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REPORTABLE

IN THE SUPREME COURT OF INDIA

CIVIL APPELLATE JURISDICTION

CIVIL APPEAL NO. 1145 OF 2006

STATE OF KARNATAKA ETC. .....APPELLANT(S)

VERSUS

M/S PRO LAB & ORS. ETC. .....RESPONDENT(S)

JUDGMENT

A.K. SIKRI, J.

Constitutional validity of Entry 25 of Schedule VI to the Karnataka Sales Tax Act, 1957 (hereinafter referred to as the 'Act') is the subject matter of the present appeal. It is the third endeavour to resurrect this entry, when on the first two occasions, the steps taken by the State were declared as impermissible. Even this time, the High Court has dumped the amendment as unconstitutional. However, the reasons advanced by the High Court in all three rounds are different. While traversing through the historical facts leading to the issue at hand, we shall be referring to the same for clear understanding of the controversy involved.

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2) This entry was inserted in the said Act by an amendment which came into effect from 01.07.1989, thereby providing levy of tax for processing and supply of photographs, photo prints and photo negatives. The validity of this entry was challenged by means of a writ petition filed in the High Court of Karnataka. The High Court in that case titled ***M/s Keshoram Surindranath Photo – Bag (P) Ltd. and others*** v. ***Asstt. Commissioner of Commercial Taxes (LR), City Division, Bangalore and others***[1], declared the said Entry to be unconstitutional. State of Karnataka had challenged that judgment by filing special leave petition in this Court. This special leave petition was dismissed vide order dated 20.04.2000, following its earlier judgment in the case of ***Rainbow Colour Lab and Another*** v. ***State of Madhya Pradesh and others***[2]. The reason for holding Entry 25 as unconstitutional was that the contract of processing and supplying of photographs, photo frames and photo negatives was predominantly a service contract with negligible component of goods/material and, therefore, it was beyond the competence of State Legislature given in Entry 25 of List II of Schedule VII of the

1 121 (2001) STC 175
2 (2000) 2 SCC 385

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Constitution to impose sales tax on such a contract.

3) It so happened that within one year of the judgment in *Rainbow Colour Lab's case*, three Judges Bench of this Court rendered another judgment in the case of ***ACC Ltd.*** v. ***Commissioner of Customs***[3], wherein it expressed its doubts about the correctness of the law laid down in *Rainbow.* We may point out at this stage itself that during the course of hearing of the present appeal, there was a hot debate on the question as to whether judgment in *Rainbow Colour Lab's* case was over-ruled in the case of *ACC Ltd.* case or not. This aspect will be gone into by us at the appropriate stage.

4) After the judgment in *ACC Ltd.* case, a circular instruction was issued by the Commissioner of Commercial Taxes to the assessing authorities to proceed with the assessments as per Entry 25. This became the subject matter of challenge before the High Court of Karnataka in the case of ***M/s Golden Colour Labs and Studio and others*** v. ***The Commissioner of Commercial Taxes***[4]. The High Court allowed the writ petition vide judgment dated 30.07.2003 holding that a provision once declared

3 (2001) 4 SCC 593
4 ILR 2003 Kar 4883

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unconstitutional could not be brought to life by mere administrative instructions. However, at the same time, the Court observed that Entry 25, Schedule VI to the Act, declared *ultra vires* the Constitution in *Keshoram's* case, cannot be revived automatically, unless there is re-enactment made by the State Legislature to that effect.

5) The appropriate procedure indicated in the aforesaid judgment emboldened the State to come out with the required legislative amendment. This paved way for the enactment of the Karnataka State Laws Act, 2004 by the State Legislature that came into force with effect from 29.01.2004. Section 2(3) of the said amendment re-introduced Entry 25 in identical terms, as it appeared earlier, and that too with retrospective effect that is w.e.f. 01.07.1989, when this provision was inserted by the amendment made in the year 1989 for the first time.

6) As was expected, this amendment was again challenged before the Karnataka High Court by the respondent herein as well as many others. Vide impugned judgment dated 19.08.2005, the High Court has again declared the said amendment as unconstitutional. It would be pertinent to mention that the High

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Court has not taken into consideration the events that followed after *Rainbow Colour Lab's* case, namely, over-ruling of the said judgment in *ACC Ltd.* Since the basis of *Keshoram's* case decided in the first calm by the High Court was same as given in *Rainbow Colour Lab*, obviously *Keshoram* also no longer remains a good law. However, the reason given by the High Court, this time, is that the ratio laid down in *Keshoram's* case continues to be binding on the State of Karnataka. As per the High Court, "the re-enactment of the said provision is possible in the event of a subsequent declaration made by the Hon'ble Supreme Court re-considering or pronouncing a similar question in terms of the findings in para 23 of the *Golden Colour Lab's* case. This is, thus, the chequered history of the litigation amply demonstrating as to how the State of Karnataka is making desperate attempts to ensure that provision in the form of Entry 25 in the said Act survives, empowering the State Government to levy sales tax for processing and supply of photographs, photo prints and photo negatives.

7) At this stage, we take note of the exact phraseology used in Entry 25 of the Act which reads as under:

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Sl. No.	Description of Works Contract	Period	Rate of Tax U/S 5-B
25	Processing and supplying of Photographs, Photo Prints and Photonegatives	1.7.1987 to 31.3.1996 1.4.1996 to 31.3.1998 from 1.4.1998	6% 8% 10%

8) We may also record at this point itself that legislative competence of the State to insert the aforesaid Entry is primarily challenged on the ground that the State Government is not empowered to levy sales tax on the processing and supplying of photographs which is predominantly in the nature of "service" and the element of "goods" therein was minimal. The respondents argue that the State Legislature does not have any power to impose tax on "services" inasmuch as the sales tax can be levied only on "sale of goods" as permitted under Article 366 (29-A) of the Constitution of India. Challenge is also laid on the retrospective effect given to the said Entry by arguing that such a move is violative of Article 265 of the Constitution of India as subjecting the assessees to such a tax from retrospective effect is confiscatory in nature and, therefore, unconstitutional.

9) We have projected, in nutshell, the chequered history of the litigation by referring to the judgments of this Court pronounced

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from time to time which have a direct bearing on the outcome of this appeal. Therefore, we are simply required to do a diagnostic of the sorts in revisiting these judgments. As we proceed with this exercise to notice and spell out the principle of law laid down in these judgments, contextually, the same would analogously facilitate in concluding the cases with very little discussion at our end.

10) In order to ensure that we avoid unnecessary burdening of judgments with the earlier case laws, it is safe to charter the journey by initiating discussion about the Constitution Bench judgment in the case of ***Gannon Dunkerley and Co. and others*** v. ***State of Rajasthan and others***[5]. That case pertained to the execution of the Works Contracts. Question involved was as to whether there could be levy of sales tax on the sale of goods involved in the execution of such Works Contracts. The assessee, viz. Gannon Dunkerley, was carrying on business as Engineering Contractors and executing the contracts pertaining to construction of building projects, dams, roads and structural contracts of all kinds. In respect of sanitary contracts, 20 per cent was deducted for labour and balance was taken as a turnover of the assessee for the purposes of levying sales tax by

[5] (1993) 1 SCC 364

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the assessing authority. Likewise, in respect of other contracts, 30 per cent was deducted for labour and on balance amount, sales tax was levied treating it as turnover of the assessee under the Madras General Sales Tax Act, 1939. The question which arose for consideration was as to whether there was any sale of goods. The Constitution Bench held that building contract was in the nature of Works Contract and there was no element of sale of goods in such a contract. In its opinion, in a building contract where the agreement between the parties was that the contractor should construct the building according to the specifications contained in the agreement and in consideration received payment as provided therein, there was neither a contract to sell the materials used in the construction nor the property passed therein as movables. It was held that in a building contract, which was one entire and indivisible, there was no sale of goods and it was not within the competence of the Provincial State Legislature to impose tax on the supply of the materials used in such a contract treating it as a sale. The Court, thus, proceeded on the basis that a building contract was indivisible and composite wherein there was no sale of goods and, therefore, the State Legislature was not competent to impose sales tax on the supply of material used in such a contract treating it as a

sale. Since, Entry 48 of the List II of Schedule VII in the Government of India Act, 1935 was under consideration that empowers State Government to levy tax "sale of goods", the Court held that the expression "sale of goods" in the said Entry is to be given the same meaning as given under the Sale of Goods Act, 1930. That would mean that it would be sale of goods only if the two essential ingredients, namely: (i) an agreement to sell movables for a price, and (ii) property passing therein persuant to that agreement, are satisfied.

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11) After the aforesaid Constitution Bench judgment, the Parliament amended the Constitution of India by the Constitution (46th Amendment) Act, 1982 which received the assent of the President of India on 02.02.1983. By this amendment, clause (29-A) was inserted in Article 366 of the Constitution, which reads as under:

JUDGMENT

> "[(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-

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> purchase or any system of payment by instalments;
>
> (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;]"

12) The challenge laid to the aforesaid amendment was repelled by this Court in the case of ***Builders Association of India and others*** v. ***Union of India and others***[6]. In this judgment, the Constitution Bench specifically noted that the purport and object of the aforesaid amendment was to enlarge the scope of the expression "tax of sale for purchase of goods" wherever it occurs in the Constitution so that it may include within its ambit any transfer, delivery or supply of goods that may take place under

6 (1989) 2 SCC 645

any of the transactions referred to in sub-clauses (a) to (f). To put it tersely, with the aforesaid amendment, the States are empowered to make the Works Contract divisible and tax "sale of goods" component. It clearly follows therefrom that the restricted meaning which was assigned to the expression "sale of goods" in Gannon Dunkerley's case is undone by the aforesaid amendment. The interpretation which is to be assigned to clause 29-A of Article 366 is stated with remarkable clarity in ***M/s Larsen Toubro and another*** v. ***State of Karnataka and another***[7], by a three Judge Bench in the following words:

> "60. It is important to ascertain The meaning of Sub-clause (b) of Clause 29A of Article 366 of the Constitution. As the very title of Article 366 shows, it is the definition clause. It starts by saying that in the Constitution unless the context otherwise requires the expressions defined in that article shall have the meanings respectively assigned to them in the article. The definition of expression "tax on sale or purchase of the goods" is contained in Clause (29A). If the first part of Clause 29A is read with Sub-clause (b) along with latter part of this clause, it reads like this: tax on the sale or purchaser of the goods" includes 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 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. The definition of "goods" in Clause 12 is inclusive. It includes all materials, commodities and articles. The

7 (2014) 1 SCC 708

expression, 'goods' has a broader meaning than merchandise. Chattels or movables are goods within the meaning of Clause 12. Sub-clause (b) refers to transfer of property in goods (whether as goods or in some other form) involved in the execution of a works contract. The expression "in some other form" in the bracket is of utmost significance as by this expression the ordinary understanding of the term 'goods' has been enlarged by bringing within its fold goods in a form other than goods. Goods in some other form would thus mean goods which have ceased to be chattels or movables or merchandise and become attached or embedded to earth. In other words, goods which have by incorporation become part of immovable property are deemed as goods. The definition of 'tax on the sale or purchase of goods' includes a tax on the transfer or property in the goods as goods or which have lost its form as goods and have acquired some other form involved in the execution of a works contract.

61. Viewed thus, a transfer of property in goods under Clause 29A(b) of Article 366 is deemed to be a sale of the goods involved in the execution of a works contract by the person making the transfer and the purchase of those goods by the person to whom such transfer is made.

62. The States have now been conferred with the power to tax indivisible contracts of works. This has been done by enlarging the scope of "tax on sale or purchase of goods" wherever it occurs in the Constitution. Accordingly, the expression "tax on the sale or purchase of goods" in Entry 54 of List II of Seventh Schedule when read with the definition Clause 29A, includes a tax on the transfer of property in goods whether as goods or in the form other than goods involved in the execution of works contract. The taxable event is deemed sale.

63. *Gannon Dunkerley-I (supra)* and few other decisions following *Gannon Dunkerley-I (supra)* wherein the expression "sale" was given

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> restricted meaning by adopting the definition of the word "sale" contained in the Sale of Goods Act has been undone by the Forty-sixth Constitutional Amendment so as to include works contract. The meaning of Sub-clause (b) of Clause 29A of Article 366 of the Constitution also stands settled by the Constitution Bench of this Court in *Builders' Association (supra)*. As a result of Clause 29A of Article 366, tax on the sale or purchase of goods may include a tax on the transfer in goods as goods or in a form other than goods involved in the execution of the works contract. It is open to the States to divide the works contract into two separate contracts by legal fiction: (i) contract for sale of goods involved in the works contract and (ii) for supply of labour and service. By the Forty-sixth Amendment, States have been empowered to bifurcate the contract and to levy sales tax on the value of the material in the execution of the works contract."

13) Notwithstanding some clear and pertinent observations made in by the Constitution Bench in *Builders Association's case*, while upholding the Constitutional validity of 46th Amendment, there was some ambiguity in the judicial thought on one particular aspect which was also one of the basis of judgment in *Gannon Dunkerley's* case. In *Gannon Dunkerley's* case, the Constitution Bench had laid down "dominant intention test" to find out as to whether a particular contract involved transfer of property in goods. The Court was of the opinion that if the dominant intention of a contract was not to transfer the property in goods, but it was Works Contract, or for that matter, a contract in the

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nature of rendering of services, even if a part of it related to the transfer of goods, that would be immaterial and no sales tax on the said part could be levied, going by the principle of dominant intention behind such a contract, which was in the nature of Works Contract in the contract relating to construction of buildings.

14) As pointed out above, in *Gannon Drunkerley's* case, the Court also held that such a contract was indivisible. No doubt, insofar as indivisibility facet of the contract is concerned, the same was done away by 46th Constitutional Amendment. However, in subsequent cases, the Court grappled with the issue as to whether the principle of dominant intention still prevailed. This very aspect came up for discussion before two Judge Bench of this Court in *Rainbow Colour Lab's case*. The Court held the view that the division of contract after 46th Amendment can be made only if the Works Contract involved a dominant intention to transfer the property in goods and not in contracts where the transfer in property takes place as an incident of contract of service. This aspect is highlighted by the said Bench in the following manner:

> "10. Since this was a judgment rendered prior to the coming into force of the 46th

Constitutional Amendment, we will have to consider whether the said Amendment has brought about any change so as to doubt the legal position enunciated in the above case. It is true that by the 46th Constitutional Amendment by incorporating Clause 29A(b) in Article 366, the definition of the words "sale" and "works contract" have been enlarged. The State of Madhya Pradesh has also brought about a consequent change in the definition of the word 'sale' in Section of its Sales Tax Act but it is to be noticed that in the said State Act the expression 'works contract' has not been specifically defined.

11. Prior to the Amendment of Article 366, in view of the judgment of this Court In State of Madras v Gannon Dunkerley and Co., the State could not levy sales-tax on sale of goods involved in a work's contract because the contract was indivisible. All that has happened In law after the 46th Amendment and the judgment of this Court in Builders case (supra) is that it is now open to the States to divide the works contract into two separate contracts by a legal fiction (i) contract for sale of goods involved in the said works contract and (it) for supply of labour and service. This division of contract under the amended law can be made only if the works contract involved a dominant intention to transfer the property in goods and not in contracts where the transfer in property takes place as an incident of contract of service. The Amendment, referred to above, has not empowered the State to indulge in microscopic division of contracts involving the value of materials used incidentally in such contracts. What is pertinent to ascertain in this connection is what was the dominant intention of the contract. Every contract, be it a service contract or otherwise, may involve the use of some material or the other in execution of the said contract. State is not empowered by the amended law to impose sales-tax on such incidental materials used in such contracts. This is clear from the judgment of this Court in Hindustan Aeronautics Ltd. v. State of Karnataka

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[1984]2SCR248, where it was held thus:

> ...Mere passing of property in an article or commodity during the course of performance of the transaction in question does not render the transaction to be transaction of sale. Even in a contract purely of work or service, it is possible that articles may have to be used by the person executing the work, and property in such articles or materials may pass to the other party. That would not necessarily convert the contract into one of sale of those materials. In every case, the Court would have to find out what was the primary object of the transaction and the intention of the parties while entering into it...."

15) While considering the validity of Entry 25 in Schedule VI of the Act and holding it to be unconstitutional, as beyond the powers of the State Legislature, the High Court of Karnataka in *Keshoram's case* examined in detail the business which was carried out by the petitioner in the said case and the process that was involved in processing and supplying of photographs, photoframes or photonegatives. By that time, 46th Constitutional Amendment had already been effected which was also taken note of by the High Court. However, the High Court took the view that the main object of the work undertaken by the petitioner in that case was not the transfer of a chattle as a chattle and, in fact, it was a contract of work and labour and there was no sale of goods involved. It is clear from the following discussion in the said

judgment:

> "30. In words and phrases the word "photography" is defined as under :
>
> "Photography" is the science which relates to action of light on sensitive bodies in production of pictures, fixation of images and the like.
>
> 31. Photography is a process of an art of producing visible images on sensitive bodies by action of light or other form of radiant energy. Duration of action of light and also use of the chemical is highly a technical expertise therefore taking into consideration the various decisions referred to above it could be considered that it is a works contract where property which is transferred in paper is only incidental to such contract. In strict sense, it is a service where the main object is not transfer of property in goods. The good photograph as observed by the apex Court is a thing of beauty and revives nostalgic memories. It is a work of art. In B.C. Kame's case [1977] 2 SCR 435 it has already been held that there is no sale involved and in spite of the fact that it is a works contract it could not be subjected to tax because the intention of the parties is not to transfer the goods in the execution of said works contract. It is only ancillary and incidental to service contract. The photographs are not marketable or saleable commodity and as such no tax can be levied. Entry 25 of the Sixth Schedule to the Karnataka Sales Tax Act, 1957, therefore is beyond the scope of Article 466 of the Constitution of India.
>
> Writ appeals are accordingly allowed."

16) It is manifest from the above that the rationale behind the judgment was to look into the main object of the work undertaken by the assessee and concluding that since it was essentially a

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Works Contract and transfer of photopaper upon which the positive prints were taken were simply incidental and ancilliary to the main transactions, that was in the nature of service contract, and, therefore, Entry 25 was beyond the scope of Article 366 of the Constitution of India. Apparently, the High Court applied dominant intention test while holding Entry 25 as unconstitutional. By the time, Special Leave Petition against this judgment came up for consideration before this Court on 20.04.2000, the judgment in the case of *Rainbow Colour Lab's* case had just been rendered observing that dominant intention test was still valid notwithstanding insertion of clause 29-A in Article 366 of the Constitution by 46th Amendment. Following this judgment, SLP was dismissed.

17) Within one year of the said judgment, this very issue again cropped up for discussion and decision before a three Judge Bench in *ACC Ltd.* case. The issue arose under the Customs Act, 1962 viz. whether the drawings, designs etc. relating to machinery or industrial technology were goods which were leviable to duty of customs on their transaction value at the time of their report. However, since the issue related to meaning that has to be given to the expression "goods", the case law on this

aspect including *Gannon Dunkerley & Kame's case* were specifically taken note of and discussed. The Court also noticed the effect of 46th Amendment and in the process commented upon the judgment in the *Rainbow Colour Lab's case*. The Court specifically remarked that *Gannon Dunkerley & Kame's* judgments were of pre 46th Amendment era which had no relevance after the said Constitutional amendment. It can be discerned from the following discussion contained therein:

> "21. All the aforesaid decisions related to the period prior to the Forty-sixth Amendment of the Constitution when Article 366(29A) was inserted. At that time in the case of a works contract it was held that the same could not be split and State Legislature had no legislative right to seek to levy sales tax on a transaction which was not a sale simpliciter of goods. Rainbow Colour Lab & Anr. Vs. State of M.P. and Others, (2000) 2 SCC 385 was, however, a case relating to the definition of the word "sale" in the M.P. General Sales Tax Act, 1958 after its amendment consequent to the insertion of Article 366(29A). The question there was whether the job rendered by a photographer in taking photographs, developing and printing films would amount to works contract for the purpose of levy of sales tax. This Court held that the work done by the photographer was only a service contract and there was no element of sale involved. After referring to earlier decisions of this Court, it was observed at page 391 as follows:
>
> > "15. Thus, it is clear that unless there is sale and purchase of goods, either in fact or deemed, and which sale is primarily intended and not incidental to the contract, the State cannot impose sales tax on a works contract simpliciter in the

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> guise of the expanded definition found in Article 366(29A)(b) read with Section 2(n) of the State Act. On facts as we have noticed that the work done by the photographer which as held by this Court in Kame case is only in the nature of a service contract not involving any sale of goods, we are of the opinion that the stand taken by the respondent State cannot be sustained."

22. Even though in our opinion the decisions relating to levy of sales tax would have, for reasons to which we shall presently mention, no application to the case of levy of customs duty, the decision in Rainbow Colour Lab case (supra) requires consideration. As a result of the Forty-sixth Amendment, sub-article 29A of Article 366 was inserted as a result whereof tax on the sale or purchase of goods was to include 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. Taking note of this amendment this Court in Rainbow Colour Lab at page 388-389 observed as follows:

> "11. Prior to the amendment of Article 366, in view of the judgment of this Court in State of Madras v. Gannon Dunkerley & Co. (Madras) Ltd. the States could not levy sales tax on sale of goods involved in a works contract because the contract was indivisible. All that has happened in law after the 46th Amendment and the judgment of this Court in 'Builders' case is that it is now open to the States to divide the works contract into two separate contracts by a legal fiction: (i) contract for sale of goods involved in the said works contract, and (ii) for supply of labour and service. This division of contract under the amended law can be made only if the works contract involved a dominant intention to transfer the property in goods and not in contracts where the transfer in property takes place as an incident of contract of

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> service. The amendment, referred to above, has not empowered the State to indulge in a microscopic division of contracts involving the value of materials used incidentally in such contracts. What is pertinent to ascertain in this connection is what was the dominant intention of the contract. Every contract, be it a service contract or otherwise, may involve the use of some material or the other in execution of the said contract. The State is not empowered by the amended law to impose sales tax on such incidental materials used in such contracts.."

23. In arriving at the aforesaid conclusion the Court referred to the decision of this Court in Hindustan Aeronautics Ltd. vs. State of Karnataka (1984) a SCC 706 and Everest Copier (supra). But both these cases related to pre-Forty-sixth Amendment era where in a works contract the State had no jurisdiction to bifurcate the contract and impose sales tax on the transfer of property in goods involved in the execution of a works contract. The Forty-sixth Amendment was made precisely with a view to empower the State to bifurcate the contract and to levy sales tax on the value of the material involved in the execution of the works contract, notwithstanding that the value may represent a small percentage of the amount paid for the execution of the works contract. Even if the dominant intention of the contract is the rendering of a service, which will amount to a works contract, after the Forty-sixth Amendment the State would now be empowered to levy sales tax on the material used in such contract. The conclusion arrived at in Rainbow Colour Lab case, in our opinion, runs counter to the express provision contained in Article 366 (29A) as also of the Constitution Bench decision of this Court in Builders' Association of India and Others vs. Union of India and Others (1989) 2 SCC 645." [emphasis supplied]

18) It is amply clear from the above and hardly needs clarification

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that the Court was of the firm view that two Judges Bench judgment in *Rainbow Colour Lab's case* did not lay down the correct law as it referred to pre 46th Amendment judgments in arriving at its conclusions which had lost their validity. The Court also specifically commented that after 46th Amendment, State is empowered to levy sales tax on the material used even in those contracts where "the dominant intention of the contract is the rendering of a service, which will amount to a Works Contract".

19) In view of the above, the argument of the respondent assessees that *ACC Ltd.* case did not over-rule *Rainbow Colour Lab's* case is, therefore, clearly misconceived. In fact, we are not saying so for the first time as a three member Bench of this Court in *M/s Larsen and Toubro* has already stated that *ACC Ltd.* had expressly over-ruled *Rainbow Colour Lab* while holding that dominant intention test was no longer good test after 46th Constitutional Amendment. We may point out that learned counsel for the respondent assessees took courage to advance such an argument emboldened by certain observations made by two member Bench in the case of ***C.K. Jidheesh*** v. ***Union of India***[8], wherein the Court has remarked that the observations in *ACC Ltd.* were merely obiter. In *Jidheesh,* however, the Court

[8] (2005) 13 SCC 37

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did not notice that this very argument had been rejected earlier in ***Bharat Sanchar Nigam Ltd.*** v. ***Union of India***[9]. Following discussion in *Bharat Sanchar* is amply demonstrative of the same:

> "46. This conclusion was doubted in *Associated Cement Companies Ltd.* v. *Commissioner of Customs,* (2001) 4 SCC 593 saying:
>
> > "The conclusion arrived at in *Rainbow Colour Lab case* (2000) 2 SCC 385, in our opinion, runs counter to the express provision contained in Article 366(29A) as also of the Constitution Bench decision of this Court in *Builders Assn. of India* v. *Union of India* – (1989) 2 SCC 645.
>
> 47. We agree. After the 46th Amendment, the sale element of those contracts which are covered by the six sub-clauses of Clause (29A) of Article 366 are separable and may be subjected to sales tax by the States under Entry 54 of List II and there is no question of the dominant nature test applying. Therefore, in 2005, *C.K. Jidheesh* v. *Union of India* - (2005) 8 SCALE 784 held that the aforesaid observations in *Associated Cement* (supra) were merely obiter and that *Rainbow Colour Lab* (supra) was still good law, it was not correct. It is necessary to note that Associated Cement did not say that in all cases of composite transactions the 46th Amendment would apply"

20) In *M/s Larsen and Toubro*, the Court, after extensive and elaborate discussion, once again specifically negated the argument predicated on dominant intention test having regard to the statement of law delineated in *ACC Ltd.* and *Bharat Sanchar*

9 (2006) 3 SCC 1

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Nigam Ltd. cases. The reading of following passages from the said judgment is indicative of providing complete answer to the arguments of the respondent assessees herein:

> "64. Whether contract involved a dominant intention to transfer the property in goods, in our view, is not at all material. It is not necessary to ascertain what is the dominant intention of the contract. Even if the dominant intention of the contract is not to transfer the property in goods and rather it is the rendering of service or the ultimate transaction is transfer of immovable property, then also it is open to the States to levy sales tax on the materials used in such contract if it otherwise has elements of works contract. The view taken by a two-Judge Bench of this Court in *Rainbow Colour Lab (supra)* that the division of the contract after Forty-sixth Amendment can be made only if the works contract involved a dominant intention to transfer the property in goods and not in contracts where the transfer of property takes place as an incident of contract of service is no longer good law, *Rainbow Colour Lab (supra)* has been expressly overruled by a three-Judge Bench in *Associated Cement*.
>
> 65. Although, in *Bharat Sanchar*, the Court was concerned with Sub-clause (d) of Clause 29A of Article 366 but while dealing with the question as to whether the nature of transaction by which mobile phone connections are enjoyed is a sale or service or both, the three-Judge Bench did consider the scope of definition in Clause 29A of Article366. With reference to Sub-clause (b) it said: "Sub-clause (b) covers cases relating to works contract. This was the particular fact situation which the Court was faced with in *Gannon Dunkerley-I* and which the Court had held was not a sale. The effect in law of a transfer of property in goods involved in the execution of the works contract was by this amendment deemed to be a sale. To that extent

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the decision in *Gannon Dunkerley-I* was directly overcome". It then went on to say that all the Sub-clauses of Article 366 (29A) serve to bring transactions where essential ingredients of a 'sale' as defined in the Sale of Goods Act, 1930 are absent, within the ambit of purchase or sale for the purposes of levy of sales tax.

66. It then clarified that *Gannon Dunkerley-I* survived the Forty-sixth Constitutional Amendment in two respects. First, with regard to the definition of "sale" for the purposes of the Constitution in general and for the purposes of Entry 54 of List II in particular except to the extent that the clauses in Article 366(29A) operate and second, the dominant nature test would be confined to a composite transaction not covered by Article 366(29A). In other words, in *Bharat Sanchar*, this Court reiterated what was stated by this Court in *Associated Cement* that dominant nature test has no application to a composite transaction covered by the clauses of Article 366(29A). Leaving no ambiguity, it said that after the Forty-sixth Amendment, the sale element of those contracts which are covered by six Sub-clauses of Clause 29A of Article 366 are separable and may be subjected to sales tax by the States under Entry 54 of List II and there is no question of the dominant nature test applying.

67. In view of the statement of law in *Associated Cement* and *Bharat Sanchar*, the argument advanced on behalf of the Appellants that dominant nature test must be applied to find out the true nature of transaction as to whether there is a contract for sale of goods or the contract of service in a composite transaction covered by the clauses of Article 366(29A) has no merit and the same is rejected.

68. In *Gannon Dunkerley-II*, this Court, inter alia, established the five following propositions: (i) as a result of Forty-sixth Amendment the contract which was single and indivisible has been altered by a legal fiction into a contract which is divisible into one for sale of goods and the other for supply of labour and service and as a result of such contract which was single and indivisible has been brought on par with a contract containing two separate agreements; (ii) if the legal fiction introduced by Article 366(29A)(b) is carried to its logical end, it follows that even in a single and indivisible works contract there is a deemed sale of the goods which are involved in the execution of a works contract. Such a deemed sale has all the incidents of the sale of goods involved in the execution of a works contract where the contract is divisible into one for sale of goods and the other for supply of labour and services; (iii) in view of Sub-clause (b) of Clause 29A of Article 366, the State legislatures are competent to impose tax on the transfer of property in goods involved in the execution of works contract. Under Article 286(3)(b), Parliament has been empowered to make a law specifying restrictions and conditions in regard to the system of levy, rates or incidents of such tax. This does not mean that the legislative power of the State cannot be exercised till the enactment of the law under Article 286(3)(b) by the Parliament. It only means that in the event of law having been made by Parliament under Article 286(3)(b), the exercise of the legislative power of the State under Entry 54 in List II to impose tax of the nature referred to in Sub-clauses (b), (c) and (d) of Clause (29A) of Article 366 would be subject to restrictions and conditions in regard to the system of levy, rates and other incidents of tax contained in the said law; (iv) while enacting law imposing a tax on sale or purchase of goods under Entry 54 of the

State List read with Article 366(29A)(b), it is permissible for the State legislature to make a law imposing tax on such a deemed sale which constitutes a sale in the course of the inter-state trade or commerce under Section 3 of the Central Sales Tax Act or outside under Section 4 of the Central Sales Tax Act or sale in the course of import or export under Section 5 of the Central Sales Tax Act; and (v) measure for the levy of tax contemplated by Article 366(29A)(b) is the value of the goods involved in the execution of a works contract. Though the tax is imposed on the transfer of property in goods involved in the execution of a works contract, the measure for levy of such imposition is the value of the goods involved in the execution of a works contract. Since, the taxable event is the transfer of property in goods involved in the execution of a works contract and the said transfer of property in such goods takes place when the goods are incorporated in the works, the value of the goods which can constitute the measure for the levy of the tax has to be the value of the goods at the time of incorporation of the goods in works and not the cost of acquisition of the goods by the contractor.

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69. In *Gannon Dunkerley-II*, Sub-section (3) of Section 5 of the Rajasthan Sales Tax Act and Rule 29(2)(1) of the Rajasthan Sales Tax Rules were declared as unconstitutional and void. It was so declared because the Court found that Section 5(3) transgressed the limits of the legislative power conferred on the State legislature under Entry 54 of the State List. However, insofar as legal position after Forty-sixth Amendment is concerned, *Gannon Dunkerley-II* holds unambiguously that the States have now legislative power to impose tax on transfer of property in goods as goods or in some other form in the execution of works

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contract.

70. The Forty-sixth Amendment leaves no manner of doubt that the States have power to bifurcate the contract and levy sales tax on the value of the material involved in the execution of the works contract. The States are now empowered to levy sales tax on the material used in such contract. In other words, Clause 29A of Article 366 empowers the States to levy tax on the deemed sale."

21) To sum up, it follows from the reading of the aforesaid judgment that after insertion of clause 29-A in Article 366, the Works Contract which was indivisible one by legal fiction, altered into a contract, is permitted to be bifurcated into two: one for "sale of goods" and other for "services", thereby making goods component of the contract exigible to sales tax. Further, while going into this exercise of divisibility, dominant intention behind such a contract, namely, whether it was for sale of goods or for services, is rendered otiose or immaterial. It follows, as a sequitur, that by virtue of clause 29-A of Article 366, the State Legislature is now empowered to segregate the goods part of the Works Contract and impose sales tax thereupon. It may be noted that Entry 54, List II of the Constitution of India empowers the State Legislature to enact a law taxing sale of goods. Sales tax, being a subject-matter into the State List, the State

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Legislature has the competency to legislate over the subject.

22) Keeping in mind the aforesaid principle of law, the obvious conclusion would be that Entry 25 of Schedule VI to the Act which makes that part of processing and supplying of photographs, photo prints and photo negatives, which have "goods" component exigible to sales tax is constitutionally valid. Mr. Patil and Mr. Salman Khurshid, learned senior counsel who argued for these assessees/respondents, made vehement plea to the effect that the processing of photographs etc. was essentially a service, wherein the cost of paper, chemical or other material used in processing and developing photographs, photo prints etc. was negligible. This argument, however, is founded on dominant intention theory which has been repeatedly rejected by this Court as no more valid in view of 46th Amendment to the Constitution.

23) It was also argued that photograph service can be exigible to sales tax only when the same is classifiable as Works Contract. For being classified as Works Contract the transaction under consideration has to be a composite transaction involving both goods and services. If a transaction involves only service i.e.

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work and labour then the same cannot be treated as Works Contract. It was contended that processing of photography was a contract for service simplicitor with no elements of goods at all and, therefore, Entry 25 could not be saved by taking shelter under clause 29-A of Article 366 of the Constitution. For this proposition, umbrage under the judgment in *B.C. Kame's* case was sought to be taken wherein this Court held that the work involving taking a photograph, developing the negative or doing other photographic work could not be treated as contract for sale of goods. Our attention was drawn to that portion of the judgment where the Court held that such a contract is for use of skill and labour by the photographer to bring about desired results inasmuch as a good photograph reveals not only the asthetic sense and artistic faculty of the photographer, it also reflects his skill and labour. Such an argument also has to be rejected for more than one reasons. In the first instance, it needs to be pointed out that the judgment in *Kame's* case was rendered before the 46th Constitutional Amendment. Keeping this in mind, the second aspect which needs to be noted is that the dispute therein was whether there is a contract of sale of goods or a contract for service. This matter was examined in the light of law prevaling at that time, as declared in *Dunkerley's* case as per

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which dominant intention of the contract was to be seen and further that such a contract was treated as not divisible. It is for this reason in *BSNL and M/s Larsen and Toubro* cases, this Court specifically pointed out that *Kame's* case would not provide an answer to the issue at hand. On the contrary, legal position stands settled by the Constitution Bench of this Court in ***Kone Elevator India Pvt. Ltd.*** v. ***State of Tamil Nadu and Ors.***[10]. Following observations in that case are apt for this purpose:

> "On the basis of the aforesaid elucidation, it has been deduced that a transfer of property in goods under Clause (29A)(b) of Article 366 is deemed to be a sale of goods involved in the execution of a Works Contract by the person making the transfer and the purchase of those goods by the person to whom such transfer is made. One thing is significant to note that in ***Larsen and Toubro*** (supra), it has been stated that after the constitutional amendment, the narrow meaning given to the term "works contract" in ***Gannon Dunkerley-I*** (supra) no longer survives at present. It has been observed in the said case that even if in a contract, besides the obligations of supply of goods and materials and performance of labour and services, some additional obligations are imposed, such contract does not cease to be works contract, for the additional obligations in the contract would not alter the nature of the contract so long as the contract provides for a contract for works and satisfies the primary description of works contract. It has been further held that once the characteristics or elements of works contract are satisfied in a contract, then irrespective of additional obligations, such contract would be covered by the term "works contract" because nothing in Article 366(29A)(b) limits the term

[10] (2014) 7 SCC 1

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> "works contract" to contract for labour and service only."

24) Another attack on the insertion of Entry 25 pertained to retrospectivity given to this provision. It was sought to be argued that amendment to the Act was made by Karnataka State Laws Act, 2004 which came into force w.e.f. 29.01.2004 and insertion of Entry 25 with retrospective effect i.e. w.e.f. 01.07.1989 was not permissible. To put it otherwise, the argument was that even if Entry 25 is held to be valid, it should be made prospective i.e. w.e.f. 29.01.2004. According to the learned senior counsel, Entry 25 with retrospective effect is onerous on the respondents and if the respondents are directed to pay these amounts, they will face severe financial crisis. Such an onerous provision, in their submission, would violate the fundamental rights of the respondents guaranteed under Article 19(1)(g) which guarantees freedom to carry on trade, business or profession.

25) We are afraid, even this argument does not cut any ice. The first thing in this regard which is to be kept in mind is that Entry 25 was inserted for the first time by amendment of the Act w.e.f. 01.07.1989. This amendment was post 46th Constitutional Amendment. However, the High Court of Karnataka declared the

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said Entry to be unconstitutional and the SLP was also dismissed. Undoubtedly, it was because of the judgment in *Rainbow Colour Lab*, which judgment was declared as not a good law in *ACC Ltd.* (which position is repeated in *BSNL* as well as *M/s Larsen and Toubro* cases). Thus, the very basis on which Entry 25 of Schedule VI was declared as unconstitutional, has been found to be erroneous. In such circumstances, the legislature will be justified in enacting the law from the date when such a law was passed originally and that date is 01.07.1989 in the instant case. We have to keep in mind the fact that on the basis of this amendment, there have been assessments made by the assessing authorities. This was admitted by the learned counsel for the respondents at bar at the time of the arguments.

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26) Position stated above has to be read in the context that the legislature is, otherwise, competent to pass amendments of this nature from retrospective effect. The principle that such a power exists with the legislature has been reiterated time and again by this Court. [See: (1) ***National Agricultural Co-operative Marketing Federation of India Ltd. and Anr.*** v. ***Union of India***[11], (2) ***Shri Prithvi Cotton Mills Ltd. and Anr.*** v. ***Broach***

[11] (2003) 5 SCC 23

Borough Municipality and Ors.[12]**,** (3) ***Indian Aluminium Co. etc. etc.*** v. ***State of Kerala and others,*** (4) ***Hiralal Rattanlal etc. etc.*** v. ***State of U.P. and Anr. etc. etc.***[13] and (5) ***Union of India (UOI) and Anr.*** v. ***Raghubir Singh (Dead) by Lrs. Etc.***[14]]. It is not necessary to discuss all these judments and our purpose would be served by extensively quoting from the case in *National Agricultural Co-operative Marketing Federation of India Ltd.*:

> "13. That the Legislature can enact laws retrospectively is not in dispute. Nor is it disputed that the amendment is intended to be retrospective and that the amendment would at least prospectively exclude all cooperative societies except the primarily society from the benefit of Section 80P(2)(a)(iii) of the Income Tax Act. According to the appellants, the amendment cannot be considered to have retrospective operation in the absence of a validating provision nor could Parliament reverse the judgment of this Court by such statutory overruling. If the amendment is construed as having retrospective operation, then, it is submitted, the amendment is unconstitutional because it seeks to impose a tax on apex societies for the last 31 years, it was contended that by denying the deduction to the apex societies, the farmers and the primary societies would be vitally affected as it would be reflected in the returns obtained by them. This would be contrary to the legislative intent which was to benefit all societies which market agricultural produce.
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> 15. The Legislative power either to introduce enactments for the first time or to amend the

[12] (1969) 2 SCC 283
[13] (1973) 1 SCC 216
[14] (1989) 2 SCC 754

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enacted law with retrospective effect, is not only subject to the question of competence but is also subject to several judicially recognized limitations with some of which we are at present concerned. The first is the requirement that the words used must expressly provide or clearly imply retrospective operation S.S. Gadgil v. Lal & Co., [1964]53ITR231(SC) . J.C. Jani, Income Tax Officer, Circle-IV. Ward-G Ahmedabad v. Induprasad Devshanker Bhatt, [1969] 72 ITR 595 (SC). The second is that the retrospectively must be reasonable and not excessive or harsh, otherwise it runs the risk of being struck down as unconstitutional Rai Ramkrishna and Ors. v. The State of Bihar, [1963] 50 ITR 171 (SC), 915; Jawaharmal v. State of Rajasthan and Ors., [1966]1SCR890, 905, Supreme Court Employees Welfare Association v. Union of India and Anr., (1993) ILLJ 1094 SC. The third is apposite where the legislation is introduced to overcome a judicial decision. Here the power cannot be used to subvert the decision without removing the statutory basis of the decision Shri Prithvi Cotton Mills Ltd. v. Broach Borough Municipality and Ors. [1971]79ITR136(SC), Lalitaben v. Gordhanbhai and Anr., AIR 1987 SC 1315; Janapada Sabha Chhindwara v. The Central Provinces Syndicate Ltd., [1970] 3 SCR 745 : Indian Aluminium Co. and Ors. v. State of Kerala and Ors., [1996]2SCR23 .

xx xx xx

16. There is no fixed formula for the expression of legislative intent to give retrospectivity to an enactment. "Sometimes this is done by providing for jurisdiction where jurisdiction had no t been properly invested before. Sometimes this is done by re-enacting retrospectively a valid and legal taxing provision and then by fiction making the tax already collected to stand

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under the re-enacted law. Sometimes the Legislature gives its own meaning and interpretation of the law under which tax was collected and by legislative fiat makes the new meaning binding upon courts. The Legislature may follow any one method or all of them, Shri Prithvi Cotton Mills v. Broach Borough Municipality, [1971] 79ITR 136 (SC) .

17. By validating clause coupled with a substantive statutory change is therefore only one of the methods to leave actions unsustainable under the unamended statute, undisturbed. Consequently, he absence of a validating clause would not by itself affect the retrospective operation of the statutory provision, if such retrospectivity is otherwise apparent.

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19. In making this change, the Legislature does not "statutorily overrule" this Courts decision in Kerala Cooperative Marketing Federation Ltd. Supra. as has been contended by the appellant. Overruling assumes that a contrary decision is given on the same facts or law. Where the law, as in this case, has been changed and is no longer the same, there is no question of the Legislature overruling this Court.

20. As has been held in Ujagar Prints v. Union of India, [1989]179 ITR 317a (SC).

> "A competent legislature can always validate a law which has been declared by courts to be invalid, provided the infirmities and vitiating in factors noticed in the declaratory judgment are removed or cured. Such a validating law can also be made retrospective. If in the light of

> such validating and curative exercise made by the legislature - granting legislative competence - the earlier judgment becomes irrelevant and unenforceable that cannot be called an impermissible legislative overruling of the judicial decision. All that the legislature does is to usher in a valid law with retrospective effect in the right of which the earlier judgment becomes irrelevant".

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22. Once the circumstances are altered by Legislation, it may neutralise the effect of the earlier decision of the Court which becomes ineffective after the change of the law.

23. Similarly in Krishnamurthi & Co. v. State of Madras and Anr., [1973] 2 SCR 54 the Madras General Sales Tax 1959 Act (as it stood) provided under Entry 47 for tax on "lubricating oils, all kinds of mineral oils (not otherwise provided for in this Act) quenching oil and greases w.e.f. 1.4.1964". The question was whether this entry covered furnace oil. The Madras High Court construed the phrase and came to the conclusion that it did not. The Legislature then enacted an Amendment Act in 1967. Entry 47 was amended - so as to expressly provide that furnace oil would be subjected to tax. The Act was made effective from 1964. The Act was challenged as being unreasonable since it retrospectively made the dealers liable for sales tax which they had not passed on to others. The challenge was negatived and it was said that

> "The object of such an enactment is to remove and rectify the defect in

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> phraseology or lacuna or other nature and also to validate the proceedings, including realisation of tax, which have taken place in pursuance of the earlier enactment which has been found by the court to be vitiated by an infirmity. Such an amending and validating Act in the very nature of things has a retrospective operation. Its aim is to effectuate and carry out the object for which the earlier principal Act had been enacted. Such an amending and validating Act to make "small repairs" is a permissible mode of legislation and is frequently resorted to in fiscal enactments".

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28. The test of the length of time covered by the retrospective operation cannot by itself, necessarily be a decisive test. Rai Ramkrishna and Ors. v. The State of Bihar, [1963] 50 ITR 171 (SC) Account must be taken of the surrounding facts and circumstances relating to the taxation and the legislative background of the provision. Jawahamal v. State of Rajasthan: [1966] 1 SCR 890 To recapitulate the legislative background of the particular statutory provision in question before us - the first authoritative interpretation of Section 80P(2)(a)(iii) was made in 1994 in Assam Cooperatives Supra when it held that the word "of" must be construed as "produced by". Therefore, the law as it stood from 1968 was, by the decision, required to be read in precisely this manner and presumably assessments of Apex Societies were commended and concluded on this basis. The situation continued till 1998 till this Court reversed Assam Cooperatives in Kerala

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> Cooperative Marketing Federation Ltd. Supra. Before the assessment year was over, by the 1998 Amendment the word "of" was substituted with "given by". In real terms therefore there was hardly any retrospectivity, but a continuation of the status quo ante. The degree and extent of the unforeseen and unforeseeable financial burden was, in the circumstances, minimal and cannot be said to be unreasonable or unconstitutional.

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27) We would also like to refer to the case of ***Hiralal Ratanlal*** v. ***State of U.P.***[15], wherein it was observed "the source of the legislative power to levy sales or purchase tax on goods is Entry 54 of the List II of the Constitution. It is well settled that subject to Constitutional restrictions a power to legislate includes a power to legislate prospectively as well as retrospectively. In this regard legislative power to impose tax also includes within itself the power to tax retrospectively."

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28) We would like to point out at this stage that the High Court in the impugned judgment has not dealt with the mater in its correct perspective. The reason given by the High Court in invalidating Entry 25 is that this provision was already held unconstitutional by the said High Court in *Keshoram's* case against which the SLP was also dismissed and in view of that decision, it was not

15 (1973) 1 SCC 216

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permissible for the legislature to re-enact the said Entry by applying a different legal principle. According to us, this was clearly an erroneous approach to deal with the issue and the judgment of the High Court is clearly unsustainable. The High Court did not even deal with various facets of the issue in their correct perspective, in the light of subsequent judgments of this Court with specific rulings that *Rainbow Colour Lab* is no longer a good law.

29) The impugned judgment of the High Court is accordingly set aside, the present appeal is allowed and as a result thereof, the writ petitions filed by the respondents in the High Court are dismissed holding that Entry 25 of Schedule VI of the Act is constitutionally valid. There shall, however, be no order as to costs.

JUDGMENT

....CJI
(H.L. DATTU)

....J.
(A.K. SIKRI)

....J.
(ARUN MISHRA)

NEW DELHI;
JANUARY 30, 2015.

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