# LAW COMMISSION OF INDIA

SIXTY-FIRST REPORT

ON

CERTAIN PROBLEMS CONNECTED WITH POWERS OF THE STATES TO LEVY A TAX ON THE SALE OF GOODS AND WITH THE CENTRAL SALES TAX ACT, 1956.

May, 1974

CONTENTS

P. B. Gajendragadkar

D.O. No. F.2(4)/73-L.C.
LAW COMMISSION OF INDIA
'A' Wing, Shastri Bhavan,
New Delhi-1.
May 21, 1974.

I have great pleasure in forwarding herewith the 61st Report of the Commission on certain problems referred by you to the Commission by your D. O. letter No. F. 352/PS/MLJ/73 dated the 12th April, 1973.

Having regard to the nature of the subject and its importance, the Commission first made a preliminary study of the said problems and framed a Questionnaire in respect of them. This Questionnaire was sent to the Ministries concerned, the State Governments, the High Courts, Bar Associations and other interested persons and bodies. The replies received in response to his Questionnaire were then duly considered by the Commission and the draft Report on the subject was prepared by the Member-Secretary, Mr. Bakshi, and discussed by the Commission. After the discussion, the Report was finalised.

One of us, Mr. S. P. Sen-Verma, has signed the Report, subject to a separate note ; which deals with the problem posed by section 5 of the Central Sales Tax Act.

I may add that some of the problems, on which recommendations have been made by the Commission in this Report, are complex and vexed; but the Commission hopes that its relevant recommendations may afford a satisfactory solution which may help solve the difficulties mentioned by you in your letter.

With the forwarding of this Report, the present Commission will have completed seventeen Reports since it began to function on the 1st of October, 1971. As you know, some of these Reports are short documents, because they deal with specific problems which, in the opinion of the Commission, needed early legislative solution.

Yours
Sd/-
(P. B. Gajendragadkar)

Hon'ble Mr. H. R. Gokhale,
Minister of Law, Justice & Company Affairs,
Government of India,
New Delhi-1.
Encl : As above.

Intro.—1. The genesis of this Report lies in a letter received by us from the Minister of Law and Justice, which is reproduced below :— Genesis, and points referred to the Commission.

"As you are aware, the Government had the advantage of obtaining the views of the Law Commission on more than one occasion in connection with certain problems arising out of the levy of sales tax and particularly central sales tax. The principles set out in the Central Sales Tax Act, 1956, for determining when a sale or purchase takes place in the course of inter-State trade or in the course of import or export of goods into or from India were laid down on the basis of the recommendations contained in the Second Report of the Law Commission. Similarly, certain problems arising out of the decision of the Supreme Court in *K. G. Khosla's* case were considered by the Law Commission in its 30th Report.

2. Experience in working of both State Sales Tax and Central Sales Tax has thrown up certain problems which are of importance not only from the point of view of the proper administration of the sales tax laws but also for raising the resources necessary for development activities.

3. As you are aware, the scope for the levy of sales tax by State Governments has been restricted in respect of works contracts, hire-purchase transactions and also on the transfer of controlled commodities by virtue of statutory orders.

4. Certain State Governments have stated that Central sales tax is being evaded by means of transfer of goods from one State to another on what *purports to be consignment* transfer or a transfer to another branch of the same institution. A suggestion has been made that such transfers should themselves be made liable to tax. A view has also been expressed that section 5 of the Central Sales Tax Act as interpreted by the Supreme Court in *K. G. Khosla's* case unduly restricts the taxing power of the State.

5. In the administration of Central Sales Tax also there are conflicting decisions of the courts as to the scope of the penal provisions of that Act. It may also be necessary to consider whether the provisions with regard to penalties for the evasion of sales tax should not be amended so as to do away with the concept of *mens rea* or to bring it in line with the recommendations made by the Commission with regard to offences under other fiscal laws.

"6. I also understand that difficulties are being felt with regard to certain other matters such as the disposal of excess amounts collected by a dealer from a customer as sales tax and the establishment of check-posts for preventing evasion and the better collection of taxes on the sale of goods.

7. Some of these issues are of considerable importance in the day-to-day administration of sales tax and are of importance to the State and to the public alike. A specific reference to some of these problems was made at the meeting of the Ministers for sales tax of the States in the Northern Zone.

8. I shall, therefore, be grateful if the Commission could look into these and other related problems arising out of the administration of Central Sales Tax and the constitutional restrictions on the imposition of sales tax by State Government."

Scope of the Report.

Intro.—2. This Report, thus, deals with certain problems connected with—

(a) power of the States to levy a tax on the sale of goods;

(b) the Central Sales Tax Act, 1956.

Neither the entire subject of Sales tax, nor the whole field of the power referred to above, is intended to be covered in this Report. Nor will the Report cover the whole of the Central Sales Tax Act. It is cofined to certain specific problems.

Constitutional position.

Intro.—3. The letter of reference[1] mentions several topics. Before discussing them, a few words about the power to levy a tax on the sale of goods would be relevant. Under the Constitution, the power to levy tax on the sale or purchase of goods

1. Para Intro. 1, *Supra*.

is referrable to the legislative power vested in the States, by virtue of the specific entry in the State list.[1] But the power to levy such tax on *inter-State sales* is vested in the Union Parliament.[2] Again, there are certain restrictions on the powers of the States[3]. We shall presently proceed to explain this apparently complex scheme. The reasons for such a complicated scheme will also be apparent from the discussion that follows.

Limitations on States powers.

Intro.—4. The legislative authority[4] of the States to impose a tax on sales and purchases is restricted by three limitations contained in articles 286(1)(a), 286(1)(b) and 286(3) of the Constitution respectively. These limitations overlap to some extent; but they are cumulative, and the legislative power to tax may be exercised only if it is not hit by any of the limitations.

There are general limitations in articles 301 to 304, but they are not material for our purpose.

Intro.—5. Before 1956, there was a fourth limitation as to inter-State sales and purchases. After 1956, this limitation assumed the form of *absence* of a power to tax inter-State sale or purchase, and the power is now exclusively vested in the Parliament[5].

The three limitations relate to —

(i) tax on sales in the course of import or export;

(ii) tax on sales outside the State; and

(iii) tax on sale of essential goods.

The main purpose of the limitation regarding tax on sale or purchase in the course of import or export is to protect international trade from taxation by States.

The main purpose of the limitation on the power of the States to tax sales or purchases *outside the State* is to prevent the imposition of an unduly heavy burden upon the consumer by multiple taxation upon a single transaction of sale[6].

---

1. Constitution, 7th Schedule, State List, entry 54.
2. Constitution, 7th Schedule, Union List, entry 92A.
3. *See* para Intro. 12, *infra*.
4. Para Intro. 3, *supra*.
5. Constitution, Seventh Schedule, Union List, entry 92A.
6. *c.f. Bengal Timber Trading Corporation* v. *C.S.T.* A.I.R. 1967 S.C. 1348, 1349; (1967) 2 S.C.R. 547 [on the old article 286 (1)].

The object of the third limitation—as to taxation of sale or purchase of essential goods—is obvious.

The object of constitutional restrictions.

Intro.—6. In considering the various topics[1] on which the Commission's views have been sought, these objects of the Constitutional restrictions as to fiscal powers will have to be borne in mind.

Two Madras cases[2] have explained in detail the scheme of the taxation of sale of goods before and after the Constitution, and under the Central Sales Tax Act, 1956. We need not go into those details here.

The matters under reference.

Intro.—7. Coming now, to the matters raised in the letter of reference, ([3]) we can broadly classify them into the following categories:—

(a) Points requiring amendment of the Constitution—particularly, State List, entry 54, which prescribes the taxing power of the States in respect of tax on the sale of goods;

(b) Points not requiring amendment of the Constitution, but requiring amendment of certain statutory provisions passed in pursuance of article 286 of the Constitution, such as sections 3, 4 and 5 of the Central Sales Tax Act, 1956.

(c) Points requiring amendment of the Central Sales Tax Act, 1956, in respect of matters other than those mentioned in (b) above (e.g. punishment for the evasion of tax).

Points at (a) and (b) involve constitutional questions.

Points enumerated.

Intro.—8. The various points that arise for consideration from the letter of reference[4] can be enumerated as follows:—

(i) The scope for the levy of sales tax by State Government, in respect of works contracts, hire-purchase transactions and also on the transfer of controlled commodities by virtue of statutory orders.

---

1. Para. Intro. 1. *supra.*

2. (a) *Larsen & Toubro Ltd.* v. *Joint Commercial Tax Officer*, (1972) 2 M.L.J. 552: (1967) 20 S.T.C. 150.
   (b) *Sitalakshmi Mills Ltd.* v. *Deputy C.T.O* (1969) 2 M.L.J. 25.

3. Para. Intro., *supra.*

4. Para. Intro., *supra.*

(ii) Evasion of Central Sales Tax by means of transfer of goods from one State to another, on what purports to be a consignment transfer or a transfer to another branch of the same institution.

(iii) Whether section 5 of the Central Sales Tax Act, as interpreted by the Supreme Court in *K. G. Khosla's* case, unduly restricts the taxing power of the States.

(iv) Conflicting decisions of the Courts as to the Central sales tax in regard to the scope of the penal provisions of that Act.

(v) Whether the provisions with regard to penalties for the evasion of the sales tax should not be amended, so as to do away with the concept of *mens rea* or to bring them in line with the recommendations made by the Law Commission with regard to offences under other fiscal laws.

(vi) Difficulties felt with regard to certain other matters, such as, the disposal of excess amounts collected by a dealer from a customer as sales tax.

(vii) Establishment of check-posts for preventing evasion and better collection of taxes on the sale of goods. We shall discuss them serially in due course.

Policy matters outside the inquiry.

Intro.—9. Our Report deals with issues which have been expressly referred to us by the Minister of Law, Justice and Company Affairs by his letter dated 12th April, 1973[1] as well as issues which arise therefrom. Before we proceed to deal with these issues, we ought, in fairness, to point out that the ultimate decision of most of these issues will involve considerations of policy of a complex political and economic character. The area covered by these considerations, however, is outside our inquiry, and our Report will be confined to the legal aspects of the issues under inquiry; and our recommendations and suggestions will be based on certain assumptions made by us from the relevant statements in the communication of the Minister for Law, Justice and Company Affairs. We shall refer to these assumptions in due course, when we deal with the serveral issues serially. We thought it necessary to make this observation, in order to avoid any misunderstanding about the scope of our inquiry and about the character and effect of our recommendations and suggestions.

---

[1] See para Intro. 1, *supra*.

Analysis of the Central Sales Tax Act.

Intro.—10. An analysis of the long title of the Central Sales Tax Act will indicate the principal purposes of the enactment. These are—

(1) to formulate principles for determining when a sale or purchase of goods takes place—

(a) in the course of inter-State trade or commerce (section 3), or

(b) outside a State (section 4), or

(c) in the course of import into or export from India (section 5);

(2) to provide for the—

(a) levy (sections 6 & 8),

(b) collection [section 9(1) and 9(2)], and

(c) distribution [see, section 9(4)] of taxes on sales at (1) above, and sale of goods declared to be of special importance in inter-State trade or commerce, and

(3) to declare certain goods to be of special importance in inter-State trade or commerce [section 14] and

(4) to specify the restrictions and conditions to which State laws imposing taxes on the sale or purchase of such goods of special importance shall be subject [section 15]

The remaining sections of the Act relate to ancillary matters or confer powers, e.g., section 1 (giving the short title, etc.), section 2 (giving definitions), section 7 (providing for registration of dealers), sections 9A, 10 and 11 (banning the collection of tax except by registered dealers, enumerating offences and providing for penalty, cognizance, etc.,) section 12 (providing for indemnity to officers), section 13 (granting a rule-making power) and section 16 (repealing an earlier Act declaring certain goods to be essential commodities).

We now proceed to discuss the questions referred to us, and such other matters as have raised difficulties.

## CHAPTER I

*The scope for the levy of sales tax by State Governments*

Introductory

1.1. We deal, in this Chapter, with the scope for the levy of sales tax by State Governments. We shall deal later in detail with the power to tax three specific transactions,—works contracts hire-purchase transactions, and the transfer of controlled commodities by virtue of statutory orders.

Absence of element of passing of property or consensual element.

1.2. The three transactions[1] mentioned above may appear to be unconnected with one another. But certain legal issues are common to them. These issues arise out of the concept of sale as known to the general law of sale of goods,—particularly, the passing of property and the consensual element in a sale. The total absence of these elements, or their presence in an inperfect form, has raised questions as to whether the transactions are taxable as sales.

Definition of "Sale" in the Sale of Goods Act.

1.3. The Constitution does not define the expression "sale". In the Sale of Goods Act[2], a contract of sale is defined as follows:—

"A contract of sale of goods is a contract whereby the seller transfers or agrees to transfer the property in goods to the buyer for a price. There may be a contract of sale between one part-owner and another".

The Act makes it clear that "a contract of sale may be absolute or conditional[3]."

The difference between a "sale" and an "agreement to sell" is also laid down in the Act[4]. "Where, under a contract of sale, the property in the goods is transferred from the seller to the buyer the contract is called a sale, but where the transfer of the property

---

1. Para. 1.1, *supra*.
2. Section 4(1), Sale of Goods Act, 1930.
3. Section 4 (2), Sale of Goods Act, 1930.
4. Section 4 (3), Sale of Goods Act, 1930.

in the goods is to take place at a future time or subject to some condition thereafter to be fulfilled, the contract is called an agreement to sell."

As to when the agreement ripens into a sale, the Act provides :[1]

> "An agreement to sell becomes a sale when the time elapses or the conditions are fulfilled subject to which the property in the goods is transferred."

Passing of property thus plays an important part in the concept of sale of goods under the Act.

**Power of states to levy tax on "sale"— meaning attributed to sale.**

1.4. The power of the States to levy a tax on the sale or purchase of goods is to be found in the Constitution, 7th Schedule, State List, entry 54. The Supreme Court[2] has consistently held that the expression "sale of goods", as used in the legislative entries in the Constitution and in the Government of India Act, 1935, bears the same meaning as it has[3] in the Sale of Goods Act, 1930.

Therefore, while the State Legislature may, under the State List, entry 54, legislate in respect of the series of acts beginning with an agreement of sale between parties competent to contract and resulting in the transfer of property from one of the parties to the agreement to the other for a price (and matters incidental thereto), it cannot levy a tax on a transaction which is not a "sale" within the Sale of goods Act.

**Sale under the English Act.**

1.4A. In England the Sale of Goods Act defines a contract of sale of goods as[4]—

> "a contract whereby the seller transfers or agrees to transfer the property in goods to the buyer for a money consideration, called the price."

---

1. Section 4 (3), Sale of Goods Act, 1930.
2. (a) State of Madras v. Gannon Dunkerley & Co. Ltd. (1959) S.C.R 379; A.I.R. 1958 S.C. 560;
   (b) New Indian Sugar Mills v. Commissioner of Sales Tax, Bihar (1933) Supp. 2 S.C.R. 459; A.I.R. 1963 S.C. 1207;
   (c) Bhopal Sugar Industries v. S.T.O. (1964) 1 S.C.R. 481; A.I.R. 1964 S.C. 1037.
3. As to the Sale of Goods Act, see para 1.3, *Supra*.
4. The Sale of Goods Act, 1893, section 1(1) and 1(3) (Eng).

The Act gives different names to the two transactions:—

> "Where under a contract of sale the property in the goods is transferred from the seller to the buyer the contract is called a sale; but where the transfer of the property in the goods is to take place at a future time or subject to some condition thereafter to be fulfilled the contract is called an agreement to sell."

Sale under common law.

1.4B. It would appear that at common law also, "sale of goods" had a narrow meaning, and the passing of property—immediately or at an appointed time—was of the essence of the transaction. As the Indian Contract Act[1] (as originally enacted) provided,—"Sale is the exchange of property for a price. It involves the transfer of the ownership of the thing sold from the seller to the buyer".

Narrow concept of "sale".

1.5. It may be that the narrow concept of sale in the common law, and in the statute based thereon[2], is due to the fact that sale was originally a "cash and carry" transaction. Perhaps, the most dramatic illustration of the difficulties in breaking with the past in this respect is the long struggle of warranty law with the principle of *caveat emptor*—the principle that "he who does not open his eyes, opens his purse",—a maxim reflecting a phase in the history of sales law when a sale was a "cash and carry" transaction[3].

This may account for the fact that the emphasis is on the passing of property,—though the position in regard to payment of the price and other aspects has undergone modification.

Some transactions which do not amount to 'sale'.

1.5A. This requirement as to the passing of property being essential, it is well-established[4] that a transaction lacking transfer of property cannot be taxed as a sale by creating a legal fiction in the shape of a deeming clause which seeks to extend the concept of 'sale'.

---

1. Section 77, Indian Contract Act (repealed).
2. Para 1.4A and 1.4B, *Supra*.
3. (a) Hamilton, "The Ancient Maxim Caveat Emptor," (1931) 40 Yale L.J. 1133.
   (b) Kessler, "Protection of the Consumer" (1964-65) 74 Yale L.J. 262, 263.
4. *Dy. C.T.O.* v. *Enfield India Ltd.*, A.I.R. 1968 S.C. 838, 840; (1968) 2 S.C.R. 421.

No property passed in hire-purchase and building contracts.

1.6. Since the expression "sale of goods" in the Constitution, State List, entry 54, has the same meaning as in the Sale of Goods Acts[1], a hire-purchase agreement is not a sale[2], as no property passes in such transaction until the option to purchase is exercised and the other terms of the agreement fulfilled[3]. Similarly, in a building contract which is entire and indivisible, there is no "sale" of goods[4]. It is a contract of works[5], involving skill and labour, and not directly pertaining to the transfer of property in goods *in specie*. Consignments of goods by a principal to his agent is also not a sale, there being no passing of property for a price[6] from one person to another.

Certain transactions not to be regarded as sale.

1.7. Several other transactions fall outside the concept of "sale" because of the absence of the essential requirement of sale. For example a transaction between an hotelier and a resident customer of the hotel is one of "service", and is not taxable[7] under the head of "sale of goods", if there is a consolidated charge for boarding and lodging.

The allotment of the goods of a firm amongst its partners, on the dissolution of the firm, also does not amount to a "sale". A provision in a Bombay Act[8], in so far as it purported to tax such allotment, was held[9] to be *ultra vires* the State Legislature.

Definition of 'sale' in the Central Sales Tax Act.

1.8. We may now refer to the definition of 'sale' in the Central Sales Tax Act, The Act defines 'sale' as follows[10]:—

> " 'Sale', with its grammatical variations and cognate expressions, means any *transfer of property in goods* by one person to another for cash or for deferred payment or

---

1. Para 1.4, *Supra*.
2. *K.L. Johar & Co.* v. *Dy. C.T.O.* A.I.R. 1965 S.C. 1082, 1089; (1965) 2 S.C. R. 112.
3. See Chapter 1-B, *infra*. (Hire-purchase).
4. *State of Madras* v. *Gannon Dunkerley & Co.* A.I.R. 1958 S.C. 560, 677; (1959) S.C.R. 379.
5. See Chapter 1-A, *infra* (Works Contract).
6. See Chapter 2, *infra* (Consignments).
7. *Associated Hotels of India Ltd.* v. *Excise & Taxation Officer, Simla* A.I.R. 1966 Punj. 449, 454 to 458, para 18 to 35.
8. Section 26(3), Bombay Sales Tax Act, 1963 (3 of 1953).
9. *State of Gujarat* v. *M/S. Ramanlal & Co.*, A.I.R. 1965 Guj. 60, 69, para 17-18.
10. Section 2(g), Central Sales Tax Act, 1956.

for *any other valuable consideration,* and includes a transfer of goods on the hire-purchase or other system of payment by instalments, but does not include a mortgage or hypothecation or a charge or pledge on goods.".

We shall discuss in detail certain elements of this definition later[1].

1.9. This, in brief, is the meaning given to the expression "sale of goods", (a) with reference to the constitutional competence of the State Legislatures to levy a tax thereon and (b) in the Central Sales Tax Act. Should the scope of "sale be widened"?

The question that now falls to be considered is:—

Is it desirable to extend the scope of taxability under the head of 'tax on the sale or purchase of goods' ? The question has several branches. Each of them requires full discussion.

---

1. Para 13.11, *infra* (Hire Purchase).

# CHAPTER I A

## TAXABILITY OF WORKS CONTRACTS

### Introductory

Introductory.

1A.1. Having discussed generally the power of the States, we now discuss the legal position regarding taxability of works contracts in particular. A typical example of a works contract is a building contract, which could be usefully considered in some detail.

### Building contracts

Hudson's definition of building contracts.

1A.2. According to Hudson :[1]

"A buliding or engineering contract may be defined, for the purpose of this book, as an agreement under which a person (in this book called variously the builder or contractor), undertakes for reward to carry out for another person (variously referred to as the building owner or employer), *works* of a building of civil engineering character."

Works, the essential feature.

1A.3. The essential nature of the contract is the carrying out of works.[2]

New Works or repairs.

1A.4. A works contract may comprise new works, and also repairs, for example, the operations of the Central Public Works Department are divided primarily into two categories, "original works" and "repairs". It has been stated[3] that "original works" comprise all new constructions, whether of entirely new works or of additions and alternations to existing works or replacement or remodelling of existing buildings. Repairs include operations undertaken to maintain buildings and works in proper condition. The works on which expenditure does not exceed Rs. 75,000

---

1. Hudson, Building & Engineering Contracts, (1965), page 1.
2. See also para 1A-7 and 1A-20, *infra*.
3. Report of the study Team on CPWD (July 1965), page 13.

are classified as minor works and those on which it exceed Rs. 75,000 as major works. All original works and repairs costing more than Rs. 5,000 and relating to Central Civil buildings are to be executed through the agency of the Central Public Works Department. Prior concurrence of the Ministry of Works and Housing is necessary for entrusting civil works to any agency other than the Central Public Works Department.".

Materials a valuable part of total cost.

1A.5. Materials do constitute a valuable part of the total cost of works. And that is why the question often arises whether a works contract can be treated as a sale for the purposes of laws taxing sales.

Materials a valuable part C.P.W.D. and department works.

1A.6. It has been estimated,[1] in the case of works constructed for the C.P.W.D. that materials and stores account for nearly two-thirds of the cost of works[2] (In the case of departmental execution of works, the Government has to arrange for all the requirements of materials and stores).[3]

*Difference between "works and sale"*

Difference between contract of works and contract for sale.

1A. 7. The primary difference between a contract for work (of service) and a contract for the sale of goods is that in the former there is in the person performing the work rendering a service, no property in the thing produced as a whole, even if a part or even a whole of the materials used by him may have been his property. [4-5]. Eventually, the property passes ;[6] in the generality of building contracts, the agreement between the parties is that the contractor should construct a building according to the specifications contained in the agreement, and in consideration therefor, he should receive the payment as provided therein. There is, in such agreement, neither a contract to sell the materials used in construction, nor does property pass therein as movables. The materials pass to the owner of the building only as an accretion to the building. A contract *for the sale* of materials cannot be implied from such an agreement.

---

1 Report of the Study Team on C.P.W.D. (July 1965), page 78.

2. Report of the Study Team on C.P.W.D. (July, 1965) page 71.

3. As to the practice regarding payment, see para 1A-18 *infra*.

4. *C.S.T.* v. *Purushottam Premji*, (1970) 26 S.T.C. 38, 41.

5. See also para 1A-27, *infra*.

6. *State of Madras* v. *Gannon Dunkerley*, (1958) A.I.R. 1958 S.C. 560 (on appeal from A.I.R. 1954 Mad. 1130).

Splitting up by assessee immaterial.

1A.8. Where the contract is indivisible, it cannot be split up, and even the fact that the assessee has split it up for his own purposes is immaterial.[1]

Gannon Dunkerley's case.

1A.9. *Gannon Dunkerley's case*[2] is an example of taxation of composite contracts, involving the supply of goods and services. It is the leading case, holding that States cannot tax works contracts.

In *Guntur Tobacco case*[3] various aspects of a contract of work were thus dealt with :—

> "A contract for work in the execution of which goods were used may take one of three forms. The contract may be for work to be done for remuneration for supply of materials used in the execution of the works for a price; it may be a contract for work in which the use of materials is accessory or incidental to the execution of the work; or it may be a contract for work, and the use or supply of materials, though not accessory to the execution of contract, is voluntary or gratituous In the last class there is no sale, because, though property passes it does not pass for a price, whether a contract is of the first or the second class must depend upon the circumstances; if it is of the first, it is a composite contract for work and sale of goods; where it is of the second category, it is a contract for execution of work not involving sale of goods."

Two types of works contracts where the element of sale can be split up and where it cannot be.

1A.11. Work contracts, thus are of various types. For the present purpose, it is sufficient to state that where the question whether a particular contract of work is taxable by the States as a contract of sale arises, one has to distinguish between contracts in which the element of sale is divisible and contracts in which such element cannot be split up and which are, therefore, indivisible. Briefly, the position is as follows:—

(a) Where the agreement constitutes a single contract (as above), it is not open to the State 'to split up' the

---

1. (a) *C. S. T.* v. *Asha Watch Co.* (1971) 28 S.T.C. 395 (Gujarat) :
   (b) *Variety Body Builders* v. *C.S.T.* (1971) 28 S.T.C. 339 (Gujarat).
2. *State of Madras* v. *Gannon Dunkerley & Co.* A.I.R. 1958 S.C. 560 (1959) S.C.R. 379
3. *Government of Andhra Pradesh* v. *Guntur Tobacco Ltd.*, (1965) 16 S.T.C. 240 at page 255 (S.C.)

agreement into its component parts, *i.e.* to single out that which relates to the supply of materials and to impose a tax thereon treating[1] it as one of sale.

(b) Where the contract is one for the execution of work for a lump sum as offered by a tender and accepted by the contractor, no separate agreement for the supply of materials is involved, [2],[3] even though there is a term in the agreement that the property in materials would pass to the employer as soon as the goods were brought to the site by the contractor.

(c) Parties may, however, enter into distinct and separate contracts, one for the transfer of materials for money consideration and the other for payment of the remuneration for services and for work done.[4]

(d) The burden of showing that a works of service contract involves a taxable sale of the materials used is upon the taxing authorities, and the burden is not discharged by merely showing that property in goods which belonged to the party performing the service or executing the contract stands transferred to the other party.[5]

*Position in some other countries*

1A.12. The position in Australia in this respect may be contrasted. In a new South Wales case,[6] the Supreme Court of New South Wales held, that the agreement between the parties was one to do certain work and to supply certain materials, and not an agreement for the sale or delivery of the goods.[7] In Australia.

---

1. *State of Madras* v. *Gannon Dunkerley*. A.I.R. 1948 S.C. 560.

2. *Peare Lal* v. *State of Punjab* (1958) 9 S.T.C. 412 (S.C.).

3. *Carl Still's case*, A.I.R. 1961 S.C. 1615, 1619.

4. *State of Madras* v. *Gannon Dunkerley*, A.I.R. 1958 S.C. 560.

5. *Government of Andhra Pradesh* v. *Guntur Tobacco Ltd.* (1965) 16 S.T.C. 240, 255 (S.C.).

6. *Sydney Hydraulic and Central Engineering Co.* v. *Blackwood & Son*, 8 N.S.W.S.R. 10.

7. Irving's Commonwealth Sales Tax Law and Practice (1950) page 77.

In 1932, the Legislature[1] intervened, and enacted, in the statute of 1930, a new provision, section 3(4), in the following terms[2]:—

> "For the purpose of this Act, a person shall be deemed to have sold goods, if, in the performance of any contract (not being a contract for the sale of goods) under which he has received, or is entitled to receive, valuable consideration, he supplies goods the property in which (*whether as goods or in some other form*) *passes*, under the terms of the contract, to some other person."

After this, the question arose in later case whether[3] a contractor who fabricated piles and used them in constructing a bridge was liable to pay sales tax on the value of the piles. The majority of the court held that though there was, in *fact, no sale of the piles, in law there was one, by reason of section* 3(4) *of the Act.*

*Passing of property*

The position regarding passing of property.

1A.13. A treatise which deals with the practice in respect of building contracts[4] states the position as to the passing of property (in the materials) in works contracts, in these words :—

> "Materials brought on to the site by the contractor remains his property, in the absence of a provision to the contrary, until they become affixed to the land i.e., are built into the works,[5-6], whereupon they become the property of the owner of the freehold.[7] If the employer has an estate or interest less than the freehold, he enjoys the property during such estate or interest. In the case of ships the property passes when the materials

---

1. *See State of Madras* v. *Gannon Dunkerley & Co.* A.I.R. 1958 S.C. 560, 570.
2. Section 3(4), Commonwealth Sales Tax Act (Australia).
3. *M.R. Hornibrook, (Priv) Ltd.* v. *Federal Commissioner of Taxation* (1939) 62 C.L.R. 272, 281.
4. Keating, Building Contracts (1955) page 96.
5. Keating, Building Contracts (1955), page 96
6. *Tripp* v. *Armitage,*(1839) 4M & W. 687.
7. *Elwes* v. *Maw,* (1802) 3 East 38

> are fixed, 'or, in a reasonable sense, made party of the corpus'."[1]

1A.14. It is, however, stated in the same treatise.[2] "I is common to have a clause which purports to vest materials and sometimes plant in the employer before they are fixed. The principal objects of such a clause are to provide a security to the employer for money advanced and to enable the employer to obtain the speedy completion of the works by another contractor in the event of the original contractor's default, by providing materials and plant on the site ready to use free from the claims of the original contractor, and his creditors, or his trustee in bankruptcy or liquidator. Whether or not the clause achieves its purpose depends upon the words used.[3] If the formula used is "the materials shall become and be",[4] or "be and become" the property of the employer, then normally "the clause means what it says, operates according to its tenor and effectively transfers the title."[5] :—

> If, on the other hand, words like 'considered to be', are used, the clause may be ineffective to achieve its purpose, the property may remain in the contractor.[6]

1A.15. Clause 11 of the form of the Royal Institute of British Architects[7] may be referred to, in this connection :— Contract form of Royal Institute of British Architects.

> "Clause 11—Unfixed materials when taken into account to be the property of the employer.

Where in any certificate of which the Contractor, has received payment the Architect has in accordance with clause 24(b)

---

1. *Scath* v. *Moore* (1896) 11 App. Cas. 350, 381, (H.L.). for other cases on ships, see *Re Salmon and Woods, ex. p. Gould*, (1885) 2 Morr. Bkptcy. Cas 137; *Reid* v. *Macbeth & Gray* (1904) A.C. 323 (H.L.). *Re Blyth Ship Building etc. Co. Ltd.* (1926) Ch. 494 (C.A.).

2. Keating, Building Contracts (1955), page 97.

3. See, e.g. clause 11, R.I.B.A. form (infra).

4. *Bennett etc. Ltd.* v. *Sugar City*, (1951) A.C. 786 (P.C.).

5. See *Reeves* v. *Barlow*, (1884) 12 Q.B.D. 436 (C.A.).

6. (a) *Bennett etc. Ltd.* v. *Sugar City*, (1951) A.C. 786, 814.
(b) *Re Winter ex* p. *Bolland*, (1878) 8Ch. D. 225.

7. Keating, Building Contracts (1955), page 230.

of these Conditions included the value of any unfixed materials and goods intended for, and placed on or adjacent to the Works, such materials and goods shall become the property of the Employer and shall not be removed except for use upon the Works unless the Architect has authorised in writing such removal, but the Contractor shall remain responsible for loss or damage to the same.".

Provision in another form adopted by Association of sub-contractors.

1A.16. Another form (adopted by the Association of sub-contractors) has this clause[1] :—

"*Vesting of Materials* :

11.—All plant, materials and equipment of any kind whatsoever which are brought on to the site by the Contractor but are not intended for incorporation in the Works shall remain the property of the Contractor in any event. Any materials, fitments or other goods delivered to the site for incorporation in the Works shall remain the property of the Contractor and shall not become the property of the Employer until whichever is earlier of the following times :—

(a) When the same have been incorporated in the Works, or

(b) When the same have been paid for in full (subject only to the deduction of such sums as the Employer may be entitled to retain in accordance with the provisions of clause 12 hereof).

without prejudice to any other rights or remedies the Contractor shall have a lien on any unincorporated materials, fitments or goods which may have become the property of the Employer for the amount of any unpaid portion of the Contract price due to the Contractor."

When does property in materials pass.

1A.17. It is not always easy to determine when the property in the materials passes in a Works Contract; this is because payment is not usually made in a lump sum.

---

1. Keating, Building Contracts (1955), page 310—311.

1A.18. Take, for example, the practice in the Central Public Works Department, which has been thus described[1-2]: "A Contractor is required to submit a running bill each month on or before the date fixed by the Engineer-in-charge for all works executed in the previous month and the Engineer-in-charge has to take or cause to be taken the requisite measurements for the purpose of having the bill verified and the claim, to the extent admissible, adjusted, as far as possible before the expiry of 10 days from presentation of the bill. If the contractor does not submit the bill within the time fixed, the Engineer-in-charge may depute a subordinate, within 7 days of the date fixed to measure the work in the presence of the Contractor whose countersignature to the measurement list will be sufficient warrant and the Engineer-in-charge may prepare a bill from such a list." Practice in C.P.W.D.

*Tests adopted*

1A.19. It may sometimes be difficult to decide whether a contract is of works or of sale. Several tests are adopted,[3] for the purpose,—e.g. one test is whether primarily the transfer of the movable article is taken as such, or whether the transfer is only ancillary to another contract. Another test is whether the article supplied has itself a general market. A contract to produce photographs of a *particular person* is, for example, one of works,[4] because the photographs would have no general market. The production is really of a work of art requiring skill.[5-6] Tests for distinguishing between works contracts and sale.

1A.20. It has been stated that states are faced with several problems[7] owing to the extension of the principle to other cases involving "body building". States faced with problem.

*Whether amendment needed*

1A.21. It is in this background that we have considered the question whether the power to tax indivisible contracts of works should be conferred on the Sates. Conclusion.

1. Report of the Study Team on Central Public Works Department (1965), page 82.
2. As to C.P.W.D. works in general, see para 1A.6, *supra*.
3. See also para 1A.7, *supra*.
4. *B. C. Kame* v. *Assistant S.T.O.*, (1971) 28 S.T.C. 1, 3 (M.P.).
5. *C.S.T.* v. *Patel India Ltd.* (1971) 28 S.T.C. 516 (Bombay) (Mody C.J. and Chandrachud J.)
6. *Camera House* v. *State of Maharashtra*, A.I.R. 1956 Bom. 437 (Abhyankar & Vimadalal JJ) (Reviews cases).
7. Notes in the Ministry of Finance.

In our view, in its judgments on this question, the Supreme Court, with respect appears to have adopted an unusually restricted interpretation of the expression "sale". It is true that the expression "sale" is not defined in the Constitution—but, it is a well-recognised canon of construction that the words used in the three Legislative Lists should receive the widest possible interpretation and it was, we venture to suggest, somewhat inappropriate to have taken recourse to the narrow definition of the word "sale" contained in the sale of Goods Act for the purpose of interpreting that expression occurring in the state List, entry 54. That is the principal juridical ground on which we have expressed our preference[1] for the transfer of the power to tax such contracts to the State Legislatures. We ought to add that before the judgment of the Supreme Court was pronounced[2] "sale" was usually regarded as including works contracts, and works contracts were, as such, regarded as falling within the power of the States to tax under State List, entry 54, and taxes on that basis were being levied and recovered.

1A.22. The present positior on the subject and the possible alternatives, may be briefly stated thus :—

(i) The Union has the power to tax works contracts under Constitution, Seventh Schedule, Union List, entry 97.

(ii) The power to tax inter-State works has not, so far, been exercised by the Uuion, and the definition of 'sale' in the Central Sales Tax Act does not include Works contract.

(iii) The power to tax works contracts *within the State* also vests in the Union, under Union List, entry 97 (as interpreted in the judgments of the Supreme Court).

Before the judgments of the Supreme Court, however, sale was usually regarded as including a works contract. The question is ultimately one of policy, but the Commission would prefer restoration of the power to the States.

Narrow interpretation of the expression "sale" was not the practice before the Supreme Court judgments. Entries in the legislative list, should receive a broad interpretation. Fine nuances

---

1. Para 1.22, *supra*.
2. *Gannon Dunkerley's* case.

need not be material. The transactions resemble sale in substance. Hence, the power should be given to the States.

If this alternative is adopted, there are several drafting devices open, e.g.:—

(a) amending State List, entry 54, or

(b) adding a fresh entry in the State List, or

(c) inserting in article 366 a wide definition of "sale" so as to include works contracts.

The Commission prefers the last one. It would avoid multiple amendments.

(iv) Whether the course at (iii) should be adopted or not, is a matter of policy, involving financial and political implications.

(v) In the alternative, power to tax intra-State works contracts could (if a policy decision to that effect is taken by the Union), be exercised by the Union, and the necessary law passed. The proceeds of the tax imposed thereunder could, then be distributed to the State Article 269 may have to be amended in that case.

(vi) Whether the course referred to at (v) above, should be adopted or not, is again a matter of policy, involving financial and political considerations.

## CHAPTER 1B

## HIRE-PURCHASE TRANSACTIONS

### *Introductory*

1B. 1. In this Chapter, we shall deal with the question of tax on hire-purchase transactions. Before dealing with the position regarding tax on such transactions, it is desirable to refer briefly to the nature of hire-purchase.

### *Nature of hire-purchase*

Nature of hire-purchase under the Indian Act.

1B. 2. The definition of hire-purchase agreement in the recent Indian Act[1] dealing with hire-purchase is as follows :—

> "(c) 'hire-purchase agreement' means an agreement under which goods are let on hire and under which the hirer has an option to purchase them in accordance with the terms of the agreement and includes an agreement under which—
>
> (i) possession of goods is delivered by the owner thereof to a person on condition that such person pays the agreed amount in periodical instalments, and
>
> (ii) the property in the goods is to pass to such person on the payment of the last of such instalments, and
>
> (iii) such person has a right to terminate the agreement at any time before the property so passes ;"

In the same Act, "hire-purchase price" is defined as follows:—

> (d) "hire-purchase price" means the total sum payable by the hirer under a hire-purchase agreement in

1. Section 2(c) and 2(d), Hire-Purchase Act, 1972 (Central Act 26 of 1972).
[It has not yet been brought into force].

order to complete the purchase of, or the acquisition of property in, the goods to which the agreement relates ; and includes any sum so payable by the hirer under the hire-purchase agreement by way of a deposit or other initial payment, or credited or to be credited to him under such agreement on account of any such deposit or payment, whether that sum is to be or has been paid to the owner or to any other person or is to be or has been discharged by payment or money or by transfer or delivery of goods or by any other means ; but does not include any sum payable as a penalty or as compensation or damages for a breach of the agreement".

Distinction between hire-purchase and other agreements —credit sales.

1B. 3. A hire-purchase agreement may be distinguished from certain other types of credit transactions.

First, there are "credit sale" agreements. A credit sale agreement in the present context may be defined as *an un-conditional* contract for the sale of goods, under which the whole or part of the purchase price is payable by instalments.[1] We are not concerned with credit sales where the entire price is payable in one instalment. We are concerned with credit sales with price payable in instalments. The contract for the sale is "unconditional", in the sense that the property in the goods is transferred to the buyer under the contract. If the transfer of the property is to take place at a future time, or subject to some condition thereafter to be fulfilled,[2] then the agreement is not a credit sale agreement, but a conditional sale.[3] Credit sales are distinct from hire-purchase agreements, because, in a credit sale, the buyer is a person to whom the property has been transferred ; he is not a hirer of the goods, but the owner. A credit sale resembles a hire-purchase, inasmuch as the price is payable by instalments.

It is obvious that the seller under a credit sale takes a risk, because in case of default by the buyer, his only remedy is to sue the buyer, for the price.

Conditional Sale.

1B. 4. Next, we must distinguish an agreement of a conditional sale from a hire purchase. A conditional sale agreement may be defined[4] as an agreement for the sale of goods under which

1. A.G. Guest, Law of Hire-purchase (1966), page 14, paragraph 32.
2. Compare the Sale of Goods Act.
3. As to conditional sales, see para 1B.4, *infra*.
4. A.G. Guest, Law of Hire-purchased (1966), page 15, paragraph 33.

the purchase price or part of it is payable by instalments, and the property in the goods is to remain in the seller (notwithstanding that the buyer is to be in possession of the goods) until such conditions as to the payment of instalments or otherwise, as may be specified in the agreement, are fulfilled. Property does not pass immediately, but remains in the seller during the continuance of the agreement. To this extent, such agreements resemble hire-purchase. But the distinction is that the buyer under a conditional sale is bound to buy the goods, while, in the case of a hire-purchase, the hire-purchaser has the right to elect whether he will buy the goods or return them to the seller.

It should be noted that though the seller in a conditional sale remains the owner, the buyer (in a conditional sale) is a person who, "having agreed to buy goods", obtains with the consent of the seller possession of the goods and, therefore, he can pass a good title to third parties.[1]

Chart Showing difference.

1B. 5. The following chart will show the similarities and differences between hire-purchase and other transactions :—

| Credit Sale with price payable in instalments | Conditional sale | Outright sale | Hire-purchase |
|---|---|---|---|
| (i) Property passes immediately. | Property does not pass immediatly. | Property passes immediately. | Property does not pass immediately. |
| (ii) Possession transferred. | Possession transferred. | Possession transferred. | Possession transferred. |
| (iii) Obligation to buy exists— in fact there is already a sale. | Obligation to buy exists. | Obligation to buy carried out by sale. | No obligation to buy, though there is an option to buy. |
| (iv) Price payable by instalments. | Price payable by instalments. | Price already paid. | Price payable by instalments. |
| (v) Buyer can pass title to third parties. | Buyer can pass title *Lee* v. *Butler*[2] | Buyer can pass title to third parties. | Buyer cannot pass title because he has not agreed to buy, (*Helby*[3-4] v. *Mathews*). |

1. See the sale of Goods Act.
2. *Lee* v. *Butler*, (1893) 2Y.B. 311.
3. *Helby* v. *Mathews*, (1895) A.C. 471.
4. See also *Butterworth* v. *Kingsway Motors*, (1954) 1 W.L.R. 1286.

1B. 6. In an outright sale, of course, the property passes immediately, and the obligation to buy has been carried out and, therefore, it is distinct from a hire-purchase. Outright sale.

1B. 7. At this stage it may be relevant to say a few words about the nature of the rights passing under hire-purchase. While, traditionally, a hire-purchase agreement has not been regarded as a mortgage or security transaction, a different view seems to have been taken in practice.[1] Professor A. G. Guest has said,[2] "It would be realistic to accept that the rights of a hirer under a hire-purchase agreement must now be regarded as a valuable species of property." It may be noted that the hire-purchase legislation of the States in Australia does recognise the "property" of hirers.[3] Nature of interest under hire-purchase.

1B. 8. For example, section 9 of the Hire-purchase Act, 1960 (New South Wales), refers to the assignment of "the right, title and interest" of a hirer. The English decision in *Wickham Holdings*[4] rejected "the nakedness of the hirer's property rights". In an earlier English case,[5] the rights of hirers had been recognised. The recognition of the property rights of a hirer is equally discernible in another English case[6]. The recent Indian Act also recognises certain rights of the hirer[7].

*Taxability of hire-purchase transactions-Position in States.*

1B. 9. Taxability of hire-purchase transactions (under the power to levy a tax on the sale or purchase of goods) can be considered separately with reference to :— Taxability of hire-purchase transactions.

(1) position as regards power of the States;

(2) position under the Central Sales Tax Act ;

(3) position as regards the Union Territories.

1B. 9A. Hire-purchase (until its fructification in sale) is a mere bailment, and is not analogous to sale. Property may ultimately pass to the hirer ; but that is problematic, and dependent on the volition of the hirer[8]. The essence of sale is the passing Power of the States —Distinction between hire-purchase and sale.

1. See R. Baxt "Correspondence", (1970) 44 Aust. L.J. 296.
2. A.G. Guest, Note in (1962) 73 L.Q.R. 30,33.
3. See R. Baxt "Correspondence", (1970) 44 Aust. L.J. 296.
4. *Wickham Holdings*, (1967) 1 W.L.R. 295.
5. *Belsize Motor Supply Co.* v. *Cox.* (1914) 1 K.B. 244.
6. *Spellman* v. *Spellman* (1961) 1 W.L.R. 921.
7. Hire-purchase Act, 1972 (Central Act 26 of 1972).
8. 3 Para 1-B-1B-5 *supra.*

of property, which is absent in the case of hire-purchase (until its ultimate fruition). The hirer enjoys the use of the goods until determination of the agreement ; but the title to goods still remains in the owner.

It is because of this difference between hire-purchase and sale that the constitutional power of the States to levy a tax on the sale or purchase of goods[1] has been construed as not including a hire-purchase which does not result in sale.[2]

If a hire-purchase results in sale, sales tax is undoubtably leviable by the States. No doubt, it is difficult to determine the "sale price" for the purpose of the sales tax law,[3] but this has no bearing on the question of legislative competence.

Position as summarised.

1B. 10. The position as regards the power of States to levy a tax on hire-purchase can be briefly stated as follows :—

(a) The States cannot tax hire-purchase transactions *not resulting in sale* ;[4]

(b) The States can tax hire-purchase transactions *resulting in sale*, but only to the extent to which the tax is levied on the sale price[5], the sale price in this case being a notional figure which has to be calculated according to the criteria legally permissible[6].

It would appear that (as of 1966) the Sales Tax Acts of some States included, within the expression "sale", hire-purchase etc. with a *non obstante* clause. But this provision must be read as subject to what is stated above.

*Position under the Central Sales Tax Act*

Position under the Central Sales Tax Act.

1B.11. The definition of "sale" in Central Sales Tax Act, which we have already quoted[7], is as follows[8] :—

"(g) 'sale', with its grammatical variations and cognate expressions, means any transfer of property in goods

1. State List, entry 54.
2. *K.L. Johar* v. *Dy.C.T.O.*, A.I.R. 1964 S.C. 1082.
3. See para 1B.26, *infra*.
4. Para 1B.9A., *supra*.
5. *K.L. Johar* v. *Dy. C.T.O.*, A.I.R. S.C. 1082.
6. Para 1 B.25 and 1 B.26, *infra*.
7. Para—8. supra.
8. Section 2(g), Central Sales Tax Act.

by one person to another for cash or for deferred payment or for any other valuable consideration, and includes a transfer of goods on the hire-purchase or other system of payment by instalments, but does not include a mortgage or hypothecation of or a charge or pledge on goods."

It is obvious that in the earlier part of the definition, transfer of 'property' is required ; but, in the latter part (the inclusive part), transfer of 'goods' is enough, and transfer of 'property' is not required. It is, therefore, a plausible view to take that hire-purchase not resulting in sale is also covered by the definition.

Discussion in Supreme Court cases as to Central Sales Tax Act.

1B. 12. The question whether the *Central Sales Tax Act* applies to a hire-purchase not resulting in sale has indirectly come up for discussion in two cases before the Supreme Court. In one of them[1] (which related actually to works contracts), the argument was advanced that because the Central Sales Tax Act was wide enough to cover such hire-purchase, it showed that the legislative entry relating to power to tax (inter-State) sales or purchase should also be widely construed ; and if that was so, then the legislative entry regarding taxation of (internal) sale or purchase (State List, entry 54), should also be widely construed so as to include works contracts. The argument did not succeed. The Supreme Court pointed out that there was a difference in the position regarding Parliament's power and power of the States. So far as Parliament was concerned, it could tax hire-purchase not resulting in sale under the residuary power.

Definition in Bengal Act as extended to Delhi as in 1954.

1B. 13. In another case,[2] the validity of the Bengal Finance Sales Tax Act, 1947 as extended to the Delhi Union Territory, was in issue, in so far as the provision in that Act taxing hire-purchase not resulting in sale was concerned. The Supreme Court upheld its validity, and again pointed out that Parliament's power of levying taxes was wider than that of the States. The Court further pointed out that this had already been held in *Mithan Lal's* case[3] where it was stated that under article 246(4)

1. *Gannon Dunkerley's case*, (Works Contracts), A.I.R. 1958 S.C. 560 (on appeal from A.I.R. 1954 Mad. 1130).

2. *Instalment Supply Ltd. case*, A.I.R. 1962 S.C. 53, 59, Para 13, reversing *Instalment Supplies Ltd.*, A.I.R. 1956 Punj. 177.

3. *Mithan Lal's case*, A.I.R. 1958 S.C. 682, 685, (Works Contracts).

of the Constitution, Parliament's power was untrammelled in relation to Part C States—now Union territories.

An argument was then advanced that since, in other Part C States, such sales were not taxed, there was discrimination against traders in Delhi. The Supreme Court rejected this argument, first on the ground that there was no evidence that in other Part C States such sales were not taxed; and secondly by observing that the Central Sales Tax Act levied tax on such hire-purchase also throughout India. With respect to the second reason (pertaining to the Central Sales Tax Act), it may be permissible to point out that the Central Sales Tax Act *relates only to inter-State sales.*

Thus, the position is that while there is no reported case *directly* relating to the scope of "sale"[3] in the Central Sales Tax Act (in relation to hire-purchase), we can draw assistance from the views of the Supreme Court which were expressed in dealing with the question of the validity of the Act, giving that expression a wide scope.

Doubt arising due to absence of *non-obstante* clause not shares.

1B. 14. A doubt was expressed during our discussion as to whether the absence of a *non-obstante* clause in the definition of "sale" in the Central Sales Tax Act[4] *makes any difference.*[5] We have, however, after careful consideration, come to the conclusion that the words "transfer of goods" are clear enough to cover hire-purchase not resulting in sale.

*Position in Union Territories—Delhi*

Position in Union Territories—Delhi.

1B. 15. By way of example of taxation on hire-purchase transactions in a Union Territory, we may take the case of Delhi to which the Bengal Finance etc. Act extends. In a judgment rendered[6] in 1962, the definition of sale was quoted as follows; and, apparently, this was[7] the definition as it stood in 1954.

> " 'Sale' means any transfer of property in goods for cash or deferred payment or other valuable consideration,

1. See on this point, para 1B.15, *infra.*
2. Para 1B.11, *supra.*
3. Para 1B.11, *supra.*
4. Para 1B.11 *supra.*
5. Such *non obstante* clause is found in some State Acts.
6. *Instalment Supply Ltd. case*, A.I.R. 1962 S.C. 53.
7. See *Instalment Supply Ltd.* v. *State of Delhi*, A.I.R. 1956 Punj. 177, para 2.

including a transfer of property in goods involved in the execution of a contract, but does not include a mortgage, hypothecation, charge or pledge.

"*Explanation.*—A transfer of goods on the hire-purchase or other instalment system of payment shall, notwithstanding that the seller retains a title to any goods as security for payment of the price, be deemed to be a sale."

1B. 16. With reference to this definition, the Supreme Court observed :

"It is clear from the definition that it includes not only what may be compendiously described as a sale under the Sale of Goods Act, but also transactions which, strictly speaking, are not sales, not even 'contracts of sale' but only contain an element of sale, that is, the option to purchase, and that is the reason why the Explanation ends with the words "be deemed to be a sale", thereby indicating that a legal fiction has been introduced into the concept of 'sale' as ordinarily understood. The Explanation has included, within its amplitude, a mere transfer of goods without the transfer of title to the goods, if it is in the course of an agreement of the nature of 'hire-purchase' or other instalment system of payment."[1]

1B.17. It was argued that the Explanation had the effect of extending the concept of "sale" to what, in law, was not a real sale and therefore, it was unconstitutional. This argument was rejected by the Court. It was pointed out that under article 246 (4) of the Constitution, it was Parliament which had the power to legislate for Part C States, that the power was untramelled by the limitations prescribed by article 246, clause (2) and (3), or State List, entry 54, that the power of Parliament was plenary and absolute, subject only to such restrictions as are imposed by the Constitution, and there was no restriction which was material to the present question. It was, therefore, competent for Parliament to impose a tax on hire-purchase transactions for Part C States and to impose it under the name of "sales tax".

---

1. *Instalment Supply Private Ltd.* v. *Union of India,* A.I.R. 1962 S.C. 53, 57, para 5,

1B. 18. The Court stated that in *Mithan Lal's case*,[1] a similar question had arisen, namely, whether Parliament can enact a law imposing tax on the supply of materials used in building contracts in Part C States. It had been held by the Court, for the same reasons, that it was within the competence of Parliament to impose such a tax. The Court also observed that the decision in the *State of Madras* v. *Gannon Dunkerley & Co. (Madras)* Ltd.,[2] was inapplicable in relation to Part C States. That decision had been given on a statute passed by the Provincial Legislature under the Government of India Act, 1935, and it had been pointed out in that case that the power of the Provincial Legislature to impose a tax on sales under Provincial Entry 48 in Schedule VII of the Government of India Act, 1935, did not extend to imposing a tax on the value of the materials in building contracts which are entire and indivisible.

Definition in Bengal Act as extended to Delhi before 1959.

1B. 19. The definition of "sale" in the Bengal Finance (Sales Tax) Act, 1941, as extended to Delhi, was as follows before 1959 :—

> "(g) 'sale' means any transfer of property in goods for money consideration and includes a transfer of property in goods supplied in the execution of a contract but does not include a mortgage, hypothecation, charge or pledge ; and any grammatical variation of the expression 'sale' shall be construed accordingly.
>
> *Explanation* 1.—A transfer of goods on hire-purchase or other instalment system of payment shall, notwithstanding that the seller retains a title to any goods as security for payment of the price, be deemed to be a sale.
>
> *Explanation* 2.—A sale shall be deemed to have taken place in the State of Delhi if the goods are actually delivered in the State of Delhi as a direct result of such sale for the purpose of consumption in the State of Delhi, notwithstanding the fact that under the general law relating to the sale of goods the property in the goods has by reason of such sale passed in another State."

---

1. *Mithan Lal* v. *The State of Delhi and another*, A.I.R. S. C. 682. S.E.C. 417.
2. *Gannon Dunkerley & Co.'s case* (1956) S.C.R. 379, 9 S.T.C. 353.

1B. 20. In 1959, the Explanation relating to hire-purchase (in the Bengal Act as extended to Delhi) was removed by a Central Act. The Statement of objects and Reasons to the Bill which led to the Amendment Act stated[1] : Amendment of 1959.

> "Sub-clauses (c) and (d)—The definitions of 'sale' and 'sale price' have been revised *so as to be in conformity with the definitions in the Central Sales Tax Act,* 1956."

The definition as substituted was as follows :—

> "(g) 'sale' with its grammatical variations and cognate expressions, means any transfer of property in goods by one person to another for cash or for deferred payment or for any other valuable consideration, and includes a transfer of goods on hire-purchase or other system of payment by instalments, but does not include a mortgage or hypothecation of or a charge or pledge on goods.
>
> *Explanation.*—A sale or purchase of goods shall be deemed to take place inside the Union territory of Delhi if the goods are within that territory :—
>
> (i) in the case of specific or ascertained goods, at the time of contract of sale is made ; and
>
> (ii) in the case of unascertained or future goods at the time of their appropriation to the contract of sale by the seller or by the buyer, whether assent of the other party is prior or subsequent to such appropriation."

1B.21. This then is the present position as to hire purchase. Present position.

*Need for amendment*

1B.22. We have made an attempt to analyse the legal position, in order to bring out certain aspects which appeared to require emphasis. Confirment of power a matter of policy.

1. Central Act 20 of 1959.

Whether or not the power to tax hire-purchase transactions (not resulting in sale) should be conferred on the States is a matter of policy.

(iii) *Financial*

There may, lastly, be a financial justification for levying a tax on hire-purchase, the object being to augment the revenues of the States. This is a matter of policy, and would require detailed examination of a financial character.

Lease treated as sale in Australia.

1B. 23. It may be noted that in Australia, a lease of goods is treated as a sale, and the lessor incurs tax liability at the time the lease is entered into.[1]

As regards hire-purchase, in Australia,[2] the sale value of goods leased under a "hire-purchase agreement" is equal to the "fair wholesale value" of the goods.

The sale value of goods leased under any other type of arrangement is the amount which, in the Commissioner's opinion, is fair and reasonable having regard to the terms and period of the lease and to the wholesale market value of the goods. In all cases, sale value does not include any amount payable in respect of sales tax, but any excise taxes on the goods are included.

Constitutional aspects.

1B. 24. Whether financial needs require such an extension of the power of the States is a question of policy. But, assuming that financial needs so require, there are certain constitutional aspects which may be dealt with.

Effect of judgment in *Johar's* case.

1B. 25. The effect of the judgment in *K. L. Johar & Co.'s case*[3] is to reduce the base on which sales tax is payable. A tax on hire-purchase can be levied on the full value of the hire-purchase transaction by the Union under the residuary power—Union List, entry 97. The "purchase ingredient" of the hire-purchase transaction is, however, within the States' legislative competence, and it is possible to argue that unless resolutions are passed by State Legislatures under article 252(2) of the

1. World Tax Series—Taxation in Australia, (1958), page 30 para 4/2.3.
2. World Tax Series—Taxation in Australia, (1958), page 82 para 4/2.6.
3. *K. L. Johar & Co.* v. *Dy. C.T.O.*, A.I.R. 1965 S. C. 1082, 1089, (1965) 2 S.C.R. 112.

Constitution the Centre may not have the power to levy a tax on the full value, *including the purchase ingredient*. A better alternative would, therefore, be to include hire-purchase within the power of the States.

Observation in *Johar's* case.

1B. 26. In *Johar's case*,[1] the Supreme Court made the following observations as to the alternative methods, under the existing constitutional set up of deciding the value of a vehicle given for hire-purchase :—

> "There may be two ways of doing it. The Sales tax authorities may split up the hire into two parts, namely, the amount paid as consideration for the use of the vehicle so long as it was the property of the owner, and the payment for the option on a future date to purchase the vehicle at a nominal price. If the first part is determined, the rest would be towards the payment of price. The first part may be determined after finding out the proper amount to be paid as hire in the market for a vehicle of the type concerned or in such other way as may be available to the sales tax authorities.
>
> "The second method may be to take the original price fixed in the hire-purchase agreement and to calculate the depreciation and all other factors that may be relevant in arriving at the price when the second sale takes place to the hirer, including the conditions of the vehicle at the time of the second sale."

"It is, therefore, for the sales tax authorities to find out the price of the vehicle on which tax has to be paid in either of the ways indicated by us above or such other way as may be just and reasonable."

*Constitutional dichotomy*

Constitutional dichotomy and complications resulting therefrom.

1B. 27. At this stage, we should point out that there are certain constitutional complications attendant on a proposal for the levy of a tax on hire-purchase. A hire-purchase transaction is a composite transaction, made up of two elements, namely, (i) bailment or hiring ; and (ii) sale which is not effected immediately. The amount paid by way of hire-purchase price under a hire-purchase agreement is, as pointed out by the Sup-

1. *K. L. Johar & Co.* v. *Dy. C.T.O.*, A.I.R. 1965 S. C. 1082, 1091, 1092 (Paras 20-22).

reme Court,[1] partly towards the hire and partly towards the payment of price.

No legislative competence to tax sale part.

1B. 28. Now, in so far as the hire-purchase price represents *the sale price* also, Parliament has no legislative competence to impose any tax thereon, because of State List, entry 54. Parliament has legislative competence to levy a tax only in relation to the 'hire' part of the hire-purchase price, and not with reference to the 'sale' part of the price.

Theoretically, the two could be treated separately, but, from a practical point of view, it would be difficult to determine what is the 'hire' part of the hire-purchase price (under a hire-purchase transaction) and what is the 'sale' part. The Supreme Court has suggested that there may be two ways of determining the 'hire' part and the 'sale' part involved in a hire-purchase price. But, both the methods suggested by the Court involve, in substance, a splitting up. If the Union decides to levy a tax on the 'hire' part only, it cannot do so without splitting up. Similarly, if the States wish to tax the 'sale' part, they cannot do so without splitting up. It would, therefore, appear that the more convenient method would be to tax the composite price,—after such constitutional amendment as is necessary. This will avoid an attack on the validity of the law on the ground that it amounts to an encroachment by Parliament into the sphere of 'sale', or an encroachment by the States into the sphere of 'hire'.

Present dichotomy to be removed by amendment.

1B. 29. Since the present constitutional position represents a dichotomy[2] in the sense that tax on the hire part is within the competence of the Union only, and tax on the sale part is within the competence of the States only, it becomes necessary to amend the Constitution, so that the amendment will authorise levy of the entire tax by one legislative authority. One alternative would be an amendment which authorises *Parliament* to levy a tax on hire-purchase, in which case, Parliament's existing residuary power to tax the 'hire' part (of the hire-purchase price) and the new power to be transferred to Parliament with regard to the 'sale' part of the hire-purchase price, will be merged, and this will enable Parliament to provide for a tax on hire-purchase transactions without the necessity of a demarcation between the

---

1. *K. L. Johar & Co.* v. *Deputy Commercial Tax Officer*, A.I.R. 1956 S.C. 1082, 1091.
2. Para 1B. 28, *supra*.

'hire' part and 'sale' part. The other alternative would be to transfer the entire power to *the States*. This will achieve a merger of the existing power of the States to tax the 'sale' part and the new power (to be transferred) to tax the 'hire' part, and will enable the State Legislatures to provide for a tax on hire-purchase price without demarcation as aforesaid.

Effects of present dichotomy.

1B. 30. The legal complications involved in a tax on hire-purchase, if the present dichotomy is maintained, may be again mentioned. The 'price' (in hire-purchases) is a composite one. Though, in one aspect, the instalments paid (or stipulated to be paid), represent the "hire" for the use of the vehicle, still they represent, in another aspect, the instalments of "price" payable as consideration for the transfer of title. If the transaction were one of pure "hiring" (i.e. without the sale element), the hirer would have paid much less.

If the Union is to tax them, it cannot tax the *sale part*. If the States are to tax them, they cannot tax the *'hire'* part. That is the present position.

(a) If the tax is levied by Parliament on the actual instalments of hire-purchase and the sale materialises, then there may be a partial encroachment on the State List, entry 54. Where the hire-purchase transaction itself results in sale, by the exercise of the option, a "sale" takes place of the goods which, till then, had been hired. As the Supreme Court has held[1] :

"When all the terms of the agreement are satisfied and the option is exercised, a sale takes place of the goods which till then had been hired. When this sale takes place, it will be liable to sales tax, for the taxable event under the Act is taking place of the sale....."

At the time when the hire-purchase transaction materialises in a sale,—usually, on payment of the last instalment with or without some nominal optional money,—sale in law and in fact has resulted, and the last instalment, since it passed the property in the goods, should be construed as effecting a sale. That, in fact, is the intention of the parties.

---

1. *K. L. Johar* v. *D.C.T.O.*, (1965) 2 S.C.A. 13, 25.

It is really the price element that goes to add to what might strictly be called the hire, to yield the amount stipulated.

(b) If the method of taxing the actual instalments (whether the tax is levied on the total, or is levied every year) is not to be adopted, the only other alternative (where the sale materialises) is to resort to notional splitting up. The notional splitting up will separate the hire part from the sale part . This is, however, a cumbersome process.

Two questions of detail thus arise when a hire-purchase agreement leads ultimately to a sale, (1) whether sales-tax could be levied at the inception of the contract of hire-purchase, or whether the taxing authority should wait till the option is exercised and the title passes. (2) What is the amount of consideration for which the sale, which takes place when the option is exercised, should be deemed to be effected.

Position if above dichotomy is not kept.

1B. 31. If we abolish the dichotomy referred to above in regard to hire-purchase, the position would become less complicated, as the above difficulties would be avoided. The whole power to tax (intra-State) hire-purchase *in the wide sense* could be transferred :—

(i) either to the Union with a provision for assignment of the proceeds to the State ;[1]

or

(ii) to the States.

Which of the two courses should be adopted is a matter of policy. Our preference is for transfer of the power to the States, because in our view basically the entire transaction takes place in the State and the States should be given the power.

Conclusion and recommendation.

1B. 32. In the light of the above discussion, our conclusions as to taxation of hire-purchase are as follows :—

*Hire-purchase not resulting in sale.*

(i) The Union has the power to tax hire-purchase not resulting in sale, inter-State or *within the State,* under the Union List, entry 97.

---

1. Article 269 of the Constitution would require to be amended, in this case.

(ii) The power to tax inter-State hire-purchase (not resulting in sale) under the Union List, entry 97, seems to have been exercised by the Union, *vide* the definition of 'sale' in the Control Sales Tax Act.

(iii) The power to tax hire-purchase *within the State* also vests in the Union, under Union List, entry 97 (as interpreted in the judgements of the Supreme Court. Whether this power should be transferred to the State is a question of policy. But in the Commission's view, a broad view[1] should be taken of the legislative entries, and fine nuances need not matter, and the Commission prefers allotting the power to the States (by amending the Constitution). The question is ultimately one of policy, as already stated.

If this alternative is adopted, there are several drafting devices open, *e.g.*

(a) amending State List, entry 54, or

(b) adding a fresh entry in the State List, or

(c) inserting, in article 366, a wide definition of 'sale'. The Commission prefers the last one, as avoiding multiple amendments.

Under the drafting device at (a) above, it will be necessary to amend State List, entry 54 (to add hire-purchase), but at the same time also to amend Union List, entry 92A, so that inter-State hire-purchase (not resulting in sale) may continue to be excluded from the purview of the States, notwithstanding the proposed addition of hire-purchase to the State List. Under this device, it will be necessary to add the following in 7th Schedule, both at the end of Union List, entry 92A and at the end of State List, entry 54 (after converting the existing full-stop into a semi-colon) :

> "transfer of goods on the hire-purchase or other system of payment by instalments, hire-purchase resulting in sale."

If necessary, a *non-obstante* clause may be added to the effect that property need not pass.

---

1. *cf.* discussion as to works contract.

The *non-obstante* clause would be as follows :

> "transfer of goods on the hire-purchase or other instalment system of payment, notwithstanding the fact that the transferor retains the title in the goods as security for payment of the amount stipulated"[1].

The second device (b) above would be to add fresh entries—say, State List, entry 54A and Union List, entry 92B.

The third device would be to add a wide definition of "sale" in article 366.

The Commission prefers the last device[2] (c) above as it avoids multiple amendments.

(iv) Whether the course at (iii) should be adopted or not, is a matter of policy, involving financial and political considerations.

(v) In the alternative, the power to tax intra-State hire-purchase could (if a policy decision to that effect is taken by the Union), be exercised by the Union, and the necessary law passed. The proceeds of the tax imposed thereunder could, then, be distributed to the States. Article 269 of the Constitution will have to be amended for the latter purpose, so as to have an expanded definition of "sale".

It will be desirable, in this case, to have separate taxing legislation, as the Central Sales Tax Act is confined to tax on *inter-State* transactions.

If this alternative is adopted, it is suggested that it will be desirable to transfer the entire power *to the Union*, i.e., the power to tax hire-purchase resulting or not resulting in sale (inter-State). This will be practically convenient, and check evasion.

---

1. As to the *non-obstante* clause, *of* section 2 (h), Explanation 1, Madras General Sales Tax Act (Madras Act 9 of 1939) quoted in *K.L. Johar & Co.* v. *Dy. C.T.O.*, A.I.R. 1965 S.C. 1082, 1086 (on appeal from A.I.R. 1958 Madras 561).
2. Amendment of article 366 of the Constitution.

(vi) Whether the course referred to at (v) above should or should not, be adopted, is again a matter of policy, involving financial and political considerations.

*Hire-purchase resulting in sale*

(vii) Hire-purchase resulting in sale is governed by the position applicable to sale in general, except that only the sale element can be taxed *under the name* of sales tax[1].

1. For a suggestion in regard to hire-purchase resulting in sale, see (v) above.

## CHAPTER 1-C

## SALE OF CONTROLLED COMMODITIES

Sale of Controlled Commodities

1-C. 1. So far, we have dealt with transactions where the fact that property does not pass immediately in the goods, or does not pass in specie, raises legal difficulties in the way of the transactions being regarded as "sale or purchase of goods" within the meaning of the constitutional power of the States to levy a tax.[1] We have now to deal with a class of transactions where such legal difficulty arises by reason of the absence of the *consensual* element required in a sale. We refer to those transactions where, by law, the free choice of the parties—usually, the seller—is restricted in the matter of price, quantity of goods to be sold, party to whom they are to be sold or any other matter pertaining to the sale. Briefly, such sales may be referred to as sales of controlled commodities. Here, there is no question about the passing of the property in the goods. The property does pass to the buyer. But the absence of the consensual element—whose place is taken by a restriction imposed by or under a statute—creates controversies as to whether and in what cases the legal restrictions imposed by or under the statute destroy the character of "sale".

Case law as showing a fluid position

1-C. 2. A study of the case law on the subject shows that the position in this respect is fluid[2]. Broadly speaking, the test adopted is, whether the area of bargaining is or is not large enough to permit the element of consent to operate. If the area of bargaining is large enough, the transaction is a sale. It was held in one judgment of the Supreme Court[3] that sales tax can be imposed on the sale of such commodities, notwithstanding that some of the terms and conditions of the sale (e.g. the price) are regulated by or under statute. An earlier judgment of the Supreme Court[4] had, however, held that if the area of bargaining

---

1. Constitution, Seventh Schedule, State List, entry 54.
2. See para 1-C. 6, *infra*.
3. *Indian Steel Wire Products* v. *State of Madras*, A.I.R. 1968, S.C. 478, 480, 483; (1968) 1 S.C.R.
4. *New India Sugar Mills Ltd.* v. *C.S.T., Bihar*, A.I.R. 1963 S.C. 1207 (1963) Supplement 2 S.C.R. 459.

is very small, the transaction is not a "sale" because the element of consensuality is missing.

Difficulty of applying the test

1-C. 3. The test mentioned above is, however, a difficult one to apply, and, to avoid controversies, it would be better if the position could be simplified. In a welfare State where the State regulates economic activities in the public interest, controls are likely to continue for sometime, and the problem in question is likely to recur.

As the Supreme Court has observed :[1]

> "the State may compel persons to make contracts, as where, by a series of Road Traffic Acts from 1930 to 1960, a motorist must insure against third-party risks ; it may, as by the Rent Restriction Acts, prevent one party to a contract from enforcing his rights under it ; or it may empower a Tribunal either to reduce or to increase the rent payable under lease. In many instances a statute prescribes the contents of the contract. The Money-lenders Act, 1927, dictates the terms of any loan caught by its provisions. The Carriage of Goods by Sea Act, 1924, contains six pages of rules to be incorporated in every contract for "the carriage of goods by sea from any port in Great Britain or Northern Ireland to any other port"; the Hire-purchase Act, 1938, inserts into hire-purchase contracts a number of terms which the parties are forbidden to exclude ; successively Landlord and Tenant Acts from 1927 to 1954 contain provisions expressed to apply notwithstanding any agreement to the contrary."

Effect of judicial

1-C. 4. A survey of the judicial decisions shows that the tests which have been adopted do not reveal a simple or single criterion which could be neatly or precisely stated. Some of the decisions might give the impression that if *the party* to whom the seller is to sell the goods is not to be selected by the Government or by the authority acting in pursuance of the law, then the transaction could be regarded as a sale. But some of the decisions do not emphasise any such test. Again, the fact that there was

1. *Indian Steel and Wire Products Ltd.* v. *State of Madras*, A.I.R. 1968 S.C. 478, 21 S.T.C. 138.

no offer and no acceptance, is sometimes highlighted ;[1] but, then, there are cases[2] where many essential matters were not subject to offer or acceptance and not only the party to whom the goods are to be delivered, but also the price and the manner of transportation and payment were determined by the Controller ; and yet the transaction was regarded as a sale. No doubt, cases at the extremes may be easy to decide. For example, where only the price is regulated by law and most of the other matters are left to contract, the transaction could be regarded as a sale, on the reasoning that the effect of the price control order is only to super-impose, upon the agreement between the parties, the rate fixed under the control order.[3] This is one extreme. At the other extreme is the case[4] where every aspect of the transaction was wholly and completely controlled, and therefore it has been held that there is no sale. But, in a fairly large number of cases, it is not easy to decide on which side of the line the case should be regarded as falling.

The undermentioned cases[5-16] show the extent of the controversy.

1. See the *New Indian Sugar Mills case*, A.I.R. 1963 S.C. 1207.
2. See the *Indian Steel & Iron Products case*, A.I.R. 1968 S.C. 478.
3. See *State of Rajasthan* v. *Karam Chand Thapar*, A.I.R. 1969 S.C. 343.
4. See *Vishnu Agencies Private Ltd.* v. *Commercial Tax Officer*, 77, Calcutta Weekly Notes, 141.
5. *M/s. New India Sugar Mills Ltd.* v. *Commissioner of Sales Tax*, A.I.R. 1963 S.C. 1207.
6. *Indian Steel & Wire Products* v. *State of Madras*, A.I.R. 1968 S.C. 478.
7. *Andhra Sugar Ltd.* v. *State of Andhra Pradesh*, A.I.R. 1968 S.C. 599.
8. *State of Rajasthan* v. *M/s. Karam Chand Thapar & Bros.*, A.I.R. 1969 S.C. 343.
9. *M/s. Chitter Mal Narain Das* v. *Commissioner of Sales Tax*, A.I.R. 1970 S.C. 2000.
10. *Salar Jung Sugar Mills and another* v. *State of Mysore*, A.I.R. 1972 S.C. 87.
11. *Vishnu Agencies Pvt. Ltd.* v. *Commercial Tax Officer, Sealdah*, 77 CWN 141 (Calcutta).
12. *Commissioner of Sales Tax, M.P.* v. *Mohammad Rasul of Panna* (1970) 26 S.T.C. 202 (Madhya Pradesh).
13. *Commissioner of Sales Tax* v. *Ram Bilas Ram Gopal*, A.I.R. 1970 All. 518 (F.B.).
14. *K.N.A. Kotih & Others* v. *State of A.P. & Others*, (1971) 27 S.T.C. 191 (Andhra Pradesh).
15. *The Excise & Taxation Officer, Hissar and another* v. *Jaswant Singh*, (1971) 27 S.T.C. 582 (Punjab & Haryana).
16. *Chigurupati Veeran* v. *Special C.T.O.* (1971) 28 S.T.C. 388, 39 (Andhra Pradesh)—(Supplies to Government under requisitio orders).

of sugarcane, an essential commodity, raised the question whether it fell within the definition of "sale" in the Mysore Sales Tax Act. Answering the question in the affirmative, the Supreme Court emphasised several aspects of the transaction in issue.

Case relating to sugarcane—a recent illustration.

First, the Supreme Court pointed out that though there was no choice (in general) as to sale by the grower of sugarcane to the factory, there was some element of choice, for example, if the factory was closed or the grower did not grow sugarcane. Secondly, though it was true that 95 per cent of the sugarcane had to be sold, the parties had the choice to increase the quantity above 95 per cent, and the delivery of the sugarcane was to be in such lots or on such dates and at such time as was agreed between the parties. Thirdly, the goods were unascertained and were to be inspected. All these aspects indicated freedom not only in the formation of the contract, but also in its performance. Even though the parties were determined by the order and the minimum price was fixed and the minimum quantity was also fixed by the order, that did not complete the picture, because the parties made the offer and acceptance, chose the terms of delivery, and could obtain supply of a larger quantity or stipulate for a price higher than the minimum.

Recommendation to cover sales of controlled commodities.

1-C. 6. It appears to us that the very fact that an elaborate analysis has to be undertaken whenever a question arises whether or not the choice left is adequate, shows that there is need for clarifying the scope of the constitutional power in this regard. We are of the view that the fact that the consensual element is lacking in some respects, does not necessarily make it unjustifiable to tax them by extending the definition of sale. There is no doubt that for a long time, controls over the transfer of goods of one class or another will be an unavoidable feature of our economy. A realistic view should, threfore, be taken. Subject to the control imposed by law, these transactions result in transfer of goods for price, and should be taxable.

One alternative—Explanation to be added to State List, entry 54.

1-C. 7. Here again, we prefer an amendment of article 366. The definition of "sale" to be inserted[2] in that article could have an Explanation as follows :

---

1. *Salarjang Sugar Mills Ltd.* v. *State of Mysore*, (1972). 29 S.T.C. 246, 261, 262 (S.C.).

2. See recommendations in connection with works contracts and hire-purchase.

"*Explanation.*—A transaction does not cease to be a sale merely because—

(a) the goods are required to be delivered in compliance with any obligation laid down by or under any law regulating trade and commerce in, or production, supply or distribution of, the goods or any law dealing with price control, or

(b) the terms and conditions on which the goods are to be delivered are laid down by or under any such law."

Another alternative—amendment of State List, entry 54.

1-C. 8. Another possible alternative is an amendment to State list, entry 54.

Recommendation.

1-C. 9. We recommend that one or the other of the two alternatives[1] mentioned above should be adopted. The first alternative[2] would be better, as it would apply to article 269 and Union List, entry 92A also.

---

1. Para 1-C. 7 and 1-C. 8, *supra*.
2. Insertion in article 366 of a definition of sale with the recommended Explanation.

## CHAPTER 1-D

## SALE BY ASSOCIATIONS TO MEMBERS

Sale by associations to members.

D—D.1. Some problems seem to have arisen in regard to the sales of refreshments and other articles by associations to their members. A few illustrative cases on the subject may be examined for understanding the problem.

Co-operative societies.

1—D.2. Co-operative societies furnish one example of such associations. In one of the earlier cases,[1] decided by the Supreme Court, it was held that where there was nothing on record to show that the co-operative canteen was acting merely as an agent of its members (in providing facilities for making food available to the members), it could not be urged that the transaction was not a sale. It could not be said that the society was acting only as an agent or a trustee. A registered society is a body corporate with power to hold property etc. and the property which it holds cannot be assumed to be the property of the members. The society is a juridical person, and the supply of refreshments by it for a price paid or promised results in a transfer of property in the refreshments. It could not, therefore, be urged as a proposition of law that when a co-operative society supplies, to its members, refreshments for a price under the scheme of distribution or supply of refreshments, the transaction can in no event be regarded as a sale.

Unincorporated associations.

1—D.3. Though the above case[2] related to a co-operative society, the court (Shah J.) did make certain observations as to the position in regard to unincorporated societies, as follows :—

> "In the case of an unincorporated society, club or a firm or an association, ordinarily the supply and distribution by such a society, club, firm or an association, of goods belonging to its members, may not result in sale of the goods which are jointly held for the benefit of the members of the society, club, firm or

1. *Dy. C.T.O.* v. *Enfield India Ltd.*, A.I.R. 1968 S.C. 838, 841, 842 843, paragraphs 7 and 13, (1968) 2 S.C.J. 348.
2. Para 1-D. 2, *supra*.

the association, when, by virtue of the relinquishment of the common rights of the members, the property stands transferred to a member in payment of a price, and the transaction may not *prima facie* be regarded as a 'sale' within the meaning of the Act."

But the Court made it very clear (towards the end of the judgment)[1] that it was not called upon in this case to decide whether an *unincorporated club* which supplies goods for a price to its members, may be regarded as selling goods to its members.

Supply by club to members not 'sale'.

1—D.4. Then, there are clubs. In a case[2] decided by the Supreme Court on appeal from Madras, the Cosmopolitan club, Madras, the Youngmen's Indian Association, Madras and the Lawley Institute, Ootacamund, filed writ petitions under article 226 of the Constitution, challenging the levy of sales tax under Madras General Sales Tax Act, 1959, on snacks, beverages and other articles supplied to their members or guests. The High Court held that the club was not a 'dealer' within the meaning of section 2(g), read with Explanation I, of the Madras Act, and that there was no 'sale' within the meaning of section 2(h), read with Explanation I, of the Act. On appeal to the Supreme Court it was held that a member's club cannot be made subject to the provisions of the Sales Tax Act concerning sales, because the members are joint owners of all the club property. The supply of articles to a member at a fixed price by the Club cannot be regarded as a "sale".

No 'sale' in such circumstances in England.

1—D.5. It is necessary to mention here that, in England, it was held in *Graff* v. *Evans*,[3] that a transaction whereby a member of a club acquired liquor which was the property of the club was not sale but merely transfer of special property. This case was decided eleven years before the English Act relating to the sale of goods was passed in 1893.

The basis of the decision was that the transaction was a release of the rights of the other members to the "purchaser". It might have been thought,[4] therefore, that when section 1(1)

---

1. *Dy. C.T.O.* v. *Enfield India Ltd.*, A.I.R. 1968 S.C. 838, 843, Para 13.
2. *J.C.T.O.* v. *Young Men's Indian Association*, (1970) 1 S.C.C. 462 (on appeal from A.I.R. 1964 Red. 63).
3. *Graff* v. *Evans*, (1882) 8 Q.B.D. 373.
4. Atiyah, Sale of Goods (1966), page 9.

of the Sale of Goods Act specifically enacted (in 1893) that—

> ".....There may be a contract of sale between one part owner and another,"

the basis of *Graff* v *Evans* had ceased to be valid.

It may be noted that the Indian Sale of Goods Act has a similar provision.[1] But in *Davies* v. *Burnett*,[2] a Divisional Court followed the earlier case, and the Sale of Goods Act was not even referred to. A well-known writer has stated,[3] that "this view of the law has now been accepted for so long that it is unlikely to be upset by a higher court."

The English cases mostly relate to licensing.[4] But the point to be noted is, that the provision in the Sale of Goods Act as to "part owner" has not come in their way.

The position in this respect, as was observed in an Australian case,[5] is simply that "a part of the common property is appropriated to the separate use of the members, and he makes a corresponding contribution from his separate property to the common fund." The question must, of course, always be as to the meaning of the word "sale" or "sell" in the particular statute which comes under consideration. If no reason is seen for giving the word an extended meaning, one would think it perfectly correct to say that an ordinary unincorporated members' club does not "sell", in the true sense, liquor which a member obtains from *the common store* on payment of money to the common fund.

General observations.

1—D.6. The broad general principle which constitutes a common feature of these transactions, is the absence of a transfer of property. It would appear that these transactions are not 'sale', because there is no transfer of property.

1—D.6A. This, then, is the present position. The question now to be considered is, whether it is desirable that the taxability of such transactions should be provided for by expanding the

---

1. Section 4(1), Indian Sale of Goods Act.
2. *Davies* v. *Burnett*, (1902) 1 K.B. 666.
3. Atiyah, Sale of Goods (1966), page 9.
4. For a review of cases, see *Trebanag Club* v. *Macdonald*, (194) 1 All E.R. 454.
5. *Watson* v. *J. & A.G. Johnson Ltd.*, (1936) 55 C.L.R 63, 70 (per Dixon J.).

concept of "sale" for the purpose of the legislative power of the States,—a result which can be achieved only by amending the Constitution.

Amendment of Constitution not needed.

1-D.7. We do not think that it would be appropriate to amend the Constitution for this purpose. The number of such clubs and associations would not be very large. Moreover, taxation of such transactions might discourage the co-operative movement.

Unincorporated associations exist in various arrangements.

1—D.8. Unincorporated associations exist in a "myriad of structural arrangements."[1] As a general proposition, each is liable for the activities of its members when the activity has been authorised, supported, or ratified by the association.

No evasion.

1—D.9. It should be also noted that there can be no serious question of evasion in such cases. A member really takes his own goods.

1—D.10. We, therefore, do not recommend any change.

---

1. American Law Institute—Study of the Division of Jurisdiction between State and Federal Courts, page 74 (Proposed Final Draft No. 1, 1965), cited in Note on "Unincorporated Associations" (1965) 75 Yale L.J. 138.

## CHAPTER 1-E

## SOME GENERAL OBSERVATIONS AS TO TAXATION ON SALE

I—E.1. So far, we have dealt with specific transactions. A few general observations may now be made. General observations as to "sale".

A sale of goods requires an agreement to transfer title in goods for money, followed by the actual passing of such title as a result of the agreement. This broad concept, thus requires (i) an *agreement* to transfer title, (ii) in goods, (iii) for *money* and (iv) passing of title as a result of the agreement. Most of the problems that have arisen as to the taxability of various transactions are due to the fact that one (or more) of the ingredients mentioned above are missing from the transaction. This will be clear if the ingredient and its antithesis are represented as in the following chart, which also mentions the situation where the antithesis exists.

| *Ingredient* | *Antithesis* |
|---|---|
| (i) *Agreement to transfer title.* | Title passing *without agreement*, or no transfer of title. |
| (ii) In goods | Title passing under agreement but *not for goods.*<br>*Illustrative situation—*<br>Works contracts (No agreement to transfer the *very goods* which come into existence). |
| (iii) *For money* | Title passing for value other than money.<br>*Illustrative situation—*<br>Baater. |
| (iv) Passing of title as a result of the *agreement* | Title does not pass because there is only an agreement (or some prior step), and no complete sale.<br>*Illustrative situations—*<br>(a) Hire-purchase.<br>(b) Consignment transfer [1] |

1. See chapter 2, in Page 51.

The basic drawback of the present scheme.

1—E.2. The basic defect in the present scheme is that a very limited type of economic activity is taxable by the States,—and other economic activities are not taxable, except by way of excise duties or indirectly by way of stamp duties. This leaves room for loopholes and gaps. It would appear that some day, it will be desirable to consider the possibility of devising a tax which will embrace all transactions which are regarded as adding value or which are entered into with that object.

## CHAPTER 2

## EVASION OF CENTRAL SALES TAX BY MEANS OF TRANSFER OF GOODS FROM ONE STATE TO ANOTHER, ON WHAT PURPORTS TO BE CONSIGNMENT TRANSFER OR A TRANSFER TO ANOTHER BRANCH OF THE SAME INSTITUTION

### *Introductory*

Ingredients of sale.

2.1. The question that is considered in this chapter is one connected with the basic concept of sale. In order that the turnover from a transaction may be taxable under the Act, the transaction must have four constituent elements, *viz.* (i) parties competent to contract; (ii) mutual assent; (iii) transfer of property in goods from the seller to the buyer, and (iv) price in money paid or promised.

Consignment transfers.

2.2. It has been stated[1] that difficulties exist in relations to the taxation of 'consignment transfers',—*i.e.* transfer of goods by one branch of a commercial agency or institution to another branch outside the State. Central Sales Tax, it is stated, cannot be levied on such transfers, because there is no inter-State 'sale', even though there is inter-State movement.

### *Evasion by reason of non-taxation.*

Fifth Finance Commission's recommendations.

2.3. The problem does not appear to be totally new. The Fifth Finance Commission had made the following observations[2] in this regard.

> "8.32. The Uttar Pradesh Taxation Enquiry Committee has also remarked that in many cases transactions shown as consignments and works contracts, which are not liable to States' sales taxation, were not genuine and that they were manipulated to hide the real nature of sales transactions. It is desirable that the Government of India as well as State Gov-

1. Notes in the Ministry of Finance.
2. Fifth Finance Commission, Report, page 89, para 8.32.

ernments may consider what measures should be devised to meet this situation."

Evasion.

2.4. It appears that States are faced with erosion of the revenue, occurring through transfers on a consignment basis.

Section 6A.

2.5. It may be noted that the Central Sales Tax (Amendment) Act, 1972 partly mitigates the situation by casting the onus on the transfer or to show that the transfer is otherwise than by way of sale.

Section 6A (newly inserted in the Central Sales Tax Act)[1] is as follows :

"6A(1) Where any dealer claims that he is not liable to pay tax under this Act, in respect of any goods, on the ground that the movement of such goods from one State to another was occasioned by reason of transer of such goods by him to any other place of his business or to his agent or principal, as the case may be, and not by reason of sale, the burden of proving that the movement of those goods was so occasioned shall be on that dealer and for this purpose he may furnish to the assessing authority, within the prescribed time or within such further time as that authority may, for sufficient cause, permit a declaration, duly filled and signed by the principal officer of the other place of business, or his agent or principal, as the case may be, containing the prescribed particulars in the prescribed form obtained from the prescribed authority, along with the evidence of despatch of such goods.

(2) If the assessing authority is satisfied after making such inquiry as he may deem necessary that the particulars contained in the declaration furnished by a dealer under sub-section (1) are true, he may, at the time of, or at any time before, the assessment of the tax payable by the dealer under this Act, make an order to that effect, and thereupon, the movement of goods to which the declaration relates shall be deemed for the purposes of this Act to have been occasioned otherwise than as a result of sale.

*Explanation.*—In this section, "assessing authority", in relation to a dealer, means the authority for the time being competent to assess a tax payable by the dealer under this Act."

1. Amendment Act 61 of 1972.

2.6. Even this provision, it is stated, has been assailed in the evidence before the Select Committee as unconstitutional.[1] We have been asked to consider whether consignments should be taxed under the Act. Criticism of section 6A

*Two types of transactions*

2.7. It seems to us that in examining this question, two types of transactions have to be kept apart from each other, namely,— *Bona fide* consignments and sham consignments.

(i) *bona fide* consignments, and (ii) sham consignments.

Where goods are consigned from one branch of an establishment to another, *bona fide*, there is no 'sale', because there cannot be a sale by the seller to himself. To constitute a 'sale', there must be two different persons.[2]

Where, on the other hand, the consignment from branch to branch is a sham transaction, and the transaction is, in reality, one intended to transfer property to a different 'person', there is no legal difficulty in taxing it as a sale.[3] No doubt, it may not be easy to discover the true nature of the transaction ; and the process of gathering the relevant facts may involve some labour.

*Case law*

2.8. A few cases dealing with the transfer of goods to a branch or the like transactions will elucidate what is stated above. In the *Tata Engineering Co. case*,[4] the assessee, a manufacturer of trucks, was assessed in respect of transactions in which the vehicles were moved from the site of works in Jamshedpur to various stockyards in different States. The terms of contract between the assessee and the dealers showed that when vehicles were moved from the works to the stockyards, it did not necessarily happen that the number of vehicles allocated to the dealer was delivered to him. *Telco case* decided by the Supreme Court.

The Supreme Court observed :

> ".....The points which would require determination would be whether the transactions which have been subjected to tax were of sale within the definition of

1. Notes in the Ministry of Finance.
2. *cf.* section 2(1)(g), Central Sales Tax Act, 1956.
3. *Mahindra Kumar* v. *State of Madras*, (1968) 12 S.T.C. 72 (Mad).
4. *Tata Engineering & Locomotive Co. Ltd.* v. *Assistant Commissioner of Commercial Taxes*, A.I.R 1970 S.C. 1281, 1285, 1286 (Grover J.).

that expression contained in section 2(g) and whether the movement of goods from Jamshedpur to the stockyards of the appellant in the different States was occasioned by any convenant or incident of the contract of sale....." After examining the procedure followed by the appellants in their negotiations with dealers and despatch of vehicles to stockyards, the Supreme Court held :—

"the allocation of letters and the statements furnished by the dealers did not by themselves bring about transactions of sale within the meaning of section 2(g) of the Act. The Assistant Commissioner himself found that sometimes the vehicles were sent from the works at Jamshedpur even before an allocation letter had been issued. It would appear from the materials placed before us that generally the completion of the sales to the dealers did not take place at Jamshedpur and the final steps in the matter of such completion were taken at the stockyards. Even if the appellant took into account the requirement of the dealers which it naturally was expected to do when the vehicles were moved from the works to the stockyards, it was not necessary that the number of vehicles allocated to the dealer should necessarily be delivered to him. The appropriation of the vehicles was done at the stockyards through specification of the engine and the chasis number, and it was open to the appellant till then to allot any vehicle to any purchaser and to transfer the vehicles from one stockyard to another..... It is not possible to comprehend how in the above situation it could be held that the movement of the vehicles from the works to the stockyards was occasioned by any convenant or incident of the contract of sale..... Consequently the appeals are allowed and the order of the High Court and the Assistant Commissioner is set aside....."

2.9. In a Madras case, *Mahendra Kumar Ishwarlal & Co.*, Vs. *State of Madras*[1] the petitioners' firm were jaggery and

1. *Mahendra Kumar Ishwarlal & Co.* v. *State of Madras*, (1968) 21 S.T.C. 72 (Madras).

foodgrains merchants. in Tirupathur, Madras State. Another firm Chunilal Bhagwandas & Co., Bombay, comprised the same partners as the petitioners. The petitioner firm (in Madras State) transferred, to the Bombay firm, jaggery of a certain value. The Sales Tax Department of the (erstwhile) Madras State took the view that the transfer of jaggery represented a "sale" by the Madras firm to the Bombay firm, and should, therefore, be assessed for Central Sales Tax. On the other hand, the petitioner contended that since the partners in both the firms were identical, therefore, in spite of the fact that their share capital ratio was different, there could be no sale at all, because one person cannot sell to himself. The Sales Tax Appellate Tribunal, to which the petitioners appealed against the decision of the assessing authority, held that even though the two firms had the same partners, the fact that the profit-sharing ratio of the partners in the two firms was different, made a difference, and that this difference would enable the two firms being viewed as two different persons, with the result that one firm could effectively sell goods to another, thereby attracting the levy of sales tax on the transactions.

2.10. The petitioners filed a revision before the Madras High Court.

It was hold that there was no sale. The High Court relied on the Supreme Court decision in *Harayanappa* v. *Bhaskara Krishnappa*[1], which said ".....since a firm has no legal existance, the partnership property will vest in all the partners and in that sense, every partner has an interest in the property of the partnership. During the subsistence of the partnership, however, no partner can deal with any portion of the property as his own. Nor can he assign his interest in a specific item of the partnership property to anyone. His right is to obtain such profits, if any, as fall to his share in the assets of the firm....."

Relying on these observations, the Madras High Court held,--

> "....What emerges, therefore, from the above reasoning is that in regard to the present transaction, it is the case of the same group of firm partners transfering a particular item of property, to which they were entitled, to themselves. In other words, the broad principle that a person cannot sell to himself will be attracted in regard to the present transaction also....."

---

1. *Harayanappa* v. *Bhaskara Krishnappa* A.I.R. 1066 S.C. 1300.

2.11. The High Court also referred, with approval, to three more cases[1], and said, "...The decisions we have cited above in support of our conclusion rely upon the definition of 'sale', and that to constitute a sale there must be two different persons, in the ordinary sense of the term 'person'. When two partnerships have transferred goods from one to the other and the partners of the two firms are identical, it will really be a case of one person transferring goods to himself. There is, therefore, no 'sale' so far as the definition of 'sale' is concerned, whether it be under the Madras General Sales Tax Act or the Central Sales Tax Act. We therefore, allow the revision case and set aside the assessment on the disputed turnover...."

*Amendment if desirable — Constitutional position*

Question of amendment considered.

2.12. This, then, is the position. Is it necessary to avoid totally the process of gathering the relevant facts referred to above, by introducing a provision taxing even consignments from branch to branch? Such a legislative provision is theoretically within the competence of Parliament, under its residuary power of taxation. But the Constitutional scheme[2]—so far as taxation on a transaction *qua* sale is concerned—is somewhat narrow.

Taxation on consignment not within present Act.

2.13. Taxation of mere consignments is not also within the scheme of the present Central Sales Tax Act. That Act is relatable to taxes on the sale or purchase of goods (other than newspapers), where such sale or purchase takes place in the course of inter-State trade or commerce[3].

The Act is intended to be administered as a complementary piece of legislation to the State Sales Tax act[4]. The constitutional provision relating[5], *inter alia*, to taxes on the sale or purchase of

---

1. (a) *The State of Madras represented by the Deputy Commercial Tax Officer, Madras Division, Madras* v. *Sri Mu.pgan Electricals*, (T.U.No. 40 of 1900; unreported case);
   (b) *Raja Chettior & Others* v. *State of Madras*, (1955) S.S.T.C. 132 (Mad).
   (c) *State of Puniab* v. *Jullundur Vegetables Syndicate*, (1966) 17 S.T.C. 326
2. See for detailed discussion, para 2.26 to (Punj) *infra*.
3. See also para 2.30, etc. seq infra.
4. Cf section 7(2), 1(2)9(2) and 9(3), Central Sales Tax Act, 1956.
5. Constitution, Articles 269(1) (g) and 269(2).

goods (other than newspapers) in the course of inter-State trade or commerce, is also limited to 'sale' in the strict sense.

Constitutional difficulty in widening the scope of sale Consignment transactions.

2.14. The proceeds of such taxes, in so far as they are attributable to the States, do not form part of the Consolidated Fund of India, and are assigned to the State in which the tax was collected[1]. When all these aspects are borne in mind, it will be realised that without a constitutional amendment widening the scope of the expression 'sale or purchase' *wherever it occurs in the Constitution in the context of inter-State sale or purchase*, confusion will result if consignment transactions are brought within the definition of 'sale' in the Central Sales Tax Act. Hence, if such transactions are to be taxed, it will be necessary to amend the Constitution in several places—*e.g.* article 209 whereunder the proceeds are distributed to the States.

Tax why justifiable.

2.15. The legal concept of "sale" requires two persons. If there is no transfer of "property" in the goods in the legal sense, there is no transfer of wealth, and since there is no transfer of wealth, the transaction also has so far remained non-taxable. Since, however, it appears that tax is evaded by *representing, no consignment transfer, what are really sales to the bulk consumer*[2], the compulsions of the situation and the need to check evasion demand that even consignments should be taxed. If goods are sent from State X to State Y as "consignment transfers", and the consignment is treated as not amounting to inter-State 'sales', Central Sales Tax cannot be levied, at present. But sales tax in State Y can be levied when the goods are sold by the branch in State Y to the bulk consumer. There is, therefore, no defeating of State sales tax in the abstract. But there might be evasion of Central Sales Tax, by fictitiously representing, as consignments, transactions which are really sales.

Supreme Court case relating to distribution agreement.

2.15A. A recent Supreme Court case has considered[3] two important questions which are relevant to "consignment transfers".

(1) Whether, in the circumstances of the case the despatch of refrigerators from the appellant's factory in Faridabad (Haryana) to their godowns in Delhi would be a 'sale' or 'Purchase'

---

1. Section 9(3), Central Sales Tax Act, 1956.
2. Para 2.3, *supra*.
3. *Kelvinator of India* v. *State of Haryana*. (1973) 2 Supreme Court Case 551, 561, 562, para 12.

in the course of inter-State trade or commerce under section 3 of the Central Sales Tax Act, 1956.

(2) Whether such despatch was, under section 3(a), of that Act 'occasioned' by a 'sale'.

The facts of the case were as follows:—

The appellants, manufacturers of refrigerators etc. had their factory in Faridabad (Haryana) and registered office and godowns in Delhi. They had entered into distribution agreements with three different distributors, under which the refrigerators were sold under three different brand names. The terms and conditions in the three agreements were similar. The refrigerators were sent from Faridabad to Delhi, and kept in the appellant's godowns and finally despatched to the distributors. The sales Tax Tribunal, Haryana referred the question whether the despatch was an inter-State sale for the opinion of the Punjab and Haryana High Court, the High Court decided the questions in favour of the deapartment and held that the despatch constituted 'sale' under section 3 of the Central Sales Tax Act, and was therefore taxable, under that Act. The appellants came in appeal before the Supreme Court by special leave. The principal question was whether the distribution agreements could be construed to be contracts of sale. On examination of the agreements the following facts had been accepted by the departmental authorities and by the High Court : (i) the dealer (appellant) manufactured and sold refrigerators, (ii) the refrigerators were sold with three different trade marks, (iii) the sale of each brand was made through a separate distributor apointed for the purpose, (iv) the manner of movement was laid down in the agreements, (v) the dealer was bound to sell a particular brand to a particular distributor, (vi) the refrigerators were exported outside India, (vii) the price of the refrigerators was fixed as mutually agreed upon from time to time, (viii) the property in the goods passed at Delhi after delivery, (ix) the prices were not settled for individual machines, but on a periodical basis, (x) the purchase orders were placed by the three distributors after the goods reached the Head Office at Delhi, (xi) after manufacture of the goods in the factory, an excise clearance pass was obtained after payment of excise duty for the transport of goods from the factory to the company's godown in Delhi, and, the excise pass was always for the movement of goods in favour of self, (xii) the appellants paid the octroi during the transport of the goods from Faridabad to Delhi, (xiii) on arrival of the goods in Delhi, the Appellant's

staff received them and put them in their godown, (xiv) the appellant's staff in Delhi gave delivery of the goods to the customer at Delhi, under a challan prepared at Delhi, (xv) the bills were raised from Delhi and the price was received by the appellant Co. in Delhi and (xvi) that all the appellants did was to manufacture the refrigerators in Faridabad and brand them differently for the purposes of sale and distributors. While, on the basis of the above facts, the High Court found that the distribution agreements constituted agreements of sale, the Supreme Court found it otherwise. Khanna J., speaking for the unanimous Bench of himself and Alagiriswami J., observed : "In the face of the facts of the present case, we find it difficult to hold that the sale of refrigerators by the appellant to the three distributors took place at Faridabad. We are also unable to agree with the High Court that the distribution agreements constituted agreements of sale".

2.15B. The following reasons were given : "It is noteworthy in this context to observe that the number of refrigerators which were to be purchased by each of the distributors was not specified in the distribution agreements, nor did the agreements contain the price which was to be charged for each refrigerator. According to the agreement, the appellant undertook to sell and the distributor undertook to purchase the products of the appellant "as mutually agreed upon from time to time." It is, therefore, plain that sales by the appellant company to the distributors "depend upon the future agreement between the parties from time to time. Distribution agreement dated September 15, 1965 and December 11, 1965, no doubt mentioned the minimum number of Leonard and Gem refrigerators which had been purchased by the distributors, the exact number of refrigerators to be sold by the appellant to these distributors was still left to volition of the appellant. The appellant company, it was also mentioned, would incur no liability if it was unable to supply the guaranteed minimum number of refrigerators. The mode of dealings between the parties was that subsequent to the distribution agreements, orders were placed by the distributors with the appellant after the refrigerators had reached the appellant's sale office and godown in Delhi. The price of the refrigerators was also to be mutually agreed upon from time to time. It is plain that it is the *orders which were placed in Delhi by the distributors that resulted in mutual agreement of sale*[1].

1. Supplied.

"It was, in our opinon, the mutual agreement between the parties at the time of the placing of the order by the distributor with the appellant which constituted the contract of sale and not the distribution agreement. The distribution agreement with each distributor provided the framework within which the different contracts of sale were entered into by the distributors with the appellant. This circumstances should not make us lose sight of the fact that in distribution agreements and the subsequent contracts of sale were distinct transaction...".

2.15C. The Supreme Court also found the argument that the first distribution agreement obliged the appellants to sell all their refrigerators to the first distributor unconvincing, as the agreement was qualified by the terms "as mutually agreed upon from time to time" and the appellant exported its products to foreign countries. The Supreme Court rejected the contention on behalf of respondents (State of Haryana) that the sale (to the distributors) took place in Faridabad and that appropriation towards the agreement took place there. The contention was advanced on the assumption that trade mark name plates for the different brands were affixed in Faridabad. The Supreme Court found no material to Support the assumption and even if the name plates were affixed there, the name plates could be removed and replaced in Delhi, as the three brands of refrigerators were identical except in respect of name plate. Another important factor was that orders in respect of the various refrigerators were placed by the distributors in Delhi after the refrigerators had been transported to the Delhi sale office and godown of the appellant. The court observed : ".....If the sale of the refrigerators in favour of the distributors had already taken place at Faridabad and the refrigerators had been appropriated there towards the sale contract, there would have arisen no occasion for the placing of the subsequent order in Delhi by a distributor with regard to the said refrigerators. The fact that subsequent orders had to be placed by the distributors in Delhi with regard to the different refrigerators after their arrival in Delhi shows that there was no earlier appropriation of those refrigerators towards any contract of sale with the distributors. The stand taken on behalf of the department that the appropriation of the refrigerators took place at Faridabad towards the contracts of sale with the distributors is inconsistent with the entire course of dealings between the parties. It may also be observed that in deciding the question whether the transactions between the parties constituted sales in the course of inter-State trade or commerce, the court should

look not merely at the distribution agreements, regard should be had of the entire course of dealings between the parties....."

**2.15D.** On the important question whether the movement of refrigerators from Faridabad to Delhi was occasioned by a sale, the Supreme Court held : ".....Assuming that the distribution agreements constituted contracts of sale, it would still have to be shown that the sale by the appellant to the distributors occasioned the movement of refrigerators from Faridabad to Delhi. In this respect, we find that according to the facts found by the Tribunal, the appellant had a godown and sale office in Delhi. There is nothing to show that the appellant has also a godown in Faridabad. The movement of refrigerators from Faridabad to the appellant's godown in Delhi in the *circumstances can* be acribed to the fact that *the appellant has a godown facility in Delhi*[1]. There were two places at which, in the nature of things, the appellant could have sold the refrigerators to the distributors. It could be either at Faridabad where the appellant has its factory wherein the refrigerators are manufactured, or in Delhi where the appellant has its office and godown and where also the three distributors have their offices. The selection of the sale depended upon mutual agreement between the parties. It is also obvious that if there is a choice before the parties of so arranging their matters that in one case they would have to incur liability to pay tax while in the other case the liability to pay tax would not be attracted, they would prefer the latter course. There is nothing illegal or impermissible to a party so arranging its affairs that the liability to pay tax would not be attracted or that the brunt of taxation would be reduced to the minimum. The appellant company in the present case would incur no liability to pay tax under the Act if it were to transport the refrigerators from its factory in Faridabad to its own office and godown in Delhi and thereafter to sell them to the distributors. The liability to pay tax under the Act would, however, arise if the sale of the refrigerators to distributors were to take place at Faridabad and the movement of refrigerators from Faridabad to Delhi were to take place under the contract of sale. The question with which we are concerned is whether the appellant entered into such an arrangement with the distributors that the liability to pay tax would be attracted and not the other arrangement under which no such liability could be fastened on the appellant. So far as this question is concerned, we find that the parties expressly

---

1. Emphasis supplied.

"stated in each of the three distribution agreements that it would be in Delhi that the sale of the refrigerators would take place to the distributors and the property therein would pass to them. It was again in Delhi that the refrigerators were delivered to the distributors. The order for the refrigerators were placed by the distributors in Delhi and it was also here that the price of refrigerators was paid. Looking to all facts of the case, we have no doubt that the arrangement between the parties was that refrigerators *would be sold by the appellant to the distributors after*[1] they had been transported to the sale office and godown of the appellant at Alipore Road, Delhi so that no liability to pay tax under the Act would arise. It cannot in the circumstances be said that the transport of the refrigerators from Faridabad to Delhi was in pursuance of contracts of sale between the appellant and the distributors....."

2.15E. The Supreme Court rejected the contention on behalf of the respondents that since under the contract the freight charges from Faridabad to Delhi were paid by the appellants, this would show that the movement of the goods was occasioned by the contract of sale. The court found that the price payable by the distributors was the aggregate of the ex-factory price and the transportation charges. Since ex-factory price changed from time to time and since the agreements provided that the sale as well as delivery to the distributors would take place in Delhi, there was nothing surprising in the clause of the distribution agreement saying that transportation charges would be added to the ex-factory prices in calculating the amount payable by the distributors to the appellant. The Supreme Court also found it as incorrect an observation made by the High Court that in two of the distribution agreements the liability for shortage of goods during transportation from Faridabad to Delhi was on the distributors and not on the appellant Co. Even in the case of the third agreement, where the Supreme Court found that there was such a stipulation, the court considered it to be of no decisive importance and only as "a matter of mutual agreement between the parties," and the distributor treating any loss or liability resulting therefrom more than offset by the distributorship of the particular brand of the refrigerator. The Supreme Court also rejected a contention based on section 23 of the Sale of Goods Act that where there was a contract for the sale of unascertained or future goods by description and goods of that description and in a deli-

1. Emphasis added.

verable state are unconditionally appropriated to the contract, either by the seller with the assent of the buyer or by the buyer with the assent of the seller, the property in the goods passed to the buyer. The Supreme Court refused to construe the distribution agreements as contracts of sale. There was also no material to show that there was any assent expressed or implied by the distributors to the appropriation of the refrigerators by the appellant at Faridabad. The Supreme Court relied upon its earlier decision in *Tata Engineering case*[1], where the Court refused to consider the transport of manufactured trucks and buses from the appellant's factories in Jamshedpur to stockyards as *inter-State sales*, as the movement could not be proved to be occasioned by sales.

2.15F. The Supreme Court held : "We accordingly accept the appeal and set aside the judgment of the High Court. The answer given by the High Court to the question referred to it is discharged. In our opinion, the three agreements between the appellant and the distributors were merely agreements for the distribution of goods and were not agreements of sale between the parties. It cannot, in our opinion, be said that there was any movement of refrigerators from Faridabad to Delhi under a contract of sale. The question in the circumstances is answered against the department. The transactions between the appellant and the distributors did not, in our opinion, constitute sale in the course of inter-State trade or commerce. As such, there was no liability to pay tax under the Act."

*Amendment, if desirable—Need to check evasion*

The problem of large-scale tax evasion.

2.16. This, then, is the present position. Need to bring, within the range of taxability, transactions not falling within the existing tax structure, in this field (or, for that matter, in any other field) can arise by reason of the fact that the narrow scope of the tax structure is being abused. In the present case, from the suggestion made by the State Governments we infer that evasion on a large-scale is being restored to. It would also appear that the insertion in 1972 of section 6A[2] is not regarded as adequate to check such evasion.

---

1. *Tata Engineering etc. Co. Ltd.* v. *Asstt. C.C.T. & another* (1970)31 S.C.R. 162: S.C.C. 622.
2. Para 2.5, *supra*.

It would seem, therefore, that it is thought that evasion cannot be checked otherwise than by taxing all consignments. Even though there is a logical difficulty in equating a consignment with a sale, it seems that that has been regarded as necessary.

Two alternatives.

2.17. On that basis, the amendment called for will have to achieve the object of bringing, within the range of taxable activities, all consignments of goods from one State to another,—subject, of course, to certain possible limitations which we shall presently deal with[1]. For achieving this object, two broad alternatives are open.

Alternative one—a separate Act

2.18. According to the first alternative, such transactions could be taxed by a *separate tax* not to be combined with the present Central Sales Tax. According to the second alternative, such transactions could be included within the present structure of the Central Sales Tax. Though the latter course is likely to necessitate a radical expansion of the scope of "sale" under the Central Sales Tax Act,—as also, perhaps, in some of the constitutional provisions[2], nevertheless, from the practical point of view, that course would appear to be preferable to the first alternative. The first alternative—that is to say, a *separate Act* to tax inter-State consignments not amounting to sale,—may mean the duplication of numerous provisions already found in the Central Sales Tax Act.

Alternative two—broadening the scope of "sale" in the Act.

The question of manner of levy.

2.19. If, then, the second alternative[3] is to be adopted, the next broad question that arises is, whether the tax on the inter-State consignments should be leviable in the same manner as the present Central sales tax is levied, or whether any other device should be adopted in that behalf. One possible device could be this—the State to which goods are consigned from another State (otherwise than by way of sale) may be empowered to levy a higher rate of tax on such goods when sold internally within the consignee State, with a provision for granting rebate in respect of such inter-State sales tax as has been actually levied on those goods. Though this device may avoid an amendment of the scope of 'sale' in the Central Sales Tax Act (which will be necessary under the other alternative), it will also involve some other amendments. Moreover, the *consignor* State would not get any additional revenue if this device is adopted, at least

---

1. See para 2.21.
2. These need not be enumerated for the present purpose.
3. Para 2.18, *supra*.

in cases where the *consignee State* does not avail itself of the power to levy higher tax. On the other hand, if the present scheme given in the Central Sales Tax Act is extended to consignments not amounting to sale, there would be symmetry, and also a certain amount of smoothness in working, because the experience gained in the working of the present Act would continue to be valuable and useful for the collection and realisation of the extended tax also.

Legislative devices.

2.20. If it is decided to pursue the approach suggested above, namely, extending the present Act to consignments not amounting to sales, there could be a number of legislative devices which one can adopt for the purpose. It is unnecessary to go into all of them. Our preference is for expanding the definition of "sale" in the Central Sales Tax Act.[1]

What should be the limitations.

2.21. We shall now consider the question whether all consignments should be covered by the extended tax, or whether any limitations in that respect are desirable. There can be no dispute that the tax should extend only to consignments made in the course of business[2], i.e. to consignments made by a dealer in the business of buying or selling goods. But a person who carries on the business of buying selling goods[3], may be a manufacturer, an importer, a distributor, a wholesaler or a retailer or may possibly fall under some other category. From the point of view of principles of economics, the State where the goods are manufactured or imported from outside India for the first time, and from which the goods are then consigned (without sale) to other States in the course of business, can legitimately claim that it should not lose, on such 'non-sale' consignments the tax which would have been earned if there had been an inter-State sale proper. The resources of the State would, to a large extent, have been employed in facilitating the manufacture or import of the goods. When one comes to the stage of the wholesaler who is not himself a manufacturer or importer, this ground of justification does not, perhaps, apply with the same force. Therefore, as a matter of abstract logic some distinction could be made between manufacturers and importers (on the one hand) and wholesalers etc. on the other hand. However, it is possible that such distinctions might lead to an increase in administrative work, and we are not inclined to recommend any such distinctions.

---

1. See para 2.23 *infra* (recommendation).
2. Compare section 2(b), definition of "dealer".
3. Section 2(b), definition of "dealer".

Definition of "sale" should cover transfers other than by sales.

2.22. The principal purpose, then (of the definition of 'sale' as proposed to be amended) will be to levy a tax on a dealer in respect of goods where the movement of such goods from one State to another is occasioned by reason of consignments of such goods by him to any other place of his business or to his agent or principal, *otherwise than by reason of sale.*

Amendment a matter of policy.

2.22A. We may state here that whether the law should or should not be amended so as to include consignments in a matter of policy. In some of the replies to the Questionnaire issued by us on the subject, the economic difficulties likely to be created if consignments are taxed have been referred to. We express no opinion on the matter.

*Recommendation to amend the Act*

Recommendation.

2.23. We, therefore, recommend[1] that if it is decided as a matter of policy to tax consignments, then the definition of "sale"[2-3] in the Central Sales Tax Act should, after carrying out the requisite constitutional amendments, be amended somewhat on these lines[4] :—

"(g) 'sale' means any transfer of property in goods by one person to another for cash or deferred payment or for any other valuable consideration[5], and includes—

(i) a transfer of goods on hire-purchase[6] or other system of payment by instalments, and

(ii) *a consignment of goods occasioning their movement from one place to another, where such consignment is by a dealer to any other place of his business or to his agent or principal.*

---

1. Amendments needed in the Constitution to be considered separately. see para 2.25 *et seq. intra.*
2. Section 2(g), Central Sales Tax Act.
3. This is not intented to be a precise draft.
4. Consequential amendments, if necessary, in the other provisions of the Central Sales Tax Act, should be separately considered.
5. As to amendment of the words referring to "valuable consideration", there is a separate recommendation. See Chapter 8.
6. Portion relating to hire-purchase is subject to the discussion in the relevant chapter.

but does not include a mortgage or hypothecation or a charge or pledge of goods ; and its grammatical variations and cognate expressions shall be construed accordingly."

The complex nature of the problem.

2.24. We are conscious that the item (relating to consignments) proposed to be added as above[1], will introduce a certain amount of complexity in the Act; but, if the object of checking evasion is to be achieved, this complexity cannot be avoided. "The tax laws are aimed at dealing with complex problems of infinite variety, necessitating adjustment of several disparate elements."

The amendment will cover all consignments.

2.25. It should, perhaps, be unnecessary to point out that the added item (as proposed above) will cover all inter-State consignments in the course of business; and will eliminate any inquiry as to whether the particular consignment constituted a *bona fide* sale or a fictitious sale. Also, it will cover successive inter-State consignments of the same goods in the course of business.

*Constitutional position—concept of sale*

Constitutional amendment also needed.

2.26. We should point out that to achieve the above object, an amendment of the Constitution, in order to authorise the distribution of the proceeds of the tax on consignments, is unavoidable. No doubt, Parliament already possesses the power to levy a tax on inter-State consignments under its residuary power. But the distribution of the proceeds of the tax to be so levied cannot be provided for within the language of article 269, and must need an expansion of the scope of article 269. It would appear that the expression "sale or purchase", occuring in article 269 (and in Union List, entry 92A) will have to be given the same interpretation as has been given to it under State List, entry 54.

When an expression is used in a legal document without change at several places, normally it should bear the same interpretation, in the interest of symmetry and to avoid confusion. This is the first point to be considered.

---

1. Para 2.23 Supra.

"Sale of goods"—a composite expression.

2.27. A decision[1] of the Supreme Court also throws light on the meaning of "sale":—

> "The expression 'sale of goods' is a composite expression, consisting of various ingredients or elements. Thus, there are the elements of bargain, or contract of sale, the payment or promise of payment of price, the delivery of goods and the actual passing of title, and each one of them is essential to a transaction of sale though the sale is not completed or concluded unless the purchaser becomes the owner of the property."

Metaphorical use of sale.

2.28. It has been observed in an Australian[2] case :—

> "The word 'sale' is used in various metaphorical senses. When a man enters into a contract of employment, he is sometimes said to 'sell his labour', but really there is no transaction of sale; the contract is a contract of employment, not a contract of sale. Similarly, when a banker 'deals in credit' he makes loan contracts and does not sell anything."

How far legal concept extended.

2.29. It may well be that the legal conception of a sale is not strictly inapplicable to the case of hire-purchase. There may be a semblance of a reason in the case of tax on a hire-purchase by treating it as sale, by acting on what we regard as the substance of the transaction. On the other hand, there is some occasion for surprise at finding in any particular legislation the word "sale" or the word "sell" used as referring to a transaction of consignment.

The meaning of "sale" laid down in *Simpson* v. *Conolly*.

2.30. A modern judicial expression of the *prima facie* meaning of "sale" is to be found in *Simpson* v. *Conolly*[3]. It was held in that case that an agreement to extinguish an existing debt if land is transferred, is not a "sale" of land. The Court observed :

> "But the general principle of English law is that a sale means the exchanging of property for money. That

---

1. *Popatlal Shah* v. *State of Madras*, A.I.R. 1953 S.C. 274.
2. *Baris of New South Wales* v. *Commonwealth*, (1948) 76 C.L.R. 1, 234 (per Latham, C.J.).
3. *Simpson* v. *Conolly*, (1953) 2 All E.R. 474, 477 (Finnemore J.). (The Edited 8th editions of Benjamin on Sales).

applies—and I think both counsel agree with this—to a sale of land and sale of chattels equally."

Such is the primary meaning of the word "sale".

2.31. There are, no doubt, to be found authorities and statutes which have extended that meaning. Upjohn J.[1], for example, cited the following from T. Cyprian Williams' Books, the Contract of sale of land. Wider definitions.

> " 'Sale' in the strict and primary sense of the word, means an agreement for the conveyance of property for a price in money; but the word 'sale' may be used in law in the wider sense and so applied to the conveyance of land for a price consisting wholly or partly of money's worth other than the conveyance of some other land."

2.32. Even here, the essential concept of *transfer* of the property in goods is not abandoned. Essential concept—transfer property.

2.33. The distinction between "sale" and "agency" has been discussed at length in *Cordon Woodraffe's* case[2]. All this discussion is intended to drive at the submission that it is difficult to place an expanded interpretation on "sale or purchase" in article 269, so as to cover a sale not properly so called. Distinction between sale and agency.

2.34. An amendment to expand the meaning of 'sale' (to cover consignment) is considered necessary because since section 9(3) of the Central Sales Tax Act has, for its power and origin, article 269(2) of the Constitution, it is desirable that the constitutional provision itself should be unambiguous, so as to authorise the distribution of proceeds of a tax on consignments under section 9(3) read with the definition of "sale". The exclusive object of entry 92A (in the Union List) was to confer, on the Union, the power to levy a tax on inter-State transactions of sale or purchase of goods. These transactions were, before the insertion of that article, regarded (according to an interpretation subsequently found to be erroneous) as falling within the power of the States. By a new entry,—entry 92A—that power was in 1956 vested in the Union, but the pro- The need to clarify the constitutional basis.

---

1. *Bohashaw Brothers* v. *Mayer*, (1958) 3 All E.R. 833, 835 (Upjohn J.).
2. *Cordon Woodraffe* v. *S.K.M.A. Majid & Co.*, A.I.R. 1967 S.C. 181.

ceeds were, by an amendment of article 269 which was made simultaneously, directed to be distributed to the States.

2.35. And since, in State List, entry 54, "sale" has been narrowly construed, it is very likely that in article 269 and Union List, entry 92A, also, it will be narrowly construed, particularly having regard to the close relationship of article 269(3) to entry 92A.

In common parlance 'sale' does not include consignments.

2.36. Consignment of goods without passing of property is not, even in popular language, equated with "sale". Thus, both the legal and popular meanings of 'sale' exclude consignments without transfer of property.

Past interpretation not a sure guide.

2.37. No doubt, it is true that the Central Sales Tax has—on one plausible interpretation[1]—itself levied a tax on hire-purchase not resulting in sale, and, on that basis, it could be argued that the strict common law concept of "sale" has not been adhered to by the legislature. But this does not necessarily lead to the conclusion that, for the purpose of article 269 of the Constitution, the interpretation of the expression "sale" should be wide. Legislative practice, reflected in a definition (which itself is open to two interpretations[2]), is not conclusive on a question of competence of the very legislature which has adopted that practice. (The word 'competence' is used here not to indicate the power of the Union to tax, but to connote its power to assign the revenues from the tax to the States).

As Lord Radcliffe emphasised[3], "resort to a later Act can rarely, if ever, be justified, unless the message that it conveys is a plain one itself, at least free from ambiguity".

The common notion is different.

2.38. Though it is commonplace, it has to be emphasised that the passing of property for price is of the essence of sale, and where the property does not pass (as in consignment transfers), an essential feature of sale as known to the law and also as understood by the layman, is missing.

---

1. See discussion relating to hire-purchase.
2. See discussion relating to hire-purchase.
3. *In Re Mac Manaway*, (1951) A.C. 161, 177 (P.C.).

As has been observed[1], "Alike in the ordinary use of language and in its legal concept, a *sale connotes* the mutual assent of two parties" and, of course, the passing of property.

*Amendment of the Constitution*

2.39. Therefore, if consignments are as a matter of policy intended to be included in the Central Sales Tax Act, it will be advisable to amend article 269(1)(g) and 269(3) of the Constitution[2], by adding an Explanation to that article, somewhat on the following lines[3]:— Recommendation to amend the Constitution.

"Explanation.—For the purpose of this article the expression "sale or purchase" includes[4]—

a consignment of goods occasioning their movement from one place to another, by a dealer to any other place of his business or to his agent or principal."

1. *Kirkness (Inspector of Taxes)* v. *Rudson (John & Co. Ltd.)* (1955) 2 All E.R. 345, 348 (H.L.) (Viscount Simonds.).
2. There are provisions of the Constitution using the expression "sale" but they do not seem to require amendment in the present context.
3. This is not intended to be a precise draft.
4. As to hire-purchase, see article 366 as proposed to be amended.

## CHAPTER 3

# SALES IN THE COURSE OF IMPORT—*KHOSLA'S CASE*

### *Introductory*

Scope of the Chapter.

3.1. In this Chapter, we shall deal with a question concerning the taxation of sales in the course of import. The question is one of considerable constitutional importance. It arises from the judgment in *Khosla's case*, which interpreted section 5 of the Central Sales Tax Act and its relationship to article 286(1)(b) and article 286(2) of the Constitution. The question is a vexed one and its proper consideration and appreciation involves a study of the historical and constitutional background[1], and that background must be dealt with in order to unrave the various issues turning essentially on the taxability of purchases connected with export and sales connected with import.

Need for demarcation

3.1A. We shall first deal with the constitutional aspect. Where there are two Governments operating in respect of a subject matter—in this case, taxation, demarcation of their respective jurisdictions becomes unavoidable. Taxation of transactions relating to commodities is a major source of revenue in almost all the countries of the world, and it is also well-known that the power to tax such transactions may have to be exercised at various stages. Where this power is divided between two Governments, care has to be taken to see that the power of one Government is not so exercised as to impede the the policy legitimately adopted by the other Government. Secondly, since matters concerning international trade have necessarily to be vested in the national Government, care has also to be taken to see that legislation passed by the States does not impinge upon international trade. These broad considerations have led to the inclusion in the Constitution of the relevant provisions, of which article 286(1) is material[2].

---

1. See para 3.13 *et See infra.* Page 80.

2. Paras 3.6, 4, *infra.* Page 76.

3.2. It may be stated that in the period prior to the Constitution, the authority of a province to levy a tax on transactions of sale was not subject to limitations of the nature laid down in article 286 of the Constitution. The provinces had power to levy a tax on the sale of goods and on advertisements under the Government of India Act, 1935, Seventh Schedule, Provincial List, entry 48. Position before the Constitution.

There was no express provision in the Government of India Act prohibiting the provinces from levying a tax on sales which took place in the course of import or export or in the course of inter state trade or commerce, or on transactions which took place outside their respective territories. Of course, as regards the legislative power of the provinces, the general limitation that they could legislate only "for the province or any part thereof", was always applicable.

A Provincial Legislature could not pass laws having extra-territorial operation. But this did not limit legislative competence (as to a tax on the sale of goods) to sales *concluded within* the boundaries of the province.[1] A sufficient territorial nexus between the taxing state and the sale[2] was enough to maintain the validity of the law.

3.2A. In this connection, a judgement of the Federal Court is of interest. In 1942, the Federal Court had to consider the question[3] whether a tax levied by a province on the first sale by the manufacturer or the producer could be said to be an excise and, therefore,outside the competence of the state. The Federal Court upheld the validity of the tax, on the ground that the tax was on the occasion of sale and not on the occasion of manufacture. In the course of the arguments, the well-known American case of *Brown* v. *The state of Maryland*[4] was cited, where an act of the state of Maryland, prohibiting the importers of foreign goods from selling their goods without taking a licence, for which 50 dollars had to be paid, was held to be repugnant to the provision in the Constitution of the U.S.A. which provides that:"no state shall, without the consent of Congress, allow any imposts or duties on on imports or exports, except what maybe absolutely necessary for executing its inspection laws." Judgment of the Federal Court.

1. *Popatlal Saah* V. *State of Madras*, (1953) 4 S.T.C. 188; A.I.R. 1953 S.C. 274; (1953) S.C.R. 677.
2. *Sundaramier & Co.* V. *State of Andhra Pradesh* A I.R. 1958 S.C. 468, 479, 493, (1968) S.C.J. 459.
3. *Madras Province* V. *Boddhu Paidanna & Sons*, A.I.R. 1942 F.C. 33, 37 Gwyer C.3.
4. *Brown* V. *State of Maryland* (1827) 12 Wheat 419.

The Federal Court pointed out that provisions which were being considered in the American case were very different from the provisions of the Government of India Act. One of the points of difference emphasised by The Federal Court was that the American Constitution also provides that Congress alone has power "to regulate commerce with foreign nations, among the several states, and with the Indian tribes"; and it was held that the Maryland tax was not less repugnant to this provision also: Marshall C.J. asked:

> "To what purposes should the power to allow importation be given, unaccompanied with the power to authorise the sale of the thing imported?.....Congress has a right, not only to authorise importation, but to authorise the importer to sell.....what does the importer purchase, if he does not purchase the privilege to sell?"

The Federal Court added:

> "On this view of the Commerce clause, it would indeed be difficult to recognise the right of the State to impose a tax upon the first sale of the commodity, at any rate so long as it remained in the importer's hands. *In the Indian Constitution Act no such question arises*:[1] and the right of the Provincial Legislatures to levy a tax on sales can be considered without any reference to so formidable a power vested in the Central Government. Lastly, the prohibition in the American Constitution is against the laying of "any imports or duties on imports or exports"; the prohibition is not merely against the laying of duties of customs, but is expressed in what we conceive to be far wider terms; and it does not appear to us that it would necessarily follow from the principle of the Maryland decision that in India the payment of customs duty on goods imported from abroad or the payment of an excise duty on goods manufactured or produced in India can be regarded as conferring some kind of licence or title on the importer or manufacturer to sell his goods to any purchaser without incurring a further

1. Emphasis Supplied.

liability to tax. That was the view which commended itself to the Court in (1827) 12 Wheat, 419[1] and it was view adopted and argued before us. The analogy with the American case is an attractive one; but, for the reasons which we have given we are wholly unable to accept it."

Section 2(g) C.P. and Berar Sales Tax 1947 and its construction by the Supreme Court.

3.3. The matter is illustrated by section 2(g) of the C.P. and Berar Sales Tax Act, 1947 (as then in force), which provided[2] as follows :

" 'sale' with all its grammatical variations and cognate expressions means any transfer of property in goods for cash or deferred payment or other valuable consideration, including a transfer of property in goods made in course of the execution of a contract, but does not include a mortgage, hypothecation, charge or pledge.

* * * *

*Explanation (II).*—Notwithstanding anything to the contrary in the Indian Sale of Goods Act, 1930, the sale of any goods which are actually in Central Provinces and Berar at the time when the contract of sale as defined in that Act in respect thereof is made, shall, wherever the said contract of sale is made, be deemed for the purpose of this Act to have taken place in the Central Province and Berar."

3.4. This Act was enacted in exercise of the powers conferred upon the Provincial Legislature by the Government of India Act, 1935, 7th Schedule Provincial list—Entry 48. In exercise of that power, the Legislature was competent to enact a law for levying sales tax acting on the principle of *territorial nexus,* i.e., the province could fix upon one or more ingredients of sale, and make it the foundation for imposing liability for sales tax. The Provincial Legislature, relying upon either the manufacture of the goods within the province, or the existence of the goods at the date of the contract of sale within the province, or the making of the contract of sale within the province, as the basis, could provide for levying sales tax. "Sale" within the territory was not a condition of the exercise of the power to levy sales tax.[3]

---

1. *Brown* V. *State of Maryland,* (1827) 12 Wheat 419.
2. See *Anwar Khan* V. *State of M.P.*, A.I.R. 1970 S.C. 1765.
3. See *Anwar Khan* V. *State of M. P.*, A. I. R. 1970 S. C. 1756 26 S. T. C. 381.

Other decisions of the Supreme Court.

3.5. It has been held by the Supreme Court in a large number of cases[1] that under the Government of India Act, 1935 the Provincial Legislature was competent to enact a law for levying sales tax acting on the principles of territorial nexus, i.e., the province could fix upon one or more ingredients of sale; and make it the foundation for imposing liability for sales tax.

The position is however, substantially different under the Constitution. Even if a sale is inside the State—and therefore not subject to the ban under article 286(1)(a)—it cannot be taxed by the States if it falls within either of the other two bans prescribed in article 286.

Position under the Constitution.

3.6. The Constitution has dealt with the matter by an express and elaborate provision. Broadly speaking, it not only prohibits taxation by the States of a sale[2] outside the State, but also prohibits taxation of a sale in the course of import or export—or in inter-State trade or commerce. This provision is to be found in article 286(1).

3.7. Under article 286(1)(b) of the Constitution, no law of a State shall impose, or authorise the imposition of, a tax on the sale or purchase of goods where such sale or purchase takes place "in the course of the import of the goods into, or export of the goods out of, the territory of India" The principal object of the prohibition is to protect international trade.

Importance of the Constitutional prohibition.

3.8. Such a prohibition[3] is based on one of those constitutional doctrines which form the heart of the federal concept. It is the basic need for the demarcation of the taxing power on

---

1. (a) *Popatlal Shah* V. *State of Madras*, A. I. R. 1953 S. C. 274; (1953) S. C. R. 677.
   (b) *Tata Iron & Steel Co. Ltd.* V. *State of Bihar*, (1968) 9 S. T. C. 267; A. I. R. 1958 S. C. 452; (1958) S. C. R. 1365.
   (c) *Bharat Sugar Mills Ltd.* V. *State of Bihar*, (1960) 11 S. T. C. 793; A. I. R. 1961 S. C. 1183.
   (d) *Tikaram & Sons Ltd.* V. *Commissioner of Sales Tax* (1968) 22 S. T. C. 308; A. I. R. 1968, S. C. 1286.
   (e) *Anwar Khan Mahboob* V. *Commissioner of Sales Tax* (1970) 26 S. T. C. 381, 383; A. I. R. 1970 S. C. 1756.

2. For brevity, "Sale" is used in the above discussion to include purchase.

3. Para 3.7, *Supra*.

transactions relating to commodities, that constitutes the spirit of the constitutional prohibition. Verbal controversies and questions of interpretation naturally arise on the formula that may be adopted to give effect to this spirit. But the essential and basic consideration is the one to which we have referred.

In the celebrated American case of *Brown* v. *Maryland*[1] Marshall C. J. observed:—

> "The constitutional prohibition on the States to lay a duty on imports, a prohibition which vast majority of them must feel an interest in preserving, may certainly come in conflict with the acknowledged power to tax persons and property within their territory. The power, and the restriction on it, though quite distinguishable when they do not approach each other, may yet, like the intervening colours between white and black, approach so nearly as to perplex the understanding, as colors perplex the vision in making the distinction between them. Yet the distinction exists, and must be marked as the cases arise. Till they do arise, it might be premature to state any rule as being universal in its application. It is sufficient for the present to say, generally, that when the importer has so acted upon the thing imported that it has become incorporated and mixed up with the mass of property in the country, it has, perhaps, lost its distinctive character as an "import" and has become subject to the taxing power of the State; but while remaining the property of the importer, in his warehouse, in the original form or package in which it was imported, a tax upon it is too plainly a duty on imports to escape the prohibition in the Constitution."

Problems of interpretation.

3.8A. Problems of interpretation of such prohibitions are unavoidable. Clark J. in *State of Wisconsin* v. *J. C. Penny Co*[2], observed as follows:—

> "that there is a 'need for clearing up the tangled undergrowth of past cases' with reference to the taxing

---

1. *Brown* V. *Maryland*, (1827) 6 L. Ed. 678.
2. *State of Wisconsin* V. *J. C. Penny Co.*, (1940) 311 U. S. 435, 445.

power of the States is a concomitant to the negative approach resulting from a case-by-case resolution of 'the extremely limited restrictions that the Constitution placed upon the States.....

"Commerce between the States having grown up like Topsy, the Congress meanwhile not having undertaken to regulate taxation of it, and the States having understandably persisted in their efforts to get some return for the substantial benefits they have afforded it, there is little wonder that there has been no end of cases testing out state tax levies. The resulting judicial application of constitutional principles to specific State statutes leaves much room for controversy and confusion, and little in the way of precise guides to the States in the exercise of their indispensable power of taxation. This Court alone has handed down some three hundred full-dress opinions spread through slightly more than that number of reports. As was said in *Miller Bros. Co.* v. *State of Maryland,*[1] the decisions have been not always clear, consistent or reconcilable. A few have been specifically over-ruled, while others no longer fully represent the present state of the law. From the quagmire there emerge, however, some firm peaks of decision which remain unquestioned....."

This shows the complexity of the question.

Question of sale in the course of import.

3.9. We now come to the specific question to be considered in this Chapter—the question of taxation of sale in the course of import, with reference to the judgment of the Supreme Court in *Khosla's* case[2].

3.10. Consideration of this question, as a matter of policy, was deliberately avoided in the earlier Report[3]. Since the present law is that a sale of the nature illustrated in *Khosla's* case is a sale in the course of import, the question to be considered is whether it should be made liable to taxation by the States—thus over-riding what was laid down in *Khosla's case.*

---

1. *Miller Bros. Co.* V. *State of Maryland.*
2. *K. U. Khosla & Co.* V. *Deputy Commissioner of Taxes,* A.I.R. 1966 S.C. 1216; (1966) 3 S.C.R. 352.
3. 20th Report, Page 65, para 131, Section 5 of the Central Sales Tax Act Taxation by States of Sales in the course of import.

3.11. As already stated,[1] the earlier Report of the Law Commission was confined to a narrow legal question. Suggestions that were received by the earlier Commission[2], however, indicate that several alternatives are open in this context. Suggestions noted in earlier Report

(i) The proposition laid down in *Khosla's case* may be left as it is[3];

(ii) The proposition laid down in *Khosla's case* may be codified[4];

(iii) That proposition may not only be maintained, but may also be extended in its scope[5];

(iv) That proposition may be abrogated, so as to allow the States to levy sales tax on such transactions[6];

3.11A. The choice is, thus fairly wide ; and a decision in the matter necessarily requires an examination of matter of constitutional policy. The reason why sales in the course of import (or export) are taken out of the domain of taxation by States is well known. Matters affecting international trade were intended to be kept exclusively within the competence of the Union, and the Constitution-makers were anxious to see that the legislative power of the State was not exercised in a manner which would impair the efficient performance of the responsibility of the Centre in the field of international relations. This is evident not only from the entries in Union List relating to international affairs in general, but also from the entries relating to international trade in particular. For example, trade and commerce with foreign countries, and imports and exports across customs frontiers, are dealt with by a specific entry in the Union List—Union List, Entry 41. Duties of customs, including export duties, fall within the exclusive competence of the Union—Union List, Entry 83. The general principles laid down in the Constitution, article 246(1), about the paramountcy of entries in the Union List need Entries in the Constitution relating to international relations.

---

1. Para 3.10, *Supra*.
2. 30th Report, pages 66 to 72, paragraphs 132 to 139.
3. Cf. 30th Report, page 66 para 133.
4. Cf. 30th Report, page 67, para 134.
5. Cf. 30th Report, page 70, para 136.
6. Cf. 30th Report, pages 67, 68 and 69, para 135.

not be elaborated here. For abundant caution, some of the entries in the State List expressly lay down that the power thereunder is to be subject to the legislative power of the Union under a specific entry. For example, see State List, entries 11, 13, 22, 24, 32, 33, 54, 63 etc. In fact, the entry relating to the taxing power of the State in relation to sale or purchase of goods (State List, entry 54) provides that the power is subject to Union List, Entry 92A. (Entry 92A—Taxes on the sale or purchase of goods other than newspapers, where such sale or purchase takes place in the course of inter-State trade or Commerce.

It is this anxiety of the Constitution-makers to preserve international trade from the taxing power of the States which is reflected in Article 286(1) (b), which prohibits the imposition, by a law of a State, of a tax on the sale or purchase of goods where such sale or purchase takes place, in the course of the import of the goods into, or export of the goods out of, the territory of India.

3.12. We may now consider whether the preservation of international trade from taxation by the States justifies the imposition of a prohibition against the levy of tax by the States on transactions of the nature which figured in *Khosla's case*. The question to be considered is, when there is a transaction in which there are two sales, namely, (i) a sale by a foreign manufacturer, dealer or other foreign trader to an Indian importer, and (ii) a sale by the Indian importer to the first purchaser in India should the second sale be regarded as deserving of exemption from state taxation, even *in the special circumstances* that were present in *Khosla's case* ?

*Chronological events relevant to the problem*

Background of the problem.

3.13. To put the question in its proper perspective, it would be convenient to refer to the legislative and judicial background of the problem. We shall deal with important developments in their chronological order. These are :

(1) Article 286, as it existed[1] before 1956;

(2) The two *Travancore* cases;[2]

---

1. Para 3.13A and 3.14, *infra*.
2. Para 3.15, *infra*.

(3) The Law Commission's 2nd Report, which used the word 'occasion', with intent to give the effect to the propositions laid down in the *Travancore* cases;[1]

(4) The Central Sales Tax Act, 1956, passed with the same intent;[2]

(5) Case-law before Khosla's case;[3]

(6) *Khosla's* case;[4]

(7) 30th Report;[5] of the Law Commission;

(8) Our conclusion;[6]

Article 286 before 1956.

3.13A. Article 286(1) before its amendment by the Constitution (Sixth Amendment) Act, was as follows:—

(1) No law of a State shall impose, or authorise the imposition of a tax on the sale or purchase of goods where such sale or purchase takes place—

(a) outside the State; or

(b) in the course of the import of the goods into, or export of the goods out of the territory of India.

(Explanation not quoted).

Article 286-width of

3.14. When article 286 of the Constitution (before 1956) used the expression "course of import" and the expression "course of export[7]", it did use language which could have a wide meaning as well as a narrow meaning. The language could, if a narrow meaning is to be given, be confined to that sale which itself constitutes the import. Or, in a wider sense, it could be applied to all transactions which took place in the course of bringing the goods from outside into India. A similar wide view was possible as regards export. In fact, one of the members of the Constituent Assembly[8], Shri Amiyo Kumar Ghosh, wished to

1. Para 3.22, *infra*.
2. Para 3.22, *infra*.
3. Para 3.23 *at see infra*.
4. Para 3.41 *at see infra*.
5. Para 3.48 *at see infra*.
6. Para 3.66 *at see infra*
7. Para 3.13 A *Supra*.
8. See Vol. 9, Constitunt Assembly Debates 333, 334, 346.

Para 3.14 (*Contd.*)

make it clear that export meant the last transactions, and that only at the point of these transactions, last or first, as the case may be, the sales will be exempted from sales tax, and at no other point. Another member—Shri Jagat Narain Das—also expressed a desire for clarification. In reply, Dr. Ambedkar stated that while he knew that some friends did not like the phraseology, he would add that the Drafting Committee had spent a good deal of time in order to choose the exact phraseology. However, Dr. Ambedkar added that the Drafting Committee would further examine this phraseology, so as to remove the criticism. The Drafting Committee, however, does not appear to have made any charge after this debate[1].

## TRAVANCORE CASES.

First *Travancore* case.

3.15. The ambiguity[2] in the language of article 286 became apparent when the first *Travancore case* was decided. As is well-known, four alternative constructions were advanced before the Supreme Court in that case as to the meaning of "course of", and the court was circumspect enough to observe that it was confining its decision to the particular situation in the case, namely, what may be described roughly as (i) import —purchase, and (ii) export—sale. These, the court held, were definitely *exempt*, whatever else may or may not fall within the exemption.

3.16. The first *Travancore case* dealt with sale by export. The second *Travancore case* also dealt with export sales. But the whole field was covered in the discussion.

In the first *Tranvancore case*,[3] the Supreme Court held as follows:—

> "Whatever else may or may not fall within article 286(1) (b), sales and purchases which themselves occasion the export or the import of the goods, as the case may be, out of or into the territory of India come within the exemption, and that is enough to dispose of these appeals."

---

1. The Report of the Drafting Committee dated 3rd November, 1949 does not deal with this point.
2. Para 3.14, *Supra*
3. *State of Tranncore-Cochin* v. *Bombay Co. Ltd.* (1952) S.C.R. 1112, AIR 1952 SC 366(1953) IMLJ1 3 STC 434.

"We are clearly of the opinion that the sales here in question, *which occasioned the export* in each case, fall within the scope of the exemption under Article 286 (1)(b). Such sales must of necessity be put through by transporting the goods by rail or ship or both out of the territory of India, that is to say, by employing the machinery of export. A sale by export thus involves a series of integrated activities commencing from the agreement of sale with a foreign buyer and ending with the delivery of the goods to a common carrier for transport out of the country by land or sea. Such a sale cannot be disassociated from the export without which it cannot be effectuated, and the sale and resultant export form parts of a single transaction. Of these two integrated activities, which together constitute an export sale, whichever first occurs can well be regarded as taking place in the course of the other. Assuming without deciding that the property in the goods in the present cases passed to the foreign buyers and the sales were thus completed within the state before the goods commenced their journey as found by sales tax authorities, the sales must, nevertheless, be regarded as having taken place in the course of the export and are, therefore, exempt under Article 286 (1)(b). That clause, indeed, assumes that the sale had taken place within the limits of the State and exempts it if it took place in the course of the export of the goods concerned."

Second Travancore case.

**3.17.** In the second *Travancore case*[1], these observations were sought to be taken advantage of, and it was argued that the last purchase of goods made by the exporter for the purpose of exporting them to implement orders already received from a foreign buyer (or expected to be received subsequently in the course of business) and the first sale by the importer to fulfil orders pursuant to which the goods were imported (or orders expected to be received after the import), would also fall within the scope of the exemption in Article 286(1)(b) of the Constitution. The majority of the judges of the Supreme Court, however, rejected this argument.

---

1. *State of Travancore-Cachin* v. *S.V.C. Factory*. A.I.R. 1953 S.C. 333, 336, 331, (1954) SCR 4 STC 205.

Summing up the conclusions, and explaining the observations in the first case, the majority observed that:

"(1) Sales by export and purchase by import fall within the exemption under article 286(1)(b).

(2) Purchase in the State by the exporter for the purpose of export as well as sales in the State by the importer after the goods have crossed the *customs barriers*[1] are not within the expression, and

(3) Sales in the State by the exporter or importer by transfer of shipping documents while the goods are beyond the customs barriers are within the exemption assuming that the State's power of taxation extends to such transactions.

(4) The word "course" and the expresion "in the course of" not only imply a period of time during which movement is in progress, but postulate also the connected relation.

(5) Therefore, the sale in the course of export out of the country should be understood as meaning a sale taking place not only during the activities directed to the exportation of the goods out of the country, but also as part of it connected with such activities. The time factor alone was not determinative."

While this was the majority view, the minority—S.R. Das J. as he then was—would regard the last purchase by the exporter and the first sale by the importer to be within the exemption.

Word 'occasion' not intended to give a precise definition.

3.18. The Supreme Court used the word 'occasion' in the *Travancore cases*. But this was not intended to give a precise definition. We may, in this connection, refer to what Lord Reid has said recently[2] about the function of a court :

"It is not the function of a court to frame definitions; some latitude should be left for future developments."

Effect of judgement in second *Travancore* case and Taxation Enquiry Commission.

3.19. In this manner, the majority judgment in the second *Travancore* case defined the scope of article 286, and narrowed down the potential width of construction which had been left

1. In the S.C.R. the expression is "barriers".
2. *Saunders* v. *Augtia Building Society* (1970) 3 All B.R. 961, 963 (H.L.)

open by the first case. The question of exemption in respect of import and export did not itself present much difficulty, either to the Government or to the business community during those years, but, as is well known, considerable complications were caused and uncertainties created by judicial pronouncements in respect of exemption under another head, namely, sales or purchase outside a State and sales or purchases in inter-State trade or commerce. Because of these complications and uncertainties, the Taxation Enquiry Commission[1] considered the question of inter-State trade in detail. The Commission found the dichotomy in article 286, as it then stood, unsatisfactory, and suggested that a new dichotomy should be adopted, namely, sales in the course of inter-State trade or commerce and sales not in the course of inter-State and commerce. Taxation of inter-State sales should be dealt with exclusively by the Centre, so as to secure uniformity and co-ordination. That Commission further recommended that the Central legislation, which would give effect to this recommendation, should also deal with the definition of the local of sales for the purpose of defining in detail the relevant jurisdictions of the Union and the States, and the States inter-se. Entirely irrespective of the power of the Central Government to levy a tax, the Commission said, that it was absolutely necessary that there should be a body of law which defines the circumstances in which a sale becomes taxable by a particular State and by no other. In support of the advantages of Parliamentary legislation as contrasted with the rigidity resulting from constitutional provisions, the Taxation Enquiry Commission made certain observations[2]. These observations were as follows :—

"We realise, of course, that the legislation itself may have to be modified from time to time in the light of new circumstances not fully provided for, or of judicial interpretation of the original provisions. Parliamentary legislation, as distinguished from constitutional provisions, will have the obvious advantage that these modifications can be made as required without undue delay or difficulty. It will not, of course, suffice to define the jurisdiction inter-se of individual States. The other important aspects of Central legislation would be the definition in adequate detail of what constitutes a sale or purchase in the course of inter-State trade

1. Taxation Enquiry Commission, Report (1953-54), Vol. 3, pages 48 to 62, paragraphs 8 to 22.
2. Taxation Enquiry Commission, Report (1953-54), Vol. 3, pages 58 59, paragraph 20.

or commerce. In this matter too, the embodient of the principles in an enactment of Parliament, and not in the Constitution itself, would have the advantage that the details of the law can, without undue rigidity, be modified to suit new facts or unforeseen circumstances. As we have stated, the Constitution itself would of course lay down the broad division of tax power between the Union and the States. The important fact would remain that all sales would fall under one or the other of these categories. The Union, which under the scheme would, of course, derive no revenue from the taxation of inter-State sales or purchases, would be solely interested, in the legislation which it promotes, in securing, from a practical angle, the maximum possible co-ordination between different States in regard to the operation of the inter-State sales tax and the maximum possible equity in the appointment of the relevant proceeds to the States in which the goods have been physically delivered and those from which the physical despatch has taken place. In the actual provisions of law, it will no doubt avoid the many pitfalls which have been a feature of the present constitutional provisions as they have been interpreted and implemented, and even if it does not fully succeed in doing so as the outset, the relevant legislation, as we have emphasised, can be modified at subsequent stages in conformity with the administrative and other requirements as they arise from time to time."

3.20 Having, thus, recommended that sales in the course of inter-State trade or commerce should be regulated by Central legislation, and that principles for determining when sales took place in the course of inter-State trade or commerce should be laid down by Parliamentary legislation, the Taxation Enquiry Commission recommended an amendment of the Constitution for conferring the necessary legislative powers on Parliament.

Along with this recommendation, relating to inter-State trade or commerce, the Taxation Enquiry Commission recommended an amendment of article 286 so that Parliament may, by law, also formulate principles for determining when a sale or purchase of goods takes place in the course of import or export[1].

Constitutional Amendment.

3.21. In pursuance of this recommendation of the Taxation Enquiry Commission, the Constitution (Tenth Amendment)

---

1. Taxation Enquiry Commission, Reports, (1953-54), Vol. 3, page 56, paragraph 15, sub-paragraph —C.

Bill[1] was introduced in Parliament, and under that Bill Parliament was empowered to formulate by law the principles for determining when a sale or purchase of goods takes place in one of the ways mentioned below :—

(i) outside a State;

(ii) in the course of the import goods into or export goods out of the territory of India;

(iii) in the course of inter-State trade or commerce.

This Bill became the Constitution (Sixth Amendment) Act, which revised article 286.

It may be stated that this power is couched in phraseology which does not compel Parliament to adopt the judicial construction placed on the constitutional power. The power is wide enough to empower Parliament to amplify or modify that construction, or to adopt a new one[2].

2nd Report of the Law Commission and Act of 1936.

3.22. The Law Commission was consulted as to the principles to be formulated under amended article 286, and the commission, with the intention of codifying what had been laid down in the *first Travancore* case and by the majority in the *second Travancore* case, suggested certain "propositions". On the basis of these proposition[3] section 5, Central Sales Tax Act, 1956 was enacted, dealing with a sale in the course of import or export.

Case law

Sections 3 and 4 of the Act also follow the Commission's recommendations, but we are primarily concerned with section 5. It may be noted that this was the view of the majority of the Law Commission.

3.23. Legislative determination (in section 5 of the Central Sales Tax Act)[4] as to when a sale is regarded as in "the course of import", did not prevent the accumulation of case law. The words "occasions the import" used in the section came up for judicial construction in several decisions, including *Khosla's* case. Most of the relevant decisions have been reviewed in the Report of the Law Commission[5] dealing with section 5. That Report was the aftermath of the judgment of the Supreme Court in *Khosla's* case.

---

1. The Constitution Tenth Amendment Bill actually passed as the Sixth Amendment.

2. See para. 3.69, *infra*.

3. 2nd Report of Law Commission.
See para. 3.26, *infra*.

4. Para. 3.22, *supra*.

5. 30th Report of the Law Commission.

3.24. An important question concerning section 5 was decided in the judgment of the Supreme Court, in *Khosla's* case[1]. At this stage, it will be sufficient to mention that in *Khosla's* case, it was held that the sale of the materials in question by *Khosla* to the Director General of Supplies and Disposals was so integrally connected with the import of those materials (at the earlier stage) from the Belgian manufacturers by *Khoslas*, that the sale to the Director General of Supplies & Disposals was to be regarded as having occasioned import, within the meaning of section 5.

The sale by *Khoslas*—which may be described as an internal sale—was not independent of the import, but had occasioned import, and was therefore held to be exempt under section 5 of the Central Sales Tax Act. Because of this Judgement, there is, at present, no right in the States to impose a tax on a sale between an Indian buyer and an Indian seller, if the transaction falls within the principle of *Khosla's* case. The question to be considered in this Chapter is, whether this position unduly restricts the taking power of the States.

3.25. The Central Sales Tax Act was itself enacted after consulting the Law Commission. After *Khosla's* case, the Law Commission was, in 1967, again requested to consider the question whether section 5 of the Central Sales Tax Act should be amended. The Commission recommended no change in the section. The question has now to be considered again, in view of the present reference.

Law Commission's earlier Report (2nd Report).

3.26. In the 2nd Report of the Law Commission, dealing with Parliamentary legislation relating to sales tax, the word 'occasion' was used by the majority of the Commission while suggesting the propositions to which legal effect should be given. The Commission,[2] (in its majority Report), after discussing the two *Travancore-Cochin* cases, came to the conclusion that the test of "occasioning" the movement lused in these cases) particularly in the light of the majority judgment in the second *Travancore* case should be adopted. But, the Commission made it very clear that it was not giving a draft.

---

1. *K. G. Khosla & Co.* V *Deputy Commissioner* (1966) 3 S.C.R. 352; A.I.R. 1966 S. C. 1216.

2. 2nd Report of the Law Commission on Parliamentary legislation, elating to sales tax, page 3, para 10.

3.27. Section 5 of the Central Sales Tax Act, which was enacted in implementation of the majority view in the 2nd Report of the Law Commission, was also intended to implement the law enunciated by the majority of the Court in the *Travancore-Cochin* cases. As observed by Shah J[1], in a later case[2], the Act gave legislative recognition to the view of the Supreme Court in the two *Travancore-Cochin* cases. This aspect of the matter was also adverted to in the 30th Report of the Law Commission.

Section 5 of the Central Sales Tax, Act 1956 implemented the law enunciated in the *Travancore-Cochin* case.

3.28. The word 'occasion' does appear to have a wide meaning as well as a narrow one, as already pointed out[3].

Wide meaning of 'occasion'.

It would appear that in *Khosla's case* the word 'occasion' (used in section 5 of the Central Sales Tax Act) received a wide interpretation whereunder the first sale after import becomes exempt, if certain conditions are satisfied. We have to examine if this wide view requires modification.

No doubt, the two *Travancore* cases did not relate to the border-line situation presented in *Khosla's case*.[4] The view taken by S. R. Das J., in his minority judgment in the second *Travancore* case, represented one extreme, that is to say, according to that view, the first sale after import and the last sale before export were to be *exempt in every case*. The argument that the first sale after import and the last purchase for export were exempt in every case was rejected by the majority in the second *Travancore-Cochin* case.

3.20. It is also true that in between the two extremes, many situations could arise, and in *Khosla's case* a broad view of the exemption was taken in respect of a sale which was treated as involving import.

Intention of majority in the second *Travancore* case.

However, it must be remembered that in *Khosla's* case, the Court was primarily concerned with the interpretation of section 5 and, as such, not necessarily bound by the earlier decisions in the *two Travancore* cases which dealt with the interpretation of article 286(1)(b). It is, therefore, permissible to infer that, in interpreting the word 'occasion' used in section 5, the Court may

1. See 30th Report of the Law Commission, page 60, para. 121.
2. *Bon Corn Nilgiri Plantation Co.* v. *Sales Tax Officer*, A.I.R. 1968 S.C. 1752, 1755.
3. Para. 3.14, *supra*.
4. See disussaion in 30th Report, page 32, para. 65(5).

have been justified in accepting the broader meaning of the word. We will refer to this aspect of the matter later,[1] when we examine the judgment in *Khosla's case* in greater detail.

Distinction between domestic sales and export sales.

3.30. A distinction between domestic sales and export sales was made in the second *Travancore* case, where the Supreme Court, in the majority judgment, said:[2]

> "As pointed out by a recent writer, from the legal point of view it is essential to distinguish the contract of sale which has as its object the exportation of goods from this country from other contracts of sale relating to the same goods, but not being the direct and immediate cause for the shipment of the goods..... When a merchant shipper in the United Kingdom buys for the purpose of export goods from a manufacturer in the same country the contract of sale is a home transaction; but when he resells these goods to a buyer abroad that contract of sale has to be classified as an export transaction: Schmittoff-Export Trade, 2nd Ed. page 3."

> "This passage shows that, in view of the distinct character and quality of the two transactions, it is not correct to speak of purchase for export as a purchase in the course of import. The same reasoning applies to the first sale after import which is a distinct local transaction effected after the importation of the goods into the country has been completed, and having no integral relation with it."

3.31. Perhaps, the words "distinct local transaction" used in the second *Travancore-Cochin* case[3] have been constructed as suggesting an antithetical situation, where the local transaction and the international transaction are not distinct from each other, but integral parts of the same transaction. But, as already stated,[4] according to the majority judgment, the intention was to exempt only the import-purchase and export-sale.

---

1. Para 3.47, *infra*.
2. *State of Travancore Cochin* v *S. V. C. Factory*. *A. I. R.* 1953 S. C. 333, 336.
3. Para 3.30, *supra*.
4. Para 3.29, *supra*.

3.32. At this stage, we may refer to several cases decided by the Supreme Court before *Khosla's* case. One of them which deals with inter-State sales, in *Tata Iron & Steel Co. v. S. R. Sarkar*,[1] on which the decision of the Supreme Court in *K.G. Khosla's case* is primarily founded. Some pre-*Khosla* cases-*case.*

In that case, the company had its registered office in Bombay, its Head Sales office in Calcutta in the State of West Bengal and its factories in Jamshedpur in the State of Bihar. The company was registered as a "dealer" under the Bihar Sales Tax Act, and was also registered as a "dealer" in the State of West Bengal under the Central Sales Tax Act, 1956. For period of assessment July 1, 1957 to March 31, 1958 the company submitted its return of taxable sales to the Commercial Tax Officer, Lyons Range, Calcutta, disclosing a gross taxable turnover of Rs. 9, 571.71 np. in respect of sales liable to Central Sales Tax in the State of West Bengal. By his memorandum dated August 12, 1959, the Commercial Tax Officer directed the company to submit a statement of sales from Jamshedpur for the period under assessment, "documents relating to which were transferred in West Bengal or of any other sales that may have taken place in West Bengal under section 3(b) of the Central Sales Tax Act, 1956." The company, by its letter dated September 30, 1969, informed the Tax Officer that the requisition for production of statement of sales made from Jamshedpur in the course of inter-State trade or commerce was without jurisdiction. The company contended that "all the sales from Jamshedpur were of the type mentioned in section 3(a) of the Central Sales Tax Act and at the same time, some of them also fell within the category mentioned in section 3(b) of the Act," that even if the sales were of the type mentioned in section 3(b) of the Act, the apporpriate State of the place where the sales take place or are effected alone had jurisdiction to assess such sales to Central Sales Tax, and that in respect of inter-State sales from Jamshedpur, the suits of the sale was always the State of Bihar as the goods were in Bihar either at the time of the contract of sale or at the time of appropriation to the contract." By his order dated October 21, 1959, the Commercial Tax Officer made a "best judment assessment" on a gross turnover of Rs. 90,00,09,561.71 np. of inter-State sales and called upon the company to pay Rs. 41,14,718.12 np. as tax under the Central Sales Tax Act.

1. *Tata Iron & Steel Co.* v. *S. R. Sarkar*, (1961) 1 S.C.R. 379; A.I.R. 1961 S.C. 65, 71, 72; 11 S.T.C. 655.

3.33. The company had, on December 15, 1958, filed with the Sales Tax Officer, Jamshedpur a return of inter-State Sales made from Jamshedpur for the period July 1, 1957 to March 31, 1958 and a return for the same period for the sales made from Dhanbad with the Sales Tax Officer, Dhanbad. In these returns, the company included all sales in which movement of the goods had taken place from the State of Bihar to destinations outside that state. The total turnover in respect of inter-State sales as shown in the return exceeded Rs. 26 crores and the company paid as required by the Bihar Sales Tax Act Rs. 71 lakhs odd as advance tax under the Central Sales Tax Act, 1956.

By this petition, the company impugned the validity of the order of the Commercial Tax Officer and claimed a writ of certiorari quashing and setting aside the assessment order dated October 21, 1959, and a writ of mandamus directing the Commercial Tax Officer to refrain from taking steps in enforcement or implementation of the order.

3.34. Mr. Justice Shah delivered the majority judgment. He first discussed the effect of the various amendments made by the Constitution (Sixth Amendment) Act of 1956 (investing Parliament with exclusive authority to enact laws imposing tax on sales or purchases taking place in the course of inter-State trade).

The actual discussion related to inter-State sales and *inter alia* to the question how far section 3(a) or section 3(b) of the Central Sales Tax Act applied to the sales in question.

According to the majority, the decision in the two cases had no bearing on the interpretation of section 3, clauses(a) and (b). In those cases, the expression "in the course of import and export" and "in the course of inter-State trade or commerce" used in article 286 fell to be determined. The Constitution did not define those expressions, and Parliament had, in the Central Sales Tax Act, sought to define (by section 3) when a sale or purchase is said to take place in the course of inter-State trade or commerce and to define (by section 5) when a sale or purchase is said to take place in the course of import or export, and further to define (by section 4) when a sale or purchase of goods is said to take place outside a State. In delivering the majority judgment, Mr. Justice Shah observed[1] :—

> "In interpreting these definition clauses, it would be inappropriate to requisition in aid the observations

1. *Tata Iron etc. v. S. R. Sarkar*, (1961) 1 S.C.R. 379, 391; A.I.R. 1961 S.C. 65, 71, 72; 11 S.T.C. 655;

made in ascertaining the true nature and incidents without the assistance of any definition clause of "sale outside the State" and "sale the course of import or export" and "sale in the course of inter-State trade or commerce" used in article 286.

"In our view, therefore, within clause (b) of section 3 are included sales in which property in the goods passes during the movement of the goods from one State to another by transfer of documents of title thereto; clause (a) of section 3 covers sales, other than those included in clause (b), in which the movement of goods *from one State to another is the result of a covenant or incident of the contract of sale*, and property in the goods passes in either State."."

3.35. In his minority judgment, Mr. Justice Sarkar (as he then was) expressed the view, that a sale cannot fall under both clause (a) and clause (b) of section 3. For, then, it would be liable to be taxed twice. Clauses (a) and (b) were mutually exclusive. Interpreting these two clauses, he said that clause (a) contemplates a sale where the contract of sale occasions the movement of the goods sold, and clause (b), a sale where transfer of property in the goods sold is effected by a transfer of documents of title to them. Of course, in the first case, the movement of the goods must be from one State to another, and in the second, the documents of title must be transferred during such movement.

Distinction between "for export" and "in the course of export".

3.36. This decision raises the question whether, if the words "in the course of", which occur in article 286(1), had been left undefined, the kind of conclusion arrived at in *Khosla's case* could have been avoided. The matter, though now academic, is of interest. A distinction between a sale "for export" and a sale "in the course of export[1]" was well-established by 1956, the former being regarded as outside the exemption (in article 286), and the latter being regarded as within the exemption.

Ben Gorm case.

3.37. In the *Ben Gorm*[2] case, on the facts of the case, the sale was regarded as not exempt. The purchasers were *local*

1. See 30th report, page 42, paragraph 93 (3)(a), and the *Ben Gorm case*. Para 3.37, *infra*.

2. *Ben Gorm Nilgiri Plantation Co.* V. *Sales Tax Officer*, A.I.R. 1964 S.C. 1752, (1964) 7 SCR 706.

*agents of foreign buyers*, and the purchase was not "in the course of export". But the judgment of the majority in that case would seem to suggest that if the integrated activity was such that the export was a necessary condition of the contract, and if there was no likelihood of diversion, then, the sale woud be in the course of export. The minority view in that case went further. It was prepared to extend that principle to a contract in which export could be *taken to the intended, and would not necessarily* confine it to cases where there was an *express provision* for the export of the goods purchased in India.

The ratio *in Ben Gorm* case.

3.38. Mr. Justice Shah, who delivered the majority judgment, laid down the principles applicable in such cases as follows[1]:—

(1) Before the Constitution Amendment of 1956 there was no legislative guidance, but such cases were governed by the interpretation put on the constitutional provisions in the two *Travancore* cases[2-3].

(2) After the amendment of 1956, guidance was provided in section 5 of the Central Sales Tax Act, which was "legislative recognition" of what was said by the Supreme Court in the two *Travancore cases*.

(3) There is a distinction between a sale "for export" and a sale "in the course of export"—

(a) In general, where the sale is effected by the seller and he is not connected with the export which actually takes place, it is a sale "for export". As an example, where a foreign purchaser or his agent purchases goods within India and they or one of them export or exports the goods out of India, the sale would be sale "for export", but such a transaction is not "in the course of export even though the Indian seller had the knowledge of intended export.

---

1. *Ben Gorm Nilgiri Plantation Co.* V. *Sales Tax Officer*, (1964) 7SCR 706, 711, 712. AIR 1964 SC 1752.

2. (1952) S.C.R. 1112 (First *Travancore* case).

3. (1954) S.C.R. 53 (Second *Travancore* case).

(b) Where the export is the result of a sale and the export is inextricably linked up with the sale, so that the bond cannot be dissociated without a breach of contract, the sale is in the course of export.

3.39. In the majority judgment,[1] it was held that the knowledge that the goods purchased are intended to be exported, did not make the sale and export parts of the 'same transaction'. There was no *statutory obligation* upon the purchaser to export the chests of tea purchased by him with the export rights. The export quota *merely enabled* the purchaser to obtain an export licence, which the purchaser may or may not obtain. There was nothing in law or in the contract between the parties, or even in the nature of the transaction, which prohibited diversion of the goods for internal consumption. The sellers had no concern with the actual export of the goods. Once the goods were sold, they (the sellers) had no control over the goods. There was therefore, no direct connection between thre sale and export of the goods, which would make them parts of an *integrated transaction* of "sale in the course of export." Knowledge of export does not make it an integral part.

3.40. Thus, several tests for determining when a sale is in the course of export, were discussed in the *Ben Gorm* case,[2] but none was regarded as applicable on the facts. The tests discussed were:— The tests which were found inapplicable in *Ben Gorm case.*

(i) obligation;

(ii) non-divertibility;

(iii) direct connection;

(iv) part of the same transaction.

We do not pause to discuss various other judicial decisions of the Supreme Court and the High Courts before and after *Khosla's case,* as these have been exhaustively reviewed in the earlier Report.[3]

---

1. *Ben Gorm Nilgiri Plantation Co.* V. *S.T.O.* (1964) 7 S.C.R. 706, 713 AIR 1964 SC 1752.

2. Para 3.38 to 3.39, *Supra.*

3. 30th Report of the Law Commission.

*Khosla's* case-facts of

3.41. We shall now concentrate on *Khosla's case.*[1] The facts of that case were these:—

*K. G. Khosla & Co.,* the asessee, entered into a contract with the Director General of Supplies & Disposals, New Delhi for the supply of "axle-box bodies". The contract provided for the manufacture of boxes in Belgium and the inspection of the manufactured articles at the work of the manufacturers by a representative of D.G.I.S.D., London who was to issue an inspection certificate. A second inspection by the Deputy Director of Inspection, Ministry of W.H. & S., Madras was provided in the contract. He was to issue inspection notes on receipt of a copy of the inspection certificate from London after verification and visual inspection by him. The contract also provided that goods were to be manufactured according to specifications by M/s. La Brugeoises Et. Nivelles, Belgium. Khosla & Co. were entitled to be paid 90 per cent of the price after inspection and delivery of the stores to the "consignee", and the balance of 10 per cent was payable on final acceptance by the "consignee". It appears that "consignee" denoted the buyer of his nominee. In the case of deliveries on f.o.r. basis, the assessee was entitled to 90 per cent payment after inspection on proof of despatch and balance 10 per cent after receipt of the goods by the "consignee" in good condition. The date of delivery, according to the contract, was "in 8 months ex-your principal's works from the date of receipt of order and the approved working drawings, i.e., delivery in India by 31st July, 1957, or earlier." The assessee was responsible for the execution of the contract in accordance with terms and conditions as specified in the tender and the Schedule attached thereto. The "purchaser", notwithstanding the approval by the inspector, could reject the stores on arrival if they were found to be not in accordance with the terms and conditions of the contract. Further, K. G. Khosla & Co., was responsible for the safe arrival of the goods at the destination. The D.G.I.S.D., London was to issue pre-inspection delay reports regularly to the D.G.S. & D., New Delhi. He was also to send copies of the inspection certificates to the Director of Inspection, Ministry of W.H. & S., Bombay. Under the Bills of lading, the goods

---

[1] *K.C. khosla & Co. Pvt. Ltd.* v. *Deputy Commissioner of Commercial Taxes, Madras,* A.I.R. 1966 S.C. 1216, 17 S.T.C 473, (1966) 3 S.C.R. 352.

were consigned to be cleared by K. G. Khosla & Co. to Madras Harbour. They were cleared by K. G. Khosla's clearing agents, and despatched for delivery to the buyers thereafter.

3.42. The Sales Tax Officer, Madras found that the transaction was an intra-State sale and not in the course of import because, the sale was completed only when goods were delivered in Madras State and, therefore, it did not occasion the import. He also relied on the terms of the contract which gave to the purchaser the right to reject the goods if they were not in accordance with the terms and conditions of the contract. On appeal, the Appellate Tribunal held that the property in the goods had not passed to the buyer while the goods were with the Belgiam manufacturers and that the sale had not occasioned the import.

3.43. The matter was taken to the Madras High Court in revision. The High Court rejected the contention that the goods must be deemed to have passed to the buyers when the goods were approved in the factory of the manufacturers. It also rejected the contention that the sale by the assesses to the Government occasioned import. In the High Court's view it was necessary that the sale should have proceded the import, and as the sale had not taken place in Belgium, there was no question of the sale occasioning import of the goods.

3.44. Against this judgment, K. G. Khosla & Co. appealed to the Supreme Court. The Supreme Court held that the transaction was not subject to payment of sales tax, as it fell within the prohibition of article 286(1)(b) read with section 5 of the Central Sales Tax Act. In interpreting the words "occasions the movement of goods" in section 5(2), the Supreme Court expressed the view that the words used in section 3(a) and 5(2) of the Central Sales Tax Act should have the same meaning in the two sections, and therefore relied on the interpretation of section 3(a) by Mr. Justice Shah[1] in the *Tata Iron & Steel Co. case.*

After referring to various judgments, the Supreme Court held, that the High Court was in error in holding that "before a sale could be said to have occasioned the import, it is necessary that the sale should "have preceded the import"[2]

---

1. *Tata Iron and Steel Co. Ltd. v. S.R. Sarkar*, para. 3.34 to 3.37 *supra.*
2. Para 3.43, *supra.*

3.45. The Supreme Court also held that the movement of the axle-box bodies from Belgium into India (Madras) was the result of the covenant in the contract of sale and was an incident of such contract. The Supreme Court lastly observed :

> "It seems to us that it is quite clear from the contract that it was incidental to the contract that the axle-box bodies would be manufactured in Belgium, inspected there and imported into India for the consignee. Movement of goods from Belgium to India was in pursuance of the conditions of the contract between the assessee and the Director-General of Supplies. There was no possibility of these goods being diverted by the assessee for any other purpose. Consequently we hold that the sales took place in the course of import of goods within section 5(2) of the Act, and are, therefore, exempt from taxation."

*Khosla's* case summarised.

3.46. The propositions laid down in *K. G. Khosla's case* may be thus summarised :—

(1) Article 286(1)(b) of the Constitution read with section 5, Central Sales Tax Act, exempts transactions from sales tax where the sale occasions the movement of goods from or to a foreign country into or from the territories of India, the movement itself being the result of a covenant or an incident of the contract of sale.

(2) It is an erroneous view of the law to think that before a sale could occasion the import, the sale should have preceded it.

(3) The contract itself showed that it was an incident of the contract that axle-box bodies would be (a) manufactured in Belgium, (b) inspected there, and (c) imported for the consignee (the buyer).

(4) Movement of goods from Belgium to India was in pursuance of the conditions of the contract.

(5) There was no possibility of the goods being diverted by K. G. Khosla for any other purpose or to any other contract.

(6) As in inter-State sales where property in the goods could pass in either State, the property could pass in either country.

Case decided exclusively on section 5.

3.47. *Khosla's case* was decided exclusively[1] on section 5 of the Central Sales Tax Act, and irrespective of article 286(1). Whether, after the passing of the legislation by Parliament formulating the principles referred to in article 286—*i.e.* the Central Sales Tax Act, 1956, Sections 3, 4 and 5—it is still necessary, in testing the validity of taxation by a State of the particular sale or purchase, to have recourse to article 286 of the Constitution, or whether the Court is to apply only the provisions of the Central Sales Tax Act relevant to the exemption claimed, is a question which is of considerable importance.

It was presumably assumed in *Khosla's case* that since Parliament had formulated principles in section 5, the test was to be sought only in that section. Apparently because of this implicit assumption, when *Khosla's case* was argued, the earlier decisions, particularly the decisions in the two *Travancore* cases, were not referred to, and the judgment of the court seems to have been based entirely on the language of section 5, without the aid of the discussion and pronouncements in the two *Travancore* cases.

Interpreting then, section 5, and taking into account only the language of section 5, the Supreme Court, in *Khosla's* case, selected, out of the two views possible as to a sale which is to be exempt as occasioning import, the wider view, which had the effect of holding that the chain of sales exempt is not necessarily confined to the import or to the sale ending with the entry of the goods into India at the customs barrier, but could, at least in the situation which presented itself in *Khosla's case*, extend beyond that point.

3.47A. In regard to the decision in *Khosla's* case, it is relevant to repeat that during the course of the arguments, the two *Travancore* decisions, which would have supported the case of the State, do not appear to have been cited on behalf of the State, nor were they cited by the assessee. And, for the assessee, reliance was placed mainly on the *Tata Iron & Steel* case. Since the parties in the case concentrated their attention on section 5, *Khosla's case* appears to have been decided independently of article 286, and on the basis only of section 5 of the Act. Because

1. Para 3.29, *supra*.

of the several distinct features of the transections with which the Court was dealing in *Khosla's case*, the purchase by Khosla from the Belgium firm and the sale by him to the Railways constituted, were regarded as inseparable. The argument that there were two different and distinct transactions—the first of which was exempt from tax, but the second was not (on the principle laid down by the Supreme Court in the two *Travancore* cases), does not appear to have been advanced.

**30th Report**

3.48. The judgment in *Khosla's case* led to a reference to the Law Commission by the Government of India in 1967. Attention to this judgment had been drawn by the State Government of West Bengal, since the judgment circumscribed the power of the State Government to impose sales tax on certain types of transactions. The exact question referred to the Law Commission in 1967 was[1] the following :—

> "Since the provisions of section 5 of the Central Sales Tax Act incorporate *verbatim* the principles recommended by the Law Commission on the basis of the earlier Supreme Court judgments in Travancore-Cochin cases, the Commission is requested to examine the matter further and consider whether they would recommend any amendments of the Act, so as to exclude transactions of the type hereinbefore discussed from the purview of section 5 of the Central Sales Tax Act."[2]

3.49. The Law Commission[3] in the reference took into account the history of the Act of 1956, judicial decisions prior as well as subsequent to that Act relating to the boundaries of the ban under article 286(1)(b) of the Constitution (imposition of sales tax on import sales), and the judgment under consideration (*Khosla's case*). The majority of the Commission took the view that the propositions which emerged from the judgment in

---

1. 30th Report of the Law Commission (Section 5 of the Central Sales Tax Act etc.) (February, 1967), page 3, para 5.

2. Second Report of the Law Commission—Parliamentry legislation relating to Sales Tax (1956).

3. 30th Report of the Law Commission (Section 5 of the Central Sales Tax Act—Taxation by the States on sales in the course of import). (February 1957), page 65, paragraph 130.

*Khosla's case* were consistent with the two *Travancore* cases on which the earlier Report of the Law Commission was based, and did not go beyond the intendment of these decisions. The minority (Shri K. G. Datar and Shri R. P. Mookerjee) took a contrary view.

The Commission, of course, took care to mention that it was permissible to bring about a suitable modification of the position in such manner as may be legally appropriate, but the Commission did not profess to deal with matters of policy.[1] For the sake of convenience, however, the Commission summarised several suggestions[2] received by it, and brought them to the notice of the Government.

After this Report,[3] there have been no notable legislative developments, relevant to the question under consideration.

Decisions after *Khosla's* case-import sales.

3.50. We shall now refer to a few decisions subsequent to *Khosla's case*. In the *State of Bihar* v. *Tata Engineering Co.*,[4] the Supreme Court stated that the decided cases established that sales will be considered as sales in the course of export or import or sales in the course of inter-State trade and commerce under the following circumstances:

(1) When goods which are in the export or import stream are sold;

(2) When the contracts of sale or the law under which goods are sold require those goods to be exported or imported to a foreign country or from a foreign country as the case may be, or the goods are required to be transported to a State other than the State in which the delivery of goods takes place, and

(3) Where, as a necessary incident of the contract of sale, goods sold are required to be exported or imported or transported out of the State in which the delivery of goods take place.

---

1. 39th Report of the Law Commission (Section 5 of the Central Sae Tax Act) Taxation by the states on Sales in the course of (import) (February, 1967), page 65, paragraph 135.
2. See para 3.11, *supra*.
3. 30th Report, page 65, page 131.
4. *State of Bihar* v. *Tata Engineering & Locomotive* (P.) Ltd. (1971) 27 S.T.C. 127, 149 (S.C.); A.I.R. 1971 S.C. 477.

Application of *Khosla's* case to export sales.

3.51. In another recent case relating to export sales,—*Tata Engineering Co.* v. *Asst. Commissioner*,[1] the Supreme Court, after referring to the earlier decisions, observed—

"It has been laid down that the sale in the course of export predicated a connection between the sale and export, the two activities being so integrated that the connection between the two cannot be voluntarily interrupted without a breach of the contract or the compulsion arising from the nature of the transaction. To occasion export, there must exist such a bond between the contract of sale and the actual exportation that each link is inextricably connected with the one immediately preceding it. The principle[2] thus admits of no doubt, according to the decisions of this court, that the sales to be exigible to tax under the Act (Central Sales Tax Act, 1956) must be shown to have occasioned the movement of the goods or articles from one State to another. The movement must be the result of a covenant or incident of the contract of sale."

It will be noticed that according to the judgments referred to above, the essential test is of an integral connection between the sale sought to be taxed and the import.

Application of the principle to inter-sales—a Kerala case.

3.52. This test of integrated connection has been applied to inter-State sales also. "To occasion export, there must exist such a bond between the contract of sale and the actual exportation, that each link is inextricably connected with the one immediately preceding it." So observing, the Kerala High Court[3] treated a sale in the following circumstances, as an inter-State sale. The facts were as follows:—

The assessee, a dealer in coir-yarn in the (erstwhile) Travancore-Cochin State, effected sales of coir-yarn to certain firms in port Cochin (then in the Madras State). The assessee used to go to the firm at port Cochin and enter into written agreements with them as to specified varieties of coir yarn, with reference to samples shown to and retained by the purchasing firms. The price per candy of coir would be fixed. The assesee then used

---

1. *Tata Engineering & Locomotive Co. Ltd.* v. *Assistant Commissioner of Commercial Taxes*, (1970) 1 S.C.J. 622; 26 S.T.C. 354 A.I.R. 1970 S.C. 1281 (1970) 3 S.C.R. 862.
2. This Sentence relates to Inter-State Sales.
3. *N.K. Subramaniam* v. *The State of Kerala*, (1971) 28 S.T.C. 733, 735 (Kerala).

to purchase coir from various manufacturers, transport the goods at his expense to the purchasing firm at port Cochin, and, when the goods arrived at port Cochin, the assessee, or his agent used to deliver the goods to the purchasers and receive an advance payment. After a week or two, the coir would be tried, inspected and re-handled, and the rate would be fixed. After final weighment and bailing, the invoice would be drawn and the balance due would be received. On these facts, it was held that the inter-State movement of the goods from the (erstwhile) Travancore Cochin State to the (erstwhile) Madras State was the direct result of a covenant or incident of the contract of sale. Thus, the principles which had been applied in relation to export sales[1] and import sales[2] was applied to inter-State sales also.

*Binani's case.*

3.52A. Recently, an important judgment relating to import sales—*Binani's case*—has been pronounced by the Supreme Court. We shall refer to this later.[3]

Patna cases relating to inter-State sales.

3.53. It was conceded in a recent Patna case[4] that the ingredients for holding that a sale or purchase of goods is in the course of import or in the course of export or in the course of inter-State trade or commerce, are similar.

A border-line case.

3.54. There are, no doubt, cases on the border-line. A Madras case is in point.[5] In that case, the National Agricultural Marketing Federation, which had the exclusive right to export dried chillies to Ceylon, entered into contracts with various co-operative establishments in Colombo for supplying chillies. Thereafter, the Federation allotted quotas to various dealers in the State of Tamil Nadu for the supply of chillies, for which purpose it entered into separate contracts with those dealers. The contract entered into by the Federation with one of the dealers—the assessee—provided (besides other matters) that the assessee should despatch the goods to the importer in Colombo, *for and on behalf of the Federation,* on or before the stipulated date, from the port of Tuticorin. It was held that the sale between the Federation and the assessee was not an export sale.

---

1. *Ben Gorm case*, A.I.R. 1964 S.C. 1752.
2. Compare *Khosla's case*, A.I.R. 1966 S.C. 1246 (1966) 3 S.C.R. 352.
3. Para 3.55, infra.
4. *Commissioner of Commercial Taxes* v. *Bhag Singh Milkha Singh* (1971) 28.S.T.C. 649, 651.
5. *Erattamuthu Nadar* v. *Joint Commercial Tax Officer*, (1971) 28 S.T.C. 649, 651 (Madras).

The stipulation in the contract (between the assessee and the Federation) requiring the assessee to put the goods on board the ship, was only to fulfil the terms of the export sale between the Federation and the foreign importer, and did not mean that transaction was inextricably connected with the export sale. The export sale was the result of the contract between the importer in Ceylon and the Federation in India. Instead of the Federation taking delivery from the assessee, the assessee, on behalf of the Federation, put the goods on board the ship, but the sale between the Federation and the assessee did not occasion export.

*Binani* Brothers' case.

3.55. Import sales came up before the Supreme Court in a recent case,—*Binani Brothers* v. *Union of India*.[1] The question related to sales tax in respect of stores supplied to the Director General of Supplies and Disposals which had been specifically imported against licences issued by the Chief Controller of Imports and Exports, on the basis of the import recommendation certificate issued by the Director General of Supplies and Disposals (or other authority like the State Trading Corporation). The transaction was held not to be exempt as a sale in the course of import.

3.55A The facts in detail were as follows:—

The petitioner was an importer and a dealer in non-ferrous metals (zinc, lead, copper, tin etc.), and was on the approved list of registered suppliers to the D.G.S&D. The petitioner had been importing and supplying non-ferrous metals to respondents Nos. 1, 2 and 3 during the past several years. The Government of India,in placing an order with the petitioner, used to grant import licences in terms of the contracts. On the basis of the judgment of the Supreme Court in *Khoslas case*[2] the respondent No. 2, issued an order to all the authorities concerned, including respondent No. 4 (namely, the Pay and Accounts Officer, Ministry of Works, Housing and Supply) directing that sales tax should not be allowed in respect of supplies/stores which had been specifically imported against licences issued by the

---

1. *M/s. Binani Bros. (P.) Ltd.* v. *Union of India and* others (W.P. No. 39 of 1969), (11.12.1973) (Ray C.J.)
   Khanna, Mathew, Alagiriswami and Bhagwati, JJ) Judgment by Mathew J. (1974) S.C.T. page 29, item 17; (1974) 1 S.C.C. 459, 474 (S.C.C. 1st April, 1974).
2. *K.G. Khosla* v. *Dy. C.C.I.* (supra).

Chief Controller of Imports and Exports on the basis of import recommendation certificate issued by the D.G.S & D. (or other authority like the S.T.C.) for supplies against contracts. The respondent No. 4, in pursuance of the said order, deducted a sum of Rs. 66,780 from the amount payable to the petitioner in respect of pending bills, and also threatened to recover Rs. 235, 130, being the amount paid by respondent No. 2 as sales tax, in respect of contracts which had already been executed. The petitioner contended that the transctions in question, namely, the sales which the petitioner made to he D.G.S. & D., were not sales which occasioned the movement of the goods in the course of imports, and were separate and distinct from the contracts of purchases made by the petitioner with the foreign sellers. The later alone occasioned the movement of the goods in the course of import and the decision in *Khosla's case* was not applicable.

3. 56. It was held that the transactions in question which the petitioner entered into with the D.G.S&D. were not "sales in the course of import," but were separate and distinct from the contract of purchases made by the petitioner with the foreign sellers. The latter alone occasioned the movement of the goods in the course of import. *Khosla's case* was distinguished, .... apparently on the ground that in that case there was an obligation to import, while there was, in the present case, no obligation regarding import. The court made these points in arriving at its conclusion:—

(a) In the case under consideration, the court was concerned with sales made by the petitioner as *principal* to the D.G.S&D. No. doubt, for effecting these sales, the petitioner had to purchase goods from foreign sellers and it was these purchases from the foreign sellers which occasioned the movement of goods in the course of import.

(b) The petitioner's sales to the D.G.S&D. were however, *distinct* and separate from his purchases from foreign sellers. To put it differently, the sales by the petitioner to the D.G.S&D. did not occasion the import. It was purchases made by the petitioner from the foreign sellers which occasioned the import of the goods.

(c) The foreign sellers did not enter into any contract, by themselves or through the agency of the petitoner, with the D.G.S&D., and the movement of goods from the foreign countries was, therefore, not occasioned

on account of the sales by the petitioner to the D.G.S&D.

(d) There was no obligation under the contracts on the part of the D.G.S&D. to procure import licences of petitioner. On the other hand, the recommendation for import licence made by D.G.S&D. did not carry with it any imperative obligation upon the Chief Controller of Imports and Exports to issue the import licence. It may appear from this judgment that *Khosla's case* will, in future, be strictly limited to cases where there is an obligation to import.

3.57. The following observations distinguishing *Khosla's case* are of importance.

"In *Khosla's case*, it might be recalled that Khosla and Co. entered into the contract of sale with the D.G.S&D. for the supply of axle bodies manufactured by its principal in Belgium and the goods were to be inspected by the buyer in Belgium but under the contract of sale the goods were liable to be rejected after a further inspection by the buyer in India. It was in pursuance of this contract that the goods were imported into the country and supplied to the buyer at Perambur and Mysore. *From the statement of facts of the case as given in the judgment of the High Court it is not clear that there was a sale by the manufacturers in Belgium to Khosla & Co. their agent in India.* It would seem that the only sale was the sale by Khosla & Co. as agent of the manufacturer in Belgium.[1] In the concluding portion of the judgement of this Court, it was observed as follows:—

". . . . . It seems to us that it is quite clear from the contract that it was incidental to the contract that the axle-box bodies would be manufacturered in Belguim, inspected there and imported into India for the consignee. Movement of goods from Belgium to India was in pursuance of the conditions of the contracts between the assessee and the Director-General of Supplies. There was no possibility of these goods being diverted by the assessee for any other purpose. Consequently we hold that the sales took place in the course of import of goods within section 5(2) of the Act, and are, therefore, exempt from taxation. As

1. Emphasis supplied.

already stated, there was to be an inspection of the goods in Belgium by the representative of the D.G.S&D. but there was no completed sale in Belgium as, under the contract, the D.G.S&D. reserved a further right of inspection of the goods on their trival in India."

*Two views possible—as to the word "occasion".*

3.58. As is apparent from the above discussion, two views are possible as to whether the word "occasions" can be construed widely as was done in *Khosla's case.* Words like 'occasion', 'case' and the like, are vague and formless, when used in the abstract. Two interpretations possible on the word 'occasion'.

As Lord Reid said recently:[1]

"In very many cases it cannot be said positively that one construction is right and other wrong. Construction so often depends on weighing one consideration against another. Much may depend on one's approach. If more attention is paid to meticulous examination of the language used in the statute, the result may be different from that reached by paying more attention to the apparent object of the statute so as to adopt that meaning of the words under consideration which best accord with it."

3.59. The word "occasion" could be, very roughly, interpreted as having a meaning approaching the meaning usually attributed to the word "cause". On such interpretation, one could state that it is because of the contract of sale between the parties that the materials had their movement from the foreign country to India, and the contract of sale between the parties has (in that sense) "occasioned the movement of the goods" into the territory of India, by way of import. 'occasion' and 'cause'.

Any argument that by virtue of the decision in *Khosla's case,* the first sale after import is regarded as 'occasioning the import' within section 5, would require a discussion of what is meant by the word "occasion" or "cause".

3.60. The meaning of the expression "cause" may, therefore, be usefully examined at this stage. "Cause" originally meant both "cause" and "reason". "Cause" is the condensed expression of the factors of any phenomenon, the effect being the fact itself."[2]

1. *R.* v. *National Ins. Comm. Ex parte Hudson* (1972) 2 W.L.R. 210, 215 (H.L.) (per Lord Reid).

2. 2 G.H. Lewes, Problems of Life and Mind, sec. 19 cited by Prescott Hall, "Doctrine of Proximate Cause" 15 Ea Harv. L. Rev. 541, 566.

> "Of these two senses of the word 'cause', viz. that which brings a thing to be, and that on which a thing under given circumstances follows, the former is that of which our experience is the earlier and more intimate, being suggested to us by our consciousness of willing and doing."[1]

3.61. On the general question of causation, there is an illumination passage in the speech of Lord Shaw of Dunfermline, in a case[2] often cited :—

> "To treat proxima cause as the cause which is nearest in time is out of the question. Causes are spoken of as if they were as distinct from one another as heads in a row or links in the chain, but—if this metaphysical topic has to be referred to—it is not wholly so. Causation is not a chain, but a net. At each point influences, forces, events, precedent all simultaneously meet ; and the radiation from each point extends infinitely. At the point where these various influences meet, it is for the judgment, as upon a matter of fact, to declare which of the causes thus joined at the point of effect was the proximate and which was the remote cause."

(This passage may have been partly inspired by the argument of Wright K. C.).

Selection of cause implicit.

3.62. In another case[3], Viscount Simon L. C. said :

> "The interpretation to be applied does not involve any metaphysical or scientific view of causation. Most results are brought about by a combination of causes, and a search for 'the cause' involves a selection of the governing explanation in each case."

In the same case, Lord Wright said :

> "This choice of the real or efficient cause from out of the whole complex of the facts must be made by applying common sense standards."

---

1. J. H. Newman, Grammer of Assent, 65.
2. *Ley and Shipping Co. Ltd.* v. *Norwich Union Fire Insurance Society Ltd.* (1918) A.C. 353, 369 (Compare Arguments of Wright K.C. at page 352, 353.
3. *Yorkshire Dale S.S. Co. Ltd.* v. *Minister of War Transport, The Cobwold* (1942) A.C. 691, 698, 706.

3.63. In yet another case[1], Denning L. J. said :

> "It is always a matter of seeing whether the particular event was sufficiently powerful a factor in bringing about the result as to be properly regarded by the law as a cause of it. .....".

Direct cause nearest to legislative intention in section 5.

3.64. Of the various kinds of "causes" discussed above, we think that the one nearest to the legislative intention in section 5 of the Central Sales Tax Act is the direct or immediate cause[2]. Even that is somewhat wider than what was intended. The word "occasion" was really used in the sense of a sale which itself *constitutes the import.*

*Parliament's intent*

Sale after import intended to be excluded by Parliament.

3.65. No doubt, even under *Khosla's case* every sale after import is not exempt. But even the situation where the import is an integral part of the sale (as in *Khosla's case*) was, in our view, intended to be excluded from the scope of section 5 according to what we presume to be the intention of Parliament.

*Conclusion*

Modification whether needed—discussion confined to legal aspects.

3.66. It is in the light of this background that we have to examine whether the position resulting from *Khosla's case* should be modified. We shall confine ourselves to the legal aspects of the matter.

3.67. In our opinion, when Parliament, in enacting section 5, used the word 'occasion', it presumably intended to adopt the narrow interpretation placed upon the word by Patanjali Sastri CJ., who spoke for the majority of the Court in the second *Travancore case*. We are, therefore, inclind to recommend that the broad interpretation placed on that word in *Khosla's* case needs to be legislatively restricted.

Two propositions which will have to be given effect to.

3.68. In view of what is stated above, we recommend an amendment of the Central Sales Tax Act which will give effect to the following propositions[3]—

(1) A purchase of goods made by an exporter from a local seller for the purpose of exporting them in order to

---

1. *Cork* v. *Kirby Maclean Ltd.* (1952) 2 All. E.R. 402, 407.
2. Cf. para 3.30 *supra.*
3. This is not a draft.

implement a contract of sale with a foreign buyer, shall not be deemed to be a purchase which has occasioned the export, even if it be a term of the contract of purchase that the goods shall be exported, and even if, pursuant to such contract, the goods are exported and even if the goods would not have been exported but for the aforesaid term of contract.

(2) A sale of goods made by an importer to a local buyer in order to implement a contract of sale with the local buyer, shall not be deemed to be a sale which has occasioned the import, even if it be a term of the contract of sale that the goods shall be imported, and even if, pursuant to such contract, the goods are imported and even if the goods would not have been imported but for the aforesaid term of contract.

Power to formulate a wide one.

3.69. Such an amendment will fall under article 286(2). We may state here[1] that the power to formulate principles under article 286(2) of the Constitution is, no doubt, a wide one; and, Parliament in exercise of this power, is not confined to merely codifying or adopting pre-existing judicial interpretation as we have already pointed out[2]. Operating within the limits necessarily implied by the expressions "import" and "export", Parliament can formulate principles which would codify the existing judicial interpretation, modify it, or extend it, or even adopt an entirely new approach. In other words, it is not merely the mechanical and verbal formulation of something which is already existing that is contemplated, but a certain amount of discretion is implicit, particularly because the power is a power to "formulate" principles—a creative function.

3.70. This is not to say that it is an unlimited power. Some time ago, a distinguished writer[2], while discussing the subject of judicial discretion in the interpretation of statutes, stated :—

> "A judge has discretion to include a flying boat within a rule as to ships or vessels. He has no discretion to include a motor-car within such a rule."

This is true of the power to formulate principles also.

---

1. See also para 3.21, supra.
2. Glanville Williams, "Language and Law", 61, L. R. 71, 302.

The principles to be formulated will not, therefore, overstep the field of "import" or "export". But, as already stated[1], within the limits indicated by import and export, there is considerable latitude, even as regards principles which may be derived from judicial decisions. The task of Parliament is creative because "cases do not unfold their principles for the asking"; and it may be necessary for Parliamentary legislation to define them from time to time, as occasion arises[2].

Judges, in the judicial process, can go with their logic, their analogies, their philosophies, till they reach a certain point. As Cardozo has pointed out[3] :—

> "At first, we (judges) have no trouble with the paths, they follow the same lines. Then they begin to diverge, and we must make a choice between them."

Where Judges have made their choice, Parliament is free to affirm or reverse or modify what they have chosen. Where judges have not, as yet, made their choice, Parliament is free to make its own choice. And, where the choice made by Parliament by formulating certain principles is frustrated, Parliament can re-formulate the principles.

Substitution of another word for the word "occasion" not possible.

3.71. We may state that during the course of our discussion, we considered the question whether it would be expedient to replace the word 'occasion' by another less ambiguous and more precise word in order to avoid any future difficulty. But we ultimately came to the conclusion that it would not be advisable to amend section 5 by substituting another word for 'occasion', because we apprehend that the use of any new word may, in turn, create problems of its own. In our view, the purpose which we have in mind would be served effectively if we add two propositions[4] to section 5, which would make it clear that the broader interpretation placed on the word 'occasion' in *Khosla's* case was not within the contemplation of Parliament when it enacted section 5.

3.72. One of us, Mr. S.P. Sen Varma has, in a separate note, suggested the insertion of elaborate provisions to emphasise that the word 'occasion' used in section 5 must receive the narrower

---

1. Para 3.69, *supra*.
2. *cf.* para 3.19, *supra*.
3. Cardozo, Nature of the Judicial Process, pages 19, 20, 22.
4. See para 3.68, *supra*.

interpretation. His suggestions are made in a positive form and they seek to make it clear that the first purchase after import and the last sale before export are not exempted from state taxation under section 5.

In fact, when we were discussing section 5, Mr. Sen Varma had urged that the Commission should adopt the course which he has ultimately adopted in his separate note. We fully discussed his proposals, but came to the conclusion that the purpose which we all had in mind would be more effectively served by adding two propositions framed in a negative form so as to remove the anomaly resulting from the wider construction placed on the word 'occasion' in *Khosla's* case.

We also felt that any attempt to achieve this result by making elaborate provisions in a positive form may conceivably raise unanticipated problems in future, and that is a possibility which we are anxious to avoid.

Besides, we were inclined to take the view that the elaborate provisions which our colleague has set out in his separate note may, with respect, appropriately form part of discussion of the point in a judgment but may be out of place in a statutory provision of the nature under consideration. That is why we regret we were not able to accept our colleague's suggestions, though we gave them the respectful consideration which they deserved.

Before we conclude, we must, however, emphasise the fact that the Commission is unanimously of the view that the word 'occasion' used in section 5 must receive a narrow construction and that the first purchase after import and the last sale before export should not be entitled to exemption from taxation by the States concerned.

*Summary of the principal points discussed in this Chapter*

3.73. We now propose to summarise the points which we have discussed in this Chapter at some length. We are conscious that this process will inevitably involve repetition, but, having regard to the fact that the problem with which this Chapter deals is vexed and complex, we think it necessary even at the risk of repetition to summarise our conclusions in order to make our view clear beyond any doubt.

(1) Before the Constitution was adopted and while the Government of India Act, 1935 was in operation, there was no specific bar on the power of the Provinces to impose a tax on all transaction in respect of commodities so long as the trans-

actions took place within their territorial limits. That being so, the provinces had the power to impose a tax on the sale or purchase of goods in the course of import or export.

(2) When the Constitution was adopted, article 286(1) put some restrictions as to the imposition of tax on the sale or purchase of goods as specified therein. Article 286(1)(b) exempts from tax the sale or purchase of goods into or export of goods out of the territory of India. The clause 'in the course of' is capable of a wider or a narrower interpretation.

(3) This clause came to be considered by the Supreme Court in the first *Travancore case*. That case was concerned with an export sale and, as such, even within the narrow meaning of the expression 'in the course of export', it was clearly exempt from being taxed. That, in fact, was the unanimous decision of the Court.

Having held that the export sale was exempt from tax under article 286(1)(b), the Court proceeded to explain the meaning of the expression 'in the course of export'. While doing so, it used the word 'occasion' and observed, *inter alia*, that a sale, which itself occasions export, would be within the protection of article 286(1)(b). This observation, we think, was intended to cover only export sales of the kind with which the Court was dealing in that case and exclude all other sales. But, it must be conceded, that the word 'occasion' used in the judgment was capable of a wider as well as a narrower interpretation.

(4) In the second *Travancore* case, the question which the Court had, incidentally, to consider was whether the word 'occasion' used in the earlier judgment was intended to be interpreted in its wider or narrower sense. Patanjali Sastri C. J., who spoke for the majority of the Court, clearly and explicitly stated that the word 'occasion' used in the earlier judgment, which was unanimous, was intended to be interpreted in the narrower sense and so the judgment expressly stated that the first sale after import and the last purchase before export did not fall within the protection of article 286(1)(b).

S. R. Das, J., however, who was a party to the earlier judgment, had presumably understood the word 'occasion' in its wider sense and so, in his minority judgment, he expressed

his view to that effect and added that the first purchase after import and the last sale before export fell under article 286(1)(b).

(5) It was in view of this disvergence of judicial opinion about the interpretation of the words 'in the course of import or export' that article 286(2) was inserted in the Constitution. By this article, Parliament was empowered to make a law formulating principles for determining when a sale or purchase of goods takes place in any of the ways mentioned in clause (1) and this includes clause 286(1)(b) in which the relevant words "in the course of" occur.

(6) Having thus empowered Parliament to formulate principles for the interpretation of article 286(1), the Union Government referred the matter to the Law Commission for its opinion. In its majority report, the Law Commission used the word 'occasion' in suggesting the principles which should be followed in enacting the law under article 286(2), and though there is reason to believe that the majority view was in favour of the narrower construction placed on the relevant words in article 286(1)(b) by the unanimous judgment in the first *Travancore* case, as explained by the majority judgment in the second *Travancore* case, the Report, in terms, did not make this position clear and was content to use the word 'occasion' without any Explanation that it was used in the narrower sense.

(7) The relevant portion of the text of section 5 similarly used the word 'occasion' without any Explanation showing that the intention of Parliament in using the word was to adopt the narrower view propounded by Patanjali Sastri J. in the second *Travancore* case. The result was that the ambiguity flowing from the use of the word 'occasion', which has a wider as well as a narrower meaning, remained and, as already explained by us, a wider view was accepted by the Court in *Khosla's* case.

(8) We are clearly of the view that the relevant words which were used in article 286(1)(b) by the Constitution were not intended to affect the pre-existing right of the States to tax the first purchase after import and the last sale before export and that the framers of the Constitution, therefore, must be presumed to have used those words in their narrower sense. That, in fact, was the judicial interpretation of the word in the two *Travancore* cases.

As we have just pointed out, when the Law Commission in its majority report, used the word 'occasion', presumably, it used that word in the narrower sense; it did not expressly say so. In the absence of any express statement to that effect in the report, in the text of section 5, which bodily lifted the word 'occasion' from the Report and inserted in Section 5, the Legislature did not add any Explanation to indicate that the word 'occasion' was used in the narrower sense and that substantially is responsible for the decision in the *Khosla's* case which placed a broader interpretation on the word 'occasion' and thereby, for the first time, unduly restricted the pre-existing right of the States to tax the first purchase after import and the last sale before export.

(9) After the Supreme Court rendered its decision in *Khosla's* case, the Union Government referred to the Law Commission for its opinion the question whether the decision in *Khosla's* case was consistent with its earlier decisions in the *Travancore* cases. This reference was presumably made because the States complained that the decisions in *Khosla's* case unduly restricted their power to tax the first purchase after import and the last sale before export.

The majority[1] of the Law Commission, in its 30th Report, expressed the view that *Khosla's* case was consistent with the two *Travancore* cases. Confining ourselves to the specific question which was referred to that Commission, we wish to state that this view of the majority was not correct, if due regard is had to the exposition of the law in the majority judgment in the second *Travancore* case.

On the specific question referred to the Commission, therefore, the minority view in the 30th Report was correct. We do not, however, wish to express any opinion with reference to the other observations made in the minority report.

(10) In this connection, it may not be irrelevant to point out that the reference to the Commission made after the Supreme Court rendered its decision in *Khosla's* case was somewhat inappropriately worded. After the passing of the Central Sales Tax Act, 1956, it was section 5 of the Act which was in operation and in that case, the decisions in the *Travancore* cases which dealt not with section 5, but with article 286(1)(b), though relevant, were technically not binding. In our view, the query addressed to the Commission should

1. 30th Report.

have been whether the Supreme Court had correctly interpreted section 5 in *Khosla's* case when it held that the sale by Khosla to the Railways fell within the protection of section 5. We have thought it necessary to make this incidential observation in order to clarify the true legal position at the time when the reference was made.

(11) After a careful study of the relevant constitutional judicial and legislative history, we have come to the unanimous conclusion that the undue restriction which after the judgement in *Khosla's* case began to operate on the power of the States to tax the two categories of transaction in question should be removed. For that purpose, we are recommending the acceptance of two propositions whilst our colleague, Mr. Sen Verma, is recommending more detailed propositions. The object of both the recommendations is, however, one and the same.

(12) Since this interpretation unduly restricts the power of the States and was not intended by Parliament, the suggestion now is that the law should be brought in line with what was decided in the two *Travancore* cases, so far as sales or purchases in the course of import and purchases in the course of export are concerned. Hence, an amendment on the lines recommended[1] is required.

1. Para 3.68, *Supra*.

## CHAPTER 4

## CONFLICTING DECISIONS OF THE COURTS AS TO THE CENTRAL SALES TAX IN REGARD TO THE SCOPE OF THE PENAL PROVISIONS OF THAT ACT

### *INTRODUCTORY*

The close relationship with State laws under section 9(2).

4.1. In this Chapter we propose to deal with a provision of the Central Sales Tax Act of considerable importance. Briefly stated, section 9(2) of the Act imposes a duty, on the sales tax officers of the States, to assess and re-assess, and to collect and enforce payment of, the Central tax. It provides that they shall also have the same powers for this purpose as they have under the State Act. These two propositions are wound up by a general enactment to the effect that, for the above purposes, the specified provisions of the General Sales Tax laws of the State shall apply in relation to the Central tax. The broad effect of this provision is that, in relation to matters concerning the administration to the tax, the Central Sales Tax Act is not self-contained. In order to ascertain the precise legal provision applicable on a point of administration, one has to consult the State law. Moreover, many of the provisions of State Sales tax law are to be ascertained from the rules made under the State law. This position, of course, is not an accident, but is deliberate.

The resulting complexity.

4.2. There is, thus, no doubt that section 9(2) necessitates a complicated study[1], involving:—

(i) the Central Act,

(ii) the State Act,

(iii) the rules under the Central Act, and

(iv) the rules under the State Act.[2]

---

1. para 4.1, *Supra*.
2. *cf.* the discussion in *C. S. T. V. Kantilal Mohanlal* (1967) 19 S. T. C. 377 (M. P.).

Legislation by reference.

4.3. Section 9(2) is, thus, an example of the familiar device of legislation by a reference. Because of the adoption of this device, however, a few problems as to the precise effect of the sub-section have arisen. We shall discuss these problems one by one.

The question of applicability of State amendments.

4.4. Under the section, the provisions of the "General Sales Tax" law of the State concerned on various matters mentioned in the section, apply in relation to the collection and assessment of tax. A controversy has arisen as to whether only the provisions of the State Act, as they *existed when the Central Act was passed, are attracted by virtue of this sub-section,* or whether amendments made in the State Act subsequent to the passing of the Central Act also become applicable.

4.5. Most High Courts[1], [2], [3] have taken the latter view. The Madhya Pradesh High Court has also held that the procedure for recovery of Central Sales Tax by the States is governed by the law in force at the time of the recovery of the tax, and not by the law in existence when the Central Act came into force.[4] The judgment points out that the definition of "sales tax law" uses the words "for the time being". This is also the Mysore view.[5] In the Mysore case[6], it was held that in the last part of sub-section (2) of section 9 of the Central Act, the applicability of the provisions of the General Sales Tax law of the State has not been confined only to those cases where the authorities have exercised any power *under that law* (i.e. the State law). Subject to any rules made under the

1. *Auto Pins (India)* V. *The State* A. I. R. 1970 Punj. 333, 337, paragraphs 8 to 11.
2. *K. V. Adinarayana Setty* V. *Com. Tax Officer* (1963) 14, S. T. C. 587 (Mys.)
3. *C. S. T.* V. *Kantilal Mohanlal.* (1967) 19 S. T. C. 377 M. P.
4. *M/s. Jiwanman Sons (P) Ltd.* V. *Deputy Commissioner of Sales Tax* (1971) M. P. L. J. 684; 28 S. T. C. 247, 251 (Bishmber Dayal, C. J. and Shiv Prasad J.) (Madhya Pradesh)
5. (a) *K. V. Adinarayana Setty* V. *C. T. O,* (1963) 14. S.T.C. 517 597 (Mysore);
   (b) *Mysore Electrical Industries* V. *C. T. O.* A. I. R. 1970 Mysore 259, 263 para 15.
6. *K. V. Adinarayana Setty* V. *C. T. O.* (1963) 14 S. T. C. 587, 597 (Mysore).

Central Act, the provisions of the general sales tax law of the State could be applicable for all or any of the purposes mentioned in section 9(2).

4.6. The Madras view, however, is different.[1] The Madras view makes a distinction between amendments of a substantial character and others; and, according to the discussion in a Madras case[2], subsequent amendments of the State Act would apply only if they do not make any substantial change. Madras view.

4.7. So far as this particular problem, namely, the applicability to the Central Act of subsequent amendments in the State Act is concerned, it would appear that the majority view[3] is likely to prevail. In fact, practical considerations demand that such amendments should apply, because otherwise the whole scheme of the Central Sales Tax Act would be frustrated. It would be obvious that the Act is intended to be administered in combination with the State Act. The view of the majority of High Courts bound to prevail.

Section 9(2) is, in fact, explicit on the point, when read with the definition of "general Sales Tax law."[4] The same authorities as administer the State Act, are expected to administer the Central Act also. Any other interpretation would necessitate the preservation of each State Act, as it existed in 1956,—which would become impossible in course of time.

4.8. The majority view is likely to prevail, as we have already stated[5]. In our view, it is necessary to make the position clear. Therefore an amendment is desirable[6]. Desirability of amendment as regards construction of section 9(2).

---

1. (a) *Haji J. A. Kareem bait* V. *C. T. O.* A. I. R. 1967 Mad. 171, 175, para 9 (Veeraswami and Natesan J J).
   (b) *Sate of Madras* V. *M. Angappa Chettiar*, (1968) S.T.C. 22 Madras.
   (c) *D. H. Shah & Co.* V. *The State of Madras*, (1967) 2 M. L.J 261.
   (d) *K. A. Ramadu Chettiar* V. *State of Madras*, (1967) 2 M.L.J. 315.
2. *Haji J. A. Kareem Sait* V. *C.T.O.* A.I.R. 1967 Mad. 171.
3. Para 4.5, *supra*.
4. Section 2(1), Central Sales Tax Act.
5. Para 4.7, *supra*.
6. See para 4.16, *infra*.

*Section 9(2)—the constitutional position*

Constitutional position considered.

4.9. So much as regards the question of *construction* of the language of section 9(2). What is a matter of more consequence is the question of *constitutionality* of the provisions of the section. In this context, we have to refer to a Madras case[1], where the High Court observed:—

> "In fact, for the Central Legislature to adopt a State law not only as it exists at the time but also as it may exist in future, including amendments made from time to time, *will amount to abdication of its* legislative functions[2]. This is because, if the Central Legislature purports to adopt a State law to be made in future by way of an amendment, the Central Legislature would have had no occasion to apply its own mind in making the law."

These observations raise an important constitutional question.

The principle in *Shama Rao's case.*

4.10. In this connection, a judgment of the Supreme Court is of importance.[3] The facts of the case were as follows:—

On 16th August, 1962, the administration of Pondicherry became vested in the Government of India by virtue of a *de jure* transfer. The Pondicherry Administration Act, 1962 (42 of 1962), constituted that territory as a separate centrally administered unit; and under the Union Territories Act, 1963 (20 of 1963), a Legislative Assembly was set up for that area. The Assembly, under that Act, acquired the power of enacting laws in respect of items in Lists II and III of the Seventh Schedule to the Constitution. The Assembly thereafter passed the Pondicherry General Sales Tax Act, 1965(10 of 1965), which was published on 3rd June, 1965, after receiving the President's assent on 25th May, 1965. The Act provided that section 1(2) of that Act would come into force on such date

---

1. *D. H. Shah & Co.* v. *The State of Madras*, (1967), S.T.C. 146., 149 (Mad) (1967) 2 M.L.J. 261.
2. Emphasis supplied.
3. *B. Shama Rao* v. *Union Territory of Pondicharry*, (1967) 2 M.L.J. (S.C.) 98, 100, 105; A.I.R. 1967 S. C. 1480; 20 S.T.C. 214; (1967) 2 S.C.R. 288.

as *the Government may by notification appoint.* Section 2(1) of the Act provided that:—

> "The Madras General Sales Tax Act 1959 (1 of 1959) (hereinafter referred to as the Act), as in force in the State of Madras immediately before the commencement of this Act shall extend to and come into force in the Union Territory of Pondicherry subject to the following modifications and adaptations....."

4.11. Thus, there was to be a time interval between the date of passing and date of commencement of the Pondicherry Sales Tax Act. If, in between the two dates, the Madras Legislature amended its own Sales Tax Act, that amendment would become applicable to Pondicherry. The validity of this position was at issue. The Supreme Court held the Pondicherry Act to be void. The reasons for this conclusion of the Supreme Court were thus stated:—

> "In the present case, it is clear that the Pondicherry Legislature not only adopted the Madras Act as it stood at the date when it passed the Principal Act, but also enacted that if the Madras Legislature were to amend its Act prior to the date when the Pondicherry Government would issue its notification it would be the amended Act which would apply. *The Legislature at that stage could not anticipate that the Madras Act would not be amended, nor could it predicate what amendment or amendments would be carried out or whether they would be of a sweeping character or whether they would be suitable in Pondicherry.*[1] In point of fact the Madras Act was amended, and by reason of section 2(1) read with section 1(2) of the principal Act, it was the amended Act which was brought into operation in Pondicherry. The result was that the Pondicherry Legislature accepted the amended Act, *though it was not and could not be aware what the provisions of the amended Act would be.* There was, in these circumstances a total surrender in the matter of sales tax legislation by the Pondicherry Assembly in favour of the Madras Legislature, and for that reason we must agree with Mr. Desai,

1. Emphasis supplied.

that the Act is void, or as is often said, "still-born".

4.12. The judgment in the case[1] cited above was considered by Subba Rao, C. J., in a subsequent case[2] relating to section 5, Punjab General Sales Tax Act. There the Chief Justice, who was a party to the majority judgment in *Shama Rao's case*, explained and distinguished the same, and observed as follows:—

> "Section 1(2) of the said Act provided that the Act would come into force on such date as the Government by notification may appoint. The effect of the section was that the Madras Act *as it stood on the date of the notification issued would be in force in the* Union Territory of Pondicherry. Indeed, it turned out that the Madras Act was amended before the said notification. This Court held that there was *a total surrender in the matter of sales tax legislation by the Pondicherry Assembly in favour of the Madras Legislature*, and for that reason the said sections were void or still-born."

An analysis of the doctrine.

4.13. If the argument that there is a total surrender of the legislative function,[3] is regarded as applicable to the provision in section 9(2) of the Central Sales Tax Act[4], then, it could be contended with some force that Parliament is not competent to apply future amendments made by the States in their own Sales Tax laws, since Parliament could not have applied its mind to them. If such a view were to be taken by the Supreme Court, the majority interpretation[5] of the present provision in section 9(2) will not stand.

---

1. *Shama Rao* V. *Pondicherry Administration* (1967) 20 S.T.C. 430 S.C.; A.I.R. 1967 S.C. 1480, para 4.11 *supra*.
2. *Messrs. Devi Dass Gopal Krishnan* V. *State of Punjab & Others* (1967), 20 S.T.C; 430; A.I.R. 1967 S.C. 1895. See para 4.13 B *infra*.
3. Para 4.12, *supra*.
4. Para 4.4, *supra*.
5. Para 4.5, *supra*

4.13A. Three cases[1] reported in 1973 raise the important question of the constitutional validity of sections 6, 8 and 9 of the Central Sales Tax Act, 1956. In all the cases, the impugned sections were challenged as violative of the principles of delegated legislation and, in particular, as violating the law laid down in *Shama Rao* v. *Union Territory of Pondicherry*.[2] While all the judgments upheld the sections, the reasonings that were given were divergent, with the result that an authoritative interpretation should await a verdict from the Supreme Court. A brief review of the cases is given below.

Three recent cases as to validity of sections 6, 8 and 9.

4.13AA. In the *Gwalior Rayon* case,[3] the main ground of challenge was that since the Constitution vested the exclusive power of imposing sales tax on inter-State transactions in Parliament, it was not competent for Parliament to delegate the power of fixing rates of tax on such transactions to State Legislatures. (Section 8, *inter alia*, provided that a State Legislature could vary the rate of tax laid down in the section in certain circumstances). Section 8(2)(b), which provided that if a State fixes a higher rate than ten per cent on intra-State sales that rate would apply to inter-State sales also in preference to the ten per cent laid down by Parliament was challenged as amounting to abdication of legislative power by Parliament in favour of State Legislatures. It was contended that section 8(2)(b) was *ultra vires* as it amounted to an effacement of itself by Parliament and, therefore, wholly invalid.

*Gwalior Rayon* case.

Dayal C. J.[4] negatived these arguments and accepted the contentions raised on behalf of the State that the instant case was not a piece of delegated legislation at all and that the principles relating thereto were inapplicable to such a case. On the other hand, he held, it was a case of legislation by reference by which an Act of another legislature was adopted without physically incorporating all the details.

4.13B. Relying on text book writers on Constitutional Law on the distinction between Delegated Legislation and Legislation

---

1. See *infra*.
2. *Shama Rao* v. *Union Territory of Pondicherry*, A. I. R. 1967 S. C. 1480 : (1967) 2 M. C. D. 98. Para 4.11, *Supra*.
3. *Gwalior Rayon Silk Manufacturing (Wvg.) Co. Ltd.* v. *Assistant Commissioner of Sales Tax*, (1973) 31 S. T. C. 9 (M. P.) (1973) M. P. L. J., 85.
4. Two separate but concurring judgements were given by Bishambhar Dayal, C. J. and Raina, J.

by reference, Dayal, C. J. concluded that since the provision actually referred to the law prevailing in a particular State and not to a particular part of the State, the reference should be treated as the adoption of the law as it stood from time to time. On this basis, he distinguished the decision in *Shama Rao's* case[1] Raina, J., also accepted the position that the present case was not a piece of delegated legislation and, therefore, there was no need to see if it suffered from excessive delegation. However, he felt that the principles which limit excessive delegation would be a good guide to examine the question of abdication of legislative power or self-effacement in the case of legislation by reference also. The question that had to be decided was whether the power to determine the rate of tax (which, according to section 8(2)(b), could be increased by State Legislature to more than 10 per cent as laid down in the Act) was an essential legislative function which could not be assigned to another legislative body, the executive or another authority. Relying on Bose, J.'s views in *Raj Narain Singh* v. *P. A. Committee*[2] that an executive authority could be authorised to modify existing and future laws excepting in essential features, Raina, J., inferred that since it was open to a Legislature to leave it to the executive to determine details relating to the working of taxation laws, such as the selection of persons on whom the tax is to be laid, the rate at which it is to be charged in respect of different classes of goods and the like, it could be said that the fixing of the rate of tax was not an essential feature of legislation relating to tax and hence could be assigned to another authority. He distinguished the decision in *Devi Dass Gopal Krishnan & Others* v. *State of Punjab*[3] on the ground that the basis principle was that fixing of rate of tax could be delegated to an authority provided the statute contained a policy or principle which would furnish guidance to the delegate in the exercise of such powers. He held that fixing the limit of the rate of tax was only *one* of the modes of exercising such guidance and was not the only method of doing so. A delegation could be controlled by indicating the policy, or by providing guidance otherwise.

---

1. He also distinguished the *Shama Rao's case* on the basis of the delegate being the executive.
2. *Raj Narain Singh* v. *P. A. Committee* (1955) 1 S. C. R. 290.
3. *Devi Das* v. *State of Punjab* (1967) 20 S. T. C. 430 (S. C.) In this case, section 5 of the Punjab General Sales Tax Act, 1948 was struck down by the Supreme Court as self-effacement by the Legislature inasmuch as it conferred an uncontrolled power on the State Government to levy tax at rates fixed by itself.

4.13C. Thus, Raina, J., though agreeing with the view that in a legislation by reference, it is permissible to adopt the provisions of another statute as they exist as well as any amendments in future, held that the question of abdication of the legislative function or self-effacement must, in such a case, be examined on the same principles as governed the limits of valid delegation. He distinguished the decision in *Shama Rao's* case[1] on one more ground other than those mentioned by Dayal, C. J., and said that in *Shama Rao's* case, an entire enactment which was not in force at the time of enactment was adopted. In the present case, there was adoption of a provision of the Act of the State Legislature by general reference, *which was limited to the rate of tax.*

*Rallis India case. (Gujarat)*

4.13D. The next case to be considered is a Gujarat one, *Rallis India.*[2] The main argument was that Parliament had abdicated its legislative function in favour of State Legislatures in enacting sections 6, 8 and 9 of the Central Sales Tax Act. Bhagwati, C. J., narrowed down the scope of the inquiry to the proposition that it was sufficient to attract the constitutional inhibition against abdication if there was surrender by the legislature of an *essential legislative function* even in respect of a particular subject matter of legislation in favour of another person or authority which was not empowered by the Constitution to exercise that function. He then went on to discuss what was an essential legislative function. Relying on Mukherjea, J.'s observations in *In re the Delhi Laws Act,* 1912,[3] that the essential legislative function consisted in the determination of the legislative policy and of formally enacting that policy into a binding rule of conduct, Bhagwati, C. J., explained that it was not always possible for the Legislature to ascertain the facts and circumstances "in all cases, which would have to be determined outside the halls of the legislature." The Legislature will have, in such circumstances, necessarily to delegate subsidiary or ancillary powers of legislation to delegates of its choice for carrying out the policy. However, such delegation should be within limits, and should not be "unconfined and vagrant". He then posed the question : ".....has the Parliament said that within its allotted field, which is here tax on inter-State sales, what will operate is not

---

1. *Shama Rao* v. *Union Territory of Pondicherry.* (1967) 20 S. T. C. 215 (S. C.)
2. *Rallis India Ltd.* v. *R. S. Joshi,* 31 S. T. C. 261, 277 (Gujarat).
3. *In re Delhi Laws Act,* 1912 (1951) S. C. R. 747.

its own legislative policy determined and "chosen by it, but legislative policy enunciated by the State Legislature, which has plenary power of legislation within its own field and which is not subject to any guidance or control from Parliament? If it has, it will be a clear case of abdication or self-effacement." After a detailed examination of sections 6, 8 and 9, he concluded that the provisions did not amount to abdication.

(i) The Court distinguished the power of State Legislatures under section 8 to declare the rate of tax as nil [under section 8(2-A)] as not amounting to 'exemption' from tax. It did not affect chargeability, though the rate of tax might be nil.

(ii) About section 8(5), which empowered the State Government in the public interest to direct that the inter-State rate of tax would be at a rate lower than those prescribed in sub-sections (1) and (2), the court held that such a power was in the nature of a conditional legislation, which had been recognised since the decision in *Queen* v. *Burah*.[1] Even assuming that the provision was a piece of delegated legislation, the court held that it was valid, because Parliament had clearly laid down the policy or principle which was to guide the State Government in exercise of the power, namely, that it should be in the public interest.

(iii) Regarding the rate of tax under section 8(2-A) [sub-section (2-A) of the section formed the target of the main attack], the court held that a deliberate choice of legislative policy on the part of Parliament was discernible, inasmuch as the purpose behind the provisions in section 8(2-A) was to ensure that consumers in the States to which the goods were imported were not placed at a disadvantage as compared with the consumers in the State from which the goods were imported. This could have been carried out by Parliament—(1) by prescribing separate schedules of rates for each State in the Act itself and by amending it from time to time as and when changes were brought in State rates, or (2) by prescribing separate schedules of rates in the Act and allowing the State to amend them from time to time, or (3) by adopting the rate structure as provided in sub-sections (1), (2) and (2-A) of section 8. The first two methods, which were undoubtedly within Parliament's competence, could not be adopted on practical considerations. The third, which provided a self-operating machinery whereby the rate

1. *Queen* v. *Burah*, (1878) 3 A.C. 889.

structure of the Central Act could be adjusted to the rate structures of State sales tax laws according to the formula laid down in section 8, provided, according to the court, a highly efficient method of carrying out the legislative policy.

4.13E. This was the position regarding section 8, as discussed in *Rallis India case.* Section 9, which provided that the existing machinery in each State for assessment, re-assessment, collection and enforcement of payment of tax on intra-State sales would assess, re-assess, collect and enforce payment of inter-State tax under the Act, was also (in that case) challenged as exceeding the limits of delegated legislation, inasmuch as it related to substantive matters rather than adoption of procedural provisions. On this, Bhagwati, C.J., found nothing excessive as far as the adoption of the general sales tax law of the appropriate State in the *matter of advance payment of tax* was concerned. On the question of adoption of provisions relating to penalty, imposition of tax liability on a transferee of or successor to a business and recovery of tax from third parties, *the court did not give any opinion.* However, it was observed that even if they were violative of any principle, the provision was clearly severable, and would not affect the validity of section 9. On the question of the applicability of *Shama Rao's case,*[1] the Court held that Parliament had applied its mind and made a deliberate choice of legislative policy, and there was no parallel between the existing situation and that decision.

4.13F. In the *Thallam case*[2] also, the grounds of attack (before the Andhra Pradesh High Court) were alleged abdication by Parliament of its legislative function in the enactment of sections 8 and 9 of the Act. Gopal Rao Ekbote, J., reduced the question to whether even essential functions of legislation, that is to say, laying down the policy and a rule of binding conduct, had been delegated by Parliament to an agency not contemplated by the Constitution. On section 8, the court held that Parliament could not be said to have abdicated its functions merely because it had authorised the State Legislature to fix the same rates in respect of transactions within the State and apply them to transactions which were subject to central tax. The Court held that it was

*Thallam case. (Andhra)*

---

1. *Shama Raov. Union Territory of Pondicherry*, (1967) 20 S.T.C. 215 (S.C.)
2. *Thallam Balasubrahmanyam* v. *State of A.P.*, (1973) 31 S.T.C. 489 (A.P.); (1972) 1 An W.R. 263.

not a case of applying future laws to central transactions without Parliament applying its mind, but a piece of delegated legislation. On this view, the Court felt it unnecessary to consider the effect of the judgment in *Shama Rao's case*[1] which, according to the Court, struck a different note as regards application of future laws from the previous decisions starting with *R. V. Burah*[2] and *In re. Delhi Laws Act*.[3] Ekbote, J., concluded with the following observations :—

> "We have no hesitation in holding that in delegating the power to fix the rates to the State Legislatures and applying those rates to the transactions subject to tax under the Central Sales Tax Act, whether prevailing or future, it is a case of permissible piece of delegated legislation and, therefore, quite valid. Sections 8 and 9, therefore, do not amount to abdication of legislative function by Parliament....."

Conclusion.

This observation would seem to indicate that the Court would have upheld any challenge as to the constitutionality of section 9(3) on the basis of prospective amendment of State Tax laws and their validity under section 9(3). The Mysore,[4] M.P.[5] and Punjab and Haryana High Courts[6] have already held that section 9(3) was valid and prospective modifications and amendments to State tax laws and their applicability to transactions under the Central Sales Tax Act was not abdication of Parliamentary duty. The Madras High Court had, however, taken a different view[7].

Punjab case.

4.13A. An argument that section 9(2) amounts to excessive delegation was advanced before the High Court[8] of Punjab,

---

1. *Shama Rao's case*, supra.
2. *Queen* V. *Burah*, (1878) 3 A.C. 889.
3. *In re. the Delhi Laws Act*, 1912 (1951) S.C.R. 747.
4. *Mysore Electrical Industries* V. *Com. Tax Officer*, A.I.R. 1970 Mys. 259.
5. *Commissioner of S.T.* V. *Kantilal Mohan Lal*, A. I. R. 1968 M. P. 20.
6. *Auto Pins (India)* V. State of Haryana, A. I. R. 1970 Punj. & Haryana 333.
7. (a) *Haji Kareem Sait* V. *Dy. Coml. Tax Officer*, A. I. R. 1967 Mad. 171.
   (b) *D. H. Shah & Co.* V. *State of Madras*, (1967) 2 ML7 261.
8. *Tek Chand Daulat Ram* V. *Excise & Tax Officer*, (1972) 29 S. T. C. 585, 603 (F. B.) Punjab.

which, however, rejected it. The High Court relied on clause (2) of article 258 of the Constitution, which runs as follows[1] :—

> "(2) A law made by Parliament, which applies in any State, may, notwithstanding that it relates to a matter with respect to which the Legislature of the State has no power to make laws, confer powers and impose duties, or authorise the conferring of powers and the imposition of duties upon the State or officers and authorities thereof."

It is in exercise of that power that section 9(2) of the Central Act had been enacted. Availing of the services of the hierarchy of the functionaries acting under the State Act and conferment of powers on them, providing for the procedure to be followed by them and imposition of duties upon them in terms of the procedural, remedial and other provisions devised thereunder to enable them to administer various provisions of the Central Act, falls squarely within the scope of clause (2) of article 258, and cannot legitimately be contended to be unauthorised or excessive delegation on the part of the Parliament in favour of the State or the authorities administering the State Act.

**Three types of provisions in section 9(2).**

4.14. It may, in this connection, be noted that section 9(2) makes three types of provisions.[2] In the first place, it imposes certain duties on the officers acting under the general Sales Tax law of the particular State, by requiring them to assess, re-assess, collect and enforce payment etc. of the tax or penalty under the Central Act, as if the tax or penalty under the Central under the Central Act, as if the tax or penalty were leviable under the State Act. Secondly, for this purpose it confers certain *powers* on the officers of the States in relation to the tax or penalty. Here again, there is a reference to the *general Sales Tax* of the State. Thirdly, it contains a general provision stating that the specified provisions of the general Sales Tax law of the State shall apply "accordingly". Each of these provision of section 9(2) refers to the "general sales tax law" of the State.[3]

If subsequent amendments of the various State laws are not attracted for the purposes of section 9(2) of the Central Act,

---

1. Constitution, Article 258 (2).
2. Para 4.5 and 4.5B, *supra*.
3. For definition of "general sales tax law", see section 2(*i*).

then the position becomes unworkable, because it is always difficult to apply, for the purposes of the Central Act, a State Law (which has been amended), without the amendment. Psychologically, there would be a difficulty in doing so, on the part of the officer concerned. Moreover, it is common experience that after some time it is not easy to get copies of the State law as it stood in 1956,—which is the year of enactment of the Central Act.

## Remedy suggested

**Alternatives for remedying the situation.**

4.15. To remedy such a situation (if it does arise), there are, theoretically speaking, several courses open. (a) In the first Provision in section 9(2), the Union could frame its own self place, instead of the incorporating contained code of the rules relating to assessment of tax under the Central Act. Whether or not the Union also appoints its own assessing authorities for the purpose, is immaterial for this purpose. It could delegate the necessary powers to the State authorities. The only difference would be that State authorities will then be deriving that power not from the *State law* read with section 9(2), but from the Central Government directly.

(b) The second alternative would be to amend the Constitution, and to provide there what is now contained in section 9(2) of the Central Sales Tax Act, 1956. For obvious reasons, this is not a very convenient method.

(c) The third alternative would be to insert, in section 9(2), a particular date, say, "as in force on the first day of April, 1974." Initially, this date could be inserted by adding the quoted words after the words "general sales tax law," wherever they occur in section 9(2) or elsewhere in the Central Sales Tax Act. Subsequently, every year, by a short amendment of the Central Sales Tax Act, the year '1974' (or the subsequent year) could be replaced by the year then current. This would mean that the Sales Tax law in force in the State on the first April of the then current year would be attracted to the Central tax. No doubt, if, after the 1st April of one year and before the 1st April of the next year, a particular State Legislature makes any amendments, those amendments would not be attracted. Theoretically this cannot be avoided. But there is a practical way of avoiding it. The Centre can request the States, by a general letter, not to make amendments in the Sales Tax laws of the

States which would be operative from a date other than the 1st April. Except to meet urgent situations, this is the practice even now, in most States.

Recommendation for amendment of section 9(2) to insert date.

4.16. As we have an apprehension that there is a reasonable possibility of section 9(2) being required to be construed as attracting only the unamended State law, we consider it advisable, and recommend that the last alternative[1] indicated above should be carried out, *as an urgent measure*. Such an amendment would be harmless in any case, and would avoid any controversy or likelihood of attack on the constitutionality of this part of the section. As a long term measure, it will of course be desirable to make the Act self contained.[2]

*Section 9(2) and offences covered*

How far offences not listed in the Central Act covered.

4.17. There is another problem arising out of section 9(2). It seems that a view prevails[3] that only offences specifically listed in the Central Sales Tax Act are recognised for the purpose of initiating action under section 9. So, for offences provided in State laws,—for example, for delay in the filing of return, delay in payment of tax etc.—punishment is not permissible.

Recommendation to add "offences" in section 9(2).

4.18. The position could be clarified by adding, in section 9(2), the word "offences" before the words "compounding of offences". We recommend an amendment of section 9(2) accordingly.

*Penalties*

Penalty under State law how far attracted—Calcutta case.

4.19. There is another question arising out of section 9(2), concerning penalties. In a Calcutta case,[4] it was held that the penalty leviable under the State law could not be imposed for failure in filing, or delay in filing, returns under the Central Act. According to this case, section 9(2) of the Central Sales Tax Act[5] does not incorporate that substantive law of penalty for non-submission of returns under the Bengal Finance (Sales Tax) Act 1941.

---

1. Para 4.15 (c), *supra*.
2. See para 4.15 (a), *supra* and para 4.28, *infra*.
3. Notes in the Ministry of Finance.
4. *Mohan Lal Chokhani* v. *S.T.O.* 28 S.T.C. 367, 373 (Cal.).
5. Referred to in the judgment as section 9 (3), because it was so numbered at the time of the assessment in question.

The principal considerations.

4.20. The principal reasons for this construction were as follows :—

In the first instance, section 9(2) of the Central Sales Tax Act, makes the whole provision "subject to the other provisions of this Act and the rules made thereunder",

Secondly, the authorities for the time being empowered to assess, re-assess, collect and enforce payment of any tax under the general sales tax law of the appropriate State are only so empowered "on behalf of the Government of India."

Thirdly, this power includes the power to "assess, re-assess, collect and enforce payment of tax, including any penalty payable by a dealer under this Act". Hence, the central idea is "penalty" payable under this (Central) Act, and not penalty payable under a State law.

Fourthly, the power is "qualified by the words as if the tax or penalty payable by such a dealer under this Act is a tax or penalty payable under the general sales tax law of the State". This is a deeming provision and can deem no more than what it says, namely that the "penalty payable under this (Central) Act", and not any other penalty, will be deemed "as if" payable under the general sales tax law of the State.

Fifthly, the other words in section 9(2) are—"for this purpose they may exercise all or any of the powers they have under the general sales tax law of the State", followed by the provisions which have also been quoted above. There, the limiting words are "for this purpose", and not "any other purpose".

Insufficient importance attached to the word 'penalties'.

4.21. It should, with respect, be stated that the Calcutta judgment[1] does not attach sufficient importance to the word "penalties", which occurs towards the end of section 9(2) before the words "compounding of offences". That word, in the context, could refer only to penalties leviable under the State Acts. However, this judgment shows the need for a clarification of the position.[2]

---

1. Para 4.19 and 4.20, *supra*.
2. See para 4.26 for further discussion.

*Section 9(2) and the equality clause*

4.22. Another point of great importance was raised in the same[1-2] Calcutta case. Counsel for the petitioner argued that if section 9(2) was to have the effect of attacking the substantive provisions of State laws as to penalties, a situation would be created whereunder the law would differ from State to State, because the substantive provisions of each State sales tax law vary. This, he argued, would introduce inequality, and violate article 14. Question of equality.

The High Court, in its judgment, referred to this argument, but did not decide it because the matter was settled by the construction placed on section 9(3)—namely that it did not attract the penalty provisions of the law of the State. Nevertheless, the judgment did discuss the matter at some length. In the course of the discussion, the Court referred to the Supreme Court judgment[3] upholding the validity of the procedure under the Income-tax Act, 1922 for the recovery of tax, and treating it as not hit by article 14. Having mentioned this judgment, the High Court also quoted the observations in the judgment made by one of the Judges—

"We must be in a position to postulate some reasonable basis for the differentiation and we cannot get away from this necessity by vague references to the wisdom of the Legislature or by indulging in pure speculation as to what might have been at the back of its mind. Speaking broadly, for the enforcement of the levy of a Central tax like the income-tax, there should be *uniformity of procedure and identity of consequences from non-payment*. The machinery for recovery might be different between the several States, but the defaulting assessee must be put on the same footing as regards the penalties."

The High Court after quoting the above passage observed :

"These observations are very relevant for the point under decision in this appeal before us. Mr. Mukherjee, the learned Advocate for the appellant, has argued that, if the Central Sales Tax Act by reason of section 9(2) of its provision is construed

1. *Mohan Lal Chokhani* v. *C.T.O.* (1971) 28 S.T.C. 363 (Cal.).
2. Para 4.19, *supra*.
3. *Purshottam* v. *Addl. Collector*, A.I.R. 1956 S.C. 20; 28 I.T.R. 891.

to authorise the State Government to impose a penalty for delay or non-submission or returns of turnover, then it will lead to a chaotic situation, because different penalties are provided under different State sales tax statutes in different States. A few illustrations were given by Mr. Mukherjee on this point. According to him, Andhra Pradesh provides only for best judgment assessment and so also the Central Sales Tax (Madras) Rule 5(4). But here, under section 11(1), a full scale assessment is contemplated in West Bengal. The State of Bihar introduces a penalty for such failure a sum not exceeding five rupees per day, whereas Orissa introduces a penalty for the same ground but for which penalty cannot exceed 1|10th per cent of the tax due or rupees five for every day thereafter."[1]

Observations of the Supreme Court in *N. K. Nataraja Mudaliar's case.*

4.23. It may be noted in State of *Madras* v. *N. K. Nataraja Mudaliar*,[2] the question mooted was as to whether, in the face of article 301 and 393 of the Constitution providing for freedom of trade, commerce and intercourse and for prohibition against preference of one State over another or discrimination between one State and another, the adoption by the Central Act of varying rates of sales tax in force in various States under the State laws was constitutionally valid. The Supreme Court observed as follows :—

"An Act, which is merely enacted for the purpose of imposing tax which is to be collected and to be retained by the State does not amount to a law giving, or authorising the giving of, any preference to one State over *another, merely because varying rates of tax prevail in different States.* The flow of trade does not necessarily depend upon the rates of sales tax ; it depends upon a variety of factors, such as the source of supply, place of consumption, existence of trade channels, the rates of freight trading facilities, availability of efficient transport and other facilities for carrying on trade. It is where differentiation is based on considerations not dependent upon natural or business factors which operate with more or less force in different localities that Parliament is prohibited from making a discrimination. *Prevailence rates of tax on sales of the same commodity cannot be regarded in isolation as discriminative of the subject to discriminate between one State and another.*"

---

1. The judgement gives other examples of disparity.
2. *State of Madras* v. *N. K. Nataraja Mudaliar*, A.I.R. 1970 S.C. 1742.

**4.24 and 4.25. This case thus related to rates. But the reasoning** in this case could perhaps be adopted to support the validity of section 9(2), against an attack on the ground of inequality. The position however, cannot be treated as being beyond doubt.

Express provision as to penalty desirable.

4.26. In view of the discussion above,[1] and particularly in view of the Calcutta case,[2] the insertion of an express provision as to penalties[3] appears to be desirable.

One alternative would be to insert the following sub-section in section 9 :—

> "(2A). In particular, without prejudice to the generality of the provisions of sub-section (2), penalties leviable under the general Sales Tax law of the State shall also be leviable for the purposes of this Act, as if the tax under this Act had been levied under the general Sales tax law of the State".

Recommendation.

4.27. But this would not meet the objection of inequality[4] which has been sometimes raised. A better course would, therefore, be to prescribe the penalties in the Central Act. We would recommend this course on principle. We cannot lay down details of the provisions to be made, as that involves various administrative aspects.

*Conclusion*

Whole Act should be self-contained.

4.28. In fact, as regards the whole Central Sales Tax Act, we may suggest that the Act should be self-contained. The specific amendments suggested above should,[5] of course, be undertaken, as an urgent measure, But, as a long term measure, it is desirable to make the Act self-contained, in respect of matters[6] for which section 9(2) at present provides.

---

1. Para. 4.19 to 4.25 *supra.*
2. *Shri Mohan Lal Chokhani* v. *C.T.O.*, (1970) 28 S.T.C. 363, 367, 373, 374, 382 (Calcutta). (P.B. Mukherjee, C.J. and B.C. Mitra J.)
3. See Para 4.21 *supra.*
4. See *Mohan Lal Chokhani* V, *Commercial Tax Officer* (1971) 28 S. T. C. 367, 373 (Cal.), Supra.
5. Para, 4.16, 4.18, 4.27 supra.
6. Cf para 4.16, *supra.* read with 4.15 (C).

## CHAPTER 5

## PUNISHMENT FOR EVASION OF SALES TAX

### *Introductory*

The question of *mens rea* with regard to offences.

5.1. One of the questions which we have been asked to consider is, whether the provisions with regard to penalties for the evasion of sales tax should not be amended, so as to do away with the concept of *mens rea* or to bring them in line with the recommendation made by this Law Commission in its 47th Report with regard to offences under other fiscal laws.

### *Mens Rea*

Recommendations in Law Commission's 47th Report.

5.2. It may be noted that this Law Commission, in its Report on the offences connected with social and economic legislation,[1] made several recommendations for amendment of the enactments dealing with social and economic offences, including laws relating to direct taxation. It should be noted, however, that not all the amendments recommended in the Report were applicable to laws relating to direct taxes. Some of the recommendations for amendment were expressly stated as not applicable to the Income-tax Act and other taxation laws, having regard to the complicated nature of offences under those laws. Thus, it was noted in that Report[2] that provisions as to the following were absent from the Income-tax Act :—

(i) Elimination or modification of *mens rea ;*

(ii) Confiscation ;

(iii) Stoppage of business (on conviction) ;

(iv) Higher powers of Magistrate ;

(v) Special rules of evidence.

---

1. 47th Report of the Law Commission (Social and Economic Offences).

2. 47th Report (Social and Economic Offences), page 130, para 15.54.

5.3. But amendments for inserting such provisions in the enactment relating to direct taxes were ruled out, having regard to the complicated nature of the offences under the Act.

Amendment on above matters not recommended in taxation law.

5.4. The same reasoning applies to offences under sales tax laws. That the offences under the Sales Tax Act will be of a complicated nature, cannot be denied. No change is, therefore, recommended on the question of *mens rea*.[1]

Change in Sales Tax law not recommended, as regards *mens rea*

5.5. and 5.6. It may also noted, with reference to *mens rea* under the Act, that it has been held that to bring home the offence under section 10(b), a guilty animus or *mens rea* is essential.[2] This view is concluded by a series of decisions.[3]

Court decisions emphasise need for *mens rea*.

5.7. We shall now examine,—(i) such provisions of the laws relating to direct taxes as are suitable for sales tax laws; and (ii) such of the amendments recommended in the Commission's Report on Social and Economic offences[4] as were intended for direct tax laws provided they are suitable for adoption in sales tax laws.

Provisions of direct tax laws considered.

*Higher punishment*

5.8. We shall first consider the question of higher punishment for certain offences. In the Commission's Report on Social and Economic Offences[5], the offence of making false statements in declarations under the Income-tax Act was specifically dealt with, and a recommendation was made to regulate the punishment according to the amount of tax which would have been evaded if the statement by the assessee (now discovered to be false), had been accepted as true. If the amount of such tax exceeds one lakh of rupees, or if the case is one of a second or subsequent conviction, the recommendation was to prescribe the maximum punishment of 7 years' imprison-

The question of higher punishment for certain offences.

---

1. Para 5.2 (i), *Supra*.
2. *Misra Limestone Co.* V. *S. T. Officer*, A.I.R. 1971 Orissa 122, 124.
3. *Manjunath Type Botreading Works* V. *State of Mysore (1969) 23 S.T.C. 438 (Mysore)*.
   (b) *Commissioner of Sales Tax, Indore* V. *Bombay General Stores*, A.I.R. 1969 Madhya Pradesh 213,
   (c) *Pannalal Umesh Kumar of Ghoghar Rewa* V. *Commissioner of Sales Tax, M.P.* (1971) 27 S.T.C. 199 (Madhya Pradesh).
4. 47th Report of the Law Commission.
5. 47th Report of the Law Commission, Page 174.

ment (and fine), with a minimum of six months' imprisonment—there was also a recommendation as to relaxation of the minimum. In other cases, the maximum imprisonment recommended was three years (with fine as an alternative), but there was to be no minimum. The same approach could be adopted for offences under the Central Sales Tax Act. But, in this case, the figure of one lakh of rupees, should be reduced to ten thousand rupees because, even for evasion of tax to the tune of Rs. 10,000, the turnover would have to be fairly high. Further, we are of the opinion that there need be no relaxation of the minimum in this case.

Recommendation to amend section 10, as to insert minimum punishment

5.9. Accordingly, we recommend that section 10 of the Central Sales Tax Act should be revised as follows :—

"10. If any person—

.....[(a) to (f) as in existing section] he shall be punishable—(i) if the amount of tax which would have been evaded if the offence had not been discovered or the amount illegally collected, as the case may be, exceeds ten thousand rupees, or if the case is one of a second or subsequent conviction for an offence under this Act, with imprisonment for a term which may extend to seven years, but which shall not be less than six months, and with, fine;

(ii) in any other case, with imprisonment for a term which may extend to three years, or with fine, or with both ;

and when the offence is a continuing one, the fine under sub-clause (i) or sub-clause (ii) of this clause, may be a daily fine which may extend to fifty rupees for every day during which the offence continues."

Adequacy of punishment—a Gujarat case.

5.10. It is heartening to note that some High Courts are alive to the need for adequate punishment for offences relating to taxes. Thus, for example, in a recent Gujarat case,[1] the High Court observed :

"One can understand an offence against the person of an individual committed on account of the emo-

---

1. *State of Gujarat* V. *Korimbhat*, (1972) 29 S. T. C. 95, 97 (Gujarat) (M.P. Thakkar J.).

tions of an individual getting the better of his reason.....When, however, offences against public revenues are committed by businessmen with deliberation, no lenient view of the matter can be taken by the courts. Let it not be forgotten that the public revenues collected by way of taxes from the citizens are *inter alia* employed by the State for ensuring that the citizens are not deprived of their right to possess property. If offences against public revenue are committed by businessmen, it would amount to robbing the State which prevents them from being robbed by others.

Where a charge is that of filing false returns and of failing to account for sales running into as large a sum of Rs. 1,38,914.31, to impose a penalty of a fine of Rs. 10 (it is no overstatement to make) is to make mockery of the provisions contained in section 63 of the Act. To impose a fine of Rs. 10 can very well be equated with the issuance of a licence to defraud public revenues on payment of Rs. 10.

A time has come when the courts cannot afford to take an unduly lenient view of contravention of the provisions enacted by the Legislature to prevent fraud against public revenues."

*Abetment*

Abetment.

5.11. The question of abetment of offences may now be considered.

Recommendation of insert section 10B relating to abetment.

5.12. In the Commission's Report[1] on Social and Economic offences, a re-draft of the section of the Income-tax Act relating to abetment,[2] was suggested. We recommend that on the same lines, a new section should be inserted in the Central Sales Tax Act[3] as follows :—

"10-B. *Abetment of false accounts, etc.*

If a person abets or induces in any manner another person to make and deliver an account, statement or declaration relating

1. 47th Report of the Law Commission.
2. Income Tax Act, 1961
3. Section 10 B

to any transaction chargeable to tax under this Act, which is false and which he either knows to be false or does not believe to be true, he shall be punishable—

(i) if the amount of tax which would have been evaded if the declaration, account or statement had been accepted as true, exceeds ten thousand[1] of rupees or if the case is one of a second or subsequent conviction for an offence under this Act, with imprisonment for a term which may extend to seven years, and with fine ;

(ii) in any other case, with imprisonment for a term which may extend to three years, or with fine, or with both.".

*Corporations*

Punishment of Corporations.

5.13. The question of punishment of Corporations was considered in the Commission's Report[2] on Social and Economic offences, and the insertion of the following section in enactments dealing with social and economic offences was recommended.

"10-B. (1) When a corporation is convicted of an offence under this Act, it shall be competent to the Court before which the conviction takes place, to pass on the corporation a sentence of public condemnation, in addition to any other punishment to which the corporation may be sentenced.

(2) When such a sentence is passed, the court shall cause the name and place of business of the corporation, the offence, the fact that the corporation has been so sentenced and any other punishment imposed, and such other particulars as the court may consider to be appropriate in the circumstances of the case, to be published at the expense of the corporation in such newspapers or in such other manner as the court may direct.

(3) The expenses of such publication shall be recoverable from the corporation in the same manner as fine.".

---

1. As to the amount *cf*—Page 59, *Supra*.

2. 47th Report, Page 172, and P. 61-62, Para 8.1.

5.14. We recommend that a similar provision should be inserted in the Central Sales Tax Act,[1] as section 10-C.

Recommendation to insert section 10-C regarding Corporations.

*Publication of names of convicted individuals*

5.15. We also recommend[2] that a provision for publication of names of convicted individuals should be added in the Central Sales Tax Act. Legislative precedents are available on the subject and we need not, therefore, suggest a draft.

Section 10D—Publication of names of convicted individuals.

1. It could be put as section 10-C

2. It could be put as section 10-D

## CHAPTER 6

## DISPOSAL OF EXCESS AMOUNTS COLLECTED BY A DEALER FROM A CUSTOMER AS SALES TAX

Collection of excess amount by dealers.—No legislative competence in States.

6.1 It appears that some difficulty has been felt as regards the disposal of amounts illegally collected as sales-tax by a dealer from a customer. Such a situation usually arises when Sales Tax is realised from a person in respect of goods not liable to tax. State Acts sometimes contain provisions to the effect that such amounts will be *forfeited* to the State Government. But such a provision has been held[1] to be beyond the legislative competence of the States, as it is not incidental to the power to levy a "tax" on the sale of goods, because, *on hypothesi,* the amount in question is not leviable as "a tax".

Thus, section 5(c) of Andhra Pradesh General Sales Tax Act (6 of 1957) as amended was held to be *ultra vires* the State Legislature,[2] on this ground. The section provided for liability of the dealer to pay illegally collected tax to the Government.

Provisions for penalty held void in absence of procedural safeguard.

6.2. Even where the provision was framed in terms of "penalty", and not merely in terms of "forfeiture", it was held to be void, in the absence of procedural safeguards which complied with article 19(1)(f) of the Constitution. On this ground, a provision in the Bombay Sales Tax Act was held to be void.[3]

Case relating to U.P. Act.

6.3. In a recent case[4] decided by the Supreme Court a dealer wrongly collected a certain sum as sales tax from the customer. The question was whether the State Legislature is

1. *Abdul Quadar and Co.* v. *Sales Tax Officer, Hyderabad* (1964) 6 S.C.R. 867; A.I.R. 1964 S.C. 922, 923 to 925 (Section 11, Hyderabad *General Sales Tax* Act).
2. *V. Audiseshtah & Co.* v. *State of Andhra Pradesh,* (1968) 22 S.T.C. 222 (Andhra Pradesh). (Section 5, Andhra Act).
3. *Kantilal Babulal* v. *H. C. Patel, A.I.R.* 1968 S.C. 445, 448, Para 9; (1968) 1.S.C.R. 735, (Section 12-A, Bombay Sales Tax Act, 1946).
4. *State of U. P.* v. *Annapurna Biscuit Mfg. Co.* (1973) 1.S.C.R. 668 (dated 3rd May, 1973). A.I.R. 1973 S.C. 1333 (July). (Section 29A, U. P. Act).

competent to pass a law for the deposit of that amount in the Government Treasury.

The U.P. Legislature had, through an amending Act, substituted the following provision (in place of the old section) in the U. P. Sales Tax Act—

"29A. (1) Where any amount is realised from any person by any dealer purporting to do so by way of realisation of tax on the sale of any goods to such person, such dealer shall deposit the entire amount so realised into the Government treasury, within such period as may be prescribed, notwithstanding that the dealer is not liable to pay such amount as tax or that only a part of it is due from him as tax under this Act.

(2) Any amount deposited by any dealer under sub-section (1) shall, to the extent it is not due as tax, be held by the State Government in trust for the person from whom it was realised by the dealer, or for his legal representatives, and the deposit shall discharge such dealer of the liability in respect thereof to the extent of deposit.

(3) Where any amount is deposited by any dealer under sub-section (1) such amount or any part thereof shall, on a claim being made in that behalf in such form as may be prescribed, be paid to the person from whom such dealer had actually realised such amount or part, or to his legal representative, and to no other person: "Provided that no such claim shall be entertained after the expiry of three years from the date of the order of assessment or one year from the date of the final order on appeal, revision or reference, if any, in respect thereof, whichever is later."

Earlier cases relied on.

6.4. The constitutional validity of this provision was challenged in the Allahabad High Court, which declared it as unconstitutional. There was an appeal to the Supreme Court (on a certificate granted by the High Court). The Supreme Court dismissed the appeal, relying on its two earlier decisions. The first was *Commissioner of Sales Tax* v. *Ganga Sugar Corporation Ltd.*,[1] in which the Supreme Court had declared a similar provision [section 8-A(4)] *ultra vires* the Constitution. Section 8-A(4) read as follows:—

1. *Commissioner of Sales Tax* v. *Ganga Sugar Corporation Ltd.* (1970) 25. S.T.C. 155 (S.C.). (Section 8A, U. P. Act).

"8-A(4). Without prejudice to the provisions of clause (g) of sub-section (2) of section 14, the amount realised by any person as tax on sale of any goods shall, notwithstanding anything contained in any other provision of this Act, be deposited by him in the Government Treasury within such period as may be prescribed, if the amount so realised exceeds the amount payable as tax in respect of that sale or if no tax is payable in respect thereof."

An Andhra Pradesh case.

The second case was *Abdul Quadar & Co.* v. *Sales Tax Officer, Hyderabad.*[1] In that case also the Supreme Court had declared section 11(2) of the Hyderabad General Sales Tax Act, which required the dealers to deposit tax wrongly collected by them in the Government Treasury, to be *ultra vires* the Constitution.

A case from Bihar.

6.5. In another judgment of the Supreme Court,[2] section 20A of the Bihar Sales Tax Act, (which was substantially similar to section 29A of the U.P. Act[3]) was held to be void. The question which the Supreme Court posed to itself was—"Is there any entry in List II or List III of the Seventh Schedule to the Constitution under which the State Legislature could make such a law?"

It was contended before the Supreme Court that Entry 54 in List II or in the alternative, entry 7 in List III gives sufficient power to the State to legislate on the subject under dispute. However, the Court rejected this contention, and dismissed the appeal, and declared the provision of the Bihar Act as *ultra vires* the Constitution.

It is needless to state that the Supreme Court decisions have been applied by several High Courts.[4]

Three aspects considered.

6.6. What, then, would be done to clarify the position ? We consider three aspects in this context—

(a) the position under the ordinary law as to the effect of mistake of law;

---

1. *Abdul Quadar & Co.* v. *Sales Tax Officer, Hyderabad,* (1964) 15 S.T.C. 493, A. I. R. 1964 S. C. 922.
2. *Asoka Marketing Ltd.* v. *State of Bihar,* (1970) 1 S.C.N.R. 283, (1970) 1 S.C.C. 354. (Section 20 A, Bihar Act).
3. Para 6.3 supra.
4. *Lakshminarayana Commercial Corp.* v. *C. T. O* (1972) 29 S.T.C. 527 (Andhra Pradesh).

(b) the proper course to be adopted;

(c) the constitutional position.

(a) *Ordinary law as to effect of mistake of law*

6.6A. The Supreme Court has held[1] that if it is established that a payment, even though it be a tax, has been by a party labouring under a mistake of law, the party is entitled to recover the same, that the party receiving the same is bound to repay or return it, and that no distinction can be made in respect of a tax liability and any other liability on a plain reading of section 72 of the Indian Contract Act.

Liability of State.

6.7. The settled position in law, as regards the liability of the State, as laid down by the Supreme Court,[2-3-4] is as follows:—

(a) Where tax is levied by mistake of law, then ordinarily it is the duty of the State, subject to any provision of the law relating to sales tax, to refund the tax;

(b) If refund is not made, remedy through court is open, subject to the same restrictions and also to the period of limitation, namely, three years, from the date when the mistake had become known to the person who had made the payment by mistake.

(c) The High Courts have the power, for the enforcement of statutory rights and fundamental rights, to give consequential relief by ordering repayment of money realised by the Government without the authority of law The power is, of course, discretionary.

---

1. *Sales Tax Officer* v. *Kanhaiya Lal*, A. I. R. 1959 S.C. 135; (1959) S.C.R. 1350.
2. *State of Kerala* v. *Aluminium Industries* (1965), 16 S. T. C. 689 (S.C.), referred to in the Yearly Digest (1965) K.L.R. 528.
3. *State of Madhya Pradesh* v. *Shailal Bhai*, A. I. R. 1964 S.C. 1000, 1010, para 14 to 17.
4. *Gill & Co.* v. *Commercial tax Officer*, Civil Appeal No. 1580-1595 of 1967 dated 9-2-1968 (1968) S. C. Notes 80; (1968) 22 S.T.C. 524 (S. C.)

Liability of the dealer.

6.8. These propositions deal with the liability *of the State* to refund money illegally realised. The liability *of the dealer* to refund, to the citizen, the amount illegally realised cannot also be disputed. It is well settled that a person who is illegally made to pay a tax is entitled to refund.[1]

Three parties involved.

6.9. It should be remembered that there are three parties involved in the question which is under consideration. First, there is the citizen who has been illegally deprived of a certain amount of money under the guise of tax; secondly, there is the dealer who, knowingly or otherwise, has recovered the amount from the citizen without the authority of law: and thirdly, there is the Government which, as a sovereign, is naturally anxious that the amount should be refunded to its rightful owner, that is, the citizen.

State to secure restoration to citizen.

6.10. Not much argument is needed in support of the proposition that the State, as the sovereign charged with the advancement of justice, ought to see that what belongs to the citizen is restored to him. The machinery by which this objective is to be achieved, and the provision to be made to achieve it and other matters, are matters of detail rather than of principle. A legislative provision dealing with this problem must take us to the point of the ultimate *destination of the amount.* The provision in most State laws relating to Sales Tax leave the matter at the stage of vesting the money in the State, or satisfy themselves with prescribing penalties for the illegal realisation of tax. It is obvious that if a satisfactory legislative formula can be devised which carries out the objective mentioned above *in the fullest manner,* it would not only advance substantive justice, but also make for a clarification of the law in a field where some such clarification or declaration of the law appears to be eminently needed. The general proposition in the Contract Act[2] for restitution gives effect to a well-established principle of the common law; and what is needed is a provision which works out this principle in the particular field of taxation in an effective manner.

---

1. *cf.* section 72, Contract Act.
2. Section 72, Indian Contract Act, 1972.

(b) *Constitutional Position*

Constitutional position.

6.11. The present constitutional position is clear. The legislative power to deal with the disposition of amounts collected illegally as sales tax is not relatable to the taxing power of the States,[1] and it would seem that this power can be derived only from the residuary legislative power, which vests in the Union.

(c) *Proper Course*

Parliament's power under the residuary power entry.

6.12. That being the position, the proper course would be to enact Central legislation on the subject of amounts illegally collected by any person from members of the public by way of tax though not chargeable as tax. Since legislative power in this regard does not fall within any particular taxation entry,[2] it would fall only under the residuary power, which rests with the Parliament.[3] Therefore, the proposed provision could be made applicable to all amounts levied under the guise of tax, but not so legally leviable.

Precedent adopted in the Income Tax Act and State Acts considered.

6.13. As to the enact content of the provision, some thinking is required. The usual provision in the State Sales Tax Act does not go to the fullest length. Then, there is the precedent adopted in the Income tax Act,[4] but it is not completely appropriate. The *theoretical* basis for the proposed provision would, of course, be unjust enrichment,[5] *but the practical* problem is, how money belonging to a member of the public should be made to reach him back. We think that it would be useful to provide that if a dealer or other person holding such money cannot prove that he has paid it to the rightful owner, he *should be required* to pay it into the State Treasury, and failure to do so should render him liable to prosecution and punishment.

No need to provide administrative penalties.

6.14. It is hardly necessary to provide administrative penalties for failure by the dealer or the person to deposit this amount. However, the Sales Tax Inspector or other officer examining the

---

1. See decisions cited in para 6.1 to 6.5, *supra*.
2. See para 6.11, *supra*.
3. Constitution Seventh Schedule, Union List, entry 97.
4. Section 276B, Income Tax Act, 1961.
5. *cf.* Section 72, Contract Act, and para 6.5, *supra*.

accounts can, if he finds that a violation of the proposed statutory requirement has been committed, initiate suitable criminal proceedings.

Recommendation to enact separate law regarding amount illegally collected as taxes.

6.15. We, therefore, recommend that a legislative provision somewhat on the following lines, should be made by a separate law[1].

"(1) Where any person other than a public officer[2] has, purporting to act in pursuance of any law imposing a tax, realised from any other person as tax any amount not legally due from such person as such tax, he shall[3], unless he proves that he has refunded the amount to that person or has otherwise accounted for the amount in accordance with such law,—

(a) deposit the amount so collected without delay in the nearest Government Treasury, and

(b) shall by general or special notice intimate the particulars of the case to that person and to the authority to whom he would be liable to account if the amount had been legally due as tax.

"(2) All amounts received under sub-section (1) shall be credited to the public account of India, or to the public account of the State[4], as the case may be; but the Union of India or the State, as the case may be, shall be liable to refund the amount to the person from whom it was realised.

(3) The Central Government or the State Government, as the case may be, shall cause public notice to be given[5] every six months of the receipt of such amounts, giving the prescribed particulars.

(4) Notwithstanding anything to the contrary in any law or contract, when any amount is deposited by a person in compliance with the provisions of this

---

1. To be implemented by a separate law.
2. The expression 'public officer' to be defined.
3. punishment for contravention can be imposed.
4. See article 266 of the Constitution.
5. Expression "prescribed" to be defined.

section, such deposit shall constitute a good and a complete discharge of the liability of that person in respect of such amount to the person from whom it was collected.

(5) The person from whom the amount deposited in pursuance of this section was collected, shall be entitled to apply to the authority to whom it was paid for refund of the amount to him, and the said authority shall allow the refund if it is satisfied that the claim is in order :

Provided that no such refund shall be allowed unless the application is made before the expiry of the period within which the applicant could have claimed the amount from the person who collected it by a civil suit, if his liability had not been discharged in accordance with the provision of sub-section (4).

Provided further that no claim for such refund shall be rejected without giving the applicant a reasonable opportunity of being heard.

(6) Nothing in sub-section (5) shall affect the right of the person entitled to refund of any amount thereunder to file a civil suit for the recovery of such amount against the Government ; and the period of limitation for such suit shall be computed from the date of receipt or publication of the notice under sub-section (3)."

**Criminal liability for overcharging tax.**

6.16. Two other questions relating to tax illegally collected were raised during our discussions, and may be examined at this stage ; first, whether a dealer who deliberately collects as tax sum not legally due, is guilty of an offence, and second, if he is not so guilty, whether a provision in that behalf should be recommended. We deal with them below :

**Offence of cheating constituted by overcharging.**

6.17. As to criminal liability for over-charging tax, the offence most probably committed by a dealer in the circumstances mentioned above is that of cheating. In so far as is material for the present purpose, the relevant section in the Indian Penal Code[1], (dealing with cheating) punishes a person who,

1. Section 415, read with section 420, I.P.C.

by "deceiving" another person, induces that person to do a certain thing,—in the present case, the payment of money not legally due. The crucial word is the word "deceiving". The starting point in the search for guilt in a case alleged to be one of cheating, is a consideration of the question whether there was a "deception". The Indian Penal Code does not define the expression "deceiving". Roughly speaking, there is deception when there is untrue representation (made knowingly), which induces belief in the mind of the person to whom the representation is made, and which is intended to induce such belief.

Overcharging whether amounts to a representation.

6.18. The first question, then, to be considered, is whether there is a representation by a dealer when he over-charges tax. It is well-established that a representation may be by words or by conduct. Verbal assertions or direct representations are not required to constitute deception. "Actions speak louder than words". In an English case often cited[1], it was pointed out that if a wrong-doer who pretends to be a college student, by putting on clothes peculiar to the students of a particular college, goes to a shop and thus obtains goods at credit, he would be guilty of the (statutory) offence of obtaining goods by "false pretences[2]", even though *he did not say* that he was a member of the college. In the present case, of course, there is really something more than an implied assertion or assertion by conduct; there is an *express demand*. Hence there is no doubt that there is a representation.

Representation as to a matter of law.

6.19. Another question to be considered, in regard to the meaning of deception or representation is, whether a representation as to a matter of law constitutes deception. In England, (in respect of the offence relating to false pretences), because of the requirement that there must be a "false pretence", the general view taken was that there must be an untrue representation as to fact[3]. In the discussion of the law on the subject, therefore, a distinction was usually made between a representation of fact (on the one hand) and a representation as to opinion, or prediction, or promise (on the other hand). It was generally stated that the "pretence" must relate to the present or the past,

1. *Rex* v. *Barnard*, (1837) 7 car and P. 784.
2. See now, Theft Act, 1968, section 15.
3. Section 32, Larceny Act, 1916 (repealed) [see now, section 15 (4), Theft Act, 1968].

and not the future. On the specific question whether a representation as to a matter of law would be covered by the statutory offence of false pretence, there was some uncertainty. Many writers took the view that it was covered, but there was no direct reported English case. The position has now been clarified by the Theft Act. Section 15, of that Act punishes a person who by "deception" induces the person deceived to do a certain thing. One of the sub-sections of the Act which is important for the present purpose[1], is as follows :—

> "(4). For the purpose of this section, "deception" means any deception (whether deliberate or reckless) by words or conduct as to fact or as to law, including a deception as to the present intentions of the person using the deception or any other person."

Significance of the word "deceiving".

6.20. Since, in India, the only crucial word is "'deceiving[2]", Courts are, it appears, free to adopt a wider interpretation than was adopted by English Courts under the old statute[3]. After all, such fraud as is deliberate, though not relating to a matter of "fact", ought not to go unpunished. The way of the transgressor ought to be made as hard as possible. It is, therefore, a proper view to take that if a dealer deliberately over-charges tax, he is deceiving the customer, because he is, by his own act, inducing the customer to believe that the tax is legally chargeable.

Adequacy of law a desideratum.

6.21. No doubt, the absence of an effective penal provision would be deplorable, "both because the courts are reluctantly compelled to allow dishonesty to go unpunished and because of the serious waste of judicial time involved in the discussion of futile legal subtleties[4]." But, as stated above, the law is adequate in India to deal with deception as to tax.

Provision in State Laws.

6.21A. As a matter of fact, many State Acts relating to Sales tax also contain provisions relating to punishment for over-charging tax ; and this provision in the State Acts would be attracted, in respect of over-charging under the Central Sales Tax Act, by virtue of the general provision in section 9(2) of

---

1. Section 15 (4), Theft Act, 1968 (Eng.).
2. Section 415, Indian Penal Code.
3. Para 6.19 *Supra*.
4. Note in (1955) 72 Law quarterly Review 183, quoted by Lord Goddard C.J, in *Russell* v, *Smith*, (1957) 2 *All*. E.R. 796, 797.

the Central Act,—particularly because it is now proposed to add the word "offences[1]" in section 9(2).

Doubt as to provisions in State laws as to overcharging.

6.22. No doubt, an objection could be raised that the sections in the State Laws are themselves invalid, because, if tax is not legally chargeable, a provision imposing a penalty for illegal charging falls outside the purview of the States' legislative power. There is some justification for entertaining such a doubt, in view of the Supreme Court decisions[2], already cited. Most of them deal with the civil aspect, but one relates to the penal aspect. That was a case from Bombay[3] and a provision in the Bombay Sales Tax Act imposing a "forfeiture" of the amount illegally collected as tax was held to be void, as violating article 19(1)(f) of the Constitution. The Court said that it "assumed" that the Legislature had legislative competence to enact the provision. But, earlier, it stated that a Gujarat decision holding that such a provision is incidental to the power to tax sale "cannot be sustained." We may, however, point out that the provision in the Penal Code[4] would apply[5], in any case. Hence the second question posed above[6] does not arise, and it is not necessary to introduce any amendment in the penal law on this point.

1. See discussion relating to section 9, Central Sales Tax Act.
2. See Para 6.1 to 6.13 *Supra*.
3. *Kantilal Babulal* v. *H.C. Patil* A.I.R. 1968 S.C. 445.
4. Section 415, Penal Code.
5. Para 6.20, *Supra*.
6. Para 6.16, *Supra*.

## CHAPTER 7

## ESTABLISHMENT OF CHECK-POSTS FOR PREVENTING EVASION AND ENSURING BETTER COLLECTION OF TAXES ON THE SALE OF GOODS

Introductory.

7.1. One of the questions which we have been asked to consider is the establishment of check-posts for preventing evasion and ensuring better collection of taxes on the sale of goods. We assume that 'check-posts', in this context, would be in the nature of barriers put up to ensure that in inter-state movement, goods do not escape the tax lawfully leviable. It appears that some obscurity exists as to legislative competence to provide for such check-posts. Because of this obscurity, our discussion will concentrate on legislative competence.

Legislative entries.

7.2. The power of the Union to levy inter-state sales tax is primarily derived from Union List, entry 92A under which (so far as is material) a law can be made imposing a tax on inter-state sale or purpose of goods. Now, it is well-settled[1] that the legislative entries in the Constitution must be given the widest possible interpretation and the Legislature is competent to enact provisions to check the evasion of tax[2]. The amplitude of the legislative power in relation to measures for enforcement[3] is well-established.

Amplitude of the entries.

7.3. On this principal, the imposition of interest on arrears of sales tax has been upheld. Though the State List, entry 54, of the Constitution does not refer to interest, the power to charge interest on arrears is regarded as incidental to the power to impose sales tax[4].

---

1. *Board of Revenue* v. *R.S. Thaver*, A.I.R. 1968 S.C. 59, 64, (1968)1 S.C.R. 148, 20 S.T.C. 453, 66 I.T.R. 664.
2. See 49th Report of the Law Commission, pages 7 to 9 para 13 to 19. (cases reviewed).
3. (a) *Ravinchandra* v. *C.I.T* (1954) 26 I.T.R. 758, (1955) 1 S.C.R. 829 (b) *Balaji* v. *I.T.O.* (1962) 2 S.C.R. 983, 43 I.T.R. 393.
4. *B. Ram Chand* v. *S.T.O.* (1968) All L.J. 970, 972; 23 S.T.C. 423(D.B.) (Oak C J. and T.P. Mukherji J.).

Suggestion referred to.

7.4. We understand, however, that States have, in view of certain judgments[1-2], urged[3] that there should be a provision in the *Central Sales Tax Act* for setting up check-posts. We, therefore, proceed to a discussion of the case law.

Judicial decisions—Andhra case.

7.5. As a starting point for discussion, we may take a recent case[4] of the Andhra Pradesh High Court. It held sub-section (3) and (4) of section 29 of the Andhra Pradesh General Sales Tax Act, 1957 to be beyond the legislative competence of the State. Under those sub-sections, the officer-in-charge of the check-post could seize goods not covered by way bills containing the prescribed particulars, and could confiscate them if the penalty levied was not paid. It was held by the High Court, following a Supreme Court judgment[5], that the power to confiscate and seize goods was not ancillary or incidental to the power to tax the sale or purchase of goods. We shall, in due course, discuss the judgment of the Supreme Court[6].

Parliament competent to set up check-post under the Central Act.

7.6. It seems to us, however, that the position should be considered separately with reference to the Central Sales Tax Act and with reference to the State Sales Tax Acts. So far as the position under the *Central Sales Tax Act* is concerned, it is obvious that the creation of check-posts and the conferment of other powers including, if necessary, powers for the seizure of goods, falls within the competence of Parliament. Whether or not such a power is incidental to the power to levy taxes, is, in the case of *Parliament*, immaterial in the present *context* because, if Union list entry 92A does not give the power, Parliament has it under its residuary legislative power. What precise amendments should be made to provide for such check-posts and to confer such powers is not a matter with which we are concerned at the moment, and we should make it clear that any provisions that may be proposed in this regard should take care to comply with the fundamental rights, particularly, articles 19 and 31 of the Constitution. But legislative competence of Parliament cannot be doubted.

---

1. Judgment reported in 27 S.T.C. page 1 and 27 S.T.C. page 4 (S.C).
2. See para 7.7 and 7.10, *infra*.
3. Notes in the Ministry of Finance.
4. *Anandpur District Co-operative Marketing Society Ltd.* v. *Special Assistance Commercial Tax Officer*, (1972) 29 S.T.C. 649, 653, 654 (Andhra Pradesh).
5. *Check-post Office* v. *K. P. Abdullah*, (1971) 27 S.T.C. 1
6. See Para 7.7, *infra*.

Check-posts under State Sales Tax laws.

7.7. So far as the creation of check-posts for the purposes of *State Sales Tax Acts* is concerned, there are two important decisions of the Supreme Court to be noted. In *K. P. Abdulla's* case[1], a section of the Madras Sales Tax Act[2] was at issue. Sub-section (1) of that section authorised Government to set up check-posts or barriers, to prevent or check the evasion of tax. Sub-section (2) of that section empowered the check-post officer *to stop* the vehicle or boat at the check-post or barrier, to keep it stationary as long as it may be reasonably necessary, to examine the contents of the vehicle or boat, to inspect the records etc. and to take the name and address of the driver, the owner of the vehicle or boat and the consignor and the consignee of the goods. Sub-section (3) of that section conferred power on the check-post officer to *seize and confiscate* any goods under transport in such vehicle or boat which were not covered by the specified documents, subject to certain procedural safeguards and subject to an option to the person in charge of the vehicle to pay, in lieu of confiscation, a specified sum, including tax. The Supreme Court found the power to *confiscate* the goods to be invalid, on the ground that such a power could not be said to be 'fairly and reasonably comprehended in the power to legislate in respect of taxes on sale or purchase of goods'. The following observations of the Supreme Court are relevant :—

> "sub-section (3) assumes that all goods carried in a vehicle near a check-post are goods which have been sold within the State of Madras and in respect of which liability to pay sales tax has arisen, and authorises the Check-post Officer, unless the specified documents are produced at the check-post or the barrier, to seize and confiscate the goods and to give an option to the person affected to pay penalty in lieu of confiscation. A provision so enacted on the assumption that goods carried in a vehicle from one State to another must be presumed to be transported after sale within the State is unwarranted. In any event, the power conferred by sub-section (3) to seize and confiscate and to levy penalty *in respect of all goods which are carried in a vehicle whether*

---

1. *Check-Post Officer, Coimbatore* v. *K.P. Abdullah,* (1971) 27 S T.C. 1; A.I.R. 1972 S.C 792, (1972) 2 SCR 817.
2. Section 42, Madras General Sales Tax Act, 1959.

*the goods are sold or not is not incidental or ancillary to the power to lavy sales tax*[1]".

State Legislatures competent to establish check-posts.

7.8. It should be mentioned here that sub-sections (1) and (2) of section 42 of the Madras Act (which related to setting up of check-posts and stopping of vehicles) were not found by the Supreme Court to be wanting in constitutional validity. What was held to be void was sub-section (3), in one respect[2]. The State Legislature can still create check-posts. The validity of that power in the abstract is not denied at all. But, if any power to seize and *confiscate*[3] the goods is to be validly given, the legislative provision conferring the power must bear in mind the observations made by the Supreme Court, perticularly as regards the invalidity of the rigid presumption of sale found in the Madras Act[4].

Constitutional amendment not appropriate.

7.9. We do not think that this position can be appropriately altered by a constitutional amendment. Nor do we think that the view taken by the Supreme Court departs from the view that it has taken regarding corresponding provisions in the legislation dealing with direct taxes. In fact, most of the judicial decisions relating to the corresponding provisions in the Income-tax Act are referred to in the judgment of the Supreme Court itself. We are mentioning this because a belief prevails in some quarters that the position is different under the Income-tax Act.

Check-posts in inter-State transactions-Rule struck down as dealing with inter-State transactions.

7.10. The second case[5],—*Hansraj Bagrecha's* case—decided by the Supreme Court also relates to check-posts. But it must be noted that in that case a rule made by the Government of Bihar was struck down because it authorised restrictions on *inter-State transactions*, — a matter admittedly beyond the competence of the State Legislature. The rule in question[6] was as follows:—

> "(1) No person shall tender at any railway station, steamer station, air-port, post office or any other place, whether of similar nature or otherwise, notified

---

1. Emphasis supplied.
2. See para 7.7, *supra*.
3. See para 7.7, *supra*.
4. See para 7.7, *supra*.
5. *Hansraj Bagrecha* v. *State of Bihar* (1971) 27 S. T. C. 4 (S. C.)
6. Rule 31-B, Bihar Sales Tax Rules, 1959.

under section 42, any consignment of such goods, exceeding such quantity, as may be specified in the notification, *for transaction to any place outside the state of Bihar,* unless such person has obtained a despatch permit in Form XXVII-D from the appropriate authority referred to in the Explanation to rule 31 and no person shall accept such tender unless the said permit is surrendered to him."

It is plain that a State Legislature has no competence to make such rules regarding inter-state sales. But the position of the Union Parliament is obviously different, and the judgment in the above cases does not throw any doubt on the legislative power of the Union.

No constitutional difficulty.

7.11. *Prima facie,* therefore, there should not be any legal difficulty in regard to the insertion of a provision for the establishment of check-posts or the adoption of other measures, which may be reasonably necessary for preventing the evasion of the tax levied under the *Central Sales Tax Act.* Any objection under article 301 of the Constitution could be met by relying article 302.

What precise provisions should be made, is a matter of administrative character; and we suggest that the Department concerned may, if it regards the establishment of check-posts (or the adoption of other measures) necessary for the proper enforcement of the Central Sales Tax Act, chalk out an outline of such measures, and process the matter in consultation with the Ministry of law. As already pointed out[1], the provisions of articles 19 and 31 of the Constitution will have to be borne in mind when drafting such provisions.

---

1. See Para 7.6 *supra.*

## CHAPTER 8

## OTHER QUESTIONS—DEFINITIONS

Introductory.

8.1. So far, we have dealt with questions specifically raised in the letter of reference. Certain other related questions concerning the Central Sales Tax Act, though not mentioned in the letter of reference, will now be considered.

Meaning of "Customs frontiers".

8.2. The first question relates to the meaning of the expression "customs frontiers". Under section 5 (1) and 5(2) of the Act, the transfer of shipping documents after the outgoing goods have crossed the "customs frontiers of India", is regarded as a sale in the course of export, and conversely, where the sale takes place before the incoming goods have entered the customs frontiers of India, it is regarded as a sale in the course of import. The result is that if the sale takes place *after* the incoming goods have entered the customs frontiers, it is not a sale in the course of import.

Now it may be noted that the Supreme Court has, in one case[1] interpreted the expression 'customs frontiers' as meaning or denoting the customs frontiers as defined[2] for the purpose of the Customs law. In that case, the State raised the contention that the sales in question (*i.e.*, sales effected while the goods were in the Madras harbour), were not sales in the course of import, as the documents of title were handed over by the assessee to the *buyers after the ship had crossed the 'territorial waters'*. According to the State, the expression 'customs frontiers', occurring in section 5(2) of the Central Sales Tax Act, 1956, was co-terminous with the extent of the 'territorial waters' of India, as fixed by the Proclamation, dated March 22, 1956 issued by the President of India. According to the State, the import was complete when the ship carrying the goods from a foreign port entered the territorial waters, and any sale by the importer, by transfer of documents of title to the goods *subsequent to such entry*, would not amount to sale in the course of import. On the other

---

1. *State of Madras* v. *Daver & Co.*, A.I.R. 1970 S.C. 165, 167, para 7.
2. Defined in section 3A, Sea Customs Act, 1878 (repealed).

hand, according to the assessee, 'customs frontiers' in section 5(2) of the Central Sales Tax Act, must be read, to analogous to 'customs barriers'[1], and, when it is so read, the position would be that a sale effected by transfer of documents of title before the goods have crossed the 'customs barrier' would not be liable to tax under the Madras Act, even though the goods have entered the territorial waters, and thus crossed the "customs frontiers".

The Supreme Court upheld the contention of the State of Madras and agreed with the former interpretation.

Position under the Customs Act, 1962.

8.3. This decision of the Supreme Court was rendered with reference to an assessment year when the Sea Customs Act of 1878 was in force, as the assessment in question related to the assessee's turnover for 1957-58. But the problem can survive under the Customs Act, 1962 also, because, under the latter Act, the definition of 'India' includes Indian territorial waters. The question could arise whether 'customs frontiers', in the Central Sales Tax Act, means the frontiers of "India" as defined in the Customs Act,—which includes territorial waters.

Difficulties caused by the present position.

8.4. The result of the interpretation placed by the Supreme Court[2] is, that if, after the goods being imported have crossed the "customs frontiers" (as interpreted by the Supreme Court) but have not yet reached the "customs barriers" as usually understood, a sale takes place by transfer of shipping documents, the sale is not regarded as taking place in the course of import. Local sales tax is, therefore, leviable on such sales. Now, it has been stated[3] by orde circles that this interpretation will cause practical difficulties.

Apparently, the practical difficulty likely to be caused is in relation to determination of the actual location of the goods at the time of sale, with reference to customs frontiers, which, after all, are not visible like barriers on the shore. The expression "customs frontiers" was given a vide meaning in the old Sea Customs Act, or to state the position in terms of the present Customs Act, 1962,—"territorial waters" have been

1. As to 'customs barriers' see para 8.6 *infra*.
2. Para 8.3 and 8.4 *supra*.
3. Notes in the Finance Ministry.

included within 'India',—because such a wide connotation is considered necessary for the purposes of the enforcement of the customs law, particularly for surveillance and similar purpose. But, in practice, the actual checking of the goods mostly takes place not at the edge of the national territorial waters, but at a "customs station", when the goods cross the customs barriers[1]. The expression "customs station" has a statutory connotation[2], and can be conveniently utilised.

Recommendation to define "crossing the customs frontiers".

8.5. It would, therefore, be convenient from the practical point of view—and theoretically unobjectionable—if the expression "crossing the customs frontiers" is defined, for the purpose of the Central Sales Tax Act, in the following terms[3-4] :—

> "(aa) 'crossing the customs frontiers' means crossing the limits of a customs station[1] established by or under the authority of the Central Government for the purpose of the Customs Act, 1962, and its grammatical variations and cognate expressions shall be construed accordingly."

We recommend an amendment of section 2 of the Central Sales Tax Act, accordingly.

Expressions used in the Customs Act, 1962.

8.6. It may, incidentally, be noted that the Customs Act, 1962, does not use the expression—

(a) 'customs frontiers', or

(b) 'customs barriers'.

The expression "customs waters" is used in section 115 of that Act. The expression "land frontiers" is used in sections 105 and 109 of the Customs Act, 1962.

The expression "customs barriers" has been used in the case-law, including the *second Travancore case* (as reported in the Supreme Court Reports), and the expression "customs frontiers" also occurs in some of the reported cases under the Central Sales Tax Act.

---

1. No definition of "Customs barriers" could be discovered in the Customs Act. See para. 8.6 *infra*.
2. Section 2 (13), Customs Act, 1962, read with section 2(10) section 2(12), section 2(29), and section 7.
3. To be inserted as section 2(aa) in the Central Sales Tax Act, 1956.
4. This is not intended to be a precise draft.

8.7. The word, 'export', which is one of the crucial words in section 5, has created some problems. It has been held[1], that in the context and setting in which the expression 'export out of the territory of India' occurs in Part XVIII of the Constitution, it is not sufficient that the goods were merely moved out of the territory of India, but that it is further necessary that the goods should be intended to be transported to a *destination beyond India*, so that they were in the course of 'import' into some other locality outside India. In other words, the concept of export, according to this view, postulates also the concept of 'import'. There should be two territories; and there is no 'export' of goods if the goods are intended to be taken out of the country without any intention of their being landed in *specie in some foreign port*. Now, it has been stated[2] that this interpretation results in the levy of local sales tax on sales of coal, aviation fuel and other supplies to ships or airlines involved in international carriage. Section 5—Meaning of 'export'.

8.8. Some of the relevant cases on the subject are summarised below :— Case Law.

In *State of Kerala* v. *Cochin Coal Co*,[3] the question decided was, whether the sale of bunker coal was in the course of export. Bunker coal was stocked at Candle island in the State of Madras. It was sold to steamers calling at the port of Cochin in the State of Travancore-Cochin, and delivered there. The assessee contended, that no sales tax could be levied on these sales, since they were either sales "in the course of export" or "in the course of Inter-State trade", and therefore, exempt under which sales falling within the Explanation to Constitution, or under the Government notification under which sales failling within the Explanation to article 286(1)(a) made during a particular period were exempted from liability to pay a tax. It was held, that the delivery was for consumption within the State, and the sale fell within the Explanation of Article 286(1) (a), and though the sales were in the course of inter-State trade falling within article 286(2) the tax was validated by the Sales-tax Validation Act, 1956. It

1. See Supreme Court cases cited in para. 8.8 *infra*.
2. Notes in the Ministry of Finance.
3. *The State of Kerala and Others* v. *The Cochin Coal Company* Ltd. (1961) 2 S. C. R. 219; A. I. R. 1961 S. C. 408, 410.

was also held, that the sales were not made "in the course of export", and did not fall under article 286 (1)(b), and that for article 286(1)(b) to apply, it was not sufficient that the goods merely moved out of the territory of India, but it was also necessary that the goods should be intended to be transported to a destination beyond India.

A similar point was raised in *Burmah Shell Oil Storage and Distributing Co. of India* Ltd. v. *the Commercial Tax Officer*[1], where the sale was of aviation spirit to international aeroplanes, and an exemption from taxation was claimed on the ground that the sale was in the "course of export". The sales were however held to be excluded from the phrase "in the course of export", because there was no destination into which the aviation spirit could be said to be imported, the sale being for use in the course of the journey. Explaining the meaning of the word "export", Mr. Justice Hidayatullah said that the test in he case of exports was that the goods must have a foreign destination where they could be said to be imported.

> "If the goods are exported and there is a sale or purchase in the course of that export, and the sale or purchase occasions the export to a foreign destination, exemption is earned... The crucial fact is the sending of the goods *to a foreign destination*—where they would be received as imports[2]. The two notions of export and import, thus, go in pairs."

> "Applying these several tests to the cases on hand, it is quite plain that aviation spirit loaded on board an aircraft for consumption, though taken out of the country, is not exported, since it has no destination where it can be said to be imported, and so long as it does not satisfy this test, it cannot be said that the sale was in the course of export. Further, as has already been pointed out, the sale can hardly be said to occasion the export. The seller sells aviation spirit for the use of the aircraft, and the sale is not integrally connected with the taking out of aviation spirit. The sale is not even for the purpose of export, as explained above.

---

1. *Burmah Shell Oil Storage and Distributing Co. of India Ltd.* v. *The Commercial Tax Officer*, (1961) 1 S. C. R. 902, 921, 923; A. I. R. 1961 S. C.315, 323, 324; 11 S. T. C. 764.

2. Emphasis supplied.

It does not come within the course of export, which requires an even deeper relation. The sales, thus, do not come within article 286(1)(b)."

These decisions were noted, in a different context, in the Report of the Law Commission on *Khosla's case*[1]. At that time, however, the question to be considered by the Commission was a narrow one, namely, whether the proposition laid down in *Khosla's case* required to be modified.

The question of modifying the position.

8.9. The question has now been raised[2], whether, in view of the effect of these decisions on liability to local sales tax, the position should not be modified. Under section 5(1) of the Central Sales Tax Act, a sale or purchase shall be deemed to take place in the course of export, if the sale or purchase occasions "export".

The Central Sales Tax Act has no definition of the expression "export", and, as construed by the Supreme Court, that expression means the taking of goods out of India *to a place outside India*[3]. If there is no precise or single destination for goods, then, according to the interpretation placed by the Supreme Court there is no "export". This has led to the sale of fuel to international carrier being taxed by the States.

Reason justifying modification of the present interpretation of 'export'.

8.10. One cannot be dogmatic as to whether this interpretation requires modification. If, however, it is felt that the present position causes hardship to aircraft and ships purchasing fuel, by rendering them liable to local taxation, we do not see any objection to the law being amended so as to regard such transactions as in the course of export.

The reasons that would justify a special provision for fuel supplied to international carriers are many. Unless there is uniformity in the levy of sales tax on such fuel, airlines or other international carriers would have a tendency to uplift fuel at a place either in a non-taxing country outside India or from States within India where the taxation is low. This aspect is directly connected with international trade, and with the prevention of discrimination between States.

---

1. 30th Report, pages 48 and 49 paragraphs 104 and 106.
2. See para 8.7, *supra*.
3. Para 8.8, *supra*.

Moreover, there is no direct benefit accruing to the Airlines from the States. Unlike road transport owners (or other internal carriers), who depend on the highways maintained by the State Governments for the efficient running of their transport, airlines or other international carriers derive no such assistance.

Other reasons.

8.11. There are also other reasons, relevant to federalism. For example, the growth of aviation and international carriage is important for national defence, and for the development of the country's economy and the spread of its culture. Hence a position which militates against such growth can, with propriety, be modified.

8.12. Only a small percentage of fuel uplifted by aircraft from a State (while operating scheduled international or domestic services) is actually used by that aircraft in that State generally.

Again, the problem of modernisation and introduction of larger and faster aircraft involves huge financial outlay and the industry has, therefore, to conserve its resources to the maximum, in order to meet these growing needs.

The profit margin of the Air Transport Industry is also quite small. Any increase in operating cost caused by a heavy State levy of sales tax on fuel would have a crippling effect on the Airline Industry. It may also affect the Tourist Industry, if on account of excessive taxation, airlines reduce the services into and operated out of India. This would entail loss of valuable foreign exchange.

Explanation regarding fuel.

8.13. It may, therefore, be convenient to add[1] an Explanation dealing with sale of fuel to an international carrier to be inserted as follows in section 5, since one of the reasons in support of the present position, as given in the judgment of Hidayatullah[2] J., is that the sale is not integrally connected with the taking out of the goods.

> "*Explanation.*—A sale of fuel to an international carrier for the purpose of consumption in international carriage shall be deemed to occasion export of the fuel."

---

1. A Constitutional amendment does not appear to be necessary. The proposed legislative provision will fall within Article 286.
2. *Burmah Shell case*, A.I.R. 1961 S.C. 315, 323, Para 8.8 *supra*.

We do not think that any general definition of 'export' is necessary.

Section 2(g)—'valuable consideration' in the definition of sale.

8.14. We shall deal with another question which also pertains to definitions contained in the Central Sales Tax Act. Most Sales Tax Acts of States (as well as the Central Sales Tax Act)[1] define 'sale' as meaning a transfer of property in goods etc. for "each or for deferred payment or other valuable consideration", or in similar terms.

Elucidating the expression "money consideration" occurring in the definition of "purchase" in the Punjab General Sales Tax Act, 1948, the Supreme Court[2] has pointed out, that the expression "valuable consideration" takes its colour from the preceding expression "cash or deferred payment". If so, it can only mean some other *monetary payment* in the nature of "cash or deferred payment."

A Madras case.

8.15. In a Madras case,[3] however, the words "other valuable consideration," which occurred in section 2(n), Madras General Sales Tax Act, 1959 (Madras Act 1 of 1959), were regarded as covering a case where the assessee supplied gold jewels and (in consideration therefor) received equal weight of gold and labour charges for making the jewels. Here the goods were transferred *in lieu of gold,* but still the transaction was held to be a sale.

An Allahabad case[4] not cited before the Madras High Court, takes a different view on this point.

Recommendation to amend section 2(g).

8.16. This being the position, it would, be advisable to clarify the law, by amending section 2(g), Central Sales Tax Act, so as to adopt the interpretation[5] placed by the Supreme Court,[6] namely, that the expression "valuable consideration" means some other payment in the nature of cash or deferred payment. We recommend an amendment accordingly.

---

1. See section 12(g), Central Sales Tax Act.
2. *Devi Dass* v. *State of Punjab* (1969) 1 S.C.J. 19, 28, 29.
3. *V.R. Vadivel Achari* v. *Madras Sales Tax Appellate Tribunal*, (1969) 2 M.L.J. 4 (D.B.) criticised in (1969) 2 M.L.J. (Journal) 9.
4. *S.T.C.* v. *Ram Kumar*, (1969) 19 S.T.C. 400 (Allahabad), (Manchanda and Beg JJ.).
5. *Devi Dass* v. *State of Punjab*, Para 8.14, *supra*.
6. Para 8.14, *supra*..

## CHAPTER 9

## SECTION 8 AND THE RATE OF TAX

Introductory

9.1. We now come to a question pertaining to the rate of tax. The rate of tax under section 8 is to be calculated according to a complicated scheme ; and the rate differs according (1) as the sale is to the Government or a registered dealer, (2) or as the sale is to any other person. The rate also differs, in the first case (sale to Government or registered dealers) if the goods are meant (a) for re-sale, as distinguished from the case where (b) they are meant for use in manufacture. In the second case, (sale to a person other than Government or a registered dealer), the rate differs (i) in regard to sale of "declared goods," as distinguished (ii) from sale of other goods ; and, in both cases, there is a special concession in the case of goods which enjoy exemption under the State law, or goods, which, under the State law, are taxable at a rate lower than 3 per cent.

9.2. The tax structure is thus somewhat complicated. The scope for simplification is limited, so long as the present structure is maintained.

Section 8(2)(b)

9.3. There is a constitutional question concerning section 8(2)(b), which requires to be considered.

Under section 8(2)(b), the tax payable by any dealer on his turnover, in so far as the turnover or any part thereof relates to the sale of goods in the course of inter-State trade or commerce not falling within sub-section (1), shall, in the case of goods other than declared goods, be calculated at the rate of ten per cent, or at the rate applicable to the sale or purchase of such goods inside the appropriate State, *whichever is higher*.

The expression 'appropriate State', as defined in the Act[1] means, roughly, the State in which the place or business of the dealer is situated.

1. Section 2(a).

9.4. Now, a question has arisen about the constitutionality of this provision. The argument is to the effect that the provision for ten per cent rate violates the freedom of trade, in cases *where the State rate is lower* than ten per cent. Several other arguments have been put forth, but only the above one has succeeded,—and that too only in the Madras High Court.[1] We have, while discussing[2] section 9 referred to certain decisions which discuss s. 8(2)(b) also. By imposing a higher rate for inter-State sale, it is stated, Parliament discriminates against importing States. The exporting State charge only the lower rate for internal sales while charging ten per cent for inter-State sales, which is unfair to the importing State.

9.5. A Supreme Court case[3], *State* v. *Nataraja Mudaliar*, on the subject may be discussed first. The background of that case was as follows :—

In an earlier case, *Larsen & Toubro Ltd.* v. *Joint Commercial Tax Officer*[4], the Madras High Court (Veeraswami J.) had struck down sub-sections (2) and (2A) and (5) of section 8 of the Central Sales Tax Act, on the ground that they violated articles 301 and 303(1) of the Constitution, inasmuch as the differential rates or exemptions in various States had an unequal burden on same or similar goods, and this affected their free movement or flow of inter-State trade and commerce. In *State* v. *Nataraja Mudaliar*[5], the Supreme Court reversed the Madras High Court decision, and upheld the validity of the various sub-sections. Shah J. delivering the judgment of the Supreme Court (for himself, Mitter and Vaidyalingam JJ.) held:

> ".....The rates of tax prevailing in different States on transactions of sale in the diverse commodities are undoubtedly not uniform. According to the High Court, such a scheme was "obviously quite discriminatory and considerably affected the freedom of trade, commerce and "intercourse", the differential

1. Case-law on the subject is discussed *infra* (Para 9.10) and also in Para 4.13A to 4.13F. *supra.*
2. Para 4.13A to 4.13F *supra.*
3. *State of Madras* v. *N. K. Nataraja Mudaliar*, (1968), 22 S.T.C. 376 (Supreme Court) (Shah J.).
4. *Larsen and Toubro Ltd.* v. *J.C.T.O.* (1967) 20 S. T. C. 150 (Mad.) (Veeraswami J.)
5. N. 3 *supra.*

rates or exemptions in various States imposing an unequal burden on the same or similar goods which affected their free movement or flow in inter-state trade and commerce, and that a higher rate of tax in a state worked as a barrier to the free movement of similar goods to another state where there was no tax or a lower rate of tax, and for trade in particular goods declared or undeclared to be free throughout the territory of India, the rate of tax or exemption as the case may be must be uniform. We are unable to accept the view propounded by the High Court. *The flow of trade does not necessarily depend upon the rates of sales tax : it depends upon a variety of factors*[1]..... Instances can easily be imagined of cases in which, notwithstanding the lower rate of tax in a particular part of the country, goods may be purchased from another part, where a higher rate of tax prevails..... The rates of tax in force at the date when the Central Sales Tax Act was enacted have again not become crystalised. The rate which the State Legislature determines, subject to the maximum prescribed for goods referred to in section 8(1) and (2) are the operative rates for these transactions ; in respect of transactions falling within section 8(2)(b) the rate is between the range of two and seven per cent. The rate which a State legislature imposes in respect of inter-state transactions in a particular commodity must depend on a variety of factors. A State may be led to impose a high rate of tax on a commodity either when it is not consumed at all within the state, or if it feels that the burden which is falling or consumers within state will be more than offset by the gain in revenue ultimately derived from outside consumers. The imposition of rates of sales tax is normally influenced by factors political and economic. If the rate is so high as to drive away prospective traders from purchasing a commodity and to resort to other sources of supply, in its own interest the State will adjust the rate to attract purchasers. Again, in a democratic constitution, political forces would operate against the levy of an unduly higher rate of tax. The rate of

1. Emphasis supplied.

tax on sales of a commodity may not ordinarily be based on arbitrary considerations, but in the light of the facility of trade in a particular commodity, the market conditions—internal and external—and the likelihood of consumers not being scared away by the price which includes a high rate of tax. Attention must also be directed to sub-section (5) of section 8 which authorises the State Government, notwithstanding anything contained in section 8, in the public interest to waive tax or impose tax on sales at a lower rate on inter-state trade or commerce. It is clear that the Legislature has contemplated that elasticity of rates consistent with economic forces is clearly intended to be maintained..... The Central Sales Tax, though levied for and collected in the name of Central Government, is a part of the sales tax levy imposed for the benefit of the States. By leaving it to the States to levy sales tax in respect of a commodity on intra-state transactions, no discrimination is practised, and by authorising the State from which the movement of goods commences to levy, on transactions of sale, Central Sales tax, at rates prevailing in the State, subject to the limitation already set out, in our judgment, no discrimination can be deemed to be practised.....Prevalence of different rates of sales tax in the State which have been adopted by the Central Sales Tax Act for the purpose of levy of tax under that Act is, as already mentioned, not determinative of the giving of preference or making a discrimination. The view expressed by the High Court that section 8(2), 8(2A) and 8(5) infringe Article 301 and Article 303(1) cannot be sustained."

9.6. Before this judgment of the Supreme Court was delivered, the question of validity of section 8(2)(b) had come up before the Madras High Court in another case. There,[1] the High Court held section 8(2)(b) of the Central Sales Tax Act, 1956, to be void and *ultra vires* article 301 of the Constitution. Section 8(2)(b) provides that certain inter-State sales are subject to a fixed rate of tax or the intra-State tax, whichever is higher.

1. *Sitalakshmi Mills Ltd.* v. *Deputy C.T.O.* (1968) 22 S.T.C. 436 (Madras) (D.B.)

The Madras High Court held that the provision for differential rates of taxation, provided in section 8, was unconstitutional and violative of the freedom of trade, commerce and intercourse guaranteed by article 301. This was also the High Court's decision in *Larsen & Toubro Ltd.* v. *Joint Commercial Tax Officer*[1], which was over-ruled later by the Supreme Court in *State of Madras* v. *N. K. Nataraj Mudaliar.*[2-4] But the Supreme Court judgment in *State of Madras* v. *N. K. Nataraj Mudaliar* was pronounced after the Madras judgment in the present case.

9.7. In a Delhi case[4], the Delhi High Court upheld the validity of section 8(2)(b), following the reasoning in the Supreme Court decision in *State of Madras* v. *A. K. Natraja Mudaliar*, and declined to follow the decision in the *Sitalakshmi Mills Ltd.*, case, decided by the Madras High Court.[5]

Conclusion.

9.8. There is, thus a conflict of decisions amongst the High Courts. But, in view of the Supreme Court judgement[6] it is almost certain that the Supreme Court will over-rule the Madras High Court judgment in the Sitalakshmi case, if the matter comes up on appeal before the Supreme Court.

Hence, no recommendation for clarification need be made.

---

1. *Larsen & Toubro Ltd.* v. *Joint Commercial Tax Officer* (1967) 20 S.T.C. 150 (Mad.)
2. *State of Madras* v. *N.K. Nataraj Mudaliar* (1968) 22 S.T.C. 376 (Supreme Court) (Shah J.)
3. Para 9.5, *Supra.*
4. *General Agencies (India) Ltd.* v. *The Sales Tax Officer* (1962) 29 S.T.C. 270, 273, 274, 277 (Delhi).
5. *Sitalakshmi Mills Ltd.* v. *Deputy C.T.O.* (1968) 22 S.T.C. 436 (Madras) (D.B.). Para 9.6 *Supra.*
6. *State of Madras* v. *Nataraj Mudaliar* See para 9.5 *supra.*

## CHAPTER 10

## RETROSPECTIVE RESTRICTIONS UNDER ARTICLE 286(3)

Question whether legislation under article 286 can be retrospective.

10.1. Under article 286(3) of the Constitution, Parliament is competent to declare certain goods to be of special importance in inter-State trade or commerce. The result of such a declaration is that any law of a State imposing tax on the sale or purchase of the goods so declared is subject to such restrictions and conditions (in relation to specified matters) as Parliament may by law specify.

It appears[1] that doubts have arisen as to whether, under this article, *restrictions* having retrospective effect could be imposed in regard to the powers of the State Legislature.

Amendment regarding coal.

10.2. In this connection, an amendment regarding coal may be referred to. In one case,[2] the Supreme Court had held that the expression "coal" in section 14 of the Central Sales Tax Act, 1956 included charcoal. But States had been treating charcoal as a non-declared commodity, and the need for amending the law and for giving retrospective effect to the amendment (to safeguard State revenues) arose. But, it is stated, the matter was not free from doubt. The amendment[3] was drafted as below, at the Select Committee stage of the 1971 Bill.

> "(a) for clause (i), the following clause shall be, and shall be deemed always to have been substituted, namely :—
>
> "(i) coal, including coke in all its forms, *but excluding charcoal* :

Provided that during the period commencing on the 3rd day of February, 1967 and ending with the date of commencement

1. Notes in the Ministry of Finance.
2. *Commissioner of Sales Tax, Madhya Pradesh* v. *Jaswant Singh Charan Singh*, (Feb. 23, 1967), 19 S.T.C. 469.
3. Central Sales Tax Amendment Bill, 1971, which led to the Amendment Act of 1972.

of section 11 of the Central Sales Tax (Amendment) Act, 1972, this clause shall have effect subject to the modification that the words "but excluding charcoal" shall be omitted."

Select Committee's observations.

10.3. The Select Committee[1] on the Bill of 1971 made the following observations which explain the above[2] amendment.

> "(i) *Sub-clause* (a)—This sub-clause seeks to exclude with retrospective effect, charcoal from the definition of "coal" contained in clause (i) of section 14 of the Principal Act. The Committee feel that the retrospective effect to the amendment through this Sub-clause excluding charcoal from the scope of the term "coal", *should not affect the position during the intervening period from the 23rd February, 1967 (the date of the Supreme Court judgment in Jaswant Singh Charan Singh's case) and the* coming into force of the amendment. It should be ensured that the Supreme Court judgment would prevail during the aforesaid period and "charcoal" will be treated as declared goods, and no dealer would be required to pay tax on "charcoal" at a rate exceeding the one applicable to "coal" in the appropriate State. The sub-clause has been amended accordingly."

Amendment illustrative of doubt on the subject.

10.4. The above amendment has been referred to as an example of the doubt prevailing on the subject of retrospective effect being given to a law falling within article 286(3). It is stated[3] that there may be similar occasions in future when retrospective effect may have to be given, and a suitable mechanism has, therefore, to be devised.

No scope for devising suitable mechanism.

10.5. We have given our careful consideration to the matter, but we do not think that any suitable mechanism could be devised

---

1. Report of the Select Committee on the Central Sales Tax (Amendment) Bill, 1971, (17th August, 1972) page viii.
2. Para 10.2, *Supra*.
3. Notes in the Ministry of Finance.

in this regard as to article 286.[1] Whenever a difficulty arises as to the interpretation of words denoting goods declared as essential by section 14, (of the Central Sales Tax Act), the necessary amendment will have to be made in the form in which it was made[2] with reference to 'coal'.[3] There does not appear to be much scope for any other device.

10.6. Hence, no amendment is recommended on the above point. No change recommended.

1. Para 10.1, *supra*.
2. The Central Sales Tax (Amendment) Act, 1972 (161 of 1972).
3. Para 10.3, *supra*.

# CHAPTER 11

## CONCLUSIONS

Points dealt with.

11.1. We have, in the preceding chapters, made an attempt to deal with such problems as appeared to require attention. The mass of case law and the numerous controversies create an impression that the Act bristles with problems. At the same time, we would like to say that there is no room for grave despondency.

Peculiarities of taxation and commodities.

11.2. We would, in this connection, like to note what has been stated by an American writer[1] on the problem of evasion of taxes on transactions relating to commodities.

> "Where the payers of a particular tax are few in number, the administration can exercise a careful and detailed supervision, which is impossible where the number of tax-payers is large. A general sales or turnover tax suffers from the circumstance that it must be collected in small amounts from a large number of tax-payers. The tax administration cannot enquire carefully into the accounts of every little country sider mill and every corner candy store. Instead, it must trust to the honesty of the tax-payers and to such devices as the sample check, even though this involves the loss of a substantial proportion of the tax revenue through evasion. The alternative—to allow an exemption which will eliminate the flood of returns from small dealers and small manufacturers—weakens the economic character of the tax."

1. Schultz and Harris, American Public Finance, (1949), pages 533-534.

## CHAPTER 12

## SUMMARY OF CONCLUSIONS AND RECOMMENDATIONS

In this Chapter, we summarise our principal conclusions and recommendations.

*Point 1—Definition of "customs frontiers".*

The expression "crossing the customs frontiers" should be defined (for the purpose of the Central Sales Tax Act), as meaning crossing the limits of a customs station established by or under the authority of the Central Government for the purposes of the Customs Act, 1962, and its grammatical variations and cognate expressions should be construed accordingly. Chapter 8.

*Point 2—Sale of fuel to international carrier*

An Explanation dealing specifically with the sale of fuel to an international carrier should be inserted in section 5 of the Central Sales Tax Act, as follows :— Chapter 8.

"*Explanation*:

Sale of fuel to an international carrier for the purpose of consumption in international carriage shall be deemed to occasion export of the fuel."

*Point 3—Section 2(g)—Definition of sale and element of valuable consideration.*

Section 2(g), Central Sales Tax Act, should be amended so as to adopt the interpretation placed by the Supreme Court,[1] namely, that the expression "valuable consideration" (in the definition of sale) means *some payment in the nature of cash or deferred payment.* Chapter 8.

1. *Devi Das* v. *State of Punjab*, (1967) 20 S.T.C. 430, 444, 445 (S.C.)

*Point 4—Works Contracts.*

Chapter 1A.

The question whether the power to tax indivisible contracts of works should be conferred on the States has been raised. The present position on the subject, and the possible alternatives, may be briefly stated thus:—

(i) The Union has the power to tax works contracts under Constitution, Seventh Schedule, Union List, entry 97.

(ii) The power to tax *inter-State* works contracts has not, so far, been exercised by the Union, and the definition of 'sale' in the Central Sales Tax Act does not include Works contracts.

(iii) The power to tax works contracts *within the State* also vests in the Union, under Union List, entry 97 (as interpreted in the judgments of the Supreme Court).

The question whether the power should or should not be transferred to the States, is one of policy. But, for the reasons given in the Report, the Commission prefers its transfer to the States.

If this alternative is adopted, there are several drafting devices open, *e.g.*—

(a) amending State list, entry 54, or

(b) adding a fresh entry in the State list, or

(c) inserting in article 366 a wide definition of "sale". The Commission prefers the last one. It would avoid multiple amendments.

(iv) Whether the course at (iii) should be adopted or not, is a matter of policy, involving financial and political considerations.

(v) In the alternative, power to tax intra-State Works contracts could (if a policy decision to that effect is taken by the Centre), be exercised by the Union, and the necessary law passed. The proceeds of the tax imposed thereunder could, then, be distributed to the States. Article 269 of the Constitution may have to be amended in that case.

(vi) Whether the course referred to at (v) above, should be adopted or not, is, again, a matter of policy, involving financial and political considerations.

*Point 5—Hire-purchase.*

The question of taxation of hire-purchase agreements not resulting in sale has been raised before the Commission. The present position and possible alternatives may be briefly stated thus:— Chapter 1B.

*Hire-purchase not resulting in sale.*

(i) The Union has the power to tax hire-purchase not resulting in sale, *inter-State* or within the State, under the Union List, entry 97.

(ii) The power to tax *inter-State* hire-purchase (not resulting in sale) under the Union List, entry 97, seems to have been exercised by the Union, *vide* the definition of 'sale' in the Central Sales Tax Act.

(iii) The power to tax hire purchase not resulting in sale, *within the State* also vests in the Union, under Union List, entry 97 (as interpreted in the judgments of the Supreme Court).

The question whether the power should or should not be transferred to the States, is one of policy. But, for the reasons given in the Report the Commission prefers its transfer to the States.

If this alternative is adopted, there are several drafting devices open, *e.g.*

(a) amending State List, entry 54, or

(b) adding a fresh entry in the State List, or

(c) inserting in article 366, a wide definition of sale.

The Commission prefers the last one (amendment of article 366), as it avoids multiple amendments. If, however, State List, entry 54 (to add hire-purchase) is amended, it is necessary also to amend Union List, entry 92A, so that *inter-State* hire-purchase (not resulting in sale) may continue to be excluded from the purview of the States, notwithstanding the addition of hire-purchase to the State List.

In case this alternative is adopted, the following could be added in the Constitution, 7th Schedule, both at the end of Union List, entry 92A and at the end of State List, entry 54 (after converting the existing full-stop into a semi-colon);

> "transfer of goods on the hire-purchase or other system of payment by instalments,[1] hire-purchase resulting in sale."

(iv) Whether the course at (iii) should be adopted or not, is a matter of policy, involving financial and political considerations.

(v) In the alternative, the power to tax intra-State hire-purchase could (if a policy decision to that effect is taken by the Union) be exercised by the Union, and the necessary law passed. The proceeds of the tax imposed thereunder could, then, be distributed to the States. Article 269 of the Constitution will have to be amended for the latter purpose.

This will, however, require separate legislation, as the Central Sales Tax Act is confined to tax on *inter-State transactions.*

If this alternative is adopted, it is suggested that it will be desirable to transfer the entire power *to the Union, i.e.,* the power to tax hire-purchase resulting or not resulting in sale (intra-State), by amending Union List, entry 92A. This will be practically convenient and check evasion.

(vi) Whether the course referred to at (v) above, should be adopted or not, is again a matter of policy, involving financial and political considerations.

*Hire purchase resulting in sale*

(vii) Hire-purchase resulting in sale is governed by the position applicable to sale in general, except that only the sale element can be taxed under the name of sales tax. For suggestions in regard to hire-purchase resulting in sale, see (v) above.

*Point* 6—*Consignments.*

Chapter 2.

What are described sometimes as "consignment transfers" are not taxable as sales under the present law. The Union can

1. If necessary, a non-obstante clause may be added to the effect that property need not pass.

tax them under the residuary power, but even if such a tax is levied, the proceeds of the tax cannot be distributed to the States without amending article 269(1)(g) and 269(3) of the Constitution.

Therefore, if, as a matter of policy, consignments are to be included in the Central Sales Tax Act, it will be necessary[1] first to amend article 269(1)(g) and 269(3) of the Constitution, by adding an Explanation to that article, somewhat on the following lines[2]:—

> "*Explanation.*—For the purpose of this article, the expression "sale or purchase" includes a consignment of goods occasioning their movement from one place to another, by a dealer to any other place of his business or to his agent or principal."[3]

*Point 7—Sale of controlled commodities.*

The position with reference to the taxability of sales of controlled commodities has become uncertain, in cases where the transactions are subject to statutory control. Although, in theory, the rules on the subject appear to be clear, in practice, their application seems to involve nice distinctions, based on how far the consensual element has been abrogated. Accordingly, it is recommended that the position in this regard may be made clear, by a constitutional amendment amplifying the power of the States. Article 366 of the Constitution should be amended for the purpose, by inserting a wide definition of 'sale'. Chapter 1C.

*Point 8—Supply of goods by clubs etc.*

A suggestion has been made that the power of the States to levy a tax on the supply of goods by clubs, societies and other associations to their members may be made clear, in view of the restrictive interpretation[4] placed by courts. No change on the Chapter 1D.

1. There are other provisions of the Constitution using the expression "sale", but they do not seem to require amendment in the present context.
2. This is not intended to be a precise draft.
3. After the proposed amendment of the Constitution, the desired amendments in Central Sales Tax Act could be made.
4. See, for example,
   (a) *Dy. C.T.O.* v. *Enfield India Ltd.* A.I.R. 1968 S.C. 838,
   (b) *J.C.T.O.* v. *Young Man's Indian Association*, (1970) S.C.C. 462.

above point is, however, considered necessary, as such cases would not be many. There is not much possibility of evasion, and the sale is really by members to members.

Chapter 3. *Point 9—Import and Export—Khosla's case.*

The judgment in *Khosla's case,*[1] which restricts the power of the States as regards sales in the course of import, is considered at length. The recommendation is for an amendment which will give effect to the following propositions.[2]

(1) A purchase of goods made by an exporter from a local seller, for the purpose of exporting them in order to implement a contract of sale with a foreign buyer, shall not be deemed to be a purchase which has occasioned the export, even if it be a term of the contract of purchase that the goods shall be exported and even if, pursuant to such contract, the goods are exported and even if but for such term, the goods would not have been exported.

(2) A sale of goods made by an importer to a local buyer, in order to implement a contract of sale with the local buyer, shall not be deemed to be a sale which has occasioned the import, even if it be a term of the contract of sale that the goods shall be imported, and even if, pursuant to such contract, the goods were imported and even if, but for such term, the goods would not have been imported.

Chapter 4. *Point 10:—Reference to State Sales Tax Law—Section 9, Central Sales Tax Act.*

Section 9(2) of the Central Sales Tax Act applies the provisions of the general Sales Tax Law of the State for the specific purpose of the Central Sales Tax Act. The question has arisen whether the reference is to the State law as it existed in 1956 (when the Central Act was enacted) or whether amendments made in the State law after 1956 can be taken into account.

There is also a doubt arising from the fact that an objection of undue delegation may be raised with reference to section 9(2) of the Central Act. To remedy such a situation, there are, theoretically speaking, several courses open.

1. *K. G. Khosla's case,* A.I.R. 1966 S.C. 1216; (1966) S.C.R. 352.
2. This is not a draft.

(i) *First alternative.*—In the first place, instead of the incorporating provision in section 9(2), the Union could frame its own self-contained code of provisions relating to assessment of tax levied under the Central Act. Whether or not the Union also appoints its own assessing authorities for the purpose, is immaterial.

Instead of so appointing the assessing authorities it could delegate the necessary powers to the State authorities. The only difference would be that State authorities will, then, be deriving that power not from the State law read with section 9(2), but from the Central Government.[1]

(ii) *Second alternative*—The second alternative would be to amend the Constitution, and to provide there what is now contained in section 9(2) of the Central Sales Tax Act. For obvious reasons, this is not a very convenient method.

(iii) *Third alternative*—The third alternative would be to insert, in section 9(2) a particular date, say, "as in force on the first day of April, 1974". Initially, this date could be inserted by adding the quoted words after the words "general sales tax law", wherever they occur in section 9(2) or elsewhere. Subsequently, every year, by a short amendment of the Central Sales Tax Act, the year then current (i.e. the year current at the time of each subsequent amendment) could be substituted.

This would mean that the Sales tax law in force in the State on the first April of the then current year would be attracted to the Central Sales Tax Act. No doubt, if, after the 1st April of one year and before the 1st April of the next year, a particular State legislature makes any amendments in its own Sales Tax Law, those amendments would not be attracted. This situation cannot, in theory, be avoided. The Union can, however, request the States, by a general letter, not to make amendment in the Sales Tax laws, during the middle of the year, as far as possible.

As a short term measure, the third alternative should be adopted. In addition, as a long term measure, the first alternative should be adopted.

*Point* 11—*Penalties—section* 9(2) *Central Sales Tax Act.* Chapter 4

There is some uncertainty as to how far section 9(2) of the Central Sales Tax Act covers penalties leviable under the State

1. See also point 12, *infra*.

Sales Tax law. The doubt arises because of absence of specific mention of penalties.

One alternative (to remove the doubt on the subject) would be to insert the following sub-section in section 9 :—

> "2(A) In particular, and without prejudice to the generality of the provisions of sub-section (2), penalties leviable under the general Sales Tax law of the State shall also be leviable for the purposes of this Act, as if the tax under this Act had been levied under the general Sales Tax law of the State."

But this would not meet the objection of inequality which has been raised in some cases[1]. To remove that objection, a better course would be to provide penalties *in the Central Act*. [Details of the provision cannot be indicated, as that involves several administrative aspects].

*Point* 12—*Central Sales Tax Act to be self-contained.*

Chapter 4. As regards the entire Central Sales Tax Act, the recommendation is that the Act should be self-contained. The specific amendments suggested above[2] should, of course, be undertaken, as an urgent measure. But, as a long term measure, it is desirable to make the Act self-contained, in respect of matters for which section 9(2), at present provides[3].

*Point* 13—*Punishment under section* 10, *Central Sales Tax Act.*

Chapter 5. Punishment for the offence of making false statements in declarations under the Act, should be dealt with on the basis of the amount involved, that is to say, by regulating the punishment according to the amount of tax which would have been evaded if the statement by the assessee (discovered to be false), had been accepted as true. If, say, the amount of such tax exceeds ten thousand rupees, or if the case is one of a second or subsequent conviction, the maximum punishment could be seven year's imprisonment, with a suitable minimum in other cases, the maximum imprisonment could be three years (with fine as an alternatixe), but there need be no minimum.

1. See *Mohan Lal Chokhani* v. *Commercial Tax Officer*, (1971) 28 S.T.C. 367, 373 (Cal).
2. Points 10 and 11, *supra*.
3. See also point 10 *supra*.

In that case, section 10 of the Central Sales Tax Act, 1956, could be revised as follows :—

"10. If any person—

.....[(a) to (f) as in existing section], he shall be punishable—

(i) if the amount of tax which would have been evaded if the offence had not been discovered or the amount illegally collected, as the case may be, exceeds ten thousand rupees, or if the case is one of a second or subsequent conviction for an offence under this Act, with imprisonment for a term which may extend to seven years but which shall not be less than six months, and with fine :

(ii) in any other case, with imprisonment for a term which may extend to three years, or with fine, or with both ;

and when the offence is a continuing one, the find under sub-clause (i) or sub-clause (ii) of this clause, may be a daily fine which may extend to fifty rupees for every day during which the offence continues.

*Point* 14—*Minimum punishment—Relaxation of.* Chapter 5.

While inserting minimum punishment[1] it is not desirable to insert any provision for relaxation.

*Point* 15—*Abetment—Proposed section* 10*B* *Central Sales Tax Act.* Chapter 5.

A new section should be inserted in the Central Sales Tax Act as follows :—

"10-B. If a person abets or induces in any manner another person to make and deliver an account, statement, or declaration relating to any transaction chargeable to tax under this Act, which is false and which he either knows to be false or does not believe to be true, he shall be punishable— Abetment of false accounts etc.

(i) if the amount of tax which would have been evaded if the declaration, account or statement had been

1. See, *supra*. Point 13.

accepted as true, exceeds of ten thousand rupees or if the case is one of a second or subsequent conviction for an offence under this Act, with imprisonment for a term which may extend to seven years[1], and with fine ;

(ii) in any other case, with imprisonment for a term which may extend to three years, or with fine, or with both.

Chapter 5 *Point* 16—*Corporations* : *Proposed section* 10-C. *Central Sales Tax Act.*

The following section should be inserted in the Central Sales Tax Act.

"10-C. (1) When a corporation is convicted of an offence under this Act, it shall be competent to the Court before which the conviction takes place, to pass on the corporation a sentence of public condemnation, in addition to any other punishment to which the corporation may be sentenced.

(2) When such a sentence is passed, the court shall cause the name and place of business of the corporation, the offence, the fact that the corporation has been so sentenced and any other punishment imposed, and such other particulars as the court any consider to be appropriate in the circumstances of the case, to be published at the expense of the corporation in such newspapers or in such other manner as the court may direct.

(3) The expenses of such publication shall be recoverable from the corporation in the same manner as fine."[2]

Chapter 5. *Point* 17—*Publication of name of convicted individual.*

A provision for publication of name of convicted individual should be added[3] in the Central Sales Tax Act.

---

1. Minimum punishment not regarded as necessary in this case.
2. *cf.* section 547, Cr.P.C. 1898.
3. It could be put as section 10-D.

*Point* 18—*Separate law regarding amount illegally collected as taxes.* Chapter 6

To facilitate and enforce recovery by the citizen of any amount illegally realised as tax by a private person (whether as sales tax or any other tax), a separate law containing a provision [somewhat on the following lines], should be made[1] by Parliament :

> "Where any person other than a public officer[2] has, purporting to act in pursuance of any law imposing a tax, realised from any other person as tax any amount not legally due from such person as such tax, he shall[3], unless he proves that he has refunded the amount to that person or has otherwise accounted for the amount in accordance with such law, deposit the amount so collected without delay in the nearest Government Treasury, and shall intimate the particulars of the case to that person by special or general notice and to the authority to whom he would be liable to account if the amount had been legally due as tax."

This is the proposed *principal provision*[4]. The Treasury would, of course, refund the amount deposited, to the person entitled. Limitation for suit for refund should run from date of publication of notice. Other incidental and procedural provisions could be devised, as may be considered suitable.

*Point* 19—*Check posts.* Chapter 7.

It has been stated that there is some constitutional difficulty in regard to provisions for the establishment of check posts for checking the evasion of tax on the sale of goods. A preliminary examination of the case law, however, shows that there should be no serious difficulty, if the provision is properly framed.

We would like to place on record our warm appreciation of the valuable assistance we have received from Mr. Bakshi, Member-Secretary of the Commission in the preparation of this Report.

1. To be implemented by a seperate law.
2. The expression "Public Officer" to be defined.
3. Punishment for contravention can be imposed.
4. See the relevant chapter for detailed recommendation.

| | |
|---|---|
| P. B. Gajendragadkar | Chairman |
| P. K. Tripathi | Member |
| S. S. Dhavan | Member |
| S. P. Sen Varma | Member[1] |
| P. M. Bakshi | Member-Secretary |

Dated : New Delhi, the 20th May, 1974.

1. Shri S. P. Sen Varma has signed the report subject to a separate note.

## LAW COMMISSION

### Note by Member, Shri S. P. Sen-Varma

Reasons for a separate note.

I regret that I have to differ from the view of my esteemed colleagues regarding the scope and nature of the amendment of section 5 of the Central Sales-Tax Act, 1956. I think that unless that section is made comprehensive as well as precise, as far as practicable, by suitable amendments, doubts and ambiguities regarding the scope and meaning of the section will persist and they will not be likely to be removed by the two proposals (negative in character) suggested in the majority report. I am fortified in the view I have taken regarding the amendment of section 5 by what S. R. Das, J. (as he then was) said in his dissenting judgment in the second Travancore case. He first posed the question as to what was the scope of the ban imposed on the States by article 286(1)(b)? He felt, the answer would depend on the meaning that may be ascribed to the phrase "in the course of" occurring in clause (1)(b) of article 286. He referred to the unanimous decision of the Court in the first Travancore case according to which "whatever else may or may not fall within article 286(1)(b), sales and purchases which themselves occasion the exports or imports of the goods, as the case may be, out of or into the territory of India come within the exemption.....". *According to him, this was sufficient to dispose of that case* and it was not then necessary to decide what else might fall within that phrase. Then Das, J. said —

"This Court is now called upon to decide that point."

(*Vide* para 48 of the judgment as reported in the A.I.R.)

In my opinion, the two proposals of the majority relating to the amendment of section 5 will leave the point still undecided thereby keeping the door open for doubts, disputes and ambiguities.

I circulated this note without this paragraph and the few subsequent paragraphs to the other Members of the Commission including the Chairman. The specific suggestions made in this note were not before the Commission on any previous occasion during our discussion although the matter was discussed in a general way when I put forward my views that a comprehensive amendment would be very likely to reduce chances of doubts and ambiguities. But neither my view expressed at that time was acceptable to my colleagues nor the specific suggestions now made in this note have been agreed to by them before the finalisation of their views.

Before I close this topic I like to make a brief mention of the objections made by the Chairman and other Members to my specific suggestions during the discussions of their note and my note.

In the revised draft note of the majority prepared after such discussions substantially the same objections in a slightly different language have been given. These objections are, (1) "it would not be quite appropriate to insert such elaborate provisions in the Act" in view of the narrow problem before the Commission arising from Khosla's case, (2) any attempt "to cover other aspects of import-sales and export-purchases is likely to create complications. The verbal formula that may be thought of in this respect would create intricacies of its own.", (3) "while a detailed discussion and elaborate treatment of various aspects might be appropriate in a judgment, it would be out of place in a statutory provision of the nature under consideration."

As regards objection (1), I may say that in view of the sharp divergence of opinions since almost the very beginning, on this complex subject not only in the highest judiciary of the land and other Courts and authorities but also in the Law Commission of India, we should try to ensure that section 5 which in a sense explains and defines the scope of article 286(1)(b) should be as clear as possible. In view of the history before us we should not hesitate to make elaborate provisions in the section in spite of the narrow problem arising from Khosla's case. *And on a perusal of the judgment in Khosla's case it appears clear that problem thrown up by it cannot be regarded as narrow because it*

*has several facets.* In my view the suggestions of the majority may make it necessary to make yet another reference to the Law Commission on the same subject as contained in section 5.

As regards objection (2), it is difficult to see why other necessary and relevant aspects of import-sales and export-purchases should not be clearly specified in section 5. Because in present section 5 this has not been done, brevity of the section has been attained with serious consequences trailing behind in the shape of ambiguities, doubts and disputes about the scope and extent of the section.

So far as sales or purchases preceding export and sales or purchases succeeding import are concerned, they may—but only may—be covered by the suggestions of the majority, but those suggestions do not expressly take such sales or purchases out of the purview and cope of section 5 and article 286(1)(b) with the result that again it may be agitated before the Supreme Court that such sales or purchases come within the scope of that section and that article. And who knows that the Supreme Court may not in the absence of clear language in section 5 in this regard decide, in spite of the suggestions of the majority being incorporated in that section, to adopt the view which Das, J. (as he then was) so elaborately and forcefully put forward in his dissenting judgment in the second Travancore case? A dissenting judgment is as if it were, to use the word of a great Judge in America, "brooding" in the heavens ready for descent and acceptance on earth at any time. In this way, the suggestions of the majority may, if accepted, create more intricacies and complications because those suggestions of the majority do not specifically exclude the first sale or purchase before the export and the last sale or purchase after the import. Therefore the sharp controversies as to whether they are sales or purchases in the course of export or import will remain. I am fortified in this view because Das, J. did not accept the view that the first sale or purchase before export and the last sale or purchase after import were sales or purchases for the purpose respectively of export or import. His stand was that such sale or purchase was so integrally connected with export or import that they formed integral parts of such export or import. In my suggestions, I have tried to make the position as clear as possible.

As regards objection (3), here again I respectfully differ. I readily admit that human language is imperfect and slippery and

any unnecessary lenth and prolixity of language must be avoided in a statute. But if after elaborate discussion and examination of an enactment from various aspects with the assistance of the members of the Bar, the Court has pointed out flaws, defects, lacunae and ambiguities in the enactment, the framers of the statute should make every attempt to remove those flaws, defects, lacunae and ambiguities and for that purpose should not fightshy of making the language of the enactment elaborate in so far as that is necessary, **but no more**. As Viscount Bryce said in his Inaugural Lecture on February 25, 1871 on entering the duties of Regius Professorship of Civil Law at Oxford —

> "The power of stating a proposition of law in comprehensive and exact terms wide enough to cover all cases contemplated and yet precise enough to exclude cases more or less similar, to which the rule is not intended to apply, is valuable to the text-writer and *quite indispensable* to the framers of statutes."
>
> (underlined by me.)

If we look at the Indian Statute Book and the Statute Book of any other English-speaking country, we shall find that they abound in sections with elaborate provisions. Even the Constitution of India has many articles which are very lengthy and these lengthy articles occur in large number in Part XIII—Finance, Property, Contracts and Suits (art. 286 occurs in this Part), because provisions relating to these matters are in their very nature very complex and intricate and to bring out their scope, meaning and implications, elaborate provisions were felt necessary.

I must admit, however, in all humility that human-being being imperfect, a perfect statute has not yet been written nor will it ever be.

Introductory

I now propose to deal with and discuss article 286(1)(b) of the Constitution and section 5 of the Central Sales Tax Act, 1956 in an attempt to find out the exact scope and meaning of these two provisions as they have been topics of controversy for a long time. For this purpose I like to discuss in brief the constitutional position in regard to sales taxes in general because that may help us in forming a clear view of the particular matter which is the immediate object of this study.

Reference from the Government in April, 1973.

The letter dated the 12th April, 1973 received from the Minister of Law, Justice and Company Affairs constitutes the third reference from the Government of India to the Law Commission relating *inter alia* to the scope, extent, meaning and implications of article 286 of the Constitution ; and as a matter of fact the Central Sales Tax Act, 1956 was passed on the recommendations contained in the Commission's report on the first reference. The first reference was made shortly after the introduction of the Constitution (Tenth Amendment) Bill, 1956 in Parliament in which there was a proposal to empower Parliament to formulate by law principles *inter alia* for determining when a sale or purchase of goods takes place in the course of the import of the goods into, or export of the goods out of, the territory of India. This Constitution (Amendment) Bill on its enactment became the Sixth Constitution (Amendment) Act, 1956. By this amendment, a number of changes was made in the Constitution with respect to sales tax. These changes in brief were as follows :—

Constitution (Sixth Amendment Act 1956.

(1) A new entry 92A was introduced in the Union List in the Seventh Schedule to the Constitution whereby Parliament acquired exclusive power to make law with respect to "taxes on sale or purchase of goods other than newspapers, where such sale or purchase takes place in the course of inter-State trade or commerce ;" formerly, Parliament's power to make law was confined to entry 92 of the Union List to "taxes on the sale or purchase of newspapers and on advertisements published therein". This entry 92 remains unchanged even now. Thus by new entry 92A, Parliament's power was enlarged to cover the power to make laws with respect to taxes on the sale or purchase of goods **other than newspapers in the course of inter-State trade and commerce.** This amendment was in a sense in consonance with the exclusive power to Parliament to make laws with respect to "inter-State trade and commerce" specified in entry 42 of the Union List. We are not however much concerned here in this note either with the new entry 92A or with the provisions contained in articles 301 to 307 which broadly speaking may be regarded as the commerce clauses of our Constitution.

(2) The second change was that a new entry 54 was substituted for the original entry 54 in the State List. Original entry 54 was as follows :—

> "54. Taxes on the sale or purchase of goods other than newspapers."

The new entry 54 reads as follows :—

> "54. Taxes on the sale or purchase of goods other than newspapers subject to the provisions of entry 92A of list 1".

The combined effect of these two changes namely, the insertion of entry 92A in List I and the amendment of entry 54 in List II as well as of the substitution of new clause (2) for the original clause in article 286 was that a State Legislature was completely denuded of whatever power it had, to make laws with respect to taxes on the sale or purchase of goods in the course of inter-State trade or commerce by virtue of the original clause (2) of article 286 and entry 54 of List II as it stood before the amendment of 1956.

(3) The third change brought about the Sixth Constitutional Amendment of 1956 was the insertion of a new sub-clause (g) in clause (1) of article 269 whereby taxes on the sale or purchase of goods other than newspapers in the course of inter-State trade or commerce "shall be levied and collected by the Government of India but shall be assigned to the States in the manner provided in clause (2)" of article 269.

(4) The fourth change made by the Sixth Amendment in 1956 was the insertion of a new clause (3) in article 269 as follows :—

> "(3) Parliament may, by law, formulate principles for determining when a sale or purchase of goods takes place in the course of inter-State trade or commerce."

(5) In the fifth place, the Explanation to clause (1) of article 286 was omitted as it became unnecessary in view of the provisions of new clause (2) of article 286. The Explanation which was omitted laid down for the purposes of article 286 (1) (a), a rule that "a sale or purchase shall be deemed to have taken place in the State in which the goods have actually been delivered as a direct result of such sale or purchase for the purpose of consumption in that State, notwithstanding the fact that under the general law relating to the sale of goods, the property in the goods has by reason of such sale or purchase passed in another State." The Explanation had also given rise to a great deal of legal controversy and practical difficulty.

(6) Sixthly, for clauses (2) and (3), two new clauses (2) and (3) were substituted in article 286 as follows:—

"(2) Parliament may by law formulate principles for determining when a sale or purchase takes place in any of the ways mentioned in clause (1).

(3) Any law of a State shall, in so far as it imposes, or authorises the imposition of, a tax on the sale or purchase of goods declared by Parliament by law to be of special importance in inter-State trade or commerce, be subject to such restrictions and conditions in regard to the system of levy, rates and other incidents of the tax as Parliament may by law specify."

Power of Parliament to formulate principles.

The above analysis shows the far-reaching changes made by the Sixth Constitutional Amendment in the structure of the sales tax system of the country and in the powers and jurisdiction of Parliament and State Legislatures with respect thereto. It was for the first time in our constitutional history that Parliament was empowered to formulate by law principles for determining when a sale or purchase of goods takes place in any of the following ways, that is to say :—

(a) where such sale or purchase takes place outside a state [art. 286(1)(a)];

(b) where such sale or purchase takes place in the course of the import of the goods into, or export of the goods out of, the territory of India [art. 286(1)(b)];

(c) where such sale or purchase takes place in the course of inter-State trade or commerce [art. 269(3)].

[*N.B.*—It seems that the use of the word "when" in article 269(3) and article 286(2) and the use of the word "where" in entry 92A of the Union List or in article 286(1), were not intended to signify any distinction and difference because such distinction and difference are not easy to discern in respect of the same subject matter. It seems that these two different conjunctions "when" and "where" were used to signify the same situation.]

The object of these provisions was to make it clear that a State Legislature cannot make any law which may have the effect

of extra-territorial operation, that is, operation beyond and outside the territory of the State. That a State Legislature has no such extra-territorial power of legislation is clear from the provisions of article 245 and article 246(3) of the Constitution. This however is not the case with Parliament in view of the specific provisions of article 245(2). In this connection the words "for the whole or any part of a State" in article 245(1) and the words "for such State or any part thereof" in article 246(3) may be noted.

The Law Commission in 1956 was invited by the Government of India to make recommendations relating to the formulation of principles in respect of the three matters specified above.

No specific entry in the Constitution relating to taxes on sales or purchases in the course of export or import.

It may not be out of place to mention here that there is no specific entry in any of the three Lists in the Seventh Schedule to the Constitution under which Parliament has the power to make law with respect to taxes on sales or purchases of goods taking place *outside a State or in the course of import or export* although Parliament may exercise such power under article 248 read with residuary entry 97 of the Union List. No such law has however, been enacted by Parliament. The position therefore is that at present there is no parliamentary law with respect to taxes on these two categories of sales and purchases and the Legislature of a State has no power at all in relation to these cases because powers of the States have been expressly taken away by article 286(1). Therefore, when in accordance with the principles formulated by Parliament in section 4 and section 5 of the Central Sales Tax Act, 1956, any sale or purchase of goods is a sale or purchase taking place outside a State or a sale or purchase taking place in the course of import or export, such a sale or purchase is not taxable at all under any law at present. The Central Sales Tax Act, 1956 provides only for the imposition of taxes on inter-State sales or purchases under Chapter III of the Central Sales Tax Act, 1956. It may be mentioned here that "goods" as defined in the Act do not include newspapers.

Exact question to be decided.

The question for our present purpose therefore naturally arises,—which exactly are the sales or purchases of goods taking place in the course of the import of the goods into, or export of the goods out of, the territory of India ? And herein lies the rub. My endeavour in this note will be to find out and recommend a correct and proper solution of this question so as to set at rest as far as practicable all doubts and controversies which have

been agitating and troubling the minds of all concerned practically since the adoption of the Constitution. And if for this purpose I am to suggest rules, principles, guidelines and criteria which may not be strictly logical and may to some extent even smack of artificiality, I should not hesitate in doing so, for, as has been said, life of the law is not logic but experience.

**Importance of foreign trade in the interests of federal finance and of sales-tax in the interests of State economy.**

Export and import trade, that is foreign trade has all along been under the exclusive power and jurisdiction of the Centre (entry 41 of the Union List). This was so even under the Government of India Act, 1935 (entry 19 of the Federal List in the Seventh Schedule); but in that Act there was no provision corresponding to article 286 of the Constitution. I need not stop here to consider section 297 of the Government of India Act, 1935 as that section cannot be of much help in grasping the scope of article 286 except that that section prohibited under sub-section (1)(a) a Provincial Legislature or a Provincial Government from enacting any law or taking any executive action prohibiting or restricting the *entry into* or *export from* the Province of goods of any class or description. It should be noted that in view of the language used, this prohibition or restriction was operative not only in relation to other Provinces but also as regards foreign countries. Foreign trade being thus within the exclusive competence of Parliament, Parliament has the power to impose by law, and has in exercise of that power actually imposed by law, customs duties on imports and exports under the Sea Customs Act, 1878 (now under the Customs Act, 1962) read with the Indian Tariff Act, 1934 (entry 83 of the Union List corresponding to entry 44 of the Federal List in the Seventh Schedule to the Government of India Act, 1935). Importance of import and export and customs duties on import and export in the interests of federal finance and economy cannot be over-emphasised. Therefore, the framers of the Constitution were anxious that our foreign trade should not be subjected to the power of the States to impose by law taxes on sales or purchases of goods if such sales or purchases could be regarded as sales or purchases of goods taking place in the course of import or export.

At the same time, in the interests of State Finance and economy, the makers of the Constitution did not like to curtail unnecessarily the power of the States to impose taxes on the sales or purchases of goods because perhaps the most important source of revenue for the States was the taxation of sales or

purchase of goods under entry 54 of the State List. They, therefore, proceeded on the view that only those sales or purchases should be taken out of the States' power to impose taxes which were in a strict sense sales or purchase taking place in the course of import and export and no more. And this objective was sought to be achieved by article 286(1)(b). In the absence of the bar of article 286(1)(b), sales and purchases taking place in the course of import or export might be subjected to taxes under the sales-tax laws of the States. The result in that case would be not only reduction of the volume of foreign trade but also double taxation. This was noted by the Supreme Court in the first Travancore case in 1952 and also in the second Travancore case in 1953. Thus, Patanjali Sastri C.J., in the first Travancore case observed in paragraph 12 of the judgment as reported in AIR as follows:—

> "It might well be argued, in the absence of a provision like clause (b) prohibiting in terms the levy of tax on the sale or purchase of goods where such sales or purchases are effected through the machinery of export and import, that both the powers of taxation though exclusively vested in the Union and the States respectively, could be exercised in respect of the same sale by export or purchase by import, the sales-tax and the export duty being regarded as essentially of a different character. A similar argument induced the Federal Court to hold in *Province of Madras* vs. *Boddu Paidanna and Sons*, 1942 FCR 90, that both Central excise duty and provincial sales tax could be validly imposed on the first sale of groundnut oil and cake by the manufacturer or producer as 'the two taxes are economically two separate and distinct imposts'. Lest similar reasoning should lead to the imposition of such cumulative burden on the export-import trade of this country which is of great importance to the nation's economy, the Constituent Assembly may well have thought it necessary to exempt *in terms* sales by export and purchases by import from sales-tax by inserting article 286(1)(b) in the Constitution."

Then in the second Travancore case in 1953, while explaining and further clarifying the decision in the first Travancore case,

the same Chief Justice (Patanjali Sastri, C.J.) observed in paragraph (14) of the judgment as reported in AIR—

> "It is true, as pointed out in the previous decision, that the export-import trade is important to our national economy, but it is no less true that the State-power of taxation is essential for carrying on its administration, and it must be as much the constitutional purpose to protect the one as not unduly to curtail the other. The question really is, how far did the Constitution makers want to go in protecting the foreign trade by restricting the power of taxing sales or purchases of goods which they conferred on the States under entry 54 of List II. The problem before them was one of balancing and reconciling the rival claims of foreign trade in the interests of our national economy and of the States' power of taxation in the interests of the expanding social welfare needs of the people committed to its charge and we have their solution as expressed in the terms of clause (1)(b). It is for the Court to interpret the true meaning and scope of those terms without assuming that the one constitutional purpose was regarded as more important than the other. This Court has already held in the previous decision that clause (1)(b) protects the export-import trade of this country from double taxation by prohibiting the imposition of sales tax by the State on export sales or import purchases, and we find no warrant in the language employed to extend the protection to cover the last purchase before export or first sale after import."

In the above analysis of the constitutional position I have tried to show that the implication of article 286 even before 1956 was that there might be some sales or purchases in the twilight zone of foreign trade which could legitimately be regarded as part and parcel of foreign trade itself and therefore be regarded as sales or purchases in the course of import or export so as to take them out of the States' power and competence. It is therefore, the essential job of all concerned to find out and pinpoint as correctly as possible, sales and purchases in that twilight zone so that such sales and purchases may be excluded from the power and competence of the States.

Before 1956, there was no specific provision in the Constitution on this aspect of the matter. Naturally therefore it was left to be decided and determined by the Courts and in final analysis by the Supreme Court itself. And as we have already indicated, Supreme Court, did decide and determine this thorny question although, as we shall presently see, the decisions of the Supreme Court could not set at rest all the doubts and misgivings as to the scope and meaning of the expression 'sale or purchase of goods taking place in the course of import of the goods into, or export of the goods out of, the territory of India'.

The first Travancore case (1952).

The case of State of Travancore-Cochin and Others *vs.* the Bombay Company Limited, AIR 1952 S. C. 366 (referred to as the first Travancore case) was one of export sales and the respondents were assessed to sales tax on the turn over of the sales of their commodities (coir products, lemon grass oil and tea) in which they dealt. The dealings followed more or less the same pattern in all the cases and consisted of export sales of the respective commodities to foreign buyers on either c.i.f. or f.o.b. terms as the case might be. The respondents claimed exemption from assessment in respect of the sales effected by them on the ground *inter alia* that such sales took place in the course of the export of the goods out of the territory of India within the meaning of article 286(1)(b) of the Constitution. However, the sales-tax authorities rejected this contention of the respondents as in their view the sales were completed before the goods were shipped and could not therefore be considered to have taken place in the course of the export. This view of the State Sales Tax Authorities might have been regarded as the only correct view had article 286(1)(b) not been there in the Constitution. Indeed such a view might be fully supported had the cases arisen under the Government of India Act, 1935 where, as already pointed out, there was no provision corresponding to article 286. But as we have tried to show that in making the provisions of article 286, the makers of the Constitution proceeded on the assumption and implication that in the interests of foreign trade of India, there might be some sales or purchases of goods which should be regarded as sales or purchases taking place in the course of the import of the goods into or export of the goods out of the territory of India, although in the narrowest sense such sales or purchases were not in the actual course of import or export. According to the narrowest view, only those sales or purchases which are effected by the tranfer of documents of title to the goods on the high seas

(beyond the customs frontiers of India) would come within the scope of article 286(1)(b) and no more.

Be that as it may, the High Court of Travancore-Cochin did not accept this narrow view and accepted the contention of the respondents, and quashed assessment made by the State Sales Tax Authorities and held that the cases came within the exemption of article 286 and were not liable to sales-tax under the State sales-tax law. As a matter of fact, the Travancore-Cochin High Court in its judgment clearly expressed the view that :—

> "The words 'in the course of' make the scope of this clause very wide. It is not restricted to the point of time at which the goods are imported into or exported from India. The series of transactions which necessarily precede export or import of goods will come within the purview of this clause. Therefore, while in the course of that series of transactions the sale has taken place, such sale is exempted from the levy of sales tax. The sale may have taken place within the boundaries of the State. Even then, sales-tax cannot be levied if the sale had taken place while the goods were in the course of import into India or in the course of export out of India".

This wide view put forward by the High Court on the meaning and scope of article 286(1)(b) drew forth from learned counsel appearing before the Supreme Court on behalf of the Union, the several State Governments, and the respondents as many as three other different views on the scope, meaning and interpretation of article 286(1)(b) thereby clearly showing that that article contained in its apparently simple language seeds of conflict, discord and dissent as each of the four views (including the view of the Travancore-Cochin High Court) might be regarded as legitimate and proper according to the upholders of the respective views. These four views were, in the words of the Supreme Court as follows :—

(1) *According to the first view* put before the Supreme Court on behalf of the State of Madras (now Tamil Nadu)— The exemption granted by article 286(1)(b) is limited to sales by export and purchases by import, that is to say, those sales and purchases which occasion the export or import, as the case may be, and extends to no other transactions however directly

or immediately connected, in intention or purpose, with such sales or purchases, and wheresoever the property in the goods may pass to the buyer. The Advocate-General, Madras thought that a State could not impose sales-tax though title passed within the State limits while the goods are still under transport on the high seas and no question of exemption could therefore arise.

(2) *According to the second view.*—In addition to the sales and purchases of kind described above (in the first view), the exemption covers the last purchase by the exporter and the first sale by the importer, if any so directly and proximately connected with the export sale or import purchase so as to form part of the same transaction. This view was sponsored by the Attorney-general of India.

(3) *According to the third view.*—The exemption covers "only" those sales and purchases under which the property in the goods concerned is transferred from the seller to the buyer during the course of transit, that is, after the goods begin to move and before they reach their foreign destination. This was the view supported by the State of Bombay (as it then was) and certain other States.

(4) *The fourth view* which was the view of the Travancore-Cochin High Court in the case, has been expressed by the High Court in the passage already extracted from its judgment.

Of these four views, according to the Supreme Court, the first view was the narrowest and the fourth view, the widest.

After referring to these four views and briefly discussing them, the Supreme Court stated in para 10 of the judgment as reported in the A.I.R.—

> "We are clearly of opinion that the sales here in question, which occasioned the export in each case, fall within the scope of the exemption under article 286(1)(b). Such sales must of necessity be put *through by transporting the goods by rail or ship out of the territory of India* that is to say, by employing the machinery of export. *A sale by export thus involves a series of integrated activities commencing from the agreement of sale with a foreign buyer and ending with the delivery of the goods to a common carrier for transport out of the country by*

> *land or sea.* Such a sale *cannot be dissociated from* the export without which it cannot be effectuated, and the sale and the resultant export form parts of a single transaction. Of these two integrated activities which together constitute an export, *whichever first occurs* can well be regarded as taking place in the course of the other. *Assuming without deciding that the property in the goods in the present cases passed to the foreign buyers and the sales were thus completed within the State before the goods commenced their journey as found by the Sales Tax* Authorities, *the sales must, nevertheless, be regarded as having taken place in the course of the export* and are therefore exempt under article 286(1)(b). *That clause, indeed, assumes that the sale has taken place within the limits of the State and exempts it if it takes place in the course of the export of the goods concerned.*"

(*N.B.*—The lines have been underlined by me.)

And in para 14 of the judgment, the Court held—

> "We accordingly hold that whatever else may or may not fall within article 286(1)(b), sales and purchases which themselves occasion the export or the import of the goods, as the case may be, out of or into the territory of India come within the exemption and that is enough to dispose of these appeals."

It may be pointed out that though in the body of the judgment the expressions "export sale", "import purchase", "sale by export" and "purchase by import" have been used, in its final conclusion in para. 14 of the judgment, quoted above, expression "sales and purchases which themselves occasion the export or import" has been used. In the second Travancore case however, as we shall have occasion to note, this order was reversed, and the expressions "sales by export" and "purchases by import" have been used in the final conclusions of the Court and not the expression "sales and purchases which themselves occasion the export or import."

The Supreme Court expressed no opinion on the point raised in the course of the argument as to whether 'sale' imports a wider concept than the passing of title in the goods from the seller to the buyer which under the law relating to the sale of

goods is determined by highly technical rules based upon the presumed intention of the parties and liable to be displaced by their expressed intention.

The Court did not accept the suggestion made from the Bar that on the construction of article 286(1)(b) indicated by the Court, a "sale in the course of export" would become practically synonymous with "export" and reduce clause (b) to a mere redundancy. The Supreme Court pointed out that in the absence of article 286(1)(b) which expressly prohibits imposition of taxes on the sale or purchase of goods in the course of import or export, the States might impose tax on such sales and purchases in exercise of their exclusive power under entry 54 of the State List and the Union also might impose customs duties in exercise of its exclusive power under entry 83 of the Union List and thus the same sale by export and the same purchase by import would be subject to both sales-tax and customs duties, because these two imposts are essentially of a different character. As already mentioned, the Supreme Court in support of this view cited the Federal Court case of Province of Madras vs. Boddu Paidanna (1942) FCR 90 where the Federal Court held that both central excise duty and provincial sales tax could be validly imposed on the first sale of groundnut oil and cake by the manufacturer or producer as "the two taxes are economically two separate and distinct imposts."

In the result the Supreme Court by agreeing with the conclusion of the Travancore-Cochin High Court *though on different grounds* dismissed the appeals filed by the State of Travancore-Cochin.

The following specific points which emerge from this decision deserve mention *seriatim* :—

(1) That the language of article 286(1)(b) which may *prima facie* appear to be simple is not so in reality and is capable of different interpretations, is clear from as many as four different views mentioned in the judgment.

(2) A sale in order that it may come within the scope of the exemption under article 286(1)(b) must be a sale which itself occasions the export (or as the case may be, which itself occasions the import.)

(3) A sale which itself occasions an export is a sale by export which involves a series of integrated activities commencing from the agreement of sale with a foreign buyer and ending

with the delivery of the goods to common carrier for transport out of the country by land or sea.

(4) Such a sale i.e. a sale which itself occasions the export therefore cannot be dissociated from the export without which it cannot be effectuated and the sale and the resultant export from parts of a single transaction.

(5) Even where the property in the goods passes to a foreign buyer and the sale *is thus completed within the State before the goods commence their journey,* the sale must, nevertheless, be regarded as having taken place in the course of export and is therefore exempt under article 286(1)(b).

(6) As a matter of fact, *article* 286(1)(b) *assumes that the sale which itself occasions an export has taken place within the limits of the State* and exempts it if it takes place in the course of the export of the goods concerned.

(7) In order that a sale or purchase can take place in the course of export or import it is not essential that the property in the goods must be transferred to the buyer *during their actual movement,* as for instance, *where (in the case of export) and shipping document are endorsed, and delivered within three State* by the seller to a local agent of the foreign buyer *after* the goods have been actually shipped or where (in the case of import) such documents are cleared on payment or acceptance by the Indian buyer *before* the arrival of the goods *within the State.* This view, which lays undue stress on the etymology of the word "course" and formulates a mechanical test for the application of clause (b) of article 286(1) *places too narrow a construction upon that clause in so far as it seeks to limit its operation only to sales and purchases effected during the transit of the goods and would,* if accepted, *rob the exemption of much of its usefulness.* (Para 13 of the judgment)

(*My comments.*—As a matter of fact, second part of sub-section (1) and second part of sub-section (2) of section 5 give effect to this view, but are not limited to it only. The first part of each of these two sub-sections goes further and gives effect to the view of the Supreme Court expressed in its final conclusion in para 14 of the judgment.)

I have dealt with and analysed this case in some detail in order to see whether the pith and substance of the meaning of

sale or purchase of goods taking place in course of import of the goods into or export of the goods out of, the territory of India, that is to say, whether the true and correct meaning and scope of article 286(1)(b) have been brought out in the judgment. The judgment, it is submitted with respect, is marked by lucidity and terseness of expression and shows clarity of views on a difficult subject but in spite of these qualities, the judgment has not been able to set at rest all doubts and disputes as to the meaning of article 286(1)(b); on the contrary, it has given rise to sharp divergence of opinions, as will appear from the second Travancore case to which we now proceed.

The second Travancore case (1953)

The controversy was raised again in the second Travancore case (State of Travancore-Cochin vs. Sanmugha Vilas Cashewnut Factory, Quilon, A.I.R. 1953 S.C. 333). The same five judges who heard and decided the first Travancore case heard and decided this case also. As a matter of fact, appeals in this case formed part of the first Travancore case also, but after they had been heard in part along with the other appeals from the same order, it was found that the material facts relating to the course of business of the respondents in the second Travancore case had not been clearly ascertained and accordingly those appeals were remitted to the High Court for further enquiry and findings in regard to those matters. The other appeal however in which the materials on record were found sufficient were finally decided in the first Travancore case.

In the second Travancore case the respondents were dealers in cashewnuts in the State of Travancore-Cochin and their business consisted in importing *raw* cashewnuts from (i) abroad, and (ii) in purchasing them from the neighbouring districts in the State of Madras as also (iii) in purchases made in the local market and after converting them by means of certain processes into edible kernels, exporting the kernels to other countries, mainly America. The oil pressed from the shells removed from the cashewnuts were also exported. The Constitution having come into force on the 26th January, 1950, the respondents in each appeal claimed exemption under article 286(1)(b) in respect of the purchases made from that date till the 29th May, 1950, the end of the account year. The sale-tax authorities having rejected the claim, the respondents applied to the High Court under article 226 and the High Court upheld the claim and quashed the assessments so far as they related to the said period. The State of Travancore-Cochin then filed the appeals to the Supreme Court.

Before considering how far the cashewnut purchases made by the respondents were entitled to the protection of article 286(1)(b), the Court again felt the necessity "to ascertain the scope of such protection." In this connection the Court reiterated and recapitulated the four different views mentioned in the first Travancore case as to the meaning and scope of article 286(1)(b) and after having done so, repeated what it had held in the previous case in para 14 of the previous judgment—

> "Whatever else may or may not fall within article 286(1)(b), sales and purchases which themselves occasion the export or import of the goods, as the case may be, out of, or into, the territory of India come within the exemption."

Then the Court proceeded to discuss and decide the only question debated before it as to "whether in addition to the export-sale and import-purchase, which were held in the previous decision to be covered by the exemption under clause (1)(b), the following two categories of sale or purchase would also fall within the scope of that exemption :—

> "(1) The last purchase of goods made by the exporter for the purpose of exporting them to implement orders already received from a foreign buyer or expected to be received subsequently in the course of business, and the first sale by the importer to fulfil orders pursuant to which the goods were imported or orders expected to be received after the import.
>
> (2) Sales or purchases of goods effected within the State by transfer of shipping documents while the goods are in the course of transit."

As regards the first category mentioned above, the Court was of the opinion "that the transactions are not within the protection of clause (1)(b)". In support of this view the Court gave a number of reasons. The Court first pointed out in para. 10 of the Judgment as reported in AIR—

> "The word 'course' etymologically denotes movement from one point to another, and the expression 'in the course of' not only implies a period of time during which the movement is in progress but postulates also a connected relation."

And in support of this reasoning the Court sought to give an analogy from the English Bankruptcy Act, 1869. It was held in the case of In re Pryce; Ex parte Rensburg (1877) 4 Ch. D. 685 that the words "debts due to the bankrupt *in the course of his trade*" in section 15(5) of English Bankruptcy Act, 1869, "do not extend to all debts due to the bankrupt during the period of his trading *but include only debts connected with the trade.* "A sale in the course of export out of the country", the Court observed in para. 10 of the judgment, "should similarly be understood in the context of clause (1)(b) as meaning a sale taking place not only *during* the activities directed to the end of exportation of the goods out of the country but also as part of or connected with such activities. The time factor alone is not determinative. The previous decision proceeded on this view and emphasised the integral relation between the two *where the contract of sale itself occasioned the export as the ground for holding that such a sale was one taking place in the course of the export.*"

(Underlined by me.)

The Court did not agree with the contention that on this principle of connected or integrated activities a purchase for the purpose of export must be regarded as covered by the exemption under clause (1)(b). The Court said—"A purchase for the purpose of export like production or manufacture for export, is only an act preparatory to export and cannot, in our opinion, be regarded as an act done 'in the course of the export of the goods out of the territory of India' any more than the other two activities (i.e. production or manufacture for export) can be so regarded." (Para. 11 of the judgment.)

The views of Schmitthoff in his book—Export Trade—were cited by the Court in this connection with approval—

> "From the legal point of view it is essential to distinguish the contract of sale which has as its object the exportation of the goods from this country from other contracts of sale relating to the same goods, but not being the direct and immediate cause for the shipment of the goods.....When a merchant shipper in the United Kingdom buys for the purpose of export goods from a manufacturer in the same country, the contract of sale is a home transaction; but when he re-sells these goods to a buyer abroad that contract of sale

has to be classified as an export transaction." (2nd Edn. p. 3).

The Court observed that "*The same reasoning applies to the first sale after Import* which is a distinct local transaction effected after the importation of the goods into the country has been completed, and having no integral relation with it." (Para. 11).

(underlined by me.)

The Court also referred to the practical difficulty in extending the exemption of article 286(1)(b) *to the last purchase for the purpose of export* and *the first sale after the import.* "Supposing", the Court observed in para. 13 of the judgment, "A is the seller from whom B the export merchant purchases the goods for export. If the sale is to be exempt, *how is A to be satisfied that the goods would actually be exported subsequently*? And even if they were, it must be difficult for A to prove to the Sales-tax Officer that they were so exported by B, if proof was required. On the other hand, B might be keeping the goods, waiting for orders to come or might change his mind and not export the goods at all but sell them locally. In that case, what would be the position of A vis-a-vis the Sales-tax Officer demanding the tax? Could A escape liability if he failed to collect the tax from B at the time of the sale? Or, is A to collect the tax ignoring B's declaration of his intention to export and leaving him to apply for refund by producing evidence of actual export, whenever that takes place? Even if a sales-tax enactment provides for adjustment on those lines, would not such legislation, in so far as it compels B to suffer the tax until he actually exports the goods, contravene clause (1)(b) which *ex hypothesi* exempts the transaction from sales-tax? And what would be the position if the goods were burnt or otherwise lost in the meanwhile, and the export never took place?"

Noticing all these practical difficulties and uncertainties, the United States Supreme Court laid down the following rule in the case of Expresa Siderurgica, S. A. *vs.* Merced (1949) 337 U.S. 154—

"It is the entrance of the articles into the export stream that marks the start of the process of exportation. Then there is certainty that the goods are headed for their foreign destination and will not be diverted to domestic use. Nothing less will suffice.

The Court then observed that similar difficulties and uncertainties would arise if the exemption were sought to be extended to the first sale after import. In the first place, the first sale after import will be a local sale because it takes place after the goods have been actually imported into India *i.e.* after the termination of the process of importation. In the next place, how is the exemption to be applied to goods imported from abroad after they are mingled with other goods and lose their distinctive character? In this connection the Court rejected the American doctrine of "original or unopened package."

It is in the light of these discussions and conclusions that the Court considered whether the imports of cashewnuts by the respondents fell within the exemption of article 286(1)(b), and if so, to what extent. These imports were divided into two categories—(i) purchases made through intermediaries (called "the Bombay party") *doing business as commission agents at Bombay*. As the Bombay party *acted as agents of the respondents* charging commission, privity was established between the respondents and the African sellers. That being so, the purchases of cashewnuts by the respondents from the African sellers occasioned the import and therefore they came within the exemption of article 286(1)(b) and were not subjected to sales-tax law of the State.

In the other category, the Bombay party indented the goods on their own account and sold the goods as principals to the respondents and other customers but the goods were shipped direct to Cochin or Quilon on c.i.f. terms. The shipping documents were made out in the name of the Bombay party as consignees and were delivered to them against payment through bankers at Bombay. The Bombay party cleared the goods through their own representatives at the port of destination and issued separate delivery orders to the respondents and other customers for the respective quantities ordered.

The Bombay party were thus the purchasers from the African sellers and the Bombay party sold the goods as principals to the respondents at the port of destination by issuing separate delivery orders against payment. No privity being established between the respondents and the African sellers, the respondents' purchases were purchases from the Bombay party of the goods within the State. In other words, they being thus local purchases could not come under the exemption under article 286(1)(b).

As regards the sales or purchases effected in the State by transfer of shipping (c.i.f.) documents while the goods are still in transit, the Court's decision was that it was well known that such sales or purchases formed a characteristic feature of foreign trade, they therefore fell within the exemption of article 286(1)(b), "if the State is constitutionally competent to tax such sales" as to which the Court expressed no opinion.

After such examination and discussion of the position, the Court summed up its conclusions as follows in para. 16 of the judgment :—

"(1) Sales by export and purchases by import fall within the exemption under article 286(1)(b). This was held in the previous decision.

(2) Purchases in the State by the exporter for the purpose of export as well as sales in the State by the importer after the goods have crossed the customs frontier are not within the exemption.

(3) Sales in the State by the exporter or importer by transfer of shipping documents while the goods are beyond the customs frontiers are within the exemption, assuming that the State power of taxation extends to such transactions."

S. R. Das, J. who was a party to the unanimous decision of the Court in the first Travancore case did not agree this time with the majority view and wrote a long dissenting judgment. He dissented from the majority view on the construction and meaning of article 286(1)(a) dealing with restrictions placed upon a State as to imposition of tax on the sale or purchase of goods where such sale or purchase takes place outside the State. He also dissented this time as to the scope of the expression "in the course of" occurring in article 286(1)(b). He posed the question, as to what was the scope of the ban imposed on the States by article 286(1)(b)? He felt that the answer would depend on the meaning that may be ascribed to the phrase "in the course of" occurring in clause (1)(b). He referred to the unanimous decision of the Court in the first Travancore case according to which "whatever else may or may not fall within article 286(1)(b), sales and purchases which themselves occasion the exports or imports of the goods, as the case may be, out of, or into, the territory of India come within the exemption....."

According to him, this was sufficient to dispose of that case and it was not then necessary to decide what else might fall within that phrase. He said, "This Court is now called upon to decide that point", (vide para. 48 of his judgment) Das, J., then described the practice of foreign trade in India and how it was carried on. And he expressed his views in para. 51 of his judgment as follows :—

> "In my judgment the purchase made by the exporter to implement his agreement for sale with the foreign buyer is to be regarded as having taken place 'in the course of' export. I take this view, not because I read the words 'in the course of' as synonymous with the words 'for the purpose of' but because I regard the purchase by the exporter as an activity so closely integrated with the act of export as to constitute a part of the export process itself and, therefore, as having taken place 'in the course of' the export. The learned Attorney-General accepts this position but the Advocates-General of the States demur. They maintain that in this view of the matter one cannot stop at the last purchase by the exporter but has to include the purchase by the person who sells to the exporter and all previous sales or purchases until one reaches the producer. I find no substance or cogency in this line of reasoning. In the last purchase by the exporter we have at least one party who is directly concerned with or interested in the actual export. The exporter is the connecting link, the commercial vinculum, as it were, between the last purchase and the export. But in the earlier sales or purchases neither the sellers nor the purchasers are personally concerned with or interested in the actual export of the goods at all. Therefore the earlier sales or purchases may be too remote and may not be regarded as integral parts of the process of export in the same sense as the last purchases by the exporter can be so regarded. The line of demarcation is easily perceptible."

He summarised his views as regards the true scope and meaning of a sale or purchase in the course of import or export in paragraph 59 of the judgmental reported in the AIR as follows:—

> ".....A sale or purchase 'in the course of' import or export within the meaning of clause (1)(b) includes

(i) a sale or purchase which itself occasions the import or export as already held by this Court, (ii) a sale or purchase which takes place while the goods are on the high seas on their import or export journey and (iii) the last purchase by the exporter with a view to export and the first sale by the importer to a dealer after the arrival of the imported goods. If a sale or purchase takes place within a State, either under the general law or by reason of the Explanation, then, if it takes place in the course of import or export as explained above, no State, not even the State within which such sale or purchase takes place can tax it by reason of clause (1)(b). This, in short, is the true meaning and import of article 286 as I read and understand it."

Complexity of the subject.

I have dealt at length with the two Travancore cases to show their supreme importance in relation to the restrictions on the power of the States to impose by law taxes on the sale or purchase of goods when such sale or purchase takes place in the course of import or export. The matter is highly complex and difficult. In my opinion, it becomes easy to grasp their true meaning, scope and content in the background of actual facts. Except in such background, our ideas may continue to remain hazy and our vision blurred. Law is a social science dealing with the actual problems faced by man as a member of society in connection with his affairs and dealing with other men. Hence it makes for clarity if legal problems are considered in the context of the realities of life. To use the language of the great German legal philosopher and sociological jurist, Rudolf Von Jhering, we are concern not so much with jurisprudence of conceptions as with jurisprudence of actualities. That article 286(1)(b) is capable of more interpretations is readily seen from the long dissenting judgment of S. R. Das, J. and I shall presently show that this divergence of views on the scope, meaning and interpretation of article 286(1)(b) of the Constitution and section 5 of the Central Sales Tax Act is still persisting. Therefore I should try my level best to define the scope of these provisions so that in future, doubts, conflicts and divergences may be reduced to the minimum if not altogether eliminated. It may be pointed out here with great respect to the views of Das, J. that his view that "a sale or purchase occasioning export or import" includes the last sale before export of the goods and the first purchase after import of the goods may not be universally acceptable as it was not acceptable to the majority of the Judges in the second Travancore case.

The last sale or the first purchase, however it may appear to be in the interests of foreign trade of our country cannot but impinge beyond reasonable limit upon the power of the States to levy sales-tax. One may take the view that to include in the name of integrated activities, such a sale or such a purchase as taking place in the course of export or import does not appear to be based upon very sound reason. For in the case of the last sale or purchase before the export-sale, where is the certainty that after such last sale or purchase and before such export-sale, the exporter will not change his mind or that the goods will not be lost, destroyed, pilfered, damaged or rendered less valuable? And in the case of the first sale or purchase after the import is completely at an end, on what rational basis can it be said that such first sale or purchase is integrally connected with the import even if such first sale or purchase is in pursuance of a contract previously entered into between the importer and the first purchaser?

There is no doubt however that the two Travancore cases decided by the Supreme Court before the Sixth Amendment of the Constitution are landmarks in our constitutional history in relation to the construction and interpretation of article 286 of the Constitution.

First reference to the Law Commission (1966).

The next phase in connection with the matter started in 1956 when the Constitution (Tenth Amendment) Bill was introduced in Parliament and passed by Parliament as the Constitution (Sixth Amendment) Act. In the same year, the Government in the Ministry of Law referred to the Law Commission, the question of the principles that should be formulated by parliamentary legislation for determining when a sale of goods takes place (a) outside a particular state, (b) in the course of import or export, or (c) in the course of inter-state trade or commerce in pursuance of the provisions of clause (2) of article 286 and clause (3) of article 269 as inserted by the Constitution Sixth Amendment. The Law Commission in its Second Report (Parliamentary Legislation relating to Sales-tax) dealt with these three matters. The report of the majority covered only about 10 pages and a separate note consisting of four pages was written by Dr. N. C. Sen Gupta, a Member of the Commission. In paragraph 10 of the majority report, the Commission recommended the acceptance of the principles laid down by the Supreme Court in the two Travancore cases and the language used by the Commission in the aforesaid paragraph 10 was more or less the same as the language used

in the decisions of the Supreme Court in the two Travancore cases, specially in the first case. The Commission did not accept the views expressed by Das, J. in the second Travancore case nor did it accept the suggestion of the Ministry of Commerce and Industry that the last purchase preceding the export should be accepted as a transaction in the course of export on the ground that the exemption of such transactions from sales-tax will stimulate exports. As that Ministry did not however suggest that a similar exemption should be granted to the first sale following the import, it appeared to the Commission to be somewhat illogical that the last purchase preceding the export should be exempt whereas the first sale following the import should not be exempted.

With great respect to the views of the Commission in the Second Report, it is felt that the Commission borrowed the language used in the unanimous decision of the Supreme Court in the first Travancore case without critically and carefully examining whether that language would be precise enough to remove all doubts and ambiguities and conflicts, as is evident from the minortiy judgment of Das, J. in the second Travancore case. Moreover, from the observations of the Court in para. 14 of the judgment in the first Travancore case, it was clear that the Court did not consider the matter in a comprehensive manner. This aspect was specifically mentioned by Das, J. in his minority judgment.

Be that as it may, the Government and Parliament accepted the majority views of the Law Commission in the Second Report in relation to sales or purchases in the course of import or export and section 5 of the Central Sales Tax Act, 1956 adopted *verbatim* the language of the recommendations of the Commission in paragraph 10 of the Report.

Khosla's case (1966).

The third phase is provided by K. G. Khosla's case (K. G. Khosla & Co. vs. Deputy Commissioner of Commercial Taxes, AIR 1966 S.C. 1216) decided by the Supreme Court on the 16th January, 1966. It is not necessary to discuss in detail the other cases on the subject decided by the Supreme Court before Khosla's case as they more or less followed the views of the Supreme Court in the unanimous judgment in the first Travancore case and majority judgment in the second case. Moreover, discussion of too many case-laws has the disadvantage of distracting one's attention from the real problem. Be that as it may, it is difficult to accept in toto the view ex-

pressed in some of these cases (not cited or discussed here) that no single test can be laid down and each case must depend on its own facts. It is submitted with respect that such a view seems to be a view of despair and underrates the importance of the principles required to be formulated by law made by Parliament under article 286(2) which have been actually formulated by Parliament in section 5 of the Central Sales Tax Act, 1956. It may even be said that if this view is accepted then there was hardly any necessity for formulating the principles in pursuance of article 286(2) as it now stands. Whether the principles formulated by Parliament require improvement is a different matter. While saying this we are not ignoring or underestimating the importance of the facts of each case. But that should not mean as to why serious endeavour should not be made to make the principles as broad and comprehensive so as to fit in with the facts of each and every case as far as practicable. We must try to find out the recommendations of the Law Commission in 1956 which recommendations in turn were based on decisions in the two Travancore cases. The observations of Das, J. in paragraph (48) of his dissenting judgment as reported in the A.I.R. will bear repetition in this connection—

> "The question arises : what is the scope of the ban thus imposed on the States ? The answer will depend on the meaning that may be ascribed to the phrase 'in the course' occurring in clause (1)(b) .....In AIR 1952 S. C. 366 (the first Travancore case) this Court has held that—
>
> "Whatever else may or may not fall within article 286-(1)(b) sales and purchases which themselves occasion the export or import of the goods, as the case may be, out of or into the territory of India come within the exemption....."
>
> In other words, this Court has held that sales or purchases which themselves occasion the imports or exports are sales or purchases which take place 'in the course of' import or export. *This was sufficient to dispose of that case and it was not there necessary to decide what else might fall within that phrase. This Court is now called upon to decide that point.*"

Coming now to Khosla's case, the following facts mentioned in the judgment of Sikri, J. led the Court to the decision it reached in the case —

(1) The appellant K. G. Khosla & Co.—mentioned in the judgment as the assessee—*entered into a contract* with the Director-General of Supplies and Disposals, New Delhi for the supply of axle-box bodies.

(2) *According to the contract* the goods were to be manufactured in Belgium and the Director-General of the Indian Supply Department (D.G.I.S.D.), London or his representative was to inspect the goods at the works of the manufacturers.

(3) He was to issue an inspection certificate.

(4) Another inspection by the Deputy Director of Inspection, Ministry of W.H. & S., Madras was provided for in the contract. It was his duty to issue inspection notes on Form No. WSB 65 on receipt of a copy of the inspection certificate from the D.G.I.-S. D., London and after verification and visual inspection.

(5) The goods were to be manufactured according to specifications by M/s La Brugeoies, ET, Nivelles, Belgium.

(6) There was a provision as to when the assessee would be entitled to be paid.

(7) *The assessee was entirely responsible for the execution of the contract in all respects in accordance with the terms as specified in the contract.*

(8) Any approval which the Inspector might have given in respect of the stores, materials or other particulars and the work and workmanship in the contract (whether with or without test carried out by the contractor's Inspector "*shall not bind the purchaser* (that is, the D.G.S. &. D.) and notwithstanding any approval or acceptance given by the Inspector, it shall be lawful for the consignee of the stores on behalf of the purchaser to reject the stores on arrival at the destination, if it is found that the stores supplied by the contractor are not in conformity with the terms and conditions of the contract in all respects."

(9) *Further, the assessee was responsible for the safe arrival of the goods at the destination.*

(10) By an endorsement the D.G.I.S.D., London was requested to issue pre-inspection delay reports regularly to all concerned including the Railway Liaison Officer c/o D.G.S.&.D., Shahjahan Road, New Delhi. He was also requested to endorse copies of the Inspection Certificates to the Director of Inspection, Ministry of Works, Housing and Supply, Bombay.

(11) It was further found by the Sales Tax Appellate Tribunal that *"the Belgium manufacturers,* after manufacture *consigned the goods to the appellants by ship under bills of lading in which the consignee was the appellants themselves.*

(12) The goods were consigned to Madras Harbour, *cleared by the appellants' own clearing agents and despatched* for delivery to the buyers thereafter."

(13) In pursuance of this contract the assessee supplied the axle-box bodies of the value of Rs. 1,74,029.50 to the Southern Railway at Perambur Works and of the value of Rs. 1,32,987.75 to Southern Railway, Mysore.

The Joint Commercial Tax Officer held that the former sales were liable to tax under the Madras General Sales Tax and the latter under the Central Sales Tax Act. He rejected the contention that the sales were in course of import. He held that *"there was no privity, of contract between the foreign seler and the Government for the goods.* The goods were shipped only as the goods of the seller and intended for them. They were cleared as their own and delivered after clearance. The transaction is therefore one of intra-state sales and not one in the course of import. The sale is completed only when the goods are delivered in this State and so it is not occasioning the import." The Joint Commercial Tax Officer also referred to the terms and conditions of the contract relating to the rejection of the goods by the purchaser to which reference has already been made.

The Appellate Assistant Commissioner agreeing with the Joint Commercial Tax Officer, rejected the appeals by the assessee. The Appellate Tribunal also held that the sale by the appellants had not occasioned the import except that sales to the extent of Rs. 22,983.75 and Rs. 10,987.50 had taken place in the course of the import as the goods had been appropriated to the contract while the goods were on the high seas. The assessee filed two revisions before the High Court and the Deputy Commissioner of Commercial Taxes, Madras also filed

two revisions challenging the deductions of the two sums of Rs. 22983.75 and 10987.50. The High Court allowed the petitions filed by the Deputy Commissioner of Commercial Taxes and dismissed the petitions filed by the assessee. The High Court rejected the contention of the assessee that the sale by the assessee to the Government Department (i.e. the D.G.S.&D.) had occasioned the import on the ground that "before a sale can be said to have occasioned the import, it is necessary that the sale should have preceded the import" and as the sale had not taken place in Belgium there was no question of the sale occasioning the import of the goods.

On the facts and materials, the Supreme Court differed from the decision of the High Court and allowed the appeals filed by the assessee and held that the sales by the assessee to the Government (Director-General of Supplies and Disposals) took place in the course of the import of goods within section 5(2) of the Central Sales Tax Act.

In coming to this decision the Court first rejected (and it is submitted rightly) the view of the Madras High Court that before a sale could be said to have occasioned import "it is necessary that the sale should have proceeded the import."

In repelling the above view of the High Court, the Supreme Court proceeded on the following lines of reasoning:—

(a) "It seems to us that the expression 'occasions the movement of goods' occurring in section 3(a) and section 5(2) must have the same meaning."

(*My comments.*—The expression "occasions the movement of goods" occurs in section 3(a) only. In section 5(2), the expression used is "occasions such import". Moreover, the words "only if" occur before the words "the sale or purchase in section 5(2) but not in section 3. These differences in language are significant. The meaning of the term *"movement" in section* 3(a) is more specific than the meaning of the term "import" in section 5(2). As has been shown already, on a very strict and narrow view of article 286(1)(b), a sale or purchase in the course of import or export would be confined only to a sale or purchase effected by a transfer of documents of title to the goods while the goods are on the high seas in the course of transit vide in this connection the observations of Patanjali Sastri, C. J. in para. 13 of the judgment (as reported in the AIR) in

the first Travancore case. There are other points of difference between a sale or purchase in the course of inter-State trade or commerce and a sale or purchase in the course of export or import. In this view of the matter, to attribute the same meaning to the expression occurring in section 3(a) and the expression occurring in section 5 does not, it is pointed out with respect, seem quite correct.)

(b) After taking the view as above, the Court cited with approval the following interpretation given by Shah, J. on section 3 in the majority judgment of the Court in Tata Iron and Steel Co. vs. S. R. Sarkar (AIR 1961 SC 65) :—

"In our view, therefore, within clause (b) of section 3 are included sales in which property in the goods passes during the movement of the goods from one State to another by transfer of documents of title thereto: clause (a) of section 3 covers sales, other than those included in clause (b), in which the movement of goods from one State to another is the result of a covenant or incident of the contract of sale, and property in the goods passes in either State."

(c) These observation of Shah, J. were cited with approval by the Court in the Cement Marketing Co. *vs.* State of Mysore (AIR 1963 SC 980) although the Court in that case was dealing not with the Central Sales Tax Act but with a similar case arising under article 286 of the Constitution before its amendment.

(d) But the same Bench of the Court in dealing with a case arising under the Act (State Trading Corporation of India Ltd. vs. State of Mysore AIR 1963 SC 548) again approved of the observations in Tata Iron & Steel Co. case

In this way, after citing a number of cases under section 3, the Court held "that the High Court was wrong in holding that before a sale could be said to have occasioned import it is necessary that the sale should have preceded the import."

When the Court was invited by the Counsel for the respondent to hold that the observations of Shah, J. in Tata Iron &

Steel Co. case were obiter, and to consider the question afresh, because Shah, J. in that case was considering clause (b) of section 3, the Court observed—"We are unable to re-open the question at this stage. Shah, J. was interpreting section 3 of the Act, and although the Court was principally concerned with the interpretation of section 3(b), it was necessary to consider the interpretation of section 3(a) in order to arrive at the correct interpretation of section 3(b)."

In this way, repelling the view of the Madras High Court, the Court in a short paragraph proceeded to the question,—

> "Whether the movement of axle-bodies from Belgium into Madras was the result of a covenant in the contract of sale or an incident of such contract. It seems to us that it is quite clear from the contract of sale that it was incidental to the contract that the axle-box bodies should be manufactured in Belgium, inspected there and imported into India for the consignee. Movement of the goods from Belgium into India was in pursuance of the conditions of the contract between the assessee and the Director-General of Supplies. There was no possibility of these goods being diverted by the assessee for any other purpose. Consequently we hold that the sales took place in the course of import of goods within section 5(2) of the Act, and are, therefore, exempt from taxation."

Thus in coming to this decision, the Court relied on only two grounds, namely,—

(1) the movement of the goods from Belgium to India was in pursuance of the conditions of the *contract between the assessee and the Director-General of Supplies;*

(2) there was no possibility of the goods being diverted by the assessee for any other purpose.

Comments on Khosla's cases.

My comments on the case are as follows :—

(1) It is difficult to find out from the judgment whether the Court treated the assessee (K. G. Khosla & Co.) as merely as agent of the D.G.S.&D. or as independent importer importing the goods from Belgium as his own goods.

(2) The terms and conditions of the contract were no doubt a bit peculiar in that under them a good deal of control over the assessee was retained by the D.G.S.&D., such as control in relation to inspection of the goods both in Belgium at the stage of manufacture and also in India at Madras and Bombay and the issue of inspection certificates and inspection notes. All this may be regarded as more in consonance with the position of the assessee as an agent than with his position as an independent importer importing goods by purchase from the Belgium manufacturers.

(3) But this is more than counter-balanced by other terms and conditions of the contracts and other facts and circumstances of the case. These terms and conditions and facts and circumstances are: (i) the assessee, Khosla & Co. was entirely responsible for the execution of the contract in all respects in accordance with the terms and conditions specified; (ii) any approval which the Inspector might have given in respect of the stores, materials etc. (whether with or without test carried out by the assessee's Inspector) shall not bind the purchaser; (iii) notwithstanding any approval or acceptance given by the Inspector it shall be lawful for the consignee of the stores (the Southern Railway on behalf of the purchaser) to reject the stores on arrival at the destination if it be found that the stores supplied by the contractor (the assessee) are not in conformity with the terms and conditions of the contract in all respects; (iv) the assessee was responsible for the safe arrival of the goods at the destination; (v) the Belgian manufacturers after manufacture, consigned the goods to the appellants (the assessee) by ship under bills of lading to which the consignee was the appellants (assessee) themselves; and (vi) the goods were consigned to Madras harbour, cleared by the appellants' own clearing agents and despatched for delivery to the buyers thereafter.

All these terms and conditions and facts and circumstances point to the assessee being the importer, himself importing his own goods. The Court however did not consider at all this aspect of the case as to whether the assessee was merely an agent of the D.G.S. & D. or was an independent importer who had entered into a contract with D.G.S. & D. to sell the goods to him *after* "the safe arrival of the goods at the destination."

(4) The Court also did not consider at all the finding of the Joint Commercial Tax Officer that "there was no privity of contract between the foreign seller and the Government for the

goods. The goods were shipped only as the goods of the seller (i.e. the assessee) and intended for them. They were cleared as their own and delivered after clearance. The transaction is therefore one of the intra-State sales and not one in the course of import." While the Court specifically stated in para. 11 of the judgment that "Movement of goods from Belgium of India was in pursuance of the conditions of the contract between the assessee and the Director-General of Supplies", there is nothing expressly stated in the judgment *whether this contract could be regarded* as one between the Director-General and the Belgium sellers.

It is not clear why the Court did not accept or reject this finding of the Joint Commercial Tax Officer.

(5) The findings that the movement of the goods were in pursuance of the contract between the assessee and the Director-General of Supplies and Disposals and that there was no possibility of the goods being diverted for any other use did not touch the question whether the purchase by the D.G.S. & D. after the arrival of the goods in Madras and termination of the process of import was an import-purchase by the Director-General of Supplies and Disposals or was the first purchase by him *after* the import.

(6) Then, the Court did not at all consider the two Travancore cases of 1952 and 1953. It does not appear that the Court's attention was drawn to these cases by the counsel who appeared for the parties. All the cases cited before and relied on by the Court were cases under section 3 of the Central Sales Tax Act, 1956 with the exception of one (Cement Marketing Co. *vs.* State of Mysore, AIR 1963 SC 980) which arose under article 286 as it stood before its amendment in 1956. The Court also did not consider any case under section 5 of the Central Sales Tax Act. For example, in Ben Gorm's case (AIR 1964 SC 1752), section 5 was specifically considered as also the two Travancore cases. In Ben Gorm's case (decided on 10th April, 1964), Shah J. speaking for the majority stated in relation to section 5 in para. 5 of the judgment as reported in AIR—

> "This was legislative recognition of what was said by this Court" in the two Travancore cases, "about the true connotation of the expression 'in the course of the export of the goods out of the territory of Inida' in article 286(1)(b). A transaction of sale which

occasions export or which is effected by a transfer of documents of title after the goods have crossed customs frontiers, is therefore, exempt from sales-tax levied under any State legislation."

Had the Court considered Ben Gorm's case, the Court would have been naturally led to consider the two Travancore cases because they were so thoroughly discussed in Ben Gorm's case. But even this was not done.

The result therefore is that we do not know as to exactly on what basis the Court proceeded, that is, whether proceeded on the view that Khosla & Co. was an agent of the D.G.S. & D. or on the view that Khosla & Co. was an independent importer importing the goods purchased by it on its account. The previous contract with the D.G.S. & D. to sell the goods to him after the goods have been imported into the territory of India is not at all inconsistent with this position. It may be pointed out that these two views would clearly come respectively within the two categories into which Group III (Imports from Africa) was sub-divided by Patanjali Sastri, C. J. in the second Travancore case (paras. 20 and 21 of the judgment of the learned Chief Justice as reported in the AIR). Therefore, perhaps we would have got a clear guidance from the Supreme Court in Khosla's case, had the Court's attention been drawn to the two Travancore cases and Ben Gorm's case.

Then each of the two final views of the Court in Khosla's case, namely, that the import was in pursuance of the conditions of the contract between the assessee and the Director-General of Supplies and Disposals and that there was no possibility of the goods being diverted by the assessee to any other purpose, would be equally compatible with the position of Khosla & Co. as an agent of the D.G.S. & D. as well as an importer of the goods on its own account.

The result, therefore, of this decision has been that an amount of confusion and uncertainty has been introduced in the law [section 5 as well as article 286(1)(b)]. The State Governments have not been happy with it. Some of them have openly remonstrated against the decision on the ground that its effect has been to curtail the States' power of imposing taxes on many sale and purchase transactions which but for the decision would be clearly subject to such taxes. The Central Government has been also

in a fix as to exact scope of the law as enunciated in article 286(1)(b) and section 5.

Second reference to the Law Commission (1966).

Therefore, within about only six months after the decision the Ministry of Finance raised the query whether the decision in Khosla's case went beyond what the Law Commission in its Second Report intended and thereupon the Ministry of Law referred the matter to the Law Commission on the 18th July, 1966 for its consideration.

After careful consideration of the whole matter at length the Commission was divided in its opinions. The majority view was that "the propositions emerging from Khosla's case *are consistent* with the two Travancore cases on which the Second Report of the Law Commission was based and do not go beyond the intendment of those decisions. The particular situation involved in Khosla's case was, no doubt, not in issue at that time, but there is nothing in those decisions, which is inconsistent with the test of contractual obligation applied in Khosla's case". But it is submitted with respect that the general conclusion of the Commission that "the propositions emerging from Khosla's case are consistent with the two Travancore cases....." is difficult to accept. If Khosla's case is consistent with the Travancore cases, then why have the States been clamouring and remonstrating against Khosla's decision? Can the States now impose tax on the first sales after import in the face of the Khosla decision? Why then did not the majority recommend that the States might exercise their powers of taxation, the Khosla decision notwithstanding? Why then the Ministry of Finance raised the query at all? All these questions remained unanswered in the report of the majority.

In my view, correct approach was adopted in the minority reports signed by Shri K. G. Datar and Shri R. P. Mookerjee. Their conclusion was that Khosla's case was inconsistent with the decisions in the Travancore cases. Mr. Datar in his report said—

> "For the reasons stated in the foregoing paragraphs, I am of the opinion that the present decision in Khosla's case is not consistent with the previous decisions of the Supreme Court which I have discussed above. In particular, the decision goes beyond the decisions of the Supreme Court in the two Travancore cases and is likely to create uncertainty in the law."

Uncertainty in the law the decision has, no doubt, created. But the small amendments suggested in section 5 by Shri Datar and Shri Mookerjee would not, I am afraid, remove the uncertainty. Shri Datar says in para. 115 of his note—

> "At present the section reads '.....if the *sale or purchase*.....occasions such import.....' and 'if the sale or purchase occasions such import.....'. If only the Travancore cases were to be followed and accepted, it would be *only the sale occasioning the export* and *only* the purchase occasioning the import."

But I do not think these small changes using *only sale* in relation to export and *only purchase* in relation to import would clear away the uncertainty and doubt. My reason is simple because every sale transaction involves a sale as well as a purchase—sale by the person *from* whom the property in the goods passes and a purchase by the person to whom such property passes. Sale and purchase may be regarded as the obverse and reverse of the same transaction. Even article 286 does not appear to have limited sale to export or purchase to import, had it been so, then in clause (1)(b) of that article the words "export of the goods out of" would have been placed before the words "the import of the goods into". Das, J. also in para. 51 and para. 59 of his judgment in the second Travancore case used the expressions interchangeably.

**My disagreement with the view taken by the majority on Khosla's case.**

In view of the detailed discussion of Khosla's case and the comments I have offered on that case, I regret to say that I find it difficult to persuade myself to accept the view of my colleagues in relation to that case in their report in the present case. I have already shown that the words "occasions such export" in sub-section (1), and the words "occasions such import" in sub-section (2), of section 5 are not free from ambiguity. We should, therefore, try as clearly as possible to define the exact scope and content of these words.

We should not hesitate even to recast section in new language by dropping the word "occasions" if that helps in defining and delimiting with sufficient clarity the limits of "the course" of import or export. The difficulty with the word "occasion" both as a verb and as a noun is that its connotation is very wide. This is why the Supreme Court in the first Travancore case used

the words "sales and purchases which *themselves* occasion the export or import of the goods, as the case may be, out of or into the territory of India"—the emphasis being laid upon the pronoun "themselves" to indicate that such sales or purchases alone (no other sales or purchases) are the *direct, proximate and immediate* cause of the import or export. Other sales or purchases may be only *indirectly or remotely* connected with the import or export, but they are not the *direct, proximate or immediate* cause. And Law Commission in making their recommendations in the Second Report borrowed the words used by the Supreme Court with this difference that instead of the words "sales or purchases which *themselves* occasion etc." the Law Commission used the words *"only if* the sale or purchase.....occasions etc." In section 5 also the words *"only if"* have been used. But even then it seems that the Supreme Court was not sure whether the language used in the first Travancore case (as cited above) would fully carry out its intention and objective. Therefore even in the first case, the Supreme Court, while expressing its clear opinion in para 10 of the judgment as reported in the AIR, used the expression "A sale by export" to mean a sale which itself occasions the export. In the second of the three views pressed from the Bar before the Court, the expressions "export sale" or "import purchase" were used. These two expressions were also used in the very same second view as reiterated by the Court in the second Travancore case. But while stating its final conclusion in para. 14 of the judgment in the first Travancore case, the Court mentioned only the expression "sales and purchases which *themselves* occasion the export or the import".

While however this expression was also quoted in the judgment in the second Travancore case, in expressing its final conclusion in para 16 of the judgment as reported in the AIR, the Court used the expression "sales by export" and the expression "purchase by import" in conclusion (1). The Court said—

"Our conclusions may be summed up as follows:—

(1) Sales by export and purchases by import fall within the exemption under article 286(1)(b). This was held in the previous decision.

(2) .....

(3) ....."

We had already referred to the importance of foreign trade and customs duties in our national finance and economy, we have also pointed out that the States' power to impose taxes on the sale or purchase of goods should not be unduly curtailed as that may adversely affect the States' finance and economy. In considering the meaning of "occasion" we should keep in view both these aspects. And we should not ignore the impact of export and import trade in its proper perspective on the industrial growth and development of our country.

Difference between the effects of export and the effects of import.

We should in this connection note not only the relative importance of export and import but also the difference between the two so far as our national economy and economic growth are concerned. Thus, increase in exports not only improves India's foreign exchange position and increases her foreign exchange reserves by reducing and ultimately eliminating adverse balance of trade and payments but also directly encourages and accelerates the industrial and agricultural growth and development of the country. Increase in imports has just the reverse effects. It tends to weaken our foreign exchange position and to deplete our foreign exchange reserves and thereby cripples our capacity for selfreliance in the economic sphere, attainment of which should, as far as practicable, be the aim of any self-respecting nation. If imported foreign goods, articles and materials flood our internal markets, then the goods, articles and materials produced in the country may find it difficult to compete with imported goods and in this process imports directly tend to hamper and hinder the growth and development of our industries, trade, business and agriculture.

Care necessary even in exports.

Even in the case of exports, care is called for so that the export of raw materials, specially those which are likely to be depleted without any chance or possibility of replenishment, is not encouraged unless that becomes absolutely necessary in the overall interests of our national economy and national economic growth. It is well-known that formerly raw materials exported from India other than those needed for immediate consumption in the foreign countries where they were exported, were quite often converted into manufactured products and finished goods and those manufactured and finished goods were imported into India for use and consumption in this country. The bitter experience in this regard in pre-Independence days is well known and has not yet been forgotten. Any student of India's economic history is aware of the baneful consequences of this two-way process in the export trade.

This is why our export and import trade has been under a strict system of control and licensing under the Import and Export (Control) Act, 1947, passed in March, 1947 on the eve of attainment of Independence when a national Government headed by Jawaharlal Nehru was in power. The Act was of temporary duration in the beginning but has continued in force ever since. It is now more or less a permanent statute. In this connection, reference may also be made to the Foreign Exchange Regulation Act, 1947, its objective being to provide in the economic and financial interests of India for the regulation of certain payment, dealings in foreign exchange and securities and the import and export of currency and billion. I may also refer to the Export (Quality Control and Inspection) Act, 1963 whose object is to provide for the sound development of the export trade of India through quality control and inspection—the aim is thus to boost the export part of foreign trade. All this shows that the Central Government and Parliament regard export trade more important than import trade in the nation's economy.

Therefore, we must be very circumspect in extending the length of the course of import. And while our national aim should be to boost and develop export trade, we should not unduly lengthen the course of export either for the simple reason that the power of the States in the field of sales-tax should not be unnecessarily curtailed. If the goods manufactured in our country are of high quality and never go below the standard quality, then that itself will, increase the demand for such goods in foreign markets specially if such quality goods are produced having regard to the tastes and fancies of foreign buyers irrespective of the imposition of taxes on the sales or purchases of the goods before their export. In this view no unnecessary encroachment in the State field is required.

Care to be taken in the use of language in legislative darfting.

In recasting section 5, we should not only specify the sales and purchases which do not come within the course of import or export but also try to indicate the positive aspect of the matter by spelling out clearly the transactions which should come within the limits and boundaries of such course. We should not forget that in judicial decisions language plays an insignificant role but in legislative enactments language is the life-blood. Therefore, in accepting a principle, criterion or guide-line laid in a judicial decision, the legislator must be very wary in adopting the language used by the Court.

In this way, we may hope to define clearly limits of scope of article 286(1)(b). There is no doubt that we are dealing with a twilight zone, but to mark out and delimit its outer boundaries is our task, however difficult it may be. This much is certain that twilight zone does not fall within the area of complete darkness. Twilight is intimately and directly connected with light, it is in a sense part of the light. There is a natural and direct link between twilight and light. At every moment twilight before the morning is gradually and imperceptibly approaching, and evolving itself into, light of the day and at every moment twilight before night is gradually and imperceptibly receding from the light of the day and involving itself into darkness of the night. Therefore, in connection with the affairs of men, one is justified in treating twilight as part of light instead of treating it as part of darkness, and then try to draw the boundary-line beyond which one should not go. To demarcate and delineate that correct boundary-line is therefore the problem and to find a solution of the problem by a pragmatic approach based upon all relevant facts and circumstances of the situation is the reward which Law, the matrix of all social sciences, hold out to those who submit to its rigorous discipline.

**Dealing with a twilight zone whose boundaries should be defined with care.**

In the light of the above discussions I suggest that section 5 of the Central Sales Tax Act, 1956 may be recast on the lines indicated below :—

**Suggestions for amendment of section 5.**

*Section* 5

The following principles are formulated for determining when a sale or purchase of goods takes place in the course of the export of the goods out of, or import of the goods into, the territory of India, namely :—

(1) A sale or purchase of goods shall be deemed to take place in the course of the export of the goods out of the territory of India, if and only if such sale or purchase, either—

(a) itself occasions such export, that is to say, itself is such as that it can be carried out only by initiating the process of export with the delivery of the goods to a common carrier for transportation to their foreign destination thereby ensuring that the goods are on their movement to such destination and there is no possibility of the goods being diverted to any transaction, use or purpose within India ; or

(b) is effected by a transfer of documents of title to the goods after the goods have crossed the customs frontiers of India.

*Explanation.*—For the purposes of this clause,—(i) goods delivered to a common carrier for transportation as aforesaid in pursuance of a contract of sale of the goods shall be deemed to be delivered in pursuance of the sale or purchase itself to which the contract relates although such sale or purchase is completed after such delivery ;

(ii) a sale or purchase of goods which itself otherwise occasions the export of the goods within the meaning of sub-clause (a) shall not cease to be so merely because such sale or purchase is completed—

(a) within the State concerned before the delivery of the goods to a common carrier for transportation as aforesaid, or

(b) after the arrival of the goods at their foreign destination.

(2) The last sale or purchase of goods preceding the sale or purchase which occasions the export of the goods under clause (1)(a) or any other sale or purchase preceding such last sale or purchase shall not be deemed to be a sale or purchase taking place in the course of the export of the goods out of the territory of India even if such last or other sale or purchase—

(i) is for the purpose of exporting the goods to implement any order already received or expected to be received from, or to implement any contract already entered or expected to be entered into, with any person for or in relation to the export of the goods, or

(ii) is an act preparatory to such export.

(3) In deciding whether a sale or purchase of goods occasions the export of such goods out of the territory of India, it shall be considered among other factors whether there is a privity of contract between the exporter and the foreign buyer for the sale or purchase of the goods.

(4) A sale or purchase of goods shall be deemed to take place in the course of the import of the goods into the territory of India, if and only if such sale or purchase either—

(a) itself occasions such import, that is to say, itself is such as that it can be carried out only by initiating

the process of import with the delivery of the goods to a common carrier for transportation to their Indian destination thereby ensuring that the goods are on their movement to such destination and there is no possibility of the goods being diverted to any transaction, use or purpose outside India ; or

(b) is effected by a transfer of documents of title to the goods before the goods have crossed the customs frontiers of India.

*Explanation*—For the purpose of this clause,—

(i) goods delivered to a common carrier for transportation as aforesaid in pursuance of a contract of sale of the goods shall be deemed to be delivered in pursuance of the sale or purchase itself to which the contract relates although such sale or purchase is completed after such delivery ;

(ii) a sale or purchase of goods which itself otherwise occasions the import of the goods within the meaning of sub-clause (a) shall not cease to be so merely because such sale or purchase is completed—

(a) within the foreign country concerned before the delivery of the goods to a common carrier for transportation aforesaid, or

(b) after the arrival of the goods at their destination in India.

(5) The last sale or purchase of goods succeeding the sale or purchase which occasions the import of the goods under clause (4)(a) or any other sale or purchase succeeding such last sale or purchase shall not be deemed to be a sale or purchase taking place in the course of the import of the goods into the territory of India even if such last or other sale or purchase is for the purpose of importing the goods to implement any order already received or expected to be received from, or to implement any contract already entered or expected to be entered into, with any person for or in relation to the import of the goods.

(6) In deciding whether a sale or purchase of goods occasions the import of such goods into the territory of India, it shall be considered among other factors whether there is a privity of

contract betwen the importer and the foreign seller for the sale or purchase of the goods.

N.B.

(1) The above suggestions do not constitute a legislative draft strictly speaking, but section 5 may be redrafted on the basis of these suggestions. I have tried to make the language wide and comprehensive enough to cover all cases contemplated and yet exact and precise enough to exclude cases to which the section is not intended to apply.

(2) I have not omitted in the above suggestions the expression "occasions such export" and the expression "occasions such import" on the ground that these expressions received judicial recognition more than twenty years back and legislative recognition eighteen years back. But I have tried to explain these expressions to define comprehensively as well as precisely, as far as practicable, their scope and content,—the necessity for such explanation being to remove the ambiguities of the word "occasions".

S. P. Sen-Verma

New Delhi, the 20th May, 1974.

MGIPRRND—20 Law/74—Sec. IV NS—21-9-74