Imagic Creative Pvt. Ltd vs Commissioner Of Commercial Taxes & Ors on 9 January, 2008

Equivalent citations: 2008 AIR SCW 844, 2008 (2) AIR KANT HCR 268, AIR 2008 SC (SUPP) 1387, 2008 (2) SCC 614, (2008) 1 CTC 843 (SC), (2008) 1 SCALE 356

Author: S.B. Sinha

Bench: S.B. Sinha, Harjit Singh Bedi

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           CASE NO.:
Appeal (civil)  252 of 2008

PETITIONER:
Imagic Creative Pvt. Ltd.

RESPONDENT:
Commissioner of Commercial Taxes & Ors.

DATE OF JUDGMENT: 09/01/2008

BENCH:
S.B. Sinha & Harjit Singh Bedi

JUDGMENT:
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J U D G M E N T (Arising out of SLP (C) No.6499 of 2007) S.B. Sinha, J.

1. Leave granted.

2. Whether the charges collected towards the services for evolution of prototype conceptual design (i.e. creation of concept), on which service tax had been paid under the Finance Act, 1994 as amended from time to time is liable to tax under the Karnataka Value Added Tax Act, 2003 (the Act) is the question involved in this appeal which arises out of a judgment and order dated 29.11.2006 passed by a Division Bench of the Karnataka High Court in STA No.7 of 2006.

3. Appellant is an advertising agency. It provides for advertisement services. It creates original concept and design advertising material for their clients and design brochures, annual reports etc. The Contract between the appellant and their clients does not appear to have been entered into in writing as no written contract as such has been placed before us.

4. We may notice a purchase order and the invoice which have been produced before us and the authenticity whereof is not in question :

ESTIMATE P & PR Unit M/S ISRO HEADQUARTERS , Antariksh Bhavan, New BEL Road , Bangalore , Estimate No. 014F Date : 26.04.2003 , Job No.: 051/APR/ 03 , Enquiry No. Co-ordinated by : Mr. C.S. Ramachandran Particulars GSAT 2 POSTER Qty.

Rate Amount Rs.

P. Rs.

P.

1.

Conceptualising, Design and Production of Computer Artwork of size A3, front back 1,500 1,500 1,500 1,500

2. B/w Line drawings in back page Artwork of size A5

3.

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Digital Inkjet Output on
Photoglossy Paper for Layout of
size A3 (1.5 sq. ft.)
@ Rs. 100/- per. sq. ft.        front
                                                  back
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4.
Four Colour Separated Positives
Size: A3 @ Rs. 250/- per colour x

front
back

5% Service Tax on item 1
5% KST on item 3
1.5% Resale Tax on item 4

1 Set
1 Set

1,000
1,000

1,000
1,000

Rupees Five Thousand Eight Hundred Ninety Five Only Total Rs.

5,895 INVOICE Consignee M/S MORRIS TOOLING PVT. LTD.

Doddaballapur Bangalore Co-ordinated by Mr. Muniswamy Invoice No. Dated 31.01.2004 Delivery Note/Date 531/23.01.04 Job No. 1175/DEC/03 Purchase Order No. MTP/PUO/2004/00002 Dated 21.01.2004 Sl.

No. Description of Goods Quantity Rate Amount Rs.

P. Rs.

P. HSK TOOL HOLDER

1. Designing and System Charges 9,000

2. Four Colour Separated Positives for Cover Size: A3 1 Set 1,728 Two Colour Separated Positives Size : A4 21 Sets 9,828 Four Colour Offset Printing on 300 GSM Matt Art Card for Cover Two Colour Offset Printing on 170 GSM Matt Art Paper for Inner pages with centre pinning 31,850 8% Service Tax on item 1 1.5 % Resale Tax on item 2-4 TOTAL 53,777 Rupees Fifty Three Thousand Seven Hundred Seventy Seven Only

5. They filed their returns both under the Finance Act, 1994 as also the Act. An order of assessment was passed by the Assessing Authority in terms of Section 12 of the Karnataka Sales Tax Act and Rule 3 of the Karnataka Sales Tax Rules, material portion whereof reads as under :

> In view of the above discussions, I hereby complete the assessment for the year 2003-2004 under section 12(3) of the KST Act 1957 by confirming the turnovers proposed in the proposition notice.
>
> Gross turnover Rs. 1,97,72,296-00 Add. Towards omissions as per. Int. report Rs. 6,07,840-00 Gross turnover determined Rs. 2,03,80,136-00 Less : Exempted turnover
>
> 1) Taxes collected Rs. 2,43,848-00
>
> 2) Discount allowed Rs. 80,332-00
>
> 3) Service charges, design & art work charges collected in which no transfer of property in goods is involved Rs. 54,27,260-00
>
> 4) Advertisment charges for Newspapers collected Rs. 80,12,976-00

5) Sales outside the state Rs. 62,400-00 Rs. 1,38,26,816-00 Taxable turnover Rs. 65,53,320-00 Classification of TTO:

1) Sale of Computer Printed materials @ 8% from 1.4.03 to 31.5.03 Rs. 4,57,242-00 Rs. 36,580-00

2) -do- from 1.6.03 to 31.3.04 @ 9% Rs. 16,19,122-00 Rs. 145,721-00

3) -do- to Government Departments against D forms @ 5% 11,45,034-00 Rs. 57,252-00

4) Sale of Printed materials as II dealer liable for RST @ 1.5% Rs. 33,31,922-00 Rs. 49,979-00

5) Addl. Tax after 1.6.03 @ 1% Rs. 27,642/-

6) Cess @ 15% on tax after 1.2.04		Rs. 5,850-00
	Total Tax	Rs. 3,23,024-00

6. After passing of the order of assessment, a raid was conducted. A criminal proceeding was initiated against the appellant-company. An application was filed by it before the appropriate authority under Section 60 of the Act for classification and advance rulings. By reason of the order dated 30th September, 2005, it was held :

The issue is examined in detail and it is seen that in the sale of the advertisement material, the background activity such as conceptualization is no doubt an idea but creation of advertisement is a comprehensive activity leading to creation of goods in question. Even when any other goods are produced there is some idea and thought regarding the shape and size etc. Therefore, to separate design and concept taking the sale value of merely the advertisement material as brochure etc. is improper.

It is further seen that in the bills there is separate charge made as content development concept, design, photography scanning and other charges such as system charges including colour sketch pen or computer used design software etc., Ultimately, the brochures come out. Considering the entire ambit of activity of the dealer it is seen tht it is a comprehensive contract or supply of printed material developed by the company. The bills also indicate the entire activity though separated is a comprehensive work. Such creation of activity tanamounts to making indivisible contract in a divisible contract. Therefore, this Authority rules that entire sale value including the creation of concept etc. done by the company forms a part of the value

> of sale of such brochures and liable to tax at 4% on the entire proceeds received including those relating to concept charges, system charges etc. In short, this Authority rules that the sale of printed material with a background of providing the concept is an indivisible activity liable to tax at 4% as a whole. (Emphasis supplied)
>
> 7. An appeal preferred thereagainst by the appellant in terms of Section 24(1) of the Kerala Sales Tax Act has been dismissed by a Division Bench of the High Court.
>
> 8. The High Court in its judgment noticed the decisions of this Court in Associated Cement Companies Ltd. v. Commissioner of Customs [(2001) 4 SCC 593]; Tata Consultancy Services v. State of A.P. [(2005) 1 SCC 132];

and Tata Consultancy Services v. Municipal Corporation of Greater Bombay & Anr. [(2006) 3 SCC 1] and held :

> In the light of the three judgments stated supra, what is clear to us is the services rendered by the appellant is an indivisible activity and liable to levy of tax. The aurhotity in Annexure-A after noticing the material facts, has chosen to hold that in the bills there is a separate charge made as content development concept design, photography scanning and other charges such as system charges including colour sketch pen or computer used design software etc. Ultimately, the brochures come out. Considering the entire ambit of activity of the dealer, it is seen that it is a comprehensive contract or supply of printed material developed by the company. The bills also indicate the entire activity tantamounts to making indivisible contract in a divisible contract . The subsequent rectification application made by the applicant dated 24.12.2005 was not considered by the authority in terms of Annexure-H, after noticing the judgment of the Supreme Court in the case of Associated Cement Companites Ltd. (Stated supra). Therefore, it is clear that there is no mistake apparent on the face of the record. We are in full agreement with the impugned orders at Annexure-A & H.
>
> 9. Mr. Joseph Vellapalli, learned senior counsel appearing for the appellant, would submit that (1) the High Court committed a serious error in passing the impugned judgment in so far as in the event the contract is held to be an indivisible one, the service element thereof being subject to service tax, no sales tax could have been levied on the incidental transfer of goods unless such transfer falls within the scope and ambit of one of the provisions contained in sub-clauses (a) to (f) of clause (29A) of Article 366 of the Constitution of India.

(2) Appellant being an advertising agency, i.e., providing professional services, is not liable to pay Value Added Tax (VAT) upon application of dominion nature test or otherwise. (3) From the orders of the assessment passed by the Assessing Authority itself, it would appear that a portion of the contract is often out sourced in which event, sale of goods are shown by the appellant as a second sale.

(4) On an indivisible contract, in view of the decisions of this Court in The State of Madras v. Gannon Dunkerley & Co., (Madras) Ltd. [1959 SCR 379]; M/s. Gannon Dunkerley & Co. & Ors. v. State of Rajasthan & Ors. [(1993) 1 SCC 364], no VAT would be payable. (5) In any event, advertisement not being goods, they cannot be bought and sold in an open market being customer specific.

10. Mr. Hegde, learned counsel appearing on behalf of the respondents- State, on the other hand, submitted that

(i) an entire transaction is a composite whole inasmuch as all what was transferred is the documents containing not only the value of the goods but also the soft skill involved therein; and

(ii) Taxable value of goods is what the buyer is buying and in view of the fact that when by some creativity the value of the goods is enhanced, the entire value has rightly been held to be taxable. Strong reliance in this connection has been placed on Associated Cement Company (supra) as also the Constitution Bench decision of this Court in Tata Consultency and Bharat Sanchar Nigam Ltd. v. Union of India [(2006) 3 SCC 1].

11. At the outset, we must express our reservation in regard to the question as to whether the appellant having already undergone the process of regular assessment before the assessing authority, an application under Section 60 of the Karnataka Value Added Tax Act, 2003 was maintainable. The purpose for which such a proceeding is taken recourse to is well known. When a decision of a competent authority is not known and an entrepreneur intends to know as to what would be his liability under the taxing statute, such a proceeding is ordinarily taken recourse to. But it is not necessary for us to consider the matter any further.

In this case, the order of assessment was complete. The State did not prefer any appeal thereagainst. The process of accounting or the methodology adopted by the assessee for the purpose of payment of both service tax as also the value added tax attained finality at least for that year.

12. Be that as it may, as the order of the competent authority under Section 60 of the Act would be binding on the assessing authority, in future also, we may examine the merit of the matter.

13. The fact that the appellant is a service provider is not in dispute. It is also not in dispute that the orders received by it to provide such services is party specific and issue specific; be it for issuance of a brochure or a year book or for any other purpose.

Appellant, in their returns, made three categorical divisions in regard to its tax liabilities (1) The amount of service tax on the specific design and production; (2) The amount of Kerala Sales Tax on the specified item on the first sale; and (3) when certain items are outsourced, the tax payable on resale of the said goods in terms of Section 6(4) of the Kerala Sales Tax Act.

14. The Tribunal as also the High Court opined that the contract was an indivisible one. The effect of such an indivisible contract, vis-`-vis work contract came up for consideration before this Court in

The State of Madras v. Gannon Dunkerley & Co., (Madras) Ltd. [1959 SCR 379] wherein it was clearly held :

> To avoid misconception, it must be stated that the above conclusion has reference to works contracts, which are entire and indivisible, as the contracts of the respondents have been held by the learned Judges of the Court below to be. The several forms which such kinds of contracts can assume are set out in Hudson on Building Contracts, at p.165. It is possible that the parties might enter into distinct and for money consideration, and the other for payment of remuneration for services and for work done.

15. The Parliament amended the Constitution to insert clause 29-A in Article 366 of the Constitution of India, Sub-clauses (a) to (f) whereof read thus :

> (29A) "tax on the sale or purchase of goods"
>
> includes
>
> (a) a tax on the transfer, otherwise than in pursuance of a contract, of property in any goods for cash, deferred payment or other valuable consideration;
>
> (b) a tax on the transfer of property in goods (whether as goods or in some other form) involved in the execution of a works contract;
>
> (c) a tax on the delivery of goods on hire-purchase or any system of payment by installments;
>
> (d) a tax on the transfer of the right to use any goods for any purpose (whether or not for a specified period) for cash, deferred payment or other valuable consideration;
>
> (e) a tax on the supply of goods by any unincorporated association or body of persons to a member thereof for cash, deferred payment or other valuable consideration;
>
> (f) a tax on the supply, by way of or as part of any service or in any other manner whatsoever, of goods, being food or any other article for human consumption or any drink (whether or not intoxicating), where such supply or service, is for cash, deferred payment or other valuable consideration, and such transfer, delivery or supply of any goods shall be deemed to be a sale of those goods by the person making the transfer, delivery or supply and a purchase of those goods by the person to whom such transfer, delivery or supply is made.

16. By reason of the said provision, therefore, a legal fiction was created so as to make the supply of goods involved in a works contract, subject to tax. A transaction of the present description was not contemplated.

The question came for consideration again in Builders Association of India & Ors. v. Union of India & Ors. [(1989) 2 SCC 645] and M/s.Gannon Dunkerley & Co. & Ors. v. State of Rajasthan & Ors. [(1993) 1 SCC 364]. It has expressly been laid down therein that the effect of amendment by introduction of clause 29A in Article 366 is that by legal fiction, certain indivisible contracts are deemed to be divisible into contract of sale of goods and contract of service. In Gannon Dunkerley case (supra), it had been held:

> Keeping in view the legal fiction introduced by the Forty-sixth Amendment whereby the works contract which was entire and indivisible has been altered into a contract which is divisible into one for sale of goods and other for supply of labour and services, the value of the goods involved in the execution of a works contract on which tax is leviable must exclude the charges which appertain to the contract for supply of labour and services.

17. We may also notice that a Constitution Bench of this Court in Tata Consultancy Services (supra), opined that having regard to the definition of the term goods contained in clause (12) of Article 366 of the Constitution of India, a software programme may consist of various commands which enable the computer to perform a designated task. The copyright in that programme may remain with the originator of the programme, but the moment copies are made and marketed, it becomes goods, which are susceptible to sales tax.

In regard to the element of intellectual property, it was held that the same having been incorporated on a media, for purposes of transfer, both tangible and intangible property capable of being transmitted, transferred, delivered, stored and possessed etc. would come within the purview thereof. It was opined :

> Thus, even unbranded software, when it is marketed/sold, may be goods. We, however, are not dealing with this aspect and express no opinion thereon because in case of unbranded software other questions like situs of contract of sale and/or whether the contract is a service contract may arise.

18. We may, furthermore, notice that therein one of us, in a separate but concurring judgment, opined as under :

> 8. A software may be intellectual property but such personal intellectual property contained in a medium is bought and sold. It is an article of value. It is sold in various forms like floppies, disks, CD-ROMs, punchcards, magnetic tapes, etc. Each one of the mediums in which the intellectual property is contained is a marketable commodity. They are visible to the senses. They may be a medium through which the intellectual property is transferred but for the purpose of determining the question as regard s leviability of the tax under a fiscal statute, it may not make a difference. A program containing instructions in computer language is subject-matter of a licence. It has its value to the buyer. It is useful to the person who intends to use the hardware viz. the computer in an effective manner so as to enable him to obtain the desired

> results. It indisputably becomes an object of trade and commerce. These mediums containing the intellectual property are not only easily available in the market for a price but are circulated as a commodity in the market. Only because an instruction manual designed to instruct use and installation of the supplier program is supplied with the software, the same would not necessarily mean that it would cease to be a goods . Such instructions contained in the manual are supplied with several other goods including electronic ones. What is essential for an article to become goods is its marketability.

19. The question yet again came up for consideration before a Three Judge Bench of this Court in Bharat Sanchar Nigam Ltd. v. Union of India (supra) wherein it was held;

> 4. Of all the different kinds of composite transactions the drafters of the Forty-sixth Amendment chose three specific situations, a works contract, a hire-purchase contract and a catering contract to bring them within the fiction of a deemed sale. Of these three, the first and third involve a kind of service and sale at the same time. Apart from these two cases where splitting of the service and supply has been constitutionally permitted in sub-clauses (b) and (f) of clause (29-A) of Article 366, there is no other service which has been permitted to be so split. For example, the sub-clauses of Article 366(29-A) do not cover hospital services. Therefore, if during the treatment of a patient in a hospital, he or she is given a pill, can the Sales Tax Authorities tax the transaction as a sale? Doctors, lawyers and other professionals render service in the course of which can it be said that there is a sale of goods when a doctor writes out and hands over a prescription or a lawyer drafts a document and delivers it to his/her client? Strictly speaking, with the payment of fees, consideration does pass from the patient or client to the doctor or lawyer for the documents in both cases.

> 45. The reason why these services do not involve a sale for the purposes of Entry 54 of List II is, as we see it, for reasons ultimately attributable to the principles enunciated in Gannon Dunkerley case 5, namely, if there is an instrument of contract which may be composite in form in any case other than the exceptions in Article 366(29-A), unless the transaction in truth represents two distinct and separate contracts and is discernible as such, then the State would not have the power to separate the agreement to sell from the agreement to render service, and impose tax on the sale. The test therefore for composite contracts other than those mentioned in Article 366(29-A) continues to be: Did the partie s have in mind or intend separate rights arising out of the sale of goods? If there was no such intention there is no sale even if the contract could be disintegrated. The test for deciding whether a contract falls into one category or the other is to as what is the substance of the contract . We will, for the want of a better phrase, call this the dominant nature test.

> 50. What are the goods in a sales transaction, therefore, remains primarily a matter of contract and intention. The seller and such purchaser would have to be ad idem as to the subject-matter of sale or purchase. The court would have to arrive at the conclusion as to what the parties had intended when they entered into a particular transaction of sale, as being the subject-matter of sale or purchase. In arriving at a conclusion the court would have to approach the matter from the point of view of a reasonable person of average intelligence.

20. We may, at this juncture, also notice the decision of this Court in Associated Cement Company (supra). The question which arose for consideration therein was as to whether any intellectual property contained in a software would be subject to custom duty within the meaning of Section 2(22) of the Customs Act, defining goods. A three Judge Bench of this Court sought to make a distinction between such a contingency arising under the Customs Act involving a works contract and a contract of sale stating :

> 2. In the sales tax cases referred to hereinabove no doubt the question which arose was whether in a works contract, where there was a supply of materials and services in an indivisible contract, but there the question had arisen because the States powers prior to the Forty-sixth Amendment to the Constitution, were not entitled to bifurcate or split up the contract for the purpose of levying sales tax on the element of moveable goods involved in the contract. Apart from the decision in Rainbow Colour Lab case 11 which does not appear to be correct, the other decisions cited related to the pre-Forty-sixth Amendment period.

Furthermore, the provisions of the Customs Act and the Tariff Act are clear and unambiguous. Any moveable articles, irrespective of what they may be or may contain, would be goods as defined in Section 2(22) of the Customs Act.

21. Evidently, therefore, the decision of Associated Cement Company Supra) whereupon strong reliance has been placed by the Tribunal as also by the High Court seeks to make a distinction between cases arising out of works contract wherefor sales tax is liable to be paid and the cases under the Customs Act.

22. Our attention has furthermore been drawn to the decision of this Court in Bharat Sanchar Nigam Ltd. (supra) wherein referring to Tata Consultancy (supra) it was observed that the approach of this Court in the said decision as to what would be goods for the purpose of sales tax is correct.

23. What, however, did not fall for consideration in any of the aforementioned decisions is the concept of works contract involving both service as also supply of goods constituting a sale. Both, in Tata Consultancy (supra) as also in Associated Cement Company (supra), what was in issue was the value of the goods and only for the said purpose, this Court went by the definition thereof both under the Customs Act as also the Sales Tax Act to hold that the same must have the attributes of its utility, capability of being bought and sold and capability of being transmitted, transferred, delivered, stored and possessed. As a software was found to be having the said attributes, they were held to be goods.

24. We have, however, a different problem at hand. Appellant admittedly is a service provider. When it provides for service, it is assessable to a tax known as service tax. Such tax is leviable by reason of a Parliamentary statute. In the matter of interpretation of a taxing statute, as also other statutes where the applicability of Article 246 of the Constitution of India, read with Seventh Schedule thereof is in question, the Court may have to take recourse to various theories including aspect theory , as was noticed by this Court in Federation of Hotel & Restaurant Association of

India, etc. v. Union of India& Ors. [(1989) 3 SCC 634].

25. If the submission of Mr. Hegde is accepted in its entirety, whereas on the one hand, the Central Government would be deprived of obtaining any tax whatsoever under the Finance Act, 1994, it is possible to arrive at a conclusion that no tax at all would be payable as the tax has been held to be an indivisible one. A distinction must be borne in mind between an indivisible contract and a composite contract. If in a contract, an element to provide service is contained, the purport and object for which the Constitution had to be amended and clause 29A had to be inserted in Article 366, must be kept in mind.

26. We have noticed hereinbefore that a legal fiction is created by reason of the said provision. Such a legal fiction, as is well known, should be applied only to the extent for which it was enacted. It, although must be given its full effect but the same would not mean that it should be applied beyond a point which was not contemplated by the legislature or which would lead to an anomaly or absurdity.

27. The Court, while interpreting a statute, must bear in mind that the legislature was supposed to know law and the legislation enacted is a reasonable one. The Court must also bear in mind that where the application of a Parliamentary and a Legislative Act comes up for consideration; endeavours shall be made to see that provisions of both the acts are made applicable.

28. Payments of service tax as also the VAT are mutually exclusive. Therefore, they should be held to be applicable having regard to the respective parameters of service tax and the sales tax as envisaged in a composite contract as contradistinguished from an indivisible contract. It may consist of different elements providing for attracting different nature of levy. It is, therefore, difficult to hold that in a case of this nature, sales tax would be payable on the value of the entire contract; irrespective of the element of service provided. The approach of the assessing authority, to us, thus, appears to be correct.

34. We may notice that the concept of aspects theory whcih had found echoes in State of U.P. Another v. Union of India & Anr. [(2003) 3 SCC 239] has expressly been overruled by a Three Judge Bench in Bharat Sanchar Nigam Ltd. (supra) stating :

> 8. But if there are no deliverable goods in existence as in this case, there is no transfer of user at all.

Providing access or telephone connection does not put the subscriber in possession of the electromagnetic waves any more than a toll collector puts a road or bridge into the possession of the toll payer by lifting a toll gate. Of course the toll payer will use the road or bridge in one sense. But the distinction with a sale of goods is that the user would be of the thing or goods delivered. The delivery may not be simultaneous with the transfer of the right to use. But the goods must be in existence and deliverable when the right is sought to be transferred.

79. Therefore whether goods are incorporeal or corporeal, tangible or intangible, they must be deliverable. To the extent that the decision in State of U.P. v. Union of India held otherwise, it was, in our humble opinion erroneous.

35. For the reasons aforementioned, the impugned judgment cannot be sustained. It is set aside accordingly. The Appeal is allowed. No costs.