PETITIONER:
M/S. HINDUSTAN SHIPYARD LTD.

Vs.

RESPONDENT:
STATE OF ANDHRA PRADESH

DATE OF JUDGMENT: 20/07/2000

BENCH:
S. Rajendra Babu, J. & R.C. Lahoti, J.

JUDGMENT:

R.C. Lahoti, J.
The question arising for decision in these appeals is whether the transactions involved in manufacture and supply of ships by the appellant to its customers are a sale as defined in clause (n) of Section 2 of the Andhra Pradesh General Sales Tax Act, 1957 (hereinafter the Act, for short) as held by the High Court or a works contract as defined in clause (t) of Section 2 of the Act and hence not exigible to sales-tax as contended by the assessee-appellant.

M/s. Hindustan Shipyard Limited, the appellant before us, is a public sector undertaking. It is engaged in the activity of building ships for different ship owners under the orders placed by them and as evidenced by the contracts entered into between them.

The facts in brief. Between the assessment years 1974-75 and 1983-84 (both years inclusive) there were 18 ships involved and formed subject matter of different assessments. The Assessing Authority and the Commissioner (Appeals) held all the transactions in question as transactions of sale liable to payment of sales-tax by the appellant. Several tax appeals preferred by the appellant were disposed of by the Sales Tax Appellate Tribunal, Andhra Pradesh, Hyderabad by a common order dated 19th July, 1989. It appears that earlier also transactions regarding building of ships by this very assessee have been a subject of controversy travelling upto the High Court of Andhra Pradesh and disposed of by a Division Bench by its order dated 27th January, 1969 reported as Hindustan Shipyard Limited, Visakhapatnam Vs. The Commercial Tax Officer, Visakhapatnam 1970 (1) Andhra Weekly Reporter 197. The High Court having examined several clauses of the contract dated 12.4.1965 entered into between the appellant and its customers concluded that the building of the ships under the contract under scrutiny was works contract and not sale. This decision was heavily relied on by the appellant before the Tribunal. The Tribunal has analysed the terms and conditions of all the contracts forming subject matter of appeals before it and thereafter divided the contracts into two groups. The Tribunal noticed that the contracts relating to 10 ships before it incorporated recitals identical or similar to the contract dated 12.4.1965 involved before the High Court in 1970 (1) Andhra Weekly Reporter 197. As to such contracts the Tribunal held that it was bound to follow the Division Bench decision of the High Court more so when the Department had not pursued its challenge to the correctness of the findings of fact and the principles laid down therein by approaching the Supreme

Court. Such contracts were held to be works contract following the abovesaid decision. This time also the Department has not pursued the matter further. Therefore as to the transactions involving 10 ships the order of the Tribunal has become final. The Tribunal has then noted in its impugned order that after the decision of the High Court dated 27th January, 1969 there was a decision of a three-Judges Bench of the Supreme Court delivered on 6th April 1977 reported as Union of India Vs. The Central India Machinery Manufacturing Co. Ltd. (CIMMCO) & Ors. 1977 (40) STC 246, wherein the relevant law was dealt with and the tests for determining the distinction between a contract of sale and a works contract were laid down. The decision in CIMMCOs case was followed by the High Court of Andhra Pradesh in P.S. & Co. Vs. State of Andhra Pradesh 1984 (56) STC 283 dealing with exigibility to sales-tax of a transaction involved in construction and supply of harbour ferry. Having followed the law laid down by the Supreme Court in the case of CIMMCO and several other decisions and having also considered the earlier Division Bench decision of the High Court of Andhra Pradesh in the case of this assessee, the Division Bench held in PS & Co.s case the transaction before it to be a sale and not merely a contract for work and labour. This being the latest decision of the jurisdiction High Court placed before the Tribunal, for the transactions relating to remaining 8 ships before it, the Tribunal applied the ratio of P.S. & Co.s case and held the transactions to be those of sales liable to sales-tax and dismissed appeals filed by the appellant. The appellant feeling aggrieved by the decision of the Tribunal to the extent to which the transactions were held to be sales, filed tax revision cases before the High Court. The decision in 1970 (1) Andhra Weedly Reporter 197 was once again heavily relied on by the appellant before the High Court. The High Court examined the contention of the appellant, scrutinised the terms and conditions of the contracts entered into by the appellant with the several ship owners and then held that the relevant terms and clauses led to an irresistible inference of sales having taken place and such a situation was governed by the Division Bench decision in P.S. & Co.s case (supra). Accordingly, the revisions filed by the appellant have been dismissed. The aggrieved appellant has come up to this Court by filing these petitions for special leave to appeal.

Clauses (n) and (t) of Section 2 of the Act respectively define sale and works contract as under :-

Sale with all its grammatical variations and cognate expressions means every transfer of the property in goods (Whether as such goods or in any other form in pursuance of a contract or otherwise) by one person to another in the course of trade or business, for cash or for deferred payment or for any other valuable consideration or in the supply or distribution of goods by a society (including a co-operative society), club, firm or association to its members, but does not include a mortgage, hypothecation or pledge of, or a charge on goods.

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Works Contract includes any agreement for carrying out for cash or for deferred payment or for any other valuable consideration, the building construction, manufacture, processing, fabrication, erection, installation, fitting out, improvement, modification, repair or commissioning of any movable or immovable property.

The distinction between a contract of sale and a works contract is not free from difficulty and has been subject matter of several judicial decisions. No straight-jacket formula can be made available nor can such quick-witted tests devised as would be infallible. 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. In State of Gujarat Vs. Variety Body Builders (1976) 38 STC 176 this Court observed that there is no standard formula by which one can distinguish a contract of sale from a contract for work and labour. There may be many common features in both the contracts, some neutral in a particular contract, and yet certain clinching terms in a given case may fortify a conclusion one way or the other. It will depend upon the facts and circumstances of each case. The question is not always easy and has for all times vexed jurists all over.

We would straightaway proceed to notice the relevant recitals of the contracts in question. During the course of hearing Shri T.L.V. Iyer, the learned senior counsel for the appellant submitted that in the case at hand there are different contracts relating to 8 ships. The terms and conditions of these several contracts are more or less similar to each other though not the same and it will suffice if the terms and conditions of one contract, viz. the one entered into between the appellant and the Great Eastern Shipping Co. Ltd. dated 3rd February, 1971 are taken into consideration. This contract relates to construction of four motor vessels of Jag Darshan type. The relevant recitals and terms and conditions of the contract are summarised and wherever necessary reproduced, as under:-

1. The appellant is called the Builder and the customer the Great Eastern Shipping Co. Ltd. - is called the Owner.

2. The Preamble to the contract speaks of the Builder having agreed to build, launch, fit, equip, test and complete in all respects four vessels at its Shipyard and after completion and successful trials in all respects deliver them alongside safe berth at Visakhapatnam from which supplies could be conveniently loaded and the crew embarked and the owner having agreed to accept delivery from the Builder of the said four vessels upon the terms and conditions hereinafter set forth.

(3) The vessels shall have Builders hull numbers 171002-3- 4-7 respectively and shall be constructed, fitted and completed in strict accordance with the plans and specifications forming part of the contract.

(4) The Builders shall arrange for assignment of a representative/s called the Classification Surveyor to the vessel from Lloyds Register of Shipping throughout the construction. The plans and drawings, materials and workmanship shall be subject to instructions and tests by the Classification Surveyor for which the facilities shall be furnished by the Builder without any charge to the owner.

(5) The Builder shall furnish all labour, machinery, materials, equipments, appurtenances, spare parts and outfits required for the construction of the vessel to make it completely ready.

(6) The total price of the vessel is fixed at Rs.5,50,00,000/- per vessel which shall be called the contract price to be paid in the following manner :-

(a) 5% of the Contract Price upon signing this Contract.

(b) 10% of the Contract Price upon Builder producing adequate documentary evidence to the Owner confirming that the Builder has placed order for main engine and steel requirement.

(c) 10% of the Contract Price upon keel laying of the vessel.

(d) 15% of the Contract Price upon Builder submitting its certificate to the Owner that 50% by weight of the steel structure of the vessels hull has been erected. (Panels placed on berth).

(e) 15% of the Contract Price upon launching of the vessel.

(f) 10% of the Contract Price upon Builder submitting its certificate to the Owner that the main engine has been lowered in position on board the vessel.

(g) 15% of the Contract Price upon satisfactory completion of the dock trials.

(h) 20% of the Contract Price upon delivery of the vessels.

(7) The contract, vide Article 3, makes provision for payment of liquidated damages at the prescribed scale by reference to the period of delay for delayed delivery and also makes a similar provision for payment of bonus by the owner to the Builder for advanced delivery.

(8) The owner has the right to appoint at its expense one or more superintendents who will be allowed to inspect regularly the building of the vessel and also the machinery and all accessories and workmanship during the work in progress.

(9) If owner may suggest any changes and alteration in the plans and drawings the same shall be carried out by the Builder subject to mutual agreement arrived at in writing between the owner and the Builder regarding additional debits and credits involved.

(10) Before the vessel being delivered there shall be trial runs intimation whereof shall be given by thirty working days advance notice in writing and all expenses in connection with the trial runs of the vessel are to be borne by the Builder. Prior to the trial runs the vessel shall be dry-docked and the bottom shall be painted as per the specifications. Dry-dockeing and painting shall be at the expenses of the Builder. The required quantity of the fuel oil, lubricating oils and greases shall be provided by the owner but paid for by the Builder.

(11) Clause 5 of Article 6 provides method of acceptance or rejection as under:-

If after successfully completed technical trial test procedures according to the Specifications no legitimate complaints are made concerning the completion or correct functioning of the vessel according to this Contract, the Drawings and Specifications, the Owner shall accept the vessel and confirm the acceptance in writing.

(12) If any defects become evident they shall be made good by the Builder at his own expense. The owner may demand a new set of trial which shall be conducted by the Builder on the same terms

and conditions as applicable to the first trial and paid for by the Builder. After the first or second trial runs, as the case may be, the owner may accept or reject the vessel by serving notice in writing within seven days and stating the reasons for rejection.

(13) Vide Article 7, there are the different dates appointed for the four vessels by which the Builder agrees to deliver the respective vessels. Simultaneously with the delivery the owner has to fulfil its obligation for payment as stipulated. Thereupon protocol of delivery shall be signed. All the documents relating to the vessel have to be delivered by the Builder to the owner upon the acceptance of the vessel by the owner.

(14) Clause 5 of Article 7, dealing with title and risk, reads as under:-

Title and risk of the Vessel shall pass to the Owner upon acceptance when delivery of the Vessel is effected, as stated above, it being expressly understood that, until such delivery is effected, the Vessel and equipment thereof, is at the entire risk of the Builder, including, but not limited to, risks of war, insurrection and seizure by Government or Authorities, whether Indian or foreign, and whether at war or at peace.

(15) There is warranty of quality to remain valid for a period of 12 calendar months from the date of actual delivery of the vessel.

(16) Vide Article 11, for a certain period of delay and default on the part of the owner the same is liable to the compensated by payment of interest. Delay and default beyond a certain time entitles the Builder to rescind the contract whereupon the Builder shall refund to the owner all the instalments already paid by the owner to the Builder without any interest thereon. In this Article nothing is said about the vessel which implies that the vessel continues to remain with the Builder.

(17) Article 15 entitled property in the vessel reads as under:-

Article 15 Property in the vessel : Without prejudice to Article 17 hereof, the vessel as constructed and her engines, boilers and machinery and all materials from time to time intended for her or appropriated to the Contract whether in the building berth, fitting out basin, workshop or elsewhere shall immediately after payment of the first instalment on account of vessel as the work proceeds, become the property of the Owner and such property shall be conspicuously marked with the hull number or with other appropriate markings for identification, as belonging to vessel/Owner as its property and shall not be within the ownership or disposition of the Builder. Until the vessel is completed and delivered the Builder, shall not use or permit to be used any such part/s, material/s, equipment and machinery so allocated to the vessel for any other vessel. The Owner to the extent of payment made by him will have a right to mortgage his interest in materials mentioned above to Indian Government, Lender and/or Shipping Development Fund Committee for loans taken by Owner and formalities as required by Lender/Owner shall be completed by the Builder. But the Builder at all times shall have a lien on the above-mentioned property fcr any unpaid portion of the price. All materials and other things appropriated but not used for the purpose of this Contract shall

after completion of the vessel become the property of Builder.

(18) Vide Article 16, in the event of the Builder defaulting in the construction of the vessel, the owner may at his option and after due notice :-

take possession of the vessel in her then state and of all engines, boilers and machinery and all materials intended for her as before mentioned and to complete the vessel, engines, boilers and machinery. For this purpose the Owner shall have power to enter into any contract with other Builders or manufacturers, and to use the Yard or Yards; Workshops, Machinery and tools of the Builders or such other Builders or manufacturers with whom the Builders may have entered Sub-contracts, and costs directly incurred by the Owners by the exercise of any of the powers vested under this clause shall be deducted from the contracted price then remaining unpaid is sufficient, and if not sufficient, shall be made good by the Builders.

(19) Article 17 provides that the vessel shall be at the risk and expense of the Builder until handed over and accepted by the owner and until then so far the interest of the owner is concerned the Builder shall keep her insured at its own cost for all Builders risks under a policy or policies taken out in the joint names of the Builder and the owner. The same clause further provides :-

If, before delivery to the Owner, the Vessel (including the engines, boilers, appurtenances or materials intended for her) hull sustain damage not amounting to total or constructive or compromised total loss, this Contract shall not be invalidated in any way. But such damage shall be made good by the Builder as speedily as may be reasonably expected having regard to all the circumstances to the satisfaction of the Classification Society and the reasonable satisfaction of the Owners authorised representative or representatives. The Insurance moneys recoverable in respect of such damage shall be applied by the Builder to such reinstatement of the Vessel. The Owner shall not on account of the said damage or repair be entitled to object to the Vessel, engines, boilers, material or equipment or to make any claim for any alleged consequential loss or depreciation.

If due to any cause the Vessel before delivery to the Owner shall be destroyed or lost or so damaged as to become or to be deemed to become at any time a total or constructive, arranged or compromised total loss the Builder shall refund to the Owner the instalments of the Contract Price if any; plus interest at the rate of 5 per cent per annum from the date of payment of monies by the Owner to the Builder out of monies payable by the Underwriters under the insurance effected with them in terms of this Contract. Every amount of the instalment, shall be endorsed on the policy/policies and such endorsement shall be sufficient authority to the Underwriters, to pay to the Owner the amount of such instalments plus interest. On payment of such instalments by the Underwriters to the Owner, the Owner shall have no further right or claim on the Builder in respect of this Contract and the Contract in respect of the particular Vessel or Vessels shall be deemed to have ended in all respects. The remaining amounts received from the Underwriters shall be retained by the Builder.

The decision of the Underwriters as to whether the Vessel is a total or constructive, arranged or compromised total loss shall be binding upon the parties to this Agreement.

Even if the recovery of the claim for loss, damage or destruction of the ship cannot be made from the insurers in terms of insurance policies either because the risks are not insured or for any reason whatsoever the Builder shall refund to the Owner the amounts of instalments paid by the Owner together with interest at the rate of 5 per cent per annum form the dates of payments of monies by the Owner to the Builder.

We will shortly revert back to analysing the above-said terms and conditions of the contract and in between try to find out the tests which would enable determination of the nature of the transactions covered by such contracts. The distinction between contract of sale and contract for work and labour has been so stated in Halsburys Laws of England (Fourth Edition, Vol.41, para 603) :-

Contract of sale distinguished from contract for work and labour. A contract of sale of goods must be distinguished from a contract for work and labour. The distinction is often a fine one. A contract of sale is a contract the main object of which is the transfer of the property in, and the delivery of the possession of, a chattel as such to the buyer. Where the main object of work undertaken by the payee of the price is not the transfer of a chattel as such, the contract is one for work and labour. The test is whether or not the work and labour bestowed end in anything that can properly become the subject of sale. Neither the ownership of the 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.

In Benjamins Sale of Goods (Fourth Edition) it is stated that it is sometimes extremely difficult to decide whether a particular agreement is more popularly described as a contract of sale of goods, or a contract for the performance of work or services to which the supply of materials or some other goods is incidental. The learned author sums up the test for distinction in the following words (vide para 1.042) :-

Where the parties have not settled the question by the form of their contract, the decision whether the bargain is one for the performance of work or the sale of a chattel must be made by the court. It is now well established that the court does so by having regard to the substance of the contract - a test which assumes that every contract must be in substance one or the other. This is a legitimate inquiry where the supply of the goods and the performance of the work are, to some extent at least, separate elements in the bargain; but it breaks down in the case where all the work goes into the making of the goods to be supplied, so that the two are inseparable. This point has unfortunately not been appreciated. In the former type of contract, the determination of the substance is a matter of degree, involving an assessment of the relative importance of the two elements; but in the latter type the designation of the contract as one of work or sale must depend upon either an arbitrary formula or a superficial impression.

The same learned author discusses the following types of contracts :-

1. Chattel to be affixed to land or another chattel. Where work is to be done on the land of the employer or on a chattel belonging to him, which involves the use or affixing of materials

belonging to the person employed, the contract will ordinarily be one for work and materials, the property in the latter passing to the employer by accession and not under any contract of sale.

2. Materials supplied wholly or principally by employer. Where an article is to be manufactured, and all the materials are supplied by the person for whom the work is to be done, it is obvious that there can be no sale unless there is a specific transfer of the materials followed by a repurchase of the product. Where each party provides some of the materials or components, the task of the court is to determine which of them has supplied the principal materials; it then follows that the materials supplied by the other vest by accession in the owner of the principal materials.

3. Services independent of creation or furnishing of product. Where work or skill is involved over and above what goes into the making of the goods delivered, it is possible and often correct to view the contract as substantially one for work or services. A doctor or veterinary surgeon who supplies medicines does so as an incident to a contract for professional services, which include diagnosis and advice over and above any work in the making up of the medicine. In contrast, a chemist who makes up a prescription sells it, since his work and skill goes entirely into the product- it is simply a component reflected in the price of the goods.

4. Work wholly a component of article produced. The most difficult type of contract remains to be discussed. In this case the whole of the work or skill involved goes into the creation of the product which is ultimately delivered in performance of the contract: for example, a contract to make a suit of clothing or to build a ship. The work or skill is here a component - perhaps the most important - of the thing produced, but is a component and nothing more. It is not logical to ask whether in such a case the parties contracted primarily or substantially for the performance of work or for the transfer of a chattel: they contracted for both. In Clay v. Yates Pollock C.B. suggested that the court should ask whether it was the work or the materials supplied that was of the essence of the contract, a question to be determined by comparing the importance, though not perhaps necessarily the value, of the two items.

Pollock & Mulla on Sale of Goods Act (1990, Fifth Edition, at page 53) lay down the test for distinction as under:-

Generally a contract to make a chattel and deliver it, when made, is a contract of sale, but not always. The test would seem to be whether the thing to be delivered has any individual existence before delivery as the sole property of the party who is to deliver it.

The learned authors have thereafter noted by way of illustrations several decided cases to notice how the principle has played with several courts in its actual application and then drawn the following deduction from the decided cases:-

It will be observed that in the cases where there is no sale there is never a moment when the thing produced is as a whole the makers absolute property, notwithstanding that part, or even the whole, of the materials may have been his property, whereas in the other case he might, if he found it possible and profitable, and if not restrained by patent, copyright or any other similar branch of laws, make in duplicate or in greater numbers chattels

of the kind ordered, appropriate one at his will to fulfil the special contract, and sell the others to other persons (s).

A number of authorities were cited at the Bar during the course of hearing. It would suffice for our purpose to notice only a few of them, namely, Patnaik and Company Vs. The State of Orissa - 1965 (16) STC 364, The State of Gujarat Vs. Kailash Engineering Co. (Pvt.) Ltd. - 1967 (19) STC 13, State of Gujarat (Commissioner of Sales Tax, Ahmedabad) Vs. Variety Body Builders - 1976 (38) STC 176, Union of India Vs. The Central India Machinery Manufacturing Co.Ltd. and Ors. - 1977 (40) STC 246, Sentinel Rolling Shutters & Engineering Company Pvt. Ltd. Vs. The Commissioner of Sales Tax - 1978 (42) STC 409, Hindustan

Aeronautics Limited Vs. The State of Orissa - 1984 (55) STC 327. The principles deducible from the several decided cases may be summed up as under:-

1. It is difficult to lay down any rule or inflexible rule applicable alike to all transactions so as to distinguish between a contract for sale and a contract for work and labour.

2. Transfer of property of goods for a price is the linchpin of the definition of sale. Whether a particular contract is one of sale of goods or for work and labour depends upon the main object of the parties found out from an overview of the terms of the contract, the circumstances of the transactions and the custom of the trade. It is the substance of the contract document/s, and not merely the form, which has to be looked into. The Court may form an opinion that 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, then it is a sale. If the primary object of the contract is the carrying out of work by bestowal of labour and services and materials are incidentally used in execution of such work then the contract is one for work and labour.

3. 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 A may transfer property for a price in a thing in which B had no previous property then the contract is a contract for sale. On the other hand where the main object of work undertaken by the payee of the price is not the transfer of a chattel qua chattel, the contract is one for work and labour.

(4) 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 a conclusion that the contract is in substance one for the sale of goods and not one for work and 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 have to be weighed. If the major component of the end product is the material consumed in producing the chattel to be delivered and the skill and labour are employed for converting the main components into the end products, the skill and labour are only incidentally used and hence 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.

There may be three categories of contracts: (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. 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. The third is a contract for sale where the goods are sold as chattels and the work done is merely incidental to the sale.

Two simple illustrations may be given to demonstrate applicability of the above-said principles. A customer goes to a tailoring shop accompanied by a suit length in his hands and entrusts the same to the tailor for stitching a suit for him as per his measurements. The tailor by devoting his skill and labour stitches the suit and delivers the same to the customer. In this process the tailor utilises lining, buttons and threads of his own. The transaction would remain a contract for work and labour. The stitched suit delivered by the tailor to the customer is not a sale. It would not make any difference if the customer would have selected a piece of cloth of his own choice for a price to be paid or paid and having purchased the suit length left it with the tailor for being stitched into a suit. The property in the suit length had passed to the customer and physical possession over the suit length by the tailor thereafter was merely that of a bailee entrusted with the suit length. However, if the tailor promises to stitch and deliver the suit for a price agreed upon, investing his own cloth and stitching materials such as lining, buttons and threads, and utilising his own skill and labour then though the customer might have chosen the piece of cloth as per his own liking as to the texture, colour and qualilty and given his own instructions in the matter of style, the transaction would remain a contract for sale of goods, that is, a stitched suit piece in as much as the object of the contract was to transfer property in the stitched suit piece alongwith delivery of the suit by the tailor to the customer, all investments, whether of material or of skill and labour having been made by the tailor incidental to the fulfillment of the contract. Yet another illustration is provided by Benjamin (ibid, para 1.046). A doctor or veterinary surgeon who supplies medicines does so as an incident to a contract for professional services, which include diagnosis and advice over and above any work in the making up of the medicine. In contrast, a chemist who makes up a prescription sells it, since his work and skill goes entirely into the product - it is simply a component reflected in the price of the goods. Benjamin concludes - Where work or skill is involved over and above what goes into the making of the goods delivered, it is possible and often correct to view the contract as substantially one for work or services. In our opinion a reverse case would be one of sale. Benjamin gives yet another illustration. A meal supplied to a customer in a restaurant is a sale of goods, the element of service being subsidiary; but a meal supplied to a lodger or a resident hotel guest is part of a contract for services.

Patnaik & Co.s case (supra) is a Constitution Bench decision. The appellant entered into a contract with the State of Orissa for the construction of bus bodies on the chassis supplied by the

State. On an interpretation of the terms of the contract this Court by a majority of 4:1 concluded that the bus body built by the appellant passed to the Government as moveable. It did not make any difference that the process of manufacture was supervised by purchaser. The contract was held to be a contract for sale of goods.

In Sentinel Rolling Shutters & Engineering Companys case (supra), the assessee carried on business as engineers, contractors, manufacturers and fabricators. It entered into a contract for fabrication, supply, erection and installation of two rolling shutters in two sheds belonging to the customer for a price which was inclusive of charges for erection at site. Once the goods were delivered, rejection claim were not to be entertained. All masonry works required before and/or after erection was to be carried out by the assessee. Payments were to be made on overall measurements to be checked by the customer after installation. This Court held that the erection and installation of rolling shutters was as much the fundamental part of the contract as the fabrication and supply. The contract was held to be a contract for work and labour and not a contract for sale.

In CIMMCOs case (supra) this Court emphasised the need of looking into the substance and not merely the format of the contract. Reading the terms and conditions of the contract before it as a whole this Court concluded that the property in the materials procured or purchased by the company against 90% bill of which advance was taken from the railways did not, before their use in the construction of the wagons, pass to the railways. With an exception of a relatively small portion of the components supplied by the railways, the entire wagon including the material at the time of its completion and delivery was the property of the company. It was held that the wagons were sold for a price and the contract was a contract for the sale of wagons and not a work contract.

In Kailash Engineering Co. (Pvt.) Ltd.s case (supra) and Variety Body Builders case (supra), bodies were built for the railways on the underframes supplied by the railways. Upon analysing the terms and conditions of the contract this Court concluded that the assessee was not the owner of the ready coaches and the property in the bodies vested in the railways even during the process of construction and therefore the transaction was a works contract not involving any sale.

In Hindustan Aeronautics Ltd.s case, the assessee HAL was to manufacture MIG engines on behalf of the Government of India for which the latter had obtained a licence from the U.S.S.R.. For the imports made from U.S.S.R., all payments under the agreement were made by HAL on behalf of the Government of India. The materials imported by HAL, stocks and stores, work-in-progress etc., were the property of the Air Force. The bills drawn by HAL against the Government of India indicated a break-up of the material cost, labour cost and sundry direct charges and further profit at a percentage. This Court held that at no point of time before the delivery of MIG engines HAL was the owner of the property, either in the equipment or in the spares or in the aircrafts and as such there could not have been any transfer of property from HAL to the Government of India. The transaction was held to be a works contract.

Reverting back to the facts of the contract under consideration before us, a few prominent features of the transaction are clearly deducible from the several terms and conditions and

recitals of the contract. The contract is for sale of a completely manufactured ship to be delivered after successful trials in all respects and to the satisfaction of the buyer. It is a contract for sale of made to order goods, that is, ship for an ascertained price. Although the plans and specifications for the ship are to be provided by the customer and the work has to progress under the supervision of the classification surveyor and representative of the buyer, but the components used in building ship, all belong to the appellant The price fixed is of the vessel completely built up although the payment is in a phased manner or, in other words, at certain percentages commensurate with the progress of the work. The payment of 15% of the price is to be made on satisfactory completion of the dock trials, that is when the vessel is ready to be delivered and strictly speaking excepting the delivery nothing substantial remains to be done. 20% of the price is to be paid upon delivery of the vessel. Thus 65% of the price paid before the trials is intended to finance the builder and to share a part of the burden involved in the investments made by the builder towards building the ship. It is a sort of an advance payment of price. The title and risk clause quoted as sub-para 14 above is to be found in 6 out of 8 contracts in question. So far as these 6 contracts are concerned they leave no manner of doubt that property in goods passes from seller to the buyer only on the ship having been built fully and delivered to the buyer. In all the contracts the ultimate conclusion would remain the same. The ship at the time of delivery has to be a completely built up ship and also seaworthy whereupon only the owner may accept the delivery. A full reading of the contract shows that the chattel comes into existence as a chattel in a deliverable state by investment of components and labour by the seller and property in chattel passes to the buyer on delivery of chattel being accepted by the buyer. Article 15 apparently speaks of property in vessel passing to the buyer with the payment of first instalment of price but we are not to be guided by the face value of the language employed; we have to ascertain intention of the parties. The property in machines, equipments, engine etc. purchased by the seller is not agreed upon to pass to the buyer. The delivery of the ship must be preceded by trial run or runs to the satisfaction of the owner. All the machinery, materials, equipment, appurtenances, spare-parts and outfit required for the construction of the vessel are to be purchased by the builder out of its own funds. Neither any of the said things nor the hull is provided by the owner and in none of these the property vests in the owner. It is not a case where the builder is utilising in building the ship, the machinery, equipment, spares and material etc. belonging to the owner, whosoever might have paid for the same. The builder has thereafter to exert and invest its own skill and labour to build the ship. Not only the owner does not supply or make available any of the said things or the hull of the ship the owner does not also pay for any of the said things or the hull separately. All the things so made available by the builder are fastened to the hull belonging to the builder and become part of it so as to make a vessel. What the owner pays to the builder in instalments and in a phased manner are all payments at the specified percentage which go towards the payment of the contract price i.e. the price appointed for the vessel as a whole. 65 per cent payment of the price is up to the stage of the main engine having been lowered in position on board the vessel i.e. the stage by which the building of the vessel is complete. 15 per cent payment is to be done on satisfactory completion of the trial and 20 per cent upon delivery of the vessel. Giving maximum benefit in the matter of construction and interpretation of this clause in favour of the appellant it can be said that it is the property in vessel which starts passing

gradually to the buyer proportionately with the percentage of payments made and passes fully with the payment of last instalment on delivery of vessel having been accepted.

In Reid v. Macbeth [1904] A.C. 223 where a contract for the construction of a ship provided that the vessel, as she is constructed and all materials from time to time intended for her [wherever situated] shall immediately as the same proceeds become the property of the purchasers, the House of Lords held as a matter of construction that various iron and steel plates lying in railway stations, which had been passed by the Lloyds surveryor and which had been marked with their proposed position in the ship, were still the property of the seller as they had not yet become part of the ships structure. (see Benjamin, ibid, para 5.093).

The marking of hull number on machines, equipments etc. achieves the object of the same being kept available for use in the ship concerned so as not to hamper the progress of work for want of

material or the available material having been utilised for construction of some other ship. Such of the things as are left unused automatically revert back to the seller. In fact, except on paper, they were not at all appropriated by the buyer. The payments made by buyer are not towards any components but towards the vessel which is yet to come in existence. The built up vessel, if the contract may fail, is available to be sold to some one else by the seller. The comparative importance is more of the hull, machine, equipments, engine, etc. then that of the labour. Present one is not a case where the materials used are insignificant or secondary or have been used just incidental to the skill and labour bestowed.

In the event of the owner committing a default in honouring the schedule of payment and the belated payment accompanied by payment of interest not wiping out the default of the owner, the vessel continues with the builder and the builder may rescind the contract. All that the builder is required to do is to refund the instalments already paid by the owner to the builder without any interest thereon.

Clauses 15, 16 and 17 of the contract confuse the issue to some extent because of the phraseology employed in drafting these clauses. Article 15 provides the property in the vessel vesting in the owner simultaneously with the payment of the first instalment and the ownership or disposition of the builder ceasing therewith. The owner also becomes entitled to mortgage his interest in the vessel to the extent of the payments made by him. However, the same clause goes on to say that such passing of the property is subject to Article 17 of the contract and also subject to the lien of the builder for the unpaid portion of the price. If the builder may commit a default in fulfilling his obligations under the contract the owner may take possession of the vessel in the State in which she is and have the remaining building of the vessel completed elsewhere out of the price remaining unpaid and the deficiency, if any, shall be made good by the builder. Vide Article 17, the insurance cover is to be obtained by the builder, the policy or policies being taken out in the joint names of the builder and the owner. What is pertinent to note is that the loss or damage, if any, occasioned to the vessel before delivery to the owner is to be suffered by the builder which would not have been so if the property in the vessel had already stood passed to the owner. It is the obligation of the builder to make the loss or destruction good for which purpose the builder may reimburse itself by claim under

the policy. In the event of destruction of the vessel the loss though responsibility of the builder may be partly or fully satisfied to the owner by refunding the amount of the instalments of the contract price plus interest at the rate of 5 per cent per annum for which purpose the builder has to make necessary endorsements on the policy and the owner may directly receive payments from the insurer. This clause also shows that interest of the owner is only to the extent of the percentage of the contract price paid by the owner to the builder. Else the loss has to be borne by the builder. The High Court has observed, and in our opinion rightly, that Article 15 is a piece of artistic drafting. Though it is said that the things mentioned therein become the property of the owner simultaneously with the first payment of the instalment, other clauses of the contract generally, and Articles 16 and 17 immediately, go to show that for all practical purposes the property in the vessel, continues to remain with the builder and passes to the owner only (i) on satisfactory completion of the work, (ii) the vessel coming into existence in a deliverable state, and (iii) satisfaction of the owner as to the vessel being seaworthy also having been built up to the satisfaction of the owner in accordance with the terms and conditions of the contract. It is not the meaning of an individual recital or the inference flowing from any term or condition of the contract read in isolation but an overview of the contract wherefrom the nature of the transaction covered thereby has to be determined.

The recitals of the contract may also be read in the light of the few provisions of Chapter III of The Sale of Goods Act. In a contract for the sale of specific or ascertained goods the property in them is transferred to the buyer at such time as the parties to the contract intend it to be transferred. Sections 20 to 24 contain rules for ascertaining the intention of the parties in this regard. When something remains to be done on the date of the contract to bring the specific goods in a deliverable state the property does not pass until such thing is done and brought to the notice of the buyer. The risk in such case remains with the seller so long as the property therein is not transferred to the buyer though the delivery may be delayed.

For all the foregoing reasons we are of the opinion that the High Court and the Tribunal have not erred in taking the view which they have done. The contracts in question involve sale of the respective vessels within the meaning of clause (n) of the Andhra Pradesh General Sales Tax Act, 1957 and are not merely works contract as defined in clause (t) thereof. The transactions have rightly been held exigible to sales tax.

The appeals are devoid of merit. They are held liable to be dismissed and are dismissed accordingly. In view of purely legal controversy arising for decision it is directed that the costs shall be borne as incurred.