

State of Gujarat

v.

Vivekanand Mills

(Supreme Court Of India)

HON'BLE JUSTICE J. C. SHAH HON'BLE JUSTICE VAIDYNATHIER
RAMASWAMI HON'BLE JUSTICE V. BHARGAVA

Civil Appeal No. 331 of 1965 | 04-10-1966

SHELAT, C.J.

1. The question arising in this reference is whether the petitioners can be said to be dealers in cotton within the meaning of the definition of "dealer" in section 2(6) of the Bombay Sales Tax Act, 1953, and whether the sale of 411 bales of Californian cotton effected by them during the assessment year 1953-54 can be included in their total turnover and be charged to sales tax.

2. The petitioners are manufacturers of cotton textile goods and for the purpose of conducting their aforesaid business, they have necessarily to purchase cotton from time to time. During the year 1953-54, the petitioners purchased cotton of the value of Rs. 47, 75, 769 and out of the cotton so purchased, they sold 411 bales of Californian cotton for Rs. 3, 89, 445 in two lots on the 31st of May, 1953, to the Khatau Mills Ltd., and the Edward Textile Mills Ltd. The price paid by the petitioners for these 411 bales was Rs. 3, 91, 433, whereas the price realised by them as a result of the said two sales came, as aforesaid, to Rs. 3, 89, 445, resulting actually in the loss of Rs. 1, 988.

3. The Sales Tax Officer included these two sales in the turnover of the petitioners and charged sales tax thereon. Aggrieved by this order, the petitioners first went in appeal before the Assistant Collector and thereafter in revision before the Additional Collector and in second revision before the Sales Tax Tribunal. These attempts to have the order of the Sales Tax Officer set aside having proved unsuccessful, a reference was made at their instance to the High Court of Bombay. The High Court felt that the statement of the case made by the Tribunal did not disclose sufficient facts to enable it to answer the

question referred to it and, therefore, remanded the case to the Tribunal for a supplemental statement of the case. The Tribunal in its turn called upon the Deputy Commissioner to make his report which the Deputy Commissioner did, but the Tribunal felt that the report made to it was not in accordance with the question posed by the High Court and therefore called upon the Deputy Commissioner to make a supplemental report. By that time, the bifurcation of the State of Gujarat from the State of Bombay had taken place and, therefore, the Sales Tax Tribunal of Gujarat submitted a supplemental statement of the case, in pursuance of the aforesaid order of the High Court of Bombay to this Court. The question referred to this Court is:

"Whether on the facts and in the circumstances of the case the Tribunal was right in holding that the applicants were dealers in respect of cotton and that accordingly the sale of cotton was liable to be taxed?"

4. It would appear that before the Tribunal, the petitioners urged that their business was of manufacturing cotton textiles and to sell them and that their business was not of dealing in cotton, that the sales in question were only two and that they were casual sales, that the sales actually resulted in loss, that the initial intention with which they purchased cotton in question was to use it in their business of manufacturing textile goods and not for selling them at profit and that, therefore, they cannot be said to be dealers in cotton. The Tribunal rejected these contentions observing that in the textile mills of this kind, it was not unusual for them to have surplus cotton at times and to sell such cotton and that it was admitted on behalf of the petitioners that in other years also, there had been sales of such surplus cotton. The Tribunal also observed that the Memorandum of Association of the petitioner-company set out amongst other objects, for which the company had been established, buying of cotton-seeds, cotton, silk, wool etc., and the sale of the same and that article 87 of the Articles of Association of the company provided that the company had power to buy and sell cotton-seeds, cotton etc. The Tribunal at the same time observed that though a large number of objects are usually mentioned in the Memorandum of Association of companies, all such objects are not necessarily implemented or realised. However, the Tribunal was of the view that there had always been a possibility of surplus cotton having to be sold and that as the imported Californian cotton in question could not be used in the mills, that cotton should be treated as surplus cotton liable to be sold. According to the Tribunal, this possibility must have been present in the mind of the petitioners from the

beginning and though occasions for such sales had not been numerous "it can be said that when the necessity or the occasion has arisen, the applicants have been selling cotton as a matter of business, with the expectation either of profit or the avoidance of loss, and not with any idea or motive suggesting that the transactions were not of the nature of a business."The question that falls for our determination is whether the petitioners can be said to be dealers in cotton, that is to say, whether the sales effected by the petitioners amount to their carrying on business of selling cotton or to a business activity incidental to their business of manufacturing cotton textiles. In considering this question, it is necessary to take into account the facts stated in the report made by the Deputy Commissioner dated 1/6th of July, 1960, which forms part of the supplemental statement of case submitted by the Tribunal in pursuance of the order made by the High Court of Bombay. According to that report, it appears that the petitioners had sold cotton during the calendar years 1947 and 1948 and during the financial years 1952-53 and 1953-54. The Deputy Commissioner has observed in his report that though as explained by the petitioners, some sales were made during these years to their sister concern Shri Ramkrishna Mills Ltd., the rest of the sales were made to the other purchasers and that these sales were relevant for the purpose of deciding whether the petitioners have effected the sale transactions as part of or incidental to their business. The petitioners explained the sales effected by them during these years by their letter dated the 21st of June, 1960. In para. 7 of that letter, they dealt with the sales effected by them in the years prior to the assessment year and explained that those sales had been made by them for three reasons, (1) for accommodating their sister concern Shri Ramkrishna Mills Ltd., (2) for accommodating their finance, and (3) in rare cases, due to change of count of yarn due to damage or inferior quality. They also emphasized the fact that during the calendar years 1950, 1951 and 1954, no sales of cotton were effected by them and that the annual value in majority of the sales was hardly to the extent of one per cent. of the total purchases price. So far as the two sales in question are concerned, they explained the circumstances in which 411 bales in question came to be purchased by them and sold. The petitioners' letter shows that they had first entered into an agreement with Messrs Ramdas Khimji Bros. of Bombay on the 15th of January, 1953, for procuring 500 bales of American quality of strict middling type with 1-5/32" length. According to them, the shipment normally used to arrive after about six months and therefore they apprehended that they would run short of the requisite cotton before the supply arrived from America. They, therefore, entered into a contract with Gopal Mills Co. Ltd., on the 31st of January, 1953, for the purchase of 300 bales of the same type of cotton. To their surprise, the indented goods arrived much earlier than was expected, namely, on

the 8th of April, 1953. It was in these circumstances that there was a surplus of cotton and consequently, they had to look out for a buyer to purchase the aforesaid surplus cotton. Since the indented goods were to arrive at Bombay, they entered into contracts of sale with Bombay purchasers in order to save such expenses as freight etc. According to this letter, these sales had to be resorted to by them so that their investment may not unnecessarily be blocked up in surplus cotton. They also made it clear that they had purchased the cotton in question under an user's import licence which clearly indicated that the purchase made by them of this cotton was not with any intention to trade in the indented cotton or to sell it as and when there was a possibility of their making any profit. It is fairly clear from the supplemental statement of the case that though the petitioners have been selling cotton from the year 1946 onwards, except of course for about three intervening years, the sales were in respect of goods purchased by them for the business of manufacturing cotton cloth and further that the sales have been effected either because cotton was surplus or they had to accommodate their sister concern or with a view that their finance was not blocked up by retaining cotton which the petitioners did not need for their business.

5. In our judgment, which we delivered on the 14/15th of November, 1963, wherein we disposed of Reference No. 34 of 1963 and three others (Reported as *Ambica Mills Ltd. and Others v. The State of Gujarat and Another* [1964] 15 S.T.C. 367.), we had to consider the question as to when a person can be said to be a dealer and we had also to consider a number of decisions of different High Courts dealing with that question and several different tests applied in those cases, and we ultimately came to the conclusion that though these tests furnished indications as to whether particular dealings amounted to the business of selling goods or not, none of them can be said to supply a uniform or a universal determinative factor and that each case would have to be determined according to its own facts. Nevertheless, there is to a certain extent consensus of opinion in those decided cases that the word "business" has to be construed in a commercial sense and that the initial intention or object with which the goods in question are purchased is a relevant factor in deciding whether the sale thereof was a part of the business or a business activity of the assessee and that if the initial intention in purchasing the goods in question was to use the goods in the business of the assessee, such as manufacturing goods or articles, then, unless that factor was offset by circumstances showing that the assessee intended to indulge in a business activity by entering into transactions of sale, the mere fact that the assessee sold the goods so purchased would not render him a dealer.

Those decided cases also lay down that the burden of establishing those circumstances offsetting the initial intention or object, is on the taxing authority. They also show that profit motive was an equally relevant factor in considering the question whether the sales effected by an assessee mean business or business activity incidental to the business in respect of which the assessee is a registered dealer or a dealer liable to be registered. Now, the fact that the Memorandum of Association of the petitioner-mills or article 87 of the Articles of Association, gave power to the petitioners to deal in cotton-seeds, cotton, silk, wool etc., does not mean, as the Tribunal itself has observed, that the petitioners have been dealing in those commodities and, therefore, that fact by itself would not be a determinative factor. Similarly, the fact that the petitioners have effected sales of cotton during the years prior to the assessment year, though an indication, is not a conclusive criterion, as the determination of the question before us depends upon the cumulative effect of the facts and circumstances due to which the sales were effected by the petitioners. As we have held in our main judgment in Reference No. 34 of 1963 in the case of *Ambica Mills Ltd. v. State of Gujarat* ([1964] 15 S.T.C. 367.), frequency and volume of sales, though a relevant factor, do not amount to a conclusive factor.

6. The Tribunal however has held that there was always a possibility of there being surplus cotton which the petitioners had to sell and that this possibility must have been present in the mind of the petitioners and, therefore, it could be said that whenever necessity or occasion for disposing of surplus cotton arose, the petitioners sold it as a matter of business, either with the expectation of profit or avoidance of loss and not with the idea or the motive suggesting that the sales were not of the nature of business. This conclusion, in our view, is not correct. It is an undisputed fact that the petitioners have been purchasing year in and out cotton for the business of manufacturing cotton fabrics and the sales effected by them were only in respect of cotton which was either surplus or redundant or, as in the present case, where they had owing to certain circumstances, purchased it in duplicate transactions. It is not the case of the department that the petitioners deliberately purchased cotton in excess of their necessity with the ultimate intention to sell such excess as and when they could obtain a higher price. The sales effected by the petitioners fall mainly into two categories, sales either to their sister concern or to the other mills, whenever there was surplus cotton. But in both the kinds of transactions, the initial intention with which cotton was purchased, was to use it for the purpose of manufacturing goods, which is their business. The department has not been able to show that there were any circumstances in this case which would offset this

circumstance and show that the cotton was purchased with any idea of selling it as and when the petitioners could get a higher price, in other words, with profit motive. As held by us in the case of *Ambica Mills Ltd.* ([1964] 15 S.T.C. 367.), the mere fact of volume and degree of frequency of sales is not a conclusive factor which can be said to be inconsistent with the conclusion that the sales were not business or business activity. So far as the cotton in question is concerned, the sales have been only two and the petitioners have explained the circumstances in which they had to sell 411 bales in question. These bales had to be sold as the petitioners found that as cotton first purchased by them arrived earlier than anticipated, their purchase of these bales remained in their hand as surplus and which, if retained, would unnecessarily mean blocking up of their capital. It would not, therefore, be right to say as the Tribunal has held, that the sales were made either with the anticipation of profit or for the purpose of avoiding loss, that is to say, loss in the business of manufacturing textile goods. The facts in the case clearly disclose that the petitioners purchased the cotton for the purpose of using it in their business of manufacturing cotton textiles, that they sold the surplus cotton, not with the object of making profit, but because it was redundant, and if not sold, would mean unnecessarily blocking up of their finance which no businessman with any reasonable prudence would do. Merely because there was a possibility in a manufacturing business of there being some surplus of raw materials left over, even if coupled with the circumstance that the businessman was aware of such possibility, would not render the disposal of such surplus as part of or incidental to his business. If such a conclusion were to be arrived at, it would make a manufacturing business almost impossible, or in any event, extremely difficult, for, no manufacturer can ever anticipate the exact and precise quantity of raw materials, such as cotton in this case, which he would require during a particular period, and there is therefore bound to be some surplus left over or likely to be left over which, unless disposed of, would result in unnecessarily blocking up of investment. If there is such a surplus and it is sold, even at profit, that would not make the disposal thereof either a part of the business or an incident to his business. Such a conclusion can never be said to be in the contemplation of the Legislature when it enacted the definition of "dealer". In the present case, the sales have been only two and the sales have resulted in fact in a loss. Considering these facts and the other circumstances of the case, it is impossible to say that the cotton was purchased with the intention to sell it at profit at any subsequent stage or that the initial intention with which it was purchased, namely, to use it for the purpose of manufacturing textile goods, has been counter-balanced by other circumstances offsetting that initial intention or that the sales were incidental to the business of the assessee. For the

reasons aforesaid, our answer to the question referred to us is in the negative. The respondents will pay to the petitioners the costs of the reference.

7. The State of Gujarat appealed to the Supreme Court.

N. S. Bindra, Senior Advocate (R. H. Dhebar with him), for the appellant.

S. T. Desai, Senior Advocate (C. C. Gandhi and I. N. Shroff with him), for the respondents.

JUDGMENT

The Judgment was delivered by

SHAH, J. -

8. The respondents own a factory at Ahmedabad and carry on the business of manufacturing cotton fabrics. During the assessment year 1953-54 the respondents purchased cotton of the value of Rs. 47, 75, 679 which included 411 bales of Californian cotton. The respondents sold during the year of assessment the bales of Californian cotton for Rs. 3, 89, 445 and in that transaction suffered a loss of Rs. 2, 000. The Sales Tax Officer brought the turnover from the sale of 411 bales of Californian cotton to tax under the Bombay Sales Tax Act, 1953. The order was confirmed in appeal by the Assistant Collector of Sales Tax in revision. A revision application to the Sales Tax Tribunal, Bombay, also met with no success.

At the instance of the respondents, the Tribunal referred the following question to the High Court of Judicature at Bombay :

"Whether on the facts and circumstances of the case, the Tribunal was right in holding that the respondents were dealers in respect of cotton and the sale of cotton was liable to be taxed ?"

In July, 1959, the High Court called for a supplementary statement of the case from the Tribunal observing :

"The statement of facts does not indicate whether the assessee was as an incident of its normal business disposing of cotton purchased by it, nor does it indicate whether the sale of cotton in question was one of many such transactions in the course of its business. If the sale of 411 bales of Californian cotton was a casual transaction, not as an incident of the business of the assessee, but because the cotton was regarded as unsuitable for manufacturing yarn or for some other similar reasons, it cannot be said that it became a part of the business activity of the assessee and made it a dealer in cotton."

The Tribunal, thereafter, submitted a supplementary statement of the case which consisted substantially of the report submitted by the Deputy Commissioner of Sales Tax (Appeals), Gujarat State, which incorporated a letter from the respondents to that officer setting out the circumstances in which the sale was made. After the reorganisation of the State of Bombay, the reference was transferred to the High Court of Gujarat. The High Court of Gujarat answered the question in the negative. With special leave, the State of Gujarat has appealed to this Court against the order of the High Court.

9. The question which falls to be determined is whether, having regard to the nature of the business, the transaction of sale of 411 bales of Californian cotton may be regarded as one carried on in the course of business of the respondents of selling cotton. The following table which is incorporated in the statement of the case submitted by the Tribunal shows the sales of cotton made by the respondents from time to time :

----- Period Total Sales to sister sales concern

1947 3, 32, 668-14-0 3, 14, 940

1948 34, 685-13-0 45, 070 1949 -- --

1-4-52 to 31-10-52 77, 938-0-0 Nil

1-11-52 to 31-3-53 30, 906-0-0 Nil

1-4-53 to 31-3-54 3, 89, 445-0-0 Nil

(There is some error in the figures of sales of cotton in the year 1948. But that error has no bearing on the question falling to be determined in this case.)

It may be noticed that in the years 1947 and 1948 the respondents sold cotton to its sister concern Shri Ramkrishna Mills Ltd. In the years 1950, 1951 and 1954 there were no sales of cotton by the respondents. In 1952-53 there were sales of cotton of the total value of Rs. 1, 08, 844-8-9 and in the year 1953-54 cotton of the value of Rs. 3, 89, 445 which is the subject-matter of this appeal was sold. The circumstances in which the respondents sold Californian cotton are set out in the respondents' letter addressed to the Deputy Commissioner of Sales Tax. The Tribunal has accepted the correctness of the statements made in that letter. The letter recites :

"4. We had entered into an agreement with M/s. Ramdas Khimji Bros. of Bombay on 15th January, 1953, for procuring 500 bales of American quality of strict middling type with 1-5/32" length. As the shipment normally used to arrive after six months, and we anticipated that we would run short of the requisite cotton before the shipment arrived, we entered into a contract with Gopal Mills Co. Ltd. on 31st January, 1953, for the purchase of 300 bales of same type. Surprisingly our indented goods arrived on 8th April, 1953. Hence a position of over-supply arose and we had actually to move out for a buyer for adjusting our supply position to normality and as this type of cotton was normally consumed by Bombay mills, we tried to find customer in Bombay, and disposed of the cotton in Bombay after taking permission of the Textile Commissioner of the Government of India, without which permission no sales can be effected. We sold off our indented goods, as we did not intend to sell the bales purchased from Gopal Mills Ltd., because there would be some saving in freight; if we would bring the indented goods to Ahmedabad, and sell the cotton

bales purchased from Gopal Mills and despatch them to Bombay, there would be an unnecessary expenditure for charges of freight etc.

The sales had to be effected because, otherwise, our finance also would have been blocked up.

Again, as we had purchased the goods sold under an user's import licence, there was definitely no intention to trade in the indented cotton. Hence, the sale cannot be imputed the character of having been effected in the course of our business."

10. The cotton bales were agreed to be purchased under an user's import licence. The respondents believed when the order was placed with M/s. Ramdas Khimji Bros., Bombay, that the cotton bales would reach India after about six months, and in the meanwhile to meet their immediate requirements arrangements had to be made to purchase cotton of similar staple from a local source. Accordingly the respondents purchased 300 bales of cotton of the same staple from Gopal Mills Co. Ltd. But unexpectedly the consignment of Californian cotton arrived early in the month of April, 1953, and the respondents had to take delivery of that cotton. A large sum of money belonging to the respondents was blocked up in purchasing that cotton and with the sanction of the authorities this cotton was sold to the Khatau Mills Ltd. and the Edward Textile Mills Ltd. in two lots on May 31, 1953. Evidently at the time when the bales of cotton were ordered and when the bales were purchased, there was no intention on the part of the respondents to carry on business in cotton. It is true that by one of the clauses of its Memorandum of Association the respondents are authorized to carry on the business of buying and selling cotton, silk, wool etc. But that in our judgment cannot be decisive of the intention to carry on business of selling cotton. Here is a case in which bales of cotton were agreed to be purchased, because they were needed for the purpose of the business of the respondents. When they were received, in pursuance of the agreement the respondents had a large quantity of similar goods which they had purchased from another source. Holding up of the bales of cotton obtained would have meant locking up a large amount of money. If in those circumstances the respondents sold the cotton bales, it cannot be

inferred that the sale was with the intention to carry on business of selling cotton.

11. The Tribunal held that there was always a possibility of there being surplus cotton which the respondents had to sell and this possibility must have been present in the mind of the respondents and therefore it could be said that whenever occasion or necessity for disposal of surplus cotton arose and the respondents sold it as a matter of business, either in the expectation of profit or avoidance of loss, they intended to carry on business. But the respondents had been purchasing large quantities of cotton every year for the purpose of their business of manufacturing cotton fabrics. The sales effected by them were either "to their sister concern or such as were found to be surplus or redundant". It was not the case of the State that the respondents had deliberately purchased a large quantity of cotton in excess of their normal requirements and had then sold the quantity not required of its manufacturing schedule. The previous dealings in cotton in the earlier years do not indicate that there was on the part of the respondents any intention to carry on the business of selling cotton; nor does the transaction of purchase and sale of Californian cotton in the year of assessment indicate any such intention. Having considered all the circumstances, we think that there was no intention on the part of the respondents to carry on business of selling cotton, and that the High Court was right in its conclusion.

12. The appeal therefore fails and is dismissed with costs.

13. Appeal dismissed.