XEROX MODICORP LIMITED. A

v.

STATE OF KARNATAKA

AUGUST 24, 2005

[S.N. VARIAVA AND TARUN CHATTERJEE, JJ.] B

Sales Tax :

Karnataka Sales Tax Act, 1957—Sections 2(t), 2(v) & 5B—Karnataka Sales Tax Rules, 1957—Explanation I to Rule 6(4)—Company doing business in Xerox machines, parts and accessories—Service-cum-maintenance agreement entered into between company and customer after sale of Xerox machine—Supply of spare parts of components like toners/developers under the agreement—Held : Supply was for a price—There was transfer of property in tangible goods before they got consumed—Hence had all elements of sale. C D

Appellants are a Public Limited Company doing business in Xerox machines, part and accessories. After the Xerox machine is sold to a customer, if the customer so desires, the Appellants enter into a Full Service Maintenance Agreement (FSMA) or a Spares and Service Maintenance Agreement (SSMA). E

In FSMA the Appellants take on the responsibility of fully maintaining the machine, servicing if and if necessary replacing parts. The Appellants also supply material, like toners and developers. They charge at a fixed rate per copy produced by the machine. Under the SSMA, the Appellants agree to maintain the machine including replacement of parts, if necessary, for a fixed lump sum amount per annum. However, the costs of toners, developers etc. are to be borne by the customers. F

The question that arose for consideration in the present appeal is whether the supply of spare parts and components like toners and developers under the aforementioned two types of agreements amounted to sale. G

Dismissing the appeal, the Court

HELD : 1.1. The Agreements are not just service contracts but also H

A maintenance contracts. Under the Agreements, apart from the service element, for which no tax is sought to be levied, there is the element of supply parts and components like toners/developers etc. Merely because price is not being separately charged for this, does not detract from the position that the supply is for a price. Such supply has all the elements B of sale as understood in law. There is transfer of title in movables for a price. [900-C-D-E]

1.2. The mere fact that it is not known in the beginning whether or not a part will have to be replaced is irrelevant. Even in the absence of any such Agreements, if a part was required to be replaced and was C replaced there would be a sale of that part. The same position remains even under the Agreements. As and when a part is required to be and is replaced, a sale takes place at that instance. The tax is on sale. So if there is no replacement of a part then there is no sale of a part. There is sale of parts, both in FSMA and SSMA. [900-E-F-G; 903-E]

D

1.3. So far as toners and developers are concerned it is known from the beginning that they will require regular replenishment. Under SSMA the customer buys them. Under FSMA they are replenished by the Appellants. There is sale of toners and developers even in the case of FSMA. [900-G-H; 903-E-F]

E

The State of Madras v. *Gannon Dunkerly & Co.,* (Madras) Ltd., [1959] SCR 379 and *State of U.P.* v. *Union of India,* [2003] 3 SCC 239, referred to.

F 2.1. Though the Appellants submitted that the part or component replaced can be considered to be material which is consumed in the execution of the maintenance contract and, therefore, not exigible to tax by virtue of Explanation I to Rule 6(4) of the Karnataka Sales Tax Rules, but the term 'consumables' used in the said Explanation has to be read in the context of the words preceding and following. [900-H; 901-A, C-D]

G

2.2. The words 'consumables' in Explanation I to Rule 6(4) refers to such items which get consumed before the property in the goods can pass. Toners and developers are liquids which are put in the Xerox machine. They perform the same function as ink in printers. Under the Sale of H Goods Act, 1930 if specified goods in a deliverable state are delivered the

property in the goods passes. Undisputably, the toners and developers are delivered in bottles/containers. [902-E-F]

Pest Control India Ltd. **v.** *Union of India & Ors.,* **(1989) 75 STC 188;** *The Deputy Commissioner of Sales Tax (Law), Board of Revenue (Taxes), Ernakulam* **v.** *M.K. Velu,* **(1993) 89 STC 40 and** *Dynamic Industrial & Cleaning Services (P) Ltd.* **v.** *State of Karala & Anr.,* **(1995) 97 STC 564, referred to.**

3.1. In the FSMA, supplies are left with the customer. For the extra stock of supplies there is a provision which provides that it is left in trust with the customers. However once the toner and developer are put into the machine they are no longer in trust. This is because the property in the toner and developer passed the moment they are put into the Xerox machine. Now they belonged to the customer. At this stage they are tangible movables in which property can pass. This is clear from the provisions that Appellants will charge for unaccounted stock at prevailing prices. [902-F-G; 903-B-C]

3.2. That they are goods in which property can pass is also clear from the fact that in the SSMA the customer has to buy the toner and developer. If as now claimed they are consumables in which property cannot be transferred how could the Appellants charge for toners and developers. The sale i.e. transfer of property takes place before the goods are consumed. The transfer takes place in respect of tangible goods. Just like petrol is consumed after sale or ink is consumed after sale in this case also the toners and developers get consumed after sale. The property passes the moment they are put in the machine. At that stage they are not consumed but are tangible good in which property can pass. [903-C-D-E]

CIVIL APPELLATE JURISDICTION : Civil Appeal No. 3339 of 2000.

From the Judgment and Order dated 18.2.99 of the Karnataka High Court in S.T.R.P. No. 31 of 1996.

S. Ganesh, Mrs. Rohina Nath, Kavin Gulati and Umesh Kumar Khaitan for the Appellant.

T.L.V. Iyer, Sanjay R. Hegde, Anil K. Mishra and A. Rohan Singh for the Respondent.

A The Judgment of the Court was delivered by

S.N. VARIAVA, J. : This Appeal is against the Judgment dated 18th February 1999 passed by the Karnataka High Court.

B Briefly stated the facts are as follows:

The Appellants are a Public Limited Company doing business in Xerox machines, parts and accessories, as part of its business. After the Xerox machine is sold to a customer, if the customer so desires, the Appellants enter into one of the two types of Agreements, namely, either a Full Service C Maintenance Agreement (FSMA) or a Spares and Service Maintenance Agreement (SSMA). In FSMA the Appellants take on the responsibility of fully maintaining the machine, servicing it and if necessary replacing parts. The Appellants also supply material, like toners and developers. They charge at the rate of 0.27 paise per copy produced by the machine. Under the SSMA, D the Appellants agree to maintain the machine including replacement of parts, if necessary, for a lump sum of Rs. 7,000 per annum. However, the costs of toners, developers etc are to be borne by the customer.

It appears that in the Returns filed by the Appellants, for Sales Tax purposes, they declared total taxable turnovers at Rs. 4,23,58,510 and Rs. E 1,63,58,556. The Assessing Authority, on verification of the books of accounts, determined the total and taxable turnovers at Rs. 10,34,70,495 and Rs. 4,70,23,693. The Assessing Authority held that amounts received for sale of parts, toners and developers, under the aforementioned two types of Agreements, were includible for the purposes of sales tax.

F

The Appellants filed an Appeal before the Joint Commissioner of Commercial Taxes (Appeals), Bangalore. In that Appeal, the matter was remanded back for purposes of considering certain reductions. An Appeal was filed before the Karnataka Appellate Tribunal which was dismissed. In the meantime, after remand the Assessing Authority again passed an Order G holding that the spare parts and goods supplied under the Service Agreements amounted to sale. The Appellants then filed a Revision Petition which was dismissed by the impugned Judgment.

Mr. Ganesh, learned senior counsel for the Appellants, submitted that H the essence of a sale of goods is that the parties must enter into a contract

for the transfer of property in movables for a price. He submitted that such a contract may be a separate and distinct contract or it may be an inseparable part of a larger contract, such as a contract for the construction of a house with materials to be supplied by the contractor. He further submitted that prior to the 46th Amendment to the Constitution of India, it had been held by this Court in the *Gannon Dunkerly's* case [1959 SCR 379] that no sales tax could be levied on the transfer of property in goods in the case of such an inseverable contract. He further submitted that Article 366(29A)(b), inserted by the 46th Amendment, only enables an inseverable contract to be split up, so as to enable sales tax to be levied on that part of it which consists of a contract to transfer property in movables for a price. He submitted that Article 366(29A)(b) does not have the effect or consequence of converting what in law is not a sale of goods into a taxable sale of goods. He submitted that Article 366(29A)(b) does not make any departure from the basic concept of the parties having to enter into a contract for the transfer of property in movables for a price. He submitted that the statutory definitions of "Sale" (Sec. 2(t), "Taxable Turnover" (Sec. 2(u-1) and "Turnover" (Sec. 2(v), read with the charging Section 5B, in the Karnataka Sales Tax Act, also indicate that there must be an agreement for transfer of property in certain goods for an identifiable price. He submitted that in a maintenance contract, the only obligation cast on the service provider is to keep the equipment in question in operating condition and to repair it if necessary and to replace a part only if found necessary. He submitted that a maintenance contract is thus not a contract which is entered into for a transfer of the property in any specific part or component for any identifiable price. He submitted that a maintenance contract, when entered into, is not an agreement for the sale of goods. He submitted that a maintenance contract does not get transformed into an agreement for the sale of goods merely by reason of the subsequent development of some parts or components being replaced by the service provider, as an integral part of the contractual obligation of keeping the equipment in good operating condition. He submitted that in a maintenance contract, the charge is paid for the service and not as a price for the replacement of any particular part or component. He submitted that when the contract is entered into, it is not even known whether any part or component will require replacement or not. He submitted that there is thus no nexus or correlation between the price paid for the contract and the value of any part or component which subsequently gets replaced, if at all, during the contract period. He further submitted that the basic and essential requisites of a contract of sale of goods are thus entirely missing in a maintenance contract,

A and the same are not created or brought into existence by the 46th Amendment. He submitted that the predominant and basic object of a maintenance contract is the rendering of a service and not the sale of any goods.

In support of his submissions Mr. Ganesh relied on the case of *State of* B *U. P.* v. *Union of India,* [2003] 3 SCC 239 where it is held that if a contract is basically a service contract, the incidental supply of goods under the contract as an essential part of the service does not attract the levy of sale of tax even after the insertion of Article 366(29A)(b). It has been held that this provision does not obliterate the distinction between a service and a sale of goods.

C

Even though at first blush the submissions of Mr. Ganesh may appear attractive, on a proper consideration, we think that Mr. Iyer was right when he submitted that the Agreements are not just service contracts but also maintenance contracts. Mr. Iyer is right that the machines belong to the D customer after they are sold to them. If after the sale some part was to be replaced or some component supplied there would be sale as understood in law. Under the Agreements, apart from the service element, for which no tax is sought to be levied, there is the element of supplying parts and components like toners/developers etc. Mr. Iyer is right in submitting that merely because price is not being separately charged for this, does not detract from the E position that the supply is for a price. Such supply has all the elements of sale as understood in law. There is transfer of title in movables for a price. The mere fact that it is not known in the beginning whether or not a part will have to be replaced is irrelevant. If there were no such Agreements, it would not be known whether or not a part would be required to be replaced. It could F not be denied that, even in the absence of any such Agreements, if a part was required to be replaced and was replaced there would be a sale of that part. The same position remains even under the Agreements. As and when a part is required to be and is replaced a sale takes place at that instance. To leave no room for doubt it must be mentioned that the tax is on sale. So if there is no replacement of a part then there is no sale of a part. So far as toners G and developers are concerned it is known from the beginning that they will require regular replenishment. Under SSMA the customer buys them. Under FSMA they are replenished by the Appellants.

Faced with this situation Mr. Ganesh next submitted that in any event, H from the point of view of the Appellants, the part or component replaced can

be considered to be material which is consumed in the execution of the maintenance contract and, therefore, not exigible to tax by virtue of Explanation I to Rule 6(4) of the Karnataka Sales tax Rules. The said Explanation reads as under :

> "for the purposes of clauses (m) and (n) of sub-rule (4), 'labour and other like charges' include charges for obtaining on hire or otherwise machinery and tools used for execution of Works Contract, charges for planning, designing and architects' fees, cost of consumables used in the execution of the works contract, cost of establishment to the extent relatable to supply of labour and services and other similar expenses relatable to supply of labour and services."

On the other hand Mr. Iyer submitted, and in our view rightly, that the term 'consumables' used in this explanation has to be read in the context of the words preceding and following. He submitted that read as such it is clear that the term 'consumables' refers to such items as are used up in execution of the works contract, so that nothing tangible is left, in which property in the goods can pass to the buyer. A part placed in the machine does not get consumed. It remains in the machine. May be over a course of time there may be wear and tear and/or deterioration but it does not get consumed.

Mr. Ganesh however strenuously submitted that in the toner or developer, supplied in the FSMA there is no transfer of property or sale. He submitted that the toner and developer are consumed in the process of the execution of the Agreement itself. He submitted that no sales tax is, therefore, leviable.

In support of this submission Mr. Ganesh relied upon the case of *Pest Control India Ltd.* v. *Union of India & Ors.* reported in (1989) 75 STC 188. In this case there was a contract for eradication of pests, rodents, termites etc. In carrying out this work chemicals were sprayed through machines. The question was whether there was a sale of chemicals in execution of the works contract. It was held once the chemicals were sprayed they got consumed and nothing tangible remained in which property could be transferred.

Mr. Ganesh also relied on the case of *The Deputy Commissioner of Sales Tax (Law), Board of Revenue (Taxes), Ernakulam* v. *M. K. Velu* reported in (1993) 89 STC 40. In this case there was a contract for display of fireworks. The question was whether there was a sale of fireworks. It was held that the

A fireworks got consumed in the process of execution of the work. It was held that thereafter no tangible property remained. It was held that there was no transfer of goods.

Mr. Ganesh next relied on the case of *Dynamic Industrial & Cleaning*
B *Services (P) Ltd.* v. *State of Kerala & Anr.* reported in (1995) 97 STC 564. In this case there was a contract to clean boilers in factories. Chemicals were used to clean the boilers. It was held that the chemicals were used up and thus there was no transfer of property and thus no sale.

Relying on these cases Mr. Ganesh submitted that toners and developers
C get consumed in the process of printing and thus there is tangible property left in which there can be transfer of property.

On the other hand, Mr. Iyer submitted that there is transfer of property in tangible goods i.e. toners and developers, before they get consumed. He
D submitted that this case is akin to sale of petrol or sale of ink. He submitted that the authorities relied upon by Mr. Ganesh are all cases where the goods get consumed in execution of the work and where there is no transfer of property in the goods before the goods are consumed. He submitted that the principles laid down in those cases have no relevance and cannot apply to the facts of this case.
E

We have considered the rival submissions. As set out hereinabove the word consumable in Explanation I to Rule 6(4) refers to such items which get consumed before the property in the goods can pass. We are informed that toners and developers are liquids which are put in the Xerox machine.
F They perform, to put it simply, the same function as ink in printers. Under the Sale of Goods Act if specified goods in a deliverable state are delivered the property in the goods passes. It could not be disputed that the toner and developer will be delivered in bottles/containers. In the FSMA supplies are left with the customer. Thus clause 9 of the Section dealing with the customers obligation provides as follows:
G

"THE CUSTOMER

.....

H 9. shall be accountable to MX for xerographic supplies stock left in

trust with the customer who shall ensure that such stock is used only in the Equipment under this Agreement. MX reserves the right to charge the Customer for any stocks which are unaccounted for, to MX's satisfaction, at the then prevailing MX prices." A

Thus for the extra stock there is a provision which provides that it is left in trust. However once the toner and developer are put into the machine they are no longer in trust. This is because the property in the toner and developer passed the moment they are put into the Xerox machine. Now they belonged to the customer. At this stage they are tangible movables in which property can pass. This is clear from the provision that Appellants will charge for unaccounted stock at prevailing prices. That they are goods in which property can pass is also clear from the fact that in the SSMA the customer has to buy the toner and developer. If as now claimed they are consumables in which property cannot be transferred how are the Appellants charging for toners and developers. In our view, Mr. Iyer is right. The sale i.e. transfer of property takes place before the goods are consumed. The transfer takes place in respect of tangible goods. Just like petrol is consumed after sale or ink is consumed after sale in this case also the toners and developers get consumed after sale. The property passes the moment they are put in the machine. At that stage they are not consumed but are tangible goods in which property can pass. B C D

In view of the above it is held that there is sale of parts, both in FSMA and SSMA. There is also sale of toners and developers even in the case of FSMA. Before us no contention is raised that sales tax is not being levied on a correct basis. On the contrary Mr. Iyer pointed out to us the Order dt. 30th August 1994 of the Joint Commissioner of Commercial Taxes wherein, whilst remitting back for recalculation of tax, the principles on which it is to be done are laid down. To us they appear to be correct. E F

In this view we see no reason to interfere with the impugned Judgment. The Appeal stands dismissed. There will be no order as to costs.

B.B.B. Appeal dismissed. G