

Concept of 'penultimate sale' - aspects emerging from judicial scrutiny

Date : October 01 2015



Puneet Bansal, Managing Partner, Nitya Tax Associates



Kulraj Ashpnani, Associate Partner

"I'm like a fine wine. I get better with age. The best is yet to come."

Richelle Mead

The above quote holds so true in the context of certain age-old concepts under the Indian tax laws. These concepts have witnessed a plethora of litigation and are still evolving. One such instance is the concept of penultimate sale under the sales tax law.

The concept of penultimate sale was introduced effective April 1, 1976 after an uproar by small manufacturers who were unable to export their produce themselves because of regulatory restrictions or commercial limitations. These manufacturers sold their produce to state corporations/ agencies for onward export. Such sales by manufacturers were not treated as in the course of export and subject to sales tax by the tax authorities. This led to an increase in the price of the export goods. With the noble objective of exporting goods and 'not taxes', the Government introduced Section 5(3) in the Central Sales Tax Act, 1956 ('CST Act').

Section 5(3) exempted the last sale (commonly known as 'penultimate sale') preceding the exports, from levy of sales tax. This was subject to condition that such sale was to comply with the export order. This exemption is granted based on provision of statutory declaration in Form H by the exporter to the taxpayer. So if A is an exporter of goods and buys goods from B to fulfill the export order, the sales made by B to A will not be subject to sales tax.

Though the law makers had all good intentions in enacting this provision, the issue of 'penultimate sale' has been a subject matter of litigation for so many decades. In this article, we have listed the following key issues on penultimate sales which have been a subject matter of judicial scrutiny in the past:

Those goods: Section 5(3) of the CST Act uses the phrase 'those goods'. Literally, it means that the exemption is available only if the same goods (as purchased by the exporter) are exported.

The issue that is often debated is whether the goods subject to processing (after purchase) and then exported, will be eligible for penultimate sale exemption. The authorities try to apply 'same goods theory' to deny the exemption. The Courts have held that it needs to be seen from the eyes of those dealing in the commodity and whether the processed commodity is regarded as distinct in character and identity from the original commodity in commercial parlance. Thus, where shrimps, prawns and lobsters were subject to cutting, peeling, cleaning etc., it was held that they retain the same character and identity as original shrimps, prawns and lobsters and the exemption of penultimate sale was granted by the Supreme Court (*Sterling Foods*).

'Those goods' issue did not rest there. Another issue came up before the Constitution Bench of Supreme Court (*Azad Coach Builders*) wherein the taxpayer was fabricating bus body on the chassis supplied by the exporter. The exported product was bus. The taxpayer contended that sale of bus bodies to exporter was penultimate sale. The tax authorities rejected the taxpayer's contention on the ground that bus body and bus are completely different commodity and the same goods have not been exported. Supreme Court rejected the 'same goods theory' adopted by the tax authorities and held that it what has to be seen is whether there is an

inextricable link between the sale and export. In this case, as the sale was inextricably linked with the export, the Court granted the exemption of penultimate sale.

- **Pre-existing export order:** The existence of a pre-existing export order to sell the specific goods to a foreign buyer is a *sine qua non* for a penultimate sale transaction. In other words, the sale from the taxpayer to exporter must take place after the agreement with the foreign buyer is entered into and the exporter does not have right to divert such goods. The rationale seems to be that there must be an inextricable link between the last purchase and the exports, which is the principle laid down by the Supreme Court (*Azad Coach Builders*).
- **Procurements by branch of exporter:** An interesting issue that arises is whether the procurement by branch of exporter would qualify for the exemption of penultimate sale where the exports are made by head office of the exporter. Recently, Madras High Court (*PVC Leathers, Paper Mills Private Limited vs. the State of Tamil Nadu*) has held that the exemption under Section 5(3) of the CST Act will be allowed even if the purchases are made by branch as long as the procurement is inextricably connected with the export and the export is made by head office.
- **Transactions preceding penultimate sale:** Another related question before the Courts has been whether a transaction preceding penultimate sale (i.e. the second last transaction preceding export) can also be treated as penultimate sale. It has been argued that such transaction was also in the course of exports and deserves exemption (or the similar treatment as penultimate sale), the Courts have held that exemption is restricted only to the last leg of sale preceding exports, and the dealer selling goods to an exporter cannot claim exemption for the purchases made by him.
- **Intra-state sale also considered as penultimate sale:** The exemption under Section 5(3) of the CST Act is not limited to inter-state sales only and even the intra-state sales are eligible for exemption. The language of Section 5(3) does not contain any restriction on the nature of sale. In the Trade Circular dated May 30, 2005, the Maharashtra Sales Tax Commissioner has clarified that intra-state purchases preceding the export transactions will be covered under Section 5(3) of the CST Act.

The above list is illustrative and not exhaustive. Being a conditional exemption which can reduce the tax burden on an exporter, it is essential that the taxpayers keep the above issues in mind before executing a penultimate sale transaction.

With Goods & Service Tax ('GST') likely to see the light of the day in India soon, this concept may still have its utility. In the GST regime, there is likely to be 1% additional tax on inter-state supply of goods. Only the time will tell whether in GST regime, the government will exempt 1% tax on penultimate sale or exempt / zero rate these sales.