SUPREME COURT OF INDIA

State of Rajasthan and Anr

Vs

Rajasthan Chemist Association

Appeal (Civil) 3552 of 2005

(Arijit Pasayat and Tarun Chatterjee, JJ)

24.07.2006

JUDGMENT

ARIJIT PASAYAT, J.

Challenge in this appeal is to the legality of the judgment rendered by a Division Bench of the Rajasthan High Court, Jodhpur holding that 4A of the Rajasthan Sales Tax Act, 1994 (in short the 'Act') as introduced by the State Finance Act, 2004 was not legally sustainable to the extent that tax on first point sale of drugs, medicines or any formulation or for that matter any other commodity by a manufacturer/wholesaler/distributor to retailer where "Minimum Retail Price" (in short 'MRP') is published on package, measure to which rate of tax is to be applied cannot be with reference to such published MRP which is neither charged nor chargeable by the wholesaler from the retailer whether the tax is charged on sales or on purchase by the parties to sale under Section 4A and the concerned Notification in this regard. Writ application filed by the respondent-Association was allowed to that extent.

The controversy arose in the following background:

By the Finance Act, 2004 Section 4A was introduced which reads as follows:

"4A. Levy of tax on retail sale price:- (1) Notwithstanding anything contained in any other provision

of this Act or the rules made thereunder, tax on sale of such goods, as may be specified by the State Government by notification in the official Gazette, shall be levied and collected on the retail sale price of such goods abated by the rate specified in the said notification.

(2) The goods to be specified under Sub- Section (1) shall be those in relation to which it is required under the provisions of the Standards of Weights and Measures Act, 1976 or the rules made thereunder or under any other law for the time being in force, to declare on the package hereof the retail sale price of such

goods.

(3) The State Government may, for the purpose of fixing the rate of abatement under sub-section (1), take into account the amount of sales tax and other local taxes, if any, payable on such goods.

Explanation: (i) Where on the package of any goods different retail sale prices are declared with reference to different areas, the retail sale price declared with reference to the area with the State in which, it is sold shall be deemed to be the retail sale price for the purpose of this Section.

(ii) Where on the package of any goods different retail sale prices are declared with reference to different areas and none of the areas fall within the State, the maximum of such retail sale prices shall be deemed to be the retail price for the purpose of this Section."

Writ Petition was filed by the present respondent questioning constitutional validity of the aforesaid provision. Section 4A in terms envisaged levy of sales tax on any transaction of sale of notified goods not on the actual price of consideration which is paid or becomes payable by the buyer to seller on such sales as have taken place, but on the MRP of the goods declared on the package as per the provisions of the Standards of weights and Measures Act, 1976 (in short 'Weight and Measures Act') or the Rules framed thereunder or any other law for the time being in force which is chargeable only at the last point sale by the retailer. The provision is not extended generally to all commodities sold in package and in relation to which it is required to print retail price thereon, but only to such goods as may be specified by the State Government by the Notification in the official Gazette as may be abated by the rates specified in the said Notification.

Primary challenge before the High Court was on the ground that it takes into account an artificial amount as turnover for the purpose of tax on "sales of goods". The tax on sale must be leviable with reference to something related to taxing event, the sale or purchase of goods which becomes subject of charge and not de hors it. With reference to Entry 54 of the Second List of Seventh Schedule to the Constitution of India, 1950 (in short the 'Constitution') it was submitted that expression "tax on sale of goods" used in said Entry means tax on the sale of goods as defined under the Sales of Goods Act, 1930 (in short the 'Sales Act') as modified/extended by Clause 29-A of Article 366 of the Constitution, inserted by 42nd Amendment Act, 1982. Single point tax is leviable on sale of medicines as per Notification issued under the Act.

Factually, the first point of sale in the State of Rajasthan in most cases which attracts levy of sales tax is by the wholesale distributors to the retailers and not by retailers to end consumers when alone MRP can be charged. Under the Weights and Measures Act and the provisions of Drug Price Control Order, 1995 (in short 'Control Order), issued by the Central Government under Section 3 of the Essential Commodities Act, 1955 (in short the 'Essential Commodities Act'), the maximum retail price is determined in the case of Scheduled Formulations only. On the other hand, MRP is required to be displayed on the label of container as well as package in respect of all drugs whether scheduled or non scheduled formulations. Mention of price on the package under the concerned provisions is the MRP and not the price necessarily or actually charged at the end sale for any transaction of sale of medicines in the State. The first sale within the State which alone is taxable is in reality at much lesser price than the MRP printed and the same is paid or payable on contractual basis. Under the Control Order the margin at which the medicines are to be sold to retailer has been fixed at a minimum level, that is to say, unless otherwise permitted, a formulation has to be sold to a retailer keeping at least 16% margin in the case of scheduled drugs. Thus by devising aforesaid legal fiction for deeming an artificial sale price for levy of tax having no nexus to the taxable event i.e. transactions of sale of goods at a money consideration paid or payable as defined under the Sales Act, is beyond the legislative competence of the legislature in the State, and therefore the provision is ultra-vires.

The State on the other hand took the stand that what is to be the measure of tax on a sale is within the domain of the State Legislature. Under the impugned provision, tax is levied on a completed sale within the meaning of Section 4 of the Sales Act. However, in what manner the charge is to be levied is a matter of details which can be worked out by Legislation. The fact that maximum retail price is to be determined statutorily and the State Legislature has taken into account the fact that the actual consideration at the first point tax may be lesser than the maximum retail price that may be charged ultimately from the consumer at the last point sale as provided for abatement of MRP by reducing therefrom the sum at prescribed rates of abatement for the purpose of levy of tax, it provides sound basis for uniform liability in the State on such transaction. The levy of tax cannot be said to be wanting in nexus with the taxing event. Therefore, the impugned provisions and the Notifications cannot be said to be ultra vires any provision of the Constitution. It was however not disputed that but for taking the MRP as a basis to provide measure of tax, no fictional price can be fixed as a measure of tax on sale of goods. The High Court on analyzing the provision in great detail came to hold as follows:

"If Section 4A is designed to bring a levy into existence which is divorced from the sale subject to tax under the Act, it falls foul with the legislative competence under Entry 54 of List II of Schedule VII so also notification- Annex.3 to the extent it is intended to levy tax on first point sale with reference to price which could be charged in respect of a subsequent sale which has not come into existence at the time liability to tax arise and is determined ex- hypothesi. However, the perusal of the language of Section 4A and the notification issued thereunder by itself does not show that it applies only in case of sales to be taxed at first point. In case the levy is on the last point and the maximum retail price is to be fixed and published under any Statute, whether instead of determining price actually charged in each case fixed formula is provided by the enactment which has correlation with determining price by keeping in view the provisions of Section 9 of the Sale of Goods Act whether the provision still falls beyond the scope of Entry 54 has not been the subject matter of contention. In this case and therefore, we have not been called upon to decide. In absence of any contention having been raised, it will be hazardous to comment upon the validity of provisions of

Section 4A in isolation and the notification issued thereunder in its entirety.

In view thereof, we confine our conclusion and hold that to the extent that tax on first point sale of drugs, medicines or any formulation or for that matter any other commodities by a manufacturer/wholesaler/distributor to retailer where MRP is published on package, measure to which rate of tax is to be applied cannot be with reference to such published MRP, which is neither charge nor chargeable by the wholesaler from the retailer whether the tax is charged on sales or on purchase by the parties to sale under Section 4A and notification.

The additional tax collected with reference to measure provided under Section 4A by the wholesalers to retailers at first point sale shall not be refunded to the dealers. In case the additional tax charged has not been transmitted to buyers, the excess tax paid may be adjusted against future liability under the Act of 1994 or any other dues to the Revenue under Rajasthan Sales Tax Act."

In support of the appeal, learned counsel for the appellants submitted that there is a source of power of the State to levy tax under Article 246 read with Entry 54 of List II of Schedule VII of the Constitution. A plain reading of the Entry clearly demonstrates that tax under the said Entry can be levied on the event of sale or purchase of goods. The said Entry nowhere requires or mandates that the same can only be on the sale price of goods. Strong reliance is placed on decisions in Andhra Sugars Ltd. V. State of A.P. (1968 (1) SCR 705) and Ganga Sugar Corpn. Ltd. V. State of U.P. (1980 (1) SCC 223) to contend that the Constitution empowers the States to levy and collect tax on the happening of the taxable event and thereafter the quantum of tax to be levied and the measure on which the same can be levied is necessarily left for the State to decide.

Per contra, learned counsel for the respondent submitted that the High Court's decision is on terra firma. On an elaborate analysis of the legal position the decision has been rendered and needs no interference. It was pointed out that the decisions in Andhra Sugar and Ganga Sugar cases (supra) were rendered on the peculiar facts of the cases and they nowhere depart from the normal principle that tax is to be levied on the sale price.

In order to appreciate rival submissions a few decisions of this Court which throw beacon light on the issues involved need to be noted. In fact, the High Court has referred to many of them.

Sales Tax Office, Pilibhit v. M/s Budh Prakash Jai Prakash (AIR 1954 SC 459) arose under the U.P. Sales Tax Act, 1948. In that case the issue related to levy of tax by the assessing authority on the turnover relating to forward contract. The assessee had challenged that the imposition of sales tax on forward contracts was ultra vires the powers of the State Legislature. The U.P. Sales Tax Act, 1948 had been enacted by the provincial legislature in terms of the legislative power conferred under the Government of India Act, 1936 under Entry 48 in List II of the Schedule Seventh of the said Act. Under Section 2(h) of the U.P. Act, a sale was defined to include forward contracts. This Court upheld the challenge by holding that the power conferred under Entry 48 to impose tax on the sale of goods can be exercised only when there is a sale under which there is a transfer of property in the goods, and not when there is a mere agreement to sell. The State Legislature cannot, by enlarging

the definition of "sale" by including forward contracts arrogate to itself a power which is not conferred upon it by the Constitution, and the definition of "sale" in Section 2(h) of the Act XV of 1948 must, to that extent, be declared ultra-vires.

It was inter-alia held as follows:

"It would be proper to interpret the expression "sale of goods" in Entry 48 in the sense in which it was used in legislation both in England and India and to hold that it authorizes the imposition of a tax only when there is a completed sale involving transfer of title".

Significantly, the Court observed about substance of the levy as under:

"The substance of the matter is that the sales tax is a levy on price of the goods, and the reason of the thing requires that such a levy should not be made, unless stage has been reached when the seller can recover the price under the contract."

The aforesaid decision makes it clear that subject 'tax on sales of goods' in Entry 48 of List II of the Seventh Schedule of the 1935 Act providing for legislative field of sale of goods ought to be confined to levy of tax on sales of goods as defined in the Sales Act and in substance, it is a levy on price of goods and the State Legislature does not have power to enlarge the definition of sales by creating a legal fiction and levy tax on a sale which has not come into existence.

State of Madras v. Gannon Dunkerley and Co (AIR 1958 SC 560) is another decision which needs to be noted. A Constitution Bench of this Court considered the construction of Entry 48 in List II of Seventh Schedule of the 1935 Act. Tax on the sale of goods is in pari materia with Entry 54 in List II of Schedule VII of the Constitution. The case arose under the Madras General Sales Tax Act, 1939 as amended by Madras General Sales Tax (Amendment) Act, 1947. The definition of "sale" in Section 2(h) was enlarged so as to include "a transfer of property in goods involved in execution of works contract". By creating a legal fiction, it was deemed that in execution of a work, property in the goods involved in works contract is transferred as goods so as to include value (not the price) of such goods as part of taxable turnover.

After referring to the definition of expression "sale of goods" from the times of Roman Law and the Law in England, this Court culled out and approved the following principle stated in Benjamin's book "Sale of Goods":-

"Hence it follows that to constitute a valid sale, there must be a occurrence of the following elements viz. (i) the parties competent to contract (2) mutual assent; (3) thing of sale or general property in which transfer from seller to buyer and; (iv) a price in money paid or promised".

On the aforesaid premises, the Court on considering the Indian Law and after referring to Section 77

of the Contract Act, (before enactment of Sale of Goods Act) defining sale as originally enacted in it, and the provisions of Sales Act reached the following conclusions about price as an essential element: "that it must be supported by money consideration, and that as a result of the transaction property must actually passed on the goods unless all these elements are present, there can be no sale".

Following conclusions were arrived approving the view in Budh Prakash's case (supra):-

"A power to enact a law with respect to tax on sale of goods under Entry 48 must, to be intra vires, be once relating in fact to sale of goods, and accordingly, the Provincial Legislature cannot, in the purported exercise of its power to tax sales, tax transactions which are not sales by merely enacting that they shall be deemed to be sales; ...."Sale" in Entry 48 must be construed as having the same meaning which it has in the Sale of Goods Act, 1930.... It is of the essence of this concept that both the agreement and the sale should relate to the same subject matter".

Summing up the conclusions it was held :- "the expression "sale of goods" in Entry 48 is a nomen juris, its essential ingredients being an agreement to sell moveable for a price and property passing therein pursuant to that agreement".

The State Legislature does not have legislative competence to give the expression "sale of goods" extended meaning and to enlarge its legislative field to cover those transactions for taxing which do not properly conform to elements of sale of goods within the Sales Act. Tax on value of the material used in construction of building was held to be ultra-vires.

The decision in Firm of M/s Peare Lal Hari Singh v. The State of Punjab and Anr. (AIR 1958 SC 664) also relates to imposition of tax on supply of materials used in building contracts and this Court followed its earlier decision in Gannon and Dunkerley case (supra) and held that the expression "sale of goods" in Entry 48 in List II of Seventh Schedule of the Government of India Act, 1935 has the same import which it bears in the Sales Act.

The principle was reiterated in Bhopal Sugar Industries Ltd., M.P. v. D.P. Dube Sales Tax Officer, Bhopal Region, Bhopal (AIR 1967 SC 549) where the question arose whether giving extended definition of "retail sale" which sought to render consumption by the owner of motor spirit liable to tax under the concerned Sales Tax Act by virtue of Section 3, is beyond the competence of the State Legislature and hence void. This Court relying on its earlier decision in Gannon and Dunkerley (supra) held as follows::

"In a transaction of sale of goods which is liable to tax there must be concurrence of the four elements, viz;

(1) parties competent to contract;

(2) mutual assent;

(3) a thing, the absolute or general property in which it is transferred from the seller to the buyer; and

(4) a price in money paid or promise.

A transaction which does not conform to this traditional concept of sale cannot be regarding as one in respect of which the State Legislature is competent to enact an Act imposing liability for payment of tax".

The Court quashed the assessment made on the aforesaid premises.

Levy by the State of Uttar Pradesh as to the basis of levy once a transaction is held to be a transaction of sale came up for consideration by a Constitution Bench in Ganga Sugar's case (supra). This Court said:

"Tax on sale or purchase must be on the occurrence of a taxing event of sale transaction".

This Court in M/s Govind Saran Ganga Saran v. Commissioner of Sales Tax and Ors. (AIR 1985 SC 1041) on analyzing Article 265 noted as follows:

"The components which entered into tax are well known. The first is the character of the imposition known by its nature which transpires attracting the levy. The second is a clear communication of the person on whom the levy is imposed and which is obliged to pay the tax. The third is rate at which the tax is imposed and the fourth is the measure or value to which the rate is applied for computing the tax liability".

Obviously, all the four components of a particular concept of tax has to be inter related having nexus with each other. Having identified tax event, tax cannot be levied on a person unconnected with event, nor the measure or value to which rate of tax can be applied can be altogether unconnected with the subject of tax, though the contours of the same may not be identified.

In Union of India v. Bombay Tyre International Ltd. (AIR 1984 SC 420) the expressions subject of tax, the measure of tax and nexus between the two have been succinctly analysed. The decision arose in the context of Central Excise and Salt Act, 1944 (in short 'Excise Act'). The controversy was what should be included in the measure of computation of liability and what fell outside the

scope of measure to be excluded from consideration. Referring to a large number of decisions of different courts, including some of the decisions we have referred to above, the principle succinctly stated in Seervai's Constitutional Law was approved by observing as follows:-

Another principle for reconciling apparently conflicting tax entries follows from the fact that a tax has two elements, the person, things or activity on which the tax is imposed, and the amount of the tax. The amount may be measured in many ways, but decided cases establish a clear distinction between the subject matter of a tax and the standard by which the amount of tax is measured. These two elements are described as the subject of a tax and the measure of a tax."

The Court also held that the measure of tax though not always essential but is often a relevant consideration to judge the nature of levy. Following passage from R.R. Engineering Company v. Zila Parishad Bareilly (AIR 1980 SC 1088) was approved:

"It may be and is often so, that the tax on circumstances and property is levied on the basis of income which the assessee receives from his profession, trade, calling or property. Therefore, while determining the nature of a tax, though the standard on which the tax is levied may be a relevant consideration, it is not a conclusive consideration".

This Court recognised greater freedom in adopting measure of the tax to be assessed by its own standard and administrative convenience and other factors may influence the stage at which the levy may be collected and there may be deviation in contours of measure of tax, but did not countenance it to be divorced from the nature of tax, by observing as follows:

"Any standard which maintain a nexus with the essential character of the levy can be regarded as a valid basis for assessing the measure of the levy".

With these premises this Court found that while nature of an excise levy is indicated by the fact that it is imposed in respect of manufacture or production of an article, the point at which it is collected is not determined by the point of time when manufacture is completed but will rest on consideration of administrative convenience and that generally it is collected when the article leaves the factory for the first time.

The question of tax on sale of goods may be examined in the said background. The subject of tax being sale, measure of tax for the purpose of quantification must retain nexus with 'sale' which is subject of tax. As noticed above, tax on sale of goods, is tax on vendor in respect of his sales and is substantially a tax on sale price. The vendor or buyer cannot be taxed de hors the subject of tax that is sale by the vendor or purchase by the buyer. The four essential ingredients of any transaction of sale of goods include the price of the goods sold, therefore, in any taxing event of sale, which become subject matter of tax price component of such sale, is an essential part of the taxing event. Therefore, the question does arise whether a particular taxing event of sale could be subjected to tax at the prescribed rate to be measured with such price which is not the component of the transaction of sale, which has attracted the sales tax.

Andhra Sugars's case (supra) concerned the challenge to levy of sales tax under Andhra Pradesh Sugarcane Regulation of Supply and Purchase Act. The tax was levied on the purchase of sugarcane as per the weights of the goods purchased. One of the contentions raised before this Court challenging its validity was that the tax must be levied with reference to the turnover only and it cannot be levied with reference to the weight of the goods purchased. The contention was rejected by this Court by saying:

"Where the purchase tax is levied on a dealer, the levy is usually with reference to his turnover, which normally means the aggregate of the amount of purchase prices. But the tax need not necessarily be levied on a dealer by reference to his turnover. It may be levied on the occupier of a factory by reference to the weight of the goods purchased by him."

However, where tax is to be measured in terms of price or in terms of weight or quantity of goods sold, whether the measure can be different from the contents of taxing event was not the proposition laid.

It was observed in Ganga Sugar's case (supra) as follows:

"It is a superstition, cultivated by familiarity, to consider that all sales tax must necessarily have nexus with the price of the commodity. of course, price as basis is not only usual but also safe to avoid uneven, unequal burdens, although it is conceivable that a legislature can regard prices which fluctuate as too impractical to tailor the purchase tax. It may even be, in rare cases, iniquitous to link purchase tax with price, if more sensible bases can be found".

It was a case in which weight of the commodity was made the basis for levy of the tax. But, price of goods was approved to be usual meaning of levy of tax on sale of goods. It does not deviate from basic principle that a tax of any nature is determined ex-hypothesi on occurrence of taxing event. Its actual computation and collection takes place later on through the machinery provided. However, the determination of charge ex-hypothesi instantly on occurrence of taxing event which inheres into it that measure of tax is integrally connected with occurrence of taxing event and is not postponed to a later date.

Thus primarily the rate of tax relates to measure of tax to come into existence simultaneous with occurrence of taxing event. The machinery provisions relating to its quantification and collection can take place later. Providing measure to which rate is to be applied is integrally connected with charge itself.

This Court considered the ambit and scope of legislative power of the State Legislature while imposing tax on sale of goods in Hotel Balaji and Ors v. State of Andhra Pradesh and Ors. (AIR 1993 SC 1048) wherein this Court said:

"So long as the levy retains the basic character of a tax on sale, the legislature can levy it in such mode or in such manner as it things appropriate".

In this connection, it is relevant for the present purpose to notice that in upholding the validity of additional purchase tax on goods, when the goods manufactured by the buyer are sold outside State was that the tax was related to purchase price, which was part of transaction of purchase and not payable on price at which he shall be selling his goods. Therefore, it retained its character on tax on purchase otherwise it would have become Duty of excise on value of goods determined in terms of price charged by manufacturer, when such sale was not subject of tax levied by State Legislature.

In Ganga Sugar's case (supra) the court emphasized the tax on sale or purchase must be on occurrence of taxing event of sale transaction. While accepting that, price of the sale transaction is not necessarily the only criterion which may form the basis of levy of tax but it opined that price as basis is not only usual but also safe to avoid unequal, uneven burdens. The Court also stated that it is common sense that the reliable standard is the price although in regard to custom duties there are still items on which duties is levied on the nature of goods rather than its value in money.

The issue which the Court was considering was the levy of tax on sale of sugarcane and the court found that weight of cane which has sucrose contents have a close nexus with price although theoretically they may appear unconnected and consequently the levy of tax with reference to weight of sugarcane was held to be a permissible hypothesis for determining the tax.

In Hotel Balaji's case (supra) levy of purchase tax at the last point sale within the State by a dealer/manufacturer who has sold the goods manufactured by him in the course of inter state trade and commerce, on the purchase price of the raw materials, was the subject of challenge. The contention has been raised before this Court that since tax was leviable in cases where the goods manufactured were not sold in the State, it amounted to levy of Excise Duty on manufacture though named as purchased tax. In holding that levy was essentially a tax on purchase of goods within the State, one of the factors which weighed with this Court was that the levy was upon the purchase price of the raw material and not upon the value of the manufactured products. That is to say when the tax was levied at the transaction of purchase, notwithstanding it was leviable in case of goods manufactured by the dealer and were sold in a manner not taxable within the State is nonetheless tax leviable at purchase price and not on the value of the manufactured products. So it was held that the essential character of tax on purchase was retained and consequently it did not lose its character as a tax on purchase of goods. The Court obviously indicated that in the case of tax on sale, price on which transaction took place and not the value of goods is relevant criterion to hold nexus between measure of tax and the taxing event.

The position would have been different had the tax on taxable transaction of purchase have been levied with reference to price relatable to subsequent transaction of sale. In that event, the price forming part of subsequent sale would have lost nexus with the transaction that become taxable in the State.

However, this case did not lay down the principle that where price is the measure to which rate of tax can be applied, it can be something else other then the price component of taxing event, whether agreed by mutual consent or as regulated by statutes.

These cases give a clear picture that Entry 54 in List II of Seventh Schedule empowers the State Legislature to impose and collect taxes on sale of goods. The measure to which tax rate is to be applied must have a nexus to taxable event of sale and not divorced from it.

The pivotal question, therefore, which needs to be considered is whether the measure to which rate of tax is to be applied on single point transaction of sale of any formulation by the wholesaler to the retailer can be something notional which is not related to subject of tax or to say in other words, whether MRP to be chargeable subsequent to taxing event by a retailer when he sells the same goods to consumer can provide a basis which has a nexus with taxable event to provide a valid measure to which rate of tax can be applied.

The principal contention about the invalidating of the basis of the measure of tax envisaged under section 4A of the Act as inserted vide Finance Act, 2004 is that while it levies taxes on the sale transaction carried on by the manufacturer or wholesalers or distributor the measure with which total turnover is to be determined is not part of the sale which attracts tax but its premise is to be found on subsequent sale which, under the scheme of single point tax is not excisable to tax at all. The MRP which a wholesaler can charge in respect of scheduled formulations too is fixed by Control Order. In respect of scheduled formulations wholesaler is required to leave at least 16% margin in the MRP for the retailers and he is entitled to retain not more than 8% profit on the purchase price. There being statutory prohibition against the wholesalers to charge MRP from its buyer, the maximum retail price fixed on the packet has no rational connection with the taxable sale effected by the wholesalers and which becomes subject matter of charge as a first point tax. In such event, there exists no nexus between the measure of levy and subject of levy.

In the context of meaning assigned to expression 'sale of goods' or price or consideration element of such 'sale of goods' as taxable event, the conclusion that can fairly be reached is that for the taxing event of sale, if the price is to be the basis for measuring tax, it must relate to actual transaction of sale that become subject of tax and not to a different transaction that may take place in future at a price.

Accepting the contention of Revenue that the retail sale price likely to be received when such transaction takes place is taken only as a basis to provide measure of levying tax on a completed transaction between wholesalers and retailer would make it suffer from basic fallacy of importing the composition of sale which has not come into existence to determine tax which is fixed as soon as the taxable sale is completed.

Section 4A of the Act which projects itself as an exception to Section 4, creates a legal fiction in respect of price of subject sale, on which rate of tax is to be applied. But levy of tax remains single

point levy in a series of sales. Point of taxable sale remains the first point sale i.e. from the manufacturer/distributor or the wholesaler to the retailer. The tax is to be charged on turnover of the Assessment Year in aggregate. "Turnover" is defined under Section 2(44) and "Taxable Turnover" under Section 2(42) of the Act. For the taxable event that has occurred, the amount received or receivable is assumed to be different from which is neither received nor receivable and that amount which neither flows from the Control Order, nor which flows from buyer to seller under the contract but is relatable to a transaction of sale by a retailer which may not have come into existence. For the present, the price to which rate of tax is sought to be applied to a sale by a wholesaler to a retailer is neither the price agreed upon by the parties to the contract of taxable sale to which charge is attracted nor flows from the Control Order under which also, it is the price of formulation before end sale is to be determined within prescribed limits.

The charging Section 4 stipulates that the tax payable by a dealer under the Act shall be at single point in the series of sales by successive dealers, as may be prescribed and shall be levied at such rates not exceeding fifty per cent on the taxable turnover, as may be notified by the State Government in the Official Gazette. This shows that there is no scope for multi point levy of tax and the tax is levied on the first point sale within the State in a series of sales and tax is leviable at rate applied to aggregate of price received or receivable by the dealer on such sales.

Section 4A does not become workable unless read along with definition of "turnover" and "taxable turnover".

The retail price of a formulation needs determination under paragraph (7) of the order and the Government if empowered by order to fix the price in accordance with paragraph (7) of the order to be charged by a retailer. Where the maximum retail price is fixed as provided under paragraph 7 of Control Order, para 19 provides for price that can be charged from a retailer by a wholesaler, it reads as under:

"19. Price of formulation sold to the dealer- (1) A manufacturer, distributor or wholesaler shall sell a formulation to a retailer, unless otherwise permitted under the provisions of this Order or any order made thereunder, at a price equal to the retail price, as specified by an order or notified by the Government (excluding excise duty, if any), minus sixteen per cent thereof in the case of scheduled drugs"

Applying the principles enunciated above, the inevitable conclusion is that when the wholesaler sells any formulation to a retailer in bulk quantity, taxable event of sale of goods takes place where wholesaler and retailers are the parties to contract, the goods in question are the formulations and the consideration is one which is agreed to between the parties to that transaction within the limits permissible by law. By substituting the assumed quantity of goods or a price which is not subject matter of that contract of completed sale for the purpose of measuring tax the legislature assumes existence of contract of sale of drugs by legal fiction which has not taken place and which cannot be considered to be a sale in the manner stated in the Sales Act, which alone can be subject of tax under Entry 54 in List II. Substitution of assumed price or the assumed quantity in place of actual

price/quantity in a completed sale transaction, for the purpose of levy of tax on the subject matter of tax results in taking away from it the character of 'sale of goods' as envisaged under the Sales Act.

Another distinguishing feature to be kept in mind is that centre point of legislation under Entry 54 of List II of Seventh Schedule is 'sale' in contrast with central point of legislation under Entry 84 of List I of Eighth Schedule i.e. 'Goods manufactured or produced". While basic nexus of levy in the former is "sale of specified goods", in the latter it is "goods manufactured or produced in India".

Every transaction of sale is independent and can be subject to levy of tax and the components and the measure which can make the tax levy effective must have nexus with the taxable event.

By devising a methodology in the matter of levy of tax on sale of goods, law prohibits taxing of a transaction which is not a completed sale and also confine sale of goods to mean sale as defined under the Act. This cannot be overridden by devising a measure of tax which relates to an event which has not come into existence when tax is ex-hypothesi determined, much less which can be said a completed sale and which cannot be subject of legislation providing tax on 'sale of goods' by transplanting a sum related to as "likely price" to be charged for subsequent sale to be taxed by the devise of measuring tax for the completed transaction which has become subject of tax.

It may be relevant to recall here that this Court in Hotel Balaji's case (supra) held that where a tax was levied as a purchase tax and was confined to the purchase price paid by the buyer, and was not chargeable at the price at which the end produce was sold later, it had retained its character as a tax on purchase.

If the legislation can provide for a measure of tax on subject of tax by substituting any notional value, which at no point of time becomes part of or related to subject of tax viz. sale of goods, then the fact that it is related to MRP loses its significance altogether. If this is permitted to be done the legislation can provide for any measure the purpose of applying the rate of tax, whether it is founded on MRP or any other fixed value which legislature may provide will make little difference. It is not contended by appellant that even if the measure is not relatable to MRP, it can substitute any value as a measure of tax. Subject of tax is not the goods or goods sold, but a transaction of 'sale of goods' as defined under the Sales Act.

Learned counsel for the appellant submitted that Union of India and Anr. v. A. Sanyasi Rao and Ors. (1996 (219) ITR 330) supports his stand. Section 44AC was inserted in Income Tax Act, 1961 (in short 'IT Act') by the Direct Tax Laws (Amendment) Act, 1989 w.e.f. 1.4.1989. Section 206C was inserted in the said Act by Finance Act, 1988 w.e.f. 1.4. 1988. Explanation to Section 44AC was inserted by Finance Act, 1990 w.e.f. 1.4.1991. These provisions enabled the revenue to estimate the profits on a presumptive basis in the case of persons dealing in country liquor, timber, forest produces etc. Revenue's intention was to get over the problem of assessing income and recovering tax in cases of person dealing in such commodities, as business of such persons existed only for short period, and after period of contract in many cases, it was not even possible to trace the concerned assesses and many were found to be dealing benami. Section 44AC occurred in Chapter

IV of the I.T. Act deals with "computation of income". Section 44AC(1) determines profits and gains of the year from trading of certain specified goods like liquor at a particular percentage of package price specified therein. The object of said provision was explained in a memorandum as "with a view to combat large scale tax evasion by person deriving income from such businesses where the bill seeks to insert new Section 44AC to provide for determination of income in such cases". About Section 206C it was stated that "it is proposed to introduce a new Section 206C to provide that any person being a seller referred to in Section 206C shall collect income tax of a sum equal to 20% of the amount paid or payable by the buyer as increased by a surcharge for the purpose of Union".

Interpretation of the two sections came up before Andhra Pradesh High Court. The said Court while upholding the validity of the Act read down the Section 44AC of the Act and held it only to be an adjunct to Section 206C and to explain provision of Section 206C and not to dispense with the regular assessment in accordance with the provisions of the I.T. Act. It was held that the subject matter of tax vis. 'income' cannot be determined notionally by making such specific provisions when in all other cases only the real income to be computed in accordance with provision of Section 28 to Section 43C. This Court noted that one of the contentions raised in the petition was that 'tax is levied on "hypothetical income" and not on "real income". In other words, the determination of "real income" was held to be the statutory mandate.

If Section 4-A is designed to bring a levy into existence which is divorced from the "sale" subject to tax under the Act, it is beyond legislative competence under Entry 54 of List II of Seventh Schedule. The notification to the extent it intends to levy tax on first point sale with reference to price which could be charged in respect of a subsequent sale which has not come into existence at the time liability to tax arise and is determined ex-hypothesi is unsustainable on that basis.

Though the decision in Ganga Sugar case (supra) at first flush appears to be supporting the stand of the appellants, on a deeper scrutiny it is crystal clear that the said decision was rendered on peculiar facts of the case. The three challenges as culled out from paragraphs 22, 23 and 25 of the judgment make the position clear that there was no discussion in the background of Entry 54. Para 16 of the judgment traced the history of levy on sugarcane and 40 years old practice of levy on sugarcane was linked with weight. It was significantly noted that it was in the background of "peculiar circumstances of sugarcane economy". The logic cannot be applied to the facts of the present case.

In Builders' Association of India and Ors. v. Union of India and Ors. (1989 (2) SCC 645) it was noted as follow:

"36. Even after the decision of this Court in the State of Madras v. Gannon Dunkerley and Co. (Madras) Ltd. it was quite possible that where a contract entered into in connection with the construction of a building consisted of two parts, namely, one part relating to the sale of materials used in the construction of the building by the contractor to the person who had assigned the contract and another part dealing with the supply of labour and services, sales tax was leviable on the goods which were agreed to be sold under the first part. But sales tax could not be levied when the contract in question was a single and indivisible works contract. After the 46th Amendment the

works contracts which was an indivisible one is by a legal fiction altered into a contract which is divisible into one for sale of goods and the other for supply of labour and services. After the 46th Amendment, it has become possible for the States to levy sales tax on the value of goods involved in a works contract in the same way in which the sales tax was leviable on the price of the goods and materials supplied in a building contract which ad been entered into in two distinct and separate parts as stated above. It could not have been the contention of the revenue prior to the 46th Amendment that when the goods and materials had been supplied under the distinct and separate contract by the contractor of the purpose of construction of a building the assessment of sales tax could be made ignoring the restrictions and conditions incorporated in Article 286 of the Constitution. If that was the position can be States contend after the 46th Amendment under which by a legal fiction the transfer of property in goods involved in a works contract was made liable to payment of sales tax that they are not governed by Article 286 while levying sales tax on sale of goods involved in a works contract? They cannot do so. When the law creates a legal fiction such fiction should be carried to its logical end. There should not be any hesitation in giving full effect to it. If the power to tax a sale in an ordinary sense is subject to certain conditions and restrictions imposed by the Constitution, the power to tax a transaction which is deemed to be a sale under Article 366(29-A) of the Constitution should also be subject to the same restrictions and conditions. Ordinarily, unless thee is a contract to the contrary in the case of a works contract the property in the goods used in the construction of a building passes to the owner of the land on which the building is constructed, when the goods or materials used are incorporated in the building. The contractor becomes liable to pay the sales tax ordinarily when the goods or materials are so used in the construction of the building and it is not necessary to wait till the final bill is prepared for the entire work. In Hudson's Building Contracts (8th Edn.) at page 362 it is stated thus:

"The well known rule is that the property in all materials and fittings, once incorporated in or affixed to a building, will pass to the freeholder quicquid plantatur solo cedit. The employer under a building contract may not necessarily by the freeholder, but may be a lessee or licensee, or even have no interest in the land at all, as in the case of a sub-contract. But once the builder has affixed materials, the property in them passes from him, and at lest as against him they become the absolute property of his employer, whatever the latter's tenure of or title to the land. The builder owner may himself be entitled to sever them as against some other person e.g. as tenant's fixtures. Nor can the builder reclaim them if they have been subsequently severed from the soil by the building owner or anyone else. The principle was shortly and clearly stated by Blackburn J. in Appleby v. Meyers(1867 LR 2 CP 651): 'Materials worked by one into the property of another become part of that property'. This is equally true whether it be fixed or movable property. Bricks built into a wall become part of the house, thread stitched into a coat which is under repair, or planks and nails and pitch worked into a ship under repair, become part of the coat or the ship."

40. We are surprised at the attitude of the States which have put forward the plea that on the passing of the 46th Amendment the Constitution had conferred on the States a larger freedom than what they had before in regard to their power to levy sales tax under Entry 54 of the State List. The 46th Amendment does no more than making it possible for the States to levy sales tax on the price of goods and materials used in works contracts as if there was a sale of such goods and materials. We do not accept the argument that sub-clause (b) of Article 366(29-A) should be read as being equivalent to a separate entry in List II of the Seventh Schedule to the Constitution enabling the States to levy tax on sales and purchases independent of Entry 54 thereof. As the Constitution exists today the power of the States to levy taxes on sales and purchases of goods including the "deemed"

sales and purchases of goods under clause (29-A) of Article 366 is to be found only in Entry 54 and not outside it. We may recapitulate here with observations of the Constitution Bench in the case of Bengal Immunity Company Ltd. v. State of Bihar (1955 (2) SCR 603) in which this Court has held that the operative provisions of the several parts of Article 286 which imposes restrictions on the levy of sales tax by the States are intended to deal with different topics and one could not be projected or read into another and each one of them has to be obeyed while any sale or purchase is taxed under Entry 54 of the State List."

In Bhopal Sugar Industries v. D.B. Dube (AIR 1964 SC 1037) it was noted as follows:

5. In Gannon Dunkerley and Company's case ([1959] S.C.R. 379.), this Court was called upon to consider whether in a building contract which is one, entire and indivisible, there is sale of goods. It was held by the Court that the Provincial Legislature was not competent under Entry 48, List II, Sch. VII of the Government of India Act, 1935, to impose tax on the supply of materials used in such a contract treating it as a sale. The decision of the Court did not rest upon any peculiar character of a building contract. It was held on the larger ground canvassed in that case, that the expression 'sale of goods' within the meaning of relevant legislative entry had the same connotation as 'sale of goods' in the Indian Sale of Goods Act, 1930, and therefore the State Legislature had no power to enact legislation to levy tax under Entry 48 of List II in respect of transactions which were not of the nature of sales of goods strictly so called; and a building contract not being a transaction in which there was a sale of materials by the contractor who constructed the building, the State was not competent to enact legislation to impose tax on the supply of materials used in a building contract treating it as a sale. It was therefore, held that the definition of sale in the Madras General Sales Tax Act IX of 1939 was to the extent of the extension invalid.

6. In Gannon Dunkerley and Company's case ([1999] S.C.R. 379.), the validity of s. 2(h)(ii) of the Madras General Sales Tax Act, 1939, as amended by Act XXV of 1947, in so far as it included goods included in a works contract fell to be determined, in the light of the competence of the Provincial Legislature under Entry 48, List II, in Seventh Schedule of the Government of India Act, 1935. Under the Constitution the relevant entry conferring legislative power upon States to tax sale of goods in Entry 54, List II. As the scheme of division of legislative power under the Constitution has remained unaltered, the principle of Gannon Dunkerley's case ([1999] S.C.R. 379.), applies in adjudging the validity of the provisions of the Madhya Pradesh Act 4 of 1958.

7. Consumption by an owner of goods in which he deals is therefore not a sale within the meaning of the Sale of Goods Act and therefore it is not 'sale of goods' within the meaning of Entry 54, List II, Schedule VII of the Constitution. The legislative power for levying tax on sale of goods being restricted to enacting legislation for levying tax on transactions which conform to the definition of sale of goods within the meaning of the Sale of Goods Act, 1930, the extended definition which includes consumption by a retail dealer himself of motor spirit or lubricants sold to him for 'retail sale' is beyond the competence of the State Legislature. But the clause in the definition in Section 2(1) "and includes the consumption by a retail dealer himself or on his behalf of motor spirit or lubricant sold to him for retail sale" which is ultra vires the State Legislature because of lack of competence under Entry 54 in List II, Schedule VII of the Constitution is severable, from the rest of the definition, and that clause alone must be declared invalid."

The traditional concept of sale was stressed upon and reference was made to M/s Gannon Dunkerley's case (supra) for the purpose of interpreting true import of the expression "sale of goods".

In that view of the matter, the judgment of the High Court does not warrant any interference and the appeal is dismissed. However, it is made clear that if the tax component has been passed on to the subsequent purchases claim for refund shall not be entertained. But where it has not been so passed on and has been deposited with the authorities, the same shall be adjusted against future demands, if any.

The appeal is dismissed. No costs.

J