



# Dimensions – 43<sup>rd</sup> Edition

### Ruling / judgment under Pre-GST era:

#### 1. M/s The Great Eastern Shipping Co. Ltd. v. The State of Karnataka & others<sup>1</sup>

<b>Issues for Consideration</b>	<ul style="list-style-type: none"> <li>Whether the State of Karnataka has jurisdiction to levy Sales tax under section 5C of the KST Act in respect of the charter party agreement (CPA)?</li> <li>Whether the CPA constitutes “transfer of the right to use”?</li> <li>Whether the State Government has the jurisdiction to levy Sales tax in respect of the vessel under CPA, which will be used within the territorial waters?</li> </ul>
<b>Discussion &amp; Judgment</b>	<p><b>Discussion:</b></p> <ul style="list-style-type: none"> <li>The Appellant entered into a CPA with New Mangalore Port Trust (Charterer / Port Trust) to provide the services of tug along with the master and other personnel of the Appellant to the Port Trust for six months.</li> <li>The Appellant was directed by the authorities to register as a dealer under the Karnataka Sales Tax Act, 1975 (KST Act) on the ground that the CPA attracted tax under section 5C of the KST Act. Aggrieved, the Appellant filed a Writ Petition before the Hon’ble High Court of Karnataka on the ground that KST Act does not extend to territorial waters of India and State is not authorised to levy any tax on hire charges received from the Port Trust. On dismissal of the Writ, appeal was filed before the Hon’ble Supreme Court of India.</li> <li>On a detailed examination of the CPA and perusal of various judicial precedents, the Hon’ble Supreme Court observed as under:             <ul style="list-style-type: none"> <li>- The term ‘let’ and ‘hire’ had been used which signified that the vessel had been placed at the disposal and control of the Charterer. The charterer had been provided</li> </ul> </li> </ul>

<sup>1</sup> 2019 (12) TMI 225 - The Hon’ble Supreme Court of India



the right to use all outfits, equipment and appliances on board at the time of delivery, including the whole reach, burthen, and deck capacity of the vessel. On a conjoint reading of the various clauses, terms and conditions of the CPA, it was observed that there was a transfer of the right to use the vessel;

- The use of various terms in the CPA is not determinative of the true character of the transaction. The intention of the parties would play a paramount role in determining whether or not there is a transfer of effective possession and control.;
- The essential condition to determine whether there has been a transfer of right to use is that the goods must be available for delivery and have been delivered to the Charterers. In this case, there was a complete transfer of right to use owing to the fact that the legal right to use and the permission or licence had been exclusively provided to the Charterer;
- Merely because the owner has provided the crew, master of the vessel etc., it cannot be said that the CPA is a service contract. If they operate under the directions of the Charterer, then the effective control and possession is transferred;
- The CPA qualifies the test laid down by the Hon'ble Supreme Court in the case of *Bharat Sanchar Nigam Ltd. & Anr. v. Union of India & Ors.*<sup>2</sup> to determine whether a transaction constitutes a transaction of right to use the goods;
- The Hon'ble Supreme Court also placed reliance on various judicial precedents wherein it is held that the conditions of the agreement and the expressed written intention of the parties must be examined in each case to conclude whether a CPA constitutes a deemed sale as a transaction for transfer of right to use the goods or a provision of service;
- The Hon'ble Supreme Court relied on its judgment in the case of *20<sup>th</sup> Century Finance Corporation Ltd. v. State of Maharashtra*<sup>3</sup> wherein it is held that the situs of the sale would be the place where the contract was entered into resulting in transfer of effective control and the location of delivery of goods cannot be the determinative factor for determining the situs of sale of goods. In the instant case, the CPA was entered into in the State of Karnataka and hence the situs of the deemed sale is within the State of Karnataka;
- Applicability of Service tax on the transaction was not examined since the question involved in the instant case related only to the applicability of Sales tax on the deemed sale under section 5C of the KST Act read with provisions contained in Article 366(29A)(d) of the Constitution of India;
- Further, since the matter pertained to the exaction of tax under KST Act, the Court refrained from considering the question in respect of the right of the States and Central Government on territorial waters.

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<sup>2</sup> (2006) 3 SCC 1

<sup>3</sup> (2000) 6 SCC 12



	<p><b>Judgment:</b></p> <p>The Hon'ble Supreme Court upheld the levy of Sales tax on the CPA as there was a transfer of right to use the vessel in view of the provisions contained in Article 366(29A)(d) of the Constitution read with section 5C and the definition of sale contained in section 2(j) of the KST Act.</p>
<p><b>Dhruva Comments / Observations</b></p>	<ul style="list-style-type: none"><li>• This decision has settled a long-standing dispute on taxability of the CPA / lease contracts. Prior to introduction of Service tax, the dispute was on leviability of Sales tax or VAT. Post introduction of Service tax, there had been a by and large consensus that these are service contracts attracting the liability under the Service tax law.</li><li>• Although, the applicability of Service tax has not been examined, it should not make any difference to the outcome. It is a settled law that if there is a transfer of possession and effective control, then VAT is applicable else Service tax will apply. Since the decision has concluded VAT is applicable, by inference Service tax will not be attracted.</li><li>• While the instant judgment upheld the levy of Sales tax or VAT on the Appellant's CPA, it leaves unresolved a tax treatment adopted by the industry in which these agreements are treated as service transactions which are liable to Service tax under the category of Supply of Tangible Goods Service.</li><li>• This judgment could have a far-reaching impact in the pre-GST period for ongoing assessments, reassessments and appeals, and could lead to the re-opening of cases subject to limitation provisions.</li><li>• On introduction of GST, the question has been neutralised since the rate of tax and more importantly, the tax applicable, is the same.</li></ul>

## 2. M/s Unicorn Industries v. Union of India & Others<sup>4</sup>

<p><b>Issue for Consideration</b></p>	<p>Whether the Appellant is eligible to claim exemption of Education Cess (EC), Secondary Higher Education Cess (SHEC) and National Calamity Contingent Duty (NCCD) on manufacture of excisable goods cleared from specified industrial centres in the State of Sikkim under the notification no. 71/2003 dated September 9, 2003 (Notification)?</p>
<p><b>Discussion &amp; Judgment</b></p>	<p><b>Discussion:</b></p> <ul style="list-style-type: none"><li>• The Appellant had set up a manufacturing unit within the state of Sikkim in 2006 for manufacture of "Indian Mouth Freshener". It being an excisable commodity, the Appellant was registered under the Central Excise Act, 1944.</li><li>• Under Notification, the Appellant was entitled to claim exemption from payment of Excise duty for specified goods cleared from specified areas within the State of Sikkim for a period of 10 years from the date of commencement of production. Under the said scheme, the Appellant was required to pay the Excise duty by utilising CENVAT credit and the balance by cash and then later avail refund or claim re-credit of net Excise duty paid in cash.</li></ul>

<sup>4</sup> Civil Appeal no. 9237 of 2019 [arising out of S.L.P. (civil) no.21622 of 2012], Civil Appeal no. 9238 of 2019 [arising out of S.L.P. (civil) no. 28966 of 2012]



- In light of the Notification, the Appellant sought an exemption from the below mentioned duties of Excise:
  - Basic Excise duty @ 37.5 % *ad valorem*;
  - NCCD @ 23% *ad valorem* (levied under section 136 of the Finance Act, 2001);
  - Additional Excise Duty (Pan Masala & Tobacco Products) @ 5.5% *ad valorem* (levied under section 85 of the Finance Act, 2005); and
  - EC @ 2% *ad valorem* (under section 91 of the Finance Act, 2004) and SHEC (levied under section 126 of the Finance Act, 2007).
- The Department issued various SCNs asking the Appellant to show cause why NCCD, EC and SHEC should not be collected along with interest & penalty.
- In the appeal filed before the Hon'ble Supreme Court the following submissions have been put forth:
  - Perusing section 136 of Finance Act, 2001 which introduced NCCD, section 91 and 93 of the Finance Act, 2004 which introduced EC and section 126 and 128 of Finance Act, 2007 which introduced SHEC, the Appellant stated that the said duties are a 'duty of Excise' and that the provisions of the Central Excise Act, 1944 relating to refunds and exemptions from duties shall apply with respect to the abovementioned duties. Accordingly, as the Notification provides for an exemption from the "duty of Excise", the duties/ cess under dispute should also be given the same treatment as Basic Excise duty, notwithstanding their nomenclature;
  - The Appellant placed reliance on the judgments pronounced by the Division Bench of the Hon'ble Supreme Court in the case of *SRD Nutrients Private Limited v. Commissioner of Central Excise, Guwahat*<sup>5</sup>, *Bajaj Auto Limited v. Union of India & others*<sup>6</sup> wherein it was held that when Excise duty itself is exempted, there cannot be any cess or surcharge on it. Further, it also referred to the circulars dated August 10, 2004 and April 8, 2011, which clarified that no EC and SHEC would be leviable on clearances where no Excise duty has been collected or Service tax is exempted, respectively.
- The Hon'ble Supreme Court made the following observations:
  - The Court drew reference to the judgment passed by three member bench of Supreme Court in the case of *Union of India v. Modi Rubber Limited*<sup>7</sup>, for the purport of understanding the expression "duty of Excise" and held that the same must be read according to its plain natural meaning and the same cannot in any circumstance bear an extended meaning;
  - The Court on perusal of the Notification observed that the exemption was granted specifically under section 5A of the Central Excise Act, 1944 concerning Additional duties under the Act of 1957 and of 1978 and the Notification does not make any

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<sup>5</sup> (2018) 1 SCC 105

<sup>6</sup> 2019 SCC OnLine SC 421

<sup>7</sup> (1986) 4 SCC 66



reference to the Finance Act 2001, 2004 and 2007. Hence, there is no source of power in the aforesaid Notification to provide an exemption to EC, SHEC and NCCD;

- The Court held that the Notification could not have contemplated inclusion of EC and SHEC for exemption which had not even been introduced at that point in time. The decision in case of *Modi Rubber Limited (supra)* strongly deterred the argument made by the Appellant that duties imposed in future not prevailing at the time of issue of the Notification shall be covered for the purpose of exemption;
- The Court held that the circulars relied upon by the Appellant have no force of law and cannot be binding on the Court;
- The Court held that the reason employed in *SRD Nutrients Private Limited (supra)* that as there was nil Excise duty, Additional duty cannot be charged is unacceptable as Additional duty can be determined and merely exemption granted in respect of Excise duty cannot come in the way of determination of yet another duty based thereupon;
- Further that the decisions in *SRD Nutrients Private Limited (supra)* and *Bajaj Auto Limited (supra)* are **per incuriam** since the said decisions were pronounced in ignorance of the view already taken by a larger bench.

#### **Judgment:**

The Hon'ble Supreme Court upheld the view taken by the Hon'ble High Court of Sikkim following the decisions of the three-member bench in the cases of *Modi Rubber Limited (supra)* and *Rita Textiles Private Limited v. Union of India*<sup>8</sup> as they are binding being a Co-ordinate bench.

#### **Dhruva Comments / Observations**

- It is settled proposition of law that in the matter of construction of an exemption notification there is no scope for intendment and a literal construction will have to be adopted. However, in the present case the Hon'ble Supreme Court has come to the conclusion that the Special or Additional duties of Excise, which are in addition to the duties of Excise, are similar to the cesses. Contrary to this belief, cesses though are in addition to the Excise duty, are actually calculated on the component of duty of Excise. Hence, where such duty is exempt or 'NIL' there can be no EC or SHEC.
- The three-member bench judgment in *Modi Rubber Limited (supra)* is applicable to a very specific set of Special and Additional duties and cannot be said to be applicable to cesses. Applicability of exemptions to cesses was specifically the subject matter before the Division bench in *SRD Nutrients Private Limited (supra)* that correctly held that since cess is computed on duty, where such duty is exempt or 'NIL' there can be no cess. It needs to be seen whether the parties would seek a review of the judgment.

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<sup>8</sup> 1986 SCC Supp. 557



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