

ESSAY

GANNON DUNKERLEY AND THE TEST OF DOMINANT INTENTION

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ABSTRACT

In its landmark decision in State of Madras v. Gannon Dunkerley, the Supreme Court defined sales for the first time. The author examines this definition in light of the treatment of hybrid contracts. The author argues that despite the deeming fiction introduced in the Constitution under Article 366(29A), the decision in Gannon Dunkerley continues to remain relevant.

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I. INTRODUCTION

The treatment of hybrid contracts has been the subject of much debate among scholars.¹ Indeed, the law has come a long way since *Lee v. Griffin*,² in which any transfer or property was regarded as a sale.

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1 BENJAMIN'S SALE OF GOODS, 31 (A. G. Guest *et al* eds., 1974).

2 *Lee v. Griffin*, (1861) 1 B.&S. 272 [Queen's Bench]. See also, *Robinson v. Graves*, [1935] 1 K.B. 579 [Court of Appeal].

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In India, this question has become particularly relevant in the context of the imposition of sales tax. The Supreme Court in *State of Madras v. Gannon Dunkerley*³ defined sales as transactions involving a transfer of property between parties, pursuant to an intention to do so. This was to be distinguished from a works contract, in which the property transferred is merely ancillary to the contract. In order to determine whether a contract was indeed a sale – and therefore, could be taxed as such – the relevant test would be of the dominant intention of the parties. The 46th Constitutional Amendment inserted Art. 366 (29A) in order to limit the effect of *Gannon Dunkerley* on the imposition of sales tax.⁴

However, it is relevant to ask what the proper scope of the 46th Amendment is, in the light of recent controversial rulings of the Supreme Court,⁵ and issues such as the taxation of software.⁶ At the heart of this is the question of the scope of the dominant intention test, and whether *Gannon Dunkerley*'s definition of sale survives the 46th Amendment.

This paper first examines the development of the test of dominant intention in distinguishing contracts of work from those of sale. Next, this paper argues that the *Gannon Dunkerley* test has survived the 46th Amendment, notwithstanding the legal fiction created in Art. 366 (29A).

3 *State of Madras v. Gannon Dunkerley*, AIR 1958 SC 560 [Supreme Court of India]. [Hereinafter, "*Gannon Dunkerley*"]

4 Art. 366 (29A) reads, "*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-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;".*

5 *Ass'n of Leasing and Financial Services Cos, v. Union of India*, (2011) 2 SCC 352 [Supreme Court of India].

6 *Infotech Software Developers v. Union of India*, 2010 (20) S.T.R. 289 (Mad.) [Madras High Court].

II. GANNON DUNKERLEY AND DOMINANT INTENTION

In Gannon Dunkerley, the Supreme Court was confronted with two important questions. First, were hybrid contracts, with elements of both work and sale, to be treated as two separate contracts, and secondly, if not, what factors would determine whether a contract was a sale for purposes of sales tax? The Court answered the first of these in the negative. In a building contract, the intention of the parties is not to transfer property in the movables used in construction, separate from the construction of the building itself.

How then was the nature of a contract to be determined? In the Court's analysis, a sale would involve first, the intention of the parties to transfer property for a price, and secondly, the transfer of property in the goods pursuant to such intention. Admittedly, Entry 54, List II of the Seventh Schedule to the Constitution⁷ is to be interpreted widely.⁸ Nevertheless, the term 'sale' is a *nomen juris* and has acquired a specific meaning in law. The legislative entry should have been interpreted in this light. This view is supported by eminent jurists.⁹

The question that follows from Gannon Dunkerley is, how are contracts to be construed? It appears that the detailed rule set forth in Gannon Dunkerley was not relied on in Patnaik v. State of Orissa.¹⁰ Instead, the majority in Patnaik found that the transfer of goods alone was sufficient to constitute a sale. It is, however, submitted that Shah J.'s opinion represents a more correct view of the matter. Shah J. examined the 'intention' of the parties as it appeared from the terms of the contract, including the nature of duties imposed on the maker of the goods, to conclude that the contract was one of 'work'.

Indeed, this examination of the intention of the parties was crystallized in Associated Hotels.¹¹ In answering the question of whether food consumed by guests at a hotel constituted a sale, the Court made the following observation:

"13. Thus, in considering whether a transaction falls within the purview of sales tax, it becomes necessary at the threshold to determine the nature of the

7 Entry 54, List II, Schedule VII, The Constitution of India, 1950 reads, "*Taxes on the sale or purchase of goods other than newspapers.*".

8 Calcutta Gas Co. v. State of West Bengal, AIR 1962 SC 1044 [Supreme Court of India].

9 H.M. Seervai, CONSTITUTIONAL LAW OF INDIA, 2328 (4th edn., 1988).

10 Patnaik v. State of Orissa, AIR 1965 SC 1655 [Supreme Court of India]. [Hereinafter, "Patnaik"].

11 State of Punjab v. Associated Hotels of India, AIR 1972 SC 1131 [Supreme Court of India]. [Hereinafter, "Associated Hotels"]

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contract involved in such a transaction for the purpose of ascertaining whether it constitutes a contract of sale or a contract of work or service...it clearly emerges that such determination depends in each case upon its facts and circumstances. Mere passing of property in an article or commodity during the course of the performance of the transaction in question does not render it a transaction of sale...*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. (Emphasis supplied)*"

This is the test of 'dominant intention', and it has been followed by a series of decisions.¹² At the heart of this test is a determination of what the parties intended from the terms of the contract. Some light is shed by the decision in *Hindustan Shipyard*,¹³ in which the Court stated that the "bulk" of labour or property transferred would determine the nature of the contract. Nevertheless, at the heart of this is a question of fact, and a determination of the intention of the parties from the terms of the contract.¹⁴ This may not be confined to the monetary value alone, as was suggested by *Kone Elevators*.¹⁵ For instance, a contract for the making of a customized prosthetic limb would probably be one for works, irrespective of the value of the goods transferred.

III. HOW ARE CONTRACTS TO BE TREATED TODAY? THE 46TH AMENDMENT AND DOMINANT INTENTION

While the decision in *Gannon Dunkerley* is the delight of any legal positivist, the same cannot be said for the Revenue. The effect of *Gannon Dunkerley* was to narrow down the scope of transactions that could be taxed as sales. For instance, a lease of films for an extended period of time could no longer be taxed as a sale,¹⁶ nor could the serving of food in a restaurant qualify as such.¹⁷ Indeed, the intention behind the enactment of the 46th Amendment was precisely to remedy this defect.

12 *State of Gujarat v. Variety Body Builders*, (1976) 5 CTR (SC) 228 [Supreme Court of India].; *Everest Copiers v. State of Tamil Nadu*, AIR 1996 SC 2662 [Supreme Court of India].; *Hindustan Aeronautics Ltd. v. State of Karnataka*, AIR 1984 SC 744 [Supreme Court of India].

13 *Hindustan Shipyard v. State of Andhra Pradesh*, AIR 2000 SC 2411 [Supreme Court of India]. [Hereinafter, "*Hindustan Shipyard*"]

14 *Sentinel Rolling Shutters v. Commissioner of Sales Tax*, AIR 1979 SC 1747 [Supreme Court of India].

15 *State of Andhra Pradesh v. Kone Elevators*, (2005)3 SCC 389 [Supreme Court of India].

16 *A.V. Meiyappan v. Commissioner of Commercial Taxes*, (1969) 1 MLJ 480 [Madras High Court].

17 *Associated Hotels*.

The purpose behind the enactment was only to expand the scope of transactions that could be regarded as sales for the purposes of taxation.¹⁸

What impact does this have on the decision in *Gannon Dunkerley v Rainbow Colour Labs*¹⁹ took the view that the decision remained unaffected, and that despite the express wording of Art. 366 (29A)(d), the goods transferred in the course of a works contract may not be taxed by the State. However, this was overruled in *Associated Cement Companies*²⁰ on the ground that the wording of Art. 366 (29A) had been ignored. It is submitted that this view is correct. Art. 366 (29A) reads "taxes on the sale or purchase of goods includes...". This definition, it is observed, is not of what constitutes a 'sale', but instead, of what would amount to a 'tax'. Moreover, a deeming fiction must be read in the light of its purpose,²¹ and the purpose here was clearly only to ensure that several transactions did not escape the tax net.²² For this limited purpose alone, contracts may be bifurcated, and taxes imposed only on the value of the property transferred.²³

This view is supported by the decision in *BSNL*.²⁴ Ruma Pal J., in determining whether the use of electromagnetic waves in mobile telephone connections constituted a 'sale', noted that

"*Gannon Dunkerley* survived the 46th 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. By introducing separate categories of 'deemed sales', the meaning of the word 'goods' was not altered. Thus the definitions of the composite elements of a sale such as intention of the parties, goods, delivery etc. would continue to be defined according to known legal connotations...But the 46th Amendment does not give a licence for example to assume that a transaction is a sale and then

18 Statement of Objects and Reasons, The 46th Constitution (Amendment) Act, 1982. [Hereinafter, "SOR"]

19 *Rainbow Colour Lab v. State of Madhya Pradesh*, AIR 2000 SC 808 [Supreme Court of India].

20 *Associated Cement Cos. Ltd. v. Commissioner of Customs*, AIR 2001 SC 862 [Supreme Court of India].

21 *Mancheri Puthusseri Ahmed v. Kuthiravattom Estate Receiver*, (1996) 6 SCC 185 [Supreme Court of India].

22 SOR.

23 *Gannon Dunkerley*.

24 *Bharat Sanchar Nigam Ltd. v. Union of India*, (2006) 3 SCC 1 [Supreme Court of India]. [Hereinafter, "BSNL"]

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to look around for what could be the goods...The second respect in which Gannon Dunkerley has survived is with reference to the dominant nature test to be applied to a composite transaction not covered by Article 366(29A). Transactions which are mutant sales are limited to the clauses of Article 366(29A). All other transactions would have to qualify as sales within the meaning of Sales of Goods Act 1930 for the purpose of levy of sales tax."

Clearly, the intention of the legislature was not to alter the test in Gannon Dunkerley, and indeed, this test continues to survive today.

BSNL was followed in *Imagic Creative*,²⁵ where the facts concerned the taxation of advertisements. Moreover, *Imagic Creative* took the view that while sales tax could be imposed on the 'sale' component, the 'works' component would be taxable as a service, as hybrid contracts are divisible for the purposes of taxation. It is therefore submitted that Gannon Dunkerley has survived the 46th Amendment, and that the test for determining whether a contract is one of sale or of work remains unchanged. This view has been reiterated by the Court in *Idea Mobile*,²⁶ as recently as in 2011.

IV. CONCLUSION

Although Gannon Dunkerley was decided in the context of the imposition of sales tax, it has had a wide impact on determining the nature of the contract that the parties have entered into. The nature of the contract determines when risk passes between parties, and the nature of care that must be adopted. In some instances – such as in *Imagic Creative* – it becomes necessary to ask whether a sale ever took place at all. It is thus important to determine whether Gannon Dunkerley has survived the 46th Amendment. It is submitted, in the light of the view in *BSNL*, that it has. Nor has the 46th Amendment impacted the dominant intention test to determine whether a contract is one of sale or of work. The specifics of this will, however, be required to be determined on fact

25 *Imagic Creative v. Commissioner of Commercial Taxes*, (2008) 2 SCC 614 [Supreme Court of India]. [Hereinafter, "*Imagic Creative*"]

26 *Idea Mobile Communication Ltd. v. C.C.E. & C.*, Civil Appeal No. 6319 of 2011 (4th August, 2011), available at [http://www.stpl-india.in/SCJFiles/2011_STPL\(Web\)_662_SC.pdf](http://www.stpl-india.in/SCJFiles/2011_STPL(Web)_662_SC.pdf) [Supreme Court of India].

