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GOVERNMENT OF ANDHRA PRADESH

v.

GUNTUR TOBACCOS LTD.

November 18, 1964

B [K. SUBBA RAO, J. C. SHAH AND S. M. SIKRI, JJ.]

Madras General Sales Tax Act (9 *of* 1939), *s.* 2(*h*)—*Redrying of tobacco—Packing of tobacco, if an integral part of process—Packing material—Passing of property in—If sale.*

The respondent-company was carrying on the business of redrying tobacco entrusted to it by its customers. The process involved the keeping C of the moisture content of tobacco leaf at a particular level, and in order to ensure that level, the leaf was packed in bales, in water-proof packing material, as it emerged from the reconditioning plant. The tobacco was then returned, packed in the costly packing material, to the constituent. In the company's charges for redrying each bale of tobacco, no separate charge was made for the value of the packing material used. The Deputy Commercial Tax Officer was of the view that the packing material must be regarded as *sold* to the constituent and that tax was exigible, under D the Madras General Sales Tax Act, 1939, on the value of the packing material used. The order was confirmed by the Deputy Commissioner of Commercial Taxes and by the Sales Tax Tribunal. The High Court, in revision, set aside the order. It was held that the packed tobacco was stored by the assessee for the requisite period, before it was returned to the customer, and that packing formed an integral part of the redrying process. The State appealed to the Supreme Court and contended that, packing of tobacco was not an integral part of the process of re- E drying, and that, since there was transfer of property in the packing material from the respondent to its customers, there was sale of the packing material for the purpose of the Act.

HELD (*Per* Shah and Sikri, JJ.) : The redrying process could not be completed without the use of the packing material, and on the finding recorded by the High Court, that tobacco was stored for the requisite period, the intention of the assessee and its customers was that the material F should from an integral part of the process. Since there was no independent contract for the sale of packing material, the fact that tobacco delivered by the constituent was taken away with the packing material would not justify an inference that there was an intention to sell the material. [184 H; 185 A-C]

In order that there should be a sale of goods which is liable to sales tax as part of a contract for work, there must be a contract in which there is not merely transfer of title to goods as an incident of the contract, G but there must be a contract, express or implied, for sale of the very goods which the parties intended should be sold for a money consideration. From the mere passing of title to goods, whether as an integral part of or independent of goods, it cannot be inferred that the goods were agreed to be sold and that the price was liable to sales tax. [181 G-H; 183 C]

Case law reviewed.

H *Per* Subba Rao, J. (dissenting) : There was nothing on the record to show that after packing the packed tobacco was retained in the factory for the completion of the redrying process. Packing, therefore, was not an integral part of the redrying process. Once the idea of packing being a part of the redrying process is eliminated, the transaction *qua* the

packing material involved either a contract of agency, gift or sale, and on the facts, a contract of sale was necessarily implied. As all the ingredients of the charging section read with the definition of "sale", were satisfied, the sales tax authorities rightly assessed the turnover in regard to the packing material. [171 D; 174 F-H; 177 A, C] A

Case law reviewed.

CIVIL APPELLATE JURISDICTION : Civil Appeals Nos. 2—4 of 1964. B

Appeals by special leave from the judgment dated the April 21, 1961, of the Andhra Pradesh High Court in Tax Revision No. 20, 21 and 22 of 1957.

A. Ranganadham Chetty and *B. R. G. K. Achar*, for the appellant (in all the appeals). C

R. Thyagarajan, for the respondent (in all the appeals).

The Judgment of Shah and Sikri JJ. was delivered by Shah J. Subba Rao J. delivered a dissenting Opinion.

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Subba Rao, J. I regret my inability to agree. The facts may be briefly stated. The respondent-Company is a dealer carrying on the business of re-drying in its factory raw tobacco entrusted to it by its customers. Its usual course of business may be described thus : A customer gives to the respondent raw tobacco for re-drying. It re-dries it in its factory, packs it in gunny, water-proof paper, bales etc. and delivers it to the customer. It charges the customer at a consolidated rate for re-drying and for the packing material supplied by it. The proportionate price of the packing material comes to about 25 per cent, of the re-drying charges. For the assessment years 1951-52, 1952-53 and 1953-54, the Deputy Commercial Tax Officer assessed the respondent under the Madras General Sales-tax Act, 1939, by different orders, on the sale price of the said packing material. The assessee took the question of his liability through a hierarchy of tribunals, but they all confirmed the assessments made by the Deputy Commercial Tax Officer. It preferred revisions to the High Court of Andhra at Guntur, and the said High Court allowed the revisions. Hence the present appeals. E F G

Mr. A. Ranganadham Chetty, learned counsel for the Revenue, contended that there was a sale of the packing material for price by the respondent to its customers and, therefore, it was liable to pay sales-tax on the said sales. H

Mr. Thyagarajan, learned counsel for the respondent, argued that packing was part of the process of re-drying and, therefore,

A there was no question of any sale of the packing material by the respondent to its customers. He further argued that the necessary ingredient of a sale, namely, a contract to sell, was absent in the transactions between the respondent and its customers and, therefore, there was no sales within the meaning of the definition of "sale" in the Madras General Sales-tax Act, 1939.

B The question raised in the appeals mainly depends upon whether packing is an integral part of the re-drying process. No acceptable material was placed before the High Court to show how packing becomes an integral part of the re-drying process. Mr. D. V. Srinivasan in his affidavit describes the scientific process C or re-drying found in books, but he does not describe how it is actually done in the factory. He says that "in order to keep the moisture content at the standardised level of 10 to 12 per cent, throughout the process of aging or fermentation the tobacco as it emerges from the re-drying machine is packed in water-proof packing material and stored for the requisite period." It only means D that packing is done to keep the moisture content at a particular level. He is vague and does not commit himself on the crucial question whether after the re-drying and packing, the tobacco bales are kept in the factory for any length of time to undergo further re-drying process. The High Court in its judgment describes the re-drying process thus :

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> "The process of re-drying tobacco brought to the assessees by their constituents is one, entire and indivisible. The object of the re-drying process is to standardize the moisture content at the required level of 10 to 12 per cent., and when the tobacco leaf emerges from F the re-conditioning chamber, it must be packed in water-proof packing material and stored for the requisite period. Unless the packing is done immediately, the tobacco loses its standardized moisture content, and without the packing, the process is not complete. It is clear that the packing of re-dried tobacco and its stor- G age for the requisite period is an integral part of the re-drying process."

The High Court accepted the description of re-drying process given by Srinivasan, but did not find that the tobacco, after it is packed, is kept in the assessee's factory for any length of time to undergo further drying process. Indeed, there is no material H on the record to give such a finding. Garner in his book on the Production of Tobacco describes how dry tobacco is packed in a factory thus, at p. 422 :

"As the tobacco emerges from the re-drying machine the hands are promptly packed in hogsheads under hydraulic pressure while toabcco is still warm." A

In *Encyclopaedia Britannica*, Vol. 22, p. 263, under the heading "Grading, Marketing, Fermentation and Aging" it is stated :

"It is common procedure to recondition the tobacco, that is, to dry the product and then return the proper amount of moisture by "re-drying" after it has been marketed and before it is packed. The purpose is to avoid damage which occurs when the leaf is packed with an excessive moisture content, and to ensure proper amount of moisture for aging. The aging period is from one to three years." B C

Learned counsel for the respondent has supplied to us some extracts from Garner's book "The Production of Tobacco", which describe the re-drying process. At p. 414, it is stated : D

"In preparation for fermentation or aging, tobacco usually is pressed into standard containers or forms—namely, boxes or "cases", hogsheads, and bales—or it is placed in large piles or bulks in a warehouse having facilities for at least partial control of temperature and humidity." E

The learned author observes at p. 418 :

"After the final packing in cases, bales or other packages, the leaf commonly undergoes further aging."

At p. 421, it is stated : F

"These cases or boxes are uniformly built 30 in. wide and 30 in. in high outside measurement, but range in length from 36 to 52 in. according to the length of leaf to be packed."

It is further stated : G

"As the tobacco emerges from the re-drying machine the hands are promptly packed in hogsheads under hydraulic pressure while the tobacco is still warm. The hogsheads are 48 in. in diameter, 48 or 54 in. in high, and contain about 1000 pounds of tabacco. . . . . H

. . . . . .

The hogsheads are stacked on their sides in large open type or thoroughly ventilated closed warehouses, and are

A freely exposed to seasonal changes in temperature and air humidity, no artificial heat being used."

These passages and similar others show that after re-drying process is over tobacco is stacked in costly containers like boxes, hogsheads etc. and the aging takes place for a considerable time B even after the packing. The process of re-drying is quite different from aging. But none of the passages extracted above established that packing is an integral part of the re-drying process. The re-dried tabacco is immediately packed to preserve the chemical changes obtained by the re-drying process and to prevent decay. So too, scents, medicines, salt, alcohol and similar commodities are C bottled or packed to preserve the high quality obtained by scientific processing. It cannot be said that bottles are part of the medicine, scent, alcohol etc., as the case may be. Further as I have indicated earlier, there is nothing on the record to show that after packing the packed tobacco is retained in the factory for the completion of the re-drying process. I, therefore, hold that the packing D is not a part of the re-drying process, and that it is done only to conserve the dried tobacco.

The next question is whether there is a sale of the packing material by the respondent to its customers. Now let us scrutinize the relevant provisions of the Madras General Sales-tax Act, for, E in the ultimate analysis, the point has to be decided on the terms of those provisions. Section 3(1) of that Act says that, "subject to the provisions of this Act, every dealer shall pay for each year a tax on his total turnover for such year". "Dealer" is defined to mean any person who carried on the business of buying or selling goods [*vide* s. 2(b)]. Under s. 2(c), "goods" means all kinds of F movable property other than actionable claims, stocks and shares and securities and includes all materials, commodities and articles including those to be used in the construction, fitting out, improvement or repair of immovable property or in the fitting out, improvement or repair of movable property. Section 2(h) defines "sale" thus :

G

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

Section 2(j) defines "turnover" thus : A

> " 'Turnover' means the aggregate amount for which goods are either bought by or sold by a dealer, whether for cash or for deferred payment or other valuable consideration provided that the proceeds of the sale by a person of agricultural or horticultural produce grown by himself or grown on any land in which he has an interest whether as owner, usufructuary mortgagee, tenant or otherwise, shall be excluded from his turnover." B

A combined reading of the provisions relevant to the question raised may be stated thus : Every person, who carries on the business of transferring property in any kind of movable property including C materials, commodities and articles in the fitting out, improvement or repair of movable property to another for valuable consideration would be liable to tax on the turnover. It is said that the decision in *The State of Madras* v. *Gannon Dunkerley & Co. (Madras) Ltd.*(1) has introduced another element in the definition of "sale", namely, a contract of sale, and that element is not present D in the instant case. In that case this Court held that the provisions of the Madras General Sales-tax Act were *ultra vires* the Legislature in so far as they sought to impose tax on the supply of material in the execution of works-contract treating it as a sale of goods by a contractor. In the course of the judgment, Venkatarama Ayyar, J., speaking for the Court, summed up the legal position thus : E

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

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To avoid misconception, the learned Judge proceeded to observe :

> ".....it must be stated that the above conclusion has reference to works contracts, which are entire and indivisible, as the contracts of the respondents have been held by the learned Judges of the Court below to be. The several forms which such kinds of contracts can H assume are set out in Hudson on *Building Contracts*,

(1) [1959 S.C.R. 379, 425, 427.

A at page 165. It is possible that the parties might enter into distinct and separate contracts, one for the transfer of materials for money consideration, and the other for payment of remuneration for services and for work done. In such a case, there are really two agreements, though there is a single instrument embodying them, and the
B power of the State to separate the agreement to sell from the agreement to do work and render service and to impose a tax thereon cannot be questioned, and will stand untouched by the present judgment."

One of the main reasons given by the learned Judge why there is
C no sale involved in a building contract is found at p. 423-424 :

> "But if there was no such agreement and the contract was only to construct a building, then the materials used therein would become the property of the other party to the contract only on the theory of accretion".

D This Court was dealing in that case with a contract to construct a building and it held that the contract did not involve an agreement to sell materials but was only to construct a building and that the building so constructed became the property of the owner of the land on the theory of accretion. I do not see any relevancy of this judgment to the question raised in the present case except
E the observation that every sale involves a contract of sale, either expressed or implied. This Court again in *M/s. New India Sugar Mills Ltd.*, v. *Commissioner of Sales-tax, Bihar*(1) reiterated that under the Sale of Goods Act a transaction is called sale only where for money consideration property in goods is transferred under a contract of sale. As in that case the transaction of des-
F patches of sugar by the assessee pursuant to the directions of the Controller were not the result of any contract of sale, this Court, by a majority, held that it was not a sale liable to sales-tax. Under s. 4 of the Sale of Goods Act a contract of sale of goods is a contract whereby the seller transfers or agrees to transfer the property in
G the goods to the buyer for a price; and under sub-s.(3) thereof, where under a contract of sale the property in the goods is transferred from the seller to the buyer, the contract is called a sale. It is clear that in order to constitute a sale under this section there must be three ingredients, namely, (i) contract of sale, (ii) transfer of property in the goods to the buyer, and (iii) payment of price
H by the buyer to the seller. Therefore, under this section there cannot be a sale unless there is a contract of sale. The section does

(1) [1963] Supp. 2 S.C.R. 459.

not say that the contract of sale must be express : it may also be implied.

If so, the question is whether the facts of the present case satisfy the definition of a sale. I have already held that the packing is not part of the re-drying process; and that the material used for packing is extraneous marketable material used to preserve the dry tobacco from contamination or loss. Tobacco after re-drying must be put in some container, such as hogsheads, boxes, gunny, water-proof paper, bales etc. They are costly materials. In the present case, it is not disputed that the price of the packing material is about 25 per cent of the re-drying charges. The packing material is clearly movable property within the meaning of goods in the Sale of Goods Act. The assessee had property in the said goods, for, it is conceded that it purchased the material and became its owner. It cannot also be disputed that it transferred the property in the packing material to the customers for price. The price for the material was also included in the consolidated rates charged by the assessee. The only question is whether there was an implied agreement for the sale of the said goods. In the usual course of business, the factory re-dries tobacco, packs it in a costly material and delivers it to the customer, including the price of the material in the consolidated rate charged by it. The customer who goes to the factory knows that the factory supplies the packing material, transfers the property in the said material to him and he has to pay for it. With that knowledge when a customer delivers his tobacco to the factory for re-drying, there is clearly an implied agreement to purchase the said packing material for price. Once we eliminate the idea of the packing being a part of the re-drying process, we arrive at the position that the transaction *qua* the packing material involves either a contract of agency, gift or sale. The concept of agency can be eliminated, as it is nobody's case that the factory is purchasing the material on behalf of a particular constituent and passing it on to him without any profit; the concept of gift may also be excluded, as it is unthinkable that a businessman will make a gift of material costing about 25 per cent. of his charges. If so, it follows that the course of business of the assessee indicates that it is part of its business to sell the material required for packing and that when a customer gives tabacco to it for re-drying, a contract of sale in regard to the packing material is necessarily implied in the transaction.

Now, coming to the decisions cited at the Bar, it is not necessary to consider the English decisions in detail. It would be enough

A if a summary of the decisions is given. The said decisions recognize four categories of contracts, namely, (1) contracts for labour and work such as one for the production of a work of art, picture, statue, etc.; (2) contract primarily for labour and the materials supplied are only ancillary *i.e.*, paper and ink used by a painter or an artist; (3) contract of sale of the finished product-
B denture or a ship of which the parts supplied become an integral part of the denture or the ship, as the case may be; and (4) contract of sale of the finished product but some of the materials supplied do not form part of the finished product but are sold separately : see *Clay* v. *Yates*(1), *Lee* v. *Griffin*(2), and *Robinson* v. *Graves*(3). Here there is no sale of any finished product, for the
C assessee has no property in the tobacco and has undertaken only to perform the re-drying process for consideration. It is simply a contract of work and labour so far as the re-drying process is concerned. But it cannot be said that the costly packing material has become an integral part of the re-drying process like the parchment
D and ink of an artist : it is extraneous marketable material used for a collateral purpose and, therefore, is subject of sale.

The Indian decisions throw considerable light on the question now raised before us. Turnover from the sale of gunny bags in which rice, which was an exempted commodity, was packed, was held to be liable to sales-tax by the Assam High Court in *Mohanlal*
E *Jogani Rice* and *Atta Mills* v. *The State of Assam*(4). Imposition of sales-tax on the packing material used for packing tobacco was approved by the Madras High Court in *Indian Leaf Tobacco Development Co., Ltd.* v. *The State of Madras*(5). Sales-tax imposed on the turnover in respect of hessian and iron hoops used for
F packing the bales of pressed gin cotton was sanctioned by the Madhya Pradesh High Court in *Nimar Cotton Press, Khandwa* v. *The Sales-tax Officer, Khandwa*(6). Sales-tax on the turnover of packing materials used for packing re-dried tobacco was held to be leviable by two decisions of the Andhra High Court in *Krishna & Co., Ltd.* v. *State of Andhra*(7) and *Hanumantha Rao* v. *The*
G *State of Andhra*(8). The Madras High Court in *Varsukhi and Co.* v. *Province of Madras*(9) held that the exemption from sales-tax given to salt could not be extended to the gunny bags wherein the salt was preserved. The sale price of packing material employed for effecting sale of cotton was held to be liable to sales-tax by the

(1) 108 E.R. 461. (2) 124 E.R. 555.
H (3) [1935] 1 K.B. 579. (4) [1953] 4 S.T.C. 129.
(5) [1954] 5 S.T.C. 354. (6) [1954] 5 S.T.C. 428.
(7) [1956] 7 S.T.C. 26. (8) [1956] 7 S.T.C. 486.
(9) [1951] 2 S.T.C. 1.

Madras High Court in *Chidambara Nadar Sons & Co.*, v. *State of Madras*(1). The learned Judges in the aforesaid cases rightly held that whether the commodity conserved in the container is sold or not, the transaction involved a contract of sale of the packing material. It was argued that as the sale of the exempted goods along with the packing material was admitted in some cases the courts have held that there was a sale of the packing materials. I cannot see any distinction on principle between the two classes of cases, namely, (i) where the goods were not sold, and (ii) where they were also sold. If the packing material became an integral part of the dried tobacco, there could not have been a sale of the material apart from the tobacco. So too, if the gunny bag was treated as an integral part of salt, the bag should have been sold as part of the salt. They were taxed because they were held to be extraneous and separate marketable material, though necessary and convenient for the preservation and delivery of tobacco or salt or cotton, as the case may be.

I shall now consider the decisions cited by the learned counsel for the respondents. In *Sri Dasarathi Mohapatra* v. *The State of Orissa*(2) the High Court of Orissa held that purchase of gunny bags for storage and transport of paddy by the assessee was part of the contract of agency and was, therefore, not the subject-matter of sale. The decision in *United Bleachers Ltd.* v. *State of Madras*(3) relates to turnover of packing materials supplied by the assessee for packing yarn and cloth given to it for bleaching. The learned Judges of the Madras High Court held that there was no agreement to sell the packing materials as the contract was merely one of service; but they did not exclude such an agreement to sell in every case, for they pointed out that the onus would be on the taxing authority to prove that there was an agreement to sell the packing material by the sale of the property therein. The decision in *The State of Madras* v. *Voltas Ltd.*(4) relates to a contract for air-conditioning of a building. The Court held that there was no agreement between the contracting parties for the sale of any part of the machinery, but it was one for building an air-conditioning unit. A similar view was also expressed by the same High Court in *State of Madras* v. *Voltas Ltd.* : No. 2(5). These two decisions of the Madras High Court have no bearing on the present question, as in the view of the learned Judges the decisions related to contracts for sale of air-conditioning units.

(1) [1960] 11 S.T.C. 321.
(2) [1957] 8 S.T.C. 720.
(3) [1960] 11 S.T.C. 278.
(4) [1963] 14 S.T.C. 446.
(5) [1963] 14 S.T.C. 861.

A To conclude, in the instant case all the ingredients of the charging section read with the definition of "sale" are satisfied. Unless it can be held that the material used for packing is transformed into some other commodity not covered by the definition of "goods", it is not possible to hold that there is no sale of the material. The packing material remained distinct from the dried tobacco. Pro-
B perty in it passed to the customer, who had paid for it. On the basis of the practice obtaining in the factory of the assessee, contracts of sale arose easily by implication. The Sales-tax authorities have rightly assessed the turnover in regard to the packing material. The order of the High Court is wrong and is, therefore, set
C aside.

In the result, the appeals are allowed. The appellant will have costs here and in the Court below.

Shah, J. Whether the respondent Company is liable to pay sales-tax under the Madras General Sales Tax Act, 1939, on the
D value of "packing material" used by it for storage of flue-cured tobacco under controlled conditions of uniform moisture, is the question which falls to be determined in these appeals. The Company conducts the business of "re-drying" tobacco and for that purpose maintains a factory at Guntur in the State of Andhra Pradesh. Freshly cured tobacco leaf is unfit to be used as smoking
E material, for it has a rank unpleasant odour and produces irritating and pungent smoke. To make it fit for use in cigars and cigarettes tobacco leaves must undergo a process of fermentation or aging, which gives the leaf a distinctive aroma. Tobacco is highly hygroscopic and when exposed to atmospheric conditions it decays as a result of action by microorganisms. The leaf has to undergo fer-
F mentation, with the moisture content of the leaf maintained at a uniform low level. Flue-cured tobacco contains 15 to 17 per cent moisture which is considered excessive. A moisture content of 10 to 12 per cent is ideal for the process of fermentation, and the time required for proper fermentation varies from eighteen months to two years. The process of re-drying is described by the High Court
G in its judgment under appeal as follows :

> "After the grading the stripping operations are over, the leaf is re-conditioned or re-dried. For this purpose all the leading exporters and cigarette manufacturers use the re-ordering or re-conditioning plant. This plant consists
H of a series of three chambers in each of which the heat and humidity are regulated. The tobacco leaf is passed through each chamber under the action of steam and

strong air current. The significance of the re-conditioning process lies in the fact that it re-dries the leaves to uniform moisture, besides helping to kill the insects and germs that may be present in the leaf by the high temperature maintained in the first chamber of the machine. The "tobacco leaf as it comes out of the plant is in a soft and pliable condition and contains 10 to 12 per cent of moisture. Immediately afterwards the leaf is packed either in bales, cases or hogsheads. In order to ensure that the moisture content is kept at the required level of 10 to 12 per cent, the tobacco leaf as it emerges from the re-drying machine is packed in water-proof packing material and stored for the requisite period."

The Company purchases "packing material" such as jute cloth, water-proof paper, twine from the market. For re-drying each bale of tobacco the Company charges Rs. 22/- and it is common ground that it makes no separate charge for the value of the "packing material" used. From the books of account of the Company, it appears—and there is no dispute about it that the Company spent for the value of "packing material" used by it at an average per package Rs. 6-1-1 in 1950-51, Rs. 5-9-5 in 1951-52, Rs. 3-13-10 in 1952-53 and Rs. 4-1-6 in 1953-54. The Deputy Commercial Tax Officer was of the view that the "packing material" used by the Company for maintaining uniformity of moisture by sealing off contact with the external atmospheric conditions after tobacco passed through re-conditioning chambers, and in which the tobacco entrusted was returned by the Company, must be regarded as sold to the constituent, and on the value of the materials tax was exigible. The order of the Deputy Commercial Tax Officer was confirmed in appeal by the Deputy Commissioner of Commercial Taxes. That Officer adopted a uniform rate of Rs. 6/- as price of the material used in each bale. Liability to pay sales-tax on the value of the "packing material" used by the Company was confirmed by the Sales Tax Tribunal, but the turnover was reduced to Rs. 5/- per each bale re-dried by the Company. The High Court of Andhra Pradesh set aside the order of the taxing authorities holding that the assessment of tax on the "packing material" could not be sustained. With special leave, the State has appealed to this Court.

It is unfortunate that the taxing authorities did not analyse the facts to ascertain the primary purpose for which the packing material was used by the Company. The Deputy Commercial Tax

A Officer stated in his order that tobacco entrusted to the Company was returned after re-drying properly packed. He observed:

> "The dealers regularly undertake to re-dry tobacco entrusted to them and return the same after packing. This regular practice of re-drying and using packing
B material is to be construed as 'in the course of business' and the sale of packing material involved is clearly assessable. The bills issued for re-drying charges cannot be said to exclude the value of packing material used."

C In appeal the Deputy Commissioner of Commercial Taxes observed that "costly packing material" was purchased and property in them was transferred for consideration which was embedded in the price charged for re-drying. He observed :

> "Packing is different from re-drying. If re-drying is their main business, packing is their subsidiary business.
D It is admitted that they are specialists in packing and it is for that reason that the owners of tobacco look to them as much for re-drying as for packing. It cannot be said that packing is not their business and that they have utilised for packing without any profit, the costly materials which they have purchased. There is, therefore,
E a transfer of property in the packing materials from the appellant to the customers which constitutes a sale for purposes of the Madras General Sales Tax Act."

The Sales Tax Tribunal was of the view that the question arising before it was covered by the decision in *A. S. Krishna & Company*
F v. *State of Andhra Pradesh*(1).

It seems to have been assumed by the taxing authorities that immediately after tobacco emerges from the reconditioning chambers it is packed in water-proof material and is handed over to the owners of the tobacco, and therefore packing of tobacco is not an integral part of the process of redrying. The assumption
G appears on the evidence not to be true. In the affidavit of D. V. Srinivasan which was not challenged, it was stated in paragraphs 4 that :

> "Re-drying is a process designed to create suitable conditions for the proper maturing of the leaf in stora-
H age. The object of the re-drying process is to reduce the moisture content i.e., to standardise the moisture content

(1) [1956] 7 S.T.C. 26.

at the required level of 10 to 12 per cent. In order to keep the moisture content at the same standardised level which x x x is an essential requisite for proper aging or fermentation, it is essential that the tobacco as it emerges from the re-drying machine and while it is still warm should be promptly packed with water-proof packing material. x x x

"In the process of reconditioning the tobacco is passed through a series of three chambers in each of which the heat and humidity are regulated so that the leaf emerges in a soft pliable condition and contains only 10 to 12 per cent moisture. It is essential in such cases that the leaf should be packed immediately. x x x Thus in order to keep the moisture content at the standardised level of 10 to 12 per cent throughout the process of aging or fermentation the tobacco as it emerges from the re-drying machine is packed in water-proof packing material *and stored for the requisite period.*"

The High Court accepted this description of the "re-drying" process, and observed :

"The process of redrying raw tobacco brought to the assessee by their constituents is one, entire and indivisible. The object of the re-drying process is to standardize the moisture content at the required level of 10 to 12 per cent, and when the tobacco leaf emerges from the re-conditioning chamber, it must be packed in water-proof packing material and stored for the requisite period. Unless the packing is done immediately, the tobacco loses its standardized moisture content, and without the packing, the process is not complete. It is clear that the packing of re-dried tobacco and its storage for the requisite period is an integral part of the re-drying process."

Counsel for the State faintly submitted that the Company maintains no storage facilities and it must be inferred that tobacco sealed in water-proof material would be stored by the owner of the tobacco after it was returned to him duly packed. But this plea was never advanced at any stage of the proceedings for assessment, and cannot be entertained at this late stage.

If the process of redrying or reconditioning does not end with the emergence of tobacco out of the last reconditioning chamber

A as suggested by counsel for the State, but consists, as held by the High Court, of cleansing it, processing it in the reconditioning chambers under controlled conditions of heat and humidity, of packing it in water-proof material to seal it off from external atmospheric conditions, and of storage to enable fermentation for the requisite period to make the tobacco mature for use in cigarettes, B cigars etc., packing tobacco in water-proof material must be regarded as an integral part of the process of re-drying and not independent of that process.

The fact that in the execution of a contract for work some materials are used and property in the goods so used passes to the C other party, the contractor undertaking to do the work will not necessarily be deemed on that account to sell the materials. A contract for work in the execution of which goods are used may take one of three forms. The contract may be for work to be done for remuneration and for supply of materials used in the execution of the work for a price; it may be a contract for work D in which the use of materials is accessory or incidental to the execution of the work or it may be a contract for work and use or supply of materials though not accessory to the execution of the contract is voluntary or gratuitous. In the last class there is no sale because though property passes it does not pass for a price. Whether a contract is of the first or the second class must E depend upon the circumstances : if it is of the first, it is a composite contract for work and sale of goods : where it is of the second category, it is a contract for execution of work not involving sale of goods.

It is true that in business transactions the work contracts are F frequently not recorded in writing setting out all the covenants and conditions thereof, and the terms and incidents of the contract have to be gathered from the evidence and attendant circumstances. The question in each case is one about the true agreement between the parties and the terms of the agreement must be deduced from a review of all the attendant circumstances. But G one fundamental fact has to be borne in mind that from the mere passing of title to goods either as integral part of or independent of goods it cannot be inferred that the goods were agreed to be sold, and the price was liable to sales-tax. In *The State of Madras* v. *Gannon Dunkerley & Company (Madras) Ltd*(1), this Court held that the expression "sale of goods" was, at the time when the H Government of India Act, 1935, was enacted, a term of well-recognised legal import in the general law relating to sale of

(1) [1959] S.C.R. 379.

goods and in the legislative practice relating to that topic, and must be interpreted in Entry 48 in List II of Sch. VII of the Act as having the same meaning as in the Sale of Goods Act, 1930. Therefore under a statute enacted in exercise of power under the Government of India Act, 1935, and in pursuance of the power reserved in Entry 48, in List II, Sch. VII of the Government of India Act, 1935; a taxable sale is one which amounts to sale of Goods under the Sale of Goods Act, 1930. Venkatarama Aiyar, J., delivering the judgment of this Court in *Gannon Dunkerley's case*(1) observed at p. 397 :

> "Thus, according to the law both of England and of India, in order to constitute a sale it is necessary that there should be an agreement between the parties for the purpose of transferring title to goods which of course presupposes capacity to contract, that it must be supported by money consideration, and that as a result of the transaction property must actually pass in the goods. Unless all these elements are present, there can be no sale. Thus, if merely title to the goods passes but not as a result of any contract between the parties, express or implied, there is no sale. So also if the consideration for the transfer was not money but other valuable consideration, it may then be exchange or barter but not a sale. And if under the contract of sale, title to the goods has not passed, then there is an agreement to sell and not a completed sale."

It was again observed at p. 413 :

> "If the words "sale of goods" have to be interpreted in their legal sense, that sense can only be what it has in the law relating to sale of goods. x x x both under the common law and the statute law relating to sale of goods in England and in India, to constitute a transaction of sale there should be an agreement, express or implied, relating to goods to be completed by passing of title in those goods. It is of the essence of this concept that both the agreement and the sale should relate to the same subject-matter. Where the goods delivered under the contract are not the goods contracted for, the purchaser has got a right to reject them, or to accept them and claim damages for breach of warranty. Under the law, therefore, there cannot be an agreement relating to one kind of property and a sale as regards

(1) [1959] S.C.R. 379.

A another. We are accordingly of opinion that on the true interpretation of the expression "sale of goods" there must be an agreement between the parties for the sale of the very goods in which eventually property passes."

The authority of State Legislatures, under the Constitution to
B enact legislation in respect of taxes on sale of goods, remains the same as it was under the Government of India Act.

In order that there should be a sale of goods which is liable to sales-tax as part of a contract for work under a statute enacted by the Provincial or State Legislature, there must be a contract in which there is not merely transfer of title to goods as an
C incident of the contract, but there must be a contract, express or implied, for sale of the very goods which the parties intended should be sold for a money consideration i.e. there must be in the contract for work an independent term for sale of goods by one party to the other for a money consideration.

No useful purpose will be served by entering upon a detailed
D analysis of the large number of cases cited at the Bar. The cases relied upon lay down no general principle and the ultimate decision in all the cases turned upon what the Courts found were the true agreements between the parties. In *A. S. Krishna & Company's* case(1) the High Court of Andhra in dealing with a contract for re-drying tobacco held on the evidence in that case
E that packing material used by the assessee did not become an integral part of the drying process and an intention to sell the packing could be properly attributed to the assessee.

In *B. V. Hanumantha Rao* v. *The State of Andhra*(2) it was held that gunny cloth and iron hoops used by the assessee who had
F undertaken a works contract for baling and pressing palymyra fibre were intended to be transferred and that the materials had not become an integral part of the product entrusted to him for baling and pressing, the price was liable to pay sales-tax.

In *United Bleachers Ltd.*, v. *The State of Madras*(3) the assessee who had entered into contracts to bleach, dye, calender, press,
G and fold unbleached yarn was held not liable to sales-tax in respect of kraft paper, hoop iron, hessian cloth, jute twine, palm mats etc. which were used for packing the goods at the time of delivery, because in the view of the Court the primary contract was one for service, viz. bleaching, dyeing etc. and as an incident of the
H service, the goods bleached or dyed were to be packed and delivered.

(1) [1956] 7 S.T.C. 26. (2) [1956] 7 S.T.C. 486.

(3) [1960] II S.T.C. 278.

In M. S. Chidambara Nadar Sons and Co., v. *State of Madras*(1) it was held that where under an agreement to purchase cotton to be delivered by the seller to the buyer, it was implicit that the goods should be delivered packed, the contract to pay for and purchase the packing material may be implied and the turnover relating to the packing material would be liable to sales-tax.

In *Mckenzies Limited* v. *The State of Bombay*(2) the price of motor-bus bodies supplied under a contract to construct and deliver to the Government of India several motor-bus bodies fitted on to the chassis supplied by the Government was held liable to be included in the turnover. The price was a fixed sum per motor body, and the material for the body and the fitting were to be provided and the work of construction was to be done by the contractors who had undertaken to deliver to the Government the completed units. It was held that in such a case there was a contract to sell motor bodies.

In *The State of Madras* v. *Voltas Limited*(3) the contractor had undertaken to instal in a building under construction a "system of airconditioning", and for that purpose to supervise the construction of the building itself in order that the air-conditioning of the building may be efficiently designed and erected. It was held on the facts and circumstances of the case that there was no agreement between the contracting parties for the sale of any part of the machinery and the contract was a contract for execution of work.

In *Chandra Bhan Gosain* v. *The State of Orissa and others*(4) this Court held that the assessee—a manufacturer of bricks—to whom land was given free for the manufacture and supply of bricks was liable to pay sales-tax on bricks delivered by him.

Whether a contract for service or for execution of work, involves a taxable sale of goods must be decided on the facts and circumstances of the case. The burden in such a case lies upon the taxing authorities to show that there was a taxable sale, and that burden is not discharged by merely showing that property in goods which belonged to the party performing service or executing the conract stands transferred to the other party.

In the present case, it must be held on the finding recorded by the High Court, that it was intended by the parties that the "packing material" should form an integral part of the process of re-dry-

(1) [1960] 11 S.T.C. 321.
(2) [1962] 13 S.T.C. 602.
(3) [1963] 14 S.T.C. 446.
(4) [1964] 2 S.C.R. 879.

A ing and without the use of the "packing material" redrying process could not be completed, and that there was no independent contract for sale of "packing materials". It is only as an incident of the redrying process and as a part thereof that the respondent Company has to seal up the package of tobacco, after it emerges from the reconditioning chamber, with a view to protect it against atmos-
B pheric action. In the absence of any evidence from which contract to sell "packing material" for a price may be inferred, the use of "packing material" by the respondent Company must be regarded as in execution of the work contract, and the fact that the tobacco delivered by the constituent is taken away with the "packing material" will not justify and inference that there was
C an intention to sell the "packing material".

The appeals therefore fail and are dismissed with costs. One hearing fee.

ORDER

D In accordance with the opinion of the majority these appeals are dismissed with costs. One hearing fee.