

**A COMMISSIONER OF COMMERCIAL TAXES, MYSORE
BANGALORE**

v.

HINDUSTAN AERONAUTICS LTD.

December 17, 1971

**B [S. M. SIKRI, C.J., J. M. SHELAT, I. D. DUA, H. R. KHANNA
AND G. K. MITTER, JJ.]**

*Sales Tax—Contract for manufacture and supply of railway coaches—
If sale or works-contract.*

C The correspondence between the Railway Board and the respondent (assessee regarding the terms and conditions for the manufacture and supply of railway coaches, and the indemnity bond in respect of the contract, disclosed that:

(i) The Railway booked capacity of the assessee for the purpose of construction of railway coaches;

D (ii) an advance, on account, was made to the extent of 90% of the value of the material on the production of a certificate by the inspecting authority.

(iii) the material used for the construction of coaches before its use was the property of the railway;

(iv) there was no possibility of any other material being used for the construction, and

E (v) the words used in the contract were, 'manufacture and supply of the following coaches.'

On the question whether there was a sale of railway coaches liable to sales tax, or only a works-contract,

HELD : The answer to the question whether a contract is a works-contract or a contract of sale depends upon the construction of the terms of the contract in the light of surrounding circumstances. [935 A-B]

F (1) In the present case, when all the material used in the construction of a coach belonged to the Railways there cannot be any sale of the coach itself. It was a pure works-contract, the difference between the price of a coach and the cost of material being only the cost of service rendered by the assessee. [935 G-H]

(2) Whether the wheelsets and underframes were supplied free of cost or not makes no essential difference. [936 A-B]

G (3) The material and wage escalator and adjustments regarding final price mentioned in the contract are neutral factors. [935G]

State of Gujarat v. Kailash Engineering Co., 19 S.T.C. 13 (S.C.) followed.

CIVIL APPELLATE JURISDICTION : Civil Appeal No. 710 of 1968.

H Appeal from the judgment and order dated March 1, 1967 of the Mysore High Court in Sales Tax Appeal No. 8 of 1966.

Somanatha Iyer, R. B. Datar and M. S. Narasimhan, for the appellant. A

S. T. Desai, Mrs. A. K. Verma, J. B. Dadachanji, O. C. Mathur and Ravinder Narain, for the respondent.

B. Sen, Santosh Chatterjee, G. S. Chatterjee and P. K. Chakravarti, for intervener No. 1. B

D. Goburdhun, for intervener No. 2.

The Judgment of the Court was delivered by

Sikri, C.J. In this appeal by certificate granted by the High Court of Mysore the only question involved is whether the delivery by the respondent—Hindustan Aeronautics Ltd.—hereinafter referred to as the assessee—to the Railway Board of railway coaches model 407, 408 and 411 is liable to sales tax under the Central Sales Tax etc. C

The Commercial Tax Officer, by assessment order dated March 28, 1964, in respect of the assessment year 1958-59, included the turnover in respect of the supply of these coaches. The Sales Tax Officer rejected the contention of the assessee that there was no sale involved in the execution of the works-contract in view of certain decisions of the High Courts; e.g., *McKenzies Limited v. The State of Bombay*⁽¹⁾ and *Jiwan Singh v. State of Punjab*⁽²⁾. D
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In appeal, the Deputy Commissioner of Commercial Taxes confirmed the order. In revision the Commissioner of Commercial Taxes also came to the same conclusion. He observed :

“The contracts specifically mentioned that the under-frame shall always remain the property of the Railway Board. On the other hand, the order placed with the assessee company here was for the ‘manufacture and supply’ of railway coaches. The payment to the assessee company is specifically referred to as ‘price’. The conditions normally included in contracts for works are absent in this order.” F
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He further observed :

“... I would like to reiterate here that even the actual contract is for manufacture and supply of rail coaches. There is no mention that the rail coaches are to be constructed on the underframes of the indenter
..... If it was really a works contract the under- H

(1) 13 S.T.C. 602.

(2) 14 S.T.C. 957.

A frames would have been made available for construction instead of being 'supplied free of cost' and the indenter's lien on them would have been made clear. The plain meaning of the contract is that the underframes were transferred to the assessee company free of cost by the Railway Board and that after construction of rail coaches on them, the rail coaches were sold to the Railway Board at the agreed price. The agreement does not also contemplate any inspection in the course of execution as would normally be provided for in a works contract. The only inspection is after completion and at Perembur."

C He thought that case of the assessee in respect of model 411 railway coaches was worse. Regarding the financial arrangement between the Railway Board and the assessee, he observed :

D "The Railway Board made only advance payments for purchase of materials and did not itself procure the material and supply them to the assessee company. The condition that the materials become property of the Railway Board as and when purchased is only for purposes of providing adequate security for the advances. In the circumstances, the materials can be deemed to be hypothecated to the Railway Board and the advance payments are really part payment of the final price. The transaction relating to Rail coaches of model 411 is clearly a sale."

He, therefore, confirmed the appellate order of the Deputy Commissioner.

F The assessee then took an appeal to the High Court of Mysore under s. 24(1) of the Mysore Sales Tax Act read with s. 9(3) of the Central Sales-tax Act. The High Court was not satisfied with the material on record and directed that a report be sent on three points, viz :

G "(i) Whether and if so to what extent the assessee has drawn advance payment from the Railway Board in respect of the material utilised for completing the contracts in question;

(ii) Whether any material, in respect of which no advance have been drawn, has been utilised by the assessee for completing the contracts; and

H "(iii) Whether the assessee has used for completing the contracts any material not specifically procured for the purposes of completing the contracts."

The Commercial Tax Officer submitted his report, and certain extracts may be reproduced below :

"My findings revealed that as and when they purchased materials, they sent to the Railway Board 'an invoice' accompanied by a list of the details regarding the materials purchased. 90 per cent of the value of these materials was then paid to the company after inspection of the materials by the board's representative. Invoice No. 31009 of 15-10-1956 is obtained as a sample. This invoice shows that materials for the value of Rs. 2,60,374-12-0 were purchased by the company for 407 model coaches. The details of the materials are given in list attached to the invoice. The invoice and the list were sent to the board with a covering letter dated 15-10-1956 asking payment of Rs. 2,34,517-4-0 being 90 per cent of the invoice amount. The amount of this invoice is included in the Board's remittance note No. 1290 of 30-10-1956 and a cheque was issued to the company for the total of several such invoices. The amount of the cheque received on 30-10-1956 was Rs. 22,90,719-0-0."

He concluded :

"(1) It is not possible to specify the exact amount received from the board as advance payments. It is said that the construction was spread out more than one year and a running account was maintained showing the debits and credits for this coaches.

(2) It is said that no materials, for which advance was not drawn, was utilised for building the coaches.

(3) It is not possible to find out whether any materials not specifically procured for the construction of coaches were used. But it is said that there is no possibility of any other materials being used for this construction. The constructions are said to be done at particular shed which is separately located. No other work is undertaken in this section. All the materials procured for constructions of coaches are said to be kept separately in this section alone. Materials not connected with this work are not mixed up with the materials in this section. Separate stock registers are maintained for this section. Receipts and issues of materials for the constructions of coaches are being accounted for in this register under code numbers."

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The High Court allowed the appeal and set aside the order including the turnover relating to the construction of railway coaches, models 407, 408 and 411. Facts found by the High Court and as they appear to us are as follows :

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On February 3, 1955, the Ministry of Railways wrote to the Hindustan Aircraft Ltd. regarding the coaching programme 1955-56. The letter reads :

"In order to book your capacity, construction of the following is planned on your works against the 1955-56 R.S.P.

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1. Third Class Coaches B.G. model 407	120
2. Military Coaches 'M' type model 408	60
Total :	180

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The intention of this intimation is to facilitate such arrangements as you may find necessary for providing for materials and for planning capacity for the stock in question. You should therefore treat this as a firm booking of your capacity."

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After discussions and settlement of terms between officers of the Government of India and of the assessee, the Railway Board placed orders with the assessee. The terms agreed between the parties are found stated in a letter of the Government of India, Ministry of Railways (Railway Board) No. 57/147/RE(163) dated May 4, 1957. This relates to the first of the models 407. We may extract some portions of the letter. It is stated thus :

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In continuation of their letter No. 56/142/3/Re dated 8-1-57 the Railway Board are pleased to place an order on your work for the manufacture and supply of the following coaching stock on terms and conditions stated under para 2 below :—

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Item No. of Rly Board's Rolling Stock Programme 1957-58	Description of stock	Particular specification and Drawing No.	Nos. Required	Price per coach (without wheels and axles and under-frames)
384	Broad Gauge Class III Coaches fully furnished to model '407'	55-B-14 CSC 1449	180	Rs. 94,731/- (Provisional)

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Following terms and conditions are relevant:

(i) *Price*

(a) The price mentioned above is for stock without wheels and axels and underframes, and is provisional. Final price will be settled by negotiations after you have submitted your claim for the coaches ordered on you up to 1954-55 Rolling Stock Programme on the basis of the wages and material escalator approved by the Board.

(b) The final price when settled shall be subject only to the Standard Wages and material escalator clauses given below.....

(c) The final payment on completion of this order shall be subject to examination and check of your books by the Chief Administrative Officer, Integral Coach Factory, Perambur, Madras.

(ii) *Wheelsets and Underframes*

The Wheelsets and Underframes for the stock will be supplied to you free of cost f.o.r. your work siding.

(iv) *Delivery*

The delivery of the above stock f.o.r. your works siding is required to commence after the completion of the stock ordered on your works against 1956-57 R.S.P. and required to be completed by January 1957, or earlier.

(v) *Inspection Authority*

The inspection of this stock shall be carried out by a representative (C.M.E. Southern Railway) before the coaches are despatched.

(vi) *Terms of payment*

(a) Advance 'on account' payment to the extent of 90% of the value of the materials shall be made to you on receipt of materials and on production of a certificate from the Inspecting Authority.

(b) Payment of full contract price, less 'on account' payment already will be made on delivery of coaches in complete condition and good working order, duly certified by the Inspecting

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Authority on the lines of procedure laid down vide Board's letter No. 57/142/6/M dated 4-2-1952 (Copy enclosed).

(vii) *Other terms of Contract.*

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(ii) If and when sales tax on this order becomes payable under law, such payments, when made, will not be on your account. The Railway will not, however, be responsible for payment of the sales tax paid by you under misapprehension of law.

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There is an indemnity bond in respect of this contract and we may set it out fully.

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"1. Standing Indemnity for advance payment against contract relating to Railway Board's order for construction and delivery of all metal III class B.G. coaches now pending under orders Nos. 52-142/4/M dated 16th February, 1952 and 53/142/4/M dated 3rd March, 1953 and against contracts in respect of future orders that may be given by the Railway Board from time to time, by the Hindustan Aircraft Ltd., Bangalore represented by General Manager hereinafter called the Company in favour of the President of Union of India. The Hindustan Aircraft Ltd., hereby undertake to hold at their works at Bangalore for and on behalf of the President of the Union of India and as his property in trust for him the Stores and articles in respect of which advances are made to them under Railway Board's letters, No. 52/142/4/M dated 16th February, 1952 and 53/142/4/M dated 3rd March, 1953 and hereafter to be made to the Company under future orders from the Railway Board from time to time.

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2. The said stores and articles shall be such as are required of the purpose of the pending and future contracts and the advances made and to be made are without prejudice to the provisions of the contract as to rejection and inspection and any advance made against stores and articles rejected or found unsatisfactory on inspection shall be refunded immediately to the President of the Union of India.

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3. The Company shall be entirely responsible for the safe custody and protection of the said articles and stores against all risks till they are duly delivered to the

President of the Union of India or as he may direct and shall indemnify the President of the Union of India against any loss, damage or deterioration whatsoever in respect of the said stores and articles while in our possession. The said articles and material shall at all times to be open to inspection of any officer authorised by Government.

4. Should any loss of damage occur or a refund become due, the President of the Union of India shall be entitled to recover from the Company compensation for such loss or damage or the amount to be refunded without prejudice to any other remedies available to him by deduction from any sum due or any sum which at any time hereafter may become due to the Company under this or any other contract."

We have set out the terms of the Indemnity Bond in great detail because the learned counsel for the appellant has strongly relied on the terms thereof.

The text of the invoice sent by the assessee for the purpose of receiving 90% advance may be seen from the covering letter dated October 15, 1956 relating to one of the invoices. The letter reads :

"On account payment of 90% on material procured for rail coaches-407 and 408 model VI order. Further to our letter No. AI/Inv/1169 dated 8-10-56 enclosing our invoice for Rs. 42,892-15-0 we enclose herewith our invoice No. 31009 dated 15-10-1956 in duplicate for Rs. 2,34,517-4-0 being 90% of materials procured in October 1956. Kindly arrange payment of the invoice alongwith the invoice already sent. Please instruct your resident representative to check the stock of materials as per lists attached to our invoices and send them to the Deputy Financial Adviser and Chief Accounts Officer, Integral Coach Factory, Perambur, so that he may send his representative to check the value of the materials."

On these facts we have to decide whether there has been any sale of the coaches within the meaning of the Central Sales Tax Act. We were referred to a number of cases* of this Court and the High Courts, but it seems to us that ultimately the answer must depend upon the terms of the contract. The answer to the

* (1) 16 S.T.C. 518—*McKenzie v. State of Maharashtra*.

(2) [1965] 2 S.C.R. 782—*Patnalk & Co. v. State of Orissa*.

A question whether it is a works contract or it is a contract of sale depends upon the construction of the terms of the contract in the light of the surrounding circumstances. In this case the salient features of the contract are as follows :

B (1) The Railway books capacity of the assessee for the purpose of construction of railway coaches.

(2) Advance on account is made to the extent of 90% of the value of the material on the production of a certificate by the inspecting authority.

C (3) The material used for the construction of coaches before its use is the property of the Railway. This is quite clear from para 1 of the Indemnity Bond set out above. No other meaning can be given to the words in the bond to the effect that "the Hindustan Aircraft Ltd. hereby undertake to hold at their works at Bangalore for and on behalf of the President of the Union of India and as his property in trust for him the Stores and articles
D in respect of which advances are made to them."

It seems to us clear that the property in the materials which are used for the construction of the coaches becomes the property of the President before it is used.

E (4) It seems that there is no possibility of any other material being used for the construction as is borne out from the report written by the Commercial Tax Officer.

(5) As far as the coaches of models 407 and 408 are concerned, the wheelsets and underframes are supplied free of cost.
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(6) In the order the words used are "manufacture and supply of the following coaches."

(7) The material and wage escalator and adjustments which are mentioned in the contract are neutral factors.

G On these facts it seems to us that it is a pure works contract. We are unable to agree that when all the material used in the construction of a coach belongs to the Railways there can be any sale of the coach itself. The difference between the price of a coach and the cost of material can only be the cost of services
H rendered by the assessee.

If it is necessary to refer to a case which is close to the facts of this case, then this case is more in line with the decision of

this Court in *State of Gujarat v. Kailash Engineering Co.*⁽¹⁾ than any other case.

The only difference as far as coach model No. 411 is concerned is that in that case the wheelsets and underframes are not supplied free of cost but otherwise there is no essential difference in the terms. This does not make any difference to the result.

In the result the appeal fails and is dismissed with costs.

V.P.S.

Appeal dismissed.

(1) 19 S.T.C. 13.