

Inter State Sale of Goods under CST Act in Pursuance of a Contract – Whether Taxable under VAT Act



Contracts are the main instruments to carry the business in the Construction Industry. In general, the Contracts can be classified as Supply Contract, Pure Labour/Service Contract and Works Contract. When a Contract is awarded for a lump sum amount, it is an Indivisible Contract i.e., a composite works contract or a turnkey contract. In a Supply Contract, the main object is the transfer of property and delivery of the possession of Chattel as a Chattel to the buyer, whereas in Works Contract the property in goods does not pass chattel qua chattel but in some other form. Involving transfer of property in goods and use of labour is the criteria in 'Works Contract'. In the present article, the author has deliberated upon whether the inter-state sale of goods under CST Act in pursuance of a contract is taxable under VAT Act. Read on to know more...



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Works Contract–Exemption of CST Turnover

It is difficult to determine the nature of a sale under the works contract as the goods may be purchased either within the State or from outside the State or from outside India for execution of the contract. Also, confusion arises as to whether a

sale of goods under a works contract should be treated as an inter-state sale or a local sale, where the contractor makes purchase of such goods from other State or from other country after entering into the contract.

In case the Contractor imported the goods from outside the State and subsequently incorporates the same in the execution of the Works Contract on taking delivery by him, the State where from the goods moved would collect CST under CST Act, 1956 and the State where the goods have been incorporated in the execution of Works Contract would levy VAT under State VAT Act. However, if the specified goods are procured in pursuance of a contract from outside the State, then the sale is covered under inter-state-sale and local tax is not payable as explained below:

- The goods move from outside the State on the basis of the agreement entered into with the Client by the Contractor for the quantity & value specified in such agreement as per the design, drawing, make & specification given by the Client.
- The Contractor in-turn place the purchase order on the manufacturer/supplier for supply of such specified goods.
- Hence the movement of goods from outside the State has taken place in pursuance of the Contract for supply of specified goods and there is no possibility of diversion of the goods procured from the vendors.

For better understanding, a specimen procurement process is given below:-

Sl. No.	Particulars
a.	The Client awards the Works Contract specifying the goods required with description, quantity and value under the Supply Schedule;
b.	The Client also specifies the technical specification for each item of the above Supply Schedule;
c.	The Client also specifies that all types of tests/inspections are to be carried out at the manufacturer's place with the particulars of approved vendors;
d.	Accordingly the approved vendor manufactures and supply the goods from outside the State;

Sl. No.	Particulars
e.	On manufacture of the item, the intimation is given for arranging the test/inspection at the manufacturer's place;
f.	On the basis of information received from the manufacturer, the contractor requests the Client to arrange for test /inspection;
g.	On the basis of intimation and instruction of Client, inspection is carried out by the inspecting agency;
h.	After inspection and if the goods conform to the specifications of the Client, identification marks are placed on the goods;
i.	The inspection report with the details of test results is certified by the Client for despatch;
j.	On receipt of the inspection report, the contractor sends it to the vendor with necessary instructions for despatch and delivery of the specified goods to the client;
k.	On receipt of the inspection report, the goods are despatched from the vendor premises under the cover of excise invoice, inspection report, despatch clearance and other relevant documents;
l.	The goods are delivered to the Client;
m.	On receipt of the goods, the Client carries out inspection and confirms that the goods bear the inspection marks and other identification as stated in the report of the inspection agency;
n.	Once the goods confirm with the report of the inspection agency, the Client approves the said purchases;
o.	The Client hands over the goods to the Contractor for erection/installation;
p.	The Contractor carries out the erection/ installation work as per the terms and conditions specified.

From the above, it is clear that the goods are procured and sold:-

- a. as per the specifications in the tender schedule,
- b. only from the vendors approved by the Client,
- c. the purchase order is placed on the basis of approval from the Client,
- d. the goods are subject to pre-despatch inspection by the agency of the Client,
- e. the goods are despatched by the manufacturer
- f. the goods are delivered to the Client and the Client receives the same,

The Contractor can claim the exemption for the sale value of goods on the ground that the sale is effected to the Client in pursuance of the Contract and is a sale in the course of interstate trade or commerce/import falling under Section 3 or 5(2) of the CST Act. The relevant provisions of the CST Act are extracted below for ready reference:-

Section 3 of the CST Act	Section 5(2) of the CST Act
A sale or purchase of goods shall be deemed to take place in the course of inter-State trade or commerce if the sale or purchase-	A sale or purchase of goods shall be deemed to take place in the course of import of the goods into the territory of India only if the sale or purchase either occasions such import or is effected by a transfer of documents of title to the goods before the goods have crossed the customs frontiers of India.
(a) Occasions the movement of goods from one State to another; or	
(b) is effected by a transfer of documents of title to the goods during their movement from one State to another.	

Hence:-

- the agreement of sale must have an express or implied stipulation for moving the goods from one State to another or the movement should be an incident or an integral part of the sale, the actual sale taking place in either of the State;
- The goods must actually move from one State to the other, and
- The property over the goods may pass from the seller to the buyer in either of the States or during their transit.

The above position is settled by the decision of the Hon'ble Supreme Court in *Builders Association of India vs. Union of India* (73 STC 370)(SC). It was held that the transfer of property in the goods involved in the execution of works contract are subject to restrictions and conditions mentioned in Article 286 of the Constitution and the principle for determining when a sale takes place in the course of interstate trade and commerce laid down in Section 3, 4 & 5 of the CST Act would apply equally on the transfer of property in the goods involved in the execution of works contract. Clause (1) of Article 286 says that no law of a State shall impose, or authorise the imposition of a tax on the sale or purchase of goods where

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such sale or purchase takes place-(a) outside the State; or (b) in the course of the import of the goods into, or export of the goods out of, the territory of India.

The Hon'ble Supreme Court again in *Gannon Dunkerley & Co. vs. State of Rajasthan* [1993] 88 STC 204 (SC) held that:- In exercise of its legislative power to impose tax on sale or purchase of goods under entry 54 of List II of Schedule VII to the Constitution of India read with Article 366(29-A)(b), the State Legislature, while imposing a tax on the transfer or property in goods (whether as goods or in some other form) involved in the execution of a works contract is not competent to impose a tax on such a transfer (deemed sale) which constitutes a sale in the course of inter-State trade or commerce or a sale outside the State or a sale in the course of import or export.

Inter-State-Sale in Pursuance of a Works Contract is Exempt-Relevant Case Laws

In the following cases, the Apex Court has considered the instances of procurement of goods from outside State vendors for the execution of works contract and still held that the sale in the course of execution of works contract is not exigible to tax under the local act, since it falls under Section 3 of the CST Act:-

- Commissioner, Delhi Value Added Tax vs. M/s ABB Limited* (2016TIOL41SC-VAT)

Recently, the Hon'ble Supreme Court held in the above case that transactions constituting inter State trade and those constituting sale or purchase in the course of import were covered by Section 3(a) and Section 5(2) respectively of the Central Sales Tax Act, 1956 and, therefore, exempt from taxation under the Delhi Value Added Tax Act, 2004. Inter State movement of goods was in pursuance of and incidental to the contract for the supply of goods used in

the execution of the works contract between the respondent assessee and the Delhi Metro Railway Corporation Ltd. The claimed sales should be deemed to have taken place in course of imports of the goods or interstate trade and that such import/movement of goods was integrally connected with the contract for their supply to DMRC.

b) *CTT vs. Indian Railway Construction Co.* (6 VST 374)(All)

In this case, the respondent-dealer entered into a contract with Northern Railways for execution of a works contract in the Agra Region for railway electrification/railway transmission line and railway sub-stations. The respondent-dealer purchased goods from outside the State of U. P. in the course of inter-State trade. The goods used in the works contract, were to be procured only from those manufacturers who were approved by Cone/Contraction as per the condition No. 12.19 of the tender document and such goods were necessarily to be inspected by the inspection body (RITES) of the contractee at the site of the manufacturers. Specific Railway Identification Codes were to be assigned by the contractee as per the drawing and Deep Railway Identification Codes have to be embossed on individual goods at the time of manufacturing by the manufacturers. The goods were to be despatched by the manufacturers against their invoices along with RITES inspection certificate mentioning the description of goods, quantity, and R. L. number. The material despatched by the manufacturers will be delivered at the Depot of appellant on behalf of Railway in presence of Railway's Representatives. The Material received Certificate (MRC) shall be signed by Appellant/Railway contractee. The goods were ordered, manufactured, imported and used as per the aforesaid terms of the contract. The aforesaid terms of contract clearly show that at the time of movement of goods lien of Indian Railway was created on the goods and it was known that the goods were being imported for use in the works contract, thus such transactions are clearly covered by Section 3 of the Central Sales Tax Act, hence not assessable to tax under the UP Trade Tax Act.

c) *Santosh & Company vs. CTT* (1999 UPTC 823 – Quoted in 6 VST 374 at 388).

The relevant portion is extracted below:-

It is not disputed that the aforesaid items of goods were moved from the State of Delhi into the State of U. P. in pursuance of the contract that was awarded to the revisionist by the Garrison Engineer, Dehradun for supplying and fixing of aluminium doors, windows, ventilators and fixed glazed partition, etc. It is also admitted that the goods that were so transported from Delhi consisted of the materials required for the fabrication of the doors, windows, etc. Therefore, the movement of goods from Delhi to U. P. was in pursuance of a works contract and it was that works contract which occasioned the movement of goods from one State to another, i.e., from Delhi to U. P.

As regards the goods brought in by the dealer from Delhi and on which the Central sales tax was already paid, the authorities below have tried to clinch the issue in favour of the Revenue by saying that since the works were executed at Dehradun, the sale was finally completed there and, therefore, the value of such things was also taxable. This contention is not correct and the law specifically provides for exclusion of goods which are the subject-matter of inter-State trade or the subject of a sale outside the State or the sale in the course of export or import and are, thus, covered by Sections 3, 4 and 5 of the Central Sales Tax Act. Admittedly, the goods were brought from Delhi to the State of U. P. in pursuance of and for the execution of the works contract and, therefore, they were covered by Section 3 of the Central Sales Tax Act and the sale value thereof could not have been subjected to trade tax under the U. P. Sales Tax Act. The fact that the sale was ultimately completed in U. P. was of no consequence, as held by the Honorable Supreme Court in *Oil India Ltd. vs. Superintendent of Taxes* [1975] 35 STC 445; [1975] 3 SCR 797; [1975] UPTC 335.

d) *Projects and Service Centre vs. State of Tripura* (82 STC 89) (Gau)

The petitioner, a firm having its place of business at Calcutta, purchased materials in several States outside the State of Tripura and also placed orders for supply of materials in Tripura for use in the execution of a works contract in Tripura. The terms of the contract stipulated movement

of the goods from such other States to the State of Tripura. The petitioner being of the view that the supplies of materials made from outside the State were inter-State sales, registered itself under the Central Sales Tax Act, 1956, in Calcutta and did not register itself under the Tripura Sales Tax Act, 1976. The Superintendent of Taxes, on the ground that the actual transfer of property in the materials used in the contract took place in Tripura, served on the petitioner a notice of demand for tax on the said transfer accompanied by an order of assessment passed under Section 11 of the Tripura Sales Tax Act, 1976. On the receipt of the said notice, petitioner filed a writ petition before the High Court. The Hon'ble High Court held that:-

In the instance case goods were involved in the execution of works contract. In the instant case the sales in question were inter-State sales. The fact that the use of the materials was made in a works contract or the property in the materials passed in the State of Tripura did not in any way affect the inter-State nature of the transaction. The order of assessment and the notice of demand were to be quashed.

- e) *CTT vs. Dharmex Private Limited* (23 VST 225) (All)

The respondent-dealer, a civil contractor having its business at Pune in Importing State, entered into a transaction of a civil contract with IFFCO for supplying equipment machinery and apparatus to its unit at Anwala in U.P. Against the assessment order passed, the respondent-dealer filed an appeal, which was dismissed. The respondent-dealer appealed to the Tribunal which declared the respondent-dealer not assessable considering the fact that the respondent-dealer had produced before it copies of form XXXI against which it had made supplies to the party in U. P. which clearly included declarations that Central sales tax had been paid at the rate of four per cent.

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The expression “sale or purchase occasions the movement of goods” means that either the contract of sale itself should provide for the movement of the goods or the movement of the goods must be incidental to the contract, there being no possibility of diversion of goods for any other purpose or to any other sale.

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On a revision petition contending that regardless of these facts, the title to the goods passed to the buyer at Anwala, and therefore the transactions were taxable in U. P. On appeal, the High Court observed that: I am of the opinion that in the present case the contract had already been concluded between the parties before the movement of the goods and it was clearly a case of inter-State trade and, therefore, no tax was liable to be paid in U. P. on these transactions. I am in agreement with the decisions cited by learned counsel for the assessee and, therefore, I see no reason to interfere with the order passed by the Tribunal, which has clearly recorded findings of fact that the contract was an inter-State contract on which Central sales tax had already been paid.

Other Case Laws

- a) In the case of *TELCO vs. Asstt. Commissioner* (26 STC 354) (SC) and *State of Bihar vs. TELCO* (27 STC 127) (SC) it was held that the expression “sale or purchase occasions the movement of goods” means that either the contract of sale itself should provide for the movement of the goods or the movement of the goods must be incidental to the contract, there being no possibility of diversion of goods for any other purpose or to any other sale.
- b) In the cases of *Union of India vs. KG Khosla & Company* (43 STC 457) (SC), *English Electrical Company of India Ltd. vs. DCTO* (38 STC 475) (SC) & *Balabhgas Hulaschand vs. State of Orissa* (37 STC 207) (SC), it was held that it is sufficient if the movement of goods from one State to another State is as a result of contract of a sale or incidental to the contract or implicit in the sale to call it as an interstate sale.
- c) *M/s State of Gujarat vs. Haridas Mulji Thakker* (84 STC 317)(Guj):- In this case the Gujarat dealer received order from another dealer in Gujarat. For supplying the said goods, the vendor dealer in Gujarat placed order on Importing State dealer and instructed to send the goods directly to the Gujarat purchasing party. The Gujarat High Court held that the sale by Importing State dealer to Gujarat vendor dealer is first interstate sale and the one by Gujarat vendor dealer to Gujarat purchasing dealer is second interstate sale. The Gujarat High Court also held that the second interstate sale is exempt u/s 6(2) being effected by transfer of documents of title to

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In order to establish that the contract between the works contractor and the contractee has occasioned the movement of the goods from outside the state, the terms and conditions of such Contract should, explicitly or implicitly, provide for a contractual obligation to necessarily import such goods from outside the state or alternatively there should be no choice for the contractor but to import goods from outside the State.

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goods. In this case, though there was no physical transfer of L.R. etc., the Gujarat High Court held that there is constructive transfer by instruction and hence duly covered by Section 6(2). This judgment duly covers both issues, that there is no need for physical transfer and also that having predetermined parties does not affect the claim.

- d) In the case of *Indure Ltd. & Another vs. Commercial Tax Officer & Others* (34 VST 509)(SC) it was held that the import had been occasioned only on account of an agreement between the parties and that the imported pipes in that case "were used exclusively for erection and commencing of the plant." Additionally, it was observed that the Respondent in that case had "failed to establish that these pipes were not used in the plant of NTPC." The crucial factor to be examined was whether there exists such a bond between the contract of sale and the actual exportation or importation, that each link is inextricably connected with the one immediately preceding India. There could be at least four sources of the obligation to import: the statute, the contract, the mutual understanding between the parties or the nature of the transaction and which obligation cannot be snapped "without committing a breach of statute or contract or mutual understanding."

In this regard, it is pertinent to refer the Circular CCT's Ref.No.AI(3)/911/2005-1 dated 23-1-2006 of the Commissioner of Commercial Taxes, Hyderabad, which is reproduced below-

".....In order to establish that the contract between the works contractor and the contractee has occasioned the movement of the goods from outside the state, the terms and conditions of such Contract should, explicitly or implicitly, provide for a contractual

obligation to necessarily import such goods from outside the state or alternatively there should be no choice for the contractor but to import goods from outside the State. If the works contractor is not under such a contractual obligation or is not forced to import the goods from outside the State, the movement of such goods cannot be said to have been occasioned by such a contract."

In this regard, it is also pertinent to refer the Supreme Court Judgement in the case of *A & G Projects and Technologies Limited vs. State of Karnataka* (19 VST 239) and the Delhi High Court Judgment in the case of *Mitsubishi Corporation India Pvt Ltd. vs. The VAT Officer & Anr* (WP (C) 11932/2009). In the case of *A & G Projects and Technologies Limited* the Hon'ble Supreme Court held that the proviso to Section 9(1) of the CST Act 1956 is not applicable to the facts of the present case as the AO has categorically held that all the three sales fell under Section 3(a) of the CST Act 1956. Once the said sales fall under Section 3(a), then under Section 9(1), the tax has got to be collected by the State of Tamil Nadu from which the movement of the goods commenced. The case of the appellant regarding subsequent sales effected during the movement of the goods stood specifically rejected both by the AO and the FAA and, therefore, the question of taxing such sales under the proviso to Section 9(1) of CST Act 1956 did not arise. In the case of *Mitsubishi Corporation India Pvt. Ltd.*, the Delhi High Court held that when the conditions specified in Section 6(2), whether in the main provision or in the provisos, are all satisfied, the dealer would be entitled to exemption and no provision has been brought to our notice which indicates or suggests that the exemption under Section 6(2) in respect of a subsequent sale cannot be granted where the first sale has had the benefit of an exemption. Thus, the only conditions that are discernible from Section 6(2) are that:-

- i) The first sale could be either a Section 3(a) or a Section 3(b) sale;
- ii) The second or subsequent sale has to be a Section 3(b) sale;
- iii) The subsequent sale has to be to a registered dealer;
- iv) The goods should be of a description referred to in Section 8(3) of the CST Act;
- v) The E-1 Form is to be furnished by the petitioner; and

vi) The C-Form obtained from the purchasing registered dealer has also to be furnished by the petitioner.

In the case of *M/s Larsen and Toubro Ltd. vs. State of Andhra Pradesh & Ors.* (2015-VIL-411-AP) the Apex Court while rejecting the submissions of the petitioners that the supply & erection contracts are divisible and independent contracts for which they are entitled to claim exemption under Section 6(2) of the CST Act, however accepted their contention that the subject sales/deemed sales fall within the ambit of Section 3(a) and 5(2) of the CST Act. Existence of 'cross-fall breach' clause or clause which enables owner to terminate supply contract for breach of erection contract and vice-versa, would mean that while in form there are two separate contracts, in substance, there is one single indivisible contract. For a sale to be exempt u/s 6(2), sale contract should come into existence and title to goods should be transferred during movement. Parties intended that title to goods would be transferred from contractor to owner only post erection and commissioning, so title transferred only after goods incorporated in works in State of AP and therefore, Revenue justified in rejecting assessee's claim of 'subsequent sale'. The assessee's plea merits acceptance that supplies in turnkey contracts were inter-state sales falling u/s 3(a), the mere fact that goods delivered within State and appropriation took place is inconsequential, if parties envisaged movement of goods from one State to another and such movement is an incident of contract of sale.

Following principles emerge on the analysis of the various judgments on "interstate sale":-

- Only a transaction of sale connected with the movement of goods can be regarded as inter-State sales.
- The movement and the sale must have a reasonable direct link. Such movement can be stipulated in the contract of sale specifically or it may be contemplated by the parties as an implied term of contract.
- Even if the movement of the goods is not specified in the contract and even if it cannot be regarded as an implied term if such movement is incidental to the contract, then in such case also such transaction would be an inter-State sale.
- The relationship between the movement and the sale should be, very broadly put, be that of effect

For a sale to be exempt u/s 6(2), sale contract should come into existence and title to goods should be transferred during movement.



and cause. The sale should have occasioned the movement or the movement should have been incidental to the sale.

- The expression "sale or purchase occasions the movement of goods", means that either the contract of sale itself should provide for the movement of the goods or the movement of the goods must be incidental to the contract, there being no possibility of diversion of goods for any other purpose or to any other sale.
- It was also not necessary that the contract of sale had to expressly provide for the movement of goods. It was sufficient if the movement of goods was implicit in the sale. {*Co-operative Sugars (Chittur) Ltd vs. State of Tamil Nadu (90 STC 1) (SC)*}.

Conclusion:

By virtue of the stipulation in the tender schedule and the terms of agreement, the goods are to be procured as per the specifications in the tender schedule and only from approved vendors stated therein. Further the goods are also subject to pre-despatch inspection. Admittedly, the approved vendors are all situated outside the state. Therefore, the sale (deemed sale) of goods has caused the movement of the said goods from outside the state. Hence, the deemed sale and the movement of goods is inextricably linked. Since the goods are also subject to pre-despatch inspection at the instance of the Client, there is no possibility of diversion of goods. Hence, the deemed sale is a sale in the course of inter-state trade falling u/s. 3(a) of the CST Act and the State does not have power to levy tax on such transactions. ■