

UNION OF INDIA

v.

CENTRAL INDIA MACHINERY MANUFACTURING CO.
LTD. & OTHERS

April 6, 1977

[V. R. KRISHNA IYER, R. S. SARKARIA AND JASWANT SINGH, JJ.]

Rajasthan Sales Tax Act, 1954—Section 2(o)—Definition of sale—Sale of Goods Act, s. 64(a)—Distinction between contract of sale and work contract—Manufacturing and supplying wagons to Railways—Whether sale or work contract—Tests to be applied—Interpretation of contract—When external aid permissible.

The appellant and respondent No. 1 company entered into a contract for the manufacture and supply of wagons. By the correspondence exchanged, the number of wagons to be supplied and the price of wagon of each type was indicated. It was provided that the contract would be governed by the Standard Conditions in so far as they are not inconsistent with the correspondence exchanged between the parties. Under the Standard conditions, 90 per cent of the payment had to be made against the Company submitting the bill to the purchaser together with the completion certificate and on payment of such 90 per cent price the vehicle in question would become the property of the purchaser. The balance of 10 per cent was to be treated as security for the due fulfilment of the contract. The balance was to be received on the receipt of certificate from the purchaser to the effect that the actual delivery of the vehicle was taken and that the delivery was made in due time. One of the clauses provided that where any raw materials for the execution of the contract are procured with the assistance of the appellant the company would hold the said materials as trustee for Government and use such materials economically and solely for the purpose of the contract against which they are issued and not dispose them of without the permission of the Government and return, if required by the purchaser, all surplus or unserviceable materials that might be left after the completion of the contract or its termination for any reason whatsoever on his being paid such price as Government might fix with due regard to the condition of the material. Clause 10 further provided that if and when the State and inter-State Sales Tax on the stock on order becomes payable under law such payments would be reimbursed by the Railway Board. The Railway Board, however, is not to be made liable for the payment of Sales Tax paid under misapprehension of law. No sales tax on materials including steel and components would be reimbursed by the Railway Board. That the stores and articles shall be such as are required for the execution of the contract and the advance made by the Railways is without prejudice to the provisions of the contract and is subject to inspection and rejection of the stores. That the said articles and materials shall at all times be open to inspection of any officer authorised by the Railways. There are 3 categories of materials, the first category admittedly was the property of the Railways; the second category is the material procured by the Company against 90 per cent advance; and the third category was at all times material of the Company. Paragraph 3 of the letter exchanged between the parties fixed the period of delivery. Para 4 provided for doing the packing of axle boxes by the Railway for which no packing charges were to be recovered from the Company. Section 2(o) of the Rajasthan Sales Tax Act, 1954 defines sale as any transfer of property in goods for cash or for deferred payment or for any other valuable consideration.

The appellant relied on the following circumstances :

Under the Special Conditions read with the indemnity bond the property in the raw materials purchased by the Company for the construction of the

A wagons passed to the Railway Board as soon as the latter advanced 90 per cent of the value of such material which thereafter is held by the Company merely as an agent or trustee for the Board. Condition No. 5 obligates the contractor to hold "as trustee for Government" and raw materials for the execution of the contract procured with the assistance of Government and further requires the contractor to use such materials economically and solely for the purpose of the contract against which they are issued and not to dispose them of without the permission of the Government. The Railway wagon at the time of its delivery had no individual existence as the sole property of the Company.

B The respondents contended that there was nothing in the Special Conditions which militates or is inconsistent with the Standard Condition No. 15.

C The Special Conditions, read as a whole show that the raw materials purchased by the Company against 90 per cent of advance payment do not become the property of the Railway Board or the Union of India because under the express terms of the contract such advance payment is made towards the contract price of the wagons and not towards price of the materials.

Dismissing the appeal,

D HELD: (1) Transfer of property in goods for a price is the linch-pin of the definition of 'sale'. The difficulties in distinguishing between the contract of sale and work contract is an age-old one. It was much debated even by the Roman Jurists. According to Pollock & Mulla, the test would be whether the thing to be delivered has any individual existence before delivery as the sole property of the party who is to deliver it. If the answer is in the affirmative it is sale of the thing otherwise not. Another rule is that if the main object of the contract is the transfer from A to B for a price of the property in a thing in which B had no previous property then the contract is a contract of sale. According to Lord Halsbury, the distinction is often a fine one. A contract of sale is a contract whose main object is the transfer of the property in and the delivery of the possession of a chattel as a chattel to the buyer. Where the main object of work undertaken by the payee of the price is not the transfer of a chattel *qua* chattel the contract is one for work and labour. The test is whether or not the work and labour bestowed and in anything that can properly become the work and labour bestowed and in anything that can properly become the subject of sale, neither the ownership of materials nor the value of the skill and labour as compared with the value of the materials is conclusive, although such matters may be taken into consideration in determining in the circumstances of a particular case whether the contract is in substance one for work and labour

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F or one for the sale of a chattel. [446 F-H, 447 A-D]

G (2) The question, whether a contract is one for sale of goods or for executing work or rendering services is largely one of fact depending upon the terms of the contract including the nature of the obligations to be discharged thereunder and the surrounding circumstances. In the present case the contract is expressly one for the manufacture and supply of wagons for a price. Price has been fixed taking the wagon as a unit. Payment of the price is made for each vehicle on its completion and delivery by the contractor to the purchaser who is described as the Union of India acting through the Railway Board. The payment is made in two instalments; 90 per cent of the value of the vehicle on completion against an On Account Bill together with the completion certificate and 10 per cent after delivery.

H The real intention of the contracting parties is primarily to be sought within the four-corners of the documents containing Standard and Special Condition of the contract. If such intention is clearly discernible from these documents it would not be proper to seek external aid from the stereo-typed indemnity bond. The terms and conditions of the contract read as a whole undoubtedly lead to the conclusion that the property in the material procured or purchased by the Company against the 90 per cent value of which

advance is taken from the Railways, does not before their use in the construction of the wagons, pass to the Railways, for the following reasons :

- (a) On account payment upto 90 per cent is a part of the full contract price for each completed wagon;
- (b) Condition No. 5 while imposing restriction as to the use and disposal of material against which advance is taken further gives a pre-emptive right to the Government to purchase all surplus or unserviceable materials from the company on its "being paid such price as Government may fix with due regard to the condition of material". If the material belonged to the Government or the Railways, no question of purchasing the same from the Company could arise. No one can be seller and purchaser of the same property at the same time.
- (c) Condition No. 10 which provides that no sales tax on materials including steel and components will be reimbursed by the Railway Board clearly postulates that the Company becomes the owner of the materials by purchase and, therefore, becomes liable to pay the sales tax. There is no condition or term in the contract that the material purchased by the Company after drawing on Account payment to the extent of 90 per cent of the value of the material became the property of the Railways. The conditions embodied in the contract read as a whole clearly show that the property in the material purchased by the company with the assistance of the Railway, does not pass to the Railway. Thus, most of the raw materials required for the construction of the wagons belong to the Company and not to the Railway Board. With the exception of a relatively small proportion of the components, the entire wagon including the material, at the time of its completion for delivery, is the property of the Company.

Clause 15 stipulates in unmistakable terms that as soon as a vehicle has been completed the Company will get it examined by the Inspecting Officer and submit to the purchaser an On Account-Bill for 90 per cent of the value of the vehicle. This clearly shows that the contract was in substance one for the sale of manufactured wagons by the Company for the stipulated prices. [441 G, 447 E-F, 451 B-H & 455 B-C]

M/s. Hindustan Aeronautics Ltd. Bangalore Division v. The Commissioner of Commercial Taxes, Mysore [1972] 2 SCR 927 and *State of Gujarat (Commissioner of Sales Tax, Ahmedabad) v. M/s. Variety Body Builders* AIR 1976 SC 2108, distinguished.

Patnaik & Company v. State of Orissa [1965] 16 STC 369 (SC), followed.

CIVIL APPELLATE JURISDICTION : Appeal No. 1812 of 1969.

(From the Judgment and Order dated 31-1-1969 of the Rajasthan High Court in Civil Misc. Writ No. 733 of 1968).

S. K. Mehta and *Girish Chandra*, for the appellant.

S. T. Desai, *G. A. Shah* and *S. K. Dholakia*, for respondent No. 1.

L. M. Singhvi, *S. M. Jain* and *Indra Mapwana*, for respondents 2—3.

Leila Seth and *G. S. Chatterjee* for the Intervener.

The Judgment of the Court was delivered by :

SARKARIA, J.—Whether on the facts of this case, the contract dated 15-6-1968 between the Union of India and the Central India

A Machinery Manufacturing Company Ltd. (Wagon & Structural Division) Bharatpur (hereinafter called the Company) for the manufacture and supply of wagons, was a contract of sale or work contract, is the principal question that falls to be determined in this appeal by certificate, filed by the Union of India against a judgment dated January 31, 1969 of the High Court of Rajasthan. It arises out of these facts :

B The Company, Respondent No. 1 herein entered into a contract (No. 67/RS(1)/954/15/396, dated 15-6-1968 with the Union of India through the Railway Board for the manufacture and supply of 258 BG Bogie covered BCX type wagons and 812 MG covered wagons of MBC type to the Railways. The sales-tax authorities of the State (Respondent 3 herein) under the Rajasthan Sales Tax Act, levied the sales tax treating the contract as one of sale and delivery of wagons.

C Under a similar past contract, the appellant reimbursed the Company the amount of sales-tax for the wagons supplied by it to the appellant in the months of March and April, 1967. In March 1967, the High Court of Mysore in the case of *Hindustan Aeronautics Ltd., Bangalore Division v. The Commissioner of commercial Taxes, Mysore*,⁽¹⁾ held that the contract for the supply of wagons to the Railway Board by HAL was in the nature of works contract and therefore sales-tax was not payable on such supplies. In view of this decision, the Railway Board by its letter dated June 7, 1968 informed the Company that the money paid by it to the Company which was not deposited with the Sales-tax Department should be refunded because the real nature of the transaction was that of a works contract and not a sale or purchase and therefore the Railway Board was not liable to reimburse the Company for the amount of sales-tax if any, paid by the Company to the State of Rajasthan.

D While in reply to the Railway Board at Company contended that the contract was for sale of wagons and not a contract for works, it took a contrary position in its representation to the Commissioner of Sales-tax, Rajasthan. Instead of giving any relief, the Sales-tax Department informed the Company that it should stop purchasing material on the strength of Form 'C' under the Central Sales-tax Act. Such stoppage would have saddled the Company with a further liability to pay tax at the enhanced rate on the purchase of material used for the manufacture of wagons.

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G The Commercial Tax Officer provisionally assessed the Company under s. 7(D) of the Rajasthan Sales-tax Act on the Sale of wagons to the Railway Board for the month of May 1968, and served a demand notice for payment of Rs. 1,91,827/79p. including Rs. 1,899.29p/ as penalty. Since the Company was registered as a dealer under the Sales-tax Act, it had to bear, in the first instance, the charge of the tax although its incidence normally passes on to the purchaser, in the absence of a contract to the contrary under the provisions of s. 64(a) of Sales of Goods Act.

H By its letter of August 14, 1968, the Railway Board finally informed the Company that, in future it would not reimburse the Company for the sales-tax if paid by it in connection with the supply of wagons.

(1) [1972] 2 S.C.R. 927.

The Company thereupon invoked the writ jurisdiction of the High Court by a petition under Article 226 of the Constitution. In the writ petition, the Commercial Taxes Officer Special Circle Jaipur, the Union of India through the Railway Board and the State of Rajasthan were impleaded as Respondents.

The relief prayed in the petition was :

- (1) That an appropriate Order be made determining whether the contract in question is in the nature of a contract for sale of goods, or works contract.
- (2) That in the event of a finding that the contract is in reality a contract for sale the respondent Union of India be prohibited from claiming refund from the petitioner of the sum of Rs. 1,56,703.20 lying in its hands for payment of Sales Tax.
- (3)
- (4) That an appropriate writ, Directive or Order be made directing the respondent Union of India through the Railway Board to reimburse the Petitioners in respect of Sales Tax for the purchases from May 1968 onwards from month to month."

The writ petition was contested by the Union of India, *inter alia*, on the ground that the contract in question was contract for works and not a contract of sale. The State of Rajasthan and the Commercial Taxes Officer in their joint reply contended that the contract was one for sale of wagons.

At the final hearing before the High Court all the parties requested the Court to resolve the dispute in the exercise of its extraordinary jurisdiction under Article 226 of the Constitution, notwithstanding the availability of an alternative remedy. The Court, in consequence, proceeded to decide the dispute on merits. After examining in detail the terms and conditions of the contract as disclosed by the relevant documents on the record, the High Court took the view that the contract in question was a contract for the manufacture and Sale of wagons to the Union of India by the Company and as such sales-tax was payable on these transactions. It thus decided the main issue against the Union of India and allowed the writ petition.

Hence this appeal by the Union of India.

The question, whether a contract is one for sale of goods or for executing works or rendering services, is largely one of fact, depending upon the terms of the Contract, including the nature of the obligations to be discharged thereunder and the surrounding circumstances. It is therefore, necessary to examine the terms and conditions of the contract in question.

There is no consolidated contract deed formally executed by the parties, on record. There are however, several documents, including

A the correspondence between the parties, which embody the terms and conditions of the contract.

B By its letters No. 67/RS(I)/954/15 dated December 23, 1967, and letter dated June 15, 1968, the Railway Board communicated to the Company, the former's acceptance of the offer made by the Company in its earlier letters, including the letter, dated 12-12-1967, to manufacture and supply, B. G. Bogie covered wagons BCX Type and M. G. Covered wagon MBC Type. The numbers of the wagons to be supplied and the price per wagon of each type were indicated in these letters. Paragraph 2 of the letter, dated December 23, 1967, stated :

C "2. *Terms and Conditions* : The contract shall be governed by the General Conditions of Contract A5-51 (Revised) in so far as these are not inconsistent with the Special Conditions of contract attached as per Annexure 'A' and these given in Paras 3 and 7 below."

Paragraphs 3 to 6 of the letter provide as under :

D "3. *Delivery* : The delivery of the stock F.O.R. your works siding is required to be completed by 30-6-69.

"4. *Packing of axle boxes* : Packing of axle boxes (Wherever necessary) will be done by Western Railway. No packing charges on account of the same will be received from you."

E "5. *Inspecting Authority* : Joint Director (R.I.), R.D.S.D., Calcutta or his representative shall constitute the Inspecting Authority for the inspection of stock built by you against this order.

"6. *Accounting and payments* : F.A. & C.A.O., Northern Railway, New Delhi will maintain accounts and arrange all payments."

F Para 7 dealt with "Material Escalations", while in para 8 it was expressed that the order was being issued in the name of the President of India.

Now the salient Standard Conditions referred to in paragraph 2 of this letter may be seen. Conditions 1 and 2 are as follows :

G "1. The "Purchaser" means the President of India in the case of carriage underframes and goods wagons (hereinafter called vehicles) ordered for Indian Railways."

2. "The work" includes materials of every kind"

Standard Condition 15 is crucial and may be extracted in full.

H "SYSTEM OF PAYMENT

15. Payments for completed vehicles delivered by the Contractor shall be made in two instalments, viz. 90 per

cent on completion and 10 per cent as provided in paragraph (2) of this clause. The procedure for such payments will be as follows :

- (1) The Contractor on receipt of a Certificate signed by the Inspecting Officer (whose decision shall be final) to the effect that one or more vehicles have been completed will submit to the Purchaser on account bill for 90 per cent of the value of vehicles in question, together with the completion certificate, the Purchaser will pay the 90 per cent bill, *and on payment of this bill the vehicles in question will become the property of the Purchaser.*

(underlining ours)

- (2) The balance of 10 percent shall be treated as security for the due fulfilment of the contract and the Contractor shall be entitled to receive payment of the balance of 10 per cent on vehicles as completed on his receiving a certificate from the Purchaser to the effect that the actual delivery of the vehicles in question has been taken, that the delivery was made in the due time, and that the Contract has been duly fulfilled in every respect in so far as it relates to the completed vehicles.

Condition 16 lays down that if the "defect arises from *inferiority of material or workmanship, or from imperfect protection or other default on the Contractor's part*, the Railway shall be at liberty to ask the Contractor to remedy the defect and deduct from any money due to the Contractor.

The Special Conditions of Contract contains in Annexure 'A' to the letter dated 23-12-1967, are as under :

SPECIAL CONDITIONS

1.3 *Material Escalations* : Adjustments due to variations in the cost of material will be confined to the variations in the prices of steel at Col. 1 rate through Governmental action for controlled categories and those fixed by J.P.C. for de-controlled categories of steel. The escalation would be allowed in respect of such of the quantities of the material *which were purchased and paid for* the manufacture of wagons on order after the variation in price over the base date and subject to examination of the actual amounts paid for the supply of such tonnage of steel which is considered reasonable for the manufacture of the wagons on order and for which prices have varied over the base date whether supplied to the Contractor or sub-contractor....

4. *Specifications and Drawings* :

The stock shall be built conforming to specifications and drawings indicated in the order which are obtainable on

A payment from the Research Design and Standards Organisation, Lucknow, with such modifications as may be required or approved by the Railway Board, from time to time during the execution of this contract.

B The basic price shall have reference to the specification shown in the order. Any modification to specification or design shall be subject to price adjustment over and above the basic price.....”

Special Condition 4 is important. A good deal of argument was made as to whether 90% advance made under this Condition should be taken as payment towards the price of the material or towards the price of the wagons. This condition reads :

C “4. *Terms of Payments* :

(a) ‘On Account’ payment upto 90% of the value of steel and other raw materials procured by the firm for this order will be made against such materials, on its receipt in the firms’ works, on production of a certificate to that effect from the concerned officer of the Inspection and Liaison Organisation and on the firm furnishing necessary indemnity bond to the paying Authority.

E Note : ‘On Account’ payment will be permissible on steel procured according to Joint Director (Iron & Steel), Calcutta’s planning after taking into consideration any steel offers from the floating stock held by the Railways. *If such offers are refused and steel of similar quality is obtained from other sources such quantities will be excluded from ‘On Account’ payment.* The claim for ‘On Account’ payment will be accompanied by a further certificate that similar steel has not been offered from the floating stock held by the Railways and refused by the Wagon Builders.

(b) Payment of 90% of the full contract price less ‘On Account’ payment already made vide (a) above *will be made on production of inspection certificate for each completed wagon.*

G (c) Payment of the balance 10% of the contract price will be made on the certification by the consignee Railways that wagons have been received in complete condition and in good working order, provided that the payment so made shall be provisional and subject to adjustment and finalisation by deduction of rebate in accordance with provision of clause 1.4.”

(underlining ours)

The other material Special Conditions are :

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"5. USE OF RAW MATERIALS SECURED WITH THE GOVERNMENT ASSISTANCE :

Where any raw materials for the execution of the contract are procured with the assistance of Government either by issue from Government stock or purchase under arrangements made or permit(s) or licence(s) issued by Government, *the Contractor shall hold the said materials as trustee for Government and use such materials economically and solely for the purpose of the contract* against which they are issued *and not dispose of them*, without the permission of the Government *and return*, if required by the purchaser, *all surplus or unserviceable materials* that may be left with after the completion of the contract or at its termination for any reason whatsoever, *on his being paid such price as Government may fix* with due regard to the condition of the material. The freight charges for the return of the materials according to the directions of the purchaser shall be borne by the Contractor, in the event of the contract being cancelled for any default on his part. The decision of Government shall be final and conclusive.

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(underlining ours)

... ..
 "10. *Sales Tax* : If and when State and Inter-State Sales Tax on the stock on order becomes payable under Law such payments will be reimbursed by the Railway Board. The Railway Board will, not, however, be responsible for the payments of sales tax paid under mis-apprehension of Law. *No sales tax on materials including steel or components will be reimbursed by the Railway Board.*

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(underlining ours)

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The material part of the Indemnity Bond which was subsequently executed by the Company in connection with the Contract, provide :

"Whereas under Railway Board's order No. 67/RS(1)/954/15 dated 23-12-1967, the said Contractor has been given the contract for manufacture of 258 Nos. B.G. covered wagons BCX type with Transition type Centre Buffer couplers at both ends and 812 numbers MG covered wagons MBC type (1968-69 R.S.P.) at Bharatpur. And whereas advance payment are to be made by the Railways to the Contractor against Railway Board's said order....

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That the Contractor *shall hold* at his works at Bharatpur and/or at the works of his sub-contractors the Stores and articles of the Railways in respect of which advance may be made to him against the said order.

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A That the said Stores and articles shall be such as are required for the execution of the above contract and *the advance made to him by the Railways is without prejudice to the provision of the contract and is subject to inspection and rejection of the Stores* and any advance made against stores and articles rejected or found unsatisfactory on inspection shall be refunded immediately to the Railways.

B That the Contractor shall be solely responsible for the safe custody and protection of the said stores and articles against all risks till they are duly delivered to the Railways or as they may direct. *The said articles and materials shall at all times be open to inspection of any officer authorised by the Railways.*

C (underlining ours)

Now these presents witnesseth that the Contractor . . . hereby undertakes to indemnify the Railways, should any loss or damage or deterioration occur in respect of the said stores and articles while in his possession or in the possession of his sub-contractors or if any refund becomes due to the Railways without prejudice to any other remedies available, the Railways may also deduct such amount from any sums due, or any sum which at any time hereinafter may become due to the Contractor”

D Clause (o) of S. 2 of the Rajasthan Sales Tax Act, 1954, defines “sale”. It says :

E “‘Sale’ with all its grammatical variations and cognate explanations, means any transfer of property in goods 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”

F Thus, *transfer of property* in goods for a price is the linchpin of the definition. Under Section 4 the Sale of Goods Act, 1930, also, in the definition of the term “sale” stress is laid on the element of transfer of property in the goods. According to the Roman jurists, also, the purport of a contract of sale is that the seller divests himself of all proprietary right in the thing sold in favour of the buyer. It is this requisite which often distinguishes a contract of sale of goods from a contract for work and services. Even so, the difficulty of distinguishing between these two types of contracts is an age-old one.

G It was much debated even by the Roman jurists (see Inst. III, 24,4, and De Zuluete, *The Roman Law of Sale*, pp. 15, 16). Difficulty has also been felt in England and other Common law jurisdictions to the effect of a contract to make a chattel and deliver it when made. Generally, such a contract is one of sale of Chattel, but not always.

H Jurists have differed much and striven much about the test for distinguishing between these two types of contracts. Since each contract presents its own features, and imponderables it has not been possible to devise an infallible test of universal application. According to Pollock & Mulla, “the test would seem to be whether the thing

to be delivered has any individual existence before delivery as the sole property of the party who is to deliver it". If the answer is in the affirmative, it is a 'sale' of the thing, otherwise not. Another learned author enunciates that "the general rule deducible from the cases seems to be that if the main object of the contract is the transfer from A to B, for a price, of the property in a thing in which B had no previous property, then the contract is a contract of sale." (See Chalmers' Sale of Goods, 16th Edn, page 52). The broad criteria for distinguishing between these two types of contracts have been neatly summed up in Halsbury's Laws of England, (3rd Edn., Vol. 34, page 6) thus :

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

Let us now apply the above criteria to the contract in question. The contract is expressly one for the manufacture and supply of wagons for a price. Price has been fixed taking the wagon as a unit. Payment of the price is made for each vehicle on its completion and delivery by the contractor to the Purchaser, who is described as the Union of India acting through the Railway Board. Such payment is made in two instalments, viz., 90 per cent of the value of the vehicle on completion against an 'On account' bill, together with the Completion Certificate from the Inspecting Officer appointed by the Railway Board, and the balance of 10 per cent after delivery. If clause (1) of the Standard Condition 15 is not inconsistent with anything in the Special Conditions, and as we shall presently notice it is not so—it clinches the issue in as much as it declares in unequivocal terms the intention of the contracting parties that on payment of the 90 per cent of the value, 'the vehicles in question will become the property of the purchaser.' *Prima facie*, the contract in question has all the essential attributes of a contract of sale of moveable. That is to say, here is an agreement to sell finished goods manufactured by the Sellers (Company) for a price, the property in the goods passing to the Purchaser, on completion and delivery pursuant to the agreement.

Mr. Mehta, learned counsel for the appellant, contended that what clause (1) of Standard Condition 15 appears to convey about

- A the *transfer of the property* in the completed vehicle stands inferentially *negated* and superseded by the terms of the Special Conditions and the Indemnity Bond to which the Standard Conditions, are subject. It is urged that under Special Conditions read with the Indemnity Bond the property in the raw material purchased by the Company for the construction of the wagons, passed to the Railway Board as soon as the latter advance 90 per cent of the value of such
- B material, which thereafter is held by the Company merely as an agent or trustee for the Board. Our attention has been invited to Special Condition 4 under which 'On Account' payment upto 90% of the value of 'steel and other materials' procured by the Company for this Order" will be made against such materials, on production of a certificate from the officer of the Inspection and Liaison Organisation and on furnishing necessary indemnity Bond to the Paying Authority.
- C We are also adverted to the Note under clause (a) of that Condition, according to which "On Account" payment will not be permissible *against steel* procured by the Company from a source other than the floating stock held by the Railways, except when an offer to procure it from that source is refused. Counsel has also referred to Special
- D Conditions, 5 which obligates the contractor to hold "as trustee for Government" any raw materials for the execution of the contract" procured with the assistance of Government either by issue from Government stock or purchase under arrangement made or permit(s) or licence(s) and to "use such materials economically and solely for the purpose of the contract against which they are issued and not dispose of them, without the permission of the Government." Mr. Mehta further pointed out that under Special Condition 6, other
- E essential components, viz., wheelsets for all the stock (and roller bearing axle boxes and C.F. couplers wherever applicable) are supplied to the contractor free of cost F.O.R. against a proper undertaking for their safe custody. Counsel further took us through the contents of the Indemnity Bond and placed special emphasis on its clause :

- F "That the contractor *shall hold* at his works at Bharatpur and/or at the works of his Sub-contractors the Stores and *articles of the Railways* in respect of which *advance* may, be made to him against the said order."

- G From a conjoint reading of the Special Conditions 4, 5, 7 and the Indemnity Bond it is sought to be spelt out that all the raw materials and components used in the manufacture of the wagons, belonged to the Railway Board; such materials were either procured under Special Condition 4 against 90% 'On Account' payment which should be taken as a payment towards the price of the material purchased and held by the Company on behalf of the Railway Board, or procured under Special Condition 6 free of cost. It is maintained that since purchases of raw material against 90% 'On Account' payment were made by the Company *on behalf* of and/or the Railway Board, that was why in the Indemnity Bond, the "stores and articles" in respect of which the advance has been made by the Railway Board, are described as 'of the Railways'. It is further submitted that in
- H view of the facility available to the contractor, there was little or no possibility of any materials other than those procured against 90%

'on account' payment, or supplied free of cost by the Railway under Special Condition 6, being used in the manufacture of the wagons by the Company. In sum, the proposition propounded is that since the raw materials and components used in the manufacture of a wagon under the terms of the contract belonged to the Railway Board, the wagon produced had, at the time of its completion and delivery, no individual existence as the *sole* property of the Company.

Although counsel has not specifically cited from Pollock and Mulla's commentary on the Sale of Goods Act, the test sought to be invoked is the same which has been suggested by the learned authors. Judged by this test, proceeds the argument, the contract in question is not a contract of sale of wagons, but one for work and labour.

In support of his contentions, Mr. Mehta relies on three decisions of this Court :

M/s. Hindustan Aeronautics Ltd., Bangalore Division v. The Commissioner of Commercial Taxes, Mysore⁽¹⁾ *State of Gujarat v. Kailash Engineering Co.*⁽²⁾ and the other in *State of Gujarat (Commissioner of Sales Tax, Ahmedabad), v. M/s. Variety Body Builders*⁽³⁾. According to counsel, the terms and conditions of the contract which came up for consideration in *M/s. Hindustan Aeronautics* were substantially the same, and there it was held that the contract was one for work and not of sale of vehicles. On the other hand, Dr. L. M. Singhvi, Learned Advocate-General appearing for the State of Rajasthan, and Shri S. T. Desai, learned counsel appearing for the Company have pointed out that there is nothing in the Special Conditions which militates against or is inconsistent with the Standard Condition 15; that the Special Conditions, read as a whole, show beyond all doubt that the raw materials purchased by the Company against 90% advance payment do not become the property of the Railway Board or the Union of India, because under the express terms of the contract, such advance payment is made towards the "contract price" of the wagons and not towards the price of the materials purchased by the Company, although to safeguard the interests of the Railway Board some restrictions have been placed with regard to the use and disposal of those materials on the Company who had become aware thereof by purchase for a price. In refutation of the stand taken by the appellant, it is asserted that under the terms and conditions of the contract, it is not obligatory for the Company to purchase all the materials required for the construction of the wagons, from the Government stores or with the assistance of the Government against 90% advance payment. It is submitted that in accord with the terms of the contract, lot of raw material against which no such advance was taken, was purchased by the Company and used in the construction of the wagon. With our permission, an affidavit has been filed before us on behalf of the Company to support this assertion of fact.

(1) [1972] 2 S.C.R. 927.

(2) [1967] 195 S.T. (1360).

(3) A.I.R. 1976 S.C. 2108.

A Dr. Singhvi has further submitted that the terms of the contract in question are materially different from those which were in question in *Hindustan Aeronautics* case and in *M/s. Variety Body Builders* (supra) and consequently those decisions cannot govern the instant case. According to the Counsel, the instant case is more in line with the decisions of this Court in *Patnaik and Company v. State of Orissa*(¹) and *T. V. Sundram Iyengar & Sons v. State of Madras*.(²)

B

The first question for consideration is : whether all the raw materials used in the construction of the wagons are those against the 90% value of which advance is drawn by the Company from the Railway under Special Condition 4 ?

C

In this connection, it may be noted that there is nothing in the terms and conditions of the contract which expressly or by necessary implication binds the Company to procure and use only this raw material for which advance has been drawn by it from the Railway. There is positive evidence (i.e. un rebutted affidavit of Shri C. P. Gupta, Senior Accounts and Finance Officer of the Company) that in execution of the contract in question, the Company has used such raw material also against which no advance was drawn from the Railway.

D

The raw material used in the manufacture of the wagons may be split up into three categories :

E

1. Wheelsets, axle boxes supplied by the Railway free of cost (vide Special Condition 6).
2. Raw materials such as steel against which advance was drawn.
3. Raw materials against which no such advance was drawn.

F

The first category was admittedly the property of the Railway. There can be no dispute that the third category was, at all times material, the property of the Company. Controversy converges on category (2). Does such material procured by the Company, against 90% advance, become the property of the Railway before its use in the manufacture of the wagons ? Should the "on account" payment received from the Railway by the Company under Special Condition 4, on 90% of the value of the materials, be taken as payment towards the price of the materials ? Or, should it be taken as payment towards the price of the wagons ?

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H Answers to these questions turn on a construction of the terms and conditions of the contract. A correct construction, in turn, depends on a reading of the Standard and Special conditions as a whole. It would not be proper to cull out a sentence here or a sub-clause there and read the same in isolation. Again what is required is not a

(1) [1965] 16, S.T.C. 369 (S.C.).

(2) [1975] 35, S.T.C. 24 (S.C.).

fragmentary examination in parts but an overall view and understanding of the whole. Again, it is the substance of the documents constituting the contract, and not merely the Form which has to be looked into. A

The real intention of the contracting parties is primarily to be sought within the four corners of the documents containing Standard and Special Conditions of the Contract. If such intention is clearly discernible from these documents, it will not be proper to seek external aid from the stereotyped Indemnity Bond which is not only collateral but also posterior in point of time to the contract. It will bear repetition that there is no conflict or inconsistency between Standard Condition 15 and the Special Conditions. The terms and conditions of the contract, read as a whole, indubitably lead to the conclusion that the property in the materials procured or purchased by the Company, against the 90% value of which advance is taken from the Railway, does not before their use in the construction of the wagons, pass to the Railway. Reasons for arriving at this conclusion are as under : B

(i) Clause (a) of Special Condition 4 which provides for "On Account" payment upto 90% of the value of steel and other raw materials procured by the firm (Company) is to be read with Clause (b) which makes it clear that such 'On Account' payment is a part of the "full contract price" "for each completed wagon". C

(ii) Condition 5 while imposing restrictions as to the use and disposal of materials against which advance is taken, further gives a pre-emptive right to the Government to purchase all surplus or un-serviceable materials from the Company on its "being paid such price as Government may fix with due regard to the condition of the material". If the materials belonged to the Government or the Railway, no question of purchasing the same from the Company could arise. No one can be a seller and purchaser of the same property at the same time. D

(iii) Special Condition 10 provides in unequivocal terms that no Sales Tax on materials including steel or components will be reimbursed by the Railway Board". This condition postulates two things : First, that the Company becomes the owner of the materials by purchase and therefore, in that capacity becomes liable to the charge of Sales Tax which it cannot, because of this covenant to the contrary, pass on to the President/Railway Board. Second, such steel and components are not the property of the Railway. They were not supplied by the President/Railway free of charge under Special Condition 6. E

(iv) There is no condition or term in the contract that the material purchased, by the Company after drawing 'on account' payment to the extent of 90% of the value of the material shall become the property of the Railway. F

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A (v) Standard Condition 16 provides that if within twelve months after delivery, any "defect arises from *inferiority of material* or workmanship" the Company shall be liable to remedy the defect, and to deduction of money due to it. This Condition also presupposes that the inferior material used was not the property of the Railway but of the Company.

B (vi) The stipulation in the Indemnity Bond making the Company responsible for safe custody and protection of the "Stores and articles" against all risks till they are duly delivered to the Railway, or as they may direct, nor the use of the words "of the Railway", therein, in our opinion, in the face of clear Conditions of the contract, is a ground to hold that the materials purchased by the Company for construction of the wagons would become the property of the Railway immediately on advance of an amount equal to 90% of their value under Special Condition 4.

C As rightly pointed out by the High Court the word 'of' in the expression "Of the Railway" used in the Indemnity Bond in the context of "stores and articles" appears to have been loosely used. More-over these "stores and articles" might include the wheel sets and articles supplied by the Railway free of charge from its stores under Special Condition 6. The expression 'Of the Railways' might have been possibly used in the context of such components belonging to the Railway. Furthermore under Condition 5, in respect of all surplus material, the Railway had been given a right of pre-emption. Even so much capital cannot be made out of the use of this loose expression in the Indemnity Bond, when the Conditions embodied in the contract documents read as a whole, clearly show that the property in the materials purchased by the Company with the assistance of the Railway/Government does not pass to the Railway.

D The upshot of the above discussion is that with the exception of wheelsets (with axle boxes and couples), substantially all the raw materials required for the construction of the wagons before their use belong to the Company and not to the President/Railway Board. In other words with the exception of a relatively small proportion of the components supplied under Special Condition 6, the entire wagons including the material at the time of its completion for delivery is the property of the Company. This means that the general test suggested by Pollock and Chalmers has been substantially albeit not absolutely satisfied so as to indicate that the contract in question was one for the sale of wagons for a price, the Company being the seller and the President/Railway Board being the buyer. It is true that technically the entire wagon including all the material and components used in its construction cannot be said to be the *sole* property of the Company before its delivery to the Purchaser. But as pointed out by Lord Halsbury in the above quoted passage from his renowned work neither the ownership of the materials nor the value of the skill and labour as compared with the value of the materials used in the manufacture is conclusive. Nevertheless, if the bulk of the material used in the construction belongs to the manufacturer

who sells the end product for a price that will be a strong pointer to the conclusion that the contract is in substance one for the sale of goods and not one for work and labour. A

Be that as it may Clause (1) of Standard Condition 15 dispels all doubt with regard to the nature of the contract. This clause stipulates in unmistakable terms that as soon as a vehicle has been completed, the Company will get it examined by the Inspecting Officer and submit to the Purchaser an 'On Account' Bill for 90% of the value of the vehicle and within 14 days of the receipt of such bill together with a certificate of the Inspecting Officer, the Purchaser will pay 90% bill and on such payment, the vehicle in question will become the property of the Purchaser. There could be no clearer expression of the intention of the contracting parties than this clause that the contract was, in substance, one for the sale of manufactured wagons by the Company for a stipulated price. B
C

We would therefore affirm the finding of the High Court on this point.

The ratio of *Hindustan Aeronautics* (supra) is not applicable. The present case has some special features which did not figure in *Hindustan Aeronautics*. In that case from the terms and conditions of the contract then under consideration and the report of the Commercial Tax Officer, these facts appeared to be well established : D

- (i) the material used in the construction of coaches before its use was the property of the Railway.
- (ii) There was no possibility of any other material being used excepting which belonged to the President/Railway before its use in the construction of-coaches-purch. This fact was borne out from the report of the Commercial Tax Officer. E
- (iii) Further in the contract in question in that case, there was no term corresponding to Clause (1) of Standard Condition 15. This Court therefore found that the difference between the price of a coach and the cost of material could only be the cost of services rendered by the assessee. Such is not the case here. The bulk of the material used in the construction of the wagons, as already discussed above, in the instant case belongs to the Company before its use. F
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State of Gujarat (Commissioner of Sales, Tax, Ahmedabad) v. M/s. Variety Body Builders (supra) cited by Shri Mehta, also is clearly distinguishable from the facts of the instant case. There the bulk of the materials used in the construction of coaches was supplied by the Railway. Even labour was supplied by the Railway. The contractor mainly contributed his labour and skill to manufacture the end product, being the Railway Coaches, under the constant supervision and control of the Railway. From the totality of the material terms and conditions in the agreement, in that case, it was H

A not possible to hold that the parties intended that the Contractor transferred the property in the coach to the Railway after its completion. Reality of the transaction as a whole indicated that the contract was one for work and labour while in the instant case the converse is true.

B The case before us is more in line with the decision of this Court in *Patnaik and Company v. State of Orissa* (supra). The appellants therein had entered into an agreement with the State of Orissa for the construction of bus-bodies on the chassis supplied by the Governor. The agreement provided *inter alia* that the appellants were responsible for the safe custody of the chassis from the date of their receipt from the Governor till their delivery and they had to insure their premises against fire, theft etc. at their own cost.

C The appellants had to construct the bus-bodies in the most substantial and workmanlike manner, both as regards materials and otherwise in every respect in strict accordance with the specifications. They had to guarantee the durability of the body for two years from the date of delivery. It was also provided that all works under the contract should be open to inspection by the Controller or Officers authorised by him and such officers had the right to stop any work

D which had been executed badly or with materials of inferior quality and on receipt of a written order the appellants had to dismantle or replace such defective work or material at their own cost. The Builders were entitled to 50% of the cost of the body-building at the time of delivery and the rest one month thereafter. The question before the Constitution Bench of this Court was whether on these facts, the contract was one for work or a contract for sale of goods.

E This Court held (by majority) that the contract as a whole was a contract for sale of goods and therefore the appellants were liable to sales-tax on the amounts received from the State of Orissa for the construction of the bus bodies. In reaching at this conclusion the Court paid due regard to the fact that under that contract the property in the bus-body did not pass to the Government till the chassis with the bus-body was delivered at the destination to

F be named by the Controller. Till the delivery was made the bus-body remained the property of the builder. This clinching circumstance also prominently figures in Standard Condition 15 in the instant case, also.

For the foregoing reasons, the appeal fails and is dismissed with costs.

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P.H.P.

Appeal dismissed.