EXPORT, IMPORT AND INTER-STATE SALES— A STUDY IN TAX LAW

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DECLARATION

I do hereby declare that this thesis entitled **"Export, Import and Inter-State Sales - A Study in Tax Law"** has not previously formed the basis of award of any degree, diploma, associateship, fellowship or other similar title or recognition. This research has been carried out by me under the guidance and supervision of Dr.N.S.Chandrasekharan, Reader, Department of Law, Cochin University of Science and Technology.

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CERTIFICATE

This is to certify that this thesis entitled **"Export, Import and Inter-State Sales - A Study in Tax Law"** submitted by Shri Muhamed Kutty, K.B. for the Degree of Doctor of Philosophy is the record of bona fide research carried out by him under my guidance and supervision in the Department of Law, Cochin University of Science and Technology. This thesis or any part thereof has not previously formed the basis of the award of any degree or other similar title or recognition.

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PREFACE

This is a study in sales tax law, a study on the triple concept of export, import and inter-State sales. It is in seventeen chapters spread in five parts. The introductory is an overview. It presents the thematic thrust of what follows. Part two deals with incidence of sales tax on export and import and the scope of exemption. Part three focuses attention on the various dimensions of the problem of inter-State sale. Part four is an inquiry into parliamentary control on taxes over sales and purchases and highlights inter-State and intra-State implications of discriminatory tax. Part five contains the results of empirical study and the general conclusions of the thesis. In the past no attempt has been made to analyse on identical lines the problems dealt with in this thesis. Obviously this work is original; references to other authors are made only to support the string of views evolved in this thesis.

In my work I have been benefited by the advice and assistance from many. Dr.N.S.Chandrasekharan, Reader, Department of Law, Cochin University of Science and Technology, my supervisor, is the first among them.

Prof.P.Leelakrishnan, Head of the Department of Law, Cochin University of Science and Technology, is the next. I express my gratitude to them. Other members of the faculty and research scholars, especially Mr.M.C.Pramodan, have always been extending their helping hand. I have also been benefited by frequent discussions I had with the high echelons of sales tax administration. The respondents to my questionnaire also deserve mentioning in this context. The personnel of many a library in and out of Cochin were also of great help to me. The librarians of the Kerala High Court Library, the Kerala Advocate General's Library, the Government Law College Library, Ernakulam, the Kerala University Library, Trivandrum and the Cochin University Main Library, Applied Economics Library, Management Studies Library and the Law Faculty Library, were helpful in many respects. Mr.Sasi neatly typed the script. I must thank all of them.

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PART I

INTRODUCTORY

Chapter I

INTRODUCTION

Two things are certain in human life; death and taxes. Death is as old as man himself. How old is tax? The story of taxation is shrouded in the mist of history.[1] In ancient times the needs of the public were simple and limited. These needs were met by voluntary offerings to the ruler and by proceeds from properties confiscated during war. As time went on, these sources of revenue diminished. A legal compulsion was imposed on the subject to pay for the State expenses. One finds the embryo of taxation in the process.

A tax is, says the Supreme Court, a compulsory exaction of money by public authority for public purpose enforceable by law.[2] Several kinds of taxes came into being. Sales tax was one. An impost similar to sales tax existed in ancient India.[3] A tax of one per cent was levied in ancient Rome on sales.[4] Sales tax was levied in one form or the other in Egypt

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1. A.K.Chawla, Constitutional Study of Sales Tax Legislation in India, p.1, (1973).
2. Commissioner H.R.E. v. Lakshmendra, A.I.R. 1954 S.C. 282 at 295 and Hingir Rampur Coal Co. v. State of Orissa, A.I.R. 1961 S.C. 459 at 464. For a discussion on the distinction between tax and fee, see V.K.Sushakumari, Law of Taxation, p.9, (1979); K.R.Udayabhanu, "Tax Fee Distinction: An Exegensis", [1973] 1 M.L.J. Jour.10.
3. A.K.Chawla, op.cit., p.1.
4. C.V.Mahalingam, "A Historical Sketch of Sales Tax" (1953) 4 S.T.C. (Notes) 28. See also M.C.Purohit, Sales Taxation in India, Chap.II, (1975).

and Rome and was noted as old as pyramids of Egypt.[5] Confucius opposed its imposition in China.[6] Sales tax in its modern form came to the forefront immediately after the Second World War. It was introduced to tide over the post-war financial crisis. In Germany, France and U.S. sales tax was in vogue during this period.[7]

The inauguration of modern welfare State quickened the process of taxation. Myriads of public schemes justify taxation imposed on a person from his cradle to the grave. The increase in the functions of the State compels the governments of the time to augment revenue from all possible sources.[8] Sales tax in its modern form was imposed in India when a federal structure was envisaged by the Government of India Act 1935. It was to increase the coffers of the Provinces that this system of tax was devised. To begin with it was a selective tax on sales of tobacco, motor spirits and lubricants.[9] The first State in India to introduce a selective sales tax was the Province of Bombay. A system of tax on sales of all goods, known as general sales tax, was introduced for the first time in the Province of Madras.[10] Now sales tax is levied all over India.

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5. P.Leelakrishnan, "Best Judgment in Sales Tax Assessment", [1970] 1 M.L.J.Jour. 41.
6. K.K.Singh, Central Sales Tax Laws, Vol.1, p.1, (1984).
7. S.N.Dokania, The Central Sales Tax Act, p.vii, (1985).
8. The important sources of revenue are income tax, wealth tax, gift tax, estate duty, customs duty, excise duty, property taxes, octroi, municipal taxes, agricultural income tax and sales tax.
9. The taxes were introduced by the Bombay Tobacco (Amendment) Act 1938, and the C.P. and Berar Sales of Motor Spirit and Lubricants Taxation Act 1938. See A.K.Chawla, op.cit., p.1.
10. The general levy was introduced by the Madras General Sales Tax Act, 1939.

Sales tax is a tax levied when goods are either sold or purchased. It is a tax on the proceeds of sale or purchase. The tax is levied on and collected from the seller or the purchaser. In fact sales tax is a tax on a single transaction: sale and purchase are merely two sides of the same coin. The only difference is that sales tax is levied on the seller while purchase tax is levied on the buyer. The buyer may be a manufacturer or last purchaser within the State effecting sale to outside the State. Whether the tax is collected from the seller or buyer, its ultimate burden or incidence falls on the consuming public. The reason is that the tax element is added to the price, tax being an addition to the cost.

Sales tax is a regressive tax. The burden is more on the poor than on the rich. Income tax, on the other hand, is a progressive tax; the rate of levy rises with the income. Sales tax is also called an indirect tax in contradistinction to direct tax. Its incidence is passed on to the consumer. The consumer is not often conscious of its rigour as the tax element is assimilated into the price. The oppressive nature of sales tax levy was projected as early as in 1790 by a U.S. legislator when he remarked that a time would come when the poor man would not be able to wash his shirt without paying a tax.[11] This sarcastic criticism proved to be a prophecy in our country where a cake of washing soap is taxed as a luxury.[12]

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11. E.R.A.Seligman, Essays in Taxation, p.8, (1969).
12. K.B.Mohamed Kutty, "Tax and the Consumer",in P.Leelakrishnan (ed.), Consumer Protection and Legal Control, p.315, (1984).

The coverage of taxation on sale could be far and wide. The net can be extensively spread.[13] It is possible to tax sales outside the State applying the 'nexus' theory.[14] It is possible to impose tax on export sale or import purchase. When goods are sold to a dealer or consumer and the goods move, as a result, only within the limits of a State, intra-State sales tax or local sales tax could be imposed. When goods are sold and in pursuance of that sale the goods are moved from one State to another, inter-State sales tax can be imposed. Under the scheme of the Indian Constitution, State is tabooed from levying tax on sale that takes place outside the State.[15] The Constitution prohibits tax on sale or purchase of goods in the course of import and export.[16] While the State is empowered to tax intra-State sale or purchase,[17] the Centre is authorised to tax inter-State transactions.[18] The constitutional provisions of tax immunity to export-import trade and the provision for taxation of inter-State transaction[19] raise enormous problems in their application and working.

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13. The yield from sales tax is now a major source of revenue for the States. Sanatan Mohanty, "Substitution of Sales Tax by Additional, Central Excise Duties: Some Issues", in K.N.Subrahmanya et al., (ed.), Taxation and Centre-State Financial Relations, p.96, (1983).
14. See Ch.VIII, infra.
15. Article 286(1)(a). For text see, Appendix A.
16. Article 286(1)(b). See Appendix A.
17. Constitution of India, Seventh Schedule, List II, Entry 54. It reads: "Taxes on the sale or purchase of goods other than newspapers subject to the provisions of Entry 92-A of List I".
18. Id., List I, Entry 92-A. It reads: "Taxes on the sale or purchase of goods other than newspapers where such sale or purchase takes place in the course of inter-state trade or commerce".
19. Id., Article 296(3).

The word 'export' means 'taking out'. It is derived from a Latin word 'exportare', which means 'to carry out'. The word 'import' means 'bringing in'. It is derived from the Latin word 'importare', which means 'to bring in'.[20] To be precise, "exports are usually defined as sales abroad of a country's goods and service".[21] Import is the converse of export. Importing is the "process of bringing goods from abroad to one's own country for domestic consumption or transformation".[22]

Promotion of export is vital to the economic development of the nation. It is necessary for earning foreign exchange. It is essential for importing the raw materials and securing services absolutely necessary for industrialisation. Export promotion is therefore one of the major aims of the economic policy in India. It is a well acknowledged fact that India is having a tight balance of payment position. "Our foreign exchange reserves", says a recent editorial comment of a national daily, "have tumbled by almost a third in just three months".[23] It is alarming to note that at present a quarter of all export earnings go to pay past debts.[24] Our export earnings are not anywhere near our import needs. A study of India's export policies and of the export performance of 405 private sector companies conducted by the Indian Institute of Public Administration revealed that

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20. R.V.Patel, The Central Sales Tax Act, p.190, (1966).
21. Encyclopaedia Britanica, Vol.8, p.979, (1964).
22. Id., Vol.12, p.124.
23. Indian Express, July 25, 1988 (Cochin).
24. Ibid.

net foreign exchange earnings declined between 1975-76 and 1983-84.[25] The urgent need of the hour is to boost our export so that we can import machinery and raw materials which will help Indian industry to modernise.

Barriers to export promotion are manifold. Apart from giving all sorts of facilities and incentives to exports, there should be quality control and cost control. Exports must be made profitable. The profit from export should be on par with, if not more than that, from sales in the domestic front.[26] Competition in the international market was severe and it continues to be so even now. Price is one of the decisive factors in the competitive international market. In the export trade the incidence of sales tax has far-reaching consequences. A faulty tax system adversely affects the export trade. The Constitution provides techniques to cushion its impact.

Exemption of export sale from tax reduces the price of goods leading to promotion of export in the highly competitive foreign market. Indian traders will be able to sell more goods at competitive prices and earn foreign exchange by promoting export. A tax concession on import, on the other hand,

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25. See, Indian Express, Editorial, March 25, 1988 (Cochin).
26. "Fiscal measures that ensure the overall profitability of exports over domestic sales are also necessary to ensure that the export target is reached". Indian Express, August 16, 1988 (Cochin).

enthuses industrialisation and economic development. What is the constitutional theme of restriction on the power to tax sale or purchase of goods in the course of export and import? To understand the full ramifications of the constitutional scheme, the thesis makes a scrutiny of the deliberations of the founding fathers in the Constituent Assembly.

Provisions in the Constitution are the nuclei for development of the law. Judicial exercises can either enhance or restrict the scope of the law. The question is in what way the judicial pendulum did swing. Did it lean on in the field of immunity from tax on export and import? This can be answered only by a probe into the scope of the concept of export sale or import purchase. Article 286 of the Constitution is the kingpin in this field. The complexities of the phrase 'in the course of' are notorious. The labyrinthine tax law baffles even the best brain. "More than any other branch of municipal law", observes a renowned author, "tax law is open to the reproach of being utterly incomprehensible by the individuals affected, and even frequently by their legal advisers".[27] "Neither justice nor reason", he continues, "has any place in tax law, and many decisions of superior courts are in plain conflict with all sense and reason".[28]

Interpretation by the judiciary on the scope and ambit of the concepts contained in Article 286 needs evaluation

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27. David M.Walker, The Oxford Companion to Law,pp.1207-8, (1980).
28. Ibid.

and assessment. The distinction between a sale 'for the purpos of export' and that 'in the course of export' is an important area in this respect. The distinction between a sale 'in the course of import' and that 'subsequent to the import' is anothe area of interest. Was judiciary consistent in interpreting the constitutional concepts? Necessarily the fluctuations of the judicial holdings are to be examined.

The Sixth Amendment of the Constitution bringing changes in Article 286 was a significant milestone in the history of taxation on sale of goods in the country. In pursuance of this constitutional amendment the Central Sales Tax Act 1956 was passed. This legislation lays down important formulations. One of them relates to the question when a sale or purchase shall be deemed to take place in the course of export or import. How far is this legislative prescription in consonance with the earlier judicial formulation of the norms? It is also to be examined how judiciary later looked at the legislative formulae in the Central Sales Tax Law. A word, it is said, is not a crystal, transparent and unchanged, but it is the skin of a living thought and may vary in colour and content according to the circumstances and the time in which it is used.[29] In interpreting the words 'in the course of' how far the Supreme Court absorbed the significant philosophy and message of the changing mores from time to time?

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29. See observations of Justice Khanna, referring to Justice Holmes, in Manickam & Co. v. State of Tamil Nadu, (1977) 39 S.T.C. 12 (S.C.) at 17.

A series of sales may take place before goods are finally exported outside the country. The transactions prior to the export, i.e., purchases for export or sales to the exporter, may be effected after orders for export are obtained. There may be inextricable connection or inter-dependence between such sales and the final export. In the context of stiff competition in international market in terms of price, impost of levy may well lead to shrinkage of export trade.

Import, like export, is central to the economic life of the country; it is absolutely essential to prepare the country for better industrialisation and export performances in the future. Routing of import and export through intermediaries has created some problems and a fluid state of law.

Taxation of inter-State trade and commerce is a complex area. There are many streams of revenue. Of these sales tax on inter-State transactions generates ticklish problems, not only because the levy impinges on a large number of people, but also because it is fairly well appreciated that sales tax system of one State should not impose an arbitrary burden on the consumer in another State. Experience shows that few taxes have raised so many problems as taxation of inter-State sale. It assumes great significance in a federal set up where the unitary features of the Constitution are given tremendous importance. While control over the intra-State trade and commerce is left over to the State, control

over the inter-State trade and commerce is given to the Central Government. The noble ideal behind this scheme is that there should not be any parochial trade barriers inhibiting free flow of trade throughout the country. Inter-State trade must be unrestricted for the essential unity and oneness of the country. The resources in one part of the country should be available and be of use to the entire nation.[30] It is an undeniable fact that commerce ties the nation strongly together, besides bringing economic uplift to the people. The trading activity of a country is a true barometer of its national economy.

Unless taxation of inter-State sales is properly regulated, this delicate balance may develop unwholesome tendencies. Problem of multiplicity of taxation of the same transaction by different States is one such evil which has to be effectively tackled. In inter-State trade various States may be involved. The parties entering into contract of sale may have places of business in different States. The goods may locate in one State, but property in goods may pass in another State and the delivery of goods may be elsewhere. The early history of taxation on sales reveals a dismal picture. The place of business of the parties, the place where the

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30. "...(T)he cloth manufactured in Bombay, coal quarried in Bihar and the wheat and gram produced in Punjab must be available to the entire inhabitants of India at the same price except as modified by cost of transport". See, note by Thakur Das Bhargava in the Report of the Joint Committee, Constitution 6th Amendment Bill, in Patel, The Central Sales Tax Act, pp.431 and 433, (1966).

goods were located at the time of the contract and the place where the goods were delivered as a result of sale were all treated by the States as providing sufficient nexus to levy the tax. The dominance of territorial nexus theory marks the initial stage. The distinction between a sale within a State and a sale in the course of inter-State trade or commerce was evolved to find a way out of the tangle of multiple taxation on the basis of the nexus theory by different States.

Legislation or judicial interpretation sometimes replaces one set of problems by another. Complete immunity of inter-State sales from levy of tax was one such problem. Rigidities of judicial decisions had to be overcome, adopting the law to changing needs. By the sixth constitutional amendment the power to levy tax on inter-State sale was vested in Parliament. The addition of clause (3) to Article 269 authorised Parliament to formulate the principles to determine when a sale or purchase of goods takes place in the course of inter-State trade or commerce. In pursuance of this power, Parliament passed the Central Sales Tax Act 1956 which is hereafter in this thesis called the Central Act. The expression 'Central Act' should be understood as such unless the context indicates otherwise. The Central Act contains the scheme of taxation of inter-State sale. It defines the concept of inter-State sale. The development of the statutory concept through the judicial process of interpretation is an area of investigation.

A seller may have the head office in one State and branch offices in several States. Goods may be supplied to customers from the branches, goods may move to the branches from the head office. Complex questions arise in such a situation. The main question is whether the transaction involved is inter-State or not. A decision on the question will have a direct impact on the levy of tax and the taxing powers of the Centre. The question of inter-State sale for the purpose of taxation requires to be judged taking into account the commercial significance, and commercial reality and not by a rigid interpretation based on semantics of the language. In the cases brought to the crucible of justice what has been the judicial techniques?

The concept of minimal inter-State barriers of trade and commerce is one of the ethos of the Constitution. Passage of commodities from one part of the country to the other and commercial transactions between different regions is the sine qua non of the unity and growth of the country. The progress of the nation as a whole also presupposes free flow of trade, commerce and intercourse unobstructed by barriers.[31]

Freedom of trade and commerce is guaranteed under part XIII of the Indian Constitution.[32] This part has been

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31. Basu, Introduction to the Constitution of India, p.299, (1982).
32. The problems designed to be solved by the provisions of Part XIII is in essence peculiar to a federal or quasi-federal constitution. It is not germane to a unitary structure. See, M.P.Singh, Freedom of Trade and Commerce in India, p.10, (1985).

criticised as the most badly drafted part. The freedom is not absolute, but limited by many factors. The system of non-discriminatory taxation is one. Article 304(a) permits non-discriminatory tax on goods imported from other States or the Union Territories.

The State Governments in their enthusiasm to collect maximum revenue, may impose the rate of tax of their choice in regard to internal sales. There are certain goods which are of special importance in inter-State trade or commerce. Cereals, coal, iron, steel, oil seeds and pulses are examples. The system of State taxation on such goods will obviously have its impact on inter-State trade and commerce. Hence in respect of such goods of special importance there needs to be a restriction on the State's power to levy sales tax. The Constitution does contain a scheme for this. Article 286(3) authorises Parliament to declare such goods of special importance and to impose restrictions on the levy and the rate of tax. The Central Act declares certain goods under this category and prescribes the restrictions. By this legal mechanism Parliamentary control over States' power to tax local transactions in respect of those declared goods is established. In other words, the power of the State to tax transactions taking place wholly inside a State becomes controlled by the provisions of the Central Act; comparatively lower rate of tax is ensured in respect of those important items of

merchandise. The evolutionary process of these restrictions is to be examined in order to assess the current state of law.

The study in this thesis centres round the above-mentioned aspects of law.

PART II
EXPORT AND IMPORT

Chapter II

EXPORT AND IMPORT: TAX ON SALE OR PURCHASE OF GOODS-- THE CONSTITUTIONAL SCHEME OF PROHIBITION

The Constitution places some restrictions on the power of the State to levy tax on sale or purchase of goods. One of them is that no State shall levy tax on sale or purchase of goods taking place in the course of export or import.[1] The power to levy customs duty on import and export is conferred on the Union.[2] It can make laws in respect of trade and commerce with foreign countries and import and export.[3] The power to define customs frontiers is also within the legislative sphere of the Centre.[4] Comprehensive legislative power in respect of international trade and commerce is thus conferred exclusively on the Union.[5]

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1. Constitution of India, Article 286(1)(b). For the text see Appendix A.
2. Article 246 read with Entry 83 of List I in the Seventh Schedule to the Constitution. Article 246(1) confers on Parliament exclusive power to make laws in respect of matters enumerated in List I in the Seventh Schedule. Entry 83 in List I reads, "Duties of customs including export duties".
3. Constitution of India, Seventh Schedule, List I, Entry 41. It reads: "Trade and commerce with foreign countries; import and export across customs frontiers; definition of customs frontiers".
4. Ibid.
5. For a discussion on the Commerce Power under the Constitution of India, with a comparative survey, see, G.C.Venkata Subba Rao, Legislative Powers in Indian Constitutional Law, pp. 496-520, (1982).

The Constitutional prohibition is against levy of tax by the State[6] in respect of sale or purchase in the course of export or import; a sale or purchase before the beginning of the 'course' of export is not therefore exempt from levy of tax. Same is the case with a sale or purchase after the 'course' of import. When does the 'course' of export or import begin? When does it end?

Every journey has a starting point and a terminus. Movement of goods in the 'course' of export or import also should have the same features. Does the course of export or import begin when the goods start their journey and end when they reach the destination? In other words, does the 'course' of export begin only when the goods start moving from India to a foreign destination and end when it reaches the destination? Similarly, does 'the course of import' begin on movement of the goods from a foreign country and end when they reach the Indian destination?

If the answers to the above questions are in the affirmative, certain consequences follow. A sale or purchase which itself occasions such movement of goods will not be within the sphere of exemption. Only a sale or purchase effected after the movement of the goods from one country to another will fall within the exemption, this being a sale or purchase in the course

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6. See supra, n.1.

of export or import. Suppose a merchant in Cochin sells his goods to one in London and exports the goods to London in fulfilment of the contract of sale. On the proposition raised above, the sale will not be one in the course of export. This is so because it is a sale or purchase which 'causes' the movement. It is one 'before' the movement of goods and hence is not one 'during' such movement. Therefore it will not be a sale 'in the course of' export. The State in which the sale took place can then tax the transaction[7] because there is a sale completed within the State and the export journey begins only after the sale.

Such a position will create some difficulties. Taxation of the goods at points prior to their movement to a foreign country brings about multiple tax burden on the exported goods. When States begin to tax sales involved in respect of goods exported, foreign commerce ceases to be a matter under the exclusive control of the Union. The Union may not then be able to regulate the tax burden on goods so as to give proper incentives to international trading in them. The policy of export promotion may not materialise when heavy tax burden imposed by States impede foreign trade.

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7. The power to levy tax on sale or purchase of goods within the State is vested in States. See, Constitution of India, Seventh Schedule, List II, Entry 54.

With what objective was the Constitutional prohibition[8] enacted? Was it to avoid taxation by the State and to leave 'foreign commerce' entirely at the hands of the Union? What considerations persuaded the framers of the Constitution to exempt sale and purchase of goods in the course of export and import from being taxed? Which sale and purchase were so sought to be exempted? A look at the history of enactment of the prohibitory provision in the Constitution is worthwhile in this context.

The Constitution as drafted first for the consideration of the Constituent Assembly contained no restriction on the power of the State to tax sale or purchase of goods exported or imported. A provision was proposed to be incorporated in the draft by the Central Ministry of Finance.[9] This sought to prohibit levy of tax by a State in two circumstances.[10] One was when the sale or purchase takes place in the course of import of the goods into the territory of India. The other was in respect

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8. Supra, n.1.
9. The provision was introduced as Article 246A in the draft Constitution. See, Shiva Rao, The Framing of India's Constitution, Select Documents, Vol.IV, p.682, (1968).
10. Ibid. The relevant portion of the draft Article read: "246A. Restrictions regarding taxes on sale or purchase of goods: (1) No law of a State shall impose, or authorise the imposition of a tax on the sale or purchase of goods where under the general law relating to sale of goods such sale or purchase--
    (a) takes place in the course of import of the goods into the territory of India; or
    (b) is the last sale or purchase effected in India with a view to the export of the goods out of the territory of India; or
    (c) ...."

of the last sale or purchase effected in India with a view to exporting the goods out of the territory of India. It is interesting to note the differences in the languages used. The expression 'in the course of' was confined to the context of taxation of imported goods. For exempting from tax the goods exported the expression used was 'with a view to export'. What do these expressions mean? To claim exemption from taxation a sale or purchase has to be a sale or purchase in the course of import. What constituted a sale or purchase in the course of import was a point not clear and hence debatable. But in the context of export the provision in the draft was quite clear. The sale or purchase, as the case may be, to qualify for the exemption should be the last sale or purchase effected in India with a view to exporting the goods out of the territory of India. The sale to a person for export and the purchase by him for export were sought to be brought within the coverage of the prohibition so that they could not be taxed by the State. In other words, the sale or purchase immediately preceding the export qualified for exemption.

It appears that the provisions in the draft Article[11] had two objectives. The Government of India thought that the power to levy tax on sale or purchase of goods should be vested in the Provinces. But it was also thought that the power should not be absolute and should be exercised by the Provinces in such

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11. Ibid.

a way as not to conflict with the policy of the Central Government in relation to business and industrial matters. The draft Article aimed, on the one hand, at imposing minimum restriction to safeguard the policy of the Central Government in regard to industrial development, and, on the other, securing uniformity between provinces in the matter of imposition of tax.[12]

When the draft Article was discussed in a conference with the Provincial Premiers[13] the need for changing the text was put forward by some of them. It was then agreed that the Provincial Premiers should send draft amendments to Article 264A which they desired to make and the matter would be reconsidered.[14]

The Government of West Bengal felt that the exemption of last sale or purchase effected in India 'with a view to the export of the goods' was administratively unworkable and was very vague. It expressed the view that to qualify for exemption actual export of the goods outside India must be established and the draft should be so amended to prevent provinces from taxing goods exported. The draft Article prepared by the Government of West Bengal sought to prevent States from taxing sale or purchase of goods actually exported.[15]

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12. Shiva Rao, op.cit., p.699.
13. The Drafting Committee had discussion with the Premiers of the Provinces and certain others. Id. at 683.
14. Id. at 700.
15. Id. at 712-713. The relevant portion of the draft prepared by the Government of West Bengal read: "264 A(1)--No law of a State shall impose or authorise the imposition of, a tax on the sale or purchase of goods shown, to the satisfaction of an authority appointed by or under such law, to have been despatched by or on behalf of the seller or the purchaser, according as the tax is on the sale or the purchase of the goods to an address--(i)....", (ii) outside India".

The Government of Bihar also felt that it would be administratively difficult to ascertain whether or not the goods were purchased with a view to exporting or for local sale. An exporter of goods might carry on business in the same goods in the Provinces. In that case it becomes difficult to ascertain the intention behind the purchase of goods. It was pointed out that the draft by the Ministry of Finance was defective in other ways too. It would enable levy of multiple tax except on the last stage, in respect of the goods exported. It affected adversely those Provinces which levied single point tax at the last stage. The amendment proposed by the Bihar Government provided for exemption of the sale of goods despatched by or on behalf of a dealer to any place outside India.[16]

The Government of Madras was of the view that the sale or purchase preceding the export sale should not qualify for exemption. In its view the exemption should apply only to the sale taking place when goods are exported. In other words, only export sale should qualify for exemption. The words 'in the course of import' in the draft[17] was taken to refer only to the purchase involved in the import. The draft suggested by the Government of Madras therefore sought to exempt export sale and import purchase.[18]

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16. Id. at 716.
17. Article 264 A(1)(b), supra, n.10.
18. The relevant portion of the draft suggested by the Government of Madras read, "264A. No law of a State shall impose or a authorise the imposition of a tax on the sale or purchase of goods where under the general law relating to sale of goods such sale or purchase--(a).... (b) takes place when goods are imported into the territory of India, or (c) takes place when goods are exported out of the territory of India...." Shiva Rao, op.cit., p.721.

The Government of Bombay wanted the exemption to cover all points of taxation preceding the export. The draft prepared by that Government sought to exempt taxation of sale or purchase at all points preceding export of goods outside India.[19]

The Government of United Provinces also felt that the expression 'with a view to the export' in the draft was vague and hence likely to be misused. It was therefore proposed that the exemption should be available on the sale or purchase of goods sold with a view to export only when the goods are so exported.

Amidst the conglomeration of claims and counter-claims from Provinces, the draft proposed by the Ministry of Finance was modified. The modified draft sought to prohibit States from imposing tax on the sale or purchase of goods where such sale or purchase took place in the course of import of the goods into, or export of the goods out of, the territory of India.[20] It sought to prohibit taxation of exports and

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19. The relevant portion of the draft prepared by the Government of Bombay read: "264 A(1). No law of a State shall impose or authorise the imposition of a tax on the sale or purchase of goods which are shown to the satisfaction of the appropriate authorities of the State concerned to have been despatched--(i) to any place outside the territory of India...." Id.at 723.
20. C.A.D., Vol.X, p.325. The relevant portion of the Article accepted on 16th October 1949 read: "264 A(1). No law of a State shall impose, or authorise the imposition of, a tax on the sale or purchase of goods where such sale or purchase takes place--(a).... (b) in the course of the import of the goods into, or export of the goods out of the territory of India...".

imports by the States. The attempt was only to prohibit levy of tax on the sale or purchase involved in the export and import. This was made clear by Ambedkar when he moved the draft Article[21] before the Constituent Assembly. He said:

> "The first thing that I would like to point out to the House is that there are certain provisions in this Article 264 A which are merely reproduction of the different parts of the Constitution. For instance, in sub-clause (1) of Article 264 A as proposed by me sub-clause (b) is merely a reproduction of the Article contained in the Constitution, the entry in the Legislative List that taxation of imports and exports shall be the exclusive province of the Central Government".[22]

A.K.Ghosh, participating in the debate in the Constituent Assembly pointed out that the expression 'in the course of export' will create problems. There may be many transactions of sale and purchase before a commodity is exported. All these sales and purchases will be exempt under the revised draft. There will be difficulty in ascertaining the nature of such transactions.[23] He emphasised that the term 'export' should be

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21. Ibid.
22. Id. at 326. For the provisions referred, see, Constitution of India, Article 246(1) read with Entry 83 of List I in the Seventh Schedule. See supra, n.2.
23. He cited this example: "A buys a commodity saying that he will export it. But he does not export it, but, sells to B, and B purchases it saying that he will export it, and in this manner the commodity passes on from one hand to other and from one province to another without payment of any tax, and it may be that in the end it is not exported at all. How can you check up this process? There will be a lot of difficulty and confusion if this clause is passed as it stands". See, C.A.D., Vol.X, p.333.

defined to mean the last transaction of sale and 'import' to mean the first transaction of purchase and that the exemption should operate only at these two points.[24]

Commenting on the criticisms levelled against the expressions 'in the course of export' and 'in the course of import' and the amendments moved, Ambedkar said that the phraseology was considered very carefully by the Drafting Committee. He pointed out that the Committee was of the view that the phrase was as good as any other that could be invented. He, however, said that the Drafting Committee would further examine this matter to see whether any other expression would be more appropriate.[25] No change in the phraseology was however, made subsequently. This provision remained in the same form in which it was moved by Ambedkar, put to vote and adopted as part of the Constitution.[26] While the Articles in the draft Constitution were renumbered, Article 264 A became Article 286. Article 264 A(1)(b) thus became Article 286(1)(b).

It is clear that the Constituent Assembly had the apprehension that transactions other than export sale and import

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24. Ibid.
25. Ambedkar said: "There is only one point, I think, about which I like to say a word. There are, I know, some friends who do not like the phraseology....The Drafting Committee....are satisfied that the phraseology is as good as could be invented. But I am prepared to say that the Drafting Committee will further examine this particular phraseology...." Id. at 340.
26. Id. at 341.

purchase may be exempted under the phraseology 'in the course of' and that the obvious intention behind the restriction was only to keep the power of taxing international trade within the domain of the Centre. This is evident from the speech of Ambedkar introducing the draft Article before the Constituent Assembly[27], the trend of the criticism against the phrase in the draft and the reply given by Ambedkar to the criticism.[28]

The apprehension about the phraseology 'in the course of' turned out to be true. As the terms 'export' and 'import' were not defined in the context of the phrase 'in the course of' courts were flooded with litigation. Views of different shades were canvassed for judicial acceptance. When the legislative text is vague, judicial interpretation gives the law proper shape and direction.[29] The law on the scope of exemption of sales and purchases of goods involved in export and import thus centered round judicial interpretation of the phrases 'in the course of export' and 'in the course of import'.

The judicial process at the appellate level, especially while interpreting the Constitution, is not merely one of finding

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27. See supra, n.22.
28. Supra, n.25.
29. Considerable case law has developed on the phrase 'in the course of' when the expression is used in other contexts. For instance Workmen's Compensation Act 1923, Section 3 and the case law. See S.C.Srivastava, Social Security and Labour Laws, pp.76-84, (1985).

the legislative intention but one of giving the skeleton provision flesh and blood and making it strong to meet the needs of the time. No wonder that the provisions are interpreted not completely in conformity with the original legislative intention as disclosed in the Constituent Assembly Debates.

The scope of the expression 'in the course of' appearing in Article 286 of the Constitution came up for the interpretation of the Supreme Court in the First Travancore case.[30] The assessee exported on c.i.f.[31] and f.o.b.[32] terms cashew kernel manufactured in Travancore-Cochin from cashew nut imported from East Africa. Exemption was claimed in respect of such sale on the ground that the sale took place in the course

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30. State of Travancore-Cochin v. Bombay Company Ltd., A.I.R. 1952 S.C. 366; (1952) 3 S.T.C. 434 (S.C.). This case is called the First Travancore case to distinguish it from State of Travancore-Cochin v. Shanmugha Vilas Cashewnut Factory, A.I.R. 1953 S.C. 333; (1953) 4 S.T.C. 205; which is known as the Second Travancore case.
31. Under c.i.f. contract, the price the buyer has to pay covers the cost of the goods, the charges for insurance of the goods during transit and the freight to the port of destination. The seller tenders the shipping documents namely the bill of lading, policy of insurance and the invoice to the buyer. The essential feature of a c.i.f. contract is that the requirement of delivery of goods to the buyer is satisfied by delivery of the documents. The buyer cannot insist on physical delivery of goods. If goods are lost in transit or are damaged the buyer has his remedy against the insurer or the shipper. See, David M.Sassoon and H.Orren Merren, British Shipping Laws, C.I.F. and F.O.B. Contracts, pp.3 and 4, (1984).
32. Under f.o.b. contract the seller meets the costs and bears the responsibility of putting the goods free on board. When the goods pass the ship's rail, the delivery is complete and the risk passes to the buyer. In other words the seller's duty is to make available free on board, without any expense to the buyer, goods answering the description in the contract of sale. The buyer has to advise the seller in which ship to load and make other arrangements for the transport of the goods. Id. at 331-334.

of export. The State contended that the sale was completed before the export of the goods. Taking the view that the sale cannot therefore be considered as in the course of export, the State levied tax on the transaction.

The levy was challenged by the assessee. The High Court of Travancore-Cochin did not accept the plea of the State. It gave a wide interpretation of the term 'in the course of' appearing in Article 286. The High Court said:

> "The words 'in the course of' make the scope of this clause very wide. It is not restricted to the point of time at which goods are imported into or exported from India. The series of transactions which necessarily precede export or import of goods will come within the purview of this clause. Therefore, while in the course of that series of transactions the sale has taken place, such sale is exempted from the levy of sales tax".[33]

In holding so the High Court made a reference to the Constituent Assembly Debates to ascertain the true scope of the expression 'in the course of export' and gave it a wide interpretation to cover series of sales preceding the export. Chief Justice Kunhi Raman referred to the speeches of Ambedkar winding up the discussion[34] and of A.K.Ghosh pointing out the confusion

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33. State of Travancore-Cochin v. Bombay Company Ltd., (1952) 3 S.T.C. 434 at 437.
34. Supra, n.25.

that is likely to arise about the meaning of the term 'in the course of export'.[35] The Chief Justice pointed out the fact that the amendment moved to restrict the exemption to the last sale or first purchase (export sale and import purchase) was not accepted by the Constituent Assembly. Though Ambedkar had given an assurance that if better phraseology was found to be necessary he would see that the wording was altered, no such alteration was made. These circumstances therefore pointed out, in the opinion of Chief Justice Kunhi Raman, that the framers thought that the words 'in the course of' would convey the meaning they intended to convey namely, that not only the last sale but other sales also involved in the series of transactions preceding the export did qualify for exemption.

It may be noted however, that the intention of the Constituent Assembly was not so clearly expressed in the deliberations on the lines suggested by Chief Justice Kunhi Raman. On the other hand the deliberations seemed to suggest an intention to restrict it to the export sale and import purchase.

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35. A.K.Ghosh commenting on Article 264 A(1)(b) said: "In all cases of export, there are various transactions before the commodity is actually exported from the country. But under this clause, all these transactions--the intermediate transactions which take place--are exempted from sales tax. I could have understood the position if it was that at the point of export, that is to say, the last transaction, where from it is actually exported, the sales tax will not be realisable at that point". Id. at 333.

The amendment moved by Ambedkar was considered sufficient to serve this purpose, as is clear from his clarifications and the willingness to modify the phrase[36] 'in the course of' to avoid the criticism of the possibility of its wider interpretation.

On appeal by the State, the following different views on the scope of the expression were considered by the Supreme Court:[37]

The exemption may cover sale by export and purchase by import. The scope of the expression 'in the course of' is limited to sale or purchase which occasions the export or import. It does not extend to any other sale or purchase, however directly it may be connected with the export or import.

Besides the actual export to import, the exemption may cover the purchase by the exporter for the purpose of export and also sale by the importer after the import. In other words, the exemption covers also the last purchase by the exporter and the first sale by the importer. These transactions are so proximately and directly connected with the export or import as to form part of the same transaction and hence fall within the scope of the expression 'in the course of' import or export.

The exemption may cover only sale or purchase effecte when the goods are in transit to the foreign destination. In

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36. Supra, n.25.
37. State of Travancore-Cochin v. Bombay Company Ltd., A.I.R. 1952 S.C. 366 at p.367.

other words 'in the course of' mean only sale or purchase after the goods begin their movement from one country to the other and before they reach the destination.

On a wider view, the exemption may cover all sales and purchases taking place in the series of transactions finally resulting in export or import.

The wider view which was accepted by the High Court received no approbation at the hands of the Supreme Court. The Court also disapproved the narrow view that a sale or purchase taking place in the course of the movement of the goods from one country to the other alone qualifies for exemption.[38]

The Supreme Court did not in the First Travancore case[39] deal with the question of the scope of the exemption of sale or purchase in the course of export and import in the abstract, but confined itself to the facts of the case. It held that the transaction of the first type mentioned above involved in the case, namely, export sale will be covered by the exemption. The sale had to be put through by transporting the goods out of the territory of India employing the machinery of export. It was held that the sale therefore qualified for exemption.

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38. Id. at 368.
39. Supra, n.37.

Chief Justice Patanjali Sastri observed:[40]

> "A sale by export thus involves a series of integrated activities commencing from the agreement of sale with delivery of goods to a common carrier for transport out of the country by land or sea. Such a sale cannot be dissociated from the export without which it cannot be effectuated and the sale and the resultant export form parts of a single transaction....We accordingly hold that whatever else may or may not fall within Article 286(1)(b), sales and purchases which themselves occasion the export or the import of the goods, as the case may be, out of or into the territory of India come within the exemption..."

The Court obviously did not examine the other proposition whether sales preceding the export or sales and purchases for export or local sales of imported goods by the importer qualify for exemption from levy of sales tax.[41]

In arriving at its conclusion the Supreme Court made a literal construction of the provision. It did not look at the Constituent Assembly debates.[42] Will sales of other nature

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40. Id. at 367-368.
41. Ibid. This was made clear by the words "Whatever else may or may not fall within Art.286(1)(b)..."
42. Extrinsic aids like Constituent Assembly Debates were not to be used for construction of statutes according to the view prevalent at that time. But the notion has changed since. The changed notion is reflected in the following observations: "We may, therefore legitimately refer to the Constituent Assembly Debates for the purpose of ascertaining what was the object which the Constitution makes had in view and what was the purpose which they intended to achieve..." Fagu Shaw v. State of West Bengal, A.I.R.1974 S.C.613 at 629 per Bhagavati,J. See also G.P.Singh, Principles of Statutory Interpretation, p.183, (1983).

be exempt? This question was left open. The apprehension expressed by some of the members of the Constituent Assembly[43] on the possibility of a wider coverage for the expression 'in the course of export or import' still continued.

The scope of the provision for exemption again came up before the Supreme Court in the Second Travancore case.[44] Under the Travancore-Cochin General Sales Tax raw cashew and its kernel were subjected to tax at the purchase point.[45] A cashew factory located in the erstwhile Travancore-Cochin State imported cashewnut from East Africa.[46] Cashewnut was purchased also locally and from the neighbouring State of Madras. The nuts were processed in the factory and the processed nuts and oil were exported to foreign countries. The sales tax authorities levied tax on these purchases under the Travancore-Cochin General Sales Tax Act.

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43. See for example the speech of A.K.Ghosh, supra, n.35.
44. State of Travancore-Cochin v. Shanmugha Vilas Cashewnut Factory, A.I.R. 1953 S.C. 333. This case involved appeals from the decision of the High Court of Travancore-Cochin. The appeals, though heard originally along with other appeals involved in the First Travancore case (supra, n.30) were later remitted to the High Court for further finding in respect of certain material facts relating to the business of the cashew dealers. The other appeals were disposed of in the First Travancore case (supra, n.30).
45. Travancore-Cochin General Sales Tax Act, 1124 (M.E.), Section 3(4).
46. The purchase of cashew from abroad fell into two categories. In one sort of transactions commission agent at Bombay purchased the goods while the goods were in transit in the high seas as agent of the factory. In the other set of transactions the agent at Bombay purchased the goods in their own name while the goods were in transit, took delivery of the goods at Cochin and then sold them to the factory.

The question for consideration before the Supreme Court in the Second Travancore case[47] was the validity of the levy of tax on purchase of cashew by the assessee. The issue involved was whether the purchases were exempted from levy of tax by the State by virtue of Article 286(1)(b) of the Constitution. The purchases fell into three categories: namely, (1) goods purchased from local vendors, (2) goods purchased through commission agent at Bombay when the goods were on the high seas[48] and (3) goods imported by commission agents and purchased in the State of Travancore-Cochin by the factory.[49] The first and the third categories of purchases were those made in the State. The second category was of purchase while the goods were in transit in the high seas. All the three categories of purchases were made with a view to exporting the goods after processing. An exporter may purchase goods for the purpose of exporting them to implement orders received or expected to be received. An importer may sell goods imported in accordance with the contract pursuant to which the goods were imported. Sales or purchase may be effected between parties within the State by transfer of shipping documents while the goods are in transit from one country to another. Will these transactions fall within the coverage of the constitutional exemption? These were the points of law posed before the Supreme Court for decision in the Second Travancore case.[50]

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47. Supra, n.44.
48. See n.46.
49. Ibid.
50. Supra, n.44.

The question of exemption of sale or purchase made while the goods are on the high seas was not expressly considered by the Constituent Assembly while formulating the provision for exemption.

The Supreme Court held that purchase of goods by the exporter for the purpose of export did not qualify for exemption. The sale by the importer to implement orders already received or expected to be received also did not come within the constitutional exemption. The Court pointed out that the prohibition was not on taxation of goods exported or imported. The expression 'in the course of' in the context of export or import implied both a period of time during which the movement is in progress and also a connected relation with the export or import.[51] A sale in the course of export was therefore held to mean a sale taking place during the activities connected with the export and as part of such activities. A purchase for

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51. State of Travancore-Cochin v. Shanmughavilas Cashewnut Factory, A.I.R. 1953 S.C. 333. Chief Justice Patanjali Sastri observed at p.336: "It is obvious that the words 'import into' and 'export out of' in this context do not mean the article or commodity imported or exported. The reference to 'the goods' and 'to the territory of India' makes it clear that the words 'export out of' and 'import into' mean the exportation out of the country and importation into the country respectively. The word 'course' etymologically denotes movement from one point to another and the expression 'in the course of' not only implies a period of time during the movement is in progress but postulates also a connected relation".

the purpose of export is not integrally connected with the export. The purchase by itself does not occasion the export. A sale to the foreign buyer occasions the export. It is that sale in the Court's view, which comes within the purview of exemption from levy of tax by States. Sale to or purchase by the exporter as also purchase by a dealer for sale to an exporter is not exempted from taxation.[52]

By holding so the Court did apply the intention of the framers of the Constitution to limit the exemption to one sale or purchase, namely, export sale or import purchase. Should the original intention as reflected in the Constituent Assembly debates govern the scope of the exemption for ever? One may disagree. The Constitution is a living document. Its provisions should be interpreted not too rigidly. Constitutional interpretation should involve a process of evolving the law through adaptation of the norms to the changing needs of the time. The Travancore cases[53] were decided three and a half decades ago shortly after the coming into force of the Constitution. In those early days the Supreme Court might have

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52. The Court said: "A purchase for the purpose of export like the production or manufacture for export, is only an act preparatory to export and cannot, in our opinion, be regarded as an act done 'in the course of' the export of the goods out of the territory of India..." Ibid.
53. Supra, n.30

legitimately, in tune with the intention of the Constituent Assembly, limited the purpose of the prohibition with a view to avoiding double taxation of the foreign trade, i.e., taxation of the same transaction by the Union and States.

The holding in the Second Travancore case[54], a close analysis would reveal, went beyond that. Apart from the transaction of sale and purchase between the exporter and importer in different countries which occasion the movement of goods from one country to another, a different category of sale and purchase was brought within the exemption. The transactions of import involved in the Second Travancore case[55] were not one of direct purchase of goods by the factory from a foreign seller. The purchases were made through agents, while the goods were on the high seas, by transfer of documents of title. The movement of goods from one country to another was not occasioned by the purchase; instead the purchase was made during such movements. Thus an extension of the scope of the exemption from the narrow confines of a sale occasioning the export or import contemplated by the Constituent Assembly was brought about in the Second Travancore case.[56]

When an exporter purchases goods for export or when an importer sells goods after import there is no question of

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54. Supra, n.44.
55. Ibid.
56. Ibid.

levy of duty on export or import. Will a policy of taxing such sale or purchase be against national interest? Export-import trade is essential for energising the economic activities of the country. On the one side the revenue interest of the States has to be protected. On the other side we have to boost the export to earn foreign exchange and to make available imported goods at a reasonable price in order to augment industrial adventures. These two competing interests of the nation have to be balanced in formulating the system of taxation of sale or purchase of goods involved in export and import. That is a major policy question involved in deciding the scope of exemption.

Looked at from this perspective it becomes obvious that there is need for reformation of the scope of the exemption in tune with changing times to keep a proper balance between competing claims. Clearly the law should not therefore be confined to the same narrow limits of the legislative intention behind the exemption provision reflected in the Constituent Assembly Debates or even to the limited extension of the scope of the exemption brought about in the Second Travancore case.[57]

The Court had no hesitation to declare that the sale or purchase effected by transfer of documents of title while

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57. Ibid.

the goods are on the high seas, qualifies for exemption.[58] One cannot say that these sales or purchases occasion the export, or, the import, as the case may be. A series of sales or purchase could be effected by transfer of documents of title while the goods are in transit. These sales or purchases are effected during a course of time while the goods are being exported or imported. The sale or purchase does not have a relation with the export or import as a causative factor thereof. To put it differently, the sale or purchase is effected during export or import, but not as part of the export or import. The test formulated in the First Travancore case[59], obviously, does not suit to a sale effected while the goods are in transit. Such a sale has absolutely no causal connection with the export or import.[60] Nonetheless, in order to substantiate its decision, the Court found a new line of reasoning. It observed that the process of export-import did not commence or terminate until the goods crossed the customs frontiers. So while the goods are on the high seas the goods are in the course of export. The term 'in the course of' implies a movement or progress with a beginning and an end. The transit sales or purchases are the sales and purchases effected after the beginning and before the end of such movements. They are regarded commercially as incident to the

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58. Supra, n.56.
59. Supra, n.40.
60. Supra, n.51.

import and export. They fell according to the Court within the constitutional protection. It is pertinent to note here that the question of imposing sales tax on transit sales while the goods are pursuing their export journey to a foreign country would not arise in practice. Once the sale is concluded the shipping documents are transferred to the foreign buyer. Therefore there would not be any further sale of such goods by the exporter in India. On the other hand, in the case of import to India, the importer can sell the goods in India while the goods are still on the high seas. According to the holding of the Court such sale could be regarded commercially as incident to the import and will be exempt from taxation by the State.

The extension of the exemption on application of the theory of incidence was limited by the Court to sale or purchase while goods are in transit from one country to the other. Why not the exemption be extended to purchase for export and to sale after the import on the same theory of incidence? Purchase is a necessary incident of export. One may export goods purchased after subjecting them to a process of manufacture. In both the cases the purchase has a close connection with export. But the Court expressed the view that such transaction is not an integral part of export and therefore is not 'in the course of export'. If the theory of incidence were extended to such purchases the result would have been totally different. So is the case with sale after import.

Clearly, therefore, in the Travancore cases[61] the Court adopted an attitude of widening the dimension of exemption of sale and purchases involved in export and import from the narrow confines set by the framers of the Constitution. At the same time the attitude reflected a conservative approach of limiting the exemption to two categories namely, to sale and purchase between exporter and importer and to sale and purchase during the transit while the goods are on the high seas. In so restricting the scope of the prohibition of taxation, the Supreme Court seems to have failed to appreciate the commercial reality and significance of the transactions in the context of the need for fostering foreign trade. The letter of the law and the technical aspects of the law, overshadowed its functional role.

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51. Supra, n.30.

Chapter III

HEGEMONY OF TRAVANCORE CASES

The Travancore cases[1] signify a landmark in the path of development of the law relating to taxation of export and import sales. To what extent these cases had an impact upon later development? What influence had they on the juridical approach to the provisions in the Constitution? How did the expert studies on taxation react to the judicial formulations? Did the Travancore and other cases inspire legislative reform? This chapter mainly deals with these aspects.

The earliest influence of the Travancore cases is found in Gurviah Naidu[2], when the disallowance of the claim for exemption under the constitutional provision[3] was upheld by the Supreme Court. After securing orders for supply of skin to buyers in London, the assessee purchased the requisite kind of skin to implement such orders. The question was

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1. State of Travancore-Cochin v. Bombay Company Ltd., A.I.R. 1952 S.C. 366; (1952) 3 S.T.C. 434 (S.C.); State of Travancore-Cochin v. Shanmughavilas Cashewnut Factory, A.I.R. 1953 S.C. 333; (1953) 4 S.T.C. 205 (S.C.).
2. State of Madras v. Gurviah Naidu & Co., (1955) 6 S.T.C. 717 (S.C.); A.I.R. 1956 S.C. 158.
3. Article 286(1)(b). For text, see Appendix A.

whether such purchases were in the course of export. The Court drew a distinction between a purchase in the course of export and one for the purpose of export. Purchase for the purpose of export after securing orders from abroad was not, according to the Court, one in the course of export since the purchase did not itself occasion the export.[4]

The distinction between a sale for the purpose of export and a sale occasioning the export was pushed to an illogical extent by the Supreme Court in Mysore Spinning and Manufacturing Co.[5] The assessee mills sold to exporters goods which were subsequently exported. The question for decision was whether these sales were in the course of export. The nature of the transactions between the assessee mills and the exporter and between the exporter and the foreign buyer were as follows: the exporters obtained firm orders from overseas buyers for supply of goods of the specified quality and quantity. On the basis of these

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4. Following the Travancore cases the Court said: "Such purchases were, it is true, for the purpose of export, but such purchases did not themselves occasion the export and consequently did not fall within the exemption..." State of Madras v. Gurviah Naidu and Co., A.I.R. 1956 S.C. 158 at 161 per S.R.Das, Actg.C.J.; East India Tobacco Company v. State of A.P., (1962) 13 S.T.C. 529 (S.C.); A.I.R. 1962 S.C. 1733 was also a case decided on this principle. The assessee was an exporter of tobacco. His purchase of tobacco was assessed to tax. It was upheld on the ground that a purchase for export is not within the purview of exemption and that only a sale under which an export is made qualified for exemption.
5. State of Mysore v. Mysore Spinning and Manufacturing Co., (1958) 9 S.T.C. 188 (S.C.); A.I.R. 1958 S.C. 1002.

orders they obtained provisional export licence. The exporters enquired with the mills about the possibility of supply of the required goods. On confirmation from them the exporters entered into contract with foreign buyers for supply of the goods. The exporters entered into contract with the mills for purchase of the goods at export price rates. In the light of these contracts final licences for export were obtained. Under the contract between the exporter and the mills, the latter had to pack and despatch the goods marking it 'for export'. The goods so despatched were received by the exporter who exported them to the foreign buyer. The question was whether the sales by the mills to the exporter were in the course of export and exempted under Article 286(1)(b) of the Constitution. Following the Travancore cases[6] and Gurviah Naidu[7] the Court held that only the sale which occasioned the export was exempt and not a sale to the exporter for export. The Court observed that the mills had no direct contact with the overseas buyer and that the sales that occasioned the export were not the sales by the mills to the exporter.[8]

It is important to note that the sale by the mills to the exporter was integrally connected with the export.[9] The fact

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6. Supra, n.1.
7. Supra, n.2.
8. State of Mysore v. Mysore Spinning and Manufacturing Co., (1958) 9 S.T.C. 188 (S.C.) at 193.
9. Justice Das in his dissenting judgment in the Second Travancore case (A.I.R. 1953 S.C. 333 at 348) found no difficulty in holding that a purchase by the exporter without anything more is by itself integrally connected with the export so as to fall within the scope of the expression 'in the course of export'. The facts of the present case show stronger factors which closely interlink the purchase with the export.

that the product was manufactured in tune with the export requirements, that the contract with the foreign buyer was concluded only on confirmation by the mills to supply goods according to the requirements of the foreign buyer as to quality and quantity, that the price was higher in view of the export quality and that the goods were packed and marked 'for export' when supplied by the mills clearly indicate that the sale and the export were interwoven. Yet the Supreme Court found that "there is nothing to show that these goods were manufactured with 'the main intention for export' beyond the fact that they were sold to exporters and marked 'for export' at the time of despatch".[10] The facts of the present case were different from those in the Travancore cases. From the stage of production to the final export there was obvious integrality and interdependence making the whole transaction one in the course of export. Looking at the question from a functional point of view the Supreme Court could have held that the sale to the exporter was one in the course of export.

It appears an attempt was made in Gordhandas Lalji[11] for a reconsideration of the decision in Mysore Spinning.[12]

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10. State of Mysore v. Mysore Spinning and Manufacturing Co., (1958) 9 S.T.C. 188 (S.C.) at 193.
11. Gordhandas Lalji v. B.Banerjee, (1958) 9 S.T.C. 581 (S.C.); A.I.R. 1958 S.C. 1006.
12. State of Mysore v. Mysore Spinning and Manufacturing Co., (1958) 9 S.T.C. 188 (S.C.).

Gordhandas Lalji related to export of tea. One of the questions before the Supreme Court was whether the sale to the exporter was exempt being in the course of export.[13] The Court held, following Mysore Spinning[14], that it was not exempt. The attempt made to recanvass the issue was brushed aside by the Court. The Court observed that it was faintly attempted to argue that 'there are some aspects of the question' to which attention of the Court was not drawn in the case of Mysore Spinning and that it was not impressed by that plea.[15] It is unfortunate that the Court did not state what were the aspects raised and why the Court was not impressed by the plea.

The principle formulated in the Second Travancore case[16] that a sale effected within the State by transfer of document of title to the goods while the goods are on high seas in the

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13. The assessee purchased tea at auctions in Calcutta, mixed them, repacked and loaded in ships according to the instructions from exporters in Bombay. The claim of the assessee that he was acting as agent of the exporter was rejected. The alternative plea that the sale was not in the course of export was not accepted following the Travancore cases (1952) 3 S.T.C. 434 (S.C.); (1954) 4 S.T.C. 205 (S.C.) and the Mysore Spinning case, (1958) 9 S.T.C. 188 (S.C.).
14. State of Mysore v. Mysore Spinning and Manufacturing Co., (1958) 9 S.T.C. 188.
15. Gordhandas Lalji v. B.Banerjee, (1958) 9 S.T.C. 581 (S.C.) at 589.
16. State of Travancore-Cochin v. Shanmughavilas Cashewnut Factory, (1954) 4 S.T.C. 205.

course of their movement from one country to another found application in Gokal.[17] The assessee purchased goods from outside the country. When the goods were on the high seas in the course of transit to India, the assessee delivered the documents of title to the Government of India against payment. The Government cleared the goods when the ship arrived at Bombay. The Court held that the sale by the assessee to the government was in the course of import. The Second Travancore case was not one in which the goods were sold by the importer to the third party when the goods were on the high seas. It was one of importing goods through commission agent. However, the principle was formulated in that case that a sale by an importer by transfer of shipping documents to a third party is a sale in the course of import. The sale in Gokal was of this type. Therefore the Court applied the principle formulated in the Second Travancore case and held the sale to be in the course of import.

In f.o.b. contract, property in the goods passes, unless there is a specific contract to the contrary, when the goods are loaded in the ship.[18] The nature of f.o.b. contract is that A, an exporter in India enters into a contract with B, a seller in India, that the goods shall be loaded on the specified ship at the specified port. The exporter may enter into

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17. J.V.Gokal and Co. v. Assistant Collector of Sales Tax, (1960) 11 S.T.C. 186 (S.C.); A.I.R. 1960 S.C. 595.
18. See, Ch.II, n.32.

contract with a foreign buyer C. A may sell in pursuance of such contract the goods so loaded on ship to C the foreign buyer. The sale between A and C is a sale which occasions the movement from India to a foreign country. It is clearly a case falling within the ratio of the First Travancore case.[19] But what about the transaction between A and B? The position arising from the Travancore cases[20] are that (a) sale by export and purchase by import are exempt; (b) purchase in the State by the exporter for the purpose of export as well as sale in the State by the importer after the goods have crossed the customs frontier are not entitled to exemption and (c) sale in the State by the exporter or importer by transfer of shipping documents while the goods are beyond the customs frontier are within the exemption assuming that the State's power of taxation extended to such transaction. The sale by B to A is not sale by export but a sale for the purpose of export by A, for it is A who is the exporter and not B. It is not a sale by transfer of documents of title after the goods have crossed the customs frontier. So on the principle of the Travancore cases the sale between A and B is not entitled to exemption. But improving upon the interpretation in the Travancore cases the Supreme Court in Wadeyar[21] held the view that the sale being sale in the course of export will be exempt from taxation. In Wadeyar the export

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19. State of Travancore-Cochin v. Bombay Company Ltd., A.I.R. 1952 S.C. 366.
20. Supra, n.1.
21. Wadeyar v. Daulatram Rameshwarlal, (1960) 11 S.T.C. 757 (S.C.).

was to be made under the buyer's export licence. Under the Export (Control) Order 1954 the property in the goods was vested in the exporter at the time of export. The bill of lading taken in the name of the buyer was retained by the seller till payment was effected in Bombay against presentation of the documents. So property in the goods passed when payment was effected in Bombay by the buyer. Under the Import and Export Control Act 1947, 'export' means 'taking (goods) out of India by land, sea and air'. Hence export cannot be said to have commenced till the ship carrying the goods has left the territorial waters of India.[22] The sale was complete before the ships left the port and hence before the 'export'.[23] How can a sale, completed before export and made to the exporter for the purpose of export be a sale in the course of export exempt from tax in view of the Travancore cases which held a sale to an exporter for the purpose of export to be outside the scope of the exemption? The Court found that the sale was before export but held that it was in the course of export and hence exempt from levy of tax. In its view the 'course of export' begins

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22. The Court said: "Export has been defined in the Import and Export (Control) Act 1947 as 'taking out of India by sea, land or air'... On that definition the time of the export is the time when the goods go out of the territorial limits of India. The territorial limits would include the territorial waters of India. Consequently the time of the export is the time when the ship with the goods goes beyond the territorial limits. At any rate the export of the goods cannot be considered to have commenced before the ship carrying goods leaves the port". Id. at 761, 762, per Das Gupta, J.
23. As defined in the Import and Export (Control) Act 1947.

before export. In other words, the course of export begins when the goods cross the customs barrier[24] for the purpose of loading in the ship whereas the export begins when the ship leaves the territorial waters. In other words the commencement of export and the 'course of' export were held to be different.[25]

Though a sale for the purpose of export was not exempted under the Travancore cases the interpretation in Wadeyar went a step further to carve out a new category of exemption, namely sale for the purpose of export on f.o.b. basis.[26]

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24. The phrases 'customs frontier' and 'customs barrier' have been used by the Court to indicate the same thing, namely, where the goods are examined, duty assessed and levied. For instance in Wadeyar v. Daulatram Rameshwarlal, (1960) 11 S.T.C. 757, Das Gupta, J. observed at p.762: "Whichever view is taken there is nothing to indicate that the intention to comply with the requirement of clause 5(2) of the Export (Control) Order carries with it an intention that the property should pass to the buyer at the time the goods pass the customs frontier. It is true that in the United Motors Case (1953) 4 S.T.C. 133 and in other cases it has been held by this Court that the course of export commences to run when the goods cross the customs barrier". (Emphasis mine).
25. The Court said referring to the previous cases: "These decisions as regards the commencement of the course of export are of no assistance in deciding about the point of time when the export proper commences. As we have already pointed out when export has been defined in the Import and Export (Control) Act 1947, as 'taking out of India by land, sea, or air', export in the Export (Control) Order cannot be held to have commenced till at least the ship carrying the goods has left the port, though it may in some context be more correct to say that it does not commence till the ship has passed beyond the territorial waters". Ibid.
26. This position is reiterated by the Supreme Court later by holding that when a party which had contracted to sell goods to a foreign buyer buys the goods f.o.b. Indian port from an Indian seller in order to fulfil f.o.b. contract with a foreign buyer, the two f.o.b. contracts are integrated and the former one also will be in the course of export. National Tractors v. Commissioner of Commercial Taxes, (1971) 27 S.T.C. 271 S.C. This is a case after the introduction of the Central Act. See infra, n.31, Ch.V. However the ruling in National Tractors was disapproved by the Supreme Court in Muralilal Sarawagi v. State of A.P., (1977) 39 S.T.C. 294 S.C. See also for discussion, Ch.V.

Sending or taking of goods out of the territory of India by itself is not sufficient to characterise the transaction as an export sale. Export of goods ordinarily means sending of goods from one country to another. Does the circumstance that after sale the purchaser takes the goods outside India or consumes it in the course of his travel outside India make it a sale in the course of export? This question arose in Burmah Shell Oil Storage.[27] The company sold aviation spirit at Dum Dum Airport to foreign bound aircraft and hence the goods had no specific foreign destination. The sale was held to be not in the course of export. Export and import are two sides of the same coin. When a person is exporting goods, namely, selling it outside India, there must be a person importing it, namely receiving the goods outside India. When fuel is sold to a foreign bound aircraft for its use, there is no export involved, but only a local sale, because the goods are not taken to any foreign destination where it can be said to be imported.

A similar case arose in Cochin Coal Company.[28] The company supplied coal to foreign bound ships for their use. The contention raised was that since the coal so sold was meant to be carried outside India, the sale was in the course of export.

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27. Burmah Shell Oil Storage and Distributing Co. of India v. Commercial Tax Officer, (1960) 11 S.T.C. 764 (S.C.); A.I.R. 1961 S.C. 315.
28. State of Kerala v. Cochin Coal Company, (1961) 12 S.T.C. 1 (S.C.); A.I.R. 1961 S.C. 408.

Following Burmah Shell[29] the Supreme Court held that the sales were not in the course of export.[30]

Eventhough the sale of fuel to foreign bound vehicles was completed within India, since it was clear that the goods were meant for consumption outside India and not within, the sale could have been held to be in the course of export. Commenting on the Supreme Court cases, S.N.Jain observed:[31]

> "The approach of the Burmah Shell case is not helpful to augment the export of the country. There are many reasons why such sale should be exempt. First, taxation of the above-mentioned sales may induce the foreign bound planes and steamers to purchase their fuel from countries other than India. India might lose foreign exchange on that account and the taxation of such sales might frustrate the basic idea exemption of export sales. Second, there is no danger of goods being diverted to local use and consumed locally. Therefore practical considerations do not warrant the approach adopted by the Supreme Court".

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29. Burmah Shell Oil Storage and Distributing Company of India v. Commercial Tax Officer, (1960) 11 S.T.C. 764 (S.C.); A.I.R. 1961 S.C. 315.
30. State of Kerala v. Cochin Coal Company Ltd., (1961) 12 S.T.C. 1 (S.C.). Justice Rajagopala Ayyangar observed at p.6: "In other words, the concept of export in Article 286 postulates just as the word import, the existence of termini as those between which the goods are intended to move or between which they are intended to be transported and not a mere movement of goods out of the country without any intention of there being landed in specie in some foreign port".
31. "Sale in the Course of Export: Need for Statutory Amendment", (1963) 5 J.I.L.I. 357 at 364. The Supreme Court, however, has not deviated from its stand. See, Madras Marine And Co. v. State of Madras, (1986) 63 S.T.C. 169, where the Supreme Court has followed Burmah Shell case, (1960) 11 S.T.C. 764 (S.C.).

The scope of the levy of tax on goods involved in the export-import trade came to be crystallised through a process of judicial interpretation on the scope of Article 286(1)(b) of the Constitution. The interpretation was a restrictive one. The impact of the Travancore cases[32] on the subsequent judicial formulation of the law had been tremendous. The power of the State to tax sale or purchase of goods falling in the export-import stream extended to all transactions except f.o.b. export sales, sales between Indian and foreign traders in pursuance of which goods moved from India to a foreign country and sales in which the property in goods passed from one person to another by transfer of documents of title while the goods were on the high seas. Eventhough an appropriate case for extension of the scope of export sale was there in Mysore Spinning[33], the Court abstained from enlarging the scope and adhered to the Travancore formula.

The Central Government felt the need for instituting an enquiry into the system of taxation in the country since a long period had elapsed after the question was examined by an expert body. The last enquiry in the field of taxation was in the pre-independence period. Since then substantial changes had taken place in the country in various spheres—political, social and economic. In view of these changes since the last

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32. See supra, n.1.
33. State of Mysore v. Mysore Spinning and Manufacturing Company, (1958) 9 S.T.C. 188 (S.C.) at 193. For facts, see text in n.5, supra.

enquiry in 1925[34], a Commission for investigating into the scheme of taxation at the level of the Centre, State and Local Administration was appointed by the Government of India in 1953.[35]

The Taxation Enquiry Commission, however, found the formula of exemption enunciated in the Travancore cases to be satisfactory. The Commission pointed out that hardly any State had complained about the provisions in Article 286(1)(b) of the Constitution. Perhaps the finding of the Commission might have been influenced by this fact.[36] It is not difficult to understand

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34. See Resolution of the Ministry of Finance, appointing the Taxation Enquiry Commission, 1953-54, quoted in the Taxation Enquiry Commission Report 1953-54, Vol.I, p.1,(1955).
35. Taxation Enquiry Commission 1953-54 under the Chairmanship of Dr.John Matthai. The relevant terms of reference of the Taxation Enquiry Commission were as follows:"(1) To examine the incidence of Central, State and local taxation on the various classes of people and in different States; (2) to examine the suitability of the present system of taxation—Central, State and local—with reference to (a) the development programme of the country and the resource, required for it and (b) the objective of reducing inequalities of income and wealth..., (6) to make recommendations, in particular, with regard to (a) modifications required in the present system of taxation, and (b) fresh avenues of taxation". See Report of the Taxation Enquiry Commission 1953-54, Vol.1, pp.1,2 (1955).
36. The Commission observed: "As interpreted by the Supreme Court, this position is briefly that those sales and purchases which themselves occasion the export or import and those sales in the State which are effected by the importer by transfer of shipping documents while the goods are still beyond the customs frontier are excluded from the sales tax jurisdiction of the States. Purchase in the State by the exporter for the purpose of export and sales in the State by the importer after the goods have crossed the customs frontier are held to be not within the exemption. Hardly any State has complained about the particular provision of the Constitution which concerns this aspect. We consider the position under the Constitution to be perfectly satisfactory so far as foreign trade is concerned". Government of India, Report of the Taxation Enquiry Commission, 1953-54, Vol.III, p.48 (1955).

why the States had adopted so complacent an attitude towards such a vital problem of taxation of export trade and its impact on export itself. A narrow and limited exemption means that the scope of State taxation is made wider. The obvious result is more tax revenue to the State. Possibly the States might have been led more by the immediate and visible revenue gain than by the wider national interest involved in boosting export trade when they supported the narrow interpretation by the Court on the scope of the exemption.

The Taxation Enquiry Commission suggested amendment to the Constitution for carrying out its recommendations on the system of levy of tax. The proposed amendment to Article 286 sought to enable Parliament to formulate principles for determining when a sale or purchase takes place in any of the ways mentioned in clause (1) of Article 286. The Constitution was accordingly amended.[37]

The Law Commission was invited to offer its suggestions for formulating principles in the matter.[38] The Law Commission

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37. The Constitution (Sixth Amendment) Act, 1956. For the text of Article 286 as so amended, see, Appendix A-2. The statement of objects and reasons to the amendment pointed out: "The object of this bill is to give effect to the recommendations of the Commission as regards the amendment of the constitutional provisions relating to sales tax". See R.V.Patel, The Central Sales Tax Act, p.403, (1966).
38. See Government of India, Ministry of Law, Law Commission of India, Second Report, p.1,(1956).

found no difficulty[39] in formulating the principles for determining when a sale or purchase takes place in the course of import or export in the light of the interpretation put by the Supreme Court in the Travancore cases[40] and the endorsement of that interpretation by the Taxation Enquiry Commission. The Law Commission had before it the views of the Ministry of Finance which indicated that the Supreme Court's formulation of the law in the Travancore cases had been accepted by almost all the States.[41] The Ministry had also pointed out that no difficulties were reported by the States to have arisen from the proposition of the Supreme Court in the Travancore cases.

The Law Commission recommended[42] the principles for eventual legislation in tune with the formulae in the Travancore cases.

The Law Commission referred to the dissenting judgment of Justice Das in the Second Travancore case.[43] The dissenting

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39. Id. pp.1,2.
40. Supra, n.1.
41. Government of India, Ministry of Law, Law Commission of India, Second Report, p.2, (1956).
42. The Commission recommended the following: "A sale or purchase of goods shall be deemed to take place in the course of export of the goods out of the territory of India only if the sale or purchase either occasions such export or is effected by a transfer of document of title to the goods after the goods have crossed the customs frontiers of India. A sale or purchase of goods shall be deemed to take place in the course of import of the goods into the territory of India, only if the sale or purchase either occasions such import or is effected by a transfer of documents of title to the goods before the goods have crossed the customs frontiers of India". Government of India, Ministry of Law, Law Commission of India, Second Report, p.3, (1956).
43. Supra, n.9.

view was that the last purchase preceding the export and the first sale after the import should be deemed to fall within the scope of the exemption. The Commission pointed out that the view of Justice Das was based partly on an interpretation which placed emphasis on the word 'course' in the expression 'in the course of export or import', and also from a desire not to cause hurdles on the way of export-import trade by imposing tax on the transactions closely linked with the export and import. The Commission did not endorse the view of Justice Das. The apprehension that export-import trade will be impeded by taxation of sales and purchases other than those covered by the majority decision in the Travancore cases was rejected by the Law Commission in the light of the views of the Taxation Enquiry Commission and the Report by the Finance Ministry that the decision had been accepted by the States and no difficulties were reported to have arisen from the decision.

It is clear that the Law Commission did not consider on its own the question whether export-import trade will be impeded by the existing system of taxation. The report of the Finance Ministry about the views taken by the States on the majority decision of the Supreme Court in Travancore cases accepting the decisions can in no way be taken as indicative of the fact that export-import trade will not be impeded by the system. Obviously a State cannot be expected to object to a system which enhances its revenue. It may be noted that the Taxation Enquiry Commission also appears to have been carried

away by the green signal given by States to the majority view in the Travancore cases. The Law Commission does not appear to have been justified in basing its decision on the two premises mentioned before.

Justice Das in his dissenting judgment had struck a note of warning when he said:

> "Tax such purchases and you tax the export itself and by that process eventually cripple our export trade— and bring about an adverse trade balance against us in the long run".[44]

That taxation of transaction of sale or purchase for the purpose of export would impede export trade was not a stray thought passed through the mind of an appellate judge, but a real apprehension shared by authorities closely connected with the export trade. This is evident from the report of the Law Commission itself. The Ministry of Commerce and Industry, the report of the Law Commission says[45], considered it desirable to include the last purchase preceding the export as one in the course of export since exemption of such transaction from tax would stimulate export. If exemption from tax would stimulate export, its denial impedes export trade.

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44. State of Travancore-Cochin v. Shanmugha Vilas Cashewnut Factory, (1953) 4 S.T.C. 205 at 240.
45. Government of India, Ministry of Finance, Law Commission of India, Second Report, pp.2,3,(1956).

The Law Commission did not reject the proposition that such exemption would stimulate export. But it turned down the suggestion made by the Commerce Ministry observing:

> "It was not, however, suggested [by the Ministry] that a similar exemption should be granted to the first sale following the import. It appears to us to be somewhat illogical that the last purchase preceding the export should be exempt whereas the first sale following the import should not be exempted. We are therefore unable to accept this suggestion".[46]

If the view of the Commission were that the first sale after import stands on the same footing as the last purchase before export, the proper course would have been an extension of the exemption to such sales as well. It is illogical to deny totally exemption to both the categories on the ground that exemption of only one category was mooted before the Commission.

The fact that the apprehension expressed by Justice Das in his minority judgment in the Second Travancore case and the view of the Commerce Ministry placed before the Law Commission are real, sound and substantial has been amply proved by commercial experience in later years.

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46. Id. at 3.

Chapter IV

JUDICIAL EXPOSITION: CLOUDS OF CONFUSION

What has been the trend of judicial decisions after the Sixth Constitution amendment[1] and the Central enactment[2] based on the recommendation of the Law Commission?

The principle of section 5 of the Central Act 1956 was interpreted by the Supreme Court in Ben Gorm Nilgiri Plantations.[3] The question involved was whether sale of tea by auction to the agent or intermediary of a foreign buyer was in the course of export. Tea was sold with export quota right and the agent exported the tea to his foreign principal.

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1. The Constitution (Sixth Amendment) Act, 1956.
2. The Central Sales Tax Act 1956 was passed in the light of the recommendations of the Taxation Enquiry Commission and the Law Commission. Sub-sections (1) and (2) of Section 5 of the Act contains the principles for determining when a sale or purchase takes place in the course of export or import. For the text of sub-sections (1) and (2) of section 5 see Appendix B.
3. Ben Gorm Nilgiri Plantations Co. v. Sales Tax Officer, A.I.R. 1964 S.C. 1752; (1964) 15 S.T.C. 753 (S.C.).

Obviously there was a sale and an export. But can it be said that the sale occasioned[4] the export?

In the view of the majority of the Court four ingredients must concur in a sale occasioning export. They are (1) common intention of the buyer and seller to export, (2) obligation to export, (3) actual export and (4) a foreign destination.[5] The obligation to export may arise by reason of statute, contract between parties or from mutual understanding or agreement between them, or even from the nature of the transaction which links the sale with the export. To occasion export, according to the majority opinion, there must exist a bond between the contract of sale and the actual exportation, each link being inextricably connected with the one immediately preceding it.[6] Justice Shah, speaking for the majority, said:

> "In general where the sale is effected by the seller and he is not concerned with the export which actually takes place, it is a sale for export. Where the export is the result of sale, the export being inextricably linked up with the sale so that the bond

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4. Section 5 of the Act enacts that a sale shall be deemed to take place in the course of export if the sale 'occasions' such export. See Appendix B.
5. Supra, n.3 at 1755.
6. Ibid.

> cannot be dissociated without a breach of the obligation arising by statute, contract or mutual understanding between the parties arising from the nature of the transaction, the sale is in the course of export".[7]

On an appraisal of the facts of the case the majority was unable to hold that the co-existence of various factors like selling of tea out of the export quota together with the export rights, earmarking of the goods for export, knowledge that the goods were purchased by bidders for exporting them to foreign principal, the factum of actual export and the obligation of the agents to despatch the tea to their principal, was sufficient enough to characterise the transaction as one falling in the course of export. In applying the principles in Section 5 of the Central Act to the facts of the present case, the Court appears to have fallen into errors.

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7. The point was clarified by examples: "For instance the foreign purchaser either by himself or through his agent purchases goods within the territory of India and exports the goods and even if the seller has the knowledge that the goods are intended by the purchaser to be exported, such a transaction is not in the course of export for the seller does not export the goods, and it is not his concern as to how the purchaser deals with the goods.... U nder a contract of sale with a foreign buyer....the goods...may...be delivered by the seller to a common carrier for transporting them to the purchaser. Such a sale would indisputably be one of export, whether the contract and delivery to the common carrier are effected directly or through agents". Id. at p.1756, per Shah, J.

If the buyer was acting as agent of the foreign principal, the transaction between the seller and the buyer which finally resulted in export should be one in the course of export. This is so because if 'A' in India sells to 'B', a foreigner on the basis of an understanding or contract for exporting the goods, the sale will be one in the course of export. The fact that the contract is concluded not with the foreign buyer but with his agent cannot make any difference. This position was correctly appreciated in the minority judgment. Justice Rajagopala Ayyangar, speaking for himself and Justice Wanchoo, said:[8]

> "(F)or here there is a single sale direct to a foreign buyer, the contract being concluded with and the goods sold delivered to his agent. It is hardly necessary to add that....there could be no difference in legal effect between a sale to a foreign buyer present in India to take delivery of the goods for transport to his country and a sale to his resident agent for that purpose".

Though the buyer in the auction was acting as agent of foreign principal, the majority viewed the transaction not as one between the seller and the foreign buyer acting through his agent. The majority viewed it as a transaction

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8. Id. at 1759.

between the agent and the seller, the export being a subsequent transaction between the agent and the foreign principal. The seller was not, in the majority view, concerned with the export and the sale was intended to be complete without export.[9] It appears that the minority view is correct. The agent was not free to deal with the tea as he wished, but was under an obligation with the foreign buyer to export it. As pointed by the minority it was part of the understanding between the seller and the buyer that the goods shall be exported.[10] In holding that the sale was not one in the course of the export, the majority failed to take into account the activities of the situation and the substance of the matter arising from the combination of various factors involved in the transaction.

The Supreme Court applied the test of diversion, in the context of import sale[11], in the landmark decision in Khosla and Co. v. Deputy Commissioner of Commercial Taxes.[12] The question for decision was whether certain sales of imported

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9. Id. at 1758.
10. Id. at 1761.
11. The expression 'in the course of' came to be interpreted by the Supreme Court in three contexts, namely, export, import and inter-State transactions. The ratio of the decisions under one category are of relevance in respect of the other two categories. See the observations of Justice Sikri in Coffee Board v. Joint Commercial Tax Officer, (1970) 25 S.T.C. 528 at 545; A.I.R. 1971 S.C. 870.
12. (1966) 17 S.T.C. 473 (S.C.); A.I.R. 1966 S.C. 1216. See also the observations of Khanna, J. in Mohamed Serajuddin v. State of Orissa, (1975) 36 S.T.C. 136 (S.C.) at 166.

goods in India were sales in the course of import. An Indian company entered into a contract with an Indian buyer for sale of goods. According to the contract the goods were to be manufactured in Belgium, imported into India, cleared from Madras port and then to be consigned to the stores of the buyer in States of Madras and Mysore. The buyer had the right to inspect the goods both in Belgium and in Madras. The buyer had also the right to reject the goods supplied if they were not in conformity with the terms of the contract. The company was responsible for the safe arrival of the goods. In accordance with the contract, the goods were imported and supplied to the buyer's stores in Madras and Mysore. The Sales Tax authority in Madras treated the supply as per the contract to the Madras stores as a local sale. The consignment to the Mysore store was treated as an inter-State sale. Both the transactions were held by the authorities to be liable for taxation in Madras.

The company contended that both sales were in the course of import. The Supreme Court upheld that contention, since the movement of the goods from Belgium to Madras was in pursuance of the contract between the company and the buyer and there was no possibility of the goods being diverted for any other purpose than supply to the stores of the buyer. The Court held[13] that the sale was in the course of import and

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13. Id. at 489.

hence not liable to taxation. In other words, not only a transaction between a foreign seller and Indian buyer which occasioned the movement of goods from the foreign country to India but even a sale after the import could be a sale in the course of import.

Ben Gorm[14] may be compared with Khosla.[15] Apart from the difference that the former case related to export and the latter was one of import, there was another material difference between the two. In Ben Gorm there was no integral connection, according to the majority, between the sale to the exporter or their agents and the subsequent export. The seller knew that the goods were meant for export. But there was no contract between the seller and the buyer for exporting the goods. If the goods were not exported subsequently, therefore, there would be no violation of the contract between them. In Khosla the import was integrally connected with the subsequent sale. If the import was not effected the subsequent sale could not have been possible. If after import the goods were not supplied to the buyer, there would have been a violation of the contract.

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14. Ben Gorm Nilgiri Plantations Co. v. Sales Tax Officer, (1964) 15 S.T.C. 753 (S.C.); A.I.R. 1964 S.C. 1752.
15. Supra, n.12.

In arriving at the conclusion that there could be more than one sale in the course of export, the Supreme Court has made a clear departure from the principles laid down in the Travancore cases.[16] Those cases insisted on privity of contract between the exporter and importer and held that only a transaction between them in pursuance of such a contract qualified to be a sale or purchase in the course of export or import. In the Second Travancore case[17] it was laid down that the first sale after import was not a sale in the course of import.[18] In Khosla[19] both the seller and the buyer were in India. The sale was effected after the import. According to the principles in the Travancore cases[20], only the purchase by the company from Belgium can be treated as one in the course of import being a purchase occasioning the import. But the Supreme Court went a step further in Khosla and held that the

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16. State of Travancore-Cochin v. Bombay Company, (1952) 3 S.T.C. 434 (S.C.) and State of Travancore-Cochin v. Shanmughavilas Cashewnut Factory, (1953) 4 S.T.C. 205 (S.C.).
17. Ibid.
18. The Court said: "This Court has already held in the previous decision (First Travancore case) that clause (1)(b) of Article 286 protects the export-import trade of this country from double taxation by prohibiting the imposition of sales tax by the State on export-sales and import-purchases, and we find no warrant in the language employed to extend the protection to cover the last purchase before export or the first sale after import". Id. at 215, 216 per Chief Justice Patanjali Sastri.
19. Supra, n. 12.
20. Supra, n.16.

sale by the company to the buyer in India was also one in the course of import, being one occasioning the import. The rationale of the decision was that the movement of the goods from Belgium to India was in pursuance of the conditions of the contract between the Indian company and the buyer in India and that there was no possibility of the goods being diverted to any other place, party or purpose. The decision is more in tune with the decision of the minority in Ben Gorm. The minority, it may be noted, held that there was no possibility of the goods being diverted for any other purpose than export in accordance with the contract between the agent and the foreign buyer and there was an integral connection between the sale and the export, making the sale in the course of export. Similarly in Khosla, the totality of the situation was taken into account in examining the existence of an integral connection and it was found that the non-possibility of diversion of goods for any other purpose than sale after the import in accordance with the pre-existing contract, created the integral connection between the import and the sale, making the sale in the course of import.

No law, whether it be a product of the judiciary or of the legislature, is immune from change. Law has only contextual relevance. The context may change calling for

change in the law.[21] The weighty precedent of the Travancore cases was side-tracked.

A few years after, a retreating trend appeared in Coffee Board v. Joint Commercial Tax Officer.[22] The Supreme Court took the view that mere obligation arising out of contract or compulsion stemming from a statute does not turn a local sale into a sale in the course of export. The Coffee Board, a statutory body, which controlled the sale and export of coffee, selected coffee for export and put it to auction in which only registered exporters participated. Coffee sold at the auction had to be exported within three months. The buyer had to export the coffee and produce evidence of export before the Board. Its sale within India was prohibited. The auction conditions declared that it was an essential condition of the auction that the coffee shall be exported to a foreign country within three months from the notice of tender issued to the buyer and that under no circumstances the coffee purchased at the auction shall be diverted or sold or be disposed of or otherwise released in India.[23] Failure to export within the stipulated time would entail penalty.[24] The goods would also then liable

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21. See Delvin, Foreword in Jowell et al. (ed.), Lord Denning, the Judge and the Law, p.v (1984).
22. (1970) 25 S.T.C. 528 (S.C.); A.I.R. 1971 S.C. 870.
23. Id. at 533. "Export Guarantee" Clause 26.
24. Id. at 534, Clause 30.

to be seized.[25] The question for decision by the Supreme Court was whether such auction sale by the Board was a sale in the course of export. The tax authority had treated the sale as intra-State sale taking the view that the sale was not inextricably bound up with the export. The Supreme Court confirmed this view. While doing so, it considered the decision in Ben Gorm[26] to be a more direct authority[27] than Khosla[28] on the issue.

According to Coffee Board[29] only the sale which causes the export could be regarded as one in the course of export.[30] The Court found that two independent sales were involved in the export programme. The first one was the sale by the Board to the exporter and the other by the exporter to the buyer outside India. Of the latter sale according to the Court, the Coffee Board did not have any inkling when the first sale took place. The Supreme Court ruled out the feasibility of two or more separate sales occasioning an export. The Court observed:

> "To establish export, a person exporting and a person importing are necessary elements and the

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25. Ibid, Clause 31.
26. Supra, n.14.
27. Supra, n.22.
28. Supra, n.12.
29. Supra, n.22.
30. Id. at 541.

> course of export is between them. Introduction of a third party dealing independently with the seller on the one hand and the importer on the other breaks the link between the two, for then there are two sales, one to the intermediary and the other to the importer. The first sale is not in the course of export, for the export begins from the intermediary and ends with the importer".[31]

These observations may be compared with the holding in Ben Gorm and Khosla. In Ben Gorm intermediaries were involved but there was a difference. It was not specifically found that they were dealing independently with the seller on the one hand and with the buyer on the other. They were acting as agents of foreign buyer. In Khosla there was an intermediary between the foreign supplier and the final Indian buyer of the imported goods. There was no finding that Khosla and Co., the intermediary between the foreign seller and the Indian buyer, was acting as agent of the seller or buyer.[32] The intermediary was acting independently with them. Yet the Supreme Court held in that case, that the sale by the intermediary to the Indian buyer after import was one in the course of import. When it was held that apart from the sale between the foreign seller and Khosla ar Co., the sale by Khosla to the Director General of Supplies and

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31. Ibid., per Hidayatullah, C.J.
32. However, for a finding to that effect in a later decision of the Supreme Court, see infra, n.57.

Disposals was one in the course of import, the Court was laying down the principle that more than one sale could occasion an import. The Coffee Board dictum that there was no feasibility of two sales occasioning an export was obviously a rule contrary to Khosla and thus presents a paradox. The interesting thing is that Khosla was not specifically overruled. It is important to note that the facts of these two cases were similar in one material respect. There was an obligation to export in one case and an obligation to import in the other. The decisions in both the cases should have been the same.

Coffee Board in not following Khosla and preferring Ben Gorm as a more direct authority was in fact impliedly overruling the Khosla dictum that more than one sale can be in the course of import. Notably, Justice Sikri who wrote the judgment in Khosla dissented in Coffee Board and observed:

> "It seems to me that this judgment is in effect overruling earlier decisions of this Court without saying so".[33]

The obligation to export, it was observed in Ben Gorm[34], may arise from statute, contract, understanding or

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33. Supra, n.22 at 547.
34. Ben Gorm Nilgiri Plantation Co. v. Sales Tax Officer, (1964) 15 S.T.C. 753; A.I.R. 1964 S.C. 1752.

even from the course of dealings of the parties. Just as in Coffee Board, in Mysore Spinning[35] there was an obligation to export: when the contract with the Mills was concluded by the exporter in circumstances which closely interlinked it with the export, the obligation to export arose within the coverage of the Ben Gorm formula. Contrary to the position in Coffee Board, there was no statutory compulsion to export in Mysore Spinning. Both the cases should have been decided differently.

It may be noted that the Court was examining in Coffee Board the meaning of the expression 'in the course of export' after the enactment of the Central Act. The scope of the formulation of the principles contained in Section 5(1) of the Central Act[36] was involved. Observing[37] that Section 5(1) adopted the principles laid down by the Supreme Court in the Travancore cases[38] the Court referred to those cases and proceeded to examine when a sale occasions the export as defined in Section 5(1) of the Central Act.

The Court went back to the Burmah Shell[39] dictum that an export meant not a mere taking goods out of the country

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35. State of Mysore v. Mysore Spinning and Manufacturing Co.Ltd., A.I.R. 1958 S.C. 1002; (1958) 9 S.T.C. 188. See n.5, Ch.III, supra.
36. For the text of the provision see Appendix B.
37. Coffee Board v. JointCCommercial Tax Officer, (1970) 25 S.T.C. 528 at 538.
38. Supra, n.16.
39. Burmah Shell Oil Storage and Distributing Co.of India v. Commercial Tax Officer, (1961) 11 S.T.C. 764.

but sending of goods to a foreign destination. It said in Coffee Board:

> "The same meaning must obviously be given to the phrase 'in the course of export' or the phrase 'occasions the export'".[40]

By so observing the Court equated a sale 'in the course of export' to an export sale. How does this reconcile with Wadeyar?[41] The Court pointed out that that in Wadeyar the sale was in the course of export because the property in the goods passed to the buyer after the goods had crossed the customs frontier. The sale was in the course of export because the course of export had already begun and the sale followed the commencement of export operation.[42] The Court added:

> "Transactions of the type of the one in Wadeyar's case do not cause difficulty. There the course of export is quite clear and it is easy to see that the sale is integrally connected with the export. Difficulty is likely to be felt when the sale is not so apparently connected".[43]

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40. Coffee Board v. Joint Commercial Tax Officer, (1970) 25 S.T.C. 528 at 540, per Hidayatullah, C.J.
41. Wadeyar v. Daulatram Rameshwarlal, (1960) 11 S.T.C.757 (S.C.).
42. Coffee Board v. Joint Commercial Tax Officer, (1970) 25 S.T.C. 528 at 540.
43. Ibid.

It appears from the above that the Court was formulating one test and applying another to decide the case. If a sale in the course of export is only the one between the seller and the foreign buyer, namely, an export sale, there is no question of another sale being integrally connected with it as to fall in the course of export. When the Court proceeded to examine whether the sale involved in the case was integrally connected with the export of the goods from this country to an importer in another country, it was examining whether sale other than the export sale could be one in the course of export, suggesting thereby that it could be, if there is an integral connection with the ultimate export.

Referring to Ben Gorm[44], the Court said:

> "The case, however did not attempt to lay down any test, observing that each case will depend on its own facts".[45]

The Court observed that it was possible to state some tests which could be applied in all cases. It formulated the following test:

> "....there must be a single sale which itself causes the export or is in the progress or process of export. There is no room for two or more sales in the course

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44. Supra, n.14.
45. Coffee Board v. Joint Commercial Tax Officer, (1970) 25 S.T.C. 528 at 541, per Hidayatullah, C.J.

> of export. The only sale which can be said to cause the export is the sale which itself result in the movement of the goods from the exporter to the importer".[46]

It is not correct to say that Ben Gorm did not lay down any test and only said that each case will depend on its own facts. An analysis of Ben Gorm would show that the Court in that case clearly held that when there is a sale and the goods sold are exported subsequently the sale was not in the course of export if the seller was not concerned as to how the purchaser will deal with the goods. On the other hand, under a contract of sale with a foreign buyer if the goods move outside the country it is an export sale. In between these two extremes there may be a variety of transactions in which the question whether it is for export or in the course of export may be doubtful. It is in respect of these categories that the Court said that no single test could be laid down as decisive for determining the question and that it may have to be determined on a correct appraisal of all the facts. This position is clear from the following observations in Ben Gorm:

> "There are a variety of transactions in which the sale of a commodity is followed by export thereof. At one end are transactions in which there is a sale of goods in India and the purchaser immediate or

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46. Id. at 541, 542, per Hidayatullah, C.J. (emphasis is mine).

> remote exports the goods out of India for foreign consumption....Such a transaction without more cannot be regarded as one in the course of export....At the other end is a transaction under a contract of sale with a foreign buyer under which the goods may under the contract be delivered by a seller to a common carrier for transporting them to the purchaser. Such a sale would indisputably one for export (sic),... but in between lie a variety of transactions in which the question whether the sale is one for export or is one in the course of export, i.e., it is a transaction which has occasioned the export may have to be determined on a correct appraisal of all the facts".[47]

An examination of the following observation in the judgment of the Coffee Board seems to suggest that there could be more than one sale if the sale in question is inextricably connected with particular export sale.

> "The compulsion to export here is of a different character. It only compels persons who buy on their own to export in their own turn by entering into another agreement for sale. The first sale is, therefore, an independent sale. It is a sale for export....It follows, therefore, unless the sale is inextricably bound up with a particular export it cannot be said to be in its course.

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47. Ben Gorm Nilgiri Plantations Co. v. Sales Tax Officer, (1964) 15 S.T.C. 753, at 759, 760. per Shah, J. The words 'for export' in the quotation appears to be inadvertently given, as is evident from the context, for the words, 'in the course of export'.

> If no particular export is in sight the sale by the Coffee Board could go beyond the description of sale for export".[48]

It follows that if each sale by the Coffee Board was connected by a subsequent specific export sale by virtue of a compulsion arising from statute such sale would be in the course of export in addition to the actual export sale. Such a situation would make two sales in the course of export. The position thus became paradoxical in view of the earlier stand that there is no room for two or more sales in the course of export.

Justice Sikri in his dissenting judgment found no difficulty in holding that two sales could occasion the export under the Act.[49] Many a sale can take place in the course of export if effected by transfer of documents of title while the goods are on the high seas. If so why can't more than one sale occasion the export, if such sales are closely connected with the export? Justice Sikri observed that the conditions of auction created a bond between the sale and the eventual export which made the sale of the Coffee Board in the course of export. The dissenting judgment of Justice Sikri undoubtedly projects the correct perspective.

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48. Coffee Board v. Joint Commercial Tax Officer, (1970) 25 S.T.C 528 at 543.
49. Section 5(1) of the Central Act. For text see Appendix B.

If the cases hitherto decided are based on analysis of complicated facts and exposition of complex provision of law, North Adjai Coal Co.[50] stands apart as one decided by the Supreme Court without basing it on the facts or on sound reasoning. The facts in brief were that there was agreements between the Governments of India and Pakistan under which the former agreed to supply coal to the latter. In pursuance of this contract, the assessee, a Colliery company, delivered coal to Pakistan and invoiced the Government of India. The sales tax authorities treated the sale as one between the assessee and the Government of India since there was no agreement between the assessee and the Government of Pakistan. The question was whether the sale was in the course of export, and was exempt from levy of sales tax under the Bengal Finance (Sales Tax) Act.[51] Between whom was the sale concluded? If there was a sale by the assessee to the Government of India and another one by the Government of India to Government of Pakistan can the former lie in the course of export? In the light of the principles evolved by the previous cases, these and other questions arise for consideration in a case of this nature. But, unfortunately, the Court did not address itself to these aspects but

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50. State of West Bengal v. North Adjai Coal Co., (1971) 27 S.T.C. 268 (S.C.).
51. Under Section 5(2)(a)(v) of the Bengal Finance Act 1941 sale of goods in the course of export within the meaning of Section 5 of the Central Sales Tax Act, 1956, was exempted from levy of sales tax.

summarily decided the case without assigning any reason whatsoever. The Court said:

> "The questions in dispute were whether there was a sale, and if so whether the sale was exempt from liability to pay tax. Without deciding whether there was a sale by the respondent to the Government of India or to the Government of Pakistan, it is sufficient for the purpose of this case to observe that the sale if any was by virtue of Section 5(2)(a)(v) exempt from liability to Salex Tax under the Bengal Finance (Sales Tax) Act, for it was a sale in the course of export".[52]

Was not the court begging the question when it decided that the sale was exempt because it was in the course of export? Since an export was involved in this and the sale by the assessee was intertwined with that export the decision of the court that the sale was in the course of export was, no doubt, justified.[53] Had Justice Shah based the decision on that premise and referred to and explained the principles on the basis of the previous cases decided, North Adjai[54] would have been a landmark in the path of justice-oriented law.

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52. Supra, n.50 at 271 per Shah, J.
53. It is to be noted that substantial justice was done to the respondent in spite of the fact that no counsel was appeared on behalf of the respondent before the Court. See the noting 'respondents have not appeared' at the end of the judgment. Id. at 271.
54. Supra, n.50.

Judicial decisions did not indicate any clear and consistent approach towards deciding the question when a sale or purchase could be held to occasion an export or import. The decision in Binani Bros.[55] for instance, applied the ratio of the Travancore and Coffee Board cases. Goods were imported into India for fulfilling agreement with the local buyer, the Director General of Supplies and Disposals. Having obtained the import licence from Government, since import was regulated, the assessee imported nonferrous metal and supplied it to the Director, the local buyer. Although the facts of this case may resemble Khosla[56], the sale was not considered to be in the course of import since the assessee was free to import the goods from any person to the country. Even after import there was no obligation on the assessee to supply the goods only to the Director. These facts dissociated the link between the import and the subsequent sale, making the sale after import not to be one in the course of import. The case was therefore distinguishable from Khosla. The Court therefore held that the assessee had to purchase the goods from outside the country for fulfilling the contract with the Director. But the import was not in any way related to the subsequent sale. The sale to the Director did not occasion the import. What occasioned the import was the purchase by the assessee from the foreign seller. The Court therefore rightly held that the sale did not qualify for the exemption on the basis of the principle in Coffee Board.

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55. Binani Bros. v. Union of India, (1974) 33 S.T.C. 254 (S.C.); A.I.R. 1974 S.C. 1510.
56. Supra, n.12.

In deciding Binani the Court gave a twist to Khosla and by that whittled down its significance. The Court doubted whether there were two sales in Khosla—one from foreign seller to Khosla and Co. and the second one by Khosla and Co. to the Director General of Supplies and Disposals. On an assumption that the Khosla and Co. was acting as the agent of the foreign manufacturers the Court preferred to see only one sale in Khosla, namely by Khosla and Co. as agent of the manufacturer in Belgium to the Director General of Supplies and Disposals in India.[57]

The decisions of the Supreme Court interpreting the law added to the confusion of thought. Lack of certitude in the legal position landed the trading class in a puzzling situation.[58] They were not in a position to arrange the affairs of the trade with any amount of certainty on the question of the liability. The law was ever changing. It was in a fluid state. The inexactitude of the state of law proliferated litigation at all levels. It was indeed regrettable that for every proposition of law there was a Supreme Court decision, one way or the other.

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57. The Court said: "From the statement of the facts of the case as given in the judgment of the High Court it is not clear that there was a sale by the manufacturers in Belgium to Khosla and Co., their agent in India. It would seem that the only sale was the sale by Khosla and Co. as agent of the manufacturer in Belgium". Binani Bros. v. Union of India, (1974) 33 S.T.C. 254 at 261, per Mathew, J.

58. The complexity of the law often results in haphazard assessments of the export-trade. See Government of Kerala, Report of the High Level Sales Tax Committee, p.59 (1961).

Chapter V

CANALISATION OF EXPORT TRADE: INCIDENCE OF TAX

Export trade stands on a footing different from local or even inter-State trade. Foreign markets are highly competitive and, unlike the domestic markets, incapable of being controlled by regulatory measure of domestic authorities. The price, quality, promptness in supply and a variety of other circumstances influence foreign trade. A comfortable trade balance is a desirable goal not only for developing countries but also for developed nations. For developing countries, foreign trade has an added significance. The trade enables the nation to earn foreign exchange which can be used for importing materials, machinery and know-how. Needless to say that this gain is a sine qua non for the process of industrialisation.

Control over the export trade will be more effective when it is canalised through agencies created or recognised by State. Such agencies are equipped with necessary expertise. Evils in export trade like under-billing, supply of goods of inferior quality, and delay in supply of goods can be avoided through the process of canalisation. Foreign importing agencies

may have better confidence that the transaction will be put through as per the contract when they are dealing with agencies created, or recognised, by the State than when they deal with private persons or agencies. In view of these and other considerations, export trade came to be canalised through agencies controlled by the State.

A major development in the law arose on the scope of the exemption of export sales from taxation in the context of export through canalising agency. In Mohamed Serajuddin[1] the question was whether sale to a canalising agent was a sale in the course of export within the meaning of section 5 of the Central Act. The assessee carried on the business of mining and exporting mineral ores. Export of ores was canalised through the State Trading Corporation. After entering into negotiations with foreign buyers, the assessee entered into contacts with the State Trading Corporation for the sale of ores. The Corporation in its turn entered into contract with the foreign buyer. According to the terms of the contract between the assessee and the Corporation the price was fixed in terms of dollars. The goods were to be delivered f.o.b. Calcutta port. The Corporation entered into f.o.b. contract with the foreign buyer for supply of goods and the price was specified one dollar more per specified

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1. Mohamed Serajuddin v. State of Orissa, (1975) 36 S.T.C. 136 (S.C.); A.I.R. 1975 S.C. 1564.

weight than the specified f.o.b. purchase value. The assessee agreed that the contract with the Corporation shall be deemed to be cancelled if the foreign buyer for any reason cancelled their contract with the Corporation.

Is the contract between the assessee and the Corporation one in the course of export? Is the sale inextricably bound up with the export so that the sale and the export constituted one integrated transaction? Does not the statutory compulsion for export through the Corporation constitute the connecting link between the sale by the assessee and the export, making the sale and the export an integrated transaction? Following Coffee Board[2] the Court held that introduction of an intermediary between the assessee and the foreign buyer broke the link between the sale and the export. There were two sales, one by the assessee to the intermediary and the other by intermediary to the foreign buyer. Only one sale caused the export and that sale was the one between the intermediary and the foreign buyer. The Court pointed out that it was the intermediary, the Corporation, which entered into the direct contract with the foreign buyer to export the goods. There was no privity of contract between the assessee and the foreign buyer. The Court held that it was the contract between the Corporation and the foreign buyer

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2. Coffee Board v. Joint Commercial Tax Officer, (1970) 25 S.T.C. 528 (S.C.), A.I.R. 1971 S.C. 870. See n.31, Ch.IV.

which occasioned the export within the meaning of Section 5 of the Act.[3]

The terms and conditions in the agreement between the assessee and the Corporation incorporated the terms settled on negotiation between the assessee and the foreign buyer. The contract between the assessee and the Corporation contemplated export and the terms were f.o.b. The price to be paid to the assessee by the Corporation was fixed in terms of dollars because under the export the foreign buyer was charged on dollars, and the Corporation was to be paid only one dollar per specified weight and the balance was to be paid to the assessee. The buyer to whom the goods were to be exported was also specified in the contract. These facts really establish a close and direct link between the sale by the assessee to the Corporation and by the Corporation to the foreign buyer. Justice Khanna in his dissent therefore observed:

> "S.T.C. was brought into the picture as an intermediary because of the legal requirement according to which the export....was to be canalised through S.T.C. Although the above requirement necessitated the execution of two agreements,... there can in my opinion be no doubt that the agreements were part of one integrated transaction".[4]

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3. Mohamed Serajuddin v. State of Orissa, (1975) 36 S.T.C. 136 (S.C.) at 149.
4. Id. at 162.

Moreover, the Corporation was bound to export the goods in terms of the contract between the assessee and the Corporation and it was not possible for the Corporation to divert the goods for any other purpose. In spite of this important aspect which established the inter-connection, the majority observed:

> "The appellant [assessee] sold the goods directly to the Corporation. The circumstance that the appellant did so to facilitate the performance of the contract between the Corporation and the foreign buyer on terms which were similar did not make the contract between the appellant and the Corporation the immediate cause of the export. The Corporation in regard to its contract with the foreign buyer entered into a contract with the appellant to procure the goods".[5]

It would appear from these observations that it was the State Trading Corporation which first entered into a contract with the foreign buyer and that it was for the fulfilment of this contract that it was entered into a subsequent contract with the assessee. Was this so in fact? One finds the situation to be just opposite. The preliminary negotiations with the foreign buyer were made by the assessee and the terms settled. To put through the transaction, since under law it was to be canalised through the Corporation, a

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5. Id. at 149, per Ray, C.J.

contract was concluded with the Corporation. The Corporation in turn entered into a contract with the foreign buyer on a one dollar margin for specified weight. This is evident from the following passage in the judgment of the majority:

> "On behalf of the appellant [assessee] it is said that the commodity could not be exported directly by the appellant in view of the restrictions imposed by law. The appellant entered into negotiations with foreign purchasers and settled all the conditions of the contract. The Corporation thereafter entered into an f.o.b. contract with the appellant and with the foreign buyer on identical terms. The Corporation is interested only in the commission of one dollar per long ton from the appellant. All the necessary steps including the payment of customs duty for the shipment and export have been done by the appellant".[6]

Justice Khanna, in his dissenting judgment, pointed out that the terms and conditions under which the ores were to be exported were settled between the assessee and the foreign buyer before the contract between the assessee was concluded. After stating the facts; Justice Khanna said,

> "I have given above the broad facts and it would appear therefrom that the agreement between the appellant and S.T.C. incorporated the terms and conditions which had been settled between the appellant and the foreign buyer".[7]

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6. Id. at 142, per Ray, C.J.
7. Id. at 161.

The basis on which the majority proceeded therefore appears to be incorrect. It was not a case where the Corporation for fulfilling orders from foreign buyers entered into similar contracts with local sellers for procuring the goods. It was a case of the assessee approaching the State Trading Corporation and invoking that agency as an intermediary for putting through the export, because of the statutory obligation, on terms and conditions negotiated with the foreign buyer and agreed upon. In short there were no two transactions in reality; there was only one, namely an export by the assessee to the foreign buyer through the instrumentality of the Corporation. The sale by the assessee to the Corporation, being incidental and integrally connected with the export and being part and parcel of the integrated activities leading to the export, ought to have been held in the course of export and exempt from levy of tax.

Further, it is worthy to note that the sale by Mohamed Serajuddin to the Corporation was on f.o.b. terms. The property in the goods passess in f.o.b. contracts, in the absence of contract to the contrary, when the goods are loaded on the ship. When the property in the goods so passes on shipment the sale becomes one in the course of export since the course of export starts from the point of time when the goods crosses the customs barriers. Does not the sale by the

assessee to the Corporation become one in the course of export in these circumstances? This question was specifically raised in Mohamed Serajuddin.[8]

It may be remembered that in Wadeyar[9] the Supreme Court held interpreting Article 286(1)(b) that f.o.b. sales are in the course of export.[10] In Mohamed Serajuddin the Court distinguished, and refused to apply the dictum, on more reasons than one. In Wadeyar the sales were direct, the transaction was one before the Central Act came into force and the bill of lading was in the name of the foreign buyer. The Court observed that in Mohamed Serajuddin the mention of f.o.b. price in the contract between the assessee and the Corporation did not render the contract f.o.b. contract with foreign buyer.

Had the decision in Wadeyar been that only a direct sale by the exporter to the foreign buyer alone would be, and that a sale by an assessee to the exporter on f.o.b. would not be, in the course of export, non-application of Wadeyar to Mohamed Serajuddin could have been perfectly justified. But the decision in Wadeyar was not as the Supreme Court understood it to be. It was decided in Wadeyar that a sale by an assessee

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8. Mohamed Serajuddin v. State of Orissa, (1975) 36 S.T.C.136 (S.C.).
9. Wadeyar v. Daulatram Rameshwarlal, (1960) 11 S.T.C.757 (S.C.).
10. See n.26, Ch.III supra.

to the exporter in India on f.o.b. is a sale in the course of export. Thus the point considered by the Supreme Court was not whether a sale by the exporter to the foreign buyer on f.o.b. terms was a sale in the course of export. The Supreme Court committed a glaring mistake in appreciating the facts and the ratio in Wadeyar.

How did the Supreme Court fall into such a mistake? It so happened that the Court wrongly understood the observation in the former case when it said:

> "In Wadeyar's case sales were direct between Daulatram Rameshwarlal and the foreign buyer".[11]

What were the facts in Wadeyar? According to the text of the judgment as reported there was a contract between the seller and 'buyer' on f.o.b. terms, the bill of lading was taken in the name of the 'buyer' and the export was to be at the 'buyer's' export licence. It was a condition of the licence that the goods shall be the property of the 'buyer' at the time of export.[12] The reference to the term 'buyer' in the Supreme Court judgment in Wadeyar connoted buyer in India who was the exporter and not the foreign buyer as misapprehended by the

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11. Supra, n.1. at p.151 (Emphasis is mine).
12. Wadeyar v. Daulatram Rameshwarlal, (1960) 11 S.T.C. 757 at pp.760,761.

Supreme Court in Mohamed Serajuddin. A look at the statement of facts by the High Court of Bombay in Daulatram Rameshwarlal v. Wadeyar[13] makes this position clear. The judgment of the single judge[14] from which the appeal arose stated the facts thus:

> "The petitioners themselves are not exporters of the goods. They have merely sold the goods for the purpose of export. The exporter of the goods are the purchasers from the petitioners".[15]

It becomes clear from this that the sales were not direct between Daulatram Rameshwarlal and the foreign buyer as the Supreme Court stated[16] in Mohamed Serajuddin. The term 'buyer' referred not to the foreign buyer, but to the Indian buyer who exported the goods is again clear from the following observations in the same judgment:

> "The sale by the petitioners to the exporter, who is licensee...".[17]

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13. (1957) 8 S.T.C. 617 (Bom.). Wadeyar v. Daulatram Rameshwarlal, (1960) 11 S.T.C. 757 (S.C.) was an appeal from this decision.
14. The decision of the High Court of Bombay in Daulatram Rameshwarlal v. Wadeyar, (1957) 8 S.T.C. 617 was itself an appeal from the decision of a single judge under Article 226.
15. Id. at 621.
16. Supra, n.1.
17. Daulatram Rameshwarlal v. Wadeyar, (1957) 8 S.T.C. 617 (Bom.) at 621.

Obviously, therefore, the sale was not to the 'foreign buyer' direct but it was to the Indian buyer who was the exporter. Chief Justice of the Bombay High Court posed the question in Daulatram thus:[18]

> "The question briefly is this: the sale with which we are concerned and which is sought to be taxed under the Sales Tax Act is a sale effected by the appellants with the firm of Godimotla Ghina Appalaraju (hereinafter referred to 'the exporters') .... the contention of the appellants is that the sale is exempted by the provisions of Article 286 of the Constitution inasmuch as the sale was effected in the course of export of the goods outside India. Everyone of the contract shows that the goods were sold by the appellants to the exporters f.o.b. It also shows that the exporters were to make payment against presentation of the documents, and also shows that the goods were covered by the buyers' export licence. On these provisions of the contract the material question that we have to determine is: When did the property in these goods pass?"

When the facts were so clear and the question involved was whether the sale by Daulatram Rameshwarlal to the exporter was in the course of export how could the Supreme Court say in Mohamed Serajuddin[19] that Wadeyar was concerned with a direct sale between Daulatram Rameshwarlal and the

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18. Id. at 625.
19. Supra, n.1.

foreign buyer. When it thought that the contract of sale was a direct one with the foreign buyer the Supreme Court misapprehended the ratio of Wadeyar. This led to the non-application of the principle in Wadeyar to Mohamed Serajuddin.

As in Wadeyar, Mohamed Serajuddin was also concerned with the question whether an f.o.b. sale to the exporter was in the course of export. It was held in Wadeyar that such a sale was in the course of export, because the property in the goods passed after the goods had crossed the customs barrier and thus the course of export started. The sale was therefore in the course of export. In Mohamed Serajuddin the sale by the assessee to the Corporation being on f.o.b. one, the property passed while the goods were loaded on the ship. The sale being complete after the goods crossed the customs barrier, Wadeyar applied on all fours. The sale was obviously in the course of export.

In order to distinguish the two cases the majority judgment further adds: "Wadeyar's case is before the Act".[20] The fact that this case was a case decided before the Central Act and the formulation of the principles in Section 5 for determining when a sale takes place in the course of export was not a material one for the non-application of Wadeyar in

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20. Supra n.1 at p.151.

Mohamed Serajuddin, because the Supreme Court has already held[21] that Section 5 of the Central Act is nothing but the legislative recognition of the principle evolved by the judiciary in the Travancore cases. The Supreme Court has not stated any reason why the principles were inapplicable. The fact that the case was one after the commencement of the Central Act did not make any difference at all and was not valid juristic reason for distinguishing the two cases.

Until the decision of the Supreme Court in Mohamed Serajuddin three types of transactions fell within the category of export sale falling under Section 5 of the Act. They are:

(i) A sale by the exporter in India direct to a foreign buyer[22] or through the medium of an agent;

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21. See Ben Gorm Nilgiris Plantation Co. v. Sales Tax Officer, (1964) 15 S.T.C. 753 (S.C.). Justice Shah observed at pp.757,758: "The Parliament has under the Central Sales Tax Act (74 of 1976) enacted by Section 5 that 'a sale or purchase of goods shall be deemed to take place in the course of export of the goods out of the territory of India only if the sale or purchase occasions such export or is effected by transfer of documents of title to the goods after the goods have crossed the customs frontiers of India'. This is legislative recognition of what was said by this Court in State of Travancore Cochin and others v. The Bombay Company Ltd., (1952) S.C.R. 1112; 3 S.T.C. 434 and State of Travancore-Cochin and others v. Shanmughavilas Cashewnut Factory and others, (1954) S.C.R. 53; 4 S.T.C. 205, about the true connotation of the expressions 'in the course of export of the goods out of the territory of India' in Article 286(1)(b)."
22. State of Travancore-Cochin v. The Bombay Co., (1952) 3 S.T.C. 434 (S.C.).

(ii) A sale taking place between the seller and buyer situated in India on f.o.b. terms;[23]

(iii) Sale effected by transfer of documents of title after the goods have crossed the customs frontiers of India.[24]

The first limb of sub-section (1) of Section 5 of the Central Act takes within its ambit the first and second categories referred to above, and the second limb of sub-section (1) of Section 5 covers the third category. It would thus be seen that sale effected by the assessee to the Corporation in Mohamed Serajuddin fell within the first limb of Section 5 of the Act, being a sale occasioning the export.

The view that an f.o.b. sale or purchase is one that occasions the export is fortified by the decision of the Supreme Court in National Tractors.[25] The liability of tax on the last purchase point within the State of Mysore under the local sales tax Act had to be decided in that case. This depended

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23. Wadeyar v. Daulatram Rameshwarlal, (1960) 11 S.T.C.757 (S.C.).
24. State of Travancore-Cochin v. Shanmughavilas Cashewnut Factory, (1953) 4 S.T.C. 205 (S.C.).
25. National Tractors v. Commissioner of Commercial Taxes, (1971) 27 S.T.C. 271 (S.C.). The judgment of the Mysore High Court against which appeal was preferred before the Supreme Court is reported from pages 272 to 279 of the Report. The Supreme Court judgment starts from page 280.

upon the finding which of the two sales involved was the one that could be characterised as export sale. The assessee, National Tractors, purchased iron ore from mine owners in Hospet, Mysore, and sold it to the State Trading Corporation for export. The agreement of sale between the assessee and the Corporation was f.o.b. Ore was transported by rail from Hospet to Hubli and then by road to Karwar port where it was loaded into ships for transportation to foreign destination. All expenses of transportation from Hospet to the point where the ore was loaded in ships were to be borne by the assessee. The assessee contended that the last purchaser was the State Trading Corporation who effected the last purchase within the State for export. Was such a contention sustainable in the eye of the law? The crucial point that fell to be determined was whether the purchase by the Corporation pursuant to contract entered into between the assessee and the Corporation was in the course of export. If the purchase by the Corporation was in the course of export, the assessee becomes the last purchaser within the State liable to tax. On these facts the Supreme Court observed that the contracts entered into between the parties being on f.o.b. terms the property in the goods passed on the shipment of the goods in the absence of a special agreement. The Court held[26] that relying on Wadeyar the assessee was the last purchaser.

It would be seen even after the Act codifying the principle in Section 5 a sale or purchase on f.o.b. terms will

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26. Id. at 282, per Grover, J.

be immune from levy of tax since property in the goods passess when the goods were in the export stream. The rationale of the proposition established through Wadeyar and National Tractors is that a sale or purchase on f.o.b. terms between a seller and purchaser in India is inextricably connected with the export. The integrality and interdependence of the sale or purchase with the export is clear. Being a sale or purchase occasioning the export within the meaning of sub-section (1) of Section 5 of the Central Act, it is therefore a sale or purchase in the course of export.

It seems, however, that the majority judgment in Mohamed Serajuddin did not correctly analyse National Tractors. After briefly narrating the facts in National Tractors, the Court observed in Mohamed Serajuddin:

> "The decision in National Tractors was on the question as to who was the last purchaser in the State. It was not the contention of the assessee that the sale to the Corporation was in the course of export".[27]

Will any assessee canvass a position against his own interest? The moment it raises such a contention, the assessee becomes the last purchaser, because the purchase by the Corporation from the assessee will be purchase occasioning export within the meaning of sub-section (1) of Section 5 of

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27. Supra, n.1 at 152.

the Central Act. Such a contention is tantamount to conceding the departmental plea that the assessee was the last purchaser. The uppermost and paramount question in National Tractors[28] centered round the f.o.b. nature of the sale involved in that case. And that was why the Supreme Court consistently and affirmatively applied the dictum in Wadeyar which was undoubtedly a case of two sales resulting in export and which has been later, after the commencement of the Act, approved by the Supreme Court in Ben Gorm.[29] Dealing with Wadeyar[30] the Court observed:

> "One more judgment of this Court may be noticed: B.K.Wadeyar v. M/s.Daulatram Rameshwarlal. The assessee in that case sold goods to an Indian purchaser, who agreed to sell them to a foreign buyer. The sales by the assessee were f.o.b. contracts under which they continue to be owners till the goods cross the customs barrier and entered the export stream. It was held by this Court that since the goods remained the property of the assessee till they reached the export stream, the sales were exempt from tax imposed by a State under

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28. Supra, n.25.
29. Ben Gorm Nilgiri Plantations Co. v. Sales Tax Officer, (1964) 15 S.T.C. 753 (S.C.).
30. The decision in Wadeyar was undoubtedly one which was helful to the promotion of the export trade. For a critical comment on Wadeyar see S.N.Jain, "Sale in the Course of Export—Wadeyar v. Daulatram Rameshwarlal", 5 J.I.L.I. 13 (1963).

Article 286(1)(b). This was undoubtedly a case of two sales resulting in export, and the first sale was held immune from State taxation, but that was so because the property in the goods passed to the Indian purchaser when the goods were in the export stream. The first sale itself was so connected with the export that it was regarded as a sale in the course of export".[31]

Mohamed Serajuddin proceeded on the basis that the f.o.b. contract is the one with the foreign buyer and that alone qualified for exemption. Previous decisions in Wadeyar and National Tractors held the contrary view. These two decisions were not expressly overruled by the Supreme Court in Mohamed Serajuddin, but the Court mistook the holdings. The Court proceeded on the basis that a sale in the export stream was possible only in a direct sale by the Indian seller and the foreign buyer. The Court thought that a sale in the course of export is nothing other than the export. An export transaction may involve two sales integrally connected with it. This is the case when there is an f.o.b. contract between A and B in India and a resultant f.o.b. contract between B in India and C in a foreign country on an identical f.o.b. terms. The first sale, though not on f.o.b. contract, with a foreign buyer is inextricably connected with it and one made during the course of export since the property in the

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31. Supra, n.29 at 763, per Shah, J.

goods passess at a point after the customs barrier. The sale is therefore in the course of export though the contract is between an Indian seller and a foreign buyer. The mistaken approach in regard to f.o.b. transaction is obvious from the following observations of the Court:

> "In the present case, the mention f.o.b. price in the contract between the appellant and Corporation does not render the contract f.o.b. contract with the foreign buyers....The appellants were required under the contract between the appellant and the Corporation to bring the goods to the ship named by the Corporation".[32]

It is clear from this that the contract between the assessee and the Corporation was f.o.b. The ratio in Wadeyar and National Tractors was squarely applicable. The legal aspects relating to f.o.b. sales were beyond any shadow of doubt. One naturally wish that the Supreme Court should have been more cautious in restating the ratio of earlier cases.

The casual and oversimplified manner in which National Tractors was treated in Mohamed Serajuddin led to perpetuation of the mistake in a later decision of the Supreme Court in Murarilal Sarawagi v. State of Andhra Pradesh.[33] That

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32. Supra, n.1 at 152, 153, per A.N.Ray, C.J.
33. (1977) 39 S.T.C. 294 (S.C.); A.I.R. 1977 S.C. 247.

was also a case of imposing tax on the last purchaser within the State of Andhra Pradesh under the Andhra Pradesh General Sales Tax Act. The assessee sold manganese ore to the Mines Minerals Trading Corporation (MMTC) for export to foreign buyers. The judgment starts posing the question whether the assessee was the last purchaser of the commodity in question. The assessee's contention was that the last purchaser was the MMTC who exported the goods. The High Court found that the assessee was the last purchaser, since, according to it, the contract between the assessee and MMTC indicated that the assessee's contract of sale occasioned the export since it was integrally connected with the contract entered into by the MMTC with the foreign buyer. The Supreme Court reversed this ruling and held that these two contracts were distinct and different and hence MMTC was the last purchaser.

In coming to the above conclusion the Supreme Court relied on Mohamed Serajuddin and rejected the plea of the State based on the f.o.b. character of the contract between the assessee and the MMTC, observing that:

> "This Court in Serajuddin's case pointed out that mention of f.o.b. price in the contracts between the manganese merchants and the S.T.C. did not render those contracts f.o.b. contracts with the foreign buyers from the S.T.C. The reason is simple. The contract between the S.T.C. and the

> foreign buyers are different contracts and it is the S.T.C., which entered into the independent contracts with their foreign buyers on f.o.b. basis."[34]

The Supreme Court had an opportunity in this case to correct its earlier position. Instead it blindly followed the misinterpretation in Serajuddin. By categorically declaring that after the decision of the Court in Mohamed Serajuddin the decision in National Tractors case is no longer good law[35] the Supreme Court was really reaffirming its own mistake.[36]

Murarilal made an incorrect statement of the law laid down in Coffee Board. The Court said:

> "The correct law is laid down by this court in Coffee Board case and Serajuddin's case. The law is this: It has to be found out whether the contracts between the merchants and the Corporation are integrated contract in the course of export or they are different".[37]

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34. Id. at 297, per Ray C.J.
35. Id. at 298.
36. The lamentation of the Supreme Court in Murarilal that the decisions in National Tractors made no reference to the decision of the Coffee Board case, is without substance. These two decisions had nothing in common.
37. Supra, n.33 at 299 per Ray, C.J.

In fact, Coffee Board did not formulate any test of integrality. The test formulated by the Coffee Board was that there must be a single sale, which itself causes the export or is in the progress or process of export. There is no room for two or more sales in the course of export.[38]

A pertinent argument raised in Mohamed Serajuddin was that even if it was found that the assessee did not have any contract with the foreign buyer the rigid rule of privity of contract should be relaxed in consideration of equity and justice. That indeed was a plea for adopting realistic approach in the context of the emergence of canalising agencies at the instance of the State. The extent of freedom that was available for export in the days of Travancore cases, are no longer in vogue. Statutory compulsion to export such goods through specified agencies has been introduced. The entering into contract through the channel of a Corporation raises in reality a presumption of such a corporation being an agent of the seller. Viewed from such perspective, it could be seen that the transaction between the assessee and the Corporation was indubitably integrated with the export. In reality, the assessee was exporting the goods to the foreign buyer through an intermediary or agent. Though the

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38. Coffee Board v. Joint Commercial Tax Officer, (1970) 25 S.T.C. 528 (S.C.) at pp.541,542.

majority dismissed the plea of agency holding that there was no principal and agent relationship between the assessee and the Corporation[39], Justice Khanna in his dissenting opinion, looking at the true nature of the transaction, found rightly that the introduction of a statutory agency with the only claim for kickbacks would not affect the real nature of the transaction that the assessee was to export the goods to the foreign buyer.[40]

In Mohamed Serajuddin the Supreme Court looked at the form of the contract rather than the substance of the transaction. A narrow dimension was given to the exemption clause[41] by this decision. The legal position reverted back to the original restrictive interpretation of the exemption provision visualized in the Travancore cases.[42] No doubt, the Rupreme Court has been instrumental in advancing the cause of justice in many important respects in various branches of law. But regrettably the experience has been quite contrary in this particular area of taxation law. In moulding norms of taxation of export-import trade what has been the contribution of the Supreme Court. A retrospect presents a dismal picture.

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39. Supra, n.1 at p.150.
40. Id. at 165.
41. Article 286(1)(b) read with Section 5 of the Central Sales Tax Act 1956.
42. See, Ch.II.

The dissenting view expressed by Justice Das in the Second Travancore[43] case is worth noting in this context. He adopted a liberal approach. To his mind the phrase 'in the course of' conveyed the idea of a 'gradual and continuous flow, an advance, a journey, a passage or progress from one place to another'. A purchase by the exporter to implement agreement for sale with a foreign buyer is, in his view, one in the course of export.[44] Such purchase is closely integrated with the export. He did not, however, think that the exemption should extend to all purchases and sales preceding the export.[45]

Purchase by the exporter or sale to him is directly connected with the export. The exporter is the 'connecting link, the commercial vinculum', between the last purchase and the export.[46] Overseas orders, purchases of goods for its fulfilment and the actual export are three activities intimately and closely connected with one another. These activities are 'like cause and effect with the actual export that they may well be regarded as integral parts of the process of export itself.[47] Such purchases must be immune from levy.

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43. State of Travancore-Cochin v. Shanmughavilas Cashewnut Factory, (1953) 4 S.T.C. 205. See also n.43, Ch.III.
44. Id. at 234.
45. Id. at 236,237.
46. Id. at 237.
47. Ibid.

Even if purchase is made anticipating receipt of orders for export the purchase is a necessary incident of the export. The goods, it is true, are stored in the godown for a while awaiting actual exportation but that is like 'a stream falling into a lake and getting out of an outlet at the other end so that the undercurrent of the flow, even if imperceptible on the surface, is nevertheless continuous'[48]. Who can ignore these well-known preliminary but essential activities incidental to export? The preceding sale cannot therefore be considered as an independent local sale distinct from the export trade.

Introduction of an agency to channellise export is designed to regulate and to boost the export trade. If there is an increased incidence of taxation consequent on its introduction a hurdle in the way of export trade is created.[49] If the trader himself exports the goods under an export licence the transaction is exempt from tax. But when an intermediary steps in the transaction is split into two, one by the trader to the intermediary and then by the intermediary to the foreign buyer. The tax burden is added to the goods when the former is taxed. The export trade of the dealer is virtually converted into local sale with the export agency. Obviously such a situation is not encouraging to the export trade.

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48. Id. at 238.
49. See V.D.Sebastian, Indian Federalism, The Legislative Conflicts, p.150, (1980).

The Court's approach to the interpretation of the law really dwindled initiative in the realm of export through canalising agency. It remains an undeniable fact that a sale of goods to the canalysing agency is closely and inseparably connected with the export. If such a sale does not qualify for the immunity from taxation, the result would be disastrous for the export trade, since increased price due to the added tax incidence makes the export uncompetitive in a thoroughly competitive international market.[50]

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50. The following observations which are relevant even today highlight this aspect: "With the mounting foreign exchange expenditure on defence and economic development of the country and the exports remaining at a stagnant level. India is in the grip of a foreign exchange crisis. Ways and means are being found to augment the exchange position. One solution to the problem is promoting of exports. With the growth of new sources of supply in other countries India's exports are meeting with tough competition. It has become a desideratum to remove all factors which inhibit our export....Sales tax on goods ultimately exported out of the country makes our exports less competitive and it is, therefore, necessary to reduce the present incidence of sales tax on our exportable goods". S.N.Jain, "Sales in the Course of Export: Need for Statutory Amendment", 5 J.I.L.I. 357 (1963).

Chapter VI

THE LAW BUNGLES

Mounting pressure on Parliament for changing the law was the aftermath of Mohamed Serajuddin.[1] The narrow and pedantic holding in that decision that only a face-to-face sale by an Indian exporter to the foreign importer qualified for exemption from tax planted apprehension in the minds of the trading class. It placed hurdles in the path of international trade. According to the Exports (Control) Orders[2], export of certain goods can be made only by specified agencies such as the State Trading Corporation (S.T.C.), Minerals and

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1. Mohamed Serajuddin v. State of Orissa, (1975) 36 S.T.C. 136 (S.C.).
2. Exports (Control) Orders are issued under the Imports and Exports (Control) Act 1947. Section 3 of the Central Act confers power on the Central Government to make provisions by order for prohibiting, restricting or otherwise controlling the import into and export of goods out of India. Besides the Imports and Exports (Control) Act 1947 there are Central enactments which control exports and imports in regard to specific commodities. The Foreign Exchange Regulation Act 1947 regulates the import and export of gold, silver, coin, currency notes and bank notes. The Customs Act 1962 invests the Central government with power to prohibit export and import of goods for the purposes mentioned therein. The export of coffee is regulated by the Coffee Board under the Coffee Act 1942. Similarly export of tea is regulated by the Tea Board under the Tea Act 1953, and coir and coir products by the Coir Board under the Coir Industry Act 1953.

Metal Trading Corporation (M.M.T.C.) and Cashew Corporation of India.[3]

Manufacturers and traders in spheres other than those affected by specific regulations, particularly in the small and medium sectors, also have to depend upon experienced export houses for exporting the goods. Special expertise is needed for carrying on export trade. Needless to say, the sale of goods made to the canalising agency or export house for export is inextricably connected with the export. If such a sale does not qualify for exemption as one in the course of export, it would be subjected to tax under the respective sales tax law of the State. The tax element will enter into the price structure of the commodity. This leads to increase of price of exportable goods. There is great competition in the world market. The Indian sellers have to capture market against tremendous odds. The price factor is an important criterion in this respect. The Central government realised the ill-effects of the Supreme Court decision and they wanted to allay the fear of the trading

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3. The constitutional validity of the system of canalisation of export has been upheld by the Supreme Court in Glass Chatons Importers and Users' Association v. Union of India, 1962 1 S.C.R. 862, Daya Son of Bhimji Gohil v. Joint Chief Controller of Imports, 1963 2 S.C.R. 73; Daruka and Co. v. Union of India, (1973) 2 S.C.C. 617.

community. Parliament came forward with an amendment Act to nullify the effect of Mohamed Serajuddin. Accordingly a new sub-section[4] was added to the provision dealing with the definition 'in the course of export'. The new law provided that sale or purchase of any goods immediately preceding the sale or purchase occasioning the export shall also be deemed to be in the course of export.[5]

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4. The new provision is contained in sub-section (3) of Section 5 of the Central Act. See for text Appendix B. In the statement of objects and reasons accompalying the Amendment Bill touching upon the consequential effect of Mohamed Serajuddin, it is stated: "This would make our exports uncompetitive in the fiercely competitive international markets. It is therefore proposed to amend....Section 5... to provide that the last sale or purchase of any goods preceding the sale or purchase occasioning export of those goods out of the territory of India shall also be deemed to be in the course of such export...." See the Statements of Objects and Reasons accompanying the Amendment Bill cited in G.C.Mathur, S.D.Singh's The Law of Central Sales Tax, p.375, (1985).
5. The need for an amendment of the Central Sales Tax Act to exempt last sale prior to export was canvassed by S.N.Jain early in 1963. He has quoted the following passage from p.36 of the Report of the Import and Export Policy Committee (Mudaliar Committee), 1962: "It has been reported to us that the definition of the expression 'in the course of export' in the Central Sales Tax Act is so worded as to exclude sales which are really intended wholly and definitely for export. For instance if a manufacturer sells to the agent of a foreign dealer and the delivery is given in India with the express and avowed object of removing the goods beyond the customs frontier, sales tax is levied on the ground that delivery was given in India. This conception of 'sale in the course of export' is believed to be much narrower than that adopted, for instance, by the Supreme Court of the United States in a number of cases. The present definition has caused some hardship; and it is suggested that a liberal view should be taken of the expression 'in the course of export and import'; and the Central Sales Tax Act should be suitably amended". See, "Sale in the Course of Export: Need for Statutory Amendment", 5 J.I.L.I. p.357 (1963) at 374, 375.

The Import and Export Policy Committee (Mudaliar Committee) appointed by the Ministry of Commerce, Government of India, had prophesied the injurious nature of the earlier provision and sagaciously suggested a wholesome liberal change in the law as early as in 1962.[6] Though late the Indian Parliament rose to the occasion after thirteen long years.[7] If the Central government had translated into reality the suggestion of the Committee that a liberal view should be taken of the expression 'in the course of' so as to include sale 'for export' as well within its ambit, a great amount of judicial time could have been saved. The necessary fillip to push up export trade could have been provided from that time onwards. In the agonising history of cold-storaging expert committee reports by the powers-that-be, Mudaliar Committee Report appears to be a tragic instance.

Even the new provision[8] enacted by Parliament in 1976 defies solution. It created a host of new problems than it attempted to solve. This was due to the apparent ill-drafting of the provision. It would be seen that sub-section (3) of Section 5 used ambiguous language. Parliament seems to have reluctantly or hesitatingly extended the concession, as is clear from the conditional clause of exemption.

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6. Ibid.
7. Section 5(3) came into force with effect from April 1, 1976.
8. Ibid.

The provision was designed to put an end to the zig zag trends in appellate judicial thinking in the area. The new law provided that sale or purchase of any goods immediately preceding the sale or purchase occasioning the export would also be deemed to be in the course of export. This was, however, subject to conditions. Such penultimate sale or purchase must have taken place after an agreement has been concluded for export of the goods or an order for such export has been received. Further the sale or purchase must be made for the purpose of complying with such agreement or order.

Thus in the context of export, the expression 'in the course of' included the last sale or purchase of any goods preceding the dexport.

Before examining the ramifications of this legislative provision, an unjust omission in the legislative scheme needs to be pointed out. That is the disallowance of similar concession in the case of first sale following import. This is not indeed the first time such an omission was made. One may recall here that long ago at the very threshold of legislative attempt to codify the legal principles in this field of taxation, the Commerce Ministry suggested before the Law Commission the desirability of including the last purchase preceding the export as a transaction in the course of export. It was thought that such a measure would stimulate export. The Ministry did not put forward a similar suggestion for exempting first sale following import.

The Law Commission therefore turned down the suggestion.[9] It is not known why and under what circumstances the Ministry of Commerce confined its proposal to export only. However, the Law Commission stated that the discriminatory approach was illogical. The Commission itself could have resolved the unreasonableness by proposing an extension of the exemption to both export and import fronts.

The aim of exemption of sale preceding the export is to boost the export trade with a view to earning foreign exchange. It may be argued that a similar exemption need not be extended in the case of sale after the import.[10] This argument is based on a mistaken assumption that by so extending the exemption the import will be pushed up. An exemption from tax on sale after import can result in an inflow of goods from other countries only in a free market economy where the import trade is uncontrolled by government regulations. When in pursuance of well-considered import policy, absolutely essential goods like raw materials and machinery are imported with hard earned foreign exchange, a policy of taxation that would create burden by way of price increase in respect of those goods is unscientific.

The absence of logic pointed out long ago by the Law Commission still continues. It calls for correction by extending the exemption in the context of import also.

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9. See Ch.III, n.46.
10. See for instance, S.N.Jain, "Sale in the Course of Export: Need for Statutory Amendment", 5 J.I.L.I. p.357 (1963) at pp.372-373.

The Constitution authorises[11] Parliament to formulate principles governing when a sale or purchase takes place in the course of export or import. Parliament enacted that sale or purchase penultimate to export shall be deemed to be in the course of export when certain conditions are satisfied. Can it be said that it was formulating any principle? Was it not merely declaring that certain sales shall be deemed to be in the course of export? If so was not the provision ultra vires the Constitution? These questions were posed before the Supreme Court in Consolidated Coffee Ltd. v. Coffee Board.[12]

The Court rightly held that what was contained in the provision was not a mere fiction but a general principle. The word 'deem' in the provision did not mean a fiction, but it is used to declare a principle. A 'principle' is a guiding rule applicable generally and does not include specific directions. Approaching the question from this angle, the Court saved the provision from attack on the ground of constitutional invalidity. The Court held that the provision formulated a principle inasmuch as it laid down the general guiding rule applicable to all penultimate sales that satisfied the conditions specified therein.[13] The case came before the Supreme Court by way of writ petition under Article 32 of the Constitution moved by

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11. Constitution of India, Article 286(2). For text, see Appendix A.
12. (1980) 46 S.T.C. 164 (S.C.); A.I.R. 1980 S.C. 1468.
13. Id. at 175,

registered exporters of coffee. The validity of a circular demanding deposit and bank guarantee from registered exporters as also the scope of Section 5(3) of the Central Act came to be determined by the Supreme Court in Consolidated Coffee.[14]

The language of the provision[15] granting the exemption is ambiguous and equivocal. The exemption is conditional. To qualify for exemption there has to be an agreement for export. Agreement with whom? With a foreign buyer? Or, would it include an agreement to export and for that a sale to a local party? The view was canvassed that the term should be understood to cover not only an agreement with a foreign buyer, but also an enforceable agreement to export, even with a local party to implement which the penultimate sale was made.

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14. Ibid. The Coffee Board issued a circular which stipulated conditions to avail of the benefit of exemption. The traders had to furnish deposits or bank guarantees equal to the amount of sales tax which would be due if the sales were not held to be exempted under Section 5(3), in respect of the coffee sold by it at the export auction. According to the circular, the buyer at the auction should, in order to get exemption from tax in respect of the purchase of coffee at the auction must have an export contract (namely either agreement or order) with a foreign buyer at the time of auction and that the coffee purchased by him at the auction should be exported in pursuance of it and proof of export produced. The sale of coffee by the Board to the buyers (registered exporters) took place on the condiction which was an express one and an essential term of the contract, namely, the coffee shall be exported and shall not be diverted to any other destination or sold or disposed of or released in India. The question was whether the auction sale of coffee by the Board to the exporters on such condition was exempt from levy of sales tax.
15. Central Sales Tax Act 1956, Section 5(3).

The Supreme Court did not uphold the view that an agreement to export need not be with a foreign buyer but can be with a local person for the purpose of making the penultimate sale a sale in the course of export. The reasoning of the Court in arriving at the conclusion was that Section 5(3) of the Central Act provided that the penultimate sale should be for the purpose of complying with the agreement or order in relation to the export. The word 'order' in the context of the legislation must be understood in a commercial sense, meaning firm request for supply of goods emanating from a buyer. It cannot mean an order, direction, mandate, command or authorisation to export that may be issued by a statutory body like the Coffee Board. An order for export therefore means an order for supply from a foreign buyer. The word 'agreement' according to the Court, would take colour from the word 'order' and would on the principle of noscitur a sociis also mean, an agreement with a foreign buyer.[16] More importantly, the Court found justification for its stand from the user of the definite article 'the' before the word agreement, because Parliament has not said 'an agreement' or 'any agreement' for or in relation to such export. In the context, the expression 'the agreement' would refer to that agreement which is implicit in the sale occasioning the export, clearly suggesting that the agreement is one with the foreign buyer.[17] The agreement with or order from the foreign buyer must be available before the penultimate sale was complete.[18]

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16. Consolidated Coffee Ltd. v. Coffee Board, (1980) 46 S.T.C. 164 at 179.
17. Id. at 197.
18. Ibid.

The provision, as it stands, is detrimental to foreign trade. If it is insisted that there has to be an existing agreement with a foreign buyer and that the sale to the exporter should be in pursuance of it would take a lot of goods exported outside the purview of exemption. On the other hand, a provision to the effect that a contract even with a local buyer to export would qualify the sale for exemption has a beneficial implication. It will make sales to exporters free from tax. This in turn would promote export trade since goods could be made available at competitive rates in international market.

Why not the penultimate sales also be exempt even if the orders are obtained by the exporter afterwards if the sale takes place on the express condition that the goods shall be exported and the same shall not be diverted to another destination or sold or disposed of or released in India? An agreement with the export house or the agency that the latter shall export the product should be sufficient to qualify for exemption. It would facilitate export at competitive price. The exemption should not therefore depend on the circumstances of a pre-existing foreign contract or order. A legislative reform is the proper remedy at this juncture.

The Supreme Court[19] noted that the question of exemption from tax of the export trade involves two public interests.[20]

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19. For a comment on the Consolidated Coffee case, see S.N.Jain, 1980 A.S.I.L. 508 at pp.514-518.
20. Supra, n.12 at p.183.

Promotion of export trade is one public interest.[21] Augmentation of State revenue is another. By a liberal construction the former public interest is served, but the latter public interest is severely curtailed. The Court observed that it is difficult to hold that Parliament intended to prefer one and sacrifice the other. The limitation of exemption to penultimate sale that satisfied the condition was indicative of State's anxiety not to diminish States' revenue unduly.[22]

The public interest involved in export promotion and earning of foreign exchange should be given precedence over the public interest involved in raising internal tax revenue in a developing country. The nation strives to earn foreign

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21. The Attorney-General appearing for the Coffee Board stated that a liberal construction of Section 5(3) extending the exemption to sales to exporters would promote the export trade by making the Indian coffee available at competitive rates at international market. Id. at 177.
22. Justice Tulzapurkar said: "....it is obvious that if the liberal construction, as suggested by the counsel for the petitioners, is accepted the former public interests will undoubtedly be served while the latter will greatly suffer and if the narrow construction is accepted the latter public interest will be served and the former will suffer. It is difficult to say that the Parliament intended to prefer one and sacrifice the other. In fact the granting of exemption to penultimate sales was obviously with a view to promote the exports but limiting the exemption to certain types of penultimate sales that satisfy the two specified conditions displays an anxiety not to diminish the States' revenue beyond a certain limit". Ibid.

exchange by all means. India's industrialisation depends largely upon it. Through industrial endeavours the States could earn by levying taxes on manufactured goods, which will raise tax revenue, besides creating new employment opportunities to the people. The loss of revenue for the States due to the liberal construction of the provision does not appear to be serious when compared to the benefit that it may bring due to industrialisation and the increase of employment potential. The exemption provision therefore calls for a change.

In Ben Gorm[23] the Court had observed that a sale is inextricably bound up with the ultimate export if the link between the two cannot be voluntarily interrupted without a breach of the contract. The link is created by the obligation to export. Such obligation can arise by reason of statute, contract or even mutual understanding between the parties. There was an obligation to export in Consolidated Coffee.[24] Coffee was sold to the exporters by the Coffee Board for export. Was not the penultimate sale therefore exempt as a sale in the course of export being a sale occasioning the export on the basis of Ben Gorm? Such a contention was raised in the case. The Court answered the question in the negative.

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23. Ben Gorm Nilgiri Plantations v. Sales Tax Officer, (1964) 15 S.T.C. 753.
24. Supra, n.12.

The Court severely curtailed the dimensions of the Ben Gorm doctrine[25] and observed that the doctrine should be read in the context of the facts of that case.[26] This appears to be a polite way of diluting the dictum. The celebrated dictum was a general statement obtaining from the legal position as it stood then, and not from ephemeral observations rendered exclusively for deciding Ben Gorm.[27] The Court drew up the general principle in that case, which may apply in the absence of peculiar factors which may call for formulation of a different test. The Court said that whether a sale is for export or one in the course of export is a question to be decided on the basis of an appraisal of all the facts. The Court added however that though no single test could be laid down as decisive for determination of that question, the distinction between a sale for export and one in the course of export was real. After the crucial sentence[28] the Court in the same paragraph proceeded to say in Ben Gorm:

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25. Ibid.
26. Supra, n.12 at 183.
27. See Deputy Commissioner of Agricultural Income Tax and Sales Tax v. Indian Explosives Ltd., (1985) 60 S.T.C. 310 at 313 where Justice Tulzapurkar observed that the text of integral connection is formulated by the Supreme Court in Ben Gorm, (1964) 15 S.T.C. 753 (S.C.) at 759.
28. The crucial sentence in Ben Gorm is this: "The obligation may arise by reason of statute, contract between the parties, or from mutual understanding or agreement between them, or even from the nature of the transaction which links the sale to export..." Ben Gorm Nilgiris Plantations v. Sales Tax Officer, (1964) 15 S.T.C. 753 at 759 per Shah, J.

> "....In general, where the sale is effected by the seller, and he is not connected with the export which actually takes place, it is a sale for export. Where the export is the result of sale, the export being inextricably linked up with the sale so that the bond cannot be dissociated without a breach of the obligation arising from the statute, contract, or mutual understanding between the parties arising from the nature of the transaction, the sale is in the course of export".[29]

The words 'in general' clearly indicate the general nature of the statement of the law. Moreover the generality of the statement was so understood by the Supreme Court itself in cases[30] prior to Consolidated Coffee, dealing with similar issues. If the observations were related only to the facts in Ben Gorm, the Court would not have banked upon them in the prior cases.

After stating that Ben Gorm did not lay down any general proposition of law, the Court proceeded to say in Consolidated Coffee:

> "....even if the Ben Gorm Nilgiri Plantations case is regarded as laying down a general proposition... still the question would be what type of obligation

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29. Id. at 760. (Emphasis is mine).
30. See for instance, Coffee Board v. Joint Commercial Tax Officer, (1970) 25 S.T.C. 528 at 541; Binani Bros. v. Union of India, (1974) 33 S.T.C. 254 at 259; Mohamed Serajuddin v. State of Orissa, (1975) 36 S.T.C. 136 at 146.

> and arising from what circumstances would be necessary or enough in the case of penultimate sale must depend upon the language of the statute concerned and therefore the question will again be what type of obligation and arising from what circumstances has been prescribed by the Parliament by enacting Section 5(3) and that would depend upon the proper construction of the phrase 'the agreement or order for or in relation to such export' occurring therein...."[31]

The above-quoted observations of the Court, curtail the meaning of the concept of sale 'occasioning the export' enshrined in Section 5(1) of the Central Act. That concept has been given shape in Ben Gorm and other cases. The obligation to export may, accordingly, stem from a variety of circumstances. But in Consolidated Coffee it is confined to two circumstances, namely prior agreement or order from foreign buyer. This erroneous view resulted from the linking up of Section 5(3) with Section 5(1). The two sections deal with distinct and separate situations. Section 5(1) deals with sale occasioning export. Section 5(3) deals with sale preceding the one which occasions the export. This is evident from the historical background of section 5(3). There was no need for clubbing the two and limiting the scope of Section 5(1) by interpolating words which were not there. There was no need for borrowing words from Section 5(3)

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31. Consolidated Coffee Ltd. v. Coffee Board, (1980) 46 S.T.C.164 at 184.

to interpret Section 5(1). In so doing the Court limited the scope of Section 5(1) in a manner not warranted by the circumstances.

It appears that the Court was in error in not applying the Ben Gorm doctrine to the facts of the Consolidated Coffee where the sale, looked at from any angle, was unquestionably integrated with the export. If the goods are not exported, that would entail penalty, besides seizure by the Coffee Board. Property passed to the auction purchaser after the same is shipped or sent to the customs station. Till then Coffee Board had right over the goods. The sale had almost an f.o.b. connotation and even then the Court adopted a narrow view.

The Court committed a fundamental mistake in holding that the obligation to export should, after the enactment of Section 5(3) of the Central Act, be of a nature specified in that enactment. When in Ben Gorm it was held that the obligation to export may arise from statute, the Court was referring to a statutory requirement to export which would make the sale one occasioning the export. The provision in Section 5(3) of the Central Act that a sale to exporter to fulfil prior contract with a foreign buyer would be in the course of export, does not create any obligation to export. Section 5(3) of the Central Ac was laying down a principle for deciding when a sale not occasioning the export would qualify for exemption, on fulfilment

of the two conditions. When a sale is closely connected with export, as in a case where the statute creates an obligation to export, the sale is one which occasions the export. For deciding whether or not such an obligation to export exists, the Court in Consolidated Coffee ought to have looked into the Coffee Act, 1942. The mistake of the Court did lay in applying Section 5(3) of the Central Act for deciding the question of statutory obligation to export.

The requirement that there should be a pre-existing contract with the foreign buyer for the supply of goods and a resultant purchase by the exporter for the purpose of exemption of penultimate sale raises some problems. Suppose an exporter purchases packing materials for packing marine products exported by him. The pre-existing contract is for supply of marine products only. But these products cannot be exported without packing. Will the purchase of the necessary packing materials by the exporter or the sale of such materials to him be eligible for exemption under Section 5(3)? This question came up for adjudication before the Madras High Court in Packwell Industries v. State of Tamil Nadu.[32] The Court held that packing materials, required for packing of marine products for export, supplied to exporters did not qualify for exemption as they were not the

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32. (1982) 51 S.T.C. 329 (Mad.).

subject-matter of the contract of export with the foreign buyer.[33] This position exposes the inadequacy of the provision of granting exemption to the penultimate sales enacted with a view to boosting export trade.[34]

What would be the case if the goods sold to exporter from part of the goods for which there exists a pre-existing contract for export. In other words if the goods contracted to be exported are purchased in part from different sellers will the transaction be eligible for exemption? A question of this nature arose in Girdharilal.[35] There was a contract for export of football including bladders. Orders were placed by the exporters to the assessee. The assessee manufactured only football covers. He sold the football covers to the exporter. The sale occasioned the export of those goods in the same condition in which they were received by the exporters. The High Court of Andhra Pradesh on these facts held[36] that the contention of the State that for the purpose of being entitled to exemption under Section 5(3) of the Act the assessee must sell

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33. Id. at 330. The Tribunal had found that the packing cases were not the subject-matter of the contract for export. In view of this finding the Court held that packing materials did not qualify for exemption.
34. For a comment pleading for an inference of an implied term in the contract also for the packing material of the exported good, see S.N.Jain, (1982) A.S.I.L. 500, at pp.509,510.
35. Commissioner, Sales Tax v. Girdharilal Football Maker, (1987) 65 S.T.C. 287 (All.).
36. Id. at 289.

football bladder as well as covers, was not correct. The sale of the football covers by the assessee was held to be eligible for exemption.

The exemption for penultimate sales will be available when two conditions are satisfied, namely, there must be an anterior contract for export and the same goods purchased in pursuance of such contract should be exported.[37] Exemption is not allowable if the goods agreed to be supplied to the foreign buyer are different from the goods purchased. Obviously if the goods purchased are subjected to a process of manufacture before export the goods exported cannot be said to be the same as the goods purchased. Quite often it may become necessary to process the goods before they are exported. In such a context disputes would arise on the eligibility of penultimate transactions for exemption under Section 5(3).

A question of such a nature arose, though not in the context of Section 5(3) of the Act, in Kailash Nath v. State of U.P.[38] The assessee sold cotton cloth to exporters who after dyeing and hand-printing, exported them outside India. Under a notification issued by the State Government, sale of cotton cloth with a view to export outside India was not taxable if proof of

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37. Central Sales Tax Act 1956, Section 5(3).
38. (1957) 8 S.T.C. 358 (S.C.); A.I.R. 1957 S.C. 790.

actual export was furnished. The State levied tax on the transaction. The contention that when cloth was coloured and printed it was transformed into some other material did not succeed.

In Deputy Commissioner of Sales Tax (Law) v. Neroth Oil Mills Co.,[39] the assessee purchased prawns from catching centres. They were subjected to processing, namely, pealing, cleaning, grading, cooking and freezing before export. The claim for exemption of the purchase turnover from levy of tax was rejected by the sales tax authority on the ground that what was exported was not the same commodity. The claim of the assessee for exemption was upheld by the Sales Tax Appellate Tribunal.[40] On revision the High Court of Kerala held that the prawns purchased by the assessee and the prawns exported after processing are commercially the same commodity.[41] Peeling, cleaning and processing were held to be the minimum requirements for making the article exportable, and these activities, did not convert the thing into a different article.[42] The question ultimately came up before the Supreme

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39. (1982) 49 S.T.C. 249 (Ker.).
40. The Tribunal upheld the claim by applying the decision of the Supreme Court in Deputy Commissioner of Sales Tax (Law) v. Pio Food Packers, (1980) 46 S.T.C. 63 (S.C.); A.I.R. 1980 S.C. 1227 wherein pinapple fruit was purchased and afterwards sliced, packed and sold in sealed containers. The Court held that although a degree of processing is involved in preparing pinapple slices from the original fruit, the commodity continues to possess its original identity, notwithstanding the process involved.
41. Supra, n.39.
42. The Madras High Court also held a similar view. See, State of Tamil Nadu v. Cevere Southern, (1983) 52 S.T.C. 328 (Mad.) and State of Tamil Nadu v. Tata Oil Mills Co., (1983) 52 S.T.C. 328. These two cases are reported in the same page.

Court in another case, Sterling Foods v. State of Karnataka.[43] The Court held that frozen shrimps, prawns and lobsters are commercially regarded the same commodity as raw shrimps, prawns, and lobsters. Cutting of head and tail, peeling, deveining, cleaning and freezing did not alter the nature of the goods. The Court formulated the test for determining whether the processing alters the original character and identity of the goods. The test is whether the processed commodity is regarded in the trade by those who deal in it as distinct in identity from the original one or is regarded the same as the original. The Court said:

> "With each process suffered, the original commodity experiences change. But it is only when the change or a series of changes take the commodity, to the point where commercially it can no longer be regarded as the original commodity, but instead is recognised as a new and distinct commodity that it can be said that a new commodity, distinct from the original has come into being".[44]

This decision has been followed in Canara Exports v. State of Karnataka.[45] In Shiphy International[46] also the same view was reiterated. The test of commercial parlance applied by the

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43. (1986) 63 S.T.C. 239 (S.C.); A.I.R. 1986 S.C. 1809.
44. Id. at 243, per Bhagwati, J.
45. (1987) 66 S.T.C. 153 (S.C.).
46. Deputy Commissioner of Sales Tax (Law) v. Shiphy International, (1988) 69 S.T.C. 325; A.I.R. 1988 S.C. 992.

Court for deciding the question whether the processing amounts to manufacturing resulting in a change of identity of the goods is quite apposite.

While it appears that the controversy on eligibility for exemption of purchase tax on marine products has been satisfactorily adjudicated by the Supreme Court[47], the dispute in regard to the claim of exemption in the case of purchase of cashew-nuts by an exporter for exporting kernel after processing it in factory is awaiting adjudication by the Supreme Court.

The question whether cashewnut and its kernel are two different commercial commodities came up for adjudication before the Andhra Pradesh High Court in Malabar Cashewnuts and Allied Products.[48] The assessee was an exporter of cashew kernel. He purchased raw cashewnut in the State of Andhra Pradesh. After processing them in the factory he exported the kernel to countries outside India. The purchase turnover of cashew was subjected to tax under the local Act. The claim for exemption on the ground that the raw cashewnut was purchased in the State solely for the purpose of complying with the agreement entered

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47. See supra, nn.43,45,46.
48. Malabar Cashew Nuts and Allied Products v. State of A.P., (1988) 68 S.T.C. 269 (A.P.).

into with foreign buyers for sale of cashew kernel and that the transaction should be exempted since cashew nut and kernel were the same commodity was rejected by the sales tax authority. The High Court, however accepted the contention of the assessee following an earlier ruling of the same court in Singh Trading Co.[49], though in a different context. In that case it was held that though cashew kernel is taken out by drying of cashew nut and breaking open the shell of the nut and that involves a certain process, still it could not be said that cashew nut and kernel are two different commercial commodities. Cashew nut is subjected to that kind of process only to make the kernel usable.

The Madras[50] and Kerala[51] High Courts have disagreed with this view. According to these courts when cashew nut was subjected to the process, whether manually or mechanically, the product which came out of it was different commercially. However the Madras High Court decision[52] is pending in appeal before the Supreme Court.[53] The controversy whether cashew nut

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49. Singh Trading Company v. Commercial Tax Officer, (1979) 44 S.T.C. 1 (A.P.).
50. Dinod Cashew Corporation v. Deputy Commercial Tax Officer, (1986) 61 S.T.C. 1 (Mad.).
51. State of Kerala v. Sankaran Nair, (1986) 63 S.T.C. 225 (Ker.).
52. Dinod Cashew Corporation v. Deputy Commercial Tax Officer, (1986) 61 S.T.C. 1 (Mad.).
53. Justice Anjanayelu observes in Malabar Cashew Nuts and Allied Products v. State of A.P., (1988) 68 S.T.C. 269 (A.P.) at 273: "It is submitted that the Madras High Court's decision is the subject-matter of appeal before the Supreme Court".

and its kernel are the same commercial commodity remains unsettled. A decision by the Supreme Court that cashew nut and cashew kernel are one and the same commodity and that the identity remains the same even after the processing would be one in tune with the purpose of enactment of the provision. Such a decision will serve the cause of our export trade better.

When an exporter purchases pepper and after a process of garbling, exports it, is the exemption available under Section 5(3) of the Act? It was contented on behalf of the Revenue in Sheth Brothers[54] that it was not a purchase in the course of export falling under the exemption clause. It was argued by the State that the goods exported were not the same goods purchased by the exporter. No doubt the purchase by the exporter in the context of Section 5(3) is a purchase occasioning the export. The question was decided by the Kerala High Court against the revenue. The Court rightly held that merely because pepper purchased was subject to a process of cleaning and making it presentable for the export market the identity of the goods did not change. By a process of garbling, pepper did not undergo a process which changed its character so as to render it a different commercial commodity. What was purchased by the exporter and what was sold by him was pepper. Garbling involves only a work incidental to export such as stone-picking,

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54. Deputy Commissioner of Sales Tax v. Sheth Bros., (1983) 52 S.T.C. 40 (Ker.).

dust removing, washing, drying, oil polishing, grading and packing. The States take up the position that such processes change the identity of the goods with a view to impose tax on the transaction. Obviously, States have no interest or concern in the export trade. The State wants to squeez the last drop of revenue by way of tax from the dealer. It has least consideration for lessening the tax burden in order to provide exhileration to the exporter. The State, it appears, sees the earning of foreign exchange as exclusively the responsibility of the Centre. A change in the attitude of the State is necessary. Some practical steps should be adopted to achieve this.

The denial of exemption to penultimate transactions of goods which are exported appears to be illogical in the context of the obvious legislative intention to boost export trade. The purpose of boosting the export will be better served by exempting all sales to exporters. The denial of exemption on the ground that the goods purchased are processed or manufactured or packed to make it exportable, and therefore, they are not the same goods, is unjustifiable.

Export trade would in the ultimate analysis generate more revenue. The foreign exchange earned by export trade could be used for developmental and productive purposes which would undoubtedly produce more tax bases and would generate more revenue. There may be loss of revenue to a particular

State at a given time by not taxing a sale involved in export. But such loss will be compensated when more and more industrialisation is rendered possible by import of raw materials, and machinery using the foreign exchange earned as a result of export. Subsidiary industries may also grow up widening the scope of employment as also the tax base. Tax reduction or cut will inspire manufacturing and productive endeavours. Imposition of heavy taxes may not always result in more revenue.[55] It may, on the other hand, generate a tendency for evasion.[56] The loss incurred by the State on account of exemption given to export oriented sales should be reimbursed to the State by the Central Government in proportion to the quantum of export made from each State. Such a measure has an added advantage. States will cooperate more with the Centre in promoting export.

The legislative attempt in mid-seventies extending the tax exemption to limited spheres of export trade has misfired. The amendment was too efficacious to achieve the desired goal. Ambiguous and half-baked, the law had the provision hedged in by limitations. In setting the law in the right direction, the Supreme Court had a tremendous opportunity which it did not make the most of. Instead of accelerating the goal-oriented justice, the Court applied a break, and caused setback to export trade.

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55. See, N.A.Palkhivala, We, the People, p.92 (1984).
56. For a discussion on the evasion of tax see, Government of Kerala, Report of the Committee on Commodity Taxation, pp.46-53 (1976).

Chapter VII

IMPORT OF GOODS AND TAX IMMUNITY: PROBLEMS AND PERSPECTIVES

In the context of stiff competition in international market tax exemption to export sale is one of the significant factors helpful to capture foreign trade. Incentive to export is a measure to save the country from falling balance of trade. The process of import involves payment in foreign exchange. Ostensibly, the criterion for tax exemption in respect of import purchase need not be the same as for export.

There has been spectacular industrial and technological progress in the country after the attainment of independence. The phenomenon of growing trends in the economy does not however rule out the need for import of essential raw material and sophisticated machinery. The need for import of such material and machinery continues to be imperative not only for maintaining the present rate of growth but also for quickening the pace of industrial development and technological advancement.

> The power to tax may become the power to destroy.[1]

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1. McCulloch v. Maryland, 4 L.Ed. 579 (1819) at 607. It was observed by Chief Justice Marshall in declaring a State tax on a Federal Bank as unconstitutional, "That the power to tax involves the power to destroy; that the power to destroy may defeat and render useless the power to create....are propositions not to be denied". Also see, V.G.Ramachandran, "Is the Constitution of India Federal", 1959 1 M.L.J.Jour. 31 at 33.

A tax on raw materials imported for feeding indigeneous industry will be a real tax on industrialisation. Naturally, exemption from tax will always be a blessing for those who deal in goods. On certain occasions it may even be pace-setter for economic development. A member of the Central Board of Taxes in an enlightening study, observes:[2]

> "Series of provisions for tax exemption, concessions, reliefs and incentives in our tax laws are intended to assist economic development of our country".

Import is regulated by law.[3] Under the Importy Policy of the Government of India there are different categories of importers.[4] Of these, import by the actual user who imports through another person has given rise to disputes regarding liability to tax.

If another person is engaged to import goods against licence issued to the actual user, the licence has to be handed over to the importer. A letter of authority for import obtained

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2. R.D.Shah, "Tax Reliefs and Incentives for Foreign Investments", in D.C.Pande, (ed.), Government Regulation of Private Enterprises, p.317 (1971).
3. For a study on Import Trade Control in India, see S.N.Jain, "Import Trade Control in India", in D.C.Pande, op.cit., p.317.
4. For a short survey of current import policy and licensing procedures, see K.P.Jain et al. (eds.), Nabhi's Importer's Guidelines (1986-87), pp.13-32, (1986).

from the concerned authority should also be given to the importer. Is the transaction of supply of goods by the importer to the actual user liable to tax or is it exempt being in the course of import? This has been the subject matter of legal dispute.

The Supreme Court had the occasion to consider a case involving such a question in Deputy Commissioner v. Kotak.[5] Kotak and Company entered into contract with certain textile mills for importing and supplying cotton. The import was to be made by the Company on the basis of actual users' import licence issued to the textile mills and letter of authority issued by the Government. The letter of authority authorised the company to import cotton against import licence issued to the mills. The contract between the mills and the Company specified the quantity, quality and price of the goods. The place from where the goods were to be imported was also specified. The contract was irrevocable and the sale was subject to the conditions of import licence. After shipment of the goods at the foreign port the documents of title were sent to the Company who received the same from the bank on payment of the value. The Company then gave information to the mills, who made payment in accordance with the terms of the contract with the company. Thereafter the goods were cleared and delivered to the mills by the clearing agent.

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5. (1973) 32 S.T.C. 6 (S.C.).

The question was whether the sale of cotton by the company to the mills occasioned the import. The Supreme Court held that it did so.[6]

It may be noted that the question whether the relationship between Kotak and Company and the mills was one of agent and principal was not specifically raised and decided in the case. The letter of authority issued in favour of the company contained a clause to the effect that the company will act purely as an agent of the licensee. The goods imported will be the property of the licensee at the time of clearance through customs and afterwards. If the company was acting only as an agent, the privity of contract will be between the mills and the foreign supplier and the sale will be between these two. The court found that the clause in the letter of authority must be read as part of the contract. However it proceeded on the basis that transaction between the mills and the company was one of sale.[7] The question that was actually decided therefore was

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6. Ibid. The Court arrived at this decision thinking that this case and the Khosla case discussed earlier (Ch.IV, n.12) had similar facts.
7. Referring to the clause in the letter of authority the Court said: "This clause must be read as part of the contract entered into between the respondents and the mills. Even if this clause had not been there there would have been no difficulty in coming to the conclusion that the respondents were precluded from selling the goods to anybody other than the mills to whom the user's import licence had been granted. From the facts set about above, it is obvious that the respondents could not have sold the goods to anybody other than the licence holders". Id. at 12, per Hegde, J.

whether the sale by the company to the mill was one occasioning the import.

The legal position was made clearer by the Supreme Court in Deputy Commissioner v. Indian Explosives.[8] Chemicals and dyes were imported by Indian Explosives, the assessee, on the strength of the actual user's import licences obtained by its customer. The imported goods were supplied to the customer for use in their factory. The customer placed orders with the assessee. The assessee in turn placed orders with the foreign supplier. In such orders the name of the customer who required the goods and the number of the licence were specified. The letter of authority was also given authorising the assessee to import. The import licence expressly contained two conditions: One was that the goods imported will be the property of the licensee at the time of clearance through customs. The other was that the goods will be utilised only for consumption as raw material or accessories in the licensee's factory. On a construction of the documents the Court held that the import of the goods by the assessee was for and on behalf of the customer and the assessee could not, without committing a breach of the contract, divert the goods so imported for any other purpose. It could not be disputed that there was an integral connection

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8. (1985) 60 S.T.C. 310 (S.C.); A.I.R. 1985 S.C. 1689.

between the sale to the customer and the actual import.[9] The Court applied the test of integral connection or inextricable link between the sale and the actual import.[10]

The case proceeded on the basis as in Kotak that there was a sale by Indian Explosives to its customer although the decision was however not referred to. The Court held that such sale to the customer is inextricably connected with the import, because of two circumstances, namely, the use of actual users import licence for the import and the condition prohibiting diversion of goods after import. It held:[11]

> "In fact, it is these two factors obtaining in the instant case which established the integral connection or inextricable link between the transactions of sale and the actual import making the sales in the course of import. In fact, as pointed out earlier, the movement of the goods from the foreign country to India was in pursuance of the requirements flowing from the contract of sale between the respondent-assessee and the local purchaser and as such the sales in question must be held to be in the course of import".

When import licence is obtained by the actual user and letter of authority is issued to another person to import the

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9. Id. at 312.
10. Ibid.
11. Id. at 313, 314, per Tulzapurkar, J. (Emphasis mine).

goods on behalf of the actual user, does the importer become the agent of the actual user? Will the transfer of the imported goods to the actual user amount to a transaction between agent and principal and not one between seller and purchaser? This aspect was not examined in Indian Explosives.

If the nature of the relationship between the actual user and the importer is one of agency, will not the supply of the imported goods to the actual user be one in the course of import, the two parties to the transaction being the foreign seller and the Indian buyer connected through the medium of agency, i.e., the intermediary?

Courts had the occasion to approach the problem from such an angle. Arthur Import Export Company[12] is a case in point. The question of exigibility to tax on supply of goods after import was involved. The assessee placed orders for import and afterwards canvassed orders from mills for sale of those goods. The mills obtained permit for import of the goods and afterwards entered into contract with the assessee for supply of goods f.o.r. destination at specified price. A letter of authority was also issued in favour of the assessee. The assessee arranged through bank for clearance of the goods on

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12. Arthur Import Export Co. v. State of Madras, (1963) 14 S.T.C. 1022 (Mad.).

arrival and for despatch to the mills. The goods could not have been diverted to anybody else. The railway receipts were delivered to the mills on payment of a major portion of the price. The balance was to be paid after the goods were received by the mills and weighed. The question was whether the assessee acted as agent of the mills which had obtained the import permit. In other words, was there a sale by the assessee to the mills? The court observed that there were a number of factors which indicated that the relation between the assessee and the mills was not one of agency. In arriving at the conclusion it relied on the facts that the contract referred to the transaction as one of sale of goods at a specified price, at that price, quoted was f.o.r. destination, that in advance of contract the assessee had placed bulk orders with foreign supplier and that the assessee arranged for clearance of the goods. The facts that the import licence was issued to the mill and that the goods could not have been disposed otherwise than supply to the mills did not, in the view of the court, militate against the relationship of seller and purchaser as between the assessee and the mills. The court said:

> "It was sufficient compliance with the Act (Import and Export Control Act, 1947), notification, in terms of the licence and letter of authority that the petitioners assessee did after importing the goods sell them to the particular mill concerned. So long as that compliance was ensured there was

> nothing to present the petitioners being the purchasers of the goods from the foreign suppliers and sellers thereof to the mills".[13]

Clearly, therefore, the terms of the contract between the parties will have to be examined to decide the question whether the transaction is one of sale or not. One cannot rule out the possibility of an agency relationship being created in such a context. In the case of agency, the sale in the course of import will be one between the foreign seller and the ultimate purchaser to whom the actual user's import licence was issued.

Another instance which came up for determination was in Rajeswari Mills.[14] The assessee obtained licence to import foreign cotton. The letter of authority was issued to an importer who imported the goods, cleared them from customs, railed them and sent the railway receipt to the assessee through bank. The assessee took delivery of the Railway receipt from the bank on

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13. Id. at 1029, per Venkataraman, J.
14. Rajeswari Mills Ltd. v. State of Madras, (1964) 15 S.T.C. 1 (Mad.). The case involved two questions: (a) Whether the relationship between the importer and the mill was one of agent and principal, (b) if not, whether the purchase by the mill from the importer was in the course of import. The court held that (a) the transaction was one of sale, and (b) that the purchase was not in the course of import. The latter holding, namely the purchase was not in the course of import is however no longer good law in view of the decision in Khosla and Co., (1966) 17 S.T.C. 473 (S.C.). See, also, Larsen & Toubro v. Joint Commercial Tax Officer, (1967) 20 S.T.C. 150 (Mad.) at 190; Sri Rani Lakshmi Ginning, Spinning and Weaving Mills v. State of Madras, (1972) 30 S.T.C. 387 (Mad.) at 389.

payment of 90% of the value of the goods and cleared the goods from the railway. The cotton bales were weighed in the presence of the representative of the importer. The final bill adopting the contract rate was then drawn up. The condition attached to the letter of authority stated that the person in whose favour it had been issued would purely act as an agent of the licensee and the goods imported would be the property of the licensee, both at the time of clearance through the customs and subsequent thereto. Treating the transaction as a purchase of cotton from the importer the tax authority included the purchase value in the taxable turnover of the assessee under the Madras General Sales Tax Act, 1959. The assessee contended that the importer was only its agent and there was no sale by the importer to it and the purchase by it was in the course of import. This claim of the assessee was rejected. The transaction was held to be a sale to the assessee by the importer.

The Court pointed out that what constitutes agency is the jural relationship of principal and agent. The rights and liabilities of the parties flow from such relationship. An inference of agency should not be drawn from the existence of a few rights or liabilities. The word 'agent' used in the statute was in a loose sense. It did not create an agency status. It created only a fiduciary position analogous to that of an agent.[15]

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15. Ibid.

Evidently, therefore, though the letter of authority or the import licence do not ipso facto creates the jural relationship of agency between the importer and the actual user, such a relationship can be created by the terms of the contract between parties. The nature of relationship between parties and the nature of the transaction between them are to be decided not solely with reference to the terms and conditions of the statutory stipulation or official prescription but also with reference to the specific terms and conditions of the contract.

A situation of the above type presented itself in Hard Castle.[16] The assessee imported materials on the strength of the actual user's import licence and letter of authority issued to a company. It was made clear in the letter of authority that the goods were being imported by the assessee as agent of the company and that the property in the goods will remain in the licensee namely, the company, at the time of clearance through customs and subsequence thereto. The correspondence between the assessee and the company disclosed that the assessee was to act as agent of the company. The revenue treated the supply as sale of goods. The assessee contented that it was not a sale between the assessee and the company.

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16. Commissioner of Sales Tax v. Hard Castle Waud and Co., (1976) 37 S.T.C. 479 (Bom.).

The Bombay High Court pointed out that the correspondence between the assessee and the company creating the contract made it clear that the assessee was to act purely as an agent of the company. Hence the transaction was not one of sale. The court added that when goods were imported on the basis of actual user's licence and letter of authority which provided that the importer was to act as the agent of the actual user, one should normally expect that the transaction would be one of agency and not of sale[17], unless the circumstances clearly show that the transaction was not intended to be one of sale.

This view looks at the problem from the correct perspective. The nature of the contract, the terms of the actual user's licence and the letter of authority show that the relationship between the parties is one not of purchaser and seller, but of principal and agent.

The agency status of the intermediary importer was approved by courts in later cases. In Metal Distributors[18] the assessee imported electrolytic copper ingot bars for the holder of an actual user import licence on the strength of the letter of authority. A letter issued by the assessee to the actual user stated that the assessee was merely acting as indenting agent

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17. Id. at 483.
18. Commissioner of Sales Tax v. Metal Distributors, (1977) 39 S.T.C. 212 (Bom.).

for importing the goods on account of the actual user. The invoice sent by the foreign seller to the assessee mentioned the price of the goods and the number of the import licence. In the bill issued by the assessee to the licensee the price of the goods was shown the same as that was charged by the foreign seller. In addition to the price the licensee was required to pay a certain sum towards clearing expenses, transportation, labour charges, customs duty, despatching charges and the commission payable to the assessee. The bill did not specify the exact amount to be paid by way of commission.

It was argued that there were two sales, one by the foreign seller to the assessee and the other by the assessee to the licensee. The High Court held that the dominant intention of the parties as disclosed by the documents was that the assessee was to act as agent. The assessee's main interest in the transaction was of earning commission.[19]

The counsel for the assessee has not taken an alternative plea of integral connection based on Khosla[20] or Kotak[21] to establish that the sale was in the course of import and therefore not liable to be taxed, if at all the transaction was one of sale.

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19. Id. at 217.
20. Ch.IV, n.12.
21. Supra, n.5.

The decision in Madras Motor Parts Dealers Association[22] reflects a liberal approach. The members of the association desirous of importing motor parts after specifying the nature of the goods required by them, entrusted the money with the association. For this arrangement the association had to act as agent of its members to import on their behalf. But it was not possible for the association to import, because the licence for the import had been given only to the State Trading Corporation. However the letter of authority given to the corporation authorised the corporation to permit the association to import on behalf of the corporation.[23] According to the licensing condition the goods should be the property of the licensee at the time of clearance through customs and thereafter. The goods imported by the association on behalf of the corporation should be supplied to actual users only at prices fixed by the corporation. An agreement was entered into between the corporation and the association by which the association was obligated to sell the goods only to actual users specified by the corporation.[24] No sale was possible to anybody else.

The contention of the assessee association that the sale was between the foreign seller and the members of the

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22. State of Tamil Nadu v. Madras Motor Parts Dealers' Association, (1978) 42 S.T.C. 243 (Mad.).
23. Id. at 244, 245.
24. Id. at 245.

association did not succeed. The import, the Madras High Court pointed out[25], had to be by the corporation and the letter of authority stated that the import was to be made by the association on behalf of the State Trading Corporation. The import was in favour of the State Trading Corporation, the association acted as its agent. It was not possible for the association or its members to contend that the import was in favour of the association or its members.[26] Nonetheless, co-relating the arrangements that had been reached between the association and the State Trading Corporation and the association and its members, the court found that what was done by the association was merely an act of distribution. The court relied strongly on the agency element manifested from the nature of the transaction.

Exemption on the basis of agency relationship between the parties thus stands on a different footing in relation to both export and import. One should not mix up the question with the question of integral connection.

It may be noted that the question whether there was a sale by the corporation to the members of the association was not examined by the court. It proceeded on the basis that there was no sale. The court assumed that there was a case of agency.

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25. Id. at 246.
26. Ibid.

Obviously there were no factors justifying an agency status in this case. If the corporation was acting as an agent, who was the principal? If the members were the principal and the corporation only an agent or intermediary bringing together the foreign seller and the members the sale will be between the foreign seller and the members. If so the sale from the foreign seller to the members will be one in the course of import. The rejection of the contention of the assessee that the sale was in the course of import would not then be justified.[27] However the finding that an agency relationship is possible in the case of export and import through a canalising agency like the State Trading Corporation is a sound one. This view renders possible an extension of the exemption to spheres other than import through actual user's licence.

Another decision of the Madras High Court, Akhtar and Company v. State of Tamil Nadu[28] is worth noting. It related to transaction in the course of export. The assessee owned a tannery. It sent tanned hides and skins to the godown of the exporter at Madras for assortment, packing and export. The exporter contacted the foreign buyer for direct export of the

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27. The court observed: "It is therefore evident from the facts of this case that the import sale was in favour of the State Trading Corporation". per Govindan Nair, C.J. Id. at 246.
28. Akhtar and Co. v. State of Tamil Nadu, (1981) 47 S.T.C. 62.

goods, and finalised export contracts on price agreeable to the assessee. Letters of credit were opened in the name of the exporter. Written communication was sent by the exporter to the assessee indicating the quantity, rate specification, shipment details, terms of payment and the discount to be offered. The entire expenses of export were debited to the assessee. Invoices were raised by the exporter on the foreign buyer. The net amount after crediting the expenses was credited to the account of the assessee. The stocks, at any point of time, in the hands of the exporter were treated as stocks of the assessee. The exporter was paid commission.

The law to be applied in such circumstances had already been laid down by the Madras High Court in an earlier decision, State of Tamil Nadu v. Shafeeq Ahmed and Co.[29] It was observed in that case:

> "If the contention of the assessee is that they were the exporters in fact and any other person was acting only as their agent, the privity of contract between the assessees and the foreign exporter would be established and the assessee themselves could become an exporter. But if the facts were to be that the contract was entered into by the agent on

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29. (1979) 44 S.T.C. 263.

> his own rights and not as an agent of the assessee, there shall be deemed to be a sale by the assessee to the agent, and there would be no privity of contract between the assessee and the foreign buyer and it would amount to a case of sale for export to a local agent".[30]

Applying the above principle the court rightly held that so long as there is proof of agency, there was privity of contract between the principal and the foreign purchaser. This was so even if the agent had not disclosed the name of the principal.[31] The court upheld the agency status of the exporter.

A comparative look at Akhtar and Madras Motor Parts Dealers' would show that the former related to export and the latter to import. The principle applicable was squarely the same. When a transaction with foreign buyer or seller is effected by an agent, the privity is established between the principal and the foreigner. The transaction is one of sale or purchase between them. It may be noted that the specific

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30. Id. at 264 per, Ramaswami, J. See also Hajee Abdul Khalique Sahib and Co. v. State of Tamil Nadu, (1979) 44 S.T.C. 261.
31. Supra, n.28 at 66. See also State of Tamil Nadu v. Rafeeq Ahamed and Co., (1983) 52 S.T.C. 281 (Mad.).

point to which the attention of the court was not focused in Madras Motor Parts Dealers' Association presented itself squarely in Akhtar. In Akhtar the transaction between the assessee and the exporter was not treated as one of sale but one of transfer to an agent. The transaction of sale was between the assessee and the foreign buyer. Had such a specific point been raised in Madras Motor Parts Dealers' Association the decision of the court would have been different. The sole question for consideration of the court was whether there was a sale from the Association to its member. The court answered the question in the negative. If there were two independent sales, one from foreign seller to corporation and the other from corporation to the members of the association, the sale by the corporation to the members of the association would have been assessable. If the purchase of goods from foreign seller by the corporation was in the capacity of an agent of the actual local buyer, there is no case of sale by the corporation to the members. On the reasoning of Akhtar, privity between the foreign seller and the members of the association will be established and the sale will be between them. Such a sale or purchase will be clearly one in the course of import of the goods.

Two premises are deducible in the case of import purchase: (1) More than one purchase could take place, but they may be fused into one. The purchases are closely integrated

with the import that they are in the eye of the law one in the course of import; (2) There could be only one purchase since the purchase from the foreign buyer is arranged through the medium of an agent who connects the import purchaser with the foreign seller. The privity of contract is then established between the actual user and the foreign seller.

But there are decisions showing an incorrect appraisal of the distinction between the above-mentioned two premises. In I.C.I.[32], for example, even after having found the import was effected by the assessee as an agent of its customer, the Kerala High Court applied the test of integrality. In Voltas[33], however, though both contentions based on agency and integrality were raised, the Calcutta High Court held that the sale occasioned the import, without looking into the question of agency. On the other hand in Minerals and Metal Trading Corporation[34] the Madras High Court held that the import of the assessee was

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32. Deputy Commissioner of Sales Tax (Law) v. I.C.I.(P) Ltd., (1981) 47 S.T.C. 149 (Ker.). The customers of the assessee had actual users' licence. They entered into contract with the assessee quoting their licence number etc. There was a condition that the goods imported shall be the property of the licensee. All documents showed that the assessee acted on behalf of the licensee.
33. Voltas Ltd. v. Commercial Tax Officer, (1982) 51 S.T.C. 151 (Cal.). The assessee imported goods on the basis of the actual users' licence and letter of authority obtained by the customers and supplied them to the customers and raised bills for the supply and charged the agreed commission.
34. Minerals and Metals Trading Corporation of India Ltd. v. State of Tamil Nadu, (1983) 52 S.T.C. 85 (Mad.). MMTC imported goods from Japan and supplied to allottees of Yen credit as required by them. MMTC was never owners of goods. There was no contract of sale between the parties.

on behalf of its customer applying the principle of agency. Though the result achieved is the same by applying the two tests, the difference between the two concepts may assume importance, if the test of integrality is eventually discarded by courts.

Suppose that the contract between the importer and the person to whom goods are supplied after import is not one of agency but of sale. In the absence of integral connection of such sale with the import, the sale will not be in the course of import. For instance, in Blue Star[35], the Madras High Court refused to accept the claim of agency, which appears to be technically justifiable but at the same time caused hardship to the actual user. Facts of the case will make the position clear. Goods were imported from Germany by the assessee after orders were obtained from local buyers. There was no stipulation in the contract with the local buyers that the goods were to be imported. The foreign seller raised the invoice in the name of the assessee. As it did not possess any import licence it entered into a contract with Project Equipment Corporation (PEC) for importing the goods. The goods so imported should be delivered to the actual users to whom release orders had been issued by the P.E.C. P.E.C. obtained the import licence in its own name with letters of authority in favour of the assessee to

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35. Blue Star Ltd. v. State of Tamil Nadu, (1984) 56 S.T.C. 172 (Mad.). The same view was taken in East Asiatic Co. (India) v. State of Tamil Nadu, (1987) 64 S.T.C. 25 (Mad.).

enable it to import the goods from Germany, but reserved the right to nominate users. The court expressed the view that the import was necessitated only because of the contract between the assessee and the foreign seller. It had nothing to do with the sales between the assessee and the actual user. The transaction envisaged sale between the assessee and the foreign seller and sale between the assessee and the actual user. It rejected the plea that the assessee acted, as agent of the actual users. The actual user did not hold the import licence.[36]

The agency status of the assessee was correctly upheld by the Madras High Court in I.B.M. World Trade Corporation.[37] After stating the facts the Court observed[38] that since 'the assessee has acted only as agent for the import of the goods, there is only one sale from the foreign seller to the I.I.T. through the assessee as the importing agent'.[39]

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36. Id. at 179.
37. State of Tamil Nadu v. I.B.M. World Trade Corporation, (1985) 60 S.T.C. 118 (Mad.). The same view was taken by the court in State of Tamil Nadu v. Manotype India, (1986) 62 S.T.C. 434 (Mad.). In this case the court found that the assessee was not only agent of the foreign principal but also the agent of the actual user. Id. at 435.
38. The assessee entered into agreement with the I.I.T. Madras for supply of machines. The I.I.T. obtained the import licence, and the letter of authority in favour of the assessee. On the basis of these documents the assessee imported and supplied the machines to I.I.T. The assessee could not have diverted the goods.
39. Id. at 122, per Ramanujam, J.

Clearly, the court has analysed the problem from the correct perspective.

Two recent decisions relating to purchase of cashew through intermediary present interesting study. One is Cashew Corporation[40] decided by the Karnataka High Court and the other is Gopinathan Nair[41] decided by the Kerala High Court. In the first case the Corporation imported cashew from East Africa under licence issued to the Corporation by the Controller of Imports and Exports. The Corporation allotted the imported cashew to actual users. One of the conditions of the import licence granted to the corporation was that the corporation should remain the owner of cashew imported under the licence upto the time of clearance through customs. The corporation came into existence in 1970 as a subsidiary to the State Trading Corporation owned by the Government of India. Prior to the coming into existence of the corporation, the users of raw cashew were themselves importing raw cashew from East African countries. The corporation functioned to ascertain the requirement of the users. It took letters of acceptance from them and thereafter placed orders for the supply of cashew with the foreign exporters. Separate bills of entry were drawn. Each

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40. Cashew Corporation of India v. State of Karnataka, (1986) 63 S.T.C. 90 (Kar.).
41. Gopinathan Nair and Co. v. State of Kerala, (1987) 64 S.T.C. 452 (Ker.).

lot was separately marked. On arrival of the ship in Indian port the corporation gave letter of authority to the captain of the ship authorising him to deliver the goods earmarked to the allottees. The letter of authorities were sent through bank and the allottees received the same after making payments. The allottees paid the customs duty on behalf of the corporation and took delivery of the goods.

The Court rejected the contention that corporation was only an agent of the allottees. The ground was that there was no privity of contract between the foreign supplier and the allottees. The corporation remained the owner of the goods till customs clearance. The supply of cashew by the corporation to the allottees was therefore held to be sale liable to be taxed.

While cashew was taxable at the point of sale in the Karnataka State it was taxable at the point of purchase in the Kerala State. The second case is decided by the Kerala High Court and involved the question of assessability of the purchase by the allottee from the Cashew Corporation who imported the goods. In other words, the question here also was whether the sale by the corporation to the allottee or the purchase made by the allottee was in the course of import. The Sales Tax Tribunal had entered the finding that the corporation was not the agent of the allottee and upheld the assessment. The Kerala High Court pointed out that, notwithstanding the finding of the Tribunal,

the purchase made by the allottee could still be one in the course of import. The court observed that the integral connection or link between the first sale to the allottee following the import and the actual import provided by an obligation to import should arise from statute, contract or mutual understanding or nature of the transaction which links the sale to import. These factors had not been examined by the Tribunal and hence its order was found to be unsound. The approach of the court in this case shows a welcome trend.

The cases discussed in this chapter indicate that exemptions are allowed or disallowed by courts on technical criteria of mixed questions of fact and law. The evil consequence is that a trader or an industrialist who intends to import raw materials does not know the exact scope of the exemption available. Judgments at the High Court and the Supreme Court level should lay down correct propositions of law to be concretised as acceptable norms for future behaviour. Instead, the judicial process in the area illustrates employment of the juridical technique for finding easy answers and quick solutions in individual cases. Perhaps these solutions may be instrumental in meeting out individual justice. But this may not help evolution of a healthy tax jurisprudence. The principle evolved in the decisions of courts should be so clear and coherent that trade and industry as a class must be in a position to arrange their affairs conveniently with a substantial

degree of definiteness. For this, a pragmatic scheme of taxation on sales is an imperative. Tax exemption extended to first sale or purchase after import will be not only a great encouragement to industry but also a measure of reducing litigation.

In moulding the policy governing taxation, apart from the revenue aspect, the overall repurcussions of tax in industrial endeavours has also to be seriously taken note of. What is needed is legislative activism providing exemption for first sale or purchase after import. Such a proposal, it may be noted, was mooted by the Commerce Ministry before the Law Commission.[42] The lingering dissatisfaction in the trade circle and the ever growing litigation at different levels bespeaks the need for reform of the law. A reform is all the more necessary now since similar exemption has been introduced for sale or purchase preceding the export.[43] Logically[44] and needfully, similar exemption should be given in the realm of import also. It will be a boon to industrial endeavours. It

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42. See Ch.III, n.45.
43. Central Sales Tax Act, 1956, Section 5(3). For the text see Appendix B.
44. The Law Commission pointed out that it was illogical to allow exemption on sale preceding export if no exemption is given for first sale following the import. See Ch.III, n.46. Now that sale preceding export is exempt under Section 5(3), a denial of exemption for sale following import is illogical.

will be an antidote to price hike. It will eliminate the evil of excessive taxation which may gradually derail the developmental process.

PART III

INTER-STATE SALE

Chapter VIII

INTER-STATE NATURE OF EXPLANATION SALES: CONFLICT OF VIEWS

Different parts of the nation have varying resources. The economic activities depend substantially on such native resources. Productive schemes of the people vary from place to place. Climate, soil and a lot of related infra-structural factors have a definite bearing on production. Hence in each part of the country the resources and skills available are utilized for the production of the commodity for which it is quite suited. Naturally the output of one region, in respect of some goods, may be more than the requirement of that region. The excess will have to be disposed of. At the same time, a State or region may not attain self-sufficiency in respect of a variety of other goods. Such goods will have to be brought in from other States. The shortage or, as the case may be, surplusage of goods has to be tackled by sale of excess goods to, and purchase of deficit goods from, other States. A trader in one part of the country may have to sell to, or buy from, a trader in another part of the country. Thus movement of goods takes place from one part of the country to another.

The system of levy of tax on sale or purchase of goods has great revenue potential. The power to tax if applied with foresight is a power to generate initiative and boost production. It is also a power which will create havoc if applied without imagination.

Any kind of restriction, regulation or imposition of tax on inter-State trade and commerce is a matter affecting the whole country. Such a measure should be placed beyond the purview of the power vested in individual States.

The burden of tax may ultimately be passed on to the consumer. Yet, if the incidence of the tax is burdensome on the trader, it will create discouraging trends in commercial activity. Any setback in the commercial activity will have an adverse chain reaction in the manufacturing activity. The taxation policy must be designed so as to promote manufacturing and trading activity.

The history of taxation, in this vital area, before the commencement of the Constitution presents a sordid picture. The incidence of sales tax was heavy. The same commodity was subjected to tax several times before it reached the consumer.

A system of multiple taxation emerged. The legal foundation for it was laid on the theory of nexus.[1]

The power to levy tax on the sale of goods and on advertisements was vested in the Provinces under the Government of India Act 1935.[2] Sale and purchase are two sides of the same transaction. The power to levy tax on sale of goods therefore included the power to levy tax on purchase of goods.[3] In exercise of this power tax laws were enacted by Provincial Legislatures.

A sale or purchase involves several ingredients like the agreement to sell or purchase, the passing of property in the goods, delivery of the goods, the situs of the goods, the parties namely the buyer and the seller, the manufacture of

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1. See infra, n.4. The theory came into vogue in India under the scheme of the Government of India Act 1935. This Act made India a Federation. It was a Unitary State under the Government of India Act 1919. Before the Government of India Act 1935, there was no scope for the application of the theory of nexus.
2. Government of India Act 1935, Section 1000, read with Entry 48 of List II in Schedule VII which read: "Taxes on the sale of goods and on advertisements".
3. Syed Mohammed and Co. v. State of Andhra, A.I.R. 1954 S.C. 314. The constitutional validity of the Madras General Sales Tax Act 1939 was challenged in this case. The contention raised was that the Provincial Legislature had no power under the Government of India Act 1935 to enact a law imposing a levy of tax on purchases. Rejecting this contention and agreeing with the view taken by the High Court, Das, J. observed at p.315: "Further we agree with the High Court that Entry 48 in List II of the Seventh Schedule to the Government of India Act, on a proper construction, was wide enough to cover a law imposing tax on the purchase of the goods as well...".

goods and payment of price. For the purpose of taxation of sales the levy could be geared to any one of these ingredients. The Provincial enactments picked out one or the other of them and made the nexus between the State and that ingredient as the basis for taxation. Some Provinces made the manufacture of the goods within their jurisdiction on the basis for taxation. Some others relied on the existence of the goods within the Province on the date of conclusion of the contract of sale as providing the nexus for taxation. Some others considered conclusion of sale within their territory the basis for the levy.

The following observations of Chief Justice Patanjali Sastri is indicative of the diversity of approach:[4]

> "Assam and Bengal made among other things the actual existence of the goods in the Province at the time of the contract of sale the test of taxability. In Bihar the production or manufacture of the goods in the Province was made an additional ground. A net of the widest range perhaps was laid in Central Provinces and Berar where it was sufficient if the goods were actually 'found' in the Province at any time after the contract of sale or purchase, in respect thereof was made".

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4. State of Bombay v. United Motors, (1953) 4 S.T.C. 133 (S.C.) at 142; A.I.R. 1953 S.C. 252 at 256.

Levy of tax on sale of goods on the basis of proper nexus was held to be valid. In Poppatlal Shah[5] the Supreme Court observed that it would be quite competent for Provincial Legislature "to enact a legislation imposing taxes on transactions concluded outside the Province, provided that there was sufficient and a real territorial nexus between such transactions and the taxing province".[6]

Similarly in Tata Iron and Steel[7] the Supreme Court, by majority held[8] that the presence of the goods, at the date of the agreement for sale, in the taxing State or even the production of the goods in that State, constituted a sufficient nexus between the taxing State and the sale so as to enable it to levy tax on sale of such goods.

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5. Poppatlal Shah v. State of Madras, (1953) 4 S.T.C. 188 (S.C.).
6. Id. at 192.
7. Tata Iron and Steel Co. v. State of Bihar, (1958) 9 S.T.C. 267 (S.C.).
8. Id. at 283,284. Justice Bose, however, dissented with the view and said at p.287: "The States may tax the sale but may not disintegrate it and, under the guise of taxing the sale in truth and in fact, tax its various elements, one its head and one its tail, one its entrails and one its limbs by a legislative fiction that deems that the whole is within its claws simply because, after tearing it apart, it finds a hand or a foot or a heart or a liver still quivering in its grasp". He further observed at p.285 that since a State can only impose a tax on the sale of goods, it had no power to tax extra-territorially and therefore it could only tax sales that occur in the State. It was fallacious in his view to look to the goods, or the elements that constitute a sale, because the power to tax is limited to the sale and the tax is not on the goods or on the agreement to sell or on the price as such but only on the sale. Therefore unless the sale itself took place in the State the State could not tax. He observed at p.287: "I would therefore reject the nexus theory in so far as it means that any one sale can have existence and entity simultaneously in many different places".

The result of levy of tax on the basis of the nexus theory was that even sale which substantially took place outside the territorial limit of a province could be subjected to tax by that province. Such a system of levy developed by the operation of the 1935 Act led to multiple taxation. The cumulative burden of tax undoubtedly fell on the consumer.

The makers of the Constitution desired to put an end to this unsatisfactory state of affairs by placing some fetters on the multifold or cumulative impost.[9] To achieve this purpose Article 286 of the Constitution was brought in. The power of State to levy tax on sale or purchase of goods was made exercisable only within its territory. The State Legislature was divested with the power to tax sale or purchase of goods taking place outside the State.[10]

When does a sale or purchase take place outside the State? It was necessary to define this. An Explanation to Article 286(1)(a) defined what an inside sale was. Impliedly, a sale inside one State will be outside all other States. The

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9. Chief Justice Chagla observed in United Motors v. State of Bombay, (1953) 4 S.T.C. 10 at 26 (Bom.): "It is not too much to assume that our Constitution-makers were anxious to protect the interests of the consumer. They did not want a consumer to pay more than one sales tax..."
10. Constitution of India, Article 286(1)(a). For text, see, Appendix A.

Explanation stated that a sale shall be deemed to have taken place in the State in which the goods have actually been delivered as a direct result of such sale or purchase for the purpose of consumption in that State.[11] According to the Explanation, the decisive factor was the delivery of goods for consumption, and not the passing of property or any other similar criterion. By the Explanation the sale or purchase was deemed to have taken place in the delivery State.

The Explanation fixed the situs of sale by an artificial definition. Where more States than one were involved in a transaction, the situs of sale was deemed to be in the delivery-cum-consumption State which only could levy tax. In this arrangement some sales in which two States were involved—in that sense could broadly be termed as inter-State sales—came to be treated as local sales for purposes of taxation by the delivery State.

This scheme was easily workable. It evolved for the first time a rational basis for taxation. By enacting that the State in which the goods were delivered for consumption, alone could tax, multiple taxation was avoided. This provided immense protection to the consumer. Such a measure was also

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11. Ibid.

conducive to strengthening the national economy. The Constitutional device in Article 286 was indeed a pioneering consumer protection measure.

Article 286(2) created[12] a ban on States to levy tax on inter-State sale. Of course, Parliament was free to lift the ban. Until lifted, the ban was operative. The ban had a laudable purpose. It was to prevent States from introducing barriers of heavy taxes and interfering with the free flow of inter-State commerce.

However, the ban created some confusion of thought. A combined reading of Article 286(1)(a) and Article 286(2) generated divergent views. The meaning of concepts like 'inside sale', 'outside sale' or 'inter-State sale' was not clear.

The legal battle in this area was triggered off by the decision of the Madras High Court in Govindarajulu Naidu v. State of Madras.[13] One of the points considered by the court was the scope of the Explanation. A contract of sale was concluded in Madras. The property in the goods passed in Madras. The goods were actually delivered in the State of Bombay for

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12. For the text, see Appendix A.
13. (1952) 3 S.T.C. 405 (Mad.).

consumption there. Could the State of Madras levy tax on such sale? The court posed such a problem[14] to examine the scope of the Explanation. Did the Explanation purport to restrict the legislative competence of the State? Or did it enlarge the scope of its power? Was the effect of the Explanation such that it divested the State of Madras, in the given case, with the power to levy tax on the transaction? Or was the effect such that in addition to the State of Madras, the State of Bombay also could levy tax on the transaction? Bombay being the State of delivery of the goods for consumption,can it tax the sale? To put it briefly, the question for determination was whether the power of taxation conferred by the Explanation was in addition to the power possessed by the State or in substitution of such power. The Madras High Court took a stand supporting the view that the Explanation enlarged the power. The Explanation did confer an additional power on the State and held[15] that the effect of the Explanation was to remove the limitation on State's power to make extra-territorial laws.[16]

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14. Id. at 429.
15. Ibid.
16. The limitations of State's power are imposed by Article 245 and Article 286(1). For the text of Article 286(1) see Appendix A. Article 245 reads as follows: "245(1). Subject to the provisions of this Constitution Parliament may make laws for the whole or any part of the territory of India and the Legislature of a State may make laws for the whole or any part of the State. (2) No laws made by Parliament shall be deemed to be invalid on the ground that it would have extra territorial operation".

A State was permitted to levy tax on extra-State sale if goods were delivered within its territory.

The above holding created a baffling situation: the transaction of sale could be subjected to tax in Madras by virtue of Article 246 of the Constitution[17] and also in Bombay in terms of the Explanation.[18] This amounted to approval of double taxation.[19] The tax incidence doubled to the detriment of the consumer.

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17. Article 246 read with Entry 54, List II of the Seventh Schedule to the Constitution confers the necessary power. Clause (3) of Article 246 confers exclusive power on the State Legislature to make laws for the State or any part thereof with respect to any matters enumerated in List II of the Seventh Schedule. Entry 54 reads: "Taxes on the sale or purchase of goods other than newspapers".
18. The court said, "It is undoubted that under the Explanation the State of Bombay will have the power to impose the tax. If the Explanation has to be interpreted as conferring an additional power, then both the States will have the power to tax, the State of Madras acting under entry No.54 and under the Madras General Sales Tax Act and the State of Bombay by virtue of the Explanation." Govindarajulu Naidu v. State of Madras, (1952) 3 S.T.C. 405 (Mad.) at 429 per Venkatarama Ayyar, J.
19. The High Court of Madras was aware of this consequence. But it preferred such double taxation to deprivation of the power to tax, of the State which could otherwise have levied the tax. The court said referring to the view taken by it: "...it results in double taxation of the same transaction. But if we adopt the view that the Explanation has the effect of superseding powers of State Legislature in cases falling under the Explanation, that will have the effect of depriving the States of revenue in respect of transactions which are substantially effected there." Ibid.

The Bombay High Court, however, held a different view. In United Motors[20] it adopted a construction of the Explanation which avoided the possibility of double taxation of the same transaction. The challenge in United Motors[21] was against the levy of tax on the transaction of sale in which the property in the goods passed in Bombay, but the goods were delivered in another State for consumption there. It was argued on behalf of the State of Bombay that when the property in the goods passed in Bombay, the State of Bombay was competent to levy tax on the transaction even if the goods were delivered outside Bombay.[22] The court held that only the delivery-State can tax the sale. Such a sale would be outside all other States and hence no other State had authority to tax it.[23] According to the court the purpose of the Explanation was to save the consumer from a multifold impost. It applied the principle that when a taxing provision comes up for construction before it and if the provision is capable of being interpreted in different ways, the court must prefer that construction which would advance the interest of the national economy and also if possible the interest of the ordinary humble consumer in the country.[24]

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20. United Motors (India) v. State of Bombay, (1953) 4 S.T.C. 10 (Bom.).
21. Ibid.
22. Id. at 25.
23. Id. at 26.
24. Id. at 27.

The two High Courts thus expressed conflicting views. Uncertainty of the law is a hurdle on the path of economic growth. The after-effects of wide judicial fluctuations on frontiers of commerce will have unhealthy and unforeseen repurcussions on the economy of the nation. The State of Bombay filed an appeal to the Supreme Court. The Court delivered a classic judgment[25] after making a detailed probe[26] into the mechanics of the Constitutional scheme. The Court preferred the Bombay view to the Madras view. It held that the Explanation prohibited tax on sale or purchase involving inter-State elements by all States, except the one in which the goods were delivered for consumption. The Court pointed out that if both the selling State and the delivery State taxed the transaction, there will be double taxation which becomes discriminatory, compared to a local sale, and offends against the principle of freedom of inter-State commerce because it places inter-State trade at a disadvantage in competition with local trade.[27]

What then is the effect of Article 286(2)? Does the Explanation nullify the prohibition on taxation of inter-State transactions by the State? One view canvassed before

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25. State of Bombay v. United Motors, (1953) 4 S.T.C. 133 (S.C.).
26. Considering the importance of the matter the Supreme Court allowed various States to intervene. The Union Government also intervened. The case was heard by five judges. The decision was by majority.
27. State of Bombay v. United Motors, (1953) 4 S.T.C. 133 (S.C.) at 150.

the Supreme Court was that neither State could tax the sale or purchase referred to in the Explanation until Parliament lifted the ban. If such a restricted view is taken, the consequence would be that out-of-State goods will be cheaper than local goods. Obviously, local dealer would suffer a competitive disadvantage compared with the outside dealer. One cannot stretch the freedom of inter-State commerce to such an extent. There is no justification whatsoever in requiring a State to foster commerce to the detriment of its own domestic trade. A State may be required to desist from imposing discriminatory taxation on goods imported from outside the State. But it would be inappropriate and unjust, the Court observed, in a federal polity to require a State to place local products and local business at a disadvantage while competing with outside goods.

The Court held[28] that the operation of clause (2) of Article 286 stands excluded as a result of the legal fiction created in the Explanation. The effect of the Explanation in the Court's view was to invest what, in truth, is an inter-State transaction with an intra-State character in relation to the State of delivery.[29] Clause (2) could have no application to such sales or purchases.

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28. Id. at 147.
29. Ibid.

The construction put on the Explanation by the majority judgment had definite advantages. It avoided double taxation. The consumer was saved from the cumulative tax burden. It prevented placing of inter-State trade at a disadvantageous position compared to local trade. It also avoided the anomaly of making inter-State trade free to the detriment of domestic trade. By its interpretation, the Court put local trade and inter-State trade on an equal footing. The delivery State could tax both local and out-of-State dealers equally in respect of the sales, without any discrimination.

Justice Bose, however, dissented[30] from the majority view. To him the ban created by Article 286(2) was a real ban operative in all cases when a sale was effected partly in one State and partly in another. No tax could be imposed by a State on such a sale. On the other hand, all the ingredients of a sale took place in one State it was an intra-State sale which could be taxed by that State. Article 286(2) was not attracted to such cases. Complications may spring up only when the ban on levy of tax on inter-State sale imposed by Article 286(2) is lifted. A controversy may then arise as to which State has got competency to levy tax in respect of

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30. Id. at 157.

inter-State sales. The makers of the Constitution had before them the bitter experience of the working of the nexus theory. It became necessary therefore to define where a sale shall be deemed to take place when the different ingredients of a sale are located in different States. The Explanation by a fiction defined it. The sale shall be deemed to take place where it is delivered for consumption and that State could tax the sale. In the view of Justice Bose this was the result achieved by introducing the Explanation.

Justice Bhagwati had a different view of the Explanation. In a separate judgment he expressed the view that by virtue of the Explanation, notwithstanding the fact that under general law the property in the goods may pass in another State, a sale shall be deemed to take place in the State in which it is delivered for consumption. In his view this meant that two States can levy tax on the transaction, namely the State in which the sale took place under the general law and the State in which the goods were delivered for consumption.[31] But in view of Article 286(2), the sale being inter-State, it cannot be taxed by the State in which under the general law the sale takes place.[32] However, as far as the delivery State is concerned the sale is deemed to be intra-State by virtue

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31. Id. at 172.
32. Id. at 175.

of the Explanation and hence could be taxed by it.[33] When the ban under Article 286(2) is lifted, in the view of Justice Bhagwati, both States could levy tax on the transaction.[34]

The language of the Article 286 was simple. The provision was short. Yet clarity was wanting. In legal enactments simplicity of language is seldom found. In the present context we find three views emerging from the same text. The majority view was that the Explanation converted inter-State sale into intra-State transaction. The dissenting view was that it did not do so. And Justice Bhagwati's view was that the ban on inter-State levy applied to the State in which under the general law the sale took place but did not apply to delivery-cum-consumption State.

The decision in United Motors created panic in the minds of the people engaged in inter-State dealings. A dealer selling goods to persons in different States for consumption became liable to be taxed in all such States. They had to be conversant with sales tax laws of various States, since according to the majority view, all delivery States could require them to file returns and produce books of accounts before the concerned assessing authorities in those States for making tax assessments.

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33. Id. at 176,177.
34. Id. at 178.

United Motors did not hold the field for long. The Supreme Court, by a thin majority of four to three, overruled the decision in Bengal Immunity[35] wherein the Court held that until Parliament by law lifted the ban, no State had the power to impose tax on inter-State transactions.[36] In overruling[37] the decision in United Motors the Supreme Court found ample justification. The majority decision in United Motors did not merely determine the rights of the two contending parties. Its effect was far-reaching. It affected the rights of the

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35. Bengal Immunity Co. v. State of Bihar, (1955) 6 S.T.C. 446 (S.C.); A.I.R. 1955 S.C. 661. The assessee was a company selling sera, vaccine, biological products and medicines, having its registered head office and factory in West Bengal. It was registered there as a dealer. Its products had extensive sales. The goods were despatched from Calcutta against orders accepted by the company at Calcutta. The Bihar sales tax authorities issued notice on the company since according to them the company was liable to pay tax but had nevertheless wilfully failed to apply for registration under the Act. The company denied the liability because it was not a resident in Bihar. It challenged the notice before the High Court of Patna as ultra vires, but without success. This was the backdrop of the appeal. In view of the importance of the issue several States (Madras, U.P., M.P., West Bengal, Orissa, Punjab, Pepsu, Mysore, Rajasthan and Travancore-Cochin) intervened.
36. For a discussion and the development of the law, see, Walter W.Brudno et al., World Tax Series: Taxation in India, pp.434,435 (1960); N.Arunachalam, "State Barriers", [1960] 1 M.L.J. Jour. 77 at 90-93.
37. The question whether an earlier decision can be overruled was first considered by the Supreme Court in Bengal Immunity. See, Rajeev Dhavan, The Supreme Court of India: A Socio-Legal Critique of its Juristic Techniques, p.40 (1977).

consuming public. It involved an adjudication on the taxing power of States. An erroneous decision has tremendous consequences in such a context. Referring to United Motors, the Supreme Court therefore said,

> "If the decision is erroneous, as indeed we conceive it to be, we owe it to that public to protect them against the illegal tax burdens which the States are seeking to impose on the strength of that erroneous recent decision".[38]

The Court further expressed the view[39] that it is difficult to give the majority decision in United Motors that amount of sanctity and reverence which is usually attributed to an unretracted[40] majority decision of the Court. Moreover the

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38. Bengal Immunity Company v. State of Bihar, (1955) 6 S.T.C. 446 at 464 (S.C.) per S.R.Das, Actg.C.J.
39. Id. at 464.
40. In that judgment Bose, J. dissented. Bhagwati, J. though agreed with the majority then, now reconsidered his view and expressed his dissent with the majority view in United Motors. Justice Das in the Second Travancore case, (1954) 4 S.T.C. 205 (S.C.), which was heard immediately after the hearing of the United Motors, (1953) 4 S.T.C. 133 (S.C.), also expressed his dissent. When all these are taken into account the judicial opinion on the point in United Motors can be deemed to have been divided three to three. Ibid.

previous judgment suffered from some vagueness, if not inconsistency.[41]

Considering all these aspects and also the fact that the impugned decision was not a long standing one and that it was difficult to rectify the error by legislative process[42], the Supreme Court thought that a reconsideration of that decision was called for.

Four different views in regard to the meaning of the Explanation were canvassed in Bengal Immunity for consideration by the Supreme Court.

The first view, called the strict view, was that the Explanation clarifies where a sale or purchase took place. Article 286(1)(a) banned States from taxing outside sales. The

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41. The Court pointed out at pp.464,465 that the majority in the previous judgment held that the expression 'for the purpose of consumption in that State' must be understood as having reference to consumers in general within the State. Thus all buyers within the State of delivery from out of State sellers, except those buying for re-export out of the State, would be within the scope of the Explanation and liable to be taxed by the State on their inter-State transaction. See State of Bombay v. United Motors, (1953) 4 S.T.C. 133 (S.C.) at 146. This observation in United Motors seems to suggest that it is the buyers falling within the Explanation who are liable to be taxed. At the same time the whole trend of the rest of the majority judgment in that case runs counter to this conclusion.
42. A Constitutional amendment requires a specific majority which may not be always available. If it involves an amendment of the legislative list it will require the consent of a requisite number of the States, which in the circumstances of the case, could not reasonably be expected.

The question therefore arises what is an outside sale. Where does a sale take place? Does it take place where the contract is made? Or where the property in the goods passes? Or where the goods are delivered? The explanation answers this question. It says that the sale shall be deemed to take place in that State where the goods are delivered. The Explanation is not an exception or a proviso to Article 286(1)(a). It only explains what is an outside sale. The Explanation does not confer legislative power on the delivery State to tax such sale. Article 286(1) places restrictions on legislative power; it does not confer legislative power.

The second view was that the Explanation fixes the situs of sale. When the situs is within one State it is outside all other States. The Explanation not only explains what is an outside sale but also fixes the situs within one State. The delivery State is therefore free to tax it in exercise of its legislative power. This was the view expressed in United Motors.

The third view was that the Explanation concerned itself with notionally fixing the situs in the delivery State but in no way it affected the taxing power of the State in which under the general law the property in the goods passed. In other words, the State in which under the general law the

property in the goods passed had also the power to levy tax on the transactions, in addition to the delivery State, when the ban under Article 286(2) is lifted.

The fourth view was founded on the non-obstante clause in the Explanation. According to this view the Explanation concerned itself only with two States, namely, the title State (the State in which under the general law, title to the goods passes to the purchaser) and the delivery State (the State in which goods are actually delivered as a direct result of the sale or purchase for consumption). The Explanation took the taxing power out of the title State and vested it in the delivery State. In the result, the only State which was prohibited from taxing a sale or purchase on the ground that the sale or purchase took place out of its territory was the State in which the property in the goods passed.

Each one of these views had its own demerits. The criticism against the first view is that the Explanation covers only one category of the different types of inter-State sales. When the ban under Article 286(2) prohibiting the levy of tax on inter-State sale is lifted the question which State can tax the sale will arise. Obviously the State in which the sale takes place can tax the transaction. In respect of inter-State sales where the goods are delivered for consumption in a State

the Explanation undoubtedly fixes the situs there. But what about inter-State sales for re-export of the goods? The Explanation does not cover such a case. Therefore the view that the purpose of the Explanation is to explain what is an outside sale appears to be not correct.

The second view is open to criticism that such a construction uses the Explanation for a purpose which is beyond the scope of Article 286(1)(a). A fiction created for the purpose of sub-clause (a) of Article 286(1) is, by such a construction, used for locating the situs of the sale and purchase. The view is also open to criticism that it totally ignores the existence of another ban in Article 286(2) on all States including the delivery State, namely, against taxation of inter-State sales so long as Parliament does not lift the ban. There is the further objection that it does not fix the situs for all sales. For instance the question still remains which State can tax inter-State sale, after the ban is lifted, when the sale is not for consumption but for re-export.

The criticisms against the second view are applicable to the third view. In addition, the third view gives rise to double taxation of the same transaction in so far as there can be one levy by the selling State or the title State and another by the buying State.

The fourth view suffers from the defect that it does not avoid the evil of multiple taxation of the same transaction. If the Explanation concerns itself only with the title State and delivery State, and says that not the title State but the delivery State can tax, what about other States which may seek to tax the transaction on some other nexus like production or conclusion of contract? Such States will obviously be able to tax, according to the fourth view.

The Supreme Court held in Bengal Immunity that the ban in clause (2) against levy of tax on inter-State sale is absolute and independent. Parliament not having by law otherwise provided, no State law can tax inter-State sale or purchase. The Explanation could not be projected to Article 286(2) so as to enable the delivery State to levy tax on inter-State sale. The Explanation did not have the effect of converting an inter-State sale or purchase into an intra-State sale or purchase. The substance of the majority judgment is this. The different bans imposed by Article 286 on the taxing power of the States are independent and separate. Each ban has to be got over before the legislature can impose a tax on such transaction.

The meaning and content of the expression 'sale or purchase in the course of inter-State trade or commerce' was not analysed in Bengal Immunity. The Court thought it not

necessary to enter upon a discussion on the scope of the phrase since it was common ground that the sale or purchase made by the appellant actually took place in the course of inter-State trade or commerce.[43]

The consequence of the view taken by the Supreme Court in Bengal Immunity was that inter-State sale became completely free from taxation. The practical working of such an arrangement created anomalies. When a retail dealer purchased goods for resale from a local market he was put in a disadvantageous position. He had to pay tax on the transaction. On the other hand, when a person purchased goods from other States no tax was payable. The retail dealer purchasing goods for resale from a seller within the State was thus discriminated against. The majority view in Bengal Immunity does not seem to have responded in a creative manner to this discriminatory aspect. Justice Das observed that if there was any hardship in this respect there is Parliament invested with sufficient power to lift the ban under clause (2). He said:

> "Why should the Court be called upon to discard the cardinal rule of interpretation for mitigating a hardship, which after all may be entirely fanciful,

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43. Supra, n.35 at 478. Also see Ch.IX, n. 22.

> when the Constitution itself has expressly provided for another authority more competent to evaluate the correct position to do the needful".[44]

It is clear that the learned judge kept aloof from deciding the issue with a wider and pragmatic perspective. Rather he preferred to adopt a narrow and conservative approach. He confined himself to what he described as adoption of a cardinal rule of interpretation[45], namely, reading the provision literally.

It was not correct to say that the anomaly was fanciful. There was obvious discrimination. It is more and more realised that it is the function of courts to set the law in the right direction by avoiding absurd results. Appellate judges make law, their function is not mere interpretation of the law.[46] Of course, in so doing, policy issue may come in. What of that? Ultimately, at the apex appellate level, any interpretation is a matter of judicial policy. The nation's Supreme Court is a Court of policy. Moreover, Parliament does not always sit to correct immediately the wrong policy or to eradicate a hardship. It becomes therefore the duty of the Court to avoid hardship through the device of interpretation.

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44. Id. at 488.
45. Ibid.
46. See Upendra Baxi, Courage Craft and Contention, The Indian Supreme Court in the Eighties, p.3 (1985).

The judgment contemplated perhaps free flow of goods from one State to another. According to the law laid down, such movements were not fettered by any levy of tax. The working of such a system may lower the prices. Non-taxation of inter-State sales resulted in discrimination against local trade because local sales were taxable. The discrimination or hardship was really caused by local tax. This could be set at naught by the concerned State, if it so desired, through legislative means, by providing exemption. The discrimination, if any, could be avoided in this manner. But no State adopted such a course. Instead all the States imposed more and more tax on local sale as sales tax was a major source of revenue. The need for augmenting the State revenue was stressed by the intervening States in Bengal Immunity. But this was given a deaf ear. The judgment rather repelled the idea, and even recorded a note of rebuke with regard to the stand taken by the judges in the United Motors case. This is evidenced by the remark in Bengal Immunity about the decision in United Motors that the "harrowing picture of economic collapse of the States has been pressed upon this Court on this as on the previous occasion and it evidently oppressed the minds of the Judges who were parties to the majority decision.[47]

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47. Supra, n.35 at p.489.

The argument that an economic crisis would arise from the position that the delivery State cannot tax the inter-State sale, was considered by the Court to be not fully correct.[48] Frequently, inter-State sale is effected, the Court observed, between a dealer in one State and a dealer in another. It is very rarely that a dealer sells to a consumer from another State. The goods purchased inter-State by a dealer are sold locally in the delivery State. The dealer who purchases inter-State and sells locally can be required to register and pay tax on his annual turnover. The question of loss of State revenue did not therefore arise, the Court observed, except in marginal cases where a local consumer brings goods from out of his State.

The harrassment and inconvenience caused to the trading class under the law as declared by the Court in United Motors were taken into account by the majority in Bengal Immunity. Where the delivery State imposed tax traders had to get themselves registered in each State. They had to conform to the requirements of various sales tax laws which were by no means uniform. Sometimes, books of accounts would be required to be produced at the same time before officers of different States. Books of accounts might be detained for a long time by the authorities in one State for purposes of

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48. Ibid.

verification and the assessee might not therefore be able to produce them before another authority. This might cause ex parte assessment and raising of huge artificial demands unrelated to actual state of affairs. In different stages of the proceedings like assessment, appellate and revisional levels much time would be absorbed. A dealer with inter-State dealings in different States would be in a state of perpectual litigation, anxiety and worry.

Yet, resolving of the difficulties caused by the extra-territorial operation of tax law could have been possible without adopting very drastic step of declaring the levy itself illegal as was done in Bengal Immunity. This could have been possible as indicated in the dissenting views in Bengal Immunity either by some agreed coordination and congenial arrangements between States or by enacting appropriate legislative measures, if found necessary.[49] It was possible for Parliament to enact a law constituting an Inter-State Commerce Commission under Article 307 and confer on it the power to receive from the sellers one consolidated statement of all their sales outside their States and determine the precise extent of purchase or sale effected in the States for the purpose of assessment.[50] As was rightly pointed out by Justice Venkatarama Ayyar such a procedure would, on the one hand, secure to the

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49. Id. at 562.
50. Id. at 599.

States the finance legitimately due to them under the Explanation, and, at the same time, save the sellers from the harrassment of multiplicity of proceedings.[51]

The mischief stated to have been caused by the decision in United Motors and the delay that might be caused for remedying the mischief through legislative process were not compelling circumstances justifying a sudden departure from the view taken by the Court a couple of years ago after full and meticulous consideration of the various aspects of the question. Eventhough the Supreme Court has the competence to reconsider the correctness of its prior decisions, it is only a rule of prudence that such power be sparingly exercised. The Court is expected to exercise the power only when the prior decision is manifestly wrong and its operation would bring in its train public mischief. United Motors was decided after hearing the arguments from both sides for twelve working days.[52] The Indian Union and eight States were permitted to intervene. The judgment reveals that full consideration of all conceivable aspects was given before taking the decision. There was no compelling situation for overruling United Motors.

It appears that the decision in Bengal Immunity departing from the well considered view taken in United Motors

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51. Ibid.
52. Id. at 549, per Jagannatha Das, J. The case was argued from 9th February to the 25th February 1953.

did not lay down the correct principle. No doubt all the judges who delivered the majority and minority judgments in Bengal Immunity agreed that in a proper case it is permissible for the Supreme Court to go back upon its previous decision. But they were divided on the issue whether the case before them was a fit one for reviewing the previous decision. It seems that the minority judges have established that sufficient grounds were not made out for overruling the previous decision which had been taken after hearing all the parties interested. No suggestion was made in any of the arguments that any relevant constitutional provision or any other aspects of law had been omitted to be taken note of in United Motors or that the Court proceeded on wrong premises. The majority decision in Bengal Immunity does not seem to have taken into account the fact that certainty of the law is a necessary concomitant of rule of law. Stability of law must be the rule, and change only the exception. If decisions could be reversed simply because another view is possible on the subject, there will be proliferation of litigation and perpectual instability. Moreover, taxing the non-resident dealer under the scheme which existed prior to Bengal Immunity was just and proper because each State claimed under the scheme only what is realised by way of tax from the consumers resident within its respective territory. What was paid to the exchequer as tax was the amount collected from persons in the State where goods were brought for consumption.

The decision in Bengal Immunity was likely to create some perplexing problems. Inter-State sale or purchase was declared free from taxation. Local sale or purchase was subjected to tax. Purchasers might be inclined in such a situation to buy goods inter-State provided, of course, other market conditions remained the same. The result would be less demand for local goods. Immunity from tax on inter-State sale would cause undue hardship in some cases. For example, if raw materials are sold inter-State to a dealer he gets them without paying any tax, whereas if the raw materials are sold locally tax will have to be paid by the purchaser. The out of State purchaser in such a situation may offer a higher price than the local purchaser, since the sale to the former is tax free. This would ultimately cause hardship to local industry. Local manufacturing units may find it difficult to procure raw material locally. Even if it is procured locally, goods manufactured locally would carry a higher price compared to imported goods because of the incidence of tax on raw materials. The end result would be that the goods produced elsewhere capture the local market.

In a field of paramount importance like taxation of inter-State sale which is instrumental to the growth and development of the economy and the well-being of the public at large, the law was thus in a thoroughly unsatisfactory state. No doubt,

the position arose out of a narrow approach in interpreting the law. In matters like this the role played by the Supreme Court should not be narrow and technical. It has a greater role; it should decide cases taking into account the real need of the nation. In doing so, the Court becomes a Court of policy and there is nothing wrong in its so becoming. The judgment of the majority in Bengal Immunity left the hardship and inconvenience that might be caused by the judgment to be remedied by Parliament.

Chapter IX

INTER STATE SALE: THE COMPLEX LEGAL CONCEPT

The Constitution imposed some restrictions on the power of States to levy tax on sale or purchase of goods. One of them was on the power to levy tax on the sale or purchase in the course of inter-State sale or commerce.[1]

A look at the deliberations of the Constituent Assembly while enacting Article 286(2) of the Constitution will be helpful in understanding the considerations which weighed with them in imposing the restrictions. The draft Article as originally proposed by the Ministry of Finance[2] sought to prohibit imposition of tax by States on sale or purchase of goods when it took place in the course of inter-State trade or commerce and with a view to resale or use for any manufacturing business or building contract.[3] This proposal was not acceptable to many of the Provinces.

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1. Article 286(2). For the text, see Appendix A.
2. Article 264-A(1)(d) of the draft.
3. For the text of the draft, see Shiva Rao, The Framing of India's Constitution, Select Documents, Vol.IV, p.682 (1968).

The State of Bihar objected to the scheme of exemption on many grounds. Exemption from tax on sales to dealers, manufacturers and building contractors would mean a drastic reduction of revenue of States. The industrially backward States which did not have large commercial centres would be hit by such exemption. There would be further difficulty in ascertaining whether the sales were with a view to resale or use for the purposes mentioned in the Article. Further, States, which had a system of single point levy will be hit by the provision. The Bihar Government expressed the view that the appropriate course was not to introduce a total prohibition of levy of tax on inter-State sale, but to fix a ceiling on the rate of tax.[4] Madras and United Provinces felt that the prohibition to tax might be abused. Madras Government suggested that irrespective of the purpose to which goods were put, all sales from one State to another must be exempted. It clarified that a sale in the course of inter-State trade or commerce should mean the last sale taking place in the course of inter-State transaction.[5] The Government of United Provinces held the view that exemption of inter-State sales effected with a view to resale or use for the stated purposes, should be granted only when the goods are actually exported to another

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4. Id. at 716,717.
5. Id. at 719,720.

State and the goods are resold or used for the stated purpose. This change was suggested to avoid the abuse of the provision for evasive designs.[6] The Bombay view was that unless compensatory source of revenue was made available, it could not agree with the scheme of prohibition of tax on inter-State sales.[7]

In view of the objections of the provinces the Article was redrafted. The revised draft, by clause (2), prohibited levy of tax on sale and purchase of goods in the course of inter-State trade or commerce but authorised Parliament to lift the ban.[8]

Draft Article 264-A corresponding to Article 286 of the Constitution was introduced in the Constituent Assembly on the morning of 16th October 1946. It was then pointed out by the members that the proposed draft was received by them only at about 9 a.m. on that day.[9] Even the proposal to postpone the discussion of the Article to the afternoon was turned down.[10]

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6. Id. at 730.
7. Id. at 722.
8. For the text of draft Article 264 A(2) moved for consideration of the Constituent Assembly, see C.A.D. Vol.X, p.326 (1949).
9. Mr.Naziruddin Ahmed from West Bengal stated that he had to read them on his way to the Assembly. See, C.A.D. Vol.X, p.325 (1949).
10. Sri.Mahavir Tyagi from United Province and Sri.H.J.Khawdekar from C.P. and Berar put forward the proposal to adjourn the discussion to the afternoon session. Ibid.

Naziruddin Ahmed expressed his anxiety:

> "There are very intricate matters and they are re-opening discussions of the House already taken... It is difficult for any one, even the fastest brain, to follow these changes. No indication is given as to what changes are to be made".[11]

Ambedkar, however, moved the amendment in the morning session itself. Referring to sub-clause (2) which deals with prohibition of levy of tax on sale or purchase in the course of inter-State trade, and commerce he said:

> "Sub-clause (2) is merely a reproduction of Part X-A which we recently passed dealing with provisions regarding inter-State trade and commerce. Therefore so far as sub-clause (2) is concerned there is really nothing new in it. It merely says that if any sales tax is imposed it shall not be in conflict with the provisions of Part X-A".[12]

The discussion after moving the draft Article 264A(2) mainly centered round the propriety of imposing restrictions on the States' power to tax. The debate on the scope of the phrase 'in the course of' was scant.

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11. Ibid.
12. Id. at 326. Part X-A deals with draft Articles corresponding to Articles 301 to 304 of the Constitution. For discussion of the Constituent Assembly on these Articles see, C.A.D., Vol.IX, pp.1138-43.

The purposes of Article 286 of the Constitution are multidimensional. Control of inter-State trade, one of the objectives, was a delicate task. Establishment of a uniform pattern of control mechanism in the matter of inter-State trade and commerce throughout India was necessary for the unity of India. Encouragement for the growth of trade and commerce had to be given without discrimination. If that power was given to the States, the result at times would be disastrous. Imposing imaginative direct taxes on income of persons will reduce to some extent disparity between haves and have-nots. Imposing indirect taxes like sales tax on inter-State dealings affects, on the other hand, the commercial and productive activities of the nation. If States, in their enthusiasm to reap maximum revenue, adopt the policy of killing the golden goose by introducing unbearable tax burden, trade and commerce will decline and perish. One of the constitutional goals is to avert such a crisis.

It is a lamentable fact that the constitutional provision was not clear enough to lay down precisely the circumstances under which the exemption is granted. The ambiguity of the provision led to legal battles and uncertainties.

As has been stated in chapter II, the expression 'in the course of' was not defined in the Constitution. The exact scope and ambit of the expression was the subject matter

of debate from its inception. Does the term 'in the course of inter-State trade' mean a transaction between a dealer in one State and a consumer in another State? Should the movement of goods from one State to another necessarily be the result of a prior agreement to sell? Or will it cover only a sale effected while the goods are in transit from one State to another? Will sale between parties in the same State be an inter-State sale if goods move to a destination outside the State? A plethora of questions sprang up when the constitutional provision was put to working. The judiciary had a heavy task in interpreting the provision.

It was already noticed that the scope of the expression 'in the course' came up for consideration of the Supreme Court for the first time in the Travancore cases.[13] Principles were evolved to decide the question in the export-import context. If these principles are applied to the inter-State context there will be two categories of inter-State sales.[14] They are sales occasioning inter-State movement and sales effected by transfer of documents while goods are in inter-State movement. Sales involving movement of goods from one State to another constitutes

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13. See supra, Ch.II, n.30.
14. For a discussion on the concept of inter-State sales, see N.S.Chandrasekharan, "The Concept of Inter-State Sale", 1974 Cochin University Law Review, p.69.

inter-State sale. A sale and resultant movement of goods from one State to another make the sale inter-State. Here the sale occasions the movement. Any other sale, however directly connected with the inter-State movement, will not be of inter-State character. A sale while the goods are in transit from one State to another is another category. Here the sale would be effected by transfer of documents of title. Such a transit sale will also be inter-State.

What is an inter-State sale was incidentally examined in the Second Travancore case.[15] One type of transactions in that case involved movement of goods from the State of Madras to the State of Travancore-Cochin. The purchase was made outside the State of Travancore-Cochin, but delivery was effected through the ordinary commercial channels at the assessee's depot in the State of Travancore-Cochin. The Court observed that when purchase was effected outside the State and delivery made in the State through normal commercial channel the transactions would be inter-State.[16] The inter-State character was attributed obviously because the inter-State movement of the goods was part and parcel of the transaction. The transaction was effected through commission agents. When

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15. State of Travancore-Cochin v. Shanmughavilas Cashewnut Factory, (1953) 4 S.T.C. 205 (S.C.).
16. Id. at 218.

delivery is made through normal commercial channels, the inter-State movement was inseparably connected with the sale.

Will a sale between a dealer in one State and a consumer in another be inter-State? In the United Motors case[17] the Advocate General of Bombay raised a view point that the expression inter-State trade and commerce in clause (2) of Article 286 may be construed as meaning dealings between a trader in one State and a trader in another, so that the clause would be applicable only to sale between such traders.[18] If this was so, the ban under clause (2) could not affect the taxability of a sale by a trader in one State to a consumer in another. The Court held that such a restrictive interpretation could not be given to the expression 'inter-State trade and commerce'. According to the Court the sale by a trader in one State to a consumer in another would also be a sale in the course of inter-State trade.

Justice Vivian Bose who dissented with the majority in United Motors was of the view that even when the whole transaction of sale is constituted in one particular State, in the sense that every essential ingredient necessary to constitute a sale takes place there, the sale would be in the

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17. State of Bombay v. United Motors, (1953) 4 S.T.C. 133 (S.C.).
18. Id. at 147.

course of inter-State trade or commerce.[19] He clarified the point by an illustration. A Bombay dealer sells goods to a Madras dealer for consumption in Madras. Delivery of goods is made to the Madras dealer in Bombay. The Madras dealer carries the goods across the State in person. Justice Bose observed:

> "....if that is the normal way in which trade and commerce in that particular line of goods flows across the boundary, then that would, in my opinion be a sale in the course of inter-State trade and commerce despite the facts, including delivery, mentioned above".[20]

This view does not however totally reject the connection between sale and inter-State movement of goods. It recognises the principle that such connection could be implied by the consent of the parties. In other words, the requirement of movement of goods outside the State could be an implied term of the contract in view of the trade practice or conduct of the parties.

In Bengal Immunity[21] the majority did not examine the characteristics of inter-State sale since it was conceded

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19. Id. at 166.
20. Ibid.
21. Bengal Immunity Co. v. State of Bihar, A.I.R. 1955 S.C. 661.

by the parties that the sales involved in the case were inter-State in character.[22] The Court simply examined the scope of Article 286(2). What was provided in that Article was that no law of a State shall impose a levy of tax on inter-State sales or purchases "except in so far as Parliament may be by law otherwise provide. Parliament may, by lifting the ban permit States to levy tax on inter-State sales. The lifting of the ban on taxation of inter-State sales may be total or partial. What all things Parliament could do, in exercise of its legislative powers when it makes law on taxation of inter-State trade, are, however, matters relating to legislative competence of Parliament. The competence would be decided by the Court only when Parliament brings the legislation. The Court therefore abstained from further discussion on the scope of the power of Parliament. The Court observed that it need not advise Parliament in advance as to the scope of its legislative competency and on what all things Parliament may do while lifting the ban.

Justice Venkatarama Ayyar, however, in his dissenting judgment dealt with the question of inter-State sale. He

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22. See supra, Ch.VIII, n.43. Das, Actg.C.J. observed at 478: "It is not necessary, for the purpose of this appeal, to enter upon a discussion as to what is exactly meant by inter-State trade or commerce or by the phrase 'in the course of', for it is common ground that the sales or purchases made by the appellant company which are sought to be taxed by the State of Bihar actually took place in the course of inter-State trade or commerce".

did so while discussing the merits of the contention that the sale to which the Explanation to Article 286(1) applied, took place in the course of inter-State trade. The argument was that the Explanation could not be construed as altering the inter-State character of the transaction. The true scope of the Explanation according to that argument[23] was merely to shift the situs of sale from the selling State to the delivery State. Justice Venkatarama Ayyar considered the argument fallacious. The fallacy lay in thinking that after the shifting of the situs from one State to another, the sale could still be regarded as one in the course of inter-State trade.[24] In his view a sale could be said to be in the course of inter-State trade only if two conditions concur. The first condition is a sale of goods. The second condition is that such sale

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23. Id. at 583. The contention was as stated by Justice Venkatarama Ayyar: "Conceiving inter-State trade as a stream flowing from point A in the selling State to a point B in the delivery State, it was argued that what the Explanation did was to shift the situs of the sale from point A to point B, that the stream was still there, despite the shifting and that the sale therefore did not cease to be in the course of inter-State trade".
24. Justice Venkatarama Ayyar held that when the delivery of goods is made in one State and the Explanation creates a fiction that the sale also takes place in that State the sale cannot be said to be inter-State, but is intra-State. Id. at 584.

should be accompanied by a transport of goods from one State to another. Unless both these conditions were satisfied, a sale will not be in the course of inter-State trade.[25]

Suppose a merchant in State A goes to State B, purchases goods there and transports them into State A. Here there is an inter-State movement of goods. But that movement is not under any contract of sale. It is independent of the sale. Hence according to Justice Ayyar, the sale is not in the course of inter-State trade or commerce. Suppose the dealer after so transporting the goods into State A sells them in State A. Then also there is no sale in the course of inter-State trade. Of course, there is a sale and a movement of goods from one State to another. But the sale is not inter-State, the movement being unconnected with the sale. This is because there was no sale at the time of transportation.[26]

This view emphasises the need for linking up of transport, or movement of the goods, with the contract of sale as an essential factor of inter-State sale. A sale and

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25. Id. at 583. The test was formulated by Justice Venkatarama Ayyar thus: "A sale could be said to be in the course of inter-State trade only if two conditions concur: (1) A sale of goods, and (2) a transport of those goods from one State to another under the contract of sale. Unless both these conditions are satisfied, there can be no sale in the course of inter-State trade".
26. Id. at 583, 584.

subsequent transportation of the goods outside the State, without any linkage between the two are not sufficient to characterise the transaction as inter-State. The transport must be in pursuance of a contract of sale. This theory assumed tremendous significance in later years.[27]

Will a sale be inter-State if the out-of-the State supplier is a registered dealer in the delivery State? Mohanlal Hargovind Das[28] involved such a question. The assessee was a firm carrying on business in Madhya Pradesh. They manufactured and sold bidies. For their business they required finished tobacco. This was imported from Bombay. The tobacco was delivered to them in Madhya Pradesh. The assessee was assessed to tax under C.P. and Berar Sales Tax Act, 1947 on the purchase turnover of tobacco. The assessee contented that the transaction had taken place in the course of inter-State trade, and the State of Madhya Pradesh had no authority to impose tax on the transaction as it was violative of Article 286(2). The Bombay dealers who supplied the goods to the assessee were also registered dealers in Madhya Pradesh. It

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27. It became the future Law. See Central Sales Tax Act 1956, Section 3. For the text, see, Appendix B. Justice Rajagopalan observed in India Coffee Board v. State of Madras, (1956) 7 S.T.C. 135 (Mad.) and 143: "Eventhough the observations of Venkatarama Ayyar constituted obiter dicta they are entitled to highest respect".
28. Mohanlal Hargovind Das v. State of Madhya Pradesh, (1955) 6 S.T.C. 687 (S.C.); A.I.R. 1955 S.C. 786.

was contended on behalf of the State of Madhya Pradesh that the transactions were between two registered dealers in Madhya Pradesh and therefore the sales involved were internal sales. The Court observed that the fact that the Bombay dealers who supplied the goods were also registered dealers in Madhya Pradesh would not be sufficient to invest a transaction which was in the course of inter-State trade with the character of an intra-State transaction. The Court pointed out that merely because a dealer outside the State gets himself registered in the State as a dealer, it could not be said that whatever transactions he entered into with other dealers in the State were all intra-State transactions irrespective of the fact that they involved movement of goods across the border.[29] The Court rightly held that the transactions were in the course of inter-State trade.[30]

One of the points in dispute in Indian Coffee Board[31] was the inter-State nature of certain transactions. Coffee was sold and delivered to the agents of the purchasers in the State of Madras. The coffee was bought with the definite intention of transporting it outside the State. It was in

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29. Id. at 692.
30. Id. at 693.
31. Indian Coffee Board v. State of Madras, (1956) 7 S.T.C. 135 (Mad.).

fact transported outside the State. Antecedent to the transport the property in the goods had passed to the purchaser. The purchaser transported it out of the State as his goods. The Madras High Court held that the sale was not inter-State. The court noted the difference of the facts in this case with those in the Second Travancore case[32] where after purchase by commission agents delivery of goods was made through normal commercial channels.[33] In Indian Coffee Board, delivery was taken by agents of buyers and they transported the goods to out of States buyers. The court held that since all the ingredients of sale were completed in Madras and the transport was not connected with the sale, the transaction was not inter-State.[34]

The Travancore-Cochin High Court was prepared in K.A.Davies v. Sales Tax Officer[35] to look at the nature of the transaction from the point of view of its commercial significance.[36] The buyer was from outside the State but delivery of

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32. Supra, n.15.
33. Supra, n.31.
34. Ibid at p.144. The same view was taken in State of Madras v. Indian Coffee Board, (1956) 7 S.T.C. 522 (Mad.).
35. (1956) 7 S.T.C. 829.
36. Ibid. The court quoted at p.830 the following observations of Dixon, J. in Clements and Marshall Proprietory Ltd. v. Field Peas Marketing Board, (1947) 76 C.L.R. 401: "We should consider the commercial significance of transactions and whether they form an integral part of the continuous flow or course of trade, which, apart from the theoretical legal possibilities, must commercially involve transfer from one State to another".

the goods was effected to the agent of the buyer within the State. The court held that the sale did not take place in the course of inter-State trade or commerce as the sale and the subsequent transport were not linked together. The court found that even when looked at from the point of view of commercial significance of the transaction it did not form "an integral part of a continuous flow or course" of inter-State trade or commerce.[37]

In Kerala Arecanut Company[38] the assessee acted as commission agent both for sellers and non-resident buyers. The assessee purchased arecanut, paid the price and despatched the goods outside State. It was not contended that the transportation across the State frontier was a term of the contract of sale. The question for determination was whether, in the absence of such a term, the purchase can be considered to be in the course of inter-State trade or commerce. The court answered the question negatively. It was held that the assessee was liable to pay purchase tax, he being the last purchaser within the State. Referring to the view[39] of Justice Bose in United Motors the court remarked that it meant only that in interpreting a contract of sale its 'commercial significance' and the 'normal way in which trade and commerce in that

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37. Id. at 830.
38. Kerala Arecanut Company v. State of Travancore-Cochin, (1957) 8 S.T.C. 817 (Ker.).
39. Supra, n.20.

particular line of goods flows across the boundary' should not be forgotton. The court pointed out[40] that Justice Bose was emphasising a mode of construction and a way of approach rather than postulating a rule to the effect that even if the contracts of sale do not require or necessarily involve transportation across the State boundary, the sale should none-the-less be considered as taking place in the course of inter-State trade or commerce.

A similar situation arose in Agarwalla and Bros.[41] The assessee claimed deduction, from their turnover, of the value of jute despatched to mills outside the State of Orissa under instructions of the buyer. He contended that the transaction was inter-State. The assessee sold the goods to a dealer in Madhya Pradesh. But delivery of goods was given inside the State of Orissa. Subsequently the goods were despatched outside the State under instructions of the buyer. It was stated that the assessee was merely a commission agent of the outside mills. It was said that he charged only a commission. But the books of accounts revealed a different story. The accounts evidenced outright sale. The Orissa High Court held[42] that the sale by the assessee to the dealer

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40. Supra, n.38 at p.822.
41. Agarwalla and Bros. v. Collector of Sales Tax, (1958) 9 S.T.C. 31 (Orissa).
42. Id. at 42.

in Madhya Pradesh was completed within the State and that it could not be said that the subsequent movement was occasioned by the sale. The transaction was not inter-State in character.

In Bhadraiah Setti[43] the assessee sold goods to Mysore Starch Manufacturing Co. carrying on business in Mysore State. The contention was that the sale was effected in the course of inter-State trade and therefore was exempted from tax under Article 286 of the Constitution. The sale between the assessee and the buyer was effected in Andhra Pradesh. The goods were booked by the buyer, by rail, to a station outside the State. The buyer figured both as consignor and consignee. The Andhra Pradesh High Court held[44] that the sale was completed within the State of Andhra Pradesh and since the transport was made by the buyer the transaction was purely internal and liable to be taxed under the State law.

A person purchases goods locally. The purchase is made with the intention of selling them outside the state. He does in fact so sell them. Can such purchase be characterised as inter-State? This was the question before the Supreme Court in Endupuri Narasimham[45]. The assessee carried on business in

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43. Bhadraiah Setti v. State of Andhra, (1959) 10 S.T.C.222 (A.P.)
44. Id. at 229.
45. Endupuri Narasimham & Son v. State of Orissa, (1961) 12 S.T.C. 282 (S.C.).

Orissa. The business consisted of purchase of goods like caster seeds and turmeric and of selling them to dealers outside the State. The purchase made by the assessee was assessed to sales tax under the State sales tax Act. The assessee challenged the validity of the levy. He contended that the purchase was made in the course of inter-State trade and that the levy of tax contravened Article 286(2). The goods were purchased for sale to dealers outside the State and that they were in fact so sold. It was argued that therefore the purchase was inter-State. The transactions subjected to tax were made wholly inside the State. The taxable event was sale by persons in the State to persons in the same State. The subject matter of the sale, namely the goods, was also in the State. Is the fact that the purchaser sold the goods subsequently to dealers outside the State relevant so as to give the purchase an inter-State character? This question was answered in the negative by the Court. The transaction of sale by the assessee to dealers outside the State was separate from the sale or purchase by the assessee. The tax was imposed not on the former, but on the latter. The levy not being on the sale by the assessee to persons outside the State, but on the purchase by him inside the State, was held to be valid[46]. Because clearly the sale by the assessee to

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46. Id. at 284. This decision was followed in Himatsingka Timber Co. v. State of Orissa, (1966) 18 S.T.C. 235 (S.C.).

persons outside the State was in the course of inter-State trade and hence not taxable under Article 286(2); the sale to the assessee or the purchase by him in the State was purely local in nature and hence not hit by Article 286(2).

Mohanlal Hargovind Das[47] also involved purchase of goods and subsequent sale outside the State. The goods purchased were delivered inside the State of Madhya Pradesh. But the Court held that the purchase was inter-State.[48] In Endupuri Narasimham[49] also there was a purchase of goods and sale of goods outside the State subsequently. But, in that case the purchase was held to be a local transaction.[50] Where does the difference lie which made the purchase in the former case inter-State and that in the latter intra-State. There were material differences between the two cases. In Mohanlal Hargovind Das the purchase was from dealers in Bombay. Under the contract of sale the goods were transported from the State of Bombay to the State of Madhya Pradesh and delivered to the assessee at Madhya Pradesh. The purchase therefore involved an inter-State movement of the goods. In Endupuri Narasimham the purchase by the assessee was from persons in the State of

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47. Supra, n.28.
48. Supra, n.30.
49. Supra, n.45.
50. Supra, n.46.

Orissa and the goods were in the State of Orissa. The purchase therefore involved no movement of goods from one State to another. In order that a sale or purchase might be inter-State there must be a sale and a transport of goods from one State to another under the contract of sale.[51] This test[52] was not satisfied in Endupuri Narasimham. Hence the purchase was, unlike that in Mohanlal Hargovind, intra-State.

The principle that a sale and a movement of goods from one State to another are not enough to constitute a sale into an inter-State one, but the movement must be resultant of the sale itself, found application in Krishna and Co.[53] The assessee had purchased goods within the State. After purchase the assessee transported the goods in vehicles arranged by him. The seller was in no way connected with the transport. The purchase was completed within the State. The goods moved out of the State as the goods of the assessee. The court held that the purchase was not inter-State. It was observed that though there was a movement of goods across the frontiers of the State, the movement was not the direct result of the sale. It was held that the mere fact that there is

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51. The test was evolved by Justice Venkatarama Ayyar in the dissenting judgment in Bengal Immunity Co. v. State of Bihar, (1955) 6 S.T.C. 446 at 583. See supra, n.25.
52. The Supreme Court approved this test. See, Endupuri Narasimham v. State of Orissa, supra, n.45.
53. (1961) 12 S.T.C. 640 (A.P.).

movement of goods was not sufficient to constitute the inter-State trade and that in addition it should be under the contract of sale.

In Bapputty[54] the contract was for supply of sleepers to the railway. Delivery of the goods was to be made at Railway yard in Kerala. The assessee had to arrange for the loading of goods into railway wagons and book them to the consignee. The sleepers could be reinspected at any time within two months after they had been passed initially. The assessee was given 90 per cent of the value on production of the railway traffic receipt. The claim of the assessee that the transaction was exempted under Article 286(2) did not succeed, as according to the Kerala High Court, the title passed with the delivery of sleepers at railway station within the Kerala State and the later movement according to the Court was for the better enjoyment of the goods. The agreement, the court held[55], did not put the sleepers into the channel of inter-State trade and that the journey started after the goods had been delivered. In so deciding, the court did not correctly appreciate the factual situation. The movement was necessitated as a result of the contract. The goods were railed to

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54. Bapputty v. Government of Kerala, (1961) 12 S.T.C. 722 (Ker.).
55. Id. at 727.

destination outside the State in fulfilment of a contractual condition. But the court merely based the decision on the wrong premise of passing of property.

Tests similar to those evolved in the export context were applied in Khaitan Minerals[56] to decide the inter-State nature of sales. The full facts of the case were not available to the court. The turnover in dispute related to sales of manganese ore. The goods were in Mysore when the contract of sale was made. The ore had to be analysed by an expert and after approval it had to be stored at railway sidings in Mysore. The railway weighment was final. The buyer arranged for transportation of the goods though rail. Accordingly goods moved to destinations outside the State. One of the contentions raised in the case was that the sale should be considered inter-State and the levy of the tax was prohibited by Article 286(2).

The court observed that sale or purchase for the purpose of inter-State trade was not a sale or purchase in the course of inter-State trade. A sale in the course of inter-State trade must necessarily be put through by transportation of the goods outside the State. A sale or purchase

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56. Khaitan Minerals v. Sales Tax Appellate Tribunal, (1962) 13 S.T.C. 508 (Mys.).

becomes inter-State when it occasions the inter-State trade or commerce. The sale or purchase must, in other words, be inextricably bound up with inter-State trade or commerce and must form an integral part of it.[57] Since the full facts were not available the court remanded the case to the Tribunal for disposal in accordance with the principles of law.

Evidently, principles similar to these evolved in the export-import context have been applied in this case. The Court had already developed a theory distinguishing a sale for export from a sale in the course of export.[58]

One of the questions that came up for consideration of the Supreme Court in Singareni Collieries[59] was the inter-State nature of the sale of coal involved in the case. Coal was a controlled commodity. Its supply was regulated by the Coal Commissioner. The assessee was engaged in the business of mining coal and supplying it to the consumers. Under the Colliery Control Order, the price of coal was fixed by the Central Government. The colliery owners were prohibited from

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57. Id. at 520.
58. See supra, Ch.III.
59. Singareni Collieries Co. v. Commissioner of Commercial Taxes, (1966) 17 S.T.C. 197 (S.C.).

selling coal to a consumer unless an allotment was made by the Deputy Coal Commissioner. The Central Government could issue directions to the colliery owner regulating the disposal of his stock. The Commissioner could also order that coal despatched to any person be diverted and delivered to another person specified in the order. No colliery owner could despatch any coal except under the authority of the Central Government. The course of transactions involved was that the Coal Commissioner addressed the colliery owner authorising him to despatch, on request of the consumers, coal not exceeding the quantities specified, during the periods and according to the schedule specified in the latter. The schedule contained the names of the persons to whom coal was to be supplied. Intimation about this was given to the consumer, who addressed the colliery requesting for despatch of the coal so allotted. The consumer gave despatch instructions regarding the booking and the collection of price. The colliery, owner then loaded the coal in railway wagons, made a sale note mentioning the price f.o.r. and despatched the goods with 'freight to pay'. On such loading the property in the goods and the risk passed to the consignee.

Were these sales inter-State? The Court relying on the observations of Justice Venkatarama Ayyar in Bengal Immunity held the transactions to be inter-State. The Court

observed that in these sales coal was transported outside the State in pursuance of allotment orders. Since compliance with allotment orders resulted in a contract of sale and there was inter-State movement in pursuance thereof the Court held[60] the transaction to be in the course of inter-State trade.

The concept of inter-State sale projected in the dissenting judgment of Justice Venkatarama Ayyar in Bengal Immunity thus gradually attained strength. It received the approval at the hands of the Supreme Court and found application in subsequent cases. The principles which thus got themselves firmly embedded in the case law through the process of judicial interpretation helped future concretisation of the law through the legislative process.

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60. Id. at 209.

Chapter X

CRYSTALLISATION OF THE LAW

The middle of 1950s witnessed a setback in the revenue collection and a lull in inter-State trading and commercial activity. The clouds of confusion generated by the conflicting decisions of the Supreme Court in United Motors[1] and Bengal Immunity[2] led to this declining trend. The States stood on the verge of a financial collapse.

On the basis of Article 286 of the Constitution as interpreted in the United Motors[3] non-resident dealers had been subjected to levy of sales tax by States in respect of delivery and sale of goods within their territory. The despatching State had no part or lot in taxing such sales. They had no fiscal interest in those dealings. The tax collection from their residents went straightaway to the coffers of other States. To unearth evasion of tax the despatching State

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1. State of Bombay v. United Motors (India) Ltd., (1953) 4 S.T.C. 133 (S.C.); A.I.R. 1953 S.C. 252.
2. Bengal Immunity Co. v. State of Bihar, (1955) 6 S.T.C. 446 (S.C.); A.I.R. 1955 S.C. 661.
3. Supra, n.1.

adopted a non-cooperative attitude. Lack of co-ordinated work by the States prevented effective checking of evasionary tactics. Tax dodgers had a hey day. They evaded assessment. Only honest dealers paid the tax. This paradox naturally created a demoralising effect on the honest and the sincere.

The decision of the Supreme Court in Bengal Immunity[4] overruling United Motors[5] showed a red signal. It tabooed taxing inter-State sale. The consequences were far-reaching.[6] The most baffling and urgent problem was the claims of refund of tax already collected. The States had collected large amount of tax on inter-State sale on the authority of United Motors. Some dealers who collected tax kept the amount without paying to the exchequer. No demand could be raised by the States in respect of such collection. It was an unjust gain for those who collected and kept the same. "Judicial review has more than justified itself under our Constitution", observes Seervai, "but the Bengal Immunity decision emphasises the fact that there is a price for judicial review and it can be heavy".[7]

Though rule by Ordinance is not generally considered a welcome measure in the history of Indian Constitutional

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4. Supra, n.2.
5. Supra, n.1.
6. See, Ch.VIII.
7. Seervai, Constitutional Law of India, Vol.II, p.2028 (1984).

development there were instances when public interest was protected through ordinances in times of administrative emergency. The Sales Tax Laws Validation Ordinance 1956 was one such instance.[8] It removed the ban on taxation of inter-State sale with retrospective effect, with a view to validating the levy of tax on sales from one State to another for consumption in the latter State. The States were thus absolved from payment of huge amounts by way of refund.

The validity of the Validation Act was challenged and the state of instability continued till the challenge was repelled by the Supreme Court in Sundararamier's case.[9] The Validation Act was only a temporary stop-gap arrangement. It was necessary to find out a lasting solution and to evolve a new policy of inter-State taxation.

The Taxation Enquiry Commission[10] in its report pointed out that sales tax, in essence, must continue to

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8. The Ordinance validated levy, assessment and collection of tax between 1st April 1951 to 6th September 1955. The Ordinance was replaced by the Sales Tax Validation Act 1956. The validation of the levy was made only till the judgment in Bengal Immunity namely 6th September 1955. Therefore Article 286(2) of the Constitution remained operative after that date. Constitution (Sixth Amendment) Act was passed with effect from September 11, 1956 amending Article 286(2). For amended Article, see Appendix A.
9. Sundararamier & Co. v. State of Andhra Pradesh, (1958) 9 S.T.C. 298 (S.C.); A.I.R. 1958 S.C. 468.
10. For the terms of reference of the Taxation Enquiry Commission, 1953-54, Ch.III, n.35.

be a State tax. The reasons were not patent. Tersely speaking, the Commission expressed the view that States cannot do without sales tax.[11] In the intra-State sphere the States should be free to develop systems suitable to their varied conditions. There will then be in each State a system adopted to its own needs. Moreover, sales tax is not only one of the largest single sources of revenue to the States but also a source which has shown the greatest flexibility in terms of revenue yield.[12] It has become an integral part of the State financial system, having been in force in States for many years. The financial structure of the States would be considerably dislocated if, at this late stage, so important and flexible an item of revenue as the sales tax was removed from the State List.

Touching upon the proposal to transferring the power to levy and collect sales tax to the centre and making provision for distributing the receipts from sales tax to the States, the Commission observed:

> "The argument that the receipts from the tax can be distributed to the States and their finances not adversely affected, does not take into account the

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11. Report of the Taxation Enquiry Commission 1953-54, Vol.III, p.45 (1955).
12. Id. at 46, 47.

> many practical difficulties attendant upon the centralisation of a tax with such strong local moorings as the sales tax".[13]

Moreover, the Commission thought that where both the dealer and consumer were situated in the same State, the levy of tax by the Government of that State could not be objected. It is where either the dealer or the consumer is outside the State which seeks to impose tax that real difficulty is experienced.[14] After dispassionately evaluating the pros and cons of the question the Commission categorically stated that sales tax, in essence, must continue to be a State tax. As a source of revenue (subject to the very minor exception in respect of newspapers) it must wholly belong to the States.[15] The sphere of power and responsibility of the States, the Commission pointed out, must be said to end, and that of the Union to begin, when the sales tax of one State impinges administratively on the dealers and physically on the consumers, of another State. It has to be ensured that the sales tax system of one State does not impose an arbitrary and unregulated burden on either consumer or dealer of another State or unduly interfere with the free flow of

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13. Id. at 47.
14. Id. at 53.
15. Id. at 54.

trade and commerce.[16] In inter-State dealings complete exemption of sales outside the State places the exporting State in a disadvantageous position. The Commission explained the situation thus:

> "A State with a backward economy and relying on revenue from sales tax leviable on its main source of agricultural or industrial raw materials suffers financially from this restriction".[17]

The regulation of levy of sales tax on inter-State transaction is necessary, not a prohibition of tax on such transaction. The Commission thus felt that inter-State sales should be the concern of the Union.

However, it was not envisaged that the Central Government should maintain elaborate administrative machinery for the purpose of assessment and collection of tax on inter-State sales. The States have provided machinery for assessment and collection of local sales tax. It would be both economical to the Central Government and also convenient to the traders who would otherwise be subject to two assessing

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16. Id. at 48.
17. Ibid.

authorities, if the State machinery is used for levy and collection of the central sales tax. The Commission therefore recommended that the Union responsibility for collection could be exercised using the State machinery and the revenue from inter-State taxation must be devolved on States.[18]

Article 286 as it originally stood divided sale of goods into two categories. One was goods sold and delivered for consumption in another State. The other was goods sold within the State. The Commission found that this dichotomy was imperfect from the point of view of tax administration.[19] The Commission felt that all sales of goods could both usefully and effectively be divided into two compartments; namely those in the course of inter-State trade and commerce and those not in the course of such trade and commerce. Inter-State sphere should be left to the Union for policy formulation. The revenue therefrom should be devolved on the respective States. The intra-State sphere should be dealt with by the States both in respect of policy and administration. The Commission hoped that this arrangement would ensure both co-ordination and adaptation to changing

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18. Id. at 56-57.
19. Id. at 54.

needs more effectively than rigid constitutional provision supplemented by occasional judicial interpretation.[20]

The Commission suggested that the receipts from the Central levy should not be credited to the Central revenues, but should be retained by the States. The intention of the central levy was not to provide a source of revenue for the Centre. The main intention was to ensure that some revenue should be accrued to the exporting State without raising unduly the burden on consumers in the importing State. The central legislation must, therefore, specify a reasonable rate at which the tax on sales in the course of inter-State trade and commerce should be levied.[21]

Inter-State trade comprises (1) transactions which only registered dealers are involved and (2) transactions in which unregistered dealers are involved. Should the low rate recommended for inter-State taxation extended to dealings with unregistered dealers? The Commission emphatically rejected uniform pattern in respect of these two distinct type of dealings, and observed:

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20. Ibid.
21. Id. at 57.

> "Where transactions take place between registered dealers in one State and unregistered dealers or consumers in another, this low rate of levy will not be suitable, as it is likely to encourage avoidance of tax".[22]

Transactions involving unregistered dealers and consumers should, the Commission suggested, be taxable at the same rates which the exporting States impose on similar transactions within their own territories. The unregistered dealers and consumers involved in inter-State transactions will not then be in an advantageous position.

The Commission further recommended that in cases where no tax was levied for sale of goods, or a lower rate of tax levied by the exporting State, the tax to be collected by it on the inter-State sale of those commodities should be similarly exempted or, as the case may be, taxed at the same lower rate.[23] The Commission with a view to reducing the burden of tax, suggested that no purchase tax should be levied by the State on the specified goods on which a central tax on inter-State trade has already been levied.[24]

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22. Ibid.
23. Id. at 58, 61.
24. Id. at 61.

Specific recommendations made by the Commission on the policy to be pursued in regard to taxation of goods declared by Parliament to be of special importance[25] have been dealt with in a separate chapter.[26]

For the effective implementation of these proposals, the Commission suggested draft amendments to the Constitution. In the Union List a new entry was proposed to be inserted so as to enable Parliament alone to legislate on taxes on sales or purchases other than newspapers taking place in the course of inter-State trade or commerce.[27] Consequential amendments were suggested to entry 54 in List II of Seventh Schedule and to Articles 269 and 286. The Commission also suggested amendment for investing Parliament with power to formulating principles to determine when a sale or purchase takes place outside a State or in the course of inter-State trade and commerce.

The Constitution (Sixth Amendment) Act 1956[28] was passed for implementing the proposals made by the Taxation Enquiry Commission. By virtue of Article 269(3), newly

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25. Constitution of India, Article 286(3).
26. See Ch.XIV, infra.
27. For the text of the amendments suggested. See Appendix C.
28. For the amended provision of Article 286, see, Sppendix A.

inserted, Parliament has been authorised to formulate by law principles for determining when a sale or purchase of goods takes place in the course of inter-State trade or commerce.[29] Parliament was invested with exclusive power to make laws imposing tax on the sale or purchase of goods in the course of inter-State trade or commerce.[30] The amounted collected by way of such tax was to be assigned to those States which levied the tax.[31] Parliament thus became the paramount authority in the field of taxation of inter-State sale.

Parliament reappraised the situation in the light of the constitutional change and in the wider perspective of national economy. Taxing inter-State sale is a vexed problem.

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29. Article 269(3), newly inserted by the Constitution (Sixth Amendment) Act 1956, is as follows: "269(3). Parliament may by law formulate principles for determining when a sale or purchase of goods takes place in the course of inter-State trade or commerce".
30. By the Constitution Sixth Amendment Act 1956, a new entry was added to List I of the Seventh Schedule as under: "92A. Taxes on the sale or purchase of goods other than newspapers where such sale or purchase takes place in the course of inter-State trade or commerce".
31. Article 269(g) inserted by the Constitution (Sixth Amendment) Act 1956 was as follows: "269. Taxes levied and collected by the Union but assigned to the States:- (g) Taxes on the sale or purchase of goods other than newspapers, where such sale or purchase takes place in the course of inter-State trade or commerce".

There are a host of factors which are significant in moulding tax policy. Freedom of trade and commerce is one. Denial of power to the States to impose tax on inter-State transactions is another. The need for reducing tax burden on the consuming public is yet another. Factors which cripple industrial units have to be avoided. If this is not done there will be loss of production leading to less employment opportunity. While exercising the power vested in it, Parliament had to take into account these aspects.

The Ministry of Law referred to the Law Commission the question of formulating the principles for determining when a sale or purchase takes place in the course of inter-State trade or commerce.[32] The Law Commission took note of the main purpose behind the recommendation of the Taxation Enquiry Commission to the effect that the power to tax inter-State transaction be vested in Parliament and that it be empowered by law to formulate the principles for deciding when a sale or purchase takes place in the course of inter-State trade or commerce. The idea behind the recommendation was that the rate of tax on inter-State transactions should

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32. See, Ministry of Law, Government of India, Law Commission of India, Second Report, p.1 (1956).

be fixed by Parliament in the interest of the country as a whole. It was also necessary that the principles for determining the inter-State nature of the transaction should be fixed by Parliament. An ordinary enactment could avoid the rigidity of a constitutional provision. It could be varied to suit the needs from time to time.

The Law Commission pointed out that two aspects had to be born in mind while formulating the principles. Unlike the position in the case of export import trade the question was not one of exemption from tax. But the position was one of taxation of the inter-State transaction by the Union the proceeds of which were to be assigned to the States. While imposing tax an important consideration had always to be kept in mind, namely, the interest of the trade and commerce which under the constitutional policy had to be free. This will be possible if the tax burden was limited by the Union.[33]

The Law Commission took the view that only a transaction which in fact occasioned the movement of goods from one State to another State should be characterised as inter-State transaction. Transactions within the State contemplating subsequent inter-State movement should not be treated as inter-State dealings. The test was similar to

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33. Id. at 3.

the one formulated to decide the question when a sale or purchase shall be in the course of export or import.[34]

One may however note that the above mentioned two tests may not necessarily be common. This is because the purpose of control on the two transactions are different. The incidences are different. The purpose of regulation of export is to capture foreign market. In the context of import the purpose is to make available things absolutely necessary for the country at the minimum possible cost. The incidence of the regulation is therefore by way of total exemption from tax liability. In the context of inter-State trade the purpose of regulation is to facilitate inter-State commerce by limiting the tax burden. The incidence of regulation is not by way of exemption from tax but by way of regulated imposition of tax in a reasonable way. The tests can therefore be different.

The Law Commission distinguished a sale in the course of inter-State trade from an intra-State trade. A sale or purchase becomes inter-State when such sale or purchase itself occasions the movement of goods from one State to another. For instance, 'A' buys goods in State 'B' and

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34. Id. at 4.

then takes it to State 'C'. In the view of the Law Commission the same would be the result even if 'A' had the intention to take the goods to State 'C' after purchase, because even then the sale to 'A' does not by itself occasion the movement of goods to State 'C'. But when 'A' buys goods in State 'B' and requires the seller to deliver the goods to a carrier for transmission to State 'C' and to deliver him the goods there, the sale becomes inter-State. Because there is a movement of the goods in pursuance of the contract. The sale occasions the movement of goods from one State to another.[35]

Another problem that arises in the context is the nature of the sale effected during the course of movement of goods from one State to another. For example, in a sale between 'A' in State 'B' and 'C' in State 'D', goods move from State 'B' to State 'D'. While the goods are so in transit 'C' in State 'D' may sell it to 'E' in the same State by transfer of documents of title. Will be transaction between 'C' and 'E' in State 'D' be inter-State? The Law Commission took the view that it should be.[36] Will not then transaction which is in fact intra-State, be converted into inter-State by transfer of documents of title? For example in the

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35. Id. at 5.
36. Ibid.

illustration, 'E' can sell to 'F' and 'F' to 'G' and so on, all persons in the same State, by transfer of documents of title and the transactions will be inter-State in character. The Law Commission did not consider it a serious problem. It observed that it is unlikely that dealers would resort to such dealings.[37] Proceeding on the basis that all such inter-State sales would be taxed, the Law Commission said,

> "We are not inclined to attach much importance to this suggestion as in any case the sale or purchase will not escape taxation altogether and it is unlikely that dealers would resort to such attempt in order to save inter-State and intra-State tax".[38]

Suppose such subsequent inter-State sales are not taxable.[39] Then the dealers will be at an advantageous position by effecting sales by transfer of documents of title. This is because, if the sale is inter-State there is no liability, whereas if the sale is local there is liability. In other

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37. Ibid.
38. Ibid.
39. The development of the law had created such a situation. Exemption was granted to such subsequent inter-State sales in 1958 by the Central Sales Tax (Second Amendment) Act, 1958 which added sub-section (2) to Section 6 of the Act. For the text of Section 6, see Appendix B.

words if the subsequent sale is effected by transfer of documents of title there will be no liability, but if the sale is effected after taking delivery of goods liability to pay tax under the local sales tax law would arise. In such a situation there will be a tendency for the dealers to effect sales by transfer of documents of title to escape liability for payment of sales tax under the sales tax law of the State.

Even if such a situation arises, the question still is whether sale effected by transfer of documents of title should be characterised as inter-State. The answer should be in the affirmative. This is because such sale cannot be treated as local sale, but should be treated as inter-State since the sale is effected before the termination of the inter-State movement of the goods, which stamps the inter-State character on the sale.

The Law Commission finally formulated the principles for determining the inter-State character of a sale or purchase. The Commission recommended that a sale or purchase of goods shall be deemed to take place in the course of inter-State trade or commerce if the sale or purchase - (a) occasions the movement of goods from one State to another,

or (b) is effected by a transfer of documents of title to the goods during their movement from one State to another. The Commission clarified that where goods are delivered to a carrier or other bailee for transmission, the movement of the goods shall, for the purposes of transit sale under clause (b) be deemed to commence at the time of such delivery and terminate at the time when delivery is taken from such carrier or bailee.[40]

Article 286 prohibited levy of tax on outside sale. The purpose of such prohibition was to avoid the evil of multiple taxation of the same transaction by different States. The Law Commission therefore addressed itself to the task of laying down principles for determining when a sale or purchase takes place outside the State. The problem it had to decide was therefore one of giving situs to the sale by picking up any one among the various possible ingredients of sale. The Commission was of the view[41] that the location of the goods shall be the suitable text for determining the situs. The location of the goods is easily ascertained. The only problem is the fixation of the point of time at which the location of the goods is to be taken for the purpose of the situs. It was fixed at the time of

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40. Supra, n.32 at p.5.
41. Id. at 6,7.

making of the contract of sale in the case of specific or ascertained goods. In the case of unascertained goods the time of their appropriation to the contract of sale was taken to be decisive of the situs. It happens in the commercial world that in respect of unascertained or future goods the seller or buyer may make an appropriation of the goods and put them in the course of transit without the assent of the other party. In such a case the location of the goods at the time of assent may be different from its location at the time of appropriation. In such cases, the Commission observed, the location of the goods at the time of assent was irrelevant and it was the location at the time of appropriation that was the decisive factor. It may also happen that a single contract of sale may cover goods in different States. How to fix the situs in such case? The Commission found a solution by suggesting that such sale should be regarded as separate contract in relation to the goods located in different States. The position was clarified that when a sale is, in accordance with the above principle, deemed to have taken place inside a State it shall be deemed to have taken place outside all other States. The Commission recommended accordingly.[42]

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42. Id. at 8. The principles enunciated by the Law Commission were as follows:- 1. A sale or purchase of goods shall be deemed to take place where the goods are--(a) in the case of specific or ascertained goods, at the time of the contract of sale is made; and (b) in the case of unascertained

(contd...)

The Central Act was passed by Parliament with a view to implementing the constitutional mandate.[43] Principles for determining when a sale or purchase of goods takes place in the course of inter-State trade or commerce were formulated. The recommendation of the Law Commission in this respect was accepted. The provision in the Act clarified that where the movement of the goods commenced and terminated in the same State, the movement is not inter-State merely because of the fact that in the course of such movement goods might have been passed through another State.

In enacting the law, Parliament accepted the distinction made out by the judiciary between transport of goods outside the State as part of the sale and transport subsequent to the completion of the sale. Manifestly, the judge-made law in this regard received legislative approval.

(f.n.42 contd.)

> or future goods, at the time of their appropriation to the contract of their sale by the seller or by the buyer, whether the assent of the other party is prior or subsequent to such appropriation. Explanation:- When there is a single contract of sale or purchase of goods situated at more places than one the above provision shall apply as if there were separate contracts in respect of the goods at each of such places.
> 2. When a sale or purchase of goods is determined in accordance with sub-clause (1) to be within a State, such sale or purchase shall be deemed to have taken place outside all other States".

43. For the important provisions of the Act, see, Appendix B.

The Central Act laid down principles for determining when a sale or purchase of goods takes place outside a State.[44] It gives importance to the situs of the goods. Under the Constitution sale outside the State cannot be taxed by the State; State can tax only inside or local sale. The Act avoids competing claims of States and multiple levy of tax when two or more States have a connection or nexus with a sale on account of some element of the sale taking place within its territorial limit. It defines when a sale or purchase shall be deemed to take place inside a State. In so defining the Act adopted the recommendations of the Law Commission.

The Central Act creates a charge[45] on every dealer who effects sale of goods in the course of inter-State trade or commerce. No tax is levied on inter-State purchases. The Act provides for registration of dealers.[46] Registration ensures accountability and confers certain benefits: Administratively it may not be feasible to locate the numerous dealers, big, medium and small. So the burden is placed on the dealers to get themselves registered. The registered

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44. Central Sales Tax Act 1956, Section 4. In formulating the principles the Act adopted the recommendations of the Law Commission.
45. Id., Section 6.
46. Id., Section 7.

dealers were under obligation to maintain true and correct accounts. They can enjoy concessional rate of tax if they comply with the conditions prescribed for the purpose.[47] A higher rate of tax is provided in respect of inter-State sales between persons other than registered dealers. In respect of goods exempt from tax under the local law or is subject to a lower rate of tax under it the rate of tax on sale in the course of inter-State trade or commerce is calculated at the same rate and in the same manner as would have been done if the sale had in fact taken place inside the 'appropriate' State. The assessment and collection of tax are to be made using the sales tax machinery of the State Government.[48] The State Government is authorised to give exemption or reduction in the rate of tax.[49]

The Central Act declares goods which are of special importance in inter-State trade or commerce in compliance with the constitutional provisions.[50]

It would be seen that judiciary had evolved principles governing inter-State trade and commerce while interpreting constitutional provisions contained in Article 286(2)

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47. Id., Section 8.
48. Id., Section 9(2).
49. Id., Section 8(3).
50. For a discussion on this aspect see, Ch.XIV.

before its amendment in 1956. According to the Supreme Court[51], Section 3 of the Central Act is a legislative recognition of those principles.

On enactment of the law, the responsibility fell upon the judiciary to find out the contours and to give meaning and content to the concept. Section 3 of the Act takes within its ambit two kinds of inter-State sale or purchase. One is sale occasioning the movement. The other is transit sale. A transaction could be taxed if two conditions concur: namely, there must be a sale and such sale must be inter-State.

The scope of the levy of tax under the Central Act came up for the consideration of the Supreme Court in Tata Iron.[52] The company had its registered office in Bombay. Its head sales office was in West Bengal. The factories were in

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51. In Cement Marketing Co. of India v. State of Mysore, (1963) 14 S.T.C. 175 Justice Kapur of the Supreme Court observed at p.182: "In Section 3 of the Central Sales Tax Act (Act 74 of 1956) the legislature has accepted the principle governing inter-State sales as laid down in Mohanlal Hargovind's case, (1955) 6 S.T.C. 687". See also the observations of Justice Sarkar in State Trading Corporation v. State of Mysore, (1963) 14 S.T.C. 416 at 419.
52. Tata Iron and Steel Co. v. S.R.Sarkar, (1960) 11 S.T.C. 655 (S.C.).

Bihar. The company was a registered dealer under the Central Act in West Bengal. It was also a registered dealer under the State sales tax law in Bihar. The company filed return in respect of the sale liable to tax under the Central Act in West Bengal. The sale from Jamshedpur had not been included in these returns. According to the company such sale from Jamshedpur was liable to tax not in West Bengal but in Bihar since the situs of sale was in Bihar. The sale from Bihar fell into two categories. Sale which occasioned inter-State movement of goods and also sale which was effected by transfer of documents of title. The West Bengal sales tax authority took the position that in respect of sale by transfer of documents of title the situs of sale was the place where the documents were transferred. The goods being located in the State of Bihar at the time of contract and appropriation, the company took the stand that the State of West Bengal had no jurisdiction to assess the transaction. However the assessing authority made the assessment and called upon the company to pay the tax, though tax under the Central Act on the same transaction was paid in Bihar.

An inter-State sale becomes taxable falling either under the concept of occasioning the movement of goods or under the concept of transit sale by transfer of documents of title to the goods. The levy under the former arises when

the sale occasions the movement from one State to another and under the latter when the sale is effected by transfer of documents of title during inter-State movement of goods. Can the same sale fall under both? The Supreme Court answered it in the negative.[53] The Court held that Section 3(a) covers sales in which the movement of goods from one State to another was the result of a covenant or incident of the contract of sale.[54] The property in the goods may pass in either State, namely the State from which the movement commences or the State in which the movement ends.

Which type of sale is covered by Section 3(b) of the Act, i.e., transit sale? A sale in which the property in the goods passed before the movement of goods from one State to another does not fall under it. Similarly a sale in which the property in the goods passed after the termination of the movement of goods will also not fall under Section 3(b). This is because the transit sale is one which is effected by transfer

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53. Supra, n.52 at 666. Justice Shah, speaking for the Court observed at p.667: "In our view, therefore, within clause (b) of Section 3 are included sales in which property in the goods passes during the movement of goods from one State to another by transfer of documents of title thereto: Clause (a) of Section 3 covers sales, other than those included in clause (b), in which the movement of goods from one State to another is the result of a covenant or incident of the contract of sale, and the property in the goods passes in either State". See also, Ch.XII, n.26.
54. Id. at 667.

of documents of title to the goods during their movement from one State to another. The Court therefore clarified that a sale effected by transfer of document of title after the commencement of movement and before its conclusion alone will be inter-State sale under Section 3(b).[55]

Which State is entitled to levy and collect the tax when a sale is effected by transfer of documents of title? Where does the situs of such a sale lie? Is it the State, in which the documents of title were transferred? The Court held that, in the absence of an indication to that effect in the statute, the place where the documents were transferred could not be taken to be the place of sale. Were it so, the Court pointed out rightly, large scale evasion of the tax could ensue. It is possible that the documents may be handed over outside India. In such a case the inter-State sale becomes one not taxable by any State in India. What is then the test to decide the question? The Court found the answers in Section 4 of the Central Act.[56] Applying that provision in the case of ascertained goods the sale took place in the State in which the goods were located at the time of the contract of sale. In the case of unascertained goods the sale took

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55. Id. at 666.
56. For the text of the provision, see Appendix B.

place in the State in which the goods were located at the time of their appropriation to the contract of sale.[57]

The purpose of denial of power to the States to levy tax on inter-State sale was to avoid multiple taxation. The Central Act could not therefore have intended to tax the same transactions twice. Under the Act the tax payable is a certain percentage of the turnover.[58] The tax being only a certain percentage of the total sale price, it can be taxed only once. When the Act provides that the tax shall be collected by the appropriate State, it indicates that it is collected by one State only.

The decision in Tata Iron introduced the doctrine of 'incident' in the concept of inter-State sale. A sale becomes an inter-State sale if the movement of goods from one State to another is under a covenant or an incident of the contract

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57. Supra, n.52 at 672. After formulating the principles the Court did not proceed to examine, in the absence of complete details of the modus operandi of the business transaction of the company, whether the sale involved in the case in respect of which assessment proceedings were initiated by the Commercial Tax Officer, Calcutta were those falling under Section 3(a) or Section 3(b) and whether the State of West Bengal or State of Bihar was entitled to levy.
58. Central Sales Tax Act 1956, Section 8.

of sale. The idea of movement as an 'incident', however, is not seen in the test formulated by the minority[59] in Tata Iron. According to the minority a sale occasions the movement of the goods only when the terms of contract provide that the goods would be moved. Simply because the contract between parties does not expressly provide for the movement of goods, one cannot totally disregard the nature of the transaction if it impliedly provides for the movement. It is a matter of common knowledge that very often transactions are governed in the business world by a course of conduct or by implication or understanding between the parties. In such circumstances there may not be express contract providing for the movement of goods. Denial of inter-State character of the transaction for that reason will be a miscarriage of justice.

The concept of movement as an incident of the contract in the majority judgment has widened the ambit of the provision.

Another important wholesome development brought about by Tata Iron is the declaration that though there may be two inter-State sales falling under both the limbs of Section 3, there would be only one sale exigible to tax. Had

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59. Supra, n.52 at 670.

it not been so confined, the result would have been that certain sale could be taxed under both. Taxes could be imposed when there is a movement of goods as a result of a contract and also when a sale is effected by transfer of document of title during their movement from one State to another. This has been rightly prevented by this decision.

When one looks at the legal principles originally enunciated by the judiciary and subsequently approved by the legislature, one sees that the common thread woven in the concept of inter-State sale, whether it be a transit sale or non-transit sale, is the movement of goods from one State to another. So in order to ascertain whether there is an inter-State sale as understood in law the preliminary question is whether there is movement of goods from one State to another. If the answer to this question is in the affirmative, in the case of non-transit sale it has to be ascertained further whether such a movement was the result of covenant or incident of the contract. In transit sale there is no scope for enquiry about contract; what is to be ascertained is only whether the sale is effected by a transfer of documents of title to the goods.

Chapter XI

CONCEPT OF OCCASIONING INTER-STATE MOVEMENT

The various dimensions of the concept of inter-State sale were brought out by the judiciary through a series of decisions. The first limb of Section 3 of the Central Act enacts that a sale or purchase which occasions the movement of goods from one State to another shall be inter-State. What does this mean? Does it mean what it says? Many a legal battle was fought. Many a battle is still on.

Where ownership of goods situated in one State passes to another within that State it is a sale within that State. Will such a sale be inter-State if the sale causes the goods to move outside the State? This was the question in Mulji Ratanshi.[1] The Kerala High Court observed that where the transaction causes transfer of ownership in goods and provides for outside movement, it is an inter-State sale. Even if a sale is an inside sale within a State, if it causes the goods to move from one State to another it would be an

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1. Mulji Ratanshi and Co. v. State of Kerala, (1961) 12 S.T.C. 657 (Ker.).

inter-State sale.[2] Even if such movement is incidental to the bargain between the seller and the buyer, the transaction would be inter-State.[3]

What is the nature of the transaction of f.o.r. sales, when goods are booked by rail under instructions from parties? Sudarsanam Iyengar[4] was a case where such a question arose. The turnover related to sale effected by the assessee from Kerala to Madras. The terms of sale were f.o.r. railway station in Kerala. The outside parties placed orders with the assessee orally or through correspondence. Goods were booked by the assessee in railway wagons. Sometimes goods were booked 'self' and sometimes in the name of the buyer. Expenses upto the point of loading were borne by the assessee. Freight was payable at destination by the buyer. The invoices and the railway receipts duly endorsed were sent by post to the Madras parties. On these facts, the State contended that this was f.o.r. contract and that the title to the goods passed within the state of Kerala. The argument of the State was that the obligations of the seller were at an end with the delivery of the goods to the common carrier. The Kerala High

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2. Id. at 661.
3. Id. at 663.
4. Sudarsanam Iyengar and Sons v. State of Kerala, (1962) 13 S.T.C. 17 (Ker.).

Court did not consider the argument sound. The court correctly held that the delivery to the railway was so intimate and real that it must be said that the movement was occasioned, caused or brought about by the sale.[5] The sale was accordingly held to be inter-State. Looking in retrospect one finds Bapputty's case[6] decided by the same High Court barely one month earlier failed to apply the correct test followed here.

In a large number of cases it may be difficult for the adjudicating authority to decide the issue one way or the other. Whether or not the sale occasioned the movement of goods from one State to another is often an intricate question of law and facts mixed together. From this mixture one has to correctly identify the nature of the transaction. The same set of facts are prone to different interpretations.

Dhiraj Lal's case[7] is an example. Goods were sent from West Bengal factory to Jamshedpur in Bihar. Orders for supply of goods were placed in Calcutta. Delivery was to be made to a lorry in Calcutta arranged by the purchaser, the

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5. Id. at 20.
6. Bapputty v. Government of Kerala, (1961) 12 S.T.C. 722 (Ker.). See Ch.IX, n. 55.
7. Dhiraj Lal v. Commissioner of Commercial Taxes, A.I.R. 1963 Cal. 442.

Tatas, through Kaiser Engineers Overseas Corporation, who was the agent of the purchaser. The controversy mainly centered round a term in the contract by which the seller had liability for all loss or damage to the merchanidse until delivered to purchaser at the delivery point. Upon completion of delivery of the goods to purchaser's designated consignee, any loss or damage of such merchandise thereafter was to be borne by the purchaser. On the basis of this clause the West Bengal authority took the view that the sale took place in that State, when the goods were loaded into the vehicle. According to them the subsequent transport across the border to Jamshedpur did not convert the transaction into an inter-State one.

The Calcutta High Court found that there were no two separate contracts for sale. It could not be said that the assessee sold the goods to Kaiser Engineers and thereafter Kaiser Engineers entered into separate contracts of sale with Tatas. There was only one contract and that was between the assessee and the Kaiser Engineers acting as agent for their disclosed principal, the Tatas. Dealing with the terms, relating to liability for loss or damage, relied on by the taxing authority, the court observed that they stipulated a mode of assuming liability for loss or damage. The apportionment of such liability between the buyer and seller on the basis of delivery at the delivery point was not

decisive of the question whether the sale was intra-State or inter-State. To determine the nature of the transaction the whole context, its terms and conditions and purpose, has to be judged. The very origin of the contract and the placing of the purchase order with the assessee showed that the goods were intended to be moved from Calcutta to Jamshedpur. The sale, the court held, occasioned the movement. It would not have been necessary to move the goods to Jamshedpur if the sale was not there. The fact that the Kaiser Engineers arranged for lorry in Calcutta, in which the assessee could load the goods, did not make the transaction any the less inter-State. The court further observed[8] that even if there was appropriation or delivery to the buyer neither such appropriation nor delivery prevented the transaction being a sale in the course of inter-State trade or commerce.

In the course of the judgment the court posed the question, though it was not necessary to decide the issue involved in the case, whether the term inter-State trade meant only trade or commerce between the States as such, i.e., between a seller State and a purchaser State? The court repelled the idea of confining the scope of inter-State sale to transactions between States. It was inter-State trade,

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8. Id. at 455.

the court observed, where goods, sold or purchased under contract of sale, between persons, moved from one State to another. Trade or movement of goods from one State to another is the insignia of inter-State trade. Usually this trading is carried on by individuals, firms, companies and corporations.[9]

Will purchase effected in a State on receipt of orders for supply of goods from buyers in other States be in the course of inter-State trade? This was one of the issues in Gandhi Sons.[10] The assessee purchased goods liable to be taxed at the purchase point under the sales tax law of the State. Such purchases were, however, made by the assessee after receipt of orders for supply of such goods from buyers in other States. The sales tax authority assessed the purchase by the assessee to tax under the sales tax law of the State. The assessee challenged the levy on the ground that the transactions were inter-State. It was contended that the orders from outside buyer, the purchase in the local market by the assessee and the movement of goods to destination outside the State in pursuance of sale in compliance with orders from the outside buyer constituted an integrated

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9. Id. at 450.
10. Gandhi Sons v. Sales Tax Officer, (1963) 14 S.T.C. 304 (Ker.).

commercial adventure. Hence the purchase, it was contended, took place in the course of inter-State commerce.

The Kerala High Court observed that a purchase takes place in the course of inter-State trade when it occasions the movement of goods from one State to another. Did the local purchase of goods occasion its inter-State movement? The court answered the question in the negative.[11] The court observed that the words 'course' and 'occasion' were synonymous. To make a purchase in the course of inter-State trade, it must occasion such movement. In other words there should be a causal connection between the purchase and the movement. In the present case there was no such causal connection between the two. The fact that the purchase was after securing the orders and before despatch of goods, did not by itself create a causal connection between the purchase and the movement of goods. The assessee was not bound to utilise the goods purchased to fulfil the orders received. The transaction was not therefore inter-State.

Goods may be despatched from one State to another by V.P.P. Is it an inter-State sale? In such a sale property

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11. Id. at 307.

in the goods would pass and the sale would be complete when the buyer pays the price of the goods. If the goods are returned, there would be no sale at all. When the postal parcel is paid for what is the nature of the transaction? In Prem Payari Aggarwal[12] the goods sold by V.P.P. had moved from Punjab to Uttar Pradesh. The movement was a direct result of sale. The court observed that for the purpose of law, it hardly matters whether the goods move before the sal was completed or after, and the sale was held to be inter-State.

Does the expression 'incident of the contract of sale'[13] convey a wider meaning than the expression 'covenant of a contract of sale'? This question was posed in Jeewanlal.[14] The assessee's registered office was in Calcutta. It manufactured aluminium utensils. It entered into a contract of sale with the Government of India. Accordingly, goods were delivered in West Bengal. Both payment of price and passin,

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12. Prem Payari Aggarwal v. Punjab State, (1966) 18 S.T.C. 150 (Punj.).
13. The Supreme Court held in Tata Iron and Steel Co. v. S.R.Sarkar, (1960) 11 S.T.C. 655 (S.C.) that when inter-State movement is an incident of the contract of sale, the sale is inter-State. See, Ch.XII, n.26.
14. Jeewanlal (1929) Ltd. v. Commercial Tax Officer, (1967) 20 S.T.C. 345 (Cal.).

of property were in West Bengal. The goods were transported from West Bengal to outside the State. The assessee had no connection with the transportation.

The sales tax authorities in West Bengal were of the view that the sale was completed within the State of West Bengal and the transaction was therefore liable to be taxed under the local sales tax Act. The counsel for the assessee argued that eventhough it was not one of the terms of the contract that the seller would have anything to do with the movement of goods from one State to another the transaction may be said to be in the course of inter-State trade or commerce, provided the contract showed that the goods were intended to be moved from one State to another. The substance of the argument was this: It may not be the obligation of the seller to take steps for the carriage of the goods from one State to another. But so long as it appears from the contract that the goods were not to remain in the State in which they were sold, but would be taken to some other State, the transaction must be one falling under the category of inter-State sale.

The court observed that the movement in question must be one of the terms of the covenant of contract of sale or it must be as a result of such terms or covenant or in

pursuance of a condition in the contract. Expressions like 'incident of the contract of sale' or 'incidental to the contract of sale' did not, according to the court[15], convey a different meaning. A sale or purchase occasions the movement when the contract of sale itself contemplates or necessarily involves the movement. The movement must occur under the contract. When the inter-State movement of goods was not under the contract, but due to reasons extraneous to the obligation under the contract, the court observed[16] that it could not be said that the sale was in the course of inter-State trade or commerce.

Was there such an obligation under the contract? The argument of the assessee was that the schedule to the acceptance of the tender had specified that though the stores were to be delivered to the inspecting authority at Calcutta, they were so delivered for onward despatch to the ultimate consignee at Kanpur. However, upon examination of ther terms of the contract, the assessing authority had come to the conclusion that the inspecting authority received the goods at Calcutta on behalf of the buyer at Kanpur. With the approval of the authority, the goods were appropriated to the contract. The argument that the movement aspect was

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15. Id. at 353.
16. Id. at 360.

embedded in the contract and that the contract necessarily involved a movement, did not convince the court.[17] The goods were delivered in West Bengal. The property in the goods passed to the buyer in West Bengal. The price and transportation of the goods from Calcutta to Kanpur was made by or on behalf of the buyer with which the seller had nothing to do. The sale was held to be intra-State and not inter-State.

Goods were procured from outside the State to fulfil a contract between the purchaser and another. Under the contract, the purchaser had to supply the goods in connection with a construction work within the State. Is the transaction of such supply an inter-State sale, since the goods so supplied came from outside the State? This was the question in Nechupadam Construction Engineering.[18] The petitioner in this case was not a dealer, but a corporation which undertook the construction work for forming embankment for a dam in Kerala State. The Government undertook to supply petrol and high speed diesel to the corporation. The value thereof was agreed to be deducted from the payments due to the corporation. Petrol and diesel were liable to be taxed within the State at

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17. Id. at 364.
18. Nechupadam Construction Engineering Contractors v. Executive Engineer, (1967) 20 S.T.C. 82 (Ker.).

the point of first sale. The government deducted, besides the value of the petrol and diesel supplied, the sales tax due on the value , the goods being liable to be taxed at the first sale point within the State of Kerala. The supply was made according to the contract between Government and the petitioner. It was in pursuance of that contract that the Government purchased petrol and diesel oil from Madras State and transported to Kerala. The petitioner contended that the sale of petrol and diesel oil to it was inter-State in character.

On an analysis of the agreement between the Government and the contractor, it was found that there was no contract between them for sale of petrol and diesel. The corporation had according to the agreement only an option to purchase the goods from Government.[19] There was no obligation on the part of the petitioner to purchase petrol or diesel oil from the Government. It could not be said, therefore, that the contract between them involved the movement of goods from Madras to Kerala. Nor could it be said, the court pointed out[20], that the movement of goods was the necessary result of the contract. The sale by the Madras

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19. Id. at 86.
20. Ibid.

supplier to the Government of Kerala, in the circumstances of the case, would be an inter-State sale, but the sale by the Government to the petitioner was a local sale liable to be taxed under the local sales tax Act.

While inter-State movement of goods was admitted to be occasioned by a contract, would it be proper to hold that the transaction would be local on the ground that the place of despatch was not agreed upon between the parties? In Jayajothi[21], in terms of the contract, cotton had to be moved from places outside the Madras State. The place of despatch was not noted in the contract. The Madras High Court held[22] that eventhough the place of despatch did not find a place in the contract, that was of no significance. What was important was whether there was a movement of goods from one State to another. When there was a contract for movement of goods from one State to another, it was immaterial that the place outside the State from where the goods were to be despatched was not mentioned in this contract. Clearly the goods moved to Madras State as part of the terms of the contract and this feature established that the sale was inter-State.

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21. Jayajothi and Co. v. State of Madras, (1969) 23 S.T.C. 321 (Mad.).
22. Id. at 322.

Whether the parties to a sale had the intention to move the goods from one State to another may have to be ascertained sometimes on an overall assessment of the terms of the contract. It becomes therefore necessary for the courts quite often to analyse the various terms of the contract to decipher the true intendment of the parties. The Supreme Court had such a task in Allwyn Cooper.[23] The assessee sold manganese ore pursuant to different contracts. Under one contract there was a clause to the effect that the price was f.o.r. at railway station in Madhya Pradesh and the first weighment was to be made at the weigh bridge at Gondia which fell en route between the place of despatch and the destination in Maharashtra. In another contract it was stipulated that the price would take in the freight from the loading station in Madhya Pradesh to the destination in Andhra Pradesh and that the balance ten per cent of the price was to be paid only after weighing and despatch of the ore to destination outside to State. In another contract the price included the freight and the balance ten per cent of the price was to be paid only after acceptance of the goods at the buyer's end.

The Court held that it was manifest that the first weighment at the Gondia weigh bridge was the basis of fixation

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23. Commissioner of Sales Tax v. Allwyn Cooper, (1970) 25 S.T.C. 26 (S.C.).

of price and the parties therefore necessarily contemplated the movement of the goods across the State's border in fulfilment of the terms of the contract.[24] The movement of goods was a direct and necessary consequence of the covenant with regard to the fixation of price. In the case of other contracts the Court found that there was an express covenant for the despatch of ore to an outside destination and for payment of a price which included the railway freight from the Madhya Pradesh railway siding to the terminal in Andhra Pradesh. Under one agreement, the final balance payment had to be paid after loading, weighing and despatch and under the other, the balance of the price was payable after the acceptance of the goods at the receiving end. The sales in all the cases occasioned inter-State movement.[25] The sales were therefore inter-State under the Central Act.

A dealer may place standing orders for purchase of goods with another dealer and then instruct him to consign the goods to another State. The High Court of Madhya Pradesh was faced with such a case in Ramchandra Rampratap.[26] The assessee was a registered dealer in Madhya Pradesh. He

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24. Id. at 30.
25. Id. at 32. This case was followed by the Supreme Court in Hanuman Mining Corporation v. Commissioner of Sales Tax, (1970) 25 S.T.C. 60 (S.C.).
26. Ramchandra Rampratap v. Commissioner of Sales Tax, (1970) 26 S.T.C. 334 (M.P.).

received standing orders, from one doing business in Nagpur, for supply of oil seeds. Accordingly the assessee purchased oil seeds from local markets, appropriated the goods to the account of the Nagpur purchase and debited him with the purchase price. Intimation about it was given to the Nagpur dealer. According to his instructions the goods were despatched to a destination in Madras, the assessee acting both as the consignor and consignee. The railway receipts, bills and hundis were sent through bank. The hundis were drawn against the Nagpur dealer. The question for determination was whether the sales were local liable to be taxed under the Madhya Pradesh General Sales Tax Act or were inter-State.

Was there a movement of goods from one State to another as a result of the sale between the assessee and the Nagpur merchant? The Central Act does not say that such movement should take place before the property in the goods passes from the seller to the buyer. It does not also stipulate that the movement of the goods should be from the State of the seller to the State of the buyer. All that is stated is that there should be an inter-State movement of goods occasioned by a sale. In this case there was a sale and in pursuance of the directions from the buyer there was a movement of goods from the State of Madhya Pradesh to the State of Madras. Was not the sale then inter-State? The

court answered this question in the negative and held that the sale was not inter-State.[27] The court noted that there was a standing order from the Nagpur dealer. The purchase of goods was made by the assessee in pursuance of this. The property in the goods passed to the Nagpur buyer at the time of unconditional appropriation of the goods by the assessee towards that contract. When the standing order was made the destination to which the goods had to be sent was not specified. After the sale was thus complete, the Nagpur dealer issued instructions to the assessee to send the goods to a destination in Madras. This was in pursuance of a contract of sale between the Nagpur dealer and the Madras dealer. The despatch was not in direct consequence of the contract of sale between the assessee and the Nagpur dealer. The court held[28] the transactions to be local sales.

If the substance of the transaction in its entirety is taken into account one cannot characterise it as purely intra-State. The property in the goods might have passed at the time of appropriation of the goods. But there was no stipulation that the delivery of the goods was to be made in Madhya Pradesh to the Nagpur dealer. The case was not therefore one similar to that of a dealer in another

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27. Id. at 339.
28. Id. at 337.

State coming to a State and making a local purchase. It was implicit in the nature of the transactions between the assessee and the Nagpur dealer that the goods should be disposed of in the manner specified by the Nagpur dealer subsequently. The subsequent instructions should have been treated as part and parcel of the contract of sale, since the contract contemplated disposal of the goods accordingly. The Nagpur purchaser could have instructed the assessee to deliver the goods to a person in the State of Madhya Pradesh. Had that been the case, the sale would have been a local one, since there was no inter-State movement of goods. When the Nagpur dealer instructed the assessee, in pursuance of the transactions between them, to despatch the goods to a destination outside the State of Madhya Pradesh, the transaction between them should have been held to be inter-State. This is because the inter-State movement of the goods could be deemed to be under the contract of sale between the assessee and the Nagpur dealer. The contract between them becomes complete by the issuance of delivery instructions subsequently. The communication of the place where actual delivery is to be made is part of the contract itself and not a mere mode of performing the contract.[29] When the goods were on its move-

29. See Amritsar Sugar Mills Co. v. Commissioner of Sales Tax, (1966) 17 S.T.C. 405 (S.C.) at 413. The Supreme Court observed: "When the despatch instructions were given, it was not a case of performing the contract but specifying a team in the contract. If the place of actual delivery had been specified and it was a question merely of communicating the route by which the goods were to be delivered

(contd...)

ment to Madras, the Nagpur dealer, on receipt of the document of title from the assessee, could effect a sale by transferring them to Madras buyer. Such a sale would be a second inter-State sale in respect of the goods.

When a dealer sells goods inter-State, will the purchase by him for effecting such sale be in the course of inter-State trade or commerce? Just as a purchase 'for the purpose' of export cannot be one 'in the course of' export[30], a purchase for the purpose of inter-State sale was held to be not one in the course of inter-State trade, in Dhirendranath.[31] The assessee purchased fish from fishermen in Orissa. He despatched the fish to Calcutta dealers. The assessee raised the contention that the despatch of the goods to Calcutta was in the course of inter-State trade and as such the purchase of goods by him from the fishermen should be held to be in the course of inter-State trade or commerce.

(f.n. 29 contd.)

this would perhaps relate them to the mode of performance of the contract. But communications of the place where actual delivery is to be given does not relate to the mode of performance but formation of the contract".

30. See Ch.II, n.52.
31. Dhirendranath v. State of Orissa, (1970) 26 S.T.C. 522 (Orissa).

The sale of fish by the fishermen to the assessee and the sale by the assessee to the Calcutta dealers were two independent transactions. The court held, applying the principles in Khosla[32] that the purchase by or the sale to the assessee was not in the course of inter-State trade. A common intention on the part of the seller and purchaser for inter-State movement of goods, an obligation for such movement and actual inter-State movement were the ingredients of an inter-State sale. The obligation may arise from statute, contract, mutual understanding or from nature of the transaction. The court held that the assessee was under no obligation to export the fish to Calcutta after purchase from the fishermen. The assessee could have sold the fish within the State itself. The fishermen were in no way concerned with the despatch of the goods outside the State. The assessee might have had an intention to despatch the goods to Calcutta. But he was under no obligations to do so. The court held[33] that the mere factual inter-State sale

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32. The principles applicable to decide when a sale or purchase occasions the export or import and when a sale or purchase occasions inter-State trade or commerce were held by the Supreme Court to be the same. See K.G.Khosla and Co. v. Deputy Commissioner of Commercial Taxes, (1966) 17 S.T.C. 473 at 487.
33. Dhirendranath Das v. State of Orissa, (1970) 26 S.T.C. 522 (Orissa) at 527. Chief Justice Misra observed: "In this case the fishermen (seller) might have even the knowledge that the fish would be exported by the assessee to Calcutta, but there is no integral link between the sale and the export... The purchase from the fishermen was for the purpose of export of fish outside the State, but not in the course of inter-State trade".

of the goods does not make the purchase for such sale an inter-State one.

What would be the nature of the transaction when goods are sold to a dealer within the State who entered into a transaction with a party outside the State to whom delivery was effected by the assessee? This question arose in Maheswari Devi Jute Mills.[34] The assessee mill in Kanpur produced jute goods. Orders, in printed forms, were secured by its selling agents from local parties in Kanpur. The contract provided expressly that the goods would be sold ex-mill delivery. The agents sent the orders to the assessee. The local parties, subsequently instructed the assessee to despatch the goods ordered, to third parties outside the State. Goods were accordingly booked by the assessee by rail. In some cases the railway receipts, wherein the assessee was both the consignor and consignee, were sent to local parties to whom goods were sold and in some cases direct to out-of-State parties to whom the goods were sent.

The mill contended that the sale was effected by it to out of State buyer and that the contract between the

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34. Maheswari Devi Jute Mills v. Commissioner of Sales Tax, (1971) 27 S.T.C. 61 (All.).

assessee and the local parties at Kanpur, evidenced by the printed form was a mere agreement of sale, which did not mature into a completed sale. While the revenue argued that the despatch of the goods by rail by the assessee was merely made to accommodate the buyer, the assessee contended alternatively that the despatch was occasioned by the sale and hence would be an inter-State sale.

On these facts, the court held that it made no difference that the goods were booked by rail, that the railway receipts showed the assessee as consignee or that the railway receipts were sent to third parties outside the State. The case was one not of sale to outside parties but one wherein the assessee sold goods to a local buyer who in his turn entered into a transaction with a party outside the State to whom delivery was effected. There were, according to the court, two transactions. The first was an intra-State sale between the assessee and the local buyer. The second was a sale between the local buyer and the outside party. It is pertinent to note here that there was no obligation on the part of the assessee, under the contract, to despatch the goods to outside parties as desired by the local buyer.

Slight difference in the contractual terms may thoroughly alter the situation in law. J.K.Jute Mills[35] would be a telling instance. Here the facts were similar to those in Maheswari Devi Jute Mills with one difference. The contract imposed a duty on the assessee to despatch the goods to destinations indicated by the local buyer. The goods were accordingly despatched to outside the State by the assessee. The terms of the contract conferred on the buyers a right to issue despatch instructions and that was an integral part of the contract itself.[36] The movement of goods was occasioned by the contract of sale.[37] The sale was therefore inter-State.

A dealer in one State places an order with a dealer in another State over telephone and purchases goods. The goods are transported to him. Is such a sale inter-State? Bhag Singh Milkha Singh[38] presented this question. The assessee was a registered dealer in the State of Bihar. A dealer in West Bengal used to place orders with the assessee

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35. Commissioner of Sales Tax v. J.K.Jote Mills, (1971) 27 S.T.C. 69 (All.).
36. Id. at 71.
37. Id. at 72.
38. Commissioner of Commercial Taxes v. Bhag Singh Milkha Singh, (1972) 29 S.T.C. 463 (Pat.).

over phone for supply of timber. The timber so purchased used to be carried by truck from Bihar to West Bengal on the same day or on the following day. The credit memo issued by the seller in favour of the purchaser showed the number of the truck by which the goods were transported to West Bengal. The goods were delivered at West Bengal. The assessing authority held that the transaction was not inter-State sale and assessed it to tax under the State sales tax Act. The question before the High Court was whether on the facts of the case the sale could be held to be inter-State.

The Patna High Court held that the facts of the case justify an inference that there was an obligation to transport the goods to West Bengal.[39] The credit memo which indicated the number of the truck, and the naming of the place in another State where the goods were to be transported to indicated that there was an obligation to move the goods as an integral part of the contract of sale. If the goods were not transported to West Bengal there would have been a breach of contract. The sale and the resultant transport therefore formed part of an integrated transaction. The sale was inter-State because it occasioned the inter-State movement of the goods.[40]

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39. Id. at 468.
40. Id. at 469, 470.

This is a case where an obligation to move the goods and a common intention for movement of goods from one State to another were inferred by the court from the course of dealings of the assessee. The principles evolved in the cases relating to sales in the export and import context[41] were thus applied to hold that the sales in were inter-State.

Khosla and Co.[42] related to the inter-State nature of goods transported from Haryana to Delhi and sold to customers in pursuance of anterior contracts. The assessee was a registered dealer in Delhi and also in Haryana. The head office of the assessee was in Delhi. Its factories were in Haryana. The goods manufactured at factories in Haryana were sold through the head office at Delhi. Orders for supply of goods were being received from its customers at the head office in Delhi. The head office then used to instruct the factory in Haryana to produce goods according to specifications. After manufacture, the goods were brought to Delhi and from there supplied to customers, in and outside Delhi, who had placed the orders. The question was whether such sales were inter-State.

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41. Ch.IV, n.7.
42. Union of India v. Khosla and Co., (1979) 43 S.T.C. 457 (S.C.).

The problem for determination was whether the contract of sale occasioned the inter-State movement of goods. Was the movement of goods from Haryana to Delhi occasioned by the contract of sale? There was a contract of sale before the goods were manufactured. That contract was one under which goods according to specifications were to be supplied to the customers. It was clear that the contract of sale did not itself provide for any movement of goods from one State to another. All that it provided was that goods according to specifications should be supplied.

The Court held[43] that it is not necessary to make a sale in the course of inter-State trade that the contract of sale itself must provide for inter-State movement. It is enough if the movement is a necessary incident of the contract of sale. The contract of sale provided for manufacture of goods according to specifications. These goods were manufactured by the assessee's factories in Haryana. The contract of sale could be performed by getting the goods manufactured according to the specifications in these factories at Haryana and supplying the goods to the customers who had placed the orders. This necessarily involved movement of goods from Haryana with the intention of delivering

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43. Id. at 462.

them to the customers. When the contract could not be performed otherwise than by such movement of goods, the movement was incidental to the contract of sale and hence the sale was inter-State.

A mere movement of goods from one State to another by itself is not sufficient for characterising a transaction as inter-State sale. The movement must be as a result of a contract of sale. A question arose in Haseeb and Co.[44] whether the mere fact that the buyer's name was mentioned in the lorry way bill would be sufficient to assume that there was an anterior contract for the purpose of establishing the inter-State nature of the movement.

The vendor was an out of state dealer and the vendee a local dealer and the goods moved from the vendor to the vendee. The way bills showed the name of the vendee. The revenue contended that the entry in the way bill indicated only that the consignment was intended to the assessee. That would not show that there was a prior contract for sale or purchase. This argument of the Revenue was accepted by the Court and the purchase was held to be a local purchase liable to be taxed.[45]

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44. Haseeb and Co. v. State of Madras, (1973) 31 S.T.C. 213 (Mad.).
45. Id. at 215.

If, however a prior contract, express or implied, for inter-State movement of goods could be established by adducing necessary proof it appears that the court would have decided the case otherwise, holding that the inter-State movement was under such contract of sale.

Is it necessary that the sale must precede the movement in order to come to the conclusion that a sale occasions the movement? Should the covenant for inter-State movement be specified in the contract of sale? These questions arose for consideration of the Supreme Court in Oil India.[46] Oil India, the assessee, with its head office in Assam entered into agreement with Government of India and other oil companies. In pursuance of such agreement it supplied crude oil to Indian Oil Corporation's refinery in Bihar. The oil was supplied from Assam to Bihar through pipe line. The pipe line was constructed by the assessee for the purpose of transporting the oil from Assam to Bihar. The crude oil from the oil fields in Assam were then pumped through the pipes to the tanks of the Indian Oil Corporation in Bihar. After the measurements, Indian Oil Corporation

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46. Oil India v. Superintendent of Taxes, (1975) 35 S.T.C. 445 (S.C.). See also Oil and Natural Gas Commission v. State of Bihar, (1976) 38 S.T.C. 435 (S.C.) and Indian Oil Corporation v. Union of India, (1981) 47 S.T.C. 1 (S.C.).

took delivery of the crude oil. The transaction was assessed by the State of Bihar as local sale effected in Bihar. Later, the sales tax authorities of Assam proceeded to assess the transactions under the Central Sales Tax Act on the ground that the transaction was inter-State. This assessment was challenged by the assessee before the Supreme Court. An alternative plea was also taken that if the sales are held inter-State, the assessments under the Bihar sales tax law should be quashed.

The Court observed that if the movement of goods from one State to another is the result of a covenant or incident of the contract of sale, the transaction is inter-State sale.[47] There was an agreement which provided that the assessee should arrange for construction of pipelines for the transport of oil from Assam to the refinery in Bihar. The construction of the pipe line was for the purpose of transporting the crude oil from Assam to Bihar according to the agreement. This clearly indicated, the Court held, that the parties contemplated transport of goods from Assam to Bihar.

There was no express term in the agreement that the oil shall be moved from Assam to Bihar. The Court, however, observed that eventhough there was no express term

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47. Id. at 448.

in the agreement for transport of the goods, it was clear that the parties envisaged the movement. The inter-State movement was therefore incidental to the contract of sale. The court held that a sale which occasions the movement from one State to another is an inter-State sale, irrespective of the fact whether the property passed in one State or the other. The Court laid down the law that it was not necessary that the sale must precede the inter-State movement or that the covenant for inter-State movement must be specified in the contract itself. The covenant could be express or implied. The movement may be incidental to the contract of sale.

Does the term 'sale' in Section 3(a) of the Act include a contract of sale, in the sense of 'an agreement to sell'? This was one of the aspects considered by the Supreme Court in Balabhagas Hulaschand.[48] The assessee a dealer in jute, with head office in Calcutta, agreed to supply jute to various dealers in Calcutta. When the contract of sale was entered into, the jute was not ready, it was only being grown in Orissa. When the goods were ready, the assessee despatched them by rail from Orissa to Calcutta, in the name of the buyer. The goods were inspected by the buyer. If

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48. Balabhagas Hulaschand v. State of Orissa, (1976) 37 S.T.C. 207 (S.C.).

they were found to be in accordance with the specifications in the agreement the goods were accepted. The sale thus took place in Calcutta. The goods moved to Calcutta prior to the sale. Was the sale inter-State?

The Court noted that the Central Act defines sale[49] in wide terms. The word 'contract of sale' in Section 4 of the Central Act and the word 'sale' in Section 3 of the Act are used in the same sense. An agreement to sell is an element of sale. A sale involves an agreement to sell and a transfer of property, a concluded sale, in pursuance thereof. The Sale of Goods Act provides that a contract of sale includes an agreement to transfer property in goods for a price.[50] An agreement to sell is an essential ingredient of sale when it contains a stipulation for transfer of property from the seller to the buyer. The Court therefore held that when there is an inter-State movement of goods under a contract of sale which later merges into a sale the movement would be deemed to have been occasioned by the sale itself.[51]

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49. Central Sales Tax Act 1956, Section 2(g). For the text see, Appendix B.
50. Sale of Goods Act 1930, Section 4(1).
51. Balabhagas Hulaschand v. State of Orissa, (1976) 37 S.T.C.207 (S.C.) at 214.

In inter-State commercial transactions sale may take place after movement of goods. Inter-State sale involves movement of goods under a contract of sale resulting in a sale. The taxable event being sale, no tax can be levied under the Central Act unless the movement results in a sale.[52]

When the above principles are applied the following will be the position as to inter-State nature of sale. 'A' transfers goods from State 'B' to 'C' in State 'D' in pursuance of a contract between them. 'C' does not accept the goods as they do not conform to the specifications in the contract. Here there is no inter-State sale because though there is a contract of sale and movement of goods the transaction does not become a concluded sale. Suppose in the above example the goods are according to the specifications and 'C' accepts them. There is an inter-State sale because there is an inter-State movement under a contract of sale resulting in a sale of goods. 'A' in State 'B' takes his goods to State 'D' and sells it to 'C' a dealer there. The sale is a local sale in State 'D'. The sale is not inter-State because the movements of goods

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52. Id. at 216. The decision was followed by the Supreme Court in Manganese Ore v. Regional Assistant Commissioner, (1976) 37 S.T.C. 489 (S.C.).

was not in pursuance of a contract of sale between 'A' and 'C'. Similarly 'C' a dealer in State 'D' goes to State 'B' and purchases goods there from 'A', a dealer in State 'B'. After purchase, 'C' transports it to State 'D'. It is a local sale in State 'B'. The sale is not inter-State because the movement of goods is not occasioned by the contract of sale between 'C' and 'A', 'C' transports the goods as his own to State 'D'.

Clearly a sale and a mere inter-State movement will not be sufficient to treat the transaction as an inter-State sale. It is essential that such movement must be as a result of a contract of sale itself. Any other arrangement for moving the goods will not suffice. In the case of Cement Distributors[53], the assessee was an agent of the State Trading Corporation. Under the Cement Control Order the State Trading Corporation procured cement from manufacturers. The Regional Cement Officer of the Corporation, in Tamil Nadu, authorised the assessee to sell a stated quantity of cement to persons directed by his counter-part in Calcutta. The cement was despatched to Calcutta. The assessee contended that while despatching cement to Calcutta there was no contract of sale with the buyer and hence the sale was not

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53. State of Tamil Nadu v. Cement Distributors, (1975) 36 S.T.C. 389 (S.C.).

inter-State. The contract was made only after the authorisation in favour of the buyer had been issued by the Regional Cement Officer, Calcutta. That authorisation was subsequent to the despatch of goods. The Supreme Court found that the despatch of goods was made by the assessee without reference to any buyer. Hence the transaction was held to be not inter-State sale.[54]

On many occasions goods might be sent to the consignee as 'self' in order to ensure payment and to avoid future dispute. Delivery will be made to the buyer only on payment of the price. In such a case, there might be the possibility that the goods could be diverted by the consignor before they are delivered. But if the goods were moved in pursuance of a contract and was intended to be delivered to the consignee, the transaction becomes an inter-State sale. This view was expressed in Rukmini Mills.[55] The assessee in Tamil Nadu, wrote a letter to its depot keeper in Bombay, stating that it would make available for sale some quantity of cotton. The depot keeper contacted the intending buyers and obtained orders from them for supply of cotton. He sent the orders to the assessee. The goods were sent by the

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54. Id. at 390.
55. Rukmini Mills v. Government of Tamil Nadu, (1975) 36 S.T.C. 425 (Mad.).

assessee through lorries. The name of the consignee in the way bills was noted as 'self'. Bills were discounted through bank. The invoices were prepared by the depot keeper which included his commission as well. By presenting the invoices and paying the way bill the buyers cleared the goods from lorries.

The assessee attempted to establish that these were not inter-State sales, but only local sales at Bombay. The court however held that the goods were despatched in pursuance of the order placed by the Bombay purchaser with the assessee through its depot in Bombay.[56] According to the court, the consignment was identifiable with the contract itself. The fact that the buyers placed orders with the depot keeper at Bombay, or the fact that the payment was first made by demand draft drawn on the depot keeper which was discounted, did not in any manner convert the transaction into an intra-State one.

In an agreement there may be a covenant to supply goods to another either from within the State or outside the State. The movement of goods may be effected from outside the State. The goods may be consigned to self and delivery

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56. Id. at 428.

effected after inspection by the buyer. In such cases also, dispute may arise whether the sale was a local one or inter-State. In Bharathi Pulvarising Mills[57] a dispute of this nature arose. The assessee carried on business in Madras. It entered into an agreement with the Government of Andhra Pradesh. Under the agreement the assessee had to supply pesticide against indents placed by the Government of Andhra Pradesh. The contract was f.o.r. Andhra Pradesh railway station. The supply was to be made promptly on placement of orders, from the stocks in the assessee's factory at Madras, or from its depot at Vijayawada. Goods were sent in pursuance of the agreement from the Madras factory to Andhra Pradesh against indent placed by the government. The way bills and railway receipts were taken in the assessee's name and the invoices prepared in the name of its office at Guntur in Andhra Pradesh. The staff of the assessee did not take delivery of the goods in Andhra Pradesh before the goods were delivered to the Government officers. The question was whether the sale was local sales in Andhra Pradesh or inter-State sales by the assessee resulting in movement of goods from Madras to Andhra Pradesh.

The court held[58] that it is immaterial where the property in the goods passed. The question that was material

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57. Bharathi Pulvarising Mills v. State, (1977) 40 S.T.C. 15 (Mad.).
58. Id. at 18.

was whether the movement of the goods was as a result of a covenant or incident of a contract of sale. There was a term in the contract that the goods are to be supplied from Madras or Vijayawada. In pursuance of the contract, the goods were supplied from the factory in Madras. Hence the movement of goods from Madras to Andhra Pradesh was in pursuance of a covenant in the contract of sale. The sale was not therefore a local sale in Andhra Pradesh. The case was not one where an inter-State movement took place without any prior contract. It was not a case where the assessee booked to self the goods and cleared them himself in the delivery State and effected a sale. Had it been the case, the transaction would have been a local sale. But in the present case the movement itself was in pursuance of a contract of sale and hence the sale was inter-State.

Whether the movement of goods from one State to another is under a covenant or as an incident of the contract of sale may have to be inferred taking into account the totality of the transactions. In Bengal Paper Mills[59] the assessee had its mills in West Bengal. It obtained a forest contract for extraction of bamboo from forests situated in Madhya Pradesh. Under the terms of the contract the forest

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59. State of Madhya Pradesh v. Bengal Paper Mills Company, (1979) 44 S.T.C. 347 (M.P.).

produces extracted were to be used at the mills in West Bengal for purposes other than manufacturing of paper. The question was whether sales tax under the Madhya Pradesh Sales Tax Act was exigible in respect of the bamboo sold to the assessee which were used for the manufacture of paper in its mills in West Bengal.

The Court noted that the stipulation in the contract that the goods were to be used for manufacture of paper in the assessee's mills, made it obligatory in the part of the assessee to move the goods to West Bengal for using them for the stated purpose. It was not open for the assessee to divert the goods for any other purpose. The obligation for movement of goods to West Bengal was inferable from the circumstances. The Court therefore held[60] that the movement of bamboo from Madhya Pradesh to West Bengal was under a covenant of the contract of sale and that such movement was a necessary incident of the contract of sale. There was a direct nexus between the sale and inter-State movement of goods. The sale was therefore inter-State and hence not liable to tax under the State sales tax Act in Madhya Pradesh.

Routing or arranging the inter-State transaction through another person does not for that reason alone change

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60. Id. at 349.

the inter-State character of the trade. In the case of Singhbhum Timber Trading Co.[61], the assessee carried on business at Rurkela in Orissa. It supplied, in Orissa, timber to the railways through the Forest Utilisation Officer, Bihar. The supply was in compliance with a contract, as evidenced by the minutes of the meetings of the authorities of the Railway Board and of the Bihar Forest Department. The Forest Utilisation Officer of the Government of Bihar was bound, under an arrangement made with the railway administration, for securing sleepers for railway tracks. The sleepers were purchased by him, in Orissa, with the money of the railway, exclusively for the purpose of the railway and then transported to Bihar. Was there a local sale by the assessee to the Forest Utilisation Officer and then an inter-State sale by the Forest Utilisation Officer to the railway? The Court held that a clear link has been established between the purchase from the assessee and the transport to Bihar.[62] There were no two independent transactions one between the assessee and the Forest Officer and the other between the Forest Officer

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61. Singhbhum Timber Trading Company v. State of Orissa, (1982) 51 S.T.C. 334 (Orissa) (App.II).
62. Id. at 335. This decision was followed in Kunjabihari Sahoo v. State of Orissa, (1982) 51 S.T.C. 330 (Ori.) and Kshem Chand Aggarwala v. Sales Tax Officer, (1988) 69 S.T.C. 93 (Ori.).

and the railway. The purchase was made on the basis of a contract which envisaged transport of goods from Rourkela to Bihar. The assessee himself had put the goods on the rail for movement to Bihar. This was an inter-State sale between the assessee and the Forest Officer and not a local sale in Orissa.

If passing of property in one State or the other is not material or relevant in determining the character of inter-State sale, it follows that a sale completed within the State before the movement of goods does not in any way affect the inter-State nature of the transaction But it appears that the Madras High Court has not appreciated this position in Parrys Confectionary[63]. The defence department in Bombay, placed orders with the assessee in Madras, for supply of confectionary. The consignor and consignee had to be the counterpart of the department in Madras. Pursuant to this the assessee despatched the goods from Madras to Bombay. The military credit note submitted to the railway station master contained a certificate which stated that the stores were bona fide property of the Ministry of Defence at the time of despatch and that freight was payable by that

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63. Parrys Confectionary v. State of Tamil Nadu, (1983) 52 S.T.C. 168 (Mad.).

Ministry. The Canteen Stores Department (India) Bombay had the right to reject the goods. The price had to be paid at Bombay.

While deciding the case to be a local sale in Madras, and not an inter-State sale, the court observed:

> "The test is not as to the person who buys the goods is in the State or not. The test is whether the goods are bought within the State or not".[64]

Applying this test the court came to the conclusion that even before the movement of the goods by rail, there was a completed sale by the assessee in favour of the Canteen Stores Department (India), Bombay. As the goods moved from Madras to Bombay as the property of the buyer, the court held that it was an internal sale.

This decision is contrary to the principle[65] enunciated by the Supreme Court that sale may precede or follow the movement.

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64. Id. at 174, per Padmanabhan, J.
65. Tata Iron and Steel Company v. S.R.Sarkar, (1960) 11 S.T.C. 655 at 667.

Suppose components are taken to another State for making the ultimate product and supplying the product there. What is the nature of the transaction vis-a-vis the component? Is there an inter-State sale of components as part of the sale contract? Hooghly Docking and Engineering Company[66] was a case involving such a question. Under a contract the assessee was required to sell and supply dredgers in Kashmir. For the execution of the contract the component parts of the dredgers were required to be taken to Kashmir from West Bengal. The component parts were assembled in Kashmir. Delivery of the dredger had to be given afloat in Kashmir. The contract envisaged payment of freight from West Bengal to Kashmir and insurance charges.

On a construction of the contract the court found that the clause for payment of price, and other terms showed that it was a composite contract which involved movement of components of goods from West Bengal to Kashmir, and making of dredger and supplying completed dredger in Kashmir. Dredgers could not be bodily taken to Kashmir for delivery. The component parts had to be taken in order to perform the contract. The Calcutta High Court therefore held that the

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66. Hooghly Docking and Engineering Company v. Commissioner of Commercial Taxes, (1983) 53 S.T.C. 198 (Cal.).

contract of sale has occasioned or caused the movement of the components from one State to another[67] and hence the transaction was inter-State sale in character.

If however, the terms of the contract was only for sale of a dredger in Kashmir, without mentioning anything about transportation of components and assembly work and payment of transport and insurance charge, the decision would have been different.

In respect of purchase of goods liable to be taxed at the last purchase point within the State, an interesting question may crop up, when such goods are procured by an agent on behalf of an out-of-State principal and ultimately despatched to him. The question is whether such purchase by the agent is a local purchase or one in the course of inter-State trade or commerce. If it is a local purchase and not one in the course of inter-State trade he will be liable to pay tax under the local sales tax Act. Otherwise not. In Shankar Lal Kedar Nath[68] it was held that in such circumstances the purchase shall be deemed to be the purchase in the course of inter-State trade by the out-of-State principal,

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67. Id. at 201.
68. Shankar Lal Kedar Nath v. Commissioner of Sales Tax, (1983) 53 S.T.C. 382 (All.). See also, Commissioner of Sales Tax v. Hanuman Trading Company, (1979) 45 S.T.C. 408 (All.).

the agent acting only as an extended arm of the principal. In other words the substance of the transaction is a sale by a dealer within the State to another outside the State and a movement of the goods effected through a nominee, namely, the agent of the outside dealer.

Is there any incongruity or incompatibility in saying that a sale is one in the course of inter-State trade and simultaneously also one inside a State? This question has relevance in the context of claiming concession under the local sales tax Act for resale of the goods within the State. The question came up for adjudication before the Supreme Court in Onkarlal Nandlal.[69] The assessee purchased goods furnishing declaration under the Rajasthan Sales Tax Act, 1947 stating that the goods were purchased for resale within the State. He thus claimed exemption on the purchase turnover. After purchasing the goods, the assessee resold the same inter-State. According to the assessing authority this was a violation of the condition that the goods should be sold within the State. The assessee contended that the sale, though inter-State, was one completed within the State. The goods were specific and ascertained. They were situated within the State when the contract of sale was made. Hence

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69. Onkarlal Nandlal v. State of Rajasthan, (1985) 60 S.T.C. 314 (S.C.).

it was a sale within the State under Section 4 of the Central Act. At the same time it was also an inter-State sale under Section 3 of the Act. The assessee contended that it could not be said that the goods were not used by him, for the purpose mentioned in the declaration furnished by him, namely for resale within the State.

The Court held that there was no violation of the condition in the declaration as the goods were sold inside the State, though that sale amounted to an inter-State sale. Section 4(2) of the Central Act lays down principles for deciding when a sale or purchase shall be deemed to take place inside a State. The court observed that the opening words "subject to the provision contained in Section 3", of Section 4 of the Central Act intended to convey the idea that even when a sale is inside a State it would not exclude the applicability of Section 3 of the Act.[70] If the requirements of Section 3 are satisfied, an inside sale would still be a sale in the course of inter-State trade.

A contract entered into between two persons in the same State may result in an inter-State sale, if the seller,

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70. Id. at 322.

instead of delivering the goods to the buyer in the same State, transports them to a party outside the State as contemplated in such contract. Vinay Cotton Waste Company[71] is such a case. The assessee in Coimbatore sold cotton waste to buyers in Madras who had entered into a contract for sale of cotton waste to another company in Pondicherry. The assessee despatched the goods to Pondicherry and raised invoice on the Madras buyer, who raised bills on the Pondicherry buyer. On these facts the sale effected by the Coimbatore seller was held to be inter-State[72] as the contract had specifically provided that the assessee would have to arrange the transport by lorry from Coimbatore to Pondicherry, showing the Madras buyer as the consignor. The court also held[73] that even assuming that the despatch of the goods by the seller was on behalf of the buyer, the movement of the goods was occasioned in pursuance of the contract between the assessee and the Madras buyer and hence the transaction was inter-State.

It would be seen from this holding that privity of contract need not be between the seller and the ultimate

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71. Vinay Cotton Waste Company v. State of Tamil Nadu, (1986) 63 S.T.C. 391 (Mad.).
72. Id. at 393.
73. Id. at 394.

receiver of the goods outside the State. The only requirement is that goods must move out of the State in pursuance of a contract between two parties. Such contract of sale could be concluded even as between persons in the same State. Yet the sale will be inter-State.

Is mere knowledge that the goods would be moved to a destination out of the State be treated as sufficient to characterise the sale as inter-State? The Rajasthan High Court held that inter-State movement must be shown to be connected with the contract of sale for treating the sale inter-State. In Poddar Spinning Mills case[74] the court found that the transaction was complete at Jaipur after delivery of the machinery to the buyer. Thereafter the seller's entire obligation under the contract came to an end. The court observed that there was no material to show that under the contract the seller was associated with the removal of the goods thereafter from Rajasthan.[75] It is not based solely on seller's obligation to move the goods that the character of the inter-State sale is to be determined. The seller or the buyer may have the obligation to move or to arrange for moving the goods. What is to be looked into

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74. Commercial Tax Officer v. Poddar Spinning Mills, (1987) 67 S.T.C. 359 (Raj.).
75. Id. at 361.

is whether there is an understanding between the parties, as an express or implied term of the contract, that the goods are to be moved outside the State. A mere knowledge by the seller that the goods will be taken by the buyer outside the State will not suffice. An understanding is different from mere knowledge. If inter-State movement was contemplated by the parties and there was an actual movement that would be sufficient to make the sale inter-State.

A review of the case law reveals the complex dimensions of the concept of occasioning movement of goods from one State to another. An inside sale and an inter-State sale, though totally different in common parlance, at times synchronise in the context of the Central Act. An inside sale coupled with certain other ingredients like an obligatory inter-State movement gets itself transformed into inter-State in character. It is often a question of law and fact mixed together whether a sale occasions the movement of goods and hence is an inter-State sale. Quite often minute analysis of the express terms and ascertainment of the implied terms of the contract become necessary to decide the inter-State nature. Even a stipulation for weighment of goods somewhere outside the State may be sufficient to infer an obligation for inter-State movement. Courts have often inferred, on an

appreciation of the nature of the transactions, an implied term in the contract for inter-State movement by holding that such movement is incidental to the contract of sale. On the whole judicial approach in interpreting the concept reflects a liberal approach.

A common intention on the part of the seller and purchaser, an obligation arising from the contract for the movement and an actual inter-State movement are the necessary ingredients of inter-State sale. If a dealer in one State orders for supply of goods to him from a dealer in another State and the goods are so delivered to him in his State the sale is inter-State. This is because there is an inter-State movement under the contract of sale. Should a term in the contract for such movement be decisive of the issue? Levy of tax should be similar in all cases where there is a sale and an immediate flow of goods from one State to another. Such a scheme would better facilitate trade and commerce. If this goal is to be achieved the concept of inter-State sale has to be widened. It should not be confined to a sale occasioning inter-State movement under the contract of sale. When a sale or purchase and an immediate subsequent inter-State movement of the goods are proved, such a sale or purchase should also be treated one

in the course of inter-State trade or commerce. In other words, not only when a dealer in one State purchases from a dealer in another State and gets the goods delivered to him in his State in pursuance of the contract should the transaction be inter-State. When a dealer purchases goods in another State and then immediately transports them to his State the sale to him should also be treated inter-State, irrespective of the absence of any contractual obligation for such movement. Over-dependence on the contractual obligation to move the goods inter-State leads to miscarriage of justice in respect of certain transactions which are substantially and from a functional point of view inter-State in character.

The distinguishing mark of modern law is not logic. There is a shift from the analytical to the functional perspective. It is absolutely necessary that the concept of inter-State sale be reshaped in consonance with the noble ideal of freedom of trade and commerce. Such freedom is a basic feature of the Indian federal structure. National unity and growth through trade and commerce should be a prime consideration when one tackles the question of taxation on sale or purchase.

Chapter XII

SALE BY TRANSFER OF DOCUMENTS OF TITLE

A sale effected by transfer of documents of title during the movements of goods from one State to another is also inter-State in nature.[1] This type of sale is called transit sales because the sale is effected during the time when the goods are in transit. Sales in the course of import and export are also effected by transfer of documents of title.[2] Unlike in the case of a sale occasioning inter-State sale or export or import there is no question of prior contract being the causative factor of movement of goods in transit sale. The movement and a sale during such movement are the ingredients of transit sale. When the transit is between two countries it becomes transit sale in the course of export or import. When the transit is between two States the sale becomes inter-State.

The inter-State character of sale effected by transfer of documents of title during the inter-State movement of goods by rail was involved in Vemula Seshaiah.[3] The

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1. Central Sales Tax Act 1956, Section 3(b). For the text see Appendix B.
2. Id., Section 5(2).
3. Vemula Seshaiah v. State of Andhra Pradesh, (1963) 14 S.T.C. 730. (A.P.).

case is one of those rare instances where an assessee approaches the court with a plea that he should be assessed to tax. The request of the assessee in this case was that he should be assessed to tax under the State sales tax law on the sale turnover of groundnut oil. He purchased groundnut locally. He manufactured oil out of it and sold the oil. The assessing authority did not assess the sale of oil to tax under the State sales tax law, since the sale was, in its view, inter-State. If the groundnut, from which oil was produced, had been subjected to tax and the oil so produced was sold within the State, the assessee was entitled to a rebate under the State sales tax law. The assessee included the turnover of the sale of oil in his tax return under the State sales tax law for purposes of assessment to tax under the State law. But the assessing authority, took the view that the sale was inter-State. The assessee contended that the transactions were intra-State and should be subjected to tax so that he could claim the rebate. The assessee had despatched goods to outside destinations. The railway receipts were obtained in his name. They were endorsed in favour of the buyer when the goods were in the course of movement by rail from one State to another. The sale was effected only when the railway receipt was endorsed by the seller in favour of the buyer. The sale being

effected by transfer of documents of title during the inter-State movement of goods the sale was held to be inter-State and hence not assessable to tax under the sales tax law of the State as an intra-State transaction.

The questions whether the sale was inter-State and if so which was the appropriate State that could levy tax arose in Thiruvengadaswami Iyengar.[4] The assessee, a dealer in paddy and rice in Madras, despatched goods to destinations in Kerala. He took out railway receipt to 'self' and made endorsement in it for delivery to State Bank of India or order. The assessee had an agent in Kerala. If the person, for whom the goods were intended, refused to pay the price and take delivery of the goods, the agent could sell the goods to another. The court held[5] that where the goods moved from one State to another without any privity of contract it could not be said that there was a sale occasioning such movement. When in respect of the goods despatched from one State to another without any privity of contract, a sale is effected by transfer of documents of title during such movement, the sale becomes inter-State in character, falling under clause (b) of Section 3.

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4. Thiruvengadaswami Iyengar v. State of Madras, (1963) 14 S.T.C. 856 (Mad.).
5. Id. at 859.

Which was the State competent to levy the Central sales tax in the case of transit sale? The State competent to levy tax on sale effected by transfer of documents of title was the 'appropriate State'. The State where the sale was effected was the appropriate State.[6] As sale was effected in the State of Kerala, it was held that[7] State could levy tax on the transaction.

A commission agent may endorse the railway receipt in favour of the purchaser while the goods despatched by his principal outside the State are in transit. What is the nature of such a transaction? The answer would depend on whether the commission agent was acting in the capacity of an agent of the principal or in his own capacity as a dealer vis-a-vis the purchaser. Sri. Ram Avattar Agarwalla[8] was

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6. Under the original scheme the appropriate State which could levy tax on inter-State sales under Section 3(b) of the Act was, according to the definition of Section 2(a), the State where the sale was effected. This position was changed subsequently. The law now is that in respect of inter-State sales both under Section 3(a) and 3(b) of the Act, the tax is to be levied by the State from which the movement of the goods commences. In the case of subsequent taxable inter-State sales by a registered dealer, tax is to be levied by the State which granted registration to the dealer and in the case of unregistered dealer, in the State from which the subsequent sale is effected. See, Central Sales Tax Act 1956, Section 9. See also infra, nn.41 and 43.
7. Supra, n.4 at 860.
8. State of Orissa v. Sri.Ram Avattar Agarwalla & Co., (1973) 31 S.T.C. 215 (Ori.).

concerned with such a situation. The assessee despatched rice from Orissa to West Bengal in the name of its commission agent. Subsequently the railway receipt was sent to the agent who endorsed the same to the purchaser while the goods were in transit. The purchaser took delivery of the goods on the strength of the railway receipt. Whether such a sale fell under the second limb of Section 3? The movement of the goods had not terminated. Delivery of the goods from the railway had not been taken while the sale was effected. The court found it difficult to answer the question whether the commission agent effected the sale on behalf of the principal or on his own behalf. There was no finding by the Tribunal in this regard. The court felt that this aspect had to be examined with reference to the terms of the agreement between the parties, especially when a specific contention was raised that the commission agent acted as principal vis-a-vis the purchaser and not as an agent of the assessee. The court therefore sent back the case to the Tribunal for making a probe into the question whether the commission agent acted as a mere agent by virtue of the covenant in the agreement between the assessee and the commission agent, or he acted as a principal.

If a commission agent has authority in his own right to pass title, then he does not act as an agent. In such a case

he becomes liable to be assessed to tax. If he had no such authority to sell the goods in his own name then he is acting only as agent of the principal. The question of agency will have to be determined according to the general law, as the term 'agent' or 'agency' has not been defined in the Act. Generally speaking contracts with commission agents are of different types to suit varying commercial situations.[9] Each agreement has to be analysed to ascertain its true import.

In pursuance of instructions by the assessee's branch at Punjab goods were moved, in Tulsi Bhai Gordhan Bhai[10], from the head office to destinations in Punjab. The assessee carried on the business of tobacco and bidis. The head office was at Delhi. The branch at Punjab was maintaining its own books of accounts. The branch used to procure orders from dealers in Punjab for supply of the goods. The goods were consigned to self from the head office in Delhi to various destinations in Punjab. During the movement of goods the branch in Punjab endorsed the documents to purchasers in Punjab. Was it inter-State sale?

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9. Id. at 218. Chief Justice Misra pointed out: "In modern contracts it has acquired an extended meaning, often the so called agent is merely a buyer. One has, therefore, to look into the terms of the agreement".
10. Lt.Governor v. Tulsi Bhai Gordhan Bhai, (1974) 33 S.T.C. 103 (Del.).

There was no direct sale from Delhi to the dealers in Punjab. But the sale was effected by consigning the goods to 'self' and by transferring documents of title while the goods were in transit from one State to another. The goods were sent in the present case by rail. The goods are deemed to be in the course of inter-State movement from the time they are delivered to the carrier till the time when delivery is taken from the carrier. The sale was effected by transfer of documents during the course of journey when the goods, were with the railways. The purchasers took delivery of them when they got the documents endorsed in their favour. Hence the sales were held to be inter-State[11] falling under Section 3(b) of the Central Act.

The case would have fallen under Section 3(a) of the Central Act had it been a case where the contract was between the assessee's head office at Delhi and the various dealers in Punjab and goods moved in pursuance of such contract of sale direct to the dealers. Since the sale occasioned the inter-State movement a case of inter-State sale falling under Section 3(a) of the Central Act would then have been made out.

The goods move under a contract of sale. The documents are endorsed in favour of purchaser while the goods are

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11. Id. at 105, 106.

in movement. Will the sale fall under clause (a) or clause (b) of Section 3? This was the problem in Mewa Lal Kewal Kishore.[12] In pursuance of contracts of sale with dealers in U.P. the assessee a dealer in U.P. despatched goods outside the State of U.P. According to the contract goods were to remain the property of the assessee until the goods were booked through railway and endorsed the railway receipts in favour of the U.P. purchasers. The sales tax authorities found that the sale was inter-State falling under Section 3(b) of the Act, since it was a sale by transfer of documents of title. The court on an appreciation of the facts found that the sale was not one falling under Section 3(b), but one under Section 3(a) of the Act,[13] the sale being one occasioning the inter-State movement of goods. The despatch of goods outside the State in this case was an integral part of the contract of sale. The contract of sale itself occasioned the inter-State movement of goods. The court held that the fact that the railway receipts were made out in the name of the assessee and were endorsed in favour of the purchaser subsequently, did not alter the nature of the sale.

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12. Mewa Lal Kewal Kishore v. Commissioner of Sales Tax, (1974) 34 S.T.C. 110 (All.). This was followed in Commissioner of Sales Tax v. Mewa Lal Kewal Kishore, (1976) 38 S.T.C. 551 (All.).
13. Id. at 112.

In East India Corporation case[14] the same transaction was taxed both under the local sales tax Act and under the Central Act. The assessee in Madras, dealt in cotton. It purchased cotton from out of the State sellers. Ninety per cent of the value of the goods against railway receipt taken delivery from the bank. It then sold the goods by delivery of the railway receipt to another dealer in Madras and received payment. The assessee's sale was taxed under the Central Act. The purchaser from the assessee was taxed under the Madras Sales Tax Act on the purchase turnover. Hence the same transaction was taxed again. Admittedly the sale was by transfer of document of title while the goods were in transit from one State to another. The court upheld the levy under the Central Act.[15] The levy under the local Act was clearly without jurisdiction as there was only one transaction which fell under Section 3(b).

Suppose there is a contract of sale between 'A' a dealer in State 'B' and 'C' a dealer in State 'D'. 'A' is the purchaser. He instructs 'C' in State 'D' in pursuance of contracts with certain other dealers in State 'B', to

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14. East India Corporation v. State of Tamil Nadu, (1975) 36 S.T.C. 370 (Mad.).
15. Id. at 372.

despatch the goods in the name of such dealers in State 'B'. The goods are so despatched but the documents are sent to 'A'. 'A' endorses them to the dealers to whom the goods are consigned. Does the sale by 'A' to the dealers in State 'B' fall under Section 3(a) or 3(b) of the Central Act? Galia Kotwala[16] raised this point before the Supreme Court.

The assessee had his place of business in Madras. Certain mills in Madras entered into agreement with the assessee for purchase of cotton. The assessee in turn entered into contract with a dealer in Bombay for purchase of cotton. The assessee, however, instructed the dealer in Bombay, the seller to the assessee, to consign the goods to the mills in Madras. The goods were so consigned by the Bombay seller. The railway receipts were sent by the Bombay seller to the assessee. The assessee after collecting substantial portion of the sale price form the mills endorsed the documents in their favour.

Under Section 6(2) of the Central Act[17] when a sale in the course of inter-State trade or commerce has occasioned the movement of goods from one State to another

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16. Galia Kotwala & Co. v. State of Madras, (1976) 37 S.T.C. 536 (S.C.).
17. For the text, see, Appendix B.

any subsequent sale during their movement from one State to another is exempt, on production of prescribed declarations to prove that the sale was to a registered dealer. The assessee had not produced such declarations. When the assessment was questioned before the Tribunal it took the view that the sales were effected by the assessee to the mills by transfer of documents of title during the inter-State movement of goods. They were inter-State sales falling under Section 3(b) of the Act. Since the assessee failed to produce declarations, no exemption for second inter-State sale could be granted. The High Court upheld this view. Before the Supreme Court it was contended that the sale was a direct inter-State sale by the Bombay dealer to the mills falling under Section 3(a) of the Central Act. The goods were sent by the Bombay seller to the mills directly. The property in the goods passed to the mills when they took delivery of the goods. It was argued that the sale fell under Section 3(a) of the Act because the sale occasioned the movement of goods from Bombay to Madras. The inter-State sale was between the Bombay dealer and the mills it was contended, and not between the asessee and the mills.

The Court found that the railway receipts were sent by the Bombay dealer not to the mills but to the assessee. The bills were endorsed in favour of the mills by the assessee.

The contract was entered into between the assessee and the mills and the goods would not have been appropriated to that contract in Bombay since the railway receipts were sent by the Bombay seller to the assessee. The sale by the Bombay seller was not therefore to the mills but to the assessee. That sale to the assessee was an inter-State sale falling under Section 3(a) of the Central Act because there was an inter-State movement of goods under that sale. The fact that the goods were consigned to the mills from Bombay did not mean that there was an inter-State sale direct between the Bombay dealer and the mills. What occasioned the movement of the goods was the sale between the Bombay dealer and the assessee[18]. That sale was an inter-State sale falling within the first limb of Section 3 and not the sale effected by the assessee to the mills. The sale by the assessee to the mills fell under Section 3(b) of the Central Act.

The sale effected by the assessee to the mills was therefore a second inter-State sale. But since the declarations proving that such second sales were to registered dealers had not been produced the assessee was held[19] not entitled to exemption.

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18. Galiakotwala & Co. v. State of Madras, (1976) 37 S.T.C. 536 at 539.
19. Id. at 540.

A dealer agrees to supply goods to another dealer in the State and in pursuance thereof obtains inter-State the goods. In the course of inter-State movement of goods the documents are transferred by him by endorsement to such dealer. Is the sale inter-State? This question came up in Bombay Metal Depot.[20] The assessee bid for supply of goods by tender called for by the Government of Kerala. The assessee placed the tender in its name and Madras address. The tender was accepted. An agreement as specified in the tender was executed before despatch of goods. Under the agreement the goods were to be delivered f.o.r. Ernakulam in Kerala. The payment was to be paid after inspection of the goods. The assessee then placed orders with Bombay seller for supply of identical goods. The Bombay party sent the goods and forwarded the documents of title to the assessee. The documents of title were endorsed by the assessee in favour of the purchaser in Kerala to whom goods had to be supplied in pursuance of the tender. Is the sale so effected by transfer of documents of title by the assessee to the purchaser in Kerala an inter-State sale falling under Section 3(a) or 3(b)? In other words was it inter-State on the ground that there was a movement of goods, under a contract of sale, from one State to another?

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20. State of Tamil Nadu v. Bombay Metal Depot, (1978) 41 S.T.C. 140 (Mad.).

Or was it inter-State on the ground that sale was effected by transfer of inter-State movement of goods?

The court observed that a sale falls within Section 3(b) if the sale is effected by transfer of documents of title to the goods during the movement of goods from one State to another. The transfer was effected, in the present case, after the goods were entrusted with the common carrier, the railway. The sale was effected during the course of movement of goods from one State to another. The court held[21] that the sale fell within Section 3(b) of the Act.

It may be noted that in this case there was a prior agreement for supply of goods. But since the sale was effected by transfer of documents during inter-State movement of the goods the sale was held to fall within Section 3(b) of the Central Act. The decision of the Allahabad High Court in Mewalal Kewal Kishore[22] may also be referred to in this context. In that case in pursuance of agreement to sell, goods moved from one State to another, but the sale was effected by transfer of documents of title to the goods. It was held in that case that the sale falls within Section 3(a) of the Central Act.[23]

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21. Id. at 144 and 147.
22. Supra, n. 12.
23. Supra, n.13.

Which of the two views is correct? The correct view appears to be that of the High Court of Madras in Bombay Metal Depot[24] in the light of the dictum in Tata Iron and Steel Company.[25] The Supreme Court observed[26] in that case,

> "A sale being by the definition, transfer of property becomes taxable under Section 3(a) if the movement of the goods from one State to another is under a covenant or incident of the contract of sale, and the property in the goods passes to the purchaser otherwise than by transfer of documents of title when the goods are in movement from one State to another".

This statement of the law would indicate that even if the movement is occasioned by a contract of sale, if there is a passing of property by transfer of documents of title during the inter-State movement of the goods the sale would fall within Section 3(b) of the Central Act and not under Section 3(a). If so, it follows that the holding in Bombay Metal Depot[27] reflects the correct view.

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24. Supra, n.20.
25. Tata Iron and Steel Company v. S.R.Sarkar, (1960) 11 S.T.C. 655 (S.C.).
26. Id. at 666, per, Shah, J. (Emphasis is mine).
27. Supra, n.20.

Whether the intermediary is acting in the capacity of a buyer or seller, or only as a guaranter or an agent for collecting the price from the customer is a difficult question that arises in the context of Section 3(b). When goods move from a dealer to a customer but the documents of title are sent to another who pays the amount and then endorses them during the inter-State movement of goods to the customer the question is whether there is an inter-State sale by the intermediary under Section 3(b) of the Act.

In Satcowrie Dass[28] orders were collected by the assessees from customers outside the State for supply of goods from the company. The company forwarded goods direct to customers outside the State. The bills were drawn in favour of the customers. The bills and the railway receipts were forwarded by the company to the assessee. The amounts as per the bills were then paid by the assessee to the company. The assessee made out similar bills and they were sent to the customers along with copies of the bills issued by the company. The railway receipts were endorsed to the customers. The assessee received payments from them through bank. There was no written agreement between the company and the assessee.

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28. Satcowrie Dass and Co. v. Commissioner of Commercial Taxes, (1979) 44 S.T.C. 337 (Cal.).

Was there an inter-State sale by the assessee to the customers under Section 3(b)?

Did the transfer of documents of title by the company to the assessee and the payment of the amount of the bill by the latter make the assessee the owner of the goods? Did the endorsement of the documents by the assessee in favour of the customers amount to a sale? The court observed that there was no evidence of an agreement between the assessee and the customer for sale of goods consigned by the company to the customer.[29] After the goods were so consigned to the customers the bills and documents were sent to the person who collected the orders for supply, namely the assessee. They were sent for collection of the price. The assessee, acting as a guarantor, advanced the price. The assessee then endorsed the railway receipts and forwarded them with its bill, as also a copy of the bill of the company through bank for payment by customers. The customers retired the same from the bank on payment. It was held to be a case of the assessee reimbursing itself of the amount advanced by it to the company.[30] There was no contract of sale either between

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29. Id. at 344.
30. Ibid.

the company and the assessee or between the assessee and the customers. The sale was by the company to the customers. There was no inter-State sale by the assessee to the customers.

When does the inter-State movement start and when does it end? This problem is solved by a provision in the Central Act.[31] It provides that where goods are delivered to a carrier or bailee for transmission, the movement of the goods is deemed to commence at the time of such delivery to the carrier or bailee. The inter-State movement is deemed to terminate at the time when delivery is taken from such carrier or bailee. It has to be ascertained whether the sale is effected during such movement or after it was terminated. If the sale is effected after the termination of the inter-State movement the sale will not be exigible to tax under the Act, for the sale is not inter-State. The sale will be a local one, assessable under the local sales tax law.

In Arjan Dass Gupta[32] the assessee was carrying on the business of importing coal from Bengal and Bihar and selling it to retail dealers in Delhi. The course of business

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31. Central Sales Tax Act 1956, Section 3, Explanation I. For the text, see, Appendix B.
32. Arjan Dass Gupta and Brothers v. Commissioner of Salex Tax, (1980) 45 S.T.C. 52 (Del.).

of the assessee was that it would place orders with the owners of colliery in Bengal and Bihar for purchase of coal. The goods were accordingly consigned to the assessee, with freight to pay at Delhi. The invoices were issued to the assessee. On arrival of the goods the railway receipts had to be got endorsed by the civil supplies authorities, coal being a controlled commodity. After this was done the railway receipts were endorsed by the assessee in favour of the retail purchasing dealers in Delhi. The retail purchasing dealers to whom the railway receipts were so endorsed paid the railway freight to the railway authorities and took delivery of the coal.

Was such sale by the assessee an inter-State sale? The court held that it was not. The court observed[33] that the reference of the two States in Section 3(b) of the Central Act[34] made it clear that the termination of the journey takes place when the goods are landed in the delivery State. Normally delivery will be taken by the importers on arrival of the goods at the destination. The court pointed out that though technically there may be a gap between arrival of goods and taking delivery of them, the usual commercial practice is that both will be almost simultaneous.[35] The court held that such being

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33. Id. at 57.
34. For the text of Section 3(b), see Appendix B.
35. Supra, n.32 at 57.

the commercial fact, it was not possible to agree with the contention that the movement continues even after the goods reach the destination. If taking delivery of the goods from the carrier is the test, the court observed[36], an anomalous result would be there. The goods may have to be treated as in movement for long periods even after arrival at destination. There could be several sales by transfer of documents after arrival of the goods at the destination. The Explanation in Section 3 did not expand, the court held, the movement of goods beyond the time of physical landing of the goods in the delivery State.[37]

The decision is contrary to the clear intendment of the Explanation. Had Section 3(b) stood without the Explanation the decision of the court would have been justified. Suppose Section 3(b) stated that an inter-State sale is the one effected during the movement of goods from one State to another. The course of movement must then be between the starting of the movement and the end of it. When goods leave the forwarding State the journey begins. When they land in the delivery State the journey ends. But ascertainment of the time when the movement starts and ends may be difficult.

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36. Ibid.
37. Ibid.

After entrustment with the common carrier, the actual movement may start only after three or four days. Documents may be endorsed before that time. Evidence as to the time of actual movement of goods may be necessary to ascertain the nature of the sale and this may create problems. An alternative course is therefore adopted. The explanation creates a fiction. The fiction is that even if the goods are not actually in movement, they are deemed to be in movement between two points of time, namely the time of entrustment with the common carrier and the time of taking delivery from it. This test makes it easy to ascertain whether the sale was in the course of movement because both the starting point and the terminal points are evidenced by records, the former by the records of entrustment with the common carrier and the latter by records of taking delivery from the carrier. Any sale by transfer of documents between these two termini in point of time and fact is inter-State. The holding in Arjan Dass Gupta runs counter to this statutory scheme and is incorrect.

Under a contract of sale with a dealer in another State goods move to him. But he refuses to accept the goods. The seller therefore makes out a bill in favour of another and the goods are delivered to the latter. Is the sale to

the latter an inter-State sale? This was the question in Thavakkal Agencies.[38] The assessee, a dealer in fertilisers in Coimbatore, sold goods to a dealer in Bangalore. The goods were despatched from Coimbatore to Bangalore. The purchaser in Bangalore did not accept the goods. Hence the assessee found another buyer, raised bills in his favour and arranged the goods to be delivered to him. The question was whether such sale was an inter-State. The court held[39] that it was a case where during movement of goods from one State to another sale had been effected by raising bills in the name of the purchaser and hence an inter-State sale under Section 3(b). Under the Explanation to Section 3, when goods are delivered to a carrier, the movement is deemed to commence from the time of delivery to such carrier and to terminate when delivery is taken from such carrier. When the sale took place, the goods had not been taken delivery of by anybody from the carrier. Hence the inter-State movement had not terminated. The goods were delivered to the purchaser. The sale was therefore rightly held to fall within Section 3(b).

According to the proviso to Section 9(1) of the Central Act tax is leviable on subsequent inter-State sale

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38. Thavakkal Agencies v. State of Tamil Nadu, (1981) 47 S.T.C. 179 (Mad.).
39. Id. at 181.

if no exemption from tax on such turnover is allowable under Section 6(2).[40] The proviso as it stood originally cast liability to pay such tax only on registered dealers.[41] The Supreme Court held that an unregistered dealer effecting such sale would not be liable to tax under the Act.[42] This created an anomalous position. The proviso was therefore amended fixing similar liability on unregistered dealer as well.[43] In Coal and Coke Supplies Corporation[44] the Supreme Court observed that there was no dispute that the retrospective amendment had nullified the effect of earlier decision.[45] The Supreme Court has held in Oriental Coal Corporation[46] that the amendment to

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40. For text see Appendix B.
41. The proviso to Section 9(1) as it originally stood read as follows: "Provided that, in the case of sale of goods during their movement from one State to another, being a sale subsequent to the first sale in respect of the same goods, the tax shall, where such sale does not fall within sub-section (2) of Section 6, be levied and collected in the State from which the registered dealer effecting the subsequent sale obtained or, as the case may be, could have obtained the form prescribed for the purposes of clause (a) of sub-section (4) of Section 8 in connection with the purchase of such goods".
42. State of Uttar Pradesh v. Kasturi Lal Har Lal, (1987) 67 S.T.C. 154 (S.C.).
43. Where such sale is effected by an unregistered dealer the amended proviso stipulated that the tax shall be levied and collected in the State from which such subsequent sale has been effected.
44. Sales Tax Officer v. Coal and Coak Supplies Corporation, (1988) 68 S.T.C. 392 (S.C.).
45. Id. at 396.
46. Sales Tax Officer v. Oriental Coal Corporation, (1988) 68 S.T.C. 398 (S.C.).

the proviso to Section 9(1) of the Act was not retrospective. An unregistered dealer was not therefore liable to pay central sales tax, in respect of second or subsequent inter-State sale during the period prior to the amendment.[47]

Second or subsequent inter-State sale is given exemption from levy of tax under Section 6(2) of the Act. But such exemption is subject to conditions provided in the section. One such condition is that the second sale should be to Government or to a registered dealer under the Central Act. The other condition is that the goods must be of the description referred to in sub-section (3) of Section 8.[48] Still further the dealer effecting the second inter-State sale shoul furnish a certificate from the registered dealer from whom the goods were purchased containing the particulars regarding the registration and payment of tax in regard to first inter-State sale and a declaration from the purchaser stating that he is a registered dealer and the goods are required for the stated purposes.

A question arose in Raj Small Industries Corporati whether Section 15 of the Central Act which imposes restrictio

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47. The amended provision is operative from September 7, 1976.
48. Section 8(3) of the Central Sales Tax Act provides that th goods shall be those entered in the certificate of registr tion as being intended for resale for use in manufacture, mining or generation and distribution of power; or for use as containers and packing material.
49. Commercial Tax Officer v. Raj Small Industries Corporation (1988) 68 S.T.C. 101 (Raj.).

on the levy of tax on declared goods[50] has any bearing on the levy pertaining to inter-State sale. The assessee purchased coal, a declared commodity, from collieries in Bihar and supplied it to allottees in Bihar. The supplying colliery in Bihar charged the assessee central sales tax at 2%, and issued railway receipt in favour of the assessee. The assessee endorsed the same to various allottees during the movement of coal from Bihar to Rajasthan. The sale to allottees falling under Section 3(b) was admittedly second inter-State sale. The question for consideration was whether the sale was exempt from payment of tax. The assessee had not complied with the conditions for exemption stipulated by the statute[51] by filing the necessary declarations.

Dealing with the applicability of Section 15 of the Act, the court observed that the Section imposes restriction on the legislative powers of the States in the matter of imposition of tax on the sale or purchase of the declared goods. It has no bearing on the levy of central sales tax. In other words the prohibition of levying tax at more than one stage is operative only with regard to local tax. There

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50. The declared goods shall be taxed only at one stage under the State law. For a discussion on the levy of tax on declared goods, see, Ch.XIV.
51. See supra, n.47.

is no prohibition in the Central Act that tax shall be charged only at one stage.[52] The fact that Central Act permits levy of tax on second and subsequent inter-State sale, irrespective of the fact whether the goods are declared or not, shows that there is no such prohibition. The only limitation, according to the court, in respect of levy of tax under the Central Act on declared goods was that contained in clause (a) of sub-section (2) of Section 8 which prescribes that in the case of declared goods the tax payable in respect of sale in the course of inter-State trade or commerce shall be calculated at twice the rate applicable to the sale or purchase of such goods inside the appropriate state.[53]

The philosophy behind the concept of transit sale or inter-State sale by the process of transfer of documents of title while the goods are in movement, without any requirement of a prior contract between parties, is nothing but one of commercial expediency. It recognises a long standing trade practice in the realm of inter-State commerce. We find that judicial recognition of this practice in the Second Travancore case[54] where the Court interpreted the scope of the phrase

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52. Supra, n.49 at 111.
53. Ibid.
54. State of Travancore-Cochin v. Shanmughavilas Cashewnut Factory, A.I.R. 1953 S.C. 333; (1953) 4 S.T.C. 205 (S.C.). See Ch.II, supra.

'in the course of'. Later the principle was adopted both by the judiciary and the legislature while evolving the concept of inter-State sale. As a matter of fact, transit sale has a wider prevalence in inter-State commerce than in foreign trade. Transit sale by transfer of documents of title during the movement of goods from one State to another is doubtlessly covered by the concept of inter-State sale. The procedure for effecting such a sale is simple. It is perhaps because of this reason that we do not find major legal battles in this region. However, in a string of decisions courts have clarified the legal position, whenever disputes arose, satisfactorily. Obvious anomalies have been corrected by legislative process from time to time.

Chapter XIII

INTER-STATE TRANSACTIONS THROUGH AGENTS AND BRANCHES

Manufacturers and big business houses maintain branch offices in different parts of the country. They do business through branches. The transaction of sale through branch may partake the character of inter-State sale or intra-State sale depending upon the modality of the transaction. If goods are transferred by the head office to a branch and stored there for eventual sale, it would be only a transfer of goods, and not an inter-State sale. The head office cannot sell to its own branch. There is no contract of sale at all. But there may be contract of sale between the head office in one State and a buyer in another State, the goods may move to the branch office in the buyer's State in pursuance of the contract and may be delivered to the buyer through the branch office. Will the sale be inter-State? Similarly a contract may be made between the buyer and the branch in one State, the movement of goods may begin from a place outside the State and the goods delivered to the buyer in pursuance of the contract. Will that sale be inter-State? Problems of these types arise in the context of the varying nature of commercial transactions. Not infrequently legality of assessments is assailed when commercial transactions are arranged through the medium of agency or branches.

In Cement Marketing Co.[1] the question of the inter-State nature of the sales made through sales managers who had head office in one State and branch in another State was involved. Cement Marketing Company were the sales managers of Associated Cement Company who manufactured cement in its factories located in different States. Cement Marketing Company had its head office at Bombay and branch office at Bangalore in the State of Mysore. Supply of cement was regulated by Government. Every one who wanted to buy cement had to get an authorisation from the concerned Government authority. The government authority issued authorisations to the Cement Marketing Company at Bangalore intimating it the name and address of the person to whom the cement was to be supplied, the factory from where the goods were to be supplied and the quantity of cement to be supplied. On receipt of the authorisation the buyer placed orders with the Cement Marketing Company who then entered into contract with the Associated Cement Company. Thereupon Cement Marketing Company instructed its Bombay office to despatch goods in accordance with the authorisation and the instructions of the buyer. The records showed that the Cement Marketing Company was acting for and on behalf of the Associated Cement

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1. Cement Marketing Co. v. State of Mysore, (1963) 14 S.T.C. 175 (S.C.).

Company as its sales managers. In accordance with the instructions given, goods moved from the factories outside the State of Mysore to persons within the State of Mysore. The question was whether the sales were local transactions or inter-State sales. The sales tax authorities treated the transactions as local sales and assessed them under the Mysore Sales Tax Act. The levy was upheld by the High Court. The Supreme Court held that since an inter-State movement of goods was involved under the contract, the sales were inter-State. The Court noted that cement was supplied from a particular factory not at the option of the Cement Marketing Company. It was decided by the government authority when the authorisation was issued. The supply was so made from factories situated outside the State of Mysore. The Court observed that the contract of sale itself involved the movement of goods from the factory outside the State to the purchasers inside the State of Mysore. It was held therefore that in view of the nature of the transaction the sale itself occasioned the inter-State movement of goods and hence the sale was inter-State.[2] This case related to a period before the

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2. Id. at 180.

commencement of the Central Act.[3] The question in it was the inter-State character of the transactions under Article 286(2) of the Constitution.

State Trading Corporation v. State of Mysore,[4] however, related to a period after the commencement of the Central Act.[5] The question involved was whether the sales were inter-State in nature within the meaning of the Act. Assessments were made under the Mysore Sales Tax Act on the Cement Marketing Company who was sales of cement to several persons in the State of Mysore as agents of the State Trading Corporation. The supply of cement was made from factories outside the State of Mysore. The supply of cement was regulated by permits issued by government. Cement could be purchased only under such a permit issued to the purchaser. The factory which was to supply cement was

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3. Section 3 of the Central Sales Tax Act 1956, which defined inter-State sale, came into force on January 5, 1957. The assessments challenged in the case related to a period prior to this date. The period of assessment was 1955-56, from April 1, 1955 to March 31, 1956. The disputed turnover related to the period between September 6, 1955 to March 31, 1956.
4. State Trading Corporation v. State of Mysore, (1963) 14 S.T.C. 188 (S.C.).
5. The assessment related to the year 1957-58.

specified in the permit. All the factories so mentioned in the permit were situated outside the State of Mysore. On receipt of the permit the purchaser placed orders for supply and made a contract with the Cement Marketing Company. The assessments were made by the Mysore Sales Tax authorities under the sales tax law of the State of Mysore, treating the sales as local ones on the ground that the contract did not provide for supply of cement from any particular factory and the movement of goods from a factory outside the State was not as a direct result of any covenant in the contract of sale. Was it necessary that there should be an express covenant in the contract itself for inter-State movement of the goods to make a sale inter-State? This was the problem that came up for consideration in the case. The Court held that the sales in question were inter-State. Sale of cement could be effected only under a permit. The permit named one or the other factory outside the State from which the cement was to be supplied. The Court held that under such circumstances the contract must be deemed to have contained a covenant that the goods would be supplied from a factory outside and that therefore a sale under such a contract would be an inter-State sale. State Trading Corporation[6]

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6. Supra, n.4.

thus gave an extension to the concept of inter-State sale by deeming a covenant in the contract when the circumstances of the case warranted it.

The Second State Trading Corporation case[7] involved sales by the Cement Marketing Company as agents of Associated Cement Company and of State Trading Corporation during the assessment year 1956-57. Whereas Cement Marketing Co.[8] involved the nature of inter-State sale in the context of ban of taxation under Article 286(2), and State Trading Corporation[9] the scope of inter-State sale under the Central Sales Tax Act, the Second State Trading Corporation[10] case involved sales falling under both these categories and in addition to sales during the period after the amendment of Article 286[11] by the Constitution Sixth Amendment Act and before the enactment of the Central Act. These latter sales fell during the period when Article 286(2) did not contain any prohibition on levy of tax on inter-State sale and

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7. State Trading Corporation v. State of Mysore, (1963) 14 S.T.C. 416 (S.C.).
8. Supra, n.1.
9. Supra, n.4.
10. Supra, n.7.
11. For the text see Appendix A.

Article 269(3) provided that Parliament may by law formulate the principles for determining when a sale or purchase of goods takes place in the course of inter-State trade or commerce, but no such principles had been formulated by Parliament.

The nature of sales involved in the Second State Trading Corporation case[12] was similar to those in the first State Trading Corporation case.[13] Sales during the period when Article 286(2) in its original form was there, were held to be inter-State[14] applying Cement Marketing Company[15] and those during the period when Section 3 of the Central Act was in force was held inter-State[16] applying the State Trading Corporation.[17] The Court then addressed itself how inter-State sale was to be understood during the period in between. The Court held that inter-State sale during this period was to be understood in its ordinary sense.[18] It was in this sense that the Court construed it

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12. Supra, n.7.
13. Supra, n.4.
14. State Trading Corporation v. State of Mysore, (1963) 14 S.T.C. 416 (S.C.) at 419.
15. Supra, n.1.
16. State Trading Corporation v. State of Mysore (1963) 14 S.T.C. 416 (S.C.) at 418.
17. Supra, n.4.
18. State Trading Corporation v. State of Mysore (1963) 14 S.T.C. 416 (S.C.) at 419.

in the context of Article 286(2) in Cement Marketing Company.[19] The Court further held that inter-State sale as contemplated in Article 286(2) before its amendment was the same as that defined in Section 3(a) the Central Act. The same principles were applicable in all the three contexts.[20] The Court held the sales in question inter-State.

In pursuance of a contract between the seller in one State and the purchaser in another there is movement of goods from one State to another. The agent of the seller takes delivery of the goods in the delivery State. He then, through a different mode of transport, takes the goods to the buyer and delivers it. Is the sale intra-State or inter-State? This was the question in Lakshmi Mills Co.[21] The assessee, a dealer in Madras, purchased cotton from a Bombay dealer. Under the contract the goods were to be delivered to the assessee at a place in the State of Madras on f.o.r. terms. The Bombay dealer shipped the goods to Tuticorin in

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19. Supra, n.1.
20. State Trading Corporation v. State of Mysore, (1963) 14 S.T.C. 416 (S.C.) at 419. See also Cement Marketing Co. v. State of Mysore, (1963) 14 S.T.C. 175 (S.C.) at 182.
21. Lakshmi Mills Co. v. State of Madras, (1963) 14 S.T.C. 899 (Mad.).

Madras. At Tuticorin, the agent of the Bombay dealer took delivery of the goods. After taking delivery the agent transported the goods by lorry and delivered them at the buyer's end. The Sales Tax Authorities in Madras treated the transaction a local purchase in Madras and assessed it to tax. The Tribunal upheld the assessment holding that the inter-State character of the transaction ceased when the goods were landed in Tuticorin and the agent of the seller took delivery of the goods.[22] The movement from the port in Tuticorin to the buyer was distinct from the inter-State movement. The transaction was, therefore, according to the holding of the Tribunal, a local sale. The court however differed from the view of the Tribunal. The sale was between the Bombay dealer and the Madras dealer on the condition that the goods were to be delivered at a place in Madras. This involved a movement of goods from Bombay and its delivery at the specified place. The characteristic of an inter-State sale is that there must be inter-State movement of goods under a contract of sale. The method of delivery, the route for transport and the stages involved in the course of the journey were all extraneous considerations to determine the nature of the sale.[23] At the inception of the contract the Bombay dealer

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22. Id. at 901.
23. Id. at 902.

and the Madras dealer entered into a contract that the goods shall be delivered at the specified place in Madras.[24] The fact of landing of the goods at Tuticorin and its transport by the agent of the seller through lorry did not therefore in any way destroy the inter-State nature of the transaction. The movement of the goods from Bombay to the specified place in Madras was occasioned by the contract. The transaction was inter-State sale.

Agent plays a prominent role in the network of commercial activity. When the local agent of a non-resident principal procures goods from outside the State and supplies them to the local buyer, the nature of the transaction becomes often debatable. Suppose such goods are taxable under the State law at the point of first sale. If the transaction is construed to be an inter-State purchase by the local buyer, he will have to pay tax under the local Act when he resells the goods in the State because his sale will be the first local sale. On the other hand if the transaction is considered to be a local purchase from the agent, the local buyer will be exempt from liability, because it is the agent and not the local buyer who is the first seller within the State and liable to tax under the sales tax law of the State.

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24. Id. at 903.

A similar issue came up for decision before the Madras High Court in Jain Jari Stores.[25] The assessee was a registered dealer in textiles under the Madras General Sales Tax Act 1939. He purchased textiles from local agent of a non-resident principal. The non-resident supplier despatched the goods to the agent on the basis of orders placed by him. The railway receipts were collected by the agent of the non-resident supplier. The assessee secured these receipts from the agent after payment and took delivery of the goods. The assessee contended that in view of the facts that the local agent booked the order, got the order confirmed and got seisin of the railway receipt, the goods were despatched 'self' by the non-resident and that the railway receipt, a mercantile document, was transferred to the assessee by the agent after payment of the price, the agent was the first seller. The assessee argued that it was beyond the field of the State to tax the assessee, he being only the second seller in the State.[26]

The transaction apparently involved an inter-State journey. The goods were delivered tc a carrier for transmission. The inter-State journey commenced at the time of

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25. Jain Jari Stores v. State of Madras, (1969) 24 S.T.C. 67 (Mad.).
26. Id. at 72.

such delivery and terminated only when delivery was taken from such carrier. The journey terminated only when the assessee took delivery of the goods. In spite of the intermediate role played by the agent, there was a conceivable link between the non-resident dealer and the assessee. It was therefore stressed on behalf of the State[27] that the sale to and the purchase by the assessee was inter-State and that it was only the subsequent sale by the assessee which was the first sale within the State.

On evaluating the rival contentions the court found that the goods were consigned by the non-resident dealer to 'self'. His agent in Madras, who was admittedly a resident in Madras, took control over the goods and dealt with the railway receipt. The dealer resident outside the State was effecting the sale through his accredited agent in Madras. The agent who was resident in Madras was therefore held to be the first seller.[28]

In the context of Section 3(b) of the Central Act after booking the goods 'self', transmission of the documents of title to the agent or any other person does not result in

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27. Ibid.
28. Id. at 77.

termination of the inter-State journey. The journey terminates only when delivery is taken from the carrier and not before that.[29] A sale effected by transfer of documents during such period will be an inter-State sale under Section 3(b) of the Central Act. In that view the transaction fell clearly within the second limb of Section 3 of the Central Act. The purchase made by the assessee would then be an inter-State purchase. The sale effected to the assessee would therefore be inter-State sale. The subsequent sale by the assessee would then be the first sale in the State liable to be taxed under the State sales tax law. The court did not address itself to this aspect when it held that the sale by the assessee was the second sale in the State.

Big concerns, for instances those engaged in automobiles, operate through different units or centres in the State with a co-ordinating head office at one place. The course of business dealings by them with customers may be complex. The question whether sales by them are inter-State or local ones has to be decided often by examination of minute details of the course of dealings.

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29. Central Sales Tax Act 1956, Section 3, Explanation I. For the text, see Appendix B.

Tata Engineering and Locomotive Company[30] was one such case. The sales office of the assessee was in Bombay. It had its factory in Jamshedpur in the State of Bihar. It had stock yards in various States. Retail sales of motor vehicles were effected through dealers in various States with whom the assessee had entered into dealership agreement. According to the agreement the dealers were to place with the assessee, each month, firm orders for supply of motor vehicles for the subsequent month. Dealers had also to inform the assessee the estimated requirements of vehicles for subsequent two months. The sales office of the assessee in Bombay instructed the factory at Jamshedpur to transfer stocks of vehicles to the stock-yards in various States. Allottments of vehicles were made to dealers by an allocation letter by the sales office in Bombay. The vehicles were distributed to dealers from the stock-yards. The question for consideration of the Supreme Court was whether the sales of the motor vehicles by the assessee were intra-State or inter-State.

The Court observed that the principles enunciated in Ben Gorm[31], in export import context, to decide when a

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30. Tata Engineering and Locomotive Co. v. Assistant Commissioner of Commercial Taxes, (1970) 26 S.T.C. 354 (S.C.).
31. Ben Gorm Nilgiri Plantations Co. v. Sales Tax Officer, (1964) 15 S.T.C. 753 (S.C.).

sale can be deemed to occasions it, are applicable to decide the question when a sale occasions the movement of goods from one State to another.[32] According to that test the movement should be as a result of a covenant or incident of the contract of sale. The sale in the course of inter-State trade or commerce predicates a connexion between the sale and an inter-State movement of goods, the two activities being so integrated that the connection between the two cannot be voluntarily interrupted without a breach of contract or the compulsion arising from the nature of the transaction. Unless the sale occasions the inter-State movement of goods the sale is not inter-State.

On an examination of the course of dealings between the assessee and the dealers the Court noted that placing of firm orders by the dealers was not insisted upon by the assessee. Sometimes vehicles were sent from the factory at Jamshedpur to the stock-yards in different States even before allocation letters were issued to the dealers. The appropriation of the vehicles took place at the stock-yards. The sales were not completed at Jamshedpur but at the stock-yards. The assessee could transfer the stock from

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32. Supra, n.30, at 376.

one yard to another before it was appropriated, at the stock-yard to any contract. The Court held[33] that in the circumstances it could not be said that the inter-State movement of the goods from Bihar to the various stock-yards was occasioned by any covenant or incident of the contract of sale.

The Court had held in Khosla[34] that the principle to determine when a sale or purchase occasions the movement of goods from one State to another are applicable to decide when a sale or purchase occasions the import of goods. In Tata Engineering and Locomotive Company[35] the Court observed[36] that the principles evolved in the export-import context are applicable to decide the inter-State nature of a transaction.

Can the same transaction be both a sale falling under Section 3(a) and (b) of the Act? Are there two sales when a sale is effected by the assessee's head office, the documents are transferred to its branch office and such

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33. Id. at 380.
34. Khosla and Co. v. Deputy Commissioner of Commercial Taxes, (1966) 17 S.T.C. 473 (S.C.).
35. Supra, n.30.
36. Supra, n.33.

documents are endorsed by the branch in favour of the purchaser on receipt of the price? In Larsen and Toubro[37] the assessee was a dealer in machinery, electrical goods and tractor parts. It had its factory and head office in Bombay, and branches in other States. In respect of sales to customers in South India, the Madras branch was the administrative office. Goods were manufactured according to the orders of customers and despatched direct to railway stations nearest to the customers. The sale occasioned the movement of goods from one State to another. The movement of goods being incidental to the contract the sale was inter-State under Section 3(a) of the Act. After despatch of the goods the assessee forwarded the railway receipts and other documents to the Madras branch. The branch at Madras endorsed these documents in favour of customers and collected the price. This was done during the inter-State movement of goods. Is this a case of inter-State sale, effected by the Madras branch, by transfer of documents of title?

The court observed that if the goods were appropriated to the contract at Bombay when they were put on

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37. Larsen and Toubro v. Joint Commercial Tax Officer, (1972) 30 S.T.C. 77 (Mad.).

rail, the sale will be one occasioning the inter-State movement and hence an inter-State sale. The contract of sale was between the head office at Bombay and the customers. The branch was only concerned with the collection of the price of the goods. A transaction falling under Section 3(a) cannot at the same time fall under Section 3(b). When a sale occasioned the movement, there should be a subsequent sale if it was to fall under Section 3(b). In other words, unless there was a sale from the Bombay office to the Madras branch, there was no possibility of a further sale by the Madras branch by transfer of documents of title. There was no such transaction of sale between the head office and the branch. The court therefore held[38] that it was a case of sale occasioning the movement from Bombay to Madras, the sale being by the assessee at Bombay to the customers in Madras.

A business concern appoints one in another State as sole selling agent and effects sale through such agent. The agent procures orders and transmits them to the business concern. In pursuance of such orders goods are supplied. In such a system questions may arise, apart from the inter-State nature of the transactions, about the

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38. Id. at 84.

person liable to pay tax on such sales. Tata Oil Mills[39] involved a problem of this nature. The assessee, Tata Oil Mills, Allahabad was the sole selling agent of the Products of Tata Chemicals, Bombay who manufactured goods in its factory at Mithapur in Gujarat. Under an agreement Tata Oil Mills were responsible for the sale of the products using their sales depots and other facilities. The rate of commission payable to the assessee for making such sales was also specified. The assessee procured orders from buyers in U.P. and the manufacturers despatched the goods to the destinations in U.P. in execution of those orders. The railway receipts were made out in the name of the manufacturers and were negotiated through the banks. The purchasers themselves retired them from the banks. The question was whether the sale was inter-State and if so who was the seller?

The court held that the sales were clearly inter-State. The assessee procured orders and the manufacturers despatched goods from Gujarat to various destinations in U.P. in pursuance of such orders. The movement of goods was therefore under the contract of sale. The sales were inter-State since the sale occasioned the movement of goods

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39. Commissioner of Sales Tax v. Tata Oil Mills, (1972) 30 S.T.C. 520 (All.).

from one State to another. Who was the seller liable to pay tax? Was it the manufacturer or the assessee? The court, on an examination of the agreement between the assessee and the manufacturer and of the course of dealings between them, held that the manufacturer was the seller and the assessee was only an agent for procuring orders and arranging the sale of the products of the manufacturer. The property in the goods remained with the manufacturer until it was transferred to the buyer. The assessee was entitled only to a commission depending on the quantum of the sales turnover. The assessee had to submit to the manufacturers statements of sales. The goods were despatched by the manufacturers to the assessee. All money realised by the assessee from the buyers had to be deposited in the account of the manufacturers. The court held[40] that the modus operandi and the terms of the agreement clearly indicated that there was no purchase of goods by the assessee from the manufacturer. The status of the assessee was only that of a selling agent.

Where business is carried on through the system of net work of distributors complicated facts and issues may be involved. The determination of the question whether or

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40. Id. at 525, 526.

not the transaction is inter-State becomes then rather difficult. The same set of facts may be differently viewed by different courts. Kelvinator of India[41] is an example. The assessee had its factory at Faridabad in Haryana. The factory manufactured refrigerators. Its registered office, sale office and godowns were at Delhi. The assessee was a registered dealer in Haryana. Under distribution agreements the assessee agreed to sell and the distributors undertook to buy at mutually agreed prices, the products manufactured by the assessee.

The goods were delivered to the distributors in Delhi. The property in the goods passed in Delhi. The distributors had to pay the assessee transportation charges from Faridabad to Delhi since the price was fixed ex-factory. The excise duty and the octroi at the barrier at Delhi were paid by the assessee. Specific purchase orders were placed by the distributors after the goods reached Delhi and to the extent goods were available in Delhi. In pursuance of the orders from the distributors delivery of goods was made to them in Delhi. The bill was issued from Delhi. The price was received there. The question was whether the sale by the assessee to the distributors was inter-State.

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41. Kelvinator of India v. State of Haryana, (1973) 32 S.T.C. 629 (S.C.).

The principle to be applied to decide the question was clear. A sale would be inter-State if the movement of goods from one State to another was occasioned by the contract of sale. The Sales Tax Tribunal held that the contract entered into by the assessee with the distributors was contract of sale and the transaction was inter-State. The High Court of Punjab and Haryana held that the Tribunal was right. The Supreme Court, however, differed from this view and held that the agreement between the assessee and the distributors was merely agreement for distribution of the products, and not agreement of sale.[42] The price and the number of refrigerators which were to be purchased were not specified in the distribution agreement. Sale between the parties therefore depended on a future agreement. Specific purchase orders were placed by the distributors after the goods reached Delhi. It is this order and the acceptance thereof that resulted in the agreement of sale. The movement of goods from Faridabad to Delhi, not being under a contract of sale, the transaction between the assessee and the distributors did not constitute a sale in the course of inter-State trade or commerce.

Customers may place orders at the head office for goods produced in a factory outside the State. The

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42. Id. at 645.

factory may pack and label the goods customer-wise and send them to the head office for delivery to the customer. Is it an inter-State sale?

In J.M.A. Industries[43] this was the problem. The contract was placed with the head office in Delhi. The goods moved from Faridabad in Haryana to Delhi as a result of the contract. On receipt of instructions from Delhi office, the factory packed and labelled the goods customer-wise. The consignments were accounted in the factory. The payments received by the head office were billed to the factory. The factory had no godown in Delhi. No stock register was maintained nor any entries made regarding the goods received and sold in the accounts maintained in the head office at Delhi.

The head office performed certain administrative functions in handling the goods before delivery to the Delhi customers. There was no document available to show that the head office at Delhi, also maintained an additional organisation for conducting the sales as distinct

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43. J.M.A. Industries v. State, (1973) 32 S.T.C. 36 (P&H).

from the office at Faridabad.[44] The role that the head office played was that of a broker or a promoter. The court found that the goods reached Delhi in pursuance of specific orders and were delivered to persons who ordered the goods. The transactions were held[45] to be inter-State sale from the State of Haryana.

It is possible that a depot agent may appropriate goods, sent from outside the State, to particular contract, without reference to the principal. Such sale as held in Radhakrishna Mills,[46] will have no inter-State element. The mill in Tamil Nadu despatched to Calcutta in their own name bulk quantities of yarn. The goods were cleared by the Mill's agent at Calcutta. Thereafter the goods were sold at the discretion of the agent to some of the several buyers whose contracts were pending on the date of despatch. This was held to be a local sale, since at no time the goods moved from Tamil Nadu for purpose of satisfying a definite contract.[47] There was no inter-State movement of goods under a contract of sale. The transaction clearly fell outside the scope of an inter-State sale.

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44. Id. at 40.
45. Id. at 42.
46. Radhakrishna Mills v. State of Tamil Nadu, (1973) 32 S.T.C. 166 (Mad.).
47. Id. at 169.

An agent books orders from purchasers outside the State. In pursuance of that goods are despatched 'self' by the principal. Railway receipts are sent to a bank for delivery against payment by buyers. Is it a case of inter-State sale? This question squarely came up in Raju Industries.[48] The assessee was a dealer in graphite and crucibles in Andhra Pradesh. The agents booked orders from purchasers outside the State. Goods were despatched 'self' by rail. Railway receipt was sent to the bank for transmission to the buyer on payment of the value of the goods. The order form clearly showed all the terms and conditions of the sale agreed between the buyer and the agents of the assessee. The items were specified, the price was fixed and the mode of transport provided. The buyer agreed to bear the loss on account of any eventual failure to take delivery of the goods. Goods moved in pursuance of such a contract. The court held[49], that the movement of the goods was as a result of the covenant in the contract of sale or as an incident of it. The sale occasioned the movement of the goods and was therefore inter-State.

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48. Raju Industries v. State of Andhra Pradesh, (1975) 36 S.T.C. 297 (A.P.).
49. Id. at 299.

An intermediary such as the seller's own representative or branch office may initiate the contract of sale. Interception of such intermediary acting on behalf of the seller in the delivery State will not make the transaction an intra-State one. In the case of English Electric Company[50] this position was recognised by the Supreme Court. The company had its registered office in Calcutta with branch offices in Bombay, Madras and Delhi. A buyer in Bombay asked for quotation of certain articles from Bombay office. The Bombay branch office in turn obtained the particulars from the office in Madras. The buyer was appraised of the position that the price was f.o.r. Madras and delivery ex-works, Madras. The Bombay buyer placed the order with the Bombay branch. The Bombay office prepared an indent order and sent it to Madras. After manufacturing the goods, the Madras office despatched them as per the directions of the Bombay office. The goods were consigned to Bombay office and the railway receipt and the other documents were sent to it for disposal. The Bombay office subsequently prepared an invoice for the supply of the goods to the buyer. Almost all correspondence sent from Bombay to Madras and vice-versa distinctly contained the name of the buyer. All the important letters between the Bombay office and the buyer were copied to Madras. Once the goods were despatched the risk passed to the buyer.

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50. English Electric Company of India v. Deputy Commercial Tax Officer, (1976) 38 S.T.C. 475 (S.C.).

It was contended that in the absence of a direct contract between the company and the buyer, the mere movement of the goods was not decisive and that the transaction would amount to only replenishing of the stock of one branch by another and that therefore the State of Madras had no jurisdiction to treat the transaction as an inter-State sale basing its claim on inter-State movement. The contention was based on the fact that the Bombay buyer placed the firm order at Bombay, payment was made there, railway receipt was in the name of the Bombay branch and that the goods were to be delivered at Bombay. It was emphasised that there was no privity between the Madras branch and the Bombay buyer. On the other hand the privity of the buyer was with the Bombay branch. The Court refused to accept this plea. The Bombay office, according to the Court, was acting as an in-between. It was the Madras branch that caused the movement of goods in pursuance to the contract, from Madras to Bombay. The Court held that the sale as well as the movement of goods from Madras to Bombay was part of the same transaction[51] and the sale was inter-State.[52] The movement was integrated with the contract of sale. It is important to note that all prices were shown f.o.r. Madras and goods

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51. Id. at 478.
52. Id. at 480.

despatched at the risk of the Bombay buyer. The buyer accepted these terms and conditions. The freight charges from Madras was borne by the buyer. The movement of the goods from Madras was an incident of the contract of sale. There was no question of diverting the goods which were sent to the Bombay buyer. It did not matter in which State the property in goods passed. What was decisive was whether the sale was one which occasioned the movement of goods[53] from one State to another. Viewed from this perspective the sale was inter-State in character.

When goods are delivered through branches in other States the question arises whether the sale is a direct inter-State sale between the head office and the purchaser. South India Automotive Corporation[54] was such a case. The assessee was a dealer in motor cars and spare parts in Madras. It had its branch in Nellore in Andhra Pradesh. A party who wanted to purchase a motor car had

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53. The Court further amplified the scope thus: "If there is a conceivable link between the movement of the goods and the buyer's contract, and if in the course of inter-State movement the goods move only to reach the buyer in satisfaction of his contract of purchase and such a nexus is otherwise inexplicable, then the sale or purchase of the specific or ascertained goods, ought to be deemed to have taken place in the course of inter-State trade or commerce as such a sale or purchase occasioned the movement of the goods from one State to another". Id. at 479-480, per Ray, C.J.
54. South India Automotive Corporation v. State of Tamil Nadu, (1980) 46 S.T.C. 1 (Mad.).

to make a security deposit of a specified amount. This was to be deposited in a post office savings bank account and the deposit account was to be pledged in favour of the automobile dealer. An intending purchaser of motor car deposited such amount at Nellore. The assessee's head office on receipt of the motor car, earmarked the car, with chassis number and engine number specified, to a particular purchaser and transferred the car with notes indicating the details to the Nellore branch in Andhra Pradesh. The Nellore branch made an invoice to the purchaser and released the pledge of security deposit. The car was delivered to the purchaser. The question was whether there was an inter-State sale from Madras or it was a local sale in Andhra Pradesh.

The court held that there was an inter-State sale. There was an earmarking of the car in Madras and a subsequent transfer to Andhra Pradesh. There was a sale to the purchaser. The movement of goods was in pursuance of the sale. The sale was a credit sale. The money had to be realised through the branch office at Nellore. There was an agreement, it would be inferred from the circumstances, to sell the vehicle to the purchaser at Nellore. It was in pursuance of such contract that the goods were earmarked in Madras. The goods moved to Andhra Pradesh in pursuance of such agreement and

the goods were delivered to the purchaser in Andhra Pradesh. This was therefore a case of inter-State sale by the assessee.

Supply of goods to customers outside the State may be regulated by government by issuance of allotment orders. Under this scheme the assessee has to offer goods to a specified buyer outside the State. The course of dealings may be routed through a selling agent outside the State. In such a context also the question whether the sale is inter-State or a local one would arise. In South India Viscose[55] the assessee was a dealer in yarn with its factory in Coimbatore in the State of Tamil Nadu. It was registered as a dealer in Coimbatore. Supply of yarn was regulated by the Government of India. Under this scheme of regulation yarn was to be sold to the allottees named by the Government. The Government issued allotment orders to various dealers outside the State of Tamil Nadu. A contract of sale had to be entered into within a specified time. The transaction was put through the assessee's agent outside the State. The assessee contended that the sale was not inter-State because there was no movement of goods under a contract of sale.

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55. South India Viscose v. State of Tamil Nadu, (1981) 48 S.T.C. 232 (S.C.).

When the allottees communicated their desire to purchase goods there was a contract of sale between the assessee and the buyers outside the State. It was in pursuance of that contract the goods were sent outside the State. The selling agent who prepared the invoice and delivered the goods acted only as a conduit pipe. It did not alter the character of the transaction of sale between the assessee and the buyer outside the State. Since the goods were despatched in pursuance of contract of sale between the assessee and the buyer outside the State, the sale was rightly held[56] to be inter-State.

At times goods are manufactured with a mark of the buyer's name on them. When such goods are despatched to buyers outside the State, would it be inter-State sale? Indian Duplicators[57] posed this question. The assessee was a manufacturer and dealer in duplicators, in Madras. It had a branch at Hyderabad in Andhra Pradesh. The tender of the Hyderabad branch for supply of goods was accepted by the Government of Andhra Pradesh. Thereafter the goods were indented on the Madras factory which manufactured the same

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56. Id. at 239.
57. Indian Duplicators v. State of Tamil Nadu, (1984) 57 S.T.C. 263 (Mad.).

with the marking "Government of Andhra Pradesh 72-73". The goods were despatched to the Hyderabad branch. The branch supplied them to the Government department. The assessing authority took the view that the goods moved from Madras specifically for satisfying the requirement of the buyer in Andhra Pradesh and hence it was an inter-State sale. The assessee contended that it was only a stock transfer, and not inter-State sale.

The court held that though there was movement of goods from one State to another such movement was in the ordinary or general course of business of the assessee and for being sold as and when the manufacturers received orders for purchase at its branch office.[58] The mere fact that the mark of the out-of-State buyer's name was found on the goods would not necessarily lead to the conclusion that there was a completed transaction of sale by the assessee in Madras. The marking at best would indicate, it was held[59], that the goods were intended for the person who had entered into contract of purchase with the branch office.

The orders placed with the branch amounted to orders placed with the assessee. The orders specified the

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58. Id. at 269.
59. Id. at 268.

marking of the name of an out-of-State buyer on the goods. The goods so made, in fact moved to another State. This would show that the goods moved in pursuance of a specific anterior contract of sale. It appears that this aspect was not fully appreciated by the court.

Does the head office and branch possess different legal personalities? When the branch effects a sale does it not act for and on behalf of the head office? This was one of the points dealt with in Sahney Steel.[60] The registered office and factory of the company was at Hyderabad in Andhra Pradesh. It had branches situated outside that State. The branches in various States received orders from customers outside Andhra Pradesh for supply of goods conforming to definite specifications and drawings and advised the registered office for compliance. Goods were manufactured according to the designs and specifications and despatched to the branches. The goods were booked 'self' and sent by lorries. The branches entered them in the stock and kept them for delivery to customers. Nearby customers inspected and accepted the goods. To distant customers goods were despatched. The branches raised the bill and received

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60. Sahney Steel and Press Works v. Commercial Tax Officer, (1985) 60 S.T.C. 301 (S.C.).

money. The company was assessed to local tax in the respective States. The Andhra Pradesh authorities sought to tax the company in respect of the same transactions treating them as inter-State sales.

The assessee argued that he could not be assessed both under the Central Act and the State Act in respect of the same transaction. It was argued that the levy under the Central Act was illegal. Alternatively it was contended that, if there was liability under the Central Act, the local assessment should be set aside. The Supreme Court held that the head office and the branch did not possess separate juridical personality.[61] The movement from Hyderabad was occasioned by the order placed by the customers in different States. The movement was an incident of the contract.[62] It was intended that the same goods should be delivered by the branch office to the buyer. There was no break in movement of goods. The branch acted only as a conduit through which the goods passed to the buyer. It would have been a different matter, the Court held, if the goods had not been manufactured according to specification and despatched by the registered office to the branch for sale in the open market and without reference to any order placed by the customer.

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61. Id. at 305.
62. Id. at 306.

Unless there is an element of sale in a transaction, it is not exigible to sales tax. Inter-State branch transfer by business houses and manufacturers or that transfer by principal to agent functioning outside the State is therefore beyond the purview of taxation. Agent or branch is nothing but a projected image of the principal. This position is congenial to inter-State flow of goods, because no tax is impossible on such transactions. Nonetheless, inter-State transactions through the agent have led to ceaseless fight between the taxpayers and tax gatherers. The case law bears ample testimony to this.

One finds a penumbral area in this region where certainty of law is a myth. Instances abound where same set of transactions are viewed differently. This is a disheartening trend pointing to the inadequacy of existing legal provisions.

The commercial significance and expediency of effecting inter-State branch transfer of goods are obvious. It vitalises inter-State trading activity. It serves, incidentally, the interest of the ordinary consumer because of the free flow of goods from one State to another and the low price. But if by interpretational gimmick based on a

clog in a contractual clause, tax liability is imposed it will be bad for the trade and bad for the consumer interest. It is absolutely necessary that these transactions should be viewed in their proper perspective. The technicalities of the provisions contained in Section 3 of the Act or the niceties of the language of the contract shall not be a hurdle in the way. It may be true that higher judiciary may impart justice by tearing the veil and recognising the reality of the transaction. But that takes time. It is therefore necessary that the law in this region has to be clearly laid down. In accordance with the changing economic pattern the law has to be reshaped. In the bye-gone decades inter-State trading and flow of trade through branches had not assumed the dimension it has today. Trade and commerce is not a phenomenon which could be decided once and for all. They are growing day by day. Law has to be attuned to the growing commercial needs. Taxation should not strangulate the commercial adventures. Inter-State trade and intra-State trade are bound up with each other. A slump in inter-State trade leads to decline of intra-State trade. Encouragement of inter-State trade and commerce by liberalised tax policy appears to be necessary in the present context, by making suitable amendment to the Act.

When a dealer operates through branch or agent in other State, the transactions of sale involving movement of goods through such branch or agent must be treated as transfer of stock for sale by the branch or agent and not inter-State sale direct to the buyer. This would facilitate inter-State trade. Government thinking, however, does not seem to be in harmony with such a policy. May be due to the pressure of State governments, a constitution amendment to facilitate levy of tax even on inter-State transfer of stock from head office to branch and from principal to agent has been made by the Constitution (Forty-sixth Amendment) Act, 1982. This amendment empowers the Central Government to introduce a consignment tax on transfer of goods from one State to another.[63] Parliament has not so far passed such a legislation. If passed, its effect may not be encouraging. Branch transfers and consignment sale through agents will be in decline. It will hamper free flow of trade. Much more distressing would be the adverse effect on the employment front when branches are eventually closed down.

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63. Constitution of India, Article 269(1)(h) read with Entry 92-B, List I, Seventh Schedule.

PART IV

INTER-STATE TRADE AND COMMERCE

Chapter XIV

GOODS OF IMPORTANCE IN INTER-STATE TRADE AND COMMERCE: PARLIAMENTARY CONTROL OVER TAXATION

The system of public revenue, whatever be its form has tremendous impact on the consumer in modern times. The needs of welfare State make it a necessary obligation on the part of the citizen to pay tax and thereby participate in the nation building process. But when taxes are beyond the bounds of reason and good sense, it is violative of one of the cherished cannons of taxation, namely the cannon of propriety. Excessive rates of tax create obstacles in free flow of trade, intra-State and inter-State. Very often when the administration imposes taxes on the subject with all the zest for revenue, the limits of reason and propriety are transgressed and the taxes become oppressive. Heavy taxes, being unjust extraction of money, sometimes strangulate initiative for establishing new enterprises and lead to economic stagnation. Sometimes heavy taxes lead to large scale evasion and retard the planning process. Does the system of sales tax levy in India respond to the needs of the ordinary consumer? Does the Indian law protect the manufacturer from the evils of excessive taxation

of essential raw materials? How far the system protects the interest of export, industrialisation and inter-State trade and commerce? What modification is necessary? These are some of the matters that call for consideration.

A historical retrospect into the framing of the constitutional provisions would show that the power to levy sales tax was vested in the Provinces under the pre-constitutional set up. This power was absolute. In the changed political and constitutional framework India has become one country without any provincial or parochial barriers. It had to be considered, while the Constitution was drafted, whether an absolute right to levy sales tax should be vested in the States as in the past. When the Constitution was drafted it was agreed that sales tax should be the exclusive right of the States. But the general feeling was against giving an absolute power to the States in the matter. It was thought that there should be some limit on the power so that the exercise of the right by the States may not conflict with the policy of the Central Government with regard to the regulation of business and industrial matters. It was also felt desirable that there should be a certain degree of uniformity among States in the matter.[1] A new

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1. B.Shiva Rao, The Framing of India's Constitution: Select Documents, Vol.IV, p.699.

Article, namely 264A[2] was proposed by the Central Ministry of Finance. Clause (2) of this article imposed restriction on levy of tax on essential goods.[3]

The provision was discussed when the drafting committee met provincial premiers and finance ministers in a conference for the purpose. It was agreed that the Provincial Governments may suggest amendments and the drafting committee would, in consultation with the finance committee, reconsider the matter.[4] Accordingly different proposals were put forward by the Provinces.

The Central Provinces and Berar expressed the view that Parliament should be vested with the power to prohibit imposition of tax by States on goods essential for

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2. Article 264 A of the draft Constitution corresponds to Article 286 of the Constitution of India.
3. Shiva Rao, op.cit.,p.682.Clause (2)of the Article 264A, proposed by the Central Ministry of Finance read: "Except in so far as Parliament may by law otherwise provide, no law of State shall impose, or authorise the imposition of, a tax on the sale or purchase of any such goods as may be declared by Parliament by law to be essential for the life of the community or for the purpose of the industrial or economic development of the Union".
4. Id. at 700.

the life of the community. It also felt that there should be no levy of tax on goods which are essential for the development of agriculture. In its view sale of food-grains, agricultural implements and manures should be made tax free, and for sometime agricultural machinery also be exempt from sales tax. In respect of goods meant for delivery outside the State, levy of sales tax by States was to be made subject to a ceiling prescribed by Parliament when the goods were declared by Parliament to be essential for the purpose of industrial or economic development of the Union.[5] The scheme of restriction proposed by the Central Provinces and Berar therefore was one of total prohibition from taxation in respect of goods which are essential for the life of the community and for agricultural development and one of regulated taxation in respect of goods essential for industrial and economic development of the nation.

The Government of Orissa wanted the provision to contain a prohibition of any State levy of sales tax in respect of goods declared by Parliament to be essential to the life of the community, and in respect of agricultural

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5. Id. at 708. For the draft provision proposed by the Central Provinces and Berar, see Id. at 709, 710.

implements. It also felt[6] that Parliament should be empowered to prescribe the maximum rates of levy of sales tax in the case of goods necessary for industrial and economic development of the States or the economic welfare of the people.

The West Bengal Government felt[7] that it was improper that the taxing power conferred on the Provincial Legislature be controlled by conferment of regulatory power on the Central Government. It felt that if conferment of such power cannot be avoided, safeguards should be taken to see that it is not used to restrict the jurisdiction of the Provincial Legislature and to widen the jurisdiction of the Central Legislature in the matter of taxation.

The Bihar Government strongly objected[8] to a system of complete prohibition of levy of sales tax on essential goods. In its view such a measure would be a serious encroachment on the legislative power of the Province and would hardly hit States like Bihar which had extensive dealings in goods like coal, coke, iron, steel and cement. It was agreeable to a ceiling on the rate of tax in respect of these goods, though the State could not agree to total prohibition of taxation in respect of them.

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6. Id. at pp.710, 711. For the draft of the Article prepared by the Government of Orissa, see, Id. 711.
7. Id. at 713.
8. Id. at 718.

Article 264A(2) was totally unacceptable to the State of Madras.[9] The Government pointed out that it would lose bulk of its tax revenue if sales tax levy of goods essential to the life of the community like rice, wheat and pulses is prohibited. The proposal for exemption of goods considered essential for the economic and industrial development was also not acceptable to it. In its view no State would resort to taxation in a manner detrimental to industrial development.

The Government of Bombay felt[10] that the essential goods for which exemption was to be given should be restricted to raw materials to be mentioned in the Article itself.[11] The provision in the draft proposed by the Central Ministry was, according to the Government of Bombay[12], too wide and vague and bound to lead to avoidable friction between the Union and the States and among States.

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9. Id. at 720. See also G.Austin, The Indian Constitution: Corner Stone of Nation, p.229 (1966).
10. Id. at p.724.
11. Id. at 723. The relevant portion of the draft prepared by the State of Bombay, read: "Except in so far as Parliament may by law otherwise provide, no law of a State shall impose or authorise the imposition of a tax on the sale or purchase of coal, cement, steel, cotton and cotton yarn and jute".
12. Id. at 724.

While the Government of East Punjab was agreeable to the draft[13], the Government of Assam preferred imposition of a ceiling on the rate of tax.[14] The Government of the United Provinces though agreeable to the principle contained in Article 264A(2), was of the opinion[15] that instead of stipulating it in the Constitution necessary alternative arrangement to realise that objective had to be made.

After examining the comments of the Provincial Governments the Drafting Committee finalised the draft after introducing some changes and moved the draft in the final form before the Constituent Assembly. The final draft provided that the State law, levying tax on goods declared by Parliament to be essential for the life of the community, required the assent of the President. Introducing the draft, Ambedkar told the Constituent Assembly that before a Province levied tax on goods which were essential to the life of the community, it was necessary that the law made for the purpose should receive the assent of the President, for it would then be possible for the President and the Central Government to see that no hardship was created by such levy.

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13. Id. at 726.
14. Id. at 727, 728.
15. Id. at 730.

H.N.Kunzru, in the course of the discussion, emphasised that with a view to protecting the interest of the consumer two things were to be done. Sales tax should be levied only at the point of sale to the consumer. Such levy should be subject to a maximum rate prescribed by Parliament.[16] He pointed out, quite rightly, that while the restrictions on the levy of sales tax on export and import transactions protected the interest of the Central Government and the restrictions on inter-State sale protected the interest of the State to which the goods are sold, there was no provision which protected the interest of the consumer. Clause (3) of Article 264A did not, in his view, protect the interest of the consumer except in a limited way. It was so because only those articles which were declared by Parliament fell within the coverage of such prohibition. It would depend on the Central Government, from time to time, to decide what goods should fall in the

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16. C.A.D. Vol.10, p.335. The amendment suggested by H.N. Kunzru sought to incorporate two clauses in Article 264A, as follows: "(1a) No law of a State shall impose or authorise the imposition of a tax on the sale or purchase of goods within a State except where such sale or purchase is made to or by a consumer. (1b) Parliament may, by law, fix the maximum rate at which a sales tax may be levied by a State on the sale or purchase of goods".

category. He felt that the rate of tax was not to be left to be fixed by the State, on an appreciation of the general economic condition of the people in the State. Fixation of appropriate rate that way, as a result of experience, is a method of fixation by trial and error. It may adversely affect the trade. Taxation at every stage till the product reaches the consumer, creates a heavy burden on the consumer since tax factor will become a considerable element of the ultimate price he has to pay for the goods. Fixation of an upper limit for the rate of tax may not be necessary in all cases, for example luxury goods. Kunzru felt[17] that fixation of an upper limit of tax was necessary in respect of all such goods which were so much in general demand that it would be a hardship to the people to go without them.

These suggestions, which were excellent from the point of view of the consumer, did not find favour with the Constituent Assembly. The proposal did not receive the serious consideration which it deserved, but was brushed aside with an observation from Ambedkar that the protection of the interest of consumer is covered by the Explanation in clause (1). He said:

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17. Id. at 336.

> "Now, coming to the amendment of my honourable friend Pandit Kunzru, I am inclined to think that the purpose of his amendment is practically carried out in the explanation to sub-clause (1) where also we have emphasised the fact that the sales tax in its fundamental character must be a tax on consumption and I did not think that his amendment is going to improve matters very much".[18]

An examination of the provisions of the Explanation[19] to Article 264A(1) would reveal that it was enacted for the purpose of explaining an outside sale and that it provided that where goods are delivered in a State for consumption, sale shall be deemed to have taken place in that State, notwithstanding the fact that the property in the goods passed in another State. In other words, it provided that where two States are involved it is the consuming State that can tax and not the selling State. This was not the situation conceived of by Kunzru. His point was that it is at the point of sale to the consumer that a State shall be authorised to levy tax and that too within prescribed limits. He said clearly,[20]

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18. Id. at 340.
19. Explanation to Article 264A(1) is identical to the Explanation in Article 286(1) as it originally stood. For the text of Article 286(1) as it originally stood, see Appendix A.
20. C.A.D. Vol.10, p.335.

> "In some of the countries, there are multiple-point sales taxes. Perhaps the economic condition of those countries permits of the imposition of such taxes. But, in India, particularly at the present time when the prices are high, obviously it is undesirable that each of the processes that has to be gone through before the manufactured goods reach the hands of a consumer should be subjected to the payment of a tax on the sale or purchase of goods".

The point stressed by him, namely, imposition of a reasonable rate of tax at the point of sale to the consumer is not one covered by the Explanation mentioned by Ambedkar. The valid point raised by Kunzru got lost in the course of the pressing business transactions of the Constituent Assembly. The point raised by him requires serious consideration even today. Sales tax law is in need of a consumer oriented approach.

The Constituent Assembly passed clause (3) of Article 264A in the form in which it was moved by Ambedkar. On renumbering of the provisions, it became Article 286(3). Article 286(3) provided that no law made by the Legislature of a State imposing a tax on the sale or purchase of any such goods declared by Parliament by law to be essential for the life of the community, could have effect unless it was reserved for

the consideration of the President and received his assent.[21] Though in the draft proposed by the Central Ministry of Finance there was provision empowering Parliament to declare not only commodities essential for the life of the community, but also commodities essential for the purpose of industrial or economic development of the Union, the latter category was dropped in the final draft adopted by the Constituent Assembly. Article 286(3) did not therefore cover the latter category of goods.

Parliament did in true spirit comply with the Constitutional dictate in Article 286(3). In terms of Article 286(3) of the Constitution, Parliament passed the Essential Goods (Declaration and Regulation of Tax on Sale or Purchase) Act, 1952. The goods declared by that Act were indisputably essential for day to day life of the community.[22]

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21. Supra, n.2.
22. Section 2 of the Essential Goods (Declaration and Regulation of Tax on Sales or Purchase) Act 1952 declared that the goods specified in the schedule are essential for the life of the community. The schedule enlisted a number of items, such as cereals and pulses, fresh and dried fruits, sugarcane, coconuts, vegetables, edible oils, fresh milk and milk products, meat, fish and eggs, edible oil and oil seeds, gur, salt, all cloth woven or handloom, raw cotton, hides and skins, fertilizers and manures, agricultural machinery, cattle feeds, coal including coke, iron and steel, books, exercise books, slate, slate pencil and periodical journals. The Act was repealed by the Central Sales Tax Act with effect from 5th January 1957.

These goods were declared for exercising control over State taxation on them. The goods included essential consumer goods, basic raw materials and things required for production or manufacture of goods. The legislation aimed at less tax burden on the common man.

The Taxation Enquiry Commission in its report[23], recommended[24] a change in the above mentioned scheme. It recommended conferment of a blanket power on the States vis-a-vis local sales tax, with only a limited control over taxation in respect of raw materials. This control was to avoid increased cost of manufactured articles due to imposition of sales tax on raw materials by the States. A policy of taxation on the raw materials has an inter-State bearing. Therefore intra-State sales tax in respect of such goods was an appropriate matter for control by the Union. The Commission recommended that the selection of the commodities

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23. Government of India, Report of the Taxation Enquiry Commission, 1953-54, Vol.III (1956).
24. Id. at p.51. The Commission said, "In regard to the impact of the sales tax of a particular State on the people of that State, it seems to us unnecessary that the Central Government should exercise, through Parliamentary Legislation, a jurisdiction which, in terms of the States own powers is at once concurrent and overriding".

for the purpose should not be done in a haphazard manner. It must be done with caution based on known principles. For selection of commodities the Commission suggested a combination of three conditions: Firstly the goods should be raw-materials or largely in the nature of raw materials. Secondly, either as a raw material or later as a finished goods based on such raw materials, they should, in terms of volume of inter-State transactions be of special importance in inter-State trade or commerce. Thirdly, in terms of the country as a whole, they should also be of special importance from the point of view of the consumer or of industry.[25] The Commission found[26] six categories of goods, namely, coal, iron, steel, cotton, hides and skins, oil seeds and jute which would satisfy the requirements.

In the light of the recommendations of the Taxation Enquiry Commission Article 286(3) was amended by the Constitution (Sixth Amendment) Act 1956. The amended Article[27] empowered Parliament to declare certain goods to

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25. Id. at p.55.
26. Id. at p.61.
27. For the text of Article 286(3) as amended in 1956, see Appendix A. For a discussion on "declared goods" see, Viswanatha Aiyar, "Sales Tax and Inter-State Trade", [1965] 1 M.L.J.(Jour). at 7.

be of special importance in inter-State trade or commerce and to impose restrictions in regard to tax on sale or purchase of such declared goods within a State. In respect of the goods which are of importance in inter-State trade and commerce State taxation had to be made subject to control by Parliament. In conformity with this objective the Central Act declared certain goods as of special importance in inter-State trade or commerce.[28] Restrictions and conditions in regard to tax on sale or purchase of such goods within a State were so laid down.[29] Levy of tax on the sale or purchase of declared goods at more than one stage is banned. The scheme of taxation in respect of these goods has therefore to be single point.[30] The Central Act further restricts that the levy cannot exceed certain specified percentage. Provision is made for reimbursement of the local tax paid if goods subjected to local tax are subsequently sold inter-State. The object of the single point levy for declared goods and the fixation of an upper limit on the rate of tax is to ensure that

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28. Central Sales Tax Act 1956, Section 14. For a discussion of Section 14 of the Act see, Anirudh Prasad, Centre-State Relations in India, p.593 (1985).
29. Central Sales Tax Act, Section 15.
30. Id. Section 15(b). Where such goods are sold inter-State and tax paid under the Central Act, the tax paid under the local sales tax law will be refunded.

the prices of goods inside and outside the State do not unduly go high due to incidence of taxation. The scheme guarantees that inter-State trade and commerce will not be hampered by heavy taxation inside the State by subjecting such goods to excessive rate of tax and multi-point levy.[31]

The list of declared goods was modified subsequently by adding some more goods like sugar, tobacco, cotton fabrics, rayon or artificial silk fabrics and wollen fabrics.[32]

The state of law today is different from that in the original constitutional scheme. Originally Parliament was authorised to declare goods essential for the life of the community. The declaration today is confined to goods of special importance in inter-State trade or commerce. Under the new scheme Parliament could specify the system of levy, rate and other incidence of tax. Under the former scheme no tax was leviable by the State on declared goods without the assent of the President. Under the new scheme no assent is needed.

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31. See Govind Saran Ganga Saran v. Commissioner of Sales Tax, (1985) 60 S.T.C. 1 at 4 (S.C.).
32. Additional Duties of Excise (Goods of Special Importance) Act 1957, Section 7.

The essential goods declared by the Parliament under the pre-existing law contained several raw materials. Tax relief could have been extended to raw materials under the earlier scheme as well. An examination of the list of goods declared to be of special importance in inter-State trade nand commerce would reveal that it contains several items of essential commodities like cotton fabrics, rayon or artificial silk fabrics, tobacco, wollen fabrics, silk fabrics and sugar which are not raw materials as such. It excluded several items[33] covered by the Essential Goods (Declaration and Regulation of Tax on Sale or Purchase) Act 1952.

Description of items in the list of declared goods has been a source of litigation. Interpretation, one way or the other, on the scope of an item has considerable tax impact. Hence dispute arises not only as to whether a commodity falls within an item but also as to the effect of enumeration of various commodities under an item in the list

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33. The excluded items are fresh milk, milk products, meat fish, eggs, edible oil, gur, salt, fertilisers, manures agricultural machinery and implements, cattle feeds, coaks, exercise books, slate and slate pencils, periodical journals.

of declared goods. Two instances, one of a liberal and another of restrictive interpretation may be pointed out in this context.

Coal is an item of declared goods. The question arose in J.Singh's case[34] whether 'coal' included 'charcoal'. If charcoal fell within the expression 'coal' it was taxable only at 2 per cent. If not, it was taxable at 4 per cent. The assessing authority had taxed charcoal at 4 per cent treating it as an item different from coal. Coal is a mineral product. Charcoal is manufactured by human agency from products like wood. The Supreme Court interpreted the term 'coal' in a liberal manner and held that coal included 'charcoal' also. In its view it was not the technical meaning, but the meaning of the term in common parlance that had to be looked into for ascertaining the meaning of the expression 'coal'. The Court held that viewed from that angle, both a merchant dealing in coal and a consumer wanting to purchase it would regard coal not in its geological sense but in its ordinary sense taking within its ambit 'charcoal' also.[35]

The legislative intention being only to restrict the levy of tax on coal including coke, but not on charcoal, a correctional legislation[36] was brought in, making it clear that coal does not include charcoal.

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34. Sales Tax Commissioner v. M/s.J.Singh, A.I.R.1967 S.C.1454.
35. Id. at 1456.
36. Central Sales Tax (Amendment) Act 1972, Act 61/72.

An instance of restrictive interpretation was of Pyarelal Malhotra.[37] Iron and steel is a declared item. Under this item some sub-items are given. In each sub-item several articles are mentioned. The question arose whether iron and steel was a single item or whether the different categories mentioned under the entry constituted new species of commercial commodity taxable separately. The assessee was sought to be assessed on sales of steel rounds and flats. manufactured out of iron and steel scrap. The assessee raised the plea that iron and steel scrap was already taxed and hence the iron and steel products manufactured out of them cannot be taxed again since the levy was violative of Section 15 of theCCentral Act which provided that the 'declared goods' shall be subjected to tax only at one stage. The question was whether both the commodities, namely, the scrap and the things like steel rounds and flats made out of it, were 'iron and steel' taxable only at one stage. The High Court took the view that the scrap when converted into rounds and flats are still 'iron and steel' and hence cannot be taxed again.

The Supreme Court however, reversed the decision of the Madras High Court and held[38] that each sub-item under

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37. State of Tamil Nadu v. Pyarelal Malhotra, A.I.R. 1976 S.C. 800; (1976) 37 S.T.C. 319 (S.C.).
38. Id. at 806.

the entry 'iron and steel' is a separate taxable commodity.[39]

The effect of the Supreme Court judgment is that price of iron and steel goes up. If the different commodities enumerated under the title "iron and steel" are treated as separate and distinct commodities and taxed, the purpose behind Section 15 will be defeated. There will be multiple taxation and high tax burden on different forms of iron and steel. Under the Essential Goods Act 1952 which is the forerunner of the present legislation, the entry was simply 'iron and steel' without any sub-categorisation. If the entry was like that in Section 14 of the Central Act the present interpretation would not have been possible and the difficulty would not have arisen. An amendment of the law is therefore called for.

The list of declared goods should be clear and comprehensive and as far as possible exhaustive. If so there will be less scope for dispute. For this purpose a comprehensive list could be evolved in agreement with the States. Parliament may incorporate those items in Section 14 of the Act.

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39. Referring to the Statement of Objects and Reasons for the amendment to Section 14 in 1972 the Court observed that the purpose of the amendment was to elucidate the definition of 'iron and steel' by giving a comprehensive list so as to remove ambiguity. Id. at 803.

The list of declared goods needs to be expanded, both in respect of consumer goods and raw materials. The list must contain metals of primary commercial importance such as copper, zinc, tin, aluminium, nickel, magnesium. It should contain consumer items like timber, kerosene, ink and paper.

The provision of Section 15(b) of the Central Act[40] for reimbursement of the local tax when goods in respect of which such tax is levied are sold inter-State only if tax under the Central Act is paid, creates undue hardship. Instead of the requirements of payment of Central sales tax and then refund of the tax paid under the State law it would be more advantageous for the State as also for the dealer if the tax paid under the State law is set off against the tax demand under the Central law. The balance if any, alone need be demanded by the State and paid by the dealer. The present system involves initial double payment by the dealer followed by a refund. It also involves a collection process by the State twice over followed by a refund procedure. The proposed scheme would avoid these difficulties both for the State and for the dealer.

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40. See supra, n.30.

Chapter XV

DISCRIMINATORY SALES TAXATION AND FREE FLOW OF TRADE: INTER-STATE AND INTRA-STATE IMPLICATIONS

The doctrine of trade and commerce embodied in the Constitution has direct relationship with the power to tax sale or purchase of goods at intra-State and inter-State levels. However, a detailed probe into and a thorough analysis of the scope of freedom of trade and commerce is outside the scope of this thesis and this chapter.[1] What is particularly examined in the following pages is the constitutional concept of the non-discriminatory taxation on sale or purchase of goods. A historical examination of the scheme of Part XIII of the Constitution is made, however, to focus the scope and application of this concept in its true setting.

A tax legislation must conform to the constitutional mandates.[2] Apart from Article 286 in Part XII which imposes

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1. For such a detailed discussion see C.M.Jariwala, Freedom of Inter-State Trade in India (1975); K.Parameswaran, Power of Taxation under the Constitution, (1987); M.P.Singh, Freedom of Trade and Commerce in India, (1985); William G.Rice, "Division of Power to Control Commerce between Centre and States in India and in the United States", 1 J.I.L.I. 151 (1959); David P.Derham, "Some Constitutional Problems arising under Part XIII of the Indian Constitution", 1 J.I.L.I. 523 (1958-59); M.Ramaswamy, "Indian Constitutional Provisions against Barriers to Trade and Commerce Examined in the Light of Australian and American Experience", 2 J.I.L.I. 321 (1960); D.K.Singh, "Trade, Commerce and Intercourse in India: A Reappraisal of Some Constitutional Problems", 14 J.I.L.I. 39 (1972); C.Krishnan, "Trade, Commerce and Intercourse within the Territory of India", [1962] 2 M.L.J.Jour. 45.
2. See Constitution of India, Articles 13, 14, 19(1)(g), 245, 246, 265, 286, 301, 302, 303 and 304.

restrictions on the levy of tax on the sale or purchase of goods, Articles 301 to 304 contained in Part XIII of the Constitution are important from the angle of freedom of trade and commerce.

The Constitution declares trade and commerce to be free throughout India.[3] However, Parliament may impose restrictions on freedom of trade and commerce between States or within any part of India, as public interest may require.[4] State legislature may impose restrictions on the freedom of trade and commerce with or within that State.[5] No legislation providing for preference or discrimination among States in relation to trade and commerce shall be made.[6] However, Parliament may pass such a law, if it becomes necessary to do so, to deal with a situation arising from scarcity of goods in any place in the country.[7] State legislature may impose tax on goods brought to that State from other States, so as not to discriminate between goods brought and goods produced in that State.[8]

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3. Constitution of India, Article 301.
4. Id., Article 302.
5. Id., Article 304(b).
6. Id., Article 303(1).
7. Id., Article 303(2).
8. Id., Article 304(a).

The articles have been drafted in a very complex way.[9] There is an incomprehensible and patently deranged mix up of exceptions over exceptions resulting in a smog of confusion complicating the attempts at deciphering the scope and amplitude of the provisions. Criticising this complexity woven into these provisions, P.S.Deshmukh said humorously that the whole situation is like this:

> "We first of all provide and say or declare that a certain person is a man. Then, we say, notwithstanding this declaration, you shall wear a sari and nothing but a sari....Then, notwithstanding the fact that you are considered a man, and notwithstanding the fact that you wear nothing else but saris, you will wear a Gandhi cap also. Then we have another 'notwithstanding'. Notwithstanding that you are a man, notwithstanding that you shall wear nothing but a sari, notwithstanding that you shall also wear a Gandhi cap, you will be at liberty to describe yourself as a woman".[10]

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9. P.S.Deshmukh referring to the draft of the Articles stated in the Constituent Assembly: "If we analyse the new articles that have been proposed, it is very difficult to understand them and I think the comment is absolutely justified that that is going to be a lawyers' Constitution, 'a paradise for lawyers' where there will be so many innumerable loopholes that we will be wasting years and years before we could come to the final and correct interpretation of many clauses". C.A.D.Vol.IX, p.1131.
10. C.A.D. Vol.IX, pp.1131, 32.

Trade, commerce and intercourse throughout the country is declared to be free. Freedom not only of inter-State trade but also of intra-State trade is ensured. The freedom is however, subject to the other provisions of Part XIII. The other provisions fix certain limitations on the freedom.

The problems of inter-State trade and commerce during the pre-independence era, the geographical and economic unity of India during the post-independent period and the necessity for free flow of inter-State trade, commerce and intercourse throughout the country have been borne in mind by the founding fathers of the Constitution.[11]

One of the issues on which there arose a difference of opinion in the Constituent Assembly was the extent of limitation that could be put on this freedom. The draft moved by Ambedkar contained several limitations.[12] Thakkur

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11. Larsen and Toubro Ltd. v. Joint Commercial Tax Officer, (1967) 20 S.T.C. 150 (Mad.) at 162.
12. Presenting the draft articles 274A, 274B, 274C and 274D, which later became Articles 301, 302, 303 and 304 respectively of theConstitution, Ambedkar observed: "I should also like to say that according to the provisions contained in this part it is not the intention to make trade and commerce absolutely free, that is to say, deprive both Parliament as well as the States of any power to depart from the fundamental provision that trade and commerce shall be free throughout India. The freedom of

(contd...)

Das Bhargava expressed the view that the restrictions imposed by Parliament on the freedom of trade and commerce have to be reasonable[13] and the States should not be empowered to impose restrictions[14] and that trade, commerce and intercourse shall be absolutely free, and subject to restrictions in the public interest only in times of scarcity or national emergency.[15] Babhu Dayal Himat Singka also shared this view. Alladi Krishna Swamy Iyer supporting the draft provision said that in a federalism the larger interests of the nation have to be taken into account and freedom of trade and commerce has to be permitted as far as possible without ignoring regional interests and there must be power in the centre to interfere in any case of crisis to deal with peculiar problems that may arise in any part. According to him these purposes were served by the draft provisions.[16] Changes proposed were negatived, the draft was passed by the Constituent Assembly and the articles became part of the Constitution.

(f.n.12 contd.)

trade and commerce has been made subject to certain limitations which may be imposed by Parliament or which may be imposed by the Legislatures of various States, subject to the fact that the limitation contained in the power of Parliament to invade the freedom of trade and commerce is confined to cases arising from scarcity of goods in any part of the territory of India and in the case of the States it must be justified on the ground of public interest". C.A.D. Vol.IX, p.1124.

13. Id. at 1128.
14. Id. at 1129.
15. Id. at 1128.
16. Id. at 1141.

Article 301 depicts India as a unit, devoid of any kind of barriers. Free flow of trade, commerce and intercourse right through and across the country is its motto. Parliament is permitted to impose restrictions on the freedom in public interest. The public interest contemplated in the Article could be for various purposes such as preventing evasion of tax or for canalising inter-State commerce through registered dealers. The concession granted to Parliament to impose any restriction in the public interest on the freedom, however, does not extend to making or authorising any preference to or any discrimination between one State and another by virtue of any entry relating to trade and commerce in any of the lists in the Seventh Schedule. The same embargo is extended to the States as well.

Apart from the power vested in the State to impose reasonable restrictions on the trade freedom under Article 304(b), the State Legislature is authorised to impose non-discriminatory taxes on goods imported from other States or Union Territories compared with goods manufactured or produced in the taxing State.

Atiabari[17] and Rajasthan Automobiles[18] are the landmark decisions which cleared the clouds that shadowed the constitutional guarantee of freedom of trade and commerce.[19] In Atiabari, the validity of the Assam Taxation on Goods (Carried by Roads or Inland Waterways) Act, 1954 was challenged. The Act imposed tax on tea carried by road and inland waterways. The Supreme Court by majority held the Act violative of the freedom guaranteed under Part XIII of the Constitution. As observed by Justice Gajendragadkar, "restrictions on freedom which is guaranteed by Article 301 would be such restrictions as directly and immediately restrict or impede free flow or movement of trade".[20] The tax imposed directly and immediately restricted trading in tea and thus violated Article 301.

In Rajasthan Automobiles[21] the appellants were inter-State stage carriage operators stationed in Ajmir. Their vehicles had to pass through the territory of Rajasthan

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17. Atiabari Tea Co. v. State of Assam, A.I.R. 1961 S.C. 232.
18. Automobile Transport v. State of Rajasthan, A.I.R. 1962 S.C. 1406.
19. For an illuminating comment on these two decisions, see S.N.Jain, "Automobile Transport (Raj.) Ltd. v. State of Rajasthan--Validity of Rajasthan Motor Vehicles Taxation Act, 1951 under Article 301 of the Constitution", 4 J.I.L.I. 291 (1962).
20. Supra, n.17 at 254.
21. Supra, n.18.

State. The State of Rajasthan imposed tax on their vehicles under the Rajasthan Motor Vehicles Taxation Act, 1951. This was challenged as violative of the freedom guaranteed under Part XIII of the Constitution. The Court held that a tax may restrict or impede the freedom of trade and commerce, but only that law imposing taxes which directly and immediately restrict the trade and commerce will be violative of Article 301. Taxes which are of regulatory or compensatory nature do not come within the prohibition. A tax on motor vehicles yields revenue to the State which maintains its roads and thus is obviously compensatory in nature. The postulate that regulatory and compensatory taxes are not violative of Article 301 was a step ahead of Atiabari.[22] The expanse of freedom adumbrated by the Supreme Court in Atiabari that Article 301 guaranteed freedom of the widest amplitude--freedom from prohibition, control, burden, or impediment in commercial intercourse--did not find full support in Rajasthan Automobiles.[23] Of course, the majority in the latter case accepted the majority view of the earlier case, but subject to an important clarification that 'regulatory measures or measures imposing compensatory taxes for

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22. Supra, n.17.
23. Supra, n.18.

the use of trading facilities do not come within the purview of the restrictions contemplated by Article 301 and such measures need not comply with the requirements of the proviso to Article 304(b) of the Constitution'.[24] Though this statement appears to be clarificatory, it substantially altered the dictum of the former case.[25]

The prohibition incorporated in Article 304(a) against discriminatory tax by the State deserves detailed examination. Article 304(a) is the only provision in part XIII which directly deals with the power of the State to tax, with the built-in prohibition against discriminatory taxation. Under this clause the State can impose on goods imported from other States any tax to which similar goods manufactured or produced in the State are subject. The imposition of the tax should not amount to discriminationn between goods so imported and those manufactured and produced within the same State. The paramount policy of the provision is that goods produced in a State should not be thrown into a disadvantageous situation in comparison with similar goods

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24. Id. at 1424.
25. Justice Hidayathulla however, expressed the dissenting view on behalf of the minority that tax on vehicles was a direct impediment to the freedom of trade guaranteed by Article 301 and that the impugned tax was not compensatory. Id. at 1463, 1464.

imported from other States. In other words, goods produced and manufactured inside the State should be so taxed or not taxed that similar goods imported into the State may also be taxed or not taxed in a way which may not amount to discrimination.

Discriminatory taxation has a direct impact on inter-State trade and commerce. Even provisions which may at first sight appear as non-discriminatory may turn out to be highly discriminatory on close scrutiny. Firm A.T.B. Mehtab Majid[26] is an example. The assessee was a dealer in tanned hides and skins in Madras. He used to sell hides and skins tanned outside Madras as also those tanned in Madras itself. Under the sales tax law in Madras hides and skins, whether tanned or untanned, were subject to tax only at single point. Rule 16 of the Madras General Sales Tax Rules provided that untanned hides and skins sold within the State shall be liable to tax at the last purchase point.[27] It was also provided that tanned hides and skins imported from outside the State will be taxed at the first sale point within

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26. Firm A.T.B.Mehtab Majid v. State of Madras, A.I.R. 1963 S.C. 928.
27. Madras General Sales Tax Act (Turnover and Assessment) Rules 1939, Rule 16(1).

the State.[28] Another notable provision[29] in the Rule provided that tanned hides and skins produced and manufactured within the State would also be taxed at the first sale point. An exception[30] to these was that if tax has been proved to be paid already on the purchase point in respect of untanned hides and skins out of which the tanned hides and skins were produced the dealer shall not be liable to pay tax at the first sale point.

These provisions were challenged by the assessee as violative of Article 304(a) on the ground of higher incidence of tax on imported hides and skins than on indigenous hides and skins. This is so because the imported tanned hides and skins are taxed on sale point, whereas the locally tanned hides and skins are taxed only on the purchase price which obviously will be less than the sale price of tanned hides and skins. Further, the raw hides and skins purchased and imported from outside the State and tanned within the State and sold were taxable at the sale point even though untanned hides and skins were subjected to a levy on the purchase turnover only. It is this proviso to the sub-rule (2)

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28. Id., 16(2)(i).
29. Id., 16(2)(ii).
30. Id., 16(2), proviso.

of Rule 16 which did the mischief. On production of proof that untanned hides and skins out of which the tanned hides and skins were produced and sold later on had already been taxed on the last purchase point, the dealer of tanned hides and skins was given exemption from paying the tax. The result was that dealers were reluctant to import tanned hides and skins for sale or untanned hides and skins for tanning purpose. The above trend of argument by the assessee had been countered by the State of Madras on the following grounds, namely, (i) sales tax did not come within Article 304(a) as it was not a tax on the import of goods at the point of entry; (ii) 'rule' is not law by the legislature as envisaged under Article 304(a); (iii) the impugned rules did not impose the tax but only fixed the nature of the single point levy imposed by the provisions of the Act, and (iv) the impugned rule was made in tune with Section 5(vi) of the Act which provided for a single point levy at the point prescribed by the rules and not with an intention to discriminate against imported goods.

The Supreme Court referred to Atiabari[31] and Rajasthan Automobiles[32] and held that taxing laws which

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31. Supra, n.17.
32. Supra, n.18.

directly and immediately restrict the free flow of trade will hit Article 304(a) if the taxes imposed therein were not compensatory and regulatory in nature.[33] Justice Raghubar Dayal held that sales tax can neither be regulatory, nor compensatory. Sales tax was not a measure for regulating and trade. Sales tax was not a compensatory tax levied for use of trading facilities. He observed that sales tax which discriminates between goods of one State and of another offends Article 301 and will be valid only if it comes within the protection of Article 304(a).[34]

The Court did not accept the plea that the tax contemplated under Article 304(a) should only be an entry tax and not be a tax levied after the goods have entered the State.[35] The Court rejected the second plea and held that a rule framed in pursuance of a provision in the statute will have statutory force and is a law and thus Rule 16 is a law made by the State Legislature.[36] The third argument that the rule fixed only the point of levy and did not impose the tax was rejected, holding that the Rule "provides a step necessary for the imposition of tax".[37]

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33. Firm A.T.B.Mehtab Majid v. State of Madras, A.I.R. 1963 S.C. 928. at 931.
34. Ibid.
35. Ibid.
36. Ibid.
37. Ibid.

The Court further observed that fixation of point of levy of sales tax by a rule did not justify making a rule which discriminated between tax imposed on imported goods, and that imposed on goods produced and manufactured within the State.[38]

The Court also examined the question whether the impugned rule was discriminatory between hides and skins imported from outside the State and those manufactured or produced in the State. The cumulative effect of the different provisions in Rule 16 was that it did discriminate between those goods.

The Court made a deep probe into the provisions from the functional angle and exposed the mischief hidden therein. The Court observed:[39]

> "If the dealer has purchased the raw hides and skins in the State, he does not pay on the sale price of the tanned hides and skins. He pays on the purchase price only. If the dealer purchases raw hides and skins from outside the State and tans them within the State, he will be liable to

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38. Id. at 931, 932.
39. Id. at 932.

> pay sales tax on the sale price of the tanned hides and skins. He too will have to pay more for tax even though the hides and skins are tanned within the State, namely, on account of his having imported the hides and skins from outside, and having not therefore paid any tax (on purchase price)".

Mehtab Majid[40] is a typical illustration how the taxing power of the State, especially on sale or purchase of goods, be used as an instrument obstructing free flow of trade and commerce across the State boundaries. As stated in United Motors,[41] by virtue of Article 304(a) the commercial unity of India is made to give way before the State power of imposing any non-discriminatory taxes imported from sister States. The manipulative State stragegem in imposing taxes shrewdly, which prima facie look to be innocent, but a bitter pill with a sugar coat, is a clarion call for tariff wars between States and States making the inter-State dealers armless wounded soldiers. It is here that the provision under Article 304(a) assumes importance. It plays a peace keeping role

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40. Supra, n.26.
41. State of Bombay v. United Motors (India) Ltd., A.I.R. 1953 S.C. 252 at 257.

whenever attempts at tariff wars manifest themselves. Mehtab Majid is a case which went directly to the Supreme Court under Article 32 of the Constitution and thus obviously illustrates the important part played by the Supreme Court in keeping the discriminatory tussles among States at rest.

Within a few months the Supreme Court had to examine a similar problem in Bhailal Bhai.[42] Levy of sales tax on tobacco imported from outside the State, at the point of sale by the importer in Madhya Bharat was held to be discriminatory. There was no provision in the impugned legislation for a tax on tobacco leaves manufactured or produced in the State of Madhya Bharat. Relying on[43] Atiabari[44], Rajasthan Automobiles[45] and Mehtab Majid[46], the Supreme Court held that the tax is not saved under Article 304(a). Noting that the dealers who dealt only in home-grown and home produced tobacco were not liable to pay the tax and that by itself would bring in the vice of discrimination under Article 304(a), the Court observed:

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42. State of Madhya Pradesh v. Bhailal Bhai, A.I.R. 1964 S. 1006.
43. Id. 1009.
44. Supra, n.17.
45. Supra, n.18.
46. Supra, n.26.

"There can therefore be no escape from the conclusion that similar goods manufactured or produced in the State of Madhya Bharat have not been subjected to the tax which tobacco leaves, manufactured tobacco and tobacco used for beedi manufacturing, imported from other States have to pay on sale by the importer. This law is therefore not within the saving provision of Article 304(a)".[47]

The State of Madras tried to tide over the difficulty caused by Mehtab Majid by a legislative device. The State passed an Act[48] with a view to resolving the discrimination and authorising levy of tax.[49] Section 2 of the Act imposed tax in respect of the sale of dressed hides and skins. The scheme of levy was that tax was leviable on them

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47. State of Madhya Pradesh v. Bhailal Bhai, A.I.R. 1964 S.C. 1006 at 1010.
48. Madras General Sales Tax (Special Provisions) Act, 1963.
49. The Madras General Sales Tax (Special Provisions) Act, 1963 was preceded by an Ordinance. The relevant portion of the explanatory statement attached to the Ordinance stated: "The decision of the Supreme Court (in Firm A.T.B. Mehtab Majid & Co. v. State of Madras, A.I.R. 1963 S.C. 928) will result in claims for refund of tax being preferred by dealers in hides and skins already assessed under the impugned rule thereby resulting in huge loss of revenue and will also result in administrative complicatio It is therefore considered necessary to avoid these difficulties by removing the discrimination in the matter of le of tax in hides and skins pointed out by the Supreme Court and to provide for the assessment or re-assessment and the collection of the tax from the dealers in hides and skins without any discrimination by leaving the tax in all cases on the basis of the purchase price of the hides and skins in the untanned condition". See Hajee Abdul Shukoor and Co. v. State of Madras, A.I.R. 1964 S.C. 1729 at 1730.

only if no tax had been levied in the State on the raw hides and skins from which they were made. Raw hides and skins were taxable in the State at 3 paise in the rupee. The levy related to a period prior to the introduction of metric system of naya paise. The tax imposed by the Act was payable by the first seller in tanned hides and skins in Madras. The rate of tax was 2 per cent of the amount at which such hides and skins were last purchased in their untanned condition. The defect that was highlighted in Mehtab Majid, namely, taxation on the sale price of tanned hides and skins in one case and in effect on the purchase price of raw hides and skins on the other, the value of the former being higher than the latter, which resulted in discrimination, was then sought to be remedied by making a uniform levy. The levy was, as stated before, on the seller of hides and skins but calculated at two per cent of the last purchase price of raw hides and skins.

Under this scheme, a dealer who purchased raw hides and skins within the State of Madras, tanned and sold them was not liable to tax at the time of sale if the purchase was liable to tax. If the raw hides and skins did not so suffer tax, for any reason, at the last purchase point, the seller of tanned hides and skins had to pay tax. Similarly,

a dealer who purchased untanned hides and skins from outside the State, tanned them and sold the tanned hides and skins in Madras, was liable to tax.

Apparently the defect pointed out in Mehtab Majid[50] was cured. But a closer scrutiny would reveal one material point. While raw hides and skins was liable to tax at 3 paise in the rupee, sale of tanned hides and skins was taxable at 2 per cent, both being calculated on the purchase turnover. Three paise in the rupee amounted to about 1.6 per cent. Hence a higher incidence falls on tanned hides and skins imported from outside the State.[51]

This aspect was raised before the Supreme Court in Abdul Shukoor.[52] The Court held that the effect of the levy under the scheme of the rectificatory legislation[53] was the same as under the Rule[54] impugned in Mehtab Majid. In

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50. Supra, n.26.
51. At that period 12 paise constituted one anna, and 16 annas constituted one rupee; in other words 192 paise constituted one rupee. Two per cent of 192 paise amounts to 3.84 paise. Hence raw hides and skins were taxable at 3 paise, but tanned hides and skins at 3.84 paise in the rupee. The difference (84/192) works out to 17/1600th of a rupee.
52. Hajee Abdul Shukoor and Co. v. State of Madras, A.I.R. 1964 S.C. 1729.
53. Madras General Sales Tax (Special Provisions) Act, 1963, supra, n.48.
54. Madras General Sales Tax (Turnover and Assessment) Rules 1939, Rule 16(2).

Mehtab Majid discrimination was brought about, the Court observed[55], on account of sale price of tanned hides and skins being higher than the sale price of untanned hides and skins, though the rate was the same. In the present case though discrimination did not arise on that ground, there arose discrimination, the Court held[56], on account of the fact that the rate of tax on the sale of tanned hides and skins was higher than that on the sale of untanned hides and skins. The Court on this ground held that the provision in the Madras General Sales Tax (Special Provisions) Act 1963, discriminated against imported hides and skins. Abdul Shukoor thus lays down that difference in rate of tax can amount to discriminatory taxation not saved by Article 304(a).

It is true that a differential rate in levy of tax by a State between local goods and goods imported from other States will be violative of Article 301 and not saved by Article 304(a). Will differential rate of tax in different States for purposes of levy of the Central Act be violative of the freedom of trade and commerce? This question was involved in Nataraja Mudaliar.[57] The assessee, a dealer having his place of business in Madras, was assessed to tax

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55. Supra, n.52.
56. Ibid.
57. State of Madras v. Nataraja Mudaliar, A.I.R. 1969 S.C. 147.

under the Central Act. He challenged the validity of the assessment. One of the grounds was that the provisions in the Central Act, which authorised levy of tax at varying rates in different states on transactions of the same nature, were violative of freedom of trade and commerce, being hit by Articles 301 and 303(1).

The scheme of levy of tax under Section 8 of the Central Act was as follows. Inter-State sales to registered dealers and government, were liable to tax at the rate of two per cent.[58] In the case of sale of declared goods[59] the rate was the one applicable to the sale of such goods within the State. In respect of other goods, the rate was 7 per cent or the rate of tax applicable to the sale or purchase of those goods within the State which ever was higher.[60] If under the sales tax law of the State, sales of such goods were exempt generally or subject to a rate lower than two per cent, then in respect of them, for levy of central sales

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58. Central Sales Tax Act, 1956, Section 8(1), as it stood at the material time.
59. Goods declared under Section 14 of the Central Sales Tax Act 1956 as of special importance in inter-State trade. See Ch.XIV.
60. Central Sales Tax Act 1956, Section 8(2), as it stood then.

tax, that rate was applicable.[61] The State Government was authorised to grant exemption from tax and reduction in rate of tax.[62]

The contention raised before the Supreme Court was that the liability to pay tax on inter-State transactions depended upon the rate of tax prevailing in the State from which the goods are sold and that this hampered trade and commerce in so far as it gave preference to one State over another and made discrimination between one State and another and thereby violated the guarantee of freedom of trade, commerce and intercourse.

Addressing itself to the scope of Article 301, the Court observed that the freedom of trade and commerce is available against the imposition of barriers both intra-State and inter-State. Restrictions and impediments on trade, which are direct and immediate, would fall within the mischief of Article 301 and subject to the other provisions they would be void.[63] Taxes may come within the prohibition

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61. Id., Section 8(2A), as it stood then.
62. Id., Section 8(5) as it stood at the material time.
63. Supra, n.57 at 154.

of Article 301 when they directly and immediately restrict trade.[64] The Court observed that a tax may in certain cases directly and immediately restrict or hamper the flow of trade, but every imposition of tax does not do so.[65]

Parliament may by law impose restrictions on the freedom of trade and commerce in the public interest.[66] But such law imposing restrictions cannot be one giving or authorising the giving of any preference to one State over another or making or authorising the making of, any discrimination between one State and another.[67] In other words, the power conferred on Parliament to impose restrictions in the public interest is itself subject to a restriction against preferential and discriminatory legislation.

Can a law which is enacted for imposing tax to be collected and retained by the State amount to such a preferential or discriminatory legislation? Does the fact that different rates of tax existing in various States are applicable for levy of tax under the Central Act be discriminatory

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64. Supra, n.20.
65. Supra, n.57 at 155.
66. Constitution of India, Article 302.
67. Id., Article 303(1).

so as to affect the free flow of trade? The Court answered these questions in the negative.[68]

The Court pointed out that the rates of tax are not necessarily decisive of the free flow of trade. A variety of factors, other than tax, may influence the flow of trade.[69] Even if the rate is low, goods may not be purchased if the other factors are adverse. Similarly if other factors are favourable there may be free flow of trade notwithstanding the higher incidence of tax. A discrimination is there only when there is a differentiation not based on considerations dependent upon natural and business factors.

Under the scheme of the Central Act the State rate of tax is applied only in certain specific situations.[70] In such situations where the levy is geared to the rates prevalent in the State, no discrimination would arise. Further, the Central Act authorised the State to grant

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68. Supra, n. 57 at p.156.
69. Ibid. Such factors are, for instance, source of supply, place of consumption, trade channels, transport and communication facilities, existence of long standing business relations and credit facilities.
70. See Central Sales Tax Act, 1956, Section 8(2) and (2A).

exemptions, or lower rates tax in respect of inter-State sales. This indicates elasticity of rates consistent with the economic and other forces in the State. Rational rates of tax by States based on a variety of factors cannot amount to discriminatory legislation nor does it affect the flow of trade. The Constitution empowers the States to levy tax on intra-State sales. If leaving it to the States to levy tax on intra-State sales results in no discrimination in practice, the Court held, adoption of those rates for purposes of the Central Act, which is also a levy for the benefit of the States, can result in no discrimination.[71]

The question of differential taxation remains. There is difference in rate of tax between different States. A differential incidence in rate of tax was held to be discriminatory in Mehtab Majid[72] and in Abdul Shukoor.[73] The Court distinguished those two cases as dealing with different situations. Those cases related to a situation of discriminatory taxation by a State between goods imported from other States and those produced locally. It was for that reason hit by Article 301 and not saved by Article 304(a).

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71. Supra, n. 57 at 158.
72. Supra, n.26.
73. Supra, n. 52.

The present case is not one of discrimination by the State in the matter of taxation between local goods and imported goods, but one of differential rates of tax in different States. Article 304(a) has no application to such cases.[74] But the question was whether Article 303(1) was violated which prohibits discrimination between one State and another.

The Court held in Nataraja Mudaliar that the prevalance of different rates of sales tax in States, adopted by the Central Sales Tax Act is not determinative of giving any preference or making any discrimination and is not restrictive of freedom of trade and commerce. The decision in this case brings to focus an important issue of differential taxation by different States in respect of the same goods which has been held to be constitutionally permissible. A differential tax rate, other conditions remaining the same, is definitely a fetter on free flow of goods through trade channels. If goods are taxed in State A at a higher rate and at a lower rate in this neighbouring State B, persons in State A may be inclined to purchase it from the neighbouring State. This affects trade in State A. It may be that the transportation cost may dissuade persons in State A from purchasing it from State B. But if the transportation cost is

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74. Supra, n.57 at 159.

less than the high tax incidence which would otherwise be there, they will be inclined to purchase. A uniform rate of tax in all the States, it is submitted, will therefore be in the better interest of the trade and the consuming public.

If the difference in incidence of tax is not the result of discriminatory taxation but the result of difference in price of the goods there is no violation of Article 304(a). In Rattanlal[76] a contention was raised that the Punjab General Sales Tax (Haryana Amendment and Validation) Act, 1967 violated Article 304, since there was discrimination between imported goods and local goods in the matter of levy of sales tax even though the rate of tax applied was the same, the resulting amount of tax was different between imported goods and locally manufactured goods because of the difference in price of the two types of goods. Imported goods are more expensive than local goods by reason of expenses like freight being added to the price and when the same rate of tax is applied to both types of goods, the amount of tax payable on the imported goods will be more. The contention was that this heavier burden of tax is

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75. Rattanlal v. Assessing Authority, A.I.R. 1970 S.C. 1742.

violative of Article 304. This contention was rightly rejected by the Court. The Court observed that what is prohibited is the imposition of differential rates of tax by the same State on goods manufactured or produced in the State and similar goods imported in the State. When the taxing State is not imposing rates of tax on imported goods different from the rates of tax on goods manufactured or produced in the State, Article 304 has no application. The rate of tax was the same, in the case, on local and imported goods. The tax imposed on imported goods could not be said to be high because of the fact that when the rate of tax is applied the resulting amount of the tax is somewhat higher, because that is the result not of inequality in tax, but because of the difference in price resulting from the cost of production and importation from outside the State.[76]

A situation slightly different from that in Mehtab Majid[77] arose in V.G.Naidu[78]. Sales of dressed hides and skins were not liable to tax under the local Act if tax

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76. Id. at 1750. Justice Hidayattullah observed: "Even in the case of local manufacturers if their cost of production varies, the net tax collected will be more, or less in some cases, but that does not create any inequality because inequality is not the result of the tax but results from the cost of production of the goods or the cost of their importation".
77. Supra, n.26.
78. Guruvaiah Naidu v. State of Tamil Nadu, A.I.R. 1977 S.C. 548.

had been levied on the raw hides and skins at the last purchase point. Tax at a lower rate was imposed on dressed hides and skins imported from outside the State and sold within the State. On tanned hides and skins sold within the State, where they were produced from raw hides and skins imported from outside the State, tax was levied at a lower rate. The rate of tax on sale of dressed hides and skins so liable to tax was about half the rate applicable to raw hides and skins. The levy of tax on dressed hides and skins was held to be non-discriminatory. Sale of tanned hides and skins made out of imported hides and skins was subjected to tax. Similar sales of dressed hides and skins made out of raw hides and skins which had suffered the last purchase point tax within the State were not subjected to tax. Therefore it was argued that the levy of tax on the former is discriminatory. This argument was rejected by the Court. The Court observed that Article 304(a) did not prevent levy of tax on goods. What it prohibited was a levy which would result in discrimination between goods imported from other States and similar goods manufactured or procured within the State. The Court said:

> "The object is to prevent discrimination against imported goods by imposing tax on such goods at a rate higher than that borne by local goods since

> the difference between the two rates would constitute a tariff wall or fiscal barrier and thus impede the free flow of State trade and commerce".[79]

Observing that the question whether a levy of tax would be discriminatory would depend upon a variety of circumstances including the rate of tax, the Court held that the present case did not disclose such a discrimination. While raw hides and skins are subjected to tax at three per cent, in respect of dressed hides and skins when they were imported from outside and sold within the State, the rate was only one and half per cent. Similarly, when hides and skins were tanned in the State from raw hides and skins imported from outside the State and then sold in the State the rate was only one and a half per cent.

This levy, the Court held, was not discriminatory as it took into account the higher price of dressed hides and skins and also the fact that no tax under the State Act had been levied in respect of them.[80]

The Central Act prescribes a higher rate of tax in respect of inter-State sale to unregistered dealers and

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79. Id. at 551, per Khanna, J.
80. Ibid.

consumers. It adopts the State rate for the levy, if the State rate is higher than the rate under the Central Act.[81] Does this affect freedom of trade and commerce? Is the scheme constitutionally valid? This question arose in Sitalakshmi Mills.[82] Section 8(2)(b) of the Central Sales Tax Act was challenged as violative of Articles 301 and 303 of the Constitution.

The policy of law was to canalise inter-State trade through registered dealers over whom States have better control. A higher rate of tax imposed on inter-State sales to unregistered dealers serves some purposes. It discourages inter-State sales to unregistered dealers. It places such unregistered dealers on a par with the local consumers of the selling State. Prevention of evasion of tax is in the public interest. Exercise of the power to tax may also be presumed to be in the public interest. Even if tax at a higher rate imposes restrictions on freedom of trade and commerce, those restrictions are saved by Article 302. Hence the Court held that Section 8(2)(b) is not violative of the freedom of inter-State trade and commerce.

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81. Central Sales Tax Act, 1956, Section 8(2)(b).
82. State of Tamil Nadu v. Sitalakshmi Mills, A.I.R. 1974 S.C. 1505.

When the State rates were adopted the rate of levy will vary from State to State. The Court held that this is not violative of Article 303(1) in view of the decision in Nataraja Mudaliar.[83]

A tax on inter-State sale effected to an unregistered dealer, at rate lower than the local rate, would be discriminatory. Indian Cement[84] is a recent instance. The India Cement Company had its manufacturing unit in Tamil Nadu. They had sales offices in Andhra Pradesh and Karnataka. The State of Andhra Pradesh issued a notification, under the Andhra Pradesh General Sales Tax Act, imposing a lower rate of tax on sale of cement manufactured by cement factories in the State and sold to manufacturing units situated within the State making cement products. Obviously in respect of sale of cement by the India Cement Company, which had its manufacturing unit in Tamil Nadu and sale office in Andhra Pradesh, the concessional rate was not available. On challenge under Article 32, the Supreme Court pointed out[85] that the exemption was hit by Article 301. The prescribed rate of tax on sale of cement in Andhra Pradesh was 13.75 per cent. Under

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83. Supra, n.57.
84. Indian Cement v. State of Andhra Pradesh, (1988)(1) SCALE 43.
85. Id. at 51, 52.

the notification only 4 per cent tax was leviable in respect of the sale covered by it. Hence in regard to the local tax the indigenous producers of cement had a benefit of 9.75 per cent. This discriminatory treatment, not being saved by any of the other provisions in Part XIII, was violative of free flow of trade and commerce.

The case also involved the question of a lower rate of levy of tax on inter-State sale. The State of Andhra Pradesh and Karnataka had issued notifications imposing a lower rate of levy of central sales tax[86] in respect of inter-State sale to unregistered dealers. Under the scheme of levy of tax under the Central Act a higher rate of central sales tax than that applicable to inter-State sale of goods to registered dealers was leviable on such sales to unregistered dealers. The rate prescribed was 10 per cent or if the rate of tax under the local sales tax law was higher than 10 per cent, that higher rate was leviable. By notification issued under the Central Act, the State of Karnataka and Andhra Pradesh imposed a lower rate of 4 per cent tax only on inter-State sale of goods to unregistered dealers.

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86. The notification was issued under Section 8(5) of the Central Sales Tax Act, 1956.

The higher rate of tax was imposed in the Central Act with a purpose. It was to prevent evasion of tax. When sales are made to unregistered dealers evasion of tax becomes easy. States have better control if inter-State transactions are routed through registered dealers. Where higher rate of tax is prescribed, unregistered dealers in other States may not be in a position to gain any advantage by such inter-State purchase over those who purchase such goods locally. A reduction in the rate of levy was therefore held to affect free trade and commerce, contrary to the scheme of Part XIII of the Constitution. The notification was held to be ultra vires the Constitution.

The question involved in Associated Tanners[87] was whether item 9(b) in the Third Schedule to the Andhra Pradesh General Sales Tax Act was violative of Article 304(a). Under the Andhra Pradesh General Sales Tax Act item 9 in the Third Schedule prescribed for levy of tax on hides and skins. Untanned hides and skins, according to item 9(a), was taxable at the rate of 3 paise in the rupee[88] when purchased by a

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87. Associated Tanners v. Commercial Tax Officer, A.I.R. 1987 S.C. 1922.
88. For full facts of the case, see, judgment of the High Court of Andhra Pradesh in Associated Tanners v. Commercial Tax Officer, 1973 Tax.L.R. 2590.

tanner in the State of Andhra Pradesh at the point of purchase and in all other cases at the point of purchase by the last dealer in respect of them in the State. Tanned hides and skins, which were not so subjected to tax in the untanned condition, according to item 9(b), were taxable at the rate of 3 paise in the rupee when purchased by a manufacturer in the State of Andhra Pradesh, at the point of purchase by him. In all other cases it was taxable at the purchase point by the last dealer in respect of them in the State.

Under the scheme raw hides and skins locally purchased by a tanner was liable to tax on the purchase value. When it was tanned and sold there was no levy of tax under item 9(b). If untanned hides and skins were purchased from outside the State of Andhra Pradesh and tanned within the State there was tax on the sale of tanned hides and skins. The rate of tax in both the cases was the same. The difference lay in the fact that in one case tax was levied on the price of raw hides and skins and in the other on the tanned hides and skins.[89]

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89. It may be noted that the situation is similar to that in Mehtab Majid, supra, n.26, where in respect of hides and skins tanned within the State and outside the State, as also in respect of tanned hides and skins made from hides and skins purchased from outside the State, tax was leviable at the same rate, but in respect of tanned hides and skins produced from untanned hides and skins subject to tax under the State law at the purchase point no tax was leviable, which resulted in a situation of discriminatory taxation depending on whether the raw hides and skins were purchased from inside or outside the State.

A dealer who purchased untanned hides and skins in the State of Andhra Pradesh, tanned and sold them challenged the provision. The High Court of Andhra dealing with the contention observed that the case was similar to the one in Mehtab Majid and that if that decision had remained unaffected by subsequent decisions it could have held that item 9(b) of Schedule III was discriminatory and unconstitutional.[90] In the view of the High Court of Andhra Rattanlal[91] and Nataraja Mudaliar[92] applied a test different from that in Mehtab Majid and in the light of those two decisions item 9(b) of Schedule III was not discriminatory and did not offend Article 304(a) of the Constitution.[93] The Supreme Court, in appeal, upheld the decision of the High Court. The Court observed that the rate of tax was the same both for the goods transported from outside as well as local goods and it would not be said such tax was hit by Article 304.[94] In coming to the conclusion the Court referred to the decisions in Nataraja Mudaliar and Rattanlal.

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90. Supra, n.88 at 2595.
91. Supra, n.75.
92. Supra, n.57.
93. Supra, n.88 at 2596.
94. Supra, no.87 at 1925. Justice Sabyasachi Mukherji speaking for the Court said, "In the instant appeal before us the tax was at the same rate. It cannot be said to be higher in respect of the imported goods. When the rate is applied the resulting tax might be somewhat higher but that did not contravene the equality clause contemplated by Article 304 of the Constitution".

Agreeing with the views expressed therein, the Court did not discuss in detail the prior cases, namely Mehtab Majid[95] and Abdul Shukoor. The Court brushed aside the consideration of those decisions after referring to Nataraja Mudaliar and Rattanlal and holding that Article 304 is not violated since the rate was the same and that it did not matter that the tax result was higher in one case when the rate was applied.

An examination of the facts in Associated Tanners[96] reveals one fact. The assessee was not a dealer who purchased raw hides and skins or tanned hides and skins from outside the State. He purchased the hides and skins locally, tanned them and then sold them. Therefore in his case there was no discrimination in the matter of taxation. The facts in Mehtab Majid and Abdul Shukoor were different. In Mehtab Majid the assessee had dealings in tanned hides and skins imported from outside the State. The scheme of levy of tax at the sale point in respect of imported hides and skins and on the purchase value of raw hides and skins in respect of the tanned hides and skins produced from locally purchased raw hides and skins, put a higher tax burden on him in respect of imported goods

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95. Supra, n.26.
96. Supra, n.87.

sold by him in comparison with locally tanned goods, with the result that it operated as a trade barrier in his case in respect of imported goods. In Abdul Shukoor[97] also the assessee was a dealer who purchased hides and skins from outside the State. No such situation was there in Associated Tanners[98] as the assessee purchased hides and skins only from within the State.

The fact that there was no discrimination creating an invisible barrier for trade in his case, might have been the inarticulate premise which persuaded the Court not to apply the dicta in Mehtab Majid and Abdul Shukoor, to Associated Tanners.

There was one point of similarity between Nataraja Mudaliar[99] and Associated Tanners. In both, the scheme of levy under the Central Act gearing the rate of levy to the local sales tax law was involved. But there is also a material difference between Nataraja Mudaliar and Associated Tanners. In Nataraja Mudaliar the question was whether a provision in the Central Act adopting the rates of tax under the State Act

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97. Supra, n.52.
98. Supra, n.87.
99. Supra, n.57.

was violative of the guarantee of freedom of trade and commerce. The question in that case was not whether the provisions were violative of Article 304(a). In Associated Tanners the question raised was not one of differential rate of tax in different States, but of incidence of differential tax in the same State resulting in discrimination between imported goods and local goods. The question involved therefore was not one falling under Article 303 but under 304(a). Application of Nataraja Mudaliar to Associated Tanners does not appear to be fully justified.

The question of violation of Article 304(a) was raised only incidentally in Rattanlal.[100] The substantial question in that case was whether the provisions in the State enactment did offend Section 15 of the Central Act.

Domestic tariff walls and narrow trade barriers are anathema to a federal polity. In regulating inter-State commerce protection from discriminatory treatment is of supreme importance in a big country like India. Part XIII of the Constitution assumes significance in this context. However, the admittedly clumsy provisions in this Part have been the subject matter of severe criticism. In resolving disputes

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100. Supra, n.75.

in this area, naturally, courts are burdened with a heavy task. The provisions are designed to ensure freedom of trade, commerce and intercourse and to circumscribe restrictions that may be put on free movement and exchange of goods throughout the Indian territory. That indeed is essential for the economic unity of the nation and for sustenance and improvement of living standards of the people. The economic unity is fundamental to stability and progress of the nation politically and culturally. In construing the provisions courts have always to balance the clashing interests--the business interests of the trading class, the welfare goals of the consuming public and the revenue needs of the administration.[101] The inevitable result is that freedom must be tempered with restriction imposed by the State in the interest of public welfare. The dispute resolving mechanisms should be conditioned by a comprehensive approach to the problems of the nation. The real enquiry must be whether the freedom of trade and commerce has been impeded. Viewed from this angle juristic expositions generally display a wholesome trend.

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101. Rapid economic development is a primary goal of all developing countries. See B.B.Goenka, Corporate Taxation, p.1 (1985). See also Menon and Mysore, Laws Relating to Government Control Over Private Enterprise, p.385 (1970).

PART V
EMPIRICAL STUDY AND CONCLUSIONS

Chapter XVI

EMPIRICAL STUDY: PUBLIC RESPONSE ON PROBLEMIC AREAS

Certain questions that arose in the discussion of judicial decisions and taxation policy were digested in the form of a questionnaire[1] which was put to a cross section of society. This was with a view to assessing the impact of the existing law on our developing economy and to knowing whether any change is necessary. Law derives its strength from public opinion. Public opinion reacts to the legal norms. It is important to decipher how public opinion creates law and how law creates public opinion.

The people who responded include the merchant community, a section of the consuming public, and experts from administrative, professional and academic fields. This chapter is an analysis of the responses from these people. The questions relate to tax immunity to sale and purchase connected with export and import, the need for altering the list of goods declared by Parliament to be of special importance in inter-State trade or commerce, the problems arising out of transfer

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1. For questionnaire, see Appendix D.

of goods through branches, the desirability of a uniform sales tax code and to the impact of border check-posts on inter-State trade.

Seventy-two persons from different walks of life answered the questionnaire. The persons who responded to the questionnaire are categorised into three main groups:[2] the merchant community, the consuming public and the experts. The experts are of five types, namely, (a) officers of the Kerala Sales Tax Administration, (b) senior officers retired from the Kerala Sales Tax Department, (c) professional men like lawyers and chartered accountants, (d) economists, and (e) academics from disciplines of law and commerce.[3]

Exemption from tax and promotion of export

The question whether tax immunity for export trade should be extended to more transactions than the existing ones has relevance in the context of the need for encouraging

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2. To the total responses, the percentage of different groups has been as follows: Merchant community 17 per cent, Consuming public 25 per cent, and Experts 58 per cent.
3. Of the experts the percentage of the sub-groups has been as under: Officials 12 per cent, Retired senior officers 12 per cent, Professionals 31 per cent, Economists 24 per cent, Academics 21 per cent.

foreign trade. The sale immediately preceding the export is already exempt subject to conditions. There may be more transactions in the chain leading to export. The question is whether all those transactions are to be exempted. Will further extension of the exemption be beneficial to economic growth through export orientation? Would it be an impetus to export trade? The question indeed assumes importance at a time when the country faces crisis in foreign exchange. The choice is only between the two--export or perish.

The trade and commerce circles[4] take a definite positive stand in support of further exemption to export. A leader of merchants pointed out that the rate of sales tax is the highest in India. The tax is absorbed in the price. Price is one of the decisive factors in foreign market riddled with severe competition from different countries. In such a contingency it was pointed out that tax exemption will have tremendous influence upon export trade. A Company Executive expressed the view that exemption should not be confined to actual or penultimate export sale. Apart from these, transactions closely and inseparably

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4. Ninety-two per cent of the merchants, who responded strongly advocated for extension of exemption to all transactions relating to export while eight per cent abstained from expressing any view.

connected with export should be given exemption. Such transactions, he said, should be treated as 'deemed export' for the purpose of giving tax concession. Incapable of giving competitive global tenders for supply of goods the Indian exporter is driven out from the foreign market. Everything being equal, the tax element pushing up the price may tilt the confirmation of the contract in favour of an outsider. Though it is only one of the unfavourable factors to the export trade from India, price is a factor to be seriously reckoned with. The opinion of a Commercial Manager of a reputed private company is not different. According to him Government's desire for a big leap forward in export can never be realised without more tax immunity and resultant reduction in cost of goods facilitating international trade.

The response from the public also exhibits massive support for a liberal exemption from tax on transactions connected with export.[5] The consensus is that further exemption will push up export. It will be a worthy step in the direction of earning more foreign exchange, especially

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5. Eighty-nine per cent of the consuming public pleaded for a liberal approach. While 5.5 per cent is satisfied with the status quo, another 5.5 per cent did not properly respond to.

when India faces a crisis of adverse balance of payment. Such a policy would also enhance trading activity and opportunities of employment within the country. A consumer commented that Government policies in this regard should not be too rigid. According to him a policy which was noble and right at one time may be suffocating or unsuitable at another. Rigidity in economic policy leads to strife and stress. Therefore periodical review of the policy is desirable.

Men in the realm of affairs of the Sales Tax administration are totally opposed to the idea of giving further exemption to sale connected with export mainly on the ground of resultant loss of revenue to the States. Besides, they felt, there is likelihood of raising fictitious claims of exemption. Verification of such claims would be impracticable.[6] A former Deputy Commissioner of Kerala Sales Tax Department noted that by a new provision exempting sale immediately preceding the actual export, States incurred huge loss of revenue. If exemption is extended, there may not be any transaction left in the chain liable to be taxed.

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6. All the senior officers retired from the Sales Tax Department fully concur with this view.

Response from professional experts like lawyers and chartered accountants were in favour of a liberal policy of exemption to export oriented sales.[7] Chartered accountants familiar with the ins and outs of tax burden hold that existing exemption scheme is not helpful to the exporter and that indirect taxes increasing the cost should not be imposed.

It is interesting to note that while the officers in the sales tax department were against exemption, a lawyer who defended many cases for the department whole-heartedly supported the policy of widening the exemption in order to increase export trade. He, however, cautioned that there should be sufficient safeguards for preventing unscrupulous dealers from misusing the provision for exemption. One of the reasons why the present scheme would suffice was that more exemption would mean more litigation since it is not easily ascertainable whether or not the exemption claimed related to goods ultimately exported.

Economists[8] expect a boost in export if a policy of liberalising exemption is adopted.[9] However, a

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7. Forty-six per cent welcomed, 8 per cent conditionally supported, 31 per cent opposed and 15 per cent did not respond to the question.
8. Working in universities, colleges and other institutions.
9. Ninety per cent of the economists who responded held this view. Only 10 per cent disagreed.

University Professor of Economics observed that many exporters do not get the benefit of tax exemption. This may be due to cumbersome procedure. According to him the bottleneck that affects production should be eliminated. Tax immunity, according to him, is a small measure which by itself may not bring major upheaval. Another economist suggested that the fall in revenue should be reimbursed to the States by the Centre.

Academics from the disciplines of law and commerce do not seem to be vehement in their support for l liberalisation of tax exemption. They were divided on the issue.[10] A novel suggestion put forward by one respondent is rebate in the place of exemption. When goods are exported the course of the anterior transactions must be traced back, and rebate of tax should be granted to earlier sales on production of proof of actual export. This method has an implicit advantage. Dealers will not be in a position to raise false claims of exemption stating that the sales were connected with export.

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10. Thirty-three per cent are in favour of liberalisation. An equal percentage, expressed a negative view. The rest did not make any remark on the issue.

A perusal of the views indicates the growing awareness on the need for encouragement to export trade. India is warming up for a record jump in the export front. Where our balance of payment position is in a deplorable state[11] and import needs for outweigh export earnings, it is necessary to fill up existing trade deficit by balancing foreign exchange earnings against import.[12]

No doubt that tax exemption alone cannot step up export. A confluence of a variety of favourable factors such as friendly relations, mutual co-operation between countries, advanced technology, expertise, quality and price is necessary for the purpose. A condition akin to open market situation often exists in foreign market[13] which turns the world market into a buyer's market where price and quality are of prime importance.[14] It is regrettable that even then the Indian export structure has not changed to any significant extent.[15]

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11. It is commented in an editorial: "The steep drop in the foreign exchange reserve by Rs.1900 crores in the first quarter 1988-1989 has caused concern". The Economic Times, August 6, 1988 (Bombay).
12. Jay Narayana Vyas, Imports of Capital Goods and Raw Materials, Introduction, p.1 (1985).
13. T.A.S.Balagopal, Export Management, p.162 (1977).
14. Kalipada Deb, Export Trade in India, p.301 (1976).
15. R.N.Tripati in Foreword to B.N.Tripati, Export and Economic Growth, p.vi (1985).

In framing the export strategy a proper stock-taking and analysis of the entire situation of the world market are necessary. The price of the exportable commodity is one of them. The trade tax has a definite drawback. It discourages export[16] since price is an important factor that influences procurement of orders of export.[17]

A decline in export is visible in respect of certain goods due to price factor. Examples are the dwindling export in South Indian tea[18] and cashew.[19] The adverse circumstances in the international market must be viewed in the background of the alarming balance of payment position. Considering this the export target has been raised by 20 per cent to the export performance of the last year.[20]

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16. The Economic Times, July 21, 1988 (Bombay).
17. An editorial of a commercial daily comments: "The bald truth about export is that they face a number of constraints internally as well as externally. High cost of production have not come down which affect the country's competitiveness in the world market". Business Standard, August 11, 1988 (Calcutta).
18. In 1987 the export of tea declined to 34 million Kg. from 47 million Kg. in 1980 and 62 million Kg. in the previous year. The fall in export is attributed to, among other things, to lower prices of Sri Lankan tea. The Economic Times, August 1, 1988 (Bombay).
19. The high price for raw cashew fixed at Rs.15.48 per Kg. (including sales tax) by the Kerala Government has resulted in Indian cashew kernel being out-priced in the internationa market by Gautimala. Financial Express, July 9, 1988 (Bombay).
20. The Economic Times, Editorial, August 6, 1988 (Bombay).

Tax has its adverse impact on export. The plea for a further tax cut is therefore justified. The apprehension of misuse of the concession shall not be a criterion to reject the plea. Such apprehension is applicable to any suggestion. Misuse should be checked by evolving effective implementation procedure.

The fear of loss of revenue to the States is baseless. When exemption results in increased export, national interest is better served. The revenue loss to the States should be compensated by the Centre. When balanced against the revenue loss to the States, the economic advantage in the form of augmented foreign exchange earnings resulting from increased export should be treated as more important.

Exemption and Import

Is there any need for changing the policy of exemption from sales tax on import generally? In other words, is there any need for extending exemption to more transactions after the import? This question also has relevance today.[21]

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21. The proposal of the Commerce Ministry before the Law Commission at a time when the Central Act was about to take shape may be recalled. The proposal was to give tax exemption on sale immediately preceding the export. The Law Commission had turned down the proposal stating that similar exemption was not mooted by the Ministry in respect of first sale after import. The Commerce

(contd...)

The majority of the merchants thought that exemption is to be extended to import.[22] An expert working as the Secretary of a Chamber of Commerce suggested that the loss of revenue to the States on this exemption should be compensated by the Centre. An industrialist, however, seeks to impose some limitations on the exemption. According to him exemption should be extended only to (1) those goods utilised for export-oriented production; (2) those goods which are not indigenously available, and (3) those goods, the use of which are capable of generating more employment opportunities. In the eyes of a merchant organisation activist sales tax on imported goods increases cost and it does not provide an encouraging trend. An executive in a public sector undertaking pointed out the anomaly that whilst direct import is exempt from the levy of tax, an actual user who imports through canalising agency will have to pay tax in certain circumstances. According

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(f.n. 21 contd.)

Ministry's proposal to exempt from tax the sale immediately preceding the export was later implemented through introduction of Section 5(3) of the Central Act. The question whether exemption should be given to sale after import is pertinent in this context.

22. From the merchant community 50 per cent voted for tax exemption on imported goods. Thirty-three per cent voted against such exemption and 17 per cent stated that they have not fully studied the problem.

to him when import could be made only through Government agencies such import must be given exemption. A top executive of a private tyre manufacturing company holds the view that extension of exemption can be justified only when the imported goods are utilised for the manufacture of export-oriented goods and when the ultimate product could be sold out in foreign market at lower price. The respondents who want to continue the present system of taxation have not given any cogent explanation to substantiate their stand.

Among the consumers[23] those who are in favour of further tax exemption put forward several suggestions. Exemption should be restricted to essential products so that foreign exchange may not be depleted unnecessarily. It has been pointed out that items which have a bearing on the upgradation of technology must be given exemption.[24] Any

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23. The majority of the consumers who responded to the questionnaire, namely 44 per cent, supported the view of liberal exemption. Twenty-eight per cent, however, opposed this view. Another 28 per cent did not express any specific view point on the question.
24. Such a view is held by an expert on cost analysis. According to him the concession should be limited to those goods which will be utilised for re-exporting. The concession indirectly helps export trade.

step towards industrial activism and economic regeneration is welcome. Import is not allowed freely. Only goods considered to be necessary under the Import Policy are allowed to be imported. It is therefore only logical that exemption is given at all stages.

Consumers who oppose further exemption champion the cause of State revenue and seek to avoid import for tapping of the untapped indigeneous resources.[25] However, it has to be conceded that import of machinery, technology and inevitable raw materials will have to be continued for some time. Ultimately, we should update our technology and stop imports, as far as possible.

Among the experts, the officers who man the administration entertain views both for and against the widening

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25. The States are economically weak and if the existing source of revenue is taken away the States will be further weakened. The direct import purchase and the purchases while the goods are in transit from a foreign country to India are already exempt under the Central Act. It is observed that these exemptions are sufficient. Still another view is that India being a country with ample resources must tap all the untapped resources and import must be discouraged at any rate. Import will jeopardise the balance of payment position. Minimum import and maximum export is the wise policy.

of the exemption. Many stand for maintaining the status quo.[26] While one officer feels that the benefit of exemption goes only to large business houses and not to the people as such, another working in a legal wing of the administration said that more concessions on imported goods would hamper the interest of native industries. It is also said that extension of concession to any further stage may not be necessary because chances for subsequent sales of imported goods are rather remote. Imported goods are generally raw materials and machinery for the purpose of industries and they will not go beyond one step after the import.

The second category of experts, senior officials retired from the Sales Tax Department, unanimously opposed any further exemption on the ground of fall in State revenue. A minority, however, thought that in the case of raw materials the exemption of one transaction after import would be a boon to small industries.

The next category of experts, professional lawyers and chartered accountants, are divided in their

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26. While 80 per cent of the officials did not agree with changing the existing pattern, 20 per cent welcomed a change.

attitude.[27] A Chartered Accountant urged the need for technological upgradation in some areas of the economy. One example is agro-based industries like export-oriented agricultural goods. Import of machinery may be required in key industries like fertilizers and steel. In his view tax exemption should be extended to such limited areas. An advocate stated that immunity should be extended to food-stuffs, and life-saving medicines. On the other hand, those who stand for the continuance of the existing scheme stated that manufacturers who hold actual user's licence can import the goods directly or through agent without incurring any tax liability. As no tax is being levied on import by manufacturer who is holding actual user import licence, they said, no further exemption is necessary.

Economists[28] are found to be not generally in favour of further exemption on sale of imported goods. Those who supported think that exemption is necessary for

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27. While 54 per cent of them opposed the concession, 46 per cent argued for bettering the present formula with a view to creating a favourable climate for enthusiastic manufacturers and industrialists.
28. Fifty per cent expressed their dissent against further exemption. Twenty per cent expressed no comment and 30 per cent favoured tax exemption.

domestic economic development. Those who dissented have not given reasons for their negative stand. The academic response also on the issue is mostly not in favour of tax exemption.[29] No new argument, either for or against, has been advanced by the academics.

Import of Raw Materials and Exemption

Import of raw materials stands on a different footing. The effect of a liberal policy of tax exemption for import of raw material is not without significance. It is also to be assessed how far a liberal policy could be beneficial to national interest. The response to the question is quite different from that relating to policy of exemption in regard to import generally.

Here also the majority of merchants are in favour of exemption.[30] The main reason for demanding more tax concession is that it will reduce production cost of exportable goods. The President of a Chamber of Commerce supporting

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29. Support for further exemption comes only from 33 per cent. Fifty-six per cent of the academics said an emphatic no, and 11 per cent kept aloof from expressing any comment.
30. Sixty-six per cent of the merchant community canvassed for a liberal policy of tax exemption in regard to imported raw material. Only 17 per cent of them opposed it. Anothe 17 per cent made no comment on the issue.

liberal exemption points out that sale of the product does not depend on the exemption factor alone. Production cost is affected by various factors including wage structure. A person engaged in packing business observed that liberal tax exemption would be beneficial to export oriented units. A tyre manufacturer in the public sector states that price of tyre will definitely be reduced if Government allows tax concession. According to him, if the import of raw material is meant for re-export after manufacturing process the exemption policy would be beneficial. Any policy leading to increase in productivity is a sign of growth. It brings more employment and economic stability. If the policy does not work in that direction, it will be a drain on our economy.

Consumers also are in favour of exemption.[31] One sounds however a note of caution: an excessive liberality may discourage the use of domestic raw material. A Cost Analyst of a public undertaking is of the view that a liberal policy of tax exemption in respect of imported raw materials can be considered only in those cases where they are absolutely

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31. Of the consumers, the response from 61 per cent shows a favourable trend for liberalisation of exemption in respect of imported raw materials. Twenty-eight per cent did not favour further liberalisation. Eleven per cent expressed no comment.

essential for the purpose of production and are not available in the local market. A consumer points out that if imported raw material is tax-free and duty free, it will save 50 per cent material cost to industry.

Among experts, the proverbial opposition of the officers of the Sales Tax Department to liberalisation is to be noted from the responses.[32] Their view appears to be that India is a developing country and for the prosperity of the nation every resource available in the country has to be exploited and utilized to the maximum instead of relying on import. Tax exemption on import will affect industries using indigenous raw material. Retired officers are worried more in the fall in State revenue.[33] The concession may not, in their view, serve the overall national interest. Revenue is needed for financing various development projects. Tax concession, it is argued, will therefore be detrimental to the national interest.[34]

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32. Eighty per cent of them did not approve the policy of giving exemption to raw material.
33. Of the senior retired officials of the Sales Tax Department, 60 per cent is not favourable to any further exemption, inasmuch as it would lead to appreciable fall in State revenue.
34. However, 40 per cent of the retired officers supported a liberal exemption policy.

The responses of the professionals to this question reveal massive support for liberalisation.[35] The consensus is that the concession need be given only to industrial raw material meant for production of exportable items and that too only when such raw material produced in India is of poor quality. It is pointed out that certain imported raw material may be beneficial to industrial development in point of cost. At the same time the market for domestic raw material should be kept up. Import of raw material without taking into account the internal resources will not be in the national interest. Tax policy on imported goods should be formulated without causing hardship to traditional sectors. It is pointed out that employment potential will not be adversely affected if only raw materials which are not available in India are imported.

A lawyer specialising in tax law strongly pleaded for exemption, especially in the case of small scale industrial units. These units do not directly import raw materials. They depend upon an importer for the purpose. They incur tax liability. On the other hand, a direct importer who uses the imported raw material in his own

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35. Eighty-five per cent emphasised the need for giving exemption while only the rest disagreed.

factory has no tax liability. Such direct importers are major industrialists. This anomaly in the case of small scale industries has to be remedied, he pointed out, by a liberalised tax policy.

The economists are equally divided in their opinion. The liberalists believe that such a measure would give a further fillip to economic growth and development by increasing the competitive efficiency of the Indian industry.[36] Efficiency being the prime concern of the economy, it is time that we put a stop to the spiralling taxes and mushrooming of sick industries. A policy that will facilitate production and thereby enhance the welfare of the people must be adopted. The antagonistic view is that due to import consumption of domestic raw material will be reduced. Dependence upon foreign sources for the sustenance of Indian industry is ill-advised.

Academic opinions reflect conflicting views.[37] It is remarked that if import is to make up deficit in

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36. A Professor of Economics who guides several research programmes in a University Department of Applied Economics welcomes the measure.
37. Fifty-six per cent of the academics is in full agreement with extension of the exemption. Twenty-two per cent disagreed. Eleven per cent extended conditional support. Another 11 per cent did not respond to the question.

domestic production, it is quite welcome, because it will help making full use of the capacity of the industry. An enthusiastic advocate of industrial growth is of the view that obviously the policy of extending the exemption from tax will inspire confidence in the minds of the indigenous entrepreneures of industry. Growth of indigenous industry serves national interest. It is not by imposing tax that industry and trade have to be regulated. To tax is to discourage them. What is needed is imposition of stringent restrictions and disciplines on the production front. A law teacher conversant with taxation, views the problem from a different perspective. According to him, a liberal policy of taxation can in no way boost import, for import is regulated by the State. When imported raw materials are used for production of exportable goods a tax on import is really a tax on export. A Professor of Statistics sounds a note of caution that dependence on foreign sources is not good. Just because they are available in plenty outside India, we should not go after them. We should find our own sources. The nation faces severe unemployment problem. Indian industry will flourish only if we make full use of our own natural resources and the huge indigeneous manpower.

There does not appear to be much enthusiasm towards a policy of tax exemption in respect of all imported goods. But in the case of import of raw materials the trend is different. Clearly majority of the respondents assert the need for extending tax exemption to imported raw materials. Personnel currently managing the sales tax administration and those retired from the sales tax department appear to be anxious more about the fall in revenue to the States, which can be remedied by a measure of appropriate relief to the States by means of aid from the Centre. The increased industrial activity, better employment opportunities and the resultant economic development are matters which should be balanced against the possible immediate loss of revenue to the States.

Goods of Special Importance in Inter-State Trade and Commerce

Goods declared by Parliament to be of special importance in inter-State trade and commerce have been enlisted in the Central Act.[38] The law relating to such goods has been discussed.[39] The idea is that 'declared

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38. Central Sales Tax Act 1956, Section 14.
39. See Ch. XIV.

goods' should not be subjected to tax by States at a rate more than that prescribed by Parliament. The list has not been revised for quite some time now.[40]

Should there be any change in the items of goods? Responses were obtained from different classes of society on this issue. Interestingly enough, no trader has opposed the idea.[41] A dealer who does business in the Cochin city for the last three decades is of the view that 'cement' should be included in the list. A Company Executive is of the view that the list should be enlarged in order to avoid the multiple effect of sales taxation. He has not named by commodity to be included. The President of a Chamber of Commerce stated that petrol, diesel and liquid petroleum (L.P.G.) should be included in the list. Such inclusion will however cause decline and fall in the State revenue. It is perhaps because of this Parliament is reluctant to interfere. The Chamber President suggests a solution that

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40. More than a decade is now over, without any change being effected, in the list of declared goods. After 7th September, 1976 no amendment has been effected and no new commodities added or the old one deleted. The amendment in 1978 (Act 38 of 1978) did not add any new item, but clarified an entry.
41. Out of the merchant community who responded, 42 per cent desires a change in the existing list. Fifty-eight per cent of this group does not give any answer.

the percentage of share due to the State from the central excise duty should be enhanced to compensate the fall.

The responses[42] from the consuming public indicate support for inclusion of more items in the list. The addition is canvassed on the ground that the list is intended to cover goods of importance in inter-State trade and commerce. The objective of the provision is to make such goods available at a lower rate of tax. The State levy is therefore controlled by the Centre. The design of control aims at industrialisation also since a number of raw materials are covered by the list. As it takes in only a few consumer items the present list, it is suggested by one, should be enlarged to include all goods of the day-to-day use of the consumer. This will reduce the burden of tax on the common man. Another said that the list should be reviewed from time to time so that unnecessary items could be eliminated and necessary items included. A view that deserves consideration is that the list must be prepared in consultation with the States and taking into account the overall economic climate of the country. An agriculturist holds the view that pepper and rubber should be added to the list.

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42. Sixty-seven per cent wanted to add more goods. Only 5 per cent of the consumers desired the present list to continue. Twenty-eight per cent did not express any opinion.

The experts differ in their views.[43] A high official in the sales tax department who is familiar with the legal problems has admitted that now the thrust of the list is more on raw material than consumer goods and suggested that more goods should be added.[44] Responses from retired officials are revealing as their opinions are not tainted by official bias. While one points out that expansion of science, industry and technology is one of the considerations, another seems to hold the view that certain goods should find their way in the list so that a particular State which produces those items in a large manner is not discriminated. Take the case of rubber. Rubber is almost a monopoly of Kerala as jute is of West Bengal. Jute is included as a declared item. It is only just and proper that rubber is included. In the view of still another retired official coir must be included, as it is an item of as much national importance from the standpoint of industry as jute. In the view of an officer who retired as a judge of the Sales Tax Appellate Tribunal more items such as metal and metal products, paper, edible oil, tea and coffee, milk and milk products, petroleum and its products, and drugs, allopathic, ayurvedic, unani or sidha, are to be included in the list.

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43. While 40 per cent of the officials wanted a change in the list, 60 per cent desired no such change at all. Among the retired senior officials, 80 per cent stands for radical change. Only 20 per cent wants the status quo.
44. He suggests that cooking gas and soap are inevitable items that should find a place in the list.

Experts from professional field[45] hardly show enthusiasm in altering the list. Those who wanted change include a lawyer who pleads for inclusion of tools and machinery connected with agricultural operation and small scale industries and another lawyer who stresses on the need for achieving uniformity in the rate of tax. The case for including medicines and chemicals used for manufacture of medicines was canvassed on the ground that tax on medicine is tax on health and Government should not take advantage of the misfortune of those who undergo medical treatment. Those who said that no change was necessary in the list do not care to give reasons for their stand and have to be regarded as not applying their mind to the problem.

Responses from the economists and academics are mixed,[46] but indicative of the application of their mind to the problems. A Professor of Commerce is of the view that one should not look at commodities as source of revenue for

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45. Only 31 per cent of them wanted change; 46 per cent opposed any change. Twenty-three per cent of the professionals did not express any opinion.
46. Among the economists 30 per cent wanted a change. Another 30 per cent opposed it and 40 per cent expressed no opinion. Among the academics 33 per cent supported change, 11 per cent opposed any kind of alteration and 56 per cent gave no response to the question.

the State. Any tax that tends to increase production and sale is preferable to that which causes reduction in production and sale. Policy of taxation should always be on an adhoc basis. Changes should be made whenever they are needed. Another professor of commerce thinks that free movement of essential commodities is necessary. A Professor of Law has his eye on uniformity. According to him, by adding goods to the list of declared goods, certain amount of uniformity in taxation could be achieved. Uniform tax code may be a distant goal. Still, inclusion of more goods in the list would be practicable than pursuing for total uniformity.

It is submitted that responses to the question of declared goods indicate the need for a fresh look. A trend in favour of inclusion of more essential goods and consumer items is evident. It would be appropriate that a study by a team of experts is held and a revision of the list to suit best the national interest is carried out.

Sales through Branch and Agency Deal

Dealings through branches or agents situated outside the State have created problems and generated confusion. The law demarcates the frontiers within which inter-State transfer of goods between head office and branch or between

principal and agent can operate. Such transactions without any sales being involved are clearly branch transfers and not exigible to sales tax. But when goods are despatched in connection with a sale through branch or agent functioning outside the State the nature of the transaction has given rise to disputes at all levels. The dispute is whether it is an inter-State sale, or branch transfer or sale by the branch to the buyer in the other State. The decision in each case ultimately depends upon the terms of the agreement between parties and the overall circumstances and the course of the transaction. This is an unsatisfactory state of law. Should the law specify conditions?

The majority of the merchants who responded have no doubt in their minds that the law should be made explicit by specifying the conditions.[47] A dealer said that if the legislature prescribes conditions for treating a transaction as transfer in cases other than the existing ones there will be less scope for dispute. According to a top executive in a large manufacturing concern the law is not clear in the matter. Manufacturing units that effect sale to out of State buyer through agent or branch office are often put to dilemma.

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47. Seventy-five per cent of them expressed the view that the law should specify conditions. Only 8 per cent opposed any change. Seventeen per cent did not say any opinion.

Consumers and experts vehemently support making of a new provision.[48] Some of the sales tax department officials lamented over the unsatisfactory state of the law. An officer who has sufficient experience in deciding appeals against assessments pleaded for clear rules and specific conditions to identify inter-State branch transfer from inter-State sale. Retired officers also concur with this view.[49]

The professional opinion is more in favour of detailed provisions pertaining to branch transfer of goods.[50] A lawyer expressed the view that though professional men may be in a position to know the intricacies of the law through judicial discussions, statutory prescription would be more helpful to dealers. A Senior Government Pleader who argues

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48. While 72 per cent pleaded for it only 6 per cent of the consumers desired no change. Twenty-two per cent did not respond. Experts also wanted more elaborate provisions in this area. Eighty per cent of the officials of the Sales Tax Department recommended modification of the existing provision. Only 20 per cent abstained from expressing any view.
49. Sixty per cent of the retired officials wanted to change, 40 per cent expressed the need for clear provisions.
50. Fifty-four per cent of the lawyers and chartered accountants voted for detailed provisions whereas 46 per cent was of opinion that the present state may continue.

cases for the State expressed his independent opinion and supported the idea of specifying the conditions in the statute itself. According to a chartered Accountant clear-cut provision of law will obviate to a large extent arbitrary and whimsical assessments.

The economists are not completely convinced.[51] Academicians are also for clearer provisions of law.[52] It has been pointed out that lacunae can be found out even if conditions are laid down, but that does not mean that prescription of conditions is unnecessary. Another view is that conditions can be prescribed, but they should not fetter the free movement of goods.

The fact that the members of the public are not generally satisfied with the present state of the law is clearly made out. The respondents generally feel, and quite

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51. Fifty per cent of the economists did not express any view in the matter, the question having no such direct bearing on economics as it has on law. However, 40 per cent of the economists felt that prescription of the conditions would better the position. Ten per cent of the economists said that the present position may continue.
52. Among academics 56 per cent desired for detailed provisions of law concerning transfer of goods from head office to branch or agent for delivery to the buyer outside the State. Twenty-two per cent of the academics desired to continue the law without any further change and another 22 per cent abstained from giving any opinion.

justifiably, that the legal position may be crystallised through statutory provisions. It is desirable to prescribe conditions under which a transfer of goods to a branch or agent connected with a sale will be treated as a transfer to the branch or to the agent for sale and not as an inter-State sale to the buyer through the branch or agent.

Uniform Sales Tax Code

Some time ago there was a strong demand that sales tax in all States should be replaced by additional duty of excise levied at the point of manufacture. States, however, resisted such a move.[53] Being a major source of revenue for the State, no State will be prepared to give up sales tax. No other source would provide for the State so much flexibility and revenue potential. Sales tax has become an inevitable and inseparable part of the State finance. The proposal for replacement of sales tax with excise duty is not currently a serious topic for discussion as in the past.

How far the plea for a uniform sales tax code applicable to all States justifies in the present context?

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53. Anirudh Prasad, op.cit., p.350.

The data gathered from the questionnaire shows strong support[54] from the merchant community for the introduction of a uniform code. A leader of the traders commented that it is a long pending demand of merchants. If the sales tax tariff is lower in the neighbouring States, the tendency of dealers will be to go over there and effect purchases at a lower rate. A Chamber of Commerce advocated for a uniform code applicable to all States. If for any reason uniform code is not practicable, uniformity at least on regional basis could be achieved. An idea was mooted by the Chamber that India can be divided into four zones for the purpose and zonal codes could be implemented. This will help, says the Chamber President, to reduce the deflection of trade from one State to another on account of differences in sales tax. It was stated that there are many instances of such shifting of trade from one State to another solely on account of difference in sales tax.

The opinions of consumers for a uniform sales tax code are unanimous.[55] This response reflects the need

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54. The positive response was as high as 92 per cent. Only a small minority of 8 per cent opposed the idea of a uniform code.
55. Hundred per cent of the consumers who responded favoured the code.

for uniformity in that branch of law affecting the consumer in a big way in their day to day life. It is correctly pointed out that in the absence of a code the same commodity may have different prices in different States due to varying incidence of rate of tax.

The Sales tax administration[56] and retired officers[57] supported the uniform sales tax code along with merchants and consumers. According to them if uniform code at national level is not possible, attempt at evolving a regional code may be made. If even that is not possible, at least uniform rates of tax could be adopted in a region. The only argument against the code is that it would be an onslaught on the State's power to tax. Sales tax is not merely a major source of revenue but also a flexible one. This flexibility will be lost when a code is introduced. Some States may not agree, it was pointed out, with the proposal for a uniform code. The majority of the retired officials hold that the code is capable of attaining uniformity in

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56. Majority of the officials, 60 per cent of them, stood for a uniform code; only 40 per cent was against it.
57. Eighty per cent of them highlighted the advantage of such a reform. Twenty per cent however was doubtful about is merits.

the scheme of legislation as well as incidence of tax. It serves to streamline the administration, obviates the present tendency for diversion of trade to the detriment of the economically and industrially backward States. To a certain extent the code will reduce the scope for litigations.

It is admitted that elasticity of revenue may be an advantage for the States. But elasticity is at times misused in levying tax with no regard to the hardship of the consumer and tax payer. A retired official who was at the helm of affairs of administration for a long time illustrated saying that when central excise duty is enhanced on petrol a corresponding decrease in sales tax on the item by the State can never be expected. According to him a uniform sales tax law helps inter-State trade in a better way. Elimination of the evil of multiple taxation is another gain of uniform code minimising irritation of the entrepreneur. Experts[58] are also for uniform code. According to them such a step reduces evasion of tax and make implementation and administration of tax law easy. Further still, since rate of tax is the same tin all States, inter-State trade will be

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58. Seventy-seven per cent of the advocates and chartered accountants expressed willingness for a code.

based on original cost of goods. This will develop a healthy competition among producers all over the country to keep the cost down. A lawyer advocating for the code remarked that the code should be simple and understandable to know the exact legal position. It is pointed out that uniform code will advance the economic and industrial activity in the country. The opponents of the code mainly urge that each State should have the freedom to decide how best it could augment its revenue since business trends vary from State to State depending upon a variety of factors like production of commercial crops, industrial climate and availability of raw materials.

Some economists are in favour of the code; some are against.[59] Majority of academics supported the code.[60] A professor of commerce regards it as ideal for encouragement of inter-State trade. There are several fundamental issues involved in the matter of imposition of a sales tax on commodities. Any tax structure that tends to increase

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59. Fifty per cent of the economists stressed the need for a uniform sales tax code. Thirty per cent of them opposed the idea, and 20 per cent abstained from expressing any view.
60. Seventy per cent of the academics welcomed the code, while 22 per cent of them expressed dissent. The rest did not make any comment.

sale and production are preferable to those that cause reduction in production and sale.

It is however not possible to introduce a uniform tax code governing sales tax by the Central Government. Sales tax is a subject within the exclusive purview of the States. A joint effort by the Centre and the States is called for in the matter. A uniform code would be convenient for the dealers, consumers and the administration. The moderate view that even if it is not feasible at all India level, to begin with, an attempt must be made to introduce a uniform code at regional level deserves serious consideration.

Check Posts: Do They Impede Inter-State Trade?

When sale or purchase is intra-State in nature the power to levy tax on such transaction is vested in the State. In respect of inter-State sale or purchase the power to tax is vested in the Centre. The power to check evasion of tax is incidental or ancilliary to this power. A trader may attempt to evade tax. Tax evasion is planned long before the initiation of the assessment proceedings. So the machinery to check evasion must operate in advance. Sales tax check-posts are established under sales tax laws of the State as a measure to check evasion of tax. Some of these

check-posts are functioning in interior parts of the State. They are called internal check-posts. Some of them are established on the borders of the States. They are referred to as border check-posts. The check-posts intercept the transport. In the absence of documents prescribed under the law an inference is drawn that an attempt at evasion is made. Goods are detained and released on payment of a security amount ordered by the check-post authority. When evasion is established the security amount is adjusted towards penalty of the offence.

The Central Act does not contain any provision for establishment of check-post. The check-posts functioning on the border are concerned with checking of transport of incoming and outgoing goods. The border check-post thus mainly aims at intercepting and checking inter-State movements of goods. The operation of the border check-posts established under the State sales tax law is not restricted to transactions in the course of intra-State trade and commerce.

How is check-post established by the State sales tax law viewed by respondents? Is it considered as a barrier to inter-State trade? Curiously the responses of the merchant

community are almost equally divided.[61] Those who think that check-post is a barrier say that dealers are subjected to harassment when goods are transported through check-post. It is stated that unauthorised and unaccounted transport is allowed to pass by accepting bribe. Corruption is said to be rampant in check-post. Border check-post is considered a barrier to free movement of goods. Different states prescribe different statutory forms and different procedures for transport of goods. Even the language of the forms, it is said, is not understood by some of the officers, manning the check-post. A former Member of the Sales Tax Advisory Committee in Kerala State holds that check-post is necessary for preventing evasion, but the way in which it is organised is questionable. Goods are to be intercepted only if evasion is suspected, but in practice even for insignificant or technical mistakes like clerical error goods are detained. Honest people are harassed more on account of silly and trivial flaws. A General Manager of a public undertaking said that honest traders are even intimidated in the check-post. According to him check-post is a centre of

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61. Forty-two per cent expressed the view that the functioning of the border check-post would be a barrier. However 58 per cent did not think so.

corruption. The officials humiliate even ordinary people carrying luggages not meant for trading. The dealers who justify the need for check-post condemn them for the corruption and harassment practised. A Company Executive has a horror for check-posts. He said that ordinary dealers do not take to inter-State trade due to corruption and intricate formalities.

The consumer view reflects a favourable trend for the check-post.[62] According to consumers it may be a barrier to inter-State movement but necessary to check evasion. When goods pass through check-post the transactions would be entered in the accounts. However if corruption reigns supreme in the check-post, the consequence is different. Even illegal payment made to officials would be passed on to the consumer and collected from him in the form of price. The remedy, however, does not lie in abolishing the institution. The flaw is not so much in the law as it is in the personnel who man the check-post. Personnel of honesty and integrity should be appointed in the check-post.

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62. Only 28 per cent of them considered that it is a barrier. Seventy-two per cent did not object to its continuance.

The procedure may be simplified, the time of detention of goods in the check-post minimised and harassment of dealers avoided.

The views of experts deserve special attention.[63] One official who worked in the check-post stated that the formalities prescribed for the transport of goods through the check-post are cumbersome and even goods transported by bona fide registered dealers with the required documents may have to be detained on technical grounds. Even non-dealers also have to comply with certain formalities while taking their goods through checkpost. However so long as dishonest dealers continue their malpractice of suppression and evasion check-post is considered necessary by a good number of people.

Majority of retired personnel consider check-post as a barrier.[64] The law does not prohibit a dealer who holds no registration under State sales tax law, or a private individual from purchasing goods inter-State. When

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63. Sixty per cent of the officials in the administration admitted that check-post is a trade barrier. Forty per cent disagreed with this view.
64. Sixty per cent of the retired senior officials considered check-post as a barrier. The rest did not think so.

such a person brings goods from outside the State the transport is obstructed suspecting it to be an attempt at evasion. It is interesting to note the view of a former law officer of the Sales Tax Department and later a Judge of the Kerala Sales Tax Appellate Tribunal who criticised the present functioning of check-post vehemently. Goods from one State to another have to pass through half a dozen check-post barriers resulting in delay, harassment and waste. According to him the border check-post must be manned jointly by the personnel of the two border States so that the number of check-posts could be reduced. A former Intelligence Officer who was in charge of the check-post in the State of Kerala thinks it as a necessary evil to prevent evasion of tax.

Professional response presents a mixed feeling.[65] One view is that regulatory measures to check evasion must be introduced without adversely affecting the freedom of trade. An advocate who was formerly a member of the Sales Tax Appellate Tribunal observed that border check-posts are certainly barriers to inter-State trade. It is inconceivable that one cannot transport goods freely from one part of the

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65. Fifty-four per cent emphasised the need for it. Others stood for its discontinuance.

country to the other without impediment. It is regrettable to see dozens of lorries parked on both sides of the check-post waiting to be cleared through. He feels that it is doubtful whether these check-posts fully serve the purpose for which they are established. A former Senior Government Pleader who conducts sales tax cases in the High Court stated that if a trader complies with the statutory formalities he would not find any difficulty in the check-post. A Senior Government Pleader currently appearing in tax matters stated that check posts are not trade barriers. This view, however, is contradicted by many.

Economists[66] generally consider the check-post a trade barrier. A noted economist observed that waste of time in the check-post, the malpractices and the creation of a divisional thinking in the minds of people belonging to different States are evils inherent in the process of checking. The hindrance in moving the goods would in turn lead to a reduction in aggregate production affecting the

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66. Eighty per cent of the economists who responded are of this view. Only 10 per cent approved it. Another 10 per cent had no comments.

welfare of the people. In the eyes of a professor of law[67] the ultimate victim of corruption was the consumer. Consumer sovereignty, an ideal goal in a welfare state, becomes a myth.

Responses to the Questionnaire: Beacon Lights

The responses to the questionnaire disclose many things. The need for giving further exemption to sales of export-oriented goods is re-affirmed by all sections of society. The loss of revenue which the States will have to incur in the event of a further tax cut has generated apprehension more in the minds of people concerned with the administration than in those of other sections. There is a need for refashioning the policy from a national perspective. The responses clearly favour a liberal tax exemption policy in respect of imported raw materials. A genuine demand for reform of the law governing inter-State dealings in goods through branches and agents has been made out. The need for enlarging the list of declared goods, the desirability for evolving a uniform sales tax code and the indispensability of revamping check-post administration are the other highlights.

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67. While 44 per cent of the academics who responded opposed the system of check-post, 56 per cent supported it.

Chapter XVII

CONCLUSIONS

The consequence of indirect taxation is now widely recognised. With massive dimensions, sales tax has a creative role in the economic life of the people. Needless to say that unimaginative impost may work as an engine of destruction affecting vital fabric of the economy. How to tax is, therefore, a baffling question. No wonder that there is difficulty in evolving an exemplary policy. This is increasingly realised in the realms of export and import as well as inter-State trade.

Multiple levy, by the Centre and by the States, strangulates the initiative for foreign trade. With great insight and wisdom, the architects of the Constitution therefore shaped the linchpin provision in Article 286 with the purpose of averting such a crisis. The provision prohibits the States from levying tax on sale or purchase of goods where such transaction takes place in the course of import into or export out of India. The intention is clear: incidence of a State levy should not be a hindrance to the promotion of foreign trade.

It seems that the Constituent Assembly passed the provision in haste. Members expressed doubts on the nebulous expression 'in the course of'. But these doubts were not paid due attention. Ambedkar's assurance to find out another suitable expression was not at all carried out.

In the early 1950s by interpretational device the Supreme Court liberated the constitutional provision from the narrow confines. The Court extended the coverage of immunity to a new category, namely sale and purchase taking place during the movement of goods from one country to another. Later it carved out one more category, namely, f.o.b. sales. The Court stopped at this point. This judicial restraintivism on the scope of the exemption is quite visible.

Purchase by or sale to the exporter is directly and inseparably connected with export. The Supreme Court ought to have recognised this fundamental reality while determining the ambit of the concept of export sale. Had the Court done so the course of history of taxation in this vital field would have been different. The Supreme Court should have acted as a Court of policy. Instead, the Court missed tremendous opportunities for showing the path of commercial development through judicial creativity. It could have widened the scope of the exemption. But it clung to the earlier formula.

The Taxation Enquiry Commission and the Law Commission of India had a complacent attitude. This is borne out from the fact that without studying deeply the ramifications of the issues involved, they gave a green signal for legislative adoption of judicial restraint.

The provision for exemption in the Central Act opened a Pandora's box. Judicial decisions did not indicate any consistent approach laying down guidelines. On the other hand, judicial conservatism asserted itself against the genuine interest of the export trade. Denial of tax exemption to export through canalising agency was a real blow. This is so when there was stiff international competition. It seems as though the Court had a rigid and less sensitive line of thinking.

The legislative measure to extend the immunity to transaction preceding the export was largely narrowed down by judicial interpretations. The legislative language, it is true, was ambiguous. A judicial gloss was the result. It wove more restrictions into the law. There is no rationale in laying down the condition that the purchase should be for the fulfilment of a prior export order. Even a contract with a local buyer to export must qualify for exemption. The policy must be to extend the exemption to any

sale culminating in actual export. The legislation hedged in by limitations imposed by the Supreme Court virtually nullify the full benefit of exemption to a large number of dealers. Obviously this state of affairs needs a change: the law requires a suitable amendment. It is necessary that the exemption be extended to all transactions in the chain leading to export.

India is on the brink of a crisis in foreign exchange. It is time that taxation policy is streamlined with orientation towards export. Cut in tax on export sale promotes export accompanied by more employment and prosperity.

States may not share the zeal for providing more exemption. This is so on account of the obvious loss of revenue. The anxiety of the States in the matter cannot be belittled. The States have to be compensated by the Centre in proportion to the export performance from each State. When this is done there would be no objection from States. On the other hand, the whole-hearted co-operation of the States in the export adventure is obtained. In any event, the Central Government must evolve a new strategy with the concurrence of the States. Export promotion must be viewed as a joint adventure of the industry, the Centre and the States.

In modern times no country is an island and can depend entirely on its own indigenous sources for survival. Growing interdependence among nations makes even advanced countries to rely on import. A developing country like India has to import not only essential consumer goods but also a variety of raw materials and equipments. Tax relief will doubtlessly have an encouraging impact on trade, commerce and industry. The enigma of decline of State revenue and the need for the industry to get tax concession for import can be solved only by policies formulated with insight and perception. In the import sector the law governing exemption does not appear to be in a satisfactory state. Denial of concession to the sale after import appears to be unjust. Exemption should be extended at least to the first sale or purchase after import in respect of raw materials. This would be positively helpful to industrial growth. Excessive taxation of such goods makes the industry unprofitable. Tax exemption promotes industrialisation.

The formulation of policy to regulate inter-State trade is fundamental to the economic growth and consumer welfare. A sagacious taxation policy can act as a mainspring of inspiration to trading activity throughout the length and breadth of the country. The constitutional scheme originally evolved for the purpose was excellent. But the

inconsistency in judicial decisions and lack of guidelines from the Court in the early days caused considerable difficulty. The overruling by the Supreme Court of its own eminently sensible judgment was an unwise step which necessitated the Central Act. The definition of inter-State sale in this new law appears to be unsatisfactory. The phraseology 'in the course of' added to the confusion in the case of inter-State sale.

In tailoring the definition of inter-State sale Parliament was adopting the view of a particular judge of the Supreme Court. The judge made a distinction between transport of goods outside the State under the contract of sale and transport subsequent to the completion of sale. Only the former category, according to him, attained the character of inter-State sale. This view was given legislative recognition in the Central Act.

Levy of tax should be similar in all cases where there is a sale and an immediate flow of goods from one State to another. Such a scheme facilitates trade and commerce. The definition has therefore to undergo a change. The dominant theme of inter-linking of contract with movement has to be replaced by a more realistic principle. In deciding whether a contract of sale or purchase occasions the

movement of goods from one State to another, the totality of the situation or the integrality of the transaction has to be reckoned with. The sale following the transport or the transport following the sale are closely interlinked. When a person who buys goods in one State for taking it to another State, does in fact take it outside, the sale should be inter-State. Similarly, when a person takes the goods from one State to another with a view to selling it there and does in fact sell, the sale should be inter-State. Insistence on the contractual stipulation or understanding to move the goods in inter-State commerce does not take into account the realities of the situation and leads sometimes to miscarriage of justice.

The concept of inter-State sale should be given a wide interpretation. All impediments in the way of inter-State trade should be removed. More revenue to the coffers of the State should not be the consideration that reign the policy of taxation on inter-State trade. Long term perspective designed to achieve growth of trade and commerce should not give way to short term and short-sighted schemes of revenue. If revenue is the goal it is not possible to eliminate tariff wars across the border of States in a federal system like that of India. National unity and integrity are not to be sacrificed when inter-State tax policies are formulated.

Sale by transfer of documents of title while the goods are in movement from one State to another is less controversial. This is a comparatively peaceful zone. Courts have clarified the law satisfactorily in the area.

The concept of inter-State transaction through agent or through branch has created confusion. This is a twilight area. Similar transactions are viewed differently. When a dealer operates through branch or through agent in another State, transactions of sale involving movement of goods through such branch or agent must be treated as transfer of stock for sale by the branch or agent, and not inter-State sale direct to the buyer.

In interpreting an entry in the list of declared goods the judiciary should look into the purpose and philosophy of the provision. Otherwise the consumer will be the ultimate victim. Unfortunately, judicial responses do not reflect a consumer justice oriented approach.

The list of declared goods should be enlarged taking within its wing primary articles of commercial importance and essential consumer goods. This will be a useful step towards uniformity at national level of sales taxation.

There should be periodical review of the list with a view to updating it in tune with the needs of inter-State trade and commerce from time to time. The constitutional mandate for declaration of goods of special importance in inter-State trade and commerce can be fulfilled effectively only if periodical revision is made.

The present scheme for payment of central tax and refund of the State tax in respect of declared goods is inconvenient both to the tax-payer and to the tax administration. The tax paid under the State law should be set off against the tax due under the Central Act to avoid inconvenience. A reform in the law is called for.

The soul of trade is its freedom. Freedom of trade is therefore of supreme importance. There is no justification for maintaining narrow domestic tariff walls and trade barriers. In evolving the law in the field of discriminatory taxation the judiciary has acted with vision. It has rendered substantial, if not full, justice in adjudicating the complex issues.

Taxation is a question of public finance. How to tax is a problem for the planners. Law renders a

formal model for the economic programme of taxation. Ideas emerge from factors such as political conviction and intellectual acumen. The empirical study helps bringing to light the agonies of the traders, the woes of the consumers and the tyranny of the administration. The study reveals the essential need for a uniform sales tax code for the entire nation. This could be achieved in a phased manner. The maladministration of the check-post emphasises the imperative need for corrective action. The responses in the empirical study show status-obsessed contentment of the administration. However, the lawyers, economists, academicians and other segments of society desire a change. The analysis of judicial decisions also indicates the need for a change in law in the field of export, import and inter-State trade.

In fine, liberalisation of tax exemption on export-import trade and widening of the concept of 'inter-State sale' are the desiderata for betterment of the structure of sales taxation.

APPENDICES

APPENDIX - A

Article 286 of the Constitution before the Constitution (Sixth Amendment) Act, 1956

286. Restrictions as to imposition of tax on the sale or purchase of goods--

(1) No law of a State shall impose, or authorise the imposition of, a tax on the sale or purchase of goods where such sale or purchase takes place--(a) outside the State; or (b) in the course of the import of the goods into, or export of the goods out of, the territory of India.

Explanation-- For the purposes of sub-clause (a), a sale or purchase shall be deemed to have taken place in the State in which the goods have actually been delivered as a direct result of such sale or purchase for the purpose of consumption in that State, notwithstanding the fact that under the general law relating to sale of goods the property in the goods has by reason of such sale or purchase passed in another State.

(2) Except in so far as Parliament may by law otherwise provide, no law of a State shall impose, or authorise the imposition of, a tax on the sale or purchase of

any goods where such sale or purchase takes place in the course of inter-State trade or commerce:

Provided that the President may by order direct that any tax on the sale or purchase of goods which was being lawfully levied by the Government of any State immediately before the commencement of this Constitution, shall, notwithstanding that the imposition of such tax is contrary to the provisions of this clause, continue to be levied until the thirtyfirst day of March, 1951.

(3) No law made by the Legislature of a State imposing, or authorising the imposition of, a tax on the sale or purchase of any such goods as have been declared by Parliament by law to be essential for the life of the community shall have effect unless it has been reserved for the consideration of the President and has received his assent.

Article 286 of the Constitution as at present

286. Restrictions as to imposition of tax on the sale or purchase of goods--

(1) No law of a State shall impose, or authorise the imposition of, a tax on the sale or purchase of goods

where such sale or purchase takes place--(a) outside the State; or (b) in the course of the import of the goods into, or export of the goods out of the territory of India.

(2) Parliament may by law formulate principles for determining when a sale or purchase of goods takes place in any of the ways mentioned in clause (1).

(3) Any law of a State shall, in so far as it imposes, or authorises the imposition of,-- (a) a tax on the sale or purchase of goods declared by Parliament by law to be of special importance in inter-State trade or commerce, or (b) a tax on the sale or purchase of goods, being a tax of the nature referred to in sub-clause (b), sub-clause (c) or sub-clause (d) of clause (29-A) of Article 366, be subject to such restrictions and conditions in regard to the system of levy, rates and other incidents of the tax as Parliament may by law specify.

APPENDIX - B

Important provisions of the Central Sales Tax Act 1956

Definition of sale

Section 2(g): "'Sale', with its grammatical variations and cognate expressions, means any transfer of property in goods by one person to another for cash or for deferred payment or for any other valuable consideration, and includes a transfer of goods on the hire purchase or other system of payment by instalments, but does not include a mortgage or hypothycation of or a charge or pledge on goods."

x x x

Formulation of Principles for Determining when a sale or purchase of goods takes place in the course of inter-State trade or commerce in or outside a State or in the course of import or export

A. Sale or purchase in the course of inter-State trade

Section 3: "A sale or purchase of goods shall be deemed to take place in the course of inter-State trade or commerce if the sale or purchase--

(a) occasions the movement of goods from one State to another or,

(b) is effected by a transfer of documents of title to the goods during their movement from one State to another.

Explanation 1. --Where goods are delivered to a carrier or other bailee for transmission, the movement of the goods shall, for the purposes of clause (b), be deemed to commence at the time of such delivery and terminate at the time when delivery is taken from such carrier or bailee.

Explanation 2. --Where the movement of goods commences and terminates in the same State it shall not be deemed to be a movement of goods from one State to another by reason merely of the fact that in the course of such movement the goods pass through the territory of any other State."

x x x

B. Sale or purchase outside a State

Section 4. "(1) Subject to the provisions contained in Section 3, when a sale or purchase of goods is determined in accordance with sub-section (2) to take place inside a State, such sale or purchase shall be deemed to have taken place outside all other States.

(2) A sale or purchase of goods shall be deemed to take place inside a State if the goods are within the State--(a) in the case of specific or ascertained goods, at the time the contract of sale is made; and (b) in the case of unascertained or future goods, at the time of their appropriation to the contract of sale by the seller or by the buyer, whether assent of the other party is prior or subsequent to such appropriation.

Explanation --Where there is a single contract of sale or purchase of goods situated at more places than one, the provisions of this sub-section shall apply as if there were separate contracts in respect of the goods at each of such place."

C. Sale or purchase in the course of export or import

Section 5. "(1) A sale or purchase of goods shall be deemed to take place in the course of the export of the goods out of the territory of India only if the sale or purchase either occasions such export or is effected by a transfer of documents of title to the goods after the goods have crossed the customs frontiers of India;

(2) A sale or purchase of goods shall be deemed to take place in the course of the import of the goods into the territory of India only if the sale or purchase either occasions such import or is effected by a transfer of documents of title to the goods before the goods have crossed the customs frontiers of India.

(3) Notwithstanding anything contained in sub-section (1), the last sale or purchase of goods preceding the sale or purchase occasioning the export of those goods out of the territory of India shall also be deemed to be in the course of such export, if such last sale or purchase took place after, and was for the purpose of complying with the agreement or order for or in relation to such export."

x x x

D. Liability to tax on inter-State sales

Section 6. "Subject to other provisions contained in this Act, every dealer shall, with effect from such date as the Central Government may, by notification in the official Gazette, appoint, not being earlier than thirty days from the date of such notification, be liable to pay tax

under this Act on all sales of goods other than electric energy effected by him in the course of inter-State trade or commerce during any year on and from the date so notified:

Provided that a dealer shall not be liable to pay tax under this Act on any sale of goods, which in accordance with the provisions of sub-section (3) of Section 5, is a sale in the course of export of those goods out of the territory of India.

(1A) A dealer shall be liable to pay tax under this Act on a sale of any goods effected by him in the course of inter-State trade or commerce notwithstanding that no tax would have been leviable (whether on the seller or the purchaser) under the sales tax law of the appropriate State if that sale had taken place inside that State.

(2) Notwithstanding anything contained in sub-section (1) or sub-section (1A), where a sale of any goods in the course of inter-State trade or commerce has either occasioned the movement of such goods from one State to another or has been effected by a transfer of documents of title to such goods during their movement from one State to another, any subsequent sale during such movement effected by a transfer of documents of title to such goods,--

(A) to the Government, or

(B) to a registered dealer other than the Government, if the goods are of the description referred to in sub-section (3) of Section 8,

shall be exempt from tax under this Act:

Provided that no such subsequent sale shall be exempt from tax under this sub-section unless the dealer effecting the sale furnishes to the prescribed authority in the prescribed manner and within the prescribed time or within such further time as that authority may, for sufficient cause, permit,--

(a) a certificate duly filled and signed by the registered dealer from whom the goods were purchased containing the prescribed particulars in a prescribed form from the prescribed Authority; and

(b) if the subsequent sale is made--

(i) to a registered dealer, a declaration referred to in clause (a) of sub-section (4) of Section 8, or

(ii) to the Government, not being a registered dealer, a certificate referred to in clause (b) of sub-section (4) of Section 8:

Provided further that it shall not be necessary to furnish the declaration or the certificate referred to in clause (b) of the preceding proviso in respect of a subsequent sale of goods, if--

(a) the sale or purchase of such goods is, under the sales tax law of the appropriate State, exempt from tax generally or is subject to tax generally at a rate which is lower than four percent (whether called a tax or fee or by any other name); and

(b) the dealer effecting such subsequent sale proves to the satisfaction of the authority referred to in the preceding proviso that such sale is of the nature referred to in clause (A) or clause (B) of this sub-section.

APPENDIX - C

Recommendations of Taxation Enquiry Commission (1953-54)

"The recommendations for Constitutional amendment which are set out below in the form of draft amendments are based on the foregoing considerations.

A -- Seventh Schedule

(1) In List I, after entry 92, the following new entry shall be inserted, namely:-

'92A. Taxes on sales or purchases of goods other than newspapers, where such sale or purchase takes place in the course of inter-State trade or commerce.

(2) In List II, for entry 54, the following entry shall be substituted, namely:-

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

B -- Article 269

In clause (1), after sub-clause (f), the following sub-clause shall be inserted, namely:-

'(g) taxes on the sale or purchase of goods other than newspapers, where such sale or purchase takes place in the course of inter-State trade or commerce.'

C -- Article 286

(1) In clause (1), the Explanation shall be omitted, and for the words 'territory of India', the following shall be substituted, namely:-

'territory of India; or (c) in the course of inter-State trade or commerce.'

(2) For clauses (2) and (3), the following clauses shall be substituted, namely:-

(2) For the purpose of clause (1) of this article, article 269, entry 92A of the Union List, and entry 54 of the State List, Parliament may by Law formulate principles for determining whether a sale or purchase of goods takes place in any of the ways mentioned in clause (1) of the article.

(3) Any law of a State shall, in so far as it imposes, or authorises the imposition of, a tax on the sale or purchase of goods declared by Parliament by law to be of special importance in inter-State trade or commerce, be subject to such restrictions and conditions in regard to the system of levy, rates and other incidents of the tax as Parliament may be law specify."

APPENDIX - D

Q U E S T I O N N A I R E

Name: ...

Address: ...

Occupation ...

Would you like to remain anonymous (The identity of those who desire to remain anonymous will not be disclosed) ...

1. Do you think that the border check posts established by the State sales tax laws are barriers to inter-State trade. Why?

2. Should the law specify the conditions for treating a transfer of goods as inter-State branch transfer?

3. Do you advocate for a uniform Sales Tax Code for all States to follow?

4. (i) Do you think that the tax immunity for export trade should be extended to more transactions than the existing ones? Why?

   (ii) What about imports? Should the exemption be extended to more areas? If so to what extent?

5. (i) Do you feel that a liberal policy of tax exemption in respect of imported raw-materials will help Indian industry? If so how?

(ii) Will such a policy be beneficial to national interest?

6. Do you think that any change is required in the items of goods declared by Parliament to be of special importance in inter-State Trade and Commerce? Why?

7. General remarks:

Signature

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