BSNL v. *Union*, (2006) 3 S.C.C. 1

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This note discusses the various issues arising in the case of BSNL v. Union of India, which raised the issue of whether sales tax could be charged on rental and other incidental charges in the sale of a mobile phone connection. The article argues that barring a few exceptions the decision was appropriate in holding that such sales tax cannot be charged. This is because firstly, electromagnetic waves are not 'goods' and secondly, there is no sale or right to transfer the use of sim cards or electromagnetic waves.

I. INTRODUCTION

Can sales tax be levied on the rental and other incidental charges in a mobile phone connection? The answer, according to a three judge Bench of the Supreme Court, in *BSNL v. Union of India*,[1] ["*BSNL*"] is an unambiguous no. We argue that this case is appropriately decided, with a few exceptions.

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1 BSNL v. Union of India, (2006) 3 S.C.C. 1.

It is convenient at the outset to note that sales tax on any transaction can be levied in only one of two ways:

a) Proving that the transaction satisfies the definition of a 'sale', under a state Sales Tax Act passed under Entry 54, List II[2]

b) Proving that the extended meaning to 'sale' accorded by Art. 366(29A) is satisfied.

In *BSNL*, the State tried to prove that mobile phone connections ["the transaction"] constitute a deemed sale under Art. 366(29A)(d), by arguing that there was a transfer of the right to use electromagnetic waves ["EM waves"] to the user of mobile phones. The States also argued that (a) In any event, different legislatures would be competent to tax different aspects of the same transaction and (b) telephony does not necessarily include the factor of service. All of these contentions were rejected by Ruma Pal J., who held that the States are not competent to levy sales tax on the transaction. However, in order to appreciate the import of this decision, it is also necessary to examine the contention that there is a sale of SIM cards, or in the alternative, a transfer of the right to use them, prominently made in *Escotel Mobile v. Union of India*[3] [*"Escotel"*]. Thus, the issues that arise for examination are (a) whether there is the sale of any 'goods' in the transaction, or (b) whether there is a transfer of the right to use them.

II. Are EM Waves or SIM Cards 'Goods'?

The Indian Telegraph Act, 1885 ["Telegraph Act"] defines a telegraph as including an "*appliance...used for transmission of signals... through... electromagnetic emissions...*" Licenses under the Telegraphs Act are granted to service providers by the Central Government.[4] As is well known, signals emitted from a mobile phone are transmitted to the receiving phone through these electromagnetic waves, enabling conversation. Consequently, the State in *BSNL* argued that there is a transfer of the right to use a telegraph, attracting Art.

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[2] Constitution of India, Schedule VII, List II:

54. Taxes on the sale or purchase of goods other than newspapers, subject to the provisions of entry 92A of List I.

[3] Escotel Mobile Communications v. Union of India, [2006] 2 S.T.R. 567.

[4] § 4, Indian Telegraphs Act, 1885.

366(29A)(d).[5] It is evident that this argument rests on two crucial limbs: (a) That 'electromagnetic waves' are goods and (b) that there is a transfer of the right to use them- The first is examined in this section, and the second in the next.

As pointed out in *BSNL*, *State of Madras v. Gannon Dunkerley*[6] is the *locus classicus* and continues to be relevant even after the 46th Amendment to the Constitution. Venkatrama Aiyar J. had held that 'sale of goods' in Entry 54 means the same as in the Sale of Goods Act, and that it is a *"nomen juris, its essential ingredients being an* ***agreement*** *to sell movables for a price ... In one* [contract] *entire and indivisible..., there is no sale of goods and it is not within the competence of the Provincial* [State] *Legislature under* Entry 48 [54] *to impose a tax..."*[7] [emphasis ours]. It was further held that a sale required an agreement to transfer title, supported by consideration, resulting in an actual transfer of title.

The Law Commission was of the view that *Gannon Dunkerley* was 'unduly narrow', not applying the principle of broad construction of legislative entries.[8] Despite this, and the *obiter* observations of Chandrachud J. in *Vishnu Agencies*,[9] questioning the appropriateness of *Gannon Dunkerley*, it is Venkatrama Aiyar J.

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5 CONSTITUTION OF INDIA, Article 366(29A):

tax on the sale or purchase of goods" includes-

(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;

...

and such transfer, delivery or supply of 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;

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6 State of Madras v. Gannon Dunkerley, A.I.R. 1958 S.C. 560.

7 *Id.*

8 *"In our view... the Supreme Court, with respect appears to have adopted an unduly restricted interpretation of the expression 'sale'. It is true that the expression 'sale' is not defined in the Constitution- but it is a well-recognised canon of construction that words used in the three Legislative Lists should receive the widest possible interpretation, and, it was, we venture to suggest, somewhat inappropriate to have taken recourse to the narrow definition of the word 'sale' contained in the Sale of Goods Act for the purpose of interpreting that expression occurring in the State List, Entry 54..." See* LAW COMMISSION OF INDIA, 61ST REPORT 21 (1974).

9 Vishnu Agencies v. Commercial Tax Officer, (1978) 2 S.C.R. 433.

clearly reached the correct[10] conclusion,[11] which is also in consonance with English law.

The 46th Amendment, as noted in *BSNL*, sought to bring specific transactions within the purview of 'sale', though they lacked the essential ingredients laid down in *Gannon Dunkerley*. One of these was covered by clause (d) - a transaction where the seller retained title, and transferred the right to use to the buyer. Ruma Pal J., in *BSNL*, therefore correctly noted that *Gannon Dunkerley* still applied to transactions *outside* the purview of Article 366(29A)- in other words, if a transaction does not fall within a specific 'exception' to *Gannon Dunkerley*, carved out by the 46th Amendment, it would still have to satisfy the three-pronged test to be taxed, and a composite contract remains indivisible unless the parties intended otherwise. However, if a transaction *does* fall within one of the exceptions, its

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[10] While the view of the Law Commission that legislative entries must be broadly interpreted is correct, its conclusion ignores that the wide interpretation has already been given. Entry 54, List II, uses the words 'tax on the sale and purchase of goods'. *Gannon Dunkerley* considered the meaning of 'sale'. Now, though it does not say so, the meaning of 'goods' is relevant in determining the meaning of sale. India accords an unusually wide ambit to 'goods', so much so that lottery tickets, copyright, electricity etc. were at some point considered goods. This may be contrasted with, for instance, the American Sale of Goods jurisprudence, which allows sales tax only on sale of 'tangible personal property'. Given that 'goods' were already accorded a wide meaning, interpreting 'sale' in the manner suggested by the Law Commission would destroy the essence of sale, and allow sales tax on transactions *that were patently bereft of any aspect of sale.*

Further, the well-settled principle of tax law is that one merely has to look at what is clearly said. Now, while it is true that this principle applies to a tax *law*, and not to a legislative entry on tax, *the principle reflects the policy of the law in avoiding broad interpretations of the taxing power,* given that it imposes a non *quid pro quo* liability on its subjects. These observations have become part of the ethos of tax law:

"In a taxing Act one has to look merely at what is clearly said. There is no room for any intendment. There is no equity about a tax. There is no presumption as to tax. Nothing is to be read in, nothing is to be implied. One can only look fairly at the language used." Cape Brandy Syndicate v. Inland Revenue Commissioners, [1921] 1 K.B. 64.

"It is further well-settled that a transaction in a fiscal legislation cannot be taxed only on any doctrine of "the substance of the matter" as distinguished from its legal signification, for a subject is not liable to tax on supposed "spirit of the law" or 'by inference or by analogy.'" State of West Bengal v. Kesoram Industries, (2004) 10 S.C.C. 201.

"If the person sought to be taxed comes within the letter of the law he must be taxed, however great the hardship may appear to the judicial mind to be. On the other hand, if the Crown seeking to recover the tax, cannot bring the subject within the letter of the law, the subject is free, however apparently within the spirit of law the case might otherwise appear to be." Per Lord Cairns, Parlington v. Attorney General, (1869) L.R. 4 E. & I. App. 100.

[11] H.M.SEERVAI, CONSTITUTIONAL LAW OF INDIA 2331 (1996).

'dominant nature' or the intention of the parties is irrelevant.[12] *State of UP v. Union of India*,[13] overruled by *BSNL*, held in this connection that a composite contract may be divided if the sale and service elements are 'equally prominent' and are 'clubbed into one contract'. This, it is submitted, is in direct contravention of *Gannon Dunkerley, Builders Association*[14] and *Associated Cement v. Commissioner of Customs*,[15] all of which endorsed the above analysis.

According to Article 366(12) of the Constitution, goods includes *'all materials, commodities and articles'*. The Sale of Goods Act includes within it all movables except 'actionable claims' and money.[16] It includes *'property of every description except immovable property'*.[17] It can be incorporeal as well, such as copyright,[18] or electricity.[19] It is important to note that intention is irrelevant in determining whether an object constitutes a good or not- even *Gannon Dunkerley* mandates an inquiry into intention to determine whether there has been a *sale of goods*, which presupposes the objective existence of goods. This conclusion is supported by *Sunrise Associates v. Govt. of NCT, New Delhi*,[20] where Ruma Pal J. held, *"The word "property" may denote the nature of the interest in goods and when used in this sense means title or ownership in a thing. The word may also be used to describe the thing itself."* Clearly, neither an interest in goods nor the good itself requires the Court to delve into the intention of the parties. Also, *Sunrise* seems to suggest that the existence of a good cannot depend on the nature of the transaction, by holding the word 'property' in sales tax statutes refers to *subject matter of ownership*. On the other hand, Para 49 of *BSNL* seems an aberration *"What are the "goods" in a sales transaction, therefore, remains primarily a matter of contract and intention"*. While no case may have expressly said that the determination of whether an object is a good must necessarily be through an objective test, this seems to be the implication of the cases that have gone before *BSNL*. The para 49 observation seems to be *obiter*, or worse, *per incuriam*.

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[12] Ruma Pal J. overruled Rainbow Colour Labs v. State of M.P., (2000) 2 S.C.C. 385, which had held that sales tax could not be levied on the transaction of a photographer delivering prints, since the 'dominant nature' was one of service. This case had been disapproved in Associated Cement v. Commissioner of Customs, (2001) 4 S.C.C. 593.

[13] (2003) 3 S.C.C. 239.

[14] Builders Association v. Union of India, (1989) 2 S.C.C. 645.

[15] (2001) 4 S.C.C. 593.

[16] § 2(7), Sale of Goods Act, 1930.

[17] Anraj v. Government of Tamil Nadu, (1986) 1 S.C.C. 414.

[18] Savitri Devi v. Dwarka Prasad, A.I.R. 1939 All. 305.

[19] Commissioner of Sales Tax, Madhya Pradesh, Indore v. Madhya Pradesh Electricity Board, Jabalpur, (1969) 1 S.C.C. 200.

[20] Sunrise Associates v. Government of New Delhi, (2006) 5 S.C.C. 603 [hereinafter *Sunrise*].

In *Associated Cement*[21] it was held that even information or advice, when put on a media, such as paper or CD's, constitutes a chattel, whose value is enhanced by the intellectual input. The charge of a duty is on the final product.

Tata Consultancy Services v. State of AP[22] is one of the most important decisions in this connection. Variava J. held that property, with reference to 'goods' cannot be taken in a narrow sense. Variava J. held, *"In India the test, to determine whether a property is "goods", for purposes of sales tax, is not whether the property is tangible or intangible or incorporeal. The test is whether the concerned item is capable of abstraction, consumption and use and whether it can be transmitted, transferred, delivered, stored, possessed etc."* In sum, all movable property, except an actionable claim or money, is 'goods', corporeal or incorporeal, provided it satisfies the above tests. This was the definition applied in *BSNL*.

Ruma Pal J. in TCS held that EM waves are not goods because they are "are neither abstracted nor are they consumed in the sense that they are not extinguished by their user... "They are not delivered, stored or possessed. Nor are they marketable. They are merely the medium of communication. What is transmitted is not an electromagnetic wave but the signal through such means." The second reason, which to her was more 'basic', was that a subscriber could not have intended to acquire a right to use EM waves. It is submitted that the first reason is incorrect, and the second irrelevant.

Applying the criteria laid down in *TCS*, EM waves are clearly goods, since they can be transmitted[23] and transferred.[24] The ability of a good to be abstracted

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[21] (2001) 4 S.C.C. 593.

[22] Tata Consultancy Services v. State of A.P., (2005) 1 S.C.C. 308 [hereinafter *TCS*]. The question before the Court was whether branded and unbranded software constituted 'goods', and whether sales tax could be levied on their 'sale'. The Court held that the tax could be levied.

[23] "The *propagation of electromagnetic waves* depends upon the properties of the wave and the environment. Radio wave is propagated from the transmitting to the receiving antenna. In a radio system, an electromagnetic wave travels from the transmitter to the receiver." *cited from* K.M. VERGHESE, FUNDAMENTALS OF PHYSICS 221(1993).

[24] "An electromagnetic wave consists of gamma rays, X-rays, UV rays, Infra red rays and radio waves. *A signal emitted by an antenna from a certain point can be received at another point in two ways.* One known as *ground wave* travels along the surface of the earth. The other is *sky wave* which is reflected back by the ionosphere. The ground wave attenuation increases with frequency so that transmission via ground wave is possible for frequencies upto 1300 Hz (ë= 200m). Above this frequency communication is possible by sky wave only. These two regions are called medium

or consumed is only a sufficient condition to satisfy the test, but it is not a necessary condition. In other words, the mere fact that something cannot be 'abstracted' need not be determinative of its nature as a good—it may fall within that classification because it fulfills another, independent limb of the *TCS* test, of which transmission is one.

The test to determine whether an object is a good cannot depend on the function it performs in a particular case- it must be an objective test. *Sunrise Associates* seems to suggest this.[25] Moreover, it is absurd to adopt a subjective test for goods, since that would mean that a transfer of a cell phone by A to B is a sale but is not to C. Further, the line of cases noted here is united in one effort- identifying a set of conditions which an entity would have to fulfill to be considered a good. Tests like abstraction and consumption can certainly not depend on party intention. If, at any time, the object is capable of objectively satisfying *any* of the tests laid down in *TCS* in any manner, it is a good for all purposes. However, we must remember that the question here relates to whether the object is a good specifically for the purpose of incidence of sales tax. Merely because an object has fulfilled one or more limbs of the objective test and can be classified as a good, one cannot conclude that it is liable to sales tax in all such respects. There is a difference between 'goods' and 'sale of goods' and not all transactions involving goods are chargeable to sales tax. At times, goods are part of a larger, indivisible service contract- that, however, does not alter the fact that they are goods. Thus, Ruma Pal J. erred in not applying the definition she approved.

Ironically, Ruma Pal J. reverts to the objective test when examining whether the 'sale' of SIM cards can be taxed. Ruma Pal J. correctly holds that a Court cannot finally opine on the issue of 'what a SIM card represents'. "*If the SIM Card is not sold by the assessee to the subscribers but is merely part of the services rendered by the service providers, then a SIM card cannot be charged separately to sales tax. It would depend ultimately upon the intention of the parties. If the parties intended that the SIM card would be a separate object of sale, it would be open to the Sales Tax Authorities to levy sales tax thereon.*" This, it is submitted, is the correct test to apply- objectively determine whether 'X' is a good, and then determine with reference to intention whether a transaction involving 'X' is a sale

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wave and short wave bands. Beyond a certain frequency (above 40 MHz) the ionosphere bends any incident electromagnetic radiation but does not reflect it back to the earth. Since television signals have frequencies in the range 100-200 mhz range- transmission by sky wave is not possible. ***Reception is possible*** only if the receiver antenna directly intercepts the signals." ***Ibid.*** at 322.

[25] ***See supra*** note 20 and discussion leading thereto.

or not. Thus, while a SIM card is clearly a good- applying the tests in *TCS* or *Associated Cement* as to a physical object, it does not follow that there is a 'sale of goods'—it may be that the transaction can best be described as a provision of services, where the transfer of a SIM card to the user is the first step to initiate the provision of the service.

In sum, it is submitted that *BSNL* was incorrect as to whether EM waves constitute goods, but appropriately decided the question of SIM cards.

In this regard, it is pertinent to note another aspect of State of UP. It held that the telephone service of "allotment of number, installation of an instrument/ apparatus and other appliances at the premises of a subscriber" is a good. BSNL overrules this ruling.[26] This, it is submitted, is incorrect, for the same reasons outlined above- the test must be objective, and hence the telephone instrument and other appliances are 'goods', which are not necessarily subject to sales tax.

III. Is There a Transfer of the Right to Use SIM Cards or EM Waves?

Article 366(29A)(d) uses the phrase, 'a transfer of the right to use any goods for any purpose'. In this section, we will assume first that EM waves are goods, and secondly, that SIM cards are goods, and proceed to examine whether *BSNL* was correct in holding that there was no transfer of the right to use them.

In *20th Century Finance v. State of Maharashtra*,[27] the Supreme Court held that clause (d) does not require delivery to the transferee. "*What is required is that the goods should be in existence so that they may be used*". The obvious reason for holding that the goods must be in existence is to ensure that the right to use can actually be exercised by the transferee. This was confirmed in *Andhra Pradesh v. Rastriya Ispat Nigam Ltd.*[28] However, *State of UP* held that the right to use the telegraph had in fact been transferred to the service providers, stating, "*providing telephone service by the DoT which comprises of allotment of number, installation of an instrument/apparatus and other appliances at the premises of a subscriber, which are connected with a telephone line to the area exchange to*

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[26] *BSNL*, at ¶ 65.

[27] 20th Century Finance v. State of Maharashtra, (2000) 6 S.C.C. 12 [hereinafter 20th Century Finance].

[28] "*The effective control of the machinery even while the machinery was in use of the contractor was that of the respondent Company; the contractor was not free to make use of the machinery.*" (2003) 3 S.C.C. 214.

enable him to have access to the whole system... [Falls] *within the meaning of 'the transfer of the right to use any goods".*

In *BSNL*, Ruma Pal J. doubted that *20th Century Finance* is authority for the proposition that delivery is not a *sine qua non* of the transfer of right, pointing out that the majority in that case, which was in fact considering the question of situs, emphasized that the goods must be in *existence*. This led Ruma Pal J. to conclude that the 'essence of the right' under Art. 366(29A)(d) relates to 'use of goods', which required that the goods must be available and capable of delivery, at the time of execution of the transfer agreement. *20th Century Finance* did hold that the locus of the deemed sale is the place where the right to use the goods is transferred.

One other observation in 20th Century Finance is germane to the BSNL ruling. "What is required is that the goods should be in existence so that they may be used. And further contract in respect thereof is also required to be executed."[29] [Emphasis ours]. There are two possible interpretations of the latter part of the statement: (a) that the parties must intend and contract to transfer the right 'in respect of the goods' or (b) that the right must be transferred as a result of, or incidental to, an executed contract in respect of the goods. It is submitted that the second interpretation is preferred, since intention of parties is irrelevant where one of the clauses of Article 366(29A) is attracted. If this is not true, the object of the 46th Amendment will be defeated, which was to bring transactions admittedly lacking the consensual element of sale within the purview of sales tax.

Hence, in sum, a transfer of right requires the existence of deliverable goods at the time of the execution of the agreement, and effective control must be transferred to the transferee. These principles were applied to both EM waves and SIM cards.

A. Is the Right to Use EM Waves Transferred to the Subscriber?

Assuming that, as we have argued, EM waves are goods, it would follow that they can be taxed if they are sold. However, it is clear that a subscriber does not intend to purchase EM waves, or the right to use them, while procuring a connection. Applying *Gannon Dunkerley* then, there is no sale. *This* is where the 'second reason' given by Ruma Pal J. is relevant—*at the point of determining sale.* Since there is no sale, the State has to now rely on the second option of proving a deemed sale by showing a transfer of right to use, which is the subject of the present section.

[29] 20th Century Finance v. State of Maharashtra, (2000) 6 S.C.C. 12.

In *BSNL*, the service providers argued that there was no transfer of control or equipments at any stage since the service providers provided merely a means of communication. The argument was that only the sounds of the message or signals, generated by the subscribers themselves, were transferred, Ruma Pal J. held, "*if there are no deliverable goods in existence as in this case, there is no transfer of use at all. Providing access or telephone connection does not put the subscriber in possession of the electromagnetic waves any more than a toll collector puts a road or bridge into the possession of the toll payer by lifting a toll gate.*" Notwithstanding that Ruma Pal J. herself noted that possession is not a *condition sine qua non*, there is a more basic flaw with the argument. At no point in time does the subscriber acquire 'control' over EM waves, as required by *Rastriya Ispat*. Control means 'to exercise a directing, restraining, or governing influence over'.[30] The subscriber does not acquire any such right over EM waves. It is untenable to argue that the service provider transfers the right to use EM waves to millions of subscribers, and then uses those EM waves to provide connectivity for the subscribers. It is clear that there is there is no transfer of the right to use EM waves.

B. Is the Right to Use a SIM Card Transferred to the Subscriber?

This is a more complex issue. *BSNL* held that sales tax could not be levied on the rental and activation charges of a SIM, if it was provided as part of a composite service, which would be determined by contractual intention. While this is correct as to whether there is a 'sale' of a SIM card, it ignores the more complex issue of whether the right to use the SIM is transferred to the subscriber. If so, intention becomes irrelevant and Article 366(29A)(d) is attracted.

At first glance, it seems a plausible argument, since the subscriber pays for the SIM Card, and is obliged to return it when he terminates his connection. *Escotel* approved this argument. However, it is still submitted that there is no transfer of the right to use a SIM Card, for the following reasons:

In *Anraj*, it was argued that there is no transfer of the right to participate in a lottery draw through the sale of a lottery ticket, since the right arises *after* the ticket is sold to the ticket holder. The dealer has no right to participate in the draw. Since it is conceptually impossible to transfer a right that one does not have, it was argued that there was no transfer of the right. This was rejected with hesitation by Mukharji J., for the wholly irrelevant reason that one of the parties involved in the contract was a State Government, and that due leeway must be

[30] A.W. READ ET AL., THE NEW INTERNATIONAL WEBSTER'S DICTIONARY OF THE ENGLISH LANGUAGE 284 (1998).

accorded to it. The Court seemed inclined to accept this argument in *Sunrise*, but decided the case on other points. This argument, with modification, can establish that there is no transfer of the right to use a SIM card.

In *BSNL*, it was argued that the service providers merely import the SIM cards and sell it to franchisees, and that consequently there is no sale from the service provider to the subscriber. Even if this is factually accurate, the contract is still between the service provider and the subscriber- a franchisee is an agent, and a principal-agent relationship subsists, with power to bind.[31] Though *BSNL* did not finally decide this point, it is submitted that the right to use a SIM card actually connotes the right to use an activated SIM card. Now, it is obvious that the service provider could not have used *its own SIM card*, by *registering with itself*. The right to use the SIM card can conceptually belong only outside the provider of the SIM card. Hence, the question of the service provider transferring a right does not arise, since it did not have the right in the first place. It is therefore submitted that there is no transfer of the right to use a SIM card.

BSNL overruled *Escotel* for relying on the 'aspects' doctrine and including the cost of service in the sales tax. Further, it is submitted that *Escotel* was also incorrect because it overlooked the fact that there cannot be a transfer of the right to use a SIM card. *BSNL* also held that the cost of service cannot be included in the sale, and vice versa, which, it is submitted, is correct.

III. Conclusion

In conclusion, *BSNL* held that (a) It is not permissible to divide the mobile phone transaction unless it falls within Article 366(29A); (b) EM waves are not goods; (c) *State of UP* was incorrect in holding that the telephone system is a good; (d) There is no transfer of right to use EM waves; (e) There is no sale of a SIM card; (f) The SIM rental may be taxed only if the parties intended to have separate transactions; (g) In any event, the value of service cannot be included in assessing sales tax and vice versa. Of these, it is submitted that conclusions (b) and (c) require reconsideration, and that additionally, there is no transfer of the right to use a SIM either. At the most basic level, sales tax cannot be levied since neither of the two tests highlighted in the introductory section of this note is satisfied- no sale occurs, and there is no transfer of the right to use either EM waves or SIM cards.

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[31] G.H. Treitel, The Law of Contract 655 (10th ed., 1999); E.H. Brousseau & J.M. Glachant, The Economics of Contracts: Theories and Applications 285 (2002); R. Stone, Law of Agency 69 (1996).