Supreme Court of India
K. L. Johar And Company vs Deputy Commercial Tax Officer on 10 November, 1964
Equivalent citations: 1965 AIR 1082, 1965 SCR (1) 112
Author: K Wanchoo
Bench: Gajendragadkar, P.B. (Cj), Wanchoo, K.N., Hidayatullah, M., Dayal, Raghubar, Mudholkar, J.R.

PETITIONER:
K. L. JOHAR AND COMPANY

Vs.

RESPONDENT:
DEPUTY COMMERCIAL TAX OFFICER

DATE OF JUDGMENT:
10/11/1964

BENCH:
WANCHOO, K.N.
BENCH:
WANCHOO, K.N.
GAJENDRAGADKAR, P.B. (CJ)
HIDAYATULLAH, M.
DAYAL, RAGHUBAR
MUDHOLKAR, J.R.

CITATION:
1965 AIR 1082 1965 SCR (1) 112
CITATOR INFO :
RF 1966 SC1178 (2,23)
R 1973 SC 376 (8)
F 1974 SC1105 (5,8,9)
F 1985 SC1293 (45)

ACT:
Madras General Sales Tax Act IX of 1939, Explanation 1 to s. 2(h)--Hire-purchase transactions included in term 'sale'-Validity of Explanation-Price of vehicles for purposes of tax how to be fixed-Sale when completed.

HEADNOTE:
The appellant carried on hire-purchase business in Motor vehicles. The course of business was that the price of the vehicle would be paid by the appellant to the motor dealer and the vehicle would be hired out to the intending purchaser. The latter had to pay the hire money in instalments and when all the instalments according to the agreement had been paid, he would exercise the option of purchasing the vehicle by a final payment of Re. 1/-. It

was clearly laid down in the hire-purchase agreement that for the duration of the hire the vehicle would remain under the ownership of the appellant. The sales tax authorities in Madras imposed sales tax on the appellant for the assessment year 1955-56 and 1956-57. The hire-purchase transactions were treated as sale transactions under Explanation 1 to S. 2(h) of the Madras General Sales Tax Act, 1939. The appellant's writ petition before the Madras High Court challenging the said assessment failed but a certificate of fitness to appeal to the Supreme Court was granted.

The main contentions of the appellant were : (i) there was really one sale in the present case by the motor dealer to the intending purchaser of the vehicle, the appellant being a mere financing agent. There was no transaction of sale between the appellant and the intending purchaser (ii) Explanation 1 to s. 2(h) of the Act which included hire-purchase agreement within the term 'sale' was ultra vires and (iii) in any case sale took place only when the option to purchase was exercised by the hirer by the payment of Re. 1/- which should therefore be taken as the sale price.

HELD : (i) The various terms of the hire purchase agreement showed that the appellant remained the owner of the vehicle for the duration of the agreement. Therefore it could not be said that the appellant was a mere financier while the real transaction was between the motor dealer and the intending purchaser. There were in fact two sales one by the dealer to the appellant, and the other by the appellant to the person who wanted to purchase the vehicle. As the Act levied a multi-point sales tax at the relevant time, it was open to the State to tax both the sales. 11 21 B-C]

(ii) The State Legislature when it proceeds to legislate either under Entry 48 of List 1 of the Seventh Schedule to the Government of India Act, 1935 or under Entry 54 of List 11 of the Seventh Schedule to the constitution, can only tax a 'sale' within the meaning of that word defined in the Sale of Goods Act. [123 H]

Sales Tax Officer v. M/s. Budh Prakash Jai Prakash [1955]1 S.C.R. 243 and State of Madras v. Gannon Dunkerley & Co . [1959] S.C.R. 379, affirmed.

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The essence of sale under the sale of Goodss Act is that property shall pass from the seller to the buyer when the contract of sale is made except in a. case of conditional sale. Hire-purchase agreements are not conditional sales. [124 A-B]

Therefore any legislation by the State Legislature making an agreement or transaction, in which property does not pass from the seller to the buyer, a sale, would be beyond its legislative competence. [124 B]

What Explanation I does is to lay down that a hire-purchase agreement shall be deemed to be a sale in spite of fact that the property does not pass at the time of such agreement

from the seller to the buyer. There fore Explanation 1 as it stands is beyond the legislative competence of the State Legislature. It must therefore be held to be invalid, L124 B-C]

(iii) A hire purchase agreement has two elements : (1) element of bailment and (2) element of sale in the sense that it contemplates an eventual sale. The element of sale fructifies when the option is exercised by the intending purchaser after fulfilling the terms of the agreement. When all the terms of the agreement a-re satisfied and the option is exercised a sale takes place of the goods which till then had been hired. When this sale takes place it will be liable to sales tax under the Act for the taxable event under the Act is the taking place of the sale, the Act providing for a multipoint sales tax at the relevant time. As the taxable event is the sale of goods the tax can only be levied when the option is exercised after fulfilling all the terms of the bire-purchase agreement. Tax not exigible at the time when the hire-purchase agreement is made for at that time the taxable event has not taken place. [125 H-124 E]

(iv) Although according to the terms of the agreement the vehicle was purchased by the payment of Re. 1/- it would be absurd to say that that was the price at which the vehicle must be taken to have been sold. It would be equally wrong to say that the total amount of hire paid in instalments including the final payment of Re. 1/- constituted the sale price. The price had to be worked out by the sales tax authorities in a fair and reasonable manner taking into account the depreciation of the vehicle between the date of hire-purchase agreement and the exercise of the final option to purchase. [126 G-H; 128 B-G]

Darngavil Cool Co. v. Francis, (1913)7 Tax Cases, Part 1 page 1. referred to.

JUDGMENT:

CIVIL, APPELLATE JURISDICTION : Civil Appeal No. 245, 246 of 1963.

Appeals from the judgment and order dated January 17, 1958 of the Madras High Court in Writ Petitions Nos. 500 and 671 of 1957.

A. V. Visivanatha Sastri, B. R. L. Iyengar, B. D. Dhawan, S. K. Mehta and K. L. Mehta, for the appellants (in both the appeals).

A. Ranganadham Chetty, V. Ramaswamy and A. V. Rangam, for the respondent (in both the appeals) and intervener No. 6. S. V. Gupte, Solicitor-General, and B. R. G. K. Achar, for intervemer No. 1.

B. V. Subramaniam, Advocate-General, Andhra Pradesh and B. R. G. K. Achar, for intervener No. 2.

Naunit Lal, for intervener No. 3.

V. P. Gopalan Nambiar, Advocate-General, Kerala, V. A. Syied Muhammad, for intervener No. 4.

M. Adhikari, Advocate-General, Madhya Pradesh and I. N. Shroff, for intervener No. 5.

R. N. Sachthey, for interveners No. 7.

C. B. Agarwala and 0. P. Rana, for intervener No. 8. The Judgment of the Court was delivered by Wanchoo, J. These two appeals on certificates granted by the Madras High Court raise common questions and will be dealt with together. The appellant is a financing company consisting of a number of partners. Its main business is to advance money to persons who purchase motor vehicles but are themselves not in a position to find ready money to pay the price. The course of business followed by the appellant is to enter into hire-purchase agreements with those who want to purchase motor vehicles. It is necessary to refer to the terms of hire-purchase agreements which are on a set pattern in order to understand the points raised in these appeals. Any person desirous of acquiring a motor vehicle makes the selection of the make and type and fixes the price therefore with the motor dealer. Such person then approaches the appellant for financial assistance on a hire-purchase basis. Sometimes an initial payment is made to the motor dealer which is taken into account at the time of the hire-purchase agreement while at others the payment is made in a number of instalments to the appellant. In either case the appellant pays the price or the balance thereof to the dealer and thereafter the hire-purchase agreement is entered into between the appellant and the person who wants to purchase the motor vehicle. The appellant is described in the agreement as the owner of the vehicle and the person who wants to purchase it as the hirer.

The material terms of the agreement may be summarised here. The agreement provides that the owner (namely, the appellant) will let and the hirer (namely, the person who wants to purchase the vehicle) will take on hire the vehicle in question for such period as may be fixed in each case, (cl. 1). The hirer has to pay a certain amount per month to the owner and where an initial deposit is made this amount is larger for the first month and other monthly payments are smaller. The hirer has to pay during the period of hire the monthly instalment, the vehicle is registered in the name of the owner and the hirer is forbidden to represent himself as the owner thereof or to do anything to suggest that he is the owner thereof; the hirer has to keep the vehicle in good and serviceable repair, order and condition to the satisfaction of the owner, and he is also to insure and keep insured the vehicle against loss or damage by fire, accident and third party risks and punctually pay premia and all moneys payable in respect of such insurance : (see cl. 3). The hirer has further to pay all taxes, licence fees, duties, fines, registration charges and other charges payable in respect of the vehicle and all rents and outgoings payable by the hirer in respect of the premises where the vehicle is kept or garaged when the same respectively become due : [see cl. 3

(e)]. He has also to satisfy the owner about all the above things having been duly done. He cannot sell, charge., pledge, assign or part with possession of the vehicle [cl. 3

(g)]. The hirer has also to make good all damages to the vehicle (fair wear and tear excepted) and pay the owner the full value of the vehicle in the event of total loss, whether the damage or loss be caused accidentally or otherwise and to keep the vehicle at the sole risk of the hirer until the hirer purchases the vehicle or returns it to the owner : (cl. 5). If the hirer makes default in the payment of any rent for seven days, the hiring immediately determines and the owner may without notice retake possession of the vehicle, and it shall be at the option of the owner to reinstate the contract on such conditions as it deems fit after the determination of the hiring as aforesaid : (cl. 14). Upon the determination of the hiring as above, all arrears of rents upto the date of determination and all costs and expenses incurred by the owner in the exercise of the powers conferred by the agreement shall be paid by the hirer, and the hirer shall not be entitled to any repayment of any sum previously paid and all such rents and sums shall belong to the owner absolutely : (cl. 15). The hirer may determine the hire at any time by delivering the vehicle to the owner and by paying him any part of the current rent due upto the date of such delivery and all other sums, if any, which upto such date, the hirer may have become liable to pay the owner under the agreement: (cl. 18). Cl. 20 of the agreement, which is important for our purposes reads thus :-

> "If the hirer shall duly observe and perform all the conditions and stipulations herein contained and on his part to be observed and performed and shall duly pay to the owner all rents hereby reserved during the term of hiring together with all other sums, if any payable by him to the owner under the provisions of this agreement, then and at the termination of the hiring, the hirer may purchase the vehicle from the owner for a sum of Re. 1/-."

Clause 21 provides that the hirer may at any time determine the hiring and become purchaser of the vehicle by paying to the owner such sum as together with the sums previously paid will amount to the total sum payable by way of rent thereunder together with all sums (if any) payable to the owner and in addition a sum of Re. 1/-. Clause 22 provides that "if the hirer fails to observe and ,perform the conditions and stipulation herein contained and fails to exercise the option of purchasing the vehicle in accordance with the provisions of the last preceding clause, and the vehicle is not returned to the owner on the termination of the hiring, the hirer shall pay the owner a certain sum every month until the vehicle is handed over to the owner by the hirer." Clause 23 provides that until the vehicle shall have become the property of the hirer under the provisions of the agreement it shall remain the absolute property of the owner, and the hirer shall have no right or interest in the same other than as the hirer under the agreement. The agreement :is not assignable : (cl. 24). It is unnecessary to refer to other clauses of the agreement as they are immaterial for our purposes. After such an agreement has been made, the hirer takes possession of the vehicle and if all its terms are carried out, the hirer becomes the owner of the vehicle when he exercises his option to purchase the vehicle after paying the sum of Re. 1/- including the instalments then outstanding, if any.

The appellant commenced business in February 1955 and in the course of such business entered into several hire-purchase agreements relating to motor vehicles both new and second- hand. On April 28, 1956, the appellant submitted a return to the Assistant Commercial Tax Officer, Coimbatore, showing a turnover for the purposes of sales tax for Rs. 2,37,993/- for the year 1955-56. The appellant had also collected (though it now claims that it was done erroneously) from the hirers of

motor vehicles amounts equivalent 'to sales tax on their transactions and those amounts were kept in suspense account. The hirers however began to claim refund of this amount on the ground that hire-purchase agreements were not within the ambit of "sale" as defined in the Madras General Sales Tax Act, No. IX of 1939, (hereinafter referred to as the Act). But the Assistant Commercial Tax Officer made a provisional assessment on the basis of the return submitted by the appellant and fixed instalments for payment thereof. The appellant paid the instalments but preferred a revision to the Commercial Tax Officer objecting to the assessment mainly on the ground that hire-purchase agreements were not transactions of sale liable to be taxed under the Act. The revision was however dismissed on the ground that there was no necessity for interfering with the provisional assess-

ment at that stage. Later, the Deputy Commercial Tax Officer passed the final order of assessment relating to the year 1955-56 holding that the hire-purchase transactions were subject to sales, tax and overruled the objection that the transactions were only a system of financing and not sales. The appellant preferred an; appeal to the Commercial Tax Officer against the order of assessment for the year 1955-56. That appeal is said to have been heard but no orders had been passed thereon, when the writ petition was filed in the High Court on June 29, 1957. In the meantime provisional assessment had been made for the year 1956-57 and the appellant was being pressed to pay that amount also. Consequently the appellant filed a writ petition on June 29, 1957 challenging the provisional assessment with respect to the year 1956-57. Later lie filed another writ petition on August 18, 1957 challenging the final assessment for the year 1955-56.

The main contention of the appellant in the two writ petitions was that levy of sales tax in respect of hire purchase transactions was illegal and unconstitutional as Explanation 1 to s. 2(h) of the Act defining "sale" was beyond the competence of the State legislature. The Explanation is in these terms:-

> "A transfer of goods on the hire-purchase or other instalment system of payment shall, notwithstanding the fact that the seller retains the title in the goods as security for payment of the price, be deemed to be a sale."

The appellant contended that this amounted to an extension of the meaning of the word "sale" as used in Entry 54, List II of the Seventh Schedule to the Constitution and Entry 48 of List H of the Seventh Schedule to the Government of India Act 1935 beyond what it meant in the Indian Sale of Goods Act, No. 3 of 1930. The State legislature therefore could not arrogate to itself the power to levy a tax in respect of transactions which in form and in substance did not constitute sales as understood in the Indian Sale of Goods Act by merely adopting a wide definition. It was therefore incompetent for the State legislature to enact Explanation

1. If the Explanation falls on account of the incompetence of the legislature, no sales tax could be levied on hire- purchase transactions in view of Art. 265 of the Constitution which lays down that "no tax shall be levied or collected, except by authority of law".

These two writ petitions along with a number of others of the same kind dealing with hire-purchase agreements were heard by the High Court together. The first question to which the High Court

addressed itself was whether there were two sales in case or only one sale, for the contention on behalf of the appellant, apparently was that there was only one sale by the dealer to the ;person who wanted to purchase the motor vehicle and that the appellant was merely a financing agent of such person. The High Court however held that there were two sales in these cases, first sale by the motor dealer to the appellant and the second by the appellant to the person who wanted to purchase the motor vehicle. Thus there were two distinct sales of the vehicle involved in the process by which the property in the vehicle passed from the dealer to the person who wanted to purchase it. It appears that sales tax was paid on the sale by the dealer and the contention of the appellant was that was all the tax to which the transaction could be subjected. The High Court however held that as there were two sales involved in the transaction and the Act levied a multipoint tax on sales, tax could be levied again when the appellant sold the vehicle to the intending purchaser.

The High Court then considered the nature of hire-purchase agreements, with particular reference to the agreement in the present case and held that a hire-purchase agreement of this kind had two elements, one of bailment and the other of sale, and rejected the contention of the appellant that such hire-purchase agreements were nothing more than hiring agreements involving bailment. Having held that the hire- purchase agreement of this type involved two elements which were both real (i.e. element of bailment and element of sale), the next question to which the High Court addressed itself was whether tax liability could be fastened on the appellant immediately it entered into the agreement of hire- purchase or whether the tax could only be constitutionally and legally levied after the intending purchaser had exercised the option which resulted in the transfer of property in the vehicle to such person. The High Court held that in most of the transactions of this nature the intending purchaser pays up the instalments and exercises the option and thus acquires title to the vehicle. But there might be cases where such a person might be unable to become the owner, in the sense of obtaining the title to the vehicle by paying the instalments. In such a case the property would remain with the appellant and bailment element would be the only element, the option to purchase having not been exercised. In this latter class of cases, there would be no sale, though there was an agreement granting an option to purchase which by itself would not amount to a sale. Such transactions could not in the view of the High Court be brought within the charging provisions of the section. The Court therefore held that Explanation 1 to s. 2(h) of the Act referred to those hire-purchase agreements only which fructify into sale and not to those which did not, and in this view of the matter upheld the validity of the Explanation.

The High Court then considered when the tax should be levied even in those cases which fructify into sales. It held that where a hire-purchase agreement fructifies and results in a sale there could be no impediment in the way of the tax being levied even when the hire-purchase agreement is entered into. The High Court then considered the question as to what would be the quantum of consideration for the sale that is ultimately effected, and held that the total of all the instalments paid made up the sale price, though they were designated as instalments of hire.

The High Court summed up its conclusion thus: (1)That the transaction of hire-purchase entered into by the appellant constitute sales, rendering it liable to sales tax on its turnover, excepting in cases where owing to the default on the part of the hirer in the payment of instalments of hire, the vehicle is seized by the appellant and therefore no title passes to the intending purchaser.

(2)That these transactions of hire-purchase could having regard to their main intent and purpose be treated as sales at the moment the agreements were entered into, subject to adjustment by elimination of such portion of the turnover where no sale resulted;

(3)That for the purpose of computing the turnover of the appellant, the total of the hire stipulated to be paid in instalments should be treated as price or consideration for the sale.

On this view the High Court dismissed the writ petitions. The appellant then applied for certificates which were granted; and that is how the matter has come up before us. The matter first came up for hearing before us on August 31, 1964. It was then represented that there were provisions similar to Explanation 1 to s. 2(h) of the Act, in the sales tax statutes of other States. We therefore decided to give notice to the Advocates General of all States. It was also decided to give notice to the Attorney-General of India, particularly as the view taken by this Court in two earlier cases, namely, the Sales Tax Officer v. Messrs Budh Prakash Jai Prakash(1) and the State of Madras v. Gannon Dunkerley & Co.(2) was being assailed as incorrect. The appeals were then finally heard on September 29, 1964 and subsequent dates after such notice had been served. The first question that has been urged before us is that there was really one sale in the present case by the motor dealer to the intending purchaser of the vehicle and that the appellant was a mere financing agent of such person and that the High Court was in error in holding that there were two sales one by the dealer to the appellant and the other by the appellant to the person who intended to purchase the vehicle. We are of opinion that the view taken by the High Court in this behalf is correct. This will be clear from a consideration of the various terms of the hire purchase agreement which we have already summarised above. That agreement shows that the whole of the price of the vehicle is paid by the appellant to the dealer. Even where a part of the price is paid by the intending purchaser, the payment is shown as hire for the first month and is made to the appellant. So far as the dealer is concerned the whole price is paid by the appellant. The agreement also shows that the appellant is the owner of the vehicle and the intending purchaser is merely a hirer thereunder. The vehicle has to be registered in the name of the appellant, though the fact of registration by itself in one name or another may not be determinative of the ownership of the vehicle. Clauses 14 and 15 of the agreement clearly show that there was no sale by the dealer to the intending purchaser of the vehicle at the time of the hire-purchase agreement. These clauses give power to the appellant to retake possession of the vehicle and determine the agree- ment. Now if the property in the vehicle had passed to the intending purchaser at the time of the hire-purchase agreement it would not have been open to the appellant to take possession of the vehicle or to insist on payment of arrears or to become entitled to everything that had been paid upto that day. Under the law all that the appellant would have been entitled to was to realise the loan he had given by filing a suit and then attaching and selling the vehicle. These two clauses are therefore clear indication of the fact that there was no sale by the dealer to the person who wanted to purchase the vehicle at the time of the hire-purchase agreement, and that at that time the sale was by the dealer to the appellant. Then clauses 20 and 21 enforce this conclusion inasmuch as they give an option to the person who wanted to purchase the vehicle to do so by exercising his option under the conditions mentioned (1) [1955] 1 S.C.R. 243.

(2) [1959] S.C.R. 379.

therein. If he had already become the owner when the agreement had been entered into, these two clauses could not have been included in the agreement. Then again cl. 23 makes it clear that till the option is exercised the vehicle remains the absolute property of the appellant and the intending purchaser has no right in it except that of a hirer. We therefore agree with the High Court that in cases of this kind there are two sales, one by the dealer to the financier (namely, the appellant in this case) and the other by the financier (namely, the appellant) to the person who wanted to purchase the vehicle. As the Act levied a multi- point sales tax at the relevant time it was open to the State to tax both the sales and the fact that the sale by the dealer to the appellant had been taxed will not affect the liability of the second sale by the financier to the person who wanted to purchase the vehicle. What is the extent of that liability and when is that tax to be levied will be considered by us in connection with the second contention urged on behalf of the appellant. This brings us to a consideration of the validity of Explanation 1, which we have already set out. It is necessary in this connection to understand the nature of a typical hire purchase agreement as distinct from a sale in which the price is to be paid later by instalments. In the case of a sale in which the price is to be paid by instalments, the property passes as soon as the sale is made, even though the price has not been fully paid and may later be paid in instalments. -This follows from the definition of sale in s. 4 of the Indian Sale of Goods Act (as distinguished from an agreement to sell) which requires that the seller transfers the property in the goods to the buyer for a price. The essence of a sale is that the property is transferred from the seller to the buyer for a price, whether paid at once or paid later in instalments, on the other hand, a hire purchase agreement, as its very name implies, has two aspects. There is first an aspect of bailment of the goods subjected to the hire purchase agreement, and there is next an element of sale which fructifies when the option to purchase, which is usually a term of hire purchase agreements is exercised by the intending purchaser. Thus the intending purchaser is known as the hirer so long as the option to purchase is not exercised, and the essence of a hire purchase agreement properly so called is that the property in the goods does not pass at the time of the agreement but remains in the in- tending seller, and only passes later when the option is exercised by the intending purchaser. The distinguishing feature of a typical hire purchase agreement therefore is that the property does not pass when the agreement is made but only passes when the option p./65-9 is finally exercised after complying with all the terms of the agreement.

Explanation 1 specifically brings out this characteristic of hire purchase agreements. It provides that a transfer of goods on hire purchase or other instalment system of payment (which presumably is of the same type as the hire purchase agreement) shall be deemed to be a sale, even though the property in the goods does not pass to the intending purchaser and remains in the intending seller. The Explanation recognises by using the words "deemed to be a sale" that there is no passing of the property at the time of the hire purchase agreement, but provides by a fiction that the property shall be deemed to have passed notwithstanding the terms of the agreement. This deeming takes place under the Explanation immediately on the hire purchase agreement being made.

The contention on behalf of the appellant is that the State legislature was not competent thus to expand the meaning of the words "sale of goods" used in Entry 54 of List II of the Seventh Schedule to the Constitution, which corresponds to Entry 48 of the Provincial List of the Government of India Act, 1935, and make something a sale which is not a sale under the law contained in the Indian Sale of Goods Act. It is clear that if the Explanation is good, the second sale in the present case must be

held to have taken place at the time the hire purchase agreement was made. On the other hand, if the Explanation is beyond the competence of the State legislature and falls, the sale cannot be said to have taken place when the hire purchase agreement was made and can only take place when the option is exercised after all the terms of the agreements have been satisfied. This Court had occasion to deal with the interpretation of Entry 48 of List II of the Seventh Schedule to the Government of India Act, 1935 in The Sales Tax Officer v. Messrs Budh Prakash Jai Prakash(1). It held that Entry 48 in question conferred power on the Provincial legislature to impose a tax only when there had been a completed sale and not when there was only an agreement to sell. It was pointed out that there was a well defined and well established distinction between a sale and an agreement to sell. Consequently, the definition in s. 2(h) of the U.P. Sales Tax Act, No. XV of 1948, enlarging the meaning of the word "sale" so as to include forward contracts was to that extent declared ultra vires. That case dealt with forward contracts but it brings out the distinction between a sale and an agreement to sell and it was held that the State legislature had no power under the relevant Entry (1) [1955] 1 S.C.R. 243.

in the Government of India Act to extend the definition of sale so as to include an agreement to sell.

The matter came up again before this Court in Gannon Dun- kerley's(1) case and it was held that the expression "sale of goods' was at the time when the Government of India Act was enacted a term of well recognised legal import in the general law relating to sale of goods and in the legislative practice relating to that topic and must be interpreted in Entry 48 in List II of the Seventh Schedule as having the same meaning as in the Sale of Goods Act. Entry 54 of List III of the Seventh Schedule to the Constitution uses the same words (namely, taxes on sale of goods) as in Entry 48 of List H of the Seventh Schedule to the Government of India Act and therefore the words must bear the same meaning as explained in these two cases.

Learned counsel for the respondent however urges that the view taken by this Court in Gannon Dunkerley's(1) case requires reconsideration. We have given our earnest consideration to this argument and are of opinion that considering that view has stood for so many years and has been accepted in later cases, there is no case made out for reconsideration thereof. In this connection our attention was drawn to Entry 92-A of List 1 of the Seventh Schedule to the Constitution, which refers to taxes on sale of goods where such sale takes place in the course of inter-State trade or commerce and to the provisions of the Central Sales Tax Act, No. 74 of 1956, where "sale" has been defined as including "a transfer of goods on the hire purchase or other system of payment by instalments". It is urged that this definition of "sale" under the Central Sales Tax Act shows that the words "sale of goods" used in Entry 92-A have a wider meaning. We are of opinion that there is no force in this argument, for the Central Sales Tax Act was passed by Parliament and its validity has to be considered not only with reference to Entry 92-A of List 1 of the Seventh Schedule to the Constitution but also with reference to Art. 248(2) of the Constitution read with Entry 97 of List 1 of the Seventh Schedule to the Constitution. The fact that the definition of "sale, in the Central Sales Tax Act includes words contained in Explanation 1 therefore is of no help in construing the meaning of the words "sale of goods", which have been authoritatively pronounced upon by this Court in Gannon Dunkerely's(1) case following Budh Prakash's (2) case. It is clear therefore that the State legislature when it proceeds to legislate either under Entry 48 of List II of the Seventh Schedule to

the Government of India Act 1935 or under Entry 54 of List H of the Seventh Schedule to the (1) 1959] S.C.R. 379.

(2) [1955] 1 S.C.R. 243.

Constitution, can only tax sale within the meaning of that word as defined in the Sale of Goods Act. The essence of sale under the Sale of Goods Act is that the property should pass from the seller to the buyer when a contract of sale is made except in a case of conditional sale. Hire purchase agreements are not conditional sales. Therefore, any legislation by the State legislature making any agreement or transaction in which the property does not pass from the seller to the buyer a sale would be beyond its legislative competence. What Explanation 1 does is to lay down that a hire purchase agreement shall be deemed to be a sale in spite of the fact that the property does not pass at the time of such agreement from the seller to the buyer. 'Therefore, Explanation 1 as it stands is beyond the legislative competence of the State Legislature. It is urged however that the property eventually does pass from the seller to the buyer when the option is exercised and other terms of the hire purchase agreement are fulfilled and therefore the Explanation should be read as confined to those cases only where property does eventually pass from the seller to the buyer. We are of opinion that this argument cannot be accepted, for the intention of the Explanation clearly is to provide that the hire purchase agreement shall be deemed to be a sale immediately on the date it is made, even though property has not passed from the seller to the buyer on that day. If this were not the real purpose and intention of Explanation 1, its enactment would be entirely unnecessary for the main definition of "sale" under s. 2 (h) will apply to a hire purchase agreement at the time when the property passess from the seller to the buyer on the option being exercised and on other terms of the agreement being fulfilled. We cannot therefore agree with the High Court that the Explanation should be confined only to those cases where the property does eventually pass for the obvious intention of the legislature in enacting the Explanation was to provide that the hire purchase agreement shall be deemed to be a sale on the very date on which it is made, even though no property passes from the seller to the buyer on that date. In this view of the matter it must be held taking into account the purpose, the intention and the interpretation of Explanation 1 that it is beyond the competence of the State legislature. It must therefore be held to be invalid and struck down accordingly.

The next question that arises is whether a hire purchase agreement ever ripens into a sale and if so when. We have already pointed out that a hire purchase agreement has two elements : (i) element of bailment, and (ii) element of sale, in the sense that it contemplates an eventual sale. The element of sale fructifies when the option is exercised by the intending purchaser after fulfilling the terms of the agreement. When all the terms of the agreement are satisfied and the option is exercised a sale takes place of the goods which till then had been hired. When this sale takes place it will be liable to sales tax under the Act for the taxable event under the Act is the taking place of the sale, the Act providing for a multi- point sales tax at the relevant time. Where however option is not exercised or cannot be exercised because of the inability of the intending purchaser to fulfill the terms of the agreement, there is no sale at all. As the taxable event is the sale of goods, the tax can only be levied when the option is exercised after fulfilling all the terms of the hire purchase agreement. We cannot agree with the view of the High Court that because in most of such cases the option is exercised, tax is

leviable immediately on the making of the hire purchase agreement and that in a few cases where there is failure to carry out the terms of the agreement or to exercise the option, there can be adjustment by elimination of such portion of the turnover. As we have pointed out the taxable event under the Act is the sale of goods and until that taxable event takes place there can be no liability to pay tax. Therefore, even though eventually most cases of hire purchase may result in sales by the exercise of the option and the fulfilment of the terms of the agreement, tax is not eligible at the time when the hire purchase agreement is made, for at that time the taxable event has not taken place; it can only be eligible when the option has been exercised and all the terms of the agreement fulfilled and the sale actually takes place. When sale takes place in a particular case will depend upon the terms of the hire purchase agreement but till the sale takes place there can be no liability to sales tax under the Act. The High Court therefore was in error in holding that transactions of hire purchase of the kind with which we are dealing having regard to their main intent and purpose might be treated as sales at the time the agreement is entered into; in all hire purchase agreements of the type with which we are dealing sale only takes place when the option is exercised after all the terms of the agreement are fulfilled and it is at that time that the tax is eligible. This brings us to the last question, namely, what is the quantum ,of sale price which is to be the basis of taxation under the Act. The argument on behalf of the appellant in this connection is that the sale price in the particular cases with which we are concerned is only Re. 1 /- which the hirer has to pay when he exercises his option to purchase. On the other hand the contention on behalf of the respondent is that the sale price is the entire amount paid by the hirer to the financier and the tax is eligible on this entire amount. We are of opinion that neither of these two contentions is correct. It stands to reason that Re. "A/- cannot be the price of a vehicle in these cases for even if the vehicle is treated as secondhand when the option is exercised the sum of Re. 1/- would be an absurd price for a second-hand vehicle of the kind with which we are concerned. The argument in this connection is that the entire amount paid as hire is really for hire and the price is only the sum of Re. 1 /- which is paid for the option which finally results in sale. This contention overlooks the essence of hire purchase agreements which is that the hire includes not only what would be payable really as hire but also a part of it is towards the price. The contention that the price is only Re. 1/- which is paid for the option therefore cannot be accepted.

On the other hand the contention on behalf of the respondent that the price is the entire amount paid as hire including Re. 1/ paid for the option also does not seem to be correct. This ignores the fact that at any rate part of what is paid as hire is really towards the hire of the vehicle for the period when the hirer is only a hirer. This will also be clear from the fact that if the entire hire is treated as price, the result would be that the price of what is a second-hand vehicle when the sale eventually takes place would be more than the price of the new vehicle. This will be clear from an example of a hire purchase agreement, which was given to us on behalf of the appellant. In the particular example, the price of the vehicle was Rs. 5,0001-. The hire purchase agreement however provided for payment of Rs. 6,487/6/- by the hirer to the owner in seven- teen instalments. The hirer would become the owner on the exercise of the option after he had paid all the instalments. But if an the instalments are to be treated as price the result would be that a vehicle which was priced at Rs. 5,0001- when the agreement was made and must have depreciated during the seventeen months when it was on hire would be valued at Rs. 6,487/6/- at the time when the option is exercised and the sale in favour of the hirer takes place. This is clearly impossible to accept and therefore the

contention of the respondent must also be rejected. The real position in our opinion as to price of the vehicle when the option is exercised would be this. Its value at that time is neither Re. 1/- which is the nominal amount to be paid for the option nor the entire amount which is paid as hire including Re. 1/-. The value must be something less than the original price, which in the example mentioned by us above was Rs. 5,0001-. In order to arrive at the value at the time of the second sale to the hirer, the sales tax authorities should take into consideration the depreciation of the vehicle and such other matters as may be relevant in arriving at such price on which the sale can be said to have taken place when the option is exercised, but that price must always be less than the, original price (which was Rs. 5,0001- in the example given above by us).

We may in this connection refer to Darngavil Coal Company v. Francis(1). That was a case under the (English) Income Tax Act, and the question that directly arose for consideration was with respect to deductions to be allowed from profits in the circumstances of that case. The facts were these : The appellant, a coal company, in order to obtain railway wagons for the conveyance of coal from its collieries to its customers from time to time entered into agreements with a wagon company under which a certain annual sum was paid for a period of years for a certain number of wagons. By the terms of the agreements the coal company during the periods of the payments used the wagons at its own risk and was bound to keep them in repair, and at the end of the period it had the option of purchasing the wagons at the nominal price of one shilling for each wagon. It will be seen that the agreement was in the nature of hire purchase agreement of wagons. The question then arose whether any deductions from profits could be allowed to the coal company in the circumstances. It was held that the annual payments under the agreements were divisible into two, namely, (i) consideration paid for the use of the wagons, and (ii) payments for an option at a future date to purchase the wagons at a nominal price. It was also held that insofar as the payments represented the consideration for the use of the wagons during the period of agreement they were admissible as deduction in the computation of the coal company's profits for the purpose of assessment to income-tax. It was observed that it was perfectly clear that during the course of the period of years the wagon still was the property of the wagon company and not of the coal com- pany; but the coal company wished to use it and accordingly an extra payment was made in respect of that. No discrimination was made between the two kinds of payment; it was a lumpsum that was paid. In such cases two things were going on concurrently -there was a sale and purchase agreement under certain terms not a sale at that moment, but an option on certain terms on a future date to have a sale and on the other hand there was also concurrent with that a hiring agreement. The Court then went on to observe that it had no materials for splitting up that payment showing what was truly hire and what was truly payment towards (1) [1913] 7 Tax Cases, Pt. I. P. 1.

eventual purchase. Finally the case was remitted to the Commissioners with instructions that they were bound to allow as deduction such portion of the yearly payment made in respect of the wagons agreements as represented the consideration paid for being allowed to us wagons which under the contract were not yet the property of the coal company and that the Commissioners must decide that question for themselves if parties did not agree.

This case in our opinion brings out the true nature of the payment made as hire in hire purchase agreement. Part of the amount is towards the hire and part towards the payment of price, and it

would be for the sales tax authorities to determine in an appropriate way the price of the vehicle on the date the hirer exercises his option and becomes the owner of the vehicle after fulfilling the terms of the agreement. There is no legislative guidance available as to how this would be done and perhaps it would be better if the legislature gives guidance in such matters. But even in the absence of legislative guidance it would be for the sales tax authorities to decide as best as they can the value of the vehicle on the date the option is exercised and the property passes to the hirer. There may be two ways of doing it. The sales tax authorities may split up the hire into two parts, namely, the amount paid as consideration for the use of the vehicle so long as it was the property of the owner, and the payment for the option on a future date to purchase the vehicle at a nominal price. If the first part is determined the rest would be towards the payment of price. The first part may be determined after finding out the proper amount to be paid as hire in the market for a vehicle of the type concerned, or in such other way as may be available to the sales tax authorities. The second method may be to take the original price fixed in the hire purchase agreement and to calculate the depreciation and all other factors that may be relevant in arriving at the price when the second sale takes place to the hirer including the condition of the vehicle at the time of the second sale. It is therefore for the sales tax authorities to find out the price of the vehicle on which tax has to be paid in either of the ways indicated by us above or such other way as may be just and reasonable.

We therefore allow the appeals in part and set aside the order of the High Court and the assessments made, and direct that the sales tax authorities will determine the price in accordance with what we have said above and thereafter proceed to levy sales tax according to law. The appellant will get its costs from the respondent-one set of hearing fee.

Appeals partly allowed.