CHAPTER 3

Sale of Goods Act

3.1 Relevance to GST

Contract of sale is also formed and interpreted in every way as a contract that is not for sale. Law on sale of goods cannot be applied to 'services'. But the eight (8) forms of supply listed in section 7(1)(*a*) of Central GST Act, are expressed in a manner that it applies to 'goods'. For purposes of understanding these forms of supply *qua* services, it is sufficient to supplant 'object of contract' from goods with services to examine the treatment applicable. Sale, Benjamin defined to be, a transfer of the absolute or general property in a thing for a price in money. And such a sale is just one of the eight forms that supply takes. Without knowing sale incisively, the understanding about the other forms of supply, can hardly be satisfactory.

Example (198): Supply of service of repairing an equipment being supply of skill of the Supplier that is non-reusable by Recipient, it is not a lease but a license.

Example (199): Supply of service of training in repair of equipment being supply of skill of the Supplier that is reusable by Recipient, it is not lease.

Uniformity of tariff classification applicable to supply of goods and services undermines deep study into their differences. But when it comes to disputes about valuation of supply of services, then these differences greatly assist the cause of defence to challenge instances put forward by Revenue as comparable. No such deep study will be complete without considering works by Pollock and Benjamin on this subject.

It may be of interest to mention that Sale of Goods Act was located in sections 76 to 123 of Indian Contract Act until it came to be relocated. For this reason, entire body of earlier deliberations on Contract law are relied upon extensively here and expected to be considered subconsciously while considering ensuring deliberations on Sale of Goods Act.

3.2 Object of sale

3.2.1 Goods

Law contained in Sale of Goods Act does not relate to immovable property or services. And to come within the scope and operation of this law requires that the 'object of contract' (discussed earlier) be goods and the transaction a sale (discussed later).

> *Section 2(7) "goods" means every kind of movable property other than actionable claims and money; and includes stock and shares, growing crops, grass, and things attached to or forming part of the land which are agreed to be severed before sale or under the contract of sale;*

Note that the definition is exhaustive as well as illustrative. And actionable claims are excluded, and stocks and shares are included in the definition, contrary to section 2(52) of Central GST Act.

Exclusion of actionable claims renders the statute and deliberations about its interpretation inapplicable. But for limited purposes of GST, actionable claims must be extended the full force of the prevailing jurisprudence.

Standing crop is not the same as growing crop. While both are attached to the earth and hence, immovable, standing crop is that which has ceased its dependence on land on which it stands and derives its nourishment unlike growing crop. Standing crop has completed growing and ready to be severed and made movable property, that is, goods. Growing crop is still dependent and continues growing until its dependence on land is not to grow any further but to remain on it. Understanding this aspect is of great importance for purposes of this and GST law.

Due to the presence of 'comma' before *"and things…."*, growing crop and grass have been excluded from qualification by the words that follow, that is, *"which are agreed to be severed before sale or under the contract of sale"*. Contrast this with the definition in section 2(52) of Central GST Act and the difference jumps out – 'comma' before *"and things…."*, is deleted by Legislature.

> *Section 2(52) "goods" means every kind of movable property other than money and securities but includes actionable claim, growing crops, grass and things attached to or forming part of the land which are agreed to be severed before supply or under a contract of supply;*

Words of qualification – which are agreed to be severed before sale or under the contract of sale – do not touch classes that are before the comma because comma separates the classes to which the words of qualification is meant to affect. Therefore, all things that are attached but agreed to be detached will

also be goods for purpose of GST and the others – actionable claims, growing crop and grass – are goods even when there is no agreement to severe them from the land. This is correct application of words of qualification and can be more completely appreciated along with deliberation about immovable property (discussed later).

3.2.2 Future goods

Existing goods that are yet to be appropriated to the contract of sale are not future goods. Goods that are not yet in existence but taken up for negotiations in anticipation of their production for appropriation are future goods.

> *"Section 2(6) "future goods" means goods to be manufactured or produced or acquired by the seller after the making of the contract of sale;"*

Contracts can be entered into in respect of future goods provided acknowledgement of their non-existence is not made. If it is acknowledged that the object of this contract is future goods, then the contract is *non est*. Parties cannot be said to agree about a thing that does not exist. Parties, without referring to its non-existence, may enter into a contract on the assertion by Seller that they exist and will be ready before the date due for their delivery. Contracts may be entered into in respect of existing goods but by the due date of delivery new stock of identical goods may be produced and ready for appropriation.

Contracts of sale, especially, of custom-built articles cannot be negotiated *in vacuuo* and customs of trade expose their non-existence and defeat the contract. For this reason, it is necessary to grasp the implications of future goods forming object of negotiations as being goods not in existence than merely being in existence pending appropriation. As such, these will be contract for works.

> *Example (200): Contract to sell a cruise ship cannot be a contract of sale because the specifications are so unique that once it is built, it is to be one-of-a-kind and hence, cannot already exist to be a sale simplicitor and this contract is something more.*
>
> *Example (201): Contract for sale of laptop could well be contract of sale even if inventory with the OEM is NIL.*

Forward contracts with intent to deliver goods are mere promises *in praesenti* since the object of contract (goods) are not yet in existence. But forward contracts without intent to deliver, will be valid as they are contract involving 'securities' being derivatives (discussed later).

3.2.3 Ascertained Goods

Goods set apart for delivery to a Customer cannot be diverted to another Customer with earlier delivery date. Setting apart is not linking Customers to

available inventory in an irreversible manner. Ascertainment is such 'setting apart' but this does pre-empt 'passing of title' (discussed later).

Offer whose acceptance brings about a binding contract of sale will be of existing goods even if unascertained. Ascertainment does not pass risks to Acceptor (Promisee) unless appropriated as per terms of sale. Sale *in praesenti* can be entered into of goods in existence even if not ascertained from common stock. Unascertained goods does not mean future goods.

3.2.4 Merchantability

Fit-for-purpose refers to the purpose for which the goods are designed and produced. Goods meeting the purpose of their design and declared end-use are goods of merchantable quality. Whether the goods are fit-for-purpose is decided by the trade and the stated purpose in that trade. Where goods are custom-built then the purpose must be defined in such arrangement.

Goods that are unfit-for-purpose cannot be identified as those goods but some other goods such as scrap or something else but not the identity with which those that are fit-for-purpose.

> *Example (202): Expired medicines being returned to manufacturer are not medicines. Identity flows from implied merchantable quality or fit-for-purpose attribute of those goods.*

Contract of sale using certain description for the object of sale bears an implied warranty that goods, if they are asserted by Seller to meet their description, will be fit-for-purpose. Sale is complete on delivery and goods delivered are fit-for-purpose is implicit in delivery. And on inspection if they are found unfit-for-purpose, the sale is void *ab initio*. Declarations cannot be collected every time delivery is attempted. Delivery proceeds on an understanding or expectation that Seller will ensure that only fit-for-purpose stocks are delivered subject to risk of failure during inspection and voiding contract. Assumption about completion of sale stands impeached by discovery of failure of fit-for-purpose warranty. Any tax treatment extended due to this assumption is liable to be reversed on discovery of failure.

Fit-for-purpose is evidence of consensus *ad idem* test of valid contract. And this consensus is necessary to locate the 'object of contract' and that which enjoys consensus must be the object.

> *Example (203): Contract for healthcare services cannot be for sale of prosthetics although price-longevity-benefits aspects may be discussed and approved by Patient, yet object is not for sale of goods.*

Example (204): Contract for supply of items of food preserved in sugar syrup or in vacuum sealed container bearing MRP label and presented as if fit-for-redistribution is contract of sale of goods.

*Example (205): Contract for supply of items of food bearing declaration (*i*) no preservatives added (*ii*) best to consume within three (3) days (*iii*) contains milk, will curdle (*iv*) MRP label not applicable (*v*) quantity when packed.....grams and non-standard quantities suited for consumption in one occasion (*vi*) handle unsealed package with care, fit for reuse and may be recycled, contraindicates identity as goods.*

Example (206): Old newspaper is NOT newspaper since it is not current and hence, not fit-for-purpose as newspaper.

Example (207): Old motor vehicle is still motor vehicle since it is fit-for-purpose as such.

Where merchantability is in doubt, HSN code of merchantable quality of goods cannot be applied. And when the object of contract of sale is not goods, then it will be a contract for supply of services in GST.

3.2.5 Condition

Sale may be absolute or conditional. Condition cannot be tendering of consideration by Promisee (Buyer). Conditions are not conforming to description or sample. Condition are those which furnish occasion to constitute a sale. Conditions may be:

(*a*) conditions precedent where sale does not arise unless conditions are fulfilled;

(*b*) conditions concurrent which are to be shown to be fulfilled at time of passing title; or

(*c*) conditions subsequent where sale is concluded by Seller in anticipation that conditions will be subsequently fulfilled.

Example (208): Perfecting title by Seller before conferring title to Buyer is condition precedent.

Example (209): Sale of equipment subject to installation and testing is conditional sale where the condition is subsequent to sale.

Example (210): Works contractor's bills being 'subject to' approval of works completed by Project Engineer is NOT a conditional sale. Approval of works is determination of completion.

Conditional sales are necessary because this law is 'law of merchants' that is codified and necessities of trade demand that in certain instances, conclusion of sale be delayed until conditions precedent are fulfilled and in other instances, conclusion of sale NOT be delayed pending fulfilment of

conditions subsequent. Reference may be had to sections 51 to 58 of Contract law on the contours of these conditions.

Failure of conditions denies the sale, even if concluded already. Failure is not rejection because rejection implies subjective examination with description or sample. Failure goes to the root of the transaction and leaves the transactions *non est*. Condition is central and substantive to the sale itself.

3.2.6 Warranty

Continuation of assertions made at the time of sale that are essential to satisfaction of sale during the agreed tenure such as fit-for-purpose, title, time as essence (or not) for performance, measure of performance, payment, credit period and interest, liquidated damages, non-fatal breach and waiver, etc. are warranties by seller.

> *"Section 14. Implied undertaking as to title, etc.—In a contract of sale, unless the circumstances of the contract are such as to show a different intention, there is—*
>
> *(a) an implied condition on the part of the seller that, in the case of a sale, he has a right to sell the goods and that, in the case of an agreement to sell, he will have a right to sell the goods at the time when the property is to pass;*
>
> *(b) an implied warranty that the buyer shall have and enjoy quiet possession of the goods;*
>
> *(c) an implied warranty that the goods shall be free from any charge or encumbrance in favour of any third party not declared or known to the buyer before or at the time when the contract is made."*

Terms of contract containing warranty is a good indicator of the object of contract. It can be seen in *Kone Elevators India (P.) Ltd.* v. *State of TN* [2014] 45 taxmann.com 150 (SC), that whether the object of contract was sale *simplicitor* or works contract was not categorically decided by Apex Court but left be determined based on the terms of each contract and its stipulations. This decision appears to be indecisive but shows great discernment in leaving room for play based on stipulations in each contract to guide the object of said contract and procure the tax treatment.

3.2.7 Condition as warranty

Non-fatal breach or fatal breach waived by Promisee can result in saving the contract and the Parties from re-tendering and to accept the variation caused by these events. It is provided in section 13 to treat a condition as a warranty not to dilute the rigours of performance in future but avoid repudiation of contract and save executed portion of the contract.