [1977] 40 STC 246, Spirit Warehouse Vs. The State of Madras, and Deputy Commissioner of Sales Tax v. Kerala Distilleries & Allied Products (P) Ltd. [1993] 89 STC 58 (Ker).

5. In order to properly appreciate the contentions advanced on behalf of the parties, it is necessary to refer to the contract between the respondent and M/s. IBDL in some detail. The agreement between the respondent and IBDL is entered in October, 1983 which is stated to have been in force during the relevant period with which we are concerned in this case also. The agreement contains certain recitals in relation to the nature of the activities carried on by the respondent and IBDL. IBDL owns a distillery at Hallikhad in Bidar District in the State of Karnataka and has a licence to run a distillery under the Karnataka Excise Act.

There are certain definition clauses in the agreement. Spirit is defined as potable alcohol spirit manufactured and distilled out of molasses and in accordance with the specifications and tolerances specified in appendix A to the agreement. Distillery is defined to be the distillery run by the IBDL at Hallikhad in Bidar District and also includes the potable liquor manufactured and/or other distillery at any other place as may be mutually agreed upon by the parties from time to time. IMFL products would mean products manufactured by IBDL under the agreement for supply to Shaw Wallace and Company, that is, respondent herein, consisting of the spirit as defined earlier and blended and bottled in accordance with the provisions of the agreement. Clause (2) provides, IBDL will manufacture spirit as its distillery in such quantity as may be required by the parties subject to a minimum of 3,50,000 bulk litres in a calendar year for the purpose of utilising such spirit for the IMFL products to be marketed by Shaw Wallace under the trade name of "Shaw Wallace" or such other trade name or names as Shaw Wallace may determine. It is also agreed to between the parties that the spirit shall be manufactured and distilled only from molasses and shall be in accordance with the specifications and tolerances required by Shaw Wallace from time to time. The respondent would supply a sample of the spirit which shall conform to such a sample within tolerances as given by Shaw Wallace. Clause (4) is of some importance and much of the argument advanced on behalf of the parties had been upon the interpretation of the said clause. Therefore, we shall set out the same verbatim.

"Technical representative :

India Brewery & Distillery will allow Shaw Wallace to post its technical representative hereinafter called "technical representative" at the distillery for the following purposes, viz., to check and supervise the manufacture and distillation of the spirit and to advise the batch or batches, quality of which should be acceptable to him. If the spirit supplied by India Brewery & Distillery is not found acceptable by Shaw Wallace's representative, India Brewery & Distillery undertakes to take back the spirit and supply spirit of a quality acceptable to him provided the spirit falls within the specifications and tolerances given by Shaw Wallace. The decision of Shaw Wallace will be binding in so far as the quality of spirit is concerned. The technical representative shall, if so required by Shaw Wallace, also deal with the blending of the spirit in the manufacture of the IMFL products as hereinafter provided."

The next important clause is clause (6) by which it is provided notwithstanding the posting of a technical representative, the IBDL will be solely responsible for the quality of spirit supplied for the purpose of blending. All equipments required for the manufacture and supply to respondent of the IMFL products under the agreement will be provided by the IBDL at its cost. Clause (8) again, is a very important one for the purpose of interpretation of the nature of the transaction between the parties and therefore, we propose to set out the same in full :

"The essence/blends required for the production of the IMFL products under this

agreement will be provided by Shaw Wallace at its cost and the blending with the spirit manufactured and distilled by India Brewery & Distillery will be done by Shaw Wallace's representative sent for this purpose from time to time or by the technical representative of Shaw Wallace stationed at the distillery. Blending will be done after the quality of the spirit is accepted by Shaw Wallace. Once the blending is completed, India Brewery & Distillery will not be liable to Shaw Wallace for the quality of the spirit which shall be deemed to have been accepted by Shaw Wallace."

Clause (9) provides that IBDL will reduce the spirit to the required strength for which purpose demineralised water is used which conforms to the specifications and tolerances mentioned in appendix B which thereafter will be stored either in an anodized aluminium tank or in a stainless steel tank. Clause (10) is also very important from the point of view of finding the nature of the transactions between the parties. Therefore, we set out clause (10).

"India Brewery & Distillery shall for and on behalf of Shaw Wallace manufacture IMFL products from the spirit supplied hereunder to Shaw Wallace by India Brewery and obtain at its cost such licences as may be necessary for the manufacture, blending, bottling, sale and delivery of IMFL products to Shaw Wallace and this will include cost of obtaining export/transport permits to despatch to various destinations from the distillery. All excise formalities required for the distillery shall be the responsibility of India Brewery & Distillery."

The next clause is clause (13). It provides for filtration and as to the consequences that would follow if there are any foreign particles or sedimentation or is not of clear quality at the time of bottling. Clause (14) provides that respondent would supply at its cost to IBDL, bottles, labels, filtrate powder, seals, capsules, corrugated boxes, wooden cases, etc., required for packing of the IMFL products, and these materials belong to and supplied by the respondent shall be its property and it will accordingly be its responsibility to arrange for proper insurance of the property at the distillery. IBDL will be a bailee of such material and will carefully store and utilise such goods. Clause (18) provides that the IMFL products shall be supplied and delivered to the respondent in sealed bottles, labelled and packed in boxes which have to conform to the statutory regulations as may be laid down by the Excise Department and other authorities. Clause (19) provides that the brand name and the get up in which the IMFL products will be supplied to the respondent which will be sold by the respondent are the sole property of the respondent and IBDL has no right and shall not at any time claim any right whatsoever to the use of the said labels, brand names or get up of the IMFL products. Clause (20) provides for the quantity that could be lifted by the respondent and the undertaking of the IBDL to supply the minimum quantity of IMFL products. Clause (21) relates to neutral alcohol distillation plant to produce spirit in accordance with the specification laid down in appendix A and IBDL will have to reimburse the respondent total cost of the plant including the cost of installation

and the expenses incurred by them together with interest at 10 per cent annum in 36 equal monthly instalments commencing from the date of commissioning of the plant. Pending installation of the neutral alcohol plant, IBDL was to purchase the said quantities of neutral alcohol from other distilleries in Karnataka or from distilleries outside the State matching with the samples provided by the respondent. Clause (23) provides for manufacture and distillation of sufficient quantities of spirit for the manufacture, blending and bottling, for Shaw Wallace. Clause (24) among other things, provides for complying with the excise formalities which shall be the responsibility of IBDL which will include the registration of the labels, for manufacture, blending, bottling and supplying of IMFL products to the respondent. Clause (25) provides for the price at which the respondent would purchase IMFL products from IBDL which is Rs. 27 per case for products produced with rectified spirit and Rs. 31 per case for products wholly produced with extra neutral alcohol. The price is also inclusive of sales tax, excise duty, export fee, octroi, insurance, excise escort charges and other tax or duty as may be applicable or that may become applicable from time to time. It also provides therein, excepts as provided elsewhere, losses until the IMFL product leaves the distillery will be on account of IBDL. There are the usual indemnity clauses provided, delivery schedule and provisions relating to packing under clauses (26), (27) and (28). Clause (29) provides for reprocessing and is of importance in the interpretation of the agreement. Therefore, we reproduce the said clause :

"Re-processing :

If any IMFL product is declared unsaleable in any State of India owing to its being under strength then India Brewery & Distillery undertakes to take back all such stocks and reprocess them so as to conform to the excise formalities. All expenses incurred in this connection will be on account of India Brewery & Distillery.

If however, stocks are to be taken back for any other reasons, for example, sedimentation then India Brewery & Distillery will undertake to obtain necessary permission from excise for taking back such stocks and provide facilities for its reprocessing. Representatives of both sides will have to examine the causes for such sedimentation and the apportioning of costs for such taking back and reprocessing between Shaw Wallace and India Brewery & Distillery will have to be agreed mutually."

Credit is given for payment of the price of IMFL under certain terms provided in clause (30). Clause (31) enables the respondent to sell IMFL products in or outside India. Clause (32) and (33) are not of much importance. Clause (34) states that IBDL shall not manufacture any IMFL products in the distillery in its own name or on behalf of any party other than the respondent. The rest of the clauses does not have relevance for the present case.

6. The learned counsel for the State contended that a reading of the clauses

referred to now would make it clear that what was really manufactured by the IBDL is only spirit and apart from manufacture, the rest of the activities are done, controlled and supervised by the respondent starting from the stage of blending and what was done by IBDL so far as preparation, manufacture of IMFL is concerned, is in the nature of a works contract. The work is carried on for and on behalf of the respondent and therefore, really there is no sale of IMFL. This argument on behalf of the State was rejected by the Tribunal particularly in view of the agreement between the parties that on proper appraisal of the method of manufacture of IMFL products, the respondent being in possession or custody of essence and the blend, is aimed at guarding its trade secret and that would not go to prove that the respondent has given an undertaking to manufacture IMFL products and the acceptance of the quality of spirit would not imply purchase of spirit by the respondent-company and simply because there is supply of essence for the preparation of blend by the technical representative of the respondent-company would not take away the character of sale in IMFL with reference to the concept of supply of "principal material". The value of essence supplied by the respondent is insignificant in value and such an action aimed at guarding their secrecy relating to various brands cannot be deemed to be a manufacturing activity of IMFL and to presume purchase of spirit. Under the excise enactment, IBDL was authorised only to sell IMFL and not spirit and what is manufactured and sold by IBDL to the respondent was not spirit but IMFL. Reference was made to the decision of the Supreme Court in *Joint Secretary to the Government of India and Others Vs. Food Specialities Ltd.*, that the value of the goods sold by the manufacturer to the trade mark owner constitutes the value for the purpose of excise duty. Reference was also made to the decision in the case of *Union of India (UOI) and Others Vs. Cibatul Limited*, which action arose under the Central Excises and Salt Act, wherein it was held that though the goods were manufactured to the programme drawn by the buyer and the seller and the buyer was obliged to purchase the goods if it conformed to buyer's standard, the seller will have to be treated to have manufactured the goods on his own account and wholesale price of goods manufactured by seller was the wholesale price at which it sold goods to buyers. It was pointed out that the goods were manufactured by the seller on his own account and not on behalf of the buyer. Therefore, the contention advanced on behalf of the State that there is a deemed sale of spirit on the principles of appropriation was rejected. It was next argued that in *Union of India (UOI) Vs. The Central India Machinery Manufacturing Company Ltd. and Others*, wherein bulk of materials used by the seller belonged to the buyer, there was a sale and the contract was not one of works contract and the argument that it is in the nature of works contract in the present case is rejected.

7. On behalf of the respondent, it was contended that from a perusal of the agreement, it could be inferred that there is no clear expression used in the agreement as to purchase, sale, supply and utilisation. Therefore, the use of the expression supply and utilisation by themselves may not be very clear and it is

only on the reading of the various terms in its totality, it must be inferred that there is no sale of IMFL and whether there has been any sale of spirit or not may be relevant in the present case. The expression "sale" has been used or "purchase" has been used only in relation to clauses relating to fixation of price and not anywhere else. Other clauses are in relation to manufacture, supply or spirit being utilized for the purpose of manufacture of IMFL and would not indicate that there is any sale of spirit as such nor is there any sale of IMFL subsequently. It is also contended that considering the manner in which the clauses in the agreement are termed that would indicate the property of the goods which is the most crucial test in determining whether there is a sale or not, are clearly to the effect, would not pass until the goods are sent to the respondent. Moreover, the responsibility of the IBDL would not cease until proper goods are supplied to the respondent and when once the quality of spirit is accepted, blending takes place, and that would not guarantee that IMFL manufactured thereafter belong to the respondent but in the event there are any impurities thereto or there are any foreign particles or sedimentation, the respondent reserve the right to reject the IMFL manufactured by IBDL, and what is required in the agreement is the manufacture of IMFL to the standard set by the respondent and therefore, there is no camouflage in the nature of the transaction indicated in the agreement. Therefore, it is contended that there is no substance in the contention advanced on behalf of the State.

8. From the terms of the agreement, it is clear IBDL will manufacture spirit for the purpose of utilising the same for IMFL to be marketed by the respondent under its trade mark. One part of the agreement relates to manufacture of spirit in the distillery of IBDL. There is necessary infrastructure and facilities to manufacture spirit. On the manufacture of spirit, respondent through its technical representative, gets it checked and tested regarding the quality of spirit and in the event any defects are found, the same would be rejects which IBDL undertakes to take back the spirit and supply spirit of quality acceptable to the technical representative. Once such quality of spirit as approved by the technical representative is manufactured, the respondent's representative would do the blending by utilising the essence provided by the respondent. Blending will be done after quality of spirit is accepted by the respondent. Once blending is completed, IBDL will not be liable for Shaw Wallace for the quality of the spirit which shall be deemed to have been accepted by them. Thereafter, IBDL reduces the strength of the spirit to the required strength by utilising appropriate demineralised water. It is clear that the spirit once blended cannot be dealt with by IBDL in any manner they want. That quantity of spirit which is blended by the technical advisor will have to be held by IBDL for the benefit of the respondent alone in appropriate tanks provided thereto. It is no doubt true that IBDL will conform to the standard of storing and the quality of IMFL to be supplied to them. But, it is clear that the spirit manufactured by IBDL are subjected to certain processes under the supervision and control of the respondent. When it becomes clear that the spirit which is blended by the technical representative of

the respondent cannot be utilized for any other purpose by IBDL nor can the same be sold to any other party, it is clear that it becomes the property of the respondent. If it is so, further processes that are done by IBDL are for and on behalf of the respondent. This position becomes clear by referring to clause (10) of the agreement which provides that IBDL shall for and on behalf of the respondent manufacture IMFL products from the spirit supplied under the agreement. May be for purpose of manufacture of IMFL licences are held by IBDL. That does not take away the effect that IBDL manufactures IMFL for and on behalf of M/s. Shaw Wallace. However, Sri Natarajan, learned counsel for the respondent, placing very strong reliance upon the decision in Union of India (UOI) and Others Vs. Cibatul Limited, , pointed out that the entire question before the court is whether the goods are manufactured by the seller or manufactured by the seller on behalf of the buyer, when the manufacturing programme is drawn up jointly by the buyer and the seller and not merely by the seller. In that case, the clauses were clear that if the goods manufactured were not of the standard to that of the purchaser, they could reject those goods and there were several alternatives to the manufacturer such as, the manufacturer could sell the manufactured goods to other to even to destroy such goods. In the present case, all that the manufacturer - IBDL can do is to reprocess the goods if the same are rejected as containing any foreign particles or sedimentation or if it is not of the required strength and it is only in cases of sedimentation or for other reasons they have to take back the stock and examine the causes of such sedimentation and apportion the cost for taking back the same and reprocess the same. When these are the terms under which the goods are manufactured, it becomes clear the quality prescribed is only towards the work done by IBDL for and on behalf of the respondent. Manufacturer has absolutely no control over such goods. Therefore, the principle laid down in Union of India (UOI) and Others Vs. Cibatul Limited, cannot be applied to the facts of this case. The next decision relied upon by the learned counsel for the respondent is Union of India (UOI) Vs. The Central India Machinery Manufacturing Company Ltd. and Others, . In that case, the raw materials considered of three categories in the manufacture of wagons. While the first category was admittedly the property of the railways, the third category thereto was at all times, the material of the company. The controversy was only in relation to raw material such as steel, against which advances were made. There were certain special conditions provided in the agreement thereto and that is why the court examined as to whether bulk of the materials upon which the work was done came from the company or from the railways. It is only thereafter, it was found that when the bulk of the material came from the company, the same could not be treated as works contract. In this case, such a conclusion cannot be drawn on the basis of the agreement for, in the manufacture of IMFL, blending is an essential part. For purposes of blending, essence is provided by respondent-company and blending is done by its technical representative. It shows as to how important for the respondent the blending is and the manner in which it should be done apart from maintaining the trade secrets. Without blending there cannot be manufacture of IMFL at all.

When that becomes an essential part of the manufacturing process of IMFL, we do not think we can minimise the importance of the same as could be done in the manufacture of railway wagons. Therefore, we do not think that decision can be of any assistance to the respondent.

9. In the circumstances, we do not think the respondent is justified in contending that IBDL has sold IMFL manufactured by it to the respondent. From the terms, as we could see, the spirit manufactured by IBDL is subjected to certain processes. While part of the process is done by the respondent itself, the other part is done under the control and supervision of the respondent.

10. It was very strenuously contended that if there has been any sale of IMFL as to what interpretation will have to be given to the clause providing for price. The price at which Shaw Wallace will purchase IMFL will be at particular rates provided in clause (25). As rightly pointed out by the learned counsel for the respondent, the expressions "supplied" and "utilized" and "purchase" have been loosely used throughout the agreement and no strict interpretation of the same can be given. Viewed from that angle, it becomes clear the first part of the same is manufacture of IMFL by IBDL for the respondent which also results in the supply of IMFL products by respondent and there is really no purchase of IMFL product by the respondent on the true interpretation of the agreement. What price the spirit has been purchased or IMFL has been supplied need not be dealt with. It is enough to state that IMFL has not been purchased by the respondent from IBDL under the terms of the contract.

11. It is urged on behalf of the respondent, the respondent wanted proper quality of IMFL maintained and at the same time maintain secrecy so far as the essence supplied by it and therefore, the terms in the clauses were used in the manner referred to by us. Even assuming that to be correct, it would not necessarily follow that there has been sale of IMFL by IBDL to the respondent. The mere fact that the respondent need not hold licence for the manufacture of IMFL would not carry the matter far. The respondent themselves need not hold any licence, anybody who acts on their behalf holding such licence would be sufficient for them. Therefore, the argument advanced on behalf of the respondent that they did not hold licence and therefore, did not manufacture IMFL will be of no significance to the respondent. Therefore, these revision petitions are allowed. The order made by the Tribunal is set aside. However, we cannot make any order except what has been done by the first appellate authority in these cases inasmuch as against the order made by the first appellant authority, no appeal had been preferred by the Revenue to the Tribunal. As a consequence, the order made by the first appellate authority will stand restored.

12. Petitions allowed.