

Mani Muthusamy Vs Personal Assistant to the Collector

Court: Madras High Court

Date of Decision: Oct. 15, 2009

Acts Referred: Constitution of India, 1950 " Article 226
Income Tax Act, 1961 " Section 194, 194C, 194C(1), 197(2)

Citation: (2010) 230 CTR 542 : (2010) 186 TAXMAN 339

Hon'ble Judges: T.S. Sivagnanam, J

Bench: Single Bench

Advocate: G.R. Swaminathan, for the Appellant; Pala Ramasamy and S. Srimathy, for the Respondent

Final Decision: Dismissed

Judgement

T.S. Sivagnanam, J.

By consent, all the writ petitions are taken up for final disposal. Since the prayers sought for in all the writ petitions are identical, the writ petitions are disposed of by a common order.

2. The question which has been raised for consideration in the above writ petitions is as to whether the contract in question is a contract of sale or

a contract of work and labour.

3. Mr. G.R. Swaminathan, learned Counsel for the petitioners requested that the facts in W.P.(MD) No. 2571 of 2009 may be taken up for the

disposal of all the writ petitions. Accordingly, the facts in the said case are taken up.

4. All the petitioners are suppliers of eggs. The Government of Tamil Nadu in order to ensure that the school children are provided adequate

nutrition, brought out a scheme for supply of eggs in the noon meal centres. The present issue is one such a contract between the petitioner and the

State Government represented by the first respondent. The reason for approaching this Court is that on the instructions of the second respondent

Department, the first respondent has demanded payment of Income Tax on such supply since the second respondent has stated that tax ought to

have been deducted at source itself.

5. The facts which are necessary for the disposal of the writ petitions are that the petitioners entered into an agreement for supply of eggs to noon

meal centres in Madurai and Theni Districts respectively. Originally tenders were invited in which all the petitioners herein were successful bidders.

The supply of eggs has been made in terms of the specifications contained in the contract. The second respondent by communication, dated 31-

12-2008, stated that the transactions are liable for payment of Income Tax and based on such communication, the first respondent informed the

petitioners that Income Tax has to be deducted at source in respect of their contract. The petitioners would further contend that it is a mere supply

of eggs and no processing has been done by them and therefore, it cannot be construed as a works contract. By relying upon a circular of the

Central Board of Direct Taxes (CBDT), dated 8-3-1994, it is stated that when a contractor agrees to supply eggs according to the specification of

Government and when owner of the goods passes on the delivery, tax deduction at source as contemplated u/s 194C of the Income Tax Act

would not apply. The Department has made a demand for the assessment years 2005-06, 2006-07 and 2007-08 with interest. The petitioners

would contend that they have effected supply and bill value has been collected by the petitioners and now the demand has been raised and,

therefore, they have approached this Court by invoking the extra jurisdiction under Article 226 of the Constitution.

6. Learned Counsel for the petitioners would assail the correctness of the demand made and the order passed by the second respondent on the

following grounds, viz., that the respondents have totally misconstrued the transaction in question as the contract is to supply eggs and it should be

construed as a contract of sale and not a works contract. It is further submitted by the learned Counsel that if the intention is to transfer goods for a

price in which the transferee had no property and such contract of sale is the transfer of property and delivery of possession. In respect of contract

of work, there is no transfer of property but it is one for work and labour. Therefore, learned Counsel would submit that all the petitioners are only

vendors and not work contractors.

7. It is next contended by the learned Counsel for the petitioners that the subject transaction falls outside the purview of Section 194C of the

Income Tax Act and the circular of the CBDT, dated 8-3-1994, more particularly Clause No. 7(vi)(b) of the said circular amply makes it clear

that the transaction cannot be construed as a contract for works. It is further contended that such demands have been made only in respect of

Madurai District and there is discrimination.

8. Learned Counsel would further submit that under the contract, the supplier is required to give a colour coding for the eggs by adopting a

particular colour for a particular day with the emblem of the State Government. It is further contended that the colouring of the eggs is to ensure no

misuse and also to ensure their quality but this does not change end use of the product. Therefore, the product in question, namely, eggs cannot be

termed as tailor-made since the natural form of the product remains the same even at the end use stage.

9. It is further stated that under the contract, the supplier is required to supply additional eggs because of breakage and this will not alter the nature

of contract.

10. Further, learned Counsel for the petitioners would submit that no extra cost is paid for transportation and it is covered in the bill value itself

and, therefore, the communication is without jurisdiction. Finally, learned Counsel would contend that the agreement has to be read as a whole and

the nomenclature of the agreement is not the criteria for deciding the nature of the contract.

11. Learned Counsel would place reliance on a decision of the Hon"ble Supreme Court in State of Andhra Pradesh Vs. Kone Elevators (India)

Ltd., and contend that the transaction in the instant case also is something akin to the transaction which was subject-matter in the above referred

case and the said case squarely applies to the facts of the instant case.

12. On behalf of the first respondent Mr. Pala Ramasamy, learned Special Government Pleader and on behalf of the second respondent

Department Mr. R. Sathiyamoorthy, learned Senior Standing Counsel made its submissions. Learned counsels relied upon the counter-affidavit

filed which has raised common points.

13. The contentions raised on behalf of the respondents are that the supply of eggs is in the light of the direction issued by the Government in

G.O.Ms. No. 135, dated 7-8-2007 and the consequential proceedings issued by the District Collectors. Under the contract, the period and rate

have been specified which includes, insurance, freight, transport and all other charges. The contractor is required to deposit one per cent of the

consignment value of one month supply and the rate accepted cannot be revoked and there cannot be any claim for escalation. It is further

stipulated under the contract that the eggs are required to be of a particular size and weight and recovery will be effected for supply of bad eggs.

Further, the contractors have to supply these eggs in containers and these containers will be returned through the respective Panchayat Union

Offices. Further, six tree eggs per 1000 eggs are required to be supplied to cover wastage during transportation and replacement for

damaged/rotten eggs has to be made within 24 hours. It is further stated under the agreement that any revision of sales tax or other taxes will not

affect the rates in which supply has to be effected. In the event of delay in supply by the contractor, the Collector of the District is entitled to

purchase the eggs from the local market. The contract also contemplates power to terminate agreement for violation of terms and conditions and

the earnest money deposit paid by the contractors will be returned after the completion. The agreement also provides for a widely couched

arbitration clause.

14. Learned Counsel for the second respondent would first contend that the writ petitions are not maintainable. It is contended that in order to

determine as to whether the subject contract is a contract of supply or a works contract, it is necessary to dwell deep into the facts of the case,

appreciate documents on record and examine such other matters including affording opportunity to the assessee and thereafter determine the

question.

15. Therefore, it is their submission that when the matter relates to essentially a decision on facts, this Court would refuse to entertain the writ

petitions as the petitioners have an effective remedy under the provisions of the Income Tax Act and the rules framed thereunder.

16. Without prejudice to the said contentions, learned Counsel for the respondents would submit that supply by weightage or 12 pieces of

particular weight have to be made as per the demand three times in a week. As regards the colour coding, elaborate instructions have been given

and the supplier is also required to affix the seal of the Government of Tamil Nadu. Therefore, the unit supply value is fixed, keeping in mind

various items of expenses.

17. In the counter-affidavit, the first respondent has set out some of the essential items of work involved in the meeting of the contract agreement.

By relying upon the said conditions, the learned counsels would contend that the contract in question is a works contract.

18. It is next contended that the present contract is an indivisible contract for supply of a tailor-made product involving not only cost of goods but

also value of service, transportation, handling/breakage, inventory management, etc., therefore, it is submitted that composite contract involving

supply of goods and labour, is definitely a works contract.

19. On the aspect regarding how the contract has to be interpreted, it is submitted that it is necessary that the essence of contract has to be taken

into consideration for judging whether it is a contract for work or for sale. In the counter-affidavit, the Department has denied the allegation of

discrimination. Learned Counsel for the second respondent would further contend that terms of Section 197(2) of the Income Tax Act provide for

obtaining a lower deduction certificates or nil deduction certificate from the Jurisdictional Assessing Officer after particulars are furnished by the

assessee and in terms of Section 194(c), the petitioners have got sufficient remedy under the Act and since alternative remedy is efficacious, the

writ petitions have to be dismissed.

20. It is further submitted that affixing seal of the Government of Tamil Nadu on the product, the same could be supplied only to the district

authorities and this imposed restriction on the sale of the product in the open market. It is, therefore, contended that the goods become property of

the buyer Government by the theory of accretion even before the actual delivery takes place. When the goods are rejected on account of bad

quality, the commercial value of the goods become zero. Further, learned Counsel for the second respondent would submit that the supply of

additional quantity of eggs is not essential ingredient of a normal sale transaction. In support of its contentions, learned Counsel for the second

respondent would place reliance upon the following decisions:

(i) In Sentinel Rolling Shutters and Engineering Company (Pvt.) Ltd. Vs. The Commissioner of Sales Tax, .

(ii) In State of Tamil Nadu Vs. Anandam Viswanathan, .

(iii) In Hindustan Aeronautics Ltd. Vs. State of Karnataka, .

21. Therefore, learned Counsel would submit that based on the above facts and the legal position, the writ petitions should not be entertained and

the petitioners should be directed to avail alternative remedy under the provisions of the Income Tax Act.

22. Heard Mr. G.R. Swaminathan, learned Counsel for the petitioners, Mr. Pala Ramasamy, learned special Government pleader for the first

respondent and Mr. R. Sathiyamoorthy, learned senior standing Counsel for the second respondent and perused the entire materials available on

record.

23. As stated, the question to be considered is whether the contract for supply of eggs to the first respondent as per the terms and conditions

contained in G.O.Ms. No. 135, Social Welfare and Noon Meal Programme Department, dated 7-8-2009, and the consequential proceedings

issued by the respective District Collectors, is a contract of sale or a works contract. If it is a case of contract of sale, the question of deduction of

tax at source does not arise and if it is otherwise, the first respondent is statutorily bound to deduct tax at source.

24. Before going into the facts of the present case, it is necessary to look into the law laid down by the Hon"ble Supreme Court on the subject.

25. In the case of Sentinel Rolling Shutters & Engg. Co. (P.) Ltd. (supra), the petitioner before the Hon"ble Supreme Court was a company

engaged in fabrication, supply, erection and installation of rolling shutters. The Hon"ble Supreme Court decided the question whether that particular

contract is a contract of sale or contract of work and labour and while deciding such question, the Hon"ble Supreme Court held as follows:

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. (p. 1749)

26. In the case of Anandam Viswanathan (supra) before the Supreme Court, the question was whether the printing contract for question papers of

Universities is a works contract. The Hon"ble Supreme Court while deciding the said issue held as follows:

26. The primary difference between a contract for work or service and a contract for sale is that in the former there is in a person performing or

rendering service, no property in the thing produced as a whole, notwithstanding that a part or even the whole of the material used by him may

have been his property. Where the finished product supplied to a particular customer is not a commercial commodity in the sense that it cannot be

sold in the market to any other person, the transaction is only a works contract. (p. 971)

27. In Hindustan Aeronautics Ltd.'s case (supra), the Hon"ble Supreme Court was considering several questions one of which was about

taxability of the turnover in respect of sales made in the canteen of the appellant- company. While deciding such question, the Hon"ble Supreme

Court, analysed the difference between the works contract of service and contract for sale of goods and held as follows:

13. 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 some time before delivery and the property therein passed only under the contract relating thereto to the other party for

price. It is necessary, therefore, in every case for the courts to find out whether in essence there was any agreement to work for a stipulated

consideration. If that was so, it would not be a sale because even if some sale may be extracted that would not affect the true position. Merely

showing in the bills or invoices, it was contended on behalf of the appellant, the value of materials used in the job would not render the contract as

one of sale. The nature and type of the transactions are important and determinative factors. What is necessary to find out, in our opinion, is the

dominant object. (p. 748)

28. In *Associated Cement Co. Ltd. v. CIT* [1993] 207 ITR 435 : 67 Taxman 346, the Hon^{ble} Supreme Court was deciding the question

whether a person who credits to the account of a contractor any sum payable by any of the organisations specified in Section 194C carrying out

any work in pursuant to a contract, is liable to deduct 2 per cent sum as Income Tax as required under the said sub-section. The Hon^{ble} Supreme

Court while considering the said issue has held as follows:

5. Thus, when the percentage amount required to be deducted under the Sub-section as Income Tax is on the sum credited to the account of or

paid to a contractor in pursuance of a contract for carrying out a work or supplying labour for carrying out a work, of any of the organisations

specified therein, there is nothing in the Sub-section which could make us hold that the contract to carry out a work or the contract to supply

labour to carry out a work should be confined to "works contract" as was argued on behalf of the appellant. We see no reason to curtail or to cut

down the meaning of plain words used in the section. "Any work" means any work and not a "works-contract", which has a special connotation in

the tax law. Indeed, in the sub-section, the "work" referred to therein expressly includes supply of labour to carry out a work. It is a clear

indication of Legislature that the "work" in Sub-section is not intended to be confined to or restricted to "works contract". "Work" envisaged in the

subsection, therefore, has a wide import and covers "any work" which one or the other of the organisations specified in the Sub-section can get

carried out through a contractor under a contract and further it includes obtaining by any of such organisations supply of labour under a contract

with a contractor for carrying out its work which, would have fallen outside the "work", but for its specific inclusion in the sub-section.

(6) ** ** *

(7) The above decision cannot be of any help to the appellant for it does not lay down that the percentage amount deductible u/s 194C(1) should

be out of the income of the contractor from the sum or sums credited to the account of or paid to him. The words in the Sub-section "on income

comprised therein" appearing immediately after the words "deduct an amount equal to two per cent of such sum as income tax" from their purport,

cannot be understood as the percentage amount deductible from the income of the contractor out of the sum credited to his account or paid to him

in pursuance of the contract. Moreover, the concluding part of the Sub-section requiring deduction of an amount equal to two per cent of such sum

as Income Tax, by use of the words "on income comprised therein" makes it obvious that the amount equal to two per cent of the sum required to

be deducted is a deduction at source. Indeed, it is neither possible nor permissible to the payer to determine what part of the amount paid by him

to the contractor constitutes the income of the latter. It is not also possible to think that the Parliament could have intended to cast such impossible

burden upon the payer nor could it be attributed with the intention of enacting such an impractical and unworkable provision. Hence, on the

express language employed in the sub-section, it is impossible to hold that the amount of two per cent required to be deducted by the payer out of

the sum credited to the account of or paid to the contractor has to be confined to his income component out of that sum. There is also nothing in

the language of the Sub-section which permits exclusion of an amount paid on behalf of the organisation to the contractor according to Clause 13

of the terms and conditions of the contract in reimbursement of the amount paid by him to workers, from the sum envisaged therein, as was

suggested on behalf of the appellant. (p. 351)

29. Therefore, based on the law laid down by the Hon"ble Supreme Court, what is required to be seen is the nature and type of transaction, which

are determinative factors and it is necessary to find out what is the dominant object of the said contract. Next, it has to be seen as to whether there

is no transfer of property by the supplier to the Government as such a chattel and whether considering all the obligations under the contract if it is

one and single indivisible contract. Therefore, it is to be noted that as held by the Hon"ble Supreme Court 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.

30. Further, the Hon"ble Supreme Court in the case of Anandam Viswanalhan (supra), held that where the finished product supplied to a particular

customer is not a commercial commodity in the sense that it cannot be sold in the market to any other person, the transaction is only a works

contract. Therefore, all these issues are essential questions of fact which cannot be effectively adjudicated in the writ petitions filed under Article

226 of the Constitution of India.

31. Learned Counsel for the petitioners would submit that the agreement has to be examined as a whole and the nomenclature alone shall not be

the criteria. Therefore, whether subject contract could be construed as a works contract has to be decided on facts which require thorough

analysis and the scope of the contract and such other documentary evidence which may be placed by the assessee. Therefore, I am inclined to

agree with the objections raised by the respondents as regards the maintainability of the writ petitions at this stage.

32. Much reliance has been placed by the learned Counsel for the petitioners on the decision in Kone Elevators (India) Ltd."s case (supra).

33. First, it is to be noted that in all the decisions rendered by the Hon"ble Supreme Court as referred to above, the parties have exhausted their

remedies available under the Income Tax Act.

34. In the case of Kone Elevators (India) Ltd. (supra) the Supreme Court, the assessee filed monthly returns in Form A-2 for the months of April

and May, 1995 and the assessee was provisionally assessed by the Commercial Tax Officer for certain other period and the assessee claimed a

deduction by stating that the work undergone by it constituted under the works contract involving manufacture, supply, installation etc. While

deciding the said question, the Supreme Court has held as follows:

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 ""contract for work"" is not the transfer of the property but it is on 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.

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9. In the case of M/s. Hindustan Shipyard Ltd. Vs. State of Andhra Pradesh, 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. (p. 394)

35. Therefore, even in the said case, it has been held by the Hon'ble Supreme Court that there is no standard formula by which one can distinguish

a contract for sale from a works contract and the question is largely one of fact depending upon the terms of the contract, on proper construction

of the terms and conditions between the parties including the obligation cast upon them which has to be discharged under the contract.

36. In that context, the Hon"ble Supreme Court held that it is settled-law that substance and not the form of the contract is material in determining

the nature of transaction. Therefore, by relying upon the decision of the Supreme Court in the case of Kone Elevators (India) Ltd. (supra), also it is

fortified that the question of fact has to be gone into on case to case basis. This in my view, cannot be done in a writ petition filed under Article 226

of the Constitution of India and that apart, the Income Tax Act and the Rules framed thereunder is a complete self contained code by itself. There

are multi-level remedies available to the assessee and such remedies are efficacious. The authorities functioning under the statute have got

adjudicatory powers and to examine the fact of agreement and the assesseees are entitled to submit oral and documentary evidence in support of

their claim.

37. It has been further stated in the counter-affidavit that in respect of the petitioners in W.P. No. 5262 of 2008, they have already cleared the tax

dues and TDS is deducted. Further, it has been stated that the contractors were undergoing the above contract in different districts of Tamil Nadu

on routine basis or regional basis taking lower/nil deductions certificate from their Assessing Officers at Namakkal and Salem.

38. Therefore, I find that there is no valid reason as to why all the petitioners cannot avail on such a remedy especially when either themselves or

persons similarly placed like them have been approaching the authorities under the provisions of the Income Tax Act while effecting supplies in

other districts, through Jurisdictional Assessing Officer under the Income Tax Act.

39. For the above reasons, I find that the writ petitions are not maintainable since the issue involved is essentially a question of fact which cannot be

effectively adjudicated in the present writ petitions. Therefore, while dismissing the writ petitions, liberty is granted to the petitioners to work out

their remedies by taking appropriate proceedings under the provisions of Income Tax Act, 1961 and the Rules as framed thereunder. During the

pendency of the writ petitions, the petitioners had the benefit of interim stay. Therefore, since the writ petitions are now dismissed and liberty has

been granted to approach the Department, the petitioners are granted four weeks" time to approach the concerned authority under the provisions

of the Act seeking for appropriate remedy. Till such time, the respondents shall not initiate any coercive steps for recovery of the Income Tax dues.

No costs. Consequently, connected miscellaneous petitions are closed.