

# E-COMMERCE AND SALES TAX

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"Free Enterprise was born with man  
and shall survive as long as man  
survives".

**-A.D. Shroff**

1899-1965

Founder-President

Forum of Free Enterprise

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By

**N.C. Mehta\***

In order that implications of transactions of sale of goods taking place in the course of electronic trade or commerce can be appreciated, one has to understand basic principles of the Constitutional and other laws applicable to such transactions.

In State of Orissa Vs. Titaghur Paper Mills Co. Ltd. (1985-60 Sales Tax Cases, 213 at 237) Supreme court has observed that: "As any attempt on the part of the State to impose by legislation sales tax or purchase tax in respect of what would not be a sale or a sale of goods under the Sale of Goods Act, 1930 is unconstitutional, any attempt by it to do so in the exercise of its power of making subordinate legislation, either by way of a rule or notification, would equally be unconstitutional; and so would such an act on the part of the authorities under a Sales Tax Act purporting to be done in the exercise of powers conferred by that Act or any rule made or notification issued thereunder."

**Taxable Event** : As observed by the Supreme Court in *Burmah Shell Co. Ltd. Vs. Commercial Tax Officer* (1960-11 Sales Tax Cases, 764 at 775), what is to be taxed under the Constitution is a sale completed by the

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\*The author, is a Chartered Accountant and a leading authority in India on Sales Tax. The text is based on a presentation made at a programme on E-Commerce arranged by the Forum of Free Enterprise jointly with a few other organizations on 26th April 2000 in Mumbai.

transference of property in the goods. The taxable event thus cannot be found at any earlier stage when the sale is not completed by the passing of property. This explains why the 46th Amendment of the Constitution had to cover non-sale transactions so that the States and the Central Government can be enabled to levy sales tax on such 'deemed sales', so described by the Supreme Court.

**Constitutional Provisions** : Under article 246(3) of our Constitution Legislature of any State has exclusive power to make laws with respect to any of matters enumerated in List II in the Seventh Schedule in the Constitution, one such matter being taxes on the sale or purchase of goods other than newspapers, subject to the provisions of entry 92A of List I. Entry 92A covers taxes on the sale or purchase of goods other than newspapers, where such sale or purchase takes place in the course of inter-State trade or commerce. Article 269(3) provides that Parliament may by law formulate principles for determination when a sale or purchase of goods takes place in the course of inter-State or commerce. Such principles have been embodied in section 3 of the Central Sales Tax Act, 1956 (the Central Act).

Article 246(1) provides that Parliament has exclusive power to make laws with respect to any of the matters enumerated in List I, entry 92A being one such matter. Parliament has not exercised this power for the levy of tax on 'deemed' sales/purchases taking place in the course of inter-State trade or commerce, which it could have done by amendment of section 6 read with section 2(g) of the Central Act, whether such transactions are put through electronic or the conventional media. Thus inter-State 'deemed' sales/purchases of goods are immune from tax under a State sales tax law, as well as under the Central Act.

**Meaning of `Goods` :** Article 366(12) of the Constitution defines `goods` to include all materials, commodities and articles. Section 2(7) of the Sale of Goods Act, 1930 defines `goods` to mean every kind of movable property other than actionable claims and money; and it includes stock and shares, growing crops and things attached to or forming part of the land which are agreed to be severed before sale or under the contract of sale.

In *State of Madras Vs. Gannon Dunkerley & Co.* (1958-9 Sales Tax Cases, 353) Supreme Court having laid down that under entry 54 in the List II only those transactions were covered which were sales under the Sales of Goods Act, 1930, in *Anraj Vs. Government of Tamil Nadu* (1986-61 Sales Tax Cases, 165) the Supreme Court had to decide whether entitlement to participate in a draw embodied in a lottery ticket could be deemed to be `goods` for the purpose of levy of tax under the sales tax laws of Tamil Nadu and West Bengal. Supreme Court held that such right was a property being goods of incorporeal or intangible nature, (which should be the case for sales tax laws of all the States). Apropos to this judgment, in *Bharat Fritz Werner Ltd. Vs. Commissioner of Commercial Taxes* (1992-86 Sales Tax Cases 175) Division Bench of the Karnataka High Court affirmed the judgment of the Single Bench that right under REP (replenishment) licence was goods, Supreme Court affirming this Division Bench Judgment in *Vikas Sales Corporation Vs. Commissioner of Commercial Taxes* (1996-102 Sales Tax Cases, 106). In this case Supreme Court also held that exim scrips were goods, affirming the Madras High Court judgment in *P.S. Apparels Vs. Deputy Commercial Tax Officer* (1994-94 Sales Tax Cases, 139). In *Anraj* case Supreme Court with approval referred to the Madras High Court judgment holding copy

rights to be goods in Meiyappan Vs. Commissioner of Commercial Taxes (1967-20 Sales Tax Cases, 115). In Commissioner of Sales Tax Vs. Madhya Pradesh Electricity Board (1970-25 Sales Tax Cases, 188) Supreme Court had held that electricity was goods.

**Incorporeal - Intangible Goods :** Consequent upon pronouncement of the law in Anraj case States have been making specific provision to bring into tax net such 'goods' as patents, trade marks, import licences, export permit, licence or quota, software packages, credit of Duty Entitlement Pass Book (DEPB), technical know-how, goodwill, copy-rights, designs under the Designs Act, 1911. There would be many other items known as intellectual property rights, such as transfer of the right to use specific goods, popularly known as lease of goods as well as transfer of property in goods involved in the execution of a works contract. The latter two rights are covered respectively by sub-clause (d) and (b) of clause (29A) of article 366 of the Constitution. These two rights alongwith other items covered by sub-clauses (a), (c), (e) and (f) of clause (29A) of article 366 have been described by the Supreme Court in Builders Association of India Vs. Union of India (1989-73 Sales Tax Cases, 370) as 'deemed sales' as they do not involve transfer of property in goods as a sale within the meaning of the Sale of Goods Act.

**Situs of Sale :** Clause (1) of article 286 of the Constitution provides that no law of a State shall impose or authorise the imposition of a tax on the sale or purchase of goods where such sale or purchase takes place (a) outside the State, or (b) in the course of import of the goods into, or export of the goods out of, the territory of India. Clause (2) provides that Parliament may by law formulate principles for determining when a sale or purchase of

goods takes place in any of the ways mentioned in clause (1). Such principles have been embodied in sections 4 and 5 of the Central Act. Thus both situs as well as nature of sale/purchase, whether it takes place in the course of inter-State or commerce or in the course of import or export of goods, are important to be determined from the view point of levy of tax under a State sales tax law. In Builders Association case (supra) and reiterated in Gannon Dunkerley & Co. Ltd. Vs. State of Rajasthan (1993-88 Sales Tax Cases, 204), by virtue of the provisions of the Constitution (Forty-sixth Amendment) Act, 1982 Supreme Court has held that provisions of article 286 are applicable to 'deemed sales' as well. Determination of situs of a sale both of corporeal or tangible goods as well as goods of incorporeal or intangible character is very much important to determine the levy or non-levy of tax under a State sales tax law and/or the Central Act.

In the following cases, Supreme Court has held that a sale taking place in the course of import of goods into, or export of goods out of, the territory of India or in the course of inter-State trade or commerce has a situs in one State or another or in another country or in India.

(i) State of Travancore-Cochin Vs. Bombay Company Ltd. (1952-3 Sales Tax Cases 434 at 439); (ii) State of Travancore-Cochin Vs. S.V.C. Factory (1953-4 Sales Tax Cases 205 at 242-243); (iii) Bengal Immunity Co. Ltd. Vs. State of Bihar (1955-6 Sales Tax Cases, 446 at 481); (iv) Onkarlal Nandlal Vs. State of Rajasthan (1985-60 Sales Tax Cases, 314).

However, inspite of the aforesaid sales being within the State, they cannot be subjected to tax under a State

sales tax or under the Central Act by reason of the Constitutional restrictions.

**Tangible Goods:** Section 4(2) of the Central Act provides that a sale or purchase of goods shall be deemed to take place inside a State if the goods are within the State - (a) in the case of specific or ascertained goods, at the time the contract of sale is made; and (b) in the case of unascertained or future goods, at the time of their appropriation to the contract of sale by the seller or by the buyer, whether assent of the other party is prior or subsequent to such appropriation.

Obviously above provision can be applicable only to tangible goods. Again, as held by the Bombay High Court in *Batliboi & Co. Pvt. Ltd. Vs. State of Maharashtra* (1981-47 Sales Tax Cases, 321) situs of a sale under the above provision can be determined only where two States of our country are involved, that is, for sale within the country and not two countries, a foreign country and India. In this case situs of a sale has to be determined under the common law of our country, as propounded by our Apex Court. Following are some of the cases in which Supreme Court has held that a sale of goods would take place where property in the goods, which are the subject matter of sale would be transferred, some of the cases decided on the footing that income would accrue where the sale took place on transfer of property in the goods.

(i) *Commissioner of Income Tax Vs. P.M. Rathod & Co.* (1959-37 Income Tax Reports 145); (ii) *Commissioner of Income Tax Vs. Mysore Chromite Ltd.* (1955-27 Income Tax Reports 128); (iii) *Poppatlal Shah Vs. State of Madras* (1953-4 Sales Tax Cases, 188); (iv) *Ramlingam & Co. Vs. State of Madras* (1962-13 Sales Tax Cases, 335), etc.



In the case of tangible goods situs of a sale within one State or another has to be decided as provided in section 4(2) of the Central Act. In the case of incorporeal or intangible goods situs will have to be decided on the basis of where property in such goods would pass under the law, whether between two States of our country or between another country and India, which should be so for tangible goods also.

**Salmond on Jurisprudence:** In Salmond on Jurisprudence (12th Edition) it has been stated: "Where, however, a thing is capable of being owned, the methods of acquiring ownership over it will vary from legal system to legal system. Basically one can acquire ownership in two ways: by operation of law or by reason of some act or event." (p.232). Mode of transfer of ownership is not discussed here. So far as the legal system, referred to by Salmond is concerned, one has to go by provisions of Sale of Goods Act, Indian Contracts Act and Transfer of Property Act. In the case of tangible goods sale would be concluded by transfer of property on actual or physical delivery of goods or constructive or notional delivery of goods through transfer of documents of title to the goods or symbolic delivery of goods. Transfer of ownership of goods of incorporeal or intangible character can be effected through documentary evidence or conduct of the parties.

**Sections 3 and 5 of the Central Act:** Under Section 3 of the Central Act a sale of tangible goods may occasion inter-State movement of goods, when inter-State movement is the result of a Covenant or an incident of contract of sale or the sale may be effected by transfer of documents of title to the goods when the goods are in movement from one State to another. Similarly, under section 5 of the Central Act a sale may occasion import

or export of goods or the same may be effected by transfer of documents of title to the goods before/after the goods cross the customs frontiers of India within the meaning of section 2(ab) of the Act. These provisions would not be applicable to sale of goods of incorporeal or intangible character. Thus sale of purchase of goods of incorporeal or intangible character should always be within one State, and, therefore, outside all other States of India as provided in Section 4(1) of the Central Act or such sale should always be within the territory of India or outside such territory. Supreme Court has yet to decide this issue.

**Illustrations:** Following are some of the illustrations as to how the above principles should be applicable.

(1) A of country X enters into a contract of sale to B, delivering goods out of the Stock lying in one of the Indian cities. Such sale being within India, the same should attract tax under the sales tax law of the State in which the goods are delivered. If A has to move the goods to another State for delivery to B, A's sale would be in the course of inter-State trade or commerce governed by the provisions of the Central Act.

(2) If in the above case A exports the goods to India for delivery to B, A's sale would be in the course of import of goods into India and hence immune from tax under a State sales tax as well as under the Central Act.

(3) In the above case if A delivers the goods to C who would have bought the goods from B, there would be sale by A to B and that by B to C.

(4) A has stock of goods outside India. A delivers such stock to B against delivery order issued by him in the favour of B. If in such a case delivery order, as a document

of title to the goods, is transferred in India resulting in transfer of property in the stock from A to B, sale by A would be within India notwithstanding stock of goods lying outside India and so also actual delivery of goods being effected outside India against tender of delivery order by or on behalf of B. In such a case provisions of section 4(2) of the Central Act would not come into play.

(5) A of country X places purchase order on B for export of goods to C in country Y. Sale by B to A and that by A to C, where goods are exported to country Y, would be in the course of export and hence immune from sales tax.

(6) A exports machinery to company B in India towards equity participation; there being no sale, there would be no liability for sales tax. In this context following observations in Benjamin's Sale of Goods (3rd Ed.) should be noted, namely: "For example, plant and stock-in-trade may be sold to a company for a price to be satisfied by the allotment of shares, rather than in consideration of the allotment." (p.33). Following judgments also need to be noticed. (i) Premier Electro Mechanical Fabricators Vs. State of Tamil Nadu (1984-55 STC 371) (Mad); (ii) State of Tamil Nadu Vs. T.M.T. Drill (P) Ltd. (1991-82 Sales Tax Cases, 59) (Mad); (iii) I.B.P. Co. Ltd, Vs. Asstt. Commissioner of Commercial Taxes (2000-118 Sales Tax Cases 33) (WBTT).

(7) Machinery exported to India by A to B is taken on lease to be used in India, lease agreement having been executed in India. If on execution of such agreement transfer of the right to use machinery belonging to A should take place, strictly speaking, such taxable event, being of goods of incorporeal or intangible character, would take place in the State in which the agreement is

executed. However, observations of the Supreme Court particularly in Gannon Dunkerley case (1993-88 STC 204) should indicate that if machinery is imported with the sole object to lease it to B, such lease would be in the course of import within the meaning of the first limb of section 5(2) of the Central Act. More so, if under the lease agreement A is under obligation to import specific machinery for being leased to B.

(8) What is stated above about lease of imported machinery should apply to export of machinery to be leased under a lease agreement.

(9) When after the lease period is over, the equipment is appropriated towards sale, such sale would be a local sale in the State in which the equipment would be located at such point of time.

(10) A of Mumbai downloads software which is on the Webnet installed by B of USA. He pays fees for the same. This would be transfer of the right to use software belonging to B. Such right should be exigible to sales tax in Maharashtra based on the following observations in Salmond on Jurisprudence (12th Ed.)

"The leading principle as to the local situation of rights is that they are situated where they are exercised and enjoyed. Rights over material things therefore have the same situation as those things themselves. The goodwill of a business is situated in the place where the business is carried on. (Inland Revenue Commissioners Vs. Muller & Co.'s Margarine Ltd. [1901] A.C. at p.236). Debts are in general situated in the place where the debtor resides since it is there that the creditor must go to get his money.

There are certain cases, however, which have been decided on the assumption that incorporeal property possesses no local situation at all. For this reason it was held in *Smelting Co. of Australia Vs. Commissioners of Inland Revenue* [1897] 1 Q.B.172, that a share of a New South Wales patent, together with the exclusive right of using it within a certain district of that colony, was not property "locally situated out of the United Kingdom" within the meaning of sect.59(1) of the Stamp Act, 1891. "I do not see", says Lopes L.J. at p.181, "how a share in a patent, or a licence to use a patent, which is not a visible or tangible thing, can be said to be locally situate anywhere." See, however, as to this case, the observations of Vaughan Williams L.J. in *Muller & Co.'s Margarine Ltd. Vs. Inland Revenue Commissioners* [1900] 1 Q.B. at 322 and of Lord Lindley on appeal in the House of Lords [1901] A.C. at p.237. See further, as to the local situation of incorporeal property, *Att. Gen. Vs. Diamond* [1881] 1 Cr. & J.356; *Commr. Of Stamps Vs. Hope* [1891] A.C. 476; *Danubian Sugar Factories Vs. Commissioner of Inland Revenue* [1901] 1 K.B. 545; *Re Clark* [1904] 1 Ch.294 (pp.419-420).

(11) In the case of auction sale of goods on internet, transaction would be concluded when successful bid is accepted, which may be evidenced by intimation to the bidder. However, transfer of property in goods would take place on fulfilment of the conditions subject to which bid is accepted as provided in section 64 read with section 62 of the Sale of Goods Act. In the very nature of such a transaction, it should be reasonable view that property in the goods would pass at the place where the goods are delivered. If such delivery is effected outside India, sale would be exempt from sales tax.

**Indivisible Works Contracts:** Deemed sale under sub-clause (b) of clause (29A) of article 366 of the Constitution is transfer of property in goods (whether as goods or in some other form) involved in the execution of a works contract. Such transfer should take place on the principle of accretion or accession to the holder of the land who may be the owner, lessee or licensee, or through accession to the owner of the asset. As such accretion or accession takes place only as and when and to the extent work is carried out, it would take place at the site of work and hence it would be a local deemed to sale to which provisions of section 3 or 5 of the Central Act cannot be applicable. However, in Gannon Dunkerley case (1993-88 STC 204) Supreme Court having rejected this contention, deemed sale resulting from execution of an indivisible works contract can be in the course of inter-State trade or commerce under section 3(a) or in the course of import of goods into the territory of India within the meaning of the first limb of section 5(2) of the Central Act.

**Hire-purchase - Installment Sale:** Sub-clause (c) of clause (29A) of article 366 covers delivery of goods on hire-purchase or any system of payment by installments (installment sale as distinct from credit sale). Delivery here has to be actual or physical delivery and not constructive or notional delivery. This too is a deemed sale to which what is stated above should be applicable. When hire-purchase or installment sale fructifies into a concluded sale, the same may attract sales tax in the State in which the goods would be located at this point of time, depending upon provisions of the applicable sales tax law.

*The views expressed in this booklet are not necessarily those of the Forum of Free Enterprise.*

**"People must come to accept private enterprise not as a necessary evil, but as an affirmative good".**

**-Eugene Black**

## FORUM OF FREE ENTERPRISE

The Forum of Free Enterprise is a non-political and non-partisan organisation started in 1956, to educate public opinion in India on free enterprise and its close relationship with the democratic way of life. The Forum seeks to stimulate public thinking on vital economic problems of the day through booklets and leaflets, meetings, essay competitions and other means as befit a democratic society.

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