The entire deed must be considered to decide the existence of partnership.

The appellant was a firm consisting of six partners and the partnership was constituted under the document, dated March 20, 1959. The business of the partnership, as recited in the deed, is stated to have been carried on in partnership from October 1, 1958. The partnership was registered under the Indian Partnership Act, 1932, (the Partnership Act) on or about August 11, 1959. For the assessment year 1959-60, corresponding to the previous year ending March 31, 1959, the appellant filed an application to the ITO under Section 26-A for registration of the partnership in the name of M/s K. D. Kamath & Company. The ITO declined to grant registration on the ground that there was no genuine partnership brought into existence by the deed of March 20, 1959 and that the claim of the firm having been constituted was not genuine. The ITO further held that the business should be held to be the sole concern of K. D. Kamath. The sum and substance of his finding was that there was no relationship of partners inter se created under the said document. The Department did not challenging the genuineness of the document. On appeal of the assessee, the AAC confirmed the order of ITO. The Appellate Tribunal came to the conclusion that the two essential requirements as laid down by the Courts for determining whether there was a partnership, namely, an agreement between the parties to share profits and each of the parties acting as agent of all were fully satisfied in this case. The Tribunal held that the partnership deed made it clear that profits and losses were to be shared between the parties and that, subject to the over-riding authority of K. D. Kamath, the other partners could act for the firm. In this view, the Appellate Tribunal held that the deed did create a relationship of partners inter se between the parties and directed the ITO to register the firm under Section 26-A of the Income-Tax Act.

The CIT made an application under Section 66(1) of the Income-tax Act praying for a reference being made by the Appellate Tribunal to the High Court of the question of law mentioned in the application. The Tribunal referred to the High Court for its opinion the following question of law:

“Whether, on the facts and in the circumstances of the case, M/s K. D. Kamath & Co., could be granted registration under Section 26-A of the Act for the assessment year 1959-60?”

The High Court answered the question against the assessee.

**Partnership deed:** “Instrument of partnership.—Articles of agreement made at Hubli, this 20th day of March, 1959, among (1) Shri Krishnarao Dadasaheb Kamat, hereinafter called the party
hereto of the 1st part, (2) Shri Narayan Ganesh Kamat hereinafter called the party hereto of the 2nd part, (3) Shri Shripadrao Damodara Kamat, hereinafter called the party hereto of the 3rd part, (4) Shri Dayanoba Jotiram Mohite, hereinafter called the party hereto of the 4th part, (5) Shri Shankar Govind Joshi, hereinafter called the party hereto of the 5th party, and (6) Shri Yashavant Bhawoo Kate, hereinafter called the party of the 6th part. All Hindu inhabitants, residing at Hubli, and whereas the parties from 2 to 6, who have been serving with party No.,1 since a very long time and in view of the appreciation of their honest and sincere services which the above parties have rendered in past and with the object that the above parties should also have their material and economical progress, party No. 1, i.e., Shri K.D. Kamat has been pleased to convert his sole proprietary concern, as a partnership concern, by admitting the above parties from 2 to 6 as working partners and the party No. 1 shall be the main financing and managing partner and the business of the partnership is agreed and is being carried on accordingly in partnership as from 1st day of October, 1958, as contractors or any other business that the parties may think fit under the name and style of Messrs. K. D. Kamat & Co., Engineers and Contractors, Hubli and it is hereby agreed by and among the parties to this Agreement as under.

2. That the business of the partnership is running under the name and style of Messrs. K. D. Kamat & Co., Engineers and Contractors, Hubli as from the 1st day of October 1958, and this agreement shall take retrospective effect and shall be deemed to have come into operation as from the commencement of October 1, 1958.

3. That the duration of the partnership shall be at will.

4. That the business of the partnership is running at Hubli and shall run at Hubli or at such other place or places, as the case may be under the name and style of Messrs. K. D. Kamat & Co., Engineers and Contractors, or in such other name or names that the parties may from time to time decide and agree upon.

5. That the final accounts of the partnership firm shall be made up on the last day of each year of account, which shall generally be on 31st day of March every year of account and the accounts shall be taken up to that date of all the stock-in-trade and after providing for all the working expenses, the remaining net profits or losses, as the case may be, shall be shared by the parties hereto as under omitted).

6. That it is agreed among the partners that the party No. 1, i.e., Shri K. D. Kamat, shall be the principal and financing partner and the rest of the partners, i.e., from 2 to 6 are admitted only as working partners contributing labour.

7. That the good-will of the firm shall be wholly and solely belong to party No. 1, i.e., Shri K.D. Kamat.
8. That the party No. 1, i.e., Shri K.D. Kamat, who is the principal and financing partner and by virtue of his having the longstanding experience in the line of business together with the technical knowledge of Engineer, shall have full right of control and management of the firm's business and in the best interest of the firm, it is thus decided and agreed upon among all the partners that all the working partners from 2 to 6 shall always work according to the instructions and directions given from time to time by Shri K. D. Kamat, in the actual execution of works and in any other matter connecting thereof, pertaining to this partnership business. The decision of the principal partner on the aspect of taking any new business or giving tenders for new works, shall always vest with him, whose decision shall be final and binding upon all the working partners.

9. That it is also agreed among the partners that no working partner or partners is/are authorised to raise a loan for and on behalf of the firm or pledge the firm's interest directly or indirectly and such an act shall not be binding on the firm, except under the written authority of the principal partner.

10. That it is further expressly agreed that excepting the parties No. 1 and 2, i.e. Shri K.D. Kamat and Shri N.G. Kamat, the other parties from 3 to 6 shall not do contract business, so long as they are partners in this firm and this clause is inserted in the betterment of the firm's business and with the object that the firm's business should not suffer and the works if taken or standing in the name of the said parties from 3 to 6, the same shall be the business of the firm.

11. That it is also further agreed that the Managing Partner Shri K.D. Kamat shall alone operate the Bank accounts and in case of any need for convenience, the partner authorised by him in writing and so intimated to the Bank or Banks, shall operate the Bank accounts.

12. That in the course of the business or during the existence of the firm's business, the principal partner has reason to believe that any working partner or partners is/are not working and conducting to the best interest of the firm, the principal partner shall have a right to remove such a working partner or partners from the partnership concern and in such an eventuality the outgoing working partner or partners, shall have only right of the profit or loss up to the date of his retirement, as may be decided by the principal partner in lump sum either by paying or receiving, regard being had to the progress of the business or otherwise up to the date of retirement, only on the completed works.

13. That proper books of accounts shall be kept by the said parties and entries made therein of all such matters, transactions and things as are usually entered in the books of accounts kept by the persons engaged in business of a similar nature; all books of accounts, documents, papers and things shall be kept at the principal place of business of the firm and each partner shall at all times, have free and equal access to them.
14. That each partner shall be just and faithful to the other or others in all matters relating to the business of the firm, shall attend diligently to the firm's business and give a true account and shall give information relating to the same without fail.

15. That each partner shall withdraw such sums as will be mutually determined by the partners from time to time, in anticipation of the profit falling to their individual share and in case of loss, the same shall be made good by the partners.

16. Thus subject to the provisions herein mentioned and laid down and made thoroughly known by each of the parties to this Agreement with sound mind and body, the firm's affairs be carried on for mutual gain and benefit and if any questions which may arise or occur touching to the conduct or management or liability of the firm, the same shall be amicably settled among the parties with the consent of principal partner, whose decision in the matter shall be final and binding on all partners.

C.A. VAIDIALINGAM, J. - 8. The High Court has generally considered the effect of Clauses 5 to 9, 12 and 16 of the partnership deed. The High Court also considered the question whether the partnership deed satisfies the two essential requisites to constitute the partnership, namely: (1) whether there is an agreement to share profits as well as the losses of the business, and (2) whether each of the partners under the deed can act as agent of all. From the discussion in the judgment, the learned Judges, so far as we could see, have not thought it necessary to consider elaborately the question whether there is an agreement in the partnership deed to share the profits and losses of the business. Obviously, the High Court must have been satisfied from the recitals in the partnership deed that this requirement is amply satisfied in this case. That is why we find that the learned Judges have focussed their attention as they themselves say in the judgment on the question whether it is possible to hold from the recitals in the partnership deed that each partner is entitled to act as agent of all. In considering this aspect, the learned Judges have referred particularly to Clauses 8, 9 and 16 of the partnership deed and have held that it is clear from these clauses that the management, as well as the control of the business, is entirely left in the hands of the alleged first partner K.D. Kamath and that the other partners are only to work under his directions and share profits and losses in accordance with the proportions mentioned in Clause 5. It is the further view of the High Court that it is not within the power of the other five parties to act as agent of the other partners as they cannot accept any business except with the consent of K.D. Kamath; nor can they raise any loan or pledge the firm's interest. On this reasoning the High Court has come to the conclusion that there is no relationship of partners created under the partnership deed and as this essential element of agency is lacking, the appellant was not eligible to be granted registration under Section 26-A.

9. Mr S.K. Venkataranga iyengar, learned counsel for the assessee appellant, referred us to the various clauses in the partnership deed and urged that the view of the High Court that the essential element of agency is absent in this case, is erroneous. The counsel further urged that the
partnership deed, read as a whole, leaves no room for doubt that there is an agreement to share the profits and losses of the business in the proportion mentioned in the deed. Therefore, one of the essential ingredients to constitute a partnership is satisfied in this case. He further urged that though a large amount of control regarding the conduct of business may have been left in the hands of the first partner K. D. Kamath, that circumstance, by itself, does not militate against the view of one partner acting as agent of the other partners. He referred us in this connection, to certain decisions of the High Courts as well as of this Court, where under circumstances similar to the one existing before us, it has been held that the mere fact that more control is to be exercised only by one of the partners is not a circumstance which militates against the parties having entered into a partnership arrangement as understood in law.

10. Mr S.K. lyer, learned counsel for the Revenue, supported the reasoning of the High Court in its entirety. According to the learned counsel, the question whether there is an agreement to share the profits and the losses of the business and the further question whether each of the partners is entitled to act as agent of all are to be determined by looking into all the facts as borne out by the deed of partnership. He urged that on a consideration of all such facts, the High Court has held that one of the essential conditions, namely, the right of one partner to act as agent of all, does not exist in the present case. If so, the opinion expressed by the High Court that the appellant is not eligible for registration under Section 26-A is correct.

11. In considering the question whether the partnership deed creates the relationship of partners as between the parties thereto, as understood in law, it is desirable to have a complete picture of the entire document.

12. The High Court has rested its decision on five circumstances for holding that there is no relationship of partners as between the parties inter se created under the partnership deed. They are based on consideration in particular of Clauses 8, 9 and 16. The following are the circumstances, which according to the learned Judges militate against holding in favour of the assessee: (1) The management as well as the control of the business is entirely left in the hands of the alleged first partner K. D. Kamath; (2) The other partners can merely work under his directions and share in the profits and losses in accordance with the proportion mentioned in Clause 5; (3) It is not within the power of the parties Nos. 2 to 6 to act as agent of other partners; (4) The said parties cannot accept any business except with the consent of K.D. Kamath; and (5) Those parties cannot raise any loan or pledge the firm's interest, directly or indirectly except under the written authority of K.D. Kamath. In view of all these circumstances, according to the High Court, one of the essential element to constitute partnership, namely, agency is lacking.

16. From a perusal of the partnership deed one thing is clear, namely, under clause (1) what was originally the sole proprietary concern of K.D. Kamath has been converted as partnership concern by admitting parties Nos. 2 to 6 as working partners, alone with party No. 1, and party No. 1 is the main financing and managing partner of the business. That clause has to be read
along with clause (6) whereunder the partners have agreed that K. D. Kamath shall be the principal and financing partner and the rest of the partners, namely, parties Nos. 2 to 6 are admitted only as working partners contributing labour. Clause (4) deals with the running of the partnership business at Hubli as also other place or places or with such other name or names that the parties (which means partners Nos. 1 to 6) may from time to time decide and agree upon. From clauses (1), (2) and (3), it is clear that the business of the partnership is that of Engineers and Contractors. We are referring to this aspect because it will have a bearing regarding the control of the business agreed to be vested in K. D. Kamath. There does not appear to be any controversy that party No. 1 has been carrying on such business as a proprietary concern for a long time before the partnership was formed and as such he is considerably experienced in the said technical type of business. Clause (5) provides that final accounting is to be taken as on March 31 of every year and the net profits and losses are to be shared by the parties thereto in the proportion of the shares specified in the said clause.

17. Under clause (11), apart from the managing partner, K. D. Kamath operating the bank accounts, any other partner authorised by him is also eligible to operate the bank accounts. Clause (12) entitles a partner, when he ceases to be a partner to be paid his share of profit or loss, up to the date of his so ceasing to be a partner. Clause (13) provides that books of accounts are to be properly maintained and each partner has a right at all times to have free and equal access to them. Clause (14) enjoins on each partner to be just and faithful to the other partners in all matters relating to the business of the firm and each of them has got a duty to diligently attend the business of the firm. Each of them has also an obligation to give a true account and information regarding the business of the firm. Clause (15) enables the partners to withdraw the amounts in anticipation of profits falling to their individual share; and in case of loss, each of them is also liable to make good the same in proportion to his share in the partnership. Clause (16) enjoins on the partners to carry on the affairs of the firm for mutual gain and benefit.

18. All the above clauses clearly, in our opinion, establish that the sole proprietary concern of K.D. Kamath has vanished. The above clauses also establish the right of each of the partners to share the profits and also to bear the losses in the proportion of their shares mentioned in clause (5). Therefore, one of the essential ingredients to constitute partnership, namely, that there should be an agreement to share the profits and the losses of the business is more than amply satisfied in this case.

19. Then the question is whether the circumstances pointed out by the High Court and referred to by us earlier, necessarily lead to the conclusion that no relationship of partners, as understood in law, has been created as between the parties under the partnership deed.

23. In certain decisions of the High Courts the two essential conditions necessary to form the relation of partnership have been stated to be: (1) that there should be an agreement to share the profits and losses of the business, and (2) that each of the partners should be acting as agent of all.
Though, these two conditions, by and large, have to be satisfied when the relationship of partners is created between the parties, we would emphasise that the legal requirements under Section 4 of the Partnership Act to constitute a partnership in law are: (1) there must be an agreement to share the profits or losses of the business; and (2) the business must be carried on by all the partners or any of them acting for all. There is implicit in the second requirement the principle of agency.

28. From a review of the above decisions, it is clear that the mere nomenclature given to a document is by itself not sufficient to hold that the document in question is one of partnership. Two essential conditions to be satisfied are: (1) that there should be an agreement to share the profits as well as the losses of business; and (2) the business must be carried on by all or any of them acting for all, within the meaning of the definition of "partnership" under Section 4 of the Partnership Act. The fact that the exclusive power and control, by agreement of the parties, is vested in one partner or the further circumstance that only one partner can operate the bank accounts or borrow on behalf of the firm are not destructive of the theory of partnership provided the two essential conditions, mentioned earlier, are satisfied.

29. In the light of the principles laid down by this Court in Steel Brothers and Co. Ltd. v. Commissioner of Income-tax [AIR 1958 SC 315], the reasons given by the High Court for holding that the relationship of partners has not been created under the deed of partnership before us, cannot be sustained. As the control and management of business can be left by agreement in the hands of one partner to be exercised on behalf of all the partners, the other consequence by way of restriction on the rights of the other partners lose all significance. In fact the clauses providing that the working partners are to work under the directions of the managing partner and the further clause restricting their right to accept business or raise any loans or pledge the firm's interest except with the consent of the managing partner K.D. Kamath, have all to be related with the agreement entered into by the partners regarding the management and control by K.D. Kamath. We are of the opinion that under the partnership deed the relationship which has been brought into existence between the six parties is a relationship of partners who have agreed to share the profits and losses of business carried on by all or any of them acting for all and it satisfies the definition of "partnership" under Section 4 of the Partnership Act. We have already pointed out that there is a sharing of the profits or losses of the business by the partners in the ratio of the proportion mentioned in clause (5). That clause read with other clauses already discussed by us clearly shows that the first condition, namely, all persons agreeing to share profits or losses is satisfied. Even on the basis that the entire control and management of the business is vested in K. D. Kamath, party No. 1, and that parties Nos. 2 to 6 as working partners have to work under his direction, from all the other circumstances it is clear that the conduct of business by party No. 1, is done by him acting for all the partners. There is no indication to the contrary in the partnership deed. Therefore, even without anything more, it is clear that as the partnership business is carried on by party No. 1, acting for all, the second condition of agency in also satisfied. This idea is reinforced by clause (16) which provide that the firm's affairs are to be
carried on for mutual benefits. That clause is to the effect that the firm’s affairs which are managed by party No. 1 is really for the mutual gain and benefits of all the partners.

30. It is, no doubt, true that the second essential test of the business being carried on by all or any of the partners acting for all must be satisfied. The provisions in the partnership deed clearly establish that K.D. Kamath, the managing partner, carries on the business, acting for all the partners.

31. Much stress has been laid by the High Court on the fact that under clause (9) parties Nos. 2 to 6 have no right to raise loans for and on behalf of the firm or pledge the firm’s interest. This circumstance, according to the High Court, is destructive of the element of partnership. We have already held that the management and control of the business done by party No. 1, is carrying on of the business on behalf of all the partners. No doubt under Section 18 of the Partnership Act, a partner is the agent of the firm for the purpose of the business of the firm. But that section itself clearly says that it is subject to the provisions of the Act. It is open to the parties under Section 11 to enter into an agreement regarding their mutual rights and duties as partners of the firm and that can be done by contract, which in this case is evidenced by the deed - of partnership. Further Section 18 will have to be read along with Section 4. If the relationship of partners is established as a "partnership" as defined in Section 4, and if the necessary ingredients referred to in that section are found to exist, there is no escape from the conclusion that in law a partnership has come into existence. It is in the light of these provisions that Section 18 will have to be appreciated. Section 18 only emphasises the principle of agency which is already incorporated in the definition of "partnership" under Section 4.

32. It should be remembered that so far as the outside world is concerned, so long as the parties Nos. 2 to 6 are held out as partners of this firm, as has been done under the partnership deed, their acts would bind the whole partnership. The provision in clause (9) in our opinion, is only an inter se arrangement entered into by the partners, in and by which, the working partners have agreed not to raise loans or pledge the firm’s interest.

33. Mr S.K. lyer, learned counsel for the Revenue, placed some reliance on Section 14 of the Partnership Act. According to the counsel, there is no contract to the contrary in the partnership deed that the assets brought in by party No. 1, do not belong to the partnership. It is his further contention that under Section 14, those assets will belong to the partnership, in which case, it will be open to any partner, as agent of the other partners to pledge the firm’s interest or raise loan for partnership purposes. This right, according to the counsel is restricted by clause (9) and that clause negatives the theory of agency. In our opinion, this contention of the learned counsel cannot be accepted. Section 14 of the Partnership Act itself clearly shows that the provisions contained therein are subject to the contract between the parties. We have already held that the provision regarding the control and management vesting in party No. 1 is not by itself destructive of the theory of partnership. Clause (9) in our opinion, itself shows that the theory of agency is
recognised. But the parties, by mutual agreement, have placed a restriction on the working partners’ right to borrow on behalf of the firm or pledge the firm’s interest without the written authority of the principal partner.

35. To conclude, we are of the opinion that all the ingredients of partnership are satisfied under the partnership deed, dated March 20, 1959 and that the view of the High Court that the appellant-firm cannot be granted registration under Section 26-A of the Income-tax Act for the assessment year 1959-60, cannot be sustained.

36. In the result, we answer the question of law in the affirmative in favour of the assessee.
Cox v. Hickman

(1860) 8 H.L.C. 268

[Mode of determining the existence of a partnership – sharing of profits – creditor-debtor relationship]

Smith and Smith carried on business under the name of B. Smith & Son. They got into difficulties and called a meeting of their creditors. Later they executed a deed of arrangement in favour of their creditors. The parties to the deed being S. and S. of the first part, five of the creditors (including Cox and Wheatcroft) of the second part, and the general body of creditors of the third part, and the deed provided that the five creditors of the second part were to carry on the business of S. and S. as trustees for the creditors under the name of "The Stanton Iron Company," and to divide the net income of the business, after paying the expenses, among the general creditors of S. and S., such net income to be deemed to be of the creditors to be held, and that at any such meeting a majority in value of the creditors present was to have power to make rules as to the mode of conducting the business, or to order its discontinuance, and that when all the debts had been paid the trustees were to hold the property assigned under the deed in trust for S. and S. themselves. The deed also contained a covenant by the parties who executed it, not to sue S. and S. for their debts. Cox never in fact acted as a trustee, and Wheatcroft resigned six weeks after the deed, and before the goods for which bills now sued were given had been supplied, and no new trustees were appointed in place of Cox and Wheatcroft. The remaining three of the five creditors who were the parties to the deed of the second part, carried on the business under the provisions of the deed, and goods were supplied to the business by Hickman. Hickman drew three bills of exchange for the goods supplied by him, those bills were accepted on behalf of the Stanton Iron Company by one of the above-mentioned three creditors. Hickman sued Cox and Wheatcroft on those three bills, and alleged that they were liable upon them as partners in the business of the Stanton Iron Company because they were two of the five creditors who were the original parties to the deed of the second part and had executed the deed accordingly.

THE LORD CHANCELLOR (LORD CAMPBELL) - The only question in these cases is whether the defendants by executing the deed of 13th November, 1849, as creditors of Messrs. Smith & Co., rendered themselves liable to the creditors who should afterwards deal with the trustees appointed by this deed to carry on the concern of Messrs. Smith & Co., under the new firm of "The Stanton Iron Company." The Plaintiff alleges that although the Defendants never acted or held themselves out as partners in this new firm, and the creditors of the new firm are entitled to sue the creditors of the old firm as partners in the new firm.
It is quite clear that the creditors of the old firm, by executing the deed, never intended to incur such a liability, and I think that the creditors of the new firm cannot be supposed to have dealt with this firm in the belief that they could have a remedy against all or any of the creditors of the old firm.

Is there such a participation in the profits of the new firm by the creditors of the old firm, as to make them partners in the new firm? They certainly are not partners inter se, as was properly held by the Master of the Rolls and they could derive no profits from the new business, beyond the payment of the debts due to them from the old firm. There was a formal release of these debts; but we must look at the real nature of the transaction, according to the understanding of all who were parties to it. The business of Messrs. Smith & Co. was to be carried on by the trustees till the debts of that firm were paid, and then the business was to be transferred back to Messrs. Smith & Co.

I am of opinion that the creditors of the old firm cannot be considered, by executing the deed, as having authorised the trustees as their agents either to purchase the goods or to accept the bills....

I must, therefore, advise your Lordships to reverse the judgment of the Court of Common Pleas, and to adjudge that the Defendants below are not liable, as acceptors of the bills of exchange, on which the action is brought.

LORD CRANWORTH - In the first place let me say, that I concur with those of the learned Judges who are of opinion that no solid distinction exists between the liability of either defendant in an action on the bills, and in an action for goods sold and delivered. If he would have been liable in an action for goods sold and delivered, it must be because those who were in fact carrying on the business of the Stanton Iron Company, were carrying it on as his partners or agents, and, as the bills were accepted, according to the usual course of business for ore supplied by the plaintiff, I cannot doubt that if the trade was carried on by those who managed it as partners or agents of the defendant, he must be just as liable on the bills as he would have been in an action for the price of the goods supplied. His partners or agents would have the same authority to accept bills in the ordinary course of trade, as to purchase goods on credit.

The liability of one partner for the acts of his co-partner is in truth the liability of a principal for the acts of his agent. Where two or more persons are engaged as partners in an ordinary trade, each of them has an implied authority from the others to bind them all by contract entered into according to the usual course of business in that trade. Every partner in trade is for the ordinary purposes of the trade, the agent of his co-partners, and all are therefore liable for the ordinary trade contracts of the others. Partners may stipulate among themselves that some one of them only shall enter into particular contracts, or into any contracts, or that as to certain of their contracts none shall be liable except those by whom they are actually made; but with such private
arrangements third persons, dealing with the firm without notice, have no concern. The public have a right to assume that every partner has authority from his co-partners to bind the whole firm in contracts made according to ordinary usages of trade. This principle applies not only to persons acting openly and avowedly as partners, but to others who, though not so acting, are by secret or private agreement, partners with those who appear ostensibly to the world as the persons carrying on the business.

In the case now before the House, the Court of Common Pleas decided in favour of the respondent that the appellant, by his execution of the deed of arrangement, became, together with the other creditors who executed it, a partner with those who conducted the business of the Stanton Iron Company. The Judges in the Court of Exchequer Chamber were equally divided so that the judgment of the Court of Common Pleas was affirmed. The sole question for adjudication by your Lordships is, whether this judgment thus affirmed was right.

In the first place there is an assignment by Messrs. Smith to certain trustees of the mines and all the engines and machinery used for working them, together with all the stock in trade, and in fact, all their property, upon trust to carry on the business, and after paying its expenses, to divide the net income rateably amongst the creditors of Messrs. Smith, as often there shall be funds in hand sufficient to pay one shiling in the pound; and after all the creditors are satisfied, then in trust for Messrs. Smith.

Upto this point the creditors, though they executed the deed are merely passive, and the first question is, what would have been the consequence to them of their executing the deed if the trusts had ended there? Would they have become partners in the concern carried on by the trustees merely because they passively assented to its being carried on upon the terms that the net profits should be applied in discharge of their demands. I think not; it was argued that as they would be interested in the profits, therefore they would be partners. But this is a fallacy. It is often said that the test, or one of the tests, whether a person not ostensibly a partner, is nevertheless, in contemplation of law, a partner, is whether he is entitled to participate in profits. This, no doubt is in general, a sufficiently accurate test; for a right to participate in profits affords cogent, often conclusive evidence that the trade in which the profits have been made, was carried on in partnership for or on behalf of the person setting up such a claim. But the real ground of the liability is that the trade has been carried on by persons acting on his behalf. When that is the case he is liable to the trade obligations, and entitled to its profits, or to a share of them. It is not strictly correct to say that his right to share in the profits, makes him liable to the debts of the trade. The correct mode of stating the proposition is to say that the same thing which entitles him to the one makes him liable to the other, namely, the fact that the trade has been carried on his behalf, i.e., that he stood in the relation of principal towards the persons acting ostensibly as the traders by whom the liabilities have been incurred and under whose management the profits have been made.
Taking this to be the ground of liability as a partner, it seems to me to follow that the mere concurrence of creditors in an arrangement under which they permit their debtor, or trustees for their debtor, to continue his trade, applying the profits in discharge of their demands, does not make them partners with their debtor, or the trustee. The debtor is still the person solely interested in the profits, save only that he has mortgaged them to his creditors. He receives the benefit of the profits as they accrue, though he has precluded himself from applying them to any other purpose than the discharge of his debts. The trade is not carried on by or on account of the creditors; though their consent is necessary in such a case, for without it all the property might be seized by them in execution. But the trade still remains the trade of the debtor or his trustees; the debtor or the trustees are the persons by or on behalf of whom it is carried on.

I have hitherto considered the case as it would have stood if the creditors had been merely passively assenting parties to the carrying on the trade, on the terms that the profits should be applied in liquidation of their demands. But I am aware that in this deed special powers are given to the creditors, which, it was said, showed that they had become partners, even if that had not been the consequence of their concurrence in the previous trust. The powers may be described briefly as, first, a power of determining by a majority in value of their body, that the trade should be discontinued, or, if not discontinued, then, secondly, a power of making rules and orders as to its conduct and management.

These powers do not appear to me to alter the case. The creditors might, by process of law, have obtained possession of the whole of the property. By the earlier provisions of the deed, they consented to abandon that right, and to allow the trade to be carried on by the trustees. The effect of these powers is only to qualify their consent. They stipulate for a right to withdraw it altogether; or, if not, then to impose terms as to the mode in which the trustees to which they had agreed should be executed; I do not think that this alters the legal condition of the creditors. The trade did not become a trade carried on for them as principals, because they might have insisted on taking possession of the stock, and so compelling the abandonment of the trade, or because they might have prescribed terms on which alone it should be continued. Any trustee might have refused to act if he considered the terms prescribed by the creditors to be objectionable. Suppose the deed had stipulated, not that the creditors might order the discontinuance of the trade, or impose terms as to its management, but that some third person might do so, if, on inspecting the accounts, he should deem it advisable. It could not be contended that this would make the creditors partners, if they were not so already; and I can see no difference between stipulating for such a power to be reserved to a third person, and reserving it to themselves.

I have on these grounds, come to the conclusion that the creditors did not, by executing this deed, make themselves partners in the Stanton Iron Company, and I must add that a contrary decision would be much to be deprecated. Deeds of arrangement like that now before us, are, I believe, of frequent occurrence; and it is impossible to imagine that creditors who execute them, have any notion that by so doing they are making themselves liable as partners. This would be no
reason for holding them not to be liable, if, on strict principles of mercantile law, they are so; but
the very fact that such deeds are so common, and that no such liability is supposed to attach to
them, affords some argument in favour of the appellant. The deed now before us was executed
by above a hundred joint creditors; a mere glance at their names is sufficient to show that there
was not intention on their part of doing anything which should involve them in the obligations of
a partnership. I do not rely on this; but, at least, it shows the general opinion of the mercantile
world on the subject. I may remarks that one of the creditors I see is the Midland Railway
Company, which is a creditor for a sum of £ 39, and to suppose that the directors could imagine
that they were making themselves partners is absurd.

LORD WENSLEYDALE - The question is whether either of the defendants, Cox or
Wheatcroft, was liable as acceptor of certain bills of exchange... drawn by the plaintiff below on
the Stanton Iron Company, and accepted by one James Haywood as Pro that Company.
And the simple question will be this, whether Haywood was authorised by either of the
defendants, as partner in that Company, to bind him by those acceptances. Haywood must be
taken to have been authorised to accept for them by those who actually carried on business under
that firm. Were the appellants partners in it? The case will depend entirely on the construction of
the deed... There is no other evidence affecting either of them. And the question is whether the
subscription of both, as creditors of the Smiths, made them partners in the business carried on by
the trustees in the name of the Stanton Iron Company. Wheatcroft could not be liable in the
character of trustee, for he had ceased as such before the bills were drawn, and the plaintiff knew
it.

One of the provisions in the deed was this: that it gave authority to the trustees to execute
all contracts and instruments in carrying on the business, which would certainly authorise the
making or accepting bills of exchange. The question then is, whether this deed makes the
creditors who sign in partners with the trustees, or what is really the same thing, agents, to bind
them by acceptances on account of the business.

The law as to partnership is undoubtedly a branch of the principal and agent; and it would
lend to simplify and make more easy of solution, the questions which arise on this subject, if this
true principle were more constantly kept in view. Mr. Justice Story lays it down in the first
section of his work on Partnership. He says, "Every partner is an agent of the partnership, and his
rights, powers, duties, and obligations, are in many respects governed by the same rules and
principles as those of an agent; a partner virtually embraces the character of both a principal and
agent."

A man who allows another to carry on trade, whether in his own name or not, to buy and
sell and to pay over all the profits to him, is undoubtedly the principal, and the person so
employed is the agent, and the principal is liable for the agent's contracts in the course of his
employment. So if two or more agree that they should carry on a trade, and share the profits of it,
each is a principal, and each is an agent for the other, and each is bound by the other's contract in carrying on the trade, as much as a single principal would be by the act of an agent, who was to give the whole of the profits to his employer. Hence it becomes a test of the liability of one for the contract of another, that he is to receive the whole or a part of the profits arising from the contract by virtue of the agreement made at the time of the employment. I believe this is the true principle of partnership liability. Perhaps the maxim that he who partakes the advantage ought to bear the loss, often stated in the earlier cases on this subject is only the consequence, not relation of principal, agent, and partner.

Can we then collect from the trust deed that each of the subscribing creditors is a partner with the trustee and by the mere signature of the deed constitutes them his agents for carrying on the business on the account of himself and the rest of the creditors? I think not. It is not true that by this deed the creditors will gain an advantage by the trustees carrying on the trade; for if it is profitable, they may get their debts paid, but this is not that sharing of profits which constitutes the relation of principal, agent and partner.

If a creditor were to agree with his debtor to give the latter time to pay his debt till he got money enough out of his trade to pay it, I think no one could reasonably contend that he thereby made him his agent to contract debts in the way of his trade; nor do I think that it would make any difference that he stipulated that the debtor should pay the debt out of the profits of the trade.

The deed in this case is merely an arrangement by the Smiths to pay their debts, partly out of the existing funds and partly out of the expected profits of their trade; and all their effects are placed in the hands of the trustees, as middlemen between them and their creditors, to effect the object of the deed, the payment of their debts. These effects are placed in the hands of the trustees as the property of the Smiths, to be employed as the deed directs, and to be returned to them when the trusts are satisfied. I think it is impossible to say that the agreement to receive this debt, so secured, partly out of the existing assets, partly out of the trade, is such a participation of profits as to constitute the relation of principal and agent between the creditors and trustees. The trustees are certainly liable, because they actually contract by their undoubted agent; but the creditors are not, because the trustees are not their agents. I, therefore, advise your Lordships to reverse the judgment. Judgment reversed.

* * * * *
Mollwo, March & Co. v. The Court of Wards

(1872) L.R. 4 P.C. 419

[Creditor-debtor relationship]

The Plaintiffs/Appellants, merchants of London, brought an action against the late Rajah Pertab Chunder Singh, to recover a balance of nearly three lacs of rupees claimed to be due to them from the firm of W.N. Watson & Co. of Calcutta. The Rajah having died during the pendency of the suit, the defence was continued by the Respondent, the Court of Wards, on behalf of his minor heir.

The plaint alleged that the firm of W. N. Watson & Co. consisted of W.N. Watson, T.O. Watson, and the Rajah, liable as a partner in it. The two Watsons commenced business in partnership, as merchants at Calcutta, in 1862, under the firm of W.N. Watson & Co. Their transaction consisted principally in making consignments of goods to merchants in England, and receiving consignments from them. The Watsons had little or no capital. The Rajah supported them, and in 1862 and 1863, he made large advances to enable them to carry on their business, partly in cash, but chiefly by accepting bills, which the Rajah met at maturity. In the middle of 1863, the total amount of these advances was considerable and the Rajah desired to have security for his debt and for any future advances he might make and also wished to obtain some control over the business by which he might check what he considered to be the excessive trading of the Watsons.

Accordingly, an agreement was entered into on the 27th of August, 1863, between the Rajah of the one part, and "Messrs. W.N. Watson & Co." on the other part, by which, in consideration of money already advanced and which might be thereafter advanced by the Rajah to them, the Watsons agreed to carry on their business subject to the control of the Rajah in several important particulars. Under the agreement, whilst the advances made by the Rajah remained unpaid, the Watsons bound themselves not to make shipments, or order consignments, or sell goods, without his consent. No money was to be drawn from the firm without his sanction, and he was to be consulted with regard to the office business of the firm, and he might direct a reduction or enlargement of the establishment. It was also agreed that the shipping documents should be at his disposal, and should not be sold or hypothecated, or the proceeds applied, without his consent; and that all the proceeds of the business should be handed to him, for the purpose of extinguishing his debt. They further agreed to, and in fact did, hand over to the Rajah the title deeds of certain tea plantations, and they also agreed, that all their other property including landed or otherwise including their stock in trade, should be answerable for the debt due to him. This agreement was not signed by the Rajah, but he was undoubtedly an assenting party to it.
Subsequent to the agreement, the Rajah made further advances, and the amount due to him ultimately exceeded three lacs of rupees. In 1864 and 1865, the firm of W.N. Watson & Co. fell into difficulties. An arrangement was then made under which the Rajah upon the Watsons executing to him a formal mortgage of the tea plantations, to secure the amount of his advances, released to them, by a deed bearing date the 3rd of March, 1865 all right to commission and interest under the agreement of August, 1863, and all other claims against them.

In point of fact, the Rajah up to this time, had never received possession of any of the properties or moneys of the firm, nor any of the proceeds of the business; and did not in fact receive any commission. A sum of Rs. 27,000 on this account was, indeed, on the 30th of September 1863 placed to his credit in the books of the firm in a separate account opened in his name, but the sum so credited was never paid to him and was subsequently written back by the Watsons. Some evidence was given as to the extent of the interference of the Rajah in the control of the business. It seems the Rajah knew little of its details for it was conceded that the Rajah availed himself only in a slight degree of the powers of control conferred upon him by the agreement; in fact, that he did no more, but much less, than he might have done under it.

SIR MONTAGUE E. SMITH - It may be assumed, although the exact amount is a question in dispute in the appeal, that a large balance became due from the firm to the Plaintiffs during the time when it is contended that the Rajah was in partnership with the two Watsons.

The question in the appeal depend, in the main, on the construction and effect of a written agreement entered into between the Watsons and the Rajah. The subsequent acts of the Rajah do not in any way add to or enlarge his liability.

(No) liability can in this case be fastened upon the Rajah on the ground that he was an ostensible partner, and, therefore, liable to third persons as if he was a real partner. It is admitted that he did not so hold himself out; and that a statement made by one of the Watsons to the Plaintiffs to the effect that he might be in law a partner, by reason of his right to commission on profits, was not authorized by the Rajah.

The liability, therefore, of the Rajah for the debts contracted by W.N. Watsons & Co. must depend on his real relation to that firm under the agreement.

It was contended, for the Appellants, that he was so liable:

First, because he became by the agreement, at least as regards third persons, a partner with the Watsons; and

Secondly, because, if not a true partner the Watsons were the agents of the Rajah in carrying on the business and the debt to the Plaintiffs was contracted within the scope of their agency.
The case has been argued in the Courts of India and at their Lordships Bar, on the basis that the law of England relating to partnership should govern the decision of it. Their Lordships agree that, in the absence of any law or well-established custom existing in India on the subject, English law may properly be resorted to in mercantile affairs for principles and rules to guide the Courts in that country to a right decision. But whilst this is so, it should be observed that in applying them, the usages of trade and habits of business of the people of India, so far as they may be peculiar, and differ from those in England, ought to be borne in mind.

The agreement, on the face of it, is an arrangement between the Rajah, as creditor, and the firm consisting of the two Watsons as debtors, by which the Rajah obtained security for his past advances; and in consideration of forbearance, and as an inducement to him to support the Watsons by future advances, it was agreed that he should receive from them a commission of 20 per cent, on profits, and should be invested with the powers of supervision and control above referred to. The primary object was to give security to the Rajah as a creditor of the firm.

It was contended at the Bar that, whatever may have been the intention, a participation in the net profits of the business was in contemplation of law such cogent evidence of partnership that presumption arose sufficient to establish, as regards third parties, that relation unless rebutted by other circumstances.

It appears to their Lordships that the rule of construction involved in this contention is too artificial: for it takes one term only of the contract and at once raises a presumption upon it. Whereas the whole scope of the agreement, and all its terms, ought to be looked at before any presumption of intention can properly be made at all.

It certainly appears to have been at one time understood that some decision of the English courts had established, as a positive rule of law, that participation in the net profits of a business made the participant liable as a partner to third persons. The rule had been laid down with distinctness by Eyre, C.J. in Waugh v. Carver [(1793) 2 W.B. 998] and the reason of the rule the Chief Justice thus states: "Upon the principle that, by taking a part of the profits, he takes from the creditors a part of that fund which is the proper security to them for the payment of their debts. That was the foundation of Grace v. Smith [(1775) 2 W.B. 998] and we think it stands upon fair grounds of reason.”

The rule was evidently an arbitrary one, and subsequent discussion had led to the rejection of the reason for it as unsound. Whilst it was supposed to prevail, much hardship arose from its application, and a distinction, equally arbitrary was established between a right to participate in profits generally and such and a right to a payment by way of salary or commission in proportion (to use the words of Lord Eldon) to a given quantum of the profits.
It was also affirmed and acted on the *Pott v. Eyton*. [(184) 3 C.B. 32]. Where C.J. É in giving the judgment of the Court, adopts the rule as laid down the Lord Eldon and say, 'Nor does it appear to make any difference whether the money is received by way of interest on money lent, or wages, or salary as agent, or commission on sales.

The present case appears to fall within this distinction. The Rajah was not entitled to a share of the profits “as such”, he had no specific property or interest in them qua profits for, subject to the power given to the Rajah by way of security, the Watsons might have appropriated or assigned the whole profits without any breach of the agreement. The Rajah was entitled only to commission, or a payment equal in proportion to one-fifth of their amount.

This distinction has always been admitted to be thin, but it may be observed that the supposed rule itself was arbitrary in the sense of being imposed by law and of being founded on an assumption opposed in many cases to the real relation of the parties; and when the law thus creates a rule of liability and a distinction both equally arbitrary, the distinction which protects from liability is entitled to as much weight as the rule which imposes it.

But the necessity of resorting to these fine distinctions has been greatly lessened since the presumption itself lost the rigid character it was supposed to possess after the full exposition of the law on this subject contained in the judgment of the House of Lords in *Cox v. Hickman* (1860) 8 HLC 268 and the cases which have followed that decision. It was contended that these cases did not overrule the previous ones. This may be so, and it may be that former cases were rightly decided on their own facts; but the judgment in *Cox v. Hickman* had certainly the effect of dissolving the rule of law which had been supposed to exist, and laid down principles of decision by which the determination of cases, of this kind is made to depend, not on arbitrary presumptions. Profits of trade is a strong test of partnership, and that there may be cases where, from such participation alone, it may as a presumption not of law but of fact, be inferred; yet that whether that relation does or does not exist must depend on the real intention and contract of the parties.

It is certainly difficult to understand the principle on which a man who is neither a real nor ostensible partner can be held liable to a creditor of the firm. The reason given in *Grace v. Smith* [(1975) 2 W.B. 998], that by taking part of the profits he takes part of the fund which is the proper security of the creditors, is now admitted to be unsound and insufficient to supports it; for of course the same consequences might follow in a far greater degree from the mortgage of the common property of the firm, which certainly would not of itself make the mortgagee a partner.

Where a man holds himself out as a partner, or allows others to do it, the case is wholly different. He is then properly estopped from denying the character he has assumed, and upon the faith of
which creditors may be presumed to have acted. A man so acting may be rightly held liable as a partner by estoppel.

Again, wherever the agreement between parties creates a relation which is in substance a partnership, no mere words or declarations to the contrary will prevent, as regards third persons, the consequences flowing from the real contract.

It was strongly urged that the large powers of control and the provision for empowering the Rajah to take possession of the consignments and their proceeds, in addition to the commission on net profits, amounted to an agreement of this kind, and that the Rajah was constituted, in fact, the managing partner.

*The contract undoubtedly confers on the Rajah large power of control. Whilst his advances remained unpaid, the Watsons bound themselves not to make shipments, or order consignments, or sell goods, without his consent. No money was to be drawn from the firm without his sanction, and he was to be consulted with regard to the office business of the firm, and he might direct a reduction or enlargement of the establishment. It was also agreed that the shipping documents should be at his disposal, and should not be sold or, hypothecated, or the proceeds applied, without, his consent; and that all the proceeds of the business should be handed to him, for the purpose of extinguishing his debt.*

*On the other hand, the Rajah had no initiative power; he could not direct what shipments should be made or consignments ordered, or what should be the course of trade. He could not require the Watsons to continue to trade, or even to remain in partnership; his powers, however large, were powers of control only. No doubt he might have laid his hands on the proceeds of the business; and not only so but it was agreed that all their property, landed and otherwise should be answerable to him as security for his debt.*

Their Lordships are of opinion that by these agreements the parties did not intend to create a partnership, and that their true relation to each other under the agreement was that of creditor and debtors. The Watsons evidently wished to induce the Rajah to continue his advances, and for that purpose were willing to give him the largest security they could offer; but a partnership was not contemplated and the agreement is really founded on the assumption, not of community of benefit, but of opposition of interests.

It may well be that where there is an agreement to share the profits of a trade, and no more, a contract of partnership may be inferred, because there is nothing to show that any other was contemplated; but that is not the present case, where another and different contract is shown to have been intended, viz. that of loan and security.
It was strongly insisted for the Appellants that if a true partnership had not been created under agreement, the Watsons were constituted by it the agents of the Rajah to carry on the business, and that the debt of the Plaintiffs was contracted within the scope of their agency.

Of course, if there was no partnership, the implied agency which flows from that relation cannot arise, and the relation of principal and agents must on some other ground be shown to exist. It is clear that this relation was not expressly created, and was not intended to be created by the agreement, and that if it exists it must arise by implication. It is said that it ought to be implied from the fact of the commission on profits, and the powers of control given to the Rajah. But this is again an attempt to create, by operation of law, a relation opposed to the real agreement and intention of the parties, exactly in the same manner as that of partners was sought to be established, and on the same facts and presumptions. Their Lordships have already stated that reasons which have led them to the conclusion that the trade was not agreed to be carried on for the common benefit of the Watsons and the Rajah so as to create a partnership; and they think there is no sufficient ground for holding that it was carried on for the Rajah as principal, in any other character. He was not, in any sense, the owner of the business, and had no power to deal with it as owner. None of the ordinary attributes of principal belonged to him. The Watsons were to carry on the business; he could neither direct them to make contracts, nor to trade in the manner which he might desire; his powers were confined to those of control and security, and subject to those powers, the Watsons remained owners of business and of the common property of the firm. The agreement in terms and, as their Lordships think, in substance, is founded on the relation of creditor and debtors, and establishes no other.

Their Lordships opinion in this case is founded on their belief that the contract is really and in substance what it professes to be viz., one of loan and security between debtors and their creditor. If cases should occur where any persons, under the guise of such an arrangement, are really trading as principals, and putting forward, as ostensible traders, others who are really their agents, they must not hope by such devices to escape liability; for the law, in cases of this kind, will look at the body and substance of the arrangement, and fasten responsibility on the parties according to their true and real character.

For the above reasons their Lordships think that the Judges of the High Court, in holding that Rajah was not liable for the debts of the firm of W.N. Watson & Co., took a correct view of the case; and they will, therefore, humbly advise Her Majesty to affirm their judgement, and to dismiss this appeal with costs.

* * * * *
Miles v. Clarke

[1953] 1 All ER 779

[Partnership Property]

HARMAN, J. This is a partnership action in which the issues on the writ, at the hearing of a motion, and on the pleadings when the matter came to be dealt with in this court were two: First, was there a partnership at all? Secondly, if there was a partnership, what were the assets of the partnership? The defendant was advised, and I think obviously rightly advised, that to contest the issue whether in law there was a partnership was to contest the incontestable, and that, therefore, at the outset he would be wise to concede that a partnership had existed, and that a partnership at will had begun on April 1, 1950, and had expired at the issue of the writ in the action. This advice he rightly took. The expiry of the partnership may conveniently be taken to have occurred on May 29, 1952. That left to be decided the question: What were the partnership assets? Though it was pleaded in the defence that none of the assets used in the business belonged to anyone but the defendant, yet the statement of claim, as it stood, did not conveniently raise that matter. It seemed to me and to counsel who represented the parties that the right course to take was to treat the hearing as deciding that a partnership existed and make an order on that footing, and then order the ordinary partnership accounts with an addition in a special form in order to raise the matters which remained in controversy between the parties. Consequently, on Feb. 19, 1953, I made an order declaring that there was a partnership between the plaintiff and the defendant, and that it began on April 1, 1950, and was dissolved on May 29, 1952. I ordered, first, the following inquiry:

Any inquiry whether any and if so which of the following items as at April 1, 1950, formed part of the partnership property or whether any and if so which of them remained the separate property of the plaintiff or the defendant as the case may be....

and then follows the list: (i) the lease of the property at Shepherd's Market where the business was carried on; (ii) the furniture and fittings in the studio; (iii) and, perhaps, most important, the equipment of the studio; (iv) the plaintiff's and the defendant's photographic negatives and prints which were brought in by each of them at the outset; (v) the defendant's goodwill or reputation; and (vi) the plaintiff's goodwill or reputation. That order was followed by an order (in para. 2 and para. 3) for the taking of the usual account and inquiry in a partnership, in common form. In para. 4 I ordered an inquiry whether either the plaintiff or the defendant was entitled to be credited in the partnership accounts with any sum on account of any of the items referred to. I then treated the summons to proceed as having been issued and having come before the master and the inquiries ordered in para. 1 and para. 4 of the order as having been adjourned into court. This judgment will be a judgment to assist the master in answering the inquiry ordered in paras. 1 and 4 when the matter is sent back to him.

The defendant, who was a gentleman of some means, was minded to start a business in commercial and fashion photography. After looking about for some time, he found the premises which subsequently became the place of business of the partnership and in June 1948, he entered into a lease whereby the property, which consisted of two squash racquets
courts, dressing-rooms, and so forth, was demised to him for a period of seven years from midsommer, 1948, at a rent of £400 a year, which was, I am told, an advantageous lease, bearing in mind the neighbourhood and the fact that squash racquets courts are easily adaptable as photographic studios, having a good overhead light. One court was left open as a large studio, the other was divided by partitions and a floor put in, part of it being used as dark rooms, part as offices, and part as a smaller studio. There the defendant started to carry on a photographic art or craft, but he employed persons to carry out the photographic work for him. At the beginning he made a very considerable loss. In January, 1950, after some earlier approaches which were ineffective, he applied to the plaintiff to see whether he would come into business as a partner. The plaintiff has been taking photographs all his life, and he is, apparently, well-known and has a good connection in this particular work. He was at that time working for others, using their studio partly for his own purposes and partly on their behalf, and he was making a very considerable income as what he called a free-lance photographer. He, it seems, was not very anxious to come in, and during the first month or so of 1950 he came down occasionally to the defendant’s studio and took photographs, but from about the beginning of April he attended there as a full-time occupation and brought with him his own considerable connection. He took photographs of such subjects and such models as the defendant on his side should provide. The upshot of it was a very successful business. The plaintiff’s faithful clients followed him, and brought their work to him. The business is now in the hands of a receiver, after the partnership quarrel, in a flourishing condition.

These two people, having, as it were, thrown in their lot together in this way, were too busy to think about the terms on which they should carry on business. They agreed that the profits, if there should be any, should be shared equally, and I take it the losses also, though, of course, they did not contemplate losses, and they did not have to face any. There also appears to have been an agreement reached that the plaintiff should draw £125 a month on account of his share of the profits, but that arrangement did not always continue, because the plaintiff appears to be a rather improvident person who is almost incapable of managing his own life. The only two matters that were agreed were that there should be an equal sharing of the profits and that the plaintiff should have these monthly drawings on account. They both contemplated a regular legal connection, and the plaintiff employed as his solicitors Messrs. Blacket Gill & Topham, who, as early as January 1950, can be found writing to the defendant setting out what the plaintiff understood. At that time the plaintiff, by the advice, no doubt, of his solicitors, contemplated that there would be a limited company and not a partnership to carry on the business. Whether the matter was carried on in one guise or the other really made no difference in substance to the parties. Miss Blacket Gill, the senior partner in that firm of solicitors, who conducted all the negotiations on the part of the plaintiff, wrote on January 31, 1950, in these terms:

We understand from (the plaintiff) that you and he are desirous of forming a limited company to carry on business as photographers. The business will be carried on at 5, Shepherd Street and the assets of the company will consist of Mr. Miles’s goodwill, your goodwill and a lease and you will each hold shares in accordance with the value of the assets you put into the company. We understand that very little detail has been arranged between you except that you both agree that you wish to proceed on these lines.
The defendant employed an accountant who treated as an item on the debit side of the business a bank overdraft of £1,000 or so, which was, in fact, the defendant's private bank overdraft which neither party had contemplated for one moment as being a liability of the business. As the so-called accounts start from that monstrous unreality, it seems to me impossible to place any reliance on what should be put on the other side. On the other side, in fact, certain assets, including the lease and the stock-in-trade, are set down as assets of the business, but when one knows that the chief liability shown is not a business liability I do not think one is entitled to assume that that which appears as an asset is in truth an asset of the business. It is obvious that these parties and their advisers, so far as they thought about it at all, always contemplated that the lease, the equipment and the studio furniture, and the stock-in-trade and so forth should all be brought into the common pool, but the fact is that nothing was ever finally agreed about it, and they just drifted on.

On what terms were these people partners? The only answer one can give is that they were partners on the terms that they shared the profits between them. What more? It is said, and I think rightly, that, even though there was no further agreement, one must assume that the stock-in-trade, such as stocks of film, was put into the pool and cannot be taken out again, but must become part of the partnership assets. That is not denied. There remain, however, more important items. The first is the lease and the second is the plaint which may be worth £2,000. It is said with force by counsel for the plaintiff that those two classes of assets were put forward throughout as being brought in as part of the assets of the intended association, and, the plaintiff having come into the business on that footing, it would be inequitable now to deny him a right to share in those assets. It is said on the other side that it is not necessary to assume any further agreement between the parties, but one need only say that everything that belonged to one of them at the beginning of the partnership still belonged to that one at the end, and that the law will not make any imaginary agreement between the parties, it being ascertained as a fact that there was no agreement. In my judgment, no more agreement between the parties should be supposed than is absolutely necessary to give business efficacy to that which has happened, and that, I think, is the only safe way to proceed.

It is absolutely necessary to assume that things quae ipso usu consumuntur, the stock-in-trade, must be treated as having been brought into the partnership and their value must be ascertained by inquiry. They were all brought in by the defendant. I do not see the necessity of assuming that anything else went into the partnership. It seems to me that, as the parties failed to agree, it is not for me to say that the defendant must be assumed to have thrown the lease and the plant into the pool. The partnership could get on quite well if he gave his partner a licence to go on the leasehold property for the purposes of the business and to use the cameras to make the joint profile. Therefore, in my judgment, nothing changed hands except those things which were actually used and used up in the course of the carrying on of the business. The stock of negatives which each of these partners brought in was for the use of the business so long as it was going on. As I understand there is no great difficulty in separating them again now, and, indeed, being ex necessitate negatives or photographs taken before 1950, so far as they are fashion negative I cannot think that, except historically, they have any great value. However, if desired, the parties can each take away their negatives. Of
course, the stock of negatives of photographs taken during the course of the partnership must be a partnership asset. Everything that changed its existence during the currency of the partnership must be.

It was said that, apart from those matters, each party brought in a connection, and that the plaintiff brought in something of value in the shape of his good will or connection which must in some way be quantified or valued and treated as an asset of his. Some such scheme was, undoubtedly, envisaged, but it was never agreed on, and it seems to me it would be idle to suggest that, as the parties had not agreed anything of that sort, it ought to be treated as having happened. The plaintiff came there because, having the connection he did, if he had the studio and the equipment to his hand, he could make a good profit and presumably it would be worth his while to take half that profit in return for the benefit of the use of the studio and the equipment. I see no reason to suppose that, though his connection and skill were very useful to make profits, one ought to treat them in some way as capital assets. Therefore, neither his connection, nor the defendant’s connection, if it was of any value (which I doubt), should be treated in any way as being a partnership asset.

The only partnership assets remaining are, I think, the studio name, or the goodwill, such as it is, which has been attaching to it (and should have thought that was probably little), and the photographs in so far as they accumulated during the two years when the partnership was subsisting. Now that the parties have separated, the plaintiff will take away his own connection, no doubt, and his own clients, just as he brought them, and the defendant will presumably keep his own. It may be that it will be to his advantage that he will be able to keep the leasehold premises, but, as they were his before and he did not agree to assign them or to sub-let them, that is the inevitable result of the failure of the parties to make a more reasonable bargain.

Therefore, I propose to answer the inquiries by declaring that the lease, furniture and fittings, and the equipment of the studio did not form part of the partnership property, but remained the separate property of the defendant; that the plaintiff’s and defendant’s photographic negatives and prints brought into the business on April 1, 1950, remain the property of the person bringing them in; and, further, that neither the defendant’s nor the plaintiff’s goodwill or reputation form part of or should be treated as assets of the partnership. I will make a general declaration on the contrary that the stock-in-trade and consumable chattels ought to be treated as partnership property brought in by the defendant, and, in default of an agreement, I will direct a further inquiry, namely, as to what value ought to be attributed to those things in taking the partnership account. Lastly, it is suggested that, if the property remains that of the defendant, it is not right, in taking the accounts, to treat any depreciation as a charge against the profits, which would mean that the plaintiff would pay half of it. In my judgment, that is right. It would not be right to assume that the defendant leased or licensed either the leasehold property or the plant in the partnership at any price at all, because he did not, and, therefore, in my judgment, the result of no agreement works in the plaintiff’s favour, and is that he does not have to contribute to wear and tear on those assets. That being so, in taking the accounts no sum ought to be charged against profit by
way of depreciation. It is also said that certain partnership profits have been devoted to making improvements. For all I know that may be true or there may be nothing in it. The accounts are not sufficient to show. If it turns out that there is nothing in it the parties need not proceed with that inquiry.
"Trimble v. Goldberg"

(1906) AC 494 (PC)

[Accountability for profits of competing business -section 16]

LORD MACNAGHTEN - This is an appeal from an order of the Supreme Court of the Transvaal reversing the judgment of the Witwatersrand High Court at Johannesburg.

The trial of the action took place before Smith J. On all questions of disputed fact and on all questions of law but one of the learned judges of the Supreme Court agreed with the trial judge. On one point they differed from him. Founding their opinion on an equity he had failed to appreciate or discover, they entered judgment for the respondent declaring him entitled to share with the appellants in the profits of a purchase which they had made secretly and meant to keep to themselves. Considering the purchased property, though not within the scope of the partnership adventure, yet connected with it indirectly and thinking the purchase injurious to the common interest, they held on general principles that the appellants were liable to account to their partner for any profit derived from the transaction; and they regarded the veil of secrecy as a damning proof of guilt and aggravation of the wrong of which, in their view, Goldberg was entitled to complain.

Goldberg was a land speculator. Trimble was an auctioneer: he had been acting chief detective of the whole of the Transvaal before the war. Bennett was a merchant in Durban in a good financial position. The partnership agreement between Goldberg, Trimble and Bennett was dated February 10, 1902. The object of the joint adventure was the purchase and re-sale of certain properties belonging to a gentleman named Hollard. They consisted of 5500 shares in a company called the Sigma for building and other real estate in Johannesburg and elsewhere in South Africa.

There was nothing special in the partnership agreement of February 10, 1902. Profits and losses were to be shared equally. No partner was to sell or dispose of his interest without the consent in writing of his partners, All dealings with the property of the partnership were to be transacted by and through Trimble, to whom the other partners were to give powers of attorney.

The Sigma Syndicate, whose full title was the Sigma Building Syndicate, Limited, had been formed in 1896 under the laws of the South African Republic with limited liability. Its capital was £ 25,000/- divided into 25,000 shares of 1 £ each all fully paid up. The Board of Directors was to consist of at least four and at most six members of the company. The management of the company’s affairs was committed to the board with the most extended powers and without limit or reserve. The powers of the board specially enumerated included any purchase, sale, or exchange of immovable properties.
The syndicate was formed for the purpose of making profit by purchasing and re-selling a number of stands on Marshall Square and Government Square in Johannesburg.

In the early part of 1902, Hollard, a wealthy man and a director of the Sigma Syndicate, was about to leave South Africa and anxious to dispose of everything he had there before quitting the country. He put all his properties on the market for sale through Goldberg. Goldberg was furnished with a prospectus or proposal containing a schedule of the various lots shewing the aggregate price of the lots and the value placed on each. The total was £94,566/. The Sigma shares were put at £30,000/-. The prospectus was accompanied by an elaborate report prepared by a Mr. Dumat, an attorney in Johannesburg. Goldberg's original intention seems to have been to form a syndicate for the purpose of purchasing the property, charging the syndicate 9500/- as commission for his services. The gentlemen who were to compose the syndicate wanted further time. After carefully considering Dumat's report and expressing no little disappointment and dissatisfaction with it, Goldberg advised Hollard not to grant an extension of time to the syndicate, and proposed to accept Hollard's offer and buy on his own account. Bennett and Trimble joined him in the adventure. The one would not come in without the other, and so the syndicate disappeared, and the partnership agreement of February 10, 1902, was arranged. To meet Hollard's requirements a remittance of £12,500/- was telegraphed in advance and Trimble was dispatched to Johannesburg to complete the business.

Armed with powers of attorney from his two partners, Trimble went to Johannesburg, saw Hollard there, and settled the terms of the purchase offhand. The purchase deed was executed by Hollard and by Trimble on behalf of himself and his partners on February 14, 1902. The purchase price as proposed was £94,566/. The sum of £12,500/-, which had been sent forward, was taken as part payment; the balance was secured by mortgage bonds over the several properties comprised in the purchase.

After this matter was settled, Trimble went one day with Hollard to see the stands belonging to the Sigma Syndicate. When they came to Government Square Trimble asked Hollard if the syndicate would sell the stands there en bloc. Hollard said "Yes", adding that he thought the board would sell for £120,000/- Trimble asked about conditions, and Hollard referred him to Davis, the secretary, who would, he said, lay the matter before the board. It seems that the syndicate had tried without much success to sell their stands. They had put them up for sale by auction, but had only managed to sell one stand on Marshall Square. The board, holding as they did 23,000 shares out of 25,000, decided in the presence of all the shareholders to take 100,000/- for their stands on Government Square, and negotiations were going on with the Government or the private secretary to his Excellency on that footing. Trimble, of course, was not made aware of this fact, and after some negotiation with Davis he was content to take an option to buy for £110,000/- Trimble at once communicated with Bennett, and told him that he thought from some secret information he had gained, which it seems would not bear the light, that money was to be made out of the deal. He asked Bennett to join with him in the speculation, intimating that he was prepared to give even a larger price. Bennett consented to join, and agreed to finance the enterprise. The directors of the syndicate
were only too glad to accept Trimble's offer, and thus he secured the stands on Government Square for himself and Bennett at the price of £110,000/-.

Goldberg was not told anything about this purchase at the time. He did not hear of it until the end of 1902 or some time in 1903. Meeting Trimble one day in the street, he said, according to Trimble's uncontradicted evidence, corroborated by an accountant called Winship, who was present, "Don't you think you might have let me have a show in?" Later on, however, he took a more exalted view of his rights, and in June, 1904, he brought this action, alleging, in the first place, that the partnership had given Trimble a mandate to buy the stands on joint account - an allegation which both Courts held not proved. He also contended that, on general principles applicable to all cases of partnership, he was entitled to share with his partners in the benefit of their purchase. On this ground the Court of Appeal gave effect to his claim.

It seems to their Lordships that judgment of the Court of Appeal is not well founded. The purchase was not within the scope of the partnership. The subject of the purchase was not part of the business of the partnership, or an undertaking in rivalry with the partnership, or indeed connected with it in any proper sense. Nor was the information on which it seems Trimble acted acquitted by reason of his connection with the Sigma Syndicate. The way in which the information was acquired may have been much to Trimble's discredit, as the Court of Appeal has pointed out; but Goldberg is not in a position to complain of that. He at least is not averse to sharing the profit to which it seems to have conducted.

Now if the purchase from Hollard had been completed so far as to make the partnership the absolute and unincumbered owner of the 5500 shares in the Sigma Syndicate, and if those shares had been divided between the three partners and registered in their separate names any one of the three would have had as good a right to buy any property of the syndicate which the direction might think fit to offer for sale as any other shareholder in the syndicate or any member of the general public.

The Court of Appeal appears to have regarded the purchase in question, though not expressly prohibited by the partnership articles, as a breach of good faith and consequently as a violation of the fundamental condition of the partnership. Suppose it had been forbidden in express terms, what would have been the result? The other partners or partners discovering the breach of contract might have claimed immediate dissolution, or even damages, on proof of actual loss to the partnership. But a claim to share in the profits of the forbidden purchase would not have been warranted by principle or precedent. And here there was no loss to the partnership; only a disappointment to the partner left out in the cold. The purchase apparently was an advantage to the partnership. Through it the directors of the Sigma Syndicate were enabled to obtain for their property £10,000/- more than they would have obtained if they had sold to the Government at their own price. And the partnership, as a shareholder in the syndicate, was proportionately the gainer.

The Court of Appeal seems to have been much impressed by the secrecy of the transaction. No doubt it would have been better if Goldberg had been told at the time that
Trimble and Bennett were making this purchase. In a case in the House of Lords, which will be mentioned presently, in which the circumstances were somewhat analogous, Lord Blackburn observed, “I generally think it is advisable as a matter of prudence, as well as on other grounds, to let everything be above board.” That is a very proper sentiment, worthy, perhaps, of a more unhesitating acceptance. But still there was no legal obligation on Trimble or Bennett to tell Goldberg what they were doing unless he had a right to take part in the speculation if he chose to do so. Their excuse for silence, if it be an excuse, was that they considered Goldberg an undesirable partner and not financially strong.

The learned judges of the Court of Appeal also seem to lay some stress on a provision in the articles of association of the Sigma Syndicate which states that “Each share gives, according to the issued shares, a right to a proportionate share in the ownership of the company’s assets and in the distribution of profits.” But there is nothing special in that provision. It is no more than an accurate description of the position of every shareholder in every trading company limited by shares.

Then there was an argument which it is very difficult to follow. It was said that the moment Trimble determined to buy these stands, he put himself in a position in which his interest and his duty conflicted. It was his interest to buy as cheaply as he could. It was his duty to sell the Sigma shares as dearly as possible. The value of the shares depended on the value of the stands, and so it was his duty to enhance the value of the stands by every legitimate means in his power. He ought not to have thought of buying them for less than the utmost price he felt he might have been forced or tempted to give. He knew he was buying cheaply, he told Bennett so. The fallacy of this line of argument lies in assuming that Trimble had anything to do with selling the stands, or any right to meddle with the conduct of the sale. That was in the hands of the directors. They were dealing at arm’s length with him. It seems extravagant to suppose that he would have advanced the interests of the partnership by retiring from the field and declining to enter into a competition which actually had the effect into a competition which actually had the effect of raising the price of the stands and so improving the value of the Sigma shares.

In Cassels v. Stewart, which was an appeal from two concurrent judgments in Scotland, three gentlemen, Reid, Cassels and Stewart, were partners in an undertaking called the Glasgow Iron Company. The contract of co-partnership contained an article forbidding any partner to assign his interest, or give any person or persons a right to interfere with the business, and declaring further that any such assignation should be of no effect as regards the company. There was also a clause declaring that on the retirement of a partner, the remaining partners should have power to buy his interest at the amount standing to his credit at the last balance. Reid sold all his interest to Stewart. Reid’s name, however, remained on the books, and he signed all deeds relating to the business until his death, which occurred seven years after the sale. Cassels was not till then informed of the arrangement. When he found it out he claimed to participate in the purchase on the ground that a mandate had been given to Stewart to buy Reid’s interest for the partnership; (2) that under the terms of the partnership agreement the purchase could only be legally made with his consent; and (3) that Stewart had
Miles v. Clarke

secretly acquired a benefit for himself within the scope of the partnership business. It was held that the alleged mandate was not proved. But it was argued by Sir F. Herschell, the Solicitor-General, and the Lord Advocate that, putting aside the alleged mandate, the agreement was entered into under such circumstances as entitled the appellant to participate in it. The acquisition of the shares of outgoing partners...was one of the objects of the company. Apart from the express terms of the contract the secret agreement by which the respondent acquired for himself alone a benefit falling within the scope of the partnership business was a breach of the good faith of the partnership, and when such a benefit was acquired each partner had a right to demand that it should be communicated to each of them equally. From general principles it was inequitable, having regard to the fiduciary relations due to each other, that such an agreement should be made behind the back of another partner. Without calling on to the respondent, the House, consisting of Lord Selborne L.C. and Lords Penzance, Blackburn and Watson dismissed the appeal.

It seems to their Lordships that the decision of the Supreme Court of the Transvaal in the present case cannot stand with the decision in Cassels v. Stewart. There was at least as close a connection between the partnership and the partner’s purchase in that case as there is in this. In their Lordships’ opinion the order under appeal cannot be supported on authority or on any recognized doctrine of equity. Their Lordships will therefore humbly advise His Majesty that the appeal should be allowed, the order of Smith J. restored, and the appeal from that order dismissed with costs.

* * * * *
RELATIONS OF PARTNERS TO THIRD PARTIES

Holme v. Hammond

(1872) L.R. 7 Ex. 218; 41 L.J. Ex. 157

[ Section 19 – Duty of a partner as an agent of the firm]

Thomas and William Henry Fisher and George Henry Smith carried on business in co-partnership as auctioneers, under a deed which provided that in case of the death of Thomas Fisher, the other two partners should carry on the business, or what was called the co-partnership and should pay to the executors of Thomas Fisher the share of the profits to which he would have been entitled if he had survived. Thomas Fisher died in August, 1869; the two survivors carried on the business until the death of Smith, when William Henry Fisher continued to carry it on alone. W.H. Fisher and Smith having sold a mill and machinery in May, 1870, on account of the plaintiff and having received the proceeds of the sale in the following month of July. The plaintiff brought an action against W.H. Fisher and the defendants to recover that sum as money had and received insisting that the defendants, who are the executors of Thomas Fisher, and who have claimed to be entitled to the share of the profits which the testator would have been entitled to if he had lived and in respect of which they have received certain sums together with other moneys due to the estate of Thomas Fisher not specifically as profits, but generally on account), became partners with W.H. Fisher and Smith upon or after the death of Thomas Fisher, and as such are liable to the demand in this action.

KELLY, C.B. – The single question in this case is, whether the defendants at the time when this money was received were the partners of W.H. Fisher and Smith; and this depends upon whether they have expressly or impliedly entered into a contract of co-partnership, since the death of Thomas Fisher, with W.H. Fisher and Smith, who survived him. It is contended that having claimed and actually received portion of the profits of the business as supposed to have been ascertained upon an account taken from the 30th of June, 1869 to the 30th of June 1870, the defendants have made themselves, or must be taken to have become, partners, and as such liable to this action.

Upon a careful consideration of the authorities bearing on this question, it certainly appears to have been thought in former times, and there are judicial dicta to that effect, that the mere reception of a share in the profits of a commercial co-partnership made the participator a partner and liable to the debts and losses of the firm. But looking to the decisions themselves in which the question has arisen, it will be seen that in no one case has the party sought to be charged been held liable except where a contract of co-partnership has been found to have been entered into.

In Grace v. Smith[WM. Blacks 998] in which the language of De Gray, C.J., and Blackstone, J., appears to support the argument for the liability as partners of all who
participate in the profits of a commercial concern, the decision was that there was no sufficient evidence of a contract of co-partnership and so no liability as partners.

In the leading case of Waugh v. Carver [(1763) 2 Hy. Bl. 235] where the defendant was held liable as partner, it was because the contract proved was decided, and rightly decided, to be a contract establishing a commercial co-partnership, and the agreement in the articles that neither should be liable for the acts or the losses of the others, but each for his own (though valid and binding inter se), was of no effect against the creditors of the co-partnership firm.

So in Cox v. Hickman [(1860) 8 H.L.C. 268]; Bullen v. Sharp, [(1865) L.R. 1 C.P. 86], and the Irish case of Shaw v. Galt [16 Irish Com. Law Rep. 357], the parties sought to be charged were held not liable, on the ground that the acts done and the contracts entered into in those cases did not amount to contracts of co-partnership so that the parties had not become partners. It is necessary to consider the various terms and provisions of the contracts which were brought into question in those and other cases. It is enough to say, that whenever the plaintiff has failed to establish a contract of co-partnership the action has failed and the decision has been that the defendant was not liable.

In some of those cases the law of principal and agent has been referred to as governing the matters in question, but this branch of the law has really no bearing upon the case of partnership, except, indeed, that whenever a contract of partnership among commercial men exists, each partner is in point of law the agent for the others and for the firm collectively, and they are bound by any contract he may enter into within the scope of the partnership with reference to the nature of the undertaking, this agency being an incident to the contract of co-partnership.

It has also been argued that the statute 28 & 29 Vict. C. 86, enacting that widows, lenders of money, and some other classes of persons taking a share in the profits of a co-partnership shall not be deemed partners, would be useless if these and other classes of persons might at common law become sharers in profits without incurring such liability. But it seems to me that the effect of the statute is sharing in profits shall be no evidence at all of a contract of partnership, whereas, with regard to others, it is evidence, though insufficient of itself to establish the liability.

We have, therefore, now to look to the facts of the present case to determine whether upon the evidence the defendants have become parties to contract of partnership. Upon the death of Thomas Fisher the partnership before subsisting was dissolved by operation of law; W.H. Fisher and Smith from that time carried on the business; But this was, in contemplation of law, a new partnership. The defendants could not become partners with them but by some agreement, express or implied, to which they were parties. At the trial, taking into consideration the claims of the defendants to a share in the profits the acquiescence in that claim by the two survivors, and the actual payment and acceptance of the proportion of the profits supposed to have been ascertained, together with the accounts made out of the transactions of the firm, which were alleged, and which indeed did seem, to show that the
defendants instead of calling for an account of the state of the partnership at the death of their testator, and withdrawing from the concern whatever money or stock of property belonged to his estate, had left a portion of his capital and his share in the partnership stock and property in the business. I was, with all the circumstances before me and the accounts unexplained, inclined, to think that, upon the whole evidence, a contract by the defendants to succeed their testator and to become partners in his stead might be inferred. But now that it appears that there was no capital at all, either of the testator or the other partners, employed in the business; that the stock and co-partnership property consisted merely of a small quantity of furniture and fittings in the office of the value of £100.00; that the defendants neither left in nor drew out any money of the testator except that they drew out several successive sums of £100.00, upon the general account of what might turn out to be due to the estate; and that, consequently, the whole case for the plaintiff was reduced to the single fact that, in pursuance of the clause in the articles of partnership, the parties considered that in paying and receiving those sums they were to be taken as well on account of the share of the profits as of other moneys due to the testator; I am of opinion that there is no evidence whatever to establish a contract of co-partnership on the part of the defendants, and, consequently, that the action is not maintainable.

MARTIN, B. – I was under the impression that Thomas Fisher had left capital in the concern, and that the defendants had suffered this capital to remain, but it appears that this was not so, and that the testator, Thomas Fisher, had drawn out all his capital, and that the defendants did nothing more than claim and receive profits under the above clause. In my opinion this act did not make them liable to the plaintiff's demand. They did nothing on their own behalf at all; they merely did that which a court of equity would have compelled them to do as executors under the will, and in my opinion it would be contrary to reason to hold them liable by that act to a responsibility which must of necessity be borne by them in their own personal capacity, and paid out of their private funds; Wightman v. Townroe [(1813) 1 M. & S. 412]. It seems admitted by the learned counsel for the plaintiff that the defendants could not have interfered in or meddled with the sale; so also the money, the proceeds of it; was not their property, and if they had taken possession of it against the will of the surviving partners in order to pay it to the plaintiff they would have been trespassers; and it is difficult to understand how defendants can, in contemplation of law, have received money of which they had neither right nor possession, and their taking which against the will of the surviving partners would have been a wrongful act.

As I have said, up to a certain time in the argument I was in favour of the plaintiff. I understood that part of Thomas Fisher's capital remained, by the permission of the defendants, in the firm, and that they took a share in the profits in part earned by it. Under such circumstances I thought it not unreasonable that they should be liable upon a valuable contract by means of which the profits were in part earned, and that the principle of Waugh v. Carver [(1793) 2 Hy. Bl. 235], applied; but upon consideration, I doubt whether this was correct. The principle of Waugh v. Carver has been much broken in upon...It seems to me that the principle on which their opinions Lord Wensleydate and Lord Cranworth in Cox v. Hickman [(1860) H.L.C. 268] proceeds is correctly stated by O'Brien, J., in the case of...
Shaw v. Galt [16 Irish Com. Law Rep. 357]. He there expresses himself as follows: "The principle to be collected from them appears to be, that a partnership, even as to third parties, is not constituted by the mere fact of two or more persons participating or being interested in the net profits of a business; but that the existence of such partnership implies also the existence of such a relation between those persons as that each of them is a principal and each an agent for the others. If this principle be correct, the defendants are clearly not liable. The surviving partners were not agents of theirs in any sense; all that the defendants did was in an adverse character to them, and was a requirement that they should fulfil their contract with the testator by paying the one-third of the net profits for the benefit of his estate...As I have already said, in my opinion the defendants are entitled to the judgment of the Court.

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**Rhodes v. Moules**

(1895) 1 Ch. 236 (CA)

*The securities misappropriated by one partner were habitually held by the firm*

**LORD HERSCHELL L.C.** – This is one of those painful cases in which whatever judgment is pronounced the loss must fall upon some innocent person who has not by act or default contributed to it.

The litigation in this case has arisen out of the frauds of Mr. Rew, who practiced his profession as a solicitor in partnership with Messrs. Hughes and Masterman and the City of London. There is no doubt that the certificates of 280 De Beers shares were placed in his hands by Mr. Rhodes, the Plainitiff, in August, 1891. Those shares he has fraudulently misappropriated, and the first question is whether his partners, Messrs. Hughes and Masterman, are liable to make good the loss to the Plaintiff. Before stating the circumstances under which the shares were received by Rew, it is necessary to revert to some prior transactions between the Plaintiff and Mr. Rew acting on behalf of the firm. It is clear that Mr. Rhodes was a client of the firm, and that the firm had acted for him in previous matters.

His Lordship stated that facts as given above, and then proceeded as follows:

Some criticisms were presented to the Court on the evidence of Mr. Rhodes, and the learned Judge in the Court below has adverted to some inconsistencies in his evidence. I have read his evidence, and there seem to me to be no inconsistencies in it which are at all material. I think it cannot be doubted that Mr. Rew had represented to Mr. Rhodes that the lenders required some security beyond the mortgage of the freehold, that such security was to be collateral and to consist of these De Beers shares, and that he induced Mr. Rhodes to leave the De Beers shares with him on the representation that he would arrange with the lenders that he should hold them as for them collateral security or their loan. Whatever verbal differences there may be, I think there can be no doubt that this is the substance of the transaction in view, net merely of Mr. Rhodes’ statements, but of the letters to which I have referred written previously by Mr. Rew to Mr. Rhodes.

The question is whether under these circumstances the firm are liable in respect of these shares which have been misappropriated in the manner I have mentioned. It is said that they are not, inasmuch as it was beyond the scope of Mr. Rew’s authority as a solicitor to take the shares for any such purpose, or under such circumstances, and that, inasmuch as his partners were admittedly ignorant of his having so taken them, they cannot be bound by the transaction or incur any liability in respect of it. It is clear that on previous occasions the firm had acted for Mr. Rhodes in negotiating loans, and in receiving from him these very securities and transmitting them to the lenders, and in the first instance certainly receiving them back from the lenders. That that was a firm transaction I think it is impossible to dispute, because as I have shewn, it passed through the books of the firm, the firm credited themselves with the charges in respect of it, and an account was sent in the name of the firm, and that account was discharged by Mr. Rhodes. Therefore, it is impossible to dispute that Mr. Rhodes had on the
previous occasion actually carried through a transaction with the firm, and as a part of the transaction they not only negotiated the loan, but received from him these very securities to be handed to the lender. Even apart from that, I am not satisfied that it would be outside the scope of a solicitor’s business when they were negotiating a loan for one of their clients to receive from him securities, whatever their nature, for the purpose of transmission to any of their clients who were making the loan. It is not necessary to decide that as a matter of law; all I say it, I am not satisfied. But, in the present case, having regard to the prior dealings of this gentleman with the firm, I think it is impossible for them to say that Mr. Rhodes was not perfectly justified in assuming that the partner with whom on this occasion he dealt had authority from the firm to receive from him the shares which he handed for the purpose of carrying out the mortgage transaction which they were negotiating for him. If these shares had been handed over to the lenders the transaction would be on all fours with the one which had been previously carried through by him on behalf of the firm. In the present case it is true that the shares were not handed over to the lenders; but Mr. Rew represented to the Plaintiff that this was by arrangement between him and the lenders, who were also his clients, and who had arranged that he, or rather that the firm, should hold the securities on behalf of the lenders instead of handing them over to him. It seems to me that that can make on possible difference in the result. That was merely a matter between Mr. Rew, or the firm, and their other clients with whom they had negotiated the loan. If in fact that authority had been received—a question which I shall have to deal with presently—it seems to me it would be quite immaterial whether the transaction was carried out in that way or by Mr. Rew receiving them to hand them over afterwards to his clients, the lenders.

For these reasons, apart from authority, I find it difficult to discover any ground upon which it could be said that Mr. Rhodes was not justified in treating, and entitled to treat, the transaction as a transaction with the firm which rendered, not Mr. Rew only, but the firm responsible, if the shares received under the circumstances I have detailed were misappropriated and not forthcoming. This, of course, is subject to the question whether the firm had discharged themselves by shewing that they were held for the Defendants Moules under such circumstances that those Defendants are liable to the Plaintiff; in which case, of course, the firm would be discharged from liability, because they would in fact have handed them over to the lenders, and be freed from responsibility to Mr. Rhodes, the lenders being then the persons responsible; but that is a subsequent part of the case which I will deal with presently.

The Defendants relied mainly upon the case of *Cleather v. Twisden* [28 Ch. D. 340], decided in this Court in the year 1884. It was said that this case established that it was not part of the business of a solicitor to take over for custody bonds payable to bearer, and, consequently, when one partner had done so without his other partners being aware of it, they were under no liability if he misappropriated them. I do not think that case covers the present one. In the view which I take, these bonds were not handed to Mr. Rew merely for safe custody: they were handed to him in connection with a mortgage transaction which he was carrying out, in order that they should pass through him as collateral security to the lenders for whom he was acting. But it is to be observed that in the case of *Cleather v. Twisden* Lord
Justice Bowen said [28 Ch. D. 349]: The claim is against the firm to which Parker belonged in respect of the custody of certain bonds by Parker. This is conceded to be beyond the ordinary scope of the business of solicitors, though, of course, it may be brought within it by special circumstances. There was, therefore, there no evidence on the question; but it was conceded by those who were arguing the case that such a transaction was beyond the ordinary scope of the solicitors. It cannot be said, therefore, that in that case it was held as a matter of law to be so, because obviously when that had been conceded as a matter of fact any finding as a matter of law would have been superfluous. So that I do not think the case can be taken as a decision in point of law that such a transaction would be beyond the scope of solicitor's authority. As the Lord Justice said, it must depend upon the special circumstances; and certainly if it were to appear that it had been part of the practice of solicitors in the City to take securities of this description for safe custody, or if indeed in the case of a particular firm it appeared that such had been the practice, the case would have been one requiring the Court to determine whether in the case of that firm at all events, if not generally, it was not a matter within the scope of the authority of one of the partners. I should say the decision in Cleather v. Twisden appears to me substantially to have amounted only to this, that Parker had really taken charge of the bonds for a client as a personal matter as between him and that client, as a solicitor of course, but still not as a member of the firm, but as an individual. That seems to have been the conclusion at which the Court arrived, and there were undoubtedly circumstances which point to that conclusion to which it is not necessary to refer further. Lord Justice Bowen says this [28 Ch. D. 351]: That the bonds were in the custody of Parker is common ground, the real question is whether in letters for which the firm are responsible, language has been used which would justify the plaintiffs in assuming that Parker's custody was the custody of the firm. In the present case I have a difficulty in seeing how it can be doubted that letters for which the firm were responsible - letters relating to the previous transaction to which I have alluded, which passed through the letter-book of the firm, charges made by the firm and paid by the Plaintiff - would justify the Plaintiff in assuming that when Rew received those shares he received them, not as an individual, but on behalf of the firm, and that his receipt of them was the receipt of the firm. In Lord Justice Fry's judgment he says this [28 Ch. D. 356]: He (that is, Parker) was advising the trustees in the realization of the property, and I do not doubt that as to any parts such as the mortgages, which were received by Parker for distribution, the firm would be responsible; but as to the bonds they were not received for the purpose of distribution but for safe custody long before the distribution began. Therefore, I do not see any reason to think that if circumstances such as we have in the present case had been brought before the Court which decided that case - if they had been aware of such transaction as we are aware of here, and had seen that the securities were received in connection with a mortgage transaction in the way they were here - they would have come to any other conclusion than that in which we have arrived.

But then it is said on behalf of the Plaintiff, the Defendants Moules are responsible for these shares, and the receipt of them by Mr. Rew was a receipt on their behalf. He held them on their behalf, and whatever the liability of the firm to the Moules they cannot call upon the Plaintiff to repay the sum lent without not only reconvening to him, but giving up to him these De Beers shares. In order to establish this case I think they must make out two things:
first, that Mr. Rew did in fact receive an hold these De Beers shares for the Defendants Moules; and secondly, that he did so with the authority of the Moules. Now, I have not been satisfied that he did in fact receive them, or ever intended to receive them and hold them for the Moules. No doubt he led Mr. Rhodes to believe that he did: but that is quite a different question.

The case is a very peculiar one. Mr. Rew when he drew up the mortgage from Mr. Rhodes to the Moules made himself a mortgage, not only without any authority to do so, but without any legitimate reason for doing so. He was, of course, not a mortgagee. He had told Mr. Rhodes that the mortgagees would require some collateral security and that he thought they would take the De Beers shares. He had no communication on the subject with the Moules at all; they never required further security, and he never communicated with them on the subject. He told Mr. Rhodes that it was by arrangement with them that the shares were to be left in the custody of the firms. No such arrangement had been made: and again, as I have said, there was no communication on the subject. We know that Mr. Rew had commenced the Stock Exchange transactions which ultimately led to his ruin at a date prior to this, viz., in the January of that year, and he ultimately did dispose of those shares as his own. Under those circumstances I cannot say, in the absence of any evidence, that he ever identified them as their property, that he ever put them in an envelope or wrote their name on them or did anything to earmark them as theirs; and, in view of the falsehoods and irregularities to which I have referred, I cannot be satisfied that at the time he received those shares he ever meant to hold them really for the Moules. But even if he did, is there evidence that he had authority to receive and hold these shares on behalf of the Moules so as to make them liable? It was not suggested that he received any express authority, that they ever actually heard anything of the transaction: but it is said that he had a general authority, that the whole of the business in connection with the estate in which they were interested was left so entirely to Mr. Rew that he was intended to be by them absolutely master of the situation, taking what he pleased and doing what he pleased. Now, I have read the correspondence, and it conveys to my mind precisely the opposite impression. I do not find Mrs. Moules leaving everything to him in that blind way at all. She requires to know about everything. He professes to tell her about everything. He asks her approval at every step, and that approval is conveyed, and doubts were sometimes suggested, and, seeing that neither she nor her son ever learned that these shares had been taken or held for them by Mr. Rew or the firm, it seems to me it would be somewhat extravagant to arrive at the conclusion, notwithstanding all that, that they were held by the firm or Mr. Rew for the Moules, or that, having been in effect handed to them, they had become responsible for them.

For these reasons I am unable to come to the conclusion that the Defendants the Moules are liable. I do not think that the firm who undoubtedly received these shares from Mr. Rhodes have discharged themselves of liability. It follows in the result, I think, that as regards the Moules, the appeal should be dismissed with cost; and as regards the other Defendants the judgment must be reversed with the usual result, and that judgment with costs should be for the Plaintiff.
* * * * *
Hamlyn v. Houston & Co.

(1903) 1 K.B. 81

[Liability of other partners/firm for wrongful acts of a partner- One partner bribed the clerk of a competing firm to obtain information relating to contracts]

 COLLINS, M.R. The decision of the learned judge in this case was, in my opinion, right. The defendant Strong appears to have been a sleeping partner in a firm consisting of himself and the defendant Houston, or, at any rate, he delegated the transaction of the whole of the firm's business to Houston. The jury have found that it was in the course of the business of the firm to obtain by legitimate means information in regard to contracts made or tendered for with brewers and with buyers of grains by competing firm What Houston did for the purpose of obtaining information which, according to the finding of the jury, it was within the scope of his authority to obtain by legitimate means, was to bribe the clerk of the plaintiff, who was a competitor in business, to give him access to documents belonging to the plaintiff; indeed, it would appear that he actually had possession of one of the plaintiff's books for a time. It was argued for the defendants that this action by Houston was so completely outside the scope of the authority given to him that the defendants' firm cannot be responsible for it in an action brought against them by the plaintiff for damages thereby occasioned to him. The defendants' counsel have endeavoured to frame a definition with regard to what is an what is not within the scope of an agent's authority so as to render his principal liable. They suggested that, where the end sought to be obtained by the agent is in itself illegal, and the means employed to accomplish it are illegal, it cannot be said that the action of the agent is within the scope of the general authority given to him to conduct a business, but that it is otherwise where the end and the means employed are legal, or where the end is legal or illegal. Trying this case by the test so suggested, was the end to be obtained here in itself illegal? The defendants' counsel say that it was, but it does not appear to me to be so. According to the finding of the jury it was part of the defendants' business to obtain information as to the contracts and tenders of competitors in business, and, the more secret these matters were, the greater was the value of that information to the defendants' firm. The jury have in effect found that it was within the scope of the authority given to Houston to obtain such information by legitimate means, and I do not see that there was anything illegal in so obtaining it. It is too well established by the authorities to be now disputed that a principal may be liable for the fraud or other illegal act committed by his agent within the general scope of the authority given to him, and even the fact that the act of the agent is criminal does not necessarily take it out of the scope of his authority. If the act done by the agent is within the general scope of the authority given to him, it matters not for the present purpose that it was directly contrary to the instructions of his principal, or even that it may have been an offence against society itself. The test is that which is applied to this case by the learned judge. Was it within the scope of the authority given to Houston to obtain this information by legitimate means? If so, it was within the scope of his authority for the present purpose to obtain it by illegitimate means, and the defendants are liable. That is the law as expressed in the Partnership Act, 1890, and as laid down by decisions previous to that Act, in which it has been held that a principal is liable for
the fraud or other wrongful act of his agent if committed within the scope of his employment. This doctrine does not appear to rest upon the notion of the principal's holding out the agent as having authority. The grounds upon which it seems to rest, as explained in cases such as Barwick v. English Joint Stock Bank [(1867) L.R. 2 Ex. 259], appear to be that the principal is the person who has selected the agent, and must therefore be taken to have had better means of knowing what sort of a person he was than those with whom the agent deals on behalf of his principal; and that, the principal having delegated the performance of a certain class of acts to the agent, it is not unjust that he, being the person who has appointed the agent, and who will have the benefit of his efforts if successful, should bear the risk of his exceeding his authority in matters incidental to the doing of the acts the performance of which has been delegated to him. For these reasons I think this application must be dismissed.

METHEW, J. - I agree. A little confusion has been introduced into this case by the reference made to the criminal law. It is not suggested that Houston's partner would be liable determinally; the question is only one of civil liability. The rule of law applicable is perfectly plain. The question is whether the action of Houston was within the scope of his authority for the purpose of making the firm liable. I think the jury were entirely warranted in finding that Houston was authorized to obtain information as to the contracts and tenders made by competing firms by legitimate means. He did obtain such information by illegitimate means. It being within the scope of his authority to procure the information, it is immaterial for the present purpose whether the acts which he committed in order to procure it were fraudulent or even criminal or not, and his partner is responsible for those acts.

* * * * *
Tower Cabinet Co., Ltd v. Ingram

(1949) 1 KBD 1032

[ Holding out - section 28 ]

LYNSKEY, J. - The respondent company, the Tower Cabinet Co., Ltd., claimed from Merry's, who in the writ were described as "sued as a firm", the sum of £23.17s. for the price of six suites of furniture sold and delivered. Judgment was obtained, and the company then sought to render a Mr. S. G. Ingram liable for the debts of Merry's. They alleged that he was liable, first, under s. 14, and, secondly, under s. 36, of the Partnership Act, 1890. The matter was referred for trial before Master Grundy, the issue being whether Mr. Ingram had represented himself to be, or knowingly suffered himself to be represented to be, a partner under S. 14, or was liable under the provisions of S. 36 as, a partner.

The facts found by the learned master were that in January, 1946, Mr. A. H. Christmas and Mr. Ingram commenced together to carry on business in partnership as household furnishers under the name of Merry's at Silver street, Edmonton. The partnership was registered under the Registration of Business Names Act, 1916, as being carried on by Mr. Christmas and Mr. Ingram. That partnership subsisted until Apr. 22, 1947, on which date the parties agreed to dissolve it. The master was satisfied that there was a dissolution of this partnership in April, 1947, and that Mr. Ingram had given notice to the firm's bankers that he had ceased to be a partner in the business carried on in the name of Merry's. From then until some time in May, 1948, Mr. Ingram had no connection with the partnership except that Mr. Christmas had agreed to pay him for his share of the partnership a sum of some £3,000, and by May, 1948, about £1,000 had been paid by instalments. Mr. Ingram was not professionally represented at the time of the dissolution. He arranged with Mr. Christmas to notify those dealing with the firm that he (Mr. Ingram) had ceased to be connected with it, but he did not advertise or procure the advertisement in the London Gazette of the fact that he had ceased to be member of the firm. After his cessation of membership, new notepaper was printed for use in the future business of the firm. While Mr. Ingram had been a partner, the notepaper had been headed "Merry's" and thereunder had borne the names: fA. H. Christmas and S. G. Ingramf. After the dissolution the name "Merry's" appeared on the new notepaper, and fA. H. Christmas, Directorf. apparently as being the person responsible for the running of the business.

In January, 1948, Mr. Christmas, or Merry's, were approached by the Tower Cabinet Company through their representative, a Mr. Harold Selbey, who obtained an order for six suites of furniture. He reported the order to one of the directors of the company, Mr. Jack Smead, who telephoned to Merry's and asked for a director in order to secure confirmation of the order. It is not clear to whom he spoke. In pursuance of that conversation, a letter was written in the form of an order, and dated Jan. 5, 1947, in mistake for Jan. 5, 1948. That order
form read: "Merry's, A. H. Christmas, S. G. Ingram. Household Furnishers. To Tower Cabinet Co., Ltd. Please supply six light bedroom suites £ 168 units on delivery." It was signed by Mr. Christmas as the manager. That order or confirmation was given on the notepaper which had been the notepaper of the firm at the time when Mr. Ingram was a member, but Mr. Christmas had no authority from Mr. Ingram to use it, and in using it he was acting in direct conflict with the arrangement that he had made with Mr. Ingram that he should notify people that Mr. Ingram was no longer interested in the firm.

In May, 1948, Mr. Ingram was worried about the state of the business, and he came to try and see if he could resuscitate it in order to salvage his share in the previous partnership. He seems to have put some £300 into the business, and to have endeavoured to take control again. A letter was written by Mr. Christmas to the company in May, 1948, saying:

Dear Sirs, I wish to advise you that as from today I am no longer connected with the above business. Mr. S. G. Ingram is now sole proprietor and responsible for all outstanding debts. Yours faithfully, (signed) A. H. Christmas.

According to the evidence of Mr. Ingram, that letter was written without his knowledge and without his authority and he had no idea it was being sent, but it is not of any great materiality from the point of view of the questions which we have to decide in this case. It is clear on the master's finding that in January and February, 1948 when the goods were ordered and delivered Mr. Ingram was not in fact a partner in this business. The question is whether the company are able to make him liable as a partner by reason of the provisions of the Partnership Act, 1890, dealing either with holding out or with failure to give notice when a partnership has ceased and credit has been given to the partnership firm as if the outgoing partner were still a partner.

[Section 14 of the Act of 1890 was identical with the provisions of section 28 of the Indian Partnership Act, 1932. The court re-produced section 14 and proceeded.]

Before the company can succeed in making Mr. Ingram liable under this section, they have to satisfy the court that Mr. Ingram, by words spoken or written or by conduct, represented himself as a partner. There is no evidence of that. Alternatively, they must prove that he knowingly suffered himself to be represented as a partner. The only evidence of Mr. Ingram's having knowingly suffered himself to be so represented is that the order was given by Mr. Christmas on notepaper which contained Mr. Ingram's name. that would amount to a representation of Mr. Christmas that Mr. Ingram was still a partner in the firm, but on the evidence and the master's finding that representation was made by Mr. Christmas without Mr. Ingram's knowledge and without his authority. That being the finding of fact, which is not challenged, it is impossible to say that Mr. Ingram knowingly suffered himself to be so represented. The words are "knowingly suffers" i.e. not being negligent or careless in not seeing that all the notepaper had been destroyed when he left.

The company also rely on s. 36 which provides:

(1) Where a person deals with a firm after a change in its constitution he is entitled to treat all apparent members of the old firm as still being members of the firm until he has notice of the change. (2) An advertisement in the LONDON GAZETTE as to a firm whose principal place of business is in England or Wales, in the EDINBURGH
GAZETTE as to a firm whose principal place of business is in Scotland, and in the
DUBLIN GAZETTE as to a firm whose principal place of business is in Ireland, shall
be notice as to persons who had not dealings with the firm before the date of the
dissolution or change so advertised. (3) The estate of a partner who dies, or who
becomes bankrupt, or of a partner who, not having been known to the person dealing
with the firm to be a partner, retires from the firm, is not liable for partnership debts
contracted after the date of the death, bankruptcy, or retirement respectively.

It is said by counsel for the company that sub-s. (1) deals with the case in which it appears
to the world that a man is still a partner in a firm and notice must be given before his liability
as a retiring partner can cease. Secondly, he says that sub-s. (2) equally applies to the position
of a partner when it is apparent to the world that he was a partner.

Referring to the old authority of Farrar v. Delfinne, counsel for the company says that
the distinction has to be drawn between what are described by Cresswell, J., in that case as
notorious partners of the partnership and partners who are "profoundly secret" members of
the partnership. Counsel says that this section, being in a codifying Act, re-enacts the law as it
existed in 1843 and later. It should be noticed that even in Farrar case Cresswell, J., laid
considerable emphasis on the question of actual notice. He said (1 Car. & Kir. 580):

Todd and the defendant were once in partnership, but they have not been so since the
year 1837. The plaintiff dealt with the firm during the partnership, and he continued
to do so afterwards; and the question is, whether the defendant is liable in respect of
such subsequent dealings now that the partnership is dissolved. The law stands thus:
If there had been a notorious partnership, but no notice had been given of the
dissolution thereof, the defendant would have been liable. If there had been a general
notice, that would have been sufficient for all but actual customers; these, however,
must have had some kind of actual notice. If the partnership had remained
profoundly secret, the defendant could not have been affected by transactions which
took place after he had retired; but if the partnership had become known to any
person or persons, he would be in the same situation, as to all such persons, as if the
existence of the partnership had been notorious. The question for you, therefore, is
was this partnership actually known to the plaintiff, either by general report, or by
direct communication? Because, if it were, and he did not know, either from notice
of the fact, or from surmise, that the dissolution had taken place, you must infer that
he still dealt on the faith of the partnership, and the defendant will therefore be liable.

It is said by counsel for the company, who seeks to adopt this judgment in his favour, that
s. 36(1) and (2) are dealing with what are described in the judgment as "notorious"
partnerships, and sub-s. (3) is dealing with cases of "profoundly secret" partnerships.
Looking at the Act itself, I find difficulty in adopting that suggested construction. The words
of sub-s. (1) are:

Where a person deals with a firm after a change in its constitution he is entitled to
treat all apparent members of the old firm as still being members of the firm until he
has notice of the change.
The point depends, in my view, on what is the meaning of sub-s. (1) of "apparent members." Apparent to whom? Does it mean apparent to the whole world, or notorious, or does it mean apparent to the particular person with whom the section is dealing? In my reading of that sub-section, "apparent members" means persons who appear to be members to the person who is dealing with the firm, and they may be apparent either by the fact that the customer has had dealing with them before, or because of the use of their names on the notepaper, or from some sign outside the door, or because the customer has had some indirect information about them. Both sub-s. (1) and sub-s. (2), in my view, deal with cases where they are apparent members.

Sub-section (3) again deals with the particular individual. It does not deal with the public at large. Its words are, to my mind, simple and obvious. It does not deal merely with question of apparent members or non-apparent members. It implies the test: "... a partner who, not having been known to the person dealing with the firm to be a partner..." Whether he was to other people an apparent partner, or whether he was a dormant partner, the words seem to me to be equally applicable. If the person dealing with the firm did not know that the particular partner was a partner, and if that partner retired, then, as from the date of his retirement, he ceases to be liable for further debts contracted by the firm with that person. The fact that later the person dealing with the firm may discover he was a partner seems to me to be irrelevant, because the date from which the sub-section operates is the date of the dissolution. If the person who subsequently deals with the firm had no knowledge prior to the dissolution that the retiring partner was a partner, then sub-s. (3) comes into operation, and, in effect, relieves the person retiring from liability.

It is said by counsel for the company that the company did know that Mr. Ingram was a partner because the order for the goods contained a statement to the effect, or, apparently, to the effect, that he was a partner of the firm. In my view, that document, which only came into existence in January, 1948, was, no doubt, a representation by Mr. Christmas that Mr. Ingram was a partner at that particular date. That representation was untrue. He was not a partner at that date, and it seems to me one cannot draw the inference that that gave the company knowledge that, in fact, Mr. Ingram had been a partner prior to the date of his dissolution in April, 1947. Even if it did give such notice, in my view, the section had already commenced to operate, and it would not avail, subject to s. 14 dealing with holding out, to render Mr. Ingram liable.

The result is that, in my view, the learned master was not correct in his view of the effect of the sub-section or of the decision which he quoted. In my view, it is established that the company had no knowledge that Mr. Ingram was a partner prior to the date of the dissolution. That being so, Mr. Ingram is brought directly within the words of sub-s. (3), and is, therefore, under no liability to the company in respect of the debts subsequently incurred by Mr. Christmas at a time when he was not a partner. This appeal ought to be allowed.

**Lord Goddard, C.J.** - I agree. I need only add that, in my opinion, the words "all apparent member" in s. 36(1) mean all members apparent to the person dealing with the firm. Secondly, I think sub-s. (3) exactly applies to the facts of this case, and I can see no good reason for holding that that they apply to the case of a dormant partner. I think that the Act,
which is a codifying Act, intends in this section to incorporate the law, except with regard to the notices in the LONDON GAZETTE, which was new, laid down by Cresswell, J. in *Farrar v. Definie* (1), to which my brother has referred, or, at any rate, to adopt the statement of law which he there lays down when he told the jury that the question for them was: "Was this partnership actually known to the plaintiffs, either by general report, or by direct communication?" I feel convinced that the true construction to put on this section is that there must be actual knowledge which may be acquired either because of the fact that it is notorious, or because it has been directly communicated, but it is not enough to say that other people knew. The fact may be so notorious that a jury would be justified in finding that the person did know a certain fact, but it does not follow because other people know it that he knew it. I think what Cresswell, J. meant in that case was that the jury must be satisfied that there was actual knowledge, which might be gained from either of one of two sources.

* * * * *
[Can a minor who was admitted to the benefits of a partnership can be adjudicated insolvent on the basis of debt or debts of the firm after the partnership was dissolved, on the ground that he attained majority subsequent to the said dissolution, but did not exercise his option to become a partner or cease to be one of the said firm]

K. SUBBA RAO, J. - 2. The facts are not in dispute and may be briefly stated. Mallappa Mahalingappa Sadalge and Appasaheb Mahalingappa Sadalge, Respondents 2 and 3 in the appeal, were carrying on the business of commission agents and manufacturing and selling partnership under the names of two firms "M. B. Sadalge" and "C.N. Sadalge". The partnership deed between them was executed on October 25, 1946. At that time Chandrakant Nilakanth Sadalge, Respondent 1 herein, was a minor and he was admitted to the benefits of the partnership. The partnership had dealings with the appellants and it had become indebted to them to the extent of Rs 1,72,484. The partnership was dissolved on April 18, 1951. The first respondent became a major subsequently and he did not exercise the option not to become a partner of the firm under Section 30(5) of the Indian Partnership Act. When the appellants demanded their dues, Respondents 2 and 3 informed them that they were unable to pay their dues and that they had suspended payment of the debts. On August 2, 1954, the appellants filed an application in the Court of the Civil Judge, Senior Division, Belgaum, for adjudicating the three respondents as insolvents on the basis of the said debts. The 1st respondent opposed the application. The learned Civil Judge found that Respondents 2 and 3 committed acts of insolvency and that the 1st respondent had also become partner as he did not exercise his option under Section 30(5) of the Partnership Act and, therefore, he was also liable to be adjudicated along with them. The first respondent preferred an appeal to the District Judge, but the appeal was dismissed. On second appeal, the High Court held that the 1st respondent was not a partner of the firm and, therefore, he could not be adjudicated insolvent for the debts of the firm. The creditors have preferred the present appeal against the said decision of the High Court.

3. Learned counsel for the appellants, Mr Pathak, contends that the 1st respondent had become a partner of the firm by reason of the fact that he had not elected not to become a partner of the firm under Section 30(5) of the Partnership Act and, therefore, he was liable to be adjudicated insolvent along with his other partners.

4. The question turns upon the relevant provisions of the Provincial Insolvency Act, 1920 (5 of 1920) and the Indian Partnership Act. Under the provisions of the Provincial Insolvency Act, a person can only be adjudicated insolvent if he is a debtor and has committed an act of insolvency as defined in the Act: see Sections 6 and 9. In the instant case Respondents 2 and 3 were partners of the firm and they became indebted to the appellants and they committed an
5. But the question is whether the first respondent could also be adjudicated insolvent on the basis of the said acts of insolvency committed by Respondents 2 and 3. He could be, if he had become a partner of the firm. It is contended that he had become a partner of the firm, because he did not exercise his option not to become a partner thereof under Section 30(5) of the Partnership Act. Under Section 30(1) of the Partnership Act a minor cannot become a partner of a firm but he may be admitted to the benefits of a partnership. Under sub-sections (2) and (3) thereof he will be entitled only to have a right to such share of the properties and of the profits of the firm as may be agreed upon, but he has no personal liability for any acts of the firm, though his share is liable for the same. The legal position of a minor who is admitted to a partnership has been succinctly stated by the Privy Council in *Sanyasi Charan Mandal v. Krishnadhan Banerji* [ILR 49 Cal, 560, 570] after considering the material provisions of the Contract Act, which at that time contained the provisions relevant to the law of partnership, thus:

A person under the age of majority cannot become a partner by contract ... and so according to the definition he cannot be one of that group of persons called a firm. It would seem, therefore, that the share of which Section 247 speaks is no more than a right to participate in the property of the firm after its obligations have been satisfied.

It follows that if during minority of the 1st respondent the partners of the firm committed an act of insolvency, the minor could not have been adjudicated insolvent on the basis of the said act of insolvency for the simple reason that he was not a partner of the firm. But it is said that sub-section (5) of Section 30 of the Partnership Act made all the difference in the case. Under that sub-section the quondam minor at any time within six months of his attaining majority, or of his obtaining knowledge that he had been admitted to the benefits of partnership, whichever date is later, may give public notice that he has elected to become or that he has elected not to become a partner in the firm and such notice shall determine his position as regards the firm. If he failed to give such a notice, he would become a partner in the said firm after the expiry of the said period of six months. Under sub-section (7) thereof where such person becomes a partner, his rights and liabilities as a minor continue up to the date on which he becomes a partner, but he also becomes personally liable to third parties for all acts of the firm done since he was admitted to the benefits of partnership and his share in the property and profits of the firm shall be the share to which he was entitled as a minor. Under the said two sub-sections, if during the continuance of the partnership, a person, who was admitted at the time when he was a minor to the benefits of the partnership, did not within six months of his attaining majority elect not to become a partner, he would become a partner after the expiry of the said period and thereafter his rights and liabilities would be the same as those of the other partners as from the date he was admitted to the partnership. It would follow from this that the said minor would thereafter be liable to the debts of the firm and could be adjudicated insolvent for the acts of insolvency committed by the partners. But in the present case the partnership was dissolved before the first respondent became a major; from the date
of the dissolution of the partnership, the firm ceased to exist, though under Section 45 of the Act, the partners continued to be liable as such to third parties for the acts done by any of them which would have been the acts of the firm if done before the dissolution until public notice was given of the dissolution. Section 45 *proprio vigore* applies only to partners of the firm. When the partnership itself was dissolved before the first respondent became a major, it is legally impossible to hold that he had become a partner of the dissolved firm by reason of his inaction after he became a major within the time prescribed under Section 30(5) of the Partnership Act. Section 30 of the said Act presupposes the existence of a partnership. Sub-sections (1), (2) and (3) thereof describe the rights and liabilities of a minor admitted to the benefits of partnership in respect of acts committed by the partners; sub-section (4) thereof imposes a disability on the minor to sue the partners for an account or payment of his share of the property or profits of the firm, save when severing his connection with the firm. This sub-section also assumes the existence of a firm from which the minor seeks to sever his connection by filing a suit. It is implicit in the terms of sub-section (5) of Section 30 of the Partnership Act that the partnership is in existence. A minor after attaining majority cannot elect to become a partner of a firm which ceased to exist. The notice issued by him also determines his position as regards the firm. Sub-section (7) which describes the rights and liabilities of a person who exercises his option under sub-section (5) to become a partner also indicates that he is inducted from that date as a partner of an existing firm with co-equal rights and liabilities along with other partners. The entire scheme of Section 30 of the Partnership Act posits the existence of a firm and negatives any theory of its application to a stage when the firm ceased to exist. One cannot become or remain a partner of a firm that does not exist.

6. It is common case that the first respondent became a major only after the firm was dissolved. Section 30 of the Partnership Act, therefore, does not apply to him. He is not a partner of the firm and, therefore, he cannot be adjudicated insolvent for the acts of insolvency committed by Respondents 2 and 3, the partners of the firm. The order of the High Court is correct. In the result, the appeal fails and is dismissed with costs.

* * * * *
The assessee firm was constituted under a deed of partnership, dated October 6, 1955. It was to come into existence with effect from November 5, 1954. The assessee filed an application under Section 26-A of the Act for registration of the firm for the assessment year 1956-57. The previous year of the firm was shown as the year ending October 26, 1955. This application was received by the Income-tax Officer on October 14, 1955. On October 20, 1955, the assessee filed before the Registrar of Firms a statement under Section 58 of the Indian Partnership Act, 1932. On November 2, 1955, the Registrar of Firms filed the statement of the assessee and made entries in the register of firms. On March 23, 1961, the Income-tax Officer passed an order refusing to register the firm under Section 26-A, interalia, for the reason that the application had not been made in time. The appeal taken to the Appellate Assistant Commissioner by tax assessee failed. The Income-tax Appellate Tribunal also upheld the order of the Income-tax Officer and the Appellate Assistant Commissioner. On that a reference was sought and the High Court answered the question referred in favour of the assessee on the ground that the application had been filed in time.

Section 26-A of the (Income Tax) Act provides that an application may be made to the Income-tax Officer on behalf of any firm constituted under an instrument of partnership specifying the individual shares of the partners for registration for the purposes of the Act. The application has to be made by such person or persons and at such time and has to contain such particulars, etc., as may be prescribed. Rules 2 to 6(6) of the Rules made under Section 59 of the Act deal with registration of firms. The material portion of Rule 2 reads:

Such application shall be made......

(a) Where the firm is not registered under the Indian Partnership Act, 1932 (IX of 1932) or where the deed of Partnership is not registered under the Indian Registration Act, 1908 (XVI of 1908) and the application for registration is being made for the first time under the Act.

(i) Within a period of six months of the constitution of the firm or before the end of the previous year of the firm whichever is earlier, if the firm was constituted in that previous year,
(ii) before the end of the previous year in any other case,

(b) Where the firm is registered under the Indian Partnership Act, 1932 (IX of 1932) or where the deed of partnership is registered under the Indian Registration Act (XVI of 1908) before the end of the previous year of the firm.

A.N. GROVER, J. - Now it is common ground that the application for registration was not made within the period prescribed by Rule 2 (a). What has been urged throughout on behalf of the assessee is that the application to the Income-tax Officer was governed by Rule 2(6) and was in time as the firm should be deemed to have been registered not on the date on which it was actually registered by the Registrar of Firms but with effect from the date on which the application for registration was presented to the Registrar. In other words the firm should be considered to have been registered on October 20, 1955, on which date the statement under Section 58 of the Partnership Act was filed by the assessee before the Registrar of Firms.

4. The real question which has to be determined is whether the registration of a firm under the Partnership Act takes place with effect from the date on which the application for registration is made in accordance with Section 58 of that Act. Section 58(1) provides that the registration of a firm may be effected at any time by sending by post or delivering to the Registrar of the area in which any place of business of the firm is situated or proposed to be situated a statement in the prescribed form and accompanied by the prescribed fee stating...... under Section 59 when the Registrar is satisfied that the provisions of Section 58 have been duly complied with he shall record an entry of the statement in a register called the "register of firms" and shall file the statement. In Ram Prasad v. Kamla Prasad [AIR 1935 All. 898], it was laid down that the registration of a firm under the Partnership Act takes place only when the necessary entry is made in the register of firms Even under Section 69 of the Partnership Act which deals with the effect of non-registration it has been consistently held that the registration of a firm subsequent to the filing of the suit did not cure the defect. Thus under the Partnership Law it can be taken to have been settled by decisions of High Courts from a long time that the registration of a firm takes place only when the necessary entry is made in the register of firms under Section 59 of the Partnership Act by the Registrar. It is true that sub-section (1) of Section 58 employs language which without anything more may lend support to the view that the registration of a firm may be effected merely by sending an application which would mean that as soon as an application is sent and if entry is made under Section 59 pursuant to it the registration would be effective from the date when the application was presented. But Section 58(1) is not to be read in isolation and has to be considered along with the scheme of the other provisions of the Act, namely Section 59 and Section 69. The latter section may not have a direct bearing on the point under our consideration but it throws light on what was contemplated by the Legislature with regard to the point of time when the firm could be regarded as registered. The Kerala High Court has in Kerala Road Lines Corporation v. Commissioner of Income-tax Kerala [51 ITR 711] clearly expressed the view that reading Sections 58 and 59 of the Indian Partnership Act together a firm cannot be said to be registered when the statement prescribed by Section 58...
and the required fee are sent to the Registrar and that the registration of the firm is effected only when the entry of the statement is recorded in the register of firms and the statement is filed by the Registrar as provided in Section 59. In that case also an identically similar question arose in respect of registration of a firm under Section 26-A of the Income-tax Act.

5. The High Court in the judgment under appeal referred to the statement extracted from the report of the Special Committee which had been appointed by the Government of India to examine the provisions of the Bill before it came to be passed by the Central Legislature as the Partnership Act and reference was made in particular to the statement relating to Clause 58 corresponding to Section 59 of the Partnership Act to the effect that the Registrar was a mere recording officer and that he had no discretion but to record the entry in the register of firms. We are unable to see how that statement can be taken into consideration for the purpose of interpreting the relevant provisions of the Partnership Act. We also cannot concur with the other reasoning of the High Court for coming to the conclusion that the partnership should be deemed to have been registered on the date when the application was presented and that the requirement of Rule 2(b) would be satisfied if it became registered under the Partnership Act even after the application was filed. For the reasons given above the appeal is allowed. The answer to the question referred must be given in the affirmative and against the assessee.
Jagdish Chandra Gupta v. Kajaria Traders (India) Ltd.

AIR 1964 SC 1882

[Reference of dispute to arbitration as envisaged in the partnership agreement – whether barred by section 69]

M. HIDAYATULLAH, J. - By a letter dated July 30, 1955, M/s. Kajaria Traders (India) Ltd. and M/s. Foreign Import and Export Association (sole proprietary firm owned by the appellant Jagdish C. Gupta) entered into a partnership to export between January and June 1956, 10,000 tons of manganese ore to Phillips Brothers (India) Ltd., New York. Each partner was to supply a certain quantity of manganese ore. We are not concerned with the terms of the agreement but with one of its clauses which provided:

“That in case of dispute the matter will be referred for arbitration in accordance with the Indian Arbitration Act.”

The company alleged that Jagdish C. Gupta failed to carry out his part of the partnership agreement. After some correspondence, the company wrote to Jagdish C. Gupta on February 28, 1959 that they had appointed Mr R.J. Kolah (Advocate O.S.) as their arbitrator and asked Jagdish Chander Gupta either to agree to Mr Kolah’s appointment as sole arbitrator or to appoint his own arbitrator. Jagdish Chander Gupta after consideration and on March 17, 1959 the company informed Jagdish Chander Gupta that as he had failed to appoint an arbitrator within 15 clear days they were appointing Mr Kolah as sole arbitrator. Jagdish C. Gupta disputed this and the company filed on March 28, 1959 an application under Section 8(2) of the Indian Arbitration Act, 1940 for the appointment of Mr Kolah or any other person as arbitrator.

2. Jagdish Chander Gupta appeared and objected inter alia to the institution of the petition. Two grounds were urged (i) that Section 8(2) of the Indian Arbitration Act was not applicable as it was not expressly provided in the arbitration clause quoted above that the arbitrators were to be by consent of the parties and (ii) that Section 69(3) of the Indian Partnership Act, 1932 afforded a bar to the petition because the partnership was not registered. The petition was referred by the Chief Justice to a Divisional Bench consisting of Mr Justice Mudholkar (as he then was) and Mr Justice Naik. The two learned Judges agreed that in the circumstances of the case an application under Section 8 of the Indian Arbitration Act was competent and that the court had power to appoint an arbitrator. They disagreed on the second point. Mr Justice Mudholkar was of the opinion that Section 69(3) of the Indian Partnership Act barred the application while Mr Justice Naik held otherwise. The case was then referred to Mr Justice K.T. Desai (as he then was) and he agreed with Mr Justice Naik with the result that the application was held to be competent.
3. In this appeal it was not contended that the conclusions of the learned Judges in regard to Section 8(2) were erroneous. The decision was challenged only on the ground that Section 69(3) was wrongly interpreted and the bar afforded by it was wrongly disallowed.

The section, speaking generally, bars certain suits and proceedings as a consequence of non-registration of firms. Sub-section (1) prohibits the institution of a suit between partners inter se or between partners and the firm for the purpose of enforcing a right arising from a contract or conferred by the Partnership Act unless the firm is registered and the person suing is or has been shown in the Register of Firms as a partner in the firm. Sub-section (2) similarly prohibits a suit by or on behalf of the firm against a third party for the purpose of enforcing rights arising from a contract unless the firm is registered and the person suing is or has been shown in the Register of Firms as a partner in the firm. In the third sub-section a claim of set-off which is in the nature of a counter claim is also similarly barred. Then that sub-section bars "other proceeding." The only doubt that has arisen in this case is regarding the meaning to be given to the expression "other proceeding." One way to look at the matter is to give these words their full and natural meaning and the other way is to cut down that meaning in the light of the words that precede them. The next question is whether the application under Section 8(2) of the Arbitration Act can be regarded as a proceeding to enforce a right arising from a contract and therefore, within the bar of Section 69 of the Indian Partnership Act.

4. Mr Justice Mudholkar in reaching his conclusion did not interpret the expression "other proceeding" ejusdem generis with the words "claim of set-off." He held further that the application was to enforce a right arising from the contract of the parties. Mr Justice Naik pointed out that the words used were not "any proceeding" nor "any other proceedings" but "other proceeding" and that as these words were juxtaposed with "claim of set-off" they indicated a proceeding of the nature of a claim in defence. On the second point Mr Justice Naik held that this was not a proceeding to enforce a right arising from a contract but was a claim for damages and such a claim could be entertained because it was based on something which was independent of the contract to supply ore. He held that the right which was being enforced was a right arising from the Arbitration Act and not from the contract of the parties. Mr Justice K.T. Desai agreed with most of these conclusions and suggested that the words preceding "other proceeding" namely, "claim of set-off" had "demonstrative and limiting effect." He seems to have ascertained the meaning of the expression "other proceeding" by reference to the meaning of the words "claim of set-off" which he considered were associated with it.

5. The first question to decide is whether the present proceeding is one to enforce a right arising from the contract of the parties. The proceeding under the eighth section of the Arbitration Act has its genesis in the arbitration clause, because without an agreement to refer the matter to arbitration that section cannot possibly be invoked. Since the arbitration clause is a part of the agreement constituting the partnership it is obvious that the proceeding which is before the Court is to enforce a right, which arises from a contract. Whether we view the contract between the parties as a whole or view only the clause about arbitration, it is impossible to think that the right to proceed to arbitration is not one of the rights which are
founded on the agreement of the parties. The words of Section 69(3), “a right arising from a contract” are in either sense sufficient to cover the present matter.

6. It remains, however, to consider whether by reason of the fact that the words “other proceeding” stand opposed to the words “a claim of set-off” any limitation in their meaning was contemplated. It is on this aspect of the case that the learned Judges have seriously differed. When in a statute particular classes are mentioned by name and then are followed by general words, the general words are sometimes construed ejusdem generis i.e. limited to the same category or genus comprehended by the particular words but it is not necessary that this rule must always apply. The nature of the special words and the general words must be considered before the rule is applied. In Allen v. Emersons [(1944) 1KB 362]. Asquith, J., gave interesting examples of particular words followed by general words where the principle of ejusdem generis might or might not apply. We think that the following illustration will clear any difficulty. In the expression “books, pamphlets, newspapers and other documents” private letters may not be held included if “other documents” be interpreted ejusdem generis with what goes before. But in a provision which reads “newspapers or other document likely to convey secrets to the enemy” the words “other document” would include document of any kind and would not take their colour from “newspapers”. It follows, therefore, that interpretation ejusdem generis or noscitur a sociis need not always be made when words showing particular classes are followed by general words. Before the general words can be so interpreted there must be a genus constituted or a category disclosed with reference to which the general words can and are intended to be restricted. Here the expression “claim of set-off” does not disclose a category or a genus. Set-offs are of two kinds—legal and equitable—and both are already comprehended and it is difficult to think of any right “arising from a contract” which is of the same nature as a claim of set-off and can be raised by a defendant in a suit. Mr. B.C. Misra, whom we invited to give us examples, admitted frankly that it was impossible for him to think of any proceeding of the nature of a claim of set-off other than a claim of set-off which could be raised in a suit such as is described in the second sub-section. In respect of the first sub-section he could give only two examples. They are (i) a claim by a pledgor of goods with an unregistered firm whose good are attached and who has to make an objection under Order 21 Rule 58 of the Code of Civil Procedure and (ii) proving a debt before a liquidator. The latter is not raised as a defence and cannot belong to the same genus as a “claim of set-off”. The former can be made to fit but by a stretch of some considerable imagination. It is difficult for us to accept that the legislature was thinking of such far-fetched things when it spoke of “other proceeding” ejusdem generis with a claim of set-off.

7. Mr Justice Naik asked the question that if all proceedings were to be excluded why was it not considered sufficient to speak of proceedings along with suits in sub-sections (1) and (2) instead of framing a separate sub-section about proceedings and coupling “other proceeding” with “claim of set-off”? The question is a proper one to ask but the search for the answer in the scheme of the section itself gives the clue. The section thinks in terms of (a) suits and (b) claims of set-off which are in a sense of the nature of suits and (c) of other proceedings. The section first provides for exclusion of suits in sub-sections (1) and (2). Then it says that the same ban applies to a claim of set-off and other proceeding to enforce a right arising from a
contract. Next it excludes the ban in respect of the right to sue (a) for the dissolution of a firm, (b) for accounts of a dissolved firm and (c) for the realisation of the property of a dissolved firm. The emphasis in each case is on dissolution of the firm. Then follows a general exclusion of the section. The fourth sub-section says that the section as a whole, is not to apply to firms or to partners and firms which have no place of business in the territories of India or whose places of business are situated in the territories of India but in areas to which Chapter VII is not to apply and to suits or claims of set-off not exceeding Rs 100 in value. Here there is no insistence on the dissolution of the firm. It is significant that in the latter part of clause (b) of that section the words are for any proceeding in execution or other proceeding incidental to or arising from any such suit or claim and this clearly shows that the word proceeding is not limited to a proceeding in the nature of a suit or a claim of set-off. Sub-section (4) combines suits and a claim of set-off and then speaks of any proceeding in execution and other proceeding incidental to or arising from any such suit or claim as being outside the ban of the main section. It would hardly have been necessary to be so explicit if the words other proceeding in the main section had a meaning as restricted as is suggested by the respondent. It is possible that the draftsman wishing to make exceptions of different kinds in respect of suits, claims of set-off and other proceedings grouped suits in sub-sections (1) and (2), set-off and other proceedings in sub-section (3) made some special exceptions in respect of them in sub-section (3) in respect of dissolved firms and then viewed them all together in sub-section (4) providing for a complete exclusion of the section in respect of suits of particular classes. For convenience of drafting this scheme was probably followed and nothing can be spelled out from the manner in which the section is sub-divided.

9. In our judgment, the words other proceeding in sub-section (3) must receive their full meaning untrammelled by the words any claim of set-off. The latter words neither intend nor can be construed to cut down the generality of the words other proceeding. The sub-section provides for the application of the provisions of sub-sections (1) and (2) to claims of set-off and also to other proceedings of any kind which can properly be said to be for enforcement of any right arising from contract except those expressly mentioned as exceptions in sub-section (3) and sub-section (4).

10. The appeal is, therefore, allowed.

* * * * *
Haldiram Bhujiawala v. Anand Kumar Deepak Kumar
(2000) 3 SCC 250

Sections 69(2), 2(d)

M. JAGANNADHA RAO, J - 2. This appeal has been preferred by the two defendants, M/s Haldiram Bhujiawala and Shri Ashok Kumar against the judgment of the Delhi High Court in FAO No. 365 of 1999 dated 30-11-1999. By that order the High Court summarily dismissed the appellants\' appeal against the order of the learned Single Judge dated 2-11-1999 in IA No. 5996 of 1999 in Suit No. 635 of 1992. The IA was filed under Order 7 Rule 11 CPC by the appellants for rejection of the plaint filed by two plaintiffs, Anand Kumar Deepak Kumar trading as Haldiram Bhujiawala and Shiv Kishan Aggarwal, on the ground that the 1st plaintiff was a partnership not registered with the Registrar of Firms on the date of the suit i.e. on 10-12-1991 and that the subsequent registration of the firm on 29-5-1992 would not cure the initial defect.

3. The suit was filed by the plaintiff (1) for permanent injunction restraining the defendant appellants, their partners, servants etc. from infringing Trademark No. 285062 and from using the trademark/name "HALDIRAM BHUJIAWALA" or any identical name/mark deceptively similar thereto, (2) for damages in a sum of Rs 6 lakhs, and (3) for destruction of the material etc.

4. As we are dealing with a matter arising under Order 7 Rule 11 CPC, it will be necessary to refer to the plaint allegations. One Ganga Ram (sic Bishan) alias Haldiram, carried on business in the name of Haldiram Bhujiawala, since 1941. In 1965, he constituted a partnership with his two sons Moolchand, Shiv Kishan and his daughter-in-law Kamla Devi (wife of another son R.L. Aggarwal) to carry on business under the same name. In December 1972, the said firm applied for registration before the Registrar of Trademarks for registration of the name Haldiram Bhujiawala - Chand Mal - Ganga Bishan Bhujiawala, Bikaner. The Registrar of Trademarks granted registration with No. 285062. On 16-11-1974, the partnership was dissolved and under the terms of the dissolution deed the above trademark fell exclusively to the share of Moolchand, son of Ganga Bishan and father of the plaintiffs, for the whole country (except West Bengal). Thus Shri Moolchand became sole proprietor of the trademark in the said area while Smt Kamla Devi was given ownership of the trademark rights for West Bengal. It is stated that Shri Lala Ganga Bishan Haldiram executed his last will dated 3-4-1979 and also reiterated the rights conferred by the dissolution deed on the respective parties. Ganga Bishan died in 1980. His will was later acted upon. Later, the testator\'s son, Shri Moolchand too died in 1985 leaving behind his four sons, Shiv Kishan, Shiv Ratan, Manohar Lal and Madhusoodan. All of them got their names recorded as subsequent joint proprietors. The latter three formed a partnership in 1983 and were running a shop in Chandni Chowk, New Delhi selling various goods under the above said trademark of Haldiram Bhujiawala. In the meantime, on 10-10-1977, Moolchand\'s brother Shri R.L. Aggarwal (husband of Kamla Devi) and his son Prabhu Shankar, Calcutta applied for registration in this very name at Calcutta claiming to be full owners of the said trademark without disclosing the dissolution deed dated 16-11-1974. When the Registrar objected on 14-
4-1978, they replied on 18-7-1978 that they alone were trading in this name in Calcutta. The defendants have no right to use the said trademark beyond Calcutta. The plaintiffs registered trademark was, in the usual course, renewed on 29-12-1986 till 28-12-1993. The plaintiffs have also acquired a right on account of prior adoption and long user. The 1st plaintiff firm, consisting of three sons of Moolchand and the 2nd plaintiff (the fourth son of Moolchand) are joint owners of the trademark (except in West Bengal). The 1st defendant firm is a newly-constituted firm intending to start its business and has been formed by Ashok Kumar, son of Kamla Devi. The 2nd defendant is Ashok Kumar himself in his individual capacity. They have no right to use this trademark outside West Bengal. The plaintiffs came to know of the violation of the trademark by Defendants 1 and 2 in December 1991 when the defendants opened a shop at Arya Samaj Road, Karol Bagh, New Delhi. The cause of action for the suit is the fact that the defendants acted

in violation of the common law and contractual rights of the plaintiff

On these grounds, the defendants are to be restrained by permanent injunction from using the trademark and a sum of Rs 6 lakhs is payable as damages.

6. In this appeal, learned Senior Counsel for the appellants, Shri Ashok Desai and Shri R.F. Nariman contended that the 1st plaintiff firm was not registered with the Registrar of Firms on the date of suit, that the plaint repeatedly referred to the proprietary right of the late Moolchand as having arisen out of the dissolution deed dated 16-11-1974 and that without reference to the said document - which was a contract - the plaintiffs could not prove their right to the trademark through Moolchand and the suit was barred since Section 69(2) referred to a right "arising from a contract". The plaintiffs' right was based on the contract dated 16-11-1974. The words "arising from a contract" were akin to the words "arising out of a contract" used in Ruby General Insurance Co. Ltd v. Pearey Lal Kumar [AIR 1952 SC 119], wherein while construing those words in relation to an arbitration clause, this Court held that the said words had to be construed widely. The learned counsel contended that, on the facts of this case and as stated in the plaint at several places, the 1st plaintiff was compelled to rely on the contract of dissolution dated 16-11-1974 to prove title to the trademark and thereby for an injunction and hence it was not a right claimed under common law or under any statute, like the Trade Marks Act.

7. On the other hand, learned Senior Counsel for the respondent-plaintiffs, Shri Gopal Subramanium supported the view of the High Court by contending that the suit for injunction was based upon two rights, one being statutory under the Trade Marks Act arising out of prior registration of the trademark and alternatively, the suit was also based on the common law right available in a passing-off action. The suit was not based on any contract between the plaintiffs and the defendants. The provision in Section 69(2) did not apply if the right sought to be enforced did not arise out of a contract between the plaintiffs' firm and the defendants. The reference in the plaint to the dissolution deed dated 16-11-1974 was merely a reference to a historical fact that that was the source of the right of Moolchand and on his death, the said right to the trademark devolved on his sons, - three of whom are joined in a firm (i.e. the 1st plaintiff) and the fourth son is the second plaintiff. The plaintiffs were not parties to the deed
of dissolution. The defendants too were not parties to the dissolution deed though their mother was. Hence, the bar under Section 69(2) did not apply.

8. The points that arise for consideration are:

(i) Whether Section 69(2) bars a suit by a firm not registered on the date of suit where permanent injunction and damages are claimed in respect of a trademark as a statutory right or by invoking common law principles applicable to a passing-off action?

(ii) Whether the words "arising from a contract" in Section 69(2) refer only to a situation where an unregistered firm is enforcing a right arising from a contract entered into by the firm with the defendant during the course of its business or whether the bar under Section 69(2) can be extended to any contract referred to in the plaint unconnected with the defendant, as the source of title to the suit property?

**Point 1**

9. The question whether Section 69(2) is a bar to a suit filed by an unregistered firm even if a statutory right is being enforced or even if only a common law right is being enforced came up directly for consideration in this Court in **Raptakas Brett Co. Ltd v. Ganesh Property** [(1998) 7 SCC 184]. In that case, Majmudar, J. speaking for the Bench clearly expressed the view that Section 69(2) cannot bar the enforcement by way of a suit by an unregistered firm in respect of a statutory right or a common law right. On the facts of that case, it was held that the right to evict a tenant upon expiry of the lease was not a right "arising from a contract" but a common law right or a statutory right under the Transfer of Property Act. The fact that the plaint in that case referred to a lease and to its expiry, made no difference. Hence, the said suit was held not barred. It appears to us that in that case the reference to the lease in the plaint was obviously treated as a historical fact. That case is therefore directly in point. Following the said judgment, it must be held in the present case too that a suit is not barred by Section 69(2) if a statutory right or a common law right is being enforced.

10. The next question is as to the nature of the right that is being enforced in this suit. It is well settled that a passing-off action is a common law action based on tort. Therefore, in our opinion, a suit for perpetual injunction to restrain the defendants not to pass off the defendants' goods as those of the plaintiffs by using the plaintiffs' trademark and for damages is an action at common law and is not barred by Section 69(2). The decision in **Virendra Dresses v. Varinder Garments** [AIR 1982 Del 482] states that Section 69(2) does not apply to a passing-off action as the suit is based on tort and not on contract. In our opinion, the above decisions were correctly decided. (Special Leave Petition No. 18418 of 1999 against the latter was in fact dismissed by this Court on 28-1-2000.) The learned Senior Counsel for the appellants no doubt relied upon **Ruby General Insurance Co. Ltd v. Pearey Lal Kumar**. That was an arbitration case in which the words "arising out of a contract" were widely interpreted but that decision, in our view, has no relevance in interpreting the words "arising from a contract" in Section 69(2) of the Partnership Act.
11. Likewise, if the reliefs of permanent injunction or damages are being claimed on the basis of a registered trademark and its infringement, the suit is to be treated as one based on a statutory right under the Trade Marks Act and is, in our view, not barred by Section 69(2).

12. For the aforesaid reasons, in both these situations, the unregistered partnership in the case before us cannot be said to be enforcing any right arising from a contract. Point 1 is therefore decided in favour of the respondent-plaintiffs.

**Point 2**

13. Question however arises as to what is the scope of the words enforcing a right arising under the contract used in Section 69(2)? Learned Senior Counsel for the appellants repeatedly drew our attention to the allegation in the plaint at various places that it was only under the deed of dissolution dated 16-11-1974 that Moolchand, the father of the partners of the 1st plaintiff firm and the 2nd plaintiff became proprietor of the trademark for the whole of India (except West Bengal). That right devolved on the plaintiffs on the death of Moolchand. Therefore, it was contended that the 1st plaintiff firm was definitely seeking to enforce a right arising from a contract, namely, the contract of dissolution dated 16-11-1974. It was argued that the 1st plaintiff could not claim any injunction or damages unless reliance was placed on the said contract and hence the suit was barred by Section 69(2).

14. For the purpose of deciding this point, it is necessary to go into the question as to what the legislature meant when it used the words arising from a contract in Section 69(2).

15. In our view, it will be useful in this context to refer to the Report of the Special Committee (1930-31) which examined the Draft Bill and made recommendations to the legislature.

16. Before going into the above Report of the Special Committee which preceded the Partnership Act, 1932, it will be necessary to refer to the case in *CIT v. Jayalakshmi Rice and Oil Mills Contractor Co.* (1971) 1 SCC 280, where this Court refused to refer to this very Report for construing Section 59 of the Partnership Act. But, in our view, that decision is no longer good law as it was clearly dissented on this aspect in the judgment of the Constitution Bench in *R.S. Nayak v. A.R. Antulay* (1984) 2 SCC 183. In a number of later judgments, this Court has referred to the reports of similar committees or commissions (vide G.P. Singh’s *Interpretation of Statutes*, 7th Edn., 1999, pp. 196-97). In the latest case in *Hyderabad Industries Ltd. v. Union of India* notes on clauses were relied upon by the Constitution Bench for understanding the legislative intent. A restricted view was no doubt expressed in *P.V. Narasimha Rao v. State* (1998) 4 SCC 626 (at pp. 691-92) that such reports can be looked into for the purpose of knowing the historical basis or mischief sought to be remedied, but not for construing the provision unless there is ambiguity. Even going by this restricted view, we find that there is considerable ambiguity in Section 69(2) (unlike the English Statute of 1916 and 1985) as to what is meant by the words arising out of a contract inasmuch as the provision does not say whether the contract in Section 69(2) is one entered into by the firm with the defendant or with somebody else who is not a defendant, nor to whether it is a
contract entered into with the defendant in business or unconnected with business. Hence, in our view, it is permissible to look into the Report even for purpose of construing Section 69(2).

17. We may state that it was on the basis of the Report of the Special Committee that the Partnership Act, 1932 was later passed by the legislature. The Committee consisted of Sir Brojendra Lal Mitter, Sir Dinshah F. Mulla, Sir Alladi Krishnaswamy Iyer and Mr Arthur Eggar. Para 16 of the Report states that the Bill seeks to overcome this class of difficulty by making registration optional, and by creating inducements to register which will only bear upon firms in a substantial and fairly permanent way of business. The Committee consisted of Sir Brojendra Lal Mitter, Sir Dinshah F. Mulla, Sir Alladi Krishnaswamy Iyer and Mr Arthur Eggar. Para 16 of the Report states that the Bill seeks to overcome this class of difficulty by making registration optional, and by creating inducements to register which will only bear upon firms in a substantial and fairly permanent way of business. Paras 17, 18 and 19 of the Report are important (see Mulla: Partnership Act, 1st Ed., 1934, p. 167, at pp. 176-77) reads:

Paras 17, 18 and 19 of the Report are important (see Mulla: Partnership Act, 1st Ed., 1934, p. 167, at pp. 176-77) reads:

17. The outlines of the scheme are briefly as follows. The English precedent insofar as it makes registration compulsory and imposes a penalty for non-registration has not been followed, as it is considered that this step would be too drastic for a beginning in India, and would introduce all the difficulties connected with small or ephemeral undertakings. Instead, it is proposed that registration should lie entirely within the discretion of the firm or partner concerned; but, following the English precedent, any firm which is not registered will be unable to enforce its claim against third parties in the civil court; and any partner who is not registered will be unable to enforce his claims either against third parties or against fellow partners.

It will be noticed that the above extract refers to the English precedent which is partly not followed and which is partly followed. We shall be referring to the said English precedent shortly but before we do so, we have also to refer to paras 18 and 19 of the said Report.

18. The Report states in paras 18 and 19 as follows:

18. Once registration has been effected the statement recorded in the register regarding the constitution of the firm will be conclusive proof of the facts therein contained against the partners making them and no partner whose name is on the register will be permitted to deny that he is a partner - with certain natural and proper exceptions which will be indicated later. This should afford a strong protection to persons dealing with firms against false denials of partnership and the evasion of liability by the substantial members of a firm.

19. On the other hand, a third party who deals with a firm and knows that a new partner has been introduced can either make registration of the new partner a condition for further dealings, or content himself with the certain security of the other partners and the chance of proving by other evidence, the partnership of the new but unregistered partner. A third party who deals with a firm without knowing of the addition of a new partner counts on the credit of the old partners only and will not be prejudiced by the failure of the new partner to register.

Similarly, para 23 also refers to those who deal with the firm.

19. The English precedent referred to in para 17, which has been not followed in part but followed in part in drafting Section 69(2) is the one contained by the Registration of Business
Names Act, 1916. Section 7 of that Act refers to penalties for default in registration. As stated in the Report, the penalty part of that Act has not been introduced in India but the provisions of Section 8 creating disabilities in the way of the firm in default is adopted. Section 8 of the above English Act is relevant and it speaks of

(T)he rights of that defaulter under or arising out of any contract made or entered into by or on behalf of such defaulter in relation to the business in respect of the carrying on of which particulars were required to be furnished (see Halsbury Statutes, 3rd Edn., Vol. 37, p. 867).

The above provision clearly signifies that the right that is sought to be enforced by the unregistered firm and which is barred must be a right arising out of a contract with a third-party defendant in respect of the firm’s business transactions.

20. The Business Names Act, 1985 has replaced the above Act of 1916 and Section 4 of the new Act refers to the "civil remedies for breach of Section 4". It provides for dismissal of the action to enforce a right arising out of a contract made in the course of a business if the firm is not registered (see Halsbury Statutes, 4th Edn., Vol. 48, p. 101).

21. The above Report and provisions of the English Acts, in our view, make it clear that the purpose behind Section 69(2) was to impose a disability on the unregistered firm or its partners to enforce rights arising out of contracts entered into by the plaintiff firm with the third-party defendants in the course of the firm’s business transactions.

22. In Raptakos Brett and Co., it was clarified that the contractual rights which are sought to be enforced by the plaintiff firm and which are barred under Section 69(2) are "rights arising out of the contract" and that it must be a contract entered into by the firm with the third-party defendants. Majmudar, J. stated as follows:

A mere look at the aforesaid provision shows that the suit filed by an unregistered firm against a third party for enforcement of any right arising from a contract with such a third party would be barred. (emphasis supplied)

From the above passage it is firstly clear that a contract must be a contract by the plaintiff firm not with anybody else but with the third-party defendant.

23. The further and additional but equally important aspect which has to be made clear is that the contract by the unregistered firm referred to in Section 69(2) must not only be one entered into by the firm with the third-party defendant but must also be one entered into by the plaintiff firm in the course of the business dealings of the plaintiff firm with such third-party defendant.

24. It will also be seen that the present defendants who are sued by the plaintiff firm are third parties to the 1st plaintiff firm. Section 2(d) of the Act defines "third parties" as persons who are not partners of the firm. The defendants in the present case are also third parties to the contract of dissolution dated 16-11-1974. Their mother, Kamla Devi was no doubt a party to the contract of dissolution. The defendants are only claiming a right said to have accrued to
their mother under the said contract dated 16-11-1974 and then to the defendants. In fact, the said contract of dissolution is not a contract to which even the present 1st plaintiff firm or its partners or the 2nd plaintiff were parties. Their father Moolchand was a party and his right to the trademark devolved in the plaintiffs. The real crux of the question is that the legislature, when it used the words "arising out of a contract" in Section 69(2), it is referring to a contract entered into in course of business transactions by the unregistered plaintiff firm with its defendant customers and the idea is to protect those in commerce who deal with such a partnership firm in business. Such third parties who deal with the partners ought to be enabled to know what the names of the partners of the firm are before they deal with them in business.

25. Further, Section 69(2) is not attracted to any and every contract referred to in the plaint as the source of title to an asset owned by the firm. If the plaint referred to such a contract it could only be as a historical fact. For example, if the plaint filed by the unregistered firm refers to the source of the firm’s title to a motor car and states that the plaintiff has purchased and received a motor car from a foreign buyer under a contract and that the defendant has unauthorisedly removed it from the plaintiff firm’s possession, -it is clear that the relief for possession against the defendant in the suit does not arise from any contract which the defendant entered into in the course of the plaintiff firm’s business with the defendant but is based on the alleged unauthorised removal of the vehicle from the plaintiff firm’s custody by the defendant. In such a situation, the fact that the unregistered firm has purchased the vehicle from somebody else under a contract has absolutely no bearing on the right of the firm to sue the defendant for possession of the vehicle. Such a suit would be maintainable and Section 69(2) would not be a bar, even if the firm is unregistered on the date of suit. The position in the present case is not different.

26. In fact, the Act has not prescribed that the transactions or contracts entered into by a firm with a third party are bad in law if the firm is an unregistered firm. On the other hand, if the firm is not registered on the date of suit and the suit is to enforce a right arising out of a contract with the third-party defendant in the course of its business, then it will be open to the plaintiff to seek withdrawal of the plaint with leave and file a fresh suit after registration of the firm subject of course to the law of limitation and subject to the provisions of the Limitation Act. This is so even if the suit is dismissed for a formal defect. Section 14 of the Limitation Act will be available inasmuch as the suit has failed because the defect of non-registration falls within the words "other cause of like nature" in Section 14 of the Limitation Act, 1963. (See Surajmal Dagduramji Shop v. Shrikisan Ramkisan.)

27. For all the reasons given above, it is clear that the suit is based on infringement of statutory rights under the Trade Marks Act. It is also based upon the common law principles of tort applicable to passing-off actions. The suit is not for enforcement of any right arising out of a contract entered into by or on behalf of the unregistered firm with third parties in the course of the firm’s business transactions. The suit is therefore not barred by Section 69(2).

28. For the aforesaid reasons, the appeal fails and is dismissed without costs. We should not be understood as having said anything on the merits of the case for we have confined
ourselves to the allegations in the plaint as we are here only dealing with an application filed by the appellants under Order 7 Rule 11 CPC.

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DISSOLUTION OF A FIRM

Saligram Ruplal Khanna v. Kanwar Rajnath

AIR 1974 SC 1094

[Partnership for a fixed term – dissolution on expiry of the term - section 42, 47]

H.R. KHANNA, J. - This appeal by special leave is directed against the judgment of a Division Bench of the Bombay High Court affirming on appeal the decision of the learned Single Judge whereby a suit for dissolution of partnership and rendition of accounts filed by the two plaintiff-appellants, Saligram Ruplal Khanna and Pessumal Atalrai Shahani, against Kanwar Rajnath defendant-respondent was dismissed. The partnership which was sought to be dissolved carried on business under the name and style of Shri Ambernath Mills Corporation (hereinafter referred to as SAMCO). The property which according to the appellants belonged to the partnership consisted of three mills at Ambernath. One of them was a woollen mill, the other was a silk mill and the third was an oil and leather cloth factory with land, bungalows and chawls attached thereto. In addition to that, there was a bobbin factory at Taradeo with offices at Bombay, Ahmedabad and other places. For the sake of convenience, the above property may be described, as it was done in the High Court, as "Ambernath Mills". Although the case involves a tangled skein of facts, the points which survive for determination in appeal are rather simple.

2. The Ambernath Mills originally belonged to a company called Ahmed Abdul Karim Bros. Private Ltd. The mills were declared to be evacuee property in September, 1951 and the Custodian took over the management of the mills in pursuance of the provisions of the Administration of Evacuee Property Act, 1950. It was then decided that the mills should be managed by displaced persons who had been industrialists in Pakistan. A private limited company was formed of 31 persons for taking over the management of the mills. Rs 25,000 were contributed by each one of those persons in that connection. The appellants and the respondent too were members of the company. Appellant No. 1 and the respondent had migrated at the time of partition from Gujarat in West Punjab. The respondent was a big industrialist and left behind extensive properties in Pakistan. He held verified claim of rupees 23 lakhs in lieu of property left by him in West Pakistan. Appellant No. 1 had a verified claim of Rs 22,000 in respect of residential property left in Pakistan. In addition to that, he had a disputed claim in respect of industrial properties. Appellant No. 2 had a verified claim of about Rs 30,000. The two appellants and the respondent were associated by the Custodian with the management of the Ambernath Mills. By August, 1952 all the members of the private limited company dropped out. It was accordingly decided by the Custodian to grant a lease of the Ambernath Mills to the respondent and the two appellants. On August 30, 1952 two documents were executed. One of the documents was an agreement of partnership between
the two appellants and the respondent for carrying on the business of Ambernath Mills under the lease in the name and style of Shri Ambemath Mills Corporation. The other document was the agreement of lease executed by the Custodian of Evacuee Property as lessor and the appellants and the respondent carrying on business in partnership under the name and style of SAMCO as lessees. The subject-matter of the lease was Ambernath Mills. It was stated in the lease that the lessees had appointed the respondent as their chief representative with full powers of control, management and administration of the entire demised premises. The lease was to be for a period of five years to be computed from the date on which the possession of the demised premises was handed over to the lessees, subject to sooner determination thereof on any of the contingencies provided in Clause 21 or on the breach of any condition on the part of the lessees or in the event of any dispute among the lessees resulting in the closure of the mills. It was also provided that the lessees would purchase and the lessor would sell to the lessees at an agreed price the stocks of raw materials, unsold finished goods, consumer's stores, spare parts, cars and trucks and other moveables which had already been vested in the lessor, as well as three diesel generating sets purchased by the lessor. In the event of any difference on the question of the price, the same was to be fixed through one or more experts. The sale was to be completed within a period of three months from the date of the agreement. The lessees were authorized to take as partner one or more displaced persons who had filed claims under the Displaced Persons Claims Act, 1950 subject to the prior approval of the Government. The agreement also contained a provision for reference of any dispute arising out of the agreement of lease to arbitrators chosen by the parties by mutual consent. The annual rent payable by the lessees was fixed at Rs 6,00,000 payable in four quarterly instalments of Rs 1,50,000 each on or before 30th day of each quarter. The lessees also undertook to deposit or furnish bank guarantee in the sum of Rs 7,00,000 as security for the payment of the value of raw material, unsold finished goods, stores, spare parts and other articles.

According to the partnership agreement executed by the two appellants and the respondent on August 30, 1952, each partner has agreed to contribute a capital of Rs 1,00,000. The amount of Rs 25,000 already paid by each partner to the Custodian was regarded as part payment of the capital of rupees one lakh. Each partner had one-third share in the partnership, but it was provided that the shares would be adjusted by the respondent if fresh partners were taken in the partnership. The respondent was to be the managing partner and was entitled to assign work in the partnership to the two appellants. It was agreed that the appellants were not to interfere directly or indirectly in any manner with the management and control of the business by the respondent. The respondent was also authorised to form a limited liability company for running the business of the partnership with the consent of the Custodian and the appellants agreed to join the company as shareholders on such terms and conditions as might be agreed when such company was formed. The period of the partnership was five years being the period of said lease.

3. The partnership took possession of Ambernath Mills on August 31, 1952. The respondent directed Appellant No. 1 to be in charge of the administration of the mills at Ambemath,
while Appellant No. 2 being an engineer, was placed in charge of the properties, machinery and stores of the mills. The respondent was in overall charge of the concern.

4. It appears that the partnership made some progress in the first few months. The stocks of raw material, finished goods, stores and other moveables which were deemed to have been purchased by SAMCO under the terms of the agreement of lease were in the meantime valued by an auditor appointed by the Custodian at rupees 30 lakhs. The Custodian called upon the partnership in April, 1953 to pay a sum of rupees 7 lakhs or to furnish a bank guarantee for the said amount as provided in the agreement of lease. This payment could not be made by the partnership. There was also difficulty in paying the sixth instalment of the rent. A cheque for Rs 1,50,000 was issued but the same was dishonoured. Subsequently, arrangements were made to pay Rs 1,00,000. An amount of Rs 50,000 out of the sixth instalment remained unpaid.

5. On February 12, 1954 the Custodian served a notice on the respondent and the two appellants to show cause why the agreement of lease should not be cancelled on account of breach of conditions in the matter of the payment of the sixth quarterly instalment of rent and the failure to deposit or furnish bank guarantee for the amount of Rs 7,00,000. A writ petition was thereupon filed by the partnership on February 16, 1954 in the Bombay High Court for quashing the notice issued by the Custodian.

6. In the meantime. Appellant No. 2 sent letter dated February 8, 1954 to the respondent suggesting that his share in the partnership be reduced to 1 anna in a rupee or to such other fraction as the respondent thought fit. A similar letter was addressed by Appellant No. 1. On February 24, 1954 the parties entered into a second agreement of partnership. It was agreed in the new partnership agreement that the share of Appellant No. 1 would be 3 annas and that of Appellant No.2, 1 anna in a rupee. The respondent was to have the remaining 12 annas share. It was also agreed that the two appellants would not have the right, title and interest in the name, capital assets and goodwill of the partnership. It was provided that the new partnership would be deemed to have been formed as from October 1, 1953. Accounts for the period from August 30, 1952 to September 30, 1953 were to be made upon the basis of the partnership agreement dated August 30, 1952 and the profits and losses for that period were to be distributed accordingly. The capital of the partnership was agreed to be arranged by the respondent and he was to be the managing partner in control of the entire affairs of the partnership. He was also to get interest at six per cent on all finances arranged by him. The appellants agreed to carry on such duties in the concern as might be assigned to them by the respondent. The period of the partnership was to be the outstanding period of the lease.

7. The writ petition referred to above filed by the partnership to quash the notice of the Custodian was allowed by a Single Judge of the Bombay High Court on March 31, 1954. On appeal filed by the Custodian, a Division Bench of the High Court as per judgment dated April 13, 1954 set aside the order of the Single Judge and dismissed the writ petition. Certificate of fitness for appeal to this Court was granted by the High Court on May 5, 1954. Stay order was also issued on that day restraining the Custodian from dispossessing the respondent and the appellants from Ambernath Mills. Appeal against the decision of the
Division Bench of Bombay High Court was then filed in this Court. The Custodian of Evacuee Property made an order on May 25, 1954 cancelling the agreement of lease of Ambernath Mills, dated August 30, 1952. The possession of the mills was voluntarily delivered by the partnership to the Custodian on June 30, 1954.

8. Representations were made on behalf of SAMCO to the Minister of Rehabilitation during the later half of 1954 for being allowed to retain Ambernath Mills. A communication was also addressed on December 14, 1954 to the Minister of Rehabilitation suggesting, inter alia, that the claim of the Custodian against the partnership in respect of arrears of rent and the value of raw material and other goods should be referred to arbitration.

13. The respondent was unable to submit to the Central Government compensation claims to the extent of Rs 30,00,000 within three months of the agreement dated August 14, 1957. By April, 1959 he submitted compensation claims to the extent of Rs 20,00,000. A supplemental agreement was executed by the respondent and the President on April 29, 1959. In this agreement the President acknowledged the receipt from the respondent of the sum of Rs 20,00,000 by way of adjustment of compensation claims. The respondent undertook to pay the remaining amount of Rs 30,11,000 and Rs 18,00,000 under the award of Mr Morarji Desai, in all, Rs 48,11,000. It was agreed that the aforesaid amount would be paid by the respondent in seven annual instalments. A second supplemental agreement was executed by the President and the respondent on April 6, 1960, but we are not concerned with that. On April 21, 1960 the grant of the Ambernath Mills was made by the President to the respondent. The same day the respondent executed in favour of the President a mortgage of the Ambernath Mills for the payment of Rs 48,11,000. The sum was payable in seven equal annual instalments. On April 22, 1960 the respondent took possession of Ambernath Mills which had been lying idle for nearly six years since June 30, 1954. On May 7, 1960 the respondent sent a circular letter to all displaced persons whose compensation claims had been transferred to him informing them that possession of the mills had been handed over to him by the Central Government. They were also informed that statement of their accounts was being prepared. One such letter was sent to Appellant No. 1. He also received a statement of account and in September 1960 a cheque for Rs 204 was sent to him by way of interest.

15. It was alleged in the plaint that after the termination of the agreement of lease by the Custodian on May 25, 1954 the two appellants and the respondent assembled and orally agreed not to dissolve the partnership in spite of the termination of the lease. The agreement between the parties was further stated to be that the partnership should be continued for the purpose of acquiring on behalf and for the benefit of the said partnership the properties Ex.1 (Amarrnath Mills) hereto and to exploit the said industries. The respondent was stated to have made a representation that he was acquiring the Ambernath Mills on behalf of the partnership and that the agreement had been executed in the respondent's name because the Central Government desired to deal with only one individual. It was also stated that the respondent had admitted utilisation of a sum of Rs 2,00,000 out of the partnership fund for payment of earnest money. The respondent being a partner, according to the appellants, stood in a fiduciary character vis-a-vis the appellants and was bound to protect their interest. He
could not gain for himself pecuniary advantage by entering into dealings under circumstances in which his interest were adverse to those of the appellants. The properties and profits acquired by the respondent were stated to be for the benefit of the partnership also. In the plaint, as it was initially filed, the appellants prayed for a declaration that the partnership between them and the respondent was still subsisting on the terms and conditions set out in partnership deed dated February 24, 1954 excepting the terms relating to the period of partnership. Prayer was made for a declaration that the Ambernath Mills belonged to the partnership and for rendition of the partnership accounts. By a subsequent amendment prayer was added that the partnership be dissolved from the date of the filing of the suit.

16. The respondent in his written statement denied the alleged oral agreement between the parties on or about May 25, 1954. According to the respondent, the partnership stood dissolved on March 10, 1955 when the Central Government acquired the Ambernath Mills. According further to the respondent, the funds of the partnership were utilized for the payment of various creditors of the partnership and after those payments were made the partnership did not have sufficient funds to pay to the remaining creditors. With regard to the negotiations for the acquisition of the mills, the respondent stated that Appellant No. 1 was aware that Ambemath Mills were being acquired by the respondent for himself alone. The respondent denied that he ever told Appellant No. 1 that the amount of earnest money of Rs 2,00,000 for the purchase of the Ambemath Mills had been paid out of funds belonging to the partnership. Allegation was also made by the respondent that Appellant No. 1 had requested that he might be given some benefit in the nature of appointment of agency in the business of Ambemath Mills. The claim of the appellant for rendition of the accounts was stated to be barred by limitation. In an affidavit filed on January 11, 1961 the respondent stated that in case it was held that there was an oral agreement of partnership between the parties, the same should be taken to have been dissolved.

17. Learned trial Judge held that the appellants had failed to prove that there was an oral agreement between the parties on or about May 25, 1954. It was further held that there was no agreement, express or implied, to form a partnership for acquiring the mills and for carrying on the business thereon. The appellants were held not entitled to have the mills treated as partnership assets by invoking principles enunciated in Section 88 of the Indian Trusts Act, to which reference had been made on behalf of the appellants. The learned Judge also held the appellants's claim for rendition of accounts to be barred by limitation because in his view the partnership had stood dissolved on May 25, 1954 when the agreement of lease was cancelled. In any case, according to the learned Judge, the partnership must be deemed to have been dissolved either on January 14, 1957 when the suit filed by the two appellants and the respondent against the Custodian and the Central Government for permanent injunction was finally dismissed in appeal by a Division Bench of the Bombay High Court or on August 30, 1957 when the period of the lease came to an end.

18. In appeal before the Division Bench the following four contentions were advanced on behalf of the appellants:
(1) that on May 25, 1954 the parties expressly agreed to continue their partnership for acquiring the mills and exploiting them, that a partnership at will thus came into existence between them, and that therefore the mills acquired by the defendant or his agreement with the President of India, dated August 14, 1957 and the subsequent grant by the President of India on April 21, 1960 must be held to be an asset of the said partnership;

(2) that if such an express agreement is held not to have been proved, an implied agreement to the same effect should be inferred from the conduct of the parties and the correspondence between them;

(3) that, even supposing that there was no express or implied agreement as stated above, the rights acquired by the defendant as a result of his agreement with the President of India, dated August 14, 1957 and the subsequent Presidential grant are impressed with a trust in favour of the partnership under Section 88 of the Indian Trusts Act; and

(4) that, even if it is held that the mills are no longer an asset of the partnership, the plaintiffs are still entitled to accounts of the partnership which admittedly existed between them and the defendant for working the mills under agreement of lease dated August 30, 1952.

The learned Judges constituting the Division Bench repelled all the contentions advanced on behalf of the appellants and substantially agreed with the findings of the trial Judge. On the question of limitation, the learned Judges held that the partnership had been dissolved at the latest on November 10, 1955 when all the attempts of the partners to get the Custodian’s order dated May 25, 1954 set aside came to an end with the decision of the Supreme Court. The present suit for rendition of accounts brought on December 20, 1960 more than three years after the date of the dissolution of the partnership was held to be barred by limitation. In the result the appeal was dismissed.

19. In appeal before us Mr S.T. Desai on behalf of the appellants has frankly conceded that he is not in a position to challenge the concurrent findings of the trial Judge and the appellate Bench that the appellants had failed to prove that on May 25, 1954 the parties had expressly agreed to continue the partnership for acquiring the mills and exploiting them. Although Mr Desai indicated at the commencement of the arguments that he would challenge the finding of the Appellate Bench that the rights acquired by the respondent as per agreement dated August 14, 1957 with the President and the subsequent Presidential grant are impressed with trust in favour of the partnership under Section 88 of the Indian Trusts Act, no arguments were ultimately advanced by him on that score. Mr Desai, has, however, challenged the finding of the trial Judge and the Appellate Bench that no implied agreement as alleged by the appellants could be inferred from the material on record. The main burden of the arguments of Mr Desai, however, has been that the appellants were entitled to the accounts of the partnership which admittedly existed between the parties as per partnership agreements dated August 30, 1952 and February 24, 1954. According to Mr Desai, there had been no dissolution of the firm of the parties prior to the institution of the suit and the appellants’s suit for rendition of accounts was not barred by limitation. The High Court, it is urged, was in error in holding to the contrary. The above contentions have been controverted by Mr Cooper on behalf of the respondent and, in our opinion, are not well-founded.
We may first deal with the question as to whether the implied agreement as alleged by the appellants can be inferred from the material on record. In this respect Mr Desai has submitted that the appellants no longer claim any interest in the ownership of Ambernath Mills which now vests in the respondent. It is, however, urged that an agreement can be inferred from the conduct of the parties that Ambernath Mills were to be run by the respondent in partnership with the appellants, even though the ownership of the same might vest in the respondent. In this connection we find that no case of such an implied agreement was set up in the trial Court, either in the plaint or otherwise, nor was such a case set up in appeal before the Division Bench. What was actually contended was that the agreement was for acquiring the mills as an asset of the partnership. The above stand of the appellants could plainly be not accepted when one keeps in view the agreement of lease dated August 30, 1952 as well as other documents on record. The said agreement of lease shows that Ambernath Mills would become the absolute property not only of the appellants and the respondent but of all persons who were to be associated with the lessees in the ownership of the proprietary interest in proportion to the total compensation payable to each of them. The agreement of lease further contemplated that the lessee rights of the two appellants and the respondent were to be distinct from the proprietary interest in the demised premises and that the lessees were at liberty, in spite of the transfer of proprietary interest, to continue the lease for the unexpired residue of the term on the terms and conditions of the lease and payment of rent prescribed thereunder. The respondent submitted representation on August 9, 1954 on behalf of the SAMCO to the Custodian for the restart of the mills and along with it the respondent sent copies of letter of authority and particulars of verified claims of 30 displaced persons. It is implicit in the representation that in case Ambernath Mills was transferred, the same would vest in all the 30 displaced persons whose claims were submitted.

There are two documents which run counter to the stand taken on behalf of the appellants in this Court that there was an implied agreement that in case the respondent acquired the ownership of the mills, the mills would be worked by the respondent in partnership with the appellants. One of those documents is agreement dated September 20, 1957 which was signed by the Appellant No. 1 and the respondent a day before the respondent executed bond in favour of that appellant in view of the fact that Appellant No. 1 agreed to have his claim compensation amounting to Rs 6,994 adjusted towards the price of Amberth Mills. It was stated in the agreement dated September 20, 1957 that the respondent was contemplating the formation of joint stock company to own, run and manage the mills and it was agreed between the parties that in the event of such company being formed, Appellant No. 1 would have the option to purchase shares of the said company to the extent of 50 per cent of the amount of the adjusted claim compensation. In case the option was exercised in favour of the purchase of the shares of the company, the respondent was to ensure that the said shares would be allotted to Appellant No. 1 at par. It was further agreed that if the shares applied for or any proportion thereof were not allotted to Appellant No. 1 by the said company, the respondent would not in any way be liable to Appellant No. 1 on that account. In the bond the respondent agreed to pay to Appellant No. 1 interest at the rate of six per cent on the amount of compensation from the date of the adjustment of the Appellant No. 1's claim compensation. Had Appellant No. 1 any interest in the Ambenath Mills which were being
acquired by the respondent there could arise no occasion for the execution of the agreement dated September 20, 1957 and the bond dated September 21, 1957. All that was agreed by the respondent in those two documents was that in case he promoted a company for owning, running and managing of the Ambernath Mills, Appellant No. 1 would get a share of the value of half of his claim compensation of Rs 6,994. The said amount when compared to the price of Ambernath Mills was wholly insignificant. No question could arise of the respondent borrowing money from Appellant No. 1 for payment of price of the mills, in case the acquisition of the mills was for the benefit of the respondent as well as the appellant. It may also be stated that the interest on account of the above compensation was duly paid by the respondent to Appellant No. 1.

22. Another document which has a bearing in the above context is letter dated December 18, 1959 which was addressed by Appellant No. 1 to the Collector of Bombay in connection with the recovery of arrears of sales tax. Appellant No. 1 in that letter stated that the responsibility for the payment of such arrears of sales tax was that of the respondent and Appellant No. 1 was no more in picture. The above letter shows that Appellant No. 1 repudiated his liability for the payment of the sales tax by disclaiming his connection with the business in question.

24. We are, therefore, of the view that no inference of the implied agreement referred to by Mr Desai can be drawn from the material on record.

25. So far as the question is concerned as to whether the claim for rendition of accounts was within time, we find that according to Clause 16 of the partnership deed dated August 30, 1952 the period of partnership was fixed at five years, being the period of lease. Clause 17 of the deed of partnership dated February 24, 1954 provided that the period of partnership shall be the outstanding period of such lease. The possession of Ambernath Mills under the agreement of lease was delivered on August 31, 1952. The period of five years of the lease was thus to expire on August 30, 1957. As the partnership was for a fixed period, the firm would in normal course dissolve on the expiry of the period of five years on August 30, 1957. No agreement between the partners to keep the firm in existence after the expiry of the fixed term of five years has been proved.

The above provision (of section 42) makes it clear that unless some contract between the partners to the contrary is proved, the firm if constituted for a fixed term would be dissolved by the expiry of that term. If the firm is constituted to carry out one or more adventures or undertakings, the firm, subject to a contract between the partners, would be dissolved by the completion of the adventures or undertakings. Clauses (c) and (d) deal with dissolution of firm on death of a partner or his being adjudicated insolvent.

26. It was indicated in the agreement of partnership that the period of partnership had been fixed at five years because that was the period of the lease of Ambernath Mills. The lease, however, ran into rough weather. On February 12, 1954 the Custodian served notice on the respondent and the two appellants to show cause why the agreement of lease should not be cancelled in accordance with the terms of that agreement on account of the breach of conditions in the matter of payment of instalment of rent and the failure of the respondent and
the appellants to deposit or furnish bank guarantee for the amount of Rs 7,00,000. The respondent and the appellants challenged the validity of the above notice by means of a writ petition and, though they succeeded before a Single Judge, the Appellate Bench of the Bombay High Court upheld the validity of the notice. On May 25, 1954 the Custodian cancelled the lease of Ambernath Mills and on June 30, 1954 got possession of the mills. The respondent and the appellants assailed the decision of the Appellate Bench of the Bombay High Court in this Court, but this Court also took the view as per judgment dated November 10, 1955 that there was no legal infirmity in the notice for the termination of the lease issued by the Custodian. After the above judgment of this Court, whatever hope or expectation the partners of SAMCO had of running Ambernath Mills on lease under the agreement of lease dated August 30, 1952 came to an end and were extinguished.

27. In the meantime, as already stated earlier, the possession of Ambernath Mills was handed over by the partners of SAMCO to the Custodian on June 30, 1954. On March 10, 1955 the Central Government issued notification under Section 12 of the Displaced Persons (Compensation and Rehabilitation) Act, 1954 for acquiring the mills. The mills were then advertised for sale. The partners of SAMCO having been thwarted for good in their efforts to get back the mills on lease now made an effort to acquire the ownership of the mills in accordance with Clauses 17 to 21 of the agreement of lease. Suit was accordingly brought by the respondent and the appellants for permanent injunction restraining the Central Government and the Custodian from selling the Ambemath Mills to any person other than the partners of SAMCO. The suit was dismissed by the City Civil Court and the appeal filed by the partners of SAMCO too was dismissed by a Division Bench of the Bombay High Court on January 14, 1957. The Division Bench held that the agreement of purchase contained in Clauses 17 to 21 of the agreement of lease was indefinite and vague and such agreement of sale was not capable of specific performance. It was further held that in view of notification dated March 10, 1955, the Central Government acquired the mills free from all encumbrances. The rights of the partners of SAMCO which were in the nature of an encumbrance were held to be no longer enforceable. No appeal was filed against the above decision of the Bombay High Court. As such, the aforesaid judgment became final. Any expectation which the partners of SAMCO could have of acquiring the ownership of Ambernath Mills under Clauses 17 to 21 of the agreement of lease was also thus dashed to the ground.

30. Reference has also been made on behalf of the appellants to the consent given by the respondent on behalf of SAMCO on November 13, 1957 to the award of Rs 18,00,000 by Mr Morarji Desai in favour of the Custodian against SAMCO. It is urged that this document would go to show that the firm of SAMCO had not been dissolved before that date. We are unable to agree. The arbitration proceedings had been started as a result of application under Section 20 of the Arbitration Act filed on April 21, 1955 when SAMCO was in existence and was a running concern. The arbitration proceedings related to a claim of the Custodian of Rs 3,00,000 on account of the price of stocks of raw material, stores and other moveables as well as about the arrears of rent. Counter-claim had also been made by SAMCO against the Custodian for a sum of Rs 17,67,080 as per written statement dated December 18, 1956 filed
in arbitration proceedings. The consent which was given by the respondent on November 13, 1957 was with a view to get the dispute between SAMCO with the Custodian finally settled. This was a necessary step for the purpose of winding up the affairs of SAMCO and to complete transaction of arbitration proceedings which had been begun but remained unfinished at the time of dissolution. According to Section 47 of the Indian Partnership Act, after the dissolution of a firm the authority of each partner to bind the firm, and the other mutual rights and obligations of the partners, continue notwithstanding the dissolution, so far as may be necessary to wind up the affairs of the firm and to complete transactions begun but unfinished at the time of the dissolution, but not otherwise. The word ‘transaction’ in Section 47 refers not merely to commercial transaction of purchase and sale but would include also all other matters relating to the affairs of the partnership. The completion of a transaction would cover also the taking of necessary steps in connection with the adjudication of a dispute to which a firm before its dissolution is a party. The legal position in this respect has been stated on page 251 of *Lindley on Partnership*, 13th Edn. as under:

Notwithstanding a dissolution each partner can pay, or receive payment of, a partnership debt; for it is clearly settled that payment by one of several joint debtors, or to one of several joint creditors, extinguishes the debt irrespective of any question of partnership. So, again, it has been held that a continuing or surviving partner may issue a bankruptcy notice in the firm name in respect of a judgment obtained before the dissolution, and that notice to him of the dishonour of a bill of exchange is sufficient, and that he can withdraw a deposit or sell the partnership assets, or pledge them for the purpose of completing a transaction already commenced, or of securing a debt already incurred, or the overdraft on the partnership current account at the bank.

31. The proposition, in our opinion, cannot be disputed that after dissolution, the partnership subsists merely for the purpose of completing pending transactions, winding up the business, and adjusting the rights of the partners; and for these purposes, and these only, the authority, rights, and obligations of the partners continue (see page 573 of *Halsbury’s Laws of England*, 3rd Edn., Vol. 28). We would, therefore, hold that the consent given by the respondent on November 13, 1957 to the award of Mr Desai would not detract from the conclusion that the firm of the parties stood dissolved on the expiry of the fixed period of partnership, viz., August 30, 1957.

32. The proposition of law referred to by Mr Desai that a dissolution does not necessarily follow because a partnership has ceased to do business would not be of any material help to the appellants because we are not basing our conclusion of the dissolution of the firm of the parties upon the fact that the partnership had ceased to do business. On the contrary, we have arrived at the above conclusion in accordance with the principle of law that a firm constituted for a fixed term shall stand dissolved, in the absence of a contract to the contrary, on the expiry of that term.

33. Our attention has also been invited to the correspondence between Appellant No. 1 and the respondent during the period from June to September, 1957. These letters reveal that Appellant No. 1 entertained hopes and expectations of deriving some benefit in case the respondent succeeded in acquiring the Ambemath Mills. The exact nature of the benefit was
not, however, specified in the letters. The respondent in his replies while not belying those hopes and expectations took care not to make any commitment. After, however, the respondent succeeded in acquiring the mills, there developed a coolness in his attitude towards Appellant No. 1. This circumstance must necessarily have caused disappointment and disillusionment to Appellant No. 1. The respondent, it seems, kept some kind of carrot dangling before Appellant No. 1 during the delicate stage of his negotiations with the Government for the acquisition of the mills lest Appellant No. 1 did something to sabotage those efforts. After acquisition of the mills by the respondent his attitude changed and he gave a cold rebuff to Appellant No. 1. The above conduct of the respondent may have a bearing on the question of the award of costs, but it cannot affect our decision on the point as to whether the suit is within limitation or not.

* * * * *
According to the plaintiff-appellant he had a mill at Nojai where he was carrying on his milling business. The defendants represented to him that if the milling business was carried on in partnership with them then the plaintiff would make large profits and on that representation and assurance he entered into a partnership with the defendants on or about January 10, 1948. The partnership business, to quote the plaintiff, commenced from about the middle of January 1948, and the work continued up to September 10, 1948. Some disputes arose and on or about November 6, 1946 Murzamull Agarwal told the plaintiff that the business in partnership was no longer possible. In September 1951, the plaintiff instituted the present suit for dissolution of partnership and accounts out of which the present appeal arises. In Para 13 of the plaint it was averred that the partnership in question had stood dissolved on and from November 6, 1948.

Besides other legal objections taken by the defendants in their written statement it was pleaded that there was no partnership between the parties and that there was only a milling agreement, dated January 11, 1948 between them under which the defendants were getting paddy milled in the plaintiff’s rice mills for which the dues had all along been paid to the plaintiff in accordance with the milling contract. This plea gave rise to issue no. 1. The trial court decreed the suit holding issue no. 1 in favour of the plaintiff.

On appeal, the High Court had come to the conclusion that there was no partnership between the parties and dismissed the plaintiff’s suit.

I.D. DUA, J. - 5. Before us Shri Nag, the learned counsel for the appellant, has very fairly and frankly conceded that there is no written instrument of partnership. According to him the partnership was oral and was entered into some time on or about January 10, 1948. We have on the record a written agreement between the parties Ex. B, dated January 11, 1948. This agreement purports to be a milling hire arrangement between Santi Ranjan Das Gupta, proprietor of Das Gupta Rice Mills, Nojai, Nowgong (plaintiff-appellant in this litigation) and Messrs. Dasuram Murzamull of Gauhati (defendants-respondents). According to this agreement, the plaintiff who was not able to run the mill business for himself entered into a milling hire arrangement with the defendants on the following conditions:

1. An amount of as. 8 (annas eight only) per maund of paddy milled by me will be paid to me by Messrs. Oasuram Murzamull and this would include boiling, drying, milling, storing and loading in wagons of the rice produced in the mills. All the running expenses of the mills including cost of labour, lubricants, spare parts etc., will be borne by me.
2. The stock of paddy maintained by Messrs. Dasuram Murzamull in my mills will be absolutely theirs and I shall have no claim on it or any rent for it. Creditors of mine will have also no claim for the paddy or rice or products thereof etc.

3. The milling charges will be payable to me either daily or weekly as may be demanded at the rate of eight annas per maund of paddy, rice, khudi, gura, husks etc., will all go to M/s Oasuram Murzamull.

4. That this milling arrangement will continue till 31st Chaitra 1364 B. S.

6. According to Shri Nag this agreement is merely a paper transaction designed to defeat the plaintiff’s creditors because he was in a bad financial position . . . Reliance in support of the plaintiff-appellant’s version was placed on the evidence of the plaintiff himself as P. W. 1. According to his testimony he had in Baisakh 1363 B. S. Entered into a partnership with Bijali Das Gupta, Renubora Das Gupta, Mihir Das Gupta and that the partnership was registered as such. The business, according to him, was being run even on the date of his evidence (December 9 1957) under the same name and style. In 4948 the defendant firm entered into a partnership business with the plaintiff when he was the sole proprietor of his mill, Murzamull Babu in his capacity as managing partner of the defendant firm having entered into the partnership on behalf of that firm. There was, however, no written document executed for this partnership. Information regarding this partnership was sent to the bank concerned and to the Deputy Director of Procurement, Nowgong, orally. This witness had to admit that there was no written proof of the partnership nor was there any written record with respect to such partnership. The partnership was dissolved because the defendants’ men had left the mill with their stock when the plaintiff was out of Assam between August and October, 1948. Reference was also made to the testimony of Nirmal Chandra Basu (P. W. 2) who claims to have been an employee of the Assam Bank in 1948. According to him in the middle of January, 1948 he learnt that the plaintiff and the defendant had entered into a partnership. According to his evidence also the factum of the partnership was never reduced to writing. The other circumstances on which Shri Nag mainly placed reliance in support of the existence of the partnership are that the rate charged for milling by the plaintiff were much lower than the prevailing market rates and that the loading and unloading charges were also undertaken by the plaintiff. These circumstances, according to the learned counsel suggest that the milling agreement was merely a device or a paper transaction and that the real arrangement between the parties was that they were to do their business in partnership.

7. In our opinion, the evidence to which our attention was drawn by Shri Nag is wholly inadequate for coming to the conclusion that the plaintiff-appellant and that defendant firm had entered into a contract of partnership as suggested on behalf of the plaintiff. It is inconceivable that the parties should have entered into an oral agreement of partnership without retaining any record of its terms and conditions. This is not the normal course of business. It is equally inconceivable that the partnership business should have maintained no accounts of its own, which would be open to inspection by both parties even though kept secret from the rest of the world. Absence of such accounts is conceded by the appellant before us. Maintenance of separate accounts by the plaintiff and the defendant firm as
suggested by the appellant is no substitute for the maintenance of the accounts of the partnership business as such, accessible to both parties and, indeed, keeping only separate accounts by the parties would tend to negative rather than support the plea of partnership. Some of the other features which go against the appellant's plea are: (1) no account of the partnership was opened with any bank and mere oral information with respect to the newly created partnership was sent to the bank and (2) no written intimation was conveyed to the Deputy Director of Procurement with respect to the newly created partnership, only oral information having been sent to him. These circumstances further render the story of the partnership more doubtful.

8. Shri Nag submitted that the trial court had on a consideration of the entire material come to a positive finding on issue No. 1 and that the High Court was, therefore, not justified in reversing it. The trial court, in our view, was influenced by considerations which are wholly inadequate for supporting the conclusion that the parties had entered into a partnership. According to the trial court the terms of partnership as reproduced in the plaint are reasonable whereas the terms contained in Ex. B suggest that the plaintiff had agreed to charge very low rates for milling the defendants' paddy and he had also undertaken expenses for loading and unloading, which unfairly increased the financial burden on him without any corresponding remuneration. The trial court has also more than once made a reference to the likelihood of the parties making concealed profits from the partnership business and this in its view accounted for the absence of written deed of partnership. This reasoning is, in our view, too thin to satisfactorily explain or justify the extraordinary circumstance of complete absence of accounts even for the private use of the parties. Whenever the parties try to conceal the real nature of an agreement of partnership between them they almost invariably, in their own self-interest, take good care to have in their respective possession written records of their rights and liabilities as also of their partnership business dealings. They further try to keep full record of the accounts of the business. This conduct is guided by the ordinary rules of prudence which govern normal human behaviour. Those accounts no doubt may not be described or treated as official accounts of the partnership maintained in the ordinary course of business. They are intended to be kept strictly and exclusively for the personal and private use of the parties themselves. In the present case it is admitted on both sides that there is no such written record nor were any such accounts ever maintained by the parties for their own exclusive use.

9. The High Court, in our opinion, adopted a correct approach to the case, giving due weight to the absence of written records. On proper consideration of all circumstances of the case, it came to the correct conclusion that there was no reliable evidence on which the existence of partnership could be founded. We find no reason to disagree with this view. The appeal accordingly fails and is dismissed with costs.

* * * * *
M/s. Juggilal Kamlapat v. M/s. Sew Chand Bagree

AIR 1960 Cal. 463

[Dissolution of firm – No public notice under section 45(1)]

G.K. MITTER, J. - This is an application in execution of a decree on an award made by the Bengal Chamber of Commerce dated June 14, 1950 on a dispute between Juggilal Kamlapat, the award holders, and Sew Chand Bagree, against whom the award was made. The decree was passed on May 28, 1951 for a total sum of over Rs. 31,000/-. (2) The award was given in respect of a contract entered into between Sew Chand Bagree and Juggilal Kamlapat on Sep. 25, 1948. The application is being opposed by Manik Chand Bagree and Moti Chand Bagree whose case is that the firm of Sew Chand Bagree was dissolved in Oct. 1945 by mutual consent of its partners and that thereafter their brother Jankidas Bagree started a new business in the name of Sew Chand Bagree with which they the other brothers had no concern. Sew Chand Bagree the individual, was the father of the three persons already mentioned. From a copy of entries in the Register of firms maintained by the Registrar of Firms, West Bengal, it appears that the business of Sew Chand Bagree was established in the year 1924, that it was formerly a joint Hindu family business and that the partnership firm was started on October 28, 1933. The three partners shown in the said record are Manik Chand Bagree, Moti Chand Bagree and Jankidas Bagree. This document does not show that there has been any change in the constitution of the firm ever since its inception. It is contended by the award holders that no change in the constitution of the firm having been notified an no public notice of the dissolution of the firm having been given under the provision of the Indian Partnership Act, all the partners continue to be liable for any act done by any of them. The award holders further do not admit that there was a dissolution of the firm in the year 1945 as alleged by the Bagrees. On the evidence adduced I must hold that there was a dissolution of the firm. On this finding the question is whether sub-section (1) of Sec. 45 of the Partnership Act is brought into play or whether the point is covered by the proviso to the said sub-section.

(8) Mr. Tiberwalla, Counsel for the Juggilal Kamlapat, argued that it had not been established by the evidence that the firm of Sew Chand Bagree had ever been dissolved. He submitted that no attempt had been made to get any alteration in the constitution of the firm noted in the records of the Registrar of Firms up to the year 1959 although dissolution is alleged to have taken place in the year 1945. Counsel submitted that the Bagrees had not examined any disinterested third party to show that the dissolution, if any, was known to outsiders, that no advertisement of the dissolution had appeared in any newspaper, that there was no evidence of the issue of any circular with regard to it and that no broker other than Sriratan Damani had been examined. He relied strongly on the absence of the books of account of Sew Chand Bagree and contended that the same, if produced, would have established that the firm had never been wound up. There is certainly some force in these contentions, specially the comment on the non-production of the books of account. But I must hold on a consideration of the entire evidence adduced that the firm had been dissolved.
The deed of agreement prepared by Messrs. Dutt and Sen and signed by the Bagree brothers, the issue of the trade license by the Corporation of Calcutta, the opening of the account with Hindustan Commercial Bank Ltd., and the letter written to Bank of Baroda Ltd., all corroborate the oral testimony adduced on behalf of the Bagrees. The contracts of Juggilal Kamlapat with Manik Chand Bagree in a name and style other than Sew Chand Bagree tend to prove the disruption in the family. On the evidence as a whole I accept the case of the Bagrees that the firm of Sew Chand Bagree had come to an end in the year 1945.

(13) The registration of the firm under the Act is not compulsory but unless the firm is so registered it cannot file a suit to enforce a right arising out of a contract. The application for registration must comply with the provisions of Sec. 58 of the Act. Registration is effected under Sec. 59. Provision is made for recording of (a) alterations in the firm's name, (b) changes in the names and addresses of partners, (c) changes in and dissolution of the firm under Secs. 60 and 63 of the Act. Under Sec. 68 any statement, intimation or notice recorded or noted in the Register of Firms shall, as against any person by whom or on whose behalf such statement, intimation or notice was signed, be conclusive proof of any fact therein stated. Under Sec. 72 of the Act a public notice under the Act relating to the retirement of a partner from the registered firm or to the dissolution of a registered firm etc., has to be given by notice to the Registrar of Firms and by publication in the local official Gazette and in at least one vernacular newspaper circulating in the district where the firm to which it relates has its place or principal place of business. For the proper interpretation of S. 45 of the Partnership Act, Mr. Tibrewalla referred me to a judgment of Garth C. J., in _Chundee Churn Dutt v. Eduljee Cowasjee Bijnee_ [ILR 8 Cal 678]. This judgment turned on the interpretation of Sec. 264 of the Contract Act of 1872 which provided:

Persons dealing with a firm will not be affected by dissolution of which no public notice has been given unless they themselves has notice of such dissolution.

(19) Section 45 sub-s. (1) of our Act without the proviso is no doubt somewhat similar to Sec. 36 sub-section (1) of the English Act but the provisions of the two Acts are not identical. Under Sec. 45 notwithstanding the dissolution of a firm the liability of the partners continues until public notice is given of the dissolution in respect of any act which would have bound the firm if done before the dissolution. But the proviso to this sub-section restricts the scope of it considerably and exempts the estate of a partner who dies or who is adjudicated an insolvent or of a partner, who not having known to the person dealing with the firm to be a partner, retires from the firm if the act is done after the date on which he ceases to be a partner. Under Sec. 36(1) of the English Act an apparent member continues to be liable to an outsider unless the latter has notice of the change in the firm. But even if there be no such notice a partner who was not known to the outsider as such ceases to be liable after his retirement under Sub-sec. (3) of Sec. 36. In the Indian Act the proviso replaces sub-sec. (3) of the English section. The only difference between Sec. 36 sub-sec. (1) of the English Act and Sec. 45 sub-sec. (1) of the Indian Act seems to be that under the former any one who is an apparent member continues liable while...
under the latter any one who was a member, whether apparently so or not remains liable until public notice of dissolution as given. But the proviso to the Indian Section cuts down the liability in the case of a partner who was not known as such to the person seeking to make him liable. Except for the use of the qualifying word "apparent" in sub-sec. 1 of Sec. 36 of the English Act the effect seems to be the same.

(20) "The proper function of a proviso said Lord Macmillan in *M. and S. M. Rly. Co. v. Bazwada Municipality* [AIR 1944 PC 71]. "Is to except and deal with a case which would otherwise fall within the general language of the main enactment, and its effect is confined to that case. But for the proviso the dissolution of a firm would not have affected the liability of a partner who had gone out of it or of a dormant partner until public notice of the dissolution was given. The effect of the proviso is to except the case of a partner who was not known to the person dealing with the firm to be a partner and who has retired from the firm without any public notice of dissolution being given.

(21) It was admitted by Rameshwar Agarwalla that he did not know Manik Chand Bagree and Moti Chand Bagree to be partners of Sew Chand Bagree until six months or a year ago and even this he came to know only from a copy of the entries made in the records of the Register of Firms. These persons, therefore, were not known to Juggilal Kamlapat to have been partners of the firm and they had gone out of the firm before the contract in this case was entered into. Clearly the proviso is attracted to the facts of this case and Manik Chand Bagree and Moti Chand Bagree cannot be made liable for payment of the decretal amount.

(22) Mr. Tibrewalla argued that the exception, if any, is limited to the case of a partner who "retries from the firm" and does not apply to the case of a dissolution of the firm whereby the relationship of all the partners inter se is put an end to for ever. In my view, this contention has no substance because the case of a retiring partner is expressly provided in Sec. 32 of sub-sec. (3) and the proviso to the said sub-section. It certainly would have been better if instead of the words "retires from the firm", the legislature had used the expression "severs his connection with the firm". Probably the actual words used have been taken from the English Act. Without entering into speculation of this kind it is not difficult to find out what the legislature intended. It appears to me, however, that the contingencies of death, insolvency, retirement and even expulsion of a partner having already been provided for by the Indian Act in Secs. 35, 34, 32 and 33 of the Act respectively, Sec. 36 might well have dealt with the case of a dissolution of firm simpliciter.

(23) The fact that the entries in the record of the Registrar of Firms still show that Manik Chand Bagree and Moti Chand Bagree, does not help the decree-holder in this case. If the decree-holder had adduced evidence to the effect that these records had been scrutinized by it before the transaction was entered into the position might have been different.

(25) The application will, therefore, be dismissed with costs as against Moti Chand Bagree and Manik Chand Bagree. There will be an order in terms of prayer (a) as against Jankidas Bagree.

* * * * *
Sharad Vasant Kotak v. Ramniklal Mohanlal Chawda

(1998) 2 SCC 171

Section 46

K. VENKATASWAMI, J. - 2. This appeal by special leave has arisen under the following circumstances: The appellants are the partners of a suit firm called M/s Paramount Builders. The partnership was entered into on 29-11-1979 with (seven) individuals as partners.

3. The said partnership firm was registered on 15-12-1980 under Registration No. 158675 with the Registrar of Firms. On 6-5-1986, Shri Mohanlal Hinji Chawda, a partner of the firm (Sr. No. 6 above) died and in his place, his widow Smt Jijiben Mohanlal Chawda was admitted as a partner in the firm. After the admission of the said Smt Jijiben Mohanlal Chawda, another deed of partnership was made consisting of the six old partners and the newly admitted partner Smt Jijiben Mohanlal Chawda. As a matter of fact, the induction of the new partner was not brought to the notice of the Registrar of Firms by forwarding the required particulars. It is on record that still later on 3-11-1992 another partnership deed was brought into existence consisting of the same partners. It is also on record that yet another partner Smt Hemkuver B. Kotak (S. No. 4 above) died in September 1994. The fact of death of this partner also was not intimated to the Registrar of Firms. While so, the 1st respondent gave a notice of dissolution of the firm to the appellants and also filed a suit for the dissolution of the partnership firm bearing Suit No. 5016/94 on 15-12-1994 in the High Court of Judicature at Bombay on the original side. Initially in the plaint, the constitutional validity of Section 69(2-A) of the Indian Partnership Act (hereinafter called the Act), as amended by the Maharashtra Act, was not raised. The 1st respondent moved a Chamber Summons No. 301 of 1997 seeking permission of the Court to carry out certain amendments to the plaint. Briefly, the amendments sought were that subsequent changes and/or modifications in the partnership deed of M/s Paramount Builders under the deed of partnership dated 20-10-1986 and also in the deed of partnership dated 3-11-1992 are merely in the nature of changes and/or modifications which do not affect registration of the said firm of M/s Paramount Builders, as required under the Act, for entitling a partner to institute a suit for reliefs against the partners on dissolution of firms and alternatively, the other amendment sought was to challenge the vires of Section 69(2-A) of the Act as in force in State of Maharashtra.

4. The amendment sought was seriously opposed by the appellants inter alia contending that the suit as filed was not maintainable and, therefore, the amendment cannot be allowed. In other words, according to the appellants on and from 20-10-1986 when a new partnership deed was made, the registration already given to the firm ceased to have validity and the partnership as at present must be deemed to be an unregistered one and, therefore, the suit was hit by Section 69(2-A). It was also contended that without impleading the State of Maharashtra and the Union of India, the vires of Section 69(2-A) in the Partnership Act cannot be challenged. The learned trial Judge accepting the objections raised by the appellants found that Section 69(2-A) of the Act creates a bar on the threshold of the filing of the suit for the relief covered in the suit and the very suit filed by the plaintiff was incompetent. That
being the position, the application for amendment could not be permitted. Consequently, the application was rejected.

5. Aggrieved by the rejection of the amendment application, the first respondent preferred an appeal to the Division Bench of the High Court in Appeal No. 509 of 1997.

6. The appellate court was of the view that the registration of the firm continues to be in force notwithstanding any reconstitution of the firm and even when dissolution takes place, the registration of the firm continues. The Division Bench further held that Section 69(2-A) requires the registration of a firm and it does not require a fresh registration each time a reconstitution or dissolution of the continuing firm takes place. After finding that the suit filed by the first respondent was not hit by Section 69(2-A), the Division Bench held as follows:

The proposed amendment consists of two parts. The first part is only a factual aspect which has been sought to be introduced in order to demonstrate that the bar under Section 69(2-A) is not attracted. There is no reason as to why such an amendment should not be granted. The second part of the amendment pertains to the constitutional challenge of the validity of Section 69(2-A). As we have already taken a view that Section 69(2-A) is not attracted, the question of challenge does not survive and, therefore, it is not necessary to grant the amendment containing constitutional challenge.

7. Ultimately the appellate court allowed the appeal and permitted the amendment only regarding the factual portions and not regarding the constitutional validity of Section 69(2-A).

9. In this appeal, the following substantial question of law arises for our consideration:

Whether on the facts of this case the suit for dissolution and account of partnership is hit by Section 69(2-A) of the Act as amended in the State of Maharashtra?

(2-A) No suit to enforce any right for the dissolution of a firm or for accounts of a dissolved firm or any right or power to realise the property of a dissolved firm shall be instituted in any court by or on behalf of any person suing as a partner in a firm against the firm or any person alleged to be or to have been a partner in the firm, unless the firm is registered and the person suing is or has been shown in the Register of Firms as a partner in the firm:

Provided that the requirement of registration of firm under this sub-section shall not apply to the suits or proceedings instituted by the heirs or legal representatives of the deceased partner of a firm for accounts of a dissolved firm or to realise the property of a dissolved firm.

11. Before proceeding further, we remind ourselves that we are concerned with a suit filed by a partner for dissolution and accounts. No third-party rights or liabilities are involved in the present suit filed by Respondent 1.

12. Undoubtedly counsel on both sides addressed arguments covering larger questions. But we propose to confine ourselves strictly to the facts of the case and decide the controversy
without touching upon the larger issues or connected issues arising out of the pleadings because the maintainability of the suit is the sole issue based on Section 69(2-A) of the Act.

13. Section 69(2-A) (extracted above) requires two conditions before a partner can sue for dissolution of a firm and for accounts:

1. The firm must be registered.

2. The person suing is or has been shown in the register of firms as partner in the firm.

14. It is not in dispute that the partnership as entered into under a deed dated 28-11-1979 was duly registered and a certificate of registration was granted. It is also an admitted fact that the plaintiff, first respondent herein, was one of the founder partners under the deed dated 28-11-1979 and his name did find a place in the register of firms as a partner and there is nothing to show that at any point of time, his name has been removed from the register of firms. We have seen that on the death of one of the partners, his widow was inducted into the partnership and a deed was entered into on 20-10-1986, repeating almost all the clauses in the partnership deed dated 28-11-1979 except for consequential changes necessitated by the induction of a new partner in the place of the deceased partner.

15. It is the contention of the learned Senior Counsel, Mr Nariman, that when the new partner was inducted under the partnership deed dated 20-10-1986 in the place of the deceased partner, the firm registered under the partnership deed dated 28-11-1979 ceases to be on the records of Registrar of Firms and, therefore, the registration already given will not enure to the benefit of the partnership entered on 20-10-1986. If that be so, according to Mr Nariman, learned Senior Counsel, the conditions imposed by Section 69(2-A) are not satisfied and, therefore, the suit as filed was not maintainable.

16. In support of his argument, he placed strong reliance on the expression ‘partnership’ as defined in Section 4 of the Act. It is the contention of Mr Nariman that bearing in mind the definition in Section 4 of the Act, the partners including the second respondent will collectively be a firm and that firm is not registered inasmuch as the name of the second respondent does not find a place in the register of Registrar of Firms. Therefore, the learned Single Judge was right in holding that the suit was not maintainable at the threshold. According to the learned Senior Counsel, the mere fact that the plaintiff’s name find a place in the register of Registrar of Firms is not sufficient to maintain the suit when admittedly one of the partners name (second respondent’s name) was not shown in the register of Registrar of Firms. He also contended that a comparison of language employed in Sections 31 and 32 of the Act will show that whenever a partner is inducted into an existing firm, the old firm ceases to exist and an altogether new firm comes into existence from the date of induction of the new partner and that new firm must get fresh registration. He also submitted that the partners entered into another deed on 3-11-1992 and they have expressly treated the firm as a reconstituted one. In other words, according to the learned Senior Counsel, the deed dated 20-10-1986 in the absence of such expression (reconstituted firm) the understanding was the old firm, ceases to be in existence and a new firm was brought into existence. For this, he also
placed reliance on clauses 4 and 5 regarding "Commencement" and "Accounting Year". He also placed reliance on a passage from *Lindley on Law of Partnership*, 15th Edn., p. 374:

Each partner is, it is true, the agent of the firm; but as pointed out before, the firm is not distinguishable from the persons from time to time composing it; and when a new member is admitted he becomes one of the firm for the future, but not as from the past, and his present connection with the firm is no evidence that he ever expressly or impliedly authorised what may have been done prior to his admission. This is wholly consistent with the fact that after the admission of a new member, a new partnership is constituted, and thus special circumstances are required to be shown before the debts and liabilities of the old partnership are treated as having been undertaken by the new partnership.

17. Contending contrary and supporting the judgment of the Division Bench, Mr Soli J. Sorabjee, learned Senior Counsel, submitted that there is a well-recognised distinction between the legal concept of dissolution and reconstitution of a firm. In the case of an incoming or an outgoing partner in an existing firm, there is only a reconstitution of the firm and in all other respects, the existing firm continues with old and new partners. A look at Chapter V of the Act, according to him, will fortify the above contention. In other words, Chapter V deals with "Income and Outgoing Partners" while Chapter VI separately deals with "Dissolution of a Firm". The two are totally different concepts and cannot in law be equated with each other. According to the learned Senior Counsel, the rules framed by the Maharashtra Government in 1989 and the forms prescribed under the rules in particular Forms E, G and H clearly support the said contention. It is also his contention that even when there is a dissolution of a firm, it does not cease to be a registered firm but for the purposes of Partnership Act it continues to be registered. In other words, according to the learned Senior Counsel, the registration of a firm is valid till it is cancelled in a manner known to law. Non-compliance of Sections 61, 62 and 63, as amended in Maharashtra, if at all, will attract the penalties prescribed under Section 69-A and nothing more and it is incorrect to contend that non-compliance of the said provisions will result in deregistration of the firm. As the consequence of deregistration is a drastic one, it is impermissible to hold that non-compliance with Sections 63(1) and 63(1-A) would lead to deregistration of a firm in the absence of express and clear legislative provision to that effect. He further contended that merely because another partnership deed was made on 20-10-1986, it cannot be said that there was a dissolution of the old firm and consequential formation of a new firm under the latter deed. According to the learned Senior Counsel, it is the substance of the matter that is relevant to be looked into and not the phraseology employed by the parties. In other words, the test is whether after the execution of the deed dated 20-10-1986, for all intents and purposes, the firm as reconstituted was a different unit or remained the same unit in spite of change in its constitution. Looked at from this angle, the unit remained the same as it originally was in spite of change in its constitution and the contention to the contrary, according to the learned Senior Counsel, was not correct. To support this, he pointed out the similarities between the two deeds. The alleged dissimilarities as found in clauses 4 and 5 of the document dated 20-10-1986 are really not dissimilarities but consequential and incidental changes.
In reply to the contention of Mr Nariman that the purpose for which Section 69(2-A) was introduced by the Maharashtra Legislature will be the last if the view projected by him is not accepted, Mr Sorabjee submitted that failure to comply with the mandatory provisions in Section 61, 62 or 63 may attract the penalties provided under Section 69-A of the Act but not the deregistration of the firm.

At the outset, we would like to deal with the substance of the partnership deeds in this case. As noticed earlier, the first deed of partnership was entered into on 29-11-1979 and that partnership firm was registered on 15-12-1980. One of the partners (Shri Mohanlal Hinji Chawda) died on 6-5-1986 and in his place, his widow was inducted. The second deed of partnership was drawn on 20-10-1986. By reason of the second deed of partnership, can it be said that the existing firm dissolved or ceased. It is relevant here to note that in both the deeds it was expressly made that the death, insolvency or retirement of any partner shall not dissolve the partnership firm. On the other hand, the partner shall be entitled to carry on the partnership business on the terms and conditions mutually agreed upon by the said partners (vide clause 11). Therefore, it cannot be contended by the appellants that by reason of death of one of the partners, the existing firm stands dissolved. Can it then be said that by reason of inducting the widow of the deceased partner the existing registered firm ceased and totally a new partnership firm came into existence. According to the appellants, by reason of clauses 4 and 5 in the second deed of partnership, it must be deemed that the old partnership ceased and entirely a new partnership firm was found under the second deed. We are unable to agree with the contention of the learned Senior Counsel for the appellants on this aspect. Clauses 4 and 5 relate to commencement of the partnership and accounting year. These are minimal changes introduced in the second deed of partnership by reason of the introduction of a new partner in place of clauses 4 and 5 in the first partnership deed and in other respects, namely, the name of the partnership firm, the address and location of the firm, the business carried on and shares allotted among the partners and duration of the partnership, are identical. Moreover a careful reading of clauses 5 and 6 of the second partnership deed will give an impression that the partners have agreed to continue the existing firm. The profits or losses for the period prior to and up to the death of the deceased partner is dealt with and provided. There is no indication that the old firm was dissolved. Likewise, reliance placed on the recitals in the third deed of partnership drawn on 3-11-1992 will not come to the help of the appellants. Learned counsel for the appellants placed reliance on the term used in the third partnership deed reconstituted in the preamble portion. We are of the opinion that this does not make any substantial difference when we look into the substance of the three deeds.

The contention of the learned counsel for the appellants that the induction of the new partner will result in dissolution of the firm is not also acceptable. Reliance placed on the language of Sections 31 and 32 of the Act to support the said contention will be of no avail if we look into Section 17 of the Act. Section 17(a) of the Act (extracted above) suggests only reconstitution of the firm where a change occurs in the constitution of the firm. Otherwise, the old firm remains the same.
25. The next question is whether the registration given to the firm under the first partnership deed ceases when a new partner was introduced into the firm. For this, we refer to Sections 58, 59 and 63, the relevant portions have already been extracted. Rules 3, 4, 6 and 17 have also been extracted. The forms prescribed in this connection have also been extracted. A close perusal of these provisions with Forms A, E, G and H will show that there is a definite distinction between the Certificate of Registration given to the firm and any alterations to be entered in the Register of Firms. This will suggest in no uncertain terms that the changes in the constitution of the firm will not affect the registration once made. In other words, it is not required that every time a new partner is inducted, fresh registration has to be applied and obtained. However, information about changes have to be given. Failure to comply attracts penalties under Section 69-A of the Act.

27. In Pratapchand Ramchand & Co. [AIR 1940 Bom 257], the Bombay High Court observed as follows:

Dealing in particular with Section 63(1), that sub-section among other things provides that when a registered firm is dissolved any person who was a partner immediately before the dissolution, or the agent of any such partner or person specially authorized in this behalf, may give notice to the Registrar of such change or dissolution, specifying the date thereof, and the Registrar shall make a record of the notice in the entry relating to the firm in the Register of Firms, and shall file the notice along with the statement relating to the firm filed under Section 59. Pausing there, that section evidently contemplates in the case of a dissolution of a firm by death that notwithstanding the death the firm should still be treated for the purpose of the Act as still registered. Mr Davar has argued that by reason of the death and the dissolution of the firm the firm ceased to be registered, and in his argument he went so far as to say that the firm ought to have been registered again. No doubt it would have been logical having regard to Section 42 if the Act had so provided. But in fact it has not. The Act does contemplate notwithstanding dissolution by death that so far as registration is concerned the firm is to be deemed still to be registered, and it empowers any person who was a partner immediately before the dissolution to give notice of the change and requires the Registrar to record that notice in the entry relating to the registration of the firm and to file it along with the original statement which had been filed. The next section requiring notice is Section 69(2).

Applying that sub-section to the present case the firm was registered and in my opinion continued to be registered on the date of the institution of this suit on 26th October, 1939. There is no time-limit fixed in any of the Sections 60 to 63 as to when notice of alterations or changes should be given. Mr Davar argued that the word when with which each of those sections begins involves an obligation upon the person proposing to give notice of the change to give it immediately upon the change occurring. The sections do not say so. The position therefore is this: The firm was registered at the time of the institution of the suit. The firm then consisted of Chhogomal Dhanaji and Chunilal Idanji, two of the original partners whose names were shown on the register on the date of registration and were shown on the register on the date of the institution of the suit. The fact that the firm was registered on the date of the
institutions of the suit and that the names of the persons suing (the firm being a compendious name for the persons suing) were shown in the register on the date of the institution of the suit appears to me to be a compliance with Section 69(2) of the Act.

It would seem that the legislature introduced the words with which that sub-section concludes, viz., and the persons suing are or have been shown in the register of firms as partners in the firm advisedly. If additional partners had come into the firm as partners since the date of registration and their names had not been entered on the register in accordance with notice of a change in the constitution of the firm given to the Registrar, it may well be that the firm as then constituted could not sue, because although it was a registered firm some of the persons then suing would not be shown in the register of firms as partners in the firm on the date of the suit. That is not this case. The partners who are suing were shown in the register originally and are still shown, and the firm according to my construction of the Act remained registered notwithstanding the death of one of the original partners.

29. In our opinion, the view taken by the Bombay High Court and followed by the other High Courts is the right view.

30. Learned counsel for the appellants placed strong reliance on the Objects and Reasons for the amendments introduced in the Maharashtra Act. According to the learned counsel, if his contention is not accepted, the object with which Section 69(2-A) was introduced will be lost. We do not think so. In this context, we wish to point out that Section 69(3)(a) of the Central Act enables the partners of both registered and unregistered firms to file a suit for dissolution and/or accounts. That being the position by introducing sub-section (2-A) in Section 69, the Maharashtra Legislature has placed certain restrictions to the extent that even the suit for dissolution of a firm or for accounts, the suit can be filed only if the firm is registered and the person suing as a partner is shown in the Register of Firms as a partner in the firm. In other words, a person, who is not shown in the Register of Firms by induction after registration even though the firm is registered, cannot file a suit for dissolution or accounts. This does not in any way mean that the registration given to the firm earlier will cease. In this case, the firm was registered and there was only a reconstitution of the firm and the first respondent, the plaintiff in this case, is a person whose name is shown in the Register of Firms along with the names of the appellants and, therefore, there is compliance of Section 69(2-A). The contention to the contrary by the learned counsel for the appellants cannot be accepted.

32. We are also not impressed by the arguments of the learned counsel for the appellants that if the definition of Section 4 is applied to Section 69(2-A) then unless the names of all the partners find a place in the Register of Firms, the suit filed by the plaintiff cannot be sustained. The fact that the firm was registered and the plaintiff’s name finds a place in the Register of Firms is not in dispute. The name of the newly introduced partner, of course, does not find a place in the Register of Firms. That means the person whose name does not find a place in the Register of Firms may incur certain disabilities and that will not disable the plaintiff to press the suit against the firm, which was registered against the persons whose names find a place in the Register of Firms. We are not called upon to decide what are the disabilities of the person, whose name does not find a place in the Register of Firms. For the
purpose of Section 69(2-A), the partnership firm will mean the firm as found in the certificate of registration and the partners as found in the Register of Firms maintained as per rule in Form 9a. The present suit being one for dissolution and accounts by one of the partners, whose name admittedly finds place in the Register of Firms along with the names of all the appellants, the requirements of Section 69(2-A) are satisfied. Section 4 of the Act is also complied with for this limited purpose.

33. Our conclusion is that on the induction of the second respondent, the existing firm was only reconstituted on the facts of this case and, therefore, there is no necessity to get a fresh registration. If by virtue of non-compliance of certain mandatory provisions in not informing the Registrar of Firms about the change in the constitution of the firm, certain penalties provided in the Act alone are attracted and that will not lead to the conclusion that the registration of the firm ceased. This conclusion is based on a conjoint reading of Sections 58-63 and the forms prescribed thereunder. Further, this conclusion does not in any way militate the object of the Maharashtra Amendment introduced by Act 29 of 1984.

34. In the result, we hold that the suit in question is not hit by Section 69(2-A) of the Act and, therefore, the Division Bench is right in allowing the appeal. Consequently, the appeal is dismissed. However, there will be no order as to costs.

* * * * *
S.V. Chandra Pandian v. S.V. Sivalinga Nadar

(1993) 1 SCC 589

[Mode of settlement of accounts - section 48(b)(iv)]

(The four appellants and respondents 1 and 2 were brothers carrying on business in partnership in the name and style of Messers Sivalinga Nadar & Brothers and S.V.S. Oil Mills, both partnerships being registered under the Partnership Act, 1932. Most of the properties were acquired by the firm of Sivalinga Nadar & Brothers. The firm of Ms. S.V.S. Oil Mills merely had leasehold rights in the parcel of land belonging to the first-named firm on which the superstructure of the oil mill stood. Both the partnerships were of fixed durations. Disputes arose between the six brothers in regard to the business carried on in partnership in the aforesaid two names. For the resolution of these disputes the six brothers entered into an arbitration agreement dated October 8, 1981, which was as under:

"We are carrying on business in partnership together with other partners under several partnership names. We are also holding shares and managing the Public Limited Company, namely, the Madras Vanaspati Ltd., at Villupuram. Disputes have arisen among us with respect to the several business concerns, immovable and moveable properties standing in our names as well as other relatives.

We are hereby referring all our disputes, the details of which would be given by us shortly to you, namely, Sri B.B. Naidu, Sri K.R. Ramamani and Sri Seetharaman.

We agree to abide by your award as to our disputes."

The arbitrators directed that the firms of M/s Sivalinga Nadar & Bros. and M/s S.V.S. Oil Mills and also the joint house property Rent Account be dissolved as at the close of business on July 14, 1984.

The arbitrators set out the properties belonging to or claimed to belong to the two firms in paras. 6 to 24 of their award. Paragraph 25 was a residuary clause which said that any asset left out or realised hereafter or any liability found due other than those reflected in the account books was to be divided and/or borne equally among the disputants. Paragraphs 26 and 27 deal with the use of the firm names. Paragraph 29 referred to the business carried on by the relatives of the disputants in the names of Sri Brahmasakthi Agency and Srimagal Finance Corporation. The arbitrators had recognised the fact that even though the said business was not carried on by the disputants it was desirable to dissolve the firms also w.e.f. July 24, 1984 in the larger interest of peace and amity among the disputants and their relatives. Paragraph 30 referred to the properties standing in the name of the father of the six disputants, i.e., partners of the two firms in question. The award set out the share of the disputants.

After the award was made, O.P. No. 230 of 1984 was filed by S.V. Chandrapandian and others for a direction to the arbitrators to file their award in Court which was done.
Thereupon, the applicants S.V. Chandrapandian and others filed a Miscellaneous Application No. 3503 of 1984 requesting the Court to pass a decree in terms of the award. Before orders could be passed on that application, O.P. Nos. 247 and 275 of 1984 were filed by S.V. Sivalinga Nadar and S.V. Harikrishnan respectively under Section 30 of the Arbitration Act to set aside the award. The applications came up for hearing before a learned Single Judge of the High Court. The learned Single Judge observed as under:

The learned counsel for the respondents also contended that the award falls under Schedule I Article 12 of the Stamp Act and the allocation of properties owned by partnership firm on dissolution to the erstwhile partners is not partition of immovable properties. In this connection, learned counsel for the respondents placed reliance on the decision reported in Addanki Narayanappa v. Bhaskara Krishtappa which decision has been confirmed in Addanki Narayanappa v. Bhaskara Krishnappa. It was submitted by the learned counsel for the respondents that the contentions with regard to stamp and registration put forward by the petitioner cannot be accepted. It is to be pointed out that the award has been submitted for registration long ago on October 27, 1984 itself and it is stamped and if there is any deficiency, the registering authority could direct proper stamp to be affixed and therefore I feel there could be no impediment for the award being made a rule of the Court and a decree being passed in terms of the award as contended by the learned counsel for the respondents.

The learned Single Judge made the final order in the following terms:

Thus on a careful consideration of the materials available and the contentions of either side it has to be decided that Application No. 3505 of 1984 in O.P. No. 230 of 1984, filed by the petitioners therein praying for a decree in terms of the arbitration award dated July 9, 1984 has to be allowed and O.P. Nos. 247 and 275 of 1984 and the applications filed in those two petitions, i.e., Application Nos. 3474, 3476, 5030, 5031, 5032, 2827, 2828, 3773, 3762, 3874 of 1984 and 4886 and 4887 of 1985, are dismissed. The petitioner in O.P. No. 230 of 1984 and the applicants in Application No. 3505 of 1984 are directed to take steps for getting the award registered. The parties in all these proceedings are directed to bear their own costs.

Against the judgment of the learned Single Judge, the matter was carried in appeal to a Division Bench of the High Court of Madras which reversed the finding recorded by the learned Single Judge and came to the conclusion that the award required registration under Section 17(1) of the Registration Act

In this view of the matter the Division Bench allowed the appeal and set aside the impugned judgment of the learned Single Judge and held that as the award was not registered it could not be made the rule of the Court.

A.M. AHMADI, J. - 7. Section 4 (of the Partnership Act, 1932) defines partnership as a relationship between persons who have agreed to share the profit of a business carried on by all or any of them acting for all. Section 14 provides that subject to contract between the
partners, the property of the firm includes all property and rights and interests in property originally brought into the stock of the firm, or acquired, by purchase or otherwise, by or for the firm, or for the purposes and in the course of the business of the firm, and includes also the goodwill of the business. It is also clarified that unless the contrary intention appears, property and rights and interest in property acquired with money belonging to the firm shall be deemed to have been acquired for the firm. Section 15 says that the property of the firm shall be held and used by the partners exclusively for the purposes of the business subject of course to contract between the partners. Says Section 18, subject to the provisions of the Act, a partner is the agent of the firm for the purposes of the business of the firm. Under Section 19 the act of a partner which is done to carry on, in the usual way, business of the kind carried on by the firm, shall bind the firm. This authority to bind the firm is termed as implied authority. Section 22 lays down that in order to bind a firm, an act or instrument done or executed by a partner or other person on behalf of the firm shall be done or executed in the firm name, or in any other manner expressing or implying an intention to bind the firm. Section 29 deals with the rights of transferee of a partner's interest. Sub-section (1) thereof provides that such a transferee will not have the same rights as the transferor-partner but he would be entitled to receive the share of profits of his transferor on the account of profits agreed to by the partners. Sub-section (2) next provides that upon dissolution of the firm or upon a transferor-partner ceasing to be a partner, the transferee would be entitled against the remaining partners to receive the share of the assets of the firm to which the transferor-partner was entitled and will also be entitled to an account as from the date of dissolution. Section 30 deals with the case of a minor admitted to the benefits of partnership. Such a minor is given a right to his share of the property of the firm and also a right to share in the profits of the firm as may be agreed upon but his share is made liable for the acts of the firm though he would not be personally liable for the same. Sub-section (4), however, debars a minor from suing the partners for an account or for his share of the property or profits of the firm except when he severes his connections with the firm, in which case for determining his share the law requires a valuation of his share in the property of the firm to be made in accordance with Section 48. Sections 31 to 38 relate to incoming and outgoing partners. Section 32 deals with the consequences of retirement. Sub-sections (2) and (3) of Section 32 deal with the consequences of retirement while Sections 36 and 37 speak about the rights of an outgoing partner to carry on competing business and in certain cases to share subsequent profits. Chapter VI deals with the dissolution of a firm. Section 40 provides that a firm may be dissolved with the consent of all the partners or in accordance with the contract between the partners. Sections 41 and 42 deal with dissolution on the happening of certain events while Section 43 permits a partner to dissolve a firm by notice if it is a partnership at will. Section 44 speaks of dissolution through Court. Section 48 indicates the mode of settlement of accounts between the partners on dissolution while Section 49 posits that where there are joint debts due from the firm, and also separate debts due from any partner, the property of the firm shall be applied in the first instance in payment of the debts of the firm, and, if there is any surplus, then the share of each partner shall be applied in payment of his separate debts or paid to him. The separate property of any partner shall be applied first in the payment of his separate debts, and the surplus (if any) in the payment of the debts of the firm, Chapter VII deals with the registration of firms, etc., and Chapter VIII contains the saving clause.
8. The above provisions make it clear that regardless of the character of the property brought in by the partners on the constitution of the partnership firm or that which is acquired in the course of business of the partnership, such property shall become the property of the firm and an individual partner shall only be entitled to his share of profits, if any, accruing to the partnership from the realisation of this property and upon dissolution of the partnership to a share in the money representing the value of the property. It is well settled that the firm is not a legal entity, it has no legal existence, it is merely a compendious name and hence the partnership property would vest in all the partners of the firm. Accordingly, each and every partner of the firm would have an interest in the property or asset of the firm but during its subsistence no partner can deal with any portion of the property as belonging to him, nor can he assign his interest in any specific item thereof to anyone. By virtue of the implied authority conferred as agent of the firm his action would bind the firm if it is done to carry on, in the usual way, the business of the kind carried on by the firm but the act or instrument by which the firm is sought to be bound must be done or executed in the firm name or in any other manner expressing or implying an intention to bind the firm. His right is merely to obtain such profits, if any, as may fall to his share upon the dissolution of the firm which remain after satisfying the liabilities set out in the various sub-clauses (i) to (iv) of clause (b) of Section 48 of the Act.

9. In the present case the six brothers who were carrying on business in partnership fell out on account of disputes which they could not resolve inter se. The partnership being of fixed durations could not be dissolved by any partner by notice. As they could not resolve their disputes they decided to resort to arbitration. The three arbitrators chosen by them were men of their confidence and they after giving the partners full and complete opportunity took care to first circulate a proposed award to ascertain the reaction of the disputants therein. The letter written to the arbitrators by S.V. Sivalinga Nadar dated February 16, 1983 indicates that he was quite satisfied with the hearing given by the arbitrators. He was also by and large satisfied with the proposed award but thought it warranted certain adjustments to make it acceptable and rational. He was of the view that the award should provide for the reallocation of the shareholdings of Madras Vanaspati Ltd., whereas Brahmasakthi Tin Factory owned by his sons should be kept out of the purview of the arbitrators since it was not the subject-matter of arbitration. Then he raised some objection as to the percentage of his share and the amount found due to him. In the subsequent letter written on September 9, 1983 he has reiterated these very objections while raising certain questions regarding valuation of partnership properties. Even the application filed under Sections 30 and 33 of the Arbitration Act in the High Court the objections to the award as enumerated in paragraph 15 mainly concerned (i) the conduct of the arbitrators who, it is alleged, acted negligently, with bias and against principles of natural justice (ii) deliberate act in leaving out certain properties from consideration e.g., shareholdings of Madras Vanaspati Ltd., stock-in-trade and cash deposits, the properties of Velayudha Perumal Nadar, etc., and (iii) failure to grant him a higher share to which he was entitled. No contention was raised regarding the want of registration of the award. However, being a question of law, the learned Single Judge entertained the plea and rejected it but it found favour with the Division Bench.
The submission made in this behalf before the courts below was that the award involved a partition of immovable properties as a consequence of dissolution of the firms and since the value of the immovable properties which are the subject-matter of the award indisputably exceed the value of Rs 100, the award was compulsorily registrable in view of the mandatory nature of the language of Section 17(1) which uses the expression ‘shall be registered’. On the mandatory character of the provision there is no dispute. The question which requires determination is whether on the dissolution of the partnership the distribution of the assets of the firm comprising both moveable and immovable properties after meeting its obligations on settlement of accounts amongst the partners of the firm in proportion to their respective shares amounts to a partition of immovable properties or a relinquishment or extinguishment of a share in immovable property requiring registration under Section 17 of the Registration Act if the allocation includes immovable property of the value of Rs 100 and above? In other words the question to be considered is whether the interest of a partner in partnership assets is to be treated as moveable property or both moveable and immovable depending on the character of the property for the purposes of Section 17 of the Registration Act?

12. In CIT v. Juggilal Kamalapat [AIR 1967 SC 401], the facts were that three brothers and one J entered into a partnership business. The firm owned both moveable and immovable properties. Sometime thereafter the three brothers created a Trust with themselves as the first three trustees and simultaneously executed a deed of relinquishment relinquishing their rights in and claims to all the properties and assets of the firm in favour of J and of themselves in the capacity of trustees. Thereafter a new partnership firm was constituted between J and the Trust with specified shares. The Trust brought a sum of Rs 50,000 as its capital in the new firm. The new firm applied for registration under Section 26-A of the Income Tax Act, 1922 but the application was rejected by the authorities. The Tribunal held that the deed of relinquishment being unregistered could not legally transfer the rights and the title to the immovable properties owned by the original firm to the Trust. Since the immovable properties were not separable from the other business assets it held that there was no legal transfer of any portion of the business assets of the original firm in favour of the Trust. A reference was made to the High Court on the question whether the new partnership legally came into existence and as such should be registered under Section 26-A. The High Court held that there was no impediment to its registration. The matter was brought in appeal before this Court. This Court pointed out that the deed of relinquishment was in respect of individual interests of the three brothers in the assets of the partnership firm in favour of the Trust and consequently, did not require registration, even though the assets of the partnership included immovable property. In taking this view reliance was placed on the decision Ajudhia Pershad case, AIR 1947 Lah 13 as well as the decision of this Court in Addanki Narayanappa, AIR 1966 SC 1300.

13. Again in CIT v. Devas Cine Corporation [AIR 1968 SC 676], the partnership firm was dissolved and on dissolution it was agreed between the partners that the theatres should be returned to their original owners who had brought them into the books of the partnership as its assets. In the books of accounts of the partnership the assets were shown as taken over on October 1, 1951 at the original price less depreciation, the depreciation being equally divided between the two partners. In the proceedings for the assessment year 1952-53 the firm was
treated as a registered firm. The Appellate Tribunal held that restoration of the two theatres to the original owners amounted to transfer by the firm and the entries adjusting the depreciation and writing off the assets at the original value amounted to total recoupment of the entire depreciation by the partnership and on that account the second proviso to Section 10(2)(vii) of the I.T. Act, 1922 applied. The High Court in reference upturned the decision of the Tribunal and held in favour of the assessee against which the Revenue appealed to this Court. This Court after referring to Sections 46 and 48 of the Partnership Act held that on the dissolution of the partnership each theatre must be deemed to be returned to the original owner in satisfaction partially or wholly of his claim to a share in the residue of the assets after discharging the debts and other obligations. In law there was no sale or transfer by the partnership to the individual partners in consideration of their respective share in the residue. In taking this view reliance was once again placed on the decision of this Court in Addanki Narayanappa.

14. In CIT v. Bankey Lal Vaidya [AIR 1971 SC 2270], this Court pointed out that on dissolution of partnership the assets of the firm are valued and the partner is paid a certain amount in lieu of his share of the assets, the transaction is not a sale, exchange or transfer of assets of the firm and the amount received by the partner cannot be taxed as capital gains.

15. Again in Malabar Fisheries Co. v. CIT [AIR 1980 SC 176], the facts were that the appellant firm which was constituted on April 1, 1959 with four partners carried on six different businesses in different names. The firm was dissolved on March 31, 1963 and under the deed of dissolution the first business concern was taken over by one of the partners, the remaining five concerns by two of the other partners and the fourth partner received his share in cash. It appears that during the assessment years 1960-61 to 1963-64 the firm had installed various items of machinery in respect of which it had received Development Rebate under Section 33 of the I.T. Act, 1961. On dissolution, the Income Tax Officer took the view that Section 34(3)(b) of the Act applied on the premiss that there was a sale or transfer of the machinery by the firm whereupon he withdrew the Development Rebate earlier allowed to the firm by amending the orders in that behalf. The appeal filed on behalf of the dissolved firm was dismissed by the Appellate Assistant Commissioner but was allowed by the Tribunal. At the instance of the Revenue a reference was made to the High Court and the High Court allowed the reference holding that there was a transfer of assets within the meaning of Section 34(3)(b). The dissolved firm approached this Court in appeal. This Court after referring to the definition of the expression ‘transfer’ in Section 2(47) of the Act and the case-law on the point concluded as under:

Having regard to the above discussion, it seems to us clear that a partnership firm under the Indian Partnership Act, 1932 is not a distinct legal entity apart from the partners constituting it and equally in law the firm as such has no separate rights of its own in the partnership assets and when one talks of the firm’s property or firm’s assets all that is meant is property or assets in which all partners have a joint or common interest. If that be the position, it is difficult to accept the contention that upon dissolution the firm’s rights in the partnership assets are extinguished. The firm as such has no separate rights of its own in the partnership assets but it is the partners who own jointly in common the assets of the partnership and, therefore, the
consequence of the distribution, division or allotment of assets to the partners which flows upon dissolution after discharge of liabilities is nothing but a mutual adjustment of rights between the partners and there is no question of any extinguishment of the firm's rights in the partnership assets amounting to a transfer of assets within the meaning of Section 2(47) of the Act.

16. From the foregoing discussion it seems clear to us that regardless of its character the property brought into stock of the firm or acquired by the firm during its subsistence for the purposes and in the course of the business of the firm shall constitute the property of the firm unless the contract between the partners provides otherwise. On the dissolution of the firm each partner becomes entitled to his share in the profits, if any, after the accounts are settled in accordance with Section 48 of the Partnership Act. Thus in the entire asset of the firm all the partners have an interest albeit in proportion to their share and the residue, if any, after the settlement of accounts on dissolution would have to be divided among the partners in the same proportion in which they were entitled to a share in the profit. Thus during the subsistence of the partnership a partner would be entitled to a share in the profits and after its dissolution to a share in the residue, if any, on settlement of accounts. The mode of settlement of accounts set out in Section 48 clearly indicates that the partnership asset in its entirety must be converted into money and from the pool the disbursement has to be made as set out in clause (a) and sub-clauses (i), (ii) and (iii) of clause (b) and thereafter if there is any residue that has to be divided among the partners in the proportions in which they were entitled to a share in the profit. So viewed, it becomes obvious that the residue would in the eye of law be moveable property i.e. cash, and hence distribution of the residue among the partners in proportion to their shares in the profits would not attract Section 17 of the Registration Act. Viewed from another angle it must be realised that since a partnership is not a legal entity but is only a compendious name each and every partner has a beneficial interest in the property of the firm even though he cannot lay a claim on any earmarked portion thereof as the same cannot be predicated. Therefore, when any property is allocated to him from the residue it cannot be said that he had only a definite limited interest in that property and that there is a transfer of the remaining interest in his favour within the meaning of Section 17 of the Registration Act. Each and every partner of a firm has an undefined interest in each and every property of the firm and it is not possible to say unless the accounts are settled and the residue or surplus determined what would be the extent of the interest of each partner in the property. It is, however, clear that since no partner can claim a definite or earmarked interest in one or all of the properties of the firm because the interest is a fluctuating one depending on various factors, such as, the losses incurred by the firm, the advances made by the partners as distinguished from the capital brought in the firm, etc., it cannot be said, unless the accounts are settled in the manner indicated by Section 48 of the Partnership Act, what would be the residue which would ultimately be allocable to the partners. In that residue, which becomes divisible among the partners, every partner has an interest and when a particular property is allocated to a partner in proportion to his share in the profits of the firm, there is no partition or transfer taking place nor is there any extinguishment of interest of other partners in the allocated property in the sense of a transfer or extinguishment of interest under Section 17 of the Registration Act. Therefore, viewed from this angle also it seems clear to us that when a dissolution of the partnership takes place
and the residue is distributed among the partners after settlement of accounts there is no partition, transfer or extinguishment of interest attracting Section 17 of the Registration Act.

17. Strong reliance was, however, placed by the learned counsel for the respondents on two decisions of this Court, namely, (1) Ratan Lal Sharma v. Purshottam Harit [(1974) 1 SCC 671] and (2) Lachhman Dass v. Ram Lal [(1989) 3 SCC 99]. Insofar as the first-mentioned case is concerned, the facts reveal that the appellant and the respondent who had set up a partnership business in December 1962 soon fell out. The partnership had a factory and other moveable and immovable properties. On August 22, 1963, the partners entered into an agreement to refer the dispute to the arbitration of two persons and gave the arbitrators full authority to decide their dispute. The arbitrators made their award on September 10, 1963. Under the award exclusive allotment of the partnership assets, including the factory, and liabilities, was made in favour of the appellant and it was provided that he shall be absolutely entitled to the same in consideration of a sum of Rs 17,000 plus half the amount of realisable debts of the business to the respondent. The arbitrators filed the award in the High Court on November 8, 1963. On September 10, 1964, the respondent filed an application for determining the validity of the agreement and for setting aside the award. On May 27, 1966, a learned Single Judge of the High Court dismissed the application as barred by time but declined to make the award the rule of the Court because in his view the award was void for uncertainty and created rights in favour of the appellant over immovable property worth over Rs 100 requiring registration. The Division Bench dismissed the appeal as not maintainable whereupon this Court was moved by special leave. Before this Court it was contended (i) that the award is not void for uncertainty; (ii) that the award seeks to assign the respondent’s share in the partnership to the appellant and therefore does not require registration; and (iii) that under Section 17 of the Arbitration Act, the court was bound to pronounce judgment in accordance with the award. This Court while reiterating that the share of a partner in the assets of the partnership comprising even immovable properties, is moveable property and the assignment of the share does not require registration under Section 17 of the Registration Act. The legal position is thus affirmed. However, since the award did not seek to assign the share of the respondent to the appellant but on the contrary made an exclusive allotment of the partnership asset including the factory and liabilities to the appellant, thereby creating an absolute interest on payment of consideration of Rs 17,000 plus half the amount of the realisable debts, it was held to be compulsorily registrable under Section 17 of the Registration Act. The Court did not depart from the principle that the share of a partner in the asset of the partnership inclusive of immovable properties, is moveable property and the assignment of the share on dissolution of the partnership did not require registration under Section 17 of the Registration Act. The decision, therefore, turned on the interpretation of the award in regard to the nature of the assignment made in favour of the appellant. So far as the second case is concerned, we think it has no bearing since that was not a case of assignment of partnership property under a dissolution deed. In that case, the dispute was between two brothers in 2-1/2 killas of land situate in Panipat, Haryana. The said land stood in the name of one brother - the appellant. The respondent contended that he was a benamidar and that was the dispute which was referred to arbitration. The Arbitrator made his award and applied to the Court for making it the rule of the Court. Objections were filed by the appellant raising various contentions. The award declared that half share of the ownership of the appellant shall
be now owned by Shri Ram Lal, the respondent in addition to his half share owned in those lands. Therefore, the award transferred half share of the appellant to the respondent and since the value thereof exceeded Rs 100, it was held that it required registration. It is, therefore, obvious that this case has no bearing on the point in issue herein.

18. In the present case, the Division Bench of the High Court concluded that the award required registration because of an erroneous reading of the award. The Division Bench after extensively reproducing from the Schedules ‘A’ to ‘F’ of the award proceeded to state in paragraph 39 that the allotments are exclusive to the brothers and they get independent rights of their own under the award in the properties allotted under the schedule and hence it is not a case purely of assignment of the shares in the partnership but it confers exclusive rights to the allottees. On this line of reasoning it concluded that the award required registration. The court next pointed out in paragraph 42 of the judgment that the award also partitions certain immovable properties jointly owned by the disputants. In this connection it has placed reliance on paragraph 10(c) of the award which reads as under:

(c). Other Lands and Buildings and House properties belonging to S.V. Sivalinga Nadar & Bros. standing in the name of the firm and/or otherwise jointly owned by the disputants. These have been allotted by us to one or other or jointly to some of the disputants as per schedules annexed hereto.

The reasons which weighed with the Division Bench of the High Court in concluding that the award requires registration appear to be based on an erroneous reading of the award. We have carefully read the award and it is manifest therefrom that the Arbitrators had confined themselves to the properties belonging to the two firms in question and scrupulously avoided dealing with the properties not belonging to the firm. This is manifest from paragraphs 15 to 18 of the award. However, properties standing in the names of disputants, individually or jointly, and others as benamidars but belonging to the firm also came to be included in the distribution of the surplus partnership asset under the award. That is the purport of paragraph 10(c) extracted hereinabove. When on settlement of accounts the residue is required to be divided among the partners in proportions in which they entitled to share profits under sub-clause (iv) of clause (b) of Section 48, the properties will have to be allocated to the partners as falling to their share on the distribution of the residue and, therefore, the Arbitrators indicated in the schedules the properties falling to the share of each brother. Mere statements that a certain property will now exclusively belong to one partner or the other, as the case may be, cannot change the character of the document or the nature of assignment because that would in any case be the effect on the distribution of the residue. The property falling to the share of the partner on the distribution of the residue would naturally then belong to him exclusively but so long as in the eye of law it is money and not immovable property there is no question of registration under Section 17 of the Registration Act. Besides, as stated earlier, even if one looks at the award as allocating certain immovable property since there is no transfer, no partition or extinguishment of any right therein there is no question of application of Section 17(1) of the Registration Act. The reference to other land and buildings and house properties jointly owned by the disputants in clause (c) of paragraph 10 of the award merely indicates that certain properties belonging to the firm stood in the names of individual partners or in their joint names but they belonged to the firm and, therefore, they were taken
into account for the purpose of settlement of accounts under Section 48 of the Partnership Act and distributed on the determination of the residue. The award read as a whole makes it absolutely clear that the Arbitrators had confined themselves to the properties belonging to the two firms and had scrupulously avoided other properties in regard to which they did not reach the conclusion that they belonged to the firm. On a correct reading of the award, we are satisfied that the award seeks to distribute the residue after settlement of accounts on dissolution. While distributing the residue the Arbitrators allocated the properties to the partners and showed them in the schedules appended to the award. We are, therefore, of the opinion that on a true reading of the award as a whole, there is no doubt that it essentially deals with the distribution of the surplus properties belonging to the dissolved firms. The award, therefore, did not require registration under Section 17(1) of the Registration Act.

19. For the above reasons, we allow these appeals and set aside the impugned orders of the Division Bench and remit the matters to the Division Bench for answering the other contentions which arose in the appeal before it but which were not decided in view of its decision on the question of registration of the award. We also make it clear that the award which is pending for registration may be registered by the Sub-Registrar notwithstanding the objection raised by one of the partners, S.V. Sivalinga Nadar through his lawyer if that is the only reason for withholding registration. The appeals are allowed accordingly with costs.

* * * * *
The issue is this: has the advocate a lien for his fees on the litigation papers entrusted to him by his client?

The appellant has been practising as an advocate mostly in the courts at Bhopal, after enrolling himself as a legal practitioner with the State Bar Council of Madhya Pradesh. According to him, he was appointed as legal advisor to Madhya Pradesh State Cooperative Bank Ltd. (the Bank) in 1990 and the Bank continued to retain him in that capacity during the succeeding years. He was also engaged by the said Bank to conduct cases in which the Bank was a party. However, the said retainership did not last long. On 17-7-1993 the Bank terminated the retainership of the appellant and requested him to return all the case files relating to the Bank. Instead of returning the files the appellant forwarded a consolidated bill to the Bank showing an amount of Rs 97,100 as the balance payable by the Bank towards the legal remuneration to which he is entitled. He informed the Bank that the files would be returned only after settling his dues.

We would first examine whether an advocate has lien on the files entrusted to him by the client. Learned counsel for the appellant endeavoured to base his contention on Section 171 of the Indian Contract Act which reads thus:

171. Bankers, factors, wharfingers, attorneys of a High Court and policy-brokers may, in the absence of a contract to the contrary, retain as a security for a general balance of account, any goods bailed to them; but no other persons have a right to retain, as a security for such balance, goods bailed to them, unless there is an express contract to that effect.

Files containing copies of the records (perhaps some original documents also) cannot be equated with the goods referred to in the section. The advocate keeping the files cannot amount to goods bailed. The word bailment is defined in Section 148 of the Contract Act as the delivery of goods by one person to another for some purpose, upon a contract that they shall be returned or otherwise disposed of according to the directions of the person delivering them, when the purpose is accomplished. In the case of litigation papers in the hands of the advocate there is neither delivery of goods nor any contract that they shall be returned or otherwise disposed of. That apart, the word goods mentioned in Section 171 is to be understood in the sense in which that word is defined in the Sale of Goods Act. It must be remembered that Chapter VII of the
Contract Act, comprising Sections 76 to 123, had been wholly replaced by the Sale of Goods Act, 1930. The word \textit{goods} is defined in Section 2(7) of the Sale of Goods Act.

9. Thus understood \textit{goods} to fall within the purview of Section 171 of the Contract Act should have marketability and the person to whom they are bailed should be in a position to dispose of them in consideration of money. In other words the goods referred to in Section 171 of the Contract Act are saleable goods. There is no scope for converting the case files into money, nor can they be sold to any third party. Hence, the reliance placed on Section 171 of the Contract Act has no merit.

10. In England the solicitor had a right to retain any deed, paper or chattel which had come into his possession during the course of his employment. It was the position in common law and it was later recognized as the solicitor’s right under the Solicitors Act, 1860. In \textit{Halsbury’s Laws of England}, it is stated thus (vide para 226 in Vol. 44):

\textit{226. Solicitor’s rights.} - At common law a solicitor has two rights which are termed liens. The first is a right to retain property already in his possession until he is paid costs due to him in his professional capacity, and the second is a right to ask the court to direct that personal property recovered under a judgment obtained by his exertions stand as security for his costs of such recovery. In addition, a solicitor has by statute a right to apply to the court for a charging order on property recovered or preserved through his instrumentality in respect of his taxed costs of the suit, matter or proceeding prosecuted or defended by him.

12. After independence the position would have continued until the enactment of the Advocates Act, 1961 which has repealed a host of enactments including the Indian Bar Council Act. When the new Bar Council of India came into existence it framed rules called the Bar Council of India Rules as empowered by the Advocates Act. Such Rules contain provisions specifically prohibiting an advocate from adjusting the fees payable to him by a client against his own personal liability to the client. As a rule an advocate shall not do anything whereby he abuses or takes advantage of the confidence reposed in him by his client (vide Rule 24). In this context a reference can be made to Rules 28 and 29 which are extracted below:

\textit{28. After the termination of the proceeding, the advocate shall be at liberty to appropriate towards the settled fee due to him, any sum remaining unexpended out of the amount paid or sent to him for expenses, or any amount that has come into his hands in that proceeding.}

\textit{29. Where the fee has been left unsettled, the advocate shall be entitled to deduct, out of any moneys of the client remaining in his hands, at the termination of the proceeding for which he had been engaged, the fee payable under the rules of the court in force for the time being, or by then settled and the balance, if any, shall be refunded to the client.}
13. Thus, even after providing a right for an advocate to deduct the fees out of any money of the client remaining in his hand at the termination of the proceeding for which the advocate was engaged, it is important to notice that no lien is provided on the litigation files kept with him. In the conditions prevailing in India with lots of illiterate people among the litigant public it may not be advisable also to permit the counsel to retain the case bundle for the fees claimed by him. Any such lien if permitted would become susceptible to great abuses and exploitation.

14. There is yet another reason which dissuades us from giving approval to any such lien. We are sure that nobody would dispute the proposition that the cause in a court/tribunal is far more important for all concerned than the right of the legal practitioner for his remuneration in respect of the services rendered for espousing the cause on behalf of the litigant. If a need arises for the litigant to change his counsel pendente lite, that which is more important should have its even course flow unimpeded. Retention of records for the unpaid remuneration of the advocate would impede such course and the cause pending judicial disposal would be badly impaired. If a medical practitioner is allowed a legal right to withhold the papers relating to the treatment of his patient which he thus far administered to him for securing the unpaid bill, that would lead to dangerous consequences for the uncured patient who is wanting to change his doctor. Perhaps the said illustration may be an overstatement as a necessary corollary for approving the lien claimed by the legal practitioner. Yet the illustration is not too far-fetched. No professional can be given the right to withhold the returnable records relating to the work done by him with his client’s matter on the strength of any claim for unpaid remuneration. The alternative is that the professional concerned can resort to other legal remedies for such unpaid remuneration.

15. A litigant must have the freedom to change his advocate when he feels that the advocate engaged by him is not capable of espousing his cause efficiently or that his conduct is prejudicial to the interest involved in the lis, or for any other reason. For whatever reason, if a client does not want to continue the engagement of a particular advocate it would be a professional requirement consistent with the dignity of the profession that he should return the brief to the client. It is time to hold that such obligation is not only a legal duty but a moral imperative.

16. In civil cases, the appointment of an advocate by a party would be deemed to be in force until it is determined with the leave of the court [vide Order 3 Rule 4(1) of the Code of Civil Procedure]. In criminal cases, every person accused of an offence has the right to consult and be defended by a legal practitioner of his choice which is now made a fundamental right under Article 22(1) of the Constitution. The said right is absolute in itself and it does not depend on other laws. In this context reference can be made to the decision of this Court in State of M.P. v. Shobharam [AIR 1966 SC 1910]. The words "of his choice" in Article 22(1) indicate that the right of the accused to change an advocate whom he once engaged in the same case, cannot be whittled down by that advocate by withholding the case bundle on the premise that he has to get the fees for the services already rendered to the client.

17. If a party terminates the engagement of an advocate before the culmination of the proceedings that party must have the entire file with him to engage another advocate. But if the
advocate who is changed midway adopts the stand that he would not return the file until the fees claimed by him are paid, the situation perhaps may turn to dangerous proportions. There may be cases when a party has no resources to pay the huge amount claimed by the advocate as his remuneration. A party in a litigation may have a version that he has already paid the legitimate fee to the advocate. At any rate if the litigation is pending the party has the right to get the papers from the advocate whom he has changed so that the new counsel can be briefed by him effectively. In either case it is impermissible for the erstwhile counsel to retain the case bundle on the premise that fees were yet to be paid.

18. Even if there is no lien on the litigation papers of his client an advocate is not without remedies to realise the fee which he is legitimately entitled to. But if he has a duty to return the files to his client on being discharged the litigant too has a right to have the files returned to him, more so when the remaining part of the lis has to be fought in the court. This right of the litigant is to be read as the corresponding counterpart of the professional duty of the advocate.

25. We, therefore, alter the punishment to one of reprimanding the appellant. However, we make it clear that if any advocate commits this type of professional misconduct in future he would be liable to such quantum of punishment as the Bar Council will determine and the lesser punishment imposed now need not be counted as a precedent.

SETHI, J. - 31. In England also, a belief existed from the earliest times that the lawyer’s fees is not a compensation to him for discharge of legal obligations but a gratuity or an honorarium which the client bestowed on him in token of his gratitude. The lawyers were considered as officers of the court, the tradition being that the law was an honorary occupation and not a means of livelihood. Early advocates were generally persons in holy orders who rendered their services to the weak and afflicted without charge and as an act of pity.

32. Under common law, the rights of a solicitor are called as liens, which are of two types namely:

(1) a retaining lien, i.e., a right to retain property already in his possession until he has been paid costs due to him in his professional character; and

(2) a lien on property recovered or preserved, i.e., a right to ask the court to direct that personal property recovered under a judgment obtained by his exertions stand as security for his costs of such recovery.

33. According to Cordery on Solicitors, 7th Edn., the retaining lien is founded on the general law of lien which springs from possession and is governed by the same rules as other cases of possessory lien. Evershed, M.R. in Barratt v. Gough-Thomas [(1950) 2 All ER 1048], observed:

It is a right at common law depending, it has been said, on implied agreement. It has not the character of an encumbrance or equitable charge. It is merely passive and possessory, that is to say, the solicitor has no right of actively enforcing his demand. It confers on him merely the right to withhold possession of the documents or other
personal property of his client or former client. It is wholly derived from, and, therefore coextensive with, the right of the client to the documents or other property:

34. According to Cordery the property upon which lien can be claimed is in the form of deeds, papers or other personal property which comes into a solicitor’s possession in the course of his professional employment with the sanction of the client and/or client’s property, such as bill of exchange, application of shares, share certificates, a debenture trust deed, a policy of assurance, letters of administration or money. After referring to various authorities of English courts, the law relating to lien and its retention has been summarised in Halsbury’s Laws of England, Vol. 44 (1), 1995 Edn., as under:

**Property affected by retaining lien.** - The general rule is that the retaining lien extends to any deed, paper or personal chattel which has come into the solicitor’s possession in the course of his employment and in his capacity as solicitor with the client’s sanction and which is the client’s property. The following may thus be subject to a retaining lien: (1) a bill of exchange; (2) a cheque; (3) a policy of assurance; (4) a share certificate; (5) an application for shares; (6) a debenture trust deed; (7) letters patent; (8) letters of administration; (9) money, including money in a client account, although only the amount due to the solicitor, and maintenance received by a solicitor if not subject to an order as to its application or bound to be applied, in effect, as trust money; or (10) documents in a drawer of which the solicitor is given the key.

The lien does not extend to (a) a client’s original will; or (b) a deed in favour of the solicitor but reserving a life interest and power of revocation to the client; or (c) original court records; or (d) documents which did not come into the solicitor’s hands in his capacity as solicitor for the person against whom the lien is claimed or his successor, but as mortgagee, steward of a manor or trustee. Moreover, where documents are delivered to a solicitor for a particular purpose under a special agreement which does not make express provision for a lien in favour of the solicitor, as perhaps the raising of money, or money is paid to the solicitor for a particular purpose so that he becomes a trustee of the money, no lien arises over those documents or that money unless subsequently left in the solicitor’s possession for general purposes. Otherwise the lien extends to the property whatever the occasion of delivery, except that where a solicitor acts for both mortgagor and mortgagee and the mortgage is redeemed the solicitor cannot set up a lien on the deeds against the mortgagor.

It is further stated that such a lien extends only to the solicitor’s taxable costs, charges and expenses incurred on the instructions of the client against whom the lien is claimed and for which the client is personally liable including the costs of recovering the remuneration by action or upon a taxation.

35. It follows, therefore, that even under the common law no lien can be claimed with respect to the case file and such documents which are necessary for the further progress of the lis filed in
the court. Even in England the right of retention has been much diluted by various exceptions created by decisions, chiefly by the courts of equity on the basis of what may be just and equitable as between the parties with conflicting interests.

39. Reference to "goods" in Section 171 of the Contract Act cannot, by any imagination, be stretched to mean the case papers, entitling their retention by the lawyer as his lien for the purposes of realising his fee. Besides the meaning attached to the "goods" under Section 2(7) of the Sale of Goods Act, under the general law the "goods" have been defined in Bailey’s Large Dictionary of 1732 as "merchandise" and by Johnson, who followed as the next lexicographer, it is defined to be moveables in a house; personal or immovable estates; wares, freight, merchandise. Webster defines the word "goods" thus:

Goods, noun, plural; (1) moveables; household furniture; (2) Personal or moveable estate, as horses, cattle, utensils, etc. (3) wares; merchandise; commodities bought and sold by merchants and traders.

40. This Court in Union of India v. Delhi Cloth and General Mills Co. Ltd. [AIR 1963 SC 791], held that to become "goods" an article must be something which can ordinarily come to the markets to be bought and sold. In CCE v. Eastend Paper Industries Ltd. [(1989) 4 SCC 244] it was stated that goods are understood to mean as identifiable articles known in the markets as goods and marketed and marketable in the market as such. Where the Act does not define "goods", the legislature should be presumed to have used that word in its ordinary dictionary meaning i.e. to become goods it must be something which can ordinarily come to the market to be bought and sold and is known to the market as such.

41. Thus, looking from any angle, it cannot be said that the case papers entrusted by the client to his counsel are the goods in his hand upon which he can claim a retaining lien till his fee or other charges incurred are not paid. In ‘G’, a Senior Advocate of the Supreme Court, Re [AIR 1954 SC 557], this Court observed that it was highly reprehensible for an advocate to stipulate for or receive a remuneration proportioned to the result of litigation or a claim whether in the form of a share in the subject-matter, a percentage or otherwise. An advocate is expected, at all times, to conduct himself in a manner befitting his status as an officer and a gentleman by upholding the high and honourable profession to whose privilege he has been admitted after his enrolment. If an advocate departs from the high standards which the profession has set for itself and conducts himself in a manner which is not fair, reasonable and according to law, he is liable to disciplinary action. In M, an Advocate, Re [AIR 1957 SC 149], this Court observed:

As has been laid down by this Court in the matter of ‘G’, a Senior Advocate of the Supreme Court the Court, in dealing with cases of professional misconduct is not concerned with ordinary legal rights, but with the special and rigid rules of professional conduct expected of and applied to a specially privileged class of persons who, because of their privileged status, are subject to certain disabilities which do not attach to other men and which do not attach even to them in a non-professional character... he (a legal
practitioner) is bound to conduct himself in a manner befitting the high and honourable profession to whose privileges he has so long been admitted; and if he departs from the high standards which that profession has set for itself and demands of him in professional matters, he is liable to disciplinary action. It appears to us that the fact of there being no specific rules governing the particular situation, which we are dealing with, on the facts found by us, is not any reason for accepting a less rigid standard. If any, the absence of rules increases the responsibility of the members of the profession attached to this Court as to how they should conduct themselves in such situations, having regard to the very high privilege that an advocate of this Court now enjoys as one entitled, under the law, to practise in all the courts in India.

42. In our country, admittedly, a social duty is cast upon the legal profession to show the people beckon (sic beacon) light by their conduct and actions. The poor, uneducated and exploited mass of the people need a helping hand from the legal profession, admittedly, acknowledged as a most respectable profession. No effort should be made or allowed to be made by which a litigant could be deprived of his rights, statutory as well as constitutional, by an advocate only on account of the exalted position conferred upon him under the judicial system prevalent in the country. It is true that an advocate is competent to settle the terms of his engagement and his fee by private agreement with his client but it is equally true that if such fee is not paid he has no right to retain the case papers and other documents belonging to his client. Like any other citizen, an advocate has a right to recover the fee or other amounts payable to him by the litigant by way of legal proceedings but subject to such restrictions as may be imposed by law or the rules made in that behalf. It is high time for the legal profession to join heads and evolve a code for themselves in addition to the mandate of the Advocates Act, Rules made thereunder and the Rules made by various High Courts and this Court, for strengthening the belief of the common man in the institution of the judiciary in general and in their profession in particular. Creation of such a faith and confidence would not only strengthen the rule of law but also result in reaching excellence in the profession.
A.N. GROVER, J. - 5. Arguments which have been addressed by both sides have centred on question Nos. 1 and 3 which are as follows:

(1) On the facts and circumstances of the case whether or not the Madhya Pradesh Electricity Board is a dealer within the meaning of Section 2 (c) of the C. P. and Berar Sales Tax Act, and Section 2 (d) of the Madhya Pradesh General Sales Tax Act, 1958, in respect of its activity of generation, distribution, sale and supply of electrical energy?

(3) On the facts and circumstances of the case, whether or not steam is saleable goods and if they are saleable goods is the turnover representing the supply thereof liable to be assessed to sales tax in the hands of the assessee?

The definition of a "dealer" is given in the two Acts substantially is that any person who carried on the business of buying, selling, supplying or distributing the goods is a "dealer" and "goods" are defined by Section 2 (d) by Act XXI of 1947, as meaning all kinds of movable property other than actionable claims....and includes all material articles and commodities whether or not to be used in the construction, fitting out, improvement or repair of immovable property. The definition contained in Section 2(g) of Act II of 1959, is almost in similar terms except that certain additions are there with which we are not concerned. Reference may be made, at this stage, to the definition of "movable property" which has not been defined in the two Acts given in Section 2(24) of the Madhya Pradesh General Clauses Act. It has been defined to mean "property of every description, except immovable property" Section 2(18) of that Act says that "immovable property" includes land, benefits to arise out of land and things attached to the earth, or permanently fastened to anything attached to the earth.

6. The High Court went into a discussion from the point of view of mechanics relating to transmission of electric energy. It was of the view that electricity could not be regarded as an article or matter which could be possessed or moved or delivered.

7. Mr. I. N. Shroff has relied on certain decisions in which the same point was involved as in the present case, namely, whether electricity is "goods" for the purpose of imposition of sales tax. In Kumbakonam Electric Supply Corporation Ltd. v. Joint Commercial Tax Officer, Esplanade Division, Madras [14 STC 600], the Madras High Court was called upon to decide whether electricity is "goods" for the purposes of the Madras General Sales Tax Act, 1959, and the Central Sales Tax Act, 1956. After referring to the definition of "goods" as given in the Sale of Goods Act, 1930, it was observed that under that definition goods must be property and it must be movable. According to the learned Madras Judge any kind of property which is movable would fall within the definition of "goods" provided it was transmissible or transferable from hand to hand or capable of delivery which need not necessarily be in a tangible or a physical sense.
Reference was also made to the definition given in the General Clauses Act which was quite wide and it was held that if electricity was property and it was movable it would be "goods". The learned Judge found little difference between electricity and gas or water which would be property and could be subjected to a particular process, bottled up and sold for consumption. It was observed that electricity was capable of sale as property as it was sold, purchased and consumed every where. A "dealer" was defined by the Central Sales Tax Act practically in the same way as in the Madras General Sales Tax Act and it meant a person who carried on business of buying and selling goods. In the opinion of the learned Judge the concept of dealer, goods and sale comprehended all kinds of movable property. He further relied on certain decisions which have been cited before and which will be presently noticed. A similar view was expressed by Tek Chand, J. of the Punjab and Haryana High Court in Malerkotla Power Supply Company v. The Excise and Taxation Officer, Sangrur [22 STC 325]. It was held that electric energy fell within the definition of "goods" in both the Punjab Sales Tax Act, 1948, and the Central Sales Tax Act, 1956. According to the learned Judge electric energy has the commonly accepted attributes of movable property. It can be stored and transmitted. It is also capable of theft. It may not be tangible in the sense that it cannot be touched without considerable danger of destruction or injury but it was perceptible both as an illuminant and a fuel and also in other energy giving forms Electric energy may not be property in the sense of the term "movable property" as used in the Punjab and Central General Clauses Acts in contra-distinction to "immovable property" but it must fall within the ambit of "goods" even if in a sense it was intangible or invisible. As pointed out in the Madras case the statement contained in 18 Am. Jur. 407 [18 AJ 407 (2 Electy)] recognises that electricity is property capable of sale and it may be the subject of larceny. In Naini Tal Hotel v. Municipal Board [AIR 1946 All 502], it was held that for the purpose of Article 52 of the Indian Limitation Act, electricity was property and goods. In Erie County Natural Gas and Fuel Co. Ltd. v. Carroll [(1911) AC 105], a question arose as to the measure of damages for a breach of contract to supply gas. Lord Atkinson delivering the judgment of the Privy Council applied the same rule which is applicable where the contract is one for sale of goods. In other words gas was treated to be "goods".

8. The High Court, in the present case, appears to have relied on Rash Behari v. Emperor [AIR 1936 Cal 753], in which approval was accorded to the statement in Pollock and Mulla's Commentary on Sale Goods Act, 1913 that it was doubtful whether that Act was applicable to such "goods" as gas, water and electricity. The context in which this matter is discussed in the Calcutta case is altogether different and distinguishable and what was being decided there was the scope and ambit of Section 39 of the Electricity Act, 1910. As regards the entries in List II of the Seventh Schedule to the Constitution, the relevant ones may be produced:

53. Taxes on the consumption of sale of electricity.

54. Taxes on the sale or purchase of goods other than newspapers, subject to the provisions of Entry 92-A of List I.
9. The reasoning which prevailed with the High Court was that a well-defined distinction existed between the sale or purchase of "goods" and consumption or sale of electricity otherwise there was no necessity of having Entry No. 53 but under Entry 53 taxes can be levied not only on sale of electricity but also on its consumption which could not probably have been done under Entry 54. It is difficult to derive much assistance from the aforesaid entries. What has essentially to be seen is whether electric energy is "goods" within the meaning of the relevant provisions of the two Acts. The definition in terms is very wide according to which "goods" means all kinds of movable property. Then certain items are specifically excluded or included and electric energy or electricity is not one of them. The term movable property when considered with reference to "goods" as defined for the purposes of sales tax cannot be taken in a narrow sense and merely because electric energy is not tangible or cannot be moved or touched like, for instance, a piece of wood or a book it cannot cease to be movable property when it has all the attributes of such property. It is needless to repeat that it is capable of abstraction, consumption and use which, if done dishonestly, would attract punishment under Section 39 of the Indian Electricity Act, 1910. It can be transmitted, transferred, delivered, stored, possessed etc., in the same way as any other movable property. Even in Benjamin on Sale, 8th Ed. reference has been made at p. 171 to County of Durham Electrical, etc. Co. v. Inland Revenue [(1909) 2 KB 604], in which electric energy was assumed to be "goods". If there can be sale and purchase of electric energy like any other movable object, we see no difficulty in holding that electric energy was intended to be covered by the definition of "goods" in the two Acts. If that had not been the case there was no necessity of specifically exempting sale of electric energy from the payment of sales tax by making a provision for it in the schedules to the two Acts. It cannot be denied that the Electricity Board carried on principally the business of selling, supplying or distributing electric energy. It would therefore clearly fall within the meaning of the expression "dealer" in the two Acts.

10. As regards steam there has been a good deal of argument on the question whether it is liable to be assessed to sales tax in the hands of the Electricity Board. According to Mr Shroff, the Electricity Board carried on the business of selling steam to the Nepa Mills and that this has lasted for a number of years. It has been submitted that simply because the Electricity Board does not have any profit motive in supplying steam, it cannot escape payment of sales tax because the steam is nevertheless being sold as "goods". The High Court was of the view that the water which the Nepa Mills supplied free to the Electricity Board became the property of the Board and in return for this free supply the Board agreed to give steam to Nepa Mills at a rate based solely on the coal consumed in producing steam. The mills had also agreed to reimburse the Electricity Board for the loss sustained on account of the mills not taking the "full demand of steam". According to the High Court there was no contract for the sale of steam as such and it was only for the labour and cost involved in its supply to the mills. The High Court relied on the findings of the Tribunal on this point and held that the turnover in respect of steam was not taxable. The tribunal in its order, dated June 16, 1966, referred to certain conditions of working arrangement which was reduced to writing but which had not been properly executed as a contract which
showed that the mills was supplying water free and the Electricity Board was making a prorata charge of conversion of water into steam. It seems to us that the High Court was right in coming to the conclusion, on the finding of the tribunal, that the real arrangement was for supplying steam on actual cost basis and in that sense it was more akin to a labour contract than to sale.

12. On the findings of the tribunal and the High Court, we are of the opinion that the arrangement relating to supply of steam in return for the water supplied by the mills on payment of actual cost was not one of sale but was more in the nature of a works contract. In the result, the answer of the High Court to the first question is discharged and it is held that the Electricity Board is a dealer within the meaning of the relevant provisions of the two Acts in respect of its activities of generation, distribution, sale and supply of electric energy. The appeals are allowed to the extent indicated above.

* * * * *
‘SALE’ AND ‘AGREEMENT TO SELL’


1959 SCR 379

VENKATARAMA AIYAR, J. - This appeal arises out of proceedings for assessment of sales tax payable by the respondents for the year 1949-1950, and it raises a question of considerable importance on the construction of Entry 48 in List II of Schedule VII to the Government of India Act, 1935, ‘Taxes on the sale of goods’.

2. The respondents are a private limited company registered under the provisions of the Indian Companies Act, doing business in the construction of buildings, roads and other works and in the sale of sanitary wares and other sundry goods. Before the Sales Tax Authorities, the disputes ranged over a number of items, but we are concerned in this appeal with only two of them. One is with reference to a sum of Rs 29,51,528-7-4 representing the value of the materials used by the respondents in the execution of their works contracts, calculated in accordance with the statutory provisions applicable thereto, and the other relates to a sum of Rs 1,98,929-0-3 being the price of foodgrains supplied by the respondents to their workmen.

3. It will be convenient at this stage to refer to the provisions of the Madras General Sales Tax Act, (Mad. 9 of 1939), insofar as they are relevant for the purpose of the present appeal. Section 2(h) of the Act, as it stood when it was enacted, defined ‘sale’ as meaning ‘every transfer of the property in goods by one person to another in the course of trade or business for cash or for deferred payment or other valuable consideration’. In 1947, the legislature of Madras enacted the Madras General Sales Tax (Amendment) Act 25 of 1947 introducing several new provisions in the Act, and it is necessary to refer to them so far as they are relevant for the purpose of the present appeal. Section 2(c) of the Act had defined ‘goods’ as meaning ‘all kinds of movable property other than actionable claims, stocks and shares and securities and as including all materials, commodities and articles’, and it was amended so as to include materials ‘used in the construction, fitting out, improvement or repair of immoveable property or in the fitting out, improvement or repair of movable property’. The definition of ‘sale’ in Section 2(h) was enlarged so as to include ‘transfer of property in goods involved in the execution of a works contract’. In the definition of ‘turnover’ in Section 2(i), the following Explanation (1)(i) was added:

Subject to such conditions and restrictions, if any, as may be prescribed in this behalf -

the amount for which goods are sold shall, in relation to a works contract, be deemed to be the amount payable to the dealer for carrying out such contract, less such portion as may be prescribed of such amount, representing the usual proportion of the cost of labour to the cost of materials used in carrying out such contract.â€
A new provision was inserted in Section 2(i) defining "works contract" as meaning "any agreement for carrying out for cash or for deferred payment or other valuable consideration, the construction, fitting out, improvement or repair of any building, road, bridge or other immovable property or the fitting out, improvement or repair of any movable property." Pursuant to the Explanation to Section 2(l)(i), a new rule, Rule 4(3), was enacted that "the amount for which goods are sold by a dealer shall, in relation to a works contract, be deemed to be the amount payable to the dealer for carrying out such contract less a sum not exceeding such percentage of the amount payable as may be fixed by the Board of Revenue, from time to time for different areas, representing the usual proportion in such areas of the cost of labour to the cost of materials used in carrying out such contract, subject to the following maximum percentages…", and then follows a scale varying with the nature of the contracts.

4. It is on the authority of these provisions that the appellant seeks to include in the turnover of the respondents the sum of Rs 29,51,528-7-4 being the value of the materials used in the construction works as determined under Rule 4(3). The respondents contest this claim on the ground that the power of the Madras Legislature to impose a tax on sales under Entry 48 in List II in Schedule VII of the Government of India Act, does not extend to imposing a tax on the value of materials used in works, as there is no transaction of sale in respect of those goods, and that the provisions introduced by the Madras General Sales Tax (Amendment) Act, 1947 authorising the imposition of such tax are ultra vires. As regards the sum of Rs 1,98,929-0-3, the contention of the respondents was that they were not doing business in the sale of foodgrains, that they had supplied them to the workmen when they were engaged in construction works in out of the way places, adjusting the price therefor in the wages due to them and that the amounts so adjusted were not liable to be included in the turnover. The Sales Tax Appellate Tribunal rejected both these contentions, and held that the amounts in question were liable to be included in the taxable turnover of the respondents.

7. The sole question for determination in this appeal is whether the provisions of the Madras General Sales Tax Act are ultra vires, insofar as they seek to impose a tax on the supply of materials in execution of works contract treating it as a sale of goods by the contractor, and the answer to it must depend on the meaning to be given to the words "sale of goods" in Entry 48 in List II of Schedule VII to the Government of India Act, 1935. Now, it is to be noted that while Section 311(2) of the Act defines "goods" as including "all materials, commodities and articles," it contains no definition of the expression "sale of goods." It was suggested that the word "materials" in the definition of "goods" is sufficient to take in materials used in a works contract. That is so; but the question still remains whether there is a sale of those materials within the meaning of that word in Entry 48. On that, there has been sharp conflict of opinion among the several High Courts. In Pandit Banarsi Das v. State of Madhya Pradesh [(1955) 6 STC 93], a Bench of the Nagpur High Court held, differing from the view taken by the Madras High Court in the judgment now under appeal, that the provisions of the Act imposing a tax on the value of the materials used in a construction on the footing of a sale thereof were valid, but that they were bad
insofar as they enacted an artificial rule for determination of that value by deducting out of the total receipts a fixed percentage on account of labour charges, inasmuch as the tax might, according to that computation, conceivably fall on a portion of the labour charges and that would be ultra vires Entry 48. The entire controversy hinges on the meaning of the words "sale of goods" in Entry 48, and the point which we have now to decide is as to the correct interpretation to be put on them.

8. The contention of the appellant and of the States which have intervened is that the provisions of a Constitution which confer legislative powers should receive a liberal construction, and that, accordingly, the expression "sale of goods" in Entry 48 should be interpreted not in the narrow and technical sense in which it is used in the Indian Sale of Goods Act, 1930, but in a broad sense.

12. The contention of the appellant is well-founded that as the words "sale of goods" in Entry 48 occur in a Constitution Act and confer legislative powers on the State Legislature in respect of a topic relating to taxation, they must be interpreted not in a restricted but broad sense. And that opens up questions as to what that sense is, whether popular or legal, and what its connotation is either in the one sense or the other. Learned counsel appearing for the States and for the assesses have relied in support of their respective contentions on the meaning given to the word "sale" in authoritative text-books, and they will now be referred to. According to Blackstone, "sale or exchange is a transmutation of property from one man to another, in consideration of some price or recompense in value." This passage has, however, to be read distributively and so read, sale would mean transfer of property for price. That is also the definition of "sale" in Benjamin on Sale, 1950 Edn., p. 2. In Halsbury's Laws of England, Second Edn., Vol. 29, p. 5, para 1, we have the following:

"Sale is the transfer of the ownership of a thing from one person to another for a money price. Where the consideration for the transfer consists of other goods, or some other valuable consideration, not being money, the transaction is called exchange or barter; but in certain circumstances, it may be treated as one of sale.

The law relating to contracts of exchange or barter is undeveloped, but the courts seem inclined to follow the maxim of civil law, permutatio vicina est emptioni, and to deal with such contracts as analogous to contracts of sale. It is clear, however, that statutes relating to sale would have no application to transactions by way of barter."

In Chalmer's Sale of Goods Act, 12th Edn., it is stated at p. 3 that "the essence of sale is the transfer of the property in a thing from one person to another for a price" and at p. 6 it is pointed out that "where the consideration for the transfer consists of the delivery of goods, the contract is not a contract of sale but is a contract of exchange or barter." In Corpus Juris, Vol. 55, p. 36, the law is thus stated:
"Sale" in legal nomenclature, is a term of precise legal import, both at law and in equity, and has a well defined legal signification, and has been said to mean, at all times, a contract between parties to give and pass rights of property for money, which the buyer pays or promises to pay to the seller for the thing bought or sold.

It is added that the word "sale" as used by the authorities is not a word of fixed and invariable meaning, but may be given a narrow or broad meaning, according to the context.

13. It will be seen from the foregoing that there is practical unanimity of opinion as to the import of the word "sale" in its legal sense, there being only some difference of opinion in America as to whether price should be in money or in money's worth, and the dictionary meaning is also to the same effect. Now, it is argued by Mr Sikri, the learned Advocate-General of Punjab, that the word "sale" is, in its popular sense, of wider import than in its legal sense, and that is the meaning which should be given to that word in Entry 48, and he relies in support of this position on the observations in *Nevile Reid and Company Ltd. v. Commissioners of Inland Revenue* [(1922) 12 Tax Cas 545]. There, an agreement was entered into on April 12, 1918, for the sale of the trading stock in a brewery business and the transaction was actually completed on June 24, 1918. In between the two dates, the Finance Act, 1918, had imposed excess profits tax, and the question was whether the agreement dated April 12, 1918, amounted to a sale in which case the transaction would fall outside the operation of the Act. The Commissioners had held that as title to the goods passed only on June 24, 1918, the agreement dated April 12, 1918, was only an agreement to sell and not the sale which must be held to have taken place on June 24, 1918, and was therefore liable to be taxed. Sankey, J., agreed with this decision, but rested it on the ground that as the agreement left some matters still to be determined and was, in certain respects, modified later, it could not be held to be a sale for the purpose of the Act. In the course of the judgment, he observed that "sale" in the Finance Act should not be construed in the light of the provisions of the Sale of Goods Act, but must be understood in a commercial or business sense.

14. Now, in its popular sense, a sale is said to take place when the bargain is settled between the parties, though property in the goods may not pass at that stage, as where the contract relates to future or unascertained goods, and it is that sense that the learned Judge would appear to have had in his mind when he spoke of a commercial or business sense. But apart from the fact that these observations were obiter, this Court has consistently held that though the word "sale" in its popular sense is not restricted to passing of title, and has a wider connotation as meaning the transaction of sale, and that in that sense an agreement to sell would, as one of the essential ingredients of sale, furnish sufficient nexus for a State to impose a tax, such levy could, nevertheless, be made only when the transaction is one of sale, and it would be a sale only when it has resulted in the passing of property in the goods to the purchaser. It has also been held in *STO v. Messrs Budh Prakash Jai Prakash* [(1955) 1 SCR 243], that the sale contemplated by Entry 48 of the Government of India Act was a transaction in which title to the goods passes and a mere executory agreement was not a sale within that entry. We must accordingly hold that the
expression "sale of goods" in Entry 48 cannot be construed in its popular sense, and that it must be interpreted in its legal sense. What its connotation in that sense is, must now be ascertained. For a correct determination thereof, it is necessary to digress somewhat into the evolution of the law relating to sale of goods.

15. The concept of sale, as it now obtains in our jurisprudence, has its roots in the Roman law. Under that law, sale, *emptio venditio*, is an agreement by which one person agrees to transfer another the exclusive possession (*vacuam possessionem tradere*) of something (merx) for consideration. In the earlier stages of its development, the law was unsettled whether the consideration for sale should be money or anything valuable. By a rescript of the Emperors Diocletian and Maximian of the year 294 A.D., it was finally decided that it should be money, and this law is embodied in the Institutes of Justinian, *vide* Title 23. *Emptio venditio* is, it may be noted, what is known in Roman law as a consensual contract. That is to say, the contract is complete when the parties agree to it, even without delivery as in contracts *re* or the observance of any formalities as in contracts *verbis* and *litteris*. The common law of England relating to sales developed very much on the lines of the Roman law in insisting on agreement between parties and price as essential elements of a contract of sale of goods. In his work on *Sale*, Benjamin observes:

> Hence it follows that, to constitute a valid sale, there must be a concurrence of the following elements viz. (1) Parties competent to contract; (2) mutual assent; (3) a thing, the absolute or general property in which is transferred from the seller to the buyer; and (4) a price in money paid or promised.

16. Coming to the Indian law on the subject, Section 77 of the Contract Act defined "sale" as the exchange of property for a price involving the transfer of ownership of the thing sold from the seller to the buyer. It was suggested that under this section it was sufficient to constitute a sale that there was a transfer of ownership in the thing for a price and that a bargain between the parties was not an essential element. But the scheme of the Contract Act is that it enacts in Sections 1 to 75 provisions applicable in general to all contracts, and then deals separately with particular kinds of contract such as sale, guarantee, bailment, agency and partnership, and the scheme necessarily posits that all these transactions are based on agreements. We then come to the Indian Sale of Goods Act, 1930 (3 of 1930), which repealed Chapter 7 of the Contracts Act relating to sale of goods, and Section 4 thereof is practically in the same terms as Section 1 of the English Act. Thus, according to the law both of England and of India, in order to constitute a sale it is necessary that there should be an agreement between the parties for the purpose of transferring title to goods which of course presupposes capacity to contract, that it must be supported by money consideration, and that as a result of the transaction property must actually pass in the goods. Unless all these elements are present, there can be no sale. Thus, if merely title to the goods passes but not as a result of any contract between the parties, express or implied, there is no sale. So also if the consideration for the transfer was not money but other valuable
consideration, it may then be exchange or barter but not a sale. And if under the contract of sale, title to the goods has not passed, then there is an agreement to sell and not a completed sale.

17. Now, it is the contention of the respondents that as the expression “sale of goods” was at the time when the Government of India Act was enacted, a term of well-recognised legal import in the general law relating to sale of goods and in the legislative practice relating to that topic both in England and in India, it must be interpreted in Entry 48 as having the same meaning as in the Sale of Goods Act, 1930, and a number of authorities were relied on in support of this contention.

21. On the basis of the authorities, the respondents contend that the true interpretation to be put on the expression “sale of goods” in Entry 48 is what it means in the Indian Sale of Goods Act, 1930, and what it has always meant in the general law relating to sale of goods. It is contended by the appellant - and quite rightly - that in interpreting the words of a Constitution the legislative practice relative thereto is not conclusive. But it is certainly valuable and might prove determinative unless there are good reasons for disregarding it, and in STO v. Budh Prakash Jai Prakash, it was relied on for ascertaining the meaning and true scope of the very words which are now under consideration. There, in deciding that an agreement to sell is not a sale within Entry 48, this Court referred to the provisions of the English Sale of Goods Act, 1893, the Indian Contract Act, 1872, and the Indian Sale of Goods Act, 1930, for construing the word “sale” in that Entry and observed:

Thus, there having existed at the time of the enactment of the Government of India Act, 1935, a well-defined and well-established distinction between a sale and an agreement to sell, it would be proper to interpret the expression “sale of goods” in entry 48 in the sense in which it was used in legislation both in England and India and to hold that it authorises the imposition of a tax only when there is a completed sale involving transfer of title.

This decision, though not decisive of the present controversy, goes far to support the contention of the respondents that the words “sale of goods” in Entry 48 must be interpreted in the sense which they bear in the Indian Sale of Goods Act, 1930.

22. The appellant and the intervening States resist this conclusion on the following grounds:

(1) The provisions of the Government of India Act, read as a whole, show that the words “sale of goods” in Entry 48 are not to be interpreted in the sense which they have in the Sale of Goods Act, 1930;

(2) The legislative practice relating to the topic of sales tax does not support the narrow construction sought to be put on the language of Entry 48;

(3) The expression “sale of goods” has in law a wider meaning than what it bears in the Sale of Goods Act, 1930, and that is the meaning which must be put on it in Entry 48; and
(4) The language of Entry 48 should be construed liberally so as to take in new concepts of sales tax.

(1) As regards the first contention, the argument is that in the Government of India Act, 1935, there are other provisions which give a clear indication that the expression विक्रय of goods in Entry 48 is not to be interpreted in the sense which it bears in the Sale of Goods Act, 1930. That is an argument open to the appellant, because rules of interpretation are only aids for ascertaining the true legislative intent and must yield to the context, where the contrary clearly appears. Now, what are the indications contra? Section 311(2) of the Government of India Act defines वित्तीय आय as meaning वित्तीय आय as defined for the purposes of the enactments relating to Indian income tax. It is said that if the words विक्रय of goods in Entry 48 were meant to have the same meaning as those words in the Sale of Goods Act, that would have been expressly mentioned as in the case of definition of agricultural income, and that therefore that is not the meaning which should be put on them in that Entry.

In our opinion, that is not the inference to be drawn from the absence of words linking up the meaning of the word विक्रय with what it might bear in the Sale of Goods Act. We think that the true legislative intent is that the expression विक्रय of goods in Entry 48 should bear the precise and definite meaning it has in law, and that that meaning should not be left to fluctuate with the definition of विक्रय in laws relating to sale of goods which might be in force for the time being. It was then said that in some of the Entries, for example, Entries 31 and 49, List II, the word विक्रय was used in a wider sense than in the Sale of Goods Act, 1930. Entry 31 is अल्कोहोलिक नाक्सिक drugs, that is to say, the production, manufacture, possession, transport, purchase and sale of intoxicating liquors, opium and other narcotic drugs. The argument is that विक्रय in the Entry must be interpreted as including barter, as the policy of the law cannot be to prohibit transfers of liquor only when there is money consideration therefor. But this argument proceeds on a misapprehension of the principles on which the Entries are drafted. The scheme of the drafting is that there is in the beginning of the Entry words of general import, and they are followed by words having reference to particular aspects thereof. The operation of the general words, however, is not cut down by reason of the fact that there are sub-heads dealing with specific aspects. In Manikkasundara v. R.S. Nayudu [(1946) FCR 67, 84], occur the following observations:

The subsequent words and phrases are not intended to limit the ambit of the opening general term or phrase but rather to illustrate the scope and objects of the legislation envisaged as comprised in the opening term or phrase.

A law therefore prohibiting any dealing in intoxicating liquor, whether by way of sale or barter or gift, will be intra vires the powers conferred by the opening words without resort to the words विक्रय and purchase. Entry 49 in List II is cesses on the entry of goods into a local area for consumption, use or sale therein. It is argued that the word विक्रय here cannot be limited to transfers for money or for even consideration. The answer to this is that the words विक्रय
consumption, use or sale therein are a composite expression meaning octroi duties, and have a precise legal connotation, and the use of the word "sale therein" can throw no light on the meaning of that word in Entry 48. We are of opinion that the provisions in the Government of India Act, 1935 relied on for the appellant are too inconclusive to support the inference that "sale" in Entry 48 was intended to be used in a sense different from that in the Sale of Goods Act.

(2) It is next urged that for determining the true meaning of the expression "Taxes on the sale of goods" in Entry 48 it would not be very material to refer to the legislative practice relating to the law in respect of sale of goods. It is argued that "sale of goods" and "Taxes on sale of goods" are distinct matters, each having its own incidents, that the scope and object of legislation in respect of the two topics are different, that while the purpose of a law relating to sale of goods is to define the rights of parties to a contract, that of a law relating to tax on sale of goods is to bring money into the coffers of the State, and that, accordingly, legislative practice with reference to either topic cannot be of much assistance with reference to the other. Now, it is true that the object and scope of the two laws are different, and if there was any difference in the legislative practice with reference to these two topics, we should, in deciding the question that is now before us, refer more appropriately to that relating to sales tax legislation rather than that relating to sale of goods. But there was, at the time when the Government of India Act was enacted, no law relating to sales tax either in England or in India. The first Sales Tax law to be enacted in India is the Madras General Sales Tax Act, 1939, and that was in exercise of the power conferred by Entry 48. In England, a purchase tax was introduced for the first time only by the Finance Act 2 of 1940. The position, therefore, is that Entry 48 introduces topic of legislation with respect to which there was no legislative practice.

(3) It is next contended by Mr Sikri that though the word "sale" has a definite sense in the Sale of Goods Act, 1930, it has a wider sense in law other than that relating to sale of goods, and that, on the principle that words conferring legislative powers should be construed in their broadest amplitude, it would be proper to attribute that sense to it in Entry 48. It is argued that in its wider sense the expression "sale of goods" means all transactions resulting in the transfer of title to goods from one person to another, that a bargain between the parties was not an essential element thereof, and that even involuntary sales would fall within its connotation. He went on to state that such sale took place when the value of the goods is paid to the owner.

The Land Acquisition Act, 1894 refers to the compulsory taking over of immovable property as acquisition. In List II of the Government of India Act, this topic is described in Entry 9 as compulsory acquisition of land. In the Constitution, Entry 42 in List III is acquisition and requisition of property. The ratio on which the opinion of Lord Morton is based has no place in the construction of Entry 48, and the law as laid down by the majority is in consonance with the view taken by this Court that bargain is an essential element in a transaction of sale.

Another contention presented from the same point of view but more limited in its sweep is that urged by the learned Solicitor-General, the Advocate-General of Madras and the other counsel appearing for the States, that even in the view that an agreement between the parties was
necessary to constitute a sale, that agreement need not relate to the goods as such, and that it
would be sufficient if there is an agreement between the parties and in the carrying out of that
agreement there is transfer of title in movables belonging to one person to another for
consideration. It is argued that Entry 48 only requires that there should be a sale, and that means
transfer of title in the goods, and that to attract the operation of that Entry it is not necessary that
there should also be an agreement to sell those goods. To hold that there should be an agreement
to sell the goods as such is, it is contended, to add to the Entry, words which are not there.

We are unable to agree with this contention. If the words "sale of goods" have to be
interpreted in their legal sense, that sense can only be what it has in the law relating to sale of
goods. The ratio of the rule of interpretation that words of legal import occurring in a statute
should be construed in their legal sense is that those words have, in law, acquired a definite and
precise sense, and that, accordingly, the legislature must be taken to have intended that they
should be understood in that sense. In interpreting an expression used in a legal sense, therefore,
we have only to ascertain the precise connotation which it possesses in law. It has been already
stated that, both under the common law and the statute law relating to sale of goods in England
and in India, to constitute a transaction of sale there should be an agreement, express or implied,
relating to goods to be completed by passing of title in those goods. It is of the essence of this
concept that both the agreement and the sale should relate to the same subject-matter. Where the
goods delivered under the contract are not the goods contracted for, the purchaser has got a right
to reject them, or to accept them and claim damages for breach of warranty. Under the law,
therefore, there cannot be an agreement relating to one kind of property and a sale as regards
another. We are accordingly of opinion that on the true interpretation of the expression "sale of
goods" there must be an agreement between the parties for the sale of the very goods in which
eventually property passes. In a building contract, 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 receive payment as provided therein, and as will presently be shown
there is in such an agreement neither a contract to sell the materials used in the construction, nor
does property pass therein as movables. It is therefore impossible to maintain that there is implicit
in a building contract a sale of materials as understood in law.

(4) It was finally contended that the words of a Constitution conferring legislative power
should be construed in such manner as to make it flexible and elastic so as to enable that power to
be exercised in respect of matters which might be unknown at the time it was enacted but might
come into existence with the march of time and progress in science, and that on this principle the
expression "sale of goods" in Entry 48 should include not only what was understood as sales at
the time of the Government of India Act, 1935 but also whatever might be regarded as sale in the
times to come.

24. The principle of the decisions is that when, after the enactment of a legislation, new facts
and situations arise which could not have been in its contemplation, the statutory provisions could
properly be applied to them if the words thereof are in a broad sense capable of containing them.
The question then would be not what the framers understood by those words, but whether those words are broad enough to include the new facts. Clearly, this principle has no application to the present case. Sales tax was not a subject which came into vogue after the Government of India Act, 1935. It was known to the framers of that statute and they made express provision for it under Entry 48. Then it becomes merely a question of interpreting the words, and on the principle, already stated, that words having known legal import should be construed in the sense which they had at the time of the enactment, the expression “sale of goods” must be construed in the sense which it has in the Sale of Goods Act.

The argument is that the definition of “sale” given in the Madras General Sales Tax Act is in conflict with that given in the Sale of Goods Act, 1930, that the sale of goods is a matter falling within Entry 10 of the Concurrent List, and that, in consequence, as the Madras General Sales Tax (Amendment) Act, 1947 under which the impugned provisions had been enacted, had not been reserved for the assent of the Governor-General as provided in Section 107 (2), its provisions are bad to the extent that they are repugnant to the definition of “sale” in the Sale of Goods Act, 1930. The short answer to this contention is that the Madras General Sales Tax Act is a law relating not to sale of goods but to tax on sale of goods, and that it is not one of the matters enumerated in the Concurrent List or over which the Dominion legislature is competent to enact a law, but is a matter within the exclusive competence of the Province under Entry 48 in List II. The only question that can arise with reference to such a law is whether it is within the purview of that Entry. If it is, no question of repugnancy under Section 107 can arise.

26. It now remains to deal with the contention pressed on us by the States that even if the supply of materials under a building contract cannot be regarded as a sale under the Sale of Goods Act, that contract is nevertheless a composite agreement under which the contractor undertakes to supply materials, contribute labour and produce the construction, and that it is open to the State in execution of its tax laws to split up that agreement into its constituent parts, single out that which relates to the supply of materials and to impose a tax thereon treating it as a sale. It is said that this is a power ancillary to the exercise of the substantive power to tax sales. The respondents contend that even if the agreement between the parties could be split up in the manner suggested for the appellant, the resultant will not be a sale in the sense of the Sale of Goods Act, as there is in a works contract neither an agreement to sell materials as such, nor does property in them pass as movables.

32. The contention that a building contract contains within it all the elements constituting a sale of the materials was sought to be established by reference to the form of the action, when the claim is in quantum meruit. It was argued that if a contractor is prevented by the other party to the contract from completing the construction he has, as observed by Lord Blackburn in Appleby v. Myres claim against that party, that the form of action in such a case is for work done and materials supplied, as appears from Bullen and Leake’s Precedents of Pleadings, 10th Edn., at pp. 285-86, and that that showed that the concept of sale of goods was latent in a building contract. The answer to this contention is that a claim for quantum meruit is a claim for damages
for breach of contract, and that the value of the materials is a factor relevant only as furnishing a basis for assessing the amount of compensation. That is to say, the claim is not for price of goods sold and delivered but for damages. That is also the position under Section 65 of the Indian Contract Act.

33. Another difficulty in the way of accepting the contention of the appellant as to splitting up a building contract is that the property in materials used therein does not pass to the other party to the contract as movable property. It would so pass if that was the agreement between the parties. But if there was no such agreement and the contract was only to construct a building, then the materials used therein would become the property of the other party to the contract only on the theory of accretion. When the work to be executed is, as in the present case, a house, the construction imbedded on the land becomes an accretion to it on the principle *quicquid plantatur solo, solo cedit*, and it vests in the other party not as a result of the contract but as the owner of the land. It is argued that the maxim, what is annexed to the soil goes with the soil, has not been accepted as a correct statement of the law of this country.

The decisions are concerned with rights of persons who, not being trespassers, bona fide put up constructions on lands belonging to others, and as to such persons the authorities lay down that the maxim recognised in English law, *quicquid plantatur solo, solo cedit* has no application, and that they have the right to remove the superstructures, and that the owner of the land should pay compensation if he elects to retain them. That exception does not apply to buildings which are constructed in execution of a works contract, and the law with reference to them is that the title to the same passes to the owner of the land as an accretion thereto. Accordingly, there can be no question of title to the materials passing as movables in favour of the other party to the contract. It may be, as was suggested by Mr Sastri for the respondents, that when the thing to be produced under the contract is movable property, then any material incorporated into it might pass as a movable, and in such a case the conclusion that no taxable sale will result from the disintegration of the contract can be rested only on the ground that there was no agreement to sell the materials as such. But we are concerned here with a building contract, and in the case of such a contract, the theory that it can be broken up into its component parts and as regards one of them it can be said that there is a sale must fail both on the grounds that there is no agreement to sell materials as such, and that property in them does not pass as movables.

34. To sum up, the expression "sale of goods" in Entry 48 is a *nomen juris*, its essential ingredients being an agreement to sell movables for a price and property passing therein pursuant to that agreement. In a building contract which is, as in the present case, one, entire and indivisible - and that is its norm, there is no sale of goods, and it is not within the competence of the Provincial Legislature under Entry 48 to impose a tax on the supply of the materials used in such a contract treating it as a sale.

35. This conclusion entails that none of the legislatures constituted under the Government of India Act, 1935 was competent in the exercise of the power conferred by Section 100 to make
laws with respect to the matters enumerated in the lists, to impose a tax on construction contracts and that before such a law could be enacted it would have been necessary to have had recourse to the residual powers of the Governor-General under Section 104 of the Act. And it must be conceded that a construction which leads to such a result must, if that is possible, be avoided. It is also a fact that acting on the view that Entry 48 authorises it, the States have enacted laws imposing a tax on the supply of materials in works contracts, and have been realising it, and their validity has been affirmed by several High Courts. All these laws were in the statute book when the Constitution came into force, and it is to be regretted that there is nothing in it which offers a solution to the present question. We have, no doubt, Article 248 and Entry 97 in List I conferring residual power of legislation on Parliament, but clearly it could not have been intended that the Centre should have the power to tax with respect to works constructed in the States. In view of the fact that the State Legislatures had given to the expression "sale of goods" in Entry 48 a wider meaning than what it has in the Sale of Goods Act, that States with sovereign powers have in recent times been enacting laws imposing tax on the use of materials in the construction of buildings, and that such a power should more properly be lodged with the States rather than the Centre, the Constitution might have given an inclusive definition of "sale" in Entry 54 so as to cover the extended sense. But our duty is to interpret the law as we find it, and having anxiously considered the question, we are of opinion that there is no sale as such of materials used in a building contract, and that the Provincial Legislatures had no competence to impose a tax thereon under Entry 48.

36. To avoid misconception, it must be stated that the above conclusion has reference to works contracts, which are entire and indivisible, as the contracts of the respondents have been held by the learned Judges of the Court below to be. The several forms which such kinds of contracts can assume are set out in Hudson on Building Contracts, at p. 165. It is possible that the parties might enter into distinct and separate contracts, one for the transfer of materials for money consideration, and the other for payment of remuneration for services and for work done. In such a case, there are really two agreements, though there is a single instrument embodying them, and the power of the State to separate the agreement to sell, from the agreement to do work and render service and to impose a tax thereon cannot be questioned, and will stand untouched by the present judgment. In the result, the appeal fails.
STATUTORY TRANSACTIONS

Vishnu Agencies (P) Ltd. v. Commercial Tax Officer

(1978) 1 SCC 520 : AIR 1978 SC 449

Y.V. CHANDRACHUD, J. - These appeals have been placed for hearing before a seven-Judge Bench in order to set at rest to the extent foreseeable, the controversy whether what is conveniently, though somewhat loosely, called a ‘compulsory sale’ is exigible to sales tax. When essential goods are in short supply, various types of orders are issued under the Essential Commodities Act, 1955 with a view to making the goods available to the consumer at a fair price. Such orders sometimes provide that a person in need of an essential commodity like cement, cotton, coal or iron and steel must apply to the prescribed authority for a permit for obtaining the commodity. Those wanting to engage in the business of supplying the commodity are also required to possess a dealer’s licence. The permit-holder can obtain the supply of goods, to the extent of the quantity specified in the permit, from the named dealer only and at a controlled price. The dealer who is asked to supply the stated quantity to the particular permit holder has no option but to supply the stated quantity of goods at the controlled price. The question for our consideration, not easy to decide, is whether such a transaction amounts to a sale in the language of the law.

2. We will refer to the facts of civil appeal 724 of 1976, in which a company called M/s Vishnu Agencies (Pvt.) Ltd. is the appellant. It carries on business as an agent and distributor of cement in the State of West Bengal and is a registered dealer under the Bengal Finance (Sales Tax) Act, 1941, referred to hereinafter as the Bengal Sales Tax Act. Cement being a controlled commodity, its distribution is regulated by the West Bengal Cement Control Act, 26 of 1948, referred to hereinafter as the Cement Control Act, and by the orders made under Section 3(2) of that Act. Section 3(1) of the Cement Control Act provides, inter alia, for regulation of production, supply and distribution of cement for ensuring equitable supply and distribution thereof at a fair price. By the Cement Control Order, 1948 framed under the Cement Control Act, no sale or purchase of cement can be made, except in accordance with the conditions contained in the written order issued by the Director of Consumer Goods, West Bengal or the Regional Honorary Adviser to the Government of India at Calcutta or by officers authorised by them, at prices not exceeding the notified price.

3. The appellant is a licensed stockist of cement and is permitted to stock cement in its godown, to be supplied to persons in whose favour allotment orders are issued, at the price stipulated and in accordance with the conditions of permit issued by the authorities concerned. The authorities designated under the Cement Control Order issue permits under which a specified quantity of cement is allotted to a named permit-holder, to be delivered by a named dealer at the price mentioned in the permit. A permit is generally valid for 15 days and as soon as the price of
cement allotted in favour of an allottee is deposited with the dealer, he is bound to deliver to the former the specified quantity of cement at the specified price.

5. The appellant supplied cement to various allottees from time to time in pursuance of the allotment orders issued by appropriate authorities and in accordance with the terms of the licence obtained by it for dealing in cement. The appellant was assessed to sales tax by the first respondent, the Commercial Tax Officer, Sealdah Charge, in respect of these transactions. It paid the tax but discovered on perusal of the decision of this Court in New India Sugar Mills Ltd. v. Commr of Sales Tax [AIR 1963 SC 1207], that the transactions were not exigible to sales tax. Pleading that the payment was made under a mistake of law, it filed appeals against the orders of assessment passed by Respondent 1. It contended in appeals before the Assistant Commissioner of Commercial Taxes that by virtue of the provisions of the Cement Control Act and the Cement Control Order, no volition or bargaining power was left to it and since there was no element of mutual consent or agreement between it and the allottees, the transactions were not sales within the meaning of the Sales Tax Act. The appellant further contended that if the transactions were treated as sales, the definition of "sale" in the Sales Tax Act was ultra vires the legislative competency of the Provincial Legislature under the Government of India Act, 1935 and of the State Legislature under the Constitution. The appellate authority rejected the first contention and upheld the assessments. It did not, as it could not, go into the second contention regarding legislative competence. The appellant adopted the statutory remedies open to it but since the arrears of tax were mounting up and had already exceeded a sum of rupees eight lacs, it filed a writ petition in the Calcutta High Court praying that the various assessment orders referred to in the edition be quashed and a writ of prohibition be issued directing the sales tax authorities to refrain from making any further assessments for the purpose of sales tax on the transactions between the appellant and the allottees.

8. Since the crux of the appellant's contention is that the measures adopted to control the supply of cement leave no consensual option to the parties to bargain, it is necessary first to notice the relevant provisions of law bearing on the matter. The West Bengal Cement Control Act, 26 of 1948, was enacted in order to "confer powers to control the production, supply and distribution of, and trade and commerce in, cement in West Bengal." Section 3(1) of the Act empowers the Provincial Government to provide, by order in the Official Gazette, for regulating the supply and distribution of cement and trade and commerce therein. Section 3(2) provides by clauses (b) to (e) that an order made under sub-section (1) may provide for regulating or controlling the prices at which cement may be purchased or sold and for prescribing the conditions of sale thereof; regulating by licenses, permits or otherwise, the storage, transport, movement, possession, distribution, disposal, acquisition, use or consumption of cement; prohibiting the withholding from sale of cement ordinarily kept for sale; and for requiring any person holding stock of cement to sell the whole or specified part of the stock at such prices and to such persons or classes of persons or in such circumstances, as may be specified in the order. If any person contravenes an order made under Section 3, he is punishable under Section 6 with
imprisonment for a term which may extend to three years or with fine or with both, and if the order so provides, any Court, trying such contravention, may direct that any property in respect of which the Court is satisfied that the order has been contravened shall be forfeited to the Government.

9. In exercise of the powers conferred by Section 3(1) read with clauses (b) to (a) of Section 3(2) of the Act an older which may conveniently be called the Cement Control Order was promulgated by the Governor on August 18, 1948. The relevant clauses of that order contain the following provisions: By paragraph 1, no person shall after the commencement of the order sell or store for sale any cement unless he holds a licence and except in accordance with the conditions specified in such licence obtained from the Director of Consumer Goods, West Bengal, or any officer authorised by him in writing in this behalf. By paragraph 2, no person shall dispose of or agree to dispose of any cement except in accordance with the conditions contained in a written order of the Director of Consumer Goods, West Bengal or the authorities specified in the paragraph. By paragraph 3, no person shall acquire or agree to acquire any cement from any person except in accordance with the conditions contained in a written order of the Director of Consumer Goods, West Bengal, or the authorities specified in the paragraph. By paragraph 4, no person shall sell cement at a "higher than notified price." By paragraph 8, no person or stockist who has any stock of cement in his possession and to whom a written order has been issued under paragraph 2 shall "refuse to sell the same, fix a price not exceeding the notified price, and the seller shall deliver the cement to the buyer "within a reasonable time after the payment of price." By paragraph 8A, every stockist or every person employed by him shall, if so requested by the person acquiring cement from him under a written order issued under paragraph 3, weigh the cement in his presence or in the presence of his authorised representative at the time of delivery.

11. As regards the batch of appeals from Andhra Pradesh, the levy of tax was challenged by three sets of persons, the procuring agents, the rice-millers and the retailers with the difference that the procuring agents were assessed to purchase tax, while the others to sales tax under the Andhra Pradesh General Sales Tax Act, 1957. By virtue of the provisions of the Andhra Pradesh Paddy Procurement (Levy) Orders, the paddy-growers can sell their paddy to licensed procuring agents appointed by the State Government only and at the prices fixed by the Government. The agriculturist has the choice to select his own procuring agent but he cannot sell paddy to a private purchaser. The procuring agents in their turn have to supply paddy to the rice-millers at controlled prices. The millers, after converging paddy into rice, have to declare their stocks to the Civil Supplies Department. Pursuant to the orders issued by the Department, the rice-millers have to supply a requisite quantity of rice to the wholesale or retail dealers at prices fixed by the Department. Orders for such supply by the millers are passed by the authorities under the A. P. Procurement (Levy) and Restriction on Sale Order, 1957. Under this order, every miller carrying on rice-milling operations is required to sell to the agent or officer duly authorised by the Government the minimum quantities fixed by the Government at the notified price; and no miller or other person who gets his paddy milled in any rice-mill can move or otherwise dispose of the
rice recovered by milling at such rice-mill except in accordance with the directions of the Collector. A breach of these provisions is liable to be punished under Section 7 of the Essential Commodities Act, 1955 and the goods are liable to be forfeited under Section 6A of that Act. The A. P. sales tax authorities levied purchase tax on the purchase of paddy by the procuring agents from the agriculturists and they levied sales tax on the transactions relating to the supply of rice by the millers to the wholesale and retail dealers and on the sales made by the retailers to their customers. The case as regards the sales tax imposed on the transactions between the retail dealers and the consumers stood on an altogether different footing, but the writ petitions filed by the procuring agents and rice-millers raised questions similar to those involved in the writ petition filed in the Calcutta High Court.

13. We may now notice the provisions of the Sales Tax Acts. Section 2(8) of the Bengal Finance (Sales Tax) Act, 6 of 1941, defines a "sale" to mean "any transfer of property in goods, including a transfer of property in goods involved in the execution of a contract, but does not include a mortgage, hypothecation, charge or pledge." Section 2(1) provides that the word "turnover" used in relation to any period means "the aggregate of the sale-prices or parts of sale-prices receivable, or if a dealer so elects, actually received by the dealer ...." By clause (h) of Section 2, "sale-price" is defined to mean the amount payable to a dealer as valuable consideration for the sale of any goods. By Section 4(1), every dealer whose gross turnover during the year immediately preceding the commencement of the Act exceeded the taxable quantum is liable to pay tax under the Act on all "sales" effected after the date notified by the State Government.

14. Section 2(n) of the Andhra Pradesh Central Sales Tax Act, 1957 defines a "sale" as "every transfer of the property in goods by one person to another in the course of trade or commerce, for cash, or for deferred payment or for any other valuable consideration ...." Section 5 of that Act is the charging section.

15. According to these definitions of "sale" in the West Bengal and Andhra Pradesh Sales Tax Acts, transactions between the appellants on one hand and the allottees or nominees on the other are patently sales because indisputably, in one case the property in cement and in the other, property in paddy and rice was transferred for cash consideration by the appellants; and in so far as the West Bengal case is concerned, property in the goods did not pass to the transferees by way of mortgage, hypothecation, charge or pledge. But that is over-simplification. To counteract what appears on the surface plain enough, learned Counsel for the appellants have advanced a twofold contention. They contend, in the first place, that the word "sale" in the Sales Tax Acts passed by the Provincial or State Legislatures must receive the same meaning as in the Sale of Goods Act, 1930; or else, the definition of "sale" in these Sales Tax Acts will be beyond the legislative competence of the Provincial and State Legislatures. Secondly, the appellants contend that since under the Sale of Goods Act, there can be no sale without a contract of sale and since the parties in these matters had no volition of their own but were compelled by law to supply and receive the
goods at prices fixed under the Control Orders by the prescribed authorities, the transactions between them are not sales properly so called and therefore are not exigible to sales tax.

16. For examining the validity of the first contention, it is necessary to turn to the appropriate entries in the legislative lists of the Constitution Acts, for the contention is founded on the premise that the word ‘sale’ which occurs in those entries must receive the same meaning as in the Sale of Goods Act, 1930 since the expression ‘sale of goods’ was, at the time when the Government of India Act was enacted, a term of well-recognised legal import in the general law relating to sale of goods and in the legislative practice relating to that topic both in England and in Indian Entry 48 in the Provincial List, List II of Schedule VII to the Government of India Act, 1935 relates to: ‘Taxes on the sale of goods’. Entry 54 of List II, of the Seventh Schedule to the Constitution reads to say: ‘Taxes on the sale or purchase of goods other than newspapers, subject to the provisions of Entry 92A of List I’. We are not concerned with Entry 92A of the Union List but we may refer to it in order to complete the picture. It refers 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’.

17. The contention of the appellants that the expression ‘sale of goods’ in Entry 48 in the Provincial List of the Act of 1935 and in Entry 54 in the State List of the Constitution must receive the same meaning as in the Sale of Goods Act is repelled on behalf of the State Governments with the argument that constitutional provisions which confer legislative powers must receive a broad and liberal construction and therefore the expression ‘sale of goods’ in Entry 48 and its successor, Entry 54, should not be construed in the narrow sense in which that expression is used in the Sale of Goods Act, 1930 but in a broad sense. The principle that in interpreting a constituent or organic statute, that construction most beneficial to the widest possible amplitude of its powers must be adopted has been examined over the years by various Courts, including this Court, and is too firmly established to merit reconsideration. The decisions have taken the view that a Constitution must not be construed in a narrow and pedantic sense, that a broad and liberal spirit should inspire those whose duty it is to interpret it, that a Constitution of a Government is a living and organic thing which of all instruments has the greatest claim to be construed ut res magis valeat quam pereat, that the Legislature in selecting subjects of taxation is entitled to take things as it finds them in rerum natura and that it is not proper that a court should deny to such a Legislature the right of solving taxation problems unfettered by a priori legal categories which often derive from the exercise of legislative power in the same constitutional unit.

24. In order, therefore, to determine whether there was any agreement or consensuality between the parties, we must have regard to their conduct at or about the time when the goods changed hands. In the first place, it is not obligatory on a trader to deal in cement nor on any one to acquire it. The primary fact, therefore, is that the decision of the trader to deal in an essential commodity is volitional. Such volition carries with it the willingness to trade in the commodity strictly on the terms of Control Orders. The consumer too, who is under no legal compulsion to
acquire or possess cement, decides as a matter of his volition to obtain it on the terms of the permit or the order of allotment issued in his favour. That brings the two parties together, one of whom is willing to supply the essential commodity and the other to receive it. When the allottee presents his permit to the dealer, he signifies his willingness to obtain the commodity from the dealer on the terms stated in the permit. His conduct reflects his consent. And when, upon the presentation of the permit, the dealer acts upon it, he impliedly agrees to supply the commodity to the allottee on the terms by which he has voluntarily bound himself to trade in the commodity. His conduct too reflects his consent. Thus, though both parties are bound to comply with the legal requirements governing the transaction, they agree as between themselves to enter into the transaction on statutory terms, one agreeing to supply the commodity to the other on those terms and the other agreeing to accept it from him on the very terms. It is therefore not correct to say that the transactions between the appellant and the allottees are not consensual. They, with their free consent, agreed to enter into the transactions.

25. We are also of the opinion that though the terms of the transaction are mostly predetermined by law, it cannot be said that there is no area at all in which there is no scope for the parties to bargain. The West Bengal Cement Control Act, 1948 empowers the Government by Section 3 to regulate or control the prices at which cement may be purchased or sold. The Cement Control Order, 1948 provides by paragraph 4 that no person shall sell cement at a "higher than notified price", leaving it open to the parties to charge and pay a price which is less than the notified price, the notified price being the maximum price which may lawfully be charged. Paragraph 8 of the Order points in the same direction by providing that no dealer who has a stock of cement in his possession shall refuse to sell the same "at a price not exceeding the notified price", leaving it open to him to charge a lesser price, which the allottee would be only too agreeable to pay. Paragraph 8 further provides that the dealer shall deliver the cement "within a reasonable time" after the payment of price. Evidently, within the bounds of reasonableness, it would be open to the parties to fix the time of delivery. Paragraph 8A which confers on the allottee the right to ask for weighment of goods also shows that he may reject the goods on the ground that they are short in weight just as indeed, he would have the undoubted right to reject them on the ground that they are not of the requisite quality. The circumstance that in these areas, though minimal, the parties to the transactions have the freedom to bargain militates against the view that the transactions are not consensual.

40. The resume of cases may yet bear highlighting the true principle underlying the decisions of this Court which have taken the view that a transaction which is effected in compliance with the obligatory terms of a statute may nevertheless be a sale in the eye of a law. The Indian Contract Act which was passed in 1872 contained provisions in its seventh chapter comprising Sections 76 to 123 relating to sale of goods which were repealed on the enactment of a comprehensive law of sale of goods in 1930. The Contract Act drew inspiration from the English law of contract which is almost entirely the creation of English courts and whose growth is marked by features which are peculiar to the social and economic history of England.
Historically, the English law of contract is largely founded upon the action on the case for assumpsit, where the essence of the matter was the undertaking. The necessity for acceptance of the undertaking or the promise led the earlier writers on legal theories to lay particular emphasis on the consensual nature of contractual obligations.

43. It all began with the reliance in *Gannon Dunkerley* on the statement in the Eighth Edition (1950) of *Benjamin on Sale* that to constitute a valid sale there must be a concurrence of four elements, one of which is "mutual assent." That statement is a reproduction of what the celebrated author had said in the second and last edition prepared by himself in 1873. The majority judgment in *New India Sugar Mills* also derives sustenance from the same passage in *Benjamin’s* eighth edition. But as observed by Hidayatullah J. in his dissenting judgment in that case, consent may be express or implied and offer and acceptance need not be in an elementary form (page 510). It is interesting that the General Editor of the 1974 edition of *Benjamin’s Sale of Goods* says in the preface that the editors decided to produce an entirely new work partly because commercial institutions, modes of transport and of payment, forms of contract, types of goods, market areas and marketing methods, and the extent of legislative and governmental regulation and intervention, had changed considerably since 1868, when the first edition of the book was published. The formulations in *Benamins* second edition relating to the conditions of a valid "sale" of goods, which are reproduced in the eighth edition, evidently require modification in the light of regulatory measures of social control. Hidayatullah, J., in his minority judgment referred to above struck the new path; and Bachawat J. who spoke for the Court in *Andhra Sugars* went a step ahead by declaring that "the contract is a contract of sale and purchase of cane, though the buyer is obliged to give his assent under compulsion of a statute" (page 716). The concept of freedom of contract, as observed by Hegde, J. in *Indian Steel and Wire Productions*, has undergone a great deal of change even in those countries where it was considered as one of the basic economic requirements of a democratic life (page 490). Thus, in *Ridge Nominees Ltd.*, the Court of Appeal, while rejecting the argument that there was no sale because the essential element of mutual assent was lacking, held that the dissent of the shareholder was overridden by an assent which the statute imposed on him, fictional though it may be, that a sale may not always require the consensual element mentioned in *Benjamin on Sale*, and that there may in truth be a compulsory sale of property with which the owner is compelled to part for a price against his will. Decisions in cases of compulsory acquisition where such acquisition is patent as in *Kirkness* or is inferred as in *Chhitter Mal* fall in a separate and distinct class. The observations of Lord Reid in *Kirkness* that "sale" is a *nomen juris* - the name of a particular consensual contract -have therefore to be understood in the context in which they were made, namely, that compulsory acquisition cannot amount to sale. In *Gannon Dunkerley*, Venkatarama Aiyar, J. was influenced largely by these observations and by the definition of "sale" in *Benjamin’s* eighth edition. *Gannon Dunkerley* involved an altogether different point and is not an authority for the proposition that there cannot at all be a contract of sale if the parties to a transaction are obliged to comply with the terms of a statute. Since we are putting in a nutshell what we have discussed earlier, we would like to reiterate in the interest of
uniformity and certainty of law that, with great deference the majority decision in *New India Sugar Mills* is not good law. The true legal position is as is stated in the minority judgment in that case and in *Indian Steel and Wire Products, Andhra Sugars, Salar Jung Sugar Mills* and *Oil and Natural Gas Commission*. To the extent to which *Cement Distributors Pvt. Ltd.* is inconsistent with these judgments, it is also, with respect, not good law.

44. The conclusion which therefore emerges is that the transactions between the appellant, M/s Vishnu Agencies (Pvt.) Ltd., and the allottees are sales within the meaning of Section 2(g) of the Bengal Finance (Sales Tax) Act, 1941. For the same reasons, transactions between the growers and procuring agents as also those between the rice-millers on one hand and the whole-sellers or retailers on the other are sales within the meaning of Section 2(n) of the Andhra Pradesh General Sales Tax Act, 1957. The turnover is accordingly exigible to sales tax or purchase tax as the case may be. The appeals are accordingly dismissed.

* * * * *
Coffee Board, Karnataka v. Commissioner of Commercial Taxes
AIR 1988 SC 1487

SABYASACHI MUKHARJI, J. - These appeals by certificates are from the judgment and order of the High Court of Karnataka dated August 16, 1985. By the impugned judgment and order the writ petitions filed by the Coffee Board and others were dismissed. In order to appreciate the questions involved in the decision, it may be noted that the appellant herein — Coffee Board contended that the compulsory delivery of coffee under the Coffee Act, 1942 extinguishing all marketing rights of the growers was 'compulsory acquisition' and not sale or purchase to attract levy of purchase tax: it was further contended that the appellant was only a 'trustee' or 'agent' of growers not exigible to purchase tax and that all export sales were 'in the course of export' immune to tax under Article 286 of the Constitution.

3. The power conferred on the Board under Section 25(2) of the Coffee Act, to which we will make reference later, to reject coffee offered for delivery or even the right of a buyer analogous to Section 37 of the Sale of Goods Act showed that there was an element of consensuality in the compulsory sales regulated by the Act. The amount paid by the Board to the grower under the Act was the value or price of coffee in conformity with the detailed accounting done thereto under the Act. It was further held by the High Court that the amount paid to the grower was neither compensation nor dividend. The payment of price to the grower was an important element to determine the consensuality test to find out whether there was sale under Section 4(1) of the Sale of Goods Act. The Act also ensures periodical payments of price to the growers. The Rules provide for advancing loans to growers. Therefore, according to the Division Bench of the Karnataka High Court without any shadow of doubt these elements indicated that in the compulsory sale of coffee, there was an element of consensuality. When once the Board was held to be a 'dealer' it also followed from the same that there was sale by the grower, purchase by the Board and then a sale by the Board. The purchases and the exports if any made by the Board thereafter on any principle would not be 'local sales' within the State of Karnataka. Explanation 3(2)(ii) to Section 2(1) of the Karnataka Sales Tax Act had hardly any relevance to hold that the later export sales were 'local sales' to avoid liability under Section 6 of the Karnataka Sales Tax Act. The direct export sales made by the appellant for the period in challenge were not 'in the course of export' and they did not qualify for exemption from purchase tax under Section 6 of the Karnataka Sales Tax Act. The levy of sales tax on coffee, it was held by the High Court fell, under entry 43 of the Second Schedule of the Act and it was governed by Section 5(3)(a) of the Act and not by Section 5(1) of the Act. It was further held that under Section 5 of the Central Sales Tax Act, 1956 purchases and exports made by the Coffee Board are 'for export' and not 'in the course of export' and thus did not qualify for exemption under Article 286 of the Constitution of India. It was observed by the High Court that the Board did not purchase or take delivery of any specific coffee or goods of any grower and exported the same under prior contracts of sale. The Board did not purchase any specific coffee of any specific grower for purposes of direct
exports at all. The purchases made and exports made would be for export only and not on the course of export to earn exemption under Article 286 of the Constitution of India. It was further held that Sections 11 and 12 of the Act which regulate the levy and payment of customs and excise duties when closely examined really established according to the High Court that what was grown by the growers and delivered to the Board was not at all compulsory acquisition but was sale. If it was compulsory acquisition and there was payment of compensation, then these provisions would not have found their places in the Coffee Act at all, according to the High Court. Levy of customs and excise duties on compensation was something unheard of, an incongruity and an anachronism in compulsory acquisition, according to the High Court.

11. The question involved in these appeals and the writ petitions is the exigibility of tax on sale if there be any, by the growers of the coffee to the Board. Basically, it must depend upon what is sale in the general context as also in the context of the relevant provisions of the Act namely, the Karnataka Sales Tax Act, 1957, as amended from time to time, (the Karnataka Act) and the Central Sales Tax Act, 1956, (the Central Act). We must, however, examine these in the context of general law, namely, the Sale of Goods Act, 1930 and the concept of sale in general.

12. The essential object of the contract of sale is the exchange of property for a money price. There must be a transfer of property, or an agreement to transfer it, from one party, the seller, to the other, the buyer, in consideration of a money payment or a promise thereof by the buyer. Lord Denning, M.R., in C.E.B. Draper & Sons Ltd. v. Edward Turner & Sons Ltd. [(1964) 3 All ER 148], observed as follows:

   `I know that often times a contract for sale is spoken of as a sale. But the word `sale' properly connotes the transfer of the absolute or general property in a thing for a price in money [see Benjamin on Sale, 2nd edn. (1873), p. 1, quoted in Kirkness v. John Hudson & Co., 1955 AC 696, 708, 719]. In this Act of 1926 I think that `sale' is used in its proper sense to denote the transfer of property in the goods. The sale takes place at the time when the property passes from the seller to the buyer and it takes place at the place where the goods are at that time.'


13. In the Sale of Goods Act, 1930, (Sale of Goods Act) contract of sale of goods is defined under Section 4(1) as a contract whereby the seller transfers or agrees to transfer the property in goods to the buyer for a price. It also stipulates by sub-section (4) of Section 4 that 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 to be transferred.

14. Benjamin's Sale of Goods (2nd Edn.) states that leaving aside the battle of forms, sale is a transfer of property in the goods by one, the seller, to the other, the buyer.

15. Under the Karnataka Sales Tax Act, sale is defined under Section 2(t) as:
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"Sale" with all its grammatical variations and cognate expressions means every transfer of the property in goods by one person to another in the course of trade or business for cash or for deferred payment or other valuable consideration, but does not include a mortgage, hypothecation, charge or pledge.

16. The Central Act defines "sale" as under in Section 2(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 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.

17. Coffee Board is a "dealer" duly registered as such under the Sales Tax Acts of all the States in which it holds auctions/maintains depots/runs coffee houses. The Board is also registered as a "dealer" under the Central Sales Tax Act. The Board collects and remits sales tax on all the coffee sold by it for domestic consumption to the State in which the sale takes place. Coffee is sold through auctions held in the States of Karnataka, Tamil Nadu and Andhra Pradesh, and also through the Board's own depots located in nine States. Sale is also effected by way of allotments to cooperative societies. The Board directly exports coffee and also sells coffee to registered exporters through separate export auctions. It may be mentioned that over 50 per cent of the coffee is produced in Karnataka and most of the Robusta variety of coffee is produced in Kerala. All the coffee produced in these States cannot be sold within the State where the coffee is produced. Coffee meant for export has also to be stored at convenient places. The Board, therefore, transfers coffee from one State to another. Sales tax is not payable or paid on the transfer of such coffee. In order to appreciate the actual controversy and the point at issue in the instant case, it is vital to appreciate the real nature of the transaction.

18. In 1966 this Court in the case of State of Kerala v. Bhavani Tea Produce Co. [AIR 1966 SC 677], which arose under the Madras Plantations Agricultural Income Tax Act, 1955, held that when growers delivered coffee under Section 25 of the Act to the Board all their rights therein were extinguished and the coffee vested exclusively in the Board. This Court observed that when growers delivered coffee to the Board, though the grower "does not actually sell" the coffee to the Board, there was a "sale" by operation of law. This was in connection with Section 25 of the Act. The court, however, did not hold that there was a taxable "sale" by the grower to the Board in the year in question. The sale, according to this Court in that case took place in earlier years in which the Agricultural Income Tax Act did not operate. All the States in which coffee is grown and all the persons concerned with the coffee industry, it is asserted on behalf of the Additional Solicitor General, understood this decision as laying down that the "sale" by operation of law mentioned therein only meant the "compulsory acquisition" of the coffee by the Coffee Board.

19. We are, however, bound by the clear ratio of this decision. The Court considered this question: "Was there a sale to the Coffee Board?" at page 99 of the Report and after discussing
clearly said the answer must be in the affirmative. It was rightly argued, in our opinion, by Dr Chitale on behalf of the respondents that the question whether there was sale or not or whether the Coffee Board was a trustee or an agent could not have been determined by this Court, as it was done in this case unless the question was specifically raised and determined. We cannot also by-pass this decision by the argument of the learned Additional Solicitor General that Section 10 of the Act had not been considered or how it was understood by some. This decision in our opinion concludes all the issues in the instant appeal.

20. In 1970 purchase tax was introduced. The Karnataka Sales Tax Act was amended by Karnataka Act 9 of 1970 and Section 6 was substituted. The new Section 6 provided for the levy of purchase tax on every dealer who in the course of his business purchased any taxable goods in circumstances in which no tax under Section 5 was leviable and, inter alia, despatched these to a place outside the State, at the same rate at which tax would have been leviable on the sale price of such goods under Section 5 of the Karnataka Act. The delivery of coffee by the coffee growers to the Coffee Board not being treated a purchase by the Board, the State did not demand any tax from the Board in respect of such deliveries. Demands were raised for the first time in 1983. Assessments for the years up to 1975 were completed without any demand for purchase tax being raised.

21. This Court on or about April 15, 1980 in the case of Consolidated Coffee Ltd. v. Coffee Board, Bangalore [AIR 1980 SC 1468], held that sale of coffee at export auctions were sales which preceded the actual export and thus exempt from sales tax under Section 5(3) of the Central Sales Tax Act. The court also directed the State Governments to refund the amounts collected as sales tax on such sales and set a time limit for effecting such refunds. The Karnataka Government, as a consequence, became liable to refund to the Coffee Board about Rs 7 crores which amount in turn was to be refunded by the Board to the exporters. In 1981 the Commissioner of Sales Tax, Karnataka informed the Board by a letter that the mandatory delivery of coffee to the Board by the grower would be regarded as ‘sale’ and that the Board should pay purchase tax as the coffee growers, being agriculturists are not ‘dealers’. It is the case of the Coffee Board that no such claim had been made at any time in the past in any of the States in India. The Commissioner issued a show cause notice proposing to reopen the assessment for the year 1974-75. In June 1982 pre-assessment notice was sent by the authorities proposing to assess the Board to purchase tax for the assessment year 1975-76 and a sum of Rs 3.5 crores was demanded as purchase tax on the coffee transferred from Karnataka to outside the State either as stock transfers or as exports directly to buyers abroad.

22. In August 1982 the Coffee Board along with two coffee growers filed writ petitions being Writ Petition Nos. 15536 to 15540 of 1982 in the High Court of Karnataka praying for a declaration that the mandatory delivery of coffee under Section 25(1) of the Act was not sale and that Section 2(t) of the Karnataka Sales Tax Act required to be struck down if the same encompassed compulsory acquisition also. The show cause notice and the pre-assessment notice were also challenged and prayers were made for quashing the same. The High Court granted
interim stay. In the meantime on or about February 3, 1983 Constitution (Forty-Sixth Amendment) Act, 1983 came into force and the definition of “sale or purchase of goods” was added by insertion of clause (29-A) in Article 366. This definition is prospective in operation. Subsequent to February 3, 1983, the Karnataka Sales Tax Act was amended by Act 10 of 1983, Act 23 of 1983 and Act 8 of 1984. The definition of “sale” in Section 2(t), however, was not amended. That definition was amended with effect from August 1, 1985 by the Karnataka Act 27 of 1985. After hearing the State Government, the High Court made absolute the stay of further proceedings pursuant to the show cause notice of the Commissioner proposing to reopen the assessment for the year 1974-75. The court modified the stay order regarding the pre-assessment notice and permitted the completion of assessment reserving liberty to the Coffee Board to move the High Court after the assessment was completed. On May 31, 1983 assessment order was made for the year 1975-76. On or about June 17, 1983 demand for Rs 3.5 crores as arrears of tax for the assessment year 1975-76 was issued to the Coffee Board. On July 2, 1983, the High Court stayed the assessment demand for purchase tax for the assessment year 1975-76. On or about June 18, 1983 the assessment order was issued for the year 1976-77. The Board was assessed on a taxable turnover of Rs 92.99 crores and Rs 10.18 crores was assessed as tax. Of this sum, Rs 8.06 crores is the demand on account of purchase tax. Thereafter notice demanding payment of Rs 8.06 crores as arrears of tax for the assessment year 1976-77 was issued. The Coffee Board filed a writ petition in August 1983 being Writ Petition No. 13981 of 1983 challenging the assessment and the demand for the purchase tax for the assessment year 1976-77. Rule was issued and the assessment as also demand for purchase tax was stayed. In the meantime, notice of demand for Rs 8.08 crores as arrears of tax for the assessment year 1977-78 was issued. In September 1983 Writ Petition No. 17071 of 1983 was filed by the Coffee Board for the assessment year 1977-78. Rule was issued. Assessment and demand for purchase tax was stayed. Similarly, Writ Petition No. 17072 of 1983 was filed by the Coffee Board regarding assessment year 1978-79. Rule was issued. Assessment and demand for purchase tax was stayed. In the meantime in October 1983, there was another Writ Petition No. 19285 of 1983 filed challenging the demand for the purchase tax for the year 1979-80. Rule was issued. Assessment and demand was stayed. Writ Petition No. 19118 of 1983 was filed challenging the demand of purchase tax for the year 1980-81. Rule was issued. Assessment and demand for purchase tax was stayed.

23. All these writ petitions in January 1984 were referred to the Division Bench for hearing and disposal. It may be mentioned here that in or about May 1984 the Coffee Board started for the first time to collect contingency deposits to cover purchase tax liability, if any, for the period February 3, 1983 onwards subsequent to the Forty-Sixth Amendment to a limited extent. This was by a circular. It is stated that the Board withheld about Rs 6.8 crores from the pool payment to growers for the season 1982-83 for meeting in part the liability, if any, for the purchase tax for the period subsequent to February 3, 1983. The court however, in 1985 directed the appellant-Coffee Board to remit to the State Government Rs 6.8 crores. The High Court also directed the Board to remit to the State Government Rs 1.5 crores collected by the Board as contingency deposits between May and December 1984. The State Government undertook to return these
monies with interest, in the event of the writ petitions being allowed. By the judgment delivered on August 16, 1985, the High Court dismissed the writ petitions by a common judgment and various sums of money for the various years became payable as purchase tax. The said judgment is reported in Indian Law Reports, Karnataka, Vol. 36 at page 1365. These appeals challenge the said decision.

24. In view of the decision of the High Court several questions were canvassed in these appeals. The questions were: (i) Was there transfer of coffee to the Board from the coffee growers or acquisition? (ii) Was there any element of sale involved? (iii) Was the Coffee Board trustee or agent for the coffee growers for sale to the export market, and (iv) if it is sale, is it in the course of export of the goods to the territory outside India? The first and the basic question that requires to be considered in these appeals is whether the acquisition of coffee by the Board is compulsory acquisition or is it purchase or sale? As mentioned all the questions were answered by this Court in Bhavani Tea Produce Co. case against the appellant. We were, however, invited to compare the transaction in question with transactions in Peanut Board v. Rockhampton Harbour Board [(1932-33) 48 CLR 266]. Was there any mutuality? In this connection it is necessary to analyse and compare the decision of this Court in Vishnu Agencies (Pvt.) Ltd. v. CTO and to what extent the principles enunciated in the said decision affect the position. In order to address ourselves to the problem posed before this Court, we must bear in mind the history and the provisions of the Coffee Market Expansion Act, 1942, under which the Board was constituted, which we have already noted.

25. The control of marketing of farm produce for the economic benefit of the producers and to bring about collective marketing of the produce is a recognised feature of governments of several countries, particularly, United States of America, Britain and Australia. The object was to prevent unhealthy competition between the producers, to secure the best price for the produce in the local market, to conserve for local consumption as much produce as was needed and to make available the surplus for export outside the States and also to foreign markets. The method usually adopted to achieve the object is to establish a marketing board with power to control the price, to obtain possession of the produce and to pool it with a view to collective marketing. The legislation in this behalf is compendiously described as "pooling legislation" and is based on the fundamental idea that the collectivist economy is superior to individualistic economy. There are therefore, different marketing boards for different kinds of produce, such as sugar, dairy produce, wheat, lime fruit, apples, pears and so on. The Indian Coffee Market Expansion Act was modelled somewhat on the lines which obtained in other countries and was intended to control the development of the coffee industry and to regulate the export and sale of coffee. If, however, the transaction amounts to sale or purchase under the relevant Act then that is the end of the matter.

26. All parties drew our attention to the decision in the case of Vishnu Agencies Pvt. Ltd. [AIR 1978 SC 449]. There the court was concerned with the Cement Control Order and the transactions taking place under the provisions of that control order. The Cement Control Order
was promulgated under the West Bengal Cement Control Act, 1948 which prohibited storage for sale and sale by a seller and purchase by a consumer of cement except in accordance with the conditions specified in licence issued by a designated officer. It also provided that no person should sell cement at a higher price than the notified price and no person to whom a written order had been issued shall refuse to sell cement at a price not exceeding the notified price. Any contravention of the order became punishable with imprisonment or fine or both. Under the A. P. Procurement (Levy and Restriction on Sale) Order, 1967, (CA Nos. 2488 to 2497 of 1972) every miller carrying on rice milling operation was required to sell to the agent or an officer duly authorised by the government, minimum quantities of rice fixed by the government at the notified price, and no miller or other person who gets his paddy milled in any rice mill can move or otherwise dispose of the rice recovered by milling at such rice mill except in accordance with the directions of the Collector. Breach of these provisions became punishable. It was held dismissing the appeals that sale of cement in the former case by the allottees to the permit-holders and the transactions between the growers and procuring agents as well as those between the rice millers on the one hand and the wholesalers or retailers on the other, in the latter case, were sales exigible to sales tax in the respective States. It was observed by Beg, C.J. that the transactions in those cases were sales and were exigible to tax on the ratio of Indian Steel and Wire Products Ltd. [AIR 1968 SC 478], Andhra Sugars Ltd. [AIR 1968 SC 599] and Karam Chand Thapar [AIR 1969 SC 343]. In cases like New India Sugar Mills [AIR 1963 SC 1207], the substance of the concept of a sale itself disappeared because the transaction was nothing more than the execution of an order. The Chief Justice emphasised that deprivation of property for a compensation called price did not amount to a sale when all that was done was to carry out an order so that the transaction was substantially a compulsory acquisition. On the other hand, a merely regulatory law, even if it circumscribed the area of free choice, did not take away the basic character or core of sale from the transaction. Such a law which governs a class obliges a seller to deal only with parties holding licences who may buy particular or allotted quantities of goods at specified prices, but an essential element of choice was still left to, the parties between whom agreements took place. The agreement, despite considerable compulsive elements regulating or restricting the area of his choice, might still retain the basic character of a transaction of sale. In the former type of cases, the binding character of the transaction arose from the order directed to particular parties asking them to deliver specified goods and not from a general order or law applicable to a class. In the latter type of cases, the legal tie which binds the parties to perform their obligations remains contractual. The regulatory law merely adds other obligations, such as the one to enter into such a tie between the parties. Although the regulatory law might specify the terms, such as price, the regulation is subsidiary to the essential character of the transaction which is consensual and contractual.

The parties to the contract must agree upon the same thing in the same sense. Agreement on mutuality of consideration, ordinarily arising from an offer and acceptance, imports to it enforceability in courts of law. Mere regulation or restriction of the field of choice does not take away the contractual or essentially consensual binding core or character of the transaction.
Analysing the Act, it was observed that according to the definition of "sale" in the two Acts the transactions between the appellants in that case and the allottees or nominees, as the case may be, were patently sales because in one case the property in the cement and in the other property in the paddy and rice was transferred for cash consideration by the appellants. When the essential goods are in short supply, various types of orders are issued under the Essential Commodities Act, 1955 with a view to making the goods available to the consumer at a fair price. Such orders sometimes provide that a person in need of an essential commodity like cement, cotton, coal or iron and steel must apply to the prescribed authority for a permit for obtaining the commodity. Those wanting to engage in the business of supplying the commodity are also required to possess a dealer's licence. The permit-holder can obtain the supply of goods, to the extent of the quantity specified in the permit and from the named dealer only and at a controlled price. The dealer who is asked to supply the stated quantity to the particular permit-holder has no option but to supply the stated quantity of goods at the controlled price. Then the decisions in *State of Madras v. Gannon Dunkerley & Co. Ltd.* [AIR 1958 SC 560] and *New India Sugar Mills v. CST*, were discussed and the correctness of the view taken in the former case was doubted and the majority opinion in the latter case was overruled.

27. It was submitted by the learned Additional Solicitor General that these cases, namely, *Bhavani Tea Estate* and *Vishnu Agencies* would have no application within the set up of the Coffee Act because the provisions of the statute expressly provide that there could be no sale or contract of sale, yet the High Court had for purposes of sales tax assumed (notwithstanding the statutory prohibition) that the transaction contemplated by the statute in the present case, the mandatory delivery, would be a sale. It was submitted that where a statute prohibited a registered owner from selling or contracting to sell coffee from any registered estate, there could be no implication of any purchase on the part of the Coffee Board of the coffee delivered pursuant to the mandatory provisions of Section 25(1) of the Act. It was urged that Section 17 of the Coffee Act read with Sections 25 and 47 enacts what since 1944 is a total prohibition against the sale of coffee by growers and corresponding purchase of coffee from growers. In view of Section 17 read with Section 25, purchase by the Coffee Board of coffee delivered under Section 25(1) was also impliedly prohibited. It is in view of this express prohibition of sale and corresponding implied prohibition of purchase that the Act provided the only method of disposal of coffee, viz., by the delivery of all coffee to the Coffee Board with no rights attached on such delivery, save and except the statutory right under Section 34. It was also argued that the legislature has made a conscious difference between acquisition of coffee by compulsory delivery by the growers under Section 25(1) of the Act and purchase of coffee by the Board under Section 26(2) and, as such, compulsory delivery of coffee under Section 25(1) cannot constitute a sale transaction as known to law between the growers and the Coffee Board. We are, however, unable to accept the submissions of the learned Additional Solicitor General. All the four essential elements of sale - (1) parties competent to contract, (2) mutual consent - though minimal, by growing coffee under the conditions imposed by the Act, (3) transfer of property in the goods and (4) payment of price though deferred, - are present in the transaction in question. As regards the provisions under
Section 26(2) empowering the Coffee Board to purchase additional coffee not delivered for inclusion in the surplus pool, it is only a supplementary provision enabling the Coffee Board to have a second avenue of purchase, the first avenue being the right to purchase coffee under the compulsory delivery system formulated under Section 25(1) of the Act. The scheme of the Act is to provide for a single channel for sale of coffee grown in the registered estates. Hence, the Act directs the entire coffee produced except the quantity allotted for internal sale quota, if any, to be sold to the Coffee Board through the modality of compulsory delivery and imposes a corresponding obligation on the Coffee Board to compulsorily purchase the coffee delivered to the pool, except:

(1) where the coffee delivered is found to be unfit for human consumption: and

(2) where the coffee estate is situated in a far off and remote place or the coffee grown in an estate is so negligible as to make the sale or coffee through compulsory delivery an arduous task and an uneconomical provision.

28. Since all persons including the Coffee Board are prohibited from purchasing/selling coffee in law, there could be no sale or purchase to attract the imposition of sales/purchase tax it was urged. Even if there was compulsion there would be a sale as was the position in Vishnu Agencies. This Court therein approved the minority opinion of Hidayatullah, J. in New India Sugar Mills v. CST. In the nature of the transactions contemplated under the Act mutual assent either express or implied is not totally absent in this case in the transactions under the Act. Coffee growers have a volition or option, though minimal or nominal to enter into the coffee growing trade. Coffee growing was not compulsory. If anyone decides to grow coffee or continue to grow coffee, he must transact in terms of the regulation imposed for the benefit of the coffee growing industry. Section 25 of the Act provides the Board with the right to reject coffee if it is not up to the standard. Value to be paid as contemplated by the Act is the price of the coffee. Fixation of price is regulation but is a matter of dealing between the parties. There is no time fixed for delivery of coffee either to the Board or the curer. These indicate consensuality which is not totally absent in the transaction.

29. It was urged that regard having been to the sovereign nature of the power exercised by the Coffee Board and the scheme of the Coffee Act, the ratio of Vishnu Agencies will not apply to the acquisition of coffee under Section 25(1) by the Coffee Act. It is in this connection appropriate to refer to the question of compulsory acquisition and this naturally leads to the problem of exercising eminent domain by the State. It is trite knowledge that eminent domain is an essential attribute of sovereignty of every state and authorities are universal in support of the definition of eminent domain as the power of the sovereign to take property for public use without the owner’s consent upon making just compensation. Nichols on Eminent Domain (1950 edn.) a classic authority on the subject, defines eminent domain as the power of the sovereign to take property for public use without the owner’s consent see para 1.11 page 2 of Vol. 1 which elaborates the same in these words:
This definition expresses the meaning of the power in its irreducible terms: (a) Power to take, (b) Without the owner’s consent, (c) For the public use.

All else that may be found in the numerous definitions which have received judicial recognition is merely by way of limitation or qualification of the power. As a matter of pure logic it might be argued that inclusion of the term ‘for the public use’ is also by way of limitation. In this connection, however, it should be pointed out that from the very beginning of the exercise of the power the concept of the ‘public use’ has been so inextricably related to a proper exercise of the power that such element must be considered as essential in any statement of its meaning. The ‘public use’ element is set forth in some definitions as the ‘general welfare’, the ‘welfare of the public’, the ‘public good’, the ‘public benefit’ or ‘public utility or necessity’.

It must be admitted, despite the logical accuracy of the foregoing definition and despite the fact that the payment of compensation is not an essential element of the meaning of eminent domain, that it is an essential element of the valid exercise of such power. Courts have defined eminent domain so as to include this universal limitation as an essential constituent of its meaning. It is much too late in the historical development of this principle to find fault with such judicial utterances. The relationship between the individual’s right to compensation and the sovereign’s power to condemn is discussed in Thayer’s Cases on Constitutional Law. But while obligation (to make compensation) is thus well established and clear let it be particularly noticed upon what ground it stands, viz. upon the natural rights of the individual. On the other hand, the right of the State to take springs from a different source, viz. a necessity of government. These two, therefore, have not the same origin; they do not come, for instance, from any implied contract between the State and the individual, that the former shall have the property, if it will make compensation; the right is no mere right of pre-emption, and it has no condition of compensation annexed to it, either precedent or subsequent. But, there is a right to take, and attach to it as an incident, an obligation to make compensation; this latter, morally speaking, follows the other, indeed like a shadow, but it is yet distinct from it, and flows from another source.

It is concluded thus:

Accordingly, it is now generally considered that the power of eminent domain is not a property right, or an exercise by the state of an ultimate ownership in the soil, but that it is based upon the sovereignty of the state. As the sovereign power of the State is broad enough to cover the enactment of any law affecting persons or property within its jurisdiction which is not prohibited by some clause of the Constitution of the United States, and as the taking of property within the jurisdiction of a state for the public use upon payment of compensation is not prohibited by the Constitution of the United States, it necessarily follows that it is within the sovereign power of a state, and it needs no additional justification.
31. Cooley in his treatise on the *Constitutional Limitations* Chapter XV expressed the same view at page 524 of the book in these words:

"More accurately, it is the rightful authority which must rest in every sovereignty to control and regulate those rights of a public nature which pertain to its citizens in common and to appropriate and control individual property for the public benefit, as the safety, convenience or necessity may demand."

33. This Court in the *State of Karnataka v. Ranganatha Ready* [AIR 1978 SC 215], held that the power of acquisition could be exercised both in respect of immovable and movable properties.

34. While conceding the power of acquisition of coffee in exercise of eminent domain, the scheme contemplated under the Act was not an exercise of eminent domain power. The Act was to regulate the development of coffee industry in the country. The object was not to acquire coffee grown and vest the same in the Board. The Board is only an instrument to implement the Act.

39. We accept the submission of the learned Additional Solicitor General that it is not necessary that every member of the public should benefit from property that is compulsorily acquired. But in essence the scheme envisaged is sale - and not compulsory acquisition.

40. It has also to be borne in mind that the terms 'sale' and 'purchase' have been used in some of the provisions and that is indicative that no compulsory acquisition was intended.

41. Section 34 of the Act reads as follows:

"(1) The Board shall at such times as it thinks fit make to registered owners who have delivered coffee for inclusion in the surplus pool such payments out of the pool fund as it may think proper.

(2) The sum of all payments made under sub-section (1) to any one registered owner shall bear to the sum of the payments made to all registered owners the same proportion as the value of the coffee delivered by him out of the year's crop to the surplus pool bears to the value of all coffee delivered to the surplus pool out of that year's crop."

42. The High Court has referred to the provisions of Section 34(2) of the Act and observed that the said provisions ensure periodical payments of price to the growers. The rules provide for advancing loans to the growers. Without a shadow of doubt these elements indicate, according to the High Court, that in the compulsory sale of coffee, there was an element of consensuality. We are in agreement that there is consensuality in the scheme of the section. The High Court has referred to Section 25(2) of the Coffee Act and observed that the power conferred by Section 25(2) of the Coffee Act must be read subject to the very requirement of that and all other provisions of the Act. When a grower sells coffee that has become totally unfit for human consumption for one or the other valid reason, such a grower cannot compel the Board to purchase such coffee on the ground that it was coffee and thus endanger public safety and also pay its value or price. In the very nature of things, these things cannot be foreseen or enumerated.
exhaustively. The High Court was of the view that if a grower delivered coffee to the Board, the Coffee Act extinguished his title and absolutely vested the same in the Board, however, preserving his right for payment of its value or its price in accordance with the provisions of that Act. According to the High Court the amount paid by the Board to the grower under the Act is the value or price of coffee in conformity with the detailed accounting done thereto under the Coffee Act. The High Court was right. The High Court went on to observe that the amount paid to the grower was neither compensation nor dividend. The payment of price to the grower is an important element to determine the consensuality in the sale and the sale itself is under Section 4(1) of the Sale of Goods Act. Therefore, the High Court was of the view that neither Section 25(2) read with Section 17 nor the provisions for payment of compensation indicate that coffee becomes the property of the Coffee Board not by consent but by the operation of law.

43. The levy of duties of excise and customs under Sections 11 and 12 of the Coffee Act are inconsistent with the concept of compulsory acquisition. Section 13(4) of the Coffee Act clearly fixes the liability for payment of duty of excise on the registered owner of the estate producing coffee. The Board is required to deduct the amount of duty payable by such owner from the payment to the grower under Section 34 of the Act. The duty payable by the grower is a first charge on such Pool payment becoming due to the grower from the Board. Section 11 of the Act provides for levy of duty of customs on coffee exported out of India. This duty is payable to the customs authorities at the time of actual export. The levy and collection of this duty is not unrelated to the delivery of the coffee by the growers to the Board or the pool payments made by the Board to the growers. The duty of excise as also the duty of customs are duties levied by Parliament in exercise of its powers of taxation. It is not a levy imposed by the Board. It is a fact that the revenue realised from the levy of these duties form part of the Consolidated Fund of India and can be utilised for any purpose. It may be utilised for the purpose of the Coffee Act only if Parliament by appropriation made by law in this regard so provides. The true principle or basis in Vishnu Agencies case applies to this case. Offer and acceptance need not always be in an elementary form, nor does the law or contract or of sale of goods require that consent to a contract must be express. Offer and acceptance can be spelt out from the conduct of the parties which cover not only their acts but omissions as well. The limitations imposed by the Control Order on the normal right of the dealers and consumers to supply and obtain goods, the obligations imposed on the parties and the penalties prescribed by the order do not militate against the position that eventually, the parties must be deemed to have completed the transaction under an agreement by which one party binds itself to supply the stated quantity of goods to the other at a price not higher than the notified price and the other party consents to accept the goods on the terms and conditions mentioned in the permit or the order of allotment issued in its favour by the concerned authority.

44. A contract whether express or implied between the parties for the transfer of the property in the goods for a price paid or promised is an essential requirement for a sale. In the absence of a contract whether express or implied, it is true, there cannot be any sale in the eyes of law.
However, as we see the position and the scheme of the Act, in the instant case, there was contract as contemplated between the growers and the Coffee Board. This Court applied in Vishnu Agencies case the consensual test laid down in the earlier decision of this Court in the State of Madras v. Gannon Dunkerley in this regard. In law there cannot be a sale whether or not compulsory, in the absence of a contract express or implied. The position of the Coffee Board so far as sale is concerned is explained by the Madras High Court very lucidly in Indian Coffee Board, Batlagundu v. State of Madras, where the High Court expressed the view that the Indian Coffee Board which derived its existence from the Coffee Market Expansion Act is a dealer within the meaning of Section 2 (b) of the Madras General Sales Tax Act, 1939, and is therefore, liable to sales tax on its turnover. The High Court held that the Board was not a constituted representative of the producer and it did not hold the goods on behalf of the producer. After the goods enter the pool after delivery, they become the absolute property of the Board and the producer, a registered owner, has no right or claim to the goods except to a share in the sale proceeds after the goods are sold in accordance with the provisions of the Act.

45. It was said by the learned Additional Solicitor General that the cultivation of coffee in India was over a century old and numerous plantations existed long prior to the enactment of the Coffee Act. There was no act of volition on the part of the growers in taking to coffee cultivation and subjecting themselves to the provisions of the Act by taking up such cultivation. The cultivation of coffee can be carried on only in certain types of soil and in high elevations. The land suited for coffee cultivation cannot be used for growing other crops on a similar scale. Coffee is a perennial crop. The growers have no choice in growing coffee one year and then changing to a different crop in the following year. Coffee plants have a life ranging from 30 to 70 years, the average life of the plant being 40 years. Coffee estates require constant attention and expenses have to be incurred for manuring, cultural operations, application of pesticides, etc. at regular intervals. Removal of old and diseased plants and replanting them with superior disease-resistant varieties is also necessary and is done each year. The coffee grower has thus no choice at all in continuing to be a coffee cultivator, it was argued. The cultivation of coffee is not in any way comparable to the cultivation of sugarcane, the cultivation of which can be discontinued at will. Such practical difficulties, however, do not in essence make any difference.

47. The coffee growers being agriculturists are not dealers and therefore are not liable to pay any sales tax or purchase tax, it was submitted. The demand for purchase tax is in effect a demand on the growers who were exempt from such levy, as the monies required for paying the tax if the same is lawful has necessarily to come out of the monies otherwise payable to the growers. The object of the pool marketing system is not to deprive the growers of a fair compensation for their produce by making them suffer a tax which they would not otherwise be required to suffer. An analysis of the different provisions of the Coffee Act makes it clear that there was no sale to attract exigibility to duty, it was submitted. We are unable to accept these submissions. Section 6 of the Karnataka Sales Tax Act, 1957 meets the situation created by such circumstances. This was examined by this Court in State of Tamil Nadu v. M.K. Kandaswami [AIR 1975 SC 1871],
which examined Section 7-A of Tamil Nadu General Sales Tax Act, 1959 - which was in pari materia with Section 6 of the Karnataka Sales Tax Act. In that view of the matter Section 6 of the Karnataka Act would be attracted.

48. The alternative submission of the appellant was that the Coffee Board was a trustee or agent of the growers. We are unable to accept this submission either. There is no trust created in the scheme of the Act in the Coffee Board: it is a statutory obligation imposed on the Coffee Board and does not make it a trustee in any event. It is also not possible to accept the submission that the Central Sales Tax Act will not be applicable to any sale by the Coffee Board because it was an export sale by the Coffee Board.

50. In the aforesaid view of the matter, we are of the opinion that the imposition of tax in the manner done by the sales tax authorities which has been upheld by the High Court is correct and the High Court was right. The appeals fail and are dismissed.
S. M. 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. (the assessee) to the Railway Board of railway coaches model 407,408 and 411 is liable to sales-tax under the Central Sales Tax Act.

2. 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.

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

4. The assessee then took an appeal to the High Court of Mysore under Section 24(1) of the Mysore Sales Tax Act, read with Section 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:

(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

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

5. 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 October 15, 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 October 15, 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 October 30, 1956, and a cheque was issued to the company for the total of several such invoices. The amount of the cheque received on October 30, 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 construction 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.

6. 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.

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

8. 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 litter of the Government of India, Ministry of Railways (Railway Board) No. 57/142/RE(163), dated May 4, 1957. This relates to the first of the models 407.

9. There is an indemnity bond in respect of this contract.

12. 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 the answer must depend upon the terms of the contract. The answer to the 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:

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.

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 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.

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.

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 natural factors.

13. 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 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. [19 STC 13] than any other case.

14. 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.

15. In the result the appeal fails and is dismissed with costs.
Sentinel Rolling Shutters and Engg. Co. (P) Ltd. v. CST

(1978) 4 SCC 260 : AIR 1978 SC 545

P.N. BHAGWATI, J. - This appeal by special leave raises the vexed question whether a particular contract is a contract of sale or a contract of work and labour. This has always been a difficult question, because most of the cases which come before the Court are border line cases and the decisions given by courts are by no means uniform. But so far as the present case is concerned, it does not present any serious difficulty and is comparatively free from complexity or doubt, for there is a decision of this Court which is directly applicable and is determinative of the controversy between the parties.

2. The assessee who is the appellant before us is a private limited company carrying on business as engineers, contractors, manufacturers and fabricators and in the course of its business, it entered into a contract dated June 28, 1972 with M/s C.M. Shah & Co. (P) Ltd. (hereinafter referred to as the Company) for fabrication, supply, erection and installation of Sentinels Pull and Push Type and Reduction Gear Type Rolling Shutters in shed Nos. 3 and 4 of the Sidheswar Sahakari Sakar Karkhana belonging to the company. The detailed specifications of the rolling shutters were given in the contract and the price was stipulated to be Rs 7 per sq. ft. and rt. for Pull and Push Type Rolling Shutters and Rs 9 per sq. rt. and ft. for the Reduction Gear Type Rolling Shutters, the price in both cases being inclusive of "erection at site". The contract was expressed to be subject to the terms and conditions set out in a printed form and there were also certain special terms and conditions which were specifically written out in the contract. Since considerable reliance was placed on behalf of the Revenue on some of the printed terms and conditions of the contract, we shall set them out in extenso:

2. Once the delivery of the goods is effected, rejection claims cannot be entertained.

4. All erection work shall be carried out at customer's own risk and no claim for incidental structural breakages, damages to the property of the customers or others shall be entertained. All masonry works required before and or after erection shall be carried out by customers at own cost.

10. All payment shall be on overall measurements only. Customer desiring to check the correctness of the overall measurements shall notify their intention in advance and shall get the measurements checked before installation. No dispute on this ground shall be entertained once the erection is completed.

12. Terms of Business: 50 per cent advance with the order and the balance against delivery of the goods ex-work prior to erection, or against through Banks.

The special terms and conditions provided that the actual transportation charges would be in addition to the price stipulated in the contract and the delivery would be 6/8 weeks ex-works from
the date of receipt of the final confirmation of the order. The terms of payment also formed part of the special terms and conditions and they provided 25 per cent advance, 65 per cent against delivery and remaining 10 per cent after completion of erection and handing over of shutters to the satisfaction of the Company. The assessee carried out its part of the contract and manufactured the two types of rolling shutters according to the specifications provided in the contract and erected and installed them in sheds Nos. 3 and 4 of the Sidheswar Sahakari Sakar Karkhana. It does not appear from the record as to when the bill relating to the contract was submitted by the assessee to the Company, but it was dated August 19, 1972 and presumably it was sent by the assessee after the fabrication of the two types of rolling shutters was completed, but before they were erected and installed at the premises of the Company. Since the assessee entertained doubt as to whether the contract was a contract for sale or a contract for work and labour, the assessee made an application dated September 16, 1972 to the Commissioner of Sales Tax for determining this question, for on the answer to it, depended the taxability of the amount to be received by the assessee against fulfilment of the contract. The Deputy Commissioner of Sales Tax, who heard the application, took the view that the contract was a contract for sale of the two types of rolling shutters and the work of erection and installation was merely incidental to the sale and the assessee was, therefore, liable to pay sales tax on 95 per cent of the amount receivable by it under the contract. Since that represented the sale price of the rolling shutters, the remaining 5 per cent being attributable to the work and labour involved in erection and installation. The assessee, being aggrieved by the order passed by the Deputy Commissioner of Sales Tax preferred an appeal to the Sales Tax Tribunal, but the Sales Tax Tribunal also took the same view and held that the transaction of supply of the two types of rolling shutters embodied in the contract amounted to a sale but so far as the price was concerned, the Sales Tax Tribunal observed that since 90 per cent of the amount under the contract was payable at the stage of delivery, that should be taken to be the sale price and the balance of 10 per cent should be held to be the charges for the work. The contract was thus held by the Sales Tax Tribunal to be a composite contract consisting of two parts, one for sale of the two types of rolling shutters and the other for execution of the work of erection and installation. This led to an application for a reference by the assessee and on the application, the following question of law was referred for the opinion of the High Court:

Whether having regard to the facts and circumstances of the case the Tribunal was justified in law in coming to the conclusion that the contract in question essentially consisted of two contracts, one for supply of materials for money consideration and the other for service and labour done?

The High Court made a detailed and exhaustive review of the decided cases and held, agreeing with the Sales Tax Tribunal, that the contract between the assessee and the Company was a divisible contract which essentially consisted of two contracts, one for the supply of shutters of the aforesaid two types for money and the other for service and labour, and accordingly
answered the question in favour of the Revenue and against the assessee. The assessee thereupon brought the present appeal with special leave obtained from this Court.

3. Now the question whether a particular contract is a contract for sale or for work and labour is always a difficult question and it is not surprising to find the taxing authorities divided on it. The difficulty, however, lies not in the formulation of the tests for determining when a contract can be said to be a contract for sale or a contract for work and labour, but in the application of the tests to the facts of the case before the Court. The distinction between a contract for sale and a contract for work and labour has been pointed out by this Court in a number of decisions and some tests have also been indicated by this Court, but it is necessary to point out that these tests are not exhaustive and do not lay down any rigid or inflexible rule applicable alike to all transactions. They do not give any magic formula by the application of which we can say in every case whether a contract is a contract for sale or a contract for work and labour. They merely focus on one or the other aspect of the transaction and afford some guidance in determining the question, but basically and primarily, whether a particular contract is one for sale of goods or for work and labour depends upon the main object of the parties gathered from the terms of the contract, the circumstances of the transaction and the custom of the trade.

4. It may be pointed out that a contract where not only work is to be done but the execution of such work requires goods to be used may take one of three forms. The contract may be for work to be done for remuneration and for supply of materials used in the execution of the work 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 supply of goods where some work is required to be done as incidental to the sale. Where a contract is of the first type, it is a composite contract consisting essentially of two contracts, one for the sale of goods and the other for work and labour. The second type of contract is clearly a contract for work and labour not involving sale of goods, while the third type is a contract for sale where the goods sold as chattels and some work is undoubtedly done, but it is done only as incidental to the sale. No difficulty arises where a contract is of the first type because it is divisible and the contract for sale can be separated from the contract for work and labour and the amount payable under the composite contract can be apportioned between the two. The real difficulty arises where the contract is of the second or third type, because in such a case it is always a difficult and intriguing problem to decide in which category the contract falls. The dividing line between the two types of contracts is somewhat hazy and thin partitions do their bounds divide. But even so the distinction is there and it is very much real and the Court has to perform at times the ingenious exercise of distinguishing one from the other.

5. The distinction between a contract for sale and a contract for work and labour has been pointed out in Halsbury’s Laws of England, Third Edition, Volume 34, Article 3. The primary test is whether the contract is one whose main object is transfer of property in a chattel as a chattel to the buyer, though some work may be required to be done under the contract as ancillary or incidental to the sale or it is carrying out of work by bestowal of labour and service.
and materials are used in execution of such work. A clear case of the former category would be a contract for supply of airconditioner where the contract may provide that the supplier will fix up the airconditioner in the premises. Ordinarily a separate charge is provided in such contract for the work of fixing up but in a given case it may be included in the total price. Such a contract would plainly be a contract for sale because the work of fixing up the airconditioner would be incidental to the sale. Then take a contract for constructing a building where considerable quantity of materials is required to be used in the execution of the work. This would clearly be a contract for work and labour and fall within the latter category. But, as we pointed out earlier, there may be and indeed as the decided cases show, there are a large number of cases which are on the border line and it is here that difficulty is often experienced in the application of this primary test. To resolve this difficulty, the courts have evolved some subsidiary tests. One such test is that formulated by this Court in Commissioner of M.P. v. Purshottam Premji [(1970) 2 SCC 287], where it has been said:

The primary difference between a contract for work or service and a contract for sale of goods is that in the former there is in the person performing work or rendering service no property in the thing produced as a whole. In the case of a contract for sale, the thing produced as a whole has individual existence as the sole property of the party who produced it, at some time before delivery, and the property therein passes only under the contract relating thereto to the other party for price.

This was the test applied by this Court in the State of Rajasthan v. Man Industrial Corporation [(1969) 1 SCC 567], for holding that a contract for providing and fixing four different types of windows of certain sizes according to specifications, designs, drawings and instructions set out in the contract was a contract for work and labour and not a contract for sale.

6. Now, it is clear that the contract is for fabrication, supply, erection and installation of two types of rolling shutters and not only are the rolling shutters to be manufactured according to the specifications, designs, drawings and instructions provided in the contract, but they are also to be erected and installed at the premises of the Company. The price stipulated in the contract is inclusive of erection and installation charges and the contract does not recognise any dichotomy between fabrication and supply of the rolling shutters and their erection and installation so far as the price is concerned. The erection and installation of the rolling shutters is as much an essential part of the contract as the fabrication and supply and it is only on the erection and installation of the rolling shutters that the contract would be fully executed. It is necessary, in order to understand the true nature of the contract, to know what is a rolling shutter and how it is erected and installed in the premises. It is clear from the statement Ex. C to the petition for special leave, which statement was submitted before the Sales Tax Tribunal and the correctness of which was at no time disputed before us, that a rolling shutter consists of five component parts, namely, two brackets welded with type clamps, one pipe shafting with high tension springs, shutter screen made out of 20G/18G/thickness of metal as required by the customer, side guides or guide channels welded with iron clamps to the bottom with provision of locking arrangements with
welded handles and top cover. These component parts fabricated by the manufacturer and taken
to the site and fixed on the premises and then comes into existence a Rolling Shutter as an
identifiable commercial article. The method of fixing the component parts in position in the
premises so as to bring into existence the commercial article known as a rolling shutter is fully
described in the statement Ext. C. First of all, certain masonry work is required to be done by the
customer and that has to be carried out by the customer at his own cost. Then the brackets are
fixed on either side on the top portion of the opening by grouting holes on the masonry walls and
inserting the bolts. Thereafter the holes are filled with cement and the pipe shafting with high
tension springs is inserted into the IT clamps of the brackets. Then the iron curtain of the rolling
shutter is hosted over the high tension springs and tightened by means of nut bolts and guide
channels are then fixed by grouting masonry walls where side guide clamps are to be fixed. After
fixing the clamps to the grouted portion of the wall, the same is plastered and then the iron curtain
of the shutter is lowered through the guide channels to operate the shutter manually up and down.
The rolling shutter is then born and it becomes a permanent fixture to the premises. The Indian
Standards Specification Book for Metal Rolling Shutters and Rolling Grills also gives a similar
procedure for fixing the component parts of the Rolling Shutter on the premises. It clearly shows
that a rolling shutter consists of curtain, lock plates, guide channels, bracket plates, rollers, hood
covers, gears, worms, fixing bolts, safety devices, anchoring rods, central hasp and staple. Each
guide channel has to be provided with a minimum of three fixing cleats or supports for
attachment to the walls or column by means of bolts or screws. The guide channels are further
attached to the jamb, plumbed either in the overlapping fashion, projecting fashion or embedded
in grooves, depending on the method of fixing. All these operations take place at the site after
despatch of the component parts of the rolling shutter. Hood cover is fixed in a neat manner and
supported at the top at suitable intervals. This also has to be done at the site. Item 11.1 of the
specification shows that the rolling shutter curtain and bottom lock plate are interlocked together
and rolled in one piece, but the other parts like guide channels, bracket plates, rollers, etc., are
despatched separately. Item 12.1 shows that all the rolling shutters are erected by the
manufacturer or his authorised representative in a sound manner, so as to afford trouble-free and
easy operation, long life and neat appearance. It will, thus, be seen that the component parts do
not constitute a rolling shutter until they are fixed and erected on the premises. It is only when the
component parts are fixed on the premises and fitted into one another that they constitute a rolling
shutter as a commercial article and till then they are merely component parts and cannot be said
to constitute a rolling shutter. The erection and installation of the rolling shutter cannot, therefore,
be said to be incidental to its manufacture and supply. It is a fundamental and integral part of the
contract because without it the rolling shutter does not come into being. The manufacturer would
undoubtedly be the owner of the component parts when he fabricates them, but at no stage does
he become the owner of the rolling shutter as a unit so as to transfer the property in it to the
customer. The rolling shutter comes into existence as a unit when the component parts are fixed
in position on the premises and it becomes the property of the customer as soon as it comes into
being. There is no transfer of property in the rolling shutter by the manufacturer to the customer
as a chattel. It is essentially a transaction for fabricating component parts and fixing them on the premises so as to constitute a rolling shutter. The contract is thus clearly and indisputably a contract for work and labour and not a contract for sale.

7. The Revenue leaned heavily on the provision in the contract that the delivery of the goods shall be ex-works and once the delivery of the goods is effected, no claim for rejection shall be entertained and relying on this provision, the Revenue contended that under the contract the rolling shutters were to be delivered by the assessee to the company ex-works, that is, at the works of the assessee and the property in the rolling shutters passed to the company as soon as they were delivered and hence it was a contract for sale. We do not think this contention of the Revenue has any force and it must be rejected. It is clear from the above discussion that a rolling shutter as a complete unit is not fabricated by the manufacturer in his factory but he manufactures only the component parts and it is only when the component parts are fitted into position and fixed on the premises that a rolling shutter comes into being as a commercial article and, therefore, when the contract provides that the delivery of the goods shall be ex-works, what is obviously meant is that the component parts shall be delivered to the company at the works of the assessee and once they are delivered, they shall not be liable to be rejected by the company. But that does not mean that as soon as the component parts are delivered to the company, the contract is fully executed. The component parts do not constitute a rolling shutter and it is the obligation of the assessee under the contract to fix the component parts in position on the premises and erect and install a rolling shutter. The execution of the contract is not completed until the assessee carries out this obligation imposed upon it under the contract and a rolling shutter is erected and installed at the premises. It is true that clause (12) of the printed terms and conditions provides that 50 per cent of the amount under the contract shall be paid as advance and the balance against delivery of the goods ex-works but this clause is clearly overridden by the special term specifically written out in the contract that 25 per cent of the amount shall be paid by way of advance, 65 per cent against delivery and the remaining 10 per cent after completion of erection and handing over of the rolling shutters to the satisfaction of the company. This provision undoubtedly stipulates that 90 per cent of the amount due under the contract would be paid before erection and installation of the rolling shutters has commenced, but that would not make it a contract for sale of rolling shutters. The true nature of the contract cannot depend on the mode of payment of the amount provided in the contract. The parties may provide by mutual agreement that the amount stipulated in the contract may be paid at different stages of the execution of the contract, but that cannot make the contract one for sale of goods if it is otherwise a contract for work and labour. It may be noted that the contract in *State of Madras v. Richardson of Cruddas Ltd* [(1968) 21 STC 245 (SC)] contained a provision that the full amount due under the contract shall be paid in advance even before the execution of the work has started and yet the Madras High Court held, and that view affirmed by this Court, that the contract was a works contract. The payment of the amount due under the contract may be spread over the entire period of the execution of the contract with a view either to put the manufacturer or contractor in possession of funds for the execution of the contract or to secure him against any risk of non-payment by the
customer. That cannot have any bearing on the determination of the question whether the contract is one for sale or for work and labour.

8. Here the last portion of the special terms in regard to payment of the amount due under the contract also makes it clear that it is only when the component parts are fitted into position in the premises that a rolling shutter would be complete and this rolling shutter has to be to the satisfaction of the company and it is then to be handed over by the assessee to the company and then, and then alone, would the remaining 10 per cent be payable by the company to the assessee. It is, therefore, clear that the contract is one single and indivisible contract and the erection and installation of the rolling shutter is as much a fundamental part of the contract as the fabrication and supply. We must, in the circumstances, hold, driven by the compulsion of this logic, that the contract was a contract for work and labour and not a contract for sale. This view which we are taking is completely supported by the decision of this Court in *Vanguard Rolling Shutters of Steel Works v. Commissioner of Sales Tax, U.P.* [(1977) 2 SCC 250] to which one of us (Bhagwati, J.) was a party.

9. We accordingly allow the appeal, set aside the judgment of the High Court and hold that the contract in the present case was a contract for work and labour and not a contract for sale.
Northern India Caterers (India) Ltd. v. Lt. Governor of Delhi

(1978) 4 SCC 36 & (1980) 2 SCR 650

R.S. PATHAK J. - This and the connected appeal are directed against the judgment of the High Court of Delhi disposing of a reference made to it under Section 21(3) of the Bengal Finance (Sales Tax) Act, 1941 as extended to the Union territory of Delhi on the following question:

Whether the service of meals to casual visitors in the Restaurant is taxable as a sale when the charges are lump sum per meal or when they are calculated per dish? The High Court has answered the question in the affirmative.

2. The appellant runs a hotel in which lodging and meals are provided on "inclusive terms" to residents. Meals are served to non-residents also in the restaurant located in the hotel. In the assessment proceedings for the assessment years 1957-58 and 1958-59 under the Bengal Finance (Sales Tax) Act, 1941, the appellant contended that the service of meals to residents and non-residents could not be regarded as a sale and therefore sales tax could not be levied in respect thereof. The contention was rejected by the Sales Tax authorities, who treated a portion of the receipts from the residents and non-residents as representing the price of the foodstuff served. At the instance of the appellant, the High Court called for a statement of the case on two questions. One was whether the supply of meals to residents, who paid a single all-inclusive charge for all services in the hotel, including board was exigible to sales tax. The second was the question set forth above. The High Court answered the first question in favour of the appellant and the second against it. And now these appeals by special leave.

3. Tax is payable by a dealer under Section 4 of the Bengal Finance (Sales Tax) Act, 1941 on sales effected by him, and the expression "sale" has been defined by Section 2(g) of the Act to mean "any transfer of property in goods for cash or deferred payment or other valuable consideration including a transfer of property in goods involved in the execution of a contract...". The question is whether in the case of non-residents the service of meals by the appellant in the restaurant constitutes a sale of foodstuff.

4. This is a case where the origin and historical development of an institution has profoundly influenced the nature and incidents it possesses in law. In the case of an hotelier this Court proceeded on the footing that his position in law was assimilable to that of an innkeeper. At common law an innkeeper was a person who received travellers and provided lodging and necessaries for them and their attendants and employed servants for this purpose and for the protection of travellers lodging in his inn and of their goods [Halsbury's Laws of England, 3rd Edn., Vol. 21, p. 442, para 932]. It was hospitality that he offered, and the many facilities that constituted the components of that hospitality determined the legal character of the transactions
flowing from them. Long ago, in *Crisp v. Pratt* [(1939) 79 ER 1072], it was pointed out that innkeepers do not get their living by buying and selling, and that although they buy provisions, to be spent in their house, they do not sell them but what they do is to "utter" them. Their gain is not only by uttering of their commodities, but for the attendance of their servants, and for the furniture of their house, rooms, and lodgings, for their guests ḍ. In *Newton v. Tries* [91 ER 100], Holt, C.J. defined the true status of an innkeeper by reference to the services afforded by him, that he was an "hospitator" and was not paid upon the account of the intrinsic value of his provisions, but for other reasons: the recompense he receives, is for care and pains, and for protection and security ḍ but the end of an innkeeper in his buying, is not to sell, but only a part of the accommodation he is bound to prepare for his guests. ḍ

5. Having proper regard to those particular considerations, it is not surprising that the principle was extended in England to the service of food at eating places or restaurants. The keeper of an eating house, or victualler, was regarded fundamentally as providing sustenance to those who ordered food to eat in the premises. Like the hotelier, a restaurateur provides many services in addition to the supply of food. He provides furniture and furnishings, linen, crockery and cutlery, and in the eating places of today he may add music and a specially provided area for floor dancing and in some cases a floor show. The view taken by the English law found acceptance on American soil, and after some desultory dissent initially in certain states it very soon became firmly established as the general view of the law. The first addition of *American Jurisprudence*, Vol. 46, p. 207, para 13, sets forth the statement of the law in that regard, but we may go to the case itself, *Electa B. Merrill v. James W. Hodson* [1915-B LRA 481], from which the statement has been derived. Holding that the supply of food or drink to customers did not partake of the character of a sale of goods the Court commented:

The essence of it is not an agreement for the transfer of the general property of the food or drink placed at the command of the customer for the satisfaction of his desires, or actually appropriated by him in the process of appeasing his appetite or thirst. The customer does not become the owner of the food set before him, or of that portion which is carved for his use, or of that which finds a place upon his plate, or in side dishes set about it. No designated portion becomes his. He is privileged to eat, and that is all. The uneaten food is not his. He cannot do what he pleases with it. That which is set before him or placed at his command is provided to enable him to satisfy his immediate wants, and for no other purpose. He may satisfy those wants; but there he must stop. He may not turn over unconsumed portions to others at his pleasure, or carry away such portions. The true essence of the transaction is service in the satisfaction of a human need or desire, ḍ ministry to a bodily want. A necessary incident of this service or ministry is the consumption of the food required. This consumption involves destruction, and nothing remains of what is consumed to which the right of property can be said to attach. Before consumption title does not pass; after consumption there remains nothing to become the subject of title. What the customer pays for is a right to satisfy his appetite by the process
of destruction. What he thus pays for includes more than the price of the food as such. It includes all that enters into the conception of service, and with it no small factor of direct personal service. It does not contemplate the transfer of the general property in the food applied as a factor in the service rendered.

The position was radically altered in the United States by the enactment of the Uniform Commercial Code, which provides in effect that the serving for value of food or drink to be consumed either on the premises or elsewhere constitutes a sale.

6. It has already been noticed that in regard to hotels this Court has in M/s. Associated Hotels of India Ltd. adopted the concept of the English law that there is no sale when food and drink are supplied to guests residing in the hotel. The Court pointed out that the supply of meals was essentially in the nature of a service provided to them and could not be identified as a transaction of sale. The Court declined to accept the proposition that the Revenue was entitled to split up the transaction into two parts, one of service and the other of sale of foodstuff. If that be true in respect of hotels, a similar approach seems to be called for on principle in the case of restaurants. No reason has been shown to us for preferring any other. The classical legal view being that a number of services are concomitantly provided by way of hospitality, the supply of meals must be regarded as ministering to a bodily want or to the satisfaction of a human need. What has been said in Elects B. Merrill appears to be as much applicable to restaurants in India as it does elsewhere. It has not been proved that any different view should be taken, either at common law, in usage or under statute.

7. It was urged for the respondent that in Associated Hotels of India Ltd., this Court drew a distinction between the case of meals supplied to a resident in a hotel and those served to a customer in a restaurant. We are unable to find any proposition of law laid down by the court there which could lead to that inference.

8. In the result, we hold that the service of meals to visitors in the restaurant of the appellant is not taxable under the Bengal Finance (Sales Tax) Act, 1941, as extended to the Union territory of Delhi, and this is so whether a charge is imposed for the meal as a whole or according to the dishes separately ordered.
State of Karnataka v. Udupikrishna Bhavan

(1981) 3 SCC 76

GUPTA, J. - These two appeals arise out of two revision petitions dismissed by the Karnataka High Court which were preferred by the State of Karnataka under Section 8(4) of the Karnataka Appellate Tribunal (Amendment) Act, 1976 read with Section 23 of the Karnataka Sales Tax Act, 1957. The revision petitions were directed against a common order of the Karnataka Appellate Tribunal by which the Tribunal allowed two appeals preferred by the assessee relating to the assessment for the years ended March 31, 1976 and March 31, 1977 respectively. Following the decision of this Court in Northern India Caterers (India) Ltd. v. Lt. Governor of Delhi [(1979) 1 SCR 557], the Tribunal had held that the supply of refreshments to the visitors of the two hotels owned by the respondent before us was ñpart of a social service and not a saleñ. The High Court taking the same view dismissed the revision petitions. The finding of the Appellate Tribunal, as summarised by the High Court, on which its decision rests is: ñThe assessee runs a hotel wherein food and drinks are served to the visitors.ñ We do not think that this finding only is sufficient to justify the conclusion reached by the Tribunal and the High Court. It appears that the attention of the High Court was drawn to the judgment of this Court disposing of a review petition in the Northern India Caterers case (1980) 2 SCR 650. The following extract from that judgment to which the High Court itself has referred is relevant:

Indeed, we have no hesitation in saying that where food is supplied in an eating-house or restaurant, and it is established upon the facts that the substance of the transaction, evidenced by its dominant object, is a sale of food and the rendering of services is merely incidental, the transaction would undoubtedly be exigible to sales tax. In every case it would be for the taxing authority to ascertain the facts when making an assessment under the relevant sales tax law and to determine upon those facts whether a sale of the food supplied is intended...

Clearly therefore the only finding recorded in this case that the assessee runs a hotel wherein food and drinks are served to the visitors is not sufficient.

2. We set aside the impugned order and send the case back to the Sales Tax Officer concerned for a fresh assessment according to law following the guidelines appearing in the judgment of this Court disposing of the review petition in the Northern India Caterers case.

* * * * *
M/s. Larsen & Toubro Limited V. State of Karnataka

(2014) 1 SCC 708

2. Does the two-Judge Bench decision of this Court in Raheja Development[1] lay down the correct legal position? It is to consider this question that in Larsen and Toubro[2] a two-Judge Bench of this Court has referred the matter for consideration by the larger Bench. In the referral order dated 19.8.2008, the two-Judge Bench after noticing the relevant provisions of the Karnataka Sales Tax Act, 1957 and the distinction between a contract of sale and a works contract made the reference to the larger Bench by observing as follows:

"We have prima facie some difficulty in accepting the proposition laid down in Para 20 quoted above. Firstly, in our view, prima facie, M/s Larsen & Toubro - petitioner herein, being a developer had undertaken the contract to develop the property of Dinesh Ranka. Secondly, the Show Cause Notice proceeds only on the basis that Tripartite Agreement is the works contract. Thirdly, in the Show Cause Notice there is no allegation made by the Department that there is monetary consideration involved in the first contract which is the Development Agreement.

Be that as it may, apart from the disputes in hand, the point which we have to examine is whether the ratio of the judgment of the Division Bench in the case of Raheja Development Corporation (supra) as enunciated in Para 20, is correct. If the Development Agreement is not a works contract could the Department rely upon the second contract, which is the Tripartite Agreement and interpret it to be a works contract, as defined under the 1957 Act. The Department has relied upon only the judgment of this Court in Raheja Development Corporation (supra) case because para 20 does assist the Department. However, we are of the view that if the ratio of Raheja Development case is to be accepted then there would be no difference between works contract and a contract for sale of chattel as a chattel. Lastly, could it be said that petitioner - Company was the contractor for prospective flat purchaser. Under the definition of the term "works contract" as quoted above the contractor must have undertaken the work of construction for and on behalf of the contractor (sic.) for cash, deferred or any other valuable consideration. According to the Department, Development Agreement is not works contract but the Tripartite Agreement is works contract which, prima facie, appears to be fallacious. There is no allegation that the Tripartite Agreement is sham or bogus.

For the aforesaid reasons, we direct the Office to place this matter before the Hon'ble Chief Justice for appropriate directions in this regard, as we are of the view that the judgment of Division Bench in the case of Raheja Development (supra) needs re-consideration by the larger Bench."

3. Of the 26 appeals under consideration before us, 14 are from Karnataka and 12 from Maharashtra. Insofar as Karnataka appeals are concerned, it is appropriate that we take the facts from the leading case being Larsen and Toubro. The ECC division of Larsen and Toubro (for
short, L&T is engaged in property development along with the owners of vacant sites. On 19.10.1995, L&T entered into a development agreement with Dinesh Ranka, owner of the land bearing survey numbers 90/1, 91, 92 (Part), 94, 95 and 96/1 (Part) together measuring 34 acres all situated at Kothanur Village, Begur Hobli, Bangalore South Taluk, Bangalore, for construction of a multi-storeyed apartment complex. The owner was to contribute his land and L&T was to construct the apartment complex. After development, 25% of the total space was to belong to the owner and 75% to L&T. A power of attorney was executed by the owner of the land in favour of L&T to enable it to negotiate and book orders from the prospective purchasers for allotment of built up area. Accordingly, L&T entered into agreements of sale with intended purchasers. The agreements provided that on completion of the construction, the apartments would be handed over to the purchasers who will get an undivided interest in the land also. Sale deeds, thus, were executed in favour of the intended purchasers by L&T and the owner.

4. On 12.07.2005, the business premises of L&T were inspected by the Deputy Commissioner of Commercial Taxes (Intelligence-1) South Zone, Koramangala, Bangalore (hereinafter referred to as the Deputy Commissioner) and a detailed statement of the Finance Manager was recorded.


6. On 04.10.2005, the Deputy Commissioner served a show cause notice on L&T stating that it was liable to tax as per the decision of this Court in Raheja Development. L&T responded to the show cause notice and submitted preliminary objections on 10.10.2005. By a further communication dated 10.11.2005, L&T objected to the assessment of tax for development of projects by it. The L&T inter alia submitted that the development agreement was not a works contract per se on account of the reasons: (a) the agreement was to develop and market flats to customers; (b) the intent and purpose of the agreement was to develop property by the petitioners on the one hand and the land owner on the other; (c) the construction and development of the said land involved no monetary consideration; and (d) the only consideration was that upon the completion of the entire project, L&T would be entitled to 75 per cent of the same.

7. Again on 04.01.2006, the business premises of L&T were inspected and certain documents like agreement copies and other documents relating to the transactions of the sale of flats were seized for the purposes of further investigation and verification.

8. On 02.02.2006, the Deputy Commissioner served upon L&T a further notice proposing to tax the sale of materials used in the construction of flats on the ground that it was entitled to 75 per cent of the share of the projects. L&T filed detailed objections to this notice as well.
9. On 03.07.2006, the Deputy Commissioner issued provisional assessment orders under Section 28(6) of the Karnataka Sales Tax Act, 1957 (for short, \textit{KST Act}) for the years 2000-01 to 2004-05. Along with the provisional orders, the Deputy Commissioner also issued demand notices raising a total demand of Rs. 3,99,28,636/-. 

10. Initially, L&T preferred a writ petition before this Court challenging the above demands but that writ petition was withdrawn and a writ petition under Article 226 of the Constitution of India was filed before the Karnataka High Court.

11. The Single Judge of the Karnataka High Court noted that the controversy raised by the L&T was covered by the decision of this Court in \textit{Raheja Development} and, accordingly, dismissed the writ petition on 10.07.2007 by observing as follows:

\textit{From the aforesaid observations of the Apex Court it is very much clear that as the petitioner No. 1 had entered into an agreement to carry out construction activity on behalf of someone else for cash or for deferred payment or for any other valuable construction, it would be carrying out works contract and therefore would become liable to pay turnover tax on the transfer involved in such work contracts. It is also not in dispute in this matter that the agreement of sale is entered into between the first petitioner and the buyers of the flat even prior to completion of the construction of the building. Under such circumstances, as has been held by the Apex Court in the RAHEJA DEVELOPMENT CORPORATION\textit{Case}, the petitioners are liable to pay the turnover tax on the transfer of goods involved in such \textit{works contract}. In view of the dictum laid down by the recent judgment cited supra, this Court does not find any merit in this writ petition.} 

12. L&T preferred an intra-court appeal. The Division Bench of that Court concurred with the Single Judge and dismissed the writ appeal by expressing its opinion as follows:

\textit{In our view, so far as the definition of \textit{works contract} in almost similar situation as in the present case has been well considered by the Hon\textit{e}ble Supreme Court in the case of K. RAHEJA DEVELOPMENT CORPORATION\textit{(supra)}. The question as to whether that judgment as per Article 141 of the Constitution of India is the law of the land binding on all the Courts in the Country. \textit{Prima facie}, we find that the facts and circumstances in that case are almost similar to the present case and as such, the ratio laid down in the RAHEJA\textit{Case} and relied upon by the learned Single Judge is, in our view, just and proper. So far as the other pronouncements are concerned, if the appellant feels that it is necessary to get the pronouncement in RAHEJA\textit{Case} reviewed, it is open for him to approach the Apex Court and this Court cannot substitute its own findings on the questions since the same has already been decided by the Apex Court in RAHEJA\textit{Case}.} 

17. Mr. Rohinton F. Nariman, learned senior counsel for L&T led the arguments on behalf of the appellants. His submission is that \textit{Raheja Development} does not lay down correct law. He submits that insertion of clause 29-A (b) in Article 366 following the 61st Law Commission
Report is intended to separate the goods component from the labour and services component of a composite works contract. The amendment does not in any manner undo Gannon Dunkerley-1\(^3\) insofar as that decision defines what a works contract is. In this regard, learned senior counsel extensively referred to the decisions of this Court in Builders’ Association\(^4\) and Bharat Sanchar\(^5\). It is argued by him that in Raheja Development\(^1\) it was incorrectly assumed that the definition of works contract was wide although the definition of works contract in KST Act and Madras General Sales Tax Act which was under consideration in Gannon Dunkerley-1\(^3\) was identical.

18. Alternatively, it is argued by Mr. Rohinton F. Nariman that if it is accepted that the definition of “works contract” in KST Act is wide which takes within its fold the contracts that are not commonly understood as works contract then this would be outside Entry 54 List II of the Seventh Schedule of the Constitution for the reason that “works contract” as understood in Gannon Dunkerley-1\(^3\) has not in any manner been upset by the constitutional amendment and would have to mean “works contract” as commonly understood.

19. Criticizing the conclusions drawn in paragraph 20 of the judgment in Raheja Development\(^1\), it is argued by Mr. Rohinton F. Nariman that these conclusions are incorrect for, (a) the well known tests to determine as to whether a particular contract is a “works contract” or “contract of sale” have not been adverted to; (b) the contract is not read as a whole. Its substance and the main object has not been looked at and one phrase is torn out of context without advert to any other part of the contract and based on this reasoning the contract is said to be a works contract; (c) though it is noticed that construction/development is to be on payment of a price in various installments but does not draw any conclusion from it; (d) it is noticed that developer has a lien on the property but incorrectly states that the lien is because they are not owners. The lien is obviously so that if monies are not recovered from the prospective flat purchasers, the lien can be exercised, showing thereby that the contract is a contract of an agreement to sell immovable property; (e) after noticing that developer can terminate the agreement if any one installment is not paid and can forfeit 10% of the amount that has been paid and can ultimately resell the flat, it is held that the presence of such a clause does not mean that the agreement ceases to be a “works contract” without appreciating that such a clause would have no place in a works contract and can only be consistent with the contract for the sale of immovable property inasmuch as termination can take place if the entire consideration for the immovable property is not paid; (f) it is stated that if there is termination but there is no re-sale, there would be no works contract only to that extent which is again wholly incorrect because post termination what happens to a particular flat is of no relevance inasmuch as the prospective flat purchaser goes out of the picture; and (g) the distinction between a flat being constructed and a flat under construction is a distinction without a difference for the reason that the
judgment notices that if the agreement is entered into after the flat is already constructed, there would be no sale and no works contract. This is obviously for the reason that the flat has already been developed by the developer using his material and his plan and is sold as such to a purchaser.

21. Based on the various clauses of the tripartite agreement, it is argued that the main object of the agreement read as a whole and the substance of the agreement is to sell and convey fraction of the land together with a fully constructed flat only when all installments have been fully paid. The work undertaken is for the joint development of the project as a whole, i.e., work is undertaken by the developer for himself and for the owner. The construction is not carried out for and on behalf of the purchaser, but it is carried out entirely by the owner/developer in order to exploit or get the best price for the land and the structure built thereon from various flat purchasers. The flat is to be sold as a flat and not an aggregate of its component parts. No work is carried out for the purchaser who gets title to the property only after all work is complete. Learned senior counsel argued that the ultimate test would be: if a suit for specific performance is filed by the flat purchaser against the owner/developer, such suit would invariably be for the conveyance of title and not for the construction of a building. Conversely a suit by an owner/developer against the flat purchaser would be for payment of consideration of a flat/fractional interest in the land. Such suit would never be for payment of work done at the behest of the flat purchaser and payment of consideration therefor. It is, thus, submitted that the judgment in Raheja Development does not lay down good law and deserves to be overruled.

39. In the counter arguments advanced on behalf of the two States – Karnataka and Maharashtra - Raheja Development has been stoutly defended. Mr. K.N. Bhat, learned senior counsel for Karnataka submits that view taken in Raheja Development is correct and needs no reconsideration both on merits as well as on the basis of binding precedents on the principles governing reconsideration of an earlier decision. He submits that Article 366(29-A) uses the phraseology employed in Entry 54 of List II that reads, “taxes on sale or purchase of goods” For the purpose of Entry 54 List II, “taxes on the sale or purchase of goods” includes tax on the transfer of property in goods (whether as goods or in some other form) involved in the execution of a works contract. Transfer of property in goods is the essence of definition of sale in Section 4 of the Sale of Goods Act. Article 366(29-A)(b) can be rephrased as tax on the sale of goods involved in the execution of a works contract and in any case by the deeming fiction incorporated in the above provision, it shall be deemed to be a sale of those goods by the person making the transfer and a purchase by a person to whom such transfer is made. The taxable event is the deemed sale of goods involved in the execution of works contract. Article 366 (29-A) has been inserted to remedy the situation arising from the decision in the Gannon Dunkerley-I where attempt to levy sales tax on the sale of goods involved in the
execution of works contract was held to be unconstitutional. This was on the basis that a works contract could not be dissected into contract for sale of goods and contract for sale of goods. Mr. K.N. Bhat submits, relying upon para 41 in *Builders’ Association*, that definition of works contract KST Act does not go beyond what is contemplated in the Constitution.

52. Prior to Forty-sixth Amendment in the Constitution, levy of sales tax on the sale of goods involved in the execution of the works contract was held to be unconstitutional in *Gannon Dunkerley-I*. That was a case where the assessee (Gannon Dunkerley) was carrying on business as engineers and contractors. Its business consisted mainly of execution of contracts for construction of buildings, bridges, dams, roads and structural contracts of all kinds. During the assessment year under consideration, the return filed by the assessee showed as many as 47 contracts most of which were building contracts which were executed by it. From the total of the amount which the assessee received in respect of sanitary contracts and other contracts 20 per cent and 30 per cent respectively were deducted for labour and the balance was taken as the turnover of the assessee for the assessment year in question. Sales tax was levied on the said balance treating it as taxable turnover under the Madras General Sales Tax Act, 1939. Assessee questioned the levy of sales tax on the ground that there was no sale of goods as understood in India and, therefore, no sales tax could be levied on any portion of the amount which was received by the assessee from the persons for whose benefit it had constructed buildings. The Madras High Court concluded that the transactions in question were not contracts for sale of goods as defined under the provisions of the Sale of Goods Act, 1930 which was in force on the date on which the Constitution came into force and, therefore, the assessee was not liable to pay sales tax on the amounts received by it from the persons for whom it had constructed buildings during the year of assessment. It is from this judgment that the matter reached this Court. The Constitution Bench of this Court held that in a building contract where the agreement between the parties was that the contractor should construct the building according to the specifications contained in the agreement and in consideration received payment as provided therein, there was neither a contract to sell the materials used in the construction nor the property passed therein as movables. It was held that in a building contract which was one (entire and indivisible) there was no sale of goods and it was not within the competence of the Provincial State Legislature to impose tax on the supply of the materials used in such a contract treating it as a sale. The Constitution Bench said, *quicquid plantatur solo, solo cedit*, and it vests in the other party not as a result of the contract but as the owner of the land. Vide *Hudson on Building Contracts*, 7th Edn., p. 386 It was further stated, *that exception does not apply to buildings which are constructed in execution of a works contract, and the law with reference to them is that the title to the same passes to the owner of the land as an accretion thereto. Accordingly, there can*
be no question of title to the materials passing as movables in favour of the other party to the contract.

53. In *Gannon Dunkerley-I*[^3], this Court held that in a building contract which was one, entirely indivisible, there was no sale of goods and it was not within the competence of the provincial State legislature to impose tax on the supply of materials used in such a contract treating it as a sale. The above statement was founded on the premise that the works contract was a composite contract which is inseparable and indivisible. Entry 48 of List II of Schedule Seven of the Government of India Act, 1935 was under consideration before this Court in *Gannon Dunkerley-I*[^3]. It is observed that the expression "sale" of goods in that entry has the same meaning as the said expression had in the Sale of Goods Act, 1930. In other words, the essential ingredients of sale of goods are (i) an agreement to sell movables for a price and (ii) property passing therein pursuant to that agreement.

54. The problems connected with powers of States to levy tax, *inter alia*, on goods involved in execution of works contract following *Gannon Dunkerley-I*[^3] was elaborately examined by the Law Commission of India. In its 61[^7] Report, Chapter 1A, the Law Commission specifically examined the taxability of works contract. The Law Commission noted the essential nature and features of the building contracts and the difference between contract of works and contract for sale. It examined the question whether the power to tax indivisible contracts of works should be conferred on the States. The Law Commission suggested three alternatives (a) amendment in the State List, Entry 54, or (b) adding a fresh entry in the State List, or (c) insertion in Article 366 a wide definition of "sale" so as to include works contract. It preferred the last one, as, in its opinion, this would avoid multiple amendments.

55. Having regard to the above recommendation of the Law Commission, the Constitution Bill No.52 of 1981 was introduced in the Parliament.

56. The Parliament then enacted the Constitution (Forty-sixth Amendment) Act, 1982 which received the assent of the President on 02.02.1983. Accordingly, clause 29-A was inserted in Article 366 of the Constitution which is set out as below.

(ii) the transfer of property in goods involved in the execution of a works contract;

(iii) delivery of goods on hire-purchase or any system of payment by instalments;

(iv) transfer of the right to use any goods for any purpose for cash, deferred payment or other valuable consideration;

(v) the supply of goods by an unincorporated association or body of persons to a member thereof for cash, deferred payment or other valuable consideration;
(vi) the supply, by way of or as part of any service, of food or any drink for cash, deferred payment or other valuable consideration.

12. Clause (3) of article 286 is proposed to be amended to enable Parliament to specify, by law, restrictions and conditions in regard to the system of levy, rates and other incidents of the tax on the transfer of goods involved in the execution of a works contract, on the delivery of goods on hire-purchase or any system of payment by instalments and on the right to use any goods.

13. The proposed amendments would help in the augmentation of the State revenues to a considerable extent. Clause 6 of the Bill seeks to validate laws levying tax on the supply of food or drink for consideration and also the collection or recoveries made by way of tax under any such law. However, no sales tax will be payable on food or drink supplied by a hotelier to a person lodged in the hotel during the period from the date of the judgment in the Associated Hotels of India case and the commencement of the present Amendment Act if the conditions mentioned in sub-clause (2) of clause 6 of the Bill are satisfied. In the case of food or drink supplied by restaurants this relief will be available only in respect of the period after the date of judgment in the Northern India Caterers (India) Limited case and the commencement of the present Amendment Act.Ø

(29-A) Ñtax on the sale or purchase of goodsØ includesØ

(a) a tax on the transfer, otherwise than in pursuance of a contract, of property in any goods for cash, deferred payment or other valuable consideration;

(b) a tax on the transfer of property in goods (whether as goods or in some other form) involved in the execution of a works contract;

(c) a tax on the delivery of goods on hire-purchase or any system of payment by instalments;

(d) a tax on the transfer of the right to use any goods for any purpose (whether or not for a specified period) for cash, deferred payment or other valuable consideration;

(e) a tax on the supply of goods by any unincorporated association or body of persons to a member thereof for cash, deferred payment or other valuable consideration;

(f) a tax on the supply, by way of or as part of any service or in any other manner whatsoever, of goods, being food or any other article for human consumption or any drink (whether or not intoxicating), where such supply or service, is for cash, deferred payment or other valuable consideration,

and such transfer, delivery or supply of any goods shall be deemed to be a sale of those goods by the person making the transfer, delivery or supply and a purchase of those goods by the person to whom such transfer, delivery or supply is made:Ø

57. Following the above amendment in the Constitution, the sales tax legislations in various States were amended and provisions were made for imposition of sales tax in relation to works contract. The constitutional validity of the Forty-sixth Amendment by which the
legislatures of the States were empowered to levy sales tax on certain transactions described in clauses (a) to (f) of clause 29-A of Article 366 of the Constitution as well as the amendments made in the State legislations were challenged in *Builders’ Association*. The Constitution Bench of this Court upheld the constitutionality of the Forty-sixth Amendment. The Court observed that the object of the new definition introduced in clause 29-A of Article 366 of the Constitution was to enlarge the scope of the expression ‘tax of sale or purchase of goods’ wherever it occurs in the Constitution so that it may include within its scope any transfer, delivery or supply of goods that may take place under any of the transactions referred to in sub-clauses (a) to (f). The Constitution Bench explained that clause 29-A refers to a tax on the transfer of property in goods (whether as goods or in some other form) involved in the execution of a works contract. The emphasis is on the transfer of property in goods whether as goods or in some other form. A transfer of property in goods under sub-clause (b) of clause 29-A is deemed to be a sale of the goods involved in the execution of a works contract by the person making the transfer and a purchase of those goods by a person to whom such transfer was made.

58. Article 286 puts certain restrictions upon the power of the State to enact laws concerning imposition of sales tax. It lays down that 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 import of the goods into, or export of the goods out of the territory of India. Sub-clause (2) of Article 286 enables the Parliament to enact law formulating principles for determining when a sale or purchase of goods takes place in any of the ways mentioned in clause (1). As regards inter-state trade and commerce, clause (3) puts two restrictions. It provides that any law of a State shall, insofar as it imposes, or authorises the imposition of (a) 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; (b) a tax on the sale or purchase of goods, being a tax of the nature referred to in sub-clause (b), sub-clause (c) and sub-clause (d) of clause 29-A of Article 366, be subject to such restrictions and conditions in regard to the system of levy, rates and other incidents of tax as the Parliament may by law specify. Clause (3) was substituted by Constitution Forty-sixth Amendment Act, 1982 with effect from 02.02.1983.

59. Clause 29-A was inserted in Article 366 by the Forty-sixth Amendment with effect from 02.02.1983. Entry 54 of List II (State List) enables the State to make laws relating to taxes on the sale or purchase of goods other than the newspapers, subject to the provisions of Entry 92-A of List I. Entry 63 of List II enables the States to provide rates of stamp duty in respect of documents other than those specified in provisions of List I with regard to the rates of stamp duty. Entry 92-A of List I deals with 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. Entry 6 of List III deals with the subjects, ‘transfer of property other than the agricultural land; registration of deeds and documents’.

60. It is important to ascertain the meaning of sub-clause (b) of clause 29-A of Article 366 of the Constitution. As the very title of Article 366 shows, it is the definition clause. It starts by saying that in the Constitution unless the context otherwise requires the expressions defined in that article shall have the meanings respectively assigned to them in the article. The definition of expression ‘tax on sale or purchase of the goods’ is contained in clause (29-A). If the first part of clause 29-A is read with sub-clause (b) along with latter part of this clause, it reads like this: tax on the sale or purchaser of the goods includes a tax on the transfer of property in goods (whether as goods or in some other form) involved in the execution of a works contract and such transfer, delivery or supply of any goods shall be deemed to be a sale of those goods by the person making the transfer, delivery or supply and a purchase of those goods by the person to whom such transfer, delivery or supply is made. The definition of ‘goods’ in clause 12 is inclusive. It includes all materials, commodities and articles. The expression, ‘goods’ has a broader meaning than merchandise. Chattels or movables are goods within the meaning of clause 12. Sub-clause (b) refers to transfer of property in goods (whether as goods or in some other form) involved in the execution of a works contract. The expression ‘in some other form’ in the bracket is of utmost significance as by this expression the ordinary understanding of the term ‘goods’ has been enlarged by bringing within its fold goods in a form other than goods. Goods in some other form would thus mean goods which have ceased to be chattels or movables or merchandise and become attached or embedded to earth. In other words, goods which have by incorporation become part of immovable property are deemed as goods. The definition of ‘tax on the sale or purchase of goods includes a tax on the transfer or property in the goods as goods or which have lost its form as goods and have acquired some other form involved in the execution of a works contract.

61. Viewed thus, a transfer of property in goods under clause 29-A(b) of Article 366 is deemed to be a sale of the goods involved in the execution of a works contract by the person making the transfer and the purchase of those goods by the person to whom such transfer is made.

62. The States have now been conferred with the power to tax indivisible contracts of works. This has been done by enlarging the scope of ‘tax on sale or purchase of goods’ wherever it occurs in the Constitution. Accordingly, the expression ‘tax on the sale or purchase of goods’ in Entry 54 of List II of Seventh Schedule when read with the definition clause 29-A, includes a tax on the transfer of property in goods whether as goods or in the form other than goods involved in the execution of works contract. The taxable event is deemed sale.
63. Gannon Dunkerley-I and few other decisions following Gannon Dunkerley-I wherein the expression \(\text{\textquotedbl}\text{sale\textquotedbl}\) was given restricted meaning by adopting the definition of the word \(\text{\textquotedbl}\text{sale\textquotedbl}\) contained in the Sale of Goods Act has been undone by the Forty-sixth Constitutional Amendment so as to include works contract. The meaning of sub-clause (b) of clause 29-A of Article 366 of the Constitution also stands settled by the Constitution Bench of this Court in Builders’ Association\(^4\). As a result of clause 29-A of Article 366, tax on the sale or purchase of goods may include a tax on the transfer in goods as goods or in a form other than goods involved in the execution of the works contract. It is open to the States to divide the works contract into two separate contracts by legal fiction: (i) contract for sale of goods involved in the works contract and (ii) for supply of labour and service. By the Forty-sixth Amendment, States have been empowered to bifurcate the contract and to levy sales tax on the value of the material in the execution of the works contract.

64. Whether contract involved a dominant intention to transfer the property in goods, in our view, is not at all material. It is not necessary to ascertain what is the dominant intention of the contract. Even if the dominant intention of the contract is not to transfer the property in goods and rather it is the rendering of service or the ultimate transaction is transfer of immovable property, then also it is open to the States to levy sales tax on the materials used in such contract if it otherwise has elements of works contract. The view taken by a two-Judge Bench of this Court in Rainbow Colour Lab\(^1\) that the division of the contract after Forty-sixth Amendment can be made only if the works contract involved a dominant intention to transfer the property in goods and not in contracts where the transfer of property takes place as an incident of contract of service is no longer good law, Rainbow Colour Lab has been expressly overruled by a three-Judge Bench in Associated Cement\(^2\).

65. Although, in Bharat Sanchar, the Court was concerned with sub-clause (d) of clause 29-A of Article 366 but while dealing with the question as to whether the nature of transaction by which mobile phone connections are enjoyed is a sale or service or both, the three-Judge Bench did consider the scope of definition in clause 29-A of Article 366. With reference to sub-clause (b) it said: \(\text{\textquotedbl}\text{\textacute{e}}\text{\textacute{t}}\). sub-clause (b) covers cases relating to works contract. This was the particular fact situation which the Court was faced with in Gannon Dunkerley-I and which the Court had held was not a sale. The effect in law of a transfer of property in goods involved in the execution of the works contract was by this amendment deemed to be a sale. To that extent the decision in Gannon Dunkerley-I was directly overcome. It then went on to say that all the sub-clauses of Article 366(29-A) serve to bring transactions where essential ingredients of a \(\text{\textacute{e}}\text{\textacute{t}}\) as defined in the Sale of Goods Act, 1930 are absent, within the ambit of purchase or sale for the purposes of levy of sales tax.
66. It then clarified that *Gannon Dunkerley-I* survived the Forty-sixth Constitutional Amendment in two respects. First, with regard to the definition of sale for the purposes of the Constitution in general and for the purposes of Entry 54 of List II in particular except to the extent that the clauses in Article 366(29-A) operate and second, the dominant nature test would be confined to a composite transaction not covered by Article 366 (29-A). In other words, in *Bharat Sanchar*\(^5\), this Court reiterated what was stated by this Court in *Associated Cement*\(^15\) that dominant nature test has no application to a composite transaction covered by the clauses of Article 366(29-A). Leaving no ambiguity, it said that after the Forty-sixth Amendment, the sale element of those contracts which are covered by six sub-clauses of clause 29-A of Article 366 are separable and may be subjected to sales tax by the States under Entry 54 of List II and there is no question of the dominant nature test applying.

67. In view of the statement of law in *Associated Cement* and *Bharat Sanchar* the argument advanced on behalf of the appellants that dominant nature test must be applied to find out the true nature of transaction as to whether there is a contract for sale of goods or the contract of service in a composite transaction covered by the clauses of Article 366 (29-A) has no merit and the same is rejected.

68. In *Gannon Dunkerley-II*\(^11\), this Court, *inter alia*, established the five following propositions: (i) As a result of Forty-sixth Amendment, the contract which was single and indivisible has been altered by a legal fiction into a contract which is divisible into one for sale of goods and the other for supply of labour and service and as a result of such contract which was single and indivisible has been brought on par with a contract containing two separate agreements; (ii) If the legal fiction introduced by Article 366 (29-A)(b) is carried to its logical end, it follows that even in a single and indivisible works contract there is a deemed sale of the goods which are involved in the execution of a works contract. Such a deemed sale has all the incidents of the sale of goods involved in the execution of a works contract where the contract is divisible into one for sale of goods and the other for supply of labour and services; (iii) in view of sub-clause (b) of clause 29-A of Article 366, the State legislatures are competent to impose tax on the transfer of property in goods involved in the execution of works contract. Under Article 286(3)(b), Parliament has been empowered to make a law specifying restrictions and conditions in regard to the system of levy, rates or incidents of such tax. This does not mean that the legislative power of the State cannot be exercised till the enactment of the law under Article 286(3)(b) by the Parliament. It only means that in the event of law having been made by Parliament under Article 286(3)(b), the exercise of the legislative power of the State under Entry 54 in List II to impose tax of the nature referred to in sub-clauses (b), (c) and (d) of clause (29-A) of Article 366 would be subject to restrictions and conditions in regard to the system of levy, rates and other incidents of tax contained in the said law; (iv) While enacting law imposing a tax on sale or purchase of goods under Entry 54.
of the State List read with Article 366 (29-A)(b), it is permissible for the State legislature to make a law imposing tax on such a deemed sale which constitutes a sale in the course of the inter-state trade or commerce under Section 3 of the Central Sales Tax Act or outside under Section 4 of the Central Sales Tax Act or sale in the course of import or export under Section 5 of the Central Sales Tax Act; and (v) measure for the levy of tax contemplated by Article 366 (29-A)(b) is the value of the goods involved in the execution of a works contract. Though the tax is imposed on the transfer of property in goods involved in the execution of a works contract, the measure for levy of such imposition is the value of the goods involved in the execution of a works contract. Since, the taxable event is the transfer of property in goods involved in the execution of a works contract and the said transfer of property in such goods takes place when the goods are incorporated in the works, the value of the goods which can constitute the measure for the levy of the tax has to be the value of the goods at the time of incorporation of the goods in works and not the cost of acquisition of the goods by the contractor.

69. In Gannon Dunkerley-II11 sub-section (3) of Section 5 of the Rajasthan Sales Tax Act and Rule 29(2)(1) of the Rajasthan Sales Tax Rules were declared as unconstitutional and void. It was so declared because the Court found that Section 5(3) transgressed the limits of the legislative power conferred on the State legislature under Entry 54 of the State List. However, insofar as legal position after Forty-sixth Amendment is concerned, Gannon Dunkerley-II11 holds unambiguously that the States have now legislative power to impose tax on transfer of property in goods as goods or in some other form in the execution of works contract.

70. The Forty-sixth Amendment leaves no manner of doubt that the States have power to bifurcate the contract and levy sales tax on the value of the material involved in the execution of the works contract. The States are now empowered to levy sales tax on the material used in such contract. In other words, clause 29-A of Article 366 empowers the States to levy tax on the deemed sale.

71. Now, if by legal fiction provided in clause (29-A)(b) of Article 366, the works contract becomes separable and divisible, one for the materials and the other for services and for the work done, whatever has been said by this Court in Gannon Dunkerley-I with regard to the definition of works contract in Section 2(i) of the Madras General Sales Tax Act pales into insignificance insofar as ambit and scope of the term "works contract" within the meaning of Article 366(29-A) is concerned. To say that insertion of clause (29-A) in Article 366 has not undone Gannon Dunkerley-I in any manner, in our view, is not correct. The narrow meaning given to the term "works contract" in Gannon Dunkerley-I now no longer survives.
72. There is no doubt that to attract Article 366(29-A)(b) there has to be a works contract but then what is its meaning. The term “works contract” needs to be understood in a manner that the Parliament had in its view at the time of Forty-sixth Amendment and which is more appropriate to Article 366(29-A)(b).

76. In our opinion, the term “works contract” in Article 366(29-A)(b) is amply wide and cannot be confined to a particular understanding of the term or to a particular form. The term encompasses a wide range and many varieties of contract. The Parliament had such wide meaning of “works contract” in its view at the time of Forty-sixth Amendment. The object of insertion of clause 29-A in Article 366 was to enlarge the scope of the expression “tax of sale or purchase of goods” and overcome Gannon Dunkerley-I. Seen thus, even if in a contract, besides the obligations of supply of goods and materials and performance of labour and services, some additional obligations are imposed, such contract does not cease to be works contract. The additional obligations in the contract would not alter the nature of contract so long as the contract provides for a contract for works and satisfies the primary description of works contract. Once the characteristics or elements of works contract are satisfied in a contract then irrespective of additional obligations, such contract would be covered by the term “works contract” Nothing in Article 366(29-A)(b) limits the term “works contract” to contract for labour and service only.

The Parliament had all genre of works contract in view when clause 29-A was inserted in Article 366.

77. The difference between a contract for work (or service) and a contract for sale (of goods) has come up for consideration before this Court on more than one occasion. Before we consider some of the decisions of this Court in this regard, it is of interest to refer to two old decisions of English courts. In Lee it was laid down that if a contract would result in the transaction of property in goods from one party to another then it must be a contract of sale.

78. However, the statement of law in Lee did not find favour in Robinson where it was held that if the substance of the contract required skill and labour for the production of the articles then it would not make any difference that there would pass some materials in addition to the skill.

79. In Chandra Bhan Gosain this Court exposited that for finding out whether a contract is one of work done and materials found or one for sale of goods depends on its essence. If not of its essence that a chattel should be produced and transferred as a chattel, then it may be a contract for work done and materials found and not a contract for sale of goods.
80. In *Purshottam Premji* the difference between a contract for work and a contract for sale was explained like this: The primary difference between a contract for work or service and a contract for sale of goods is that in the former there is in the person performing work or rendering service no property in the thing produced as a whole notwithstanding that a part or even the whole of the materials used by him may have been its property. In a case of contract for sale, the thing produced as a whole has individual existence as the sole property of the party who produced it at some time before delivery and the property therein passes only under the contract relating thereto to other party for price. Mere transfer of property in goods used in the performance of the contract is not sufficient; to constitute a sale there must be an agreement express or implied relating to the sale of goods and completion of the agreement by passing of title in the very goods contracted to be sold. Ultimately the true effect of an accretion made pursuant to a contract has to be judged, not by an artificial rule that the accretion may be presumed to have become by virtue of affixing to a chattel of part of that chattel but from the intention of the parties to the contract.

81. The factors highlighted in *Purshottam Premji* which distinguish a contract for work from a contract for sale are relevant but not exhaustive. It is not correct to say that these factors should be considered as the only factors to differentiate a works contract and a contract for sale. In our view, there are not and there cannot be absolute tests to distinguish a sale and works contract.

82. This Court in *Associated Hotels* stated that the determination as to whether the contract involved in a transaction constitutes a contract of sale or a contract of work or service depends in each case upon its facts and circumstances. Mere passing of property in article or commodity during the course of the performance of the transaction does not render it a transaction of sale. For even in a contract purely of work or service, it is possible that articles may have to be used by the person executing the work and property in such cases articles or materials where passed to the other party. That would not necessarily convert the contract into one of sale of those materials. It is stated in *Associated Hotels* that in every case the Court will have to find out what is the primary object of the transaction and the intention of the parties while entering upon it. It has been clarified that in some cases it may be that even while entering into a contract of work or even service, parties might enter into separate agreements, one of work and service and the other of sale and purchase of materials to be used in the course of executing the work or performing the service. But, then in such cases the transaction will not be one and indivisible but will fall into the two separate agreements one of work or service and the other of sale.

85. In *Hindustan Aeronautics*, the Court noted the difference between contract for service and contract for sale of goods in these words:
It is well settled that the difference between contract of service and contract for sale of goods, is, that in the former, there is in the person performing work or rendering service no property in the things produced as a whole notwithstanding that a part or even the whole of materials used by him had been his property. In the case of a contract for sale, the thing produced as a whole has individual existence as the sole property of the party who produced it sometime before delivery and the property therein passed only under the contract relating thereto to the other party for price. It is necessary, whether in essence there was any agreement to work for a stipulated consideration.

86. The Court went on to say further in *Hindustan Aeronautics* as follows:

It cannot be said as a general proposition that in every case of works contract, there is necessarily implied the sale of the component parts which go to make up the repair. That question would naturally depend upon the facts and circumstances of each case. Mere passing of property in an article or commodity during the course of performance of the therefore, in every case for the courts to find out transaction in question does not render the transaction to be transaction of sale. Even in a contract purely of works or service, it is possible that articles may have to be used by the person executing the work, and property in such articles or materials may pass to the other party. That would not necessarily convert the contract into one of sale of those materials.

7. In *Kone Elevators*27, the Court again highlighted the tests to distinguish a works contract and a contract for sale of goods. The Court said:

It can be treated as well settled that there is no standard formula by which one can distinguish a contract for sale from a works contract. The question 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. If the intention is to transfer for a price a chattel in which the transferee had no previous property, then the contract is a contract for sale. Ultimately, the true effect of an accretion made pursuant to a contract has to be judged not by artificial rules but from the intention of the parties to the contract. In a contract of sale, the main object is the transfer of property and delivery of possession of the property, whereas the main object in a contract for work is not the transfer of the property but it is one for work and labour. Another test often to be applied is: when and how the property of the dealer in such a transaction passes to the customer: is it by transfer at the time of delivery of the finished article as a chattel or by accession during the procession of work on fusion to the movable property of the customer? If it is the former, it is a sale; if it is the latter, it is a works contract. Therefore, in judging whether the contract is for a sale or for work and labour the essence of the contract or the reality of the transaction as a whole has to be taken into consideration. The predominant object of the contract, the circumstances of the case and the custom of the trade provide a guide in deciding whether transaction is a sale or a works contract. Essentially, the question is of interpretation of the contract. It is
settled law that the substance and not the form of the contract is material in determining the nature of transaction. No definite rule can be formulated to determine the question as to whether a particular given contract is a contract for sale of goods or is a works contract. Ultimately, the terms of a given contract would be determinative of the nature of the transaction, whether it is a sale or a works contract. Therefore, this question has to be ascertained on facts of each case, on proper construction of terms and conditions of the contract between the parties.

92. It seems to us (and that is the view taken in some of the decisions) that a contract may involve both a contract of work and labour and a contract of sale of goods. In our opinion, the distinction between contract for sale of goods and contract for work (or service) has almost diminished in the matters of composite contract involving both (a contract of work/labour and a contract for sale for the purposes of Article 366 (29-A)(b). Now by legal fiction under Article 366(29-A)(b), it is permissible to make such contract divisible by separating the transfer of property in goods as goods or in some other form from the contract of work and labour. A transfer of property in goods under clause 29(A)(b) of Article 366 is deemed to be a sale of goods involved in the execution of a works contract by the person making the transfer and the purchase of those goods by the person to whom such transfer is made. For this reason, the traditional decisions which hold that the substance of the contract must be seen have lost their significance. What was viewed traditionally has to be now understood in light of the philosophy of Article 366(29-A).

93. The question is: Whether taxing sale of goods in an agreement for sale of flat which is to be constructed by the developer/promoter is permissible under the Constitution? When the agreement between the promoter/developer and the flat purchaser is to construct a flat and eventually sell the flat with the fraction of land, it is obvious that such transaction involves the activity of construction inasmuch as it is only when the flat is constructed then it can be conveyed. We, therefore, think that there is no reason why such activity of construction is not covered by the term works contract. After all, the term works contract is nothing but a contract in which one of the parties is obliged to undertake or to execute works. Such activity of construction has all the characteristics or elements of works contract. The ultimate transaction between the parties may be sale of flat but it cannot be said that the characteristics of works contract are not involved in that transaction. When the transaction involves the activity of construction, the factors such as, the flat purchaser has no control over the type and standard of the material to be used in the construction of building or he does not get any right to monitor or supervise the construction activity or he has no say in the designing or lay-out of the building, in
our view, are not of much significance and in any case these factors do not detract the contract being works contract insofar as construction part is concerned.

94. For sustaining the levy of tax on the goods deemed to have been sold in execution of a works contract, in our opinion, three conditions must be fulfilled: (i) there must be a works contract, (ii) the goods should have been involved in the execution of a works contract, and (iii) the property in those goods must be transferred to a third party either as goods or in some other form. In a building contract or any contract to do construction, the above three things are fully met. In a contract to build a flat there will necessarily be a sale of goods element. Works contracts also include building contracts and therefore without any fear of contradiction it can be stated that building contracts are species of the works contract.

95. Ordinarily in the case of a works contract the property in the goods used in the construction of the building passes to the owner of the land on which the building is constructed when the goods and materials used are incorporated in the building. But there may be contract to the contrary or a statute may provide otherwise. Therefore, it cannot be said to be an absolute proposition in law that the ownership of the goods must pass by way of accretion or exertion to the owner of the immovable property to which they are affixed or upon which the building is built.

96. Value addition as a concept after Forty-sixth Amendment to the Constitution has been accepted by this Court in P.N.C. Construction While dealing with this concept, the Court said that value addition was important concept which had arisen after the Forty-sixth Amendment by insertion of sub-clause (b) of clause (29-A) in Article 366. It has now become possible for the States to levy sales tax on the value of the goods involved in a works contract in the same way in which the sales tax was leviable on the price of the goods in a building contract. On account of the Forty-sixth Amendment in the Constitution the State Governments are empowered to levy sales tax on the contract value which earlier was not possible.

97. Where a contract comprises of both a works contract and a transfer of immovable property, such contract does not denude it of its character as works contract. Article 366(29-A)(b) does contemplate a situation where the goods may not be transferred in the form of goods but may be transferred in some other form which may even be in the form of immovable property.

100. We have no doubt that the State legislatures lack legislative power to levy tax on the transfer of immovable property under Entry 54 of List II of the Seventh Schedule. However, the States do have competence to levy sales tax on the sale of goods in an agreement of sale of flat which also has a component of a deemed sale of goods. Aspects theory though does not allow the State legislature to entrench upon the Union List and tax services by including the cost of such service in the value of goods but that does not detract the State to tax the sale of goods element involved in the execution of works contract in a composite contract like
contract for construction of building and sale of a flat therein. In para 88 of Bharat Sanchar, the Court stated: “the aspects theory does not however allow the State to entrench upon the Union List and tax services by including the cost of such service in the value of the goods. Even in those composite contracts which are by legal fiction deemed to be divisible under Article 366(29-A), the value of the goods involved in the execution of the whole transaction cannot be assessed to sales tax. Having said that, the Court also stated that the States were not competent to include the cost of service in the value of the goods sold (i.e. the sim card) nor the Parliament could include the value of the sim card in the cost of services. But the statement in para 92(C) of the Report is clear that it is upto the States to tax the sale of goods element in a composite contract of sale and service. Bharat Sanchar thus supports the view that taxation of different aspects of the same transaction as separate taxable events is permissible.

101. In light of the above discussion, we may summarise the legal position, as follows:

(i) For sustaining the levy of tax on the goods deemed to have been sold in execution of a works contract, three conditions must be fulfilled: (one) there must be a works contract, (two) the goods should have been involved in the execution of a works contract and (three) the property in those goods must be transferred to a third party either as goods or in some other form.

(ii) For the purposes of Article 366(29-A)(b), in a building contract or any contract to do construction, if the developer has received or is entitled to receive valuable consideration, the above three things are fully met. It is so because in the performance of a contract for construction of building, the goods (chattels) like cement, concrete, steel, bricks etc. are intended to be incorporated in the structure and even though they lost their identity as goods but this factor does not prevent them from being goods.

(iii) Where a contract comprises of both a works contract and a transfer of immovable property, such contract does not deme it of its character as works contract. The term “works contract” in Article 366 (29-A)(b) takes within its fold all genre of works contract and is not restricted to one specie of contract to provide for labour and services alone. Nothing in Article 366(29-A)(b) limits the term “works contract”.

(iv) Building contracts are species of the works contract.

(v) A contract may involve both a contract of work and labour and a contract for sale. In such composite contract, the distinction between contract for sale of goods and contract for work (or service) is virtually diminished.

(vi) The dominant nature test has no application and the traditional decisions which have held that the substance of the contract must be seen have lost their significance where transactions are of the nature contemplated in Article 366(29-A). Even if the dominant intention of the contract is not to transfer the property in goods and rather it is rendering of
service or the ultimate transaction is transfer of immovable property, then also it is open to the States to levy sales tax on the materials used in such contract if such contract otherwise has elements of works contract. The enforceability test is also not determinative.

(vii) A transfer of property in goods under clause 29-A(b) of Article 366 is deemed to be a sale of the goods involved in the execution of a works contract by the person making the transfer and the purchase of those goods by the person to whom such transfer is made.

(viii) Even in a single and indivisible works contract, by virtue of the legal fiction introduced by Article 366(29-A)(b), there is a deemed sale of goods which are involved in the execution of the works contract. Such a deemed sale has all the incidents of the sale of goods involved in the execution of a works contract where the contract is divisible into one for the sale of goods and the other for supply of labour and services. In other words, the single and indivisible contract, now by Forty-sixth Amendment has been brought on par with a contract containing two separate agreements and States have now power to levy sales tax on the value of the material in the execution of works contract.

(ix) The expression Òtax on the sale or purchase of goodsÓ in Entry 54 in List II of Seventh Schedule when read with the definition clause 29-A of Article 366 includes a tax on the transfer of property in goods whether as goods or in the form other than goods involved in the execution of works contract.

(x) Article 366(29-A)(b) serves to bring transactions where essential ingredients of ÒsaleÓ defined in the Sale of Goods Act, 1930 are absent within the ambit of sale or purchase for the purposes of levy of sales tax. In other words, transfer of movable property in a works contract is deemed to be sale even though it may not be sale within the meaning of the Sale of Goods Act.

(xi) Taxing the sale of goods element in a works contract under Article 366(29-A)(b) read with Entry 54 List II is permissible even after incorporation of goods provided tax is directed to the value of goods and does not purport to tax the transfer of immovable property. The value of the goods which can constitute the measure for the levy of the tax has to be the value of the goods at the time of incorporation of the goods in works even though property passes as between the developer and the flat purchaser after incorporation of goods.

102. The crucial question would now remain: whether the view taken in Raheja Development with reference to definition of Òworks contractÓ in KST Act is legally unjustified? The following definition of Òworks contractÓ was under consideration before this Court in Raheja Development Òworks contractÓ includes any agreement for carrying out for cash, deferred payment or other valuable consideration, the building, construction, manufacture, processing, fabrication, erection, installation, fitting out, improvement, modification, repair or commissioning of any moveable or immovable property.

103. The Court also noticed the definition of ÒdealerÓ and Òtaxable turn overÓ
104. The broad facts in *Raheja Development* were these:
Raheja Development carried on the business of real estate development and allied contracts;
Raheja Development entered into development agreements with the owners of land;
Raheja Development entered into agreements of sale with intended purchasers. The agreements provided that on completion of the construction, the residential apartments or the commercial complexes would be handed over to the purchasers who would get an undivided interest in the land also;
The owners of the land would then transfer the ownership directly to the society formed under the Karnataka Ownership Flat (Regulation of the Promotion of Construction, Sale, Management and Transfer) Act, 1972 (for short, *KOFA*).

105. In light of the above facts and the definition of “works contract,” the question before this Court was whether Raheja Development were liable to pay turnover tax on the value of goods involved in the execution of the works contract.

106. Section 5-B of the KST Act provides for levy of tax on transfer of property in goods (whether as goods or in some other form) involved in the execution of works contract.

107. On consideration of the arguments that were put forth by the parties, the Court in *Raheja Development* held as under:

(i) The definition of the term “works contract” in the Act is an inclusive definition.

(ii) It is a wide definition which includes “any agreement” for carrying out building or construction activity for cash, deferred payment or other valuable consideration.

(iii) The definition of works contract does not make a distinction based on who carries on the construction activity. Even an owner of the property may be said to be carrying on a works contract if he enters into an agreement to construct for cash, deferred payment or other valuable consideration.

(iv) The developers had undertaken to build for the prospective purchaser.

(v) Such construction/development was to be on payment of a price in various installments set out in the agreement.

(vi) The developers were not the owners. They claimed lien on the property. They had right to terminate the agreement and dispose of the unit if a breach was committed by the purchaser. A clause like this does not mean that the agreement ceases to be “works contract.” So long as there is no termination, the construction is for and on behalf of the purchaser and it remains a “works contract.”

(vii) If there is a termination and a particular unit is not resold but retained by the developer, there would be no works contract to that extent.
(viii) If the agreement is entered into after the flat or unit is already constructed then there would be no works contract. But, so long as the agreement is entered into before the construction is complete it would be works contract.

108. The correctness of the view taken in Raheja Development has been doubted in the referral order principally for the reasons: (a) the developer had undertaken the contract to develop the property of the owner. It is not alleged by the department that there is monetary consideration involved in the development agreement. If the development agreement is not a works contract, could the department rely upon the second contract which is the tripartite agreement and interpret it to be a works contract; (b) if the ratio in Raheja Development is to be accepted, then there would be no difference between works contract and a contract for sale of chattel as a chattel and (c) from the definition of works contract, the contractor must have undertaken the work of construction for and on behalf of the flat purchaser for cash, deferred or any other valuable consideration but could it be said that developer was contractor for the prospective flat purchaser.

109. In Raheja Development\textsuperscript{1}, the Court on consideration of the clauses (q) and (r) of the recitals and clauses (1), 5(c) and (vii) of the agreement between the flat purchaser, developer and owner of the land observed that the agreement had an element for carrying out building and construction activity for cash, deferred payment or other valuable consideration. The developer had undertaken to build for the prospective purchaser. Having regard to the various clauses of the recitals and also the clauses of the agreement, the Court was of the view that such agreement was a typical agreement and so long as there was no termination of the contract, the construction is for and on behalf of the purchaser and it remains a works contract\textsuperscript{1}.

114. In Article 366(29-A)(b), the term \textit{\textsuperscript{1}works contract\textsuperscript{2}} covers all genre of works contract and it is not limited to one specie of the contract. In Raheja Development\textsuperscript{1}, the definition of \textit{\textsuperscript{1}works contract\textsuperscript{2}} in KST Act was under consideration. That definition of \textit{\textsuperscript{1}works contract\textsuperscript{2}} is inclusive and refers to building contracts and diverse construction activities for monetary consideration viz; for cash, deferred payment or other valuable consideration as works contract. Having regard to the factual position, interalia, Raheja Development\textsuperscript{1} entered into development agreements with the owners of the land and it also entered into agreements for sale with the flat purchasers, the consideration being payment in installments and also the clauses of the agreement the Court held that developer had undertaken to build for the flat purchaser and so long as there was no termination of the contract, the construction is for and on behalf of the purchaser and it remains a works contract\textsuperscript{1} The legal position summarized by us and the foregoing discussion would justify the view taken by the two Judge Bench in Raheja Development\textsuperscript{1}. 
115. It may, however, be clarified that activity of construction undertaken by the developer would be works contract only from the stage the developer enters into a contract with the flat purchaser. The value addition made to the goods transferred after the agreement is entered into with the flat purchaser can only be made chargeable to tax by the State Government.

116. The reasons stated in the referral order for reconsideration of Raheja Development do not make out any good ground for taking a view different from what has been taken by this Court in Raheja Development. We are in agreement with the submission of Mr. K.N. Bhat that since Raheja Development in May, 2005 almost all States have modified their laws in line with Raheja Development and there is no justification for change in the position settled after the decision of this Court in Raheja Development.

18. We are clearly of the view that Raheja Development lays down the correct legal position and we approve the same. 120. Clause (24) of Section 2 defines sale to mean a sale of goods made within the State for cash or deferred payment or other valuable consideration but does not include a mortgage, hypothecation, charge of pledge; and the words sell, buy and purchase, with all their grammatical variations and cognate expressions. An explanation is appended to this clause. Clause (b) of the explanation to Section 2(24) defines what would be a sale for the purpose of the clause and brought in its ambit the transactions mentioned therein. Explanation (b)(ii) was amended with effect from 20.06.2006 by inserting the following words after the words works contract, including, an agreement for carrying out for cash, deferred payment or other valuable consideration, the building, construction, manufacture, processing, fabrication, erection, installation, fitting out, improvement, modification, repair or commissioning of any movable or immovable property.

121. There is no doubt in our mind that the amendment in explanation b(ii) to Section 2(24) was brought because of the judgment of this Court in Raheja Development. We have already held that Raheja Development lays down the correct legal position.

125. Once we have held that Raheja Development lays down the correct law, in our opinion, nothing turns on the circular dated 07.02.2007 and the notification dated 09.07.2010. The circular is a trade circular which is clarificatory in nature only. The notification enables the registered dealer to opt for a composition scheme. The High Court has dealt with the circular and notification. We do not find any error in the view of the High Court in this regard.
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(2014) 7 SCC 1


2. By an order dated 13.2.2008 in Kone Elevator India Private Limited v. State of Tamil Nadu and others[(2010) 14 SCC 788], a three-Judge Bench of this Court, while dealing with the writ petition preferred by Kone Elevator India Pvt. Ltd. along with Special Leave Petitions, noted that the question raised for consideration in the said cases is whether manufacture, supply and installation of lifts is to be treated as "sale" or "works contract" and a three-Judge Bench, in State of A.P. v. Kone Elevators (India) Ltd.[ (2005) 3 SCC 389], had not noticed the decisions rendered by this Court in State of Rajasthan v. Man Industrial Corporation Ltd.[(1969) 1 SCC 567], State of Rajasthan and others v. Nenu Ram[(1970) 26 STC 268 (SC)] and Vanguard Rolling Shutters and Steel Works v. Commissioner of Sales Tax[(1977) 2 SCC 250] and perceiving the manifest discord, thought it appropriate that the controversy should be resolved by the larger Bench. Thereafter, keeping in view the commonality of the controversy in Civil Appeal No. 6285 of 2010 and other Special Leave Petitions, they were tagged with the originally referred matters. Thus, the matters are before us.

3. The seminal controversy which has emerged in this batch of matters is whether a contract for manufacture, supply and installation of lifts in a building is a "contract for sale of goods" or a "works contract". Needless to say, in case of the former, the entire sale consideration would be taxable under the sales tax or value added tax enactments of the State legislatures, whereas in the latter case, the consideration payable or paid for the labour and service element would have to be excluded from the total consideration received and sales tax or value added tax would be charged on the balance amount.

4. Keeping in mind the said spinal issue, we think it apposite to briefly refer to the facts as adumbrated in the writ petition preferred by Kone Elevator India Pvt. Ltd. The petitioner is engaged in the manufacture, supply and installation of lifts involving civil construction. For the Assessment Year 1995-96, the Sales Tax Appellate Tribunal, Andhra Pradesh, considering the case of the petitioner, opined that the nature of work is a "works contract" for the erection and commissioning of lift cannot be treated as "sale". On a revision being filed, the High Court of Andhra Pradesh affirmed the view of the tribunal and dismissed the Tax Case (Revision) filed by the Revenue. Grieved by the decision of the High Court, the State of Andhra Pradesh preferred special leave petition wherein leave was granted and the matter was registered as Civil Appeal No. 6585 of 1999 and by judgment dated 17.2.2005 in Kone Elevators (supra), the view of the High Court was overturned. After the pronouncement in the said case, the State Government called upon the petitioner to submit returns treating the transaction as sale. Similarly, in some other States, proceedings were initiated proposing to reopen the assessments that had already been closed treating the transaction as sale. The said situation compelled the petitioner to prefer the petition under Article 32 of the Constitution. As far as others are concerned, they have preferred the writ petitions or appeals by special leave either challenging the show cause notices or assessment orders passed by the assessing officers or affirmation thereof or against the interim orders passed by the High Court.
requiring the assessee to deposit certain sum against the demanded amount. That apart, in certain cases, appeals have been preferred assailing the original assessment orders or affirmation thereof on the basis of the judgment in Kone Elevators (supra).

5. Mr. Harish Salve, learned senior counsel for the petitioners, has contended that prior to the decision of this Court in Bharat Sanchar Nigam Ltd. and another v. Union of India and others\[(2006) 3 SCC 1\], which has been further explained in Larsen and Toubro Limited and another v. State of Karnataka and another\[(2014) 1 SCC 708\], the law as understood was (a) where a contract was divisible by itself, then the element of sale would be taxed as an ordinary sale of goods, irrespective of the element of service; (b) where a contract was for the supply of goods, and for rendition of services, if the pre-dominant intention of the parties was to supply goods, the element of service would be ignored and the entirety of the contract consideration would be treated as the price of goods supplied and the tax imposed accordingly; and (c) as the law did not provide for dividing, by a legal fiction, a contract of such a nature into a contract for goods and a contract for services, the goods in which property passed from the contractor to the owner could not be brought to tax under the law of sales tax. It is assiduously urged by Mr. Salve that the "predominant intention test" is no longer relevant and after the decision in Larsen and Toubro (supra), supply and installation of lift cannot be treated to be a contract for sale. It is argued that a lift comprises of components or parts [goods] like lift car, motors, ropes, rails, etc. and each of them has its own identity prior to installation and they are assembled/installed to create the working mechanism called lift. Learned senior counsel would contend that the installation of these components/parts with immense skill is rendition of service, for without installation in the building, there is no lift.

6. Mr. Salve, learned senior counsel, has also referred to the Bombay Lifts Act, 1939, the Bombay Lifts Rules, 1958 and Bombay Lifts (Amendment) Rules, 2010. He has referred to the Preamble of the Act which stipulates that an Act has been enacted to provide for the regulation of the construction, maintenance and safe working of certain classes of lifts and all machinery and apparatus pertaining thereto in the State of Bombay. The State Act applies to the whole of Maharashtra. He has drawn our attention to the dictionary clause of "lift" as has been defined in clause 3(c) to mean a "hoisting mechanism equipped with a car which moves in a substantially vertical direction, is worked by power and is designed to carry passengers or goods or both; and a "lift installation" which includes the lift car, the lift way, the lift way enclosure and the operating mechanism of the lift and all ropes, cables, wires and plant, directly connected with the operation of the lift. He has also placed reliance on Section 4 which deals with permission to erect a lift, Section 5 that deals with licence to use a lift and Section 7 which provides a lift not to be operated without a licence. Learned senior counsel has also drawn our attention to the various rules that deal with many a technical aspect and the terms on which lift shall work and what requirements are to be carried out by a licencee under the Act. In essence, the submission is that the manufacture, supply and the installation are controlled by the statutory provisions under an enactment of the legislature and also the rules made in consonance with the Act which would reflect that immense skill is required for such installation and the separate parts of the lift are not sold like goods, but it only becomes operational after it is installed, adjusted, tested and commissioned in a building.
7. Mr. Khambatta, learned Advocate General, appearing for the State of Maharashtra, submitted that in the case of sale and installation of a lift or elevator, the contract would include the obligation to install the lift or to undertake any services in relation to the lift and these elements of value need to be deducted while taxing the sale of goods involved in such a contract. It is his submission that in a given case, there can be a contract which is exclusively for sale of lift, i.e., for sale of goods which does not include any labour or service element at all where the lift is bought from a manufacturer but a separate contract for installation is entered into with an independent engineering contractor. Learned Advocate General urged that such an installation by way of contract is permissible under the Bombay Lifts Act, 1939 read with the Bombay Lifts Rules, 1958. It is urged by him that prior to the decision in Kone Elevators case, the State of Maharashtra had treated contracts for sale and installation of lifts as "works contract" as per the decision of the High Court in Otis Elevator Company (India) Ltd. v. The State of Maharashtra[(1969) 24 STC 525 (Bom)]. He has copiously referred to the rule position which is prevalent in the State of Maharashtra. He has brought on record a Trade Circular dated 11.11.2013 to show that from 1.4.2006, the decision in Kone Elevators (supra) has been followed in the State of Maharashtra and it has adjusted the position in accordance with the said authority and the State having adjusted its position to the law rendered by the three-Judge Bench, in case the authority in Kone Elevators (supra) is overruled, it should be given prospective effect.

8. Mr. K.N. Bhat, learned senior counsel for the State of Karnataka, has submitted that the contract of manufacture, supply and installation of lifts comprises a works contract, for the expression "works contract" is not a term of art as has been explained in Builders Association of India and others v. Union of India and others[(1989) 2 SCC 645] as well as in Larsen and Toubro (supra). It is put forth by Mr. Bhat that lifts are assembled and manufactured to suit the requirement in a particular building and are not something sold out of shelf and, in fact, the value of goods and the cost of the components used in the manufacturing and installation of a lift are subject to taxation while the element of labour and service involved cannot be treated as goods. In essence, the submission of Mr. Bhat is that taking into consideration the multifarious activities involved in the installation of the lift, it has to be construed as a "works contract" and the decision in Kone Elevators (supra) does not lay down the law correctly.

9. Mr. Rakesh Dwivedi, learned senior counsel appearing for the State of Orissa, has referred to the terms of the quotation, the confirmation letter, the letter of approval, the preparatory erection work or civil work which are to be carried out by the customer at its own cost, the specific mode of payment and the nature of supply and, on that basis, contended that the contract was for sale and supply of a lift to the customer for a monetary consideration. It is urged by him that a part of manufacture is carried out at the project site of the customer and the skill and labour deployed in the installation or the work done is merely a component of the manufacturing process and, as a matter of fact, the elevator is supplied to the customer only after its erection/installation at the site. It is further contended by him that where a manufacturer of lift first manufactures components and then completes the manufacture of the lift at the site and retains ownership in the components as property while producing the completed lift, it is a case of pure manufacture. It is contended by him that the phraseology
used in the contract is not decisive because it is the economic reality which is decisive, for the installation is a part of the manufacturing process resulting in the emergence of the product of elevator which is contracted for. Learned senior counsel would contend that it has to be construed as an elevator bought and sold as such.

11. Mr. R. Venkataramani, learned senior counsel appearing for the States of Tamil Nadu and Andhra Pradesh, has contended that the primary intention behind the demand of installation of a lift is the intention to have the lift as a system and, therefore, the work of installation merely fulfills the erection and functional part of the system. The service or work element may be the means to render a set of goods constituting a unit to be fit for use and, in fact, the act of installation is to bring the goods to use and hence, it is the culmination of the act of sale. The learned senior counsel has put forth that the contract involved would come in the category of contracts which can be described as contracts where goods, in any form whatsoever, are intended for transfer but the completion of the transfer may involve certain set of activities, by whatever name called, for the purposes of securing the use or consumption of such goods in question and to that class of contracts, the principle of deliverable state as used in Section 21 of the Sale of Goods Act, 1930 would be attracted and, therefore, such a contract would be a pure contract for sale of goods. It is emphasized by him that the threshold question to be put in every case is whether the purchaser's true object is to obtain an identifiable product or goods or the intention is to utilize the services of or works from a person for the purposes of realizing an end product which may emerge only for the reason of the execution of the work by rendering of the services in question. Applying the said principle to a lift, it is canvassed by him that a lift or an elevator is an identifiable good which is transferred to the purchaser as such and solely because certain amount of labour or service is required for the purpose of putting together all the components of the lift at the site to bring it to its usable state, the same does not make a difference as to the nature of the contract and it cannot be regarded as a works contract.

15. Mr. P.P. Malhotra, learned Additional Solicitor General of India appearing for Union of India, has submitted that parts of the lift are assembled at the site in accordance with its design and requirement of the building which may include the floor levels and the lift has to open on different floors or otherwise depending upon the requirement. It has to synchronize with the building and each door has to open on the level of each floor and hence, by no stretch of imagination, it can be treated as a manufacture or mere supply but cumulatively considered, it is a works contract and, more so, when the contract is a composite or turnkey contract. Mr. Malhotra would further submit that it is not a mere case of sale and according to the expanded definition of tax on sale, tax is leviable only on the transfer of property in goods, whether in goods or in some other form, involved in the execution of work and no sales tax is leviable on the execution of works contract. Thus, the stand of the Union of India is that supply and installation of lift is not a contract for sale but a works contract.

16. To appreciate the controversy in the backdrop of the rivalised submissions, it is necessary to delve into the genesis of the law in respect of works contract and thereafter to dwell upon how far the principles pertaining to works contract would govern the manufacture, supply and installation of lifts. In this context, it is seemly to appreciate the legal position as to how
the impost of sales tax on "works contract" was treated prior to the insertion of Clause (29A) in Article 366 of the Constitution by the Constitution (Forty-sixth Amendment) Act, 1982 with effect from 1.3.1983 and how this court has dealt with the said facet after the constitutional amendment that changed the concept of levy of sales tax on "works contract". For the aforesaid purpose, chronological recapitulation is imperative. In State of Madras v. Gannon Dunkerley & Co., (Madras) Ltd, [AIR 1958 SC 560], the assessee faced a levy in respect of goods sold in relation to works contract under the Madras General Sales Tax Act, 1939 as amended by the Madras General Sales Tax (Amendment) Act 25 of 1947 wherein certain new provisions were incorporated and one such provision, namely, Section 2(i) defined "works contract" to mean "any agreement for carrying out for cash or for deferred payment or other valuable consideration, the construction, fitting out, improvement or repair of any building, road, bridge or other immoveable property or the fitting out, improvement or repair of any movable property". In pursuance of the said provision, the rules were amended and the assessment was framed. When the matter travelled to the Constitution Bench of this Court, it was contended by the assessee that nothing could be levied that was received by the assessee from the persons for whose benefit it had constructed the buildings. On behalf of the Revenue, it was urged that once there was an agreement between the parties and in the carrying out of that agreement there was transfer of title in movables belonging to one person to another for consideration, there would be a "sale". Repelling the said submission, it was held that if the words "sale of goods" were to be interpreted in their legal sense, that sense could only be what it was in the law relating to sale of goods. It was observed that the ratio of the rule of interpretation that words of legal import occurring in a statute should be construed in their legal sense is that those words have, in law, acquired a definite and precise sense, and that, accordingly, the legislature must be taken to have intended that they should be understood in that sense and in interpreting an expression used in a legal sense, the requirement was to ascertain the precise connotation which it possesses in law because both under the common law and the statute law relating to sale of goods in England and in India, to constitute a transaction of sale, there should be an agreement, express or implied, relating to goods to be completed by passing of title in those goods. The essence of the concept that both the agreement and the sale should relate to the same subject-matter was highlighted and it was opined that under the law, there could not be an agreement relating to one kind of property and a sale as regards another. The Constitution Bench further held that on the true interpretation of the expression "sale of goods", there must be an agreement between the parties for the sale of the very goods in which eventually property passes and in a building contract, the agreement between the parties being to the effect that the contractor should construct a building according to the specifications contained in the agreement, and in consideration therefor receive payment as provided therein, there was neither a contract to sell the materials used in the construction nor did the property pass therein as movables and, therefore, it was impossible to maintain that there was implicit in a building contract a sale of materials as understood in law. Eventually, the Court summed up the conclusion by stating that the expression "sale of goods" in Entry 48 is a nomen juris, its essential ingredients being an agreement to sell movables for a price and property passing therein pursuant to that agreement and in a building contract which was one, entire and indivisible, there was no sale
of goods, and it was not within the competence of the Provincial Legislature under Entry 48 to impose a tax on the supply of the materials used in such a contract treating it as a sale.

22. In *The State of Punjab v. M/s. Associated Hotels of India Ltd.* [1972] 1 SCC 472, the Constitution Bench, while dealing with the construction of a contract of work and labour on the one hand and contract for sale on the other, opined that the difficulty which the Courts have often to meet in construing a contract of work and labour, on the one hand, and a contract for sale, on the other, arises because the distinction between the two is very often a fine one and it is particularly so when the contract is a composite one involving both a contract of work and labour and a contract of sale. The Court thereafter proceeded to state thus:

"Nevertheless, the distinction between the two rests on a clear principle. A contract of sale is one whose main object is the transfer of property in, and the delivery of the possession of, a chattel as a chattel to the buyer. Where the principal object of work undertaken by the payee of the price is not the transfer of a chattel qua chattel, the contract is one of work and labour. The test is whether or not 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 or one for the sale of a chattel.

Be it stated, in the said case, the respondent-company carried business as hoteliers and, as a part of its business, the company received guests to whom it furnished certain amenities. The Court ruled that the transaction between a hotelier and a visitor was essentially one of contract of service and facilities provided at reasonable price.

27. The aforesaid authorities clearly show that a works contract could not have been liable to be taxed under the State sales tax laws and whether the contract was a works contract or a contract for sale of goods was dependent on the dominant intention as reflected from the terms and conditions of the contract and many other aspects. In certain cases, the court has not treated the contract to be a works contract by repelling the plea of the assessee after taking into consideration certain special circumstances. No straitjacket formula could have been stated to be made applicable for the determination of the nature of the contract, for it depended on the facts and circumstances of each case. As the works contract could not be made amenable to sales tax as the State Legislatures did not have the legislative competence to charge sales tax under Entry 48 List II of the Seventh Schedule of the Constitution on an indivisible contract of sale of goods which had component of labour and service and it was not within the domain of the assessing officer to dissect an indivisible contract to distinguish the sale of goods constituent and the labour and service component. The aforesaid being the legal position, the Parliament brought in the Forty-sixth Amendment by incorporating Clause (29A) in *Article 366* of the Constitution to undo the base of the Constitution Bench decision in Gannon Dunkerley case.

28. To have a complete picture, we think it apt to reproduce the said constitutional provision:

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a) a tax on the transfer, otherwise than in pursuance of a contract, of property in any goods for cash, deferred payment or other valuable consideration;
b) a tax on the transfer of property, in goods (whether as goods or in some other form) involved in the execution of a works contract;
c) a tax on the delivery of goods on hire purchase or any system of payment by instalments;
d) a tax on the transfer of the right to use any goods for any purpose (whether or not for a specified period) for cash, deferred payment or other valuable consideration;
e) a tax on the supply of goods by any unincorporated association or body of persons to a member thereof for cash, deferred payment or other valuable consideration;
f) a tax on the supply, by way of or as part of any service or in any other manner whatsoever, of goods, being food or any other article for human consumption or any drink (whether or not intoxicating), where such supply or service, is for cash, deferred payment or other valuable consideration, and such transfer, delivery or supply of any goods shall be deemed to be a sale of those goods by the person making the transfer, delivery or supply and a purchase or those goods by the person to whom such transfer, delivery or supply is made;

32. Having dealt with the aforesaid authorities, as advised at present, we shall refer to certain authorities as to how the term “works contract” has been understood in the contextual perspective post the constitutional amendment. In Hindustan Shipyard Ltd. (supra), the Court observed that the distinction between a contract of sale and a works contract is not free from difficulty and has been the subject-matter of several judicial decisions. It is further observed that neither any straitjacket formula can be made available nor can such quick-witted tests devised as would be infallible, for it is all a question of determining the intention of the parties by culling out the same on an overall reading of the several terms and conditions of a contract. Thereafter, the two-Judge Bench set out three categories of contracts and explained the contours, namely, (i) the contract may be for work to be done for remuneration and for supply of materials used in the execution of the work for a price; (ii) it may be a contract for work in which the use of the materials is accessory or incidental to the execution of the work; and (iii) it may be a contract for supply of goods where some work is required to be done as incidental to the sale. Thereafter, it opined that the first contract is a composite contract consisting of two contracts, one of which is for the sale of goods and the other is for work and labour; the second is clearly a contract for work and labour not involving sale of goods; and the third is a contract for sale where the goods are sold as chattels and the work done is merely incidental to the sale.

40. On the basis of the aforesaid elucidation, it has been deduced that a transfer of property in goods under Clause (29A)(b) of Article 366 is deemed to be a sale of goods involved in the execution of a works contract by the person making the transfer and the purchase of those goods by the person to whom such transfer is made. One thing is significant to note that in Larsen and Toubro (supra), it has been stated that after the constitutional amendment, the narrow meaning given to the term “works contract” in Gannon Dunkerley-I (supra) no longer survives at present. It has been observed in the said case that even if in a contract, besides the
obligations of supply of goods and materials and performance of labour and services, some additional obligations are imposed, such contract does not cease to be works contract, for the additional obligations in the contract would not alter the nature of the contract so long as the contract provides for a contract for works and satisfies the primary description of works contract. It has been further held that once the characteristics or elements of works contract are satisfied in a contract, then irrespective of additional obligations, such contract would be covered by the term ‘works contract’ because nothing in Article 366(29-A)(b) limits the term ‘works contract’ to contract for labour and service only.

42. At this juncture, it is condign to state that four concepts have clearly emerged. They are (i) the works contract is an indivisible contract but, by legal fiction, is divided into two parts, one for sale of goods, and the other for supply of labour and services; (ii) the concept of ‘dominant nature test’ or, for that matter, the ‘degree of intention test’ or ‘overwhelming component test’ for treating a contract as a works contract is not applicable; (iii) the term ‘works contract’ as used in Clause (29A) of Article 366 of the Constitution takes in its sweep all genre of works contract and is not to be narrowly construed to cover one species of contract to provide for labour and service alone; and (iv) once the characteristics of works contract are met with in a contract entered into between the parties, any additional obligation incorporated in the contract would not change the nature of the contract.

45. In this backdrop, we shall now proceed to deal with the submissions advanced by the learned counsel for the respondents which we have already noted. The fundamental submission of Mr. Dwivedi is that the manufacturer of the lift retains ownership in the components as property while producing the completed lift and, hence, it would be a case of pure manufacture. A distinction has been sought to be made that if another agency is appointed to install, it does not have the ownership of the components. To bolster the basic submission, as we find, he has referred to various facets. The said proponent, as we understand, is based on the assumption that the supplier remains the owner of the components as per the contract; that the manufacture is a process or activity which brings in existence new identifiable and distinct component; that installation is an integral part of the manufacturing process and proceeds from the manufacture of the components themselves; that the concept of permanent fixture to a building cannot be enlarged to such an extent to put it in the realm of works contract or to take it away from the conceptual meaning of manufacture. We have already dealt with the principles stated in Patnaik and Co. (supra), Hindustan Aeronautics Ltd. (supra), T.V. Sundaram Iyengar (supra), Kailash Engineering Co. (supra) and the observations made by Sikri, J., in Patnaik & Co. (supra) wherein the decision in Anglo-Egyptian Navigation Co. v. Rennie[(1875) LR 10 CP 271] was distinguished by stating that whenever a contract provides for the fixing of a chattel to another chattel, there is no sale of goods. Be it noted, in Patnaik & Co. (supra), an illustration was given that when a dealer fits tyres supplied by him to the car of the customer, it would tantamount to sale of the tyres by the dealer to the customer. In these cases, the Court was really dealing with the terms of the contract contextually to come to a conclusion as to whether the contract in question was a contract for sale or a works contract. The fundamental principle that was applied is that what was sold was a chattel as chattel or the contract was a composite one on a different base/foundation.
46. The other decisions which have been relied upon by Mr. Dwivedi to show that installation is a part of the manufacturing process are J. Marcel (Furriers) Ltd. (supra), Central India Machinery Manufacturing Company Ltd. (supra), Norman Wright (Builders) Ltd. (supra), Titan Medical Systems (supra), MIL India Ltd. (supra), Eastend Papers Industries Ltd. (supra) and Aspinwall & Co. (supra). In J. Marcel (Furriers) Ltd. (supra), the plaintiff had kept a stock of furs made up ready for sale and they also made up furs, coats, jackets, and boleros for customers. An order was placed by the defendant for a mutation mink jacket. As the jacket was not up to mark, it was rejected by the defendant. In that context, the Court observed that though huge degree of skill and craftsmanship had gone into making up of a fur jacket as was made for the defendant, yet it was no more than making an article for sale to the defendant on a special order and the transaction, in fact, related to sale of a complete article and the receipt of the price.

47. In Norman Wright (Builders) Ltd. (supra), an agreement was entered into by the appellant for fixing of black-out curtains at some London police stations. The appellant-plaintiff contended before the Court that the fixing of curtains was not a sale of goods but a contract for work and labour and the supply of material in connection therewith. Repelling the said submission, it was held that as the contract involved transferring chattels, namely, curtains to the defendants for a price, in which they had no previous right, it was a sale of goods.

48. Narne Tulaman Manufacturers Pvt. Ltd., Hyderabad v. Collector of Central Excise, Hyderabad[(1989) 1 SCC 172], Eastend Paper Industries Ltd. (supra), Aspinwall & Co. Ltd. (supra), MIL India Ltd. (supra) and Sirpur Papers Mills Ltd. (supra) are the decisions under the Central Excise Act, 1944 which are really not of relevance as they relate to the concept, term and expression "manufacture" as used and understood under the said Act. The concept of "manufacture" has limited relevance and cannot be a determining factor to decide whether the contract is one for supply of goods or is a composite contract. In Narne Tulaman Manufacturers Pvt. Ltd. (supra), installation of weighbridges was held to be manufacture for the purpose of excise duty, observing that the assessee was obsessed with the idea that part of the machinery was liable to duty but the whole of the product was not dutiable as excisable goods. Similarly, in Aspinwall & Co. (supra), curing of coffee, it was held, amounts to manufacture, as a new and distinct commodity of independent identity, distinct from raw material, had come into existence. In Sirpur Paper Mills Ltd.'s case, the question arose whether paper making machine was an immovable property as it was embedded on the earth and, therefore, not exigible to excise duty. This Court opined that paper making machine was exigible to excise duty as the whole machine could be dismantled and it was attached to the earth only for operational efficiency. Though the entire machine was assembled from various components, yet, by itself, it was a new marketable commodity that had emerged as a result of the manufacturing activity. The aforesaid decisions cannot be taken aid of to come to a conclusion that installation is assembling and, in the ultimate eventuate, it is a part of the manufacturing process. We are disposed to think so as there is a fundamental fallacy in the submission as far as installation of the lift is concerned. It is not a plant which is erected at the site. It is not a different item like coffee which comes into the market after processing. It is also not like a "weighbridge" as is understood under the excise law. It has to be understood in the conceptual context of the manufacture and installation of a lift in a building. The lift
basically comprises components like lift car, motors, ropes, rails, etc. having their own identity even prior to installation. Without installation, the lift cannot be mechanically functional because it is a permanent fixture of the building having been so designed. These aspects have been elaborately discussed in Otis Elevator (supra) by the High Court of Bombay. Therefore, the installation of a lift in a building cannot be regarded as a transfer of a chattel or goods but a composite contract. Hence, we unhesitatingly hold that the said decisions are not of much help to the learned senior counsel for the State of Orissa.

49. Coming to the submissions of Mr. Venkataramani, we find that the fundamental facet of the contention is based on the principle of "deliverable state" and the intention of the purchaser to obtain an identifiable product or goods and the said identified product comes into being after the components are fixed at the site to make the lift usable. As submitted, the rendering of service is only to make the lift deliverable. The aforesaid submission, on proper appreciation, really rests on the bedrock of incidental or ancillary service involved in the installation of lift. We shall deal with this aspect when we address more elaborately to the dominant nature test and the incidental service in the context of clause 29A(b) of Article 366 of the Constitution.

50. As far as the submission put forth by the learned counsel for the State of Gujarat, it is based on the edifice that the "dominant nature test" is still available in view of the decisions in Bharat Sanchar (supra) and Larsen and Toubro (supra). On a careful reading of the written note of submission of the learned counsel for the State of Gujarat, we find that the learned counsel have not appositely understood the ratio laid down in the aforesaid authorities. Reliance was placed on para 45 of the decision in Bharat Sanchar (supra). It is noticeable that the Court was analyzing the principle stated in Gannon Dunkerley-I (supra) and thereafter, in para 49, which we have reproduced hereinabove, it has been clearly held that after the Forty Sixth Amendment of the Constitution, the works contract which is covered under Clause (29A)(b) of Article 366 of the Constitution is separable and may be subject to sales tax by the State under Entry 54 of List-II and there is no question of the dominant nature test being applicable. Thus, the submission is absolutely misconceived.

51. The submission of Dr. Manish Singhvi, learned counsel for the State of Rajasthan, primarily rests on the base that decisions which have been discussed in the referral order, do not lay down the correct law. In our considered opinion, the judgments rendered in the said cases rested on the nature of the contract and the tests laid down in Gannon Dunkerley-I (supra). We see no reason to hold that the said decisions do not lay down the correct law in the context of works contract as it was understood and treated prior to the Forty Sixth Amendment.

52. Coming to the stand and stance of the State of Haryana, as put forth by Mr. Mishra, the same suffers from two basic fallacies, first, the supply and installation of lift treating it as a contract for sale on the basis of the overwhelming component test, because there is a stipulation in the contract that the customer is obliged to undertake the work of civil construction and the bulk of the material used in construction belongs to the manufacturer, is not correct, as the subsequent discussion would show; and second, the notification dated 17th May, 2010 issued by the Government of Haryana, Excise and Taxation Department, whereby certain rules of the Haryana Value Added Tax Rules, 2003 have been amended and a table
has been annexed providing for percentages for Works Contract and Job Works under the heading Labour, service and other like charges as percentage of total value of the contract specifying 15% for fabrication and installation of elevators (lifts) and escalators, is self-contradictory, for once it is treated as a composite contract invoking labour and service as a natural corollary, it would be works contract and not a contract for sale. To elaborate, the submission that the element of labour and service can be deducted from the total contract value without treating the composite contract as a works contract is absolutely fallacious. In fact, it is an innovative subterfuge. We are inclined to think so as it would be frustrating the constitutional provision and, accordingly, we unhesitatingly repel the same.

53. As far as submissions of Mr. K.N. Bhat, learned senior counsel for the State of Karnataka, and Mr. P.P. Malhotra, learned Additional Solicitor General, are concerned, as their stand is that the decision in Kone Elevators (supra) is not correct, we have only noted that for completeness.

54. Having dealt with the submissions advanced by the learned counsel for various States and the learned Additional Solicitor General for the Union of India, we shall presently proceed to deal with the correctness of the legal position as stated in Kone Elevators case. In the said case, a three-Judge Bench took note of the submissions on behalf of the Department that the main object of the contract in question was to sell the lifts and the works done by the assessee for installation was incidental to the sale of lifts. It had also taken note of the submission that the legislature has classified the commodity lift under Entry 82 of the First Schedule to the Andhra Pradesh General Sales Tax Act, 1957 keeping in mind that the word installation was ancillary to the sale of lifts. The Court, while dealing with the differentiation between contract for sale and works contract, opined thus:

5. It can be treated as well settled that there is no standard formula by which one can distinguish a contract for sale from a works contract. The question 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. If the intention is to transfer for a price a chattel in which the transferee had no previous property, then the contract is a contract for sale. Ultimately, the true effect of an accretion made pursuant to a contract has to be judged not by artificial rules but from the intention of the parties to the contract. In a contract of sale, the main object is the transfer of property and delivery of possession of the property, whereas the main object in a works contract is not the transfer of the property but it is one for work and labour. Another test often to be applied is: when and how the property of the dealer in such a transaction passes to the customer: is it by transfer at the time of delivery of the finished article as a chattel or by accession during the procession of work on fusion to the movable property of the customer? If it is the former, it is a sale; if it is the latter, it is a works contract. Therefore, in judging whether the contract is for a sale or for work and labour, the essence of the contract or the reality of the transaction as a whole has to be taken into consideration. The predominant object of the contract, the circumstances of the case and the custom of the trade provide a guide in deciding whether transaction is a sale or a works contract. Essentially, the question is of interpretation of the contract. It is settled law that the substance and not the form of the contract is material in determining the nature of transaction. No definite rule can be formulated to determine the question as to whether a
particular given contract is a contract for sale of goods or is a works contract. Ultimately, the terms of a given contract would be determinative of the nature of the transaction, whether it is a \textit{sale} or a \textit{works contract}. Therefore, this question has to be ascertained on facts of each case, on proper construction of terms and conditions of the contract between the parties.

55. After so stating, the three-Judge Bench adverted to the definitions in the \textit{State Act}, referred to the decision in Gannon Dunkerley-I (supra), placed reliance on the decision in Hindustan Shipyard Ltd. (supra) and, analyzing the principle stated therein, observed thus:

\begin{quote}
9. In the case of \textit{Hindustan Shipyard Ltd. v. State of A.P.} this Court held that if the thing to be delivered has any individual existence before the delivery as the sole property of the party who is to deliver it, then it is a sale. If the bulk of material used in construction belongs to the manufacturer who sells the end product for a price, then it is a strong pointer to the conclusion that the contract is in substance one for the sale of goods and not one for labour. However, the test is not decisive. It is not the bulk of the material alone but the relative importance of the material qua the work, skill and labour of the payee which also has to be seen. If the major component of the end product is the material consumed in producing the chattel to be delivered and skill and labour are employed for converting the main components into the end products, the skill and labour are only incidentally used, the delivery of the end product by the seller to the buyer would constitute a sale. On the other hand, if the main object of the contract is to avail the skill and labour of the seller though some material or components may be incidentally used during the process of the end product being brought into existence by the investment of skill and labour of the supplier, the transaction would be a contract for work and labour.
\end{quote}

56. Applying the above test, the learned Judges referred to the terms of the contract and took note of the fact that the entire onus of preparation and making ready of the site for installation of lift was on the customer. It was agreed that under no circumstances would the assessee undertake installation of lift if the site was not kept ready by the customer inasmuch as under clause 4(g) of the \textit{Customers\' Contractual Obligations}, the assessee reserved the right to charge the customer for delay in providing the required facilities. The Court observed that these facts clearly indicated that the assessee divided the execution of the contract into two parts, namely, the work to be initially done in accordance with the specifications laid down by the assessee and the supply of lift by the assessee. The work part in the contract was assigned to the customer and the supply part was assigned to the assessee and the said supply part included installation of lift. Therefore, the learned Judges further observed that the contractual obligation of the assessee was only to supply and install the lift, while the customer\'s obligation was to undertake the work connected in keeping the site ready for installation as per the drawings. The Court took note of the contractual obligations of the customer and the fact that the assessee undertook exclusive installation of the lifts manufactured and brought to the site in knocked-down state to be assembled by the assessee and ruled that it was clear that the transaction in question was a contract of \textit{sale} and not a \textit{works contract}. The Court perused the brochure of the assessee Company and noticed that the assessee was in the business of manufacturing of various types of lifts, namely, passenger lifts, freight elevators, transport elevators and scenic lifts and a combined study of the above
models, mentioned in the brochure, indicated that the assessee had been exhibiting various models of lifts for sale and the said lifts were being sold in various colours with various capacities and variable voltage. From the further analysis, it is manifest that the Court took into account the fact that it was open for a prospective buyer to place purchase order for supply of lifts as per his convenience and choice and ruled that the assessee, on facts, satisfied the twin requirements to attract the charge of tax under the 1957 Act, namely, that it carried on business of selling the lifts and elevators and it had sold the lifts and elevators during the relevant period in the course of its business. To strengthen the conclusion, it has been held that the major component of the end product is the material consumed in producing the lift to be delivered and the skill and labour employed for converting the main components into the end product are only incidentally used.

57. From the aforesaid decision, it is perceptible that the three-Judge Bench has drawn distinction between the contract for sale and works contract and, in that context, the essence of the contract or reality of the transaction as a whole, regard being had to the predominant object of the contract, the circumstances of the case and the custom of the trade have been taken into consideration. In that context, the learned Judges have opined that it is not the bulk of the material alone but the relevant importance of the material qua the work, skill and labour of the payee which also has to be seen and if the major component of the end product is the material consumed in producing the chattel to be delivered and skill and labour are employed for converting the main components into the end product, the skill and labour are only incidentally used and the delivery of the end product by the seller to the buyer would constitute a sale. On the aforesaid principle, the three-Judge Bench has finally ruled that a dealer carries on business of selling lifts and elevators and the major component of the end product is the material consumed in producing the lift to be delivered and the skill and labour employed for converting the main components into the end product are incidentally used and, therefore, the delivery of the end product by the assessee qua the customer has to be constituted as a sale and not a works contract.

58. To understand the reasons ascribed in the said decision, it is requisite to appreciate the principle relating to the overwhelming component test or major component test. We have already referred to the decision in Bharat Sanchar (supra) wherein it has been clearly stated that the dominant nature test has no application. The said principle has been reiterated in Larsen and Toubro (supra) by stating thus:

"87. It seems to us (and that is the view taken in some of the decisions) that a contract may involve both a contract of work and labour and a contract of sale of goods. In our opinion, the distinction between contract for sale of goods and contract for work (or service) has almost diminished in the matters of composite contract involving both a contract of work/labour and a contract for sale for the purposes of Article 366(29-A)(b). Now by legal fiction under Article 366(29-A)(b), it is permissible to make such contract divisible by separating the transfer of property in goods as goods or in some other form from the contract of work and labour. A transfer of property in goods under clause (29-A)(b) of Article 366 is deemed to be a sale of goods involved in the execution of a works contract by the person making the transfer and the purchase of those goods by the person to whom such transfer is made. For this reason, the traditional decisions which hold that the substance of the contract must be
seen have lost their significance. What was viewed traditionally has to be now understood in light of the philosophy of Article 366(29-A). A contract may involve both a contract of work and labour and a contract for sale. In such composite contract, the distinction between contract for sale of goods and contract for work (or service) is virtually diminished.

97.6. The dominant nature test has no application and the traditional decisions which have held that the substance of the contract must be seen have lost their significance where transactions are of the nature contemplated in Article 366(29-A). Even if the dominant intention of the contract is not to transfer the property in goods and rather it is rendering of service or the ultimate transaction is transfer of immovable property, then also it is open to the States to levy sales tax on the materials used in such contract if such contract otherwise has elements of works contract. The enforceability test is also not determinative.

59. It is also necessary to state here that in Larsen and Toubro (supra), the question arose whether taxing of sale of goods in an agreement for sale of flat which is to be constructed by the developer-promoter is permissible under the Constitution. The three-Judge Bench opined that though the ultimate transaction between the parties may be sale of the flat, yet it cannot be said that the characteristics of works contract are not involved in that transaction because the term “works contract” is nothing but a contract in which one of the parties is obliged to undertake or to execute the work and such an activity of construction bears all the characteristics and elements of works contract. In that context, in paragraph 107 of the decision, reliance was placed on Builders’ Association (supra) wherein the contention that a flat is sold as a flat and not as an aggregate of its component parts was negated on the ground that the properties that were transferred to the owner in the execution of the works contract are not goods involved in the execution of the works contract, but a conglomerate, that is, the entire building which is actually constructed.

60. The aforesaid analysis has to be understood on the anvil of Article 366 (29A) of the Constitution. In this regard, we may fruitfully reproduce a passage from Builders’ Association case:

Re: After the 46th Amendment the works contract which was an indivisible one is by a legal fiction altered into a contract which is divisible into one for sale of goods and the other for supply of labour and services. After the 46th Amendment, it has become possible for the States to levy sales tax on the value of goods involved in a works contract in the same way in which the sales tax was leviable on the price of the goods and materials supplied in a building contract which had been entered into in two distinct and separate parts as stated above.

61. Explaining the said passage, the Constitution Bench, in Gannon Dunkerley-II (supra), has opined thus:

Re: This would mean that as a result of the Forty-sixth Amendment, the contract which was single and indivisible has been altered by a legal fiction into a contract which is divisible into one for sale of goods and other for supply of labour and services and as a result such a contract which was single and indivisible has been brought on a par with a contract containing two separate agreements.

62. It has been further observed therein as follows: -
If the legal fiction introduced by Article 366(29-A)(b) is carried to its logical end it follows that even in a single and indivisible works contract there is a deemed sale of the goods which are involved in the execution of a works contract. Such a deemed sale has all the incidents of a sale of goods involved in the execution of a works contract where the contract is divisible into one for sale of goods and the other for supply of labour and services.

Considered on the touchstone of the aforesaid two Constitution Bench decisions, we are of the convinced opinion that the principles stated in Larsen and Toubro (supra) as reproduced by us hereinabove, do correctly enunciate the legal position. Therefore, the dominant nature test or the overwhelming component test or the degree of labour and service test are really not applicable. If the contract is a composite one which falls under the definition of works contracts as engrafted under clause (29A)(b) of Article 366 of the Constitution, the incidental part as regards labour and service pales into total insignificance for the purpose of determining the nature of the contract.

Coming back to Kone Elevators (supra), it is perceivable that the three-Judge Bench has referred to the statutory provisions of the 1957 Act and thereafter referred to the decision in Hindustan Shipyard Ltd. (supra), and has further taken note of the customers' obligation to do the civil construction and the time schedule for delivery and thereafter proceeded to state about the major component facet and how the skill and labour employed for converting the main components into the end product was only incidental and arrived at the conclusion that it was a contract for sale. The principal logic applied, i.e., the incidental facet of labour and service, according to us, is not correct. It may be noted here that in all the cases that have been brought before us, there is a composite contract for the purchase and installation of the lift. The price quoted is a composite one for both. As has been held by the High Court of Bombay in Otis Elevator (supra), various technical aspects go into the installation of the lift. There has to be a safety device. In certain States, it is controlled by the legislative enactment and the rules. In certain States, it is not, but the fact remains that a lift is installed on certain norms and parameters keeping in view numerous factors. The installation requires considerable skill and experience. The labour and service element is obvious. What has been taken note of in Kone Elevators (supra) is that the company had brochures for various types of lifts and one is required to place order, regard being had to the building, and also make certain preparatory work. But it is not in dispute that the preparatory work has to be done taking into consideration as to how the lift is going to be attached to the building. The nature of the contracts clearly exposit that they are contracts for supply and installation of the lift where labour and service element is involved. Individually manufactured goods such as lift car, motors, ropes, rails, etc. are the components of the lift which are eventually installed at the site for the lift to operate in the building. In constitutional terms, it is transfer either in goods or some other form. In fact, after the goods are assembled and installed with skill and labour at the site, it becomes a permanent fixture of the building. Involvement of the skill has been elaborately dealt with by the High Court of Bombay in Otis Elevator (supra) and the factual position is undisputable and irrespective of whether installation is regulated by statutory law or not, the result would be the same. We may hasten to add that this position is stated in respect of a composite contract which requires the contractor to install a lift in a building. It is necessary to state here that if there are two contracts, namely, purchase of the
components of the lift from a dealer, it would be a contract for sale and similarly, if separate contract is entered into for installation, that would be a contract for labour and service. But, a pregnant one, once there is a composite contract for supply and installation, it has to be treated as a works contract, for it is not a sale of goods/chattel simpliciter. It is not chattel sold as chattel or, for that matter, a chattel being attached to another chattel. Therefore, it would not be appropriate to term it as a contract for sale on the bedrock that the components are brought to the site, i.e., building, and prepared for delivery. The conclusion, as has been reached in Kone Elevators (supra), is based on the bedrock of incidental service for delivery. It would not be legally correct to make such a distinction in respect of lift, for the contract itself profoundly speaks of obligation to supply goods and materials as well as installation of the lift which obviously conveys performance of labour and service. Hence, the fundamental characteristics of works contract are satisfied. Thus analysed, we conclude and hold that the decision rendered in Kone Elevators (supra) does not correctly lay down the law and it is, accordingly, overruled.

65. Ordinarily, after so stating, we would have directed the matter to be listed before the appropriate Division Bench. However, it is not necessary to do so in this batch of cases inasmuch as the writ petitions have been filed either against the show-cause notices where cases have been reopened or against the orders of assessment framed by the assessing officers and civil appeals filed against certain assessment orders or affirmation thereof which are based on the decision of the three-Judge Bench in Kone Elevators case. Considering the factual matrix, we direct that the show-cause notices, which have been issued by taking recourse to reopening of assessment, shall stand quashed. The assessment orders which have been framed and are under assail before this Court are set aside. It is necessary to state here that where the assessments have been framed and have attained finality and are not pending in appeal, they shall be treated to have been closed, and where the assessments are challenged in appeal or revision, the same shall be decided in accordance with the decision rendered by us.

66. The writ petitions and the civil appeals are disposed of with no order as to costs.

J U D G M E N T :-Fakkir Mohamed Ibrahim Kalifulla, J.

1. I had the benefit of reading the illuminating judgment of my brother Justice Dipak Misra. With respect, I state that I am not able to subscribe to the views and conclusions of His Lordship. Therefore, I wish to record my reasoning and conclusions holding that the manufacture, supply and installation of lifts are to be treated as a contract of ‘Sale’ in the following paragraphs.

51. Having heard the learned Counsel for the Petitioners and the Respondents and having considered the material papers placed before us and the various decisions relied upon by the Petitioners as well as the Respondents, at the foremost, what has to be first ascertained is whether the contract between the Petitioner and its Purchaser would fall within the definition of ‘Works Contract’ in order to attract clause (b) to Sub- Article (29-A) of Article 366 of the Constitution. In fact, if an answer to the said question can be held in the affirmative, then that would axiomatically lead to an answer in favour of the Petitioner. Though, several decisions, wherein various tests have been highlighted, were cited before us and also reference to
various provisions of different statutes, as well as the Finance Act provisions were brought to
our notice, in my view, before advertting to those tests and the provisions, in the first instance,
it will have to be found out as to what exactly was the nature of contract, as between the
Petitioner and its Purchasers.

52. At the outset, even before examining the terms of the contract, it will have to be stated
that the only business of the Petitioner is manufacture and supply of LIFTS/ELEVATORS. In
fact, neither Mr. Salve nor any other Counsel appearing for the Petitioners submitted before
us that the business of the Petitioner included any other activity along with the manufacture
and supply of LIFTS/ELEVATORS.

56. When examining the claim of the Petitioner that what was agreed by the Petitioner in
the contract with its Purchaser is nothing but a ‘Works Contract’ such a claim should be explicit
and must be discernable from the contract itself. When in the Contract the element of ‘Works
Contract’ is totally absent and what was agreed between the parties was only supply of its
elevator for a fixed price, mere mentioning of the expression ‘Works Contract’ or by making
reference to the basis for fixing the cost of labour involved in the manufacture or by simply
using the expression ‘Works Contract’ without any scope of performing any work at the
command of the Purchaser, in my opinion, the Petitioner’s claim to hold its activity as a
‘Works Contract’ cannot be accepted on mere asking. In other words, the contract must
disclose in no uncertain terms that it was one for carrying out the work and the supply of
the materials were part of such agreement to carry out any such specified work. Here, it is the
other way around, the contract is only for supply of LIFTS/ELEVATOR and whatever
element of works which the Petitioner claims to carry out in effecting the supply is virtually
very insignificant as compared to the element of sale, which is paramount as found in the
terms of the contract. The whole of the preparatory work for the erection of the LIFT is that
of the Purchaser and the Petitioner merely goes to the Purchaser’s premises and fixes the
various parts of the LIFT in the slots created for it.

63. With this, the ‘Conditions of the Contract’ can be referred to, which contains as many as
27 conditions. These conditions have been elaborately discussed in paragraph 18 of this
judgment, to which I once again bestow my serious consideration, in order to appreciate
whether, these conditions at least throw any light to state that the contract can be brought
within the expression ‘Works Contract’

65. A reference to the various other conditions in the contract also do not suggest that the
consideration under the Contract to be borne by the Purchaser, has got anything to do with
the installation part of the LIFT. On the other hand, the terms have downright been agreed
upon between the parties only to mandate the Purchaser to pay 90% of the contracted amount
on mere signing of the contract and to pay the balance 10% within 30 days of the Petitioner’s
offer to commission the LIFT and even if the said event of commissioning of the LIFT fails
to occur due to any reason not attributable to the Petitioner or beyond its control, within 90
days of the materials made ready for dispatch at the premises of the Petitioner. In that
situation also what all the Petitioner will have to ensure is that such components of the
LIFTS are ready for dispatch. At the risk of repetition, it can be stated that if on the date of
the signing of the contract 90% payment is made and within the contract period i.e 52 weeks,
the Petitioner is able to show that the whole of the components of the LIFTS are ready for
dispatch at its premises, the Purchaser is bound to pay the balance 10% also within 90 days from the date of such availability of materials for dispatch without any other stipulation as to such equipments or components being delivered at the spot of the Purchaser for its installation. If the conditions of the contract relating to payment are discernable to that effect, it can only be stated that the contract of the Petitioner with the Purchaser is virtually for the manufacture of the materials and for its absolute readiness to supply those materials and nothing more. The sum and substance of the conditions of the contract de hors the other clauses is only to that effect.

68. Having considered the above terms of the contract threadbare, I am convinced that it can only be concluded that this contract is only one for the manufacture and supply of the LIFT/ELEVATOR and the installation though mentioned in the contract, has very insignificant relation to the consideration agreed upon between the parties. In any event, as I have found that the contract of supply and installation are divisible in very many aspects, it is difficult to hold that it is a 'Works Contract'. Therefore, it will have to be held that the manufacture, supply and erection of LIFT/ELEVATOR agreed upon by the Petitioner to any of its customers, would only fall within the expression 'Sale' and can never be called as 'Works Contract'. Once that is the conclusion that can be made based on the contractual terms as agreed between the Petitioner and its customers, the application of Article 366(29A)(b) cannot be made and does not in any way support the contentions raised by the Petitioner.

140. In light of the above discussions, it will have to be held that even after the 46th Amendment, if Article 366(29A)(b) is to be invoked, as a necessary concomitant, it must be shown that the terms of the contract would lead to a conclusion that it is a 'Works Contract'. In other words, unless a contract is proved to be a 'Works Contract' by virtue of the terms agreed as between the parties, invocation of Article 366(29A)(b) of the Constitution, cannot be made. Alternatively, if the terms of the contract disclose or lead to a definite conclusion that it is not a 'Works Contract' but one of outright sale, the same will have to be declared as a 'Sale' attracting the provisions of the relevant sales tax enactments. Therefore, based on the conclusions arrived at and having applied the above principles to the case on hand, and having regard to the nature of the terms of the contract displayed, it will have to be held that the manufacture, supply and installation of LIFTS/ELEVATORS comes under the definition of 'Sale' and not 'Works Contract' and the decision in Kone Elevators (India) Pvt. Ltd. (supra) has been correctly decided. The Reference is, therefore, answered on the above terms.

ORDER

Keeping in view the conclusions of the majority, expressed in the judgment of Dipak Misra, J., it is held that the decision rendered in State of A.P. v. Kone Elevators[(2005) 3 SCC 389] does not correctly lay down the law and it is accordingly overruled.

2. It is directed that the show-cause notices, which have been issued by taking recourse to reopening of assessment, shall stand quashed. The assessment orders which have been framed and are under assail before this Court are set aside. It is necessary to state here that where the
assessments have been framed and have attained finality and are not pending in appeal, they shall be treated to have been closed, and where the assessments are challenged in appeal or revision, the same shall be decided in accordance with the decision rendered by us.

3. The writ petitions and the civil appeals are disposed of with no order as to costs.
**State of Karnataka and Ors. v. Pro Lab and Ors.**

AIR 2015 SC 1098

Constitutional validity of Entry 25 of Schedule VI to the Karnataka Sales Tax Act, 1957 (hereinafter referred to as the 'Act') is the subject matter of the present appeal. It is the third endeavour to resurrect this entry, when on the first two occasions, the steps taken by the State were declared as impermissible. Even this time, the High Court has dumped the amendment as unconstitutional. However, the reasons advanced by the High Court in all three rounds are different. While traversing through the historical facts leading to the issue at hand, we shall be referring to the same for clear understanding of the controversy involved.

2. This entry was inserted in the said Act by an amendment which came into effect from 01.07.1989, thereby providing levy of tax for processing and supply of photographs, photo prints and photo negatives. The validity of this entry was challenged by means of a writ petition filed in the High Court of Karnataka. The High Court in that case titled *M/s Keshoram Surindranath Photo – Bag (P) Ltd. and others v. Asstt. Commissioner of Commercial Taxes (LR), City Division, Bangalore and others*, declared the said Entry 25 to be unconstitutional. State of Karnataka had challenged that judgment by filing special leave petition in this Court. This special leave petition was dismissed vide order dated 20.04.2000, following its earlier judgment in the case of *Rainbow Colour Lab and Another v. State of Madhya Pradesh and others*. The reason for holding Entry 25 as unconstitutional was that the contract of processing and supplying of photographs, photo frames and photo negatives was predominantly a service contract with negligible component of goods/material and, therefore, it was beyond the competence of State Legislature given in Entry 25 of List II of Schedule VII of the Constitution to impose sales tax on such a contract.

3. It so happened that within one year of the judgment in *Rainbow Colour Lab's case*, three Judges Bench of this Court rendered another judgment in the case of *ACC Ltd. v. Commissioner of Customs*, wherein it expressed its doubts about the correctness of the law laid down in *Rainbow*. We may point out at this stage itself that during the course of hearing of the present appeal, there was a hot debate on the question as to whether judgment in *Rainbow Colour Lab's case* was over-ruled in the case of *ACC Ltd. case* or not. This aspect will be gone into by us at the appropriate stage.

4. After the judgment in *ACC Ltd. case*, a circular instruction was issued by the Commissioner of Commercial Taxes to the assessing authorities to proceed with the assessments as per Entry 25. This became the subject matter of challenge before the High Court of Karnataka in the case of *M/s Golden Colour Labs and Studio and others v. The Commissioner of Commercial Taxes*. The High Court allowed the writ petition vide judgment dated 30.07.2003 holding that a provision once declared unconstitutional
could not be brought to life by mere administrative instructions. However, at the same time, the Court observed that Entry 25, Schedule VI to the Act, declared ultra vires the Constitution in Keshoram's case, cannot be revived automatically, unless there is re-enactment made by the State Legislature to that effect.

5. The appropriate procedure indicated in the aforesaid judgment emboldened the State to come out with the required legislative amendment. This paved way for the enactment of the Karnataka State Laws Act, 2004 by the State Legislature that came into force with effect from 29.01.2004. Section 2(3) of the said amendment re-introduced Entry 25 in identical terms, as it appeared earlier, and that too with retrospective effect that is w.e.f. 01.07.1989, when this provision was inserted by the amendment made in the year 1989 for the first time.

6. As was expected, this amendment was again challenged before the Karnataka High Court by the respondent herein as well as many others. Vide impugned judgment dated 19.08.2005, the High Court has again declared the said amendment as unconstitutional. It would be pertinent to mention that the High Court has not taken into consideration the events that followed after Rainbow Colour Lab's case, namely, over-ruling of the said judgment in ACC Ltd. Since the basis of Keshoram's case decided in the first calm by the High Court was same as given in Rainbow Colour Lab, obviously Keshoram also no longer remains a good law. However, the reason given by the High Court, this time, is that the ratio laid down in Keshoram's case continues to be binding on the State of Karnataka. As per the High Court, the re-enactment of the said provision is possible in the event of a subsequent declaration made by the Hon'ble Supreme Court re-considering or pronouncing a similar question in terms of the findings in para 23 of the Golden Colour Lab's case. This is, thus, the chequered history of the litigation amply demonstrating as to how the State of Karnataka is making desperate attempts to ensure that provision in the form of Entry 25 in the said Act survives, empowering the State Government to levy sales tax for processing and supply of photographs, photo prints and photo negatives.

8. We may also record at this point itself that legislative competence of the State to insert the aforesaid Entry is primarily challenged on the ground that the State Government is not empowered to levy sales tax on the processing and supplying of photographs which is predominantly in the nature of service and the element of goods therein was minimal. The respondents argue that the State Legislature does not have any power to impose tax on services inasmuch as the sales tax can be levied only on sale of goods as permitted under Article 366 (29-A) of the Constitution of India. Challenge is also laid on the retrospective effect given to the said Entry by arguing that such a move is violative of Article 265 of the Constitution of India as subjecting the assessee to such a tax from retrospective effect is confiscatory in nature and, therefore, unconstitutional.

9. We have projected, in nutshell, the chequered history of the litigation by referring to the judgments of this Court pronounced from time to time which have a direct bearing on the outcome of this appeal. Therefore, we are simply required to do a diagnostic of the sorts in revisiting these judgments.
10. In order to ensure that we avoid unnecessary burdening of judgments with the earlier case laws, it is safe to charter the journey by initiating discussion about the Constitution Bench judgment in the case of Gannon Dunkerley and Co. and others. State of Rajasthan and others. That case pertained to the execution of the Works Contracts. Question involved was as to whether there could be levy of sales tax on the sale of goods involved in the execution of such Works Contracts. The assessee, viz. Gannon Dunkerley, was carrying on business as Engineering Contractors and executing the contracts pertaining to construction of building projects, dams, roads and structural contracts of all kinds. In respect of sanitary contracts, 20 per cent was deducted for labour and balance was taken as a turnover of the assessee for the purposes of levying sales tax by the assessing authority. Likewise, in respect of other contracts, 30 per cent was deducted for labour and on balance amount, sales tax was levied treating it as turnover of the assessee under the Madras General Sales Tax Act, 1939. The question which arose for consideration was as to whether there was any sale of goods. The Constitution Bench held that building contract was in the nature of Works Contract and there was no element of sale of goods in such a contract. In its opinion, in a building contract where the agreement between the parties was that the contractor should construct the building according to the specifications contained in the agreement and in consideration received payment as provided therein, there was neither a contract to sell the materials used in the construction nor the property passed therein as movables. It was held that in a building contract, which was one entire and indivisible, there was no sale of goods and it was not within the competence of the Provincial State Legislature to impose tax on the supply of the materials used in such a contract treating it as a sale. The Court, thus, proceeded on the basis that a building contract was indivisible and composite wherein there was no sale of goods and, therefore, the State Legislature was not competent to impose sales tax on the supply of material used in such a contract treating it as a sale. Since, Entry 48 of the List II of Schedule VII in the Government of India Act, 1935 was under consideration that empowers State Government to levy tax £sale of goodsâ€ the Court held that the expression £sale of goodsâ€ in the said Entry is to be given the same meaning as given under the Sale of Goods Act, 1930. That would mean that it would be sale of goods only if the two essential ingredients, namely: (i) an agreement to sell movables for a price, and (ii) property passing therein pursuant to that agreement, are satisfied.

11. After the aforesaid Constitution Bench judgment, the Parliament amended the Constitution of India by the Constitution (46th Amendment) Act, 1982 which received the assent of the President of India on 02.02.1983. By this amendment, clause (29-A) was inserted in Article 366 of the Constitution, which reads as under:

\[\text{(29A) \ a tax on the sale or purchase of goods includes -}\]

- a tax on the transfer, otherwise than in pursuance of a contract, of property in any goods for cash, deferred payment or other valuable consideration;
• a tax on the transfer of property in goods (whether as goods or in some other form) involved in the execution of a works contract;
• a tax on the delivery of goods on hire-
• purchase or any system of payment by instalments;
• a tax on the transfer of the right to use any goods for any purpose (whether or not for a specified period) for cash, deferred payment or other valuable consideration;
• a tax on the supply of goods by any unincorporated association or body of persons to a member thereof for cash, deferred payment or other valuable consideration;
• a tax on the supply, by way of or as part of any service or in any other manner whatsoever, of goods, being food or any other article for human consumption or any drink (whether or not intoxicating), where such supply or service, is for cash, deferred payment or other valuable consideration; and such transfer, delivery or supply of any goods shall be deemed to be a sale of those goods by the person making the transfer, delivery or supply and a purchase of those goods by the person to whom such transfer, delivery or supply is made;

12. The challenge laid to the aforesaid amendment was repelled by this Court in the case of Builders Association of India and others v. Union of India and others. In this judgment, the Constitution Bench specifically noted that the purport and object of the aforesaid amendment was to enlarge the scope of the expression "tax of sale for purchase of goods" wherever it occurs in the Constitution so that it may include within its ambit any transfer, delivery or supply of goods that may take place under any of the transactions referred to in sub-clauses (a) to (f). To put it tersely, with the aforesaid amendment, the States are empowered to make the Works Contract divisible and tax "sale of goods" component. It clearly follows therefrom that the restricted meaning which was assigned to the expression "sale of goods" in Gannon Dunkerley's case is undone by the aforesaid amendment. The interpretation which is to be assigned to clause 29-A of Article 366 is stated with remarkable clarity in M/s Larsen Toubro and another v. State of Karnataka and another, by a three Judge Bench in the following words:

"It is important to ascertain the meaning of Sub-clause (b) of Clause 29A of Article 366 of the Constitution. As the very title of Article 366 shows, it is the definition clause. It starts by saying that in the Constitution unless the context otherwise requires the expressions defined in that article shall have the meanings respectively assigned to them in the article. The definition of expression "tax on sale or purchase of the goods" is contained in Clause (29A). If the first part of Clause 29A is read with Sub-clause

(b) along with latter part of this clause, it reads like this: tax on the sale or purchaser of the goods" includes a tax on the transfer of property in goods (whether as goods or in some other form) involved in the execution of a works contract and such transfer, delivery or supply of any goods shall be deemed to be a sale of those goods by the
person making the transfer, delivery or supply and a purchase of those goods by the person to whom such transfer, delivery or supply is made. The definition of "goods" in Clause 12 is inclusive. It includes all materials, commodities and articles. The expression, 'goods' has a broader meaning than merchandise. Chattels or movables are goods within the meaning of Clause 12. Sub-clause (b) refers to transfer of property in goods (whether as goods or in some other form) involved in the execution of a works contract. The expression "in some other form" in the bracket is of utmost significance as by this expression the ordinary understanding of the term 'goods' has been enlarged by bringing within its fold goods in a form other than goods. Goods in some other form would thus mean goods which have ceased to be chattels or movables or merchandise and become attached or embedded to earth. In other words, goods which have by incorporation become part of immovable property are deemed as goods. The definition of 'tax on the sale or purchase of goods' includes a tax on the transfer or property in the goods as goods or which have lost its form as goods and have acquired some other form involved in the execution of a works contract.

61. Viewed thus, a transfer of property in goods under Clause 29A(b) of Article 366 is deemed to be a sale of the goods involved in the execution of a works contract by the person making the transfer and the purchase of those goods by the person to whom such transfer is made.

62. The States have now been conferred with the power to tax indivisible contracts of works. This has been done by enlarging the scope of "tax on sale or purchase of goods" wherever it occurs in the Constitution. Accordingly, the expression "tax on the sale or purchase of goods" in Entry 54 of List II of Seventh Schedule when read with the definition Clause 29A, includes a tax on the transfer of property in goods whether as goods or in the form other than goods involved in the execution of works contract. The taxable event is deemed sale.

63. Gannon Dunkerley-I (supra) and few other decisions following Gannon Dunkerley-I (supra) wherein the expression "sale" was given restricted meaning by adopting the definition of the word "sale" contained in the Sale of Goods Act has been undone by the Forty-sixth Constitutional Amendment so as to include works contract. The meaning of Sub-clause (b) of Clause 29A of Article 366 of the Constitution also stands settled by the Constitution Bench of this Court in Builders' Association (supra). As a result of Clause 29A of Article 366, tax on the sale or purchase of goods may include a tax on the transfer in goods as goods or in a form other than goods involved in the execution of the works contract. It is open to the States to divide the works contract into two separate contracts by legal fiction: (i) contract for sale of goods involved in the works contract and (ii) for supply of labour and service. By the Forty-sixth Amendment, States have been empowered to bifurcate the contract and to levy sales tax on the value of the material in the execution of the works contract.

13. Notwithstanding some clear and pertinent observations made in by the Constitution Bench in Builders Association's case, while upholding the Constitutional validity of 46th Amendment, there was some ambiguity in the judicial thought on one particular
aspect which was also one of the basis of judgment in Gannon Dunkerley's case. In Gannon Dunkerley's case, the Constitution Bench had laid down the dominant intention test to find out as to whether a particular contract involved transfer of property in goods. The Court was of the opinion that if the dominant intention of a contract was not to transfer the property in goods, but it was Works Contract, or for that matter, a contract in the nature of rendering of services, even if a part of it related to the transfer of goods, that would be immaterial and no sales tax on the said part could be levied, going by the principle of dominant intention behind such a contract, which was in the nature of Works Contract in the contract relating to construction of buildings.

14. As pointed out above, in Gannon Dunkerley's case, the Court also held that such a contract was indivisible. No doubt, insofar as indivisibility facet of the contract is concerned, the same was done away by 46th Constitutional Amendment. However, in subsequent cases, the Court grappled with the issue as to whether the principle of dominant intention still prevailed. This very aspect came up for discussion before two Judge Bench of this Court in Rainbow Colour Lab's case. The Court held the view that the division of contract after 46th Amendment can be made only if the Works Contract involved a dominant intention to transfer the property in goods and not in contracts where the transfer in property takes place as an incident of contract of service. This aspect is highlighted by the said Bench in the following manner:

110. Since this was a judgment rendered prior to the coming into force of the 46th Constitutional Amendment, we will have to consider whether the said Amendment has brought about any change so as to doubt the legal position enunciated in the above case. It is true that by the 46th Constitutional Amendment by incorporating Clause 29A(b) in Article 366, the definition of the words "sale" and "works contract" have been enlarged. The State of Madhya Pradesh has also brought about a consequent change in the definition of the word 'sale' in Section of its Sales Tax Act but it is to be noticed that in the said State Act the expression 'works contract' has not been specifically defined.

11. Prior to the Amendment of Article 366, in view of the judgment of this Court in State of Madras v Gannon Dunkerley and Co., the State could not levy sales-tax on sale of goods involved in a work's contract because the contract was indivisible. All that has happened in law after the 46th Amendment and the judgment of this Court in Builders case (supra) is that it is now open to the States to divide the works contract into two separate contracts by a legal fiction (i) contract for sale of goods involved in the said works contract and (ii) for supply of labour and service. This division of contract under the amended law can be made only if the works contract involved a dominant intention to transfer the property in goods and not in contracts where the transfer in property takes place as an incident of contract of service. The Amendment, referred to above, has not empowered the State to indulge in microscopic division of contracts involving the value of materials used incidentally in such contracts. What is pertinent to ascertain in this connection is what was the dominant intention of the contract. Every contract, be it a
service contract or otherwise, may involve the use of some material or the other in execution of the said contract. State is not empowered by the amended law to impose sales-tax on such incidental materials used in such contracts. This is clear from the judgment of this Court in Hindustan Aeronautics Ltd. v. State of Karnataka [1984]2SCR248, where it was held thus: Mere passing of property in an article or commodity during the course of performance of the transaction in question does not render the transaction to be transaction of sale. Even in a contract purely of work or service, it is possible that articles may have to be used by the person executing the work, and property in such articles or materials may pass to the other party. That would not necessarily convert the contract into one of sale of those materials. In every case, the Court would have to find out what was the primary object of the transaction and the intention of the parties while entering into it.\ldots

15. While considering the validity of Entry 25 in Schedule VI of the Act and holding it to be unconstitutional, as beyond the powers of the State Legislature, the High Court of Karnataka in Keshoram's case examined in detail the business which was carried out by the petitioner in the said case and the process that was involved in processing and supplying of photographs, photoframes or photonegatives. By that time, 46th Constitutional Amendment had already been effected which was also taken note of by the High Court. However, the High Court took the view that the main object of the work undertaken by the petitioner in that case was not the transfer of a chattel as a chattel and, in fact, it was a contract of work and labour and there was no sale of goods involved.

16. It is manifest from the above that the rationale behind the judgment was to look into the main object of the work undertaken by the assessee and concluding that since it was essentially a

Works Contract and transfer of photopaper upon which the positive prints were taken were simply incidental and ancillary to the main transactions, that was in the nature of service contract, and, therefore, Entry 25 was beyond the scope of Article 366 of the Constitution of India. Apparently, the High Court applied dominant intention test while holding Entry 25 as unconstitutional. By the time, Special Leave Petition against this judgment came up for consideration before this Court on 20.04.2000, the judgment in the case of Rainbow Colour Lab's case had just been rendered observing that dominant intention test was still valid notwithstanding insertion of clause 29-A in Article 366 of the Constitution by 46th Amendment. Following this judgment, SLP was dismissed.

17. Within one year of the said judgment, this very issue again cropped up for discussion and decision before a three Judge Bench in ACC Ltd. case. The issue arose under the Customs Act, 1962 viz. whether the drawings, designs etc. relating to machinery or industrial technology were goods which were leviable to duty of customs on their transaction value at the time of their report. However, since the issue related to meaning that has to be given to the expression 'goods' the case law on this aspect including Gannon Dunkerley & Kame's case were specifically taken note of and discussed. The Court also noticed the effect of 46th Amendment and in the process commented upon the
judgment in the Rainbow Colour Lab's case. The Court specifically remarked that Gannon Dunkerley & Kame's judgments were of pre 46th Amendment era which had no relevance after the said Constitutional amendment. It can be discerned from the following discussion contained therein:

Ref 1. All the aforesaid decisions related to the period prior to the Forty-sixth Amendment of the Constitution when Article 366(29A) was inserted. At that time in the case of a works contract it was held that the same could not be split and State Legislature had no legislative right to seek to levy sales tax on a transaction which was not a sale simpliciter of goods. Rainbow Colour Lab & Anr. Vs. State of M.P. and Others, (2000) 2 SCC 385 was, however, a case relating to the definition of the word "sale" in the M.P. General Sales Tax Act, 1958 after its amendment consequent to the insertion of Article 366(29A). The question there was whether the job rendered by a photographer in taking photographs, developing and printing films would amount to works contract for the purpose of levy of sales tax. This Court held that the work done by the photographer was only a service contract and there was no element of sale involved. After referring to earlier decisions of this Court, it was observed at page 391 as follows:

"15. Thus, it is clear that unless there is sale and purchase of goods, either in fact or deemed, and which sale is primarily intended and not incidental to the contract, the State cannot impose sales tax on a works contract simpliciter in the guise of the expanded definition found in Article 366(29A)(b) read with Section 2(n) of the State Act. On facts as we have noticed that the work done by the photographer which as held by this Court in Kame case is only in the nature of a service contract not involving any sale of goods, we are of the opinion that the stand taken by the respondent State cannot be sustained."

22. Even though in our opinion the decisions relating to levy of sales tax would have, for reasons to which we shall presently mention, no application to the case of levy of customs duty, the decision in Rainbow Colour Lab case (supra) requires consideration. As a result of the Forty-sixth Amendment, sub-article 29A of Article 366 was inserted as a result whereof tax on the sale or purchase of goods was to include a tax on the transfer of property in goods (whether as goods or in some other form) involved in the execution of a works contract. Taking note of this amendment this Court in Rainbow Colour Lab at page 388-389 observed as follows:

"11. Prior to the amendment of Article 366, in view of the judgment of this Court in State of Madras v. Gannon Dunkerley & Co. (Madras) Ltd. the States could not levy sales tax on sale of goods involved in a works contract because the contract was indivisible. All that has happened in law after the 46th Amendment and the judgment of this Court in 'Builders' case is that it is now open to the States to divide the works contract into two separate contracts by a legal fiction: (i) contract for sale of goods involved in the said works contract, and (ii) for supply of labour and service. This division of contract under the amended law can be made only if the works contract involved a dominant intention to transfer the property in goods and not in contracts where the transfer in property takes place as an incident of contract of service. The amendment, referred to above, has not empowered the State to indulge in a microscopic division of contracts
involving the value of materials used incidentally in such contracts. What is pertinent to ascertain in this connection is what was the dominant intention of the contract. Every contract, be it a service contract or otherwise, may involve the use of some material or the other in execution of the said contract. The State is not empowered by the amended law to impose sales tax on such incidental materials used in such contracts."

23. In arriving at the aforesaid conclusion the Court referred to the decision of this Court in Hindustan Aeronautics Ltd. vs. State of Karnataka (1984) a SCC 706 and Everest Copier (supra). But both these cases related to pre-Forty-sixth Amendment era where in a works contract the State had no jurisdiction to bifurcate the contract and impose sales tax on the transfer of property in goods involved in the execution of a works contract. The Forty-sixth Amendment was made precisely with a view to empower the State to bifurcate the contract and to levy sales tax on the value of the material involved in the execution of the works contract, notwithstanding that the value may represent a small percentage of the amount paid for the execution of the works contract. Even if the dominant intention of the contract is the rendering of a service, which will amount to a works contract, after the Forty-sixth Amendment the State would now be empowered to levy sales tax on the material used in such contract. The conclusion arrived at in Rainbow Colour Lab case, in our opinion, runs counter to the express provision contained in Article 366 (29A) as also of the Constitution Bench decision of this Court in Builders' Association of India and Others vs. Union of India and Others (1989) 2 SCC 645.\[emphasis supplied]\n
18. It is amply clear from the above and hardly needs clarification Bench judgment in Rainbow Colour Lab's case did not lay down the correct law as it referred to pre-46th Amendment judgments in arriving at its conclusions which had lost their validity. The Court also specifically commented that after 46th Amendment, State is empowered to levy sales tax on the material used even in those contracts where the dominant intention of the contract is the rendering of a service, which will amount to a Works Contract.\[emphasis supplied]\n
19. In view of the above, the argument of the respondent assesses that ACC Ltd. case did not over-rule Rainbow Colour Lab's case is, therefore, clearly misconceived. In fact, we are not saying so for the first time as a three member Bench of this Court in M/s Larsen and Toubro has already stated that ACC Ltd. had expressly over-ruled Rainbow Colour Lab while holding that dominant intention test was no longer good test after 46th Constitutional Amendment. We may point out that learned counsel for the respondent assessee took courage to advance such an argument emboldened by certain observations made by two member Bench in the case of C.K. Jidheesh v. Union of India\[supervising], wherein the Court has remarked that the observations in ACC Ltd. were merely obiter. In Jidheesh, however, the Court did not notice that this very argument had been rejected earlier in Bharat Sanchar Nigam Ltd. v. Union of India\[supervising].
20. In *M/s Larsen and Toubro*, the Court, after extensive and elaborate discussion, once again specifically negated the argument predicated on dominant intention test having regard to the statement of law delineated in *ACC Ltd. and Bharat Sanchar Nigam Ltd.* cases. The reading of following passages from the said judgment is indicative of providing complete answer to the arguments of the respondent assessees herein:

64. Whether contract involved a dominant intention to transfer the property in goods, in our view, is not at all material. It is not necessary to ascertain what is the dominant intention of the contract. Even if the dominant intention of the contract is not to transfer the property in goods and rather it is the rendering of service or the ultimate transaction is transfer of immovable property, then also it is open to the States to levy sales tax on the materials used in such contract if it otherwise has elements of works contract. The view taken by a two-Judge Bench of this Court in *Rainbow Colour Lab (supra)* that the division of the contract after Forty-sixth Amendment can be made only if the works contract involved a dominant intention to transfer the property in goods and not in contracts where the transfer of property takes place as an incident of contract of service is no longer good law, *Rainbow Colour Lab (supra)* has been expressly overruled by a three-Judge Bench in *Associated Cement*.

65. Although, in *Bharat Sanchar*, the Court was concerned with Sub-clause (d) of Clause 29A of Article 366 but while dealing with the question as to whether the nature of transaction by which mobile phone connections are enjoyed is a sale or service or both, the three-Judge Bench did consider the scope of definition in Clause 29A of Article 366. With reference to Sub-clause (b) it said: "Sub-clause (b) covers cases relating to works contract. This was the particular fact situation which the Court was faced with in *Gannon Dunkerley-I* and which the Court had held was not a sale. The effect in law of a transfer of property in goods involved in the execution of the works contract was by this amendment deemed to be a sale. To that extent the decision in *Gannon Dunkerley-I* was directly overcome". It then went on to say that all the Sub-clauses of Article 366 (29A) serve to bring transactions where essential ingredients of a 'sale' as defined in the Sale of Goods Act, 1930 are absent, within the ambit of purchase or sale for the purposes of levy of sales tax.

66. It then clarified that *Gannon Dunkerley-I* survived the Forty-sixth Constitutional Amendment in two respects. First, with regard to the definition of "sale" for the purposes of the Constitution in general and for the purposes of Entry 54 of List II in particular except to the extent that the clauses in Article 366(29A) operate and second, the dominant nature test would be confined to a composite transaction not covered by Article 366(29A). In other words, in *Bharat Sanchar*, this Court reiterated what was stated by this Court in *Associated Cement* that dominant nature test has no application to a composite transaction covered by the clauses of Article 366(29A). Leaving no ambiguity, it said that after the Forty-sixth Amendment, the sale element of those contracts which are covered by six Sub-clauses of Clause 29A of Article 366 are separable and may be subjected to sales tax by the States under Entry 54 of List II and there is no question of the dominant nature test applying.
67. In view of the statement of law in Associated Cement and Bharat Sanchar, the argument advanced on behalf of the Appellants that dominant nature test must be applied to find out the true nature of transaction as to whether there is a contract for sale of goods or the contract of service in a composite transaction covered by the clauses of Article 366(29A) has no merit and the same is rejected.

68. In Gannon Dunkerley-II, this Court, inter alia, established the five following propositions:

(i) as a result of Forty-sixth Amendment the contract which was single and indivisible has been altered by a legal fiction into a contract which is divisible into one for sale of goods and the other for supply of labour and service and as a result of such contract which was single and indivisible has been brought on par with a contract containing two separate agreements;

(ii) if the legal fiction introduced by Article 366(29A)(b) is carried to its logical end, it follows that even in a single and indivisible works contract there is a deemed sale of the goods which are involved in the execution of a works contract. Such a deemed sale has all the incidents of the sale of goods involved in the execution of a works contract where the contract is divisible into one for sale of goods and the other for supply of labour and services;

(iii) in view of Sub-clause (b) of Clause 29A of Article 366, the State legislatures are competent to impose tax on the transfer of property in goods involved in the execution of works contract. Under Article 286(3)(b), Parliament has been empowered to make a law specifying restrictions and conditions in regard to the system of levy, rates or incidents of such tax. This does not mean that the legislative power of the State cannot be exercised till the enactment of the law under Article 286(3)(b) by the Parliament. It only means that in the event of law having been made by Parliament under Article 286(3)(b), the exercise of the legislative power of the State under Entry 54 in List II to impose tax of the nature referred to in Sub-clauses (b), (c) and (d) of Clause (29A) of Article 366 would be subject to restrictions and conditions in regard to the system of levy, rates and other incidents of tax contained in the said law; (iv) while enacting law imposing a tax on sale or purchase of goods under Entry 54 of the

State List read with Article 366(29A)(b), it is permissible for the State legislature to make a law imposing tax on such a deemed sale which constitutes a sale in the course of the inter-state trade or commerce under Section 3 of the Central Sales Tax Act or outside under Section 4 of the Central Sales Tax Act or sale in the course of import or export under Section 5 of the Central Sales Tax Act; and (v) measure for the levy of tax contemplated by Article 366(29A)(b) is the value of the goods involved in the execution of a works contract. Though the tax is imposed on the transfer of property in goods involved in the execution of a works contract, the measure for levy of such imposition is the value of the goods involved in the execution of a works contract. Since, the taxable event is the transfer of property in goods involved in the execution of a works contract and the said transfer of property in such goods takes place when the goods are incorporated in the works, the value of the goods which can constitute the measure for the levy of the tax
has to be the value of the goods at the time of incorporation of the goods in works and not the cost of acquisition of the goods by the contractor.

69. In Gannon Dunkerley-II, Sub-section (3) of Section 5 of the Rajasthan Sales Tax Act and Rule 29(2)(1) of the Rajasthan Sales Tax Rules were declared as unconstitutional and void. It was so declared because the Court found that Section 5(3) transgressed the limits of the legislative power conferred on the State legislature under Entry 54 of the State List. However, insofar as legal position after Forty-sixth Amendment is concerned, Gannon Dunkerley-II holds unambiguously that the States have now legislative power to impose tax on transfer of property in goods as goods or in some other form in the execution of works contract.

70. The Forty-sixth Amendment leaves no manner of doubt that the States have power to bifurcate the contract and levy sales tax on the value of the material involved in the execution of the works contract. The States are now empowered to levy sales tax on the material used in such contract. In other words, Clause 29A of Article 366 empowers the States to levy tax on the deemed sale.

21. To sum up, it follows from the reading of the aforesaid judgment that after insertion of clause 29-A in Article 366, the Works Contract which was indivisible one by legal fiction, altered into a contract, is permitted to be bifurcated into two: one for the sale of goods and other for the services thereby making goods component of the contract exigible to sales tax. Further, while going into this exercise of divisibility, dominant intention behind such a contract, namely, whether it was for sale of goods or for services, is rendered otiose or immaterial. It follows, as a sequitur, that by virtue of clause 29-A of Article 366, the State Legislature is now empowered to segregate the goods part of the Works Contract and impose sales tax thereupon. It may be noted that Entry 54, List II of the Constitution of India empowers the State Legislature to enact a law taxing sale of goods. Sales tax, being a subject-matter into the State List, the State Legislature has the competency to legislate over the subject.

22. Keeping in mind the aforesaid principle of law, the obvious conclusion would be that Entry 25 of Schedule VI to the Act which makes that part of processing and supplying of photographs, photo prints and photo negatives, which have goods component exigible to sales tax is constitutionally valid.

23. For being classified as Works Contract the transaction under consideration has to be a composite transaction involving both goods and services. If a transaction involves only service i.e. work and labour then the same cannot be treated as Works Contract. It was contended that processing of photography was a contract for service simpliciter with no elements of goods at all and, therefore, Entry 25 could not be saved by taking shelter under clause 29-A of Article 366 of the Constitution. For this proposition, umbrage under the judgment in B.C. Kame's case was sought to be taken wherein this Court held that the work involving taking a photograph, developing the negative or doing other photographic work could not be treated as contract for sale of goods. Our attention was drawn to that portion of the judgment where the Court held that such a contract is for use of skill and labour by the photographer to bring about desired results inasmuch as a good photograph reveals not only the aesthetic sense and
artistic faculty of the photographer, it also reflects his skill and labour. Such an argument also has to be rejected for more than one reasons. In the first instance, it needs to be pointed out that the judgment in *Kame's* case was rendered before the 46th Constitutional Amendment. Keeping this in mind, the second aspect which needs to be noted is that the dispute therein was whether there is a contract of sale of goods or a contract for service. This matter was examined in the light of law prevailing at that time, as declared in *Dunkerley's* case as per which dominant intention of the contract was to be seen and further that such a contract was treated as not divisible. It is for this reason in *BSNL and M/s Larsen and Toubro* cases, this Court specifically pointed out that *Kame's* case would not provide an answer to the issue at hand. On the contrary, legal position stands settled by the Constitution Bench of this Court in *Kone Elevator India Pvt. Ltd. v. State of Tamil Nadu and Ors.*

On the basis of the aforesaid elucidation, it has been deduced that a transfer of property in goods under Clause (29A)(b) of Article 366 is deemed to be a sale of goods involved in the execution of a Works Contract by the person making the transfer and the purchase of those goods by the person to whom such transfer is made. One thing is significant to note that in *Larsen and Toubro* (supra), it has been stated that after the constitutional amendment, the narrow meaning given to the term "works contract" in *Gannon Dunkerley-I* (supra) no longer survives at present. It has been observed in the said case that even if in a contract, besides the obligations of supply of goods and materials and performance of labour and services, some additional obligations are imposed, such contract does not cease to be works contract, for the additional obligations in the contract would not alter the nature of the contract so long as the contract provides for a contract for works and satisfies the primary description of works contract. It has been further held that once the characteristics or elements of works contract are satisfied in a contract, then irrespective of additional obligations, such contract would be covered by the term "works contract" because nothing in Article 366(29A)(b) limits the term "works contract" to contract for labour and service only.

24. Another attack on the insertion of Entry 25 pertained to retrospectivity given to this provision. It was sought to be argued that amendment to the Act was made by Karnataka State Laws Act, 2004 which came into force w.e.f. 29.01.2004 and insertion of Entry 25 with retrospective effect i.e. w.e.f. 01.07.1989 was not permissible. To put it otherwise, the argument was that even if Entry 25 is held to be valid, it should be made prospective i.e., w.e.f. 29.01.2004.

25. We are afraid, even this argument does not cut any ice. The first thing in this regard which is to be kept in mind is that Entry 25 was inserted for the first time by amendment of the Act w.e.f. 01.07.1989. This amendment was post 46th Constitutional Amendment. However, the High Court of Karnataka declared the said Entry to be unconstitutional and the SLP was also dismissed. Undoubtedly, it was because of the judgment in *Rainbow Colour Lab*, which judgment was declared as not a good law in
ACC Ltd. (which position is repeated in BSNL as well as M/s Larsen and Toubro cases). Thus, the very basis on which Entry 25 of Schedule VI was declared as unconstitutional, has been found to be erroneous. In such circumstances, the legislature will be justified in enacting the law from the date when such a law was passed originally and that date is 01.07.1989 in the instant case. We have to keep in mind the fact that on the basis of this amendment, there have been assessments made by the assessing authorities. This was admitted by the learned counsel for the respondents at bar at the time of the arguments.

27. We would also like to refer to the case of Hiralal Ratanlal v. State of U.P.\(^1\), wherein it was observed 'the source of the legislative power to levy sales or purchase tax on goods is Entry 54 of the List II of the Constitution. It is well settled that subject to Constitutional restrictions a power to legislate includes a power to legislate prospectively as well as retroactively. In this regard legislative power to impose tax also includes within itself the power to tax retrospectively.'

28. We would like to point out at this stage that the High Court in the impugned judgment has not dealt with the mater in its correct perspective. The reason given by the High Court in invalidating Entry 25 is that this provision was already held unconstitutional by the said High Court in Keshoram's case against which the SLP was also dismissed and in view of that decision, it was not permissible for the legislature to re-enact the said Entry by applying a different legal principle. According to us, this was clearly an erroneous approach to deal with the issue and the judgment of the High Court is clearly unsustainable. The High Court did not even deal with various facets of the issue in their correct perspective, in the light of subsequent judgments of this Court with specific rulings that Rainbow Colour Lab is no longer a good law.

29. The impugned judgment of the High Court is accordingly set aside, the present appeal is allowed and as a result thereof, the writ petitions filed by the respondents in the High Court are dismissed holding that Entry 25 of Schedule VI of the Act is constitutionally valid. There shall, however, be no order as to costs.

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HIRE-PURCHASE AGREEMENTS

K.L. Johar & Co. v. Dy. CTO

(1965) 2 SCR 112 : AIR 1965 SC 1082

K. N. WANCHOO, J. - These two appeals on certificates granted by the Madras High Court raise common questions and will be dealt with together. The appellant is a financing company consisting of a number of partners. Its main business is to advance money to persons who purchase motor vehicles but are themselves not in a position to find ready money to pay the price. The course of business followed by the appellant is to enter into hire-purchase agreements with those who want to purchase motor vehicles. It is necessary to refer to the terms of hire-purchase agreements which are on a set pattern in order to understand the points raised in these appeals.

2. Any person desirous of acquiring a motor vehicle makes the selection of the make and type and fixes the price therefor with the motor dealer. Such person then approaches the appellant for financial assistance on a hire-purchase basis. Sometimes an initial payment is made to the motor dealer which is taken into account at the time of the hire-purchase agreement while at others the payment is made in a number of instalments to the appellant. In either case the appellant pays the price or the balance thereof to the dealer and thereafter the hire-purchase agreement is entered into between the appellant and the person who wants to purchase the motor vehicle. The appellant is described in the agreement as the owner of the vehicle and the person who wants to purchase it as the hirer.

3. The material terms of the agreement may be summarised here. The agreement provides that the owner (namely, the appellant) will let and the hirer (namely, the person who wants to purchase the vehicle) will take on hire the vehicle in question for such period as may be fixed in each case, (clause 1). The hirer has to pay a certain amount per month to the owner and where an initial deposit is made this amount is larger for the first month and other monthly payments are smaller. The hirer has to pay during the period of hire the monthly instalment, the vehicle is registered in the name of the owner and the hirer is forbidden to represent himself as the owner thereof or to do anything to suggest that he is the owner thereof; the hirer has to keep the vehicle in good and serviceable repair, order and condition to the satisfaction of the owner, and he is also to insure and keep insured the vehicle against loss or damage by fire, accident and third party risks and punctually pay premia and all moneys payable in respect of such insurance: (clause 3). The hirer has further to pay all taxes, licence fees, duties, fines, registration charges and other charges payable in respect of the vehicle and all rents and outgoings payable by the hirer in respect of the premises where the vehicle is kept or garaged when the same respectively becomes due: [see clause 3(e)]. He has also to satisfy the owner about all the above things having been duly done. He cannot sell, charge, pledge, assign or part with possession of the vehicle [clause 3(g)]. The hirer has also to make good all damages to the vehicle, (fair wear and tear excepted) and pay the owner the full value of the vehicle in the event of total loss, whether the damage or loss be caused accidentally or otherwise and to keep the vehicle at the sole risk of the hirer until the hirer purchases the vehicle or returns it to the owner: (clause 5). If the hirer makes default in the
payment of any rent for seven days, the hiring immediately determinates and the owner may
without notice retake possession of the vehicle, and it shall be at the option of the owner to
reinstate the contract on such conditions as it deems fit after the determination of the hiring as
aforesaid: (clause 14). Upon the determination of the hiring as above, all arrears of rents up to
the date of determination and all costs and expenses incurred by the owner in the exercise of
the powers conferred by the agreement shall be paid by the hirer, and the hirer shall not be
entitled to any repayment of any sum previously paid and all such rents and sums shall belong
to the owner absolutely; (clause 15). The hirer may determine the hire at any time by
delivering the vehicle to the owner and by paying him any part of the current rent due up to
the date of such delivery and all other sums, if any, which up to such date, the hirer may have
become liable to pay the owner under the agreement: (clause 18). Clause 20 of the agreement,
which is important for our purposes reads thus:

If the hirer shall duly observe and perform all the conditions and stipulations herein
contained and on his part to be observed and performed and shall duly pay to the
owner all rents hereby reserved during the term of hiring together with all other
sums, if any payable by him to the owner under the provisions of this agreement,
then and at the termination of the hiring, the hirer may purchase the vehicle from the
owner for a sum of Re 1.

Clause 21 provides that the hirer may at any time determine the hiring and become purchaser
of the vehicles by paying to the owner such sum as together with the sums previously paid
will amount to the total sum payable by way of rent thereunder together with all sums (if any)
payable to the owner and in addition a sum of Re 1. Clause 22 provides that if the hirer fails
to observe and perform the conditions and stipulation herein contained and fails to exercise
the option of purchasing the vehicle in accordance with the provisions of the last preceding
clause, and the vehicle is not returned to the owner on the termination of the hiring, the hirer
shall pay the owner a certain sum every month until the vehicle is handed over to the owner
by the hirer.

Clause 23 provides that until the vehicle shall have become the property of the
hirer under the provisions of the agreement, it shall remain the absolute property of the owner,
and the hirer shall have no right or interest in the same other than as the hirer under the
agreement. The agreement is not assignable: (clause 24). It is unnecessary to refer to other
clauses of the agreement as they are immaterial for our purposes. After such an agreement has
been made, the hirer takes possession of the vehicle and if all its terms are carried out, the
hirer becomes the owner of the vehicle when he exercises his option to purchase the vehicle
after paying the sum of Re 1 including the instalments then outstanding, if any.

4. The appellant commenced business in February 1955 and in the course of such
business entered into several hire-purchase agreements relating to motor vehicles both new
and second-hand. On April 28, 1956, the appellant submitted a return to the Assistant
Commercial Tax Officer, Coimbatore, showing a turnover for the purposes of sales tax for Rs
2,37,993 for the year 1955-56. The appellant had also collected (though it now claims that it
was done erroneously) from the hirers of motor vehicles amounts equivalent to sales tax on
their transactions and those amounts were kept in suspense account. The hirers, however,
began to claim refund of this amount on the ground that hire-purchase agreements were not
within the ambit of ÒsaleÓ as defined in the Madras General sales tax Act, 9 of 1939,
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The assistance Commercial Tax Officer made a provisional assessment on the basis of the return submitted by the appellant and fixed instalments for payment thereof. The appellant paid the instalments but preferred a revision to the Commercial Tax Officer objecting to the assessment mainly on the ground that hire-purchase agreements were not transactions of sale liable to be taxed under the Act. The revision was, however, dismissed on the ground that there was no necessity for interfering with the provisional assessment at that stage. Later, the Deputy Commercial Tax Officer passed the final order of assessment relating to the year 1955-56 holding that the hire-purchase transactions were subject to sales tax and overruled the objection that the transactions were only a system of financing and not sales. The appellant preferred an appeal to the Commercial Tax Officer against order of assessment for the year 1955-56. That appeal is said to have been heard but no orders had been passed thereon, when the writ petition was filed in the High Court on June 29, 1957. In the meantime, provisional assessment had been made for the year 1956-57 and the appellant was being pressed to pay that amount also. Consequently, the appellant filed a writ petition on June 29, 1957 challenging the provisional assessment with respect to the year 1956-57. Later, he filed another writ petition on August 18, 1957 challenging the final assessment for the year 1955-56.

5. The main contention of the appellant in the two writ petitions was that levy of sales tax in respect of hire-purchase transactions was illegal and unconstitutional as Explanation I to Section 2(h) of the Act defining “sale” was beyond the competence of the State Legislature. The Explanation is in these terms:

“A transfer of goods on the hire-purchase or other instalment system of payment shall, notwithstanding the fact that the seller retains the title in the goods as security for payment of the price, be deemed to be a sale.”

The appellant contended that this amounted to an extension of the meaning of the word “sale” as used in Entry 54, List II of the Seventh Schedule to the Constitution and Entry 48 of List II of the Seventh Schedule to the Government of India Act, 1935 beyond what it meant in the Indian Sale of Goods Act, 3 of 1930. The State legislature, therefore, could not arrogate to itself the power to levy a tax in respect of transactions which in form and in substance did not constitute sales as understood in the Indian Sale of Goods Act by merely adopting a wide definition. It was, therefore, incompetent for the State legislature to enact Explanation I. If the Explanation falls on account of the incompetence of the legislature, no sales tax could be levied on hire-purchase transactions in view of Article 265 of the Constitution which lays down that “no tax shall be levied or collected, except by authority of law.”

6. These two writ petitions along with a number of others of the same kind dealing with hire-purchase agreements were heard by the High Court together. The first question to which the High Court addressed itself was whether there were two sales in this case or only one sale, for the contention on behalf of the appellant, apparently was that there was only one sale by the dealer to the person who wanted to purchase the motor vehicle and that the appellant was merely a financing agent of such person. The High Court however, held that there were two sales in these cases, first sale by the motor dealer to the appellant and the second by the appellant to the person who wanted to purchase the motor vehicle. Thus there were two distinct sales of the vehicle involved in the process by which the property in the vehicle.
passed from the dealer to the person who wanted to purchase it. It appears that sales tax was paid on the sale by the dealer and the contention of the appellant was that that was all the tax to which the transaction could be subjected. The High Court, however, held that as there were two sales involved in the transaction and the Act levied a multipoint tax on sales, tax could be levied again when the appellant sold the vehicle to the intending purchaser.

7. The High Court then considered the nature of hire-purchase agreements, with particular reference to the agreement in the present case and held that a hire-purchase agreement of this kind had two elements, one of bailment and the other of sale, and rejected the contention of the appellant that such hire-purchase agreements were nothing more than hiring agreements involving bailment. Having held that the hire-purchase agreement of this type involved two elements which were both real (i.e. element of bailment and element of sale), the next question to which the High Court addressed itself was whether tax liability could be fastened on the appellant immediately it entered into the agreement of hire-purchase or whether the tax could only be constitutionally and legally levied after the intending purchaser had exercised the option which resulted in the transfer of property in the vehicle to such person. The High Court held that in most of the transactions of this nature the intending purchaser pays up the instalments and exercises the option and thus acquires title to the vehicle. But there might be cases where such a person might be unable to become the owner, in the sense of obtaining the title to the vehicle by paying the instalments. In such a case, the property would remain with the appellant and bailment element would be the only element, the option to purchase having not been exercised. In this latter class of cases, there would be no sale, though there was an agreement granting an option to purchase which by itself would not amount to a sale. Such transactions could not in the view of the High Court be brought within the charging provisions of the section. The High Court, therefore, held that Explanation I to Section 2(h) of the Act referred to those hire-purchase agreements only which fructify into sale and not to those which did not, and in this view of the matter upheld the validity of the Explanation.

8. The High Court then considered when the tax should be levied even in those cases which fructify into sales. It held that where a hire-purchase agreement fructifies and results in a sale, there could be no impediment in the way of the tax being levied even when the hire-purchase agreement is entered into. The High Court then considered the question as to what would be the quantum of consideration for the sale that is ultimately effected, and held that the total of all the instalments paid made up the sale price, though they were designated as instalments of hire.

9. The High Court summed up its conclusion thus:

(1) That the transaction of hire-purchase entered into by the appellant constituted sales, rendering it liable to sales tax on its turnover, excepting in cases where owing to the default on the part of the hirer in the payment of instalments of hire, the vehicle is seized by the appellant and, therefore, no title passes to the intending purchaser.

(2) That these transactions of hire-purchase could having regard to their main intent and purpose be treated as sales at the moment the agreements were entered into, subject to adjustment by elimination of such portion of the turnover where no sale resulted.
(3) That for the purpose of computing the turnover of the appellant, the total of
the hire stipulated to be paid in instalments should be treated as price or consideration
for the sale. On this view the High Court dismissed the writ petitions.

11. The first question that has been urged before us is that there was really one sale in the
present case by the motor dealer to the intending purchaser of the vehicle and that the
appellant was a mere financing agent of such person and that the High Court was in error
holding that there were two sales, one by the dealer to the appellant and the other by the
appellant to the person who intended to purchase the vehicle. We are of opinion that the view
taken by the High Court in this behalf is correct. This will be clear from a consideration of the
various terms of the hire-purchase agreement which we have already summarised above. That
agreement shows that the whole of the price of the vehicle is paid by the appellant to the
dealer. Even where a part of the price is paid by the intending purchaser, the payment is
shown as hire for the first month and is made to the appellant. So far as the dealer is
concerned, the whole price is paid by the appellant. The agreement also shows that the
appellant is the owner of the vehicle and the intending purchaser is merely a hirer thereunder.
The vehicle has to be registered in the name of the appellant, though the fact of registration by
itself in one name or another may not be determinative of the ownership of the vehicle.
Clauses 14 and 15 of the agreement clearly show that there was no sale by the dealer to the
intending purchaser of the vehicle at the time of the hire-purchase agreement. These clauses
give power to the appellant to retake possession of the vehicle and determine the agreement.
Now, if the property in the vehicle had passed to the intending purchaser at the time of the
hire-purchase agreement, it would not have been open to the appellant to take possession of
the vehicle or to insist on payment of arrears or to become entitled to everything that had been
paid upto that day. Under the law, all that the appellant would have been entitled to, was to
realise the loan he had given by filing a suit and then attaching and selling the vehicle. These
two clauses are, therefore, clear indication of the fact that there was no sale by the dealer to
the person who wanted to purchase the vehicle at the time of the hire-purchase agreement,
and that at that time, the sale was by the dealer to the appellant. Then clauses 20 and 21
enforce this conclusion inasmuch as they give an option to the person who wanted to purchase
the vehicle to do so by exercising his option under the conditions mentioned therein. If he had
already become the owner when the agreement had been entered into, these two clauses could
not have been included in the agreement. Then again clause 23 makes it clear that till the
option is exercised, the vehicle remains the absolute property of the appellant and the
intending purchaser has no right in it except that of a hirer. We, therefore, agree with the High
Court that in cases of this kind there are two sales, one by the dealer to the financier (namely,
the appellant in this case) and the other by the financier (namely, the appellant) to the person
who wanted to purchase the vehicle. As the Act levied a multipoint sales tax at the relevant
time, it was open to the State to tax both the sales and the fact that the sale by the dealer to the
appellant had been taxed will not affect the liability of the second sale by the financier to the
person who wanted to purchase the vehicle. What is the extent of that liability and when is
that tax to be levied, will be considered by us in connection with the second contention urged
on behalf of the appellant.
12. This brings us to a consideration of the validity of Explanation I, which we have already set out. It is necessary in this connection to understand the nature of a typical hire-purchase agreement as distinct from a sale in which the price is to be paid later by instalments. In the case of a sale in which the price is to be paid by instalments, the property passes as soon as the sale is made, even though the price has not been fully paid and may later be paid in instalments. This follows from the definition of sale in Section 4 of the Indian Sale of Goods Act (as distinguished from an agreement to sell) which requires that the seller transfers the property in the goods to the buyer for a price. The essence of a sale is that the property is transferred from the seller to the buyer for a price, whether paid at once or paid later in instalments. On the other hand, a hire-purchase agreement, as its very name implies, has two aspects. There is first, an aspect of bailment of the goods subjected to the hire-purchase agreement, and there is next an element of sale which fructifies when the option to purchase, which is usually a term of hire-purchase agreements, is exercised by the intending purchaser. Thus, the intending purchaser is known as the hirer so long as the option to purchase is not exercised, and the essence of a hire-purchase agreement properly so called is that the property in the goods does not pass at the time of the agreement but remains in the intending seller, and only passes later when the option is exercised by the intending purchaser. The distinguishing feature of a typical hire-purchase agreement, therefore, is that the property does not pass when the agreement is made but only passes when the option is finally exercised after complying with all the terms of the agreement.

13. Explanation I specifically brings out this characteristic of hire-purchase agreements. It provides that a transfer of goods on hire-purchase or other instalment system of payment (which presumably is of the same type as the hire-purchase agreement) shall be deemed to be a sale, even though the property in the goods does not pass to the intending purchaser and remains in the intending seller. The Explanation recognises by using the words "deemed to be" that there is no passing of the property at the time of the hire-purchase agreement, but provides by a fiction that the property shall be deemed to have passed notwithstanding the terms of the agreement. This deeming takes place under the Explanation immediately on the hire-purchase agreement being made.

14. The contention on behalf of the appellant is that the State legislature was not competent thus to expand the meaning of the words "sale of goods" used in Entry 54 of List II of the Seventh Schedule to the Constitution, which corresponds to Entry 48 of the Provincial List of the Government of India Act, 1935, and make something a sale which is not a sale under the law contained in the Indian Sale of Goods Act. It is clear that if the Explanation is good, the second sale in the present case must be held to have taken place at the time the hire-purchase agreement was made. On the other hand, if the Explanation is beyond the competence of the State legislature and falls, the sale cannot be said to have taken place when the hire-purchase agreement was made and can only take place when the option is exercised after all the terms of the agreements have been satisfied.

15. This Court had occasion to deal with the interpretation of Entry 48 of List II of the Seventh Schedule to the Government of India Act, 1935 in Sales Tax Officer v. Budh Prakash Jai Prakash. It held that Entry 48 in question conferred power on the Provincial legislature to impose a tax only when there had been a completed sale and not when there was
only an agreement to sell. It was pointed out that there was a well-defined and well established distinction between a sale and an agreement to sell. Consequently, the definition in Section 2(h) of the U.P. sales tax Act, 15 of 1948, enlarging the meaning of the word ‘sale’ so as to include forward contracts was to that extent declared ultra vires. That case dealt with forward contracts but it brings out the distinction between a sale and an agreement to sell and it was held that the State legislature had no power under the relevant Entry in the Government of India Act to extend the definition of sale so as to include an agreement to sell.

16. The matter came up again before this Court in *Gannon Dunkerley* case and it was held that the expression ‘sale of goods’ was at the time when the Government of India Act was enacted a term of well-recognised legal import in the general law relating to sale of Goods and in the legislative practice relating to that topic and must be interpreted in Entry 48 in List II in the Seventh Schedule as having the same meaning as in the Sale of goods Act. Entry 54 of List II of the Seventh Schedule to the Constitution uses the same words (namely, taxes on sale of goods) as in Entry 48 of List II of the Seventh Schedule to the Government of India Act and therefore, the words must bear the same meaning as explained in these two cases.

17. Learned counsel for the respondent however urges that the view taken by this Court in *Gannon Dunkerley* case requires reconsideration. We have given our earnest consideration to this argument and are of opinion that considering that that view has stood for so many years, and has been accepted in later cases, there is no case made out for reconsideration thereof. In this connection our attention was drawn to Entry 92-A of List I of the Seventh Schedule to the Constitution, which refers to taxes on sale of goods where such sale takes place in the course of inter-state trade or commerce and to the provisions of the Central sales tax Act, 74 of 1956, where ‘sale’ has been defined as including a transfer of goods on the hire-purchase or other system of payment by instalments. It is urged that this definition of ‘sale’ under the Central sales tax Act shows that the words ‘sale of goods’ used in Entry 92-A have a wider meaning. We are of opinion that there is no force in this argument, for the Central sales tax Act was passed by Parliament and its validity has to be considered not only with reference to Entry 92-A of List I of the Seventh Schedule to the Constitution but also with reference to Article 248(2) of the Constitution read with Entry 97 of List I of the Seventh Schedule to the Constitution. The fact that the definition of ‘sale’ in the Central sales tax Act includes words contained in *Explanation I*, therefore, is of no help in construing the meaning of the words ‘sale of goods’ which have been authoritatively pronounced upon by this Court in *Gannon Dunkerley* case following *Budh Prakash* case. It is clear, therefore, that the State legislature when it proceeds to legislate either under Entry 48 of List II of the Seventh Schedule to the Government of India Act 1935 or under Entry 54 of List II of the Seventh Schedule to the Constitution, can only tax sale within the meaning of that word as defined in the Sale of Goods Act. The essence of sale under the Sale of Goods Act is that the property should pass from the seller to the buyer when a contract of sale is made except in a case of conditional sale. hire-purchase agreements are not conditional sales. Therefore, any legislation by the State legislature making any agreement or transaction in which the property does not pass from the seller to the buyer, a sale would be beyond its legislative competence. What *Explanation I* does is to lay down that a hire-purchase agreement shall be deemed to be a sale
in spite of the fact that the property does not pass at the time of such agreement from the seller to the buyer. Therefore, Explanation I as it stands is beyond the legislative competence of the State legislature. It is urged however that the property eventually does pass from the seller to the buyer when the option is exercised and other terms of the hire-purchase agreement are fulfilled and therefore, the Explanation should be read as confined to those cases only where property does eventually pass from the seller to the buyer. We are of opinion that this argument cannot be accepted, for the intention of the Explanation clearly is to provide that the hire-purchase agreement shall be deemed to be a sale immediately on the date it is made, even though property has not passed from the seller to the buyer on that day. If this were not the real purpose and intention of Explanation I, its enactment would be entirely unnecessary for the main definition of "sale" under Section 2(h) will apply to a hire-purchase agreement at the time when the property passes from the seller to the buyer on the option being exercised and on other terms of the agreement being fulfilled. We cannot, therefore, agree with the High Court that the Explanation should be confined only to those cases where the property does eventually pass for the obvious intention of the legislature in enacting the Explanation was to provide that the hire-purchase agreement shall be deemed to be a sale on the very date on which it is made, even though no property passes from the seller to the buyer on that date. In this view of the matter it must be held taking into account the purpose, the intention and the interpretation of Explanation I that it is beyond the competence of the State legislature. It must, therefore, be held to be invalid and struck down accordingly.

18. The next question that arises is whether a hire-purchase agreement ever ripens into a sale and if so when. We have already pointed out that a hire-purchase agreement has two elements: (1) element of bailment, and (2) element of sale, in the sense that it contemplates an eventual sale. The element of sale fructifies when the option is exercised by the intending purchaser after fulfilling the terms of the agreement. 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 under the Act for the taxable event under the Act is the taking place of the sale, the Act providing for a multi-point sales tax at the relevant time. Where however option is not exercised or cannot be exercise because of the inability of the intending purchaser to fulfil the terms of the agreement, there is no sale at all. As the taxable event is the sale of goods, the tax can only be levied when the option is exercised after fulfilling all the terms of the hire-purchase agreement. We cannot agree with the view of the High Court that because in most of such cases the option is exercised, tax is leviable immediately on the making of the Hire-purchase agreement and that in a few cases where there is failure to carry out the terms of the agreement or to exercise the option, there can be adjustment by elimination of such portion of the turnover. As we have pointed out the taxable event under the Act is the sale of goods and until that taxable event takes place there can be no liability to pay tax. Therefore, even though eventually most cases of hire-purchase may result in sales by the exercise of the option and the fulfilment of the terms of the agreement, tax is not exigible at the time when the hire-purchase agreement is made, for at that time the taxable event has not taken place; it can only be exigible when the option has been exercised and all the terms of the agreement fulfilled and the sale actually takes place. When sale takes place in a particular case will depend upon the terms of the hire-purchase agreement but till the sale takes place there can be no liability to sales tax under the Act. The
High Court, therefore, was in error in holding that transactions of hire-purchase of the kind with which we are dealing having regard to their main intent and purpose might be treated as sales at the time the agreement is entered into; in all hire-purchase agreements of the type with which we are dealing sale only takes place when the option is exercised after all the terms of the agreement are fulfilled and it is at that time that the tax is exigible.

19. This brings us to the last question, namely, what is the quantum of sale price which is to be the basis of taxation under the Act. The argument on behalf of the appellant in this connection is that the sale price in the particular cases with which we are concerned is only Re 1 which the hirer has to pay when he exercises his option to purchase. On the other hand, the contention on behalf of the respondent is that the sale price is the entire amount paid by the hirer to the financier and the tax is exigible on this entire amount. We are of opinion that neither of these two contentions is correct. It stands to reason that Re 1 cannot be the price of a vehicle in these cases for even if the vehicle is treated as second-hand when the option is exercised, the sum of Re 1 would be an absurd price for a second-hand vehicle of the kind with which we are concerned. The argument in this connection is that the entire amount paid as hire is really for hire and the price is only the sum of Re 1 which is paid for the option which finally results in sale. This contention overlooks the essence of hire-purchase agreement which is that the hire includes not only what would be payable really as hire but also a part of it is towards the price. The contention that the price is only Re 1 which is paid for the option, therefore, cannot be accepted.

20. On the other hand, the contention on behalf of the respondent that the price is the entire amount paid as hire including Re 1 paid for the option also does not seem to be correct. This ignores the fact that at any rate part of what is paid as hire is really towards the hire of the vehicle for the period when the hirer is only a hirer. This will also be clear from the fact that if the entire hire is treated as price, the result would be that the price of what is a second-hand vehicle when the sale eventually takes place would be more than the price of the new vehicle. This will be clear from an example of a hire-purchase agreement, which was given to us on behalf of the appellant. In the particular example, the price of the vehicle was Rs 5000. The hire-purchase agreement however provided for payment of Rs 6487/6 by the hirer to the owner in seventeen instalments. The hirer would become the owner on the exercise of the option after he had paid all the instalments. But if all the instalments are to be treated as price, the result would be that a vehicle which was priced at Rs 5000 when the agreement was made and must have depreciated during the seventeen months when it was on hire would be valued at Rs 6487/6 at the time when the option is exercised and the sale in favour of the hirer takes place. This is clearly impossible to accept and, therefore, the contention of the respondent must also be rejected.

21. The real position in our opinion as to price of the vehicle when the option is exercised would be this. Its value at that time is neither Re 1 which is the nominal amount to be paid for the option nor the entire amount which is paid as hire including Re 1. The value must be something less than the original price, which in the example mentioned by us above was Rs 5000. In order to arrive at the value at the time of the second sale to the hirer, the sales tax authorities should take into consideration the depreciation of the vehicle and such other matters as may be relevant in arriving at such price on which the sale can be said to have
22. We may in this connection refer to Darngavil Coal Company v. Francis. That was a case under the (English) Income Tax Act, and the question that directly arose for consideration was with respect to deductions to be allowed from profits in the circumstances of that case. The facts were these: The appellant, a coal company, in order to obtain railway wagons for the conveyance of coal from its collieries to its customers from time to time entered into agreements with a wagon company under which a certain annual sum was paid for a period of years for a certain number of wagons. By the terms of the agreements the coal company during the periods of the payments used the wagons at its own risk and was bound to keep them in repair, and at the end of the period, it had the option of purchasing the wagons at the nominal price of one shilling for each wagon. It will be seen that the agreement was in the nature of a hire-purchase agreement of wagons. The question then arose whether any deductions from profits could be allowed to the coal company in the circumstances. It was held that the annual payments under the agreements were divisible into two, namely, (i) consideration paid for the use of the wagons, and (ii) payments for an option at a future date to purchase the wagons at a nominal price. It was also held that insofar as the payments represented the consideration for the use of the wagons during the period of agreement, they were admissible as deduction in the computation of the coal company’s profits for the purpose of assessment to income tax. It was observed that it was perfectly clear that during the course of the period of years, the wagon still was the property of the wagon company and not of the coal company; but the coal company wished to use it and accordingly an extra payment was made in respect of that. No discrimination was made between the two kinds of payment; it was a lumpsum that was paid. In such cases two things were going on concurrently - there was a sale and purchase agreement under certain terms - not a sale at that moment, but an option on certain terms on a future date to have a sale - and on the other hand, there was also concurrent with that a hiring agreement. The Court then went on to observe that it had no materials for splitting up that payment showing what was truly hire and what was truly payment towards eventual purchase. Finally, the case was remitted to the Commissioners with instructions that they were bound to allow as deduction such portion of the yearly payment made in respect of the wagon agreements as represented the consideration paid for being allowed to use wagons which under the contract were not yet the property of the coal company and that the Commissioners must decide that question for themselves if parties did not agree.

23. This case in our opinion brings out the true nature of the payment made as hire in hire-purchase agreement. Part of the amount is towards the hire and part towards the payment of price, and it would be for the sales tax Authorities to determine in an appropriate way the price of the vehicle on the date the hirer exercises his option and becomes the owner of the vehicle after fulfilling the terms of the agreement. There is no legislative guidance available as to how this should be done and perhaps it would be better if the legislature gives guidance in such matters. But even in the absence of legislative guidance it would be for the sales tax Authorities to decide as best they can the value of the vehicle on the date the option is exercised and the property passes to the hirer. 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 condition 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.

24. We, therefore, allow the appeals in part and set aside the order of the High Court and the assessments made, and direct that the sales tax Authorities will determine the price in accordance with what we have said above and thereafter proceed to levy sales tax according to law. The appellant will get its costs from the respondent - one set of hearing fee.

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J.C. SHAH, J. - On September 29, 1958 the Sales Tax Officer, 1st Circle, Ernakulam, issued a notice calling upon the appellants to file returns of their turnover from sales in the course of business and to secure registration as dealers under the Travancore-Cochin General Sales Tax Act 11 of 1125 M.E. and to furnish details of the transactions of sale with parties in the State of Kerala in the years 1955-56, 1956-57 and 1957-58. A similar notice was issued by the Sales Tax Officer on March 3, 1962 in respect of the transactions within the State for the years 1958-59 and 1959-60. The appellants contended that they were not liable to be assessed under the Act. They contended that they were mere financiers and that they did not enter into any transactions of sale of goods with parties within the State of Kerala and that they were not "dealers" within the meaning of the Act. The Sales Tax Officer by orders dated March 25, 1962 and July 6, 1962 held that the transactions between the appellants and certain parties within the State of Kerala were sales within the meaning of the Act and the appellants were dealers liable to be assessed under the Act. The Sales Tax Officer accordingly reiterated his demand upon the appellants to file returns of their turnover in respect of sales for the five years in question along with details of all transactions in the State and "to produce evidence to prove the correctness and completeness of their returns".

14. The appellants then moved the High Court of Kerala under Article 226 of the Constitution for writs of certiorari quashing the proceedings of the Sales Tax Officer and for writs of prohibition restraining that Officer from taking further proceedings against the appellants under his orders dated March 25, 1962 and July, 6, 1962. The High Court of Kerala rejected these petitions upholding the view of the Sales Tax Officer that on the transactions between the appellants and their customers sales tax was payable under the Travancore-Cochin General Sales Tax Act. With certificate granted by the High Court under Article 133(1)(a) of the Constitution, these appeals are preferred.

15. The appellants are a company incorporated under the Indian Companies Act, 1913, and have their registered office in Madras. The Company carries on business of financing purchases of motor vehicles on the security of those vehicles. The manner in which these transactions were effected is briefly this. A customer desirous of purchasing a motor-vehicle, but unable to pay the price to the dealer, agrees to purchase the vehicle, and makes part payment of the price to the dealer. He then approaches the appellants and requests that a loan be advanced to him. On the appellants agreeing to grant a loan, the customer executes nine documents - (1) an application requesting the appellants to grant a loan of a stated amount on the security of the motor-vehicle; (2) a "sale letter" reciting that the customer had on the date of the application for loan sold to the appellants the motor vehicle; (3) a bill which recites that for the amount mentioned in the "sale letter" and received in full, the customer has sold to the appellants the vehicle belonging to the customer; (4) a receipt for the amount on the security of the motor-vehicle; (2) a "sale letter" reciting appellants; (5) an agreement called the hire-purchase agreement under which the appellants agree to let out to the customer and the customer agrees to take on hire the motor-vehicle for a specified term subject to determination in conditions mentioned therein; (6) a promissory-note agreeing to pay the
difference between the price of the vehicle and the amount paid by the customer to the dealer, and interest therein at the stipulated rate: (7) a letter from the customer requesting the appellants to pay to the dealer the amount agreed to be advanced to him: (8) a letter addressed to the appellants agreeing and undertaking to keep the vehicle, on the security of which the loan was granted, insured against "comprehensive risks"; and (9) a letter addressed to the Motor Vehicles Authorities intimating that the motor-vehicle is the subject of hire-purchase agreement between the customer as owner and the appellants, and requesting the Authorities to make a note of the hire-purchase agreement in the registration certificate standing in the name of the customer. The scheme for financing the purchase of the vehicle is therefore that the customer purchases the vehicle from the dealer directly and gets it registered in his name. At his request the appellants agree to advance the balance of the price remaining to be paid, and pay it to the dealer on the customer's executing a promissory-note for repayment of the amount, a hire-purchase agreement and other related documents. On repayment of the amount stipulated to be paid, the vehicle becomes the sole and absolute property of the customer.

16. The relevant terms of the hire-purchase agreement may now be set out. In the preamble of the agreement, it is recited that the agreement is between the appellants to be described as "the owners" the customer to be described as "the Hirer" and "the Guarantor", who guarantees due performance and observance by the customer of all the clauses and covenants of the agreement and agrees to pay on demand any monies due or which may become payable to the owners under the agreement either by way of hire expenses or damages, repairs, replacements or other supplies. By the first clause it is recited that the owners (the appellants) will let and the hirer (the customer) will take on hire the motor vehicle for a specified number of calendar months subject to determination as mentioned in the agreement. Clause 2 sets out the conditions of hiring. Thereby the customer agrees to pay rent to the appellants punctually; to take proper care of the vehicle and keep it in good condition and to keep it insured for its full value; to pay all rents, rates, taxes payable by him in respect of the premises where the vehicle shall for the time being be garaged and all licence fees, insurance premium and other duties payable in respect of the said vehicle; to keep the vehicle in his sole custody and possession; and to permit the appellants to inspect the vehicle at all reasonable times during the hiring; not to cause, permit, allow or suffer any person to acquire any lien on the vehicle; not to cause, permit or allow or suffer the vehicle to become liable to distress, execution or any other process levied or issued against the customer; and not to assign, sell, pledge, charge, underlet, lend or otherwise part with the possession, custody or beneficial interest in the vehicle of the customer therein under the agreement without the consent of the owners. By clause 3 all monies payable to the customer by any insurer for loss or damage to the motor-vehicle are assigned to the owners. Clause 4 sets out the conditions in which the agreement is to stand determined without any notice to the customer.

17. Those conditions are:

(a) failure to pay any of the hiring instalments within the stipulated time;
(b) customer becoming insolvent or compounding with his creditors;
On the determination of the agreement all the instalments previously paid by the customer stand forfeited to the owners who shall thereupon be entitled to seize the vehicle and to sue for all the instalments due and for damages for breach of the agreement. Under clause 5 the customer has the option at any time to determine the agreement by delivering up the vehicle at his own cost to the owners, and by clause 6 on the customer paying the entire amounts due under the second schedule, the vehicle becomes the sole and absolute property of the customer. By clause 7 it is provided that if the appellants seize the vehicle and take possession of it under clause 4, or if the customer returns it under clause 5, the customer shall remain liable to the appellants for arrears of the amount of hire upto the date of such seizure or return. Under clause 8 it is agreed that the customer shall maintain registration of the vehicle in his own name, provided that the customer shall transfer the registration in the name of the appellants whenever required to do so by them, and especially when the customer commits a breach of any of the conditions of the agreement.

18. According to the Sales Tax Authorities, between the date on which the customer agreed to purchase a vehicle and the date on which he became full owner of the vehicle without any encumbrance, three sale transactions were interposed: a sale by the dealer to the customer; a sale by the customer to the appellants under the “sale letter” referred to earlier; and a sale by virtue of clause 6 of the hire-purchase agreement. It is common ground that the first transaction is taxable under the appropriate Sales Tax Act. On behalf of the State of Kerala it is conceded that the second transaction is not taxable, but it is so because the customer is ordinarily not a dealer within the meaning of the Act, but they contend that inasmuch as under that transaction the appellants become transferees of the rights of the customer in the vehicle under the sale letter, when by the operation of clause 6 of the hire-purchase agreement the rights of the appellants are extinguished, there results a sale in favour of the customer which is taxable under the Act. We are in this case concerned with the exigibility to tax of what the State of Kerala contends is a sale resulting from the payment of all the instalments under the hire-purchase agreement.

19. The appellants submit that execution of a “sale letter” by the customer acknowledging sale of the vehicle to them does not create in them any right of ownership, the “sale letter” being merely one of a set of documents under which arrangement for granting a loan and for ensuring repayment of the money advanced by the appellants is made. The appellants say that they do not become owners of the vehicle under the “sale letter” that the true effect of the transaction on the execution of the nine documents is to hypothecate the vehicle in favour of the appellants, that the vehicle continues to remain in the ownership of the customer, and that under clause 6 of the hire-purchase agreement there is extinction of encumbrance and not a transfer of title which may be called a sale taxable under the Travancore-Cochin General Sales Tax Act.
20. The Travancore-Cochin General Sales Tax Act 11 of 1125 M.E. was brought into force in May 1950. The State authorities had, it is conceded, no power to enact a statute for levying tax on a transaction which does not conform to the definition of sale within the meaning of the Indian Sale of Goods Act: State of Madras v. Gannon Dunkerley & Co. (Madras) Ltd. The Travancore-Cochin General Sales Tax Act by Section 2(j) define sale as follows:

sale with all its grammatical variations and cognate expressions means every transfer of the property in goods by one person to another in the course of trade or business for cash or for deferred payment or other valuable consideration and includes also a transfer of property in goods involved in the execution of a works contract, but does not include a mortgage, hypothecation, charge or pledge;

Explanation (1). A transfer of goods on the hire-purchase or other instalment system of payment shall, notwithstanding the fact that the seller retains the title in the goods as security for payment of the price, be deemed to be a sale.

It is in the light of this definition that the liability to tax of the transactions resulting from clause 6 of the agreement falls to be determined. If, by the operation of clause 6, title to the vehicle is, under an existing contract to sell, transferred to the customer for a price, the transaction is a sale, and is taxable.

21. The appellants are financiers and their business is to advance loans on favourable terms on the security of vehicles. This is effected by obtaining a promissory-note for repayment of the amount advanced, and a hire-purchase agreement which provides a mechanism for recovery of the amount. It is true that a sale letter is obtained from the customer, but the consideration for the sale letter is only the balance remaining payable to the dealer, after giving credit against the price of the vehicle the amount paid by the customer. The application for a loan, and the letter addressed to the appellants undertaking to insure the vehicle expressly mention that a loan is asked for and granted on the security of the motor-vehicle under the hire-purchase agreement. It is the customer who insures the vehicle, and in the books of the Motor Vehicle Authorities he remains, with the consent of the appellants, owner of the vehicle. Undue importance to the acknowledgment of sale in the sale letter and the recital of sale in the bill and in the receipt cannot therefore be attached. These documents - sale letter, bill and receipt - must be read with the application for granting a loan on the security of the vehicles, the letter in which the customer requests the appellants to pay the balance of the price remaining to be paid by him to the dealer, the promissory-note executed by him for that amount, the undertaking to insure the vehicle, and intimation to the Motor Vehicles Authorities to make note of the hire-purchase agreement.

22. The hire-purchase agreement executed by the customer undoubtedly contains several onerous covenants. The customer has to pay all rents, rates, taxes and other outgoings regularly, to take proper care of the vehicle, to get it insured, to keep it fully repaired, and not to assign, sell, pledge, charge, underlet, lend or otherwise to create any lien thereon. The hire-purchase agreement is liable to be determined if any of the eventualities mentioned in clause 4 of the agreement happens and the appellants have the right to seize the vehicle. These covenants are only material in considering the true intention of the parties entering into the
hire-purchase agreement: it is irrelevant that in a given case these covenants may not be enforced by a Court in a dispute arising between the appellants and the customer, or relief may be granted on the ground that they contain penal clauses. In considering the true intention of the parties, the terms of clause 6 of the hire-purchase agreement are important: it is stipulated therein that "Upon the Hirer (customer) paying the entire amount due under Second Schedule herein, the said vehicle shall become the sole and absolute property of the Hirer." The intention clearly disclosed thereby is that on payment of the amount due at any time after the hire-purchase agreement, the vehicle would be free from encumbrance. It is also to be noted that the agreement does not contemplate exercise of an option on payment of a nominal sum of money as is to be found in other hire-purchase agreements. Execution of the promissory-note, the hire-purchase agreement and the other documents, in our judgment, indicate that it was the intention of the parties not to transfer any interest in the vehicle by the customer to the appellants: it was intended to give security by hypothecating the vehicle in favour of the appellants and for ensuring repayment of the loan advanced that the customer submitted to the various onerous conditions of the hire-purchase agreement.

23. A hire-purchase agreement is normally one under which an owner hires goods to another party called the hirer and further agrees that the hirer shall have an option to purchase the chattel when he has paid a certain sum, or when the hirer-rental payments have reached the hire purchase price stipulated in the agreement. But there are variations when a financier is interposed between the owner of the goods and the customer. The agreement, ignoring variations of detail, broadly takes one or the other of two forms: (1) when the owner is unwilling to look to the purchaser of goods to recover the balance of the price, and the financier who pays the balance undertakes the recovery. In this form, goods are purchased by the financier from the dealer, and the financier obtains a hire-purchase agreement from the customer under which the latter becomes the owner of the goods on payment of all the instalments of the stipulated hire and exercising his option to purchase the goods on payment of a nominal price. The decision of this Court in *K.L. Johar & Company v. Deputy Commercial Tax Officer* [AIR 1965 SC 1082] dealt with a transaction of this character. (2) In the other form of transactions, goods are purchased by the customer, who in consideration of executing a hire-purchase agreement and allied documents remains in possession of the goods, subject to liability to pay the amount paid by the financier on his behalf to the owner or dealer, and the financier obtains a hire-purchase agreement which gives him a license to seize the goods in the event of failure by the customer to abide by the conditions of the hire-purchase agreement.

24. The true effect of a transaction may be determined from the terms of the agreement considered in the light of the surrounding circumstances. In each case, the Court has, unless prohibited by statute, power to go behind the documents and to determine the nature of the transaction, whatever may be the form of the documents. An owner of goods who purports absolutely to convey or acknowledges to have conveyed goods and subsequently purports to hire them under a hire-purchase agreement is not estopped from proving that the real bargain was a loan on the security of the goods. If there is a bona fide and completed sale of goods, evidenced by documents, anterior to and independent of a subsequent and distinct hiring to the vendor, the transaction may not be regarded as a loan transaction, even though the reason
for which it was entered into was to raise money. If the real transaction is a loan of money secured by a right of seizure of the goods, the property ostensibly passes under the documents embodying the transaction, but subject to the terms of the hiring agreement, which become part of the buyer's title, and confer a licence to seize. When a person desiring to purchase goods and not having sufficient money on hand borrows the amount needed from a third person and pays it over to the vendor, the transaction between the customer and the lender will unquestionably be a loan transaction. The real character of the transaction would not be altered if the lender himself is the owner of the goods and the owner accepts the promise of the purchaser to pay the price or the balance remaining due against delivery of goods. But a hire-purchase agreement is a more complex transaction. The owner under the hire-purchase agreement enters into a transaction of hiring out goods on the terms and conditions set out in the agreement, and the option to purchase exercisable by the customer on payment of all the instalments of hire arises when the instalments are paid and not before. In such a hire-purchase agreement there is no agreement to buy goods; the hirer being under no legal obligation to buy has an option either to return the goods or to become its owner by payment in full of the stipulated hire and the price for exercising the option. This class of hire-purchase agreements must be distinguished from transactions in which the customer is the owner of the goods and with a view to finance his purchase he enters into an arrangement which is in the form of a hire-purchase agreement with the financier, but in substance evidences a loan transaction, subject to a hiring agreement under which the lender is given the license to seize the goods.

25. A few illustrative cases decided by the Courts in England, which do not import complications arising from the Bills of Sale Act, 1878, and the Hire Purchase Act, 1938, may be briefly noticed. In Re Watson Ex parte Official Receiver in Bankruptcy [(1890) 25 QBE 27], it was held that in adjudging the true nature of a transaction purporting to be a sale of personal chattels, followed by a hiring and purchase agreements, whereby the vendor agreed to hire the chattels from the purchaser and to pay quarterly sums for such hire until a certain amount was paid, when the chattels were to become again the property of the vendor, and power was given to the purchaser to take possession of the chattels on default of payment, the form of the transaction cannot be given undue importance. The Court held that no sale or hiring of the chattel was intended, the object in truth being to create a security for a loan of money to the supposed vendor from the supposed purchaser. The transaction was therefore one of loan. Lord Esher, M.R., observed at p. 37:

"(W)hen the transaction is in truth merely a loan transaction, and the lender is to be repaid his loan and to have a security upon the goods, it will be unavailing to cloak the reality of the transaction by a sham purchase and hiring. It will be a question of fact in each case whether there is a real purchase and sale complete before the hiring agreement. If there be such a purchase and sale in fact and afterwards the goods are hired, the case is not within the Bills of Sale Act.

The document itself must be looked at as part of the evidence; but it is only part, and the Court must look at the other facts, and ascertain the actual truth of the case."
27. In *Polsky v. S. And A. Services* [(1951) 1 All ELR 185], the plaintiff purchased a motor-car and gave a cheque for the price. Being unable to make arrangement for the cheque, he entered into a transaction with the defendants who carried on the business of financing the purchase of motor-cars. Though the plaintiff had purchased the motor-car, and merely sought a loan, the transaction between him and the defendants was carried out by means of documents used by the defendants when financing purchase of motor-cars, and they purported to buy the motor-car from the plaintiff and to let it out to him under a hire-purchase agreement. The plaintiff then brought an action for a declaration claiming that hire-purchase agreement was void under the Bills of Sale Act, 1882. Lord Goddard, C.J., in upholding the claim of the plaintiff observed at p. 188:

"A considerable number of cases were cited ... on the point which may, I think, be conveniently divided into two lines of authority. There is on the one hand, the class of cases, of which *Yorkshire Railway Wagon Co. v. Maclure* - (1882) Chapter D. 309 - and *British Railway Traffic & Electric Co. v. Kahn* - (1921) W.N. 52 - are good examples, where the transaction in question has been held to be a genuine sale followed by a hire-purchase agreement, and, therefore, unaffected by the Bills of Sale Acts, and, on the other hand, there is the class, which includes *Re Watson, Ex P. Official Receiver in Bankruptcy* - (1890) 25 Q.B.D. 27 - and *Madell v. Thomas & Co.* - (1891) 1 Q.B. 230 - where the court has held, on facts not very dissimilar from those in the present case, that the real transaction was one of loan, and, therefore, it was avoided by reason of the Acts. There is no doubt, I think, as to the deciding principle. The Court has to determine whether the transaction in question is a genuine sale by the original owner of the chattel to the person who is finding the money and a genuine re-letting by the latter to the original owner on hire-purchase terms, or whether the transaction, though taking that form, is nothing more than a loan of money on the security of the goods... The Court is not to look merely at the documents. It must discover what the real transaction was.

... the court is to look through or behind the documents, and to get at the reality; and, if in reality the documents are only given as a security for money, then they are bills of sale."

28. In the light of these principles the true nature of the transactions of the appellants may now be stated. The appellants are carrying on the business of financiers: they are not dealing in motor-vehicles. The motor-vehicle purchased by the customer is registered in the name of the customer and remains at all material times so registered in his name. In the letter taken from the customer under which the latter agrees to keep the vehicle insured, it is expressly recited that the vehicle has been given as security for the loan advanced by the appellants. As a security for repayment of the loan, the customer executes a promissory-note for the amount paid by the appellants to the dealer of the vehicle. The so-called "sale letter" is a formal document which is not made effective by registering the vehicle in the name of the appellants and even the insurance of the vehicle has to be effected as if the customer is the owner. Their right to seize the vehicle is merely a licence to ensure compliance with the terms of the hire-purchase agreement. The customer remains qua the world at large the owner and remains in
possession, and on condition of performing the covenants has a right to continue to remain in possession. The right of the appellants may be extinguished by payment of the amount due to them under the terms of the hire-purchase agreement even before the dates fixed for payment. The agreement undoubtedly contains several onerous covenants, but they are all intended to secure to the appellants recovery of the amount advanced. We are accordingly of the view that the intention of the appellants in obtaining the hire-purchase and the allied agreements was to secure the return of loans advanced to their customers, and no real sale of the vehicle was intended by the customer to the appellants. The transactions were merely financing transactions. The appeals will therefore be allowed.

* * * * *
The Union of India invited tenders for the supply of paints of the description compound recolouring Olive Green Scamic 314 for faded tents to Specification Ind/327037. The plaintiff offered a tender. The laboratory did not consider the sample to be up to the mark, but the higher authorities of the Defence Department accepted this tender, and placed an order with the plaintiff for supply of 500 Cwt. of this article and the price was fixed at Rs. 256/-F.O.R. Calcutta per Cwt. According to the contract the goods were to be inspected by the Inspector at Calcutta, and if he was satisfied that these were up to the mark, then the same could be dispatched by the plaintiff on receipt of the inspection notes. The original date of delivery was fixed on 15th of October, 1952, but the plaintiff stated that it might not be in a position to do so as it had to indent some of the ingredients from U.K., and on their successive applications for extension of time, time for supply was finally extended up to the 30th of April 1953. 9 Cwt. of this article was inspected on the 16th October 1952 and accepted and dispatched on the 5th December 1952. The second lot consisting of 59½ Cwt. was inspected on the 16th March 1953, and was rejected on the 22nd April 1953, and again offered after some reconditioning on the 30th April 1953, and rejected on the 19th May 1953. The third lot of 150 Cwt. was inspected on the 30th March 1953 and accepted and dispatched on the 17th April 1953. The fourth lot consisting of 188 Cwt. was inspected on the 13th April 1953, and was rejected on the 7th May 1953. The last lot consisting of 93½ Cwt. together with 59½ Cwt. constituting the second lot, were inspected on the 30th April 1953, and rejected on the 19th May 1953. Therefore, the defendant had accepted 159 Cwt., and the balance of 341 Cwt. constitutes the disputed item. The defendant terminated this contract on the ground that the delivery was not made by the 30th April by its letter dated the 1st of May 1953. Before the receipt of this letter, Mr. Bogh the Technical Director of the plaintiff company went over to Kanpur to find out how the test was carried on there and he was given every opportunity to see that on the 1st of May 1953. On his coming back, the letter of cancellation of the contract was gone into, and the plaintiff requested the Kanpur authorities where the tests were to be done, to enable its chemist Mr. Ghosh to come and see for himself why the goods were rejected. Mr. Ghosh came there in the third week of May 1953, and with the help of Drs. Ranganathan and Balakrishnan he saw how the test was carried on. The reconditioned sample which he had brought was tested by the authorities at Kanpur, at the request of the plaintiff by its letter the 22nd May 1953, and on the 30th May the Kanpur authorities wrote to the Inspector in Calcutta, with copy to the plaintiff, that his reconditioned sample was found to conform to the quoted particulars in all respects and is therefore acceptable. There was further correspondence between the plaintiff and the defendant re: the acceptance of the goods but the defendant by its letter dated the 30th September 1953 intimated that its decision as conveyed by its letter dated the 1st of May 1953 was final and cannot be altered and further that the stores offered by the plaintiff were not in accordance with the terms of the Contract for quality. Thereafter the plaintiff served the usual notices on the defendant and the matter had also been referred to arbitration. The Arbitrators however found that under the terms of the contract, the Inspector's decision was to be final and binding on the parties, and, as such, held that they had no jurisdiction to enter into this question of the rejection of the supplies on
the ground that this did not conform to the required specification. The main ground of the plaintiff is that the test made by the Kanpur authorities was not in accordance with the agreement inasmuch as they were carrying out the test by comparing the supplied material with a tinted slip prepared some months ago with the paint from the said sample No. 30/100 and not in the same manner and at the same time as provided for in the Agreement. It was further alleged that the Inspector carried out the inspection capriciously and not in accordance with the said specification. The plaintiff further alleged that the materials were specially manufactured for the purpose of this tender and could not be resold in the market and claimed a sum of Rupees 88,496/- as damages inclusive of storing charges on the basis of the price at which the plaintiff agreed to supply together with a sum of Rs. 5,228/- by way of interest. The total claim was thus laid at Rs. 93,724/-. T
he Union of India contested the suit alleging that time was of the essence of the contract and further that the tests at Kanpur were carried on in accordance with the rules, and that the Inspector’s reports were not at all arbitrary, and that the supplies were not accepted as the same were not of the requisite quality. The learned Subordinate Judge at Alipore held in favour of the defendant on all the points involved and dismissed the suit. Hence this appeal.

S.K. CHAKRAVARTI, J. – 2. Now under the terms of the Agreement the Inspector’s decision as regards rejections aforesaid shall be final and binding on the parties. In this case, as we have already pointed out, the Inspector’s reports are to the effect that the articles are not according to the specification and the shade is lighter than the sample of 30/100 and did not match also the standard olive green scamic 314. Prima facie, therefore, the plaintiff will be bound by it and its claim to damages cannot be entertained. Mr. Rabindra Mohan Mukherjee learned Advocate appearing on behalf of the appellant submits that the Inspector did not apply his mind to the point and merely dittoed what was written by the authorities at Kanpur and, as such his Reports are perverse and arbitrary and cannot bind the parties. In the next place, it has also been urged that the tests which had been urged that the tests which had been made at Kanpur were not in accordance with the Contract, in view of the facts that the tests were not carried on with reference to the accepted sample 30/100 at the time of examination of the contents of the further supplies, but with tints made at a distant time. It has also been urged that the sample 30/100 had already been destroyed.

3. Now, if the contentions or either of them are accepted, then it must be held that the Inspector’s reports would be arbitrary, and it would be open to the plaintiff to challenge the order of rejection prima facie passed on that basis, and the order of rejection would not stand.

4. The Inspector in question, Colonel Pillay has been examined in this case and his evidence would disclose that he did apply his mind. He waited for 3 to 4 days to make up his mind after obtaining the reports from Kanpur and appears to have taken other factors also into consideration. There is no reason to disbelieve his testimony in this respect. There were not proper facilities for testing in Calcutta, and the procedure appears to be to send the same to Kanpur for testing, and on getting their reports, the Inspector in Calcutta was to decide whether the goods were to be accepted or not. Moreover, the tests at Kanpur were carried on by experts namely, Dr. Ranganathan and Dr. Balakrishnan and if the Inspector acted on the basis of such reports, it cannot be said that he did not apply his mind thereto. In the circumstances, we must overrule the contention of Mr. Mukherjee in this respect.
5. As regards the tests at Kanpur it would appear from the evidence of Dr. Ranganathan and Dr. Balakrishnan and specially of the latter that every time a sample of the supply came, they carried on the tests with reference to the sample 30/100 and that they did so even in the case of these three rejected supplies. They have emphatically denied that the sample 30/100 had been destroyed. Mr. Bogh who called on them on the 1st of May 1953 did not at all ask them as to whether that sample 30/100 had been destroyed or not. He only wanted to see how the test was done and it was not necessary therefore, to bring out the sample 30/100 which was kept in safe custody, so to say to show the method of testing. Mr. Bogh in his cross-examination had stated that that sample had been destroyed. As a matter of fact no such complaint in writing was made to the authorities concerned. Mr. I.B. Ghosh the Chief Chemist of the plaintiff firm of course states that he was told that the sample had been destroyed. This fact has been denied by Drs. Ranganathan and Balakrishnan, and the learned Judge appears to have preferred the testimony of the latter gentleman, to that of Mr. Ghosh. We see no reasons to differ from him in the assessment of his evidence. They are responsible Officers and under the rules so long as the Contract is alive they are bound to keep it and it is only when much later they came to know that the Contract had been cancelled they destroyed the sample. As a matter of fact, when Mr. Ghosh called on the Kanpur authorities in May 1953 he took with himself a reconditioned sample. It would appear from the evidence that some amount of black carbon was put in to make the colour a bit darker and thereafter that passed the test. When the second batch of 59½ Cwt. had been rejected, the plaintiff wrote to the authorities concerned that they would supply these things after reconditioning. This fact would also disclose that the supplies which had been made and rejected did not conform to the required specification. It would further appear from the evidence of Mr. Bogh and Mr. Ghosh that they did not carry on the tests in their own laboratories with any cotton Dosuti. As a matter of fact, Mr. Bogh was not aware what cotton Dosuti was, and he asked for a sample of that from the Kanpur authorities. Therefore, the fact that according to the plaintiff's own technical men, these three supplies in question were up to the specification, cannot override the opinion of the Kanpur authorities. Under the terms of the Contract, the test is to be made by applying the sample to a piece of cotton dosootie or sheeting used in the manufacture of tents. That was not done at all by the plaintiff. Mr. Mukherjee has also made grievance of the fact that the Kanpur authorities had carried on the test with a piece of scoured cotton dosootie and not an unsoured one. The evidence of Dr. Balakrishnan would show that they always carry on the test on scoured cotton dosootie and it is cotton dosootie which is mostly used in the manufacturing of tents. Scoured cotton dosootie is also cotton dosootie, and in the circumstances it cannot be said that the test carried on by the Kanpur authorities on scoured cotton dosootie would be inconsistent with the terms of the contract.

6. Mr. Mukherjee has laid stress on the fact that the plaintiff had also got the rejected supplies tested by an expert Mr. Monk and his report and evidence would disclose that the rejected articles were of the same quality as the tender sample 30/100, a duplicate of which had been kept in the plaintiff firm. Mr. Monk carried on his test in the absence of the defendant. He did so also more than three years after the articles had been made and his own evidence would disclose that the articles were not exactly of the same quality as before something having already evaporated. He also did not apply the same to any scoured cotton dosootie or any sheeting used in the manufacture of tents. What is worse, he took samples
from each of the rejected barrels and made a hotchpot of the same, and then made the comparison. The plaintiff had already written to the defendant to offer the 59½ Cwt. after reconditioning and it is quite likely that it was so done. Therefore, we cannot accept the evidence of Mr. Monk in this respect. What is more, as we have already pointed out, the Kanpur authorities had made the tests in accordance with the rules, and found the quality not up to the mark, and the Inspector’s report is based on that and the Inspector also applied his mind to it, and the Inspector’s report in this connection is final and conclusive, and cannot be overruled by Mr. Monk’s opinion.

7. It has further been urged by Mr. Mukherjee that the delivery has been made in time and that the defendant had voluntarily or involuntarily waived the quality and therefore was not competent to reject the supplies. It would appear that Mr. Ghosh went to Kanpur with the reconditioned sample and the Kanpur authorities found it acceptable. Mr. Mukherjee, therefore, submits that the defendant was not therefore right in cancelling the Contract and in refusing to give them any further time to recondition the rejected goods in accordance with the approved sample. Now, the Contract was cancelled on the 1st of May 1953 and the Contract had been made with the Director-General of Supply. The Kanpur authorities cannot extend the time of delivery, and therefore, this point also fails. At no stage was there any waiver of the quality.

8. In this connection Mr. P.K. Sengupta learned Government Advocate points out that the plaintiff did not give sufficient time for inspection even. It would appear from Section 17(2) of the Indian Sale of Goods Act that if the purchase was being made on the basis of a sample, some reasonable time must be given to the purchaser to find out if the goods offered were in accordance with the sample. It would further appear from the evidence that after the goods were manufactured, the plaintiff was to send an intimation to the Inspector in Calcutta and he would take samples and then send the same to Kanpur and there it must be tested and the test alone would take at least three days. All these were within the knowledge of the plaintiff. The plaintiff, however, offered the reconditioned second supply and the 4th and 5th instalments on the 30th April by its letter dated the 29th and the delivery date being the 30th April there was not sufficient time to inspect.

9. Mr. Mukherjee has very strenuously contended that time was not of the essence of the contract and that the respondent was not entitled therefore to cancel the Contract on the 1st of May on the alleged default to make delivery of the goods by the 30th April. It would appear from the Contract itself that time was specifically made of the essence of the Contract. Mr. Mukherjee submits that inasmuch as the time had been extended from time to time, it would appear therefrom that the Union of India did not consider the fixed time to be a condition it was a warranty and nothing more and the action of the Union of India in cancelling the Contract unilaterally was an anticipatory breach, and would entitle the plaintiff to damages. In Gomathi Nayagam v. Palaniswami [AIR 1967 SC 868], it has been laid down that intention to make time of the essence of the contract may be evidenced by either express stipulations or by circumstances which are sufficiently strong to displace the ordinary presumption that in a contract of sale of land stipulations as to the time are not of the essence. In this particular case, as we have already pointed out, there was an express stipulation that time would be of the essence of the Contract. It is no doubt a fact that the
original time for delivery in the Contract namely 15th of October 1952 was extended from time to time or the application express or implied of the plaintiff up to the 30th of April 1953. In its telegram as also letter dated the 2/3rd March 1953 the defendant made it quite clear that there would be no further extension of time. In Md. Habidullah v. Bird and Co. [AIR 1922 PC 178], it has been held by the Privy Council that when after the seller of goods has failed to deliver them at the agreed time the buyer has agreed to an extension of time for delivery, the effect of Section 55 of the Indian Contract Act is that the buyer is entitled to damages computed in the ordinary way, if the seller fails to delivery within the extended time. Mr. Mukherjee, with his usual fairness, has placed before us the aforesaid two decisions and has also relied on Burn & Co. v. Morvi State [AIR 1925 PC 188] and more particularly on Hindusthan Construction Co. v. State of Bihar [AIR 1963 Pat 254]. In Burn & Co. case, the Privy Council, on an interpretation of the terms of the Contract came to the conclusion that the intention of the parties when the Contract was made, was that time should be of the essence of the Contract. In the Hindusthan Construction Co., the court, on an analysis of the terms and specially in view of the facts, that there was a provision for daily damages after the default is made, and the State of Bihar which had the option of determining the Contract did not avail itself of the option, held that time was not of the essence of the Contract. The facts in that case are entirely different from the facts, of the present case wherein the plaintiff had asked for extension of time again and again and the defendant had reluctantly to agree thereto. Even, in this decision it has also been laid down that an intention to make time of the essence of the Contract must be expressed in explicit and unmistakable language in the agreement itself and if by any means such an intention is not explicit, it may be inferred from the antecedent conduct of the parties and surrounding circumstances but not from the subsequent conduct of the parties after the Contract was made. We are therefore, of opinion that in this particular case time was of the essence of the Contract and this time would also include the extended time as agreed upon by both the parties. This term in the agreement was a condition precedent and not a mere warranty.

10. Mr. Mukherjee has also relied on Section 23 of the Sale of Goods Act and submits that as in the month of May the Kanpur authorities found the reconditioned sample to be acceptable, Section 23 would apply. In this case the Contract was cancelled originally by letter dated the 1st of May 1953 as the goods were not delivered by the 30th of September 1953. In that letter it has been stated that the stores offered by the plaintiff were not in accordance with the terms of the Contract for quality and were therefore, rejected. At one stage of the arguments, it was urged on behalf of the appellant that as the Inspector's reports regarding the goods were not available on the 1st May 1953, the authorities had no materials before it under which it would cancel the Contract. In Nune Siwayya v. Maddu [(1935) 62 IA 89, 98 (PC)], it has been held by the Privy Council that in a suit for damages for breach by repudiation of the Contract for the sale of goods, the defendant can rely upon any grounds for repudiation which existed when he repudiated; he is not confined to the ground which he then stated. After the Inspector's reports were made available and showed that the goods were not in accordance with the tender, it was up to the Union of India to take up that ground as well. Mr. Sengupta in this connection has already drawn our attention to Ext. 3-C the condition of Contract. Now the term delivery as defined therein means delivery by the dates specified in the acceptance of tender of stores which are found acceptable by the Inspector and not the
submission of stores which are not to the required standard or which are not delivered by due dates. In this particular case, the goods were not properly delivered by the 30th of April 1953. The goods were not up to the standard, and there was no sufficient time given to Union of India for inspecting the same, as we have already pointed out.

11. Mr. Mukherjee has also submitted that as the defendant also claimed liquidated damages, the defendant was not entitled to cancel the Contract. We are not in a position to accept this contention. In Ext. 3-C it has been specifically laid down that if any stores are rejected, the Secretary shall be at liberty to (a) to allow the Contractor to resubmit the stores within a time specified by himself, (b) buy the quantity of the stores rejected by others of a similar nature elsewhere at the risk and cost of the contract etc. or (c) terminate the contract and recover from the contractor the loss the purchaser thereby incurs. Therefore, it was within the rights of the defendant to terminate the contract. The defendant has not made any attempt to recover the loss if any, he has suffered for the default of the plaintiff. By Ext. 20 the defendant while cancelling the Contract for the supply of the further materials had merely asked the plaintiff to note that right to recover liquidated damages for delayed supply was reserved. There was no claim actually made for liquidated damages. In the subsequent letter (Ext. 51) no such claim was even referred to. In the circumstances, this objection must be overruled.

12. The result, therefore, is that we find that in this case time was of the essence of the contract and that the time was extended up to the 30th of April 1953 by the mutual consent of the parties and that the goods had not been offered or delivered in time, and were also not of the requisite quality. The defendant, therefore, was within its rights to repudiate the contract for the supply of the remaining portion of the goods, and this appeal therefore, must fail.

13. At the same time we must note that we do not find that there has been any deliberate negligence on the part of the plaintiff. They had difficulties of their own, inasmuch as they had to import some of the ingredients, and the defendant itself was also responsible for some delay, inasmuch as, in the month of January it suddenly directed the defendant to supply the goods in galvanized sheets. If the plaintiff’s men had gone over to Kanpur by the 30th April on getting the rejection slip of the second lot, then further troubles might have been avoided. Unfortunately however, its representatives went to Kanpur after the cancellation of the Contract, and it is quite clear from the evidence, that the goods were required very urgently for Military purposes and it was not possible for the defendant to wait any further. We, therefore, dismiss this appeal, but direct that each party will bear its own costs.

* * * * *
DOCTRINE OF CAVEAT EMPTOR

*Jones v. Just*
(1868) 3 Q.B. 197

MELLOR, J. – In this case, it appeared that the plaintiffs, through Messrs. Beneke & Co., their brokers, entered into a contract with the defendant for the purchase of a quantity of Manilla hemp, to arrive... . The shipping documents were duly delivered to the plaintiffs, and the price was paid. All the vessels named in the contract arrived in due course, with the respective numbers of bales of hemp having marks corresponding to those specified in the contract on board; and the bales were delivered to the plaintiffs. On examination of the bales it was found that the whole of those marked J.H.V. were in such a state as to afford strong evidence that they had at some time, probably from a shipwreck when on the voyage from Manilla to Singapore, been wetted through with salt water had afterwards been unpacked and dried, and then repacked in the bales which were afterwards shipped at Singapore.

Manilla hemp is divided into several qualities. The hemp in the bales in question, if in good condition, would have been what is called *fair current Manilla hemp*, which is not the lowest quality; but in all the bales the hemp was damaged to some extent, though not so far as to make it lose the character of hemp. After some correspondence between the parties, the hemp was sold by auction by the plaintiffs' orders as *Manilla hemp, with all faults*, and at the auction it realised about 75 per cent of the price which similar hemp would have fetched if undamaged. The price of hemp had risen considerably since the contract, so that the proceeds of the sale were very nearly equal to the invoice price. There was no attempt to shew that the defendant knew of the state in which the hemp had been shipped at Singapore.

At the close of the plaintiffs' case, Mr. Brett, for the defendant, contended that, in point of law, under this written contract, there was no further condition or warranty than that the bales on their arrival should answer the description of bales of Manilla hemp, which they did, as was proved by the fact that the hemp, though sold with a stigma upon it, fetched a price only 25 per cent, below that of sound hemp; and that as to quality or condition there was no warranty; that consequently the maxim *caveat emptor* applied.

The learned judge expressed an opinion adverse to this view. He said: *I think that the question is for the jury, whether what was supplied under this contract was, when shipped at Singapore, such as to answer the description of reasonably merchantable Manilla hemp, that being the warranty which, I think, the law implies in a contract to supply, as this is: though it would be different in a sale of specific things which the purchaser might examine, or of things sold by sample. And I think the question whether it is fairly and reasonably merchantable, is a question of more or less, which must be left to the jury as reasonable men to determine.* The judge then reserved leave to move to enter the verdict for the defendant, if there was no evidence to go to the jury of a breach of warranty.

Upon this intimation of opinion, the counsel addressed the jury, and the case was left to them substantially to the effect above stated; and the jury were further told that if they found
for the plaintiffs, the damages should be measured by the rate which the hemp was worth when it arrived compared with the rate which the same hemp would have realised, had it been shipped in the state in which it ought to have been shipped: thus, in effect, giving the plaintiffs the benefit of the rise in the market.

Mr. Brett, in the ensuing Term, obtained a rule to enter the verdict for the defendant, pursuant to the leave reserved; or for a new trial, on the ground of misdirection as to the measure of damages, which he contended ought at most to have been the difference between the value of the article actually delivered, viz., fair average Manilla hemp in a damaged state, and the value of sound Manilla hemp of the lowest quality which might have been supplied at Singapore under this contract. The other objections to the direction were substantially only varied modes of putting the point reserved.

We thought that if the contract had the effect which the direction stated it to have, the true measure of the damages was given, as it put the plaintiffs in the position in which they would have been if the contract had been fulfilled; but we took time to consider the question as to what the contract really was, which is no doubt one of importance and difficulty.

After careful consideration, we are of opinion that Blackburn, J.’s direction was substantially correct. On the argument before us, it was contended that the contract was performed on the part of the defendant by the shipping at Singapore of an article which answered the description of “Manilla hemp” although at that time it was so damaged as to have become unmerchantable. It was said that there being no fraud on the part of the vendor, and both parties being equally ignorant of the past history and actual condition of the article contract for, and neither of them having had the opportunity of inspecting it, it was the duty of the vendees to have stipulated for a merchantable article, if that was what they intended to contract for. In other words, it was said that the maxim, caveat emptor, applied in such a case, in the same way as on a sale of a specific article by a person not being the manufacturer or producer, even though the defect was latent and not discoverable upon examination.

We are of opinion that there is a great distinction between the present case and the sale of goods in esse, which the buyer may inspect, and in which a latent defect may exist, although not discoverable on inspection.

The cases which bear upon the subject do not appear to be in conflict, when the circumstances of each are considered. They may, we think, be classified as follows:

First, where goods are in esse, and may be inspected by the buyer, and there is no fraud on the part of the seller, the maxim caveat emptor applies, even though the defect which exists in them is latent, and not discoverable on examination, at least where the seller is neither the grower nor the manufacturer: Parkinson v. Lee [2 East, 314]. The buyer in such a case has the opportunity of exercising his judgment upon the matter; and if the result of the inspection be unsatisfactory, or if he distrusts his own judgment he may if he chooses require a warranty. In such a case, it is not an implied term of the contract of sale that the goods are of any particular quality or are merchantable. So in the case of the sale in a market of meat, which the buyer had inspected, but which was in fact diseased, and unfit for food, although that fact was not apparent on examination, and the seller was not aware of it, it was held that
there was no implied warranty that it was fit for food, and that the maxim caveat emptor applied: *Emmerton v. Mathews* [31 L.J. (Ex.) 139].

Secondly, where there is a sale of a definite existing chattel specifically described, the actual condition of which is capable of being ascertained by either party, there is no implied warranty: *Barr v. Gibson* [3 M. & W. 390].

Thirdly, where a known described and defined article is ordered of a manufacturer, although it is stated to be required by the purchaser for a particular purpose, still if the known, described, and defined thing be actually supplied, there is no warranty that it shall answer the particular purpose intended by the buyer: *Chanter v. Hopkins* [4 M. & W. 399].

Fourthly, where a manufacturer or a dealer contracts to supply an article which he manufactures or produces, or in which he deals, to be applied to a particular purpose, so that the buyer necessarily trusts to the judgment or skill of the manufacturer or dealer, there is in that case an implied term or warranty that it shall be reasonably fit for the purpose to which it is to be applied: *Brown v. Edgington* [2 Man. & G. 279]. In such a case the buyer trusts to the manufacturer or dealer, and relies upon his judgment and not upon his own.

Fifthly, where a manufacturer undertakes to supply goods, manufactured by himself, or in which he deals, but which the vendee has not had the opportunity of inspecting, it is an implied term in the contract that he shall supply a merchantable article: *Laing v. Fidgeon* [4 Camp. 169]. And this doctrine has been held to apply to the sale by the builder of an existing barge, which was afloat but not completely rigged and furnished; there, inasmuch as the buyer had only seen it when built, and not during the course of the building, he was considered as having relied on the judgment and skill of the builder that the barge was reasonably fit for use: *Shepherd v. Pybus* [3 Man. & G. 868].

If, therefore, it must be taken as established that, on the sale of goods by a manufacturer or dealer to be applied to a particular purpose, it is a term in the contract that they shall reasonably answer that purpose, and that on the sale of an article by a manufacturer to a vendee who has not had the opportunity of inspecting it during the manufacture, that it shall be reasonably fit for use, or shall be merchantable, as the case may be, it is difficult to understand why a similar term is not to be implied on a sale by a merchant to a merchant or dealer who has had no opportunity of inspection. Accordingly in the case *Bigge v. Parkinson* [31 L.J. (Ex. 301)] upon a contract to supply provisions and stores to a ship guaranteed to pass the survey of the East India Company's officers, it was held by the Court of Exchequer Chamber that there was an implied term in the contract, that the stores should be reasonably fit for the purpose for which they were to be supplied, notwithstanding that the vendor had specially contracted that they should pass the survey of the East India Company's officers.

We are aware of no case in which the maxim, caveat emptor, has been applied where there has been no opportunity of inspection, or where that opportunity had not been waived. The case of *Gardiner v. Gray* [4 Camp. 144, 145], appears strongly in point to the present. The contract was for the sale of twelve bales of waste silk imported from the continent, and before it was landed samples were shewn to plaintiff's agent, and the bargain was then made, but without reference to the sample. It was purchased in London, and sent to Manchester, and on its arrival there was found to be of a quality not saleable under the denomination of 'waste
Lord Ellenborough expressed his opinion that the purchaser under such circumstances had a right to expect a saleable article answering the description in the contract. Without any particular warranty, this is an implied term in every such contract. Where there is no opportunity to inspect the commodity the maxim, caveat emptor, does not apply.

In general, on the sale of goods by a particular description, whether the vendee is able to inspect them or not, it is an implied term of the contract that they shall reasonably answer such description, and if they do not, it is unnecessary to put any other question to the jury; thus, in *Wieler v. Schilizzi* [25 L.J. (C.P.) 89], and in *Josling v. Kingsford* [32 L.J. (C.P.) 94], the substantial question put to the jury was, did the goods delivered reasonably answer the description in the contract? And the answer of the jury being that they did not, that answer sufficed to determine each case. In one of those cases there was no opportunity to inspect, in the other there was. So in the case of *Nichol v. Godts* [10 Ex. 191], where the contract was for the sale of "foreign refined rape oil, warranted only equal to sample," it was held in an action for not accepting the article tendered, that it was necessary for the vendor to establish that it was not only equal to the sample as to quality, but that it was in fact such an article as answered, the description of foreign refined rape oil. In *Wieler v. Schilizzi*, in which there was no opportunity to inspect, and no express stipulation as to quality, it would have been necessary, had the finding of the jury affirmed that the article delivered did in fact answer the description of "Calcutta linseed," to determine whether the judge ought not to have put the further question, was it reasonably merchantable? It certainly was not determined that such a question would have been wrong, though perhaps the words "tale quale" in that contract might have the effect of excluding any such warranty; and Willes, J., in his judgment [17 C.B. at p. 624], said that the purchaser in that case "had a right to expect, not a perfect article, but an article which would be saleable in the market as Calcutta linseed."

It appears to us that, in every contract to supply goods of a specified description which the buyer has no opportunity to inspect, the goods must not only in fact answer the specific description, but must also be saleable or merchantable under that description. In the words of Lord Ellenborough in *Gardiner v. Gray* [4 Camp. 145], "without any particular warranty this is an implied term in every such contract." In the present case the question appears to be, was the article as delivered at Singapore merchantable or saleable in the market under the description of "Manilla hemp?" Blackburn, J., appears to have divided that question into two, viz.: Was the article, in fact, Manilla hemp? Secondly, was it merchantable? The precise mode of submitting the question is not material, provided the substantial direction was correct, as we think it was.

The counsel for the defendant relied upon a case of *Turner v. Mucklow* [8 Jur. (N.S.) 870], tried before Mellor, J., in the year 1862, at Liverpool. In that case the plaintiffs were calico printers, and had contracted to sell to the defendant, who was a drysalter and dye extract manufacturer, a boat-load of "spent madder." The defendant, not finding the spent madder supplied suitable for his purpose, repudiated the contract, and refused to pay for it. It appeared that the plaintiffs, in their trade as calico printers, used large quantities of madder roots, having extracted from which the finer colouring matter by chemical processes they placed the refuse or spent madder in a large heap in their yard. They occasionally used portions of it, and by the application of other chemical processes extracted from it a colouring
matter called garancine, but they did not manufacture spent madder for sale. On a previous occasion they had sold to the defendants, who was a manufacturer of garancine, a small quantity of spent madder from their accumulation; and on the occasion in question the defendant, by letter, bargained with the plaintiffs for a quantity of their spent madder, which he did not inspect before delivery, and upon a portion of it being used by the defendant for the purpose of manufacturing garancine, it turned out that the garancine produced by it was of very inferior quality and unmarketable. The jury were directed that if the article supplied fairly and reasonably answered the description of "spent madder" there was no implied warranty that it was of any particular quality or fitness for any particular use, and upon that direction the jury found a verdict for the plaintiffs; and upon the argument on a rule which was obtained for a new trial, on the ground of misdirection, the Court of Exchequer held the direction to be right; Martin B., declaring his opinion to be "that no direction was ever more correct."

In that case it is to be observed that the defendant had the opportunity, if he had chosen to avail himself of it, to inspect the heap of spent madder; he knew that it was the refuse madder after it had gone through the plaintiffs' processes, and that it was not manufactured for sale. These circumstances entirely distinguish that case from the present.

The counsel for the defendant also relied upon the statute 19 & 20 Vict. c. 60, s. 50 [19 & 20 Vict. c. 60, s. 5]: "Where goods shall after the passing of this act be sold, the seller, if at the time of the sale he was without knowledge that the same were defective or of bad quality, shall not be held to have warranted their quality or sufficiency, but the goods with all faults shall be at the risk of the purchaser, unless the seller shall have given an express warranty of the quality or sufficiency of such goods, or unless the goods have been expressly sold for a specified and particular purpose, in which case the seller shall be considered without such warranty to warrant that the same are fit for such purpose." [This statute applies only to Scotland], as a sort of implied legislative declaration of the law of England upon that subject in favour of his argument; but, upon examining the section referred to, it does not appear to bear out that view, for all that it declares is, that a seller of goods, without knowledge that they are defective or of bad quality, shall not be held to have warranted their quality or sufficiency.

It has already appeared that there is not in general, on the sale of goods in England to be supplied, an implied warranty that they shall be of any particular quality or sufficiency for any particular purpose, but merely that they shall be merchantable goods of the description bargained for. The present case depends on the distinction between a sale of particular articles and a contract to supply articles of a particular kind.

The authority of Chancellor Kent [Kent's Commentaries, vol. II; p. 479 of the 6th ed., the last by the author himself. 11th ed., pp. 633-635] was also appealed to; but as the American cases which he cites are generally adverse to his opinion, it can at most be said that the opinion of an eminent writer is opposed to the authority of the cases which he cites.

It appears to us, in the result of this case, that the maxim of caveat emptor cannot apply, and that it must be assumed that the buyer and seller both contemplated a dealing in an article which was merchantable. The buyer bought for the purpose of sale, and the seller could not
on any other supposition than that the article was merchantable have found a customer for his goods, and the buyer must be taken to have trusted to the judgment, knowledge, and information of the seller, as it is clear that he could exercise no judgment of his own; and this appears to us to be at the root of the doctrine of implied warranty, and that in this view it makes no difference, whether the sale is of goods specially appropriated to a particular contract, or to goods purchased as answering a particular description.

It was contended further by the defendant’s counsel that the shippers at Singapore were the persons who selected the goods in question, and that the defendant, who merely sold them to arrive, was as little aware of their true condition when shipped as the plaintiffs; but it is clear that the defendant, if not directly connected with the shippers as his correspondents, must at least have purchased from them, and had recourse against them for not supplying an article reasonably merchantable.

The remarks of Cockburn, C.J., on the argument in Bigge v. Parkinson [H. 7 & N. at p. 959], though not in terms repeated by him in delivering the judgment of the Court of Exchequer Chamber, are really involved in it, and are very closely in point here.

We are therefore of opinion that Blackburn, J.’s direction was right, and that this rule must be discharged.

* * * * *
Richard Thorold Grant v. Australian Knitting Mills, Ltd.

AIR 1936 PC 34
[Section 16 - Reliance by buyer on seller’s skill]

The appellant was a fully qualified medical man practising at Adelaide in South Australia. He brought his action against the respondent, claiming damages on the ground that he had contracted dermatitis by reason of the improper condition of underwear purchased by him from the respondents, John Martin & Co., Ltd., and manufactured by the respondents, the Australian Knitting Mills, Limited; the case was tried by Sir George Murray, Chief Justice of South Australia, who after a trial lasting for 20 days gave judgment against both respondents for the appellant for £2,450 and costs. On appeal the High Court of Australia set aside that judgment by a majority. Evatt, J., dissented, and agreed with the Chief Justice. Of the majority, the reasoning of Dixon, J., with whom McTiernan, J., concurred, was in effect that the evidence was not sufficient to make it safe to find for the appellant. Starke, J., who accepted substantially all the detailed findings of the Chief Justice, differed from him on his general conclusions of liability based on these findings. The appellant’s claim was that the disease was caused by the presence in the cuffs or ankle ends of the underpants which he purchased and wore, of an irritating chemical, viz., free sulphite, the presence of which was due to negligence in manufacture, and also involved on the part of the respondents, John Martin & Co., Ltd., a breach of the relevant implied conditions under the Sale of Goods Act.

The underwear, consisting of two pairs of underpants and two singlets, was bought by the appellant at the shop of the respondents, John Martin & Co., Ltd., who dealt in such goods and who will be hereafter referred to as the retailers, on 3rd June 1931; the retailers had in ordinary course at some previous date purchased them with other stock from the respondents, the Australian Knitting Mills, Ltd., who will be referred to as the manufacturers; the garments were of that class of the manufacturers’ make known as Golden Fleece. The appellant put on one suit on the morning of Sunday, 28th June 1931; by the evening of that day he felt itching on the ankles but no objective symptoms appeared until the next day, when a redness appeared on each ankle in front over an area of about 2½ inches by 1½ inches. The appellant treated himself with calomine lotion, but the irritation was such that he scratched the places till he bled. On Sunday, the 5th July, he changed his underwear and put on the other set which he had purchased from the retailers; the first set was washed and when the appellant changed his garments again on the following Sunday he put on the washed set and sent the others to the wash; he changed again on 12th July. Though his skin trouble was getting worse he did not attribute it to the underwear, but on the 13th July he consulted a dermatologist, Dr. Upton, who advised him to discard the underwear, which he did, returning the garments to the retailers with the intimation that they had given him dermatitis; by that time one set had been washed twice and the other set once. The appellant’s condition got worse and worse; he was confined to bed from 21st July for 17 weeks; the rash became generalised and very acute. In November, he became convalescent and went to New Zealand to recuperate. He returned in the following February and felt sufficiently recovered to resume his practice, but soon had a relapse and by March his condition was so serious that he went in April into hospital where he remained until July. Meantime in April 1932, he commenced this action, which was tried in and after November of that year. Dr. Upton was his medical attendant throughout and
explained in detail at the trial the course of the illness and the treatment he adopted. Dr. de Crespigny also attended the appellant from and after 22nd July 1931, and gave evidence at the trial. The illness was most severe, involving acute suffering and at times Dr. Upton feared that his patient might die.

LORD WRIGHT, J. – It is impossible here to examine in detail the minute and conflicting evidence of fact and of expert opinion given at the trial: all that evidence was meticulously discussed at the hearing of the appeal before the Board. It is only possible to state briefly the conclusions at which their Lordships after careful consideration have arrived. In the first place, their Lordships are of opinion that the disease was of external origin. Much of the medical evidence was directed to supporting or refuting the contention strenuously advanced on behalf of the respondents that the dermatitis was initially produced and was of the type described as herpetiformis, which is generally regarded as of internal origin. That contention may now be taken to have failed: it has been rejected by the Chief Justice at the trial and in the High Court, by Starke and Evatt, JJ., and, in effect also, by Dixon and McTiernan, JJ. The evidence as to the symptoms and course of the disease given by the two doctors who attended the appellant is decisive: dermatitis herpetiformis is an uncommon disease, of a type generally not so severe as that suffered by the appellant, and presenting in general certain characteristic features, in particular, bullae or blisters and symmetrical grouping of the inflammatory features, which were never present in the appellant. Dr. Wigley, a very eminent dermatologist, who examined the appellant, and as an expert gave evidence in support of the doctors who actually attended him, expressed his opinion that all dermatitis had no external origin, but whether he was right in this or not, he was confident that in the appellant’s case the origin of the disease was external and on all the evidence their Lordships accept this view.

But then it was said that the disease may have been contracted by the appellant from some external irritant the presence of which argued no imperfection in the garments but which only did harm because of the appellant’s peculiar susceptibility. Thus the disease might have been initiated by the mechanical irritation of the wool itself or if it was due to some chemical ingredient in the garments, that might have been something in itself harmless, either because of its character or because of the actual quantity in which it was present, so that the mischief was attributable to the appellant’s own physical defect and not to any defect in the garments; the respondents, it was said, could not be held responsible for anything in the garments which would not be harmful in normal use. Two issues were thus involved: one, was the appellant’s skin normal, and the other, was there in the garments or any part of them a detrimental quantity of any mischievous chemical? The Chief Justice held that the appellant’s skin was normal. He had habitually up to the material time worn woolen undergarments without inconvenience; that he was not sensitive to the mechanical effects of wool seemed to be proved by an experiment of his doctors who placed a piece of scoured wool on a clear area on his skin and found that after a sufficient interval no trace of irritation being produced. It was said that he had suffered from tuberculosis some years before and that the disease had merely been arrested, not eliminated, and it was then said that tuberculosis made the patient more susceptible to skin disease, because it weakens the resistance of the skin and lowers the patient’s vitality. But this contention did not appear to be established. It was admitted that the appellant’s skin had by reason of his illness become what is denominated allergic, that
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is, unduly sensitised to the particular irritant from which he had suffered; but that could throw no light on the original skin condition. A point was made that a skin ordinarily normal might transiently and unexpectedly show a peculiar sensitivity, but that remained a mere possibility which was not developed and may be ignored. In the result there does not seem any reason to differ from the Chief Justice's finding that the appellant's skin was normal.

What then caused this terrible outbreak of dermatitis? The place and time of the original infection would seem to point to the cause being something in the garments, and in particular to something in the ankle ends of the underpants, because the inflammation began at the front of the shins where the skin is drawn tight over the bone, and where the cuff of the pants presses tightly under the socks against the skin, and began about nine or ten hours after the pants were first put on: the subsequent virulence and extension of the disease may be explained by the toxins produced by the inflammation getting into the blood stream. But the coincidence, it was pointed out, was not sufficient proof in itself that the pants were the cause. The appellant then relied on the fact that it was admitted in the respondents' Answers to Interrogatories that the garments when delivered to the retailer by the manufacturers contained sulphur dioxide, and on the fact that the presence of sulphur dioxide indicated the presence of free sulphites in the garment. If there were in a garment worn continuously all day next the skin free sulphites in sufficient quantities, a powerful irritant would be set in operation. Sweat is being slowly and continuously secreted by the skin, and combines with the free sulphites to form successively sulphur dioxide, sulphurous acid and sulphuric acid: sulphuric acid is an irritant which would produce dermatitis in a normal skin if applied in garments under the conditions existing when the appellant wore the underpants. It is a fair deduction from the Answers and form the evidence that free sulphites were present in quantities not to be described as small, but that still left the question whether they were present in quantities sufficient to account for the disease. It is impossible now and was impossible at any time after the garments were washed to prove what quantities were present when the garments were sold. That can only be inferred from various considerations. The garments were in July 1931 handed back to the retailers and by them sent back to the manufacturers. In November 1931 Mr. Anderson, of Victoria an analytical chemist, on the instructions of the manufacturers analysed one half of one of the pants to ascertain what quantity of water soluble salts they contained and found certain quantities of sulphates but sulphates would not irritate the skin. In the following May, Mr. Anderson made a further analysis of the other three garments and of the remaining half of the pair of pants: he was testing for sulphites, which he expressed in terms of sulphur dioxide percentage by weight. In one singlet he found a nil return, in the other 0.0070; in the pants he found 0.0082 in one and 0.0201 in the other. There was some debate whether these figures were of free sulphites, or of sulphites adherent to the wool molecule, and not soluble by sweat. Their Lordships, after careful consideration and for a variety of reasons do not differ from the conclusion of the Chief Justice that these results proved the presence of free sulphite. But the results were not such as to show quantities likely to cause irritation. On the other hand, a very eminent scientist, Professor Hicks, called by the appellant, gave his opinion that the garments before washing must have had sulphites in considerably greater quantity: and these tests of Mr. Anderson were of each garment as a whole, whereas it was clear that the relevant parts in
each pair of pants were the ankle ends since the disease was initiated at that point in each leg. It is clear that no further light could be thrown by fresh analysis of the actual garments.

Evidence was given on behalf of the manufacturers as to the processes used in the manufacture of these garments. The webs of wool were put through six different processes: of these the second, third and fourth, were the most significant for this case. The second was for shrinking and involved treatment of the web with a solution of calcium hypochloride and hydrochloric acid. The third process was to remove these chemicals by a solution of bisulphite of soda, and the fourth process was to neutralise the bisulphite by means of bicarbonate of soda; the fifth process was for washing and the sixth was a drying and finishing process. If the fourth process did not neutralise the added bisulphite, free sulphites would remain, which the subsequent washing might not entirely remove. The manufacturers' evidence was that the process was properly applied to the wool from which these garments were made and if properly applied was bound to be effective. The foreman scourer Smith was not called at the trial, where his absence was made matter of comment, but Ashworth, one of the scourers, gave evidence and among other things said that they had to be very careful that there was no excess of one chemical or the other. If there were an excess of some sort or the other, it would be bound to be somebody's fault. The washing off was to clear out as much of the traces of the previous process as possible. But something might go wrong, someone might be negligent and as a result some bisulphite of soda which had been introduced might not have been got rid of. The cuffs of the pants were ribbed and were made of a different web separately treated. The appellant's advisers had at the trial no independent information as to the actual process adopted in respect of these garments or even when they were made and, by petition, they asked for leave to adduce further evidence which would go to show, as they suggested, that the process deposed to was not adopted by the manufacturers until after 3rd June 1931. Their Lordships however feel themselves in a position to dispose of the appeal on the evidence as it stands taking due account of the fact that the manufacturers' secretary was called and deposed that in the previous six years the manufacturers had treated by a similar process 4,737,600 of these garments, which they had sold to drapers throughout Australia and he had no recollection of any complaints, which if made would in ordinary course have come under his notice. Dr. Hargreaves, an analytical chemist, on the instructions of the manufacturers analysed specimen garments, subjecting them to tests which would extract any sulphur adherent to the wool as well as free sulphites, if any were present, and found only negligible quantities. Against this evidence was that of Professor Hicks who agitated in unheated water for two minutes a singlet of the manufacturers' Golden Fleece make, purchased in November 1932, and found that the aqueous extract contained a percentage by weight of sulphite of 0.11 which in his opinion was free in the fabric and readily soluble in cold water. The significance of this experiment seems to be that however well designed the manufacturers' proved systems may be to eliminate deleterious substances it may not invariably work according to plan. Some employee may blunder.

Mr. Greene for the respondents quite rightly emphasised how crucial it would have been for the appellant's case to prove by positive evidence that in fact the garments which the appellant wore, contained an excess of free sulphites. He contended that the appellant's case involved arguing in a circle; his argument, he said, was that the garments must have caused
the dermatitis because they contained excess sulphites, and must have caused the disease: but
ought, he said, added to nought still is no more than nought. This, however, does not do
justice either to the process of reasoning by way of probable inference which has to do so
much in human affairs or to the nature of circumstantial evidence in law Courts.
Mathematical, or strict logical demonstration is generally impossible: juries are in practice
told that they must act on such reasonable balance of probabilities as would suffice to
determine a reasonable man to take a decision in the grave affairs of life. Pieces of evidence,
each by itself insufficient, may together constitute a significant whole, and justify by their
combined effect a conclusion. Dixon, J., in the judgment in which he dissented from that of
the Chief Justice, does not seem to suggest that there was no evidence for a decision in the
appellant’s favour but merely that it was not safe so to decide. But the coincidences of time
and place and the absence of any other explanation than the presence of free sulphite in the
garments, point strongly in favour of the appellant’s case: it is admitted as has been said
above that some sulphites were present in the garments, and there is nothing to exclude the
possibility of a quantity sufficient to do the harm. On the whole there does not seem adequate
reason to upset the judgment on the facts of the Chief Justice. No doubt, this case depends in
the last resort (be it inference to be drawn from retailers evidence, though on much of the
circumstances and evidence the trial judge had) by the advantage of seeing and hearing the
witnesses. The plaintiff must prove his case but there is an onus on a defendant who, on
appeal, contends that a judgment should be upset: he has to show that it is wrong. Their
Lordships are not satisfied in this case that the Chief Justice was wrong.

That conclusion means that the disease contracted and the damage suffered by the
appellant were caused by the defective condition of the garments which the retailers sold to
him and which the manufacturers made and put forth for retail and indiscriminate sale. The
Chief Justice gave judgment against both respondents, against the retailers on the contract of
sale and against the manufacturers in tort, on the basis of the decision in the House of Lords
in 1932 AC 562(1). The liability of each respondent depends on a different cause of action,
though it is for the same damage. It is not claimed that the appellant should recover his
damage twice over; no objection is raised on the part of the respondents to the form of the
judgment which was against both respondents for a single amount. So far as concerns the
retailers, Mr. Greene contends that if it were held that the garments contained improper
chemicals and caused the disease, the retailers were liable for breach of implied warranty, or
rather condition under S. 14. South Australia Sale of Goods Act, 1895, which is identical
with S. 14, English Sale of Goods Act, 1893. The section is in the following terms:

§14. Subject to the provisions of this Act, and of any Statute in that behalf, there
is no implied warranty or condition as to the quality or fitness for any particular
purpose of goods supplied under a contract of sale, except as follows:

I. Where the buyer, expressly or by implication, makes known to the seller the
particular purpose for which the goods are required, so as to show that the buyer
relies on the seller's skill or judgment, and the goods are of a description which it is
in the course of the seller's business to supply (whether he be the manufacturer or
not), there is an implied condition that the goods shall be reasonably fit for such
purpose: provided that in the case of a contract for the sale of a specified article under its patent or other trade name, there is no implied condition as to its fitness for any particular purpose:

II. Where the goods are bought by description who deals in goods of that description (whether he be manufacturer or not), there is implied condition that the goods shall be of merchantable quality; provided that if the buyer has examined the goods, there shall be no implied condition as regards defects which such examination ought to have revealed;

III. An implied warranty or condition as to quality or fitness for a particular purpose may be annexed by the usage of trade;

IV. An express warranty or condition does not negative a warranty or condition implied by this Act unless inconsistent therewith.

He limited his admission to liability under exception (ii), but their Lordships are of opinion that liability is made out under both exception (i) and exception (ii) to S. 14, and feel that they should so state out of deference to the views expressed in the Court below. S. 14 begins by a general enunciation of the old rule of caveat emptor and proceeds to state by way of exception the two implied conditions by which it has been said the old rule has been changed to rule of caveat vendor; the change has been rendered necessary by the conditions of modern commerce and trade. There are numerous cases on the section, but as these were cited below it is not necessary to detail them again. The first exception, if its terms are satisfied, entitles the buyer to the benefit of an implied condition that the goods are reasonably fit for the purpose for which the goods are supplied but only if that purpose is made known to the seller so as to show that the buyer relies on the seller’s skill or judgment. It is clear that the reliance must be brought home to the mind of the seller, expressly or by implication. The reliance will seldom be express; it will usually arise by implication from the circumstances; thus to take a case like that in question of a purpose from a retailer the reliance will be in general inferred from the fact that a buyer goes to the shop in the confidence that the tradesman has selected his stock with skill and judgment; the retailer need know nothing about the process of manufacture; it is immaterial whether he be manufacturer or not; the main inducement to deal with a good retail shop is the expectation that the tradesman will have brought the right goods of a good make; the goods sold must be, as they were in case goods of a description which it is in the course of the seller’s business to supply; there is no need to specify in terms the particular purpose for which the buyer requires the goods; which is nonetheless the particular purpose within the meaning of the section because it is the only purpose for which anyone would ordinarily want the goods. In this case the garments were naturally intended and only intended to be worn next the skin. The proviso does not apply to a case like the sale of Golden Fleece make such as is here in question, because Golden Fleece is rather a patent or trade name within the meaning of the proviso to Excep. (i). With great deference to Dixon, J. their Lordships think that the requirements of Excep. (i) were complied with. The conversation at the shop in which the appellant discussed questions of price and of
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the different makes did not affect the fact that he was substantially relying on the retailers to supply him with a correct article.

The second exception in a case like this in truth overlaps in its application the first exception; whatever else merchantable may mean it does mean that the article sold, if only meant for one particular use in ordinary course, is fit for that use; merchantable does not mean that the thing is saleable in the market simply because it looks all right. It is not merchantable in that event if it has defects unfitting it for its only proper use but not apparent on ordinary examination: that is clear from the proviso, which shows that the implied condition only applies to defects not reasonably discoverable to the buyer on such examination as he made or could make. The appellant was satisfied by the appearance of the underpants; he could not detect and had no reason to suspect the hidden presence of the sulphites; the garments were saleable in the sense that the appellant or anyone similarly situated and who did not know of their defect, would readily buy them but they were not merchantable in the statutory sense because their defect rendered them unfit to be worn next the skin. The proviso to Excep. (ii) does not apply where, as in this case, no examination that the buyer could or would normally have made would have revealed the defect. In effect the implied condition of being fit for the particular purpose for which they are required and implied condition of being merchantable produce in cases of this type the same result. It may also be pointed out that there is a sale by description even though the buyer is buying something displayed before him on the counter: a thing is sold by description, though it is specific, so long as it is sold not merely as the specific thing but as a thing corresponding to a description, e.g., woolen under garments, a hot water bottle, a second-hand reaping machine, to select a few obvious illustrations.

The retailers accordingly in their Lordships’ judgment are liable in contract: so far as they are concerned, no question of negligence is relevant to the liability in contract. But when the position of the manufacturers is considered, different questions arise: there is no privity of contract between the appellant and the manufacturers: between them the liability, if any, must be in tort, and the gist of the cause of action is negligence. The facts set out in the foregoing show in their Lordships’ judgment negligence in manufacture. According to the evidence, the method of manufacture was correct; the danger of excess sulphites being left was recognised and was guarded against: the process was intended to be fool proof. If excess sulphites were let in the garment, that could only be because someone was at fault. The appellant is not required to lay his finger on the exact person in all the chain who was responsible or to specify what he did wrong. Negligence is found as a matter of inference from the existence of the defects taken in connexion with all the known circumstances: even if the manufacturers could by apt evidence have rebutted that inference they have not done so.

On this basis, the damage suffered by the appellant was caused in fact (because the interposition of the retailers may for this purpose in the circumstances of the case be disregarded) by the negligent or improper way in which the manufacturers made the garments. But this mere sequence of cause and effect is not enough in law to constitute a cause of action in negligence, which is a complex concept, involving a duty as between the parties to take care, as well as a breach of that duty and resulting damage. It might be said that here was no relationship between the parties at all: the manufacturers, it might be said, parted once and for all with the garments when they sold them to the retailers and were
therefore not concerned with their future history, except in so far as under their contract with the retailers they might come under some liability: at no time, it might be said, had they any knowledge of the existence of the appellant: the only peg on which it might be sought to support a relationship of duty was the fact that the appellant had actually worn the garments, but he had done so because he had acquired them by a purchase from the retailers, who were at that time the owners of the goods, by a sale which had vested the property in the retailers and divested both property and control from the manufacturers. It was said there could be no legal relationships in the matter save those under the two contracts, between the respective parties of those contracts, the one between the manufacturers and the retailers and the other between the retailers and the appellant. These contractual relationships (it might be said) covered the whole field and excluded any question of tort liability: there was no duty other than the contractual duties. This argument was based on the contention that the present case fell outside the decision of the House of Lords in 1932 AC 562 (1). Their Lordships, like the Judges in the Courts in Australia, will follow that decision, and the only question here can be what that authority decides and whether this case comes within its principles. In 1932 AC 562 (1) the defendants were manufacturers of ginger beer which they bottled: the pursuer had been given one of their bottles by a friend who had purchased it from a retailer who in turn had purchased from the defenders. There was no relationship between pursuer and defenders except that arising from the fact that she consumed the ginger beer they had made and bottled. The bottle was opaque so that it was impossible to see that it contained the decomposed remains of a snail: it was sealed and stoppered so that it could not be tampered with until it was opened in order to be drunk. The House of Lords held these facts established in law a duty to take care as between the defenders and the pursuer. Their Lordships think that the principle of the decision is summed up in the words of Lord Atkin at p. 599:

A manufacturer of products, which he sells in such a form as to show that he intends them to reach the ultimate consumer in the form in which they left him with no reasonable possibility of intermediate examination, and with the knowledge that the absence of reasonable care in the preparation or putting up of the products will result in an injury to the consumer’s life or property, owes a duty to the consumer to take that reasonable care.

This statement is in accord with the opinions expressed by Lord Thankerton and Lord Macmillan, who in principle agreed with Lord Atkin. In order to ascertain whether the principle applies to the present case, it is necessary to define what the decision involves and consider the points of distinction relied upon before their Lordships. It is clear that the decision treats negligence, where there is a duty to take care, as a specific tort in itself, and not simply as an element in some more complex relationship or in some specialised breach of duty, and still less as having any dependence on contract. All that is necessary as a step to establish the tort of actionable negligence is to define the precise relationship from which the duty to take care is to be deduced. It is however essential in English law that the duty should be established: the mere fact that a man is injured by another’s act gives in itself no cause of action: if the act is deliberate, the party injured will have no claim in law even though the injury is intentional, so long as the other party is merely exercising a legal right: if the act involves lack of due care, again no case of actionable negligence will arise unless the duty to
be careful exists. In 1932 AC 562, the duty was deduced simply from the facts relied on, viz., that the insured party was one of a class for whose use, in the contemplation and intention of the makers, the article was issued to the world, and the article was used by that party in the state in which it was prepared and issued without it being changed in any way and without there being any warning of, or means of detecting, the hidden danger: there was, it is true, no personal intercourse between the maker and the user; but though the duty is personal, because it is inter partes, it needs no interchange of words, spoken or written, or signs of offer or assent; it is thus different in character from any contractual relationship; no question of consideration between the parties is relevant; for these reasons the use of the word "privity" in this connexion is apt to mislead because of the suggestion of some overt relationship like that in contract, and the word "proximity" is open to the same objection; if the term proximity is to be applied at all, it can only be in the sense that the want of care and the injury are in essence directly and intimately connected; though there may be intervening transactions of sale and purchase and intervening handling between these two events, the events are themselves unaffected by what happened between them; proximity can only properly be used to exclude any element of remoteness, or of some interfering complication between the want of care and the injury, and like "privity" may mislead by introducing alien ideas. Equally also may the word "control" embarrass, though it is conveniently used in the opinions in 1932 AC 562(1) to emphasise the essential factor that the consumer must use the article exactly as it left the maker, that is in all material features, and use it as it was intended to be used.

In that sense the maker may be said to control the thing until it is used. But that again is an artificial use, because, in the natural sense of the word, the makers parted with all control when they sold the article and divested themselves of possession and property. An argument used in the present case based on the word "control" will be noticed later. It is obvious that the principles thus laid down involve a duty based on the simple facts detailed above, a duty quite unaffected by any contracts dealing with the thing, for instance, of sale by maker to retailer, and again by retailer to consumer or to the consumer’s friend. It may be said that the duty is difficult to define, because when the act of negligence in manufacture occurs there was no specific person towards whom the duty could be said to exist: the thing might never be used: it might be destroyed by accident or it might be scrapped, or in many ways fail to come into use in the normal way: in other words the duty cannot at the time of manufacture be other than potential or contingent and only can become vested by the fact of actual use by a particular person.

One further point may be noted. The principle of (1932) AC 562 can only be applied where the defect is hidden and unknown to the consumer, otherwise the directness of cause and effect is absent: the man who consumes or uses a thing which he knows to be noxious cannot complain in respect of whatever mischief follows because it follows from his own conscious volition in choosing to incur the risk or certainty of mischance. If the foregoing are the essential features of (1932) AC 562, they are also to be found, in their Lordships’ judgment, in the present case. The presence of the deleterious chemical in the pants, due to negligence in manufacture, was a hidden and latent defect, just as much as were the remains of the snail in the opaque bottle; it could not be detected by any examination that could reasonably be made. Nothing happened between the making of the garments and their being
worn to change their condition. The garments were made by the manufacturers for the purpose of being worn exactly as they were worn in fact by the appellant: it was not contemplated that they should be first washed. It is immaterial that the appellant has a claim in contract against the retailers, because that is a quite independent cause of action, based on different considerations, even though the damage may be the same. Equally irrelevant is any question of liability between the retailers and the manufacturers on the contract of sale between them. The tort liability is independent of any question of contract.

It was argued, but not perhaps very strongly, that (1932) AC 562 was a case of food or drink to be consumed internally, whereas the pants here were to be worn externally. No distinction, however can be logically drawn for this purpose between a noxious thing taken internally and a noxious thing applied externally: the garments were made to be worn next the skin: indeed Lord Atkin specifically puts as examples of what is covered by the principle he is enunciating things operating externally, such as a noxious ointment, a soap, a cleaning fluid or cleaning powder. Mr. Greene, however sought to distinguish (1932) AC 562 from the present on the ground that in the former the makers of the ginger beer had retained "control" over it in the sense that they had placed it in stoppered and sealed bottles, so that it would not be tampered with until it was opened to be drunk, whereas the garments in question were merely put into paper packets, each containing six sets, which in ordinary course would be taken down by the shopkeeper and opened and the contents handled and disposed of separately so that they would be exposed to the air. He contended that though there was no reason to think that the garments when sold to the appellant were in any other condition, least of all as regards sulphur contents, that when sold to the retailers by the manufacturers, still the mere possibility and not the fact of their condition having been changed was sufficient to distinguish (1932) AC 562: there was no "control" because nothing was done by the manufacturers to exclude the possibility of any tampering while the goods were on their way to the user. Their Lordships do not accept that contention. The decision in (1932) AC 562 did not depend on the bottle being stoppered and sealed: the essential point in this regard was that the article should reach the consumer or user subject to the same defect as it had when it left the manufacturer. That this was true of the garment is in their Lordships' opinion beyond question. At most there might in other cases be a greater difficulty of proof of the fact.

Mr. Greene further contended on behalf of the manufacturers that if the decision in (1932) AC 562 were extended even a hairsbreadth, no line could be drawn and a manufacturer's liability would be extended indefinitely. He put as an illustration the case of a foundry which had cast a rudder to be fitted on a liner: he assumed that it was fitted and the steamer sailed the seas for some years: but the rudder had a latent defect due to faulty and negligent casting and one day it broke, with the result that the vessel was wrecked, with great loss of life and damage to property. He argued that if (1932) AC 562 were extended beyond its precise facts, the maker of the rudder would be held liable for damages of an indefinite amount, after an indefinite time and to claimants indeterminate until the event. But it is clear that such a state of things would involve many considerations far removed from the simple facts of this case. So many contingencies must have intervened between the lack of care on the part of the makers and the casualty that it may be that the law would apply, as it does in proper cases, not always according to strict logic, the rule that cause and effect must not be too remote: in any
case the element of directness would obviously be lacking. Lord Atkin deals with that sort of question in (1932) AC 562, 591, where he quotes the common sense opinion of Mathew, LJ:

   It is impossible to accept such a wide proposition, and, indeed, it is difficult to see how, if it were the law, trade could be carried on.

   In their Lordships’ opinion it is enough for them to decide this case on its actual facts. No doubt many difficult problems will arise before the precise limits of the principle are defined: many qualifying conditions and many complications of fact may in the future come before the Courts for decision. It is enough now to say that their Lordships hold the present case to come within the principle of (1932) AC 562 and they think that the judgment of the Chief Justice was right and should be restored as against both respondents and that the appeal should be allowed with costs here and in the Courts below, and that the appellant’s petition for leave to adduce further evidence should be dismissed without costs. They will humbly so advise His Majesty.

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EFFECTS OF THE CONTRACT

Passing of Property

CIT v. Mysore Chromite Ltd.

(1955) 1 SCR 849 : AIR 1955 SC 98

S.R. DAS, J. - This is an appeal from the judgment pronounced by the High Court of Judicature at Madras on 29th March, 1951 on a consolidated reference by the Income Tax Appellate Tribunal under Section 66(1) of the Income Tax Act whereby the High Court answered in the affirmative both the referred questions which were expressed in the following terms:

(1) Whether on the facts and in the circumstances of the case the profits derived by the assessee company from sales made to European and American buyers arose outside British India?

(2) Whether on the facts and in the circumstances of the case the profits derived by the assessee company from sales made to European and American buyers were received outside British India?

3. The assessee company is a private limited company registered in the Mysore State under the Mysore Company Regulations and has its registered office at Sinduvalli in Mysore State. The management and control of the assessee company was vested in Messrs Oakley Bowden & Co. (Madras) Ltd., another private limited company incorporated under the Indian Companies Act, having its registered office at No. 15, Armenian Street, Madras. The assessee company owns chromite mines in Mysore State. Chrome ores are extracted from the mines and converted into a merchantable product and then sold to buyers mostly outside India. A very small proportion of the total sales is effected in India and for the purposes of this case may be left out of consideration. The sales are mostly to buyers in America and Europe. The sales to the purchasers in Europe are put through in London by Bowden Oakley & Co. Ltd., London. The sales to purchasers in America are effected through Messrs W.R. Grace & Co., who buy for undisclosed principals. The contracts for sale to American purchasers are signed by W.R. Grace & Co., presumably in America and by Oakley Bowden & Co. (Madras) Ltd., in Madras. Specimen forms of contracts with European purchasers and those with American purchasers are set out in the order of the Tribunal dated 22nd January, 1948 out of which the present reference arises. Under both forms of contracts the price was F.O.B. Madras or Marmagoa. A very small quantity of goods was sold F.O.B. Marmagoa and the same need not be considered here. Provision was made for weighment, sampling and assay of goods at destination.
4. The course of dealing as found by the Appellate Tribunal was as follows: Before the goods were actually shipped, the buyers used to open a confirmed irrevocable Bankers' credit with some first class bank in London. Being informed of the opening of such credit the Eastern Bank Ltd., London sent intimation to the Eastern Bank Ltd., Madras, and the latter in its turn used to pass on the intimation by letter addressed to the assessee company. A specimen of such letter is also set out in the order of the Appellate Tribunal. In such communication the Eastern Bank Ltd., Madras, informed the assessee company that in accordance with advices received by letter from our London Office, a confirmed and irrevocable credit has been opened in your favour by Messrs Morgan Grenfell & Co., Ltd., London, for account of Messrs W.R. Grace & Co., New York, for a sum not exceeding £7300 (seven thousand three hundred pounds sterling) in all, available by delivery to us on or before 15th January, 1940 of the following documents: … Towards the end of the letter the Eastern Bank Ltd., Madras used to write that they were prepared in our options as customary to negotiate drafts drawn in terms of the arrangement provided that the documents as abovementioned appear to us to be in order. The letter concluded with a warning that the advice was given for your guidance and without involving any responsibility on the part of this Bank. On receipt of such intimation the assessee company placed the contracted goods on board the steamer at Madras and obtained a bill of lading in its own name. As already mentioned, the shipments were made principally at Madras Port. Thereafter the assessee company used to make out a provisional invoice on the basis of the bill of lading weight and contract price for 48 per cent Cr. 203 and used to draw a bill of exchange on the buyers' Bank, where the letter of credit had been opened, for 90 per cent of the amount of the provisional invoice payable at sight in the case of European contracts and 80 per cent of the amount of the provisional invoice at 90 days' sight in the case of American contracts and in either case the bills of exchange used to be drawn in favour of the Eastern Bank Ltd., London. The bill of exchange together with the relative bill of lading endorsed in blank by the assessee company and the provisional invoice was then negotiated with the Eastern Bank Ltd., Madras, the bankers of the assessee company, who used to credit the assessee company with the amount of the bill of exchange. The Eastern Bank Ltd., Madras, then forwarded the documents to the Eastern Bank Ltd., London, who used to present the bill of exchange to the buyers' Bank in London and upon the bill of exchange being accepted the Eastern Bank Ltd., London, used to deliver the bill of lading and the invoice to the buyers' Bank. The buyers' Bank in due course used to pay the amount of the bill of exchange to the Eastern Bank Ltd., London. Thereafter, on arrival of the goods and after weighment and assay, the sale price was ascertained and the balance of price, after deducting the payments made against the bill of exchange, used to be paid to the Eastern Bank Ltd., London, which was the assessee company's agent and banker in London.

7. Learned Solicitor-General appearing in support of this appeal contends that having regard to the terms of the contracts the sales must be regarded as having taken place in British India. The facts strongly relied on by him are (i) that the price and delivery of goods were on F.O.B. terms, (ii) that in the European contracts the insurance, if any, was to be the concern of the buyers and (iii) that payment of the 80 per cent or 90 per cent as the case may be was made in Madras by the Eastern Bank Ltd., Madras, to the assessee company on the delivery of the documents. All these facts taken together indicate, according to his submission, that the
property in the goods passed at Madras and the sales accordingly were completed in British India. We are unable to accept this line of reasoning. According to Section 4 of the Indian Sale of Goods Act 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 and 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 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. By sub-section (4) of that section 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 to be transferred.

Section 18 of the Act clearly indicates that in the case of sale of unascertained goods no property in the goods is transferred to the buyer unless and until the goods, are ascertained. In the present case, the contracts were always for sale of unascertained goods. Skipping over Sections 19 to 22 which deal with contract of sale of specific goods we come to Section 23 which lays down that where there is a contract for the sale of unascertained or future goods by description and goods of that description and in a deliverable 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 thereupon passes to the buyer. It is suggested that as soon as the assessee company placed the goods on board the steamer named by the buyer at the Madras Port the goods became ascertained and the property in the goods passed immediately to the buyer. This argument, however, overlooks the important word "unconditionally" used in the section. The requirement of the section is not only that there shall be appropriation of the goods to the contract but that such appropriation must be made unconditionally. This is further elaborated by Section 25 which provides that where there is a contract for the sale of specific goods or where goods are subsequently appropriated to the contract, the seller may, by the terms of the contract or appropriation reserve the right of disposal of the goods until certain conditions are fulfilled. In such a case, notwithstanding the delivery of the goods to the buyer, or to a carrier or other bailee for the purpose of transmission to the buyer, the property in the goods does not pass to the buyer until the conditions imposed by the seller are fulfilled. The question in this case, therefore, is: was there an unconditional appropriation of the goods by merely placing them on the ship? It is true that the price and delivery was F.O.B., Madras but the contracts themselves clearly required the buyers to open a confirmed irrevocable Bankers' credit for the requisite percentage of the invoice value to be available against documents. This clearly indicated that the buyers would not be entitled to the documents that is, the bill of lading and the provisional invoice, until payment of the requisite percentage was made upon the bill of exchange.

The bill of lading is the document of title to the goods and by this term the assessee company clearly reserved the right of disposal of the goods until the bill of exchange was paid. Placing of the goods on board the steamer named by the buyer under a F.O.B. contract clearly discharges the contractual liability of the seller as seller and the delivery to the buyer is complete and the goods may henceforward be also at the risk of the buyer against which he may cover himself by taking out an insurance. Prima facie such delivery of the goods to the buyer and the passing of the risk in respect of the goods from the seller to the buyer are strong indications as to the passing also of the property in the goods to the buyer but they are not decisive and may be negatived, for under Section 25 the seller may yet reserve to himself the
right of disposal of the goods until the fulfilment of certain conditions and thereby prevent the passing of property in the goods from him to the buyer. The facts found in this case are that the assessee company shipped the goods under bill of lading issued in its own name. Under the contract it was not obliged to part with the bill of lading which is the document of title to the goods until the bill of exchange drawn by it on the buyers' Bank where the irrevocable letter of credit was opened was honoured. It is urged that under the provision in the contract for weighment and assay, which was ultimately to fix the price unless the buyer rightly rejected the goods as not being in terms of the contract, the passing of property in the goods could not take place until the buyer accepted the goods and the price was fully ascertained after weighment and assay. It is submitted that being the position, the property in the goods passed and the sales were concluded outside British India, for the weighment, sampling, assay and the final fixation of the price could only take place under all these contracts outside British India. It is not necessary for us to express any opinion on this extreme contention. Suffice it to say, for the purposes of this case, that in any event upon the terms of the contracts in question and the course of dealings between the parties the property in the goods could not have passed to the buyer earlier than the date when the bill of exchange was accepted by the buyers' Bank in London and the documents were delivered by the assessee company's agent, the Eastern Bank Ltd., London, to the buyers Bank. This admittedly, and as found by the Appellate Tribunal, always took place in London. It must, therefore, follow that at the earliest the property in the goods passed in London where the bill of lading was handed over to the buyers' Bank against the acceptance of the relative bill of exchange. In the premises, the Appellate Tribunal as well as the High Court were quite correct in holding that the sales took place outside British India and, ex hypothesi, the profits derived from such sales arose outside British India.

8. As to the second question, the learned Solicitor-General contends that irrespective of the place where the sale may have taken place the profits derived from such sales were received in Madras. It is recalled that after shipment the assessee company, through its managing agent in Madras, prepared provisional invoices and drew bills of exchange for 80 per cent or 90 per cent, as the case may be, of the amount of such invoices and handed over the same to the Eastern Bank Ltd., Madras, and received the amount of the bill of exchange from them in Madras. He contends that the receipt of this payment by the assessee company was really the receipt of the price of the goods and amounted to receipt of profits in Madras. He draws our attention to the terms of payment in the European contract and to the letter of intimation of the opening of the credit sent by the Eastern Bank Ltd., Madras, to the assessee company which have been quoted in part in the earlier part of this judgment. He relies on the words "through the Eastern Bank Ltd." appearing in the contract and the words "available by delivery to us" appearing in the letter. We do not think that those words support the contention of the learned Solicitor-General. The words "through the Eastern Bank Ltd." appear to us to go with the preceding words "to be advised to sellers" which are put within brackets which seem to have been wrongly closed after the word "sellers" instead of after the words "the Eastern Bank Ltd." Ordinarily, the buyer opens a letter of credit with his Bank in favour of the seller and the words "through the Eastern Bank Ltd." would be meaningless unless it was intended to mean that the irrevocable credit which was in favour of the assessee company was to be operated upon by the latter through the Eastern Bank Ltd. If that were the
true meaning, then that certainly does not make the Eastern Bank Ltd. the agent of the buyers. The words ‘available by delivery to us’ occurring in the letter of the Eastern Bank Ltd., Madras, do not appear to us to indicate that this was any part of the terms of the letter of credit. This was an intimation in accordance with the advice received by the Eastern Bank Ltd., Madras, from the Eastern Bank Ltd., London, that the assessee company might avail itself of the letter of credit by delivery of the documents to the Eastern Bank Ltd., Madras. This is made further clear by the latter part of the letter where the Eastern Bank Ltd., Madras, expressed their willingness at their option to negotiate the drafts drawn in terms of the arrangement provided that the documents were in order. The concluding sentence of that letter whereby the Eastern Bank Ltd., Madras, disown any responsibility in respect of the advice clearly militates against the suggestion of the learned Solicitor-General. It is, in these circumstances, impossible to accede to the argument that the payment of 80 per cent or 90 per cent, as the case may be, of the amount of the provisional invoice by the Eastern Bank Ltd., Madras, was a payment on account of the price. Normally, price is paid by or on behalf of the buyer. In this case the fact found is that the Eastern Bank Ltd., Madras, and the Eastern Bank Ltd. London, were agents of the assessee company. Neither of them had any relation with the buyers. Therefore, a payment by them cannot be regarded as a payment of the price. The true position is very clearly put by Lord Sumner in *The Prinz Adalbert* [LR (1917) AC 586, 589]:

> When a shipper takes his draft, not as yet accepted, but accompanied by a bill of lading indorsed in this way, and discounts it with a banker, he makes himself liable on the instrument as drawer, and further makes the goods, which the bill of lading represents, security for its payment. If, in turn, the discounting banker surrenders the bill of lading to the acceptor against his acceptance, the inference is that he is satisfied to part with his security in consideration of getting this further party’s liability on the bill, and that in so doing he acts with the permission and by the mandate of the shipper and drawer.

This payment by the Eastern Bank Ltd., Madras, therefore, is nothing but an advance made by them to their own customer on the security of the goods covered by the bill of lading reinforced by the benefit of the liability taken up by the assessee company as drawer of the bill which in its turn is backed by the confirmed and irrevocable credit of the buyers’ London Bank. If this payment was on account of the price, why should the assessee company, as the seller, undertake any liability to the Eastern Bank Ltd., as the drawer of the bill of exchange? The truth of the matter is that the price was paid on behalf of the buyers by their respective London Banks in London to the Eastern Bank Ltd., London which was the agent of the assessee company. The first receipt of the price, therefore, as pointed out by the High Court, was by the Eastern Bank Ltd., London, on behalf of the sellers. There is no dispute that the balance of the price ascertained after weighment and assay and deducting the amount paid on the bill of exchange was similarly received in London by the Eastern Bank Ltd., London, on behalf of the assessee company. The subsequent adjustment made in the books of the Eastern Bank Ltd., London did not operate as a receipt of profits in British India. In our opinion the High Court correctly answered the second question also in favour of the assessee company.

9. For reasons stated above, this appeal must stand dismissed.
R. S. BACHAWAT, J. - The dispute arises out of a contract between the appellants and the respondent entered into on November 13, 1951. The terms of this contract were recorded in writing in the form of a letter written by the respondent to Appellant 1 and set out below:

Messrs. P.S.N.S. Ambalavana Chettiar and Company Ltd., 260, Angappa Naicken Street, Madras.

Dear Sirs,

We confirm having purchased from you and the Madras Paper Marketing Company, Madras, 500 tons of Russian Newsprint as per the following description:

About 70 per cent in reels of 34 inches width.

15 per cent in reels of 22 inches width; 15 per cent in reels of 36 inches width at annas 9 per lb. ex-wharf Bombay duty, etc., paid. The buyers are to take delivery within four days of the offer of delivery. Any wharfage, etc., up to the fourth day of the offer of delivery will be on seller's account and thereafter on buyer's account.

We have also sold you about 415 tons of Russian newsprint in sheets in size of about 30’ x 42” (760 mm X 1085 mm) ex-godown, Madras at Rs. 9-6 per lb. We will keep the stock of sheets in our godown on your account free of rent. We shall advance you moneys against this newsprint at annas 8 per lb. This advance will carry interest at 5 per cent per annum. We will also charge you the exact amount of insurance which we pay to our Insurance Company against the goods.

We shall pay Rs 5,60,000 to your Bankers in Bombay and take delivery of the 500 tons of newsprint from the harbour in Bombay. Accounts will be made on the basis of the above arrangement and whatever one party is liable to pay to the other will be adjusted subsequently.

2. The document shows that the respondent agreed to buy from the appellants 500 tons of Russian newsprint in reels at 9 annas per lb., ex-wharf, Bombay and to take delivery of the goods on payment of Rs 5,60,000. At the same time, the appellants agreed to buy from the Respondent 415 tons of Russian newsprint in sheets then lying in a godown in Madras at 9 annas 6 pies per lb. upon the term that the appellants would pay the insurance charge and also interest at 5 per cent per annum on an amount equivalent to the price of the goods calculated at 8 annas per lb. The understanding was that the appellants would within a reasonable time take delivery of the goods bought by them in instalments and the accounts would be finally adjusted on the completion of the deliveries. It may be mentioned that Appellant 2 carried on business under the name and style of Madras Paper Marketing Company.
3. On November 26, 1951, the parties orally agreed that instead of 500 tons the respondent would buy 300 tons of newsprint in reels and that instead of 415 tons the appellants would buy 300 tons of newsprint in sheets and the terms of the contract dated November 13, 1951 would stand varied accordingly.

4. On December 5, 1951, the respondent took delivery of 300 tons of newsprint in reels on payment of Rs 3,18,706-9-10 and a sum of Rs 57,816-13-2 remained due to the appellants on account of the price of these goods. From November 29, 1951 up to February 27, 1952, the appellants took delivery of 122324 lbs. of newsprint in sheets on payment of Rs 63,032-15-9 to the respondent. Subsequently, the appellants refused to take delivery of the balance 547501 lbs. of newsprint in sheets. Counsel for the parties agreed before us that March 29, 1952 was the date when the appellants repudiated the contract. On April 21, 1952 after giving notice to the appellants the respondent resold the balance goods to one G.R. Lala at 6½ annas per lb.

5. On April 18, 1952, the appellants filed in the High Court of Madras C.S. No. 175 of 1952 claiming from the respondent Rs 57,816-13-2 on account of the balance price of 300 tons of newsprint in reels and interest thereon. The respondent admitted the claim for the balance price. On July 30, 1952, the respondent filed in the High Court of Madras C.S. No. 262 of 1952 claiming a decree for Rs 62,266-13-2 on account of the balance price of 122324 lbs., the deficiency on resale of 547501 lbs. of the newsprint in sheets, interest and insurance charges after setting off the sum of Rs 57,816-13-2 due to the appellants. The principal defence of the appellants was that the contract with regard to 415 tons of newsprint in sheets was cancelled in November, 1951 and that Appellant 2 was not a party to this contract. The appellants also denied the factum and validity of the resale. The two suits were tried by Rajagopala Ayyangar, J. He dismissed C.S. No. 175 of 1952 and decreed C.S. No. 262 of 1952. From these two decrees, the appellants filed two appeals in the High Court of Madras. A Division Bench of the High Court dismissed the two appeals. The present appeals have been filed on certificates granted by the High Court.

6. The two courts concurrently found that (1) Appellant 2 was a party to the contract of purchase of 415 tons of newsprint in sheets, (2) on November 26, 1951 the parties orally agreed that instead of 415 tons the appellants would buy 300 tons of the newsprint and (3) there was no cancellation of the contract as alleged by the appellants. These findings are not challenged. The two Courts concurrently found that the resale held on April 21, 1952 was genuine and was effected at a proper price on due notice and after proper advertisement. Mr Gupte attempted to challenge these findings, but we see no reason to interfere with them. The principal argument advanced by Mr Gupte was that the property in the goods resold on April 21, 1952 had not passed to the appellants and the resale was consequently invalid. We are inclined to accept this argument.

7. It is to be noticed that the contract did not envisage any loan of money by the respondent to the appellants on the security of the newsprint in sheets. The payment of Rs 3,18,706-9-10 was made by the respondent towards part discharge of its liability for the price of the newsprint in reels. No doubt, the contract stated: "We shall advance you moneys against this newsprint at annas 8 per lb. This advance will carry interest at 5 per cent per annum." But the real import of this clause was that the appellants would pay interest at 5 per cent per annum on an amount equivalent to the price of the newsprint in sheets calculated at 8
annas per lb. The respondent was not a pledge of the newsprint in sheets and had no right to sell the goods under Section 176 of the Indian Contract Act, 1872. The real question is whether the respondent had the right to resell the goods under Section 54(2) of the Sale of Goods Act, 1930.

8. The seller can claim as damages the difference between the contract price and the amount realised on resale of the goods where he has the right of resale under Section 54(2) of the Sale of Goods Act. The statutory power of resale under Section 54(2) arises if the property in the goods has passed to the buyer subject to the lien of the unpaid seller. Where the property in the goods has not passed to the buyer, the seller has no right of resale under Section 54(2). The question is whether the property in the 300 tons of newsprint in sheets had passed to the appellants before the resale.

9. On November 13, 1951, the respondent agreed to sell to the appellants the stock of 415 tons of newsprint in sheets then lying in the respondent’s godown in Madras. There was an unconditional contract for the sale of specific goods in a deliverable state and the property in the goods then passed to the appellants. But on November 26, 1951, the contract was varied in a material particular. The parties agreed that the appellants would buy only 300 tons of the stock of 415 tons of newsprint then lying in the respondent’s godown. The result was that in place of the original contract for sale of specific goods a contract for sale of unascertained goods was substituted.

10. Rajagopala Ayyangar, J., held that the effect of the variation of the contract on November 26, 1951 was that the appellants and the respondent became joint owners of the stock 415 tons. In our opinion, this was not the correct legal position. The parties did not intend that the appellants would buy undivided share in 415 tons of newsprint. On November 26, 1951 the bargain between the parties was that the appellants would buy and the respondent would sell 300 tons out of the larger stock of 415 tons.

11. The appellate court held that the property in the entire 415 tons passed to the appellants who were subsequently reviewed from their liability to take 115 tons and that the respondent could resell any 300 tons out of the larger stock of 415 tons. We are unable to accept this line of reasoning. It is true that originally the property in the entire 415 tons had passed to the appellants. But the result of the variation of the contract was to annul the passing of property in the goods. The effect of the bargain on November 26, 1951 was that the respondent would sell and deliver to the appellants any 300 tons out of the larger stock of 415 tons. As from November 26, 1951, the property in the entire stock of 415 tons belonged to the respondent. The parties did not intend that as from November 26, 1951 the property in any individual portion of the stock of 415 tons would remain vested in the appellants.

12. Section 18 of the Sale of Goods Act provides that where there is a contract for the sale of unascertained goods no property the goods is transferred to the buyer unless and until the goods are ascertained. It is a condition precedent to the passing property under a contract of sale that the goods are ascertained. The condition is not fulfilled where there is a contract for sale of a portion of a specified larger stock. Till the portion is identified and appropriated to the contract, no property passes to the buyer. In *Gillett v. Hill* [149 ER 871, 873] Bayley, B. said:
Where there is a bargain for a certain quantity extra greater quantity, and there is power of selection in the vendor to deliver which he thinks fit, then the right to them does not pass to the vendee until the vendor has made his selection, and trover is not maintainable before that is done. If I agree to deliver a certain quantity of oil as ten out of eighteen tons, no one can say which part of the whole quantity I have agreed to deliver until a selection is made. There is no individuality until it has been divided.

13. No portion of 415 tons of the newsprint lying in the respondent’s godown was appropriated to the contract by the respondent with the appellants’ consent before the resale. On the date of the resale, property in the goods had not passed to the buyer. Consequently, the respondent had no right to resell the goods under Section 54(2). The claim to recover the deficiency on resale is not sustainable.

14. The respondent is entitled to claim as damages the difference between the contract price and the market price on the date of the breach. Where no time is fixed under the contract of sale for acceptance of the goods, the measure of damages is prima facie the difference between the contract price and the market price on the date of the refusal by the buyer to accept the goods, see Illustration (c) to Section 73 of the Indian Contract Act. In the present case, no time was fixed in the contract for acceptance of the goods. On March 29, 1952, the appellants refused to accept the goods. The respondent is entitled to the difference between the contract price and the market price on March 29, 1952. Counsel for both parties requested us that instead of remanding the matter we should assess the damages on this basis and finally dispose of the matter. We have gone through the materials on the record and with the assistance of counsel, we assess the market price of the Russian newsprint in sheets on March 29, 1952 at 8 annas per lb. Counsel on both sides agreed to this assessment. The claim of the respondent for Rs 6,798-5-1 on account of interest and Rs 1119-6-0 for insurance charges is admitted before us by Mr Gupte.

15. In the result, Civil Appeal No. 165 of 1965 is allowed in part, the decrees passed by the courts below are varied by substituting therefor a decree in favour of the respondent against the appellants for a sum of Rs 10,980-12-8 with interest thereon at 6 per cent per annum from July 30, 1952. Civil Appeal No. 166 of 1965 is dismissed.

* * * * *
Agricultural Market Committee v. Shalimar Chemical Works Ltd.

S. SAGHIR AHMAD, J. - 2. Agricultural Market Committee (the Committee) which is the appellant before us is a statutory body created under the Andhra Pradesh (Agricultural Produce and Livestock) Markets Act, 1966 (the Act) while the respondent is a licensed trader dealing in copra (dried coconut kernel) which it imports from various places in the State of Kerala for manufacturing coconut oil.

3. Copra is a notified agricultural produce and, therefore, the Committee has a right to levy and realise the market fee on all transactions of purchase and sale provided the transactions take place within the notified area of the Committee.

4. By orders dated 2-3-1989 and 28-3-1989, the Assessing Authority who is also the Secretary of the Committee levied the market fee on the respondent who challenged those orders in appeals filed under Section 12-E but the appeals were dismissed on the technical ground of non-compliance with Section 12-E(2) under which the whole amount of market fee had to be deposited before filing the appeal.

6. In order to levy market fee on the transaction of sale and purchase by the respondent, the Assessing Authority had relied upon Rule 74(2) of the Andhra Pradesh (Agricultural Produce and Livestock) Market Rules, 1969 (for short the Rules) and Explanation to Bye-law 24(5) of the Bye-laws of the Committee which contained a statutory presumption that if a notified agricultural produce was weighed or measured within the notified area of the Committee, it shall be deemed to have been purchased or sold within that area. The appellate as also the revisional authorities had also relied upon this provision and had held that since copra which was imported from the State of Kerala was, admittedly, weighed at Hyderabad, it shall be deemed to have been sold to the respondent at Hyderabad and, consequently, the respondent was liable to pay market fee on all the transactions of sale/purchase of copra during the period in question.

29. Let us now consider the next question relating to the nature of transaction relating to sale/purchase of copra by the respondent from various dealers in the State of Kerala.

30. It is contended by the learned counsel for the appellant that if an order was placed with a dealer in Kerala in pursuance of which goods were despatched by lorry to Hyderabad where the respondent, after making payment to and receiving documents from the bank, obtained delivery of goods, and that too, after weighment, the transaction cannot but be treated as sale at Hyderabad and not in the State of Kerala.

31. During the pendency of the proceedings before the Appellate Authority, statement of Shri Somnath Bhattacharya, Director of the respondent Company was recorded. He stated that the copra was brought into the State of Andhra Pradesh from outside. It was unloaded at the premises of the appellant where it was crushed and coconut oil was extracted. He further stated as under:

After the material comes to Hyderabad, we will weigh the same for the purpose of verification regarding the quantity despatched by the Kerala dealers. We have a running account with the dealers in Kerala State. The account of the dealers will be settled sometimes monthly and sometimes within two or three months from the date of despatch.... Very rarely it is found on weighment at Hyderabad that the quantity
despatched by the dealer at Kerala is less than the quantity mentioned in the invoice concerned and in such cases, the Hyderabad unit will send a report to our Head Office and the Head Office raises a debit note against the dealer for the shortage of copra.

32. The above statement has been considered by the High Court which came to the conclusion that the weighment was done only for the satisfaction of the buyer and was not a condition of contract. The High Court also took into consideration the contents of the invoice and Form X and observed as under:

The appellate authority has referred to a copy of Invoice No. 357 dated 16-5-1985 for arriving at the conclusion that the purchase was effected by the appellant in Hyderabad. This invoice dated 16-5-1985 shows that one Abdul Hameed despatched 200 bags of copra through Lorry No. MSQ 3971 from Alleppey in Kerala to Hyderabad and the demand draft for Rs 1,39,000 was forwarded to bank. The note to the invoice says that the despatch of the goods is made solely at the risk and responsibility of M/s Shalimar Chemical Works, the appellant herein, and that Abdul Hameed takes no responsibility or liability as to delayed despatches, losses due to theft, pilferage, rain or damage, leakage, wear and tear etc. Column 1 of the accompanying Form X mentions the name of the person consigning the goods as Abdul Hameed. Clause 5 of Form X is in the following terms:

If the consignor is transporting goods in pursuance of a sale for the purpose of delivery to the buyer, the name and address of the person to whom the goods are sold, his registration certificate no. under the Andhra Pradesh General Sales Tax Act, 1957. If he is a dealer furnish bill number and date relating in the sale.

Against this Column No. 5, it is mentioned that the appellant herein is the person to whom the goods are sold. The consignor’s name is mentioned in Column No. 6 as Abdul Hameed of Alleppey. Column No. 7 is in the following terms:

If the consignor is transporting the goods from one of his shops or godowns to an agent for sale or from one of his shops or godowns to another for the purpose of storage, the address of the agent or of the shop or godown to which the transports are made.

Against this column, it was written For Sale. Because it was written in Column No. 7 as For sale, the appellate authority held that this evidenced that the transport of copra was only to enable the appellant to purchase the same and that the same was not sold in Alleppey.

The view taken by the appellate authority is totally unsustainable.

33. The High Court further observed as under:

One significant aspect to be noticed in this case is that after the stocks were loaded into the trucks, the sellers in Kerala had absolutely no liability with regard to any future losses. That is the reason why the goods were insured and the insurance premia were paid by the appellant. Where goods have been delivered to a common carrier to be sent to the person, by whom they have been ordered, the carrier becomes the agent of the vendee and such a delivery amounts to delivery to the vendee under Section 23(2) of the Sale of Goods Act. There was thus completed sale in Kerala State and no purchase in the State of Andhra Pradesh.
34. On the basis of material placed on record, the High Court came to the conclusion that the sale of copra took place in the State of Kerala and not at Hyderabad.

35. We may, at this stage, consider certain provisions of the Sale of Goods Act, 1930, specially as the Andhra Pradesh (Agricultural Produce and Livestock) Markets Act, 1966 does not contain any definition of sale or purchase. [Sections 19 and 20 of the Sale of Goods Act were quoted by the court.

36. We may, before analysing the provisions of Sections 19 and 20, observe that the Indian Sale of Goods Act is based largely upon the English and American Acts. Under these Acts, namely, the English Sale of Goods Act, the American Uniform Sales Act and the Indian Sale of Goods Act, the relevant factor for determining where the sale takes place, is the intention of the parties. A contract of sale, like any other contract, is a consensual act inasmuch as parties are at liberty to settle, amongst themselves, any terms they may choose.

37. Section 19 attempts to give effect to the elementary principle of the Law of Contract that the parties may fix the time when the property in the goods shall be treated to have passed. It may be the time of delivery, or the time of payment of price or even the time of the making of contract. It all depends upon the intention of the parties. It is, therefore, the duty of the court to ascertain the intention of the parties and in doing so, they have to be guided by the principles laid down in Section 19(2) which provides that for ascertaining the intention of the parties, regard shall be had to the terms of the contract, the conduct of the parties and the circumstances of the case.

38. Section 20 indicates that in case of an unconditional contract of sale in respect of specified goods in a deliverable state, the property in the goods passes to the buyer at such time as the parties intend it to be transferred. Section 19(3) provides that Sections 20 to 24 contain the rules for ascertaining the intention of the parties as to the time at which the property in the goods shall be treated to have passed to the buyer. Both Sections 19 and 20 apply to the sale of specific or ascertained goods.

39. Section 20, which contains the first rule for ascertaining the intention of the parties, provides that where there is an unconditional contract for the sale of specific goods in a deliverable state, the property in the goods passes to the buyer when the contract is made. This indicates that as soon as a contract is made in respect of specific goods which are in a deliverable state, the title in the goods passes to the purchaser. The passing of the title is not dependent upon the payment of price or the time of delivery of the goods. If the time for payment of price or the time for delivery of goods, or both, is postponed, it would not affect the passing of the title in the goods so purchased.

40. In order that Section 20 is attracted, two conditions have to be fulfilled: (i) the contract of sale is for specific goods which are in a deliverable state; and (ii) the contract is an unconditional contract. If these two conditions are satisfied, Section 20 becomes applicable immediately and it is at this stage that it has to be seen whether there is anything either in the terms of the contract or in the conduct of the parties or in the circumstances of the case which indicates a contrary intention. This exercise has to be done to give effect to the opening words, namely, 'Unless a different intention appears occurring in Section 19(3). In Hoe Kim Seing v. Maung Ba Chit [AIR 1935 PC 182], it was held that intention of the parties was the decisive factor as to when the property in goods passes to the purchaser. If the contract is silent, intention has to be gathered from the conduct and circumstances of the case.
41. This Court in *Consolidated Coffee Ltd. v. Coffee Board* [AIR 1980 SC 1468], has held that in an auction-sale of chattels, property passes to the purchaser on the acceptance of his bid. This occurs not because of Section 64(2) but because of the rule contained in Section 20.

42. In the instant case, the goods which were the subject-matter of sale were ascertained goods. They were also in a deliverable state. On the order being placed by the respondent, the seller in the State of Kerala, loaded the goods on the lorry and despatched the same to Hyderabad. It is at this stage that the conduct of the parties becomes extremely relevant. It was one of the terms of the contract between the parties that the seller would not be liable for any future loss of goods and that the goods were being despatched at the risk of the respondent. The respondent had also obtained insurance of the goods and had paid the policy premium. He, therefore, intended the goods to be treated as his own so that if there was any loss of goods in transit, he could validly claim the insurance money. The weighment of the goods at Hyderabad or the collection of documents from the bank or payment of price through the bank at Hyderabad were immaterial, inasmuch as the property in the goods had already passed at Kerala and it was not dependent upon the payment of price or the delivery of goods to the respondent.

43. We are in full agreement with the view expressed by the High Court and are also of the opinion that having regard to the evidence on record which indicated that on the order placed by the respondent, the stocks were loaded into the trucks for despatch to Hyderabad with the clear stipulation that the despatch was at the risk of the purchaser and that the seller had no liability with regard to any future losses and that the stock was insured and the insurance premium was paid by the respondent, the sale took place in the State of Kerala and not at Hyderabad.

44. In view of the above, the appeal has no merit and is dismissed.

* * * * *
Pearson v. Rose & Young, Ltd.
(1950) 2 Ch. D. 1027

[Mercantile agent in possession of motor car with the consent of the owner but registration book obtained by trick. The right of innocent buyer]

The plaintiff gave possession of his motor car to H., a motor car dealer and a mercantile agent within the Factors Act, 1889, s. 2(1), for the purpose of inviting offers to purchase it. By means of a trick H., induced the plaintiff to hand him the registration book relating to the car. Later the same day H., acting without the authority or knowledge of the plaintiff, sold the car and handed the registration book to the fourth party who acted in good faith without notice of any absence of authority. The fourth party subsequently sold the car to the third party, and the third party sold it to the defendants. In an action by the plaintiff against the defendants claiming damages for the conversion of the car.

Held: Though the plaintiff consented to H.’s having possession of the car as a mercantile agent, within the meaning of s. 2(1), he did not consent to his possession in that capacity of the registration book; the sale of a car without the registration book relating to it was not a sale of goods in the ordinary course of business within s. 2(1), and the consent necessary to pass a good title to a purchaser under s. 2(1) was a consent to possession of both the car and the registration book; and, therefore, H. was unable to pass a good title to the fourth party.

SOMERVELL, LJ. – This is an appeal from a decision of DEVLIN, J., who decided against the plaintiff. There is a third and a fourth party. The claim is for damages for the conversion of a motor car, which admittedly up to Mar. 17, 1949, was the property of the plaintiff. The car came into the possession of a Mr. Hunt, admittedly a mercantile agent. The fourth party bought it from Mr. Hunt and claims a good title under s. 2(1) of the Factors Act, 1889, which is as follows:

s. 2(1) Where a mercantile agent is, with the consent of the owner, in possession of goods or of the documents of title to goods, any sale, pledge, or other disposition of the goods, made by him when acting in the ordinary course of business of a mercantile agent, shall, subject to the provisions of this Act, be as valid as if he were expressly authorised by the owner of the goods to make the same; provided that the person taking under the disposition acts in good faith, and has not at the time of the disposition notice that the person making the disposition has not authority to make the same.

The fourth party sold the car to the third party, who sold it to the defendants. The sole issue in the appeal is whether the fourth party did or did not get a good title under the Factors Act, 1889. On these findings counsel for the plaintiff submitted that the only possible conclusion was that the car was obtained by larceny by a trick. On that basis there are conflicting opinions whether s. 2(1) of the Factors Act, 1889, can or cannot apply. Counsel for the plaintiff submitted it could not. I will refer to this later because I have come to the conclusion that the appeal succeeds on the judge’s findings irrespective of that point. It is, I think, clear that on the sale of a second-hand car the vendor will ordinarily deliver and the
purchaser require the delivery of the registration, or log book. Counsel for the plaintiff stated, and I accept it, that he did not contend that cars could not be sold without their log books, but the price would be substantially reduced thereby. This shows, and I so hold, that a sale of a car without its log book would not be a sale in the ordinary course of business. The findings of DEVLIN, J., as to Mr. Hunt's reasons for getting hold of the log book support this view.

The transaction which the fourth party seeks to uphold is the sale of a car with its log book, a more valuable subject-matter than a car without its log book. Mr. Hunt, it seems to me, was never in possession of the log book with the consent of the plaintiff. One can test it in this way. If immediately after the plaintiff had left the building he had been asked: "Did you mean to leave your car?" he would have answered "Yes." If he had been asked: "Did you mean to leave your log book?" he would have answered: "No" and would have gone back and collected it. The ostensible authority which enabled Mr. Hunt to effect a sale in the ordinary course of business arose because of his possession of the log book without the consent of the owner. The relationship of the log book, which is, of course, not a document of title, to a motor car is one to which no useful analogy has occurred to me. I am, however, of opinion that on the conclusions as set out above the fourth party cannot claim the protection of the Factors Act, 1889. In cases of larceny by a trick, the person defrauded does in one sense consent to the possession of the thief, but, so far as the log book is concerned, for the reasons I have given, the plaintiff never consented to Mr. Hunt having possession of it.

The issue with regard to larceny by a trick was fully argued before us. I will deal with it because, if there was larceny by a trick of the goods sold, and this prevents the Factors Act applying, the appeal would succeed in any event. I accept the submission of counsel for the plaintiff that, on the findings of DEVLIN, J., there is only one possible conclusion — that the possession of the car was obtained by larceny by a trick. The law as to larceny by a trick is fully set out in the judgment of BANKES, L.J., in *Folkes v. King* [(1923) 1 K.B. 291 to 293]. It seems to me clear that Mr. Hunt had an animus furandi at the time he got possession of the car and that the other conditions are fulfilled. The plaintiff clearly did not intend to pass the property, nor on the judge's findings did he authorise Mr. Hunt to conclude a sale.

The question whether this necessarily excludes a purchaser from the protection of the Factors Act has been considered in more than one case, but there is not clear decision on the point. In *Folkes v. King* BANKES, L.J. and SCRUTTON, L.J. considered the point. BANKERS, L.J. said:

"The question is whether, assuming that Hudson was guilty of larceny of the car, that fact renders it impossible that anyone can have obtained a title to the car from Hudson under the Factors Act; the argument being that no one can under those circumstances prove the owner's consent to the car being in Hudson's possession. The argument against this view was admirably put by Mr. J.A. Hamilton (as he then was) in *Oppenheimer v. Frazer & Wyatt* [(1907) 1 K.B. 519], but it was expressly rejected by every member of the court. The view taken by the court in that case as to the want of bonafides on the part of the purchaser of the goods rendered it unnecessary to decide the point, and the opinions of the members of the court are
therefore, I think, strictly speaking obiter and not binding upon us. They deserve however to be treated with the greatest respect, and it is only because I am unable after full consideration to agree with them that I venture to differ from the conclusion at which they arrived.

In Oppenheimer v. Frazer & Wyatt, FLETCHER MOULTON, L.J., said:

"A mercantile agent is as capable of stealing as any other man, and, if he has stolen the goods, there can be no question, in my opinion, that he must be taken to hold possession of them without the consent of the owner. One of the recognized methods of stealing at common law is distinguished from other types of larceny, and called larceny by a trick, but it is in the eye of the law pure stealing."

With regard to the consent required for the Factors Acts, BANKES, L.J., in Folkes v. King said:

"What the section refers to is the consent of the owner. To establish a consent it is no doubt necessary to consider what the state of mind of the owner of the goods was with reference to the possession of them by the mercantile agent."

SCRUTTON, L.J., after referring to the earlier cases, said:

"First on the question whether to prove larceny by a trick is a defence to the Factors Act as excluding consent of the true owner. I can understand that where by a trick there is error in the person there is no true consent and the Factors Act is excluded. But where there is agreement on the person and the true owner intends to give him possession, it does not seem to me that the fact that the person apparently agreeing to accept an agency really means to disregard the agency, and act for his own benefit, destroys the consent of the true owner under the Factors Act. That Act intended to protect a purchaser in good faith carrying out an ordinary mercantile transaction with a person in the position of a mercantile agent. It does not do so completely, for it requires the purchaser to prove that the goods were in possession of the mercantile agent with the consent of the owner. But it does not require the purchaser in addition to prove that the mercantile agent agreed both openly and secretly, ostensibly and really, to the terms on which the owner transferred possession to the mercantile agent. It appears to me to be enough to show that the true owner did intentionally deposit in the hands of the mercantile agent the goods in question. It is admitted that if he was induced to deposit the goods by a fraudulent misrepresentation as to external facts, he has yet consented to give possession, and the Factors Act applies, but it is argued that if he deposits the goods in the possession of an agent who secretly intends to break his contract of agency the Factors Act does not apply. I do not think Parliament had any intention of applying the artificial distinctions of the criminal law to a commercial transaction, defeating it if there were larceny by a trick, but not if there were only larceny by a bailee, or possession obtained by false pretences."

I have set out these passages at some length because I agree with the conclusion and the reasons given for it and do not desire to add to them. As the issue was fully argued before us,
and as opinions have already been expressed, I thought it right to set out the conclusion to which I have come. For the reasons given above I think the appeal succeeds.

DENNING, LJ. – In the early days of the common law the governing principle of our law of property was that no person could give a better title than he himself had got, but the needs of commerce have led to a progressive modification of this principle so as to protect innocent purchasers. We have had cases in this court recently about sales in market overt and sales by a sheriff, and now we have the present case about sales by a mercantile agent. The cases show how difficult it is to strike the right balance between the claims of true owners and the claims of innocent purchasers. The way that Parliament has done it in the case of mercantile agents is this. Parliament has protected the true owner by making it clear that he does not lose his right to goods when they are taken from him without his consent, as, for instance, when they have been stolen from his house by a burglar who has handed them over to a mercantile agent. In that case the true owner can claim them back from any person into whose hands they come, even from an innocent purchaser who has brought from a mercantile agent. Parliament has not protected the true owner if he has himself consented to a mercantile agent having possession of them, because, by leaving them in the agent’s possession, he has clothed the agent with apparent authority to sell them, and he should not, therefore, be allowed to claim them back from an innocent purchaser.

The critical question, therefore, in every case is whether the true owner consented to the mercantile agent having possession of the goods. This is often a very difficult question to decide. There are three points of principle which arise for consideration in the present case.

(i) If the goods are stolen from the true owner by the mercantile agent, does that mean that the owner does not consent to the mercantile agent having possession of them? At first sight the answer seems to be obvious. No man ever consents to the theft of his goods, but therein lurks a fallacy. There are many cases of larceny where the true owner consents to the thief having possession of the goods, but not to his stealing them. For instance, if the true owner allows the agent to have the goods on hire or for repair, and the agent later on makes up his mind to steal them and does so, either by breaking bulk (common law), or by converting them to his own use (statute), the agent is guilty of larceny by a bailee, but the true owner undoubtedly consented to his having possession of them. Take the same instance where the owner lets the agent have the goods on hire or for repair, but, with this difference, that the agent from the very beginning intended to steal the goods, then on all the authorities the agent is guilty of larceny by a trick, but the owner undoubtedly consented to his having possession of them. His state of mind is the same in both instances. He consented to possession, but not to the theft of the goods. In my opinion, therefore, the fact that the agent is guilty of larceny by a trick does not prevent the operation of the Factors Act any more than the fact that he has been guilty of larceny as a bailee. I find myself in full agreement with the judgments of BANKES, L.J., and SCRUTTON, L.J., in Folkes v. King, and I see nothing to the contrary in the opinion of VISCOUNT SUMNER in Lake v. Simmons [(1927) A.C. 510, 511].

(ii) If the true owner was induced to part with the goods by some fraud on the part of the mercantile agent, does that mean that he did not consent to the mercantile
agent having possession of them? Again the answer at first sight seems obvious. A
consent obtained by fraud is no consent at all, because fraud negatives consent. The
effect of fraud, however, in this, as in other parts of the law, is as a rule only to make
the transaction voidable and not void, and if, therefore, an innocent purchaser has
bought the goods before the transaction is avoided the true owner cannot claim them
back. For instance, if a mercantile agent should induce the owner to pass the
property to him by some false pretence, as by giving him a worthless cheque, or
should induce the owner to entrust the property to him for display purposes, by
falsely pretending that he was in a large way of business when he was not, then the
owner cannot claim the goods back from an innocent purchaser who has bought them
in good faith from the mercantile agent. The agent's offence may in some cases be
obtaining goods by false pretences, or in other cases larceny by a trick, the difference
depending on whether as a result of the fraud the owner intended to pass to the agent
the property or the power to pass the property (false pretences), or only to pass the
possession (larceny by trick). In each case, whether the owner intended to pass the
property or not, at any rate he consented to the agent having possession. The consent
may have been obtained by fraud but, until avoided, it is a consent which enables the
Factors Act to operate.

(iii) If the true owner consents to the mercantile agent having the goods for repair
but not for sale, is that a consent which enables the Factors Act to operate? The
answer would seem at first sight to be "Yes" because it is undoubtedly a consent to
the agent having possession, but this needs testing. Suppose, for instance, that the
owner of furniture leaves it with a repairer for repair and that the repairer happens to
be a dealer as well. Does that mean that the repairer can deprive the true owner of his
goods by selling them to a buyer? Clearly not, if the owner did not know the repairer
to be a dealer, and, even if he did, why should that incidental knowledge deprive the
true owner of his goods? Such considerations have led the courts to the conclusion
that the consent, which is to enable the Factors Act to operate, must be a consent to
be possession of the goods by a mercantile agent as mercantile agent: That means
that the owner must consent to the agent having them for a purpose which is in some
way or other connected with his business as a mercantile agent. It may not actually
be for sale. It may be for display or to get offers, or merely to put the goods in his
showroom, but there must be a consent to something of that kind before the owner
can be deprived of his goods.

If it were right to apply these considerations to the car taken by itself, without the
registration book, I should find myself in full agreement with the judgment of DEVLIN, J.
Hunt was a mercantile agent who got possession of the car with the consent of the plaintiff. It
is true that Hunt was probably guilty of larceny by a trick. The plaintiff did not intend to pass
the property to him or even to give him the power to pass the property, and Hunt had the
animus furandi from the beginning. That does not alter the fact that the plaintiff consented to
his having possession of it. It is also true that he intended Hunt to repair it, but the plaintiff
also intended that Hunt should act in some respects as a dealer by receiving offers from
Prospective purchasers. He did, therefore, consent to his having possession of the car as a mercantile agent.

Where I do not agree with DEVLIN, J. is that he put the registration book on one side as if it was of no significance in law. He seems to have thought the Factors Act operated if the mercantile agent had possession of the car with the consent of the true owner, even though he did not have possession of the registration book. I cannot share that view. This court has recently had to consider the position of the registration book, or, as it is more commonly called, the log book of a car: It is not a document of title, but it is the best evidence of title. Everyone who buys or sells a second-hand car knows that a clean title cannot be given or obtained without the log book. The instructions on every log book tell the owner to keep this book in a safe place, not on the vehicle and that on transferring the vehicle to another person you must hand over this book to the person acquiring the vehicle. All sensible owners pay heed to these instructions. If the seller can produce the book showing that his title is in order, he will receive the proper market price, but no wise buyer pays his money except against delivery, not only of the car, but also of the log book. If the seller cannot produce it, he will receive as a rule only a fraction of the proper price, because its absence is of itself notice of a defect of title. This state of affairs was foreseen by SCRUTTON, L.J., twenty-seven years ago. In Folkes v. King, he said:

"If the production of the book, or if it was said to be lost, of a new one, was required by every purchaser, it would be very difficult to find a market for the cars which have lately been stolen in such large numbers; and the courts may have to take adverse notice of the conduct of a purchaser who does not require the production of the book of registry." The courts have adopted that suggestion, and now view with suspicion any dealing in a second-hand car without a log book.

When the significance of the log book is realised, it becomes plain that the consent of the owner, which is necessary for the Factors Act to operate, is a consent to the possession by the mercantile agent, not only of the car, but also of the log book that goes with it. So long as the owner retains the log book, the mercantile agent cannot dispose of the car in the ordinary course of his business, because it is not in the ordinary course of anyone's business to dispose of a second-hand car without a log book. The retention by the owner of the log book, therefore, effectually prevents the Factors Act from operating. The handing over of the log book with the car enables the Act to operate. The owner then clothes the agent with apparent authority to dispose of the car, and the agent is enabled to dispose of it in the ordinary course of his business, and the Factors Act operates to give a good title to an innocent purchaser. To put it shortly, in the case of a car, goods in the Act means the car together with the log book.

This brings me to the critical question in this case: Did the plaintiff consent to Hunt having possession of the log book as well as the car? On the findings of fact by DEVLIN, J., the answer is clearly No. On March 18, 1949, the plaintiff simply let Hunt have the log book in his hands to inspect it for a few moments. The plaintiff gave Hunt the barest physical custody of it while he was still there himself. He never consented to Hunt having possession
of it. Then Hunt, by a trick, managed to get the plaintiff called away while he, Hunt, still held the book. Armed thus with the log book, Hunt was able to sell the car on the very same day to an innocent purchaser, which, without it, he could not have done. On those facts the plaintiff no more consented to Hunt having possession of the log book than if Hunt had stolen it from his pocket. The Factors Act does not operate, therefore, to give a good title to the dealer who bought from Hunt, nor to the buyers in succession from him.

I confess that I come to this conclusion with some reluctance, because I recognise that the legislature intended the courts to make every reasonable presumption in favour of the innocent purchaser: see s. 2(4) of the Act, but my reluctance is tempered by the reflection that in this case the buyer, Mr. Marshall, was himself a motor car dealer, who bought the car from Hunt on March 18, 1949, for £450 and sold it on March 21, 1949, for £620. A dealer whose business enables him to make quick and large profits of that kind must not be surprised if he occasionally gets his fingers burnt. In my opinion, therefore, the appeal should be allowed.

VAISEY, J. – Where there are two innocent parties of whom one has to suffer for the criminal act of a third, no decision can be said to be satisfactory. This example of that familiar problem presents to my mind considerable difficulty. On the whole, having had the advantage of reading the judgments of my Lords which have just been delivered, I share their view that this appeal should succeed. What the relationship between a motor car and its registration book or log book really is, I find it extremely difficult to define. For many purposes the book ought not to be regarded as a part of the car in the same sense as one of the car’s four wheels can be so regarded. What strikes me as decisive of the present case is the fact, already pointed out by my Lords, that a dealer in cars, being a mercantile agent, cannot be said to be acting in the ordinary course of his business as such when selling a car without its log book, any more, in my judgment, that he would be so acting if he sold a car with only three wheels. Suppose that a car with only three of its wheels had come into the dealer’s possession with the owner’s consent, and that the dealer had proceeded to steal the fourth wheel from the owner’s garage, had placed it on the car, and had then sold the car. In such a case, I do not think that the totality of the four-wheeled vehicle could be said to have come into the dealer’s possession with the owner’s consent, so as to bring into operation s. 2(1) of the Factors Act, 1889. When once it is admitted that the sale of a car without a log book is not an ordinary, but a quite extraordinary, transaction on the part of a dealer in cars, I think it must follow that the transaction here is not within the protection of the sub-section. In suggesting the imaginary case of the stolen wheel, I am well aware of the danger of analogies, and mine may be no better than most. That Act does modify and form an exception to the general law of property by conferring a title upon strangers in derogation of the rights of the true owner, and for myself I would be reluctant to extend its operation further than its terms necessitate. The appeal appears to me to be well-founded, and I have nothing further to add.

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Mysore Sugar Co. Ltd., Bangalore v. Manohar Metal Industries, Chikpet, Bangalore
AIR 1982 Kant. 283
[Section 54 - Right of an un-paid seller]

The Mysore Sugar Company, the plaintiff in the suit, advertised for sale of certain items like copper ingots, copper scraps as well as brass tubes available with the company at Mandya by its notification dated 27th July, 1966. The defendant offered to purchase the same by his letter dated 30-6-1966. The plaintiff accepted the offer of the defendant to purchase the various items and, thereafter, the defendant lifted certain items on part-payment and when it came to lifting of copper ingots, he sought for time to pay the balance and to remove the same separating it from other things with which it was mixed up. The defendant had to lift 2,000 K.Gs. of copper scrap and 2,000 K.Gs. of copper ingots valued at Rs. 48,503-96. He wrote to the plaintiff on 28-4-1966 raising objections regarding percentage of copper contents in the articles. The plaintiff intimated to the defendant on 12-9-1966 stating that no certificate for purity of the metal would be given and the material was sold on "as is and where is" condition. In spite of repeated reminders and demands, the defendant did not take delivery of the remaining goods and remit the value. The letter dated 22-11-1966 to the defendant also did not meet with favourable response. Therefore, the plaintiff resold copper tubes and copper ingots through an advertisement dated 30th December, 1966 to M/s. Karnataka Hardware, Avenue Road, Bangalore. By the said resale, the plaintiff incurred loss of Rs. 8,643-96. The plaintiff got issued a legal notice to the defendant to make good the loss. The defendant did not. Hence, the plaintiff instituted the suit for recovery of Rs. 8,643-96 less Rs. 500/- being the initial deposit by the defendant. The plaintiff claimed, in all, Rs. 8,143-96 ps. from the defendant along with costs and interest.

The defendant contended that the suit was not tenable. According to him, what was offered was copper scraps and copper ingots in the advertisement and what was found at the spot was alloy and not pure copper. Therefore, he contended that the plaintiff committed breach of contract. He further contended that the plaintiff did not have right to re-sell and that compensation, if any, could only be recovered under the general principles contained in S. 73 of the Indian Contract Act, 1872 (hereinafter referred to as the 'Act'). According to him, Section 54 of the Sale of Goods Act, 1930 was not applicable. The defendant, according to him, was not liable to pay any damages. On the other hand, he claimed compensation of Rs. 1,000/-.

G.N. Sabhahit, J. – 8. The points, therefore, that arise for my consideration in this appeal are:

(1) Whether the Courts below were justified in holding that the defendant committed breach of contract?

(2) Whether the learned Civil Judge was justified in dismissing the suit for damages?

9. It is true that in the advertisement given by the plaintiff, it is specifically mentioned that what was offered for sale was copper scraps and copper ingots. It is further true that there was no clause in the tender stating that the goods were sold on "as is and where is" condition. It is also on record that the parties were not allowed to inspect the goods before
offering their tender. The fact, however, remains that after the tender of the defendant was accepted he had occasion to inspect the goods and he lifted part of the goods and when he came to lifting of copper scraps and copper ingots, instead of raising any protest, he prayed for extension of time to make payment and to lift the goods. That would clearly show that the defendant knew that what was offered was the material on "as is and where is" condition. Hence, the Courts below have rightly rejected the contention of the defendant that he was not offered copper scraps and copper ingots of cent per cent purity and as such the plaintiff committed the breach of contract. I have no reason to differ.

10. It is no doubt true that it is the plaintiff who has come to the Court claiming damages. The first question that would arise for my consideration is whether, under Section 54(2) of the Sale of Goods Act, the goods had already passed on to the ownership of the buyer.

11. Thus we have to find out whether the seller exercised his right of lien or stoppage in transit on the facts of this case. (The court re-produced sections 19 and 20 of the Act.)

12-A. Thus by reading Ss. 19 and 20 of the said Act, it becomes obvious that in this case an offer was made by advertising to sell all the articles in question. Thereafter, a tender was given by the defendant and his tender was accepted. Therefore, there is an unconditional contract of sale and there were, no doubt, stipulations for payment of price and delivery of goods subsequently. In such a case, the property in the goods passes on to the buyer and hence Section 54 of the Act comes into play. It is on record that the plaintiff issued a notice to the defendant as per Ex. D-10 on 22-11-1966 making his intention clear that the buyer must lift the goods on payment as otherwise he will have to resell the goods and the defendant shall be liable for any loss caused. That satisfied the condition mentioned in Section 54(2) of the Act. Thereafter, however, it was made clear by a notice to the defendant that if he did not lift the goods within three days, his contract would be treated as cancelled. That is by Ex. D-8 dated 12-9-1966. Therefore, since the goods were not lifted by the defendant, the contract came to an end on or about 15-9-1966. Within a reasonable time thereafter the company should have resold the goods by advertising it. But the evidence on record shows that the advertisement was inserted only on 30-12-1966, i.e., after nearly three months.

13. The learned Advocate appearing for the respondent-defendant urged before me that this was not re-sale within a reasonable time as contemplated under S. 54(2) of the Act. It is all the more so, according to him, because P.W. 2, the person who purchased the goods in the re-sale has clearly stated in his evidence that the prices were more three months prior to his giving the tender for resale, and, thereafter, the prices came down. Therefore it is clear from the evidence on record that the prices were falling from August 1966 and the plaintiff-company delayed for three months therefrom to give the advertisement, knowing fully well that the prices were falling; for P.W. 2 has stated that the prices were a little low at the time when he gave his tender and that the prices were a little more earlier. P.W. 2 is witness examined by the plaintiff. Making allowance for his interestedness, it is obvious that the prices were more in about September 1966 when the breach of contract occurred.

14. It is needless for me to point out that a duty lay on the plaintiff to mitigate the damages. Even in view of S. 54(2), it was the duty of the plaintiff to see that re-sale was effected within a reasonable time especially so, when the prices were falling for the relevant material. Three months delay, therefore, on the facts of this case, is certainly inordinate and
re-sale has not taken place within a reasonable time as contemplated in Section 54(2). It is relevant to mention in this context that what was the ruling price in about September 1966 is not brought on record by the plaintiff though P.W. 2, as stated above, admitted that the prices were more at that time. The difference claimed as damages on the facts of this case, is also not much. That being so, the learned Civil Judge having regard to the probabilities has observed that if the goods were re-sold in September 1966 within a reasonable time, the plaintiff would not have incurred any loss whatsoever. At any rate, since the burden of proving the damages was on the plaintiff and he has not placed any evidence on record in that behalf, the learned Civil Judge has rightly proceeded to disallow the suit for damages.

16. As explained above, there has been unreasonable delay in re-selling, on the facts of the present case, when the market price was falling. Hence, the value realised on re-sale does not afford a good ground to fix the damages. There is no evidence on record placed by the plaintiff to show the ruling price of the commodity at the time when there was breach of contract. The plaintiff has come to Court. The burden is on him to prove the alleged damages and since he has not placed any material evidence to show that he has suffered damages, he has to fail and the learned Civil Judge has rightly held so. I have no reason to differ.

17. The learned counsel appearing for the respondent-defendant submitted that S. 54(2) of the Sale of Goods Act should be read with Section 73 of the Act. It may be stated in this context that Section 73 contains the general principle with regard to fixing up of damages, whereas Section 54 speaks of specific case of moveable property sold. Section 54 is more specific whereas Section 73 is general in nature. Therefore, Section 54 prevails over Section 73 though both the sections are based on the same general principle.

18. In the result, therefore, I am constrained to hold that the appeal is devoid of merits and is liable to be dismissed and I dismiss the same.

* * * * *
The question which falls for determination in this appeal by special leave from the judgment and order of the Kerala High Court is whether the amount claimed by the appellant in a suit filed by him against the respondent was a "debt" within the meaning of that expression as defined in clause (3) of Section 2 of the Kerala Debt Relief Act, 1977, (the Act) and was, therefore, deemed to be discharged.

2. The appellant's case as founded in the plaint was that the respondent sold a cow and a calf to him for a sum of Rs 1600 and that the cow did not yield the quantity of milk which the respondent had stated it would yield and was suffering from an incurable disease which was concealed from the appellant by the respondent. For this reason, the appellant asked the respondent to buy back the said cow and the calf for the same price which had been paid by the appellant to the respondent and thereupon the respondent agreed to buy back the said cow and calf for a sum of Rs 1600. In pursuance of this agreement, the said cow and calf were returned by the appellant to the respondent. By his letter dated October 27, 1976, the respondent acknowledged that he had received back the said cow and calf and assured the appellant that he would pay the price as early as possible. In spite of repeated demands made by the appellant, including by his advocate's letter dated September 17, 1977, the respondent failed and neglected to pay to the appellant the said sum of Rs 1600 or any part thereof though he went on promising to do so by his letters dated November 25, 1976, December 30, 1976, and May 19, 1977. The appellant thereupon filed the suit out of which the present appeal arises, being Original Suit No. 242 of 1977, in the Court of the Munsiff, Taliparamba. In the plaint it was stated that though there was no agreement to pay any interest, the appellant was entitled to interest by way of damages, and interest at the rate of 6 per cent per annum was claimed on the said sum of Rs 1600 from October 27, 1976. The appellant expressly averred in the plaint that the amount claimed by him was excluded from the definition of "debt" in the said Act.

3. By his written statement the respondent contended that he had only sold a pregnant cow to the appellant for a sum of Rs 1500 and not Rs 1600 and that the cow did not suffer from any disease but by reason of the negligent manner in which the appellant handled the cow, it gave premature birth to a calf and that the appellant brought back the cow and the calf and left them in front of his house. The respondent further denied his liability to pay any amount to the appellant and alleged that he had "agreed to pay Rs 1500 to the plaintiff (appellant) by his letters for nothing." He further alleged that he had paid a sum of Rs 750 to the appellant. He also contended that he was a "debtor" and the amount claimed from him in the said suit was a "debt" within the meaning of those expressions in the said Act and that he was entitled to the benefit of the said Act and the suit was, therefore, not maintainable.

4. In order to understand the controversy between the parties it will be convenient to refer now to the relevant statutory provisions. The Kerala Debtors Temporary (Relief) Act, 1975, provided for a moratorium on the recovery of debts due from certain categories of persons, such as, indigent agriculturists, landless labourers, artisans and kudikappuks, for a period of one year from October 14, 1975, for such longer period as might be specified by the...
Government by notification in the Gazette. The period of operation of the said temporary legislation was extended until January 14, 1977, by S.R.O. No. 1031/76 dated October 7, 1976, published in the Kerala Government Gazette No. 559 dated October 8, 1976. This said temporary legislation had been enacted pending the passing of a legislation to give permanent relief to certain classes of debtors. Such permanent piece of legislation had, therefore, to come into force before the expiry of the extended period of the said Kerala Debtors Temporary (Relief) Act, 1975. As the Legislative Assembly was not in session, the Kerala Debt Relief Ordinance, 1977 (Ordinance No. 1 of 1977), was promulgated by the Governor on January 13, 1977. As a bill to replace the said ordinance could not be introduced and passed in time, in order to keep alive the provisions of the said ordinance another ordinance containing identical provisions, namely, the Kerala Debt Relief Ordinance, 1977 (Ordinance No. 9 of 1977) was promulgated by the Governor on May 6, 1977. The said Act, namely, the Kerala Debt Relief Act, 1977, repealed and replaced the said ordinance. The said Act came into force with retrospective effect from January 13, 1977, namely, the date on which the first Kerala Debt Relief Ordinance, 1977, was promulgated.

5. Clause (3) of Section 2 of the said Act defines the expression "debt." The material provisions of the said definition are:

- Any liability in cash or kind, whether secured or unsecured, due from or incurred by a debtor on or before the date of commencement of this Act, whether payable under a contract, or under a decree or order of any court, or otherwise, and subsisting on that date, but does not include:
  - any debt which represents the price of goods purchased.

6. Clause (4) of the said Act defines the expression "debtor" as meaning "any person whose annual income does not exceed three thousand rupees from whom any debt is due." There are two exceptions to this definition. We are concerned only with the first of these exceptions. Under it any person from whom debt or debts exceeding three thousand rupees (excluding interest) is or are due is excluded from the definition of the expression "debtor." Section 3 of the said Act, omitting the proviso with which we are not concerned, provides as follows:

3. **Discharge of debt.** - Notwithstanding anything contained in any other law for the time being in force, or in any contract or other instrument having force by virtue of any such law, or in any decree or order of court, with effect on and from the commencement of this Act:

- every debt and the interest thereon payable by a debtor to a creditor shall be deemed to be wholly discharged;
- no civil court shall entertain any suit or other proceeding against a debtor for the recovery of any debt or part of a debt or any interest thereon;
- all suits and other proceedings (including appeals, revision petitions, applications for review, proceedings for attachment and execution proceedings) pending at such commencement against any debtor for the recovery of any debt shall abate.
7. Thus, if the respondent’s annual income as also his total debts, excluding interest, did not exceed Rs 3000, he would be a debtor for the purposes of the said Act. In such eventuality, the amount due by him to the appellant together with interest, if any, thereon would be deemed to be wholly discharged on the date of the commencement of the said Act, namely, January 13, 1977, and the Court would have no jurisdiction to entertain the appellant’s suit inasmuch as the transaction in respect of which the claim was made in the suit took place prior to that date, unless the claim made in the suit was a debt which represented the price of goods purchased by the respondent.

11. Whether the amount due by way of refund of price would be a debt representing the price of goods sold is not a question with which we are concerned for the appellant had expressly pleaded in his plaint that the respondent had agreed to buy back the said cow and calf and had agreed to pay to him a sum of Rs 1600 as price and that he had failed to pay the said amount or any part thereof. The respondent in his written statement had denied this contract of sale. As set out earlier, at the trial of the suit the respondent abandoned this defence and the appellant restricted his claim to Rs 1500. As a result of this, the agreed and undisputed position was that there was an agreement between the appellant and the respondent under which the appellant had agreed to sell to the respondent the said cow and calf purchased by him from the respondent for a sum of Rs 1500 and had delivered the said cow and calf to the respondent in performance of his part of the contract. The High Court overlooked the fact that at the trial, the respondent had given up his contention with respect to the transaction in question resting content with contesting the suit only on the grounds of part payment and discharge of the debt by reason of clause (3) of Section 2 read with Section 3 of the said Act, and that those were the only issues on which the parties went to trial. It is also pertinent to note that it was not the case of the appellant that it was a condition of the contract that the cow would yield a particular quantity of milk and that such condition not having been fulfilled, he was entitled to reject the goods, namely, the cow and the calf, and get a refund of the price. Even if such a statement on the part of the respondent were to be treated as a warranty, a breach of warranty does not entitle a buyer to reject the goods and his only remedies would be those provided in Section 59 of the Sale of Goods Act, 1930, namely, to set up against the seller the breach of warranty in diminution or extinction of the price or to sue the seller for damages for breach of warranty. The case of the appellant was also not founded upon any breach of warranty. His case as expressly pleaded in the plaint was that he took back the cow and the calf to the respondent and that the respondent agreed to buy them back for the same price. This was, therefore, a case of a resale by the buyer to the seller, the sale price being the very same amount which the buyer had paid to the seller. Clause (10) of Section 2 of the Sale of Goods Act defines “price” as meaning “the money consideration for a sale of goods”. A resale of goods is also a sale of goods and the money consideration for such resale is the price payable in respect of such resale. When a person purchases goods, he may sell them in his turn. Such second sale is generally referred to as a resale. A resale may be to a third person or to the original seller. In either case, the money consideration for such second sale would be the price of goods resold. It is, therefore, difficult to understand how the High Court could have come to the conclusion that such money consideration would be equivalent to the price of goods purchased but would not represent the price of goods purchased. The High Court was clearly wrong in the view which it took. The amount due from the respondent
to the appellant was a debt which represented the price of goods purchased by the respondent from the appellant and was by reason of exception (f) to clause (3) of the said Section 2 of the said Act clearly excluded from the definition of "debt."

12. It was also submitted before us on behalf of the respondent that there being admittedly no agreement as to any payment of interest, the trial court was not justified in awarding interest to the appellant. The amount of interest claimed by the appellant in his plaint was not based on an agreement but was claimed by way of damages. Section 61 of the Sale of Goods Act provides for interest by way of damages and special damages. The relevant provisions of sub-section (2) of that section are as follows:

(2) In the absence of a contract to the contrary, the court may award interest at such rate as it thinks fit on the amount of the price -

(a) to the seller in a suit by him for the amount of the price - from the date of the tender of goods or from the date on which the price was payable;

13. According to the averments in the plaint it was by his letter dated October 26, 1976, that the respondent had agreed to pay the amount of the price. The appellant had accordingly made a claim for interest from the said date. Under the provisions of Section 61(2) of the Sale of Goods Act, the appellant was clearly entitled to such interest by way of damages.

14. In the result, this appeal must succeed and is allowed and the judgment and order of the Kerala High Court are set aside except as regards the order for costs and the Civil Revision Petition No. 1990 of 1979 (c) filed by the respondent in the said High Court is dismissed and the judgement and decree of the District Court of Tellicherry in Appeal Suit No. 356 of 1978 and, except with respect to the order of costs, the decree of the Court of the Munsiff of Taliparamba in Original Suit No. 242 of 1977 are restored.

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