

**SUPREME COURT OF INDIA**

Federal Bank Limited & Ors.

Vs

State of Kerala & Ors.

C.A.No.6459 of 2003

(S.H.Kapadia and B.S.Reddy,JJ.,)

21.03.2007

**JUDGMENT**

**S.H. Kapadia, J.**

1. A short question which arises in these two civil appeals is : whether banks are "dealers" under Section 2(viii) read with Explanation I of the Kerala General Sales Tax Act, 1963.

2. Since common question of law arises in both the civil appeals, they are heard together and disposed of by this common judgment. For the sake of convenience, we may refer to the facts in C.A.No.6459 of 2003 filed by Federal Bank Ltd. and Ors. V. State of Kerala and Ors.

3. By the Kerala Finance Act, 1998 a clause (g) was inserted in Section 2(viii) by which the definition of the word "dealer" was expanded to cover a bank or a financial institution which, whether in the course of its business or not, sells any gold or other valuables pledged with it to secure any loan, for the realization of such loan amount. After the said amendment, the Department called upon Federal Bank to furnish details of the gold auction during the year 1998-1999 and 1999-2000. This was vide notice dated 31.8.99 issued by the Sales Tax Officer to the assessee. On 1.11.99 the Department called upon the bank to furnish details of the turnover relating to the gold auction sale on and after 1.4.98; the Department also called upon the assessee to pay tax at 4% on the sale turnover within 15 days. This was vide notice dated 1.11.99. Federal Bank submitted its reply contending that a scheduled bank cannot be compared with a pawn broker and, therefore, it was not a dealer under the 1963 Act. The Federal Bank refused to file its return on the ground that there was no sale of ornaments pledged to the bank and that the position of the bank remained unaltered even after introduction of clause (g) in Section 2(viii) of the 1963 Act vide Kerala Finance Act 1998 dated 29.7.98.

4. Ultimately, Federal Bank Ltd. filed O.P.No.1169 of 2000 in the Kerala High Court challenging the validity of Section 2(viii)(g) of the 1963 Act as also the notices issued by the Department pursuant to the Kerala Finance Act, 1998 directing Federal Bank to file returns and pay tax on sale of pledged articles.

5. By judgment and order dated 11.4.2002 the Single Judge held that in view of Kerala Finance Act, 1998, by which clause (g) stood incorporated under Section 2(viii) of the 1963 Act, the transaction of sale, whether in the course of business or not, would cover auction sale or ornaments pledged with the bank. Therefore, banks, according to the learned Single Judge, came within the definition of the word "dealer" and since the pledged articles were goods and since the sale was for money consideration, Section 5 of the 1963 was applicable and in the circumstances the learned Single Judge upheld the demand notices leaving the question of legislative competence open to challenge.

6. Aggrieved by the said decision of the learned Single Judge, Federal Bank along with other banks carried the matter in appeal. By the impugned judgment dated 3.4.03 it was held that in view of the Kerala Finance Act, 1998 under which the definition of the word "dealer" is expanded to cover banks, the Department was right in seeking to cover the transactions of auction sale of pledged gold articles. It was further held that amended Section 2(viii)(g) was intra vires the Constitution Of India, 1950 and that the said section did not infringe Articles 14 and 19 of the Constitution Of India, 1950. It was further held that even assuming that the transaction of sale of pledged articles is not a part of the main business activity still the said transaction would come within the meaning of incidental or ancillary to the business of banking and in the circumstances there was no infirmity in the judgment of the learned Single Judge. Accordingly, the Division Bench dismissed the writ appeals filed by the appellants herein. Hence, this civil appeal.

7. At the outset, we may point out that before us the constitutional validity of Section 2(viii)(g) of the 1963 Act was not argued. Before us it was urged on behalf of banks (appellants) that although by the Kerala Finance Act, 1998 the definition of the word "dealer" under Section 2(viii) of the 1963 Act stood expanded so as to include banks, the said Act was still not applicable to "sale" of pledged ornaments as the said transaction did not take place in the course of banking business in terms of Section 2 (xxi). It was submitted that the word "sale" is defined in the said section to mean every transfer of the property in goods by one person to another in the course of trade or business for cash, deferred payment or other valuable consideration excluding mortgage, hypothecation charge or pledge. According to the banks (appellants) since the auction sale of pledged ornaments did not fall within the definition of the word "sale" in Section 2(xxi), such transaction are not exigible to tax under the said Act, even after the insertion of clause (g) to Section 2(viii). On behalf of the banks it was further submitted that even under 1949 Act the word "banking" has been defined under Section 5(b) to mean accepting, for the purpose of lending or investment, of deposits of money from the public, repayable on demand or otherwise. According to the banks (appellants) auction sale of pledged ornaments does not come under the definition of the word "banking" under Section 5(b) of the 1949 Act and, therefore, it cannot be said that the banks were in the business of selling pledged ornaments. On behalf of banks it was further submitted that under Section 6 of the 1949 Act, in addition to the business of banking, a banking company may engage in one of the following forms of business, namely, borrowing, raising of loans, lending with or without security, drawing of bills, accepting bills, discounting, buying, selling, collecting and dealing in bills of exchange. According to the

banks (appellants) the "banking business" consists of accepting deposits from the public. However, under Section 6 a bank is permitted to engage in the other form of business apart from acceptance of deposits. According to the banks (appellants) Section 6 enables a banking company if it so desires to engage in other form of business stipulated in Section 6(1)(a) of the 1949 Act. It was further contended that under Section 8 of the said 1949 Act, banks are prohibited expressly from trading in goods except to the extent of buying or selling of goods in realization of security given to it by the borrower. Under the Explanation to Section 8 of the 1949 "goods" are defined to mean every kind of movable property other than actionable claims, stocks, shares, money etc. It is submitted that in view of Section 8 banks cannot sell goods in the course of business and in view of the said prohibition it cannot be said that banks are in the business of selling pledged ornaments. Therefore, according to the banks (appellants) auction sale of pledged ornaments by banks for realization of security will not fall in the course of banking business and, therefore, such transactions will not come within the definition of the word "sale" as defined in Section 2(xxi) of the 1963 Act.8. We do not find any merit in the above contention. As stated above, we are not concerned in the present civil appeals with the question of legislative competence of the State Legislature to insert clause (g) in Section 2(viii) of the 1963 Act. In the present case, we are concerned only with the limited question argued before us, namely, whether auction sale of pledged goods by scheduled banks is a "transaction" which takes place in the course of banking business in terms of the 1949 Act. In the present case, we are concerned with the situation which arose after enactment of the Kerala Finance Act, 1998. By that amendment the definition of the word "dealer" in Section 2(viii) was expressly amended to mean any person who carries on business of buying, selling, supplying or distributing goods for cash or deferred payment or for any other valuable consideration. It is important to note that prior to Kerala Finance Act, 1998 there was litigation. The result of that litigation was that the High Court had taken the view in the earlier rounds that sale of pledged ornaments did not fall "in the course of banking business" and in order to get over the judgments, the Kerala Legislature introduced clause (g) to Section 2(viii) by making it clear that even if the sale of pledged ornaments took place, not in the course of business, still such a transaction would make the person (banks/financial institutions) a "dealer" under Section 2(viii) of the 1963 Act. Therefore, in deciding the matter we have to keep in mind the object behind the Kerala Finance Act, 1998.

8. In order to answer the controversy in hand we quote hereinbelow the relevant sections of the 1963 Act:

"Section 2. Definitions. In this Act, unless the context otherwise requires:

(vi) "Business" includes any trade, commerce or manufacture or any adventure or concern in the nature of trade, commerce, or manufacture, whether or not such trade, commerce, manufacture, adventure or concern is carried on with a motive to make gain or profit and whether or not any profit accrues from such trade, commerce, manufacture adventure or concern; and Any transaction in connection with, or incidental or ancillary to such trade, commerce, manufacture, adventure or concern.

(viii) "dealer" means any person who carries on the business of buying, selling, supplying or distributing goods, executing works contract, transferring the right to use

any goods or supplying by way of or as part of any service, any goods directly or otherwise, whether for cash or for deferred payment, or for commission remuneration or other valuable consideration and includes:-

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a casual trader;

a commission agent, a broker or a delcredere agent or an auctioneer or any other mercantile agent, by whatever name called, who carried on the business of buying, selling, supplying or distributing goods [executing works contract, transferring right to use any goods or supplying by way of or as part of any service, any goods] on behalf of any principal;

A non-resident dealer or an agent of a non-resident dealer, or a local branch of a firm or company of [association of body of persons whether incorporated or not] situated outside the State;

A person who, whether in the course of business or not, sells; Goods produced by him by manufacture, agriculture, horticulture or otherwise; or Trees which grow spontaneously and which are agreed to be severed before sale or under the contract of sale;

(f) A person who whether in the course of business or not: -

(1) Transfers any goods, including controlled goods whether in pursuance of a contract or not, for cash or deferred payment or other valuable consideration;

(2) Transfers property in goods (whether as goods or in some other form) involved in the execution of a works contract;

(3) Delivers any goods on hire-purchase or any system of payment by instalments;

(4) Transfers the right to use any goods for any purpose (whether or not for a specified period) for cash, deferred payment or other valuable consideration;

(5) supplies, by way of or as part of any service or in any other manner whatsoever, goods, being food or any other articles for human consumption or any drink (whether or not intoxicating), where such supply or service is for cash, deferred payment or other valuable consideration);

Explanation.-(1) A society (including a co-operative society, club or firm or an association or body of persons, whether incorporated or not) which whether or not in the course of business, buys, sells, supplies or distributes goods from or to its

members for cash or for deferred payment, or for commission, remuneration or other valuable consideration, shall be deemed to be a dealer for the purposes of this Act;

Explanation.-(2) The Central Government or a State Government, which, whether or not in the course of business, buy, sell, supply or distribute goods, directly or otherwise, for cash or for deferred payment, or for commission, remuneration or other valuable consideration, shall be deemed to be a dealer for the purposes of this Act.

(g) a bank or a financing institution which, whether in the course of its business or not, sells any gold or other valuable article pledged with it to secure any loan, for the realization of such loan amount;

Explanation I.-Bank for the purposes of this clause includes a Nationalised Bank or a Scheduled Bank or a Co-operative Bank;

Explanation II.- Financing Institution means a financing institution other than a bank.

(xii) "goods" means all kind of movable property (other than newspapers, actionable claims, electricity, stocks and shares and securities) and includes live stock, all materials, commodities and articles (including those to be used in the construction, fitting out, improvement or repair of immovable property or used in the fitting out, improvement or repair of movable property) and every kind of property (whether as goods or in some other form) involved in the execution of a works contract, and all growing crops, grass or things attached to, or forming part of the land which are agreed to be severed before sale or under the contract of sale.

(xxi) "sale" with all its grammatical variations and cognate expressions means every transfer (whether in pursuance of a contract or not) 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, but does not include a mortgage, hypothecation charge or pledge.

(xxv) "taxable turnover" means the turnover on which a dealer shall be liable to pay tax as determined after making such deductions from his total turnover of purchase or sale in the course of inter-state trade or commerce or in the course of export of the goods out of the territory of India or in the course of import of the goods into territory of India;

(xxvi) "total turnover" means the aggregate turnover in all goods of a dealer at all places of business in the State, whether or not the whole or any portion of such turnover is liable to tax including the turnover of purchase or sale in the course of inter-state trade or commerce or in the course of export of the goods out of the territory of India or in the course of import of the goods into the territory of India.

Section 5 Levy of tax on sale of goods.-

(1) Every dealer (other than a casual trader or agent of a non-resident dealer or the Central Government, or Government of Kerala or the Government of any other State or of any Union Territory, or any local authority) whose total turnover for a year is not less than two lakh rupees and every casual trader or agent of a non-resident dealer, the Central Government, the Government of Kerala, the Government of any other State or of any Union Territory or any local authority, whatever be its total turnover for the year, shall pay tax on his taxable turnover for that year in respect of goods included in the Schedule at the rate mentioned against such goods."

9. We also quote hereinbelow the relevant provisions of the 1949 Act:

"Section 5. Interpretation.- In this Act, unless there is anything repugnant in the subject or context, -

(b) "Banking" means the accepting, for the purpose of lending or investment, of deposits of money from the public, repayable on demand or otherwise, and withdrawable by cheque, draft, order or otherwise.

Section 6. Forms of business in which banking companies may engaged.-(1) In addition to the business of banking, a banking company may engage in any one or more of the following forms of business, namely:-(a) the borrowing, raising, or taking up of money; the lending or advancing of money either upon or without security; the drawing, making, accepting, discounting, buying, selling, collecting and dealing in bills of exchange, hundees, promissory notes, coupons, drafts, bills of lading, railway receipts, warrants, debentures, certificates, scrips and other instruments, and securities whether transferable or negotiable or not; the granting and issuing of letters of credit, traveller's cheques and circular notes; the buying, selling and dealing in bullion and specie; the buying and selling of foreign exchange including foreign bank notes; the acquiring, holding, issuing on commission, underwriting and dealing in stock, funds, shares, debentures, debenture stock, bonds, obligations, securities and investments of all kinds; the purchase and selling of bonds, scrips or other forms of securities on behalf of constituents or others, the negotiating of loans and advances; the receiving of all kinds of bonds, scrips or valuables on deposit or for safe custody or otherwise; the providing of safe deposit vaults; the collecting and transmitting of money and securities;

(b) acting as agents for any Government or local authority or any other person or persons; the carrying on of agency business of any description including the clearing and forwarding of goods, giving of receipts and discharges and otherwise acting as an attorney on behalf of customers, but excluding the business of a (managing agent or secretary and treasurer) of a company;

(c) Contracting for public and private loans and negotiating and issuing the same;

(d) the effecting, insuring, guaranteeing, underwriting, participating in managing and carrying out of any issue, public or private, of State, municipal or other loans or of shares, stock, debentures, or debenture stock of any company, corporation or association and the lending of money for the purpose of any such issue;

(e) Carrying on and transacting every kind of guarantee and indemnity business;(f) managing, selling and realizing any property which may come into the possession of the company in satisfaction or part satisfaction of any of its claims;

(g)acquiring and holding and generally dealing with any property or any right, title or interest in any such property which may form the security or part of the security for any loans or advances or which may be connected with any such security;

(h) Undertaking and executing trusts;

Undertaking the administration of estates as executor, trustee or otherwise;

(j) establishing and supporting or aiding in the establishment and support of associations, institutions, funds, trusts and conveniences calculated to benefit employees or ex-employees of the company or the dependents or connections of such persons; granting pensions and allowances and making payments towards insurance; subscribing to or guaranteeing moneys for charitable or benevolent objects or for any exhibition or for any public, general or useful object;

(k) The acquisition, construction, maintenance and alteration of any building or works necessary or convenient for the purposes of the company;

(l) selling, improving, managing, developing, exchanging, leasing, mortgaging, disposing of or turning into account or otherwise dealing with all or any part of the property and rights of the company;

(m) Acquiring and undertaking the whole or any part of the business of any person or company, when such business is of a nature enumerated or described in this sub-section;

(n) Doing all such other things as are incidental or conducive to the promotion or advancement of the business of the company;

(o) Any other form of business which the Central Government may, by notification in the Official Gazette, specify as a form of business in which it is lawful for a banking company to engage.

(2) No banking company shall engage in any form of business other than those referred to in sub-section (1).

## Section 8. Prohibition of trading.-

Notwithstanding anything contained in section 6 or in any contract, no banking company shall directly or indirectly deal in the buying or selling or bartering of goods, except in connection with the realization of security given to or held by it, or engage in any trade, or buy, sell or barter goods for others otherwise than in connection with bills of exchange received for collection or negotiation or with such of its business as is referred to in clause (i) of sub-section (1) of Section 6. Explanation.- For the purposes of this section, "goods" means every kind of movable property, other than actionable claims, stocks, shares, money bullion and specie, and all instruments referred to in clause (a) of sub-section (1) of section 6.

## Section 29. Accounts and balance-sheet.

(1) At the expiration of each calendar year (or at the expiration of a period of twelve months ending with such date as the Central Government may, by notification in the Official Gazette, specify in this behalf, ) every banking company incorporated (in India), in respect of all business transacted by it, and every banking company incorporated (outside India), in respect of all business transacted through its branches (in India), shall prepare with reference to (that year or period, as the case may be, ) a balance-sheet and profit and loss account as on the last working day of (that year or the period, as the case may be) in the Forms set out in the Third Schedule or as near thereto as circumstances admit:

Provided that with a view to facilitating the transition from one period, of accounting to another period of accounting under this sub-section, the Central Government may, by order published in the Official Gazette, make such provisions as it considers necessary or expedient for the preparation of, or for other matters relating to, the balance-sheet or profit and loss account in respect of the concerned year or period, as the case may be.

(2) The balance-sheet and profit and loss account shall be signed, -

(a) in the case of a banking company incorporated (in India), by the manager or the principal officer of the company and where there are more than three directors of the company, by at least three of those directors, or where there are not more than three directors, by all the directors, and

(b) in the case of a banking company incorporated (outside India) by the manager or agent of the principal office of the company (in India).

(3) Notwithstanding that the balance-sheet of banking company is under sub-section (1) required to be prepared in a form other than the form (set out in Part I of Schedule VI to the Companies Act, 1956 (1 of 1956), the requirements of that relating to the balance-sheet and profit and loss account of a company shall, insofar as they are not

inconsistent with this Act, apply to the balance-sheet or profit and loss account, as the case may be, of a banking company.(3-A) Notwithstanding anything to the contrary contained in sub-section (3) of Section 210 of the Companies Act, 1956 (1 of 1956), the period to which the profit and loss account relates shall, in the case of a banking company, be the period ending with the last working day of the year immediately preceding the year in which the annual general meeting is held.

Explanation.-In sub-section (3-A), "year" means the year or, as the case may be, the period referred to in sub-section (1).

(4) The Central Government, after giving not less than three months' notice of its intention so to do by a notification in the Official Gazette, may from time to time by a like notification amend the Form set out in the Third Schedule.

### "THE THIRD SCHEDULE

(See section 29)

#### FORM A

Form of Balance-sheet

[FORM TO BE CLARIFIED WITH THE ORIGINAL COURT DOCUMENT] FORM B

Form of Profit and Loss Account

Profit and Loss Account for the year ended

EXPENDITURE

Rs. P. Rs. P.

INCOME

Rs. P. Rs. P.

1. Interest on deposits, borrowings, etc.

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1. Interest and discount

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2. Salaries and allowances and provident fund

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2. Commission, exchange and brokerage

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3. Directors and local committee members' fees and allowances

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3. Subsidies and donations

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4. Rent, taxes, insurance, lighting, etc.

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4. Income from non-banking Assets and profit from sale of or dealing with such assets

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5. Law charges

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5. Other receipts

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6. Postage, telegrams and telephonic charges

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6. Loss (if any)

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7. Auditor's fees

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8. Depreciation on and repairs in property

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9. Stationery, printing and advertisement, etc.

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10. Loss from sale of or dealing with non-banking assets

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11. Other expenditure

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12. Balance of profit

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Total

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Total

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General Instructions The corresponding figures (to the nearest rupee, if so desired for the year immediately preceding the year to which the profit and loss account relates should be shown in separate columns."

10. In order to answer the contentions raised on behalf of the banks (appellants) it is important to note that we are concerned with the 1963 Act. The said Act is enacted to consolidate and amend the law relating to the levy of tax on sale or purchase of goods in State of Kerala. In our opinion, the word "sale" in Section 2(xxi) of the 1963 is very important. The word "sale" is defined to mean transfer of the property in goods in the course of trade or business for cash, deferred payment or for any other valuable consideration. This definition is different from the definition of the word "sale" under the Sale of Goods Act, 1930. When the pledged article is put to auction it is no doubt for satisfaction of claims. It also results in an income from non-banking assets. The first question which, therefore, arises is : whether sale of pledged ornaments for consideration falls in the course of trade or business of the bank. It is no doubt true that banks have to act on instructions of the borrower. In the present case, we are not concerned with the provisions of Section 176 of the Contract Act, 1872. We are concerned with the definition of the word "sale" under the 1963 Act. When a bank sells the pledged ornaments it is not acting as an agent of the borrower even under the 1949 Act. When the bank sells the goods pledged to them they do not act as the agents of the borrower. As pledgees, the banks, acting under Section 176 of the Contract Act, 1872 have a right to sell the goods. That sale is not as agents but that sale is in exercise of the statutory power under the 1949 Act. No doubt the sale is on behalf of the pledgor, however, the sale is in exercise of the statutory power [See: *The Deputy Commissioner of Commercial Taxes v. A.R.S. Thirumeninatha Nadar Firm*<sup>2</sup> To the same effect is the judgment of the Punjab and Haryana High Court in the case of *High Channel Video v. Enclave Electronics and others*<sup>1</sup> Further on reading the provisions of the 1949 Act, one finds that every bank is required to maintain its balance-sheet in Form 'A" of the Third Schedule, quoted above. The prescribed form indicates that non-banking assets acquired by the banks even in satisfaction of claims, are required to declare their holdings. The prescribed form of balance-sheet indicates that banks are required to show on the asset side non-banking assets acquired by them in satisfaction of claims. Similarly, in Form 'B' of the Third Schedule under Profit and Loss Account, banks are required to show income from non-banking assets and profit from sale of such assets. In our view, therefore, sale of pledged assets takes place in the course of banking business. Therefore, as stated above, the banks, in selling the goods

pledged to them, did not act as agents of the borrowers/pledgors and that their sale was in exercise of statutory power under the 1949 Act. Further, in our view it is no doubt true that under Section 8 of the 1949 Act banks are prohibited from trading in goods. However, if one reads Section 8 along with Third Schedule to the 1949 Act it is clear that dealing in non-banking assets is a banking business and the exception made in Section 8 which allows banks to realize security and which allows banks to engage in trade in order to realize security, falls within the banking business whenever undertaken. When a pledged article is sold in an auction, the bank recovers not only its dues but also recovers interests and its other charges. This realization falls within the parameters of the Third Schedule to the 1949 Act. In the circumstances, we are of the view that sale of pledged ornaments falls within the course of banking business under the 1949 Act. In the circumstances, such transactions are taxable under Section 2(viii)(g) read with Section 5 of the 1963 Act. We also find merit in the contention advanced on behalf of the Department (respondents herein) that the very object of the Kerala Finance Act, 1998 was to introduce clause (g) in Section 2(viii) in order to get over the judgments of the High Court which took the view that sale of pledged goods did not fall in the course of banking business. We have quoted clause (g). That clause makes it very clear that even if the sale of pledged ornaments takes place outside the banking business, the 1963 Act would cover even such transactions. Therefore, once such transactions fall under Section 2(viii)(g) of the 1963 Act, banks become "dealers" and they are liable to pay sales tax under the said 1963 Act. It is true that the definition of the word "sale" under Section 2(xxi) of the 1963 Act does not include mortgage, hypothecation charge or pledge, however, the important point to be noted is that the definition of the word "sale" under the 1963 Act is not the same as under Section 4 of the Sale of Goods Act, 1930. The definition of the word "sale" in Section 2(xxi) in the 1949 is very similar to Section 2(g) of the Central Sales Tax Act, 1956 which is held to be having a very wide meaning as compared to the definition of the word "sale" in Section 4 of the Sale of Goods Act, 1930 [See: *State of Maharashtra v. Embee Corporation, Bombay*<sup>3</sup>. Further, when charge or pledge is enforced that enforcement is by way of sale of the pledged or hypothecated goods; that sale is for consideration and, therefore, it falls within the ambit of Section 2(xxi) of the 1963 Act.11. In the circumstances, there is no infirmity in the impugned judgments of the Division Bench of the Kerala High Court.

12. Accordingly, the above civil appeals have no merit and they are dismissed with no order as to costs.

Judgment Referred.

<sup>1</sup>(1999) (116) STC 131 (P&H)

<sup>2</sup>(1967) Indlaw MAD 68 (Mad)

<sup>3</sup>(1997) 7 SCC 0190