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Supreme Court rules no branch transfer exemption if stocks transferred under a general agreement for sale with a distributor

Executive Summary

This tax alert summarizes the recent ruling of the Supreme Court (SC) 11-TIOL-27-SC-CT dated 4 March 2011 in the case of **Hyderabad Engineering Industries (Taxpayer)**, on an issue whether transfer of goods to branches is liable to Central Sales Tax in the wake of a pre-existing general agreement for sale with a distributor.

The SC ruled that movement of goods between two states caused by or under any agreement or arrangement (in writing or otherwise) with any person attracts Central Sales Tax regardless of the fact that the sale is effected after the transfer of goods to any branch or depot of the Taxpayer. The SC having examined the agreement for sale between the Taxpayer and Usha International Limited (UIL) came to a conclusion that in view of peculiar terms of the sale agreement with UIL executed for the continuous supply of goods over a period of five years, the stocks transferred by the Taxpayer to its branches / depots were not exempt from CST as a stock transfer, but were taxable interstate sales.

Back ground and facts of the case

As per CST Act, any transfer of goods which is caused by or is in pursuance of any agreement or arrangement for sale of goods is liable to tax at applicable rate. However, goods transferred to Taxpayer's own branch or depot (under form F) in the ordinary course of business does not attract the CST, since there cannot be any sale between the Taxpayer and its branch or consignment agent.

The Taxpayer is engaged in the manufacturing and sale of electrical fans, sewing machines, fuel injection parts & accessories, etc. having manufacturing units and sales depots in different states of India.

The Taxpayer had entered into an agreement dated 1-5-1979 with UIL for a period of five years under which UIL was to organize the sale and distribution of products of the Taxpayer, arrange for sales promotion and provide after sale services. As per the agreement UIL would purchase the goods as an independent principal.

The customer UIL also had divisional offices and sales depots at various states in India.

The period under consideration is the financial year 1981-82 during which the Taxpayer transferred goods to various branches of which major sales were effected to UIL. The invoices were raised by the respective branches. The Taxpayer

claimed exemption under section 6A of CST Act, as a branch transfer. The tax authority took the position that the transfer to branches effected pursuant to the agreement with UIL is liable to CST. Since the Taxpayer had not produced the information on the sales effected to other customers, relief was given by way of branch transfer exemption only to the 10% of the branch transfers and balance 90% was taxed to CST 10%. The taxpayer's contention on appeals before the first appellate authority, tribunal and High Court were rejected. Taxpayer finally preferred appeal before the SC.

Tax Authority's contentions

- In pursuance of the sales agreement, UIL placed monthly indent by telephone or telex or written communication on taxpayer for supply of goods to its offices in various states. The indent shows model wise quantity required in each destination.
- Along with goods Taxpayer sent gate pass cum challan proforma invoice, way bill, LR in the name of its own depot / godown. Simultaneously, Taxpayer also sent a direct communication to the constituent / units of UIL requesting to take delivery.
- Such units of UIL directly correspond with Taxpayer by telex / telegram for urgent dispatch of goods.
- At branches of Taxpayer, the names of purchasing units of UIL were printed on invoices issued by depot of Taxpayer, which shows that there cannot be any other purchaser.
- Taxpayer did not receive any order or indents from any of its depots or marketing department.
- There were no stock transfers from one depot to another depot. Generally, the depot has no option to choose its purchasers.
- In the books of account of Taxpayer at factory, the account of UIL was debited by the invoice value. Such invoice/hundi was discounted by Taxpayer with bankers. Upon payment by UIL to banker, its account was credited in books of the Taxpayer.
- The intimate nexus and conceivable link between the Taxpayer and the purchaser are manifest.
- It is the sale by Taxpayer to UIL that occasioned the movement of goods. The delivery and raising of invoice by the state godown are immaterial.
- From a factual description of the mode of transactions, it is evident that the interstate sales effected by Taxpayer to UIL have been camouflaged as branch transfers with a view to evade legitimate tax due to the state on these transactions.

Taxpayer's contentions

- The stock transfer from Hyderabad to other states cannot be regarded as having any connection with any particular order/s placed by UIL.
- There was no firm commitment between Taxpayer and UIL at the time of movement of goods from Hyderabad to various states.

- The tax authority was not justified in relying on letters of allocation issued by UIL as a contract of firm commitment which were mere forecast of UIL's estimate of the requirements.
- The tax authority and the High Court erred in relying upon SC ruling in the case of Sahney steel, Press Work Limited and English Electric Company of India Limited.
- The Taxpayer's case is supported by SC ruling in the case of Telco v/s ACCT (1970) 26 STC 354.

SC observation and ruling

- To make a sale as one in the course of inter-State trade or commerce, there must be an obligation, whether of the seller or the buyer to transport the goods outside the State and it may arise by reason of statute, contract between the parties or from mutual understanding or agreement between them or even from the nature of the transaction which linked the sale to such transportation.
- Such an obligation may be imposed expressly under the contract itself or implied by a mutual understanding.
- It is not necessary that there must be pieces of direct evidence showing such obligation in a written contract or oral agreement. Such obligations are inferable from circumstantial evidence.
- The applicable provision of the Act reveal that in the case of any interstate movement of the goods the Tax Authority may raise a presumption of transaction of sale which presumption can be rebuted by the Taxpayer by filing form 'F'. However, when the Tax Authority shows positive finding of a sale (rather than a presumption) the benefit of form F would be of no avail unless the Taxpayer is able to establish the Tax Authority's finding as perverse.
- SC referred to certain clauses of sales agreement dt. 1 May 1979 and observed as under:
- The agreement with UIL is specific about the products of the Taxpayer, the permitted territory for distribution by UIL, obligation of UIL in organizing, distribution, promotion and after sales service in respect of the Taxpayer's products. It is clearly specified that UIL shall act as an independent principal. The maximum price for sale of goods by UIL is fixed and the time within which the payments to be made to the Taxpayer is also fixed. More importantly, the agreement specifically states that the sales / deliveries shall be made to UIL / its nominees at any of the Taxpayer's factories, region, godowns at the option of UIL. From the aforesaid terms of the agreement it is clear that, the Taxpayer firstly undertakes to sell and supply its manufactured products to UIL who in turn will have the entire country, (except the territories specified in

the agreement), as its distribution / selling zone.

- A contract of sale of goods would be effective when a seller agrees to transfer the property in goods to the buyer for a price and that such a contract may be either absolute or conditional. If the transfer is in presenti, it is called a `sale'; but if the transfer is to take place at a future time and subject to some conditions to be fulfilled subsequently, the contract is called "an agreement to sell". When the time in the agreement to sell lapses or the conditions therein subject to which the property in goods is to be transferred are fulfilled, the "agreement to sell" becomes a `sale'.
- Referring to earlier rulings of the Court on the subject, the principle which emerges is - when the sale or agreement for sale causes or has the effect of occasioning the movement of goods from one State to another, irrespective of whether the movement of goods is provided for in the contract of sale or not, or when the order is placed with any branch office or the head office which resulted in the movement of goods, irrespective of whether the property in the goods passed in one State or the other, if the effect of such a sale is to have the movement of goods from one State to another, an inter-State sale would ensue and would result in exigibility of tax under Section 3(a) of the Central Act on the turnover of such transaction.
- For the interstate transfer of the goods to be taxable, the movement must be the result of a sale or an incident of the contract. It is not necessary that the sale must precede the interstate movement in order that the sale may be deemed to have occasion at such movement. It is also not necessary for a sale to be deemed to have taken place in the course of inter-State trade or commerce, that the covenant regarding inter- State movement must be specified in the contract itself. It would be enough if the movement was in pursuance of and incidental to the contract of sale [See Oil India Ltd. (1975) 35 STC 445 (SC)].
- This expression 'sale' was explained by the Court in Balabahagas Hulsachand vs. State of Orissa (1976) 37 STC 207 at page 213. Stating that the words `Sale of goods' used in Section 2(g) of CST Act includes `an agreement of sale' as such an agreement is an element of sale and is also an essential ingredient thereof, in terms of Section 4(1) of the Sales of Goods Act, that is, it is sufficient if the agreement of sale contemplates an inter-State movement of the goods though the sale itself may take place, at the destination or in the course of the movement of the goods.
- The consistent view of this Court appears to be that even if there is no specific stipulation or direction in the agreement for an inter-State movement of goods, if such

movement is an incident of that agreement, or if the facts and circumstances of the case denote it, the conditions of Section 3(a) would be satisfied.

- The so called "forecasts or letter of allocations" are nothing but the "firm orders or indents" placed by UIL considering the various terms of the sales agreement and therefore the transactions between the Taxpayer with its branches is a clear case of interstate sales and not branch transfers.
- Finally, since the Tax Authority, in his detailed and well considered order, has looked into nearly 378 documents and voluminous correspondence between the Taxpayer and UIL and has discussed and co-related the documents to prove on facts that the disputed transaction is inter-State sales though the Taxpayer claims that it is a mere stock transfer. Therefore, the argument of the Taxpayer that all transaction must be looked into by the authorities before coming to the conclusion is to be rejected.

Our comments

The interstate stock transfers as per section 6A of CST Act is exempt provided the stock moves to other state in the ordinary course of business without there being any firm order or contract for the transfer of goods. After the goods are received by the branch or agent, at whose behest the sales takes place. The branch / agent should have the power to sell the goods to any buyer, subject of the restrictions as to quantity / rate / other conditions as put by the head office. The customer of the branch or agent placing any order or being in communication with head office for a particular purchase of goods, would be fatal to the claim for exemption. The current rate of CST is 2% under form C. Hence, in the case of debatable stock transfers which may be treated as interstate sales by the authority, it is advisable to sell under 'C' form instead of claiming exemption under form 'F' with tax contingencies arising from the agent / branch defaulting in payment of tax or potential CST liability (with interest and penalty) on disallowance of such interstate stock transfers.

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